

It All Starts With Great Corporate Governance

Stephen J. Johnson
Insurance Financial and Regulatory Specialist
Stradley Ronon

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Why Is This So Important?

- “We conclude dramatic failures of corporate governance and risk management of many systemically important financial institutions were key cause of this crisis.”
- “Too often risk management became risk justification.”

*The Financial Crisis
Inquiry Report
January 2011*



What Are Regulators Thinking?

- An effective ERM framework, at a minimum, incorporate the following key principles:
 - Risk Culture and Governance – governance structure that clearly defines and articulates roles, responsibilities and accountability and a risk culture that supports accountability in risk-based decision-making.
- It is important to note some insurers view risk culture and governance as the cornerstone to managing risk. The *ORSA Guidance Manual* defines this item to include a structure that defines and articulates roles, responsibilities and accountability; and a risk culture that supports accountability in risk-based decision-making. Therefore, the objective is to have a structure in place within the insurer that manages reasonably foreseeable and relevant material risk in a way that is continuously improved.

NAIC Financial Analysis Handbook



There have been seismic shifts in regulatory approach by the NAIC and Insurance Departments:

- Retrospective → Prospective
- Company → Enterprise
- Financial Statement → Governance
- Rules → Principles
- Getting to Know the DNA of a Company
- Regulators are expecting more Board involvement in this new regulatory approach
- Is management ready?

Have You Ever Read The:

- NAIC's White Paper on High Level Corporate Governance Principles
- NAIC's Comparative Analysis of Existing U.S. Corporate Governance Requirements
- NAIC's Model Corporate Governance Manual Disclosure Model Act and Model Regulation
- Exhibits L & M on the NAIC's Financial Examiners Handbook
 - Exhibit L – Branded Risk Classification
 - Exhibit M – Understanding the Corporate Governance Structure
- Form F – Enterprise Risk Report
- NAIC's Own Risk and Solvency Assessment Guidance Manual
- NAIC's Own Risk and Solvency Assessment Feedback Pilot Project Observations

What Are Regulators Trying To Do Differently?

- Group vs. Legal Entity Supervision
- Corporate Governance
- Risk Management
 - Enterprise Level
 - Legal Entity Level
 - Inter-Connectivity Risks
 - Control Environment
- Capital Management
- Strategic Management (Prospective Risk)
- Verification of all of this – the Risk Focus Exam Process

Corporate Governance Annual Disclosure – Its Purpose

- **Stated Purpose:** To provide to insurance regulators a summary of the corporate governance *structure, policies and practices* to permit the regulator to *gain and maintain* an understanding of the governance framework of an insurer/insurer group
- Thus, the CGAD must go beyond the governance documents to provide information on *actual practices* and, in some cases, *rationale for and suitability of those practices*

Corporate Governance Annual Disclosure – What It Is

- A filing that includes detailed narrative and document to respond to “inquiries” under four key areas:
 1. Governance framework & structure
 2. Policies & practices of the Board & Board committees
 3. Policies & practices for directing senior management
 4. Oversight of critical risk areas
- No specified form/format:
 - CGAD is not a “check the box” filing nor is it responding to a “questionnaire/survey” and there is no specific form/format like exists for, e.g., Forms B & D
 - Instead, you have “discretion regarding the appropriate format [and are] permitted to customize the CGAD to provide the most relevant information necessary” to permit the regulator to gain an understanding of your governance structure, policies and practices

Corporate Governance Annual Disclosure

What Must Be included – A Few Examples

Governance Framework & Structure

- Rationale for Board size and structure
- Duties of the Board & each committee – and how each is governed (e.g. bylaws, charters, informal mandates, etc.)
- How the Board's leadership is structured (including a discussion of the roles of the CEO & Board chair)

Corporate Governance Annual Disclosure

What Must Be included – A Few Examples

Policies & Practices of Most Senior Governing Entity & Committees

- How the qualifications, expertise and experience of each Board member meets the needs of the insurer/insurer group
- Number of meetings of the Board and its committee and information on director attendance
- How the insurer/insurer group identifies, nominates and elects members to the Board and its committees (including a discussion on any term limits and how the election and re-election process works)
- Processes for Board to evaluate the performance of the Board and its committees; measures taken to improve performance – including training programs

Corporate Governance Annual Disclosure

What Must Be included – A Few Examples

Policies & Practices for Directing Senior Management

- Processes/practices (suitability standards) for determining whether officers and key persons in control functions have appropriate background, experience and integrity to fulfill roles
- Plan for CEO and senior management succession
- Processes for performance evaluation, compensation and corrective action (must include sufficient information for an understanding how the organization ensures that compensation programs do not encourage and/or reward excessive risk taking)

Corporate Governance Annual Disclosure

What Must Be included – A Few Examples

Oversight of Critical Risk Areas

Processes by which the Board, its committees and senior management ensure an appropriate amount of oversight of critical risk areas (i.e. risk management, actuarial, investments, reinsurance, business strategy/finance, compliance, financial reporting/internal auditing, and market conduct), including:

- How oversight and responsibilities are delegated between the Board, its committees and management
- How the Board is kept informed of strategic plans, associated risks, and monitoring and management of risk
- Frequency at which information on each critical risk areas is reported to and reviewed by management and the Board

Corporate Governance Annual Disclosure

What Regulators Will/May Do with the Filing

- Will review to gain an understanding of the corporate governance framework
- May request additional information

Corporate Governance Annual Disclosure – What You Should Be Doing NOW?

Learn about all that you must report on in the CGAD

- Could you provide rational, logical and meaningful information on all of the CGAD inquiries?
- Is your governance structure appropriate for your needs and objectives?
- Do your governance documents accurately say what you want them to say?
- Are your actual practices/policies/procedures in accordance with your governance documents?
- Are your governance structure, documents, policies and practices effective?

Have you done anything yet?

Corporate Governance Annual Disclosure Status in Surrounding States

- Pennsylvania – Plan to introduce this Spring
- Delaware – Plan to introduce this year
- New Jersey – Plan to introduce in 2018 or 2019
- Maryland – Plan to introduce in 2018
- West Virginia- Plan to introduce in 2018
- Virginia- Adopted in 2017 (Effective 1/1/2018)

NAIC's Own Risk and Solvency Assessment Filing

The ORSA has two primary goals:

1. To foster an effective level of ERM at all insurers, through which each insurer identifies, assesses, monitors, prioritizes and reports on its material and relevant risks identified by the insurer, using techniques that are appropriate to the nature, scale and complexity of the insurer's risks, in a manner that is adequate to support risk and capital decisions
2. To provide a group-level perspective on risk and capital, as a supplement to the existing legal entity view

ORSA Key Questions

- What is our strategy?
- What level of risk are we willing to assume in pursuit of the strategy?
- What are the key risks that could hinder our ability to achieve our strategy?
- How much capital do we need to cover those key risks?
- What risks – individually or collectively – would subject us to losses that exceed our tolerance levels?
- What risk scenarios would cause us to fail or stop operating as a going concern?

Don't Forget the Insurance Holding Companies Law

- The following is the representation needed to be filed with departments concerning your governance and control environment:
 - Statements that the insurer's board of director oversees corporate governance and internal controls and the insurer's officers or senior management have approved, implemented and continue to maintain and monitor corporate governance and internal control procedures.
- Form F- Enterprise Risk Report

Other Resources for Corporate Governance

- The Society of Corporate Secretaries and Governance Professionals (<http://www.governanceprofessionals.org>)
- The National Association of Corporate Directors (<http://www.nacdonline.org>)
- The Business Roundtable has a Corporate Governance Committee (<http://www.businessroundtable.org/issues/corporate-governance/committee>)
- The Conference Board Commission (<http://www.conference-board.org>)
- The Organisation for Economic Co-operation and Development (OECD) (<http://www.oecd.org/corporate/>)

Why Is This Important To You

- Great companies start with great corporate governance
- How can you be effective to your organization reporting on whether or not corporate governance and ERM are working effectively and are “best in class.”
- Has your internal audit function pivoted to responding to this new regulatory approach?

Questions