



Memo

To: Mr. Al Bottalico (CA), Chair, and members of the Financial Examiners Handbook (E) Technical Group ("FEHTG")
From: Pat Tracy and LeeAnne Creevy, Risk & Regulatory Consulting, LLC
Date: April 14, 2014
Subject: FEHTG Exposure – Corporate Governance Exhibit M

Risk & Regulatory Consulting ("RRC") supports the effort of the FEHTG to better align exam objectives with the current regulatory modernization effort. We offer the following comments for the FEHTG's and NAIC Staff's consideration.

Revisions to Exam Objective Exposure Document

We agree that the primary purpose of a risk-focused examination is to review and evaluate business processes and controls, as well as to assess the quality and reliability of corporate governance. The output of the corporate governance assessment should assist the examiner in assessing and monitoring both financial reporting and prospective solvency risks facing an insurer. We have no specific suggested changes on the revised proposed language. However, we offer the following comments and suggestions for the Working Group's consideration.

The current draft suggests deleting the preamble key concepts on the basis that the approach is no longer new and the concepts are repeated throughout the NAIC Financial Condition Examiners Handbook ("the Handbook"). There are several concepts in the preamble, however, that might be worth repeating, and the current draft could provide additional perspective on new regulatory tools like ORSA filings. RRC is willing to provide suggested language around marrying Corporate Governance, ERM and ORSA that would emphasize the importance and use of these tools on a risk-focused exam. We also believe the Handbook preamble could be used to highlight the unique benefits of the risk-focused process in assessing, tracking, monitoring and communicating risk at both the holding company and legal entity levels. Regarding ORSA, we believe discussion around stress scenarios and the related prospective risk would be helpful guidance. If the FEHTG decides to keep some sort of a preamble in the Handbook, RRC is willing to provide specific wording in a timely fashion to the Working Group for its consideration.

Under the General Review guidelines (Page 7), we suggest adding the concepts of financial reporting and prospective risk to the proposed language. The third bullet point could read "Business processes relating to significant **financial reporting and prospective** solvency risks have been adequately reviewed and concluded upon." Once available to regulators, we also believe that the ORSA filing should be reviewed prior to conducting the corporate governance assessment given the potential insight about prospective risk.

Exhibit M Exposure Document

We reviewed the proposed revisions to Exhibit M and agree with the recommendations. We offer the following suggestions:

Page 1: The third paragraph discusses holding company structures and makes the comment, "However, in certain areas it may be necessary to review governance activities occurring at a level above or below the primary level of focus." We believe that most critical aspects of corporate governance likely will take place above the legal entity level. Instead of the language noted above, we suggest the following wording for consideration: ***"The examiners should determine where corporate governance occurs in the organization's structure. Many critical aspects of governance usually occur at the holding company level versus the legal entity level. The ERM and related ORSA processes are expected to provide significant insight for examination teams regarding where key activities, and their related risks, are controlled and managed. Where possible, in a coordinated examination, the Lead State's work on the corporate governance assessment should be utilized to prevent duplication of effort and to leverage examination efficiencies."***

Page 4: Under Section B "Understanding the Organizational Structure" - The questions in section B provide significant opportunity to incorporate ERM and ORSA concepts into the examiner's evaluation process. Specifically, under question 6 on page 4 regarding sufficiency of employees and capabilities, we suggest adding a fourth bullet (letter d) as follows:

d. The skills, competencies, knowledge and background of those individuals leading the ERM and ORSA efforts are adequate to provide for a robust and disciplined approach.

Page 4: Under Question 7 regarding accountability and control over outsourcing, we suggest a third and fourth bullet (letters c and d) for consideration as follows:

c. The insurer maintained ownership of key aspects like risk identification and risk appetite if significant outsourcing efforts occurred in compiling an insurer's ERM documentation.

d. The insurer maintained control over stress scenario assumptions and key inputs into models if significant outsourcing efforts occurred (related to Sections 2 & 3 of ORSA).

We also believe that the quality of an insurer's ORSA filing should weigh heavily in the examiner's assessment of corporate governance (specifically the assessment of management's philosophy and operating style). As such we suggest an ORSA related question be added under the evaluative guidance as follows:

"Does the insurer's senior management view its ORSA report as a management tool to identify and mitigate risks, or is it primarily viewed as a regulatory compliance document? For example, are critical aspects like stressed risk scenarios and liquidity management assumptions used by management in the strategic planning process? Additionally, from a cultural perspective, does the insurer view the concepts set forth in the ORSA requirements as a means to help avoid taking on undue risk that could jeopardize the solvency of the entity?"

We appreciate the opportunity to submit these comments and would be glad to answer any questions.