

**IAIS REGIONAL TRAINING SEMINAR FOR
INSURANCE SUPERVISORS OF LATIN AMERICA**

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ICP 7 – CORPORATE GOVERNANCE

The supervisor requires insurers to establish and implement a corporate governance framework which provides for sound and prudent management and oversight of the insurer's business and adequately recognizes and protects the interests of policyholders.

I. KEY ELEMENTS

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

II. US REQUIREMENTS

- State Insurance Regulatory Requirements:
 - Model Audit Rule (NAIC #205)
 - Requires board/audit committee independence
 - Requires effective internal control over financial reporting
 - Hazardous Financial Condition Model (#385)
 - Provides authority to take corrective action to address governance deficiencies
 - Required reporting and disclosures
 - Annual statement and supplemental filings
 - Audit report and actuarial report
 - Holding company filings

II. US REQUIREMENTS

- Regulatory review practices:
 - Company licensing
 - Biographical affidavits & background checks
 - Offsite financial analysis
 - Review of new officers & directors or changes in governance practices
 - Onsite financial examination
 - Detailed review and assessment of governance practices, including interviews with key individuals

III. RECENT ENHANCEMENT - CGAD

- Corporate Governance Annual Disclosure Contents
 - Disclosure filed annually to support financial analysis process and highlight changes in governance
 - Requires insurers to provide a description of their governance processes in the following areas:
 - Corporate governance framework & structure
 - Board of director's policies & practices
 - Management policies & practices
 - Oversight of critical risk areas

CORPORATE GOVERNANCE RED FLAGS

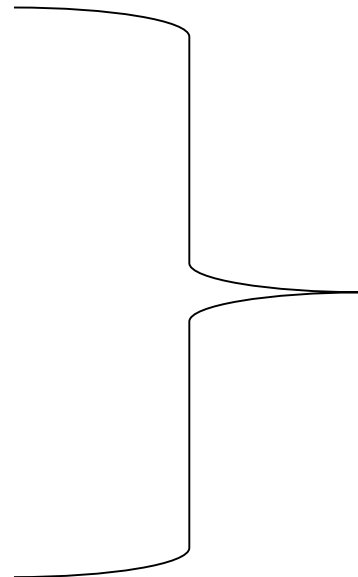
- Uncooperative or non-responsive management team
- Misleading or conflicting information
- Multiple requests for exemptions or special treatment
- Numerous filings and requests (i.e. bury them in paper)
- Lack of experience in insurance
- Lack of compliance with laws/rules/regulations/policies
- Rush to get approval (request for quick turnaround)
- Submitting new data at last minute

ICP 8 – RISK MANAGEMENT & CONTROLS

- The supervisor requires an insurer to have, as part of its overall corporate governance framework, effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters and internal audit.

I. INTERNAL CONTROLS OVERVIEW

- General control function
- ERM function
- Compliance function
- Actuarial function
- Internal audit function
- Outsourcing



All elements contribute to an effective system of internal controls

II. U.S. REQUIREMENTS

Internal Controls

- Sarbanes-Oxley Act (Federal Law)
 - Applicable to all publicly held insurers
 - Requires system of effective internal controls over financial reporting
 - Attestation by third-party accountant
- Model Audit Rule (NAIC #205)
 - Applicable to all insurers exceeding annual premium threshold of \$500 million
 - Requires system of effective internal controls over financial reporting
 - Management assertion, subject to review by supervisors

RED FLAGS

- Frequent changes in auditors and staff assigned to control responsibilities
- Material weakness or significant deficiencies reported on internal controls
 - Inability to implement corrective action in a timely manner
- Failure to appropriately document internal controls
- Failure to maintain an audit trail demonstrating operating effectiveness of controls

II. U.S. REQUIREMENTS

Risk Management

- Risk Management and Own Risk and Solvency Assessment Model Act (NAIC #505)
 - Imposes 3 core requirements on insurers
 - Maintain a risk management framework
 - Complete an Own Risk and Solvency Assessment
 - File an ORSA Summary Report with the insurance commissioner on an annual basis
 - Exempts insurers <\$500 million in annual premium, or groups<\$1 billion annual premium

RED FLAGS

- Key risks of the group aren't clearly addressed in ERM/ORSA
 - Lack of quantification on other key risks
- Risk appetites, thresholds and limits aren't clearly defined
- No planned ERM/ORSA enhancements
- Lack of support showing use of ERM/ORSA in business decision making

II. U.S. REQUIREMENTS

- Compliance Function
 - No explicit requirement for a formal compliance function
 - Compliance mandated under various acts and regulations, with penalties and fines associated with failure to comply
- The new Corporate Governance Annual Disclosure (CGAD) Model Act (#305) requires annual disclosure of Board/Sr. Mgmt. oversight of compliance activities

RED FLAGS

- Lack of formal compliance function
 - Responsibility for compliance unclear
- History of compliance problems
 - Missing or late filings
 - Misreporting of required information
- Lack of insurance industry experience
- Increased volume of consumer complaints
 - Particularly when not associated with increase in volume or cat event

II. U.S. REQUIREMENTS

- Actuarial Function - Insurance activities requiring the involvement of actuaries include the following:
 - Loss reserving
 - Rating/pricing of business
 - Enterprise risk management
 - Capital adequacy

RED FLAGS

- Loss Reserving
 - Lack of documentation when an Insurer's selected loss reserve figure is below midpoint on a range of reasonable estimates
 - Adverse reserve development; adverse reserve development trends
 - Overreliance on industry data and averages for estimating reserves
 - Insurer does not add additional reserves as a result of actuarial cash flow testing

II. U.S. REQUIREMENTS

- Internal Audit Function
 - Model Audit Rule (#205) requires insurers exceeding a premium threshold to maintain an effective internal audit function
 - Function must be independent from management and report to Audit Committee
 - Required to provide assurance regarding the insurer's governance, risk management and internal controls

RED FLAGS

- Lack of sufficient, qualified internal audit staff
- Inadequate direction and oversight of outsourced internal audit function
- Failure to implement a comprehensive and risk-based audit plan
- Company unresponsive to internal audit findings
- Internal audit function does not report directly to the board or a committee

II. U.S. REQUIREMENTS

- Outsourcing
 - Various requirements in place to address outsourcing of critical functions to third parties including:
 - Holding Company Models (#440/450)
 - Managing General Agents Act (#225)
 - Third Party Administrators Act (#1090)
 - Investment Advisors (Investment Advisers Act of 1940)
 - Investment Custodial Models (#295 & 298)

RED FLAGS

- Lack of a formal contract for outsourced services
- Contract does not contain adequate provisions
 - Ownership of data, audit provisions, termination clauses, etc.
- Frequent changes in outsourced services
- Placing services previously outsourced to a third-party with an affiliate
 - Potential for conflict of interest and/or increased fees

QUESTIONS/COMMENTS