THE CORPORATE GOVERNANCE ANNUAL DISCLOSURE (CGAD)

An overview for the General Counsel
Seismic shifts in regulatory approach by the NAIC and Insurance Departments

• Retrospective → Prospective
• Company → Enterprise
• Financial Statement → Governance
• Rules → Principals

The Solvency Modernization Initiative (SMI) is a post financial crisis self examination to update the United States insurance companies’ regulatory framework. Scope includes all aspects relative to the financial condition of an insurer and is not limited to the evaluation of solvency related areas.

Key issues-

• capital requirements
• governance and risk management
• group supervision
• statutory accounting
• financial reporting
• reinsurance
New Model Governance Law on Practices and Procedures

The NAIC defines corporate governance - “as structures, policies and processes through which an organization or entity is managed and controlled”

Model Laws require that governance practices will be reviewed through confidential filings on an annual basis

- ORSA
- ERM- Holding Company Form F
- Corporate Governance Annual Disclosure or CGAD
  — a confidential report filed by the insurer or the insurance group made in accordance with the requirements of the Act
The Corporate Governance Annual Disclosure (CGAD) Model Act ("Act") and supporting Model Regulation was approved by the NAIC in November 2014 and became effective January 1, 2016.

- The Act provides insurance regulators a method of assessing corporate governance structure, policies and practices on an annual basis.
- Confidential treatment of the disclosure and documents.
- The Act is not to prescribe or impose standards or procedures beyond that required under state corporate law.

10 States have adopted the Act so far, and the early adopters made their first filing on June 1, 2016.

- CA, CT, FL, IN, IA, LA, NE, NH, RI, VT (under consideration are OH and WY)

The Act is in the process of being included in NAIC financial standards accreditation program.
The NAIC made an affirmative decision not to exempt *small companies or fraternal insurers* from CGAD filing.

- Highlighted the need for small companies to focus on improving their corporate governance structure, strengthening their risk management governance, and ensuring that knowledgeable and qualified Board members make decisions that impact the company’s risk and finances.

- Risk Retention Groups are exempt from filing a CGAD. They are subject to their own corporate governance rules, which will apply in all states by 2017.
States will pass legislation and implement regulations- (specific to their state). Upon adoption the report will annually be due on or before June 1.

Report may be made at the ultimate controlling parent level, an intermediate holding company level and/or the individual legal entity level according to the governance framework.

There is no template, form or guidance manual- the regulation sets forth the procedures for filing and the required contents.

Substantially similar information previously provided to the regulator (e.g., ORSA Summary Report, Holding Company Form B or F, SEC Proxy Statements, foreign regulatory reporting requirements etc.) may be cross referenced to the document in which the information is provided.
All material presented in the filing is to be treated as confidential/proprietary, as if it contains trade secrets- refer to the specific statute language of the specific state.

Attestation and signature of the chief executive officer or secretary attesting that the insurer has implemented the corporate governance practices and that a copy of the disclosure has been provided to the board of directors or the appropriate committee thereof.

Failure to report in a timely manner could result in penalty.

Each year following the initial filing an amended version of the previously filed report indicating changes may be made.
CONTENTS OF THE DISCLOSURE

Material information necessary for Regulators to have a clear understanding of the corporate governance structure, policies and practices.

- Narratives should be *as descriptive as possible* including example documents demonstrating the strengths of the governance framework and practices.
- Supporting documents and submission should follow the Regulation.

Additional material may be requested by the regulator for clarity in understanding the policies, the reporting or information system or controls implementing those policies.
The new model Act will require all companies to tighten their governance structures and provide documentation supporting that the Board and Board committees have been assigned the ultimate responsibility for governing the insurer.

The report shall describe and discuss

• The rationale for the current Board size and structure
• The duties of the Board, its significant committees
• How governed (e.g., bylaws, charters, etc.)
• Board leadership structure
• Clearly defined roles and responsibilities of the Board, Chairman of the Board and CEO within the organization
Regulators will be reviewing the makeup of the Board for the appropriate background, experience and integrity to fulfill their prospective roles. The Board as a whole should possess the core competencies needed to oversee the Financial, Actuarial, Reinsurance, Compliance and Risk Management functions.

Examples of core competencies:

- Financial literacy;
- Accounting;
- Business judgment;
- Industry knowledge;
- Management;
- Leadership;
- Vision;
- Strategy; and
- The ability to communicate and navigate current technology.
Regulation states discussion of the following factors:

- Qualifications and experience of Board members, as well as the processes for electing members of the Board
- How an appropriate amount of independence is maintained
- Processes in place for the Board to evaluate its performance, those of its committees and measures taken for training of same
Description of the policies and practices in place that provide direction to Senior Management:

• Process to determine that officers and key persons in control functions have the appropriate background & experience (i.e. suitability standards)

• The Code of Business Conduct And Ethics
  — Proactive reporting of any illegal or unethical behavior

• The process for overseeing evaluations, compensation and CEO & Senior Management succession planning
Description of Management and oversight of critical risk areas

Processes by which the Board, its committees and Senior Management ensure oversight of critical risk areas impacting insurer’s business:

• How oversight and management responsibilities are delegated between Board, committees and Senior Management.

• How the Board is kept informed and frequency of reporting to the Board on strategic plans, risks and management of those risks.

• How reporting is made regarding critical risk areas, which may include: risk management, actuarial function, investment and reinsurance decision-making processes, market conduct and compliance, and risk management function oversight.
Possible documents to demonstrate the strength of the governance framework and practices:

- Holding Company Filings, SEC, ORSA or other jurisdictional required filings
- Audit, Risk & Compliance Committee Charter (one, two or three committees)
- Corporate Governance Committee Charter (Board level)
- Board of Directors Corporate Governance Guidelines
- Suitability Criteria for Board of Director Candidates
- Enterprise Risk Governance Team Charter (Company level Risk team)
- Corporate Risk Policy
Model Regulation
5(B). Description of Corporate Governance Framework and Structure
5(C). Description of BOFD and Committee Policies and Practices
5(D). Description of Management Policies and Practices
5(E). Description of Management and oversight of critical risk areas
4(B). Attestation
5(A). Supporting attachments or example documents.
EXECUTIVE SUMMARY

Regulatory focus has changed and documentation is required to show:

• A solid corporate governance structure
• Supported by an operational, effective risk management governance framework
• Governed by a board which as a whole includes the knowledge, industry expertise and skilled qualifications to make decisions based on the risk tolerance and risk profile of the company

For some insurers it will require dramatic structural and procedural changes that will take time and resources to implement.

The benefit for all companies will be a documented governance framework linking risk management, strategic planning and effective oversight.