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The Clock Is Ticking on Corporate Governance Reporting

The clock is ticking for every insurance company in America.

In less than a year, insurers – regardless of size, premium volume or their lines of business – will have to provide regulators concise information about their corporate governance practices, including insights into their corporate governance structure, board of directors practices, management polices and areas of risk.

June 1, 2016 will be the first due date for what will become an annual report to an insurer's domestic regulator.

The report will be required by the NAIC's Corporate Governance Disclosure Model, adopted by the NAIC last November, along with an accompanying regulation and the Corporate Governance Annual Filing Guidance Manual.

The reporting requirement could catch some insurers off guard, warns Carol Stern, a senior consultant with First Consulting & Administration in Kansas City.

"Some health carriers have been so wrapped up complying with the Affordable Care Act that they're just waking up and realizing they have this coming down the road," she said. "Others, like family-owned mutuals and smaller insurers that were exempted from Own Risk Solvency Assessments, may be surprised to find they have no exemption from corporate governance reporting."

The disclosure model is part of the Solvency Modernization Initiative, which focuses on such initiatives as capital requirements, governance and risk management, group supervision, statutory accounting, financial reporting and reinsurance. The Own Risk Solvency Assessment, you may recall, is also part of SMI. Form F reports and other enhancements to the Holding Company Model are, too.

Three states – Iowa in Chapter 521H (incorporated in HF 455), Indiana in HB 1341 and Vermont in HB 73 and Bulletin 185 – have already adopted the Corporate Governance Model. Legislation in three others has been proposed – in California AB 553, Louisiana HB 199 (currently awaiting action by Gov. Bobby Jindal) and Rhode Island SB 784.

More are sure to follow because states will have to adopt the governance disclosure to maintain their NAIC accreditation. So expect unanimous adoption of the model at some point.

The intended result is to give regulators more information, more often, about how insurance companies operate, Stern said.

Currently, they get updates about corporate governance practices every three to five years during financial exams. In between exams ... not so much.

Starting next summer, that will no longer be the case.

Once again ... The requirement applies to everyone. No exceptions.

In fact, the NAIC made an affirmative decision not to exempt small companies from any corporate governance requirements.

"The NAIC Corporate Governance Working Group specifically wants small companies to improve their corporate governance structure and strengthen their risk management governance," Stern said.

"Some trade associations asked us to exempt the small companies, but the working group thought that small companies needed the oversight in these models because there are few checks and balances of small firms' governance," said Susan Donegan, Vermont insurance commissioner and chair of the Corporate Governance Working Group.

What to Include in a Corporate Governance Report

The first thing to decide is the organizational level of the enterprise that will file the disclosure.

Insurers will be allowed some discretion in determining the level within the organization at which to report their corporate governance practices, depending upon the structure and organization. So a report could come from the ultimate controlling parent level, an intermediate holding company level and/or the individual legal entity level.

How to choose? As the guidance manual states, "Consideration should be given to the primary level at which decisions are made and oversight provided to the insurance activities of various entities within the organization."

The Corporate Governance Model requires "a detailed narrative" describing governance practices, but leaves specifics to individual companies. Insurers should cover, however, four main areas:

• corporate governance framework & structure;
• board of director policies & practices;
• management policies & practices; and
• oversight of critical risk areas.

The guidance manual encourages companies to address how the qualifications, expertise and experience of the collective members of the board meet the needs of the organization.

"They'll want individuals to have an appropriate background, experience and integrity," said Stern. "And a board, as a whole, should have such core competencies as financial literacy, accounting, business judgment, knowledge of the industry, leadership and vision."

A domestic regulator will also want to see evidence of:

• clearly defined roles and responsibilities;
• board members who are independent and active;
• directors who act in good faith and who exercise a duty of care, loyalty and candor; and
• sufficient oversight of significant company activities.

Regulators will also want to know how the board and its committees remain independent, and about term limits, nomination and election procedures, and diversity.

A group that leaves the rubber stamp for management in the drawer, in other words.

As to management, the report should explain how the company makes sure that its officers and key persons in control functions have the appropriate background, experience and integrity to fulfill their prospective roles. Be prepared to discuss performance evaluations and compensation, as well.

One concern for regulators is that compensation programs don't encourage or reward excessive risk taking. The guidance manual has a half-dozen bullet points reports should address about that. Stern also suggests companies explain:

• the general design philosophy of the company compensation and incentive program;
• whether the compensation committee or board approve executive incentive compensation plans; and
• the process by which changes in compensation programs are approved.

As to critical risk areas, reports should show how boards and senior management provide oversight, including how oversight and management responsibilities are delegated between the board, its committees and senior management, and how reporting responsibilities are organized for each critical risk area. Specifically, reports should address:

• risk management processes (although anything mentioned in an ORSA can simply be referenced);
• actuarial function;
• investment decision-making processes;
• reinsurance decision-making processes;
• business strategies and finance decision-making processes;
• compliance function;
• financial reporting and internal audit processes; and
• market conduct decision-making process.

Companies will be permitted to take some shortcuts in their report, said Stern, the former chief compliance officer at ING US. To avoid duplicative filings, for example, companies can reference information that's already been provided in other reports. "That means you won't have to duplicate what the company has said in SEC proxy statements, ORSA summary reports and other regulatory filings," Stern said. "For information that haven't been filed with the state, just refer to them and include a copy with the corporate governance report. State-filed forms won't have to be filed again."

Even so, this should be quite an exercise the first time through. Own Risk Solvency Assessments can easily run 50-100 pages, but Stern said "I haven't a clue" about the length for this. "It could be two inches think for a large company with lots of attachments."

But things should get easier for years two and beyond, when reports can be updated rather than written completely from scratch. The guidance manual suggests that follow-on reports can be a redline version of the filing that tracks items that have changed from the previous year. If there are no significant changes, just say so in your filing.

By the way, states reserve the right to request additional information an insurance commissioner deems material and necessary to provide a clearer understand of a company's operations.

Confidentiality Is Promised

Documents, materials and other information, including the annual disclosure, will be recognized as being proprietary and containing trade secrets. As such, they will be protected from disclosure, and not subject to subpoena or discovery in a legal proceeding.

Protections are similar to those included in other NAIC models, including the Insurance Holding Company Regulatory Act, the Risk-Based Capital Model Act and the model governing ORSAs.

States will be allowed to share information with each other, the NAIC and third-party examiners, provided confidentiality is maintained. But once an analysis is complete, the NAIC and consultants won't be allowed to store information in a permanent database.

Stern calls them "the highest confidentiality levels of protection ever crafted," and noted that some states – California and Illinois, for example – are now going back to include confidentiality protection where it didn't exist before.

"The strict confidentiality measures should encourage insurers to be open and transparent in describing their governance practices to regulators," Stern said.

Nevertheless, she advised, "this is an area that will require continued monitoring. Know your state's confidentiality protections before you file."

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Want to do a deeper dive into corporate governance and the upcoming disclosure requirements?

First Consulting & Administration is hosting a free, one-hour webinar Tuesday, June 23 at 2 p.m. Eastern. Register here. Other webinars are planned, and information about them can be found here.

It also offers a fee-based Corporate Governance Tool Kit, with templates that will help companies jumpstart the process of revising documents and protocols to comply with the new requirements. The templates are both insurance-specific and CGAD-specific, said Stern.

The tool kit has templates or tools companies can use to document any new and updated governance structures and procedures in such areas as an audit, risk and compliance committee charter; a corporate governance committee charter; and board of directors corporate governance guidelines.

Also in the tool kit are suitability criteria – characteristics a company should look for – in potential CEOs and board of director candidates.

Further, the tool kit has several sections devoted to enterprise risk management. That includes an enterprise risk governance team charter and corporate policy, templates for quarterly board of directors reports and a readily adaptable generic risk report. "Everyone, even small companies, needs ERM," said Stern.

The tool kit also has a checklist for reviewing corporate governance compliance readiness.

Best Practice Tip: Corporate Governance Review Checklist

In less than a year, insurers – regardless of size, premium volume or their lines of business – will have to provide regulators concise information about their corporate governance practices, including insights into their corporate governance structure, board of directors practices, management polices and areas of risk.

The first reports will have to be filed by June 1, 2016 (*see related article elsewhere in this edition*).

First Consulting & Administration has developed a checklist insurers can use to make sure their reports cover all the bases. Here are some questions examiners may ask when reading your report.

Board of Directors Member Independence. Does independence from management exist for directors when difficult and probing questions are raised?

Board Committees. Do appropriate board committees exist and are their responsibilities documented adequately in their charters?

Director Responsibilities. Does the company charter or other board documents clearly articulate the responsibilities of the directors?

Director Responsibilities. Do the requirements include attendance at board meetings and review of the meeting materials in advance, with the expectation that the members will ask questions and evaluate the issues knowledgeably?

Director & Management Qualifications. Do the directors have the appropriate background, experience and integrity to fulfill their prospective roles such as adequate knowledge, moral reliability and applicable industry experience to serve effectively? Do they make a commitment of time to the board and committee activities?

Core Competencies. Does the board as a whole possess such core competencies as financial literacy, accounting or finance, business judgment, industry knowledge, management, leadership, vision and strategy?

Board Leadership, Including Tone at the Top. What is the board's role in establishing the appropriate tone at the top? What examples document that the board and audit committee are sufficiently involved in evaluating the effectiveness of the tone at the top? What steps does the board take to ensure an appropriate tone?

Board Access to Management, Auditors & Advisers. What is the frequency and timeliness with which meetings are held with chief financial and/or accounting officers, internal auditors and external auditors? Does the audit committee meet privately with the chief accounting officer and internal and external auditors to discuss the reasonableness of the financial reporting process, systems of internal control, significant comments and recommendations, and management performance?

Timely Delivery of Information to the Board. How often does the board meet and review company financials, objectives and terms of significant agreements? Is the information provided to the board or its committee sufficient and timely enough to allow monitoring of management's objectives and strategies, the entity's financial position, market conduct and compliance reports, and operating results, and relationships with third parties?

Management Succession. Does the company have succession plans established to replace and retain key employees?

Board & Management Performance Evaluation. Do key members of senior management appear to be suitable for their respective roles? Do they appear to possess the necessary competence, leadership and integrity for their positions? How long has key management been with the company in their current positions, and what specific industry experience do they have?

Director & Management Compensation. What is the general design philosophy of the company compensation and incentive program? Does the compensation committee or board approve executive incentive compensation plans? What is the process by which changes in compensation programs are approved?

Oversight of the Actuarial Function. Does Management provide effective oversight of the company's actuarial function in evaluating and providing advice to the company in respect to technical provisions, premium and pricing activities, and compliance with related statutory and regulatory requirements? Are individuals within the company's actuarial function suitable for their respective roles?

Oversight of the Compliance & Risk Management Function. How is a risk-management and culture of compliance demonstrated throughout the company? Is there evidence of an Enterprise Risk Management framework? How is the compliance/risk culture positioned within the company's departments to emphasize its importance and value? How are risk tolerances and appetites defined and communicated throughout the company?