



AMERICAN ACADEMY of ACTUARIES

February 26, 2010

Group Solvency Issues (EX) Working Group
Solvency Modernization Initiatives (EX) Task Force
National Association of Insurance Commissioners (NAIC)
Via email: dvacca@naic.org

On behalf of the American Academy of Actuaries' ¹ ERM Subcommittee, I am pleased to provide its comments on the NAIC's Solvency Modernization Initiative (EX) Task Force's *Consultation Paper on Corporate Governance and Risk Management*.

Our understanding is that the purpose of this paper is to explore corporate governance and risk management "as part of the research needed to make recommendations for implementation" of the Solvency Modernization Initiative (SMI.) We also understand that the "SMI scope includes aspects relative to the financial condition of a company and is not limited to evaluation of insolvency alone."

In general, we agree that regulators could benefit by a greater understanding of corporate governance and risk management practices. We also agree that the introduction of an Own Risk and Solvency Assessment (ORSA) into the US solvency framework could provide regulators with significant insight into a company's risk management and risk governance practices. That stated, there will be challenges associated with introducing an ORSA into the US insurance solvency regulatory process, one of which relates to whether these assessments would need to be performed on an individual insurance entity basis or on a group basis.

In addition, we strongly encourage the NAIC to consider the existing environment for the US insurance sector before any new insurance regulations over corporate governance and risk management are added. Specifically, the NAIC's Risk Focused Surveillance framework includes substantial review of company risk management processes. In addition, rating agencies have significantly enhanced their assessment of companies' risk management programs, thus encouraging continued improvement in this area. We would hope that any new regulations would be enhancements to, rather than replacements of, existing frameworks.

We offer the following specific comments on the Consultation Paper:

Section 1: Corporate Governance

1. Paragraph 1.1 a): To the extent that the NAIC increases its regulatory focus on corporate governance, we agree that the SMI needs to explore the application of corporate governance principles at a group level since this is the level at which they are most often

¹ The American Academy of Actuaries ("Academy") is a 16,000-member professional association whose mission is to serve the public on behalf of the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

adopted by and communicated within large organizations. Of course, this is not to imply that individual company level principles are to be subordinated but only that group level principles merit consideration as well.

2. Paragraph 1.3 b): Board oversight of strategic planning and risk management is essential to strong corporate governance. While we agree that the "nature and extent of Board oversight" should receive additional attention from the SMI, we encourage the NAIC to consider the increased focus that other external stakeholders have placed on board oversight of risk management (e.g., Securities and Exchange Commission in a draft rule amendment requiring disclosures around board oversight of risk management.)
3. Paragraph 1.3 d): "Actuarial function" should be more clearly defined. Actuaries serve in many roles within and across insurance organizations, from the more traditional roles in reserving and pricing to less traditional roles in claims, underwriting, strategic planning, and enterprise risk management. To the extent that the "actuarial function" in this context is intended to mean pricing and/or reserving, these functions should be specifically stated.

Section 2: Risk Management

1. Paragraph 2.1 a): We agree that the "SMI should consider whether principles apply at the group level, to individual insurance entities, or some combination of both." In general, risk management programs are implemented at the group level and then applied across the organization. These programs are more likely to focus on business segments rather than on individual insurance entities, unless they are directly aligned. Therefore, the SMI will need to consider the implications of the legal entity structure of US insurance groups to the extent a process for regulatory reviews of risk management programs is adopted by the NAIC.
2. Paragraph 2.1 b): Stress testing and scenario analysis are vital to strong risk management practices, and many companies currently have processes in place to perform these analyses. Rating agencies expect to see evidence that stress testing and scenario analysis are performed by companies, and this expectation will continue to provide companies with strong motivation to perform these tests. To the extent that NAIC elects to increase the use of stress testing and/or scenario analyses for regulatory purposes, we acknowledge the challenge associated with producing standardized tests that can be both applied uniformly across all companies and provide meaningful information for regulators. However, we recommend more guidance be provided by suggesting that there should be stress testing on any significant risks to an organization/line of business by defining a threshold (e.g., could impact surplus by 20%). In addition, the specific stress/scenario tests performed should change over time as the environment changes and as new risks emerge. To the extent that the NAIC chooses to increase the use of stress testing and scenario analysis for regulatory purposes, the Academy could assist in this area.
3. Paragraph 2.3: While we agree that "an insurer should have a risk management policy that outlines the way in which the insurer manages each relevant and material category of risk, both strategically and operationally", risk management policies will likely vary significantly by company based upon their size and complexity. For example, it is

unlikely that small insurers would quantify economic capital, even if their risk management programs include sound risk management practices including the use of stress and scenario testing. Therefore, while we do agree that it would be useful for the SMI to "consider what should be included within a risk management policy", we recommend that the focus be on the core elements of a risk management policy, not on prescribing specific elements. As with our discussion in paragraph 2 of this section, a company should identify the meaningful categories and provide sufficient documentation for their inclusion as well as why some categories of risk have been excluded.

4. Paragraph 2.4: The risk appetite statement and risk tolerances defined by any individual company reflect their individual corporate culture and strategic objectives. We therefore believe that the SMI should consider what tolerances *might* be defined in a risk tolerance statement rather than what *should* be defined.
5. Paragraph 2.6: It is not currently clear whether the US will adopt the use of internal economic capital models to determine required capital for solvency purposes. Therefore the reference to "the level of internal economic capital held for solvency purposes" is not appropriate and an alternative wording should be considered such as "internal economic capital" or an alternative such as a "rating agency standard." Companies with strong risk management functions have developed and utilize internal economic capital models along with scenario analysis and stress testing. However, these risk management tools are most often used for the purpose of supporting strategic decisions rather than solvency monitoring.
6. Paragraph 2.7: We are concerned with the statement that strategic decisions should be required to be consistent with established risk management policies. We certainly agree that risk management policies should guide the board and senior management. However as worded here, the effect would be to remove decision-making from senior management. Even a well-crafted risk management policy can give vague or conflicting advice. And, given the financial collapse of 2008, it is not difficult to envision a set of circumstances that a well-crafted risk management policy fails to completely address. We believe this paragraph should be amended so that risk management policies are considered when strategic decisions are made and that any significant deviations from the risk management policy be documented, with the reasons for the deviation stated.
7. Paragraph 2.8: As previously stated, we agree that the introduction of ORSA into the US solvency framework could provide regulators with significant insight into a company's risk management and risk governance practices. To the extent it is adopted as a regulatory requirement, we encourage the NAIC to carefully consider and clearly define how often these assessments should be performed, at what level in an insurance group they are to be performed, what they should include, and how they will be used to enhance the existing solvency monitoring framework.

Thank you for this opportunity to comment. If you have any questions, please contact Tina Getachew, senior policy analyst, Risk Management and Financial Reporting Council, via email (getachew@actuary.org) or phone (202/223-8196).

Sincerely,

A handwritten signature in black ink, appearing to read "Maryellen Coggins", with a long horizontal flourish extending to the right.

Maryellen Coggins
Chairperson, ERM Subcommittee
Risk Management & Financial Reporting Council
American Academy of Actuaries



February 26, 2010

Christina Urias
Chair, International Solvency (EX) Working Group
National Association of Insurance Commissioners
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RE: *Consultation Paper on Corporate Governance and Risk Management*

Dear Director Urias:

The American Council of Life Insurers (“ACLI”) appreciates this opportunity to comment on the International Solvency (EX) Working Group’s *Consultation Paper on Corporate Governance and Risk Management*. The ACLI is the primary trade association of the life insurance industry, representing more than 300 legal reserve life insurer and fraternal benefit society member companies that account for over 90% of the assets and premiums of the U.S. life insurance and annuity industry.

Our members have long been committed to sound corporate governance and risk management practices and welcome this occasion to provide input on this very important matter. Below are general and specific comments with regard to the section on Corporate Governance, followed by overall comments on the section on Risk Management.

Corporate Governance - General Comments:

The purpose of this Paper and its recommendations is unclear. Current U.S. corporate governance requirements and protocols are quite robust, and this Paper does not identify any existing shortcomings or deficiencies. The NAIC, therefore, should not be developing solutions to problems that have not yet been identified or analyzed. Otherwise, real harm could be inflicted on existing, well-settled corporate governance requirements.

If the purpose of this Paper is to consider corporate governance requirements in the event of changes to solvency requirements, then the drafting of this Paper is premature, since any recommendations regarding governance should follow and respond to (rather than precede) any new solvency regime that is put in place in the United States.

It is also unclear if this project is being advanced as a result of the Solvency II initiative in Europe (as certain provisions seem to have been “cherry-picked”) or related activity by the IAIS or OECD. It is inappropriate for U.S. regulators to pattern or impose domestic corporate governance requirements based on rules that have been designed specifically for a system of solvency oversight that does not exist in this country, as specific corporate governance requirements are not easily exported across national boundaries.

Insurers are already subject to well-established corporate governance requirements that are derived from statutes and case law in every U.S. jurisdiction. Publicly-traded companies are also subject to SEC regulations and Sarbanes-Oxley rules. The legal underpinnings of current governance requirements have evolved over decades and form a well-considered and well-documented framework of duties and responsibilities that are carefully allocated between a board and the company’s management.

Therefore, there is no need to duplicate or replicate a system of well-settled and effective set of corporate governance laws.

The NAIC should be aware and sensitive to the fact that many of these recommendations could cause conflicts or disparities with existing laws, among different types of insurers and between insurers and other industries. Generally, the domestic insurance regulator's requirements and enforcement role are primary over those of other states' insurance regulators, much as a corporation's internal affairs are generally governed by the law of its state of incorporation under the "internal affairs doctrine". It is unclear whether the requirements and enforcement role of the domestic insurance regulator would remain primary under these proposed standards.

This Paper appears to take a "one size fits all" approach. Corporate governance laws and standards need to accommodate different types of organizations (e.g., stock companies, mutual companies, holding companies, fraternal organizations). Moreover, as noted above, publicly-traded companies are also subject to SEC, Sarbanes-Oxley and stock exchange requirements, and any guidance from the NAIC should be mindful of the need to avoid duplicative mandates.

Existing governance requirements generally apply to all corporations regardless of the type of industry and are sufficiently flexible to accommodate different types of organizations. In fact, the insurance codes and regulations of most states rely mainly on general corporate law to determine the governance practices of domestic insurers. We are unsure why a new set of governance requirements needs to be specifically developed for the insurance industry.

The NAIC should evaluate the practical impact of imposing new or significantly different governance requirements for the insurance industry as the outcome of that exercise would likely produce unanticipated and negative consequences for all stakeholders. For example, such requirements could: increase the amount of resources that a company has to designate to corporate governance for little or no benefit; make it more difficult for companies to recruit and retain qualified, competent individuals on their boards if any new requirements increase directors' liabilities; and lead to confusion and uncertainty within companies due to certain proposed terms and standards that are not well-defined and/or are vague.

To summarize, if and when a new solvency regime is developed, and the Solvency Modernization Initiative (EX) Task Force and its working groups are asked to evaluate the corporate governance implications of that regime, they should keep in mind that many of the recommendations contained in this Paper are improper and should not be advanced because they not only go beyond the bounds of existing, well-settled governance requirements, but they could also have the effect of imposing inconsistent, poorly-defined and more burdensome standards, duties and liabilities on insurers and their boards.

Corporate Governance – Specific Comments:

Paragraph 1.1.

- It is unclear where this definition of "corporate governance" is derived from.
- Use of the word "ensures" could make a board of directors responsible for the "accountability, fairness and transparency in an insurer's relationship with all its stakeholders". This would go well beyond what is required of a board under existing corporate law, and most likely beyond what it is possible for a board to undertake in its oversight role.
- The words "accountability, fairness and transparency" are all very subjective and not defined.
- This paragraph implies that existing corporate governance laws and practices are inadequate or ineffective "due to changes in the economic environment and a move toward principle-based regulation", yet no specific deficiencies or problems are identified. We strongly suggest that the NAIC focus on existing corporate governance requirements to address any regulatory concerns,

rather than proposing changes to such well-established standards which would result in various complications and unintended consequences without commensurate benefits.

Paragraph 1.1. a)

- Corporate governance laws already apply to both a holding company and its subsidiaries, and vary depending on the structure of the organization. Adding another layer of rules will inevitably lead to conflicts and create additional time and expense for companies for very little, if any benefit.

Paragraph 1.2.

- The primary responsibility for “implementing” proper corporate governance principles rests with the insurer’s management, not its board of directors.
- Boards of directors should not be required to “ensure” that corporate governance principles are effectively implemented, as they can not guarantee positive outcomes within the organization. Instead, they should oversee management’s performance of its responsibilities regarding corporate governance, much as boards oversee other aspects of an organization’s operations.
- This paragraph would also appear to require all boards of directors to be “independent”, including possibly those at the subsidiary level. If so, the requirement is too broad. In addition, it is unclear what the word “independent” means or how many board members would have to meet that standard.
- Parent companies typically already have independent members on their boards, so any new requirement that such companies have fully independent boards or that their subsidiaries have independent boards would be an unnecessary, impractical and potentially harmful change from existing law. We note that the drafters of the Model Audit Rule were sensitive to this concern. Under the rule, a subsidiary of a parent company that has an independent audit committee need not establish a separate, independent audit committee.
- The boards of subsidiary insurers tend to be made up primarily of company employees, managers and executives who fully understand their companies and how they operate. If this paragraph is intended to apply to subsidiary boards, requiring them to have independent members who are not as familiar with the businesses and their day-to-day operations would not necessarily be in the best interest of the companies or its stakeholders. Furthermore, recruiting qualified, independent board members for such boards would also be quite difficult and time-consuming, with no commensurate benefit for the organization.

Paragraph 1.2. a)

- The words “knowledgeable, independent and active” are all very subjective and not defined.
- It is unclear if this paragraph is suggesting that a board must conduct its own “decision-making process” regarding matters that are normally and appropriately performed by management. If so, this approach should be reconsidered.
- If this paragraph is intended to apply to subsidiary boards, then such boards would not be able to act independently of management since they generally contain employees, managers and executives.
- It is unclear what would constitute a “formal and transparent” board of director election process. Existing governance laws already provide well-established procedures for the election of a board of directors; therefore, these processes should remain outside of the purview of this Paper.

Paragraph 1.2. b)

- The activities of boards of directors, as well as committees thereof, are already governed by corporate bylaws, charters and/or resolutions.

Paragraph 1.2. c)

- A company’s board of directors does not manage the organization – that is the role of management.
- The terms “appropriate professional qualifications, knowledge and experience” and “good reputation and integrity” are very subjective and not defined, and it is unclear who would decide whether a potential or existing director meets these qualifications.

Paragraph 1.2. d)

- The duties of care and loyalty are not corporate governance principles – they are fundamental fiduciary duties of directors and officers of corporations. There is already a well-established body of law that defines and interprets these duties. Any attempt to expand or expound upon these duties would only cause confusion.
- The requirement that board members “have a sense of care and interest in the organization and willingness to place the organization goals above personal interest” appear to define specific criteria related to the duties of care and loyalty that could conflict with existing state laws and is inappropriate.

Paragraph 1.3.

- The parent company is already responsible for developing an adequate and transparent organizational structure that contains the clear allocation and segregation of responsibilities. If this paragraph is intended to apply to subsidiary boards, it is unnecessary to require them to duplicate this function.
- The term “significant level of strategic oversight” implies a greater level of proactivity than “oversight” in general. Again, the role of a board of directors is not to manage an organization – that is the role properly assigned to a company’s executives and managers.

Paragraph 1.3. a)

- The parent company is already responsible for executive oversight and remuneration. If this paragraph is intended to apply to subsidiary boards, it is unnecessary to require them to duplicate this function.

Paragraph 1.3. b)

- The parent company is already responsible for overseeing its strategic business plan and mission. If this paragraph is intended to apply to subsidiary boards, it is unnecessary to require them to duplicate this function.
- The board of the parent company should only be responsible for reviewing the strategic business plan of the insurer, not “formulating” or “approving” it.
- The term “corporate philosophy” is vague and not defined.
- The board should not be required to be “directly involved” in overseeing the insurer’s risk management process since management already has that primary role.

Paragraph 1.3. c)

- We agree that boards should provide oversight with regard to insurers’ audit functions, and such oversight already exists. However, a board should not have to establish a separate audit committee since, under existing requirements, including Sarbanes-Oxley, the full board can elect to serve as the audit committee. (The board of a publicly-traded company has to be fully independent, otherwise, it has to establish a fully-independent audit committee.)

Paragraph 1.3. d)

- We also agree that boards should provide oversight with regard to insurers’ actuarial functions, and such oversight already exists. However, the recommendation that boards should receive and review actuarial reports on a “regular basis” could place additional and unnecessary burdens on them and companies’ actuarial departments. Many actuarial reports are prepared and reviewed only once a year which is usually sufficient to ensure proper oversight. Boards already have ample authority to demand additional or more frequent reports if they have identified issues of concern.
- It is unclear what the term “regular basis” means.

Paragraph 1.3. e)

- The parent company is already responsible for developing a code of conduct/ethics. If this paragraph is intended to apply to subsidiary boards, it is unnecessary to require them to duplicate this function.
- While the board of the parent should be actively involved in “establishing” such code of conduct, it should not be involved in “enforcing” it. Such responsibilities are those of management.
- The term “Tone at the Top” is vague and not defined.

Paragraph 1.3. f)

- If this paragraph is intended to apply to subsidiary boards, such boards are already responsible for the oversight of regulatory compliance. They should not be required to “ensure” compliance, as the details of compliance are appropriately delegated and performed by the company’s officers and employees.

Paragraph 1.3. g)

- This paragraph addresses internal board processes (orientation programs, continuing education and performance evaluations) that are best left to the discretion of each board who is in the best position to evaluate these matters in light of the needs of its organization.
- The current arrangement of utilizing internal managers and employees as directors of subsidiary insurers who are well-familiar with the insurance industry and recent developments is far more efficient and conducive to sound decision-making than what is being proposed in this Paper.

Paragraph 1.3. h)

- The parent company is already responsible for developing a succession plan. If this paragraph is intended to apply to subsidiary boards, it is unnecessary to require them to duplicate this function.

Paragraph 1.4.

- The primary responsibility for implementing proper corporate governance principles rests with the insurer’s senior management, not with its board of directors. The board’s role is to oversee management’s performance of its responsibilities relating to governance.

Paragraph 1.4. a)

- As stated above, the terms “appropriate professional qualifications, knowledge and experience” and “good repute and integrity” are very subjective and not defined, and it is unclear who would decide whether a potential or existing senior manager meets these qualifications.

Paragraph 1.4. b)

- The board of the parent company, not senior management, may take responsibility for establishing a code of conduct/ethics. Senior management would then be responsible and accountable for adhering to and enforcing such ethical standards.
- As stated above, the term “Tone at the Top” is vague and not defined.

Paragraph 1.5.

- Information regarding corporate structure and corporate governance is already shared with domestic regulators. It is also unclear how such information would be “verified” during the financial condition examination process or what kind of standards the NAIC would consider developing “for regulatory review and use of this information in solvency monitoring”.

Risk Management – Overall Comments:

We appreciate the NAIC considering an important aspect of solvency assessment. In our view, corporate governance and risk management are two distinct, although related, subjects. We would suggest that the NAIC clarify the nexus between corporate governance and risk management and its connection to the broader concept of corporate governance covered in the first section of the Paper. In that regard, this Paper suggests that risk management is a process implemented by a board. Consistent with our comments on the Corporate Governance section above, while the board of an insurer has ultimate oversight of that process, implementation should remain the responsibility of management.

The ACLI believes that consideration of the scope and effectiveness of an insurer's risk management framework should be an integral part of the supervisor's assessment of an insurer's solvency. A solvency assessment system should require an insurer to have a sound process for assessing its capital adequacy in relation to its risk profile.

Such insurer assessment should include policies and procedures to identify and assess all material sources of risk and ensure that they are incorporated into its capital requirements. The internal risk and capital assessment should be integrated into the management process and decision-making culture of the business. Furthermore, an insurer's risk management framework should consider the interaction between solvency and liquidity.

Enterprise risk management is an emerging discipline and the ACLI can generally support the goals of this Paper in encouraging sound practices for risk management. However, this section is written as though legal requirements are being described and this seems inappropriate. Another concern is that the concepts are too process-oriented and not sufficiently principles-based. The NAIC should not seek to develop prescriptive standards for risk management by insurers; rather, insurers should be given the flexibility to shape their risk management frameworks in the way most suited to their business objectives, consistent with a range of guidance published by risk management organizations in recent years.

This section also seems to be based on the IAIS risk management papers. However, it leaves out concepts that are important and an integral part of any system, including proportionality. There needs to be language that reflects that internal risk management should be appropriate to the nature, scale and complexity of the insurer and that insurers are given the flexibility to design risk management frameworks accordingly.

The IAIS enterprise risk management work is based on a structure that encompasses a principles-based solvency framework, which is not currently in place in the U.S. Moreover, the IAIS standards on enterprise risk management were drafted in the context of prudential supervision of insurer solvency and capital adequacy, which is just one element of the IAIS global framework for insurer supervision that is currently under development. Before developing minimum standards regarding risk management, the NAIC may wish to consider preparing an overarching framework document indicating how an understanding of an insurer's risk management fits into an assessment of insurer solvency and indicating the consequences of an insurer meeting or not meeting the criteria for a risk management framework.

We think a solvency assessment framework must address the objectives and key requirements of an effective risk management framework, including an appropriate risk culture; defined strategy and appetite for managing risk; sound policies, procedures and controls to identify, assess, monitor, report on and mitigate key risks; and dedicated risk management resources and defined management responsibilities. Risk management is fundamentally about culture, people and transparency and these aspects are not addressed completely in the current draft. The terms "risk management function" and "risk management framework" seem to be used interchangeably. These should be defined uniquely.

Ultimately, the supervisory process should incorporate a suitably holistic approach in the evaluation of an insurer's overall solvency position. This implies that considerations beyond the quantitative assessment of total financial resource requirements (whether determined on standardized or advanced methods) need to be factored into the solvency assessment process and, ultimately, into any requisite supervisory actions.

These considerations could include the results of supplementary quantitative analysis, as well as more qualitative assessments of the quality and effectiveness of the insurer's risk management processes and capabilities. The perspective gained from a comprehensive evaluation of an appropriately selected set of quantitative and qualitative considerations can be significantly greater than the sum of the individual parts. That perspective is expected to result in a much more robust and effective solvency assessment regime.

An insurer that manages its risks and capital well should be recognized and the level of supervision adapted to be commensurate with a risk-based supervisory approach. This does not necessarily mean a low level of supervision, but rather a level of supervision appropriate to the level of risk to which the insurer is exposed and to its ability to manage the risks. It also implies a degree of internal risk management appropriate to the nature, scale and complexity of the insurer. Importantly, risk sensitive regulatory financial requirements should provide the incentive for optimal alignment of risk and capital management by the insurer and by the regulator.

Thank you again for this opportunity to comment. Feel free to call me at (202) 624-2135 or email me at waynemehlman@acll.com if you have any questions.

Sincerely,

A handwritten signature in black ink that reads "Wayne A. Mehlman". The signature is written in a cursive, flowing style.

Wayne A. Mehlman
Counsel, Insurance Regulation

cc: Bruce Jenson, NAIC
International Solvency (EX) Working Group
Corporate Governance (EX) Working Group
Solvency Modernization Initiative (EX) Task Force



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March 1, 2010

Director Christina Urias
Chair of the International Solvency (EX) Working Group
c/o Ms. Kris DeFrain and Mr. Bruce Jenson
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108-2662
Submitted via E-mail: kdefrain@naic.org and BJenson@naic.org

Re: *Comments of the American Insurance Association regarding:*

- *Consultation Paper on Regulatory Capital Requirements and Overarching Accounting/Valuation Issues for the Solvency Modernization Initiative*
- *Consultation Paper on Corporate Governance and Risk Management*

The American Insurance Association (“AIA”) appreciates the opportunity to provide comments on the above referenced consultation papers. AIA is a national trade association representing insurance companies writing all lines of property and casualty insurance. AIA plans to participate in the interim meeting of the Solvency Modernization Initiatives Task Force (“SMITF”), at which the issues raised in these papers are expected to be discussed. The brief comments we provide today represent our initial reactions to the consultation papers. We expect to provide more detailed comments during our testimony at the interim meeting as our member companies, who have been consumed over the past two months with year-end reporting obligations, continue to provide us with their reactions to these papers.

Consultation Paper on Regulatory Capital Requirements and Overarching Accounting/Valuation Issues for the Solvency Modernization Initiative

Concerns

Periodic review of the regulatory capital requirements in the United States is a worthwhile endeavor. As the Task Force proceeds with its review, it should be mindful of a number of concerns.

- *The purpose(s) behind the U.S. regulatory capital requirements regime.* We encourage the members of the Solvency Modernization Initiatives Task Force to review capital requirements within the U.S. regulatory system and to candidly evaluate the objectives of these capital requirements. In fact, the goals and objectives of a capital requirements

regime are fundamental threshold issues. No other question can be properly addressed if the Task Force does not first identify the purpose of a capital requirements regime.

- *The tools available for reviewing the effectiveness of the U.S. regulatory capital requirements system.* The most prominent tool for evaluating capital requirements is, of course, the risk-based capital system (“RBC”). The RBC system was developed in response to a number of insurer failures in the ‘80s and early ‘90s. It is our understanding that regulators at that time believed they needed a tool that would allow for timely intervention before an insurer failed. The Task Force should review whether the RBC system has served and continues to serve that purpose. In addition, the Task Force should consider the effectiveness of all other regulatory tools, such as the risk-focused surveillance framework, which may provide useful information for identifying conditions that may impact insurer capital levels.
- *The role of statutory minimum capital requirements.* In addition to the RBC system, states generally impose a minimum level of capital that an insurer must hold in order to qualify for a license with respect to a particular line of business. At a minimum, the Task Force should evaluate the relationship, if any, between these statutory minimum capital requirements and the RBC system. To the extent states continue to impose statutory minimum capital requirements, the Task Force ought to consider whether such requirements should be coordinated and consistent with the risk-based capital system.
- *Borrowing concepts from foreign regulatory regimes.* It is fair to acknowledge that Europe’s Solvency II directive has generated considerable discussion and introspection inside and outside of Europe. The concepts and ideas discussed in the NAIC’s consultation paper on capital requirements appear to come from documents of the International Association of Insurance Supervisors (“IAIS”), which in turn borrowed most of those concepts from Solvency II. We caution the Task Force against benign acceptance of these concepts – many of which arise from a regulatory system that does not share the U.S. perspective on contract and tort liability. The reliance on internal models for regulatory purposes may be inconsistent with regulatory objectives, since insurers use their models for internal management purposes, such as evaluating and allocating capital among its business lines and among companies within the enterprise. Also, there may be no business need for developing an internal capital model on a legal entity basis, even though the U.S. regulatory approach has been, to date, focused on the legal entity. The Task Force should refrain from adopting requirements that would lead to developing models for the legal entity model when such a model would provide no utility to the insurer.

The Task Force should also note that the history of business practices in the U.S. may be drastically different from foreign jurisdictions. Plus, many jurisdictions outside the U.S. do not incorporate the concept of guaranty funds into their regulatory structure. These examples are just a few of the key differences between the U.S. insurance regulatory system and that of the European Union, which generated the Solvency II directive. If nothing else, these differences call for caution when comparing elements of the U.S. regulatory system and those of foreign jurisdictions.

- *Jumping the gun on accounting and valuation issues.* The Financial Accounting Standards Board (“FASB”) is the U.S. accounting standard-setter. In the international arena, the International Accounting Standards Board (“IASB”) acts as the global

accounting standard-setter. The FASB and the IASB have been working in tandem on developing a global insurance contracts standard. The joint effort has not been easy and often there are divergent views on significant technical issues. Because U.S. insurance regulators historically have developed statutory accounting by modifying “generally accepted accounting principles”, as promulgated by the FASB, it may be premature for the NAIC to incorporate the accounting and valuation guidance that the IAIS has incorporated into its core principles. Instead, the Task Force should consider what U.S. regulators need in terms of accounting and valuation guidance, in order to fulfill the regulatory obligations. AIA has consistently stated that an effective insurance contracts accounting standard for U.S. insurers must:

- Reflect the legal and business environment of the insurance model, as well as the law of large numbers, the effects of diversification, and the management of claims on a portfolio basis;
- Provide a clear definition of insurance contracts and the scope of the guidance;
- Apply a measurement objective that reflects how property & casualty insurance contracts are actually settled;
- Measure pre-claim liabilities using the unearned premium reserve;
- Use entity specific cash flows to value post-claim liabilities when relevant industry data is unavailable;
- Recognize revenue as earned; and
- Allow for the preparation of understandable, comparable and consistent financial statements that provide decision useful information to users in a cost-effective manner.

If suitable for regulatory purposes, we encourage the Task Force and regulators to utilize these principles as you move forward with your evaluation of the U.S. solvency system.

Conclusion

Finally, we wish to emphasize to the Task Force that capital requirements are not – and should not be considered – a tool for preventing insurer failures. All business endeavors involve a certain amount of risk. In fact, the insurance industry developed out of the need for commercial enterprises to spread their risk, in order to mitigate the risk of failure. And that is a fundamental concept that the Task Force must always remember: insurers help to mitigate risk, but can never eliminate it; thus, taking on the risks of others creates risk of failure to the insurance enterprise. Setting capital requirements in a manner that avoids all risk to the insurer would make insurance unobtainable, and thus vitiate the important value that insurers provide to society. Instead, capital requirements should be a tool that helps management better understand the risks they take on and to encourage best management practices that will help reduce overall risk to the enterprise.

As we stated earlier, the above comments represent our initial reactions to this consultation paper. We look forward to discussing this paper more fully at the upcoming interim meeting of the SMITF.

Respectfully Submitted,

Phillip L. Carson
Assistant General Counsel

Consultation Paper on Corporate Governance and Risk Management

The American Insurance Association represents insurers that provide virtually every kind of property and casualty coverage in the U.S. and internationally. Accordingly, we have been deeply involved in U.S. and international discussions on appropriate regulatory responses to the financial crisis. We appreciate the opportunity to file these preliminary comments and to actively participate in the NAIC's future deliberations on these topics.

At the outset, it is important to take significant account of recent work on the subject of insurers and the financial crisis. Just last week, two reports were issued, one by the Geneva Association and one by Professor Weiss of the NAIC's Center for Insurance Policy Research. In general, both reports concluded that insurers, especially property and casualty insurers, had weathered the financial crisis well, are financially sound, and do not generally pose a "systemic risk". Obviously, insurers already take corporate governance and risk management seriously.

Particularly in the context of this very good performance by insurers, it is important to review any new regulatory requirements, including all of those under the Solvency Modernization Initiative (SMI), for compliance with the Organization for Economic Cooperation and Development's (OECD's) Policy Framework for Effective and Efficient Financial Regulation, including the related guidance and checklist, issued on December 3, 2009, to which the U.S. is a party. The OECD policy framework provides, *inter alia*, that new regulation should be based on a clear statement of objectives and analysis of alternatives and that the least costly, but still effective, policy option should be selected.

In light of the positive performance of insurers during the financial crisis and the OECD framework, any additional regulation, as proposed in this paper, should be justified by a clear demonstration that a serious problem exists and the selected approach is shown to be the most cost/effective remedy for the problem.

In addition, the SMI Task Force should be wary about new forays into the field of corporate governance. In addition to the usual caution that the NAIC should avoid creating possible conflicts with existing state corporate governance provisions, we encourage the Task Force to take a comprehensive look at tools and processes – such as the Model Audit Rule and the Risk-focused Surveillance Framework – that the NAIC and the states have already put in place to address corporate governance concerns.

Below are some specific comments by paragraph.

Section 1.1

The section refers to a move to principle-based regulation, yet the paper strongly suggests the possibility of extensive, specific and new regulatory mandates, that could amount to new "rules", including a "risk management policy", a "risk tolerance statement" and the "Own Risk and Solvency Assessment (ORSA)", along with potential mandates on their contents, timing, use and approval.

More importantly, the section contains no evidence that in the context of existing US corporate governance law, more regulation of insurers' governance is justified. And if some additional regulation is justified, are the specific proposals the most cost/effective alternatives? Without such showings, we are concerned that the new corporate governance mandates may not be warranted or effective.

Section 1.2

Subsections (a) and (c) seem to allow regulators to impose on Directors a “fit and proper” standard. We agree that “proper” is a legitimate concern for regulators. But allowing regulators to determine whether a Director is “fit”, especially in the highly politicized circumstances of some US insurance regulation, could be a serious mistake that could even undermine good management and effective corporate governance.

Section 1.3

This section contains a long list of proposed new specific mandates. Again, each one should be based on reliable proof that there is a problem and that the mandate will effectively and efficiently address it.

Subsection (e) suggests going beyond the current mandates, to provide new “specific oversight requirements”. Again, without a clear demonstration of need, such new requirements should not be imposed.

Experience has shown that any corporate governance structure should be supported by on-going training to assure that as personnel change, the objectives will be continuously achieved.

Section 1.4

Subsection a) again suggests a “fit and proper” standard for Senior Management. While we agree with a “proper” test, for prior compliance with law, a “fitness” test might be extremely dangerous in the politicized circumstances of some U.S. insurance regulation.

Section 1.5

Clear immunity and confidentiality protection will be needed for any new information that results from this work.

Section 2.2

This section seems quite proscriptive. Not only does it propose mandating the “framework/function” but it proposes that: “The SMI should consider what should be included within a risk management framework/function, how such a function may be independently maintained...” And in subsection a), it states that: “The SMI should consider how and when oversight should be provided by the Board of Directors in the risk management function.” Again this language suggests a detailed rules-based approach, without sufficient justification of need.

Section 2.3

This section mandates a “risk management policy” and then lays out detailed requirements, including its contents, how often it is updated, and who should approve it. Without a showing of failure under current requirements, can these new rules be proven that they are needed and that they will be cost/effective?

Section 2.4

This section would mandate still another document and related work, entitled a “formal risk tolerance statement”. Then the section goes on to suggest the adoption of highly proscriptive requirements, including “tolerances” and “how the statement should be incorporated into the

insurer's risk management practices." Again, there needs to be proof of wide-spread failure in this area and that this is the most cost effective way to address it.

Section 2.5

This would call for yet more specific mandates, including "categories of risks" and "what level of detail should be included within the documentation."

We are concerned about the provision for "reputational risk" because of its vague and subjective nature and the capability of using it as a self-fulfilling prophecy, whereby a regulator could engage in damaging publicity, however unwarranted, and then use the fallout from that publicity as a justification to carry out an adverse solvency related action.

Section 2.6

This is a highly specific, detailed new set of mandates. Not only is the ORSA required, but the section goes on to provide: a) "The SMI should consider how often an ORSA should be performed, updated and the results reported to the Board of Directors"; b) "The SMI should consider which risks should be addressed within the ORSA and at what level of detail"; and c) "The SMI should determine what the time horizon may be and what specifically should be included within such a continuity analysis." If an ORSA is to be mandated, it may be that some specificity will be helpful for compliance. But before mandating an ORSA, regulators should demonstrate that there are real problems that would be cost effectively remedied by the ORSA as proposed.

Section 2.8

This section creates the possibility for yet more specific mandates: "The SMI should consider what information should be shared with the regulator and how often, and standards should be developed for the regulatory review of risk management and ORSA information. In addition, the SMI should determine how risk management and ORSA information should be used within the solvency monitoring framework."

Conclusion

As the overall good performance of insurers demonstrates, insurers take corporate governance and risk management quite seriously and are already subject to extensive regulation. Before new regulatory mandates are created, we respectfully request the SMI to engage in a careful review of what is broken and what is the most cost effective way to fix it.

Respectfully submitted,

David F. Snyder,
Vice President and Associate General Counsel



VIA E-MAIL

26 February 2010

Honorable Christina Urias
Director of Insurance
Arizona Department of Insurance
2910 North 44th Street, Suite 210
Phoenix, Arizona 85018-7256

RE: *Consultation Paper on Corporate Governance and Risk Management*

Dear Director Urias:

I write today on behalf of America's Health Insurance Plans (AHIP) to provide input and comments on the recently exposed *Consultation Paper on Corporate Governance and Risk Management*. AHIP is the nation's trade association representing nearly 1,300 member companies providing health, long-term care, dental, disability and supplemental coverages to more than 200 million Americans. We appreciate the opportunity to provide comments on this draft document. AHIP is committed to the development and maintenance of a strong regulatory regime to oversee United States insurers, particularly those in the health sector.

We advocate for, and support, good and rational corporate governance requirements. However, we caution, as we did during similar discussions regarding principles-based reserves, that the issues of corporate governance go well beyond regulatory oversight, and touch on the very operations of the health plan or insurer. It is an easy matter to move from prudent regulation to micromanagement of the day to day operations of a company when attempting to create one-size-fits-all rules for how all insurers should govern themselves. Although inadvertent, we suggest that many of the requirements outlined in this *Consultation Paper* go well beyond prudent regulation into the actual micro-management of the industry. Regulatory requirements that make it more difficult for companies to secure talented and necessary board members, and requirements that layer reporting obligations not tied to effective and efficient regulatory oversight are not prudent; they create multiple layers of bureaucracy but no effective regulation.

The *Consultation Paper* must clearly articulate whether requirements are intended to be group-level, that is, at the enterprise level, or at the legal entity level. It must also articulate a recognition that other existing requirements, such as those contained in the NAIC's own models, already exist. Many new governance requirements have been adopted in the NAIC's *Annual Financial Reporting Model Regulation* – a model that has not yet even been adopted by all states, and has not become operative in most states. The NAIC should not develop layers of regulations on top of a set of significant regulatory requirements until the first set has been given an opportunity to be implemented

We urge the working group to bring subject matter experts into this discussion. Much as the NAIC partners with the AICPA when it discusses accounting practices, and the American Academy of Actuaries when it reviews actuarial rules and policy, similarly the NAIC should reach out to corporate governance experts across the country. The Securities and Exchange Commission, the New York Stock Exchange and the NASDAQ all have rules regarding governance, as do state corporation statutes; these rules apply across industries, with no specific industry-by-industry provisions. The NAIC has a long history of reaching out to others when developing good and prudent regulation. We strongly urge that it do so here in this critical area of governance, to ensure that insurance requirements are not developed that create dissonance and redundancies for carriers. It is critical in matters of corporate governance that the NAIC rules complement, rather than conflict with, these others.

We offer the following points as illustration.

I. Corporate Governance

1.1 Corporate Governance can be defined as a framework of rules and practices by which a board of directors ensures accountability, fairness and transparency in an insurer's relationship with all its stakeholders. Historically, regulators have set only basic requirements for insurance companies in this area, as corporate governance has been seen as a company responsibility defined by corporate law. However, due to changes in the economic environment and a move toward principle-based regulation, a greater regulatory focus on corporate governance may be required. The SMI should consider ways to improve the corporate governance of insurers as indicated throughout this section of the document.

We recognize that in the life insurance arena there has been “a move toward principle-based regulation.” However, we object to this broad-brush statement and note that it is inaccurate with respect to health insurance and health insurers. Health carriers have long operated under a more principles-based regime than have life carriers and we disagree that there has been any significant shift in the health carrier paradigm that would require additional or different oversight of health carrier corporate governance. To the extent that the move toward principles-based regulation in the life insurance arena required additional changes to governance requirements for life carriers – a principle with which we do not necessarily agree – we note that the Principles-Based Reserving Working Group has already made significant changes to corporate governance requirements for those carriers.

Given that these new requirements have been drafted, but not yet implemented, we question specifically what “improvements” the Solvency Modernization Initiatives Task Force deems necessary. Before changes to a system are undertaken, prudence requires that there be a specifically targeted set of issues or problems that are intended to be addressed. In the health insurance arena, we are unaware of any failings in corporate governance that require addressing.

1.1 a) Due to the various ways that insurance company groups are organized, it will be important to consider how corporate governance principles should be applied in a group situation. The SMI should consider whether principles apply at the group level, to individual insurance entities, or to some combination of both.

1.2 The primary responsibility for implementing proper corporate governance principles rests with the insurer's Board of Directors. It is important that a fully functional, well-qualified and independent Board of Directors be established to ensure that corporate governance principles are effectively implemented.

a) The Board of Directors should be composed of a sufficient number of knowledgeable, independent and active members to properly fulfill its governance and oversight responsibilities. The Board should be composed to ensure that it can act independently of management through a thoughtful and diligent decision-making process. The process to elect members of the Board should be formal and transparent. The SMI should consider how these standards can be effectively implemented.

The issue of legal entity versus group governance is of critical importance to health insurers and health plans. Because of the way the majority of states regulate the health insurance market, health carriers are forced to maintain large numbers of subsidiary companies. These subsidiaries will generally be wholly owned, and will have no outside shareholders. As a practical matter, it may not be appropriate for business purposes, and it may be quite difficult, to recruit outside participation in these types of subsidiaries, and indeed, given their wholly-owned status, maintaining the structure of the holding company, and having the corporate tone and risk tolerance generated for the system as a whole by the ultimate controlling entity is preferable.

As a second point, it is critical that the NAIC make a detailed survey of the existing state laws – both statutory and case law -- regarding corporate organization and corporate governance in general to ensure that any new requirements are not in contravention of existing state laws.

We question the meaning of the broad statement that “it is important that a fully functional, well-qualified and independent Board of Directors be established...” Within large holding companies, particularly those that are already SOX-compliant, or that are in compliance with the NAIC's *Model Audit Rule*, wholly-owned subsidiaries do not generally have independent directors. Those directors, however, are charged as a matter of law with the responsibility to act in the best interests of the company on whose board they serve. If the statement above is intended to mean that the Board of Directors of each legal entity must be comprised of individuals independent of the holding company system, then we object. This is impossible to accomplish, as a practical matter, as noted above, and is not in the best interest of the organization as a whole.

We similarly are unclear what the working group intends by the sentence “The process to elect members of the Board should be formal and transparent.” In most states, the required process for election of directors is already clearly set forth in state corporation laws, and in all cases, corporations will generally have a formal process by which they elect members of their Board of Directors and fill mid-term vacancies. That process will be set forth in the charter, or the corporate governance guidelines. Minutes of board meetings will reflect the process. If that is the level of “formal and transparent” that is intended by this sentence, then AHIP has no comment. If however, what is intended is that the details of search committee criteria, the search committee's discussions, and the process by which candidates are interviewed and recruited must be made public, then we object. No search committee in

any industry can operate if the public is made aware of the internal details of the conversations of those seeking to fill candidate positions, and no serious or sophisticated candidate would consent to take part in a process such as that. We request that language be removed from the consultation paper in order to avoid any future misconceptions.

1.2 c) Members of the Board of Directors should possess the appropriate professional qualifications, knowledge and experience to enable sound and prudent management. Members of the Board of Directors should be of good repute and integrity in order to properly fulfill their obligations. The SMI should consider how these standards can be effectively implemented.

AHIP agrees that knowledge and experience are important qualifications for potential board members. We question, however, whether and how the regulatory community should or could appropriately determine for any given company that the experiences of its directors as a whole are ineffective or inappropriate. Every company has a different structure and needs and most every company will benefit from having individuals with a wide diversity of experiences and talents. Insurance regulators should not develop standards for “effective implementation” of board member qualifications. We note that the NYSE has requirements for individuals who sit on specialized board committees, such as the audit committee, but even that organization has not undertaken to define the qualifications of every board member for a regulated entity. This statement is overly prescriptive and subject to severe abuse and misinterpretation. In addition, any requirements regarding qualifications of board members must be carefully coordinated not only with the NYSE, but also with the SEC, as noted in our general comments, above.

1.3 The corporate governance system implemented by the Board should include an adequate transparent organizational structure with a clear allocation and appropriate segregation of responsibilities, as well as an effective system for ensuring the transmission of information.

Again, within the confines of a large integrated holding company system, it is difficult to implement many of these requirements without doing damage to the holding company’s ability to exercise appropriate oversight and governance for the system as a whole.

The vast majority of the areas outlined in the subparagraphs following 1.3 are functions appropriately engaged in by the ultimate controlling entity. For example, subsection a) requires the Board to determine compensation. In large holding companies that function often resides at the parent company, not at the board of any given subsidiary. Subsection b) requires the board to approve “the strategic business plan governing the insurer.” In most integrated holding company systems, risk tolerances, general business plan and forward looking strategic planning will not be developed at the legal entity level. This document appears to intend that subsidiary companies take actions, or have the ability to take actions, that would undermine the long-term goals of the entire system. Particularly in the context of health carriers, where the unique nature of state licensing requires companies to maintain many state-specific subsidiaries, this would endanger the integrity of the entire structure.

Subsection c) appears to contemplate requiring carriers to establish independent audit committees at the subsidiary level. For small holding company systems this would set up an

unnecessary burden. For all systems, this again will damage the ability of a carrier to operate as an integrated whole; Sarbanes-Oxley does not require independent audit committees at subsidiary levels; the NAIC's *Annual Financial Reporting Model Regulation* – which has not yet been implemented in the states – does not require an independent audit committee at a subsidiary level. Before the NAIC makes draconian changes to its own models we should permit it to become operational and carefully study the changes it brings to the marketplace.

Subsection f) blurs the line between appropriate board and management responsibilities. Board members are not charged with direct regulatory compliance oversight. The appropriate board function is to direct management to create a compliance regime and then to provide oversight as that compliance function is carried out by management. Establishing specific compliance rules and procedures is a technical matter, requiring a great deal of specific expertise, and is not an appropriate board of directors function.

Subsection g) is an example of significant regulatory overreaching. Requiring that companies large and small create an “orientation program” leads the regulator directly into the daily business operations of the company, which is inappropriate. We question how the state regulators will determine whether an “orientation” is acceptable or effective, or whether the board is “properly fulfilling its responsibilities.”

We make the same comments with respect to Section 1.4 a). We agree with the broad statement that members of senior management should possess appropriate professional qualifications, knowledge and experience, but question whether and how state insurance regulators will make this subject determination, and whether it is intended to be implemented at the legal or enterprise level.

II. Risk Management

As a general comment, we question why the concepts of risk management and corporate governance are included in the same document. These are two separate and distinct areas of discussion, study and potential regulation and should not be intertwined in the manner in which this paper does. Risk management is certainly an area worthy of its own paper and own exploration. The areas of expertise, for those involved in governance and those involved in risk management, are not identical. We urge the NAIC to separate these two concepts into separate discussion documents.

And again, as we noted above in the Corporate Governance section of the paper, requiring the level of detailed decision-making at the legal entity level will interfere inappropriately with the operation of a large holding company. Insurer groups all typically have existing and robust risk management programs that span the entire enterprise. Defining risk management as “a process implemented by an entity’s board of directors” without recognition that “the entity” is the entire holding company system undermines the very nature of appropriate risk management that the paper wishes to encourage.

We are also concerned that the *Consultation Paper* is attempting to institutionalize “best practices” guidance and in the process, reduce flexibility in measuring risk. This will create burdensome and costly risk-reporting requirements that will be very difficult for companies of all sizes to comply with. “Guidelines” that summarize best risk management practices at a

high level are generally helpful. It is quite another thing to requirement these guidelines to be implemented by all insurers, both large and small.

We make the following specific comments on section 2, Risk Management.

2.2a) The day-to-day management and oversight of the risk management function should be provided by Senior management. However, the Board of Directors should be involved in regular oversight of the insurer's risk management function. The SMI should consider how and when oversight should be provided by the Board of Directors in the risk management function.

A requirement that the "Board of Directors should be involved in regular oversight of the insurer's risk management function" is inappropriate and unreasonable. "Regular" oversight is a management function.

2.3 In establishing a risk management function, an insurer should have a risk management policy that outlines the way in which the insurer manages each relevant and material category of risk, both strategically and operationally. The risk management policy should be transparent to various levels of management with a clear articulation and internal communication of the risk strategy. The policy should describe the linkage with the insurer's tolerance limits, regulatory capital requirements, economic capital, and the processes and methods for monitoring risk. The SMI should consider what should be included within a risk management policy as well as how often the policy should be updated and who should approve it.

Creating a risk management policy that "describe[s] the linkage with the insurer's tolerance limits, regulatory capital requirements, economic capital and the processes and methods for monitoring risk" is a laudable goal. However, it ignores the realities of the insurance marketplace, where regulatory capital requirements may change rapidly because of a significant shift in the composition of core businesses, but may have very little direct correspondence to the shift in the risk the company has undertaken in making that change to core business composition, or the company's resulting needed economic capital.

2.4 In addition to establishing a risk management policy, an insurer should establish its own risk tolerances through the adoption of a formal risk tolerance statement. The statement should set out the insurer's overall quantitative and qualitative tolerance levels and define tolerance limits for each relevant and material category of risk, taking into account the relationships between risk categories. The insurer should then embed the risk tolerances into its ongoing risk management efforts to assist in making appropriate risk management decisions. The SMI should consider what tolerances should be defined within a risk tolerance statement and how the statement should be incorporated into the insurer's risk management practices.

Attempting to quantify risk in a "formal risk tolerance statement" is extremely difficult to do, given the volatility of risk, the changes in exposure to risk, the time horizons over which these risks are material in an organization and the necessity of an organization to examine and alter its appetite and tolerance for risk to adequately respond to changes in the marketplace.

2.6 The risk management function should be utilized by the insurer to determine the level of internal economic capital that should be held for solvency purposes. The quantification of risks as well as the scenario analysis and stress testing performed should be utilized by the insurer in making these decisions. To assist in this process, the insurer should perform an Own Risk and Solvency Assessment (ORSA). An ORSA is a tool that companies use to properly assess their own short and long term risks and the amount of own funds necessary to cover them.

Insurers must have flexibility in assessing and modeling their own risks. The ORSA model would be very burdensome to perform. Insurers measure risk in a variety of ways, including financial models, reserve scenarios, etc. Prescribing only a specific model (ORSA), which is indicated in 2.6 will inhibit flexibility, hinder creating thinking regarding risk management, and limit the number of way an organization might more appropriately measure risk and utilize resources to that end.

2.8 Information regarding the risk management function of insurers should be shared with the regulator on a regular basis and verified during the financial condition examination process. In addition, the results of the ORSA should be shared with regulators and considered as a valuable input in the solvency assessment process. The SMI should consider what information should be shared with the regulator and how often, and standards should be developed for the regulatory review of risk management and ORSA information. In addition, the SMI should determine how risk management and ORSA information should be used within the solvency monitoring framework.

We question what information should be shared with regulators “on a regular basis.” We agree that this information should be shared regularly with management, and periodically to the Board as part of management’s reports. Verification that reasonable risk management is taking place upon examination is clearly an appropriate regulatory exercise. However, we do not agree that internal risk management information should be “regularly” shared with state insurance regulators.

We thank you for the opportunity to provide comments on this exposure draft. If you have any questions or comments I may be reached at (301) 774.2268 or by e-mail at reichel01@comcast.net.

Sincerely,

Randi Reichel



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March 1, 2010

The Hon. Christina Urias, Chair, and Members
International Solvency (EX) Working Group
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, Missouri 64108
Attn.: Ms. Kris DeFrain
cc: Ms. Barbara Lane
By E-Mail

Dear Commissioner Urias:

NAMIC is a trade association, and its membership in the United States includes approximately 1,300 mutual property-casualty insurers, from the very smallest to the very largest, writing about 37 per cent of the nation's property-casualty insurance. NAMIC regularly participates in NAIC committee activities and deliberations on behalf of that membership. Understandably, corporate governance, common to all insurers, is of great concern to NAMIC.

As a general preface to our comments made here, we appreciate the reasons for conduct of the Working Group's consultation as part of the SMI effort and believe a review of basic tools and disciplines originating outside the United States is appropriate. We observe at the same time that insurers in this country appear to have acquitted themselves well as tumultuous events occurred in the capital-markets. That resilience should be attributed in significant part to insurers' observance of the requirements of state insurance regulation and also to their rational stewardship intended to preserve their businesses.

The Working Group's "Consultation Paper on Corporate Governance and Risk Management" provokes a number of questions about the boundary of insurance regulation with the very substantial body of states' laws governing corporate organization and behavior. The concept of corporate governance espoused by the paper entails, in our perception, a principles-based concentration on risk that combines an element of flexibility in its orientation toward achieving and maintaining solvency and service to policyholders. Yet this concept, if correctly understood, must operate in the rules-based matrix of state law governing corporations and their governance, and those rules are obligatory. As to priority, in the instance of conflict or to attain compliance, priority may lie with rules.

As further preface to responses to the Consultation, we are forced to note that insurers and their processes are not always the source of the financial distress or irrational pricing that is enforced, if not necessarily initiated, by regulators. The typical scenario involves coastal areas subject to weather catastrophe and the pressure brought to bear by policyholders and conveyed to politicians to restrain rates. Rational risk management of an insurer's board, when irrational pricing is demanded by the regulatory apparatus, is to end coverage or leave a jurisdiction whose actions are not consistent with managing risk. More directly stated, rational risk management includes regulation that does not demand irrational risk.

We respond below to selected parts and subparts of the consultation:

1.1. a) Does corporate governance as developed here apply to non-insurance subsidiaries of a group? Can it, given the nature of state corporate law already extant? Of course the SMI includes exploration of a group capital requirement, yet the practical operation of this is very difficult, especially with international operation. Would, for example, a non-insurance member of a group, domiciled in one jurisdiction, be able to allocate capital to an insurer in another jurisdiction, if the former is itself in perilous solvency? How is corporate governance to apply to this situation?

1.1. b) and c) These, we believe, are well installed in state corporate governance laws; certainly c) is powerfully present in existing state insurance codes.

1.3. b) This is well stated, save for the board's obligation to approve the corporate philosophy and mission. For smaller mutual insurers the mission may take the form of "accepting and distributing risks and remaining solvent." For other insurers, is it providing a return to shareholders? Is this requirement needed?

1.3. c) This may be appropriate for medium and larger insurers, but it may not be so for very small insurers, which can not afford the extra expense and which are simple enough not to require an internal audit function.

1.4. a) This is wholly reasonable as an ideal, yet does it need codification, and can it be enforced? What would sanctions be? Even if the proper credentials and experience are present, an incumbent may not be compatible with the board and its intents.

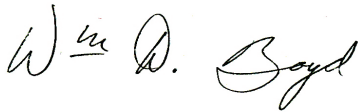
2.1. For this effort a review of the new Financial Examiner's Handbook, which concentrates on risk, should be included.

2.2. We are happy to see the word *proportionality* appear in this consultation. The risk-management framework for a very large insurer may, appropriately, feature a number of professions, including economists. This is not practical for the majority of companies. Independence, or at least the appropriate pipeline to the board, is needed. We suggest that SMI may not need to detail elements of a risk-management framework; "best practices" might suffice.

2.6. The ORSA, as a set of practices from Solvency II, is something we believe insurers, in one form or another, already do, if not the linkage of projected financial position and regulatory capital. We know that ratings firms regularly inquire into most of the subject matter described here. We know that annual audits and financial examinations evaluate significant parts of this subject matter. Why must another regulatory pancake be added here? What additional benefit will inure as a result of its cost?

We are grateful for the opportunity to comment in this consultation. We know that the NAIC mill will continue its effort to upgrade and refine regulation, but perhaps there is good reason to believe that the regulatory apparatus now required of insurers performs well.

Respectfully,

A handwritten signature in cursive script that reads "William D. Boyd". The signature is written in black ink and is positioned above the printed name.

William D. Boyd
Financial Regulation Manager

New York Recommended Changes to the December 2, 2009 NAIC Solvency
Modernization Initial International Solvency (EX) Working Group draft of
“Consultation Paper on Corporate governance and Risk Management”

Item	Recommended Change
General	<p>To the extent possible, the terminology should follow that used in the March 13, 2009 draft “Issue Paper on Corporate Governance” produced by the IAIS and OECD. As of February 9, 2010 the paper was available at http://www.oecd.org/dataoecd/43/21/42366179.pdf</p> <p>The G20 London declaration of April 2009 mandated the Financial Stability Board to implement international financial standards, including 12 key current International Standards and Codes that can be found at http://www.financialstabilityboard.org/cos/key_standards.htm</p> <p>One of the 12 standards is the “Principles of Governance” developed by the OECD.</p>
General	<p>“Corporate Governance” – is this limited to corporations or is it to cover mutuals, too?</p>
Appendixes	<p>We recommend the two appendixes be replaced with the IAIS / OECD “Guidance” noted above. This paper is more recent and had as background the two appendixes as well as other IAIS and OECD sources.</p>
Section 1.1	<p>Harmonize and incorporate in the definition the discussion in paragraphs 20 and 21 of the “Guidance”. In particular, corporate governance is the allocation and regulation of power and accountabilities within an entity.</p>
Section 1.1	<p>1st sentence, lines 2 & 3: Delete: “Corporate Governance can be defined as a framework of rules and practices by which a board of directors ensures accountability, fairness and transparency in an insurer’s relationship with its stakeholders.”</p> <p>Insert: Corporate Governance can be defined as a framework of rules and practices by which a board of directors provides oversight to ensure accountability, fairness and transparency in an insurer’s activities.</p> <p>Corporate governance is internal. While its product affects outside parties, those effects are not the primary driver for corporate governance. “Stakeholders” is not a clear concept. It does not define to whom duties are owed or, the reasons for those duties. This change would clarify regulators’ interests.</p>
Section 1.2	<p>Reword the first two sentences as follows: The primary responsibility for oversight of corporate governance rests with the insurer’s Board of Directors. It is important that a fully functional, well-qualified and independent Board of Directors be established to ensure that corporate governance is effectively implemented by management.</p>

Paragraph 1.2a	<p>sentence 2, line 2: Delete: “The Board should be composed to ensure that it can act independently of management through a thoughtful and diligent decision-making process.”</p> <p>Insert: “The Board should be composed of members capable of exercising independent judgment when fulfilling their fiduciary obligations of due care (informing themselves of all material information reasonably available to them) and loyalty (acting in the best interests of the corporation, its shareowners, and for regulators its policyholders). The Board’s composition and resources should be such that it has the ability to exercise judgment independent of undue management influence.”</p> <p>Why? Original wording conflates separate governance issues.</p>
Paragraph 1.2b	<p>Delete entire paragraph.</p> <p>Why? (1) Boards of Directors are governed by state law; (2) Boards of Directors ARE governed by bylaws; every state requires it; saying that they <i>should be</i> makes it look like we don’t even know what our own laws are; (3) Roles and responsibilities are established <i>by law and caselaw</i> (see previous memo) – if we want to say that they should be set out, OK; (4) bylaws <i>are</i> formal; (5) documentation and communication are required under state and federal law.</p>
Paragraph 1.2c	<p>Change the first sentence as follows: Members of the Board of Directors should possess the appropriate professional qualifications, knowledge and experience to enable sound and prudent oversight. consistent with the duties of care and loyalty</p>
Paragraph 1.2d	<p>Please provide a little more background on the legal meaning of “duty of care” and “duty of loyalty” as it relates to possible regulatory actions.</p>
Section 1.3	<p>Add a new paragraph a) and re-letter the other paragraphs. The new paragraph would bring in the responsibilities noted in paragraph 62 of the IAIS / OECD “Guidance”. For example: a) To articulate and commit to specific corporate governance principles. The board must regularly oversee internal reviews and authorise external reviews of corporate governance principles, processes and outcomes.</p>
Section 1.3	<p><u>Opening paragraph, sentence 1, line 3</u> Delete following “responsibilities” – “, as well as an” Insert: “and”</p> <p>Why? Punctuation (comma) incorrect; phrase “as well as” detracts reader back to start of sentence.</p> <p>Sentence 2 Delete: “Within this structure the Board of Directors should provide some level of oversight in each of the following areas some level of oversight in each of the following areas: ” Insert: “The Board of Directors should address the following.”</p>

	<p>Why? (1) Every following paragraph says “oversight;” thus, the logic of the paragraph says that the Board should exercise oversight over the board’s oversight overseeing the board’s oversight; (2) “some level” [of oversight] weakens the whole concept of oversight. If courts or regulators later establish stricter standards, then this standard is weaker; (3) the punctuation is incorrect for separate sections consisting themselves of various sentences.</p>
Paragraph 1.3a ₁	<p>sentence 1, line 1 Edit: “The Board of Directors is responsible for the appointment and compensation of the Chief Executive Officer of the insurer.”</p>
Paragraph 1.3b	<p>Consider expanding this section. See paragraph 69 to 74 of the IAIS / OECD “Guidance”. Change the third sentence as follows: In addition, the Board should <u>provide oversight of</u> the insurer’s process to identify, monitor and manage the risks the insurer faces.</p>
Paragraph 1.3c,	<p>sentence. 2, line 4 Is an audit committee required? Model Audit permits no committee (entire board is then committee).</p> <p>Delete: “Requirements for the Audit Committee have already been established for regulatory purposes in the <i>Annual Financial Reporting Model Regulation</i> (Model #205). However, requirements in this area stop short of requiring insurers to establish an internal audit function, which may require additional consideration from the SMI.”</p> <p>Why? This is a general policy paper. This section is directional. Also: consistency - there are no similar entries throughout the paper.</p> <p>Possible addition: The board must review reports which assess the corporate governance systems’ internal control structure and develop a basis for reliance on the internal control structure. The board must hold management accountable for the functioning of the corporate governance system and its internal control structure.</p>
Paragraph 1.3d	<p>Change the first sentence as follows: The Board of Directors should provide oversight to the actuarial function of the insurer by receiving and reviewing reports in this area on a regular basis, including the effectiveness of internal controls with respect to reserve <u>and risk based capital</u> calculations.</p>
Paragraph 1.3d	<p>sentences 3 & 4 Delete. Why <u>highlight our weaknesses?</u></p>
Paragraph 1.3e	<p>Consider whether this paragraph should be augmented for the ideas in paragraphs 63 and 64 of the IAIS / OECD “Guidance”.</p>
Paragraph 1.3e	<p>sent. 2, line 4 Board should approve a code of conduct for the organization; it should be responsible for enforcement of the code.</p>

	<p>Board should not be “actively involved.” It has neither the resources nor expertise as to the intricacies of the company’s structure. Any code it is “actively involved in” then, would lack the specificity necessary for the code to be effective. SMI should establish minimum criteria for Codes.</p>
Paragraph 1.3f	<p>Change the first sentence as follows: The Board of Directors, or a committee thereof, should be responsible for overseeing the process <u>that</u> ensures compliance with the applicable regulatory standards of the insurer.</p>
Paragraph 1.3f	<p>State statutes and caselaw have clearly established Board responsibility to assure regulatory compliance. We can leverage that.</p>
Paragraph 1.3g	<p>Delete: “To ensure that an insurer’s Board of Directors is properly fulfilling its responsibilities,”</p> <p>Why? That’s the whole point of this paper; it is noise. It detracts from the point to be made.</p>
Section 1.4	<p>This should be strengthened - significantly. Much of the discussion in Directors should be moved here. e.g.,</p> <ul style="list-style-type: none"> • 1.4 Senior Management plays a critical role in corporate governance. As individuals, members of senior management must act in good faith, with the care that a person in a like position would reasonably exercise under similar circumstances, and in a manner the officer reasonably believes to be in the best interests of the corporation. a) Members of Senior Management should possess the professional qualifications, knowledge, and experience commensurate with their position. Senior Managers should be of good repute and integrity in order to properly fulfill their obligations. b) Senior management operates the corporation's day-to-day business operations. It carries out the corporation's strategic objectives within the annual operating plans and budgets. It must consider the long-term interests of the corporation and its shareholders and necessarily relies on the input and advice of others, including senior management and outside advisers. The CEO keeps the board apprised of significant developments regarding the corporation's business operations. c) Senior management should implement the corporations’ Code of Ethics approved by the Board. Senior Management should be held accountable to meet ethical standards by signing and agreeing to a formal code of conduct that has been adopted by the Board. This should include informing all parts of the organization of the importance of ethical conduct. <p>Senior Management must:</p> <ul style="list-style-type: none"> • Provide Strategic Planning by identifying and developing

	<p>strategic opportunities and plans to take advantage of those opportunities, present those plans to the board; implement the plans once board review is completed; and recommend and carry out changes to the plans as necessary.</p> <ul style="list-style-type: none"> • Establish annual operating plans and budgets in light of the strategic planning. • Establish an organization structure that is efficient and select management that is qualified. • Assure integrity of accurate and transparent financial reporting and disclosures. • Establish, maintain and periodically evaluate the corporation's internal controls over financial reporting and the corporation's disclosure controls and procedures. Assure the integrity of accurate and transparent financial reporting and disclosures.
Paragraph 1.4b	The IAIS / OECD “Guidance” has the board, not management, responsible for the tone at the top, see paragraphs 52 and 64.
Section 2	There should be a recommendation that the SMI determine <i>who or at what level within an insurer</i> (directors, management) specific responsibilities lie. The governance considerations can provide guidance.
Section 2.1,	<p><u>opening paragraph</u> Delete entire paragraph.</p> <p>Insert: “Risk management is how firms actively select the type and level of risk that it is appropriate for them to assume.”¹ Risk management involves: identifying, assessing, and prioritizing risks; coordinating the application of resources to minimize and monitor those risks; and controlling those factors that an entity can reduce the probability or impact of unfortunate events or to maximize the realization of opportunities.²</p> <p>Why? That’s what it is. We should use sources the NAIC has already used.</p>
Paragraph 2.1b	Move to 2.5 – stress testing is a tool; 2.1 is a systematic consideration. It fits in 2.5’s list better
Section 2.2	<p>Paragraph 113 of the IAIS / OECD “Guidance” notes the risk management function implements the relevant board strategies and policies. Apparently, the risk management system includes the risk management function plus risk management strategies and policies. To stay with this terminology we recommend rewording:</p> <p>Each insurer should adopt a formal risk management <u>system</u> to ensure that the insurer is properly identifying, monitoring and managing the risks it faces. This risk management <u>system</u> should</p>

¹ Michel Crouhy, Dan Galai, Robert Mark, *Essentials of Risk Management* 1 (2006). This is the primary source for the Professional Risk Manager International Association’s first professional designation.

² See, ISO 31000 – the basis for New York’s & NAIC’s risk-focused approach.

	<p><u>manage, through avoidance were possible, conflicts of interest and objectively monitor and evaluate risk origination activities.</u> The SMI should consider what should be included within a risk management <u>system</u>, how such a <u>system</u> may be independently maintained, as well as how proportionality may be appropriately reflected.</p>
Section 2.2	<p>Board of Directors' discussion should be consolidated into two consecutive sentences in Paragraph a).</p> <p>Add new paragraph b): b) Senior management identifies and manages the risks that the corporation undertakes in the course of carrying out its business and its overall risk profile. Senior management should provide for the day-to-day oversight of risk management.</p>
Section 2.4	<p>The IAIS / OECD "Guidance" does not use the term risk tolerance, but uses the term risk appetite.</p>
Section 2.5	<p>Consider expanding based on the IAIS / OECD "Guidance" in paragraph 126 on stress testing and in paragraphs 127 to 129 on contingency planning.</p>
Section 2.5	<p>Eliminate enumeration of specific risks. This list in a policy paper, without turning it into the projects itself, would by definition be overinclusive or underinclusive.</p>
Section 2.6	<p>Change the first sentence as follows: The risk management function should be utilized by the insurer <u>for capital planning and to determine the level of internal economic capital that should be held for solvency purposes.</u></p>

Pennsylvania Comments (Provided by Steve Johnson, Deputy Insurance Commissioner)
on the December 2, 2009 International Solvency (EX) Working Group draft
“Consultation Paper on Corporate Governance and Risk Management”

1. There needs to be a discussion point on whether the Chairman of the Board and the CEO should be separate individuals or not.
2. There needs to be a discussion point on the maximum number of company officers that should be members of the Board.
3. There needs to be a discussion point on the maximum number of other Boards that a member of an Insurance Company or Insurance Holding Company can be on.
4. There needs to be a discussion point on whether some members of the Board should be required to have a background in the Insurance Industry.
5. The Risk Management section is written toward large companies who have the resources to establish a fully-functional risk management system. We can not forget that we regulate numerous small and middle size companies that do not have the resources for such a risk management system. We need to keep this in mind as we discuss and debate this section.



Stephen W. Broadie
Vice President, Financial Policy

March 1, 2010

Bruce Jenson, CPA
Financial Examination Manager
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108-2662

Re: Comments on Consultation Paper on Corporate Governance and Risk Management

Dear Mr. Jenson:

The Property Casualty Insurers Association of America (PCI) appreciates the opportunity to comment on the Solvency Modernization Initiative (SMI) Consultation Paper on Corporate Governance and Risk Management. PCI's more than 1,000 member property/casualty insurance companies represent the broadest cross-section of insurers of any national P/C trade association. PCI members write over \$180 billion in annual premium in the U.S., 37.4 percent of the nation's property/casualty insurance.

Corporate Governance

PCI understands that as a result of the financial crisis considerable attention has been drawn to the corporate governance and risk management of all financial institutions. We look forward to working with the NAIC as it assesses this area of insurance regulation, and we appreciate the fact that this consultation paper appropriately poses far more questions that it attempts to answer. Our specific comments follow.

Corporate governance

- The various SMI working groups should carefully review the breadth of current law and authority with regard to insurer corporate governance before taking any new steps. Corporate governance is a creature of state (and federal) corporate law as well as insurance law, and any changes must be closely coordinated with current authority. Consistency among states is also extremely important.
- In several places in the paper the drafters seem to be seeking to shift boards of directors' historic role of oversight of senior management to actual management of the insurer. For example, section 1.3(b) of the paper states that the board "should be directly involved in overseeing the insurer's process to identify, monitor and manage the risks the insurer faces." According to section 1.3(d), "the Board should provide oversight to the actuarial function of the insurer by receiving and reviewing reports in this area on a regular basis including the effectiveness of internal controls with respect to the reserve calculations. The Board should interact with senior management to resolve questions and collect additional information regarding the actuarial function as needed." Requirements such as this involve boards of directors far more deeply in actual management than is appropriate, and the NAIC should affirm the separation of the roles of oversight and management.
- Section 1.3(e) states that the board is responsible for establishing the "tone at the top". Section 1.4 (b) indicates that senior management should assume responsibility for establishing the tone at the top. Both groups should have a role here, but it is not clear from this paper what those roles should be.
- We believe that regulators should assess an insurance group's corporate governance in accordance with the way the group is managed. If the group's management is highly centralized, then its

corporate governance ought to be analyzed that way. If the group operates on a more decentralized basis, the analysis of corporate governance should take that into account.

- Proportionality, which takes into account company size, complexity of business and other individual traits in assessing corporate governance, is a key concept, and we would like to see it better reflected in this paper. Examples of areas where proportionality should be considered include sections 1.3(c) and (d)'s discussions of company internal audit and actuarial functions.
- The information discussed with regulators under section 1.5 should be kept confidential. That may be implied by the discussion of the financial examination function, but it should be made explicit.

Risk management

We likewise recognize that insurance regulators must consider the effectiveness of an insurer's risk management function. Indeed, the new risk-focused examination program is based on regulatory assessment of company risk management. The comments in the draft raise several issues, however.

- We are concerned with the paper's focus on the downside of risk. The paper does not mention that insurers are paid for taking on and managing risk. We also strongly believe that the level of enterprise risk management in place should vary based on the size, complexity, geographic footprint and other attributes of each company.
- As with corporate governance, insurer risk management should also be evaluated in the manner in which the group is managed.
- We understand that the concept of the "Own Risk and Solvency Assessment" (ORSA) has received international acceptance (in Solvency II and the International Association of Insurance Supervisors' ERM standard), but the implementation details are extremely important and the NAIC should thoroughly examine the concept before making any decisions. The ORSA discussion suggests that the NAIC shall determine which risks are material for an organization and goes further to state "the SMI should consider which risks should be addressed with the ORSA and at what level of detail." If the NAIC specifies which risks must be considered in the ORSA, it may miss key risks or require companies to waste resources considering risks to which they are not subject. Overall, the ORSA concept is worth considering, but very carefully. Any acceptable ORSA concept must be based on the way in which the insurer does its own ERM, and should not mandate a specific procedure developed by the NAIC.

PCI looks forward to discussing this paper during the March 11-12 SMI interim meeting and to working with the NAIC as the SMI process continues.

Sincerely,

A handwritten signature in black ink, appearing to read "Stephen W. Broadie". The signature is fluid and cursive, with a prominent initial "S" and "B".

Stephen W. Broadie

State Farm Mutual Automobile Insurance Company



285 Peachtree Center Avenue, NE
Suite 1200
Atlanta, GA 30303

Michael L. Lane, Counsel
404-335-2000

Sent via email to: Bruce Jenson (bjenson@naic.org)

March 1, 2010

Christina Urias
Chair, International Solvency (EX) Working Group
National Association of Insurance Commissioners
2301 McGee St., Suite 800
Kansas City, MO 64108

Re: Consultation Paper on Corporate Governance and Risk Management

Dear Director Urias:

On behalf of State Farm Mutual Automobile Insurance Company (State Farm) and its subsidiary companies we appreciate the opportunity to provide comments on the Consultation Paper on Corporate Governance and Risk Management which has been exposed by the SMI International Solvency (EX) Working Group.

State Farm supports sound corporate governance and risk management practices. Currently in the United States, well established corporate governance doctrine is already in place, generally derived from state statutes and case law. Traditionally these statutes and case law have spelled out the roles, responsibilities and duties of a company's board and management. On the other hand, not all corporate governance "best practices" are suited to the history and culture of each company. It is not clear what insurance regulatory or solvency issues will be addressed by these changes.

One important general principle of corporate law, the "internal affairs doctrine", recognizes that only one state, the state of incorporation, should have the authority to regulate a corporation's internal affairs. Otherwise, a corporation could be faced with conflicting demands as to its basic corporate structure. State Farm has questions and concerns as to how some of the recommendations within this paper will be implemented and whether or not they could lead to conflicting demands upon companies. Additionally, it is not clear what will be the role of domestic states in the NAIC's vision of governance.

Presently most corporations, regardless of the industry they represent, abide by similar corporate governance principles. This paper seems to advocate new or different principles only for insurance corporations, but it is not clear how these new principles will be applied. For instance, will it matter how the insurer or holding company is organized or whether the insurer is a stock or mutual company? And how will non-insurance company affiliates be treated? It is also not

clear who will enforce these recommendations or principles and how they will relate to current state law. The economic environment has not impacted all insurers in the same manner nor is it clear that insurers' current corporate governance contributed to these concerns.

Specific comments and questions about the Corporate Governance sections of the draft:

1.1 The move toward principles-based regulation is only just beginning and has not been fully implemented even in the life insurance industry. We doubt whether changes in the board of directors' rules or responsibilities should be made before these changes are in place.

1.2 Implementing proper corporate governance principles should be management's, as well as the board's responsibility.

It is not clear what is meant by the term "independent Board of Directors." A board may include independent directors, but an independent board is not a clear standard. Some standards are already present in state law and effectively provide for independence. See e.g., 215 ILCS 5/10 (2) and 5/40 (2). While parent company boards generally have a significant number of independent members, it is not practical for the entire board to be comprised of independent members.

Additionally, subsidiary insurers generally have few if any independent members.

Some of the standards discussed in subsection 1.2 (a) and (c) are very subjective and could be open to differing interpretations. That a Board should be "knowledgeable" and "should possess the appropriate professional qualifications" are not objective standards.

1.3 Many of the functions outlined here are already the responsibility of a parent company board. It is not clear if the intention is to apply these functions to the boards of subsidiaries, but doing so would be unnecessary and impractical.

1.4 Some of the qualifications outlined here such as "appropriate professional qualifications, knowledge and experience" and "good repute and integrity" are subjective standards.

1.5 This information is already provided to the domestic regulator. It is not clear what additional obligations are contemplated by this section.

The Risk Management sections describe activities related to enterprise risk management frameworks and functions. There is not a consistent definition of Enterprise Risk Management (ERM), but the definition from RIMS states that it "is a strategic business discipline that supports the achievement of an organization's objectives.." ERM best practices are still emerging and requiring certain practices not necessarily fully tested for insurance companies may not be appropriate.

While we are a strong supporter of sound risk management, requiring the practices outlined in the paper is not appropriate from a regulatory standpoint. ERM is about strategies of companies. Those strategies can change over time depending on company objectives, and as such ERM must be very flexible.

In addition, ERM is very company-specific as it is designed to help the organization achieve its own defined objectives. In particular, the risk management function should be tailored to the nature and complexity of an individual companies' business. It will also depend on the strategies and risk appetite of that company. However, it is helpful to regulators, in their overall risk assessment, to understand and consider the ERM policies and activities used by insurers.

Specific comments about the Risk Management sections of the draft:

2.1. This section talks about managing risk to be within the risk appetite of the company. Risk appetite will be different from one organization to another, and thus ERM functions will need to differ. In some situations, more qualitative assessments will be appropriate, while in others a more detailed quantitative analysis should be completed.

2.2. While board involvement is appropriate in risk management, oversight of the risk management function may be management's responsibility, rather than being required by the board, as it ties directly to the strategy and business objectives of the company.

2.3, 2.4. These sections require specific ERM policies related to risk identification, transparency, internal communication, formal risk tolerance statements, etc. Such a policy may represent current best practices in ERM, but this should fall under management or board discretion, not regulation. The supervisor should be comfortable that risks for the organization have been identified in determining sufficiency of capital. But, that does not require specific policies to be prescribed. The supervisor may wish to review the policies the company has developed in their assessment, but that should not be the basis of the assessment. There may be issues beyond that which are identified by an ERM policy that the supervisor may wish to have as evidence of sufficiency of capital.

2.5 Each insurer faces many risks, depending on the nature and complexity of the business. While this section does not limit those risks, it implies that certain risks are more critical. This could result in risks for some organizations being overlooked or missed in the risk assessment process if too much focus is placed on these risks. The supervisor should consider all risks of the individual organization in their assessments.

2.6 By requiring that an insurer determine the level of internal economic capital that should be held, this section is requiring that calculation to be completed. In addition, it's requiring a separate calculation for internal purposes than for regulatory reporting. A company should not be required to calculate another basis of capital unless it deems it necessary based on its own risk profile. In particular, as specific tool such as the ORSA should not be prescribed as it may not truly reflect the risks of the individual company. In addition, there's no clear definition of what

performing this on a “regular basis” means. The ORSA tests may not provide the appropriate information to management, and may therefore just be additional work to be completed without benefit.

2.7. As stated in other sections, while this may be best practice, it should not be a requirement.

2.8. It’s not clear what reporting ORSA results on a regular basis means. In addition, ORSA may not be appropriate in every situation and the regulator may need other information for their assessment that is more readily available.

Thank you for your work on this paper and for the opportunity to provide you with these comments.

Sincerely,

A handwritten signature in cursive script that reads "Michael Lane".

Michael L. Lane
Counsel