

State of Vermont
Department of Financial Regulation
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Corporate Governance Presentation for H.73
to the
House Committee on Commerce
and Economic Development

January 28, 2015

Vermont Department of Financial Regulation



National Association of
Insurance Commissioners



I. Importance of Corporate Governance

- * What is corporate governance?
- * A framework of rules and practices by which a board of directors ensures accountability, fairness and transparency in an insurer's relationship with all its stakeholders.

Importance of Corporate Governance

- * Without strong corporate governance practices, bad things can happen:

The logo for Tyco, featuring the word "tyco" in a blue, lowercase, sans-serif font.The logo for Worldcom, featuring a yellow star above a horizontal line, with the word "WORLD" in blue above "COM" in blue.The logo for Enron, featuring three stylized, overlapping rectangular shapes in red, green, and blue, with the word "ENRON" in blue below them.The logo for AIG, featuring the letters "AIG" in white, bold, serif font inside a blue square.The logo for Lehman Brothers, featuring the words "LEHMAN BROTHERS" in white, serif font inside a dark green square.

Background on Corporate Governance

- * Key elements of effective corporate governance at the Board level include the following:
 - * Clearly defined roles and responsibilities
 - * Independent and active board members
 - * Individuals are suitable for their roles
 - * Members act in good faith and exercise a duty of care, loyalty and candor
 - * Sufficient oversight provided for significant company activities

Financial Sector Assessment Program (FSAP)



US FSAP - 2009
FSAP- full in 2014



International
Monetary Fund



The World Bank

IBRD & IDA. Working for a World Free of Poverty

= FSAP

Each country pledges to review and report on its regulatory system .
.(A)ll G-20 members commit to undertake a Financial Sector Assessment Program (FSAP) report.”
November 2008 G20 Financial Summit declaration



FSAP- 2009 CG Recommendations

Topic	Recommendation
Suitability of Persons	Specific requirements in relation to individuals' fitness and propriety should be adopted.
Corporate Governance	Consider issuing more guidance on good and bad practices in corporate governance for insurers
Internal Controls	Consider the scope for issuing guidance on good and bad practices in internal control. Make a formal requirement for insurers to have an internal audit function.
Enforcement or Sanctions	The insurance laws should be changed to provide the supervisory authority with powers to fine individual directors and senior managers of insurers
Risk Assessment and Management	The relevant laws, regulations or standards should be changed to include a requirement that an insurer have in place comprehensive risk management policies and systems capable of promptly identifying, measuring, assessing, reporting and controlling their risks.
Insurance Activity: Board Approval Requirement	The relevant laws or regulation should explicitly provide that an insurer must have in place strategic underwriting and pricing policies approved and reviewed regularly by the Board.

II. Existing U.S. Requirements

- * Requirements Outside of State Insurance Regulation:
 - * General Corporate Law
 - * Case Law
 - * SEC Requirements
 - * Stock Exchange Listing Requirements
 - * 18 U.S.C. § 1033-1034

II. Existing U.S. Requirements

- * State Insurance Regulatory Requirements:
 - * Model Audit Rule (NAIC #205)
 - * Audit Committee Independence
 - * Internal Control over Financial Reporting
 - * Holding Company Models (#440 & #450)
 - * Hazardous Financial Condition Model (#385)
 - * Required Reporting and Disclosures
 - * Annual Statement and Supplemental Filings
 - * Audit Report and Actuarial Report

II. Existing U.S. Requirements

- * Regulatory Review Practices:
 - * Company Licensing
 - * Review CG information before license is granted
 - * Biographical Affidavits
 - * Criminal Background Checks
 - * Plan of Operations
 - * License denied if information is incomplete or inappropriate

II. Existing U.S. Requirements

- * Regulatory Review Practices:
 - * Financial Analysis and Reporting
 - * Code of Conduct Responses
 - * Management's Report of Internal Controls
 - * Supplemental Compensation Exhibit
 - * Information on Risk Management
 - * Holding Company Filings
 - * Actuarial Report
 - * Management's Discussion & Analysis

II. Existing U.S. Requirements

- * Regulatory Review Practices:
 - * Financial Examination
 - * Exhibit M of Financial Condition Examiners Handbook
 - * Onsite review of corporate governance and risk management.
 - * Interviews of Directors and Senior Management
 - * Review of BOD minutes and activities
 - * Overall CG Assessment

III. Recent Enhancements

- * Corporate Governance (E) Working Group
 - * Part of a broader Solvency Modernization Initiative
 - * Developed changes to improve CG practices and regulator assessment
 - * 2009 FSAP Recommendations
 - * International Developments
 - * Regulatory Needs

III. Recent Enhancements

- * Results of CGWG Efforts:
 - * Annual collection of information on company governance practices
 - * Internal audit function requirement for large insurers
 - * Require explicit commissioner authority to correct CG deficiencies

III. Recent Enhancements

- * Annual collection of information on company CG practices
 - * Developed a model act to authorize confidential collection of information:
 - * Expected to begin in 2016
 - * Refers to the Corporate Governance Annual Disclosure Model Regulation for further detail about the content of the filing
 - * Model adopted by the NAIC at its 2014 Fall NM

III. Recent Enhancements

- * Corporate Governance Annual Disclosure Model Regulation
 - * Describes the information to be provided by insurers in the following areas:
 - * Corporate Governance Framework & Structure
 - * Board of Directors Policies & Practices
 - * Management Policies & Practices
 - * Oversight of Critical Risk Areas
 - * Model adopted by the NAIC at its 2014 Fall NM

III. Recent Enhancements

- * Internal audit function requirement for large insurers
 - * Existing Model Audit Rule revised to incorporate requirement
 - * Proposed effective date of 1/1/2016
 - * Impacts insurers with more than \$500 million in annual premium or groups with more than \$1 billion in annual premium
 - * Function must be capable of providing independent assurance regarding:
 - * Corporate governance
 - * Risk management
 - * Internal controls

III. Recent Enhancements

- * Require commissioner authority to mandate correction of CG deficiencies
 - * Require an existing element of Hazardous Financial Condition Model Regulation (NAIC #385) for accreditation
 - * “Correct corporate governance practice deficiencies, and adopt and utilize governance practices acceptable to the commissioner.”
 - * Element was adopted by the Financial Regulatory Standards and Accreditation (F) Committee at the Summer 2014 National Meeting
 - * States will have until 1/1/2017 to adopt this required element to demonstrate compliance with accreditation requirements

IV. Conclusion

- * Review and assessment of an insurer's corporate governance practices is an essential element of effective solvency monitoring
- * Significant enhancements have been made to the U.S. system of corporate governance standards/requirements
- * Insurers will be required to report detailed information on their governance practices to regulators on an annual basis
- * Regulators are expected to utilize these enhancements to more effectively monitor the current and prospective solvency of insurers

Questions

