Insurance Program

EXAMINATION OBJECTIVES

To determine the level of risk that the related organization's insurance activities present to the parent thrift and to recommend corrective actions as necessary.

EXAMINATION PROCEDURES

LEVEL I

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1. Perform the appropriate examination procedures in Handbook Section 730.

2. Review the previous report of examination and all insurance-related exceptions noted and determine if management has taken appropriate corrective action.

LEVEL II

1. Review a copy of:

   - The most recent state insurance department examination report and any complaint, claims handling or market conduct reports;
   - The most recent public accounting report;
   - The most recent NASD or SEC examination report, if applicable;
   - All written agreements pertaining to the insurance operation;
   - The insurance license for each state in which the entity operates; and
   - Production and complaint reports from insurer(s) represented by the service corporation.

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2. Determine the type(s) of insurance activities and structure (i.e., agency, underwriting, reinsurance, brokerage, finance company) and the products being sold, underwritten or serviced (i.e., auto, homeowners, credit life, accident, health).

3. Determine the adequacy of management's internal controls for ensuring compliance with any written agreements and applicable state regulatory requirements or securities rules and regulations.

4. If agreements with third parties exist, verify that:

- They were approved by the service corporation's board of directors;
- The parent thrift is not a party to the agreement;
- There are no provisions pertaining to the indemnification of a third party (unless prior OTS approval was obtained);
- The agreement provides for the third party to assume liability for the actions of its employees; and
- Fees (i.e., implementation or subscription fees) paid to a third party are made in accordance with the terms established in the agreement.

5. Determine whether the safeguards set forth in TB 23-2 (i.e., disclosures, suitability standards, release of customer information, advertising, sales training), have been implemented for sales of variable annuities and insurance products that have investment features and occur on the thrift's premises or as a result of a customer referral.

6. If insurance operations involve dual employees:

- Determine the adequacy of safeguards for avoiding customer confusion (i.e., sales are conducted in segregated areas, sales staff identify the company that

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they represent, compensation paid by the subsidiary or third party is separate from compensation paid by the thrift); and

- Determine if bonuses are offered as additional compensation/incentives, and review the qualifications for the bonus. [Note: Management must be able to demonstrate that bonuses are paid in accordance with state laws and regulations.]

LEVEL III

1. When significant safety and soundness concerns are presented by agency or brokerage activities, the following procedures may be appropriate:

- Determine whether the service corporation carries adequate amounts of fidelity insurance and errors and omissions insurance.
- Verify that internal audit procedures and controls have been established and are being followed.
- Determine whether accounts receivable and accounts payable records are properly maintained.
- Determine the average age of accounts receivable, and whether there are adequate reserves for uncollectables and charge offs. (Do reserves represent a significant proportion of total receivables?)
- Determine whether premiums collected are sent to the insurer(s) regularly. (If not, indicate whether this is based on an agreement with the insurer(s).)
- Review operating financial statements for the last three years to determine trends. (Is the agency posing a financial risk to the parent thrift?)
- Review annual premium volume against business plan estimates. (The service corporation should generate sufficient annual premiums for the agency to remain viable as detailed in the business plan.)
- Verify the financial soundness of insurer(s) represented by the service corporation through a review of Best's ratings and state insurance department reports. (Another source is the NAIC's IRIS Report, available by subscription.)

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- Determine whether management, on an ongoing basis, monitors:
  - — significant changes in customer base from one year to another to determine whether changes meet overall marketing strategy, and if they are desirable;
  - — product mix changes to determine whether they are in line with overall strategies; and
  - — account mix to determine if any accounts comprise 5% or more of total revenue. (If so, concentrations may be high.)
- Review trust account balances to determine:
  - — the account balances;
  - — whether all monies owed to the insurer(s) and insureds are identified; and
  - — adherence to procedures for deposit and payout.
- Review insurers' production reports against those of the agency and verify that they balance.
- Determine on what basis the agent(s) will be remunerated and whether the records indicate that this is being followed.
- Review the adequacy of internal controls in preventing agents from changing insurance applications to ensure approval by the insurer.

7. Based on the materiality of supervisory concerns associated with underwriting, reinsurance, captives or risk retention, the following procedures may be appropriate:

- Review the insurer's annual statement, insurance expense exhibit and supporting documents to verify that the company is solvent under statutory accounting principles. (Also see Best's ratings or the NAIC's IRIS reports for evaluating the insurer's financial stability.)
- Determine whether management routinely monitors changes in customer base and product mix, and takes action when required.
- Determine whether personnel with adequate expertise are being consulted when technical risks are being insured or reinsured.

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- For reinsurance operations, determine whether internal policies provide that:
  - — management reviews an insurance company's underwriting policies before accepting its business;
  - — rates and contractual terms reflect the degree of risk being assumed; and
  - — systems are capable of estimating when a large claim will be presented.
- Verify that adequate allowances are made for loss reserves.

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8. When premium financing activities present material risk to the parent thrift, the following procedures may be appropriate:

- Determine whether internal systems and controls ensure that operations comply with state laws and regulations (i.e., limitations pertaining to interest (finance) charges, cancellation and late charges, number of days' notice to give on cancellation, language and format of notice, and contract language and format).
- Review for specific risk to the finance company:
  - — fraud by an agent through use of a wrong address or fictitious name for an insured; and
  - — insurer insolvency.
- Verify that management has established guidelines that serve to minimize risk associated with potential loan losses (i.e., require minimum down payments that reflect the level of risk involved). (Management should be able to demonstrate that these guidelines are consistent with industry norms or "rules of thumb" in this area.)
- Determine whether internal policies prohibit the approval of non-financeable policies when the premium finance company is not listed as the first loss payee.

EXAMINER'S SUMMARY, RECOMMENDATIONS, AND COMMENTS

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