

To: Director John M. Huff (MO), Chair of Financial Regulation Standards and Accreditation (F) Committee

From: Commissioner Susan Donegan (VT), Chair of Corporate Governance (E) Working Group

Date: Nov. 18, 2014

Re: Recommendation for Part A Accreditation Standards and Guidelines for the Corporate Governance Annual Disclosure Model Act and the Corporate Governance Annual Disclosure Model Regulation

Executive Summary

On November 18, 2014, the NAIC Executive Committee and Plenary adopted the *Corporate Governance Annual Disclosure Model Act* (#305) and the *Corporate Governance Annual Disclosure Model Regulation* (#306). These models were adopted as a result of a multi-year project of the Corporate Governance (E) Working Group to study and compare existing governance requirements for U.S. insurers to established best practices, international standards and U.S. regulatory needs. Upon the conclusion of this study, the Working Group identified a number of proposed enhancements to strengthen corporate governance standards within the U.S. solvency system, including the annual collection of detailed information on an insurer's corporate governance practices.

Together, Model #305 and Model #306 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. The insurer (or group of insurers) may choose to provide information on governance activities that occur at the ultimate controlling parent level, an intermediate holding company level and/or the individual legal entity level, based on its determination of the level at which decisions are made, oversight is provided and governance accountability is assessed in relation to the insurance activities of the insurer.

The insurer has discretion regarding the appropriate format for providing the information and is permitted to customize the communication to provide the most relevant information necessary to permit the domiciliary commissioner to gain an understanding of the corporate governance structure, policies and practices utilized by the insurer. However, at a minimum, the disclosure is required to address:

- The insurer's corporate governance framework and structure;
- The policies and practices of its board of directors and significant committees;
- The policies and practices directing senior management; and
- The processes by which the board of directors, its committees and senior management ensure an appropriate level of oversight to the critical risk areas impacting the insurer's business activities.

In completing the annual disclosure, the insurer may reference other existing documents (e.g., the Own Risk and Solvency Assessment (ORSA) Summary Report, holding company Form B or Form F filings, U.S. Securities and Exchange Commission (SEC) proxy statements, foreign regulatory reporting requirements, etc.) to the regulator in fulfillment of the information requested in various areas.

All information provided in the annual disclosure is recognized as being proprietary to the insurer and containing trade secrets. Therefore, confidentiality language was included in Model #305 stating that all such information is deemed confidential by law and privileged, is not subject to subpoena and is not subject to discovery or admissible in evidence in any private civil action. However, the domiciliary commissioner is authorized to use the documents, materials or other information in the furtherance of any regulatory or legal action brought as a part of the commissioner's official duties.

The requirements of the Model Act and Model Regulation are intended to be effective Jan. 1, 2016. The first annual disclosure is scheduled to be due by June 1, 2016.

A statement and explanation of how the potential standard is directly related to solvency surveillance and why the proposal should be included in the standards:

The intent of the models is to provide more information to regulators on insurers' corporate governance practices on an annual basis. Currently, regulators obtain a significant amount of information on insurers' corporate governance practices during full-scope examinations, which typically occur once every 3-5 years. However, information on governance practices, including changes that can have a substantial impact on current and prospective solvency, is not widely available to regulators in the period between onsite examinations. Through the adoption of standards in this area, regulators can ensure that sufficient information on governance practices is available to assess the solvency of insurers on an annual basis.

A statement as to why ultimate adoption by every jurisdiction may be desirable:

Ultimate adoption by every jurisdiction will result in uniform application of the disclosure requirements to all U.S. insurers, which results in an even regulatory playing field and provides equivalent information for jurisdictions to utilize in assessing an insurer's solvency position. Per Model #305, the disclosure requirements can be met by providing the annual disclosure on a group basis to the Lead State regulator and the review of the disclosure should be coordinated across jurisdictions that have domestic states in the group. As such, uniform adoption will provide that the legal framework exists in all states so that this coordinated regulatory effort can be effective.

In addition, uniform adoption across jurisdictions will assist the U.S. in meeting international standards relating to corporate governance and oversight. The IAIS has adopted principles and guidance related to corporate governance in ICP 5 – Suitability of Individuals, ICP 7 – Corporate Governance and ICP 8 – Risk Management and Internal Controls. In addition, the results of the 2009 U.S. FSAP and the 2013 FIO Insurance Modernization Report included recommendations for U.S. regulators in relation to corporate governance matters. The uniform adoption of Model #305 and Model #306 would assist the U.S. in responding to these recommendations and fulfilling international expectations in this area.

A statement as to the number of jurisdictions that have adopted and implemented the proposal or a similar proposal and their experience to date:

The Working Group is not yet aware of any states that have adopted Model #305 and Model #306. As these models were recently adopted by the NAIC, the Working Group expects jurisdictions to begin taking action to adopt the models in 2015.

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:

The Working Group recommends the following provisions be adopted to require uniform implementation of the corporate governance annual disclosure requirements:

20. 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 Disclosure Model Act* (#305) and *Corporate Governance Disclosure Model Regulation* (#306).

- a. Requires the insurer or insurance group to submit a Corporate Governance Annual Disclosure (CGAD) by June 1 of each year, similar to Section 3 of Model #305.
- b. Requires the CGAD to contain the material information necessary to permit the Commissioner to gain an understanding of the insurer or group's corporate governance structure, policies, and practices, similar to Section 5a of Model #305.
- c. Requires the CGAD to be prepared consistent with the Corporate Governance Annual Disclosure Model Regulation, similar to Section 5b of Model #305.
- d. Provides confidentiality protection for the CGAD, including provisions maintaining confidentiality for information shared with state, federal and international regulators, similar to Section 6 of Model #305.
- e. Includes an effective date no earlier than Jan. 1, 2016, similar to Section 10 of Model #305.
- f. Prescribes filing procedures for the CGAD, including required signatures, rationale for the level at which information is reported, filing with the Lead State, the ability to reference other documents and processes for describing changes from the prior year's disclosure, similar to Section 5 of Model #306.
- g. Prescribes the general content for the CGAD, including a description of corporate governance framework and structure, a description of policies and practices of the board of directors, a description of policies and practices for directing senior management and a description of oversight provided to critical risk areas impacting the insurer's business activities, similar to Section 6 of Model #306.

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:

It is the understanding of insurance regulators that insurers currently summarize and describe their corporate governance practices to a number of various stakeholders on a regular basis. In addition, the disclosure requirements allow reference to existing documents and filings and provide guidance for filing changes from the prior year to simplify the reporting process. Therefore, the costs for insurance companies to comply with the proposal are not expected to be overly significant.

In addition, the Existing sections of the NAIC's *Financial Analysis Handbook* and *Financial Condition Examiners Handbook* provide guidance to regulators for use in reviewing and assessing the corporate governance practices of insurers, which already composes a significant element of existing analysis and examination processes. The additional information provided to regulators through the CGAD may require some additional time to review and utilize, but is not expected to significantly increase the burden of regulators in this area. A referral has been provided to the Risk-Focused Surveillance (E) Working Group, the Financial Analysis Handbook (E) Working Group and the Financial Examiners Handbook (E) Technical Group to consider updating and revising the existing regulatory guidance in this area once the CGAD begins to be received.

Additional information:

None deemed necessary.

