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ARIZONA CAPTIVE INSURER REFERENCE GUIDE

For Risk Retention Groups

January 2021

This document is a guide intended to assist you in the formation and ongoing operation of a Risk Retention Group captive in Arizona and does not supersede established law or regulation. Please consult the applicable provisions of Arizona Revised Statutes (ARS), Title 20, and the Arizona Administrative Code (AAC) for specific language and/or legal requirements for the rules and statutes applicable to Arizona captives. There is a separate reference guide for captives not formed as risk retention groups.

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Section 1 – CERTIFICATE OF AUTHORITY APPLICATION PROCESS

In order to license a Risk Retention Group (RRG) captive in Arizona, please follow these steps:

Step 1: Pre-Application Call. Contact the Chief Captive Analyst at vincent.gosz@difi.az.gov to explore the proposed RRG captive. Upon the Analyst's recommendation, proceed to Step 2.

Note: For planning and formation purposes, parties interested in forming and licensing a RRG may find it useful to review guidance published by the National Association of Insurance Commissioners (NAIC) to understand and/or anticipate some of the regulatory considerations specific to RRGs, whether specific to the state of domicile or a non-domiciliary state. The Risk Retention Group Task Force and other NAIC committees will, at times, adopt or amend model laws or update other guidance and have in the past published: (1) the NAIC Risk Retention and Purchasing Group Handbook, (2) a Best Practices document and (3) a Frequently Asked Questions (FAQ) which may be helpful to potential members and managers of RRGs, etc. See https://content.naic.org.

Step 2: Pre-Application Submission. Please submit the following information for our initial evaluation:

1. **Business Plan.** A brief summary of the intended business plan, including as much of the following information as possible:

    a. Proposed effective date;
    b. An explanation as to how the RRG captive complies or will comply with the federal Liability Risk Retention Act (LRRA) and the NAIC Model Risk Retention Act (MDL #705);
    c. Proposed liability coverage and coverage limits;
    d. Disclosure regarding whether you intend to direct write or assume (reinsure) the proposed lines of coverage;
    e. Proposed reinsurance structure with identification of reinsurers if known;
    f. Range of expected gross and net premium levels;
    g. An organizational chart reflecting the relationship between the RRG captive, the insured parties, and other affiliates; and
    h. Proposed capital structure, initial amount and source of funding.

2. **Corporate Governance.** The proposed structure of the Board of Directors and any subcommittees, including the initial officers who will manage the operations, and an indication that the captive owner and/or captive manager is aware of and prepared to comply with the laws and regulations related to RRG governance, including but not limited to the provisions of ARS § 20-2402(C).

3. **Feasibility Study.** The name of the actuary who will perform the feasibility study and the status of that evaluation. Include a description of the nature and extent of specific historical loss experience available to the actuary in conducting the feasibility study.

4. **Service Providers.** The name of the proposed captive manager and principal service providers. If any of the service providers are related parties, please explain their relationship with the RRG captive.

Step 3: Pre-Application Meeting. After we review the submitted materials, we may require a pre-application meeting to discuss your proposed application. Face-to-face meetings are strongly preferred but not always required.

Step 4: Application (ARS § 20-1098.01). The license application is currently in a free form narrative format. See the application form, including instructions, on the Department website. Significant elements of the RRG application filing include:

1. **Application Fees (ARS § 20-167 & AAC R20-6-2002)**. Required application fees should be submitted at the time of application.

   Please note that our review of a prospective RRG captive's application is an examination pursuant to ARS §§ **20-1098.08(C)**, **20-148** & **20-159**. Accordingly, the applicant may bear the costs of all application review related expenses incurred in addition to application filing fees. The need for specialized external expertise is not uncommon for RRG application reviews.

2. **Biographical Affidavits.** RRG captives must provide biographical affidavits (including social security numbers) for all officers and directors. If we already have a biographical affidavit on file, you may incorporate it by reference. Please do not file multiple copies of the same biographical affidavit. See Corporate Governance in Section 4 for further information.

3. **Bylaws (ARS §§ 10-206, 20-1098.01(E) & 20-1098.04(G)).** The RRG captive's bylaws should be consistent with language in other governance documents and specifically provide for:

   a. one Board of Directors or Subscribers Advisory Committee meeting in the State of Arizona annually;
   b. principal place of business in Arizona;
   c. quorum requirements;
   d. compliance with Arizona resident director requirements; and
   e. other statutory requirements as appropriate.

4. **Capital & Surplus Requirements (ARS § 20-1098.03).** Receiving a RRG captive license requires the RRG captive to possess and maintain MINIMUM unimpaired paid-in capital & surplus of $500,000. The Director has discretionary authority to prescribe capital and surplus requirements above the statutory minimum based upon the type, volume and nature of insurance offered. We will determine if additional capital and surplus (initial or ongoing) will be required after a complete review of all necessary application information, including pro forma financial statements, sponsor's/members' financial condition, actuarial feasibility study, annual reports, etc. See Capital and Surplus Requirements in Section 3 for further information.

5. **Conflict Of Interest Statements.** Provide conflict of interest statements for each RRG captive director and officer with the application. Management should adopt policies and procedures to periodically update all conflict of interest statements. See Corporate Governance in Section 4 for further information.

6. **Feasibility Study.** Actuarial feasibility studies must accompany all applications. The feasibility study should:

a. be prepared on the actuary's letterhead and signed by the actuary;
b. include a description of all documents and materials the actuary reviewed and an explanation of how the feasibility study comports with the business plan (e.g. risks, coverages, retentions, and whether the proposed RRG captive will write business directly, cede, or assume business);
c. review of 3-5 years of loss history specific to the proposed insured population and the business plan;
d. identify the methodology used in preparing the feasibility study including confidence levels, credibility, expected results, worst and best case scenarios with premium and loss components; and
e. include conclusions on proper capitalization and pricing.

7. **Initial Balance Sheet (ARS § 20-1098.01(F)(1)).** The law requires that an initial statement of financial condition, signed by the president and secretary, be submitted prior to RRG license issuance. The initial balance sheet should include the proposed capitalization, types and source(s) of capitalization.

8. **RRG Captive Name Availability.** Check with the Department to determine the availability of the proposed name for the RRG captive.

9. **Articles of Incorporation** for the RRG captive must be pre-approved by the Department prior to your filing with the Arizona Corporation Commission. Failure to do so may cause unnecessary delays or revisions.

10. **NAIC Company Code (CoCode) Application.** This form is submitted with the captive application. We will submit the completed form to the NAIC who will then reserve a company code during application review. They will then formally assign the code upon license issuance.

Redomestication Application. RRG captives wishing to redomesticate to Arizona must follow the same procedure as outlined above for newly formed RRGs, using the same form as a new licensee. In addition to the filings required above, you must also file the following:

1. A written statement signed by the RRG captive's president and secretary that explains the reason(s) for the proposed redomestication to Arizona;

2. Stockholder(s) and Board of Director redomestication resolutions;

3. Documentation of the current domicile's approval of the redomestication;

4. A written statement of whether application for licensure, registration or redomestication has ever been denied or withdrawn from any jurisdiction; and

5. The original and three copies of the Articles of Domestication. If acceptable, the Department will stamp the Articles and return them to you. You then file them directly with the Arizona Corporation Commission (ACC). The ACC requires that a Certificate of Existence (Good Standing), duly authenticated by the official having custody of the corporate records in the jurisdiction in which the corporation was incorporated before the transfer of domicile, be attached to the Articles of Domestication.

Application Deficiencies (ARS § 20-1098.01(J)&(L)). See the most recent application form and instructions on our website to ensure the application is prepared and submitted in accordance with current requirements. Incomplete or poorly organized applications will delay our review and approval process. We will give priority to complete applications. We will notify the captive manager of application deficiencies by letter or email as soon as possible. We will complete our application review process within 30 days of receiving a complete application. The 30-day clock does not begin to run until the applicant adequately responds to all questions and supplies all requested information. If the applicant fails to satisfactorily respond to a deficiency notification within 60 days, we may deem the application inactive and the **applicant will forfeit all fees**.

License Issuance. Once an application is approved, the applicant will be required, in nearly all cases, to execute a Conditions Addendum to the Certificate of Authority, highlighting requirements specific to the risk retention group. In order to release the Certificate of Authority, evidence of initial capitalization will be required via a properly completed and delivered bank balance confirmation form. The effective date of the Certificate will generally be the date the Director signs the approval form, or a later date. Effective license dates before the Director's formal application approval date are not available.

Section 2 – ONGOING FINANCIAL FILING REQUIREMENTS

Annual Financial Statement Filings (ARS §§ 20-1098.07(A), 20-233 & 20-234). RRG captives must submit to the National Association of Insurance Commissioners (NAIC) the Annual Statement prepared on the NAIC Annual Statement blank in accordance with the NAIC's Instructions on or before March 31 of each year. The Department does NOT require hard-copy statements. The annual statement and related required filings shall be submitted to the NAIC electronically. These generally include:

1. The Annual Statement
2. The Actuarial Opinion (see Appendix A for guidance);
3. The Management Discussion and Analysis (MD&A) Report (see Appendix C for guidance); and
4. RBC Report (See RBC information below)

Required items not filed electronically with the NAIC are to be filed directly with the Department via the Captive Insurer Annual Filing Portal:

1. Properly signed Jurat pages in .pdf format;
2. The actuarial opinion summary
3. The Certificate of Disclosure form (Form E-178);
4. Any other required forms or reports specific to the RRG;
5. $5,500 renewal fee and a completed transmittal form; and
6. Survey of Arizona Domestic Insurers as part of the Premium Tax and Fees Report (see E-Survey information below).

Use of Generally Accepted Accounting Principles (GAAP). The RRG captive may use generally accepted accounting principles (GAAP) when preparing its financial statement filings unless the Department requires the RRG captive to use statutory accounting principles (SAP). The RRG captive must select either GAAP or SAP for its initial filing and may not change to the other method thereafter without approval from the Department. The use of GAAP in conjunction with the NAIC Annual Statement Blank requires certain modifications and the Department requires certain assets and liabilities to be reported as follows:

1. Reinsurance reserve credits and recoverables should be classified in accordance with the NAIC Instructions as reductions from gross reserve liabilities, rather than as assets in accordance with GAAP.

2. Letters of credit (LOC) provided as capital funds in accordance with ARS § **20-1098.03(B)**, are an asset for purposes of annual financial statement filings and should be reported at their face value as an aggregate write-in for other than invested assets in the NAIC Blank.

3. Surplus notes issued pursuant to ARS § **20-725** are to be reported as surplus items in the capital section of the NAIC Blank, rather than a liability in accordance with GAAP.

4. Fixed assets and prepaid expenses are admitted assets and reported as an aggregate write-in for other than invested assets in the NAIC Blank.

5. Deferred acquisition costs are an asset and are reported as an aggregate write-in for other than invested assets in the NAIC Blank.

Actuarial Opinion (15 USC § 3902(d)(3), ARS § 20-1098.07(C)) and Actuarial Opinion Summary (ARS § 20-697 (B)). An Actuarial Opinion on the adequacy of the RRG captive's loss and loss expense reserves must accompany the annual financial statement unless you obtain an exemption from this requirement. Detailed requirements on the Actuarial Opinion and Actuarial Opinion Summary standards are contained in Appendix A - Actuarial Opinion and Actuarial Opinion Summary Standards. Note the NAIC modifies this guidance periodically and the appendix in this guide may not reflect such changes precisely. The RRG and the opining actuary should follow the relevant NAIC guidance and instructions once formally adopted by and effective in Arizona.

The actuary signing the opinion should be a member in good standing of either the Casualty Actuarial Society or the American Academy of Actuaries, or an individual explicitly approved by the Director who has demonstrated a level of competence in loss reserve evaluations.

An Actuarial Opinion Summary must accompany the Actuarial Opinion. The Actuarial Opinion Summary must be prepared in accordance with the National Association of Insurance Commissioners' (NAIC's) Annual Statement Instructions. We may ask for a copy of the full Actuarial Report supporting the Opinion if we deem it necessary.

More Frequent Reporting. The Director may exercise discretionary authority to require an Actuarial Opinion at any time if analysis of the RRG captive's financial condition indicates its operation may be hazardous or its condition unsound with respect to the public or to its policyholders.

Annual Insurance Holding Company Registration Statement (ARS §§ 20-1098.15(F) & 20-481 et seq.). An insurance holding company system means two or more affiliated persons, one of whom is an insurer. A person affiliated with an insurer means a person that directly or indirectly through one or more intermediaries, controls, is controlled by or is under common control with the insurer. Control is presumed to exist and thus, an RRG captive is presumed to be a member of a holding company system if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing ten per cent or more of the voting securities of any other person. The definition of "affiliate" and "control" can be found at ARS § **20-481(1) and (3)**. If an RRG captive is a member of a holding company system, compliance with **all** of the applicable provisions of the Act is required. We have highlighted below just **some** of the more significant provisions and filings required to be made on Department approved forms. Additional information is available on the Department's website.

1. **Annual Registration Statement Filing (Form B and Form C) (ARS §§ 20-481.09 and 481.10, AAC R20-6-1403 and 1404)**. The Annual Registration Statement due March 31 of each year requires disclosure regarding an RRG captive's capital structure, members, and affiliates, as well as agreements and transactions between the RRG and other members of the holding company system.

2. **Prior Notice and Approval of Material Transactions (Form D) (ARS § 20-481.12, AAC R20-6-1407).** Notice of a material transaction and request for approval must be filed at least 30 days **prior** to entering into transactions within the holding company system. See ARS § **20-481.12(B)**. The statute also lists the standards applicable to all holding company system transactions (whether deemed "material" by ARS § **20-481.12(B)** or not). The request for approval of a material transaction is made on a form approved by the Department ("Form D") and requires that a decision be made within 30 days of filing. This filing requirement is in addition to the more general requirement that RRG captives must obtain prior written approval of the director before implementing any material change in its operating plans pursuant to ARS § **20-1098.22**.

3. **Annual Enterprise Risk Report (Form F) (ARS § 20-481.10).** The annual enterprise risk report due March 31 of each year shall be filed by the ultimate controlling person of the risk retention group in accordance with **20-481.10(D)** which identifies material risks within the holding company system.

4. **Extraordinary Dividends (ARS § 20-481.19, AAC R20-6-1408).** Unless the Director has otherwise restricted accrual and payment of all policyholder/member dividends or distributions as a condition of the holding company member RRG captive's license, the RRG captive must only request prior approval for dividends or distributions that exceed the threshold in law. The referenced Rule provides instructions on the information that must be provided by the RRG in its request for dividends that exceed the threshold.

5. **Disclaimers of Control (ARS § 20-481.18)**. Any person that is presumed to have control of an insurer may disclaim such control by making a filing with the Director that fully discloses all material relationships and bases for affiliation or control between such person and the RRG captive as well as the basis for disclaiming such affiliation or control.

6. **Confidential records (ARS § 20-481.21)**. Generally, this provision gives limited confidentiality to documents, materials and other information in the possession or control of the Department that was obtained by or disclosed to the Director in the course of filings, examinations or investigations made pursuant to certain provisions of the Act.

Audited Financial Report (AFR) (15 USC §3902(d)(3), ARS §§ 20-1098.07(B) & 20-698). The annual financial statement for every RRG must be audited by an independent certified public accountant and the audit and related reports must be filed with the NAIC **within 6 months** of the RRG's year-end. The audit must be conducted and filed in accordance with ARS § **20-698** and the NAIC's *Annual Financial Reporting Model Regulation* (Model Audit Rule), except that the AFR is due for Arizona domestic RRGs not later than June 30. See Appendix B for more information.

Note: In accordance with the annual statement instructions regarding audited financial reports, the audit firm should obtain an understanding of the data identified by the Appointed Actuary as significant, oftentimes via a letter requested by the Company, which is sometimes referred to as a "significant data letter".

E-Survey (AAC R20-6-205(D)). Each domestic RRG captive shall file a Survey of Arizona Domestic Insurers as part of its Premium Tax and Fees Report. The survey is submitted through the captive insurer annual report online portal or in some other manner as may be prescribed by the Department.

Quarterly Financial Statement Filings. RRG captives must file with the NAIC quarterly financial statements on the NAIC Blank forms, due May 15, August 15, and November 15 of each year. Refer to the NAIC's Property/Casualty Quarterly Statement Instructions for guidance. Any required items not filed electronically with the NAIC should be filed with the Department via the portal.

Risk-Based Capital (RBC) Report (ARS § 20-488, et. seq.). RRG captives must file a RBC Report with the NAIC concurrent with its annual financial statement. The Report and calculation of the RBC must be in accordance with the standards and instructions provided by the NAIC, except for the following:

1. If an RRG has elected to file its financial statements in accordance with GAAP, it may use GAAP-basis financial data in compiling its RBC Report.

2. Letters of credit that have been provided as capital funds in accordance with ARS § **20-1098.03(B)**, may be reported as aggregate write-in items for other than invested assets and included in total adjusted capital in the annual financial statements and RBC Report.

3. Prepaid expenses, deferred acquisition costs and other GAAP related assets may be reported as aggregate write-in items for other than invested assets and included in total adjusted capital in the annual financial statement and RBC Report.

4. A RRG is not required to make deductions from total adjusted capital for the non-tabular discount in its policyholder reserve liabilities if its plan to discount reserves has been approved by the Director.

5. The Director, in his/her sole discretion, may elect not to require action pursuant to ARS § **20-488** et seq., if the RRG has financially sound sponsor(s) and establishes to the Director's satisfaction that its sponsor(s) intend to support the capital of the RRG captive if needed.

Late Filings / Fees (ARS §§ 20-223, 20-235(D), 20-481.26 & 20-1098.09); Amended Filings.

Late Filings / Fees. In addition to possible suspension of a captive's certificate of authority, the Department may assess penalties for a captive's failure to file or pay fees timely, as required by statute. To the extent a filing and/or payment is to be made late, the captive manager should inform the Department proactively.

Annual license renewal payments may be made with most major credit cards or electronic/ACH ("e-check") using the secure online payment portal on the Department's website.

Amended Filings. A RRG captive insurer may make one or more amended annual filing when a material revision to the original reports is needed to more accurately reflect results, etc. The need for a revision may be identified by the Company, its auditors, or the Department depending on the circumstances. The Company may want to consult with the Department about a possible amended filing.

RRGs should closely follow the NAIC annual statement instructions to file an amended statement which should be submitted to the NAIC in the same way original filings are made and include an indication on the Jurat page that it represents an amended filing. A signed Jurat should accompany any amended statement filings and/or be submitted to the Department via the online portal. To the extent an amended annual statement materially affects the RBC filing/results, an amended RBC report should also be filed.

Section 3 – ONGOING GENERAL REQUIREMENTS FOR RRG CAPTIVES

Books & Records (ARS §§ 20-1098.01 & 20-1098.16). Unless the Director specifically approves otherwise, the captive manager must maintain the RRG captive's books and records (*all* information, board of director meeting minutes, financial reports, policies, underwriting and claims records, bookkeeping and accounting records, all documents pertaining to insurance or reinsurance transactions, all organizational documents, all shareholder/participant agreements, all service provider agreements, business plan, financial projections, financial reports – essentially everything) for a minimum of 7 years[1] at an Arizona location to allow for the Department's examination. The RRG captive must make all books and records available to the Department upon demand and at the RRG captive expense. The Department may require the RRG captive to replace its captive manager for failure to comply with any part of this requirement.

Business Plan Changes (ARS §§ 20-1098.01(I) & 20-1098.22). All material changes in business plans shall be submitted for review and approval **prior** to initiating the change. Please make your filings sufficiently in advance to allow the Department adequate review time before the intended effective date. More complex changes may require significant analyst and management review time. To facilitate our review, please provide the most recent financial statement and any information pertinent to our review of the change, i.e. policy forms, feasibility study, pro forma financial statements, draft agreements, etc. The criterion is *materiality*, not a fixed percentage, category or type. **This category is NOT limited to transactions required to be filed under the Holding Company Act.** If you have any question about the need to submit any transaction, agreement or other proposal/change as a material change under ARS § **20-1098.22**, please contact the Captive Chief Analyst.

Capital & Surplus Requirements (ARS § 20-1098.03). An RRG captive must at all times possess and maintain MINIMUM unimpaired paid-in capital & surplus in an amount at least equal to the **greater** of $500,000 or the minimum amount required by the Director as stated in the Conditions Addendum to the certificate of authority.

1. At any time, the Director has discretionary authority to increase an RRG captive's minimum capital and surplus if the Department determines additional capital is necessary upon financial review of the RRG captive's business plan or financial reports. The Department can amend the Conditions Addendum attached to the RRG captive's certificate of authority to increase or decrease the minimum capital requirement at any time.

2. RRG captives may not use surplus notes for their initial capitalization. Use of surplus notes for additional capitalization must comply with ARS § **20-725** and have the Director's prior approval. Requests for payment of interest and repayment of principal must be submitted to the Department for prior approval.

3. LOCs funding capital contributions (ARS § **20-1098.03(B)**) must be:

    a) Irrevocable, unconditional and include an appropriate evergreen clause;
    b) Made payable to and held by the Director;
    c) Issued or confirmed by a qualified US financial institution listed on the NAIC's approved bank list (ARS § **20-261.03)**.

[1]Other statutes or laws may require different and/or longer time periods for the maintenance of books and records. This Guide does not address any other statutory or legal requirements for the maintenance of books and records of an RRG captive.

4. The captive insurer shall not be directly or contingently liable for any letter of credit comprising its capital and surplus, and its assets shall not be pledged as security for the letter of credit (ARS § **20-1098.03(B)(2)**)

5. Unless otherwise prescribed by the director, section 20-260(A), relating to limit-of-risk compared to surplus, applies to RRGs and is a consideration for minimum capital. (ARS § **20-1098.15.H)**

Captive Manager (ARS §§ 20-1098.01(G)(5) & 20-1098.16). An RRG captive shall engage a competent captive manager that does business at a location in Arizona and maintains the RRG captive's books and records at a location in Arizona accessible to the Director.

Other matters specific to captive managers include:

1. Captive managers should have E&O coverage in place.

2. Captive managers must promptly notify the Director if the RRG captive fails to comply with any pertinent statutes, regulations, or licensure conditions.

3. As determined by the Director, the captive manager must be either a signatory or exercise prior approval on all material expenditures, disbursements and investments.

4. A change in the captive manager is considered a material change in the RRG captive's plan of operations, subject to the Department's prior approval pursuant to ARS § **20-1098.22**. An officer of the RRG captive must advise the Department of the RRG captive's intent to change the manager and provide reasons for replacement at least 30 days prior to the effective date of the change. In addition, a new Captive Insurer Management Firm Profile for the proposed new captive manager, identifying their credentials and qualifications for the position, must be submitted for approval. The exiting captive manager should provide a letter to the Department indicating the circumstances attributing to its dismissal or resignation.

Examinations (ARS §§ 20-156 & 20-1098.08). RRG captives are subject to a full scope financial examination a minimum of at least once every 5 years. At times we may determine it is necessary to conduct a limited scope exam. Such exams are in addition to a full scope exam every 5 years.

Investments (ARS § 20-1098.10). An investment policy statement must be on file with the Department as part of the RRG captive's business plan. If the Department has approved the investment plan and it is within statutory limits, you do not need prior approval for ongoing investment transactions. Please note the following specific investment policies:

1. A business plan change filing must be made to obtain prior approval for any material change in investment policy.

2. The investment policies and practices of RRGs must comply with the qualitative and quantitative limits for investments in **Title 20, Chapter 3, Article 2**.

3. Statutory investment requirements for RRG captives may not be waived by the Department.

4. To the extent practicable, investment custodial agreements should contain adequate safeguards as described in the NAICs Financial Condition Examiners Handbook.

Reinsurance Agreements (ARS §§ 20-261 & 20-1098.11). See Appendix E for additional discussion. Reinsurance transactions are almost always material to a RRG captive's financial position and operations. You must file all reinsurance agreements and material changes thereto with the Department as a change in the RRG captive's business plan. Agreements with reinsurers that are accredited or licensed by the Department or otherwise qualify for reinsurance credit require the filing of only a detailed term sheet on the reinsurance transaction.

Agreements involving unauthorized reinsurers (i.e. any reinsurer that is not accredited, does not hold a certificate of authority issued by the Arizona Department of Insurance, or otherwise qualify for reinsurance credit without acceptable reserve security) merit special attention by the Department. Such reinsurance transactions are subject to the following prior approval requirements:

1. All requests for approval must identify the proposed reinsurer(s) and include a copy of the proposed reinsurance agreement and/or a detailed itemization of terms. The request for approval must also include the reinsurer's most recent audited financial statements, a copy of the reinsurer's most recent rating agency report, if available, and/or a description of the proposed method for securing the ceded reserves (i.e., withheld funds, LOC, trust) and provide the identity of the bank/custodian and/or a copy of trust agreement.

2. RRG captive reinsurance agreements should meet NAIC requirements as amended from time to time.

3. RRG captives should submit all finalized reinsurance agreements as soon as possible after execution.

4. Prior approval is not required for renewal of reinsurance so long as the renewal contains no material changes to the existing reinsurance agreement.

Section 4 – CORPORATE GOVERNANCE

General Corporate Governance Standards. Effective August 6, 2016 RRG captives shall comply with the provisions of the Governance Standards For Risk Retention Groups developed by the NAIC ("NAIC Governance Standards") as adopted by the Department (ARS § **20-2402(C)**). The RRG Corporate Governance Standards are attached as Appendix D. In addition to those standards, the following requirements are applicable:

1. **Directors and Officers.** You do not need prior approval to appoint or change an RRG captive's officers and directors. The RRG captive must provide subsequent notice of any change in an officer or director and submit an original biographical affidavit.

2. **Biographical Affidavits**. RRG captives must provide biographical affidavits and social security numbers for all officers, directors and trustees of the RRG captive including new officers, directors or trustees appointed subsequent to issuance of the RRG captive's certificate of authority. If we already have the new officer's or director's affidavit on file, you may incorporate it by reference, but you must still notify the Department of the appointment. The Department reserves the right to request updated biographical affidavits for its files at any time.

3. **Qualifications.** Board members must demonstrate appropriate qualifications, expertise and experience to competently perform their duties (ARS § **20-1098.01(G)**). Because they are responsible for direction and corporate governance, we recommend that the RRG captive provide the Board of Directors with orientation and continuous training to assure knowledge of insurance principles and regulatory requirements.

4. **D&O.** We recommend that the RRG captive provide board members with Directors and Officers insurance coverage.

5. **Conflict Of Interest Statements.** We recommend that RRG captives adopt policies and procedures to periodically obtain updated conflict of interest statements from its directors and officers for the RRG captive's information and records, and for its annual disclosure to the Department regarding director independence.

6. **Note Regarding ARS § 20-492 et seq.** These provisions, adopted in 2019, relate to corporate governance disclosure requirements for insurance companies. Because the corporate governance provisions of the model risk retention act (**ARS § 20-2402 et seq)** apply to Arizona-domiciled risk retention groups, the provisions of ARS § 20-492 are not applied to RRGs.

Service Provider Contracts and Agreements. Formal written contracts are required for **all** service providers even if the contracting parties are related or affiliated. The following must be submitted for **prior** approval to the Director at least **30** days prior to entering into the agreement, renewal or amendment:

1. all captive manager agreements, renewals and amendments;
2. all related party or affiliate agreements, renewals and amendments,
3. material service provider agreements renewals and amendments.

Executed copies of all contracts, agreements, amendments and renewals must be filed with the Department, whether or not Director's approval was required. All agreements are required to be in the best interests of the RRG captive. Director's approval may be withdrawn at any time as circumstances may require.

1. **Broker.** Provide a copy of the executed broker agreement (specify compensation and reference broker compensation in the Management Discussion & Analysis (MD&A)) for all new engagements or changes in broker agreements.

2. **Managing General Agent (MGA Act) (ARS § 20-311, et. seq.).** If a service provider of the RRG captive meets the definition of a managing general agent under the MGA Act, the service provider must comply with the MGA Act.

3. **No Approved Service Provider List.** We DO NOT maintain a list of approved service providers. Additionally, we are not in a position to suggest a particular provider. As stated above, we review each service provider agreement individually during the application process for an initial certificate of authority or when a change in business plan filing is made with the Department.

   The Department expects service providers doing business with Arizona-domiciled captives to know and understand applicable laws and regulations governing captive insurers, and perform their duties in an ethical, competent, and professional manner. We reserve the right to require a captive to change any service provider at our discretion.

NOTE regarding the expected discontinuance of the London Interbank Offered Rate (LIBOR) as a benchmark or reference rate and the potential effects on existing or future contracts:

AZ RRGs and their affiliated group members should be aware that LIBOR is expected to cease to exist in its historically relevant form on or about December 31, 2021. To the extent the group is exposed to LIBOR as a reference rate in any financial contracts, e.g. loans, notes, derivatives, etc., without adequate reference rate fallback language, amendments or revisions may need to be made. The Department is not in a position to make this determination for the RRG or call attention to particular agreements, but we are certainly prepared to assist to the extent regulatory approvals of proposed changes may be required. We will also appreciate receiving amended agreements for any that are material to the RRG's plan of operation.

Section 5 – MISCELLANEOUS

Certificates of Compliance or Certification of Documents. Submit your request for Certificates of Compliance or certified copies of any charter documents by e-mail or post. The fee for each certificate is $3.00. If the Department is required to make photocopies of any charter documents, there is an additional fee of 60 cents per page. Fee amounts are subject to change.

Public Records Request. RRG captive records are available for public inspection unless otherwise provided by law. Contact us for the appropriate request form if you need to make a Public Records Request.

Registration in Other States. Prior approval may be required for a RRG captive to register in other states; in any case, you must provide the Department with notice of all registrations as approved or acknowledged in other states. It is not necessary to furnish the Department with the rates charged in other states.

Retaliatory Taxes. Arizona does not charge domestic RRGs a premium tax on Arizona writings. RRG captives should contact the states in which the RRG captive is registered and writing business with questions relating to retaliatory taxes due to that state.

Section 6 - WITHDRAWAL FROM THE STATE OF ARIZONA OF AN RRG CAPTIVE (AAC R20-6-303)

In order for the Department to recognize an RRG captive's withdrawal and proceed with the surrender of its certificate of authority, you must submit the following:

1. A written request for termination of Certificate of Authority;
2. Evidence that the RRG captive has reinsured all of its business in force with another insurer by entering into a bulk reinsurance agreement, effective only when filed and approved in writing by the Director pursuant to ARS §§ **20-732** & **20-734**, as may be applicable;
3. A draft of the amended articles of incorporation, articles of dissolution, articles of merger, or articles of domestication (whichever applicable);
4. Originally certified (by the corporate secretary) copies of the Board of Directors and shareholders resolutions adopting the: amendment to the articles of incorporation, dissolution, merger, or transfer of domicile (whichever applicable);
5. The RRG captive's original Arizona certificate of authority;
6. A statement of the RRG captive's financial condition verified by the RRG captive's president and secretary that includes a schedule of all assets and liabilities, with itemization and adequate detail on all outstanding liabilities, if any. The statement shall reflect the condition of the RRG captive as of a date not more than 60 days prior to the day the RRG captive files its withdrawal application with the Director.
7. A written plan for extinguishment of substantially all liability, together with such documents or assurances as may be reasonably necessary to ensure such extinguishment or a sworn affidavit stating that the RRG captive has no outstanding liabilities to policyholders or claimants under AAC **R20-6-303(C)**;
8. A satisfactory agreement from a person or entity demonstrating financial responsibility for, and guaranteeing all obligations of the RRG captive of any kind, other than policyholder claims covered by the bulk reinsurance agreement;
9. If applicable, a letter requesting release of the RRG captive's letter of credit; and,
10. An affidavit of Revocation of Articles of Dissolution (applicable to withdrawal by dissolution only).

If the RRG captive does not file the appropriate Articles with the Arizona Corporation Commission on or before its year-end, it is required to make its annual filing along with applicable fees.

Appendix A – ACTUARIAL OPINION AND ACTUARIAL OPINION SUMMARY STANDARDS

Actuarial Opinion

1. There is to be included with or attached to Page 1 of the Annual Statement the statement of the Appointed Actuary, entitled "Statement of Actuarial Opinion" (Actuarial Opinion), setting forth his or her opinion relating to reserves specified in the SCOPE paragraph. The Actuarial Opinion, both the narrative and required Exhibits, shall be in the format of and contain the information required by this section of the Annual Statement Instructions – Property and Casualty.

   Upon initial engagement, the Appointed Actuary must be appointed by the Board of Directors by Dec. 31 of the calendar year for which the opinion is rendered. The Company shall notify the domiciliary commissioner within five business days of the initial appointment with the following information:

   a. Name and title (and, in the case of a consulting actuary, the name of the firm).
   b. Manner of appointment of the Appointed Actuary (e.g., who made the appointment and when).
   c. A statement that the person meets the requirements of a Qualified Actuary (or was approved by the domiciliary commissioner) and that documentation was provided to the Board of Directors.

   Once this notification is furnished, no further notice is required with respect to this person unless the Board of Directors takes action to no longer appoint or retain the actuary or the actuary no longer meets the requirements of a Qualified Actuary.

   The Appointed Actuary shall provide to the Board of Directors qualification documentation on occasion of their appointment, and on an annual basis thereafter, directly or through company management. The documentation should include brief biographical information and a description of how the definition of "Qualified Actuary" is met or expected to be met (in the case of continuing education) for that year. The documentation should describe the Appointed Actuary's responsible experience relevant to the subject of the Actuarial Opinion. The Board of Directors shall document the company's review of those materials and any other information they may deem relevant, including information that may be requested directly from the Appointed Actuary. The qualification documentation shall be considered workpapers and be available for inspection upon regulator request or during a financial examination.

   If an actuary who was the Appointed Actuary for the immediately preceding filed Actuarial Opinion is replaced by an action of the Board of Directors, the Insurer shall within five (5) business days notify the Insurance Department of the state of domicile of this event. The Insurer shall also furnish the domiciliary commissioner with a separate letter within ten (10) business days of the above notification stating whether in the twenty-four (24) months preceding such event there were any disagreements with the former Appointed Actuary regarding the content of the opinion on matters of the risk of material adverse deviation, required disclosures, scope, procedures, type of opinion issued, substantive wording of the opinion or data quality. The disagreements required to be reported in response to this paragraph include both those resolved to the former Appointed Actuary's satisfaction and those not resolved to the former Appointed Actuary's satisfaction. The letter should include a description of the disagreement and the nature of its resolution (or that it was not resolved). Within this same ten (10) business days, the Insurer shall in writing also request such former Appointed Actuary to furnish a letter addressed to the Insurer stating whether the Appointed Actuary agrees with the statements contained in the Insurer's letter and, if not, stating the reasons for which he or she does not agree. The former Appointed Actuary shall provide a

written response to the insurer within ten (10) business days of such request, and the Insurer shall furnish such responsive letter from the former Appointed Actuary to the domiciliary commissioner together with its own responses.

The Appointed Actuary must report to the Board of Directors each year on the items within the scope of the Actuarial Opinion. The Actuarial Opinion and the Actuarial Report must be made available to the Board of Directors. The minutes of the Board of Directors should indicate that the Appointed Actuary has presented such information to the Board of Directors and identify the manner of presentation (e.g., webinar, in-person presentation, written). A separate Actuarial Opinion is required for each company filing an Annual Statement. When there is an affiliated company pooling arrangement, one Actuarial Report for the aggregate pool is sufficient, but there must be addendums to the Actuarial Report to cover non-pooled reserves for individual companies.

The Actuarial Opinion and the supporting Actuarial Report and workpapers should be consistent with the appropriate Actuarial Standards of Practice (ASOPs), including, but not limited to, ASOP No. 23, ASOP No. 36, ASOP No. 41 and ASOP No. 43, as promulgated by the Actuarial Standards Board, and Statements of Principles adopted by the Casualty Actuarial Society.

1A. Definitions

"Appointed Actuary" is a Qualified Actuary (or individual otherwise approved by the domiciliary commissioner) appointed by the Board of Directors in accordance with Section 1 of these instructions.

"Board of Directors" can include the designated Board of Directors, its equivalent or an appropriate committee directly reporting to the Board of Directors.

"Qualified Actuary" is a person who:

(i) Meets the basic education, experience and continuing education requirements of the Specific Qualification Standard for Statements of Actuarial Opinion, NAIC Property and Casualty Annual Statement, as set forth in the *Qualification Standards for Actuaries Issuing Statements of Actuarial Opinion in the United States (U.S. Qualifications Standards)*, promulgated by the American Academy of Actuaries (Academy):

(ii) Has obtained and maintains an Accepted Actuarial Designation; and

(iii) Is a member of a professional actuarial association that requires adherence to the same *Code of Professional Conduct* promulgated by the Academy, requires adherence to the *U.S. Qualification Standards*, and participates in the Actuarial Board for Counseling and Discipline when its members are practicing in the U.S.

An exception to parts (i) and (ii) of this definition would be an actuary evaluated by the Academy's Casualty Practice Council and determined to be a Qualified Actuary for particular lines of business and business activities.

"Accepted Actuarial Designation" in item (ii) of the definition of a Qualified Actuary, is an actuarial designation accepted as meeting or exceeding the NAIC's Minimum

Property/Casualty (P/C) Actuarial Educational Standards for a P/C Appointed Actuary (published on the NAIC website). The following actuarial designations, with any noted conditions, are accepted as meeting or exceeding basic education minimum standards:

(i) Fellow of the CAS (FCAS) – Condition: basic education must include Exam 6 – Regulation and Financial Reporting (United States);

(ii) Associate of the CAS (ACAS) – Conditions: basic education must include Exam 6 – Regulation and Financial Reporting (United States) and Exam 7 – Estimation of Policy Liabilities, Insurance Company Valuation, and Enterprise Risk Management;

(iii) Fellow of the SOA (FSA) – Conditions: basic education must include completion of the general insurance track, including the following optional exams: the United States' version of the Financial and Regulatory Environment Exam and the Advanced Topics in General Insurance Exam.

"Insurer" or "Company" means an insurer or reinsurer authorized to write property and/or casualty insurance under the laws of any state and who files on the Property and Casualty Blank.

"Actuarial Report" means a document or other presentation prepared as a formal means of conveying to the state regulatory authority and the Board of Directors the Appointed Actuary's professional conclusions and recommendations of recording and communicating the methods and procedures, of assuring that the parties addressed are aware of the significance of the Appointed Actuary's opinion or findings, and of documenting the analysis underlying the opinion. The required content of the Actuarial Report is further described in paragraph 7. (Note that the inclusion of the Board of Directors as part of the intended audience for the Actuarial Report does not change the content of the Actuarial Report as described in paragraph 7. The Appointed Actuary should present findings to the Board of Directors in a manner deemed suitable for such audience.)

"Property and Casualty (P&C) Long Duration Contracts" refers to contracts (excluding financial guaranty contracts, mortgage guaranty contracts and surety contracts) that fulfill both of the following conditions: (1) the contract term is greater than or equal to 13 months; and (2) the insurer can neither cancel the contract nor increase the premium during the contract term. These contracts are subject to the three tests of *SSAP No. 65—Property and Casualty Contracts* of the NAIC *Accounting Practices and Procedures Manual*.

"Accident and Health (A&H) Long Duration Contracts" refers to A&H contracts in which the contract term is greater than or equal to 13 months and contract reserves are required. See Schedule H instructions for a description of categories of contract reserves, as well as policy features that give rise to contract reserves. Two specific examples of contracts that typically require contract reserves are long-term care and disability income insurance.

1B. Exemptions

An insurer who intends to file for one of the exemptions under this Section must submit a letter of intent to its domiciliary commissioner no later than December 1 of the calendar year for which the exemption is to be claimed. The commissioner may deny the exemption prior to December 31 of the same year if he or she deems the exemption inappropriate.

A copy of the approved exemption must be filed with the Annual Statement in all jurisdictions in which the company is authorized.

Exemption for Small Companies

An insurer that has less than $1,000,000 total direct plus assumed written premiums during a calendar year, and less than $1,000,000 total direct plus assumed loss and loss adjustment expense reserves at year-end, in lieu of the Actuarial Opinion required for the calendar year, may submit an affidavit under oath of an officer of the insurer that specifies the amounts of direct plus assumed written premiums and direct plus assumed loss and loss adjustment reserves.

Exemption for Insurers under Supervision or Conservatorship

Unless ordered by the domiciliary commissioner, an insurer that is under supervision or conservatorship pursuant to statutory provision is exempt from the filing requirements contained herein.

Exemption for Nature of Business

An insurer otherwise subject to the requirement and not eligible for an exemption as enumerated above may apply to its domiciliary commissioner for an exemption based on the nature of business written.

Financial Hardship Exemption

An insurer otherwise subject to this requirement and not eligible for an exemption as enumerated above may apply to the commissioner for a financial hardship exemption. Financial hardship is presumed to exist if the projected reasonable cost of the Actuarial Opinion would exceed the lesser of:

i) One percent (1%) of the insurer's capital and surplus reflected in the insurer's latest quarterly statement for the calendar year for that the exemption is sought; or

ii) Three percent (3%) of the insurer's direct plus assumed premiums written during the calendar year for which the exemption is sought as projected from the insurer's latest quarterly statements filed with its domiciliary commissioner.

1C. Reporting Requirements for Pooled Companies

For each company in the pool, the Appointed Actuary shall include a description of the pool, identification of the lead company and a listing of all companies in the pool, their state of domicile and their respective pooling percentages.

Exhibits A and B for each company in the pool should represent the company's share of the pool and should reconcile to the financial statement for that company.

The following paragraph applies to companies that have a 0% share of the pool (no reported Schedule P data). The company shall submit an Actuarial Opinion that reads similar to that provided for the lead company. For example, the IRIS ratio and risk of material adverse deviation discussions, and other relevant comments shall relate to the risks of the lead company in the pool. The Exhibit B responses to question 5 should be $0 and to question 6

should be “not applicable.” Exhibits A and B of the lead company should be attached as an addendum to the PDF file and/or hard copy being filed (but would not be reported by the 0% companies in their data capture).

2. The Actuarial Opinion must consist of an IDENTIFICATION paragraph identifying the Appointed Actuary; a SCOPE paragraph identifying the subjects on which an opinion is to be expressed and describing the scope of the Appointed Actuary’s work; an OPINION paragraph expressing his or her opinion with respect to such subjects; and one or more additional RELEVANT COMMENTS paragraphs. These four sections must be clearly designated.

3. The IDENTIFICATION paragraph should indicate the Appointed Actuary’s relationship to the Company, qualifications for acting as Appointed Actuary and date of appointment and specify that the appointment was made by the Board of Directors.

   If the Appointed Actuary was approved by the Academy to be a “Qualified Actuary,” with or without limitation, or if the Appointed Actuary is not a Qualified Actuary but was approved by the domiciliary commissioner, the company must attach, each year, the approval letter and reference such in the identification paragraph.

4. The SCOPE paragraph should contain a sentence such as the following:

   “I have examined the actuarial assumptions and methods used in determining reserves listed in Exhibit A, as shown in the Annual Statement of the Company as prepared for filing with state regulatory officials, as of December 31, 20__, and reviewed information provided to me through XXX date.”

   Exhibit A should list those items and amounts with respect to which the Appointed Actuary is expressing an opinion.

   The Appointed Actuary should state that the items in the SCOPE, on which he or she is expressing an opinion, reflect Disclosure items 8 through 13.2 in Exhibit B.

   The SCOPE paragraph should include a paragraph such as the following regarding the data used by the Appointed Actuary in forming the opinion:

   “In forming my opinion on the loss and loss adjustment expense reserves, I relied upon data prepared by _____ (officer name and title at the Company). I evaluated that data for reasonableness and consistency. I also reconciled that data to Schedule P, Part 1 of the Company’s current Annual Statement. In other respects, my examination included such review of the actuarial assumptions and methods used and such tests of the calculations as I considered necessary.”

5. The OPINION paragraph should include a sentence that at least covers the points listed in the following illustration:

   “In my opinion, the amounts carried in Exhibit A on account of the items identified:

   A. Meet the requirements of the insurance laws of (state of domicile).

   B. Are computed in accordance with accepted actuarial standards and principles.

C. Make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its contracts and agreements."

If the Scope includes material Unearned Premium Reserves for P&C Long Duration Contracts or Other Loss Reserve items on which the Appointed Actuary is expressing an opinion, the Opinion should contain language such as the following:

D. "Make a reasonable provision for the unearned premium reserves for P&C long duration contracts and/or <insert Other Loss Reserve item on which the Appointed Actuary is opining> of the Company under the terms of its contracts and agreements.

If there is any aggregation or combination of items in Exhibit A, the opinion language should clearly identify the combined items.

Insurance laws and regulations shall at all times take precedence over the actuarial standards and principles.

If the Appointed Actuary has made use of the analysis of another actuary not within the Appointed Actuary's control (such as for pools and associations, for a subsidiary or for special lines of business) for a material portion of the reserves, the other actuary must be identified by name, credential and affiliation within the OPINION paragraph. If the Appointed Actuary has made use of the work of a non-actuary (such as for modeling) for a material portion of the reserves, that individual must be identified by name and affiliation and a description of the type of analysis performed must be provided.

A statement of actuarial opinion should be made in accordance with one of the following sections (a through e). The actuary must explicitly identify in Exhibit B which type applies.

a. Determination of Reasonable Provision. When the carried reserve amount is within the actuary's range of reasonable reserve estimates, the actuary should issue a statement of actuarial opinion that the carried reserve amount makes a reasonable provision for the liabilities associated with the specified reserves.

b. Determination of Deficient or Inadequate Provision. When the carried reserve amount is less than the minimum amount that the actuary believes is reasonable, the actuary should issue a statement of actuarial opinion that the carried reserve amount does not make a reasonable provision for the liabilities associated with the specified reserves. In addition, the actuary should disclose the minimum amount that the actuary believes in reasonable.

c. Determination of Redundant or Excessive Provision. When the carried reserve amount is greater than the maximum amount that the actuary believes is reasonable, the actuary should issue a statement of actuarial opinion that the carried reserve amount does not make a reasonable provision for the liabilities associated with the specified reserves. In addition, the actuary should disclose the maximum amount that the actuary believes in reasonable.

d. Qualified Opinion. When, in the actuary's opinion, the reserves for a certain item or items are in question because they cannot be reasonably estimated or the actuary is unable to render an opinion on those items, the actuary should issue a qualified statement of actuarial opinion. The actuary should disclose the item (or items) to which the qualification relates, the reason for the qualification(s) and the amounts of such items, if disclosed by the Company. Such a qualified opinion should state whether the carried reserve amount

makes a reasonable provision for the liabilities associated with the specified reserves, *except for* the item, or items, to which the qualification relates. The actuary is not required to issue a qualified opinion if the actuary reasonably believes that the item or items in question are not likely to be material.

e. No Opinion. The actuary's ability to give an opinion is dependent upon data, analyses, assumptions, and related information that are sufficient to support a conclusion. If the actuary cannot reach a conclusion due to deficiencies or limitations in the data, analyses, assumptions, or related information, then the actuary may issue a statement of no opinion. A statement of no opinion should include a description of the reasons why no opinion could be given.

6. The Appointed Actuary must provide RELEVANT COMMENT paragraphs to address the following topics of regulatory importance.

   a. Company-Specific Risk Factors

      The Appointed Actuary should include an explanatory paragraph to describe the major factors, combination of factors or particular conditions underlying the risks and uncertainties the Appointed Actuary considers relevant. The explanatory paragraph should not include general, broad statements about risks and uncertainties due to economic changes, judicial decisions, regulatory actions, political or social forces, etc., nor is the Appointed Actuary required to include an exhaustive list of all potential sources of risks and uncertainties.

   b. Risk of Material Adverse Deviation

      The Appointed Actuary must provide specific RELEVANT COMMENT paragraphs to address the risk of material adverse deviation. The Appointed Actuary must identify the materiality standard and the basis for establishing this standard. The materiality standard must also be disclosed in U.S. dollars in Exhibit B: Disclosures. The Appointed Actuary should explicitly state whether or not he or she reasonably believes that there are significant risks and uncertainties that could result in material adverse deviation. This determination is also to be disclosed in Exhibit B.

   c. Other Disclosures in Exhibit B

      RELEVANT COMMENT paragraphs should describe the significance of each of the remaining Disclosure items (8 through 14) in Exhibit B. The actuary should address the items individually and in combination when commenting on a material impact.

   d. Reinsurance

      RELEVANT COMMENT paragraphs should address retroactive reinsurance, financial reinsurance and reinsurance collectability.

      The Appointed Actuary's comments on reinsurance collectability should address any uncertainty associated with including potentially-uncollectable amounts in the estimate of ceded reserves. Before commenting on reinsurance collectability, the Appointed Actuary should solicit information from management on any actual collectability problems, review ratings given to reinsurers by a recognized rating service, and examine Schedule F for the current year for indications of regulatory action or reinsurance recoverable on paid losses over ninety (90) days past due. The comment should also reflect any other

information the Appointed Actuary has received from management or that is publicly available about the capability or willingness of reinsurers to pay claims. The Appointed Actuary's comments do not imply an opinion on the financial condition of any reinsurer.

Retroactive reinsurance refers to agreements referenced in SSAP No. 62R, Property and Casualty Reinsurance, of the NAIC *Accounting Practices and Procedures Manual*.

Financial reinsurance refers to contracts referenced in SSAP No. 62R in which credit is not allowed for the ceding insurer because the arrangements do not include a transfer of both timing and underwriting risk that the reinsurer undertakes in fact to indemnify the ceding insurer against loss or liability by reason of the original insurance.

e. IRIS Ratios

If the company reserves will create exceptional values using the NAIC IRIS Tests for One-Year Reserve Development to Surplus, Two-Year Reserve Development to Surplus and Estimated Current Reserve Deficiency to Surplus, the actuary must include RELEVANT COMMENT on the factors that led to the unusual value(s).

f. Methods and Assumptions

If there has been any significant change in the actuarial assumptions and/or methods from those previously employed, that change should be described in a RELEVANT COMMENT paragraph. If the Appointed Actuary is newly-appointed and does not review the work of the prior Appointed Actuary, then the Appointed Actuary should disclose this.

7. The Actuarial Opinion must include assurance that an Actuarial Report and underlying actuarial workpapers supporting the actuarial opinion will be maintained at the company and available for regulatory examination for seven (7) years. The Actuarial Report contains significant proprietary information. It is expected that the Report be held confidential and is not intended for public inspection. The report must be available by May 1 of the year following the year-end for which the opinion was rendered or within two (2) weeks after a request from an individual state commissioner.

   The Actuarial Report should be consistent with the documentation and disclosure requirements of ASOP #41, Actuarial Communications. The Actuarial Report must contain both narrative and technical components. The narrative component should provide sufficient detail to clearly explain to company management, the Board of Directors, the regulator, or other authority the findings, recommendations and conclusions, as well as their significance. The technical component should provide sufficient documentation and disclosure for another actuary practicing in the same field to evaluate the work. This technical component must show the analysis from the basic data, e.g., loss triangles, to the conclusions.

   The Actuarial Report must also include:

   A. A description of the Appointed Actuary's relationship to the Company, with clear presentation of the Appointed Actuary's role in advising the Board of Directors and/or management regarding the carried reserves. The Actuarial Report should identify how and when the Appointed Actuary presents the analysis to the Board of Directors and, where applicable, to the officer(s) of the Company responsible for determining the carried reserves.

B. An exhibit that ties to the Annual Statement and compares the Appointed Actuary's conclusions to the carried amounts consistent with the segmentation of exposure or liability groupings used in the analysis. The Appointed Actuary's conclusions include the Appointed Actuary's point estimate(s), range(s) of reasonable estimates or both.

C. An exhibit that reconciles and maps the data used by the Appointed Actuary, consistent with the segmentation of exposure or liability groupings used in the Appointed Actuary's analysis, to the Annual Statement Schedule P line of business reporting. An explanation should be provided for any material differences.

D. An exhibit or appendix showing the change in the Appointed Actuary's estimates from the prior Actuarial Report, including extended discussion of factors underlying any material changes. The exhibit or appendix should illustrate the changes on a net basis but should also include the changes on a gross basis, if relevant. If the Appointed Actuary is newly-appointed and does not review the work of the prior Appointed Actuary, then the Appointed Actuary should disclose this.

E. Extended comments on trends that indicate the presence or absence of risks and uncertainties that could result in material adverse deviation.

F. Extended comments on factors that led to unusual IRIS ratios for One-Year Reserve Development to Policyholders' Surplus, Two-Year Reserve Development to Policyholders' Surplus or Estimated Current Reserve Deficiency to Policyholders' Surplus, and how these factors were addressed in prior and current analyses.

8. The Actuarial Opinion and the Actuarial Report should conclude with the signature of the Appointed Actuary responsible for providing the Actuarial Opinion and the respective dates when the actuarial opinion was rendered. The signature and date should appear in the following format:

_____
Signature of appointed actuary
Printed name of actuary
Employer's name
Address of actuary
Telephone number of actuary
Email address of actuary
Date opinion was rendered

9. The insurer required to furnish an Actuarial Opinion shall require its Appointed Actuary to notify its Board of Directors or its audit committee in writing within five (5) business days after any determination by the Appointed Actuary that the Opinion submitted to the domiciliary Commissioner was in error as a result of reliance on data or other information (other than assumptions) that, as of the balance sheet date, was factually incorrect. The Opinion shall be considered to be in error if the Opinion would have not been issued or would have been materially altered had the correct data or other information been used. The Opinion shall not be considered to be in error if it would have been materially altered or not issued solely because of data or information concerning events subsequent to the balance sheet date or because actual results differ from those projected.

Notification is required discovery is made between the issuance of the Actuarial Opinion and December 31 of that year. Notification should include a summary of such findings.

If the Appointed Actuary learns that the data or other information relied upon was factually incorrect, but cannot immediately determine what, if any, changes are needed in the Actuarial Opinion, the Appointed Actuary and the Company should quickly undertake procedures necessary for the Appointed Actuary to make such determination. If the Insurer does not provide the necessary data corrections and other support (including financial support) within ten (10) business days, the Appointed Actuary should proceed with the notification to the Board of Directors and the domiciliary commissioner.

An Insurer who is notified pursuant to the preceding paragraphs shall forward a copy of the amended Actuarial Opinion to the domiciliary commissioner within five (5) business days of receipt of such and shall provide the Appointed Actuary making the notification with a copy of the letter and amended Actuarial Opinion submitted to the domiciliary commissioner. If the Appointed Actuary fails to receive such copy within the five (5) business day period referred to in the previous sentence, the Appointed Actuary shall notify the domiciliary commissioner within the next five (5) business days that an amended Actuarial Opinion has been finalized.

No Appointed Actuary shall be liable in any manner to any person for any statement made in connection with the above paragraphs if such statement is made in a good faith effort to comply with the above paragraphs..

10. Data in Exhibits A and B are to be filed in both print and data capture format.

Exhibit A: SCOPE
DATA TO BE FILED IN BOTH PRINT AND DATA CAPTURE FORMATS

Loss and Loss Adjustment Expense Reserves:	Amount
1. Unpaid Losses (Liabilities, Surplus and Other Funds page, Col 1, Line 1)	$ _____
2. Unpaid Loss Adjustment Expenses (Liabilities, Surplus and Other Funds page, Col 1, Line 3)	$ _____
3. Unpaid Losses – Direct and Assumed (Should equal Schedule P, Part 1 Summary, Totals from Cols. 13 and 15, Line 12 * 1000)	$ _____
4. Unpaid Loss Adjustment Expenses – Direct and Assumed (Should equal Schedule P, Part 1, Summary Totals from Cols. 17, 19 and 21, Line 12 * 1000)	$ _____
5. The Page 3 write-in item reserve, “Retroactive Reinsurance Reserve Assumed”	$ _____
6. Other Loss Reserve items on which the Appointed Actuary is expressing an Opinion (list separately, adding lines as needed)	$ _____
Premium Reserves:	
7. Reserve for Direct and Assumed Unearned Premiums for P&C Long Duration Contracts	$ _____
8. Reserve for Net Unearned Premiums for P&C Long Duration Contracts	$ _____
9. Other Premium Reserve items on which the Appointed Actuary is expressing an Opinion (list separately, adding lines as needed)	$ _____

Exhibit B: DISCLOSURES

DATA TO BE FILED IN BOTH PRINT AND DATA CAPTURE FORMATS

NOTE: Exhibit B should be completed for Net dollar amounts included in the SCOPE. If an answer would be different for Direct and Assumed amounts, identify and discuss the difference within RELEVANT COMMENTS.

1. Name of the Appointed Actuary: Last, First MI _____
2. The Appointed Actuary's Relationship to the Company.
   Enter E or C based upon the following: _____
   - **E** if an Employee
   - **C** if a Consultant
3. The Appointed Actuary's Accepted Actuarial Designation (indicated By the letter code): _____
   - **F** if a Fellow of the Casualty Actuarial Society (FCAS)
   - **A** if an Associate of the Casualty Actuarial Society (ACAS)
   - **S** if a Fellow of the Society of Actuaries (FSA) through the General Insurance track
   - **M** if the actuary member does not have an accepted actuarial Designation, but is approved by the Academy's Casualty Practice Council
   - **O** for Other
4. Type of Opinion, as identified in the OPINION paragraph.
   Enter R, I, E, Q, or N based upon the following: _____
   - **R** if Reasonable
   - **I** if Inadequate or Deficient Provision
   - **E** if Excessive or Redundant Provision
   - **Q** if Qualified. Use Q when part of the OPINION is Qualified
   - **N** if No Opinion
5. Materiality Standard expressed in US dollars (Used to Answer Question #6) $ _____
6. Are there Significant Risks that could result in Material Adverse Deviation?
   Yes [ ] No [ ] Not Applicable [ ]
7. Statutory Surplus (Liabilities, Surplus and Other Funds page, Col 1, Line 37) $ _____
8. Anticipated net salvage and subrogation included as a reduction to loss reserves as reported in Schedule P (should equal Part 1 Summary, Col 23, Line 12 * 1000) $ _____
9. Discount included as a reduction to loss reserves and loss expense reserves as reported in Schedule P
   - 9.1 Nontabular Discount $ _____
   - 9.2 Tabular Discount $ _____
10. The net reserves for losses and LAE for the company's share of voluntary and involuntary underwriting pools' and associations' unpaid $ _____

losses and expenses that are included in reserves shown on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines.

11. The net reserves for losses and loss adjustment expenses that the company carries for the following liabilities included on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines. *

11.1	Asbestos, as disclosed in the Notes to Financial Statements	$_____
11.2	Environmental, as disclosed in the Notes to Financial Statements	$_____

12. The total claims made extended loss and LAE reserve and unearned premium reserves (Greater than or equal to Schedule P Interrogatories). P Interrogatories).

12.1	Amount reported as loss and loss adjustment expense reserves	$_____
12.2	Amount reported as unearned premium reserves	$_____

13. The net reserves for the A&H long duration contracts that the Company carries on the following lines on the liabilities, surplus, and other funds page:

13.1	Losses	$_____
13.2	Loss Adjustment Expenses	$_____
13.3	Unearned Premium	$_____
13.4	Write-ins	$_____

14. Other items on which the Appointed Actuary is providing Relevant Comment (list separately, adding lines as needed) $_____

*** The reserves disclosed in item 11 above, should exclude amounts relating to contracts specifically written to cover asbestos and environmental exposures. Contracts specifically written to cover these exposures include Environmental Impairment Liability (post 1986), Asbestos Abatement, Pollution Legal Liability, Contractor's Pollution Liability, Consultant's Environmental Liability, and Pollution and Remediation Legal Liability.**

Actuarial Opinion Summary

1. For all companies that are required by their domiciliary state to submit a confidential document entitled Actuarial Opinion Summary (AOS), such document shall be filed with the domiciliary state no later than March 15 (or by a later date otherwise specified by the domiciliary state). This AOS shall be submitted to a non-domiciliary state within fifteen days of request, but no earlier than March 15, provided that the requesting state can demonstrate, through the existence of law or some similar means, that they are able to preserve the confidentiality of the document.

2. The AOS should be consistent with the appropriate Actuarial Standards of Practice (ASOPs), including but not limited to ASOPs 23, 41, and 43, as promulgated by the Actuarial Standards Board, and Statements of Principles adopted by the Casualty Actuarial Society.

3. Exemptions for filing the AOS are the same as those for the Statement of Actuarial Opinion.

4. The AOS contains significant proprietary information. It is expected that the AOS be held confidential and is not intended for public inspection. The AOS should not be filed with the NAIC and should be kept separate from any copy of the Statement of Actuarial Opinion in order to maintain confidentiality of the AOS. The AOS can contain a statement that refers to the Statement of Actuarial Opinion and the date of that opinion.

5. The AOS should be signed and dated by the Appointed Actuary who signed the Statement of Actuarial Opinion and should include at least the following:

   A. The Appointed Actuary's range of reasonable estimates for loss and loss adjustment expense reserves, net and gross of reinsurance, when calculated;

   B. The Appointed Actuary's point estimates for loss and loss adjustment expense reserves, net and gross of reinsurance, when calculated;

   C. The Company's recorded loss and loss adjustment expense reserves, net and gross of reinsurance;

   D. The difference between the company's carried reserves and the Appointed Actuary's estimates calculated in A and B, net and gross of reinsurance; and

   E. Where there has been one-year adverse development in excess of 5% of surplus as measured by Schedule P, Part 2 Summary in at least three (3) of the past five (5) calendar years, include explicit description of the reserve elements or management decisions which were the major contributors.

6. The AOS for a pooled Company (as referenced in paragraph 1c of the instructions for the Actuarial Opinion) shall include a statement that the company is a xx% pool participant. For a non-0% Company, the information provided for paragraph 5 should be numbers after the Company's share of the pool has been applied; specifically, the point or range comparison should be for each statutory Company and should not be for the pool in total. For any 0% pool participant, the information provided for paragraph 5 should be that of the lead company.

7. The net and gross reserve values reported by the Appointed Actuary in the AOS should reconcile to the corresponding values reported in the Insurer's Annual Statement, the

Appointed Actuary's Actuarial Opinion and the Actuarial Report. If not, the Appointed Actuary shall provide an explanation of the difference.

8. The Insurer required to furnish an AOS shall require its Appointed Actuary to notify its Board of Directors in writing with five (5) business days after any determination by the actuary that the AOS submitted was in error as a result of reliance on data or other information (other than assumptions) that, as of the balance sheet date, was factually incorrect. The AOS shall be considered to be in error if the AOS would have not been issued or would have been materially altered had the correct data or other information been used. The AOS shall not be considered to be in error if it would have been materially altered or not issued solely because of data or information concerning events subsequent to the balance sheet date or because actual results differ from those projected. Notification shall be required when discovery is made between the issuance of the AOS and Dec. 31 of that year. Notification should include a summary of such findings.

   If the Appointed Actuary learns that the data or other information relied upon was factually incorrect, but cannot immediately determine what, if any, changes are needed in the AOS, the Appointed Actuary and the Company should quickly undertake procedures necessary for the Appointed Actuary to make such determination. If the Insurer does not provide the necessary data corrections and other support (including financial support) within ten (10) business days, the Appointed Actuary should proceed with the notification to the Board of Directors and the domiciliary commissioner.

   An Insurer who is notified pursuant to the preceding paragraphs shall forward a copy of the amended AOS to the domiciliary commissioner within five (5) business days of receipt of such and shall provide the Appointed Actuary making the notification with a copy of the letter and amended AOS submitted to the domiciliary commissioner. If the Appointed Actuary fails to receive such copy within the five (5) business day period referred to in the previous sentence, the Appointed Actuary shall notify the domiciliary commissioner within the next five (5) business days that an amended AOS has been finalized.

9. No Appointed Actuary shall be liable in any manner to any person for any statement made in connection with the above paragraphs if such statement is made in a good faith effort to comply with the above paragraphs.

Appendix B – ANNUAL FINANCIAL REPORTING MODEL REGULATION

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Section 1. Authority

This regulation is promulgated by the commissioner of insurance pursuant to Sections [insert applicable sections] of the [insert state] insurance law.

Section 2. Purpose and Scope

The purpose of this regulation is to improve the [insert state] Insurance Department’s surveillance of the financial condition of insurers by requiring (1) an annual audit of financial statements reporting the financial position and the results of operations of insurers by independent certified public accountants, (2) Communication of Internal Control Related Matters Noted in an Audit, and (3) Management’s Report of Internal Control over Financial Reporting.

Every insurer (as defined in Section 3) shall be subject to this regulation. Insurers having direct premiums written in this state of less than $1,000,000 in any calendar year and less than 1,000 policyholders or certificateholders of direct written policies nationwide at the end of the calendar year shall be exempt from this regulation for the year (unless the commissioner makes a specific finding that compliance is necessary for the commissioner to carry out statutory responsibilities) except that insurers having assumed premiums pursuant to contracts and/or treaties of reinsurance of $1,000,000 or more will not be so exempt.

Foreign or alien insurers filing the Audited financial report in another state, pursuant to that state’s requirement for filing of Audited financial reports, which has been found by the commissioner to be

substantially similar to the requirements herein, are exempt from Sections 4 through 13 of this regulation if:

A. A copy of the Audited financial report, Communication of Internal Control Related Matters Noted in an Audit, and the Accountant's Letter of Qualifications that are filed with the other state are filed with the commissioner in accordance with the filing dates specified in Sections 4, 11 and 12, respectively (Canadian insurers may submit accountants' reports as filed with the Office of the Superintendent of Financial Institutions, Canada).

B. A copy of any Notification of Adverse Financial Condition Report filed with the other state is filed with the commissioner within the time specified in Section 10.

Foreign or alien insurers required to file Management's Report of Internal Control over Financial Reporting in another state are exempt from filing the Report in this state provided the other state has substantially similar reporting requirements and the Report is filed with the commissioner of the other state within the time specified.

This regulation shall not prohibit, preclude or in any way limit the commissioner of insurance from ordering or conducting or performing examinations of insurers under the rules and regulations of the [insert state] Department of Insurance and the practices and procedures of the [insert state] Department of Insurance.

Section 3. Definitions

The terms and definitions contained herein are intended to provide definitional guidance as the terms are used within this regulation.

A. "Accountant" or "independent certified public accountant" means an independent certified public accountant or accounting firm in good standing with the American Institute of Certified Public Accountants (AICPA) and in all states in which he or she is licensed to practice; for Canadian and British companies, it means a Canadian-chartered or British-chartered accountant.

B. An "affiliate" of, or person "affiliated" with, a specific person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.

C. "Audit committee" means a committee (or equivalent body) established by the board of directors of an entity for the purpose of overseeing the accounting and financial reporting processes of an insurer or Group of insurers, and audits of financial statements of the insurer or Group of insurers. The Audit committee of any entity that controls a Group of insurers may be deemed to be the Audit committee for one or more of these controlled insurers solely for the purposes of this regulation at the election of the controlling person. Refer to Section 14E for exercising this election. If an Audit committee is not designated by the insurer, the insurer's entire board of directors shall constitute the Audit committee.

D. "Audited financial report" means and includes those items specified in Section 5 of this regulation.

E. "Indemnification" means an agreement of indemnity or a release from liability where the intent or effect is to shift or limit in any manner the potential liability of the person or firm for

failure to adhere to applicable auditing or professional standards, whether or not resulting in part from knowing of other misrepresentations made by the insurer or its representatives.

F. "Independent board member" has the same meaning as described in Section 14C.

G. "Insurer" means a licensed insurer as defined in Sections [insert applicable sections] of the [insert state] insurance law or an authorized insurer as defined in Sections [insert applicable sections] of the [insert state] insurance law.

H. "Group of insurers" means those licensed insurers included in the reporting requirements of [insert state law equivalent of the model Insurance Holding Company System Regulatory Act], or a set of insurers as identified by management, for the purpose of assessing the effectiveness of Internal control over financial reporting.

I. "Internal control over financial reporting" means a process effected by an entity's board of directors, management and other personnel designed to provide reasonable assurance regarding the reliability of the financial statements, i.e., those items specified in Section 5B through 5G of this regulation and includes those policies and procedures that:

(1) Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets;

(2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements, i.e., those items specified in Section 5B through 5G of this regulation and that receipts and expenditures are being made only in accordance with authorizations of management and directors; and

(3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statements, i.e., those items specified in Section 5B through 5G of this regulation.

J. "SEC" means the United States Securities and Exchange Commission.

K. "Section 404" means Section 404 of the Sarbanes-Oxley Act of 2002 and the SEC's rules and regulations promulgated thereunder.

L. "Section 404 Report" means management's report on "internal control over financial reporting" as defined by the SEC and the related attestation report of the independent certified public accountant as described in Section 3A.

M. "SOX Compliant Entity" means an entity that either is required to be compliant with, or voluntarily is compliant with, all of the following provisions of the Sarbanes-Oxley Act of 2002: (i) the preapproval requirements of Section 201 (Section 10A(i) of the Securities Exchange Act of 1934); (ii) the Audit committee independence requirements of Section 301 (Section 10A(m)(3) of the Securities Exchange Act of 1934); and (iii) the Internal control over financial reporting requirements of Section 404 (Item 308 of SEC Regulation S-K).

Section 4. General Requirements Related to Filing and Extensions for Filing Annual Audited Financial Reports and Audit Committee Appointment

A. All insurers shall have an annual audit by an independent certified public accountant and shall file an Audited financial report with the commissioner on or before June 1 for the year

ended December 31 immediately preceding. The commissioner may require an insurer to file an audited financial report earlier than June 1 with ninety (90) days advance notice to the insurer.

B. Extensions of the June 1 filing date may be granted by the commissioner for thirty-day periods upon a showing by the insurer and its independent certified public accountant of the reasons for requesting an extension and determination by the commissioner of good cause for an extension. The request for extension must be submitted in writing not less than ten (10) days prior to the due date in sufficient detail to permit the commissioner to make an informed decision with respect to the requested extension.

C. If an extension is granted in accordance with the provisions in Section 4B, a similar extension of thirty (30) days is granted to the filing of Management's Report of Internal Control over Financial Reporting.

D. Every insurer required to file an annual Audited financial report pursuant to this regulation shall designate a group of individuals as constituting its Audit committee, as defined in Section 3. The Audit committee of an entity that controls an insurer may be deemed to be the insurer's Audit committee for purposes of this regulation at the election of the controlling person.

Section 5. Contents of Annual Audited Financial Report

The annual Audited financial report shall report the financial position of the insurer as of the end of the most recent calendar year and the results of its operations, cash flows and changes in capital and surplus for the year then ended in conformity with statutory accounting practices prescribed, or otherwise permitted, by the Department of Insurance of the state of domicile.

The annual Audited financial report shall include the following:

A. Report of independent certified public accountant.

B. Balance sheet reporting admitted assets, liabilities, capital and surplus.

C. Statement of operations.

D. Statement of cash flow.

E. Statement of changes in capital and surplus.

F. Notes to financial statements. These notes shall be those required by the appropriate NAIC Annual Statement Instructions and the NAIC Accounting Practices and Procedures Manual. The notes shall include a reconciliation of differences, if any, between the audited statutory financial statements and the annual statement filed pursuant to Section [insert applicable section] of the [insert state] insurance law with a written description of the nature of these differences.

G. The financial statements included in the Audited financial report shall be prepared in a form and using language and groupings substantially the same as the relevant sections of the annual statement of the insurer filed with the commissioner, and the financial statement shall be comparative, presenting the amounts as of December 31 of the current year and the amounts as of the immediately preceding December 31. (However, in the first year in

which an insurer is required to file an Audited financial report, the comparative data may be omitted).

Section 6. Designation of Independent Certified Public Accountant

A. Each insurer required by this regulation to file an annual Audited financial report must within sixty (60) days after becoming subject to the requirement, register with the commissioner in writing the name and address of the independent certified public accountant or accounting firm retained to conduct the annual audit set forth in this regulation. Insurers not retaining an independent certified public accountant on the effective date of this regulation shall register the name and address of their retained independent certified public accountant not less than six (6) months before the date when the first Audited financial report is to be filed.

B. The insurer shall obtain a letter from the accountant, and file a copy with the commissioner stating that the accountant is aware of the provisions of the insurance code and the regulations of the insurance department of the state of domicile that relate to accounting and financial matters and affirming that the accountant will express his or her opinion on the financial statements in terms of their conformity to the statutory accounting practices prescribed or otherwise permitted by that insurance department, specifying such exceptions as he or she may believe appropriate.

C. If an accountant who was the accountant for the immediately preceding filed Audited financial report is dismissed or resigns, the insurer shall within five (5) business days notify the commissioner of this event. The insurer shall also furnish the commissioner with a separate letter within ten (10) business days of the above notification stating whether in the twenty-four (24) months preceding such event there were any disagreements with the former accountant on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure; which disagreements, if not resolved to the satisfaction of the former accountant, would have caused him or her to make reference to the subject matter of the disagreement in connection with his or her opinion. The disagreements required to be reported in response to this section include both those resolved to the former accountant's satisfaction and those not resolved to the former accountant's satisfaction. Disagreements contemplated by this section are those that occur at the decision-making level, i.e., between personnel of the insurer responsible for presentation of its financial statements and personnel of the accounting firm responsible for rendering its report. The insurer shall also in writing request the former accountant to furnish a letter addressed to the insurer stating whether the accountant agrees with the statements contained in the insurer's letter and, if not, stating the reasons for which he or she does not agree; and the insurer shall furnish the responsive letter from the former accountant to the commissioner together with its own.

Section 7. Qualifications of Independent Certified Public Accountant

A. The commissioner shall not recognize a person or firm as a qualified independent certified public accountant if the person or firm:

(1) Is not in good standing with the AICPA and in all states in which the accountant is licensed to practice, or, for a Canadian or British company, that is not a chartered accountant; or

(2) Has either directly or indirectly entered into an agreement of indemnity or release from liability (collectively referred to as indemnification) with respect to the audit of the insurer.

B. Except as otherwise provided in this regulation, the commissioner shall recognize an independent certified public accountant as qualified as long as he or she conforms to the standards of his or her profession, as contained in the Code of Professional Ethics of the AICPA and Rules and Regulations and Code of Ethics and Rules of Professional Conduct of the [insert state] Board of Public Accountancy, or similar code.

C. A qualified independent certified public accountant may enter into an agreement with an insurer to have disputes relating to an audit resolved by mediation or arbitration. However, in the event of a delinquency proceeding commenced against the insurer under [cite applicable receivership statute], the mediation or arbitration provisions shall operate at the option of the statutory successor.

D. (1) The lead (or coordinating) audit partner (having primary responsibility for the audit) may not act in that capacity for more than five (5) consecutive years. The person shall be disqualified from acting in that or a similar capacity for the same company or its insurance subsidiaries or affiliates for a period of five (5) consecutive years. An insurer may make application to the commissioner for relief from the above rotation requirement on the basis of unusual circumstances. This application should be made at least thirty (30) days before the end of the calendar year. The commissioner may consider the following factors in determining if the relief should be granted:

(a) Number of partners, expertise of the partners or the number of insurance clients in the currently registered firm;

(b) Premium volume of the insurer; or

(c) Number of jurisdictions in which the insurer transacts business.

(2) The insurer shall file, with its annual statement filing, the approval for relief from Subsection D(1) with the states that it is licensed in or doing business in and with the NAIC. If the nondomestic state accepts electronic filing with the NAIC, the insurer shall file the approval in an electronic format acceptable to the NAIC.

E. The commissioner shall neither recognize as a qualified independent certified public accountant, nor accept an annual Audited financial report, prepared in whole or in part by, a natural person who:

(1) Has been convicted of fraud, bribery, a violation of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. Sections 1961 to 1968, or any dishonest conduct or practices under federal or state law;

(2) Has been found to have violated the insurance laws of this state with respect to any previous reports submitted under this regulation; or

(3) Has demonstrated a pattern or practice of failing to detect or disclose material information in previous reports filed under the provisions of this regulation.

F. The commissioner of insurance, as provided in Section [insert applicable section] of the insurance code, may, as provided in [insert applicable citation], hold a hearing to determine whether an independent certified public accountant is qualified and, considering the evidence presented, may rule that the accountant is not qualified for purposes of expressing his or her opinion on the financial statements in the annual Audited financial report made pursuant to this regulation and require the insurer to replace the accountant with another whose relationship with the insurer is qualified within the meaning of this regulation.

G. (1) The commissioner shall not recognize as a qualified independent certified public accountant, nor accept an annual Audited financial report, prepared in whole or in part by an accountant who provides to an insurer, contemporaneously with the audit, the following non-audit services:

(a) Bookkeeping or other services related to the accounting records or financial statements of the insurer;

(b) Financial information systems design and implementation;

(c) Appraisal or valuation services, fairness opinions, or contribution-in-kind reports;

(d) Actuarially-oriented advisory services involving the determination of amounts recorded in the financial statements. The accountant may assist an insurer in understanding the methods, assumptions and inputs used in the determination of amounts recorded in the financial statement only if it is reasonable to conclude that the services provided will not be subject to audit procedures during an audit of the insurer's financial statements. An accountant's actuary may also issue an actuarial opinion or certification ("opinion") on an insurer's reserves if the following conditions have been met:

(i) Neither the accountant nor the accountant's actuary has performed any management functions or made any management decisions;

(ii) The insurer has competent personnel (or engages a third party actuary) to estimate the reserves for which management takes responsibility; and

(iii) The accountant's actuary tests the reasonableness of the reserves after the insurer's management has determined the amount of the reserves;

(e) Internal audit outsourcing services;

(f) Management functions or human resources;

(g) Broker or dealer, investment adviser, or investment banking services;

(h) Legal services or expert services unrelated to the audit; or

(i) Any other services that the commissioner determines, by regulation, are impermissible.

Drafting Note: Any additions or deletions from the list of prohibited services by a state must be carefully considered as uniformity among states is essential in this section. In determining whether other services are impermissible, the commissioner shall consider utilizing the guidance provided in the SEC's Final Rule No. 33-8183, Strengthening the Commission's Requirements Regarding

Auditor Independence adopted January 28, 2003, in order to evaluate whether the provision of such services impairs the independence of the accountant.

(2) In general, the principles of independence with respect to services provided by the qualified independent certified public accountant are largely predicated on three basic principles, violations of which would impair the accountant's independence. The principles are that the accountant cannot function in the role of management, cannot audit his or her own work, and cannot serve in an advocacy role for the insurer.

H. Insurers having direct written and assumed premiums of less than $100,000,000 in any calendar year may request an exemption from Subsection G(1). The insurer shall file with the commissioner a written statement discussing the reasons why the insurer should be exempt from these provisions. If the commissioner finds, upon review of this statement, that compliance with this regulation would constitute a financial or organizational hardship upon the insurer, an exemption may be granted.

I. A qualified independent certified public accountant who performs the audit may engage in other non-audit services, including tax services, that are not described in Subsection G(1) or that do not conflict with Subsection G(2), only if the activity is approved in advance by the Audit committee, in accordance with Subsection J.

Drafting Note: A qualified independent certified public accountant who performs the audit may also engage in other non-audit services for an insurer, including tax services, that are not described in Subsection G(1) or that do not conflict with Subsection G(2) if the Audit committee is in compliance with the SEC's Final Rule No. 33-8183, Strengthening the Commission's Requirements Regarding Auditor Independence adopted January 28, 2003 and has approved such activity.

J. All auditing services and non-audit services provided to an insurer by the qualified independent certified public accountant of the insurer shall be preapproved by the Audit committee. The preapproval requirement is waived with respect to non-audit services if the insurer is a SOX Compliant Entity or a direct or indirect wholly-owned subsidiary of a SOX Compliant Entity or:

(1) The aggregate amount of all such non-audit services provided to the insurer constitutes not more than five percent (5%) of the total amount of fees paid by the insurer to its qualified independent certified public accountant during the fiscal year in which the non-audit services are provided;

(2) The services were not recognized by the insurer at the time of the engagement to be non-audit services; and

(3) The services are promptly brought to the attention of the Audit committee and approved prior to the completion of the audit by the Audit committee or by one or more members of the Audit committee who are the members of the board of directors to whom authority to grant such approvals has been delegated by the Audit committee.

K. The Audit committee may delegate to one or more designated members of the Audit committee the authority to grant the preapprovals required by Subsection J. The decisions of any member to whom this authority is delegated shall be presented to the full Audit committee at each of its scheduled meetings.

L. (1) The commissioner shall not recognize an independent certified public accountant as qualified for a particular insurer if a member of the board, president, chief executive officer, controller, chief financial officer, chief accounting officer, or any person serving in an equivalent position for that insurer, was employed by the independent certified public accountant and participated in the audit of that insurer during the one-year period preceding the date that the most current statutory opinion is due. This section shall only apply to partners and senior managers involved in the audit. An insurer may make application to the commissioner for relief from the above requirement on the basis of unusual circumstances.

(2) The insurer shall file, with its annual statement filing, the approval for relief from Subsection L(1) with the states that it is licensed in or doing business in and the NAIC. If the nondomestic state accepts electronic filing with the NAIC, the insurer shall file the approval in an electronic format acceptable to the NAIC.

Section 8. Consolidated or Combined Audits

An insurer may make written application to the commissioner for approval to file audited consolidated or combined financial statements in lieu of separate annual audited financial statements if the insurer is part of a group of insurance companies that utilizes a pooling or 100 percent reinsurance agreement that affects the solvency and integrity of the insurer's reserves and the insurer cedes all of its direct and assumed business to the pool. In such cases, a columnar consolidating or combining worksheet shall be filed with the report, as follows:

A. Amounts shown on the consolidated or combined Audited financial report shall be shown on the worksheet;

B. Amounts for each insurer subject to this section shall be stated separately;

C. Noninsurance operations may be shown on the worksheet on a combined or individual basis;

D. Explanations of consolidating and eliminating entries shall be included; and

E. A reconciliation shall be included of any differences between the amounts shown in the individual insurer columns of the worksheet and comparable amounts shown on the annual statements of the insurers.

Section 9. Scope of Audit and Report of Independent Certified Public Accountant

Financial statements furnished pursuant to Section 5 shall be examined by the independent certified public accountant. The audit of the insurer's financial statements shall be conducted in accordance with generally accepted auditing standards. In accordance with AU Section 319 of the Professional Standards of the AICPA, Consideration of Internal Control in a Financial Statement Audit, the independent certified public accountant should obtain an understanding of internal control sufficient to plan the audit. To the extent required by AU 319, for those insurers required to file a Management's Report of Internal Control over Financial Reporting pursuant to Section 16, the independent certified public accountant should consider (as that term is defined in Statement on Auditing Standards (SAS) No. 102, Defining Professional Requirements in Statements on Auditing Standards or its replacement) the most recently available report in planning and performing the audit of the statutory financial statements. Consideration shall be given to the procedures illustrated in the Financial Condition Examiners Handbook promulgated by the National Association of Insurance Commissioners as the independent certified public accountant deems necessary.

Section 10. Notification of Adverse Financial Condition

A. The insurer required to furnish the annual Audited financial report shall require the independent certified public accountant to report, in writing, within five (5) business days to the board of directors or its Audit committee any determination by the independent certified public accountant that the insurer has materially misstated its financial condition as reported to the commissioner as of the balance sheet date currently under audit or that the insurer does not meet the minimum capital and surplus requirement of the [insert state] insurance code as of that date. An insurer that has received a report pursuant to this paragraph shall forward a copy of the report to the commissioner within five (5) business days of receipt of the report and shall provide the independent certified public accountant making the report with evidence of the report being furnished to the commissioner. If the independent certified public accountant fails to receive the evidence within the required five (5) business day period, the independent certified public accountant shall furnish to the commissioner a copy of its report within the next five (5) business days.

B. No independent certified public accountant shall be liable in any manner to any person for any statement made in connection with the above paragraph if the statement is made in good faith in compliance with Subsection A.

C. If the accountant, subsequent to the date of the Audited financial report filed pursuant to this regulation, becomes aware of facts that might have affected his or her report, the commissioner notes the obligation of the accountant to take such action as prescribed in Volume 1, Section AU 561 of the Professional Standards of the AICPA.

Section 11. Communication of Internal Control Related Matters Noted in an Audit

A. In addition to the annual Audited financial report, each insurer shall furnish the commissioner with a written communication as to any unremediated material weaknesses in its internal control over financial reporting noted during the audit. Such communication shall be prepared by the accountant within sixty (60) days after the filing of the annual Audited financial report, and shall contain a description of any unremediated material weakness (as the term material weakness is defined by Statement on Auditing Standard 60, Communication of Internal Control Related Matters Noted in an Audit, or its replacement) as of December 31 immediately preceding (so as to coincide with the Audited financial report discussed in Section 4(A)) in the insurer's Internal control over financial reporting noted by the accountant during the course of their audit of the financial statements. If no unremediated material weaknesses were noted, the communication should so state.

Drafting Note: The insurer is expected to maintain information about significant deficiencies communicated by the independent certified public accountant. Such information should be made available to the examiner conducting a financial condition examination for review and kept in such a manner as to remain confidential.

B. The insurer is required to provide a description of remedial actions taken or proposed to correct unremediated material weaknesses, if the actions are not described in the accountant's communication.

Section 12. Accountant's Letter of Qualifications

The accountant shall furnish the insurer in connection with, and for inclusion in, the filing of the annual Audited financial report, a letter stating:

A. That the accountant is independent with respect to the insurer and conforms to the standards of his or her profession as contained in the Code of Professional Ethics and pronouncements of the AICPA and the Rules of Professional Conduct of the [insert state] Board of Public Accountancy, or similar code;

B. The background and experience in general, and the experience in audits of insurers of the staff assigned to the engagement and whether each is an independent certified public accountant. Nothing within this regulation shall be construed as prohibiting the accountant from utilizing such staff as he or she deems appropriate where use is consistent with the standards prescribed by generally accepted auditing standards;

C. That the accountant understands the annual Audited financial report and his opinion thereon will be filed in compliance with this regulation and that the commissioner will be relying on this information in the monitoring and regulation of the financial position of insurers;

D. That the accountant consents to the requirements of Section 13 of this regulation and that the accountant consents and agrees to make available for review by the commissioner, or the commissioner's designee or appointed agent, the workpapers, as defined in Section 13;

E. A representation that the accountant is properly licensed by an appropriate state licensing authority and is a member in good standing in the AICPA; and

F. A representation that the accountant is in compliance with the requirements of Section 7 of this regulation.

Section 13. Definition, Availability and Maintenance of Independent Certified Public Accountants Workpapers

A. Workpapers are the records kept by the independent certified public accountant of the procedures followed, the tests performed, the information obtained, and the conclusions reached pertinent to the accountant's audit of the financial statements of an insurer. Workpapers, accordingly, may include audit planning documentation, work programs, analyses, memoranda, letters of confirmation and representation, abstracts of company documents and schedules or commentaries prepared or obtained by the independent certified public accountant in the course of his or her audit of the financial statements of an insurer and which support the accountant's opinion.

B. Every insurer required to file an Audited financial report pursuant to this regulation, shall require the accountant to make available for review by insurance department examiners, all workpapers prepared in the conduct of the accountant's audit and any communications related to the audit between the accountant and the insurer, at the offices of the insurer, at the insurance department or at any other reasonable place designated by the commissioner. The insurer shall require that the accountant retain the audit workpapers and communications until the insurance department has filed a report on examination covering the period of the audit but no longer than seven (7) years from the date of the audit report.

C. In the conduct of the aforementioned periodic review by the insurance department examiners, it shall be agreed that photocopies of pertinent audit workpapers may be made

and retained by the department. Such reviews by the department examiners shall be considered investigations and all working papers and communications obtained during the course of such investigations shall be afforded the same confidentiality as other examination workpapers generated by the department.

Section 14. Requirements for Audit Committees

This section shall not apply to foreign or alien insurers licensed in this state or an insurer that is a SOX Compliant Entity or a direct or indirect wholly-owned subsidiary of a SOX Compliant Entity.

A. The Audit committee shall be directly responsible for the appointment, compensation and oversight of the work of any accountant (including resolution of disagreements between management and the accountant regarding financial reporting) for the purpose of preparing or issuing the Audited financial report or related work pursuant to this regulation. Each accountant shall report directly to the Audit committee.

B. Each member of the Audit committee shall be a member of the board of directors of the insurer or a member of the board of directors of an entity elected pursuant to Subsection E and Section 3C.

C. In order to be considered independent for purposes of this section, a member of the Audit committee may not, other than in his or her capacity as a member of the Audit committee, the board of directors, or any other board committee, accept any consulting, advisory or other compensatory fee from the entity or be an affiliated person of the entity or any subsidiary thereof. However, if law requires board participation by otherwise non-independent members, that law shall prevail and such members may participate in the Audit committee and be designated as independent for Audit committee purposes, unless they are an officer or employee of the insurer or one of its affiliates.

D. If a member of the Audit committee ceases to be independent for reasons outside the member's reasonable control, that person, with notice by the responsible entity to the state, may remain an Audit committee member of the responsible entity until the earlier of the next annual meeting of the responsible entity or one year from the occurrence of the event that caused the member to be no longer independent.

Drafting Note: In determining independence, the commissioner shall consider utilizing guidance provided in the SEC's Final Rule No. 33-8220, Standards Relating to Listed Company Audit Committees adopted April 9, 2003.

E. To exercise the election of the controlling person to designate the Audit committee for purposes of this regulation, the ultimate controlling person shall provide written notice to the commissioners of the affected insurers. Notification shall be made timely prior to the issuance of the statutory audit report and include a description of the basis for the election. The election can be changed through notice to the commissioner by the insurer, which shall include a description of the basis for the change. The election shall remain in effect for perpetuity, until rescinded.

F. (1) The Audit committee shall require the accountant that performs for an insurer any audit required by this regulation to timely report to the Audit committee in accordance with the requirements of SAS 61, Communication with Audit Committees, or its replacement, including:

(a) All significant accounting policies and material permitted practices;

(b) All material alternative treatments of financial information within statutory accounting principles that have been discussed with management officials of the insurer, ramifications of the use of the alternative disclosures and treatments, and the treatment preferred by the accountant; and

(c) Other material written communications between the accountant and the management of the insurer, such as any management letter or schedule of unadjusted differences.

(2) If an insurer is a member of an insurance holding company system, the reports required by Subsection F(1) may be provided to the Audit committee on an aggregate basis for insurers in the holding company system, provided that any substantial differences among insurers in the system are identified to the Audit committee.

G. The proportion of independent Audit committee members shall meet or exceed the following criteria:

Prior Calendar Year Direct Written and Assumed Premiums		
0 - $300,000,000	Over $300,000,000 - $500,000,000	Over $500,000,000
No minimum requirements. See also Note A and B.	Majority (50% or more) of members shall be independent. See also Note A and B.	Supermajority of members (75% or more) shall be independent. See also Note A.

Note A: The commissioner has authority afforded by state law to require the entity's board to enact improvements to the independence of the Audit committee membership if the insurer is in a RBC action level event, meets one or more of the standards of an insurer deemed to be in hazardous financial condition, or otherwise exhibits qualities of a troubled insurer.

Note B: All insurers with less than $500,000,000 in prior year direct written and assumed premiums are encouraged to structure their Audit committees with at least a supermajority of independent Audit committee members.

Note C: Prior calendar year direct written and assumed premiums shall be the combined total of direct premiums and assumed premiums from non-affiliates for the reporting entities.

H. An insurer with direct written and assumed premium, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, less than $500,000,000 may make application to the commissioner for a waiver from the Section 14 requirements based upon hardship. The insurer shall file, with its annual statement filing, the approval for relief from Section 14 with the states that it is licensed in or doing business in and the NAIC. If the nondomestic state accepts electronic filing with the NAIC, the insurer shall file the approval in an electronic format acceptable to the NAIC.

Section 15. Conduct of Insurer in Connection with the Preparation of Required Reports and Documents

A. No director or officer of an insurer shall, directly or indirectly:

(1) Make or cause to be made a materially false or misleading statement to an accountant in connection with any audit, review or communication required under this regulation; or

(2) Omit to state, or cause another person to omit to state, any material fact necessary in order to make statements made, in light of the circumstances under which the statements were made, not misleading to an accountant in connection with any audit, review or communication required under this regulation.

B. No officer or director of an insurer, or any other person acting under the direction thereof, shall directly or indirectly take any action to coerce, manipulate, mislead or fraudulently influence any accountant engaged in the performance of an audit pursuant to this regulation if that person knew or should have known that the action, if successful, could result in rendering the insurer's financial statements materially misleading.

C. For purposes of Subsection B of this section, actions that, "if successful, could result in rendering the insurer's financial statements materially misleading" include, but are not limited to, actions taken at any time with respect to the professional engagement period to coerce, manipulate, mislead or fraudulently influence an accountant:

(1) To issue or reissue a report on an insurer's financial statements that is not warranted in the circumstances (due to material violations of statutory accounting principles prescribed by the commissioner, generally accepted auditing standards, or other professional or regulatory standards);

(2) Not to perform audit, review or other procedures required by generally accepted auditing standards or other professional standards;

(3) Not to withdraw an issued report; or

(4) Not to communicate matters to an insurer's Audit committee.

Drafting Note: In determining what types of sanctions or penalties could be assessed for violations of items included in Subsections A through C, each state should refer to its individual authority provided by state statutes.

Section 16. Management's Report of Internal Control over Financial Reporting

A. Every insurer required to file an Audited financial report pursuant to this regulation that has annual direct written and assumed premiums, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, of $500,000,000 or more shall prepare a report of the insurer's or Group of insurers' Internal control over financial reporting, as these terms are defined in Section 3. The report shall be filed with the commissioner along with the Communication of Internal Control Related Matters Noted in an Audit described under Section 11. Management's Report of Internal Control over Financial Reporting shall be as of December 31 immediately preceding.

B. Notwithstanding the premium threshold in Subsection A, the commissioner may require an insurer to file Management's Report of Internal Control over Financial Reporting if the insurer is in any RBC level event, or meets any one or more of the standards of an insurer deemed to be in hazardous financial condition as defined in (include reference to Corrective Action statute).

C. An insurer or a Group of insurers that is

(1) directly subject to Section 404;

(2) part of a holding company system whose parent is directly subject to Section 404;

(3) not directly subject to Section 404 but is a SOX Compliant Entity; or

(4) a member of a holding company system whose parent is not directly subject to Section 404 but is a SOX Compliant Entity;

may file its or its parent's Section 404 Report and an addendum in satisfaction of this Section 16 requirement provided that those internal controls of the insurer or Group of insurers having a material impact on the preparation of the insurer's or Group of insurers' audited statutory financial statements (those items included in Section 5B through 5G of this regulation) were included in the scope of the Section 404 Report. The addendum shall be a positive statement by management that there are no material processes with respect to the preparation of the insurer's or Group of insurers' audited statutory financial statements (those items included in Section 5B through 5G of this regulation) excluded from the Section 404 Report. If there are internal controls of the insurer or Group of insurers that have a material impact on the preparation of the insurer's or Group of insurers' audited statutory financial statements and those internal controls were not included in the scope of the Section 404 Report, the insurer or Group of insurers may either file (i) a Section 16 report, or (ii) the Section 404 Report and a Section 16 report for those internal controls that have a material impact on the preparation of the insurer's or Group of insurers' audited statutory financial statements not covered by the Section 404 Report.

D. Management's Report of Internal Control over Financial Reporting shall include:

(1) A statement that management is responsible for establishing and maintaining adequate internal control over financial reporting;

(2) A statement that management has established Internal control over financial reporting and an assertion, to the best of management's knowledge and belief, after diligent inquiry, as to whether its Internal control over financial reporting is effective to provide reasonable assurance regarding the reliability of financial statements in accordance with statutory accounting principles;

(3) A statement that briefly describes the approach or processes by which management evaluated the effectiveness of its Internal control over financial reporting; and

(4) A statement that briefly describes the scope of work that is included and whether any internal controls were excluded;

(5) Disclosure of any unremediated material weaknesses in the Internal control over financial reporting identified by management as of December 31 immediately preceding. Management is not permitted to conclude that the Internal control over financial reporting is effective to provide reasonable assurance regarding the reliability of financial statements in accordance with statutory accounting principles if there is one or more unremediated material weaknesses in its Internal control over financial reporting;

(6) A statement regarding the inherent limitations of internal control systems; and

(7) Signatures of the chief executive officer and the chief financial officer (or equivalent position/title).

E. Management shall document and make available upon financial condition examination the basis upon which its assertions, required in Subsection D above, are made. Management may base its assertions, in part, upon its review, monitoring and testing of internal controls undertaken in the normal course of its activities.

(1) Management shall have discretion as to the nature of the internal control framework used, and the nature and extent of documentation, in order to make its assertion in a cost effective manner and, as such, may include assembly of or reference to existing documentation.

(2) Management's Report on Internal Control over Financial Reporting, required by Subsection A above, and any documentation provided in support thereof during the course of a financial condition examination, shall be kept confidential by the state insurance department.

Drafting Note: It is the recommendation that the company officer responsible for financial reporting would not be a member of the Audit committee and that the independent committee members would meet periodically, with no management present, with the independent certified public accountant to discuss the strengths and weaknesses of the insurer's or Group of insurers' internal control environments.

Section 17. Exemptions and Effective Dates

A. Upon written application of any insurer, the commissioner may grant an exemption from compliance with any and all provisions of this regulation if the commissioner finds, upon review of the application, that compliance with this regulation would constitute a financial or organizational hardship upon the insurer. An exemption may be granted at any time and from time to time for a specified period or periods. Within ten (10) days from a denial of an insurer's written request for an exemption from this regulation, the insurer may request in writing a hearing on its application for an exemption. The hearing shall be held in accordance with the regulations of the [insert state] Department of Insurance pertaining to administrative hearing procedures.

B. Domestic insurers retaining a certified public accountant on the effective date of this regulation who qualify as independent shall comply with this regulation for the year ending December 31, 20[ ] and each year thereafter unless the commissioner permits otherwise.

C. Domestic insurers not retaining a certified public accountant on the effective date of this regulation who qualifies as independent may meet the following schedule for compliance unless the commissioner permits otherwise.

(1) As of December 31, 20[ ], file with the commissioner an Audited financial report

(2) For the year ending December 31, 20[ ] and each year thereafter, such insurers shall file with the commissioner all reports and communication required by this regulation.

D. Foreign insurers shall comply with this regulation for the year ending December 31, 20[ ] and each year thereafter, unless the commissioner permits otherwise.

E. The requirements of Section 7D shall be in effect for audits of the year beginning January 1, 2010 and thereafter.

F. The requirements of Section 14 are to be in effect January 1, 2010. An insurer or Group of insurers that is not required to have independent Audit committee members or only a majority of independent Audit committee members (as opposed to a supermajority) because the total written and assumed premium is below the threshold and subsequently becomes subject to one of the independence requirements due to changes in premium shall have one (1) year following the year the threshold is exceeded (but not earlier than January 1, 2010) to comply with the independence requirements. Likewise, an insurer that becomes subject to one of the independence requirements as a result of a business combination shall have one (1) calendar year following the date of acquisition or combination to comply with the independence requirements.

Drafting Note: Adoption of Section 14 is assumed to occur one year prior to the effective date of Section 16.

G. The requirements of Section 16 and other modified sections [identify modified sections], except for Section 14 covered above, are effective beginning with the reporting period ending December 31, 2010 and each year thereafter. An insurer or Group of insurers that is not required to file a report because the total written premium is below the threshold and subsequently becomes subject to the reporting requirements shall have two (2) years following the year the threshold is exceeded (but not earlier than December 31, 2010) to file a report. Likewise, an insurer acquired in a business combination shall have two (2) calendar years following the date of acquisition or combination to comply with the reporting requirements.

Section 18. Canadian and British Companies

A. In the case of Canadian and British insurers, the annual Audited financial report shall be defined as the annual statement of total business on the form filed by such companies with their supervision authority duly audited by an independent chartered accountant.

B. For such insurers, the letter required in Section 6B shall state that the accountant is aware of the requirements relating to the annual Audited financial report filed with the commissioner pursuant to Section 4 and shall affirm that the opinion expressed is in conformity with those requirements.

Section 19. Severability Provision

If any section or portion of a section of this regulation or its applicability to any person or circumstance is held invalid by a court, the remainder of the regulation or the applicability of the provision to other persons or circumstances shall not be affected.

Chronological Summary of Actions (all references are to the Proceedings a/the NAIC).

1980 Proc. I 29, 37,212,262,266-272 (adopted).
1991 Proc. I 9,17,225-226, 426, 428, 429-434 (amended and reprinted).
1998 Proc. 2nd Quarter 12, 13, 158,226,230,231-232 (amended).
2001 Proc. 4th Quarter 6, 13-14, 531, 551, 561-563 (amended).
2003 Proc. 2nd Quarter 473, 489, 491 (amended and adopted by parent committee).
2003 Proc. 3rd Quarter 15 (adopted by Plenary).
2006 Proc. 2nd Quarter (amended and adopted by Plenary).

Appendix C – REQUIREMENTS FOR PREPARATION OF THE MANAGEMENT DISCUSSION AND ANALYSIS REPORT

Concurrent with filing the annual statement, each RRG captive must prepare a supplemental Management Discussion and Analysis Report (MD&A) that will provide detailed commentary regarding the RRG captive's financial condition, changes in financial condition and results of operations. The MD&A should provide information as specified in the following paragraphs and such other information that the RRG captive believes necessary for understanding its financial condition, changes in financial condition, and results of operations. Combine liquidity and capital discussions whenever the two topics are interrelated.

When preparing the MD&A, give particular attention to and disclose the effects of changes in the RRG captive's business plan. As required by law, you must obtain prior approval for material business plan changes and attach a copy of the approval letter to the MD&A filing. It is not necessary to attach a copy of the entire amended business plan.

Where applicable, an RRG captive's ability to continue to operate successfully in the short-term or long-term is dependent on the continued financial viability of its parent and affiliates. When preparing the MD&A, management should focus its commentary on the relevant relationship between the RRG captive and its affiliated companies and members. Describe in detail any material changes in the parent's and affiliate's business operations that are likely to impact the RRG captive's financial statements.

Introduction

1. The MD&A requirements are intended to provide, in one section, material historical and prospective textual disclosure enabling regulators to assess the financial condition and results of operations of the reporting entity. There is a need for a narrative explanation of the financial statements, because a numerical presentation and brief accompanying footnotes alone may be insufficient for regulators to judge the quality of earnings and the likelihood that past performance is indicative of future performance. The MD&A is intended to give the regulator an opportunity to look at the reporting entity through the eyes of management by providing both a short-term and long-term analysis of the business of the reporting entity.

2. The MD&A shall be of the financial statements and of other statistical data that the reporting entity believes will enhance a regulator's understanding of its financial condition, changes in financial condition and results of operations. Generally, the discussion shall cover the two year period covered by the financial statements and shall use year-to-year comparisons or any other formats that in the reporting entity's judgment enhance a regulator's understanding. However, where trend information is relevant, reference to the five year selected financial data schedule may be necessary.

3. The purpose of the MD&A shall be to provide regulators with information relevant to an assessment of the RRGs financial condition and results of operations of the reporting entity as determined by evaluating the amounts and certainty of cash flows from operations and from outside sources. The information provided pursuant to this MD&A need only include that which is available to the reporting entity without undue effort or expense and which does not clearly appear in the reporting entity's financial statements.

4. Management should ensure that disclosure in MD&A is balanced and fully responsive. To enhance regulator understanding of the financial statements, entities are encouraged to

explain in the MD&A the effects of the critical accounting policies applied, the judgments made in their application, and any subsequent changes in assumptions or conditions which would have resulted in materially different reported results. Analytical discussion of significant accounting policies in the MD&A should not include information already reported in the significant accounting policies section of the notes to the financial statement.

5. The discussion shall focus specifically on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition. This would include descriptions and amounts of (a) matters that would have an impact on future operations and have not had an impact in the past, and (b) matters that have had an impact on reported operations and are not expected to have an impact upon future operations.

6. Reporting entities are required to prepare the MD&A on a non-consolidated basis, unless the following conditions are met:

   a. The entity is part of a consolidated group of insurers that utilizes a pooling arrangement or one hundred percent reinsurance agreement that affects the solvency and integrity of the entity's reserves and such entity ceded substantially all of its direct and assumed business to the pool. An entity is deemed to have ceded substantially all of its direct and assumed business to a pool if the entity has less than $1,000,000 total direct plus assumed written premiums during a calendar year that are not subject to a pooling arrangement and the net income of the business not subject to the pooling arrangement represents less than 5% of the company's capital and surplus.

   Or

   b. The entity's state of domicile permits audited consolidated financial statements.

   If a group of insurance companies prepares the MD&A on a consolidated basis, the discussion should identify and discuss significant differences between reporting entities (e.g., investment mix, leverage, liquidity, etc.).

Results of Operations

7. Management should describe unusual or infrequent events or transactions or any significant economic changes that materially affected the amount of reported net income or other surplus gains/losses and, in each case, indicate the extent to which net income or surplus was so affected. In addition, describe any other significant components of income that, in the RRG captive's judgment, should be described in order to understand the RRG captive's results of operations.

8. Management should describe any known trends or uncertainties that have had or are reasonably probable to have a material favorable or unfavorable impact on premiums, net income or other gains/losses in surplus. The RRG captive should disclose knowledge or anticipation of events that may/will cause a material change in the expense and premium relationship.

9. To the extent that the financial statements disclose material increases in premium, please provide a narrative discussion of the extent to which such increases are attributable to any of the following: increases in prices or volume of existing products sold, or the introduction of new products.

Prospective Information

10. We encourage RRG captives to supply forward-looking information in the MD&A. nclude discussions of known trends or any known demands, commitments, events or uncertainties that will, or reasonably may, result in material changes to the RRG captive's liquidity. Also include descriptions of and expected changes in the mix, cost and known material trends in the RRG captive's capital resources. Further, you should disclose known trends or uncertainties that the RRG captive reasonably expects will have a material impact on premium, net income or other gains/losses in surplus.

11. The RRG captive should provide such prospective information in good faith and may disclaim any responsibility for the accuracy of such prospective information.

Material Changes

We require management to provide adequate disclosure and analysis of the reasons for material year-to-year changes in line items as related to financial statements, and discussion and quantification of the contribution of various factors to such material changes.

12. Fully describe the Department approved modifications to the RRG captive's operating plans and their effects on financial statements. Management should attach to the MD&A a copy of the Department's approval letter related to these business plan modifications.

13. Repetition and line-by-line analysis is not required or generally appropriate when the causes for a change in one line item also relate to other line items. Your discussion need not recite amounts of changes readily computable from the financial statements, however, do not merely repeat numerical data contained in such statements; instead, provide precise quantification using dollar amounts or percentages, as reasonably practicable.

Liquidity, Asset/Liability Matching and Capital Resources

14. The term "liquidity" as used in this MD&A refers to the ability of the RRG captive to generate adequate cash to meet the RRG captive's cash needs. Except where it is otherwise clear from the discussion, the RRG captive shall indicate those balance sheet conditions, income, or cash flow items, which the RRG captive believes may be liquidity indicators. You should discuss liquidity on both a long-term and short-term basis.

15. Generally, short-term liquidity and short-term capital resources cover cash needs up to 12 months into the future. These cash needs and the sources of funds to meet such needs relate to the RRG captive's day-to-day operating expenses and material commitments coming due during that 12-month period.

16. The discussion of long-term liquidity and long-term capital resources must address material expenditures, significant balloon payments or other payments due on long-term obligations, and other demands or commitments, including any off-balance sheet items, the RRG captive will incur beyond the next 12 months, as well as the proposed funding sources required to satisfy such obligations.

17. To the extent that an RRG captive expects to rely on funding from its parent or affiliate for short-term or long-term liquidity needs, you should describe the nature and source of that

funding. The RRG captive should extend the liquidity resources discussion to describe the resources and the parent's and affiliates' ability to fulfill the potential funding needed.

18. Management should identify any known trends, demands, commitments, events or uncertainties, likely, or reasonably likely, to result in material increases/decreases in the parent's or RRG captive's liquidity. If you identify a material decline in liquidity, indicate the course of action that the parent or RRG captive has taken or proposes to take to remedy the decline. Also identify and separately describe internal and external liquidity sources, and briefly discuss any material unused liquid asset sources.

19. Management should describe any known material trends, favorable or unfavorable, in the RRG captive's capital resources and indicate any expected material changes in the mix and relative cost of such resources. Include a discussion of changes between equity, debt and any off-balance sheet financing arrangements. If the RRG captive intends to rely on capital resources from its parent or affiliates and there are material changes in their ability to provide such resources, you must explain and discuss the resultant impact and the RRG captive's reliance on those resources.

20. We expect management to use the statement of cash flows, and other appropriate indicators, in analyzing liquidity and to present a balanced discussion dealing with cash flows from investing, financing and operational activities. Address those matters that have materially affected the most recent period presented, but not expected to have short or long-term implications; and, conversely, those matters not materially affecting the most recent period presented, but expected to have a material effect on future periods. Examples include:

    a) Changes in discretionary operating expenses;

    b) Dividend requirements to the RRG captive's parent to fund the parent's operations or debt service; or,

    c) Future potential sources of capital, such as the form and amount of a parent's planned investment in the RRG captive.

21. MD&A disclosures should not be overly general. For example, merely stating that "the RRG captive has sufficient short-term funding to meet its liquidity needs for the next year" provides little useful information for the Department. Instead, management should specifically describe the short-term funding sources and circumstances reasonably likely to affect those liquidity sources. Rather than offer "boilerplate" language, limit the discussion to material risks, and, as with the MD&A generally, be sufficiently detailed and tailored to the RRG captive's individual circumstances.

22. Management must identify and disclose "reasonably likely" circumstances that could materially affect liquidity, i.e., market price changes, economic downturns, defaults on guarantees, or parent or affiliate contractions of operations materially affecting the RRG captive's financial position or operating results.

23. When identifying trends, demands, commitments, events and uncertainties that require disclosure, management should consider the following:

    a) Provisions in financial guarantees or commitments, debt agreements or other arrangements that could trigger an early payment, additional collateral support, changes

in terms, acceleration of maturity, or the creation of an additional financial obligation, such as adverse credit ratings changes, financial ratios, earnings or cash flows;

b) Circumstances that could impair the parent's or the RRG captive's ability to continue to engage in transactions previously integral to historical operations, or financially or operationally essential, or that could render that activity commercially impracticable, such as the inability to maintain earnings levels, financial ratios, or collateral; and,

c) Factors specific to the RRG captive and its parent's markets that the RRG captive expects to be significant to the RRG captive's or its parent's ability to raise short-term and long-term financing.

Loss Reserves

24. The MD&A should include a discussion of items and description of contributing risks that affect loss reserve volatility.

25. To the extent there have been significant changes in the reserving practices during the period, disclose and discuss the reasons for making those changes along with their effects on current and future RRG captive operations. Generally consider all changes in reserving practices, whether or not they result in significant current financial statement impact, as material changes to a RRG captive's business plan that require the prior Department approval and attach a copy of the Department's approval letter to the MD&A.

Conclusion

26. The MD&A gives the Department the opportunity to look at the RRG captive through its management's eyes, providing a historical and prospective analysis of the RRG captive's financial condition and results of operations, with particular emphasis on the RRG captive's prospects for the future. Our MD&A requirements are intentionally flexible and general. Because no two RRG captives are identical, good MD&A disclosure for one RRG captive is not necessarily good MD&A disclosure for another. The same is true for MD&A disclosure of the same RRG captive in different years. We intend the MD&A to be a flexible framework for providing the Department with appropriate information concerning the RRG captive's financial condition, changes in financial condition and results of operations.

Appendix D – GOVERNANCE STANDARDS FOR RISK RETENTION GROUPS

1. **Independent Directors (ARS § 20-2402(C)).** The board of directors of the risk retention group shall have a majority of independent directors. If the risk retention group is a reciprocal, then the attorney-in-fact would be required to adhere to the same standards regarding independence of operation and governance as imposed on the risk retention group's board of directors/subscribers advisory committee under these standards; and, to the extent permissible under state law, service providers of a reciprocal risk retention group should contract with the risk retention group and not the attorney-in-fact.

   A. No director qualifies as "independent" unless the board of directors affirmatively determines that the director has no "material relationship" with the risk retention group. Each risk retention group shall disclose these determinations to its domestic regulator, at least annually. For this purpose, any person that is a direct or indirect owner of or subscriber in the risk retention group (or is an officer, director and/or employee of such an owner and insured, unless some other position of such officer, director and/or employee constitutes a "material relationship"), as contemplated by Section 3901(a)(4)(E)(ii) of the Liability Risk Retention Act, is considered to be "independent."

   B. "Material relationship" of a person with the risk retention group includes, but is not limited to **(ARS § 20-2402(D)(3))**:

      i. The receipt in any one 12-month period of compensation or payment of any other item of value by such person, a member of such person's immediate family or any business with which such person is affiliated from the risk retention group or a consultant or service provider to the risk retention group is greater than or equal to five percent (5%) of the risk retention group's gross written premium for such 12-month period or two percent (2%) of its surplus, whichever is greater, as measured at the end of any fiscal quarter falling in such a 12-month period. Such person or immediate family member of such person is not independent until one year after his/her compensation from the risk retention group falls below the threshold.

      ii. A relationship with an auditor as follows: a director or an immediate family member of a director who is affiliated with or employed in a professional capacity by a present or former internal or external auditor of the risk retention group is not independent until one year after the end of the affiliation, employment or auditing relationship.

      iii. A relationship with a related entity as follows: a director or immediate family member of a director who is employed as an executive officer of another company where any of the risk retention group's present executives serve on that risk retention group's board of directors is not independent until one year after the end of such service or the employment relationship.

2. **Service Provider Contracts (ARS § 20-2402(C)(3)).** The term of any material service provider contract with the risk retention group shall not exceed five (5) years. Any such contract, or its renewal, shall require the approval of the majority of the risk retention group's independent directors. The risk retention group's board of directors or its owners/insureds shall have the right to terminate any service provider, audit or actuarial contracts at any time for cause after providing adequate notice as defined in the contract. The service provider contract is deemed material if the amount to be paid for such contract is greater than or equal to five

percent (5%) of the risk retention group's annual gross written premium or two percent (2%) of its surplus, whichever is greater.

A. For purposes of this standard, "service providers" includes captive managers, auditors, accountants, actuaries, investment advisors, lawyers, managing general underwriters or other party responsible for underwriting, determination of rates, collection of premium, adjusting and settling claims and/or the preparation of financial statements. Any reference to 'lawyers' in the prior sentences does not include defense counsel retained by the risk retention group to defend claims, unless the amount of fees paid to such lawyers are 'material' as referenced in Section (1)(B) above. **(ARS § 20-2402(D)(4))**

B. Formal written contracts are required for **all** service providers even if the contracting parties are related or affiliated. The following must be submitted for **prior** approval to the Department at least **30** days prior to entering into the agreement, renewal or amendment:

   i. all captive manager agreements, renewals and amendments;
   ii. all related party or affiliate agreements, renewals and amendments;
   iii. material service provider agreements, renewals and amendments.

   Executed copies of all contracts, agreements, amendments and renewals must be filed with the Department, whether or not Director's prior approval was required. All agreements are required to be in the best interests of the RRG captive. Director's approval may be withdrawn at any time as circumstances may require.

3. **Written Charter (ARS § 20-2402(C)(4)).** The risk retention group's board of directors shall have a written policy in the Bylaws that requires the board to:

   A. ensure that all owner/insureds of the risk retention group receive evidence of ownership interest;

   B. develop a set of governance standards applicable to the risk retention group;

   C. oversee the evaluation of the risk retention group's management, including the performance of the captive manager, managing general underwriter or other parties responsible for underwriting, determination of rates, collection of premium, adjusting or settling claims or the preparation of financial statements;

   D. review and approve the amount to be paid for all material service providers; and

   E. review and approve, at least annually:

      i. the risk retention group's goals and objectives relevant to the compensation of officers and service providers;

      ii. the officers' and service providers' performance in light of those goals and objectives; and,

      iii. the continued engagement of the officers and material service providers.

4. **Audit Committee (ARS § 20-2402(C)(5)).** The risk retention group shall have an audit committee composed of at least three independent board members as defined in Section (1).

A non-independent board member may participate in the activities of the audit committee, if invited by the members, but cannot be a member of such committee.

A. The audit committee shall have a written charter that defines the committee's purpose, which, at a minimum, must be to:

   i. assist board oversight of (1) the integrity of the financial statements, (2) the compliance with legal and regulatory requirements, and (3) the qualifications, independence and performance of the independent auditor and actuary;

   ii. discuss the annual audited financial statements and quarterly financial statements with management;

   iii. discuss the annual audited financial statements with its independent auditor and, if advisable, discuss its quarterly financial statements with its independent auditor;

   iv. discuss policies with respect to risk assessment and risk management;

   v. meet separately and periodically, either directly or through a designated representative of the committee, with management and independent auditors;

   vi. review with the independent auditor any audit problems or difficulties and management's response;

   vii. set clear hiring policies of the risk retention group as to the hiring of employees or former employees of the independent auditor;

   viii. require the external auditor to rotate the lead (or coordinating) audit partner having primary responsibility for the risk retention group's audit as well as the audit partner responsible for reviewing that audit so that neither individual performs audit services for more than five (5) consecutive fiscal years; and

   ix. report regularly to the board of directors.

B. The Department may waive the requirement to establish an audit committee composed of independent board members if the risk retention group is able to demonstrate to the domestic regulator that it is impracticable to do so and the risk retention group's board of directors is otherwise able to fulfill the requirements of the audit committee, as described in Section (4)(a).

5. **Governance Standards (ARS § 20-2402 (C)(7)).** The board of directors shall adopt and disclose governance standards by making such information available through electronic means (e.g., posting such information on the risk retention group's website) or other means, and providing such information to members/insureds upon request, which shall include:

   A. a process by which the directors are elected by the owner/insureds;

   B. director qualification standards;

   C. director responsibilities;

   D. director access to management and, as necessary and appropriate, independent advisors;

E. director compensation;

F. director orientation and continuing education;

G. policies and procedures for management succession; and

H. policies and procedures for the annual performance evaluation of the board.

6. **Business Conduct and Ethics (ARS § 20-2402(C)(8)).** The board of directors shall adopt and disclose a code of business conduct and ethics for directors, officers and employees and promptly disclose to the board of directors any waivers of the code for directors or executive officers, which should include the following topics:

   A. conflicts of interest;

   B. corporate opportunities;

   C. confidentiality;

   D. fair dealing;

   E. protection and proper use of risk retention group assets;

   F. compliance with all applicable laws, rules and regulations; and

   G. requiring the reporting of any illegal or unethical behavior which affects the operation of the risk retention group.

7. **Reporting Non-Compliance (ARS § 20-2402(C)(9)).** The captive manager or chief executive officer of the risk retention group shall promptly notify the domestic regulator in writing if either becomes aware of any material non-compliance with any of the risk retention group's governance standards.

8. **Enforcement.** The risk retention group's domestic regulator may take appropriate regulatory action against any director or officer of the risk retention group or its captive manager, pursuant to its laws and regulations, if the risk retention group or captive manager violates these governance standards.

Appendix E – REINSURANCE GUIDELINES FOR RRGS LICENSED AS CAPTIVE INSURERS

Important: Arizona captive risk retention groups are subject to Arizona insurance laws and regulations and RRGs are expected to adhere to such requirements. These rules change relatively frequently, including significant changes in recent years, making it challenging to maintain up to date guidance in this Reference Guide.

Captive RRGs, captive managers, and other advisors should consult with reinsurance accounting, reporting and compliance experts in interpreting and implementing the most recent rules and not rely solely on guidance herein.

Useful and important resources that should be considered include:

1. Arizona Revised Statutes (ARS) sections:

    a. 20-1098.11. Reinsurance

    b. 20-261. Authorized reinsurance

    c. 20-261.01 *et seq*. Credit for reinsurance, etc.

2. National Association of Insurance Commissions (NAIC) website, including:

    a. Reinsurance (E) Task Force activities, and those of their working groups -- https://content.naic.org/cmte_e_reinsurance.htm

    b. NAIC model laws and regulations, including MDLs 785 and 786 -- https://content.naic.org/prod_serv_model_laws.htm

    c. Accounting Practices and Procedures (E) Task Force activities, and those of their working groups -- https://content.naic.org/cmte_e_app.htm

    The NAIC website also provides information regarding reinsurance accounting and reporting standards that generally apply in whole or in part to risk retention groups whether reporting on a statutory or GAAP accounting basis. See the Accounting Practices and Procedures Manual, including SSAP #62R, and the Annual Statement Instructions for more information.

    Those publications may be found at: https://www.naic.org/prod_serv_publications.htm