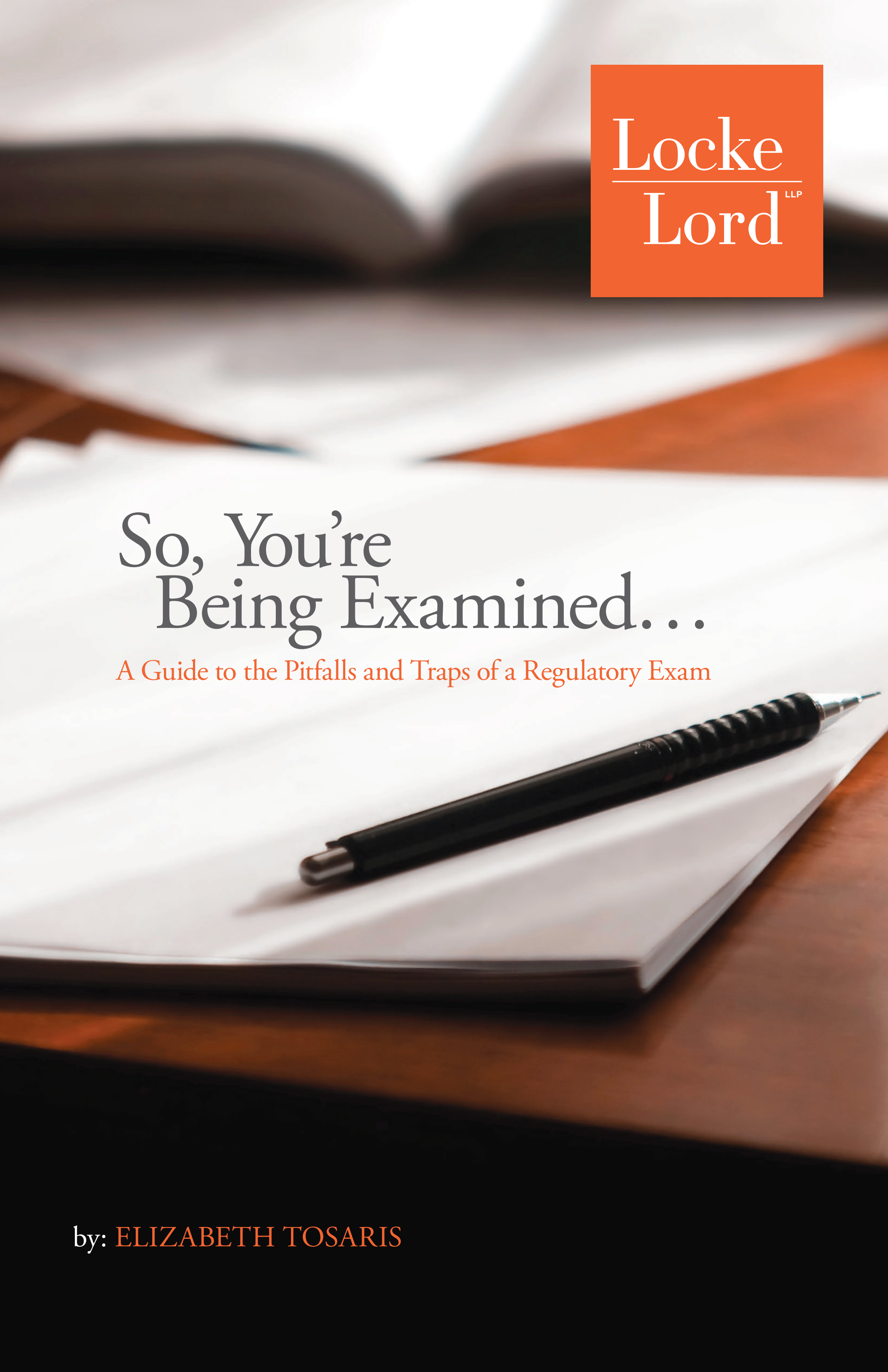

Locke Lord LLP

So, You're Being Examined…

A Guide to the Pitfalls and Traps of a Regulatory Exam

by: ELIZABETH TOSARIS

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ELIZABETH TOSARIS • 415-318-8817 • etosaris@lockelord.com

Part 1

So, You're Being Examined…

A Guide to the Pitfalls and Traps of a Regulatory Exam

By: Elizabeth Tosaris

Departments of Insurance have long held the statutory power to examine the entities that they regulate. This guide focuses on examinations of insurers, although regulators may and do examine other entities, such as third party administrators, agents, etc., and examinations of these entities may raise issues similar to those discussed in this guide. Insurance regulatory examinations run the gamut from a review of the financial condition and health of a company, to its claims handling, rate filing and underwriting practices, to its sales, marketing and anti-fraud practices. This guide is intended to describe a number of issues that can arise in the context of any of these types of exams, and to provide some practical tips for avoiding or minimizing the problems these issues can create.

1. Be right!

During an examination, the examiner reviews the company's business activities against the laws in effect in that jurisdiction. This allows the examiner either to determine the company's financial status or to determine whether the company's operations touching consumers are compliant. Because examiners are rarely attorneys, they are generally charged with measuring the company's performance against a checklist or a similar objective set of standards. Examiners generally do not have authority to make final determinations on interpretation of law and other legal questions. If the examiner determines that the company is not in compliance, that determination will result in an adverse finding or criticism in the final exam report. It is up to the company to understand how the examiner sees the facts, as well as to know what law applies and how it applies.

Companies should properly analyze any adverse determination by the examiner. First, the company should ensure that it knows what software programs, documents or other sources of information the examiner used to form his or her view of the facts. Is there an ambiguity or uncertainty in this source information? Is critical information not reflected in these sources that would alter the examiner's perception of the facts? Is there an error or misstatement in the documents or the information that the examiner reviewed? If there is a determination of non-compliant behavior, particularly where the behavior in question is one that could be significant for the company, it is well worth the trouble to double check the facts.

As a final step in the fact-checking process, and especially where the information provided is straightforward and complete, it is worthwhile to communicate directly with the examiner to ensure that the examiner has not misunderstood or misinterpreted the information that was provided. If the examiner has performed some further analysis of the information that the company provided, it can be helpful to discuss this process with the examiner so that the company can ensure that the conclusions suggested by this analysis are supported by the data. A request to the examiner for his or her understanding of the facts may be the best way to determine whether any incorrect conclusions on the part of the examiner were derived from a misunderstanding of the facts or the data provided by the company.

A second important check the company should perform is on the law itself. Violations are typically framed in terms of non-compliance with statutes and/or regulations. While is it not unheard of for a company to have a non-compliant practice, do not insist the company's position on the law is correct without first conducting research to validate that position. Review the cited provision in some detail, and consider two important issues. First, determine whether the laws in question have changed in any way since the examined activity was performed. Second, conduct a close reading of the laws to determine whether the words actually say what everyone – either at the company or on the regulatory exam team – think they say. Each of these criteria is discussed in further detail below.

Was the wording in question in effect during the exam period? Sometimes, statutes or regulations are amended, and the current wording differs from the law in effect during the examination. If so, did the company's activity comply with the law in effect at the time in question? Keep in mind that changes to the laws can give valuable insight into the meaning and requirements of the original version of the law. It is possible that amendments that have occurred since the exam period lend support for an interpretation of the intended scope or meaning of laws that were in effect during the exam period.

Take the time to research exactly what the law requires. A close reading of the language may reveal that the law is not as clear as initially thought, or that the law may not clearly apply to the facts at hand. For further nuance, there may be interpreting regulations for statutes, notices or bulletins from regulators, and there may be case law that sheds light on the correct interpretation of the law. Finally, it is worth researching regulators' previous interpretation of the laws in question for a full understanding of their application. For example, the regulator may have made statements to the legislature when a statute was under consideration or as an announcement of a new law shortly after its passage. Regulators may also have provided commentary in connection with proposed regulations that gives insight into the scope and interpretation of the rules. Finally, companies can consider regulators' application of that same law to other licensees in similar circumstances as insight into the correct interpretation. Other exam reports, decisions in enforcement hearings on similar issues and bulletins and Department of Insurance notices are all excellent resources in this regard.

Of course, there are circumstances where a company finds that the examiner has correctly understood the company's practices and correctly interpreted the law. In this case, it may be reasonable for the company to accept an adverse determination, even though this acceptance could be considered an admission against interest. This acceptance gains the company credibility with the regulators. In addition, from a strictly pragmatic point of view, there is no point in fighting the inevitable.

2. What if you find a non-compliant activity?

In the course of preparing for an examination, or as a result of exploring issues raised by the examiner, the company may find evidence of its non-compliant activity. If, after all the facts have been checked, and the law has been analyzed, the company confirms that there has been non-compliant activity, the best action is to prevent the non-compliance from continuing in the future, and also consider whether anything needs to be done as a result of any past non-compliance. The best method for achieving corrective action is extremely dependent upon the individual facts, although it is safe to say that corrective action is often easier said than done. For this reason, a more detailed discussion of the types of corrective action available to a company is beyond the scope of this guide.

However, a question that often arises in connection with the discovery and the implementation of any corrective action is whether the company has a duty to disclose the matter to the regulator. In general, there is no affirmative duty on the licensee to disclose. However, there are some notable exceptions to this rule: A small minority of states require reporting of violations of the code or reporting of particular kinds of violations. For example, Nebraska's code requires insurers to promptly report the facts and circumstances pertaining to any insurance code violation *[NEB. REV. STAT. § 44-393]*, while North Carolina requires reporting of violations of certain specified provisions of the insurance code *[N.C. GEN. STAT. § 58-2-163]*. Thus, the first determination is whether there is a specific reporting requirement that applies in the individual case.

Assuming that there are no affirmative duties to disclose, the company must then determine whether it will disclose in any event. In some states, there are incentives to disclosure, such as Colorado's requirement for the Commissioner to consider the extent to which insurers maintain regulatory compliance programs to self-assess, self-report and remediate problems detected. *[COLO REV. STAT. § 10-1-215]* For this reason, when evaluating a compliance issue, it is advisable to explore what laws the jurisdiction in question has with respect to self-reporting.

If there is no duty to disclose, or the statutes encouraging disclosure do not apply, the company may, of course, still opt to make a disclosure to the regulator. A corollary issue is to determine whether any self-auditing done in connection with the remediation is privileged, and whether the privilege surrounding this work could be retained in the face of disclosure to a regulator. Companies often make the decision to disclose when (1) the examiner is clearly about to discover the error in any event; (2) the company would like the regulator to be able to comment upon and be aware of the proposed remediation; and/or (3) the company expects its proposed remedial action may prompt consumers to contact the regulator with questions or commence civil lawsuits against the company.

In cases where the company discloses the activity to the regulator, it is best to have thorough documentation of the corrective actions taken. This documentation can be provided to the regulator along with an explanation of the problem. Depending upon the nature of the non-compliant activity, the availability of the regulator and the level of complication necessary to describe either the issue or the remedial action, the company may also wish to schedule a meeting with the regulator to explain the issue and/or to present any written documentation.

3. Understand the exam process – why was the exam called?

Each U.S. jurisdiction has a government agency charged with regulating the transaction of insurance in that jurisdiction, including monitoring and enforcing compliance with the laws of the jurisdiction and ensuring that regulated entities doing business in the state meet the applicable solvency standards. Regulators examine companies because examination is one of their most effective tools for determining whether a licensee is in compliance with the laws the regulator is charged with monitoring and whether the licensee meets the financial standards for that jurisdiction. For this reason, every U.S. jurisdiction authorizes its insurance regulator to call exams upon licensees. National Association of Insurance Commissioners (NAIC)-accredited states generally conduct financial examinations of their domestics on a cycle of once every three to four years, and some states also require market conduct examinations on a regular basis. States may, of course, call additional or targeted exams out of cycle.

It is important to know why a regulator has decided to examine a particular company in a particular way at a particular time, as this provides important insight into the likely focus of the examination. As a preliminary matter, the exam notice will specify the scope of the exam (generally in terms of the subject matter and time period), and also often indicates whether the exam is targeted or routine. Where the exam is anything other than routine, it can be helpful to obtain more information about the reasons for the exam, since knowing the reasons for the exam will not only help the company better prepare for the examination, but may also inform the company's responses to questions during the examination. In general, regulators are willing to share the reasons for the exam with the company. Where a contract examiner has been retained to conduct the exam, contacting the state regulator directly may give the company the best and most complete information about the genesis of the exam.

As mentioned above, financial examinations of insurers are generally conducted by the domestic regulator on a set cycle. NAIC accreditation depends upon the jurisdiction adopting and complying with a financial exam cycle of no less frequently than once every five years. In addition, there are a small handful of states that require even more frequent examinations for specified types of companies. *[See, e.g., VT. TITLE 8 §5105, requiring HMOs to be examined no less frequently than once every three years.]* Some states' financial examinations combine the review of the financial status with a review of other operations of the insurer, while other states divide these reviews into separate examinations. For those states that review non-financial matters separately, the standard cycle for a financial examination may or may not coincide with the other types of examinations. State law may also require market conduct examinations with a specific frequency. For example, California requires its commissioner to conduct both financial and market conduct examinations not less frequently than once every five years, although a market conduct examination may be postponed up to three years if a market analysis of the company meets certain criteria. *[CAL. INS. CODE § 730]*

Most exams are commenced simply because the entity is due for an examination under its regular examination cycle. However, many examinations are scheduled because of a specific concern on the part of the regulator. Therefore, receipt of an exam notice earlier than expected can be a sign that the regulator has concerns about the company or about the line(s) of business written by the company. These concerns may be specific to a company, an industry segment or to some other unifying characteristic of a number of companies, such as the use of a particular vendor that is not, in and of itself, regulated. On the financial exam side, a regulator may call an out-of-cycle examination if the regulators' review of the company's financial reporting, IRIS ratios or RBC ratio causes concerns. Examinations commenced because of a specific regulatory concern are called targeted examinations, although the scope of the examination may contract or expand once the examination is under way. Interest from other regulators, such as federal agencies or state attorneys general, can also prompt state insurance regulators to consider institution of a targeted examination.

Understanding the market analysis conducted by regulators offers good insight into the possible reasons for a targeted market conduct exam. Market analysis provides a structure for testing companies' conduct and identifying those companies that may require further examination and analysis. Regulators use tools offered by the NAIC as well as their own databases and other external resources to conduct their analysis. Examples of the tools offered by the NAIC for market analysis purposes include Market Conduct Annual Statement (MCAS), Market Analysis Prioritization Tool (MAPT), Market Analysis Review System (MARS), Market Initiative Tracking System (MITS), Market Analysis Profile and the Financial Annual Statement of the relevant company(ies). After consulting their various resources, regulators consider whether there is any indication of consumer harm, the urgency of action needed to prevent future harm, the prevalence of the issue, the regulator's own knowledge of the issue, and the cooperation of the entity(ies) in question. With this information, the regulators then determine where on a continuum of actions they feel their resources are most appropriately devoted. The possible range of actions runs from more information gathering to the commencement of an examination.

While market analysis is complex and relies upon many factors, it is safe to say that one common cause for a targeted market conduct examination is a trend in consumer complaints, either for a company or for an industry. It is always important from a customer service point of view to address a legitimate complaint. However, it is also important because tracking complaints allows the company to identify and address root causes of complaints, thereby stemming the flow of complaints and possibly helping the company avoid a targeted examination. In addition, quite apart from the fact that complaints can be the reason or a reason for an examination, consumer complaints received by a regulator during the exam can lead to a possible expansion of an ongoing exam. Finally, in the event that an examination results in enforcement action, both market conduct findings and consumer complaints can be the basis for the allegations in the pleading.

It is also worth noting that there is a mechanism for a group of states to work together to conduct a multistate examination. A multistate examination follows much the same course as an individual state examination, except that it is conducted by a group of two or more state insurance regulators. These examinations are coordinated through the NAIC, and occur when a number of states have engaged in their process for identifying companies for examination, have identified the same company for examination, and realize that they could use their resources most efficiently by banding together to examine the company for that particular issue, product or line of business. Multistate examinations are conducted by a lead state or states, which examines the company, issues a report and takes the lead on negotiation of any issues identified in the examinations. Other jurisdictions may then participate in the report or resolution process by adopting the necessary findings as required by their individual laws.

4. Understand the exam process – sampling, forms of reports and other logistics

Sampling is a tool commonly employed by examiners. In the financial exam context, the examiner may take a sampling of items in an account balance or a class of transactions for the purpose of evaluating some characteristic of the balance or class. In the market conduct context, the examiner may take a sampling of documents, and then extrapolate from those findings to more general conclusions about the company's practices. The NAIC publishes a Market Regulation Handbook that most market conduct examiners use as a guide in conducting exams, and a Financial Condition Examiners Handbook that most financial examiners use. These handbooks include information about how to select a representative sample, and how to extrapolate correctly from the sample. Where the examiner has employed a sampling method, the company should be certain that the sample is truly representative of the larger population to which the results will be applied. In addition, the company should ensure that the sample size and selection process support any conclusions the examiner reaches with respect to the larger population sampled.

A second piece of useful information is for the company to understand how the results of the exam will be reported. Exam reports take one of two forms: reports by exception and reports by test. A report by exception is limited to a reporting of errors or exceptions identified during an examination. In contrast, a report by test describes each test applied during the exam process and the results of that test. Different states use one or the other of these formats. Knowing which report type is employed by a particular state can help the company better anticipate the presentation of the findings.

Some states outsource some or all of the exam work, while others keep the entire process in-house. Regardless of whether the exam is conducted by vendors or state employees, states generally bill companies for the time spent by their examiners, as well as other experts, such as actuarial consultants, in conducting the examination. Fees for examiner time are typically invoiced on a per diem basis. Costs, such as lodging and travel for examiners, are also included as additional line items which are the company's responsibility to reimburse. Consequently, lengthy examinations can be costly for companies not only for the company resources that are diverted to the examination, but also due to the exam costs billed by the Department.

5. Understand the exam process – what are the phases of the exam?

A company undergoing an examination should understand how the exam is likely to progress, and what sort of questions and inquiries are standard for the particular exam in issue. On the financial exam side, over the last decade, the examination process has been evolving from a substantive testing of all material accounts to a risk-focused approach. Risk-focused examinations are "used to identify and assess risk, assess the adequacy and effectiveness of strategies/controls used to mitigate risk and assist in determining the extent and nature of procedures and testing to be utilized in order to complete the review of that activity." (See NAIC Examiners Handbook, page 1-5.) Since the risk-focused approach has been incorporated into the NAIC Examiners Handbook since 2007, most companies have already experienced this approach firsthand. However, as regulators have continued to refine the approach, and to respond to other shifts in worldwide financial regulation, the risk-focused exam process has continued to evolve.

The risk-focused approach was designed to result in more efficient, effective exams with less substantive testing of accounts. More attention was to be paid to areas in a company that were judged to be high priority because of shortcomings noted in a company's own risk assessment processes and controls. The changes in the examination approach led to very detailed questionnaires that companies needed to complete in advance of examinations, followed by in depth interviews of management conducted by examiners. Thus, while exams may be more effective, it is still unclear if risk-focused exams are more efficient (i.e., completed in a shorter period of time and at less cost).

With the recent adoption of the Own Risk and Solvency Assessment Model Act (ORSA), which will likely become effective in many states in 2015, and the development of the ORSA Guidelines, regulators are taking another step in the evolution of the financial exam process. ORSA will expand the range of subjects considered in a financial examination, as well as move regulators into a more nuanced approach for understanding larger companies or company groups' financial status. This will undoubtedly lead to requests for information not formerly requested as part of a standard exam, as well as a shift in the types of information that are ultimately reported. For example, regulators will focus more on the group's financial standing and enterprise risk and will delve even deeper into the company's proprietary risk management at all levels. The shift in focus of examinations will lead to corresponding changes in the examination process, such as the fact that, in response to companies' concerns around the sensitivity of reporting the enterprise risk in a large company group, the gathering and use of information will be treated with greater confidentiality than was previously necessary.

Different states have different processes for conducting and finalizing examination reports. Some states conduct desk audits, which involve a request to the company to send materials offsite for review, and some states send examiners to the company to conduct an audit on-site. Some states routinely ask to interview company personnel, while others rely solely on an examination of company books and records. On the market conduct side, some states write letters summarizing issues found prior to providing an exam report, while others simply issue a final report for comment. Many states proceed through at least one, and sometimes several draft reports before a final report is issued, with the intent of allowing the company to respond and even challenge the report as a part of the finalization process. Knowing the process generally employed by the regulator conducting the exam helps a company spot anomalies in the process that might signal a concern on the part of the regulator, and allows the company to anticipate the likely next step and plan its responses and outreach to the regulator accordingly.

Companies should also be aware that an examination does not necessarily conclude with the issuance of a final exam report. An exam report may be the basis of an administrative enforcement action, and administrative enforcement actions are themselves the start of yet another regulatory process that engages a company. Knowing what the enforcement process is in the jurisdiction, even during the examination phase, can help the company position itself to its best advantage in the event of a regulatory action.

6. Understand the administrative enforcement process

As noted above, the examination process can lead into an administrative enforcement action. It is not unusual for a company to be faced with this process for the first time, or faced with the prospect of an administrative proceeding for the first time in a particular jurisdiction. In most, but not all cases, the action will be handled by the Department's legal staff. However, in some states, the state attorney general has this responsibility. Every state has enacted a version of the model Administrative Procedure Act (APA) which provides the procedures for adjudicating disputes before administrative bodies. While enforcement actions following examination generally are governed by the state's APA, some states have "mini-APAs" in the insurance code which overlap, but do not entirely duplicate the APA rules and procedures.

While the APA has much in common with rules of civil procedure that are so familiar to litigators, it is important to remember that they also differ in several important ways. Under the APA model law, there are abbreviated discovery rules and rules governing hearings. *[Uniform Law Commission, STATE ADMINISTRATIVE PROCEDURE ACT, REVISED MODEL §§ 401 et seq.]* For example, all relevant evidence, including hearsay evidence is admissible, if it is the type commonly relied on by a reasonably prudent individual in the conduct of the affairs of the individual. *[Id.,§ . 404]*

In another significant deviation from criminal and civil procedure, the presiding office at a hearing must be an administrative law judge, the head of the state agency or an individual designated by the agency head. *[Id., § 402*] In practice, the final arbiter of a matter is usually the head of the insurance agency. *[Id.]* While this means that the agency charging the violations is also the agency deciding the merits of the violations, individuals within the agency who have served in the same case as a staff adversary or advocate, or who are subject to supervision by someone in this role, may not serve as presiding officer. *[Id., and comment by Uniform Law Commission]* The separation of the prosecutorial and quasi-judicial function is designed to satisfy the agency's duty to follow constitutional due process. For this reason, due process challenges to the agency head acting as "judge and jury" have been largely unsuccessful.

Once the final arbiter has issued its decision, the company still has the opportunity to seek judicial review. *[Id., § 501, et seq.]* However, since the standard of review is often an abuse of discretion or similar high standard, this leaves a large degree of latitude to the regulator. And, because regulators have so much discretion, and because the standard for judicial review is so high, it is quite difficult to overturn agency decisions upon review. A company's challenge in seeking judicial review is also often further complicated by the fact that courts often defer to administrative agencies' interpretation of the laws and regulations those agencies are charged with enforcing.

Another important difference between a civil suit and an administrative action is that the mechanisms designed to encourage settlement in the civil context – e.g., early neutral evaluations, arbitrations – may not exist in the administrative context. Thus, any continuing settlement discussions are often carried on solely between the regulator and the company, without the benefit of an objective third party. In addition, any settlement that is reached is likely to be public, as regulators are generally without authority to enter into confidential settlements. Furthermore, commissioners may elect to issue press releases around the settlement, and the settlement documents themselves may be posted on the agency's website.

7. Understand the framework for remediation

Remediation is often part of the resolution of an exam or an enforcement action arising out of an exam. This is true even though regulators are generally without authority to order remediation. However, there are exceptions to this rule, where specific statutes authorize the regulator to order remediation in certain circumstances. For example, Arkansas allows the commissioner to order restitution for persons aggrieved by violations of the statutes designed to prevent fraudulent insurance acts. *[ARK. CODE ANN. § 23-66-512]* However, even if a regulator does not have the authority to order a company to engage in restitution, the regulator does have authority to negotiate with a carrier for restitution in exchange for not exercising the regulator's authority to order a fine, take action against a license or take some other action that is authorized by the code.

In the context of considering remedial measures to correct past non-compliance, regulators generally view themselves as consumer advocates. As a result, their focus is on finding a solution that they believe will restore as many of their residents as possible to the position they would have occupied but for the violation. Because there are often no statutes governing remediation, regulators are able to work creatively with insurers within the framework of their overarching consumer protection interest.

In many cases, remediation takes the form of money back to a consumer. However, this is not the only option to be considered and accepted by regulators. Depending upon the circumstances, regulators may also consider opportunities to re-adjudicate claims, offers of a new or similar product, and other exercises of a core insurer function. In some cases, where consumers cannot be identified, the regulator may accept a solution where the insurer pays some other state or non-profit agency the amounts that would otherwise be paid to an unidentified group of consumers.

8. Take full advantage of precedent

There are many types of precedent that both the company and the regulator should consider in the context of an examination. This precedent may apply to the interpretation of a particular law that is in issue, to the formation of conclusions based upon exam findings, and to the determination of an acceptable resolution of any issue identified. From the regulators' point of view, it is important to follow the agency's own process and procedures, as a deviation from precedent could pave the way for allegations that the regulator has failed to follow due process requirements in a particular instance. Thus, it is important for a company undergoing examination to familiarize itself, to the extent possible, with any precedent within the agency concerning the laws or issues that are the subject of examination.

Some states allow their state agencies to publish decisions in enforcement actions as precedential. Where a decision is designated as precedential, it should be easily obtainable. Other decisions may not be as easily identified or located. In this case, the company may wish to consider exercising its rights to request information under the state equivalent of the Freedom of Information Act or visiting the administrative court to review dockets and filings relating to administrative actions.

There are other examples of precedent that should also be considered by a company. The legal principles of res judicata, collateral estoppel and primary jurisdiction may be relevant if the issue in the examination has been litigated or if there is ongoing litigation around the issue. While a full discussion of these principles is beyond the scope of this guide, and while these principles may not apply in every case where there is or has been litigation, it is worth considering whether these doctrines are relevant whenever there is similarity between the issue under examination and an issue in an existing or prior lawsuit.

Both res judicata and collateral estoppel bar future disputes over the same issue by the same parties. Res judicata stands for the proposition that a matter that has been adjudicated by a competent court may not be pursued further by the same parties. Thus, if the Department questions the handling of a transaction with a consumer, and that handling has already been the subject of a lawsuit, the company may point to the principle of res judicata to support the position that the resolution of the lawsuit suffices to resolve the issues for the regulator's purposes as well. A related doctrine is the doctrine of collateral estoppel, which holds that an earlier decision rendered by a court in a lawsuit between parties is conclusive as to the issues or controverted points. Accordingly, those issues cannot be litigated again in subsequent proceedings involving the same parties. This doctrine may be used to argue that an interpretation of law already decided by a court should be applied when considering the application of that law to the same consumer in the examination context.

While it is true the regulator generally is not a party to the suit that forms the basis for assertion of res judicata or collateral estoppel, regulators will often find the court's determination compelling, and may even apply the ruling more broadly than to just the individual involved in a particular court case. Regulators are even more likely to apply the ruling broadly where the lawsuit in question was a class action. To the extent that there is overlap between the class as defined in the suit, and the consumers within the exam period who were affected, there is good reason for the regulator to accept the court's determination on issues such as the interpretation of law and the resolution of any harm as dispositive for exam purposes.

The doctrine of primary jurisdiction allows a court to stay an action on a claim that is within the court's jurisdiction in favor of deferring the matter to an administrative agency within whose area of expertise the claim falls. Thus, under the doctrine, courts, even though they could decide a controversy, will pend the matter until after the state agency has rendered its decision on the matter in issue. This doctrine is not frequently employed by the courts, and different courts employ slightly different analyses to decide whether to invoke the doctrine; however, the objective of the doctrine is always to allow the courts to take advantage of the expertise and knowledge of policy objectives that lie within the regulator's authority. Insurers who are both litigating a matter and having the same issues reviewed by a regulator as part of an examination may alert the court to the existence of the examination, and request that the court exercise its authority under the doctrine of primary jurisdiction. In this manner, the court may allow the regulator to complete its examination and form its conclusions on the matter before proceeding with the civil suit.

9. Understand the relationship with civil litigation

In addition to the ability to recognize an opportunity to employ the three legal principles discussed above, there are many other reasons it is important for a company to ensure that those personnel involved with examinations are in communication with the company personnel responsible for litigation involving the company. Both civil litigation and examinations may touch upon the same issues: For example, a litigant may complain to a regulator, and the regulator may then commence or expand an examination to include the same issues at stake in the lawsuit. In addition, litigants who have been barred from receiving information through civil discovery may attempt to recover the same information through a regulator. For example, if a regulator in the exam context asks for information that might then become subject to subpoena or a public records act request, it is in the insurer's best interests to be aware of this fact from the outset.

Where the civil litigation in question is a class action, companies almost always employ outside counsel. In any case where outside counsel is involved, it is also important to ensure that outside counsel is aware of any broader regulatory picture. And, of course, care should be taken to preserve any privilege over any communications that relate to the coordination of the civil and regulatory matters.

Even civil litigation settlements should be crafted with an eye toward the possibility of subsequent regulator interest in the matter. Many settlement agreements with policyholders and claimants contain a provision that the terms of the settlement are confidential. If the same party has made a complaint to a regulator for the same matter that is the subject of the suit, a confidential settlement could preclude the company from providing the regulator with all the information necessary to the regulators' evaluation of the matter. For example, state Unfair Trade Practices Acts typically prohibit unreasonable settlement offers. If a litigant complains to the regulator that the company did not offer a reasonable amount to settle a claim, then a confidential settlement may preclude the insurer from informing the regulator of the amount that the litigant was eventually willing to accept in settlement. If this amount is relevant to establishing whether previous settlement offers were unreasonably low, the insurer has unnecessarily hampered its ability to provide a full and meaningful response to the regulator.

10. Understand the role of other government agencies

Insurers should recognize that the same activity that is the focus of an examination – and of fines or subsequent remediation – by an insurance regulator can also be the subject of an investigation and further action and penalties by other government agencies, including other agencies in the same jurisdiction. For example, if the insurer is alleged to have engaged in a pattern of misrepresentation to insureds, both a Department of Insurance and a state Attorney General may have jurisdiction, under different statutes, to address the practice. Similarly, in some states, responsibility for premium tax collection may rest with an agency other than the insurance regulator, so a misreporting of premium could fall under the jurisdiction of both the insurance regulator and the tax agency.

Action by one of multiple state agencies empowered to govern insurers may not bar another agency acting on the same activity if that activity falls within its jurisdiction as well. This is because each agency is charged with the enforcement of a particular set of laws, and the same activity could potentially violate more than one set of laws. For this reason, a settlement with one agency under one set of laws does not necessarily preclude action by other state agencies under their authorizing laws. Moreover, state agencies, including insurance regulators, are generally without authority to enter into a settlement binding upon other agencies in the state. Despite this fact, in many states, the various agencies involved in administration of laws affecting insurers tend to leave all governance of insurers to the Department of Insurance.

11. Last thoughts - prepare, prepare, prepare

There are important steps a company can take if it has concerns about examination activity. It can maintain regular communications with its regulators, especially the areas of the agency charged with examination, and encourage regulators to inform the company if there are ever particular concerns well in advance of those concerns blossoming into an examination. Companies should also be aware of targeted examinations conducted on their peers, as regulators sometimes conduct targeted examinations on a group of insurers who have a particular type of product or line of business in common. Another reason to monitor peers' examinations is to keep abreast of other regulatory trends in the context of even routine examinations.

Much of this guide has been devoted to preparation and processes that should be in place in order for companies to handle an examination as efficiently as possible. And once an exam is under way, the need for preparation continues. Preparation includes careful tracking of inquiries and responses to regulators, careful planning in advance of meetings with regulators and aggressive follow-up within the company on any issues that arise during the examination. Preparation includes providing regulators with full and complete responses to their questions and paying careful attention to the communications between the company and the examiner to be sure that these are smoothing the way through the exam process. Of course, quick and decisive action in the event of a miscommunication is also critical.

In general, attention to detail is incredibly valuable when undergoing an exam process. The company should ensure that its responses and positions taken during the exam are consistent with the positions taken and communications made in other contexts. In addition, attention to detail can help an insurer identify opportunities to exercise some of the tips listed in this guide.

This guide does not and is not meant to address every issue that can arise during a regulatory exam. Companies should consider enlisting the assistance that experienced regulatory counsel can provide in exam risk assessment and containment and, if necessary their assistance in exam preparation. Regulatory counsel can identify trends in regulatory exams, assess the company's particular circumstances and the likelihood of an exam, and help design and/or conduct compliance audits designed to identify and correct the sort of activity that leads to examinations in the first place. In the event of an exam, regulatory counsel can serve as a valuable partner in the exam process.

Part 2

About the Author

Elizabeth Tosaris

Partner

Elizabeth Tosaris is a member of the Insurance: Regulatory and Transactional Practice Group, and has more than 20 years of insurance regulatory and insurance litigation experience. She has assisted clients on a broad range of issues arising out of the regulation of the insurance industry. Her clients have included a wide variety of insurers, insurance producers, entities in non-insurance lines of business who are considering business plans with an insurance-related component, as well as Departments of Insurance.

Elizabeth has particular experience in responding to market conduct examinations, including resolving issues arising out of those exams. She regularly advises major insurers who are the target of multi-state market conduct exams. Elizabeth also has litigated examination-related and other matters at trial and in administrative hearings.

A regular part of Elizabeth's practice involves advice to clients on achieving compliance with insurance statutes and regulations, obtaining approval of rate filings, implementing claims and underwriting procedures, and developing marketing strategies. Elizabeth has worked with insurers on financial reporting and filing issues, including annual statements and related financial documents. She has extensive experience with license applications, applications to withdraw from business and holding company matters. Elizabeth also advises clients in connection with major transactions such as mergers and sales of insurers.

Another area of Elizabeth's practice involves assisting insurers in preparing responses to subpoenas and other investigatory demands from state agencies. In addition, Elizabeth has worked with insurers in preparing responses to data requests and other special reporting events called by state regulators and attorneys general.

Education

J.D., University of California, Hastings School of Law, 1991

B.A., cum laude, Williams College, 1987

Exeter College, Oxford University, 1985

Bar Admissions

California

Admitted To Practice

U.S. Court of Appeals for the Ninth Circuit

U.S. District Court for the Central District of California

U.S. District Court for the Eastern District of California

U.S. District Court for the Northern District of California

Locke Lord's Insurance Practice Areas

About The Firm

Locke Lord LLP is a full-service, international law firm with offices in Atlanta, Austin, Chicago, Dallas, Hong Kong, Houston, London, Los Angeles, New Orleans, New York, Sacramento, San Francisco and Washington, D.C.

Our team of approximately 650 attorneys has earned a solid national reputation in complex litigation, regulatory and transactional work. We serve our clients' interests first, and these clients range from Fortune 500 and middle market public and private companies to start-ups and emerging businesses.

Locke Lord's team builds collaborative relationships and crafts creative solutions to solve problems - all designed and executed with long-term strategic goals in mind. Among Locke Lord's many strong practice areas are appellate, aviation, bankruptcy/restructuring/insolvency, business litigation and dispute resolution, class action litigation, consumer finance, corporate, employee benefits, energy, environmental, financial services, health care, insurance and reinsurance, intellectual property, international, labor and employment, mergers and acquisitions, private equity, public law, real estate, regulatory, REIT, tax, technology, and white collar criminal defense and internal investigations.

We embrace multiple points of view and support Local Diversity Committees in each of our cities as well as an overall Firm National Diversity Committee. Women hold positions of power in Firm management and include our top leader, Chair Jerry Clements, six members of our Board of Directors, including a Co-Chair, and the Managing Partner of our Chicago office. Our groups and committees help promote a Firmwide philosophy of inclusion and action, helping raise scholarship money for minority and economically disadvantaged students, hosting holiday parties for lower income children and supporting longtime Firm programs like Flexible Work Arrangements, Domestic Partner Benefits and the Women's Initiative. An important part of Locke Lord's mission is to reach out to the communities we serve in meaningful partnerships and pro bono work.

Locke Lord's Mission Statement sets the tone: At the end of each year, we want our Firm to be better, stronger and more highly regarded than it was at the beginning.

Insurance

Locke Lord's more than 70 Insurance attorneys have a breadth and depth of experience that touches on every aspect of the insurance and reinsurance industries. This group focuses on a full range of insurance matters and continues a tradition of 100-plus years serving insurance clients around the United States and around the world. Locke Lord's Insurance practices have earned a global reputation for excellence, dependability, solid solutions and client service and are known for helping clients meet the challenges of today while preparing for the opportunities of tomorrow.

Our Insurance lawyers are consistently recognized in national and international publications, earning frequent inclusion in *Reactions* magazine's annual survey and in *The International Who's Who of Insurance & Reinsurance Lawyers* list of leading U.S. Firms. Our Insurance practice had also earned a string of accolades from *Chambers USA: Client's Guide of America's Leading Lawyers for Business, The Best Lawyers in America, The Legal 500 United States and Global Broker & Underwriter.*

Our Insurance: Regulatory & Transactional Practice Group focuses on the representation of clients engaged in all lines of insurance, ranging from publicly traded, international insurers to specialty lines insurers, including traditional insurance business clients such as insurers, producers, premium finance companies, third-party administrators, managing general agencies, captives and other alternative risk transfer entities, state insurance guaranty funds and state insurance departments. We also represent other business entities in connection with their subsidiary insurance operations, including commercial banks, investment banks, leasing companies and retailers, and insurance-linked securities, securitizations and other structured finance transactions. We have an accomplished bench of insurance regulatory lawyers in our offices across the United States. A former Acting Director of the Illinois Department of Insurance, the former Deputy Commissioner of the California Department of Insurance, the former Chief Examiner of the New York State Insurance Department and the former Assistant Director of the Division of Insurance and Financial Oversight of The Georgia Department of Insurance all add substantially to our insurance regulatory capability as non-lawyer specialists.

This practice also includes attorneys and former regulators who have a special expertise in helping insurers faced with regulatory examinations and proceedings. Our firm can draw on decades of experience in dealing with a wide range of examination issues. We have an in-depth understanding of the market conduct regulations and procedures of the various states. We routinely counsel clients in connection with financial examinations, multi-state examinations and targeted audits dealing with specific practices. Our connections to and experience with regulators give us an edge when it comes to predicting regulator actions and giving strategic advice.

During examination, our goal is to provide our clients with practical approaches to examinations and to minimize difficulties with examiners. We advise clients on the scope of state examination authority and assist clients in responding to data requests, advise those clients once the exam report is developed and then in negotiating acceptable settlements of issues raised on examination. We also represent clients in administrative proceedings involving market conduct issues. The insights into the examination process offered by the former insurance regulators associated with Locke Lord have been found to be invaluable during all stages of the process.

We also assist clients in conducting internal compliance reviews dealing with a wide variety of issues arising out of the marketing, design and administration of insurance products. We frequently advise clients on privilege issues related to such internal reviews. Nor is our work limited to proceedings initiated by insurance regulators. We have advised insurance clients on responding to subpoenas issued by state attorneys general and in reaching settlements of claims brought by other state agencies.

Representative Market Conduct Experience:

- Represented large life insurance companies in connection with targeted examinations focused on suitability of sales.
- Represented carriers in connection with targeted examinations of accident and health products.
- Represented health carriers in connection with examinations of claims handling practices.
- Represented carriers in connection with targeted examinations of SIU practices.

- Represented property and casualty carriers in connection with targeted examinations by individual states.
- Represented life and health carriers and property and casualty carriers in connection with targeted multistate exams.
- Represented carriers in connection with Social Security Administration Death Master File reviews and investigations.
- Represented a life reinsurance company in financial examination matter involving attempted disqualification of hundreds of millions of dollars of admitted assets held in reinsurance security trust accounts.
- Represented a life reinsurance company in major examination matter involving nine state insurance departments, including allegations of problems with advertising, underwriting procedures, marketing practices, etc.
- Analyzed market conduct risks and mitigants arising from a leading life insurance company's administration of credited interest rates and other non-guaranteed elements under direct and assumed life insurance policies and annuities.
- Advised clients on the regulatory process for selecting companies for examination, and counseling on best practices to avoid examination.

Our Reinsurance Practice Group is a premier provider of corporate, regulatory, arbitration, run-off and litigation services to the reinsurance industry. Many of the world's most prominent reinsurers rely on the Firm's depth, skill and experience, and we are recognized internationally as a leader in the field. This background and history in a dynamic, challenging and competitive environment put Locke Lord at the forefront in providing the full range of services our reinsurance clients require.

Our Insurance: Litigation & Counseling Practice Group represents insurers in high-stakes and contentious litigation around the country, often involving very significant alleged exposure to our clients, sophisticated legal issues, considerable factual and expert discovery, multi-party dynamics, multiple lines of current and historic coverages, and complex jurisdictional battles. We also are selected by insurers to defend insureds in certain tort litigation. Our lawyers have decades of experience handling unusual, complex and challenging insurance disputes. These disputes typically involve regulatory issues, challenges to a company's business practices, unique contractual issues, or raise questions of first impression. We are creative in our litigation strategy and work to see each matter to conclusion, whether through mediation or settlement, by summary judgment motions, to a bench or jury trial, or on appeal, by summary judgment motions, or through mediation or settlement.

Our Insurance: Health Care Practice Group has more than 30 attorneys who help clients achieve their business objectives and enable them to navigate the legal and regulatory complexities unique to the health care industry. We possess extensive experience in health care law and a significant record of success in representing health industry clients on transactional, regulatory, enforcement, litigation and insurance matters. Locke Lord works closely with health industry clients on a variety of regulatory and legislative matters impacting their businesses, including the Patient Protection & Affordable Care Act passed in 2010 and the adoption of its implementing regulations.

We have significant experience in handling health care related insurance and reimbursement issues. We work with insurers, HMOs, third party administrators, self-insured plans and Medicare Advantage plans to provide guidance and representation in all phases of licensing, approvals and regulatory compliance. We advise and assist on managed care contract negotiations and are regularly involved in network development and management issues for our clients. We also provide counsel regarding the application of Medicare and Medicaid reimbursement guidelines and interpretations, particularly in new and rapidly evolving areas of medical practice and technology.

Regulatory & Transactional Insurance Team

Baird Allis
Associate
ballis@lockelord.com
T: 312-443-0306
Chicago

Jonathan F. Bank
Of Counsel
jbank@lockelord.com
T: 213-687-6700
Los Angeles

Carey S. Barney
Partner
cbarney@lockelord.com
T: 213-687-6746
Los Angeles

Jon Biasetti
Partner & Insurance Practice Co-Chair
jbiasetti@lockelord.com
T: 312-443-1866
Chicago

Brian T. Casey
Partner & Insurance Practice Co-Chair
bcasey@lockelord.com
T: 404-870-4638
Atlanta

Sarah M. Chen
Associate
schen@lockelord.com
T: 212-812-8303
New York

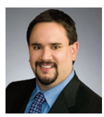
Norris W. Clark
Financial & Regulatory Specialist
nclark@lockelord.com
T: 213-687-6771
Los Angeles

Rachel B. Coan
Partner
rcoan@lockelord.com
T: 212-415-8574
New York

R. Dean Conlin
Of Counsel
rdconlin@lockelord.com
T: 312-443-0454
Chicago

Larry D. Davie
Senior Counsel
ldavie@lockelord.com
T: 404-870-4658
Atlanta

Timothy S. Farber
Senior Counsel
tfarber@lockelord.com
T: 312-443-0532
Chicago

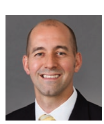


Jon Gillum
Associate
jgillum@lockelord.com
T: 512-305-4717
Austin

Patrick J. Hatfield
Partner
phatfield@lockelord.com
T: 512-305-4787
Austin

Thomas W. Jenkins
Partner
tjenkins@lockelord.com
T: 312-443-1777
Chicago

Randall Johnson
Of Counsel
rwjohnson@lockelord.com
T: 404-870-4600
Atlanta



Jay Kallas
Senior Counsel
jkallas@lockelord.com
T: 312-443-0619
Chicago

Regulatory & Transactional Insurance Team

Stewart Keir
Financial & Regulatory Specialist
skeir@lockelord.com
T: 212-812-8347
New York

William J. Kelty, III
Partner
wkelty@lockelord.com
T: 202-220-6967
Washington, D.C.

Christopher L. Martin
Partner
cmartin@lockelord.com
T: 713-226-1209
Houston

Jack Messmore
Financial & Regulatory Specialist
jmessmore@lockelord.com
T: 312-443-1871
Chicago

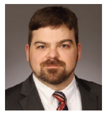
Stephanie O'Neill Macro
Of Counsel
smacro@lockelord.com
T: 312-443-0593
Chicago

J. Brett Pritchard
Partner
bpritchard@lockelord.com
T: 312-443-1773
Chicago

Michael K. Renetzky
Partner
mrenetzky@lockelord.com
T: 312-443-1823
Chicago

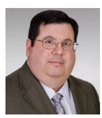
Robert A. Romano
Partner
rromano@lockelord.com
T: 212-812-8322
New York

Anthony B. Sherman
Partner
asherman@lockelord.com
T: 312-443-1737
Chicago



Trey L. Sivley
Associate
tsivley@lockelord.com
T: 404-870-4657
Atlanta

Elizabeth A. Tosaris
Partner
etosaris@lockelord.com
T: 415-318-8817
San Francisco



Kirk Van Brunt
Partner
kvanbrunt@lockelord.com
T: 202-220-6959
Washington, D.C.

Paige D. Waters
Partner
pwaters@lockelord.com
T: 312-443-1815
Chicago

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Atlanta, Austin, Chicago, Dallas, Hong Kong, Houston, London,
Los Angeles, New Orleans, New York, Sacramento, San Francisco, Washington DC