

# Financial Regulation Standards and Accreditation Program

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Insurance Commissioners**

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# The NAIC Financial Regulation Standards and Accreditation Program

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## THE NAIC FINANCIAL REGULATION STANDARDS AND ACCREDITATION PROGRAM

*(Note: The official standards, policies and procedures of the NAIC Financial Regulation Standards and Accreditation Program are contained in the Proceedings of the NAIC and should be consulted for complete, accurate and up-to-date information on the Program.)*

*This pamphlet contains only general information about the NAIC Financial Regulation Standards and Accreditation Program and is not a comprehensive statement of the official standards, policies and procedures of the Program. Although this pamphlet is periodically updated to reflect changes in the Program, the reader is advised that it may not reflect the current Program requirements.)*

### **Introduction**

#### ***What is accreditation?***

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In general, accreditation is the process by which a program has been certified as fulfilling certain standards by a national professional association. In the terms of the insurance industry, accreditation is a certification given to a state insurance department once it has demonstrated it has met and continues to meet an assortment of legal, financial, organizational, and licensing and change of control standards as determined by a committee of its peers.

#### ***Why is accreditation necessary?***

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The concept of accrediting state insurance departments began in the mid-to-late 1980s when several large insurance companies became insolvent. In May 1988, as a response to the insolvencies, a congressional inquiry began looking at the insolvencies. In turn, the NAIC began discussing and shaping the Financial Regulation Standards and Accreditation Program in September 1988.

It was apparent that a system of effective solvency regulation could provide crucial safeguards for America's insurance consumers. Insurance consumers benefit when the insurance industry is strong enough financially to be able to pay and settle claims in a timely manner, to provide diverse and competitively priced products, and to provide meaningful customer service.

An effective system of solvency regulation has certain basic components. It requires that regulators have adequate statutory and administrative authority to regulate an insurer's corporate and financial affairs. It requires that regulators have the necessary resources to carry out that authority. Finally, it requires that insurance departments have in place organizational and personnel practices designed for effective regulation.

After much discussion, the NAIC took a large step toward establishing a sound program that would aide state insurance departments and solvency regulation by adopting the Financial Regulation Standards (Standards) in June 1989. In an effort to provide guidance to the states regarding the baseline Standards and as an incentive to put them in place, the NAIC adopted in June 1990 a formal certification program. Under this plan, each state's insurance department will be reviewed by an independent review team whose job is to assess that department's compliance with the Standards. Departments meeting the Standards will be publicly acknowledged, while departments not in compliance will be given guidance by the NAIC to bring them into compliance.

The Financial Regulation Standards and Accreditation (F) Committee of the NAIC, consisting of regulators from across the country, ultimately decides whether a state meets the requirements set forth in the Standards.

The meetings in which matters of state accreditation are discussed are held in a regulator only session to protect the states, regulators, and in some instances, insurers from disclosure of confidential information.

### ***What is the program's mission statement?***

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The mission of the NAIC accreditation program is to establish and maintain standards to promote sound insurance company financial solvency regulation. The accreditation program provides a process whereby solvency regulation of multi-state insurance companies can be enhanced and adequately monitored with emphasis on the following:

1. Adequate solvency laws and regulations in each accredited state to protect consumers and guarantee funds.
2. Effective and efficient financial analysis and examination processes in each accredited state.
3. Appropriate organizational and personnel practices in each accredited state.
4. Effective and efficient processes regarding the review of primary licensing, redomestications and change of control of domestic insurers in each accredited state.

The accreditation program will accomplish its mission by continually evaluating the adequacy and appropriateness of accreditation standards in accordance with the changing regulatory environment and through continued monitoring of accredited states by conducting the following accreditation reviews:

- Pre-Accreditation Reviews to occur approximately one year prior to a state's full accreditation review. This review will entail a high-level review of the financial analysis and financial examination functions to identify areas of improvement.
- Full Accreditation Review to occur once every five years subject to interim annual reviews. This review will entail a full review of laws and regulations, the financial analysis and financial examinations functions, organizational and personnel practices, and primary licensing, redomestications and change of control of domestic insurers to assist in determining a state's compliance with the accreditation standards.
- Interim Annual Reviews to occur annually to maintain accredited status between full accreditation reviews. This review will entail a review of any law and regulation changes, the financial analysis and financial examination functions, and organizational and personnel practices and primary licensing, redomestications and change of control of domestic insurers to ensure continued compliance with the accreditation standards and to identify areas of improvement.

### ***What are the benefits of accreditation?***

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The accreditation program allows for inter-state cooperation and reduces regulatory redundancies. That is, if a company is domiciled in an accredited state, the other states in which that company is licensed and/or writes business may be assured that, because of its accredited status, the domiciliary state insurance department is adequately monitoring the financial solvency of that company. In fact, each accredited state's laws or regulations on financial examinations contain a provision that all licensed companies are to be examined periodically; however, in lieu of performing its own examination, a state may accept the examination report prepared by an insurance department that was accredited at the time of examination. Therefore, the inter-state reliance that the accreditation program produces ultimately saves millions of dollars in duplicative examination costs.

The accreditation program is a key tool in promoting and maintaining state-based regulation of the insurance industry. The creation of the accreditation program was prompted by a congressional report that highlighted weaknesses in state-based regulation, to which the Program has aided states in correcting these

deficiencies. States that maintain their accredited status demonstrate that the current scheme of regulatory monitoring is intact and continues to work effectively.

### *Who is accredited?*

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As of January 2020, there are a total of 53 jurisdictions that are accredited. All fifty states, the District of Columbia, Puerto Rico and U.S. Virgin Islands are accredited, which includes—Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Puerto Rico, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virgin Islands, Virginia, Washington, West Virginia, Wisconsin and Wyoming.

## **How the Accreditation Program Works**

The accreditation program establishes requirements under which a state insurance department may seek accreditation. Additionally, the program establishes guidelines for states already accredited to maintain their accredited status.

### *Accreditation Review Process*

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#### **Procedures in Preparation for an Accreditation Review**

1. A state requests an accreditation review by contacting the applicable NAIC staff.
2. The NAIC requests that the state submit a self-evaluation guide. This guide provides the state with the detailed requirements of the accreditation standards including laws and regulations that must be adopted, financial analysis and examination procedures that must be in place organizational and personnel practices that must be established, and organization, licensing and change of control of domestic insurers' practices that must be established.
3. The NAIC assembles proposed review teams consisting of qualified candidates that are considered experts in the insurance industry, to participate on a state's accreditation review. These proposed review teams are reviewed and approved by the chief operation officer.
4. The NAIC notifies the chair and vice-chair of the Financial Regulations Standards and Accreditation (F) Committee (the Committee) that the state has requested an accreditation review and provides the chair and vice-chair with the proposed review team, as approved by the chief operation officer.
5. The chair and vice-chair of the Committee approve the review team and the review team leader and appoint at least one NAIC observer. Review teams generally consist of three to eight individuals depending upon the size of the state as noted in the "Workplan for the Full On-Site Accreditation Review," however, the chair of the Committee may determine that a lesser number is sufficient when the size of the state's insurance industry and scope of the department's responsibilities are notable limited. The review team should include at least one disinterested former executive level regulator.
6. The NAIC notifies the state of the selection of the review team. The state is given the opportunity to object to any of the review team members.
7. The NAIC notifies the review team members. The review team members are paid by the NAIC at a set hourly rate for time spent on the accreditation review plus reasonable actual expenses incurred.

8. The NAIC works with the state to schedule the site visit and notifies the review team of the dates. Generally, a site visit requires three to five days depending upon the size of the state.
9. The NAIC sends copies of the state's completed self-evaluation guide with any applicable supporting documentation to the review team.
10. The NAIC notifies the state of the data, documentation, staff interviews, and other needs of the review team for its on-site review.
11. The NAIC Legal Division reviews the Part A responses and other pertinent information received from the state, and to the extent necessary, may analyze the state's laws, to determine whether the state is in compliance with the Part A standards and to confirm whether the citations provided by the state accurately identify the extent to which the state's laws and regulations evidence compliance with the Part A standards. Questions or concerns are forwarded to the NAIC accreditation staff and, if not resolved, are discussed with the state and, in addition, may be brought to the attention of an accreditation review team leader.
12. The report of the NAIC Legal Division on the Part A standards (Part A Report) reports the findings of the NAIC Legal Division and includes the NAIC Legal Division's conclusion on the state's compliance with the Part A: Laws and Regulations Standards. An exceptions portion of the report will highlight concerns, if any are noted during the review, together with recommendations for the state to consider enhancements to its laws and regulations providing for sound insurance regulation. The department is required to provide a formal response to any exceptions noted by the date indicated by NAIC staff. This response will be included in the accreditation report package provided to the Committee for discussion during the national meeting.
13. The Part A Report is made part of the documentation for the accreditation review. It is typically delivered to the department and the review team by the commencement of the on-site review, and is included in the materials submitted to each member of FRSAC at the conclusion of the on-site review.

#### **On-Site Accreditation Review Procedures**

1. The review team conducts the on-site review following a general outline of procedures to be performed to allow for uniformity in the evaluation process among the states. In addition, an NAIC staff representative is an observer on each site visit to help ensure uniformity and consistency in the on-site reviews. Before the on-site review, there is an initial meeting of the team members to discuss comments and concerns from review of the self-evaluation guide and supporting documentation.
2. The on-site review consists of the following:
  - Discussion with financial solvency senior management and the commissioner regarding its role in financial solvency oversight.
  - Review of examination reports and supporting work papers and analytical reviews.
  - Inspection of financial analysis and examination files for selected companies.
  - Interviews with department personnel.
  - Review of organizational and personnel practices.
  - Inspection of documentation regarding primary applications for the licensing of new companies and redomestications and Form A filings for selected companies.
  - Walk-through of the department to gain an understating of document and communication flows.
  - Meetings of the review team to discuss comments and findings from the review.
  - Private meeting of the team members to develop the review team's recommendation regarding the state's accreditation and to draft the review team's report.

- Closing conference with the state to discuss findings.
  - Draft copies of the Part A Report and the review team's report discussing Parts B, C and D, which includes any key areas for improvement, are provided to the state.
3. The review team's report includes an executive summary identifying the review team's recommendation, supporting rationale for the recommendation, positive attributes and key areas for improvement. The report template also includes a section for the review team's discussion which allows the team flexibility to include additional context and any information that would be valuable or meaningful to the Committee. The review team's report may include items that require a response from the department. In those instances, the department is required to provide a formal response by the date indicated by NAIC staff. This response will be included in the accreditation report package provided to the Committee for discussion during the next National Meeting.

### **Committee Evaluation Process**

1. The Committee typically meets at the national meetings to discuss the review team's reports. The Committee also has copies of the state's self-evaluation guide and supporting documentation available. In addition, the team leader and the NAIC observer are present at the meeting. Representatives of the state are in attendance to respond to questions from the Committee, or comment upon the review team's reports and recommendation.
2. The Committee has the option to convene into a "private" session during its Regulator-to-Regulator session meeting, at the discretion of the Chair of the Committee. The individuals in the private session would typically include only members of the Committee and their representatives, applicable NAIC staff, and the team leader. This should only occur in rare and infrequent situations when the Committee must discuss or inquire regarding sensitive issues. Examples of this could include the following:
  - a. Concern regarding the quality or competence of personnel employed by a state insurance department, or
  - b. To confer with NAIC staff on the process and results of a contentious issue that the Committee has deliberated previously.
3. Representatives of the state are excused once the Committee has no further questions for these individuals. Based on the recommendation of the review team and as a result of this meeting, the Committee makes a decision as to whether or not the state should be accredited. If the state is already accredited, the Committee makes a decision whether the state should retain its accreditation, or whether its accreditation should be placed on probation, suspended or revoked.
4. The Committee informs the state of its decision:
  - a. If the decision is to retain the state's accreditation, which includes those states granted continued accreditation although they were also placed on probation, the state receives recognition at the national meeting via inclusion in the National Meeting News.
  - b. For those states not currently accredited: If the decision is unfavorable, the state has three options: withdraw its request for accreditation; ask the Committee to hold its decision in abeyance pending legislative or other corrective action to bring the state into compliance with the standards; or appeal the decision of the Committee.
  - c. For those states currently accredited:
    - If the decision is to place a state's accredited status on probation, a letter setting forth the conditions of the probation should be sent to the state as soon as possible after the



Committee meeting. The state does not have the option to appeal the decision of the Committee.

- If the decision is to suspend a state’s accreditation, a letter setting forth the conditions of the suspension should be sent to the state as soon as possible after the Committee meeting. The state may either accept the decision or choose to appeal the decision of the Committee. In the case of an appeal, the state retains its full accredited status during the appeals process. Public acknowledgement that a state’s accreditation has been suspended should only occur after the opportunity to appeal has lapsed and the state has not chosen to do so, or if the decision by the Committee to suspend accreditation is upheld by the appeal hearing panel.
  - If the decision is to revoke a state’s accreditation, the state may either accept the decision or choose to appeal the decision of the Committee. In the case of an appeal, the state retains its full accredited status during the appeals process. Public acknowledgement that a state’s accreditation has been revoked should only occur after the opportunity to appeal has lapsed and the state has not chosen to do so, or if the decision by the Committee to revoke accreditation is upheld by the appeal hearing panel.
5. Accreditation is for a five-year period, subject to annual reviews of the state’s self-evaluation guide. Once accredited, a state is subject to a full accreditation review every five years. If information comes to the attention of the Committee that suggests that a state may no longer meet the standards, a special review may be conducted. If the Committee concludes that the state’s accreditation should be placed on probation, suspended or revoked, the specific reasons are documented in a report to the state. The state would have the right to appeal a suspension or revocation decision of the Committee utilizing the procedures outlined in the section entitled, “Appeal Procedures for the NAIC Financial Regulation Standards and Accreditation Program.”

### **Interim Annual Reviews**

1. Annually, on the anniversary of the state’s accreditation, the state shall submit an updated self-evaluation guide (interim annual reviews) to the NAIC Central Office.
2. The state’s report in the first year after an on-site accreditation review shall also provide an updated response to all recommendations made in the review team’s report, including the progress on addressing each of the recommendations. Additional updates may also be required in subsequent years to address any outstanding concerns.
3. NAIC staff will review the interim annual review report and supporting documentation submitted by the state and summarizes the information for presentation to the Committee.
4. After hearing the report from the NAIC staff, the Committee will determine whether the state remains in compliance with the standards. (The Committee may request that a representative of the state be present to answer questions, if desired.)
5. If the Committee finds the state to be out of compliance with the standards, the specific reasons will be documented in a letter to the state and the state’s accreditation will be placed on probation, suspended or revoked. The state would have the right to appeal a suspension or revocation decision of the Committee utilizing the procedures outlined in the following section entitled, “Appeal Procedure for the NAIC Financial Regulation Standards and Accreditation Program.” A state cannot appeal a decision by the Committee to place its accreditation on probation.

## **A Closer Look at the Standards**

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The Standards have been divided into four major categories: laws and regulations (Part A); regulatory practices and procedures (Part B); organizational and personnel practices (Part C); and primary licensing, redemestications and change of control (Part D).

## **Part A: Laws and Regulations –Excluding RRGs**

### *Preamble*

#### **Purpose of the Part A Standards**

The purpose of the Part A: Laws and Regulations standards are to assure that an accredited state has sufficient authority to regulate the solvency of its multi-state domestic insurance industry in an effective manner. The Part A standards are the product of laws and regulations that are considered to be basic building blocks for effective financial solvency regulation. A state may demonstrate compliance with a Part A standard through a law, a regulation, or an administrative practice that implements the general authority granted to the commissioner, or any combination thereof, which achieves the objective of the standard. The term “state” as used herein is intended to include any NAIC member jurisdiction, including U.S. territories. The term “commissioner” means commissioners, directors, superintendents or other officials who by law are charged with the principal responsibility of supervising the business of insurance within each state.

#### **Scope of the Part A Standards (Excluding Risk Retention Groups Organized as Captives)**

##### Life/Health and Property/Casualty Insurers

The following Part A standards apply to the regulation of a state’s domestic insurers licensed and/or organized under its life/health and property/casualty statutes (life/health or property/casualty insurer), but only if the insurer is a multi-state insurer. NOTE: This section does not apply to a state’s domestic insurers licensed and/or organized under its captive or special purpose vehicle statutes or any other similar statutory construct. For purposes of Part A, a life/health or property/casualty insurer that meets any of the following conditions is considered to be a multi-state insurer and subject to the Part A standards:

1. A property/casualty or life/health domestic insurer that is licensed in at least one state other than its state of domicile.
2. A property/casualty or life/health domestic insurer that is operating in at least one state other than its state of domicile.
3. A property/casualty or life/health domestic insurer that is accredited or certified as a reinsurer in at least one state other than its state of domicile.
4. A property/casualty or life/health domestic insurer that is reinsuring business covering risks residing in at least two states.
5. A property/casualty domestic insurer that is accepting business on an exported basis as an excess or surplus line insurer in at least one state other than its state of domicile.

### Captive Reinsurers

The following Part A standards apply to the regulation of a state’s domestic insurers licensed and/or organized under its captive or special purpose vehicle statutes or any other similar statutory construct (captive insurer) that reinsure business covering risks residing in at least two states, but only with respect to the following lines of business:

1. Policies that are required to be valued under Sections 6 or 7 of the *Valuation of Life Insurance Policies Model Regulation* (Model #830) (commonly referred to as XXX/AXXX policies). The application of this provision is intended to have a prospective-only effect, so that regulation of captive insurers, special purpose vehicles and any other entities that reinsure these types of policies will not be subject to the Part A standards if the policies assumed were both (1) issued prior to Jan. 1, 2015, and (2) ceded so that they were part of a reinsurance arrangement as of Dec. 31, 2014. [Drafting Note: This paragraph of the Preamble became effective Jan. 1, 2016]
2. Variable annuities valued under Actuarial Guideline XLIII—CARVM for Variable Annuities (AG 43). [Drafting Note: This paragraph of the Preamble is not yet effective. Effective date for compliance to be determined.]
3. Long term care insurance valued under the *Health Insurance Reserves Model Regulation* (Model #10). [Drafting Note: This paragraph of the Preamble is not yet effective. Effective date for compliance to be determined.]

The NAIC Executive (EX) Committee adopted the XXX/AXXX Reinsurance Framework, and the NAIC is currently in the process of adopting actions necessary for its full implementation. With regard to a captive insurer, special purpose vehicle, or any other entity assuming XXX/AXXX business, regulation of the entity is deemed to satisfy the Part A accreditation requirements if the applicable reinsurance transaction satisfies the XXX/AXXX Reinsurance Framework requirements adopted by the NAIC.

[Drafting Note: The Part A standards with respect to entities assuming variable annuities and long term care reinsurance business are intended to be effective with respect to both currently in-force and future business. However, the effective dates for variable annuities and long term care insurance are not yet determined, and their application to in-force business need further discussion].

### Other Types of Insurers

For clarity purposes, the scope of the Part A standards excludes regulation of those insurers licensed as fraternal benefit societies and title insurers except that compliance with the “Liabilities and Reserves” standard is required for entities licensed as fraternal benefit societies where specifically referenced within the standard. The scope of the Part A standards also excludes regulation of health organizations, except that compliance with the “Capital and Surplus Requirement” standard is required for entities licensed as health organizations (including health maintenance organizations, limited health service organizations, dental or vision plans, hospital, medical and indemnity or service corporations, or other managed care organizations) to the extent the insurance department regulates such entities. This definition does not include an organization that is licensed as either a life/health insurer or a property/casualty insurer, which are subject to the full Part A accreditation standards.

#### **1. Examination Authority**

The department should have authority to examine companies whenever it is deemed necessary. Such authority should include complete access to the company’s books and records and, if necessary, the records of any affiliated company, agent, and/or managing general agent. Such authority should extend not only to inspect books and records but also to examine officers, employees, and agents of the

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company under oath when deemed necessary with respect to transactions directly or indirectly related to the company under examination. The NAIC *Model Law on Examinations* or substantially similar provisions shall be part of state law.

**2. Capital and Surplus Requirement**

The department should have the ability to require that insurers have and maintain a minimum level of capital and surplus to transact business. The department should have the authority to require additional capital and surplus based upon the type, volume and nature of insurance business transacted. The *Risk Based Capital (RBC) for Insurers Model Act* and the *Risk-Based Capital for Health Organizations Model Act* or provisions substantially similar shall be included in state laws or regulations.

**3. NAIC Accounting Practices and Procedures**

The department should require that all companies reporting to the department file the appropriate NAIC annual statement blank, which should be prepared in accordance with the NAIC's instructions handbook and follow those accounting procedures and practices prescribed by the NAIC's *Accounting Practices and Procedures Manual*, utilizing the version effective January 1, 2001 and all subsequent revisions adopted by the Financial Regulation Standards and Accreditation (F) Committee.

**4. Corrective Action**

State law should contain the NAIC's *Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition* or a substantially similar provision, which authorizes the department to order a company to take necessary corrective action or cease and desist certain practices that, if not corrected, could place the company in a hazardous financial condition.

**5. Valuation of Investments**

The department should require that securities owned by insurance companies be valued in accordance with those standards promulgated by the NAIC's Capital Markets and Investment Analysis Office. Other invested assets should be required to be valued in accordance with the procedures promulgated by the NAIC's Financial Condition (E) Committee.

**6. Insurance Holding Company Systems**

State law should contain the NAIC *Insurance Holding Company System Regulatory Act* or an Act substantially similar, and the department should have adopted the NAIC's model regulation relating to this law.

**7. Risk Limitation**

State law should prescribe the maximum net amount of risk to be retained by a property and liability company for an individual risk based upon the company's capital and surplus. This limitation should be no larger than 10% of the company's capital and surplus.

**8. Investment Regulations**

State statute should require a diversified investment portfolio for all domestic insurers both as to type and issue and include a requirement for liquidity. Foreign companies should be required to substantially comply with these provisions.

**9. Liabilities and Reserves**

State statute should prescribe minimum standards for the establishment of liabilities and reserves resulting from insurance contracts issued by an insurer; including life reserves, active life reserves and unearned premium reserves, and liabilities for claims and losses unpaid and incurred but not reported claims. The NAIC's *Standard Valuation Law, Actuarial Opinion and Memorandum Regulation* and

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*Property and Casualty Actuarial Opinion Model Law* or substantially similar provisions shall be in place.

**10. Reinsurance Ceded**

State law should contain the NAIC *Credit for Reinsurance Model Law*, the NAIC's *Credit for Reinsurance Model Regulation* and the NAIC *Life and Health Reinsurance Agreement Model Regulation* or substantially similar laws.

**11. CPA Audits**

State statute or regulation should contain a requirement for annual audits of domestic insurance companies by independent certified public accountants that is substantially similar to the NAIC's *Annual Financial Reporting Model Regulation*.

**12. Actuarial Opinion**

State statute or regulation should contain a requirement for an opinion on reserves and loss and loss adjustment expense reserves by a qualified actuary or specialist on an annual basis for all domestic insurance companies.

**13. Receivership**

State law should set forth a receivership scheme for the administration, by the insurance commissioner, of insurance companies found to be insolvent as set forth in the NAIC's *Insurer Receivership Model Act*.

**14. Guaranty Funds**

State law should provide for a regulatory framework such as that contained in the NAIC's model acts on the subject, to ensure the payment of policyholders' obligations subject to appropriate restrictions and limitations when a company is deemed insolvent.

**15. Filings with NAIC**

State statute, regulation or practice should mandate filing of annual and quarterly statements with the NAIC in a format acceptable to the NAIC except that states may exempt from this requirement those companies that operate only in their state of domicile.

**16. Producer Controlled Insurers**

States should provide evidence of a regulatory framework, such as that contained in the NAIC's *Business Transacted with Producer Controlled Property/Casualty Insurer Act* or similar provisions.

**17. Managing General Agents Act**

States should provide evidence of a regulatory framework, such as that contained in the NAIC's *Managing General Agents Act* or similar provisions.

**18. Reinsurance Intermediaries Act**

States should provide evidence of a regulatory framework, such as that contained in the NAIC's *Reinsurance Intermediary Model Act* or similar provisions.

**19. Regulatory Authority**

State law should provide for a regulatory framework for the organization, licensing and change of control of domestic insurers.

**20. Risk Management and Own Risk and Solvency Assessment**

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State law should contain the NAIC *Risk Management and Own Risk and Solvency Assessment Model Act* (#505), or a substantially similar law.

## 21. Corporate Governance

State statute and/or regulation should include a requirement for insurers to provide a confidential annual disclosure of their corporate governance practices that is substantially similar to the NAIC's Corporate Governance Annual Disclose Model Act and Corporate Governance Disclosure Model Regulation.

*(Note: If a state can provide evidence that none of the entities contemplated in above standards 14, 16, 17 or 18 is either present or allowed to operate in the state, it will not need to demonstrate compliance with that standard.)*

## **Part A: Laws and Regulations – Risk Retention Groups**

### **Scope of the Part A Standards (Risk Retention Groups Organized as Captives)**

The following Part A standards apply to regulation of a state's domestic RRGs incorporated as captive insurers, but only if the RRG is a multi-state insurer. For purposes of Part A, an RRG that meets any of the following conditions is considered to be a multi-state insurer and subject to the Part A standards:

1. An RRG domestic insurer that is registered in a least one state other than its state of domicile.
2. An RRG domestic insurer that is operating in at least one state other than its state of domicile.
3. An RRG domestic insurer that is reinsuring business covering risks residing in at least two states.

This scope includes RRGs that are chartered in the accredited state and registered or operating in at least one other state.

#### **1. Examination Authority**

The department should have authority to examine RRGs organized as captive insurers whenever it is deemed necessary. Such authority should include complete access to the RRG's books and records and, if necessary, the records of any affiliated company, agent, and/or managing general agent. Such authority should extend not only to inspect books and records but also to examine officers, employees, and agents of the RRG under oath when deemed necessary with respect to transactions directly or indirectly related to the RRG under examination. The NAIC *Model Law on Examinations* or substantially similar provisions shall be part of state law.

#### **2. Capital and Surplus Requirement**

The department should have the ability to require that RRGs have and maintain a minimum level of capital and surplus to transact business. The department should have the authority to require additional capital and surplus based upon the type, volume, and nature of insurance business transacted. The *Risk-Based Capital for Insurers Model Act* or provisions substantially similar should be included in state laws or regulations.

#### **3. NAIC Accounting Practices and Procedures**

The department should require that RRGs reporting to the department file the appropriate NAIC Annual Statement Blank which should be prepared in accordance with the NAIC's Instructions Handbook, as applicable. The RRGs should follow those accounting procedures and practices prescribed by the NAIC *Accounting Practices and Procedures Manual* or another basis of accounting as permitted or prescribed by state law or regulation.

#### **4. Corrective Action**

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State law should contain the NAIC's *Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition* or a substantially similar provision which authorizes the department to order a RRG to take necessary corrective action or cease and desist certain practices which, if not corrected, could place the RRG in a hazardous financial condition.

**5. Valuation of Investments**

The department should require that securities owned by RRGs be valued in accordance with those standards promulgated by the NAIC's Capital Markets and Investment Analysis Office or, if a basis of accounting other than SAP is used, the state must have authority to determine the valuation of securities. For RRGs that use SAP, other invested assets should be required to be valued in accordance with the procedures promulgated by the NAIC's Financial Condition (E) Committee. For RRGs that use another basis of accounting, the state must have authority to determine valuation of securities.

**6. Insurance Holding Company Systems**

State law should contain the NAIC *Insurance Holding Company Systems Regulatory Act* or an act substantially similar and the department should have adopted the NAIC's model regulation relating to this law.

**7. Risk Limitation**

State law should provide the state insurance department with clear authority in statute or regulation to limit the net amount of risk retained for an individual risk.

**8. Investment Regulations**

State statute should require a diversified investment portfolio for RRGs both as to type and issue and include a requirement for liquidity.

**9. Liabilities and Reserves**

State statute should prescribe minimum standards for the establishment of liabilities and reserves resulting from insurance contracts issued by an RRG; including unearned premium reserves and liabilities for claims and losses unpaid and incurred but not reported claims.

**10. Reinsurance Ceded**

State law should contain the NAIC *Model Law on Credit for Reinsurance*, the NAIC's *Credit for Reinsurance Model Regulation* or substantially similar laws.

**11. CPA Audits**

State statute or regulation should contain a requirement for annual audits of domestic RRGs by independent certified public accountants that is substantially similar to the NAIC *Annual Financial Reporting Model Regulation*.

**12. Actuarial Opinion**

State statute or regulation should contain a requirement for an opinion on loss and loss adjustment expense reserves by a qualified actuary or specialist annually for all domestic RRGs.

**13. Receivership**

State law should set forth a receivership scheme for the administration, by the insurance commissioner, of RRGs found to be insolvent similar to the NAIC's *Insurer Receivership Model Act*.

**14. Filings with NAIC**

State statute, regulation or practice should mandate filing of annual and quarterly statements with the NAIC in a format acceptable to the NAIC except that states may exempt from this requirement those RRGs that operate only in their state of domicile.

**15. Producer Controlled Insurers**

States should provide evidence of a regulatory framework, such as that contained in the NAIC's *Business Transacted with Producer Controlled Property/Casualty Insurer Act* or similar provisions.

**16. Managing General Agents Act**

States should provide evidence of a regulatory framework, such as that contained in the NAIC's *Managing General Agents Act* or similar provisions.

**17. Reinsurance Intermediaries Act**

States should provide evidence of a regulatory framework, such as that contained in the NAIC's *Reinsurance Intermediary Model Act* or similar provisions.

**18. Governance**

State statute or regulation should contain a requirement for governance standards of domestic RRGs that is substantially similar to the NAIC *Model Risk Retention Act*.

*(Note: If a state can provide evidence that none of the entities contemplated in above standards 15, 16, or 17 is either present or allowed to operate in the state (in relation to RRGs), it will not need to demonstrate compliance with that standard.)*



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## **Part B: Regulatory Practices and Procedures**

### *Preamble*

#### **Purpose of the Part B Standards**

The purpose of Part B is to identify base-line regulatory practices and procedures required to supplement and support enforcement of the states' financial solvency laws in order for the states to attain substantial compliance with the core standards established in Part A. Part B identifies standards that are to be applied in the regulation of all forms of multi-state insurers as discussed below. The term "state" as used herein is intended to include any NAIC member jurisdiction, including U.S. territories.

Part B sets out standards required to ensure adequate solvency regulation of multi-state insurers. Each state must make an appropriate allocation of its available resources to effectively address its regulatory priorities. In addition to a domestic state's examination and analysis activities, other checks and balances exist in the regulatory environment. These include other states' regulation of licensed foreign companies, the appropriate application of FAST and IRIS ratios, the analyses by NAIC's staff, the NAIC Financial Analysis Working Group, the NAIC Analyst Team System project, and to some extent the evaluation by private rating agencies.

#### **Scope of the Part B Standards**

The scope of Part B is broader than the scope of Part A as Part B encompasses nearly all forms of insurers domiciled or chartered in the accredited state, but only if the insurer is a multi-state insurer. The term "insurer" in Part B includes regulation of a state's domestic insurers licensed and/or organized under its life/health and property/casualty statutes, those insurers licensed as fraternal orders and title insurers, risk retention groups organized as captive insurers, those insurers licensed as health organizations (including health maintenance organizations, limited health service organizations, dental or vision plans, hospital, medical and indemnity or service corporations or other managed care organizations, but only to the extent the insurance department regulates such entities), and other entities organized under other statutory schemes. Although this scope includes risk retention groups organized as a captive insurer, it does not include any other type of captive insurer. While the unique organizational characteristics of some of these entities may require specialized laws, their multi-state activity demands solvency oversight that employs the base-line regulatory practices and procedures identified in Part B. For purposes of Part B, an insurer (other than a non-RRG captive insurer) that meets any of the following conditions is considered to be a multi-state insurer subject to the Part B standards:

1. A domestic insurer that is licensed in a least one state other than its state of domicile.
2. A domestic insurer that is registered in at least one state other than its state of domicile.
3. A domestic insurer that is operating in a least one state other than its state of domicile.
4. A domestic insurer that is accredited or certified as a reinsurer in at least one state other than its state of domicile.
5. A domestic insurer that is reinsuring business covering risks residing in at least two states.
6. A domestic insurer that is accepting business on an exported basis as an excess or surplus line insurer in at least one state other than its state of domicile.

The accreditation program recognizes that complete standardization of practices and procedures across all states may not be practical or desirable because of the unique situations each state faces. States differ with respect to staff and technology resources that are available as well as the characteristics of the domestic industry regulated. For example, states may choose to emphasize automated analysis over manual or vice

versa. Reliable results may be obtained using alternative, yet effective, financial solvency oversight methodologies. The accreditation program should not emphasize form over substance in its evaluation of the states' solvency regulation.

*(NOTE: FRSAC has adopted Review Team Guidelines that provide detailed guidance to the review teams regarding how compliance with the Part B, Regulatory Practices and Procedures Standards should be assessed. These guidelines can also assist states in preparing for the accreditation review of their department.)*

## **1. Financial Analysis**

### **a. Sufficient Qualified Staff and Resources**

The department should have the appropriate staff and resources to review effectively and timely review the financial condition of all domestic insurers.

### **b. Communication of Relevant Information to/from Financial Analysis Staff**

The department should ensure that all relevant information and data obtained that may assist in the financial analysis process is provided to the financial analysis staff. The department should ensure that findings of the financial analysis staff are communicated to the appropriate person(s) within the department.

### **c. Appropriate Supervisory Review**

The department's internal financial analysis process should provide for appropriate supervisory review and comment. Supervisory review may be conducted by the analyst's supervisor or a senior level analyst whose job functions include such review duties.

### **d. Priority-Based Analysis**

The department's financial analysis procedures should be priority-based to ensure that potential problem companies are reviewed promptly. The prioritization scheme should follow the guidelines and classifications outlined in the *Financial Analysis Handbook* and utilize appropriate factors to assist in the consistent determination of priority designations.

### **e. Documented Analysis Procedures**

The department should generally follow the risk-focused financial analysis process outlined in the *Financial Analysis Handbook* to ensure that appropriate analysis procedures are performed on each domestic insurer and insurance holding company system, as applicable to either the domestic regulator or lead state depending on the filing..

### **f. Appropriate Depth and Quality of Review**

The department's financial analysis should ensure that domestic insurers and insurance holding company systems for which the department serves as the lead state receive a high quality review at an appropriate depth commensurate with their financial strength and position, and risk profile.

### **g. Reporting of and Action on Material Adverse Findings**

The department's procedures should require that all material adverse findings be promptly presented to the commissioner or an appropriate designee for determination and implementation of appropriate regulatory action. Upon the reporting of any material adverse findings from the financial analysis staff, the department should take timely action in response to such findings or adequately demonstrate the determination that no action was required.

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## 2. Financial Examinations

### a. **Sufficient Qualified Staff and Resources**

The department should have the resources to effectively examine all domestic insurers on a periodic basis in a manner commensurate with the financial strength and position of each insurer.

### b. **Communication of Relevant Information to/from Examination Staff**

The department should ensure that all relevant information and data obtained that may assist in the financial examination process is provided to the financial examination staff. The department should ensure that findings of the financial examination staff are communicated to the appropriate person(s).

### c. **Use of Specialists**

The department's examination staff should include specialists with appropriate training and/or experience or otherwise have available qualified specialists, which will permit the department to effectively examine any insurer. These specialists should be utilized where appropriate given the complexity of the examination or identified financial concerns.

### d. **Appropriate Supervisory Review**

The department's procedures for examinations should provide for supervisory review of examination workpapers and reports to ensure that the examination procedures and findings are appropriate and complete and that the examination was conducted in an efficient and timely manner.

### e. **General Examination Procedures**

The department's policies and procedures for the conduct of examinations should generally follow those set forth in the NAIC *Financial Condition Examiners Handbook*. Appropriate variations in methods and scope should be commensurate with the financial strength and position of the insurer.

### f. **Risk Assessment and Testing**

The department's performance and documentation of risk-focused examinations should generally follow the guidance set forth in the NAIC *Financial Condition Examiners Handbook*. Appropriate variations in method and scope should be commensurate with the financial strength and position of the insurer.

### g. **Scheduling of Examinations**

In scheduling financial examinations, the department should follow procedures such as those set forth in the NAIC *Financial Condition Examiners Handbook* that provide for the periodic examination of all domestic companies on a timely and coordinated basis. This system should accord priority to companies that exhibit adverse financial trends or otherwise demonstrate a need for examination.

### h. **Communication of Examination Results**

The department's reports of examination should be prepared in accordance with the format adopted by the NAIC and should be sent to other states in which the insurer transacts business in a timely fashion.

### i. **Reporting of and Action on Material Adverse Findings**

The department's procedures should require that all material adverse findings be promptly presented to the commissioner or an appropriate designee for determination and implementation of appropriate regulatory action. Upon the reporting of any material adverse findings from the financial examination staff, the department should take timely action in response to such findings or adequately demonstrate the determination that no action was required.

## 3. Department Procedures and Oversight

**a. Information Sharing**

States should have the authority to share confidential information with other state, federal, and international regulatory agencies and law enforcement authorities, and the NAIC. States should have the authority to maintain the confidentiality of information received from these parties. Further, the states should demonstrate the willingness to act on this authority to share confidential information.

**b. Procedures for Troubled Companies**

The department should generally follow and observe procedures set forth in the NAIC *Troubled Insurance Company Handbook*. Appropriate variations in application of procedures and regulatory requirements should be commensurate with the identified financial concerns and operational problems of the insurer.

**c. Department Oversight**

Department management should be involved in solvency monitoring activities for its domestic industry to ensure appropriate oversight of staffing, company interactions and key solvency issues with the ability and willingness to take action as deemed appropriate.

**Part C: Organizational and Personnel Practices****1. Professional Development**

The department should recognize and provide necessary training needs for staff involved with financial surveillance and regulation. The department should also have a policy that encourages professional development through job-related college courses, professional programs, and/or other training programs.

**2. Minimum Educational and Experience Requirements**

The department should establish minimum educational and experience requirements for all professional employees and contractual staff positions in the financial regulation and surveillance area, which are commensurate with the duties and responsibilities of the position.

**3. Retention of Personnel**

The department should have the ability to attract and retain qualified personnel for those positions involved with financial surveillance and regulation.

**4. Use of Contract Personnel**

A department that utilizes contract personnel to assist in financial surveillance and regulation should ensure that those hired in the capacity of a contractor are subject to standards that are comparable to or exceed those standards applicable to employees of the state.

**Part D: Primary Licensing, Redomestications and Change of Control*****Preamble***

The focus of the Part D standards is on strengthening financial regulation and the prevention of unlicensed or fraudulent activities. The scope of this section includes primary applications for the licensing of new companies and redomestications and Form A filings. The section applies to only traditional life/health and property/casualty companies, and this scope is narrower than that of Part B in that it does not include entities such as health maintenance organizations, health service plans, and captive insurers (including captive risk retention groups). These standards only deal with the department's analysis of domestic companies or those applying for redomestication and do not include foreign or alien insurers. The initial company licensing process does not consider the "multi-state" concept since the company is in its initial licensing phase. The standards regarding primary applications for redomestications, and Form A filings apply to only those filings submitted that are related to multi-state insurers, as that term is defined in the Part B Preamble.

**1. Sufficient Qualified Staff and Resources**

The department should have the appropriate staff and resources to effectively and timely review applications for primary licensure of new companies and redomestications, and Form A filings for all domestic insurers.

**2. Scope and Performance of Procedures for Primary Applications**

The department should have documented licensing procedures to provide for consistency in the review process and to ensure that appropriate procedures are performed on all primary applications. The use of the NAIC *Company Licensing Best Practices Handbook* is considered acceptable.

**3. Scope and Performance of Procedures for Redomestications**

The department should have documented procedures for the review of redomestication applications to provide for consistency in the review process and to ensure that appropriate procedures are performed for all redomestications. The use of the NAIC *Company Licensing Best Practices Handbook* and/or the NAIC *Financial Analysis Handbook* are considered acceptable.

**4. Scope and Performance of Procedures for Form A Filings**

The department should have documented procedures for the Form A filings to provide for consistency in the review process and to ensure that appropriate procedures are performed on all Form A reviews. The use of the NAIC *Company Licensing Best Practices Handbook* and/or the NAIC *Financial Analysis Handbook* are considered acceptable.

## **Evolving Standards: The Impact of Changes in the Financial Regulation Standards**

As insurance industry practices evolve, so must solvency regulation. Therefore, the NAIC has anticipated that the standards outlined above will not be static but will be dynamic.

### ***What is the process to add to or modify the standards?***

In March 1998, the NAIC adopted a more flexible process when adding new standards or modifying the existing standards. The process seeks extensive input from public officials, consumers, academics, regulators and industry representatives when changes in the Financial Regulation Standards and Accreditation Program are considered.

The procedures identify three ways in which the solvency standards may be modified:

1. The development of new models or amendment of existing models;
2. Additional or more specific requirements to Parts B, C and D of the standards; or
3. Indirect modification of current requirements through changes in manuals or books incorporated by reference in the standards, such as modification of the NAIC *Annual Statement Blank* required to be filed by all companies.

The process uses a set schedule to complete the deliberation process, which allows all interested parties to clearly understand the decision timetable.

With regard to the development of new models or the amendment of existing models, the proposal would be discussed at the spring national meeting by the Committee with public testimony taken at the summer national meeting. The Committee will notify all interested parties including all regulators, industry, consumer groups, the National Conference of State Legislatures (NCSL), National Governors' Association (NGA), National Conference of Insurance Legislators (NCOIL), and others, both of the potential change in the model and the process for public comment.

Additionally, any suggested addition or change to the accreditation standards will be accompanied by the following:

1. A statement and explanation of how the standard is directly related to solvency surveillance and why the proposal should be included in the standards.
2. A statement as to why ultimate adoption by every jurisdiction may be desirable.
3. A statement as to the number of jurisdictions that have adopted and implemented the proposal or a similar proposal and their experience to date.
4. A statement as to the provisions needed to meet the minimum requirements of the standard. That is, whether a state would be required to have “substantially similar” language or rather a regulatory framework. If it is being proposed that “substantially similar” language be required, the referring committee, task force or working group shall recommend those items that should be considered significant elements.
5. An estimate of the cost for insurance companies to comply with the proposal and the impact on state insurance departments to enforce it, if reasonably quantifiable.

After consideration of the testimony, the Committee will determine whether the proposal should be exposed as a potential standard. At the fall national meeting, Executive Committee and Plenary will vote on the proposal.

If the proposal is adopted by Plenary, a one-year exposure period, commencing the following January 1, for laws and regulations standards will commence during which time all interested parties will evaluate the effectiveness of the proposal.

After the exposure period has ended, the Committee will review the proposal at the spring national meeting to see what action, if any, should be taken to formally adopt the new proposal. At the summer national meeting, a public hearing will be held and the Committee will decide whether to add the proposal to the standards with a 60% majority vote needed to adopt. At the fall national meeting, Executive Committee and Plenary would also take action with 60% required to adopt. Once adopted by Plenary, the standard will become effective two years immediately following the next January 1. This provides a total of at least four full years for all parties to consider amendments or additions to the laws and regulations standards.

For additional or more specific requirements to Parts B, C and D of the standards or indirect modification of current requirements through changes in manuals or books incorporated by reference in the standards, no seasoning period is required, and these changes become effective as deemed appropriate.

If the Committee determines that a waiver of the above procedures is necessary to expeditiously consider modification or alteration of the standards, it may upon a three-fourths (3/4) majority vote, move to recommend adoption of changes or modifications to the Executive Committee. The Report of the Committee shall fully explain the necessity for expeditious action and attempt to summarize in an objective manner, the positions of the various interested parties. The Executive Committee and Plenary would vote on the Report, with a 60% majority required for adoption.

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## *Changes to the Program*

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### *Effective January 1, 2020*

- The 2014 revisions to the *Insurance Holding Company System Regulatory Act* (#440) provide authority to a designated state to act as a group-wide supervisor for an internationally active insurance group (IAIG). Provisions apply primarily to those states who act as the group-wide supervisor for an IAIG; however, there are also provisions that may impact any state with a domestic insurer in an IAIG. In addition, acquisitions or other changes in a state's domestic industry can occur quickly and change their role in overseeing a domestic insurer or their role within the holding company. Therefore, the standard was adopted as applicable to all states regardless of current involvement in an IAIG. In addition, the standard is applicable for RRGs in a holding company that meets the definition of an IAIG.
- The 2009 revisions to the *Standard Valuation Law* (#820), which authorize a principle-based reserving (PBR) methodology for life, annuity and accident and health contracts. The significant elements for these revisions are included in the Part A, Liabilities and Reserves standard. In addition to the life companies already encompassed in the Part A accreditation standards, the PBR elements, as adopted, are designed to apply to fraternal benefit societies.
- The Part A Preamble has been revised to include fraternal benefit societies with respect to principle-based reserving (PBR). There are a limited number of fraternal benefit societies that have life business that exceeds the premium threshold to apply PBR. For those fraternal benefit societies that meet or exceed the premium threshold, it is important the PBR reserving methodology is followed, and thus the laws of the regulating states must require such treatment.
- The 2014 revisions to the *Annual Financial Reporting Model Regulation* (#205), which relate to new requirements for an internal audit function is added as a new significant element in the CPA Audits standard.
- The *Corporate Governance Annual Disclosure Model Act* (#305) and the *Corporate Governance Annual Disclosure Model Regulation* (#306). These models require an insurer (or group of insurers) to provide a confidential disclosure regarding its corporate governance practices to the lead state and/or domestic regulator annually by June 1.
- Part B was updated to include timing requirements for of the review of Own Risk and Solvency Assessment (ORSA) Summary Reports. Reports for groups that include multiple insurers domiciled in various states should be reviewed and shared by the lead state within 120 days of receipt. Legal entity ORSA Summary Reports (which don't cover insurers domiciled in various states) should be reviewed within 180 days of receipt.
- Changes to the troubled company guidelines in Part B3 of the Review Team Guidelines align the current accreditation guidelines with the revisions made in the NAIC *Troubled Insurance Company Handbook*. The updates clarify expectations about timely and effective communication between domiciliary and non-domiciliary state insurance departments.
- Part D of the accreditation program was updated to promote stronger communication between states and reduce risks associated with licensing new companies, reviewing and approving redomestications, and reviewing and approving Form A filings. Updates specifically include the following:
  - Updated the guidelines to reflect current practices (Effective Jan. 1, 2020)
  - Expanded the scope to include redomestications (Effective Jan. 1, 2020)

- Subject Part D to a Recommendation A or B from the review teams with the result that the outcome can affect a state's accredited status (Effective Jan. 1, 2022)

### **What the Future Holds: A Strong System of Solvency Regulation**

The regulation of the insurance industry for solvency stands as a unique example of how an effective regulatory system can be built. The strength of that system resides in the interdependence of independent state regulators, each responsible to his or her own constituencies, yet jointly responsible for the financial health of an entire industry. At every step along the way, state insurance regulators bear in mind their duty to safeguard consumers.

Governors, legislators and state insurance regulators, not content to rest on past success, have devised in the Financial Regulation Standards and Accreditation Program, a powerful means of achieving the necessary degree of consistency among states without sacrificing the multi-state diversity that has been instrumental to that success. Since 1990, every state, the District of Columbia, Puerto Rico and the U.S. Virgin Islands have adopted legislative packages designed to bring their departments of insurance into compliance with the Standards. The partnership among state government officials has been key to the success of the accreditation program, solvency regulation, and effective consumer protection.