

**FINANCIAL
SUMMIT**
2008 LEADERSHIP INITIATIVES

Corporate Governance & Enterprise Risk Management

Tuesday, October 28, 2008
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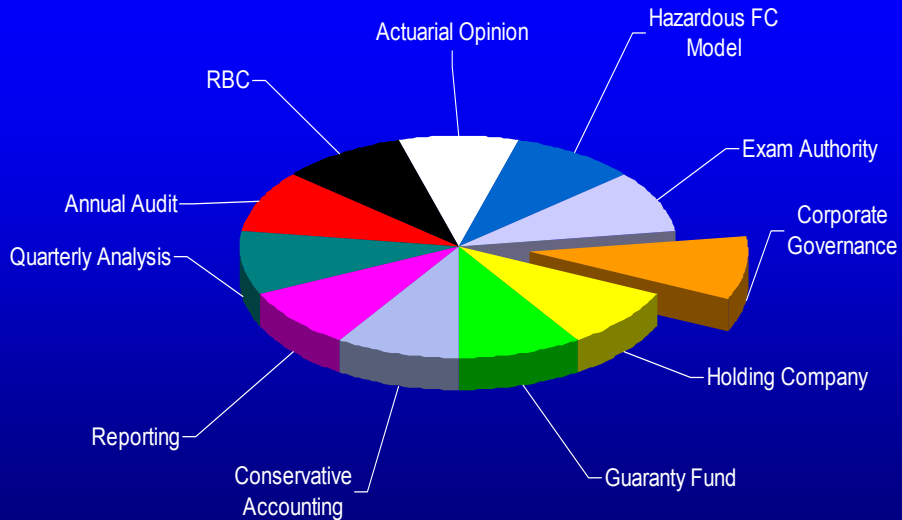
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Outline

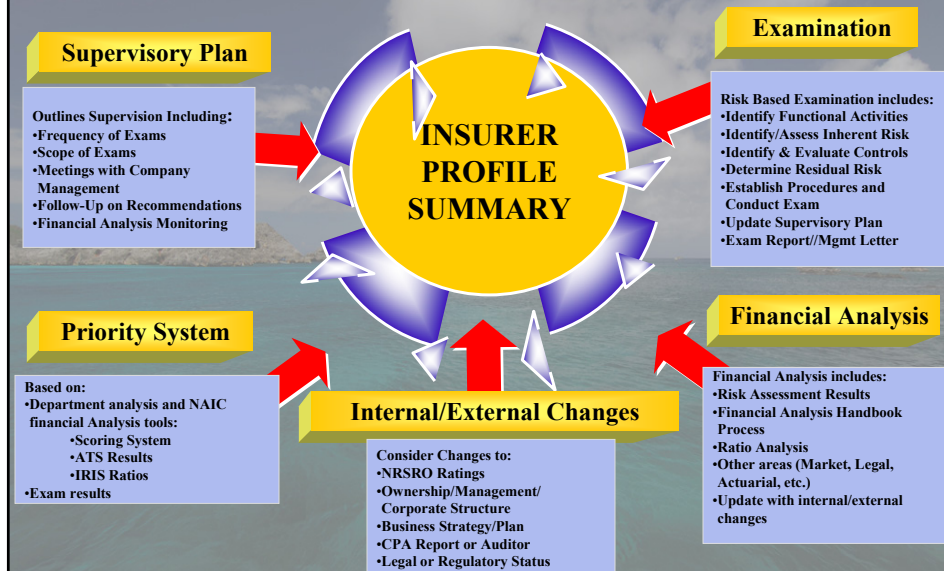
- US Solvency Regulation Framework
- NAIC Corporate Governance
 - Financial Examiners Handbook
 - Model Audit Rule
- IAIS Framework on Insurance Supervision
- IAIS Standard & Guidance on ERM
- Recent NAIC Activities
 - Solvency Modernization Initiative
 - US Response to IAIS Survey
 - Regulatory Response to Recent Economic Events

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US Solvency Regulation Framework



Risk Assessment Cycle



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- Examination Planning (Exhibit A)
 - Phase I-Understand the Insurance Company and Identify Key Functional Activities
 - ✓ Part 1-Understand the Company
 - Gather information
 - Understand the Company's business
 - Meet with the other DOI staff
 - Meet with the Company
 - Meet with the Company's CPA

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- Examination Planning (Continued)
 - Phase I-Understand the Company
 - ✓ Part 2-Understand the Corporate Governance Structure
 - Assess non financial risk management activities
 - Corporate governance framework should include various items.
 - Understand audit committee
 - Examiner should consider various items.

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- Examination Planning (Continued)
 - Phase I-Understand the Company
 - ✓ Part 3-Assess Adequacy of Audit Function
 - Meet with internal auditors
 - Review py audit WPs, management letters, consider audit programs
 - Examiner should consider internal audit dept:
 - Consider role, relationships, changes, competence of staff, supervision and review, quality of documentation, can it reduce examiner work
 - When assessing, consider composition of audit committee (independence and expertise), measuring of their performance

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- Exhibit M- Understanding the Corporate Governance Structure
 - A-Assessing the Board of Directors
 - ✓ Is board criteria sufficient?
 - ✓ Does board effectively monitor?
 - ✓ Is board independent from management?
 - ✓ Frequency and timeliness of meetings with CFO, auditors, etc
 - ✓ Is information provided to BOD sufficient and timely enough

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➤ Key questions to determine include:

- ✓ Does BOD challenge management on initiatives, transactions, budget variances?
- ✓ Are board committees sufficient in subject matter and membership?
- ✓ Is there a process for informing the BOD of significant issues?
- ✓ Does the BOD takes steps to set the tone at the top?
- ✓ Has the BOD issued directives to management dealing with actions to be taken?

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➤ B-Understanding the Organizational Structure

- ✓ Org structure is appropriate to facilitate flow of information and make decisions
- ✓ Expectations of key managers responsibilities are clear
- ✓ Executive have appropriate knowledge & experience
- ✓ Sufficiency in number of employees, particularly in management positions

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➤ C-Understanding the Assignment of Authority and Responsibility

- ✓ Is authority and responsibility for decisions appropriate and is proper information provided
- ✓ Do job descriptions, or other standards and procedures exist for control related duties
- ✓ Adequate number of employees to carry out mission, particularly IT
- ✓ Appropriate balance between authority and get the job done

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➤ D-Assessing Management Competence

- ✓ How long has management been with the company and current positions and industry experience?
- ✓ Significant turnover in management?
- ✓ Have management or BOD served in a management role in a company that has gone insolvent?

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➤ Documentation

- ✓ Summarize understanding and assessment of Company's governance as well as its assessment on the impact on the exam
- ✓ Summary should include a description of any unique examination procedures
- ✓ Matrix should be used for identification and assessment of risks, although documentation on assessment of management is at discretion of examiner (could be a memo for lower risk company)

Model Audit Rule

- Currently required for accreditation under the Part A standards
- Primary focus is on annual CPA audit
 - Designation of CPA
 - Qualification of CPA
 - Report of CPA due by June 1
 - Contents of report of CPA
 - Report on significant deficiencies

Revisions to Model Audit Rule

- Adopted by NAIC membership in June 2006
- Incorporates Sarbanes-Oxley best practices
- Highly contentious and lengthy process
 - 20 meetings, 16 conference calls, 6 exposure periods
- Revisions involve three main topics
 - Auditor Independence
 - Corporate Governance
 - Internal Control over Financial Reporting

Revisions to Model Audit Rule

- Section 7 of the MAR, qualifications of independent CPA.
 - Must be member of AICPA, no *indemnification* provisions.
 - Lead audit partner limited to 5 years.
 - Commissioner authority over person previously found guilty of fraud, violation of insurance laws, failure to detect or disclose.
 - Prohibited services:
 - Bookkeeping, information system design, appraisal or valuation services, actuarial oriented advisory services, internal audit services, management functions or HR services, broker/dealer or investment advisory, legal services.

Revisions to Model Audit Rule

- Section 14 of the MAR, certain standards for audit committees.
 - Audit committee to be responsible for the appointment and compensation of the external auditor
 - The members of the audit committee to be members of the board of directors, and “independence” requirements on the board under certain gross premium written thresholds.
 - 0 - \$300M: No independence requirement
 - \$300M - \$500M: Majority must be independent
 - Over \$500M: Supermajority must be independent
 - General interrogatories related to code of ethics

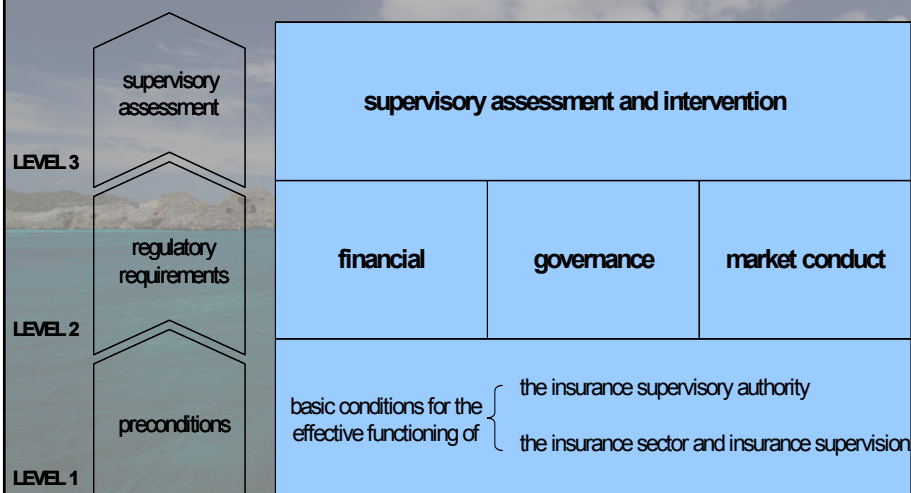
Revisions to Model Audit Rule

- Section 15 of the MAR, certain standards for directors and officers.
 - Prohibit directors and officers from making false statements or omitting information that may mislead an auditor or an accountant.
 - This section also prohibits directors and officers from coercing, manipulating or fraudulently influencing an auditor or accountant.

Revisions to Model Audit Rule

- Section 16 of the MAR, certain standards for management's reporting on internal control over financial reporting.
 - All insurers that have gross premiums of \$500 million or more are required to prepare this report, which includes among other things an assertion as to where the companies internal control is effective, a description of the process completed by management, and which is required to be signed by the CEO and CFO. Although not required, it would be assumed the board of directors would be aware of management's report.

IAIS Framework on Supervision



IAIS Paper on ERM

- 19 Key Requirements designed to assist the insurer, broken into 8 sections
- By encouraging insurers to follow the requirements in the Standard, supervisors will help to maintain the effectiveness of the solvency regime
- This paper focuses on the risk management element of governance in the context of solvency assessment and capital adequacy. The broader issues of governance are the subject of other IAIS work

IAIS Paper on ERM

- Section 1-Governance and an ERM Framework
 1. Appropriate framework for risks
 2. All reasonably foreseeable and risks
 3. Establish and operation should be led and overseen by BOD and senior management.
 4. Framework should include provision for the quantification of risk for wide range of outcomes
 5. Measurement of risk should be supported by accurate documentation providing detailed descriptions and explanation of risks

IAIS Paper on ERM

- Section 2-Risk Management Policy
 1. Policy should outline the way the insurer manages strategic and operational risk
 2. Policy should describe the linkage with tolerance limits, regulatory capital requirements, economic capital and processes for monitoring risk.

IAIS Paper on ERM

- Section 3-Risk Tolerance Statement
 1. Should set out tolerance levels and define limits for each category of risk, taking into consideration of relationships between risk categories.
 2. Risk tolerance levels should be based on strategy and be actively applied within ERM framework and risk policy.
 3. Risk limits should be embedded in ongoing operations via its risk management policies

IAIS Paper on ERM

- Section 4-Risk Responsiveness and Feedback Loop
 1. The ERM should be responsive to change
 2. The ERM should incorporate a feedback loop, based upon good information, management processes and assessment, which enable to take timely action in response to change in risk.

IAIS Paper on ERM

- Section 5-Own Risk and Solvency Assessment (ORSA)
 1. Insurer should regularly perform to provide board and senior management with current, likely future, solvency position.
 2. ORSA should encompass all reasonably foreseeable risks and should identify relationships between risk management and quality of financial resources needed and available.

IAIS Paper on ERM

- Section 6-Economic and Regulatory Capital
 1. ORSA should determine financial resources to manage its business given its own risk tolerance and business plans, and demonstrate that supervisory requirements are met.
 2. Insurer's risk management actions should be based on its economic capital, regulatory capital requirements, and financial resources.

IAIS Paper on ERM

- Section 7-Continuity Analysis
 1. ORSA should analyze ability to continue in business, and the risk management and resources required to do so over a long time horizon.
 2. Such analysis should address a combination of quantitative and qualitative elements in the medium and longer term business strategy (including projections).

IAIS Paper on ERM

- Section 8-Role of Supervision in Risk Management
 1. Should undertake reviews of an insurer's risk management processes and its financial condition. Should use its powers to require strengthening of the insurer's risk management, including solvency assessment and capital management where necessary.

Recent NAIC Activities

- Solvency Modernization Initiative
 - Adopted by Plenary at 2008 Summer National Meeting
 - Analyze other financial supervisory modernization initiatives (IAIS, EU Solvency II, Australia, Canada, Swiss, etc)
- US Response to IAIS Survey
 - 37 page response to on Corporate Governance questions
 - Corporate governance is just one aspect of regulation used to protect the financial solvency of insurers in the US.

Recent NAIC Activities

– Regulatory Response to Recent Economic Events

- October 6 conference call of the International Solvency & Accounting (E) Working Group to discuss the adoption of the ERM paper, as well as two others

- Significant reliance on ERM by many of these entities, US believes time should be taken to reflect, and consider the papers more closely given those events.
 - » Real questions appear to be directed at the framework, that us the actual use by the supervisor of ERM in determining the required capital and financial condition.
 - » Supervisory intervention needs to be developed

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