


## Special Considerations for Examinations of Risk Retention Groups

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## RRG (E) Subgroup

- Formed in September 2008
- Subgroup of the Financial Examiners Handbook (E) Technical Group (FEHTG)
- Charge: develop financial examination guidance for the unique circumstances and risks in examining Risk Retention Groups.
- Chaired by Pat McNaughton (WA)
- Member States: AL, CA, DC, NV, SC, VT



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## Background

- Regulated under the Federal Liability Risk Retention Act of 1986 (LRRRA)
- Core requirements of LRRRA:
  - Must be owned by insureds
  - Must have common trade practices, products, etc.
  - Can only offer commercial liability insurance
- Accounting Treatment:
  - May follow SAP
  - Generally GAAP or Modified GAAP Basis



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## Coordination

- Typically single state & not part of a holding company structure
  - Coordination not required through accreditation
- Required to make call in ETS
  - Not an invitation to participate
  - Notification
- Exam Report must be distributed to states in which the RRG is conducting business
  - Best Practice to distribute Mgmt letter

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## Polling Question

- Have you participated in any of the Risk-Focused Examination Trainings?
  - Yes, I participated in an on-site training several years ago.
  - Yes, I participated in an on-site training recently.
  - Yes, I participated in the online risk-focused training.
  - No, I have not participated in any trainings.

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## 7 Phase Methodology

- Phase 1 - Understand the Company & Identify KFAs to be Reviewed
  - Part 1 - Understanding the Company
    - Step 1: Gather Necessary Planning Information
    - Step 2: Review of Gathered Information
    - Step 3: Analytical and Operational Reviews
    - Step 4: Consideration of IT Reviews
    - Step 5: Update the Insurer Profile Summary
  - Part 2 - Understanding the CG Structure
  - Part 3 - Assessing Adequacy of Audit Function
  - Part 4 - Identifying Key Functional Activities
  - Part 5 - Consideration of Prospective Risks

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## 7 Phase Methodology

- Phase 2 - Identify & Assess Inherent Risk
- Phase 3 - Identify & Evaluate Risk Mitigation Strategies (Controls)
- Phase 4 - Determine Residual Risk
- Phase 5 - Establish/Conduct Detail Examination Procedures
- Phase 6 - Update Prioritization and Supervisory Plan
- Phase 7 - Draft Examination Report and Management Letter

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## Overview: RRG Exam Considerations

- RRGs are subject to the 7 phase risk focused methodology
- Areas of Focus:
  - Assessment of Corporate Governance
  - Management Interviews
  - Consideration of Information Technology (IT) risk
    - Customization similar to that of a small-to-medium sized insurer
  - Identification and Testing of Controls for RRGs heavily reliant on TPAs

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## RRGs: Special Considerations

Phase 1, Part 1: Understand the Company

- Step 1: Gather Necessary Planning Information
  - No change for RRGs
- Step 2: Review of Gathered Information
  - No change for RRGs
- Step 3: Analytical & Operational Reviews
  - No change for RRGs

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## RRGs: Special Considerations

Phase 1, Part 1, Cont'd

- Step 4: Consideration of Information Technology Risks
  - Must follow 6 step General IT Review Process
  - Exhibit C work program must be completed
    - Should be customized
    - Pre-customized Exhibit C for medium-sized insurers included on Statenet - ITEWG page
      - Good starting point
    - At minimum, must touch upon all 4 COBIT Domains
      - Plan & Organize
      - Acquire & Implement
      - Deliver & Support
      - Monitor & Evaluate

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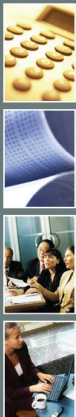
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## RRGs: Special Considerations

Phase 1, Part 1, Cont'd

- Step 5: Update Insurer Profile Summary
  - No change for RRGs

Phase 1, Part 2: Understand Corporate Governance

- BOD Independence
  - Best Practice: Majority independent members
  - RRG Independence Defined
    - Member has no material relationship with the RRG

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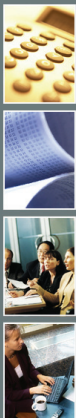
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## RRGs: Special Considerations

Phase 1, Part 2, Cont'd

- Material Relationship:
  - Compensation received greater than
    - 5% Gross Written Premium; or
    - 2% Surplus
  - Under the employ (or affiliated with) present or former auditors
  - Board member is an executive of a different company for which one of the RRGs executives is a board member

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## RRGs: Special Considerations

Phase 1, Part 2, Cont'd

- Board of Directors sophistication & involvement may vary for RRGs
  - BOD may function like that of a typical insurance company
  - BOD may not be familiar with insurance functions & heavily reliant on TPAs
    - Consider competencies, experience and results of those service providers as part of the Corporate Governance Assessment
      - May require meetings with the TPA

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## RRGs: Special Considerations

Phase 1, Part 2, Cont'd

- Conducting Management Interviews
  - Large RRGs - Generally not reliant on TPAs and function like a typical insurance company
    - Utilize Exhibit Y to assist with interviews
  - Small RRGs (Not reliant on service providers)
    - Topics outlined in RRG specific guidance
      - Employee experience & qualifications
      - Risks faced & mitigation strategies
      - Conduct & ethical practices
      - Availability of documented, effective, functioning controls
      - Functional activities & related controls
      - Any other company specific inquiries

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## RRGs: Special Considerations

- Conducting Management Interviews, Cont'd
  - Small RRGs (Reliant on service providers)
    - Inquires for RRG personnel
      - Frequency & content of communication with TPA
      - RRG monitoring of service provider controls
      - Compliance with service provider agreement
      - If applicable, implications of related party service provider transactions

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## RRGs: Special Considerations

- **Conducting Mgmt Interviews, Cont'd**
  - Small RRGs (Reliant on service providers)
    - Inquiries for service providers
      - Frequency & content of communication with RRG
      - Experience & qualifications with regard to operations of an RRG
      - Compliance with service provider agreement
      - If applicable, implications of related party service provider transactions
      - Availability of documented, effective, functioning controls (e.g. SAS 70, internal documentation, etc.)
      - Functional activities performed along with related controls

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## RRGs: Special Considerations

**Phase 1, Part 3: Assess Audit Function**

- No change for RRGs
  - Essential if placing high reliance

**Phase 1, Part 4: Identify KFAs**

- No change for RRGs
  - Generally similar to typical insurers

**Phase 1, Part 5: Prospective Risks**

- No change for RRGs
  - RRG Specific Matrix

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## RRGs: Special Considerations

**Phase 2: Identify & Assess Inherent Risk**

- No change for RRGs
- **RRG Specific Repository**
  - Considers risks unique to RRGs
    - SAP v. GAAP differences
    - Regulatory compliance
    - Reinsurance
  - Use IN ADDITION TO standard repositories

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## RRGs: Special Considerations

Phase 3: Identify & Evaluate Controls

- Required to document an understanding of controls
- Recommended examiners follow small-to-medium sized guidance in Section 2
- RRGs relying heavily on service providers
  - Obtain SAS-70 for service providers
    - Ensure RRG is adhering to user control considerations
  - If SAS-70 not available it may be necessary to go on-site and perform procedures

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## RRGs: Special Considerations

- RRG Repository
  - To be used in addition to standard repositories
  - Not all-inclusive listing
  - Includes several prospective risks
  - Sub-Activities covered include:
    - Fixed Assets
    - Expenses
    - Reinsurance
    - Reporting

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## RRGs: Special Considerations

- RRG Repository
  - Examples of Specific Risks include:
    - Loss of a service provider
    - Improper notice of Insolvency Guarantees
    - Improper letters of credit
    - Failure to comply with the LRRRA
    - Improper provision, or credit, for reinsurance
    - GAAP to SAP reconciliations

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## Future Considerations

- Applicability to all RRGs
- RRG Subgroup referral to RRG Task Force
  - Carve out certain characteristics that may exempt some RRGs from the accreditation requirement to perform a full-scope exam.
  - Suggested Considerations:
    - The size of the RRG, based upon premium volume
    - The effects the RRG has on non-domiciliary states
    - The type of business written
    - The riskiness of investments held by the RRG
    - The ownership/membership (Type) of the RRG

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## Future Considerations

- RRG Task Force formed a Subgroup to discuss the referral
  - RRGs & Risk-Focused Exams Subgroup
- Chaired by Sean O'Donnell (DC)
- Member states: AZ, DE, HI, SC, VT
- Initial Meeting Dec. 2 (tomorrow)
- Staff Support
  - Jeff Loomis ([jlloomis@naic.org](mailto:jlloomis@naic.org))
  - Julie Glaszczak ([jglaszcz@naic.org](mailto:jglaszcz@naic.org))
- NOTE: Must follow RFE process until further notice

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## Frequently Asked Questions

- Do I have to use the risk-focused methodology if my RRG operates only in my state?
  - No, but only if registered, writing and domiciled in one state.
  - Additionally, subject to state law.
- The RRG doesn't have any control documentation, do I have to document their controls for them?
  - Only must document an understanding of controls

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## Frequently Asked Questions

- If the CPA performed their audit using a substantive approach can I use the same approach for my exam?
  - Still must document an understanding of controls
  - Not required to test those controls
  - Still must use 7 Phase process
- What if the TPA doesn't have a SAS-70?
  - May be necessary to go on-site to the TPA and perform testing if the RRG doesn't.
  - For out of state TPAs it may be necessary to travel or request assistance from another state.

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## Frequently Asked Questions

- What is the extent of the IT review for a company who uses basic software (e.g. Quickbooks, Peachtree, etc.)?
  - Complete the ITPQ
  - Must consider all 4 COBIT domains
  - Doesn't have to be a time consuming exercise

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Other Questions



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