PROJECT HISTORY - 2014

CORPORATE GOVERNANCE ANNUAL DISCLOSURE MODEL ACT (#305)

CORPORATE GOVERNANCE ANNUAL DISCLOSURE MODEL REGULATION (#306)

1. Project Description

In light of the 2008 financial crisis, growing regulatory needs and various international developments, U.S. insurance regulators, working together through the NAIC, concluded that a greater regulatory focus on corporate governance was necessary and formed the Corporate Governance (E) Working Group in September 2009 to address these matters. The Working Group received a charge to outline high-level corporate governance principles for use in U.S. insurance regulation. To do so, the Working Group analyzed the existing statutory requirements, regulatory initiatives and review practices of the state insurance departments, international supervisors, other U.S. functional regulators and the insurance industry. The Working Group was also asked to determine the appropriate method to ensure adherence with such principles, giving due consideration to development of a model law and to development of additional regulatory guidance, including detailed best practices for the corporate governance of insurers.

In completing work on this charge, the Working Group developed a summary of existing corporate governance requirements found within NAIC/insurance-specific sources and within more general, broadly based sources. The goal was to identify potential changes in the existing insurance regulatory structure that could be affected through the NAIC Solvency Modernization Initiative. The Working Group then compared those existing U.S. requirements to regulatory needs, best practices and principles outlined in the Insurance Core Principles adopted by the International Association of Insurance Supervisors (IAIS). The results of this comparative analysis indicated a need to collect additional information from insurers regarding corporate governance practices on an annual basis, to facilitate the review and assessment of this information through the solvency-monitoring process.

The Working Group investigated several options for collecting confidential information from insurers on corporate governance practices before proceeding with the development of the Corporate Governance Annual Disclosure Model Act (Model Act) authorizing the collection and protection of governance information. In addition to the Model Act, the Working Group identified a need to develop a Corporate Governance Annual Disclosure Model Regulation (Model Regulation) outlining the detailed disclosure requirements.

2. Group Responsible for Drafting the Model Act and Regulation

The project to develop the Model Act and Model Regulation was given to the Corporate Governance (E) Working Group. The Working Group created a Drafting (E) Subgroup to develop an initial draft of the Model Act for the Working Group to consider, which was originally supported by a draft guidance manual. Members of the Subgroup included Vermont (chair), California, Indiana, Ohio and Pennsylvania. After the initial draft was developed by the Subgroup, it was later reviewed and revised by the full Working Group, whose members included Vermont (chair), New York (vice chair), Alabama, California, Connecticut, Florida, Iowa, Indiana, Louisiana, Missouri, New Hampshire, Ohio, Oklahoma, Pennsylvania, Virginia and Washington.

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3. Charge Authorizing the Project

On April 8, 2013, the Financial Condition (E) Committee adopted a request for model law development to develop the Model Act. The Executive (EX) Committee adopted this request July 26, 2013. The Financial Condition (E) Committee delegated the assignment of developing the Model Act to the Corporate Governance (E) Working Group, and drafting work began soon after the 2013 Summer National Meeting.

4. General Description of the Drafting Process and Due Process

- During September and October 2013, the Drafting (E) Subgroup met via conference call in regulator-to-regulator session to develop an initial draft of the Model Act, supported by a guidance manual.
- After finalizing an initial draft of the Model Act and guidance manual, the Subgroup referred the draft to the Corporate Governance (E) Working Group for its review on a Nov. 8, 2013, conference call.
- The Working Group discussed the draft on its Nov. 8, 2013, conference call and received verbal comments from interested parties. Interested parties voiced objections to the use of a guidance manual to house the filing instructions. Based on the discussions held, the Working Group agreed to develop modifications to the Model Act and the guidance manual before exposing the drafts for public comment.
- Updated drafts of the Model Act and guidance manual were presented to the Working Group at its Dec. 16, 2013, meeting at the 2013 Fall National Meeting. The updated draft of the guidance manual limited its purpose, restricted the frequency with which changes could be made and prohibited the addition of new sections to the guidance manual without updating the Model Act. The drafts of the Model Act and guidance manual were then exposed for a 45-day public comment period ending Jan. 31, 2014.
- At the conclusion of the public comment period, a number of comment letters were received, including additional objections from interested parties regarding the use of a guidance manual to house the annual filing instructions.
- In February 2014, the Working Group instructed NAIC staff to develop a draft Model Regulation to house the annual filing requirements in lieu of the guidance manual.
- A Model Regulation housing annual disclosure instructions was presented to the Working Group for review during its March 6, 2014, conference call. The Model Regulation was then exposed for a 45-day public comment period ending April 21, 2014.
- The Model Act was then revised to refer to the Model Regulation, which led to discussions at the Working Group's March 30, 2014, meeting at the 2014 Spring National Meeting and a brief exposure of the updated Model Act for a public comment period ending April 21, 2014.
- Comment letters were received on both the Model Act and the Model Regulation, which were discussed on conference calls held June 19 and July 1, 2014. Much of the discussion related to the confidentiality language included in the Model Act, which was finalized on these calls.
- The Model Act and Model Regulation were adopted by the Corporate Governance (E) Working Group Aug. 17, 2014. The Model Act and Model Regulation were adopted by the Financial Condition (E) Committee Aug. 18, 2014.

5. Discussion of Key Issues

A number of key issues were raised during the development of the Model Act and Model Regulation. These issues included confidentiality protection for the governance information to be disclosed, the level at which the disclosure should be completed, the contents of the annual disclosure, the placement of disclosure instructions and the removal of potential redundancies in other areas of insurance regulation created by the disclosure.

As demonstrated above, the most significant debate in developing both models revolved around the placement of instructions for the annual disclosure. Initially, regulators proposed the use of a guidance manual to house

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instructions that would ensure consistency across the states and to allow the ability to make modifications when necessary to address new and emerging corporate governance issues. Interested parties objected on the grounds that a guidance manual could allow for frequent and significant changes to the disclosure requirements without such changes being subject to sufficient due process. Ultimately, regulators and interested parties agreed to compromise by presenting the disclosure instructions in the Model Regulation supporting the Model Act.

Together, the Model Act and Model Regulation 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 the Model Act 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.

Some state insurance regulators expressed concern that the confidentiality language included in the Model Act (i.e., the ability to restrict discovery from the insurer) is overly broad and extends beyond the authority typically granted to the insurance department. However, the Working Group noted that the same confidentiality language has been included in multiple NAIC models and the industry argued strongly on its behalf. Therefore, the Working Group agreed to keep the standard wording in the Model Act, but recognized the fact that individual states may have to modify the confidentiality language, if necessary, in the process of adopting the Model Act.

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.

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6. Any Other Important Information

No other items identified at this time.

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