



Maryland First Financial Services Corp.
Intellectual Property Management & Finance

May 4, 2006

Julie M. Gann, CPA
Financial Examination Manager
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108-2662

Re: Risk-Focused Surveillance Handbook Guidance

Dear Ms. Gann:

Invotex Group is pleased to submit its comments on the latest exposure draft of the revisions that have been proposed by the Risk Assessment Working Group to the risk focused examination guidance. We offer first some overall reactions, and then some more detailed comments.

As you well know, the proposed guidance has been years in the making. We feel that it is far from perfect, but it is nonetheless necessary to have it because, as they say, the “train has already left the station.” Evidence of that includes the number of states that are already proceeding in various ways to utilize at least parts of the proposed risk-based examination techniques. Also, there appears to be an extremely high degree of interest by examiners with risk assessment, e.g., as seen in the agenda for SOFE’s upcoming Career Development Seminar.

Over the past 16 months, we have submitted many comments, and we regret that many of our comments – and those of other interested parties – are not adequately reflected in the current version of the proposed guidance. As a result, we feel that it is far from a perfect product. But we also recognize that no such initial product would be perfect, per se. Rather than continuing to debate this academically, we think that the guidance that is currently available can benefit to a much greater degree from actual usage in the field, feedback, and resulting refinement. The sooner that process can begin, the better.

Nonetheless, we believe it would be good for all if the NAIC would take a very candid approach in deployment by stating that the product is a new and largely untested approach. It pieces together a number of new conceptual elements and tools in a way that may not be

immediately understood by those in the field and which may not seem, at least initially, to be a good fit in application on particular exams.

A prominent caveat to that effect seems appropriate, not to scare states from moving forward with these new concepts and tools, but to suggest that, at least in the early deployment stage, it be applied to companies that are further along the learning curve in adopting risk assessment techniques. Furthermore, those exams should be led or assisted by individuals who have the experience to recognize risk, the confidence to react to it, the patience to learn, and the leadership to share those learning experiences for the betterment of the examination team and the overall insurance department staff.

With regard to the deployment, we are reminded of some other experiences that may be helpful to the RAWG to consider going forward. After passage of the Sarbanes Oxley Act of 2002, a number of professional services firms and other organizations held small discussion groups or “round table” meetings to share implementation experiences. Those events were instructive to all participants in helping to identify implementation issues, their implications, and possible best practices as well as pitfalls to avoid. It appears to us that similar events would be very helpful as the risk based approach is deployed. In this manner, field experience with the new guidance can be quickly obtained, evaluated, and where necessary, additional or revised guidance can then be more quickly developed, focused, and disseminated.

With respect to this notion of “round tables,” we also strongly suggest that industry representatives and consultants be invited to participate and that the overall process be much more transparent than the recent past experience in drafting the revisions to the handbook. Although we understand that the handbook is intended for use by examiners, industry people who work with examiners on a daily basis will quickly develop an informed point of view as to whether changes to exam procedures at their company are, or are not, responsive to the company’s risks, and their input should be actively sought. And, for better or worse, it is often the consultants who are most adept at sharing those experiences across clients and states – another look at the upcoming SOFE CDS agenda can quickly confirm that.

With that, we have some specific comments and reactions to the latest draft:

1. We were pleased with the discussion that took place at the March 20, 2006 interim meeting in Chicago. We felt that many significant comments were brought forward and that the Drafting Subgroup members responded in a reasonable fashion to those comments. Nonetheless, in reviewing the latest draft it appears that most of those comments have been addressed through revisions using an economy of words that does not adequately reflect, in our opinion, the significance of the issues. Items 2-4, below, are good examples.

2. Key Functional Activities – We are still concerned that the notion of key functional activities – the foundation for the new approach – is covered by no more than two paragraphs in the revised text, much of which is objective-oriented language as opposed to actually describing how such key activities should be identified, to what degree of granularity, etc. Also, the language refers to Exhibit K, noting that “Exhibit K illustrates the Risk Assessment Matrix that the examiner *should* utilize in documenting and assessing the key activities and sub-activities within a company.” (emphasis added). The use of the word “should” appears to be inconsistent with the discussion at the March 20, 2006 interim meeting. We suggest instead, the word “may.”
3. A significant item of discussion at the March 20 meeting involved prospective risk and the relationship of Exhibit V to the Risk Matrix. The key points that Invotex made at that meeting were that:
 - a. The traditional guidance for PM and TE in the handbook does not apply for prospective risks
 - b. For such risks it is difficult if not impossible to quantify probability of occurrence v. likely impact
 - c. The resulting examination procedures may, as a practical matter, be solely inquiry-based

It was our recollection that the subgroup concluded that the risk matrix was therefore more appropriate for traditional financial risk areas, that prospective risks were nonetheless part of the examiner’s mindset as those areas are performed, and that near the end of the exam an optional tool would be to use Exhibit V as a “tickler” to highlight potentially significant prospective risks that may not yet have come to light through the exam procedures to date. Exhibit V can then be a tool to reference where in the working papers prospective risks have already been addressed, and to the extent that additional inquiries and procedures are deemed necessary, it can reference that documentation as well.

Having said that, we see no language in the post-March 20 revisions to the handbook that reflects that discussion or those conclusions. However, a paragraph has been added to the preamble, which includes the following:

“As these prospective risks are anticipated to impact future supervisory actions on the insurer, it *may not be necessary* for these risks to be reflected within other tools (the Risk Assessment Matrix) that reflect the risks impacting the examination for a specific “as of” date. To the extent that the identified prospective risk was also present during the period of examination, the procedures performed for the current exam process, *may also be utilized* in considering the

prospective impact and surveillance necessary for these noted risks.” (Emphasis added)

Our questions and comments about that language are as follows:

- The emphasized language cited above does not appear to us to be sufficiently clear as to the working group’s intent. For example, if it is not necessary to reflect prospective risks in the risk assessment matrix – which we would agree with – then where should the consideration of those risks be documented? In a memorandum? In what level of detail? And how might the conclusions reached in that documentation differ from conclusions relating to traditional examination areas?
 - To say that current exam procedures “may also be utilized” in considering prospective risks implies that such procedures are in addition to something else – but what would that be? Do you mean to say, “may also be utilized in addition to Schedule V...”? If not that, then what?
 - Such language should be clarified for the preamble, but should also be added to the appropriate sections in the handbook itself.
4. With respect to the use of internal control documentation, we think the guidance could better distinguish between public companies that comply with SOX§404 v. other non-public companies that voluntarily comply with SOX and/or that may in the future comply with proposed changes to the MAR, if enacted. Also, the guidance states that “reliance may be placed on the fact that both management and the auditor have diligently evaluated the company’s significant processes and major transactions.” While that sounds appropriate, it doesn’t go far enough to provide guidance as to what “reliance” means in the context of examination procedures. For example, does that mean that no testing is therefore necessary? That reduced testing is appropriate and, if so, reduced by how much? That the examiner can (or should?) accept the company’s determination of key functional activities? Or does it just mean the examiner must use judgment in determining any reduced testing?

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Ms. Julie M. Gann, CPA

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We hope that you will find these comments helpful. I would be glad to respond to any questions you or the working group may have or provide further information. I also plan to attend the May 16, 2006 RAWG conference call, and the RAWG meeting in June in Washington DC and would be glad to further explain these comments and respond to questions from the working group at either time.

Sincerely,

A handwritten signature in black ink, appearing to read "A. Thomas Finnell, Jr.", written in a cursive style.

A. Thomas Finnell, Jr.
Managing Director