Attachment One

Nov. 16, 2014 Minutes
The Risk Retention Group (E) Task Force met in Washington, DC, Nov. 16, 2014. The following Task Force members participated: Dave Jones, Chair, represented by Jill Jacobi (CA); Susan L. Donegan, Vice Chair, represented by Sandy Bigglestone (VT); Germaine L. Marks represented by David Lee (AZ); Thomas B. Leonardi represented by John C. Thomson (CT); Chester A. McPherson represented by Sean O’Donnell and Dana Sheppard (DC); Kevin M. McCarty represented by David Altmaier (FL); Gordon I. Ito represented by Paul Yuen (HI); Monica J. Lindeen represented by Steve Matthews (MT); Scott J. Kipper represented by Omar Akel (NV); Kenneth E. Kobylowski represented by Rich Schlesinger (NJ); John D. Doak represented by Joel Sander (OK); and Julie Mix McPeak represented by Michael A. Corbett (TN).

1. **Adopted its Aug. 16 Minutes**

   Mr. Schlesinger made a motion, seconded by Mr. Altmaier, to adopt the Task Force’s Aug. 16 minutes (see NAIC Proceedings – Summer 2014, Risk Retention Group (E) Task Force, Aug. 16, 2014, minutes). The motion carried unanimously.

2. **Adopted a Response to the Financial Condition (E) Committee Referral Related to Control and Captive Managers**

   Ms. Jacobi said there were four comment letters received regarding the draft response (see NAIC Proceedings – Summer 2014, Risk Retention Group (E) Task Force, Attachment Three) to the Financial Condition (E) Committee’s referral related to whether captive managers could control a risk retention group (RRG). Ms. Bigglestone summarized the Vermont Department of Financial Regulation’s comment letter (Attachment One) which concurred with the proposed response and stated that, although control by a captive manager is possible, the tools are available to regulators to properly monitor an RRG, particularly through the Insurance Holding Company System Regulatory Act (#440). Additionally, the corporate governance provisions in the Model Risk Retention Act (#705) will further reduce the likelihood of a captive manager controlling an RRG.

   Ms. Jacobi said the Washington State Office of the Insurance Commissioner submitted a comment letter in support of the Task Force’s proposed response (Attachment Two). Robert “Skip” Myers (National Risk Retention Association—NRRA) summarized the NRRA’s comment letter concurring with the Task Force’s proposed response (Attachment Three). Jim McIntyre (Vermont Captive Insurance Association—VCIA) summarized the VCIA’s comment letter concurring with and not objecting to the Task Force’s proposed response (Attachment Four).

   Mr. O’Donnell made a motion, seconded by Ms. Bigglestone, to adopt the Task Force’s proposed response to the Financial (E) Committee referral related to control and captive managers. The motion carried unanimously.

3. **Received an Update on Work of Other NAIC Groups and Federal Activity**

   Julie Garber (NAIC) discussed the work of other NAIC groups and federal activity related to RRGs, noting that the NAIC continues to monitor federal legislation pertaining to potential expansion of the federal Liability Risk Retention Act. Additionally, there are a number of items before the Financial Regulation Standards and Accreditation (F) Committee.

   Revisions to Model #705 were adopted by the NAIC in December 2011. One of the main revisions deals with corporate governance standards for RRGs. Model #705 was previously exposed for a one-year public comment period, and the only comment letter received was from the California Department of Insurance, which was in favor of adding the model to the Part A accreditation standards. The Financial Regulation Standards and Accreditation (F) Committee will be considering adoption of Model #705 at this Fall National Meeting and, if adopted, will make the corporate governance requirements within Model #705 required for accreditation, effective Jan. 1, 2017.

   Ms. Garber said that, at the 2013 Fall National Meeting, the Task Force approved a referral to the Financial Regulation Standards and Accreditation (F) Committee that included proposed revisions to the effective date paragraph in the Reinsurance Guidelines for RRGs Licensed as Captive Insurers. The revisions were intended to clarify the current language, which notes that the provisions may be applied prospectively to RRGs and that certain insurers are grandfathered in under the provisions. A question had been raised regarding whether the grandfathering provision is applicable to new reinsurers or new
reinsurance contracts. The Task Force agreed that the reinsurance guidelines should apply to the reinsurer, but noted that the domestic regulator has the ability to revoke that approval of the reinsurer at any time. The Financial Regulation Standards and Accreditation (F) Committee adopted the referral at the Summer National Meeting with an immediate effective date.

Ms. Garber said that, at the Spring National Meeting, the Financial Regulation Standards and Accreditation (F) Committee exposed for a public comment period proposed revisions to the accreditation guidance that would effectively subject reinsurers assuming business from any state other than their state of domicile to the accreditation standards. The changes would apply to all forms of insurers, including captive insurers, with the one exception that it would not apply to pure captives that are established for the sole purpose of managing their parent’s own risk. There were a total of 34 comment letters received, with the majority of those letters in opposition to the proposed revisions. The Financial Regulation Standards and Accreditation (F) Committee will discuss this topic further at this Fall National Meeting.

Ms. Garber discussed federal activity related to RRGs, noting that the proposed RRG expansion bill is still in discussion draft form and has not yet been formally introduced in the U.S. Congress. A draft bill by U.S. Rep. Dennis Ross (R-FL) was discussed this spring at an insurance legislative hearing of the U.S. House of Representatives’ Committee on Financial Services. There has been no further official activity on this matter.

4. Discussed Other Matters

Ms. Jacobi said on Sept. 2, 2014, the Federal Housing Finance Agency (FHFA) proposed revisions to its regulations governing Federal Home Loan Bank (FHLB) membership, and one of the revisions would define the term “insurance company” to exclude captive insurers from being FHLB members, but would permit existing captive members to remain members for five years with certain restrictions. The proposed revisions are currently exposed for public comment through the end of the year. Mr. McIntyre and Mr. Myers said there has been concern expressed to them related to the proposed revisions to the treatment of captives, and the NRRA and VCIA expect to issue comment letters to FHFA in relation to this matter.

Mr. O’Donnell said the Risk-Based Capital (RBC) for Insurers Model Act (#312) became an accreditation standard for those states with domestic RRGs, effective Jan. 1, 2014. The year-end 2014 filings will mark the first time that some RRGs will be required to file an RBC report. He said the RBC formula has a charge for premium growth that factors four years of premium. He noted the importance for first-time RRG filers, when preparing the RBC report, to know they should populate lines with four years of premium, so the RBC ratio does not produce skewed results. To accomplish this, he said the premium information for prior years may need to be input manually. Hearing no objection, Ms. Jacobi requested that NAIC staff work with Mr. O’Donnell to prepare and send an email to those states that have domestic RRGs informing them of this.

Having no further business, the Risk Retention Group (E) Task Force adjourned.
Attachment Two

*Corporate Governance Annual Disclosure Model Act (#305)*
CORPORATE GOVERNANCE ANNUAL DISCLOSURE MODEL ACT

Table of Contents
Section 1. Purpose and Scope
Section 2. Definitions
Section 3. Disclosure Requirement
Section 4. Rules and Regulations
Section 5. Contents of Corporate Governance Annual Disclosure
Section 6. Confidentiality
Section 7. Third-party Consultants
Section 8. Sanctions
Section 9. Severability Clause
Section 10. Effective Date

Section 1. Purpose and Scope.
A. The purpose of this Act is to:
   1. Provide the Insurance Commissioner a summary of an insurer or insurance group's corporate governance structure, policies and practices to permit the Commissioner to gain and maintain an understanding of the insurer's corporate governance framework.
   2. Outline the requirements for completing a corporate governance annual disclosure with the Insurance Commissioner.
   3. Provide for the confidential treatment of the corporate governance annual disclosure and related information that will contain confidential and sensitive information related to an insurer or insurance group's internal operations and proprietary and trade secret information which, if made public, could potentially cause the insurer or insurance group competitive harm or disadvantage.
B. Nothing in this act shall be construed to prescribe or impose corporate governance standards and internal procedures beyond that which is required under applicable state corporate law. Notwithstanding the foregoing, nothing in this act shall be construed to limit the Commissioner's authority, or the rights or obligations of third parties, under [INSERT EXAMINATION CITATION]
C. The requirements of this Act shall apply to all insurers domiciled in this state.

Drafting Note: The requirements of this Act are intended to apply to all commercial risk bearing entities subject to oversight by state insurance departments. Therefore, modifications may be necessary to ensure that all entities intended to be subject to the Act, but not meeting the state's legal definition of “insurer,” are appropriately referenced.

Section 2. Definitions.
A. “Commissioner.” The Insurance Commissioner of the State.
B. “Corporate Governance Annual Disclosure (CGAD).” A Corporate Governance Annual Disclosure shall mean a confidential report filed by the insurer or insurance group made in accordance with the requirements of this Act.
C. “Insurance group.” For the purpose of this Act, the term “insurance group” shall mean those insurers and affiliates included within an insurance holding company system as defined in [insert state law equivalent to the model Insurance Holding Company System Regulatory Act.]

D. “Insurer.” The term “insurer” shall have the same meaning as set forth in Section [insert applicable section] of this Chapter, except that it shall not include agencies, authorities or instrumentalities of the United States, its possessions and territories, the Commonwealth of Puerto Rico, the District of Columbia, or a state or political subdivision of a state.

E. “ORSA Summary Report.” The term “ORSA Summary Report” shall mean the report filed in accordance with [insert applicable statutory reference to the Risk Management and Own Risk and Solvency Assessment Model Act.]

Section 3. Disclosure Requirement.

A. An insurer, or the insurance group of which the insurer is a member, shall, no later than June 1 of each calendar year, submit to the Commissioner a Corporate Governance Annual Disclosure (CGAD) that contains the information described in Section 5B below. Notwithstanding any request from the Commissioner made pursuant to Subsection C, if the insurer is a member of an insurance group, the insurer shall submit the report required by this Section to the Commissioner of the lead state for the insurance group, in accordance with the laws of the lead state, as determined by the procedures outlined in the most recent Financial Analysis Handbook adopted by the NAIC.

B. The CGAD must include a signature of the insurer or insurance group’s chief executive officer or corporate secretary attesting to the best of that individual’s belief and knowledge that the insurer has implemented the corporate governance practices and that a copy of the disclosure has been provided to the insurer’s board of directors or the appropriate committee thereof.

C. An insurer not required to submit a CGAD under this section shall do so upon the Commissioner’s request.

D. For purposes of completing the CGAD, the insurer or insurance group may provide information regarding corporate governance at the ultimate controlling parent level, an intermediate holding company level and/or the individual legal entity level, depending upon how the insurer or insurance group has structured its system of corporate governance. The insurer or insurance group is encouraged to make the CGAD disclosures at the level at which the insurer’s or insurance group’s risk appetite is determined, or at which the earnings, capital, liquidity, operations, and reputation of the insurer are overseen collectively and at which the supervision of those factors are coordinated and exercised, or the level at which legal liability for failure of general corporate governance duties would be placed. If the insurer or insurance group determines the level of reporting based on these criteria, it shall indicate which of the three criteria was used to determine the level of reporting and explain any subsequent changes in level of reporting.

E. The review of the CGAD and any additional requests for information shall be made through the lead state as determined by the procedures within the most recent Financial Analysis Handbook referenced in Paragraph A of this section.
F. Insurers providing information substantially similar to the information required by this Act in other documents provided to the Commissioner, including proxy statements filed in conjunction with Form B requirements, or other state or federal filings provided to this Department shall not be required to duplicate that information in the CGAD, but shall only be required to cross reference the document in which the information is included.

Section 4. Rules and Regulations

The Commissioner may, upon notice and opportunity for all interested persons to be heard, issue such rules, regulations and orders as shall be necessary to carry out the provisions of this Act.

Section 5. Contents of Corporate Governance Annual Disclosure.

A. The insurer or insurance group shall have discretion over the responses to the CGAD inquiries, provided the CGAD shall contain the material information necessary to permit the Commissioner to gain an understanding of the insurer's or group's corporate governance structure, policies, and practices. The Commissioner may request additional information that he or she deems material and necessary to provide the Commissioner with a clear understanding of the corporate governance policies, the reporting or information system or controls implementing those policies.

B. Notwithstanding Subsection A of this section, the CGAD shall be prepared consistent with the Corporate Governance Annual Disclosure Model Regulation [INSERT CITATION]. Documentation and supporting information shall be maintained and made available upon examination or upon request of the Commissioner.

Section 6. Confidentiality.

A. Documents, materials or other information including the CGAD, in the possession or control of the Department of Insurance that are obtained by, created by or disclosed to the Commissioner or any other person under this Act, are recognized by this state as being proprietary and to contain trade secrets. All such documents, materials or other information shall be confidential by law and privileged, shall not be subject to [insert open records, freedom of information, sunshine or other appropriate phrase], shall not be subject to subpoena, and shall not be subject to discovery or admissible in evidence in any private civil action. However, the Commissioner is authorized to use the documents, materials or other information in the furtherance of any regulatory or legal action brought as a part of the Commissioner's official duties. The Commissioner shall not otherwise make the documents, materials or other information public without the prior written consent of the insurer. Nothing in this section shall be construed to require written consent of the insurer before the Commissioner may share or receive confidential documents, materials or other CGAD-related information pursuant to Subsection C below to assist in the performance of the Commissioner's regular duties.

Drafting Note: States should consider whether to specifically invoke their examination statute as applicable additional confidentiality protection for documents submitted pursuant to this Model Act.

B. Neither the Commissioner nor any person who received documents, materials or other CGAD-related information, through examination or otherwise, while acting under the authority of the Commissioner, or with whom such documents, materials or other information are shared pursuant to this Act shall be permitted or required to testify in any private civil action concerning any confidential documents, materials, or information subject to Subsection A.
C. In order to assist in the performance of the Commissioner’s regulatory duties, the Commissioner:

1. May, upon request, share documents, materials or other CGAD-related information including the confidential and privileged documents, materials or information subject to Subsection A, including proprietary and trade secret documents and materials with other state, federal and international financial regulatory agencies, including members of any supervisory college as defined in the [insert cross-reference to appropriate section of Insurance Holding Company System Regulatory Act, as amended], with the NAIC, and with third party consultants pursuant to Section 7, provided that the recipient agrees in writing to maintain the confidentiality and privileged status of the CGAD-related documents, material or other information and has verified in writing the legal authority to maintain confidentiality; and

2. May receive documents, materials or other CGAD-related information, including otherwise confidential and privileged documents, materials or information, including proprietary and trade-secret information or documents, from regulatory officials of other state, federal and international financial regulatory agencies, including members of any supervisory college as defined in the [insert cross-reference to appropriate section of Insurance Holding Company System Regulatory Act, as amended], and from the NAIC, and shall maintain as confidential or privileged any documents, materials or information received with notice or the understanding that it is confidential or privileged under the laws of the jurisdiction that is the source of the document, material or information.

D. The sharing of information and documents by the Commissioner pursuant to this Act shall not constitute a delegation of regulatory authority or rulemaking, and the Commissioner is solely responsible for the administration, execution and enforcement of the provisions of this Act.

E. No waiver of any applicable privilege or claim of confidentiality in the documents, proprietary and trade-secret materials or other CGAD-related information shall occur as a result of disclosure of such CGAD-related information or documents to the Commissioner under this section or as a result of sharing as authorized in this Act.

Section 7. NAIC and Third-party Consultants

A. The Commissioner may retain, at the insurer's expense, third-party consultants, including attorneys, actuaries, accountants and other experts not otherwise a part of the Commissioner's staff as may be reasonably necessary to assist the Commissioner in reviewing the CGAD and related information or the insurer's compliance with this Act.

B. Any persons retained under Subsection A shall be under the direction and control of the Commissioner and shall act in a purely advisory capacity.

C. The NAIC and third-party consultants shall be subject to the same confidentiality standards and requirements as the Commissioner.

D. As part of the retention process, a third-party consultant shall verify to the Commissioner, with notice to the insurer, that it is free of a conflict of interest and that it has internal procedures in place to monitor compliance with a conflict and to comply with the confidentiality standards and requirements of this Act.
E. A written agreement with the NAIC and/or a third-party consultant governing sharing and use of information provided pursuant to this Act shall contain the following provisions and expressly require the written consent of the insurer prior to making public information provided under this Act:

1. Specific procedures and protocols for maintaining the confidentiality and security of CGAD-related information shared with the NAIC or a third-party consultant pursuant to this Act.

2. Procedures and protocols for sharing by the NAIC only with other state regulators from states in which the insurance group has domiciled insurers. The agreement shall provide that the recipient agrees in writing to maintain the confidentiality and privileged status of the CGAD-related documents, materials or other information and has verified in writing the legal authority to maintain confidentiality.

3. A provision specifying that ownership of the CGAD-related information shared with the NAIC or a third-party consultant remains with the Department of Insurance and the NAIC’s or third-party consultant’s use of the information is subject to the direction of the Commissioner;

4. A provision that prohibits the NAIC or a third-party consultant from storing the information shared pursuant to this Act in a permanent database after the underlying analysis is completed;

5. A provision requiring the NAIC or third-party consultant to provide prompt notice to the Commissioner and to the insurer or insurance group regarding any subpoena, request for disclosure, or request for production of the insurer’s CGAD-related information; and

6. A requirement that the NAIC or a third-party consultant to consent to intervention by an insurer in any judicial or administrative action in which the NAIC or a third-party consultant may be required to disclose confidential information about the insurer shared with the NAIC or a third-party consultant pursuant to this Act.

Section 8. Sanctions.

Any insurer failing, without just cause, to timely file the CGAD as required in this Act shall be required, after notice and hearing, to pay a penalty of $[insert amount] for each day’s delay, to be recovered by the Commissioner and the penalty so recovered shall be paid into the General Revenue Fund of this state. The maximum penalty under this section is $[insert amount]. The Commissioner may reduce the penalty if the insurer demonstrates to the Commissioner that the imposition of the penalty would constitute a financial hardship to the insurer.

Section 9. Severability Clause.

If any provision of this Act other than Section 6, or the application thereof to any person or circumstance, is held invalid, such determination shall not affect the provisions or applications of this Act which can be given effect without the invalid provision or application, and to that end the provisions of this Act, with the exception of Section 6, are severable.
Section 10. Effective Date.

The requirements of this Act shall become effective on January 1, 2016. The first filing of the CGAD shall be in 2016.

Chronological Summary of Action (all references are to the Proceedings of the NAIC).

Adopted by Executive/Plenary Committee at 2014 Fall National Meeting
Attachment Three

Corporate Governance Annual Disclosure Model Regulation (#306)
CORPORATE GOVERNANCE ANNUAL DISCLOSURE MODEL REGULATION

Table of Contents

Section 1. Authority
Section 2. Purpose
Section 3. Definitions
Section 4. Filing Procedures
Section 5. Contents of Corporate Governance Annual Disclosure
Section 6. Severability Clause

Section 1. Authority

These regulations are promulgated pursuant to the authority granted by Sections [insert applicable sections] and [insert applicable section] of the Insurance Law.

Section 2. Purpose

The purpose of these regulations is to set forth the procedures for filing and the required contents of the Corporate Governance Annual Disclosure (CGAD), deemed necessary by the [Commissioner] to carry out the provisions of [insert reference to Corporate Governance Annual Disclosure Model Act].

Section 3. Definitions.

A. “Commissioner.” The Insurance Commissioner of the State.

B. “Insurance group.” For the purpose of this Act, the term “insurance group” shall mean those insurers and affiliates included within an insurance holding company system as defined in [insert state law equivalent to the model Insurance Holding Company System Regulatory Act.]

C. “Insurer.” The term “insurer” shall have the same meaning as set forth in Section [insert applicable section] of this Chapter, except that it shall not include agencies, authorities or instrumentalities of the United States, its possessions and territories, the Commonwealth of Puerto Rico, the District of Columbia, or a state or political subdivision of a state.

D. “Senior Management.” The term “senior management” shall mean any corporate officer responsible for reporting information to the board of directors at regular intervals or providing this information to shareholders or regulators and shall include, for example and without limitation, the Chief Executive Officer (“CEO”), Chief Financial Officer (“CFO”), Chief Operations Officer (“COO”), Chief Procurement Officer (“CPO”), Chief Legal Officer (“CLO”), Chief Information Officer (“CIO”), Chief Technology Officer (“CTO”), Chief Revenue Officer (“CRO”), Chief Visionary Officer (“CVO”), or any other “C” level executive.

Section 4. Filing Procedures

A. An insurer, or the insurance group of which the insurer is a member, required to file a CGAD by the [insert reference to Corporate Governance Annual Disclosure Model Act], shall, no later than June 1 of each calendar year, submit to the Commissioner a CGAD that contains the information described in Section 5 of these regulations.
B. The CGAD must include a signature of the insurer’s or insurance group’s chief executive officer or corporate secretary attesting to the best of that individual’s belief and knowledge that the insurer or insurance group has implemented the corporate governance practices and that a copy of the CGAD has been provided to the insurer’s or insurance group’s Board of Directors (hereafter “Board”) or the appropriate committee thereof.

C. The insurer or insurance group shall have discretion regarding the appropriate format for providing the information required by these regulations and is permitted to customize the CGAD to provide the most relevant information necessary to permit the Commissioner to gain an understanding of the corporate governance structure, policies and practices utilized by the insurer or insurance group.

D. For purposes of completing the CGAD, the insurer or insurance group may choose to provide information on governance activities that occur at the ultimate controlling parent level, an intermediate holding company level and/or the individual legal entity level, depending upon how the insurer or insurance group has structured its system of corporate governance. The insurer or insurance group is encouraged to make the CGAD disclosures at the level at which the insurer’s or insurance group’s risk appetite is determined, or at which the earnings, capital, liquidity, operations, and reputation of the insurer are overseen collectively and at which the supervision of those factors are coordinated and exercised, or the level at which legal liability for failure of general corporate governance duties would be placed. If the insurer or insurance group determines the level of reporting based on these criteria, it shall indicate which of the three criteria was used to determine the level of reporting and explain any subsequent changes in level of reporting.

E. Notwithstanding Subsection A of this Section, and as outlined in Section 3 of the Corporate Governance Annual Disclosure Model Act, if the CGAD is completed at the insurance group level, then it must be filed with the lead state of the group as determined by the procedures outlined in the most recent Financial Analysis Handbook adopted by the NAIC. In these instances, a copy of the CGAD must also be provided to the chief regulatory official of any state in which the insurance group has a domestic insurer, upon request.

F. An insurer or insurance group may comply with this section by referencing other existing documents (e.g., ORSA Summary Report, Holding Company Form B or F Filings, Securities and Exchange Commission (SEC) Proxy Statements, foreign regulatory reporting requirements, etc.) if the documents provide information that is comparable to the information described in Section 5. The insurer or insurance group shall clearly reference the location of the relevant information within the CGAD and attach the referenced document if it is not already filed or available to the regulator.

G. Each year following the initial filing of the CGAD, the insurer or insurance group shall file an amended version of the previously filed CGAD indicating where changes have been made. If no changes were made in the information or activities reported by the insurer or insurance group, the filing should so state.

Section 5. Contents of Corporate Governance Annual Disclosure

A. The insurer or insurance group shall be as descriptive as possible in completing the CGAD, with inclusion of attachments or example documents that are used in the governance process, since these may provide a means to demonstrate the strengths of their governance framework and practices.
B. The CGAD shall describe the insurer’s or insurance group’s corporate governance framework and structure including consideration of the following.

(1) The Board and various committees thereof ultimately responsible for overseeing the insurer or insurance group and the level(s) at which that oversight occurs (e.g., ultimate control level, intermediate holding company, legal entity, etc.). The insurer or insurance group shall describe and discuss the rationale for the current Board size and structure; and

(2) The duties of the Board and each of its significant committees and how they are governed (e.g., bylaws, charters, informal mandates, etc.), as well as how the Board’s leadership is structured, including a discussion of the roles of Chief Executive Officer (CEO) and Chairman of the Board within the organization.

C. The insurer or insurance group shall describe the policies and practices of the most senior governing entity and significant committees thereof, including a discussion of the following factors:

(1) How the qualifications, expertise and experience of each Board member meet the needs of the insurer or insurance group.

(2) How an appropriate amount of independence is maintained on the Board and its significant committees.

(3) The number of meetings held by the Board and its significant committees over the past year as well as information on director attendance.

(4) How the insurer or insurance group identifies, nominates and elects members to the Board and its committees. The discussion should include, for example:

(a) Whether a nomination committee is in place to identify and select individuals for consideration.

(b) Whether term limits are placed on directors.

(c) How the election and re-election processes function.

(d) Whether a Board diversity policy is in place and if so, how it functions.

(5) The processes in place for the Board to evaluate its performance and the performance of its committees, as well as any recent measures taken to improve performance (including any Board or committee training programs that have been put in place).

D. The insurer or insurance group shall describe the policies and practices for directing Senior Management, including a description of the following factors:

(1) Any processes or practices (i.e., suitability standards) to determine whether officers and key persons in control functions have the appropriate background, experience and integrity to fulfill their prospective roles, including:

(a) Identification of the specific positions for which suitability standards have been developed and a description of the standards employed.
(b) Any changes in an officer’s or key person’s suitability as outlined by the insurer’s or insurance group’s standards and procedures to monitor and evaluate such changes.

(2) The insurer’s or insurance group’s code of business conduct and ethics, the discussion of which considers, for example:

(a) compliance with laws, rules, and regulations; and

(b) proactive reporting of any illegal or unethical behavior.

(3) The insurer’s or insurance group’s processes for performance evaluation, compensation and corrective action to ensure effective senior management throughout the organization, including a description of the general objectives of significant compensation programs and what the programs are designed to reward. The description shall include sufficient detail to allow the Commissioner to understand how the organization ensures that compensation programs do not encourage and/or reward excessive risk taking. Elements to be discussed may include, for example:

(a) The Board’s role in overseeing management compensation programs and practices.

(b) The various elements of compensation awarded in the insurer’s or insurance group’s compensation programs and how the insurer or insurance group determines and calculates the amount of each element of compensation paid;

(c) How compensation programs are related to both company and individual performance over time;

(d) Whether compensation programs include risk adjustments and how those adjustments are incorporated into the programs for employees at different levels;

(e) Any clawback provisions built into the programs to recover awards or payments if the performance measures upon which they are based are restated or otherwise adjusted;

(f) Any other factors relevant in understanding how the insurer or insurance group monitors its compensation policies to determine whether its risk management objectives are met by incentivizing its employees.

(4) The insurer’s or insurance group’s plans for CEO and Senior Management succession.

E. The insurer or insurance group shall describe the processes by which the Board, its committees and Senior Management ensure an appropriate amount of oversight to the critical risk areas impacting the insurer’s business activities, including a discussion of:

(1) How oversight and management responsibilities are delegated between the Board, its committees and Senior Management;

(2) How the Board is kept informed of the insurer’s strategic plans, the associated risks, and steps that Senior Management is taking to monitor and manage those risks;
(3) How reporting responsibilities are organized for each critical risk area. The description should allow the Commissioner to understand the frequency at which information on each critical risk area is reported to and reviewed by Senior Management and the Board. This description may include, for example, the following critical risk areas of the insurer:

(a) Risk management processes (An ORSA Summary Report filer may refer to its ORSA Summary Report pursuant to the Risk Management and Own Risk and Solvency Assessment Model Act);

(b) Actuarial function;

(c) Investment decision-making processes;

(d) Reinsurance decision-making processes;

(e) Business strategy/finance decision-making processes;

(f) Compliance function;

(g) Financial reporting/internal auditing; and

(h) Market conduct decision-making processes.

Section 6. Severability Clause

If any provision of these regulations, or the application thereof to any person or circumstance, is held invalid, such determination shall not affect other provisions or applications of these regulations which can be given effect without the invalid provision or application, and to that end the provisions of these regulations are severable.

Chronological Summary of Action (all references are to the Proceedings of the NAIC).

Adopted by Executive/Plenary at 2014 Fall National Meeting
Technical Correction – January 2015
Attachment Four

2014 Revisions to the
Annual Financial Reporting
Model Regulation (#205)
ANNUAL FINANCIAL REPORTING MODEL REGULATION

Table of Contents

Section 1. Authority
Section 2. Purpose and Scope
Section 3. Definitions
Section 4. General Requirements Related to Filing and Extensions for Filing of Annual Audited Financial Report and Audit Committee Appointment
Section 5. Contents of Annual Audited Financial Report
Section 6. Designation of Independent Certified Public Accountant
Section 7. Qualifications of Independent Certified Public Accountant
Section 8. Consolidated or Combined Audits
Section 9. Scope of Audit and Report of Independent Certified Public Accountant
Section 10. Notification of Adverse Financial Condition
Section 11. Communication of Internal Control Related Matters Noted in an Audit
Section 12. Accountant’s Letter of Qualifications
Section 13. Definition, Availability and Maintenance of Independent Certified Public Accountant Work Papers
Section 14. Requirements for Audit Committees
Section 15. Internal Audit Function Requirements
Section 16. Conduct of Insurer in Connection with the Preparation of Required Reports and Documents
Section 17. Management’s Report of Internal Control over Financial Reporting
Section 18. Exemptions and Effective Dates
Section 19. Canadian and British Companies
Section 20. Severability Provision

Section 1. Authority

This regulation is promulgated by the commissioner of insurance pursuant to Sections [insert applicable sections] of the [insert state] insurance law.

Section 2. Purpose and Scope

The purpose of this regulation is to improve the [insert state] Insurance Department’s surveillance of the financial condition of insurers by requiring (1) an annual audit of financial statements reporting the financial position and the results of operations of insurers by independent certified public accountants, (2) Communication of Internal Control Related Matters Noted in an Audit, and (3) Management’s Report of Internal Control over Financial Reporting.

Every insurer (as defined in Section 3) shall be subject to this regulation. Insurers having direct premiums written in this state of less than $1,000,000 in any calendar year and less than 1,000 policyholders or certificate holders of direct written policies nationwide at the end of the calendar year shall be exempt from this regulation for the year (unless the commissioner makes a specific finding that compliance is necessary for the commissioner to carry out statutory responsibilities) except that insurers having assumed premiums pursuant to contracts and/or treaties of reinsurance of $1,000,000 or more will not be so exempt.

Foreign or alien insurers filing the Audited financial report in another state, pursuant to that state’s requirement for filing of Audited financial reports, which has been found by the commissioner to be substantially similar to the requirements herein, are exempt from Sections 4 through 13 of this regulation if:
A. A copy of the Audited financial report, Communication of Internal Control Related Matters Noted in an Audit, and the Accountant’s Letter of Qualifications that are filed with the other state are filed with the commissioner in accordance with the filing dates specified in Sections 4, 11 and 12, respectively (Canadian insurers may submit accountants’ reports as filed with the Office of the Superintendent of Financial Institutions, Canada).

B. A copy of any Notification of Adverse Financial Condition Report filed with the other state is filed with the commissioner within the time specified in Section 10.

Foreign or alien insurers required to file Management’s Report of Internal Control over Financial Reporting in another state are exempt from filing the Report in this state provided the other state has substantially similar reporting requirements and the Report is filed with the commissioner of the other state within the time specified.

This regulation shall not prohibit, preclude or in any way limit the commissioner of insurance from ordering or conducting or performing examinations of insurers under the rules and regulations of the [insert state] Department of Insurance and the practices and procedures of the [insert state] Department of Insurance.

Section 3. Definitions

The terms and definitions contained herein are intended to provide definitional guidance as the terms are used within this regulation.

A. “Accountant” or “independent certified public accountant” means an independent certified public accountant or accounting firm in good standing with the American Institute of Certified Public Accountants (AICPA) and in all states in which he or she is licensed to practice; for Canadian and British companies, it means a Canadian-chartered or British-chartered accountant.

B. An “affiliate” of, or person “affiliated” with, a specific person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.

C. “Audit committee” means a committee (or equivalent body) established by the board of directors of an entity for the purpose of overseeing the accounting and financial reporting processes of an insurer or Group of insurers, the Internal audit function of an insurer or Group of insurers (if applicable), and external audits of financial statements of the insurer or Group of insurers. The Audit committee of any entity that controls a Group of insurers may be deemed to be the Audit committee for one or more of these controlled insurers solely for the purposes of this regulation at the election of the controlling person. Refer to Section 14E for exercising this election. If an Audit committee is not designated by the insurer, the insurer’s entire board of directors shall constitute the Audit committee.

D. “Audited financial report” means and includes those items specified in Section 5 of this regulation.

E. “Indemnification” means an agreement of indemnity or a release from liability where the intent or effect is to shift or limit in any manner the potential liability of the person or firm for failure to adhere to applicable auditing or professional standards,
whether or not resulting in part from knowing of other misrepresentations made by the insurer or its representatives.

F. “Independent board member” has the same meaning as described in Section 14C.

G. “Insurer” means a licensed insurer as defined in Sections [insert applicable sections] of the [insert state] insurance law or an authorized insurer as defined in Sections [insert applicable sections] of the [insert state] insurance law.

H. “Group of insurers” means those licensed insurers included in the reporting requirements of [insert state law equivalent of the model Insurance Holding Company System Regulatory Act], or a set of insurers as identified by management, for the purpose of assessing the effectiveness of Internal control over financial reporting.

I. “Internal audit function” means a person or persons that provide independent, objective and reasonable assurance designed to add value and improve an organization’s operations and accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

J. “Internal control over financial reporting” means a process effected by an entity's board of directors, management and other personnel designed to provide reasonable assurance regarding the reliability of the financial statements, i.e., those items specified in Section 5B through 5G of this regulation and includes those policies and procedures that:

1. Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets;

2. Provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements, i.e., those items specified in Section 5B through 5G of this regulation and that receipts and expenditures are being made only in accordance with authorizations of management and directors; and

3. Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statements, i.e., those items specified in Section 5B through 5G of this regulation.


L. “Section 404” means Section 404 of the Sarbanes-Oxley Act of 2002 and the SEC’s rules and regulations promulgated thereunder.

M. “Section 404 Report” means management’s report on “internal control over financial reporting” as defined by the SEC and the related attestation report of the independent certified public accountant as described in Section 3A.

N. “SOX Compliant Entity” means an entity that either is required to be compliant with, or voluntarily is compliant with, all of the following provisions of the Sarbanes-Oxley Act of 2002: (i) the preapproval requirements of Section 201 (Section 10A(i) of the Securities Exchange Act of 1934); (ii) the Audit committee independence
requirements of Section 301 (Section 10A(m)(3) of the Securities Exchange Act of 1934); and (iii) the Internal control over financial reporting requirements of Section 404 (Item 308 of SEC Regulation S-K).

Section 14. Requirements for Audit Committees

This section shall not apply to foreign or alien insurers licensed in this state or an insurer that is a SOX Compliant Entity or a direct or indirect wholly-owned subsidiary of a SOX Compliant Entity.

A. The Audit committee shall be directly responsible for the appointment, compensation and oversight of the work of any accountant (including resolution of disagreements between management and the accountant regarding financial reporting) for the purpose of preparing or issuing the Audited financial report or related work pursuant to this regulation. Each accountant shall report directly to the Audit committee.

B. The Audit committee of an insurer or Group of insurers shall be responsible for overseeing the insurer’s Internal audit function and granting the person or persons performing the function suitable authority and resources to fulfill their responsibilities if required by Section 15 of this Regulation.

C. Each member of the Audit committee shall be a member of the board of directors of the insurer or a member of the board of directors of an entity elected pursuant to Subsection E-F and Section 3C.

D. In order to be considered independent for purposes of this section, a member of the Audit committee may not, other than in his or her capacity as a member of the Audit committee, the board of directors, or any other board committee, accept any consulting, advisory or other compensatory fee from the entity or be an affiliated person of the entity or any subsidiary thereof. However, if law requires board participation by otherwise non-independent members, that law shall prevail and such members may participate in the Audit committee and be designated as independent for Audit committee purposes, unless they are an officer or employee of the insurer or one of its affiliates.

D-E. If a member of the Audit committee ceases to be independent for reasons outside the member’s reasonable control, that person, with notice by the responsible entity to the state, may remain an Audit committee member of the responsible entity until the earlier of the next annual meeting of the responsible entity or one year from the occurrence of the event that caused the member to be no longer independent.

Drafting Note: In determining independence, the commissioner shall consider utilizing guidance provided in the SEC’s Final Rule No. 33-8220, Standards Relating to Listed Company Audit Committees adopted April 9, 2003.

E-F. To exercise the election of the controlling person to designate the Audit committee for purposes of this regulation, the ultimate controlling person shall provide written notice to the commissioners of the affected insurers. Notification shall be made timely prior to the issuance of the statutory audit report and include a description of the basis for the election. The election can be changed through notice to the
commissioner by the insurer, which shall include a description of the basis for the change. The election shall remain in effect for perpetuity, until rescinded.

GF. (1) The Audit committee shall require the accountant that performs for an insurer any audit required by this regulation to timely report to the Audit committee in accordance with the requirements of SAS 61, *Communication with Audit Committees*, or its replacement, including:

(a) All significant accounting policies and material permitted practices;

(b) All material alternative treatments of financial information within statutory accounting principles that have been discussed with management officials of the insurer, ramifications of the use of the alternative disclosures and treatments, and the treatment preferred by the accountant; and

(c) Other material written communications between the accountant and the management of the insurer, such as any management letter or schedule of unadjusted differences.

(2) If an insurer is a member of an insurance holding company system, the reports required by Subsection GF(1) may be provided to the Audit committee on an aggregate basis for insurers in the holding company system, provided that any substantial differences among insurers in the system are identified to the Audit committee.

GH. The proportion of independent Audit committee members shall meet or exceed the following criteria:

<table>
<thead>
<tr>
<th>Prior Calendar Year Direct Written and Assumed Premiums</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 - $300,000,000</td>
</tr>
<tr>
<td>No minimum requirements. See also Note A and B.</td>
</tr>
</tbody>
</table>

Note A: The commissioner has authority afforded by state law to require the entity’s board to enact improvements to the independence of the Audit committee membership if the insurer is in a RBC action level event, meets one or more of the standards of an insurer deemed to be in hazardous financial condition, or otherwise exhibits qualities of a troubled insurer.

Note B: All insurers with less than $500,000,000 in prior year direct written and assumed premiums are encouraged to structure their Audit committees with at least a supermajority of independent Audit committee members.

Note C: Prior calendar year direct written and assumed premiums shall be the combined total of direct premiums and assumed premiums from non-affiliates for the reporting entities.

HI. An insurer with direct written and assumed premium, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, less than $500,000,000 may make application to the commissioner for a waiver from
the Section 14 requirements based upon hardship. The insurer shall file, with its annual statement filing, the approval for relief from Section 14 with the states that it is licensed in or doing business in and the NAIC. If the nondomestic state accepts electronic filing with the NAIC, the insurer shall file the approval in an electronic format acceptable to the NAIC.

Section 15. **Internal Audit Function Requirements**

A. **Exemption** – An insurer is exempt from the requirements of this section if:

1. The insurer has annual direct written and unaffiliated assumed premium, including international direct and assumed premium but excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, less than $500,000,000; or,

2. If the insurer is a member of a Group of insurers that has annual direct written and unaffiliated assumed premium including international direct and assumed premium, but excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, less than $1,000,000,000.

Note: An insurer or Group of insurers exempt from the requirements of this section is encouraged, but not required, to conduct a review of the insurer business type, sources of capital, and other risk factors to determine whether an Internal audit function is warranted. The potential benefits of an Internal audit function should be assessed and compared against the estimated costs.

B. **Function** – The insurer or Group of insurers shall establish an Internal audit function providing independent, objective and reasonable assurance to the Audit committee and insurer management regarding the insurer’s governance, risk management and internal controls. This assurance shall be provided by performing general and specific audits, reviews and tests and by employing other techniques deemed necessary to protect assets, evaluate control effectiveness and efficiency, and evaluate compliance with policies and regulations.

C. **Independence** – In order to ensure that internal auditors remain objective, the Internal audit function must be organizationally independent. Specifically, the Internal audit function will not defer ultimate judgment on audit matters to others, and shall appoint an individual to head the Internal audit function who will have direct and unrestricted access to the board of directors. Organizational independence does not preclude dual-reporting relationships.

D. **Reporting** – The head of the Internal audit function shall report to the Audit committee regularly, but no less than annually, on the periodic audit plan, factors that may adversely impact the Internal audit function’s independence or effectiveness, material findings from completed audits and the appropriateness of corrective actions implemented by management as a result of audit findings.

E. **Additional Requirements** – If an insurer is a member of an insurance holding company system or included in a Group of insurers, the insurer may satisfy the Internal audit function requirements set forth in this section at the ultimate controlling parent level, an intermediate holding company level or the individual legal entity level.
Section 16. Conduct of Insurer in Connection with the Preparation of Required Reports and Documents

A. No director or officer of an insurer shall, directly or indirectly:

   (1) Make or cause to be made a materially false or misleading statement to an accountant in connection with any audit, review or communication required under this regulation; or

   (2) Omit to state, or cause another person to omit to state, any material fact necessary in order to make statements made, in light of the circumstances under which the statements were made, not misleading to an accountant in connection with any audit, review or communication required under this regulation.

B. No officer or director of an insurer, or any other person acting under the direction thereof, shall directly or indirectly take any action to coerce, manipulate, mislead or fraudulently influence any accountant engaged in the performance of an audit pursuant to this regulation if that person knew or should have known that the action, if successful, could result in rendering the insurer's financial statements materially misleading.

C. For purposes of Subsection B of this section, actions that, “if successful, could result in rendering the insurer's financial statements materially misleading” include, but are not limited to, actions taken at any time with respect to the professional engagement period to coerce, manipulate, mislead or fraudulently influence an accountant:

   (1) To issue or reissue a report on an insurer’s financial statements that is not warranted in the circumstances (due to material violations of statutory accounting principles prescribed by the commissioner, generally accepted auditing standards, or other professional or regulatory standards);

   (2) Not to perform audit, review or other procedures required by generally accepted auditing standards or other professional standards;

   (3) Not to withdraw an issued report; or

   (4) Not to communicate matters to an insurer’s Audit committee.

Drafting Note: In determining what types of sanctions or penalties could be assessed for violations of items included in Subsections A through C, each state should refer to its individual authority provided by state statutes.

Section 1617. Management’s Report of Internal Control over Financial Reporting

A. Every insurer required to file an Audited financial report pursuant to this regulation that has annual direct written and assumed premiums, excluding premiums reinsured with the Federal Crop Insurance Corporation and Federal Flood Program, of $500,000,000 or more shall prepare a report of the insurer’s or Group of insurers’ Internal control over financial reporting, as these terms are defined in Section 3. The report shall be filed with the commissioner along with the Communication of Internal Control Related Matters Noted in an Audit described under Section 11. Management’s Report of Internal Control over Financial Reporting shall be as of December 31 immediately preceding.
B. Notwithstanding the premium threshold in Subsection A, the commissioner may require an insurer to file Management’s Report of Internal Control over Financial Reporting if the insurer is in any RBC level event, or meets any one or more of the standards of an insurer deemed to be in hazardous financial condition as defined in (include reference to Corrective Action statute).

C. An insurer or a Group of insurers that is

(1) directly subject to Section 404;

(2) part of a holding company system whose parent is directly subject to Section 404;

(3) not directly subject to Section 404 but is a SOX Compliant Entity; or

(4) a member of a holding company system whose parent is not directly subject to Section 404 but is a SOX Compliant Entity;

may file its or its parent’s Section 404 Report and an addendum in satisfaction of this Section 16-17 requirement provided that those internal controls of the insurer or Group of insurers having a material impact on the preparation of the insurer’s or Group of insurers’ audited statutory financial statements (those items included in Section 5B through 5G of this regulation) were included in the scope of the Section 404 Report. The addendum shall be a positive statement by management that there are no material processes with respect to the preparation of the insurer’s or Group of insurers’ audited statutory financial statements (those items included in Section 5B through 5G of this regulation) excluded from the Section 404 Report. If there are internal controls of the insurer or Group of insurers that have a material impact on the preparation of the insurer’s or Group of insurers’ audited statutory financial statements and those internal controls were not included in the scope of the Section 404 Report, the insurer or Group of insurers may either file (i) a Section 16-17 report, or (ii) the Section 404 Report and a Section 16-17 report for those internal controls that have a material impact on the preparation of the insurer’s or Group of insurers’ audited statutory financial statements not covered by the Section 404 Report.

D. Management’s Report of Internal Control over Financial Reporting shall include:

(1) A statement that management is responsible for establishing and maintaining adequate Internal control over financial reporting;

(2) A statement that management has established Internal control over financial reporting and an assertion, to the best of management’s knowledge and belief, after diligent inquiry, as to whether its Internal control over financial reporting is effective to provide reasonable assurance regarding the reliability of financial statements in accordance with statutory accounting principles;

(3) A statement that briefly describes the approach or processes by which management evaluated the effectiveness of its Internal control over financial reporting; and
(4) A statement that briefly describes the scope of work that is included and whether any internal controls were excluded;

(5) Disclosure of any unremediated material weaknesses in the Internal control over financial reporting identified by management as of December 31 immediately preceding. Management is not permitted to conclude that the Internal control over financial reporting is effective to provide reasonable assurance regarding the reliability of financial statements in accordance with statutory accounting principles if there is one or more unremediated material weaknesses in its Internal control over financial reporting;

(6) A statement regarding the inherent limitations of internal control systems; and

(7) Signatures of the chief executive officer and the chief financial officer (or equivalent position/title).

E. Management shall document and make available upon financial condition examination the basis upon which its assertions, required in Subsection D above, are made. Management may base its assertions, in part, upon its review, monitoring and testing of internal controls undertaken in the normal course of its activities.

(1) Management shall have discretion as to the nature of the internal control framework used, and the nature and extent of documentation, in order to make its assertion in a cost effective manner and, as such, may include assembly of or reference to existing documentation.

(2) Management’s Report on Internal Control over Financial Reporting, required by Subsection A above, and any documentation provided in support thereof during the course of a financial condition examination, shall be kept confidential by the state insurance department.

Drafting Note: It is the recommendation that the company officer responsible for financial reporting would not be a member of the Audit committee and that the independent committee members would meet periodically, with no management present, with the independent certified public accountant to discuss the strengths and weaknesses of the insurer’s or Group of insurers’ internal control environments.

Section 1718. Exemptions and Effective Dates

A. Upon written application of any insurer, the commissioner may grant an exemption from compliance with any and all provisions of this regulation if the commissioner finds, upon review of the application, that compliance with this regulation would constitute a financial or organizational hardship upon the insurer. An exemption may be granted at any time and from time to time for a specified period or periods. Within ten (10) days from a denial of an insurer’s written request for an exemption from this regulation, the insurer may request in writing a hearing on its application for an exemption. The hearing shall be held in accordance with the regulations of the [insert state] Department of Insurance pertaining to administrative hearing procedures.

B. Domestic insurers retaining a certified public accountant on the effective date of this regulation who qualify as independent shall comply with this regulation for the year ending December 31, 20[ ] and each year thereafter unless the commissioner permits otherwise.
C. Domestic insurers not retaining a certified public accountant on the effective date of this regulation who qualifies as independent may meet the following schedule for compliance unless the commissioner permits otherwise.

(1) As of December 31, 20[ ], file with the commissioner an Audited financial report

(2) For the year ending December 31, 20[ ] and each year thereafter, such insurers shall file with the commissioner all reports and communication required by this regulation.

D. Foreign insurers shall comply with this regulation for the year ending December 31, 20[ ] and each year thereafter, unless the commissioner permits otherwise.

E. The requirements of Section 7D shall be in effect for audits of the year beginning January 1, 2010 and thereafter.

F. The requirements of Section 14 are to be in effect January 1, 2010. An insurer or Group of insurers that is not required to have independent Audit committee members or only a majority of independent Audit committee members (as opposed to a supermajority) because the total written and assumed premium is below the threshold and subsequently becomes subject to one of the independence requirements due to changes in premium shall have one (1) year following the year the threshold is exceeded (but not earlier than January 1, 2010) to comply with the independence requirements. Likewise, an insurer that becomes subject to one of the independence requirements as a result of a business combination shall have one (1) calendar year following the date of acquisition or combination to comply with the independence requirements.

Drafting Note: Adoption of Section 14 is assumed to occur one year prior to the effective date of Section 1617.

G. The requirements of Section 1617 and other modified sections [identify modified sections], except for Section 14 covered above, are effective beginning with the reporting period ending December 31, 2010 and each year thereafter. An insurer or Group of insurers that is not required to file a report because the total written premium is below the threshold and subsequently becomes subject to the reporting requirements shall have two (2) years following the year the threshold is exceeded (but not earlier than December 31, 2010) to file a report. Likewise, an insurer acquired in a business combination shall have two (2) calendar years following the date of acquisition or combination to comply with the reporting requirements.

H. The requirements of Section 15 are to be in effect January 1, 2016. If an insurer or Group of insurers that is exempt from the Section 15 requirements no longer qualifies for that exemption, it shall have one year after the year the threshold is exceeded to comply with the requirements of this article.

Section 1819. Canadian and British Companies

A. In the case of Canadian and British insurers, the annual Audited financial report shall be defined as the annual statement of total business on the form filed by such companies with their supervision authority duly audited by an independent chartered accountant.
B. For such insurers, the letter required in Section 6B shall state that the accountant is aware of the requirements relating to the annual Audited financial report filed with the commissioner pursuant to Section 4 and shall affirm that the opinion expressed is in conformity with those requirements.

Section 4920. Severability Provision

If any section or portion of a section of this regulation or its applicability to any person or circumstance is held invalid by a court, the remainder of the regulation or the applicability of the provision to other persons or circumstances shall not be affected.

Chronological Summary of Actions (all references are to the Proceedings of the NAIC).

2003 Proc. 2nd Quarter 473, 489, 491 (amended and adopted by parent committee).
Attachment Five

2014 Revisions to the
Insurance Holding Company System
Regulatory Act (#440)
Section 1. Definitions

As used in this Act, the following terms shall have these meanings unless the context shall otherwise require:

A. **“Affiliate.”** An “affiliate” of, or person “affiliated” with, a specific person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.

B. **“Commissioner.”** The term “commissioner” shall mean the insurance commissioner, the commissioner’s deputies, or the Insurance Department, as appropriate.

Drafting Note: Insert the title of the chief insurance regulatory official wherever the word “commissioner” appears.

C. **“Control.”** The term “control” (including the terms “controlling,” “controlled by” and “under common control with”) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract other than a commercial contract for goods or nonmanagement services, or otherwise, unless the power is the result of an official position with or corporate office held by the person. Control shall be presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing, ten percent (10%) or more of the voting securities of any other person. This presumption may be rebutted by a showing made in the manner provided by Section 4K that control does not exist in fact. The commissioner may determine, after furnishing all persons in interest notice and opportunity to be heard and making specific findings of fact to support the determination, that control exists in fact, notwithstanding the absence of a presumption to that effect.

D. **“Group-wide supervisor.”** The regulatory official authorized to engage in conducting and coordinating group-wide supervision activities who is determined or acknowledged by the commissioner under Section 7.1 to have sufficient significant contacts with the internationally active insurance group.

D. **“Insurance Holding Company System.”** An “insurance holding company system” consists of two (2) or more affiliated persons, one or more of which is an insurer.
“Insurer.” The term “insurer” shall have the same meaning as set forth in Section [insert applicable section] of this Chapter, except that it shall not include agencies, authorities or instrumentalities of the United States, its possessions and territories, the Commonwealth of Puerto Rico, the District of Columbia, or a state or political subdivision of a state.

Drafting Note: References in this model act to “Chapter” are references to the entire state insurance code.

Drafting Note: States should consider applicability of this model act to fraternal societies and captives.

“Internationally active insurance group.” An insurance holding company system that (1) includes an insurer registered under Section 4; and (2) meets the following criteria: (a) premiums written in at least three countries, (b) the percentage of gross premiums written outside the United States is at least ten percent (10%) of the insurance holding company system’s total gross written premiums, and (c) based on a three-year rolling average, the total assets of the insurance holding company system are at least fifty billion dollars ($50,000,000,000) or the total gross written premiums of the insurance holding company system are at least ten billion dollars ($10,000,000,000).

“Enterprise Risk.” “Enterprise risk” shall mean any activity, circumstance, event or series of events involving one or more affiliates of an insurer that, if not remedied promptly, is likely to have a material adverse effect upon the financial condition or liquidity of the insurer or its insurance holding company system as a whole, including, but not limited to, anything that would cause the insurer’s Risk-Based Capital to fall into company action level as set forth in [insert cross reference to appropriate section of Risk-Based Capital (RBC) Model Act] or would cause the insurer to be in hazardous financial condition [insert cross reference to appropriate section of Model Regulation to define standards and commissioner’s authority over companies deemed to be in hazardous financial condition].

“Person.” A “person” is an individual, a corporation, a limited liability company, a partnership, an association, a joint stock company, a trust, an unincorporated organization, any similar entity or any combination of the foregoing acting in concert, but shall not include any joint venture partnership exclusively engaged in owning, managing, leasing or developing real or tangible personal property.

“Securityholder.” A “securityholder” of a specified person is one who owns any security of such person, including common stock, preferred stock, debt obligations and any other security convertible into or evidencing the right to acquire any of the foregoing.

“Subsidiary.” A “subsidiary” of a specified person is an affiliate controlled by such person directly or indirectly through one or more intermediaries.

“Voting Security.” The term “voting security” shall include any security convertible into or evidencing a right to acquire a voting security.

Section 7. Supervisory Colleges

A. Power of Commissioner. With respect to any insurer registered under Section 4, and in accordance with Subsection C below, the commissioner shall also have the power to participate in a supervisory college for any domestic insurer that is part of an insurance holding company system with international operations in order to determine compliance by the insurer with this Chapter. The powers of the commissioner with respect to supervisory colleges include, but are not limited to, the following:

1. Initiating the establishment of a supervisory college;
2. Clarifying the membership and participation of other supervisors in the supervisory college;
3. Clarifying the functions of the supervisory college and the role of other regulators, including the establishment of a group-wide supervisor;
(4) Coordinating the ongoing activities of the supervisory college, including planning meetings, supervisory activities, and processes for information sharing; and

(5) Establishing a crisis management plan.

B. Expenses. Each registered insurer subject to this section shall be liable for and shall pay the reasonable expenses of the commissioner’s participation in a supervisory college in accordance with Subsection C below, including reasonable travel expenses. For purposes of this section, a supervisory college may be convened as either a temporary or permanent forum for communication and cooperation between the regulators charged with the supervision of the insurer or its affiliates, and the commissioner may establish a regular assessment to the insurer for the payment of these expenses.

C. Supervisory College. In order to assess the business strategy, financial position, legal and regulatory position, risk exposure, risk management and governance processes, and as part of the examination of individual insurers in accordance with Section 6, the commissioner may participate in a supervisory college with other regulators charged with supervision of the insurer or its affiliates, including other state, federal and international regulatory agencies. The commissioner may enter into agreements in accordance with Section 8C providing the basis for cooperation between the commissioner and the other regulatory agencies, and the activities of the supervisory college. Nothing in this section shall delegate to the supervisory college the authority of the commissioner to regulate or supervise the insurer or its affiliates within its jurisdiction.

Section 7.1. Group-wide Supervision of Internationally Active Insurance Groups.

A. The commissioner is authorized to act as the group-wide supervisor for any internationally active insurance group in accordance with the provisions of this section. However, the commissioner may otherwise acknowledge another regulatory official as the group-wide supervisor where the internationally active insurance group:

(1) Does not have substantial insurance operations in the United States;

(2) Has substantial insurance operations in the United States, but not in this state; or

(3) Has substantial insurance operations in the United States and this state, but the commissioner has determined pursuant to the factors set forth in Subsections B and F that the other regulatory official is the appropriate group-wide supervisor.

An insurance holding company system that does not otherwise qualify as an internationally active insurance group may request that the commissioner make a determination or acknowledgment as to a group-wide supervisor pursuant to this section.

B. In cooperation with other state, federal and international regulatory agencies, the commissioner will identify a single group-wide supervisor for an internationally active insurance group. The commissioner may determine that the commissioner is the appropriate group-wide supervisor for an internationally active insurance group that conducts substantial insurance operations concentrated in this state. However, the commissioner may acknowledge that a regulatory official from another jurisdiction is the appropriate group-wide supervisor for the internationally active insurance group. The commissioner shall consider the following factors when making a determination or acknowledgment under this subsection:

(1) The place of domicile of the insurers within the internationally active insurance group that hold the largest share of the group’s written premiums, assets or liabilities;

(2) The place of domicile of the top-tiered insurer(s) in the insurance holding company system of the internationally active insurance group;

(3) The location of the executive offices or largest operational offices of the internationally active insurance group;

(4) Whether another regulatory official is acting or is seeking to act as the group-wide supervisor.
under a regulatory system that the commissioner determines to be:

(a) Substantially similar to the system of regulation provided under the laws of this state, or

(b) Otherwise sufficient in terms of providing for group-wide supervision, enterprise risk analysis, and cooperation with other regulatory officials; and

(5) Whether another regulatory official acting or seeking to act as the group-wide supervisor provides the commissioner with reasonably reciprocal recognition and cooperation.

However, a commissioner identified under this section as the group-wide supervisor may determine that it is appropriate to acknowledge another supervisor to serve as the group-wide supervisor. The acknowledgment of the group-wide supervisor shall be made after consideration of the factors listed in Paragraphs (1) through (5) above, and shall be made in cooperation with and subject to the acknowledgment of other regulatory officials involved with supervision of members of the internationally active insurance group, and in consultation with the internationally active insurance group.

C. Notwithstanding any other provision of law, when another regulatory official is acting as the group-wide supervisor of an internationally active insurance group, the commissioner shall acknowledge that regulatory official as the group-wide supervisor. However, in the event of a material change in the internationally active insurance group that results in:

(1) The internationally active insurance group’s insurers domiciled in this state holding the largest share of the group’s premiums, assets or liabilities; or

(2) This state being the place of domicile of the top-tiered insurer(s) in the insurance holding company system of the internationally active insurance group,

the commissioner shall make a determination or acknowledgment as to the appropriate group-wide supervisor for such an internationally active insurance group pursuant to Subsection B.

D. Pursuant to Section 6, the commissioner is authorized to collect from any insurer registered pursuant to Section 4 all information necessary to determine whether the commissioner may act as the group-wide supervisor of an internationally active insurance group or if the commissioner may acknowledge another regulatory official to act as the group-wide supervisor. Prior to issuing a determination that an internationally active insurance group is subject to group-wide supervision by the commissioner, the commissioner shall notify the insurer registered pursuant to Section 4 and the ultimate controlling person within the internationally active insurance group. The internationally active insurance group shall have not less than thirty (30) days to provide the commissioner with additional information pertinent to the pending determination. The commissioner shall publish in the [insert name of state administrative record] and on its Internet website the identity of internationally active insurance groups that the commissioner has determined are subject to group-wide supervision by the commissioner.

E. If the commissioner is the group-wide supervisor for an internationally active insurance group, the commissioner is authorized to engage in any of the following group-wide supervision activities:

(1) Assess the enterprise risks within the internationally active insurance group to ensure that:

(a) The material financial condition and liquidity risks to the members of the internationally active insurance group that are engaged in the business of insurance are identified by management; and

(b) Reasonable and effective mitigation measures are in place;

(2) Request, from any member of an internationally active insurance group subject to the commissioner’s supervision, information necessary and appropriate to assess enterprise risk, including, but not limited to, information about the members of the internationally active insurance group regarding:
(a) Governance, risk assessment and management;
(b) Capital adequacy, and
(c) Material intercompany transactions;

Coordinate and, through the authority of the regulatory officials of the jurisdictions where members of the internationally active insurance group are domiciled, compel development and implementation of reasonable measures designed to ensure that the internationally active insurance group is able to timely recognize and mitigate enterprise risks to members of such internationally active insurance group that are engaged in the business of insurance;

Communicate with other state, federal and international regulatory agencies for members within the internationally active insurance group and share relevant information subject to the confidentiality provisions of Section 8, through supervisory colleges as set forth in Section 7 or otherwise;

Enter into agreements with or obtain documentation from any insurer registered under Section 4, any member of the internationally active insurance group, and any other state, federal and international regulatory agencies for members of the internationally active insurance group, providing the basis for or otherwise clarifying the commissioner's role as group-wide supervisor, including provisions for resolving disputes with other regulatory officials. Such agreements or documentation shall not serve as evidence in any proceeding that any insurer or person within an insurance holding company system not domiciled or incorporated in this state is doing business in this state or is otherwise subject to jurisdiction in this state; and

Other group-wide supervision activities, consistent with the authorities and purposes enumerated above, as considered necessary by the commissioner.

If the commissioner acknowledges that another regulatory official from a jurisdiction that is not accredited by the NAIC is the group-wide supervisor, the commissioner is authorized to reasonably cooperate, through supervisory colleges or otherwise, with group-wide supervision undertaken by the group-wide supervisor, provided that:

The commissioner's cooperation is in compliance with the laws of this state; and

The regulatory official acknowledged as the group-wide supervisor also recognizes and cooperates with the commissioner's activities as a group-wide supervisor for other internationally active insurance groups where applicable. Where such recognition and cooperation is not reasonably reciprocal, the commissioner is authorized to refuse recognition and cooperation.

The commissioner is authorized to enter into agreements with or obtain documentation from any insurer registered under Section 4, any affiliate of the insurer, and other state, federal and international regulatory agencies for members of the internationally active insurance group, that provide the basis for or otherwise clarify a regulatory official's role as group-wide supervisor.

The commissioner may promulgate regulations necessary for the administration of this section.

A registered insurer subject to this section shall be liable for and shall pay the reasonable expenses of the commissioner's participation in the administration of this section, including the engagement of attorneys, actuaries and any other professionals and all reasonable travel expenses.

Section 8. Confidential Treatment

Documents, materials or other information in the possession or control of the Department of Insurance that are obtained by or disclosed to the commissioner or any other person in the course of an examination or investigation made pursuant to Section 6 and all information reported or provided to the Department of Insurance pursuant to Section 3B(12) and (13), Section 4 and Section 5 and Section 7.1 shall be confidential by law and privileged, shall not be subject to [insert open records, freedom of information,
sunshine or other appropriate phrase], shall not be subject to subpoena, and shall not be subject to discovery or admissible in evidence in any private civil action. However, the commissioner is authorized to use the documents, materials or other information in the furtherance of any regulatory or legal action brought as a part of the commissioner’s official duties. The commissioner shall not otherwise make the documents, materials or other information public without the prior written consent of the insurer to which it pertains unless the commissioner, after giving the insurer and its affiliates who would be affected thereby notice and opportunity to be heard, determines that the interest of policyholders, shareholders or the public will be served by the publication thereof, in which event the commissioner may publish all or any part in such manner as may be deemed appropriate.

B. Neither the commissioner nor any person who received documents, materials or other information while acting under the authority of the commissioner or with whom such documents, materials or other information are shared pursuant to this Act shall be permitted or required to testify in any private civil action concerning any confidential documents, materials, or information subject to Subsection A.

C. In order to assist in the performance of the commissioner’s duties, the commissioner:

1. May share documents, materials or other information, including the confidential and privileged documents, materials or information subject to Subsection A, with other state, federal and international regulatory agencies, with the NAIC and its affiliates and subsidiaries, and with state, federal, and international law enforcement authorities, including members of any supervisory college described in Section 7, provided that the recipient agrees in writing to maintain the confidentiality and privileged status of the document, material or other information, and has verified in writing the legal authority to maintain confidentiality.

2. Notwithstanding paragraph (1) above, the commissioner may only share confidential and privileged documents, material, or information reported pursuant to Section 4L with commissioners of states having statutes or regulations substantially similar to Subsection A and who have agreed in writing not to disclose such information.

3. May receive documents, materials or information, including otherwise confidential and privileged documents, materials or information from the NAIC and its affiliates and subsidiaries and from regulatory and law enforcement officials of other foreign or domestic jurisdictions, and shall maintain as confidential or privileged any document, material or information received with notice or the understanding that it is confidential or privileged under the laws of the jurisdiction that is the source of the document, material or information; and

4. Shall enter into written agreements with the NAIC governing sharing and use of information provided pursuant to this Act consistent with this subsection that shall:

   (i) specify procedures and protocols regarding the confidentiality and security of information shared with the NAIC and its affiliates and subsidiaries pursuant to this Act, including procedures and protocols for sharing by the NAIC with other state, federal or international regulators;

   (ii) specify that ownership of information shared with the NAIC and its affiliates and subsidiaries pursuant to this Act remains with the commissioner and the NAIC’s use of the information is subject to the direction of the commissioner:

   (iii) require prompt notice to be given to an insurer whose confidential information in the possession of the NAIC pursuant to this Act is subject to a request or subpoena to the NAIC for disclosure or production; and

   (iv) require the NAIC and its affiliates and subsidiaries to consent to intervention by an insurer in any judicial or administrative action in which the NAIC and its affiliates and subsidiaries may be required to disclose confidential information about the insurer shared with the NAIC and its affiliates and subsidiaries pursuant to this Act.
D. The sharing of information by the commissioner pursuant to this Act shall not constitute a delegation of regulatory authority or rulemaking, and the commissioner is solely responsible for the administration, execution and enforcement of the provisions of this Act.

E. No waiver of any applicable privilege or claim of confidentiality in the documents, materials or information shall occur as a result of disclosure to the commissioner under this section or as a result of sharing as authorized in Subsection C.

F. Documents, materials or other information in the possession or control of the NAIC pursuant to this Act shall be confidential by law and privileged, shall not be subject to [insert open records, freedom of information, sunshine or other appropriate phrase], shall not be subject to subpoena, and shall not be subject to discovery or admissible in evidence in any private civil action.
Attachment Six

Memo on Additional Analysis Guideline for Risk Retention Groups
MEMORANDUM

TO: Risk Retention Group (E) Task Force Members
FROM: Julie Garber, Senior Accreditation Manager
DATE: March 9, 2015
RE: Additional Analysis Procedures for Risk Retention Groups (RRGs)

The accreditation Review Team Guidelines currently include an additional guideline within the financial analysis section that is specifically related to captive risk retention groups (RRGs). The additional guideline was originally drafted by the Risk Retention Group (E) Task Force and adopted by the Financial Regulation Standards and Accreditation (F) Committee. As currently written, this guideline only applies to those RRGs that are organized under a state’s captive statutes. A question has been raised as to whether this guideline should also apply to those RRGs organized under a state’s P/C statutes. This issue is being presented to the Task Force for its consideration. The guideline in question is included below.

Part B1: Financial Analysis

e. Appropriate Depth of Review

5) For captive RRGs, the following procedures should also be performed and documented in the analysis file in conjunction with the review of the annual statement and/or the audited financial statement:
   ▪ Review the business plan to ensure that it is unchanged from the prior year.
   ▪ Ensure that all changes in the plan of operations have been approved.
   ▪ Review the reconciliation in Note 1 and ensure that it appears accurate and can be relied upon by others.
   ▪ Review question 13.1 (largest net amount insured) and ensure that the amount agrees with the approved plan of operations.
   ▪ Ensure that the financial projections on file accurately reflect the operations as presently conducted.
   ▪ Ensure that the “Notes” relating to the operation of the company agree with the approved plan of operation.
Attachment Seven

Section 3D of the

*Model Risk Retention Act (#705)*
MODEL RISK RETENTION ACT

Table of Contents
Section 1. Purpose
Section 2. Definition
Section 3. Risk Retention Groups Chartered in this State
Section 4. Risk Retention Groups Not Chartered in this State
Section 5. Compulsory Associations
Section 6. Countersignatures not Required
Section 7. Purchasing Groups - Exemption from Certain Laws
Section 8. Notice and Registration Requirement of Purchasing Groups
Section 9. Restrictions on Insurance Purchased by Purchasing Groups
Section 10. Purchasing Group Taxation
Section 11. Administrative and Procedural Authority Regarding Risk Retention Groups and Purchasing Groups
Section 12. Duty of Agents or Brokers to Obtain License
Section 13. Binding Effect of Orders Issued in U.S. District Court
Section 14. Rules and Regulations
Section 15. Severability
Section 16. Effective Date

Section 3. Risk Retention Groups Chartered in this State

D. Governance Standards For Risk Retention Groups - Within a year of the effective date of this Act, existing risk retention groups shall be in compliance with the following Governance Standards. New risk retention groups shall be in compliance with the standards at the time of licensure.

(1) Board of Directors – The “board of directors” or “board” as used in this section, means the governing body of the risk retention group elected by the shareholders or members to establish policy, elect or appoint officers and committees, and make other governing decisions. “Director” as used in this section, means a natural person designated in the articles of the risk retention group, or designated, elected or appointed by any other manner, name or title to act as a director.

(a) Independent Directors The board of directors of the risk retention group shall have a majority of independent directors. If the risk retention group is a reciprocal, then the attorney-in-fact would be required to adhere to the same standards regarding independence of operation and governance as imposed on the risk retention group’s board of directors/subscribers advisory committee under these standards; and, to the extent permissible under state law, service providers of a reciprocal risk retention group should contract with the risk retention group and not the attorney-in-fact.

(i) No director qualifies as “independent” unless the board of directors affirmatively determines that the director has no
“material relationship” with the risk retention group. Each risk retention group shall disclose these determinations to its domestic regulator, at least annually. For this purpose, any person that is a direct or indirect owner of or subscriber in the risk retention group (or is an officer, director and/or employee of such an owner and insured, unless some other position of such officer, director and/or employee constitutes a “material relationship”), as contemplated by Section 3901(a)(4)(E)(ii) of the Liability Risk Retention Act, is considered to be “independent.”

(b) “Material relationship” of a person with the risk retention group includes, but is not limited to:

(i) The receipt in any one 12-month period of compensation or payment of any other item of value by such person, a member of such person’s immediate family or any business with which such person is affiliated from the risk retention group or a consultant or service provider to the risk retention group is greater than or equal to five percent (5%) of the risk retention group’s gross written premium for such 12-month period or two percent (2%) of its surplus, whichever is greater, as measured at the end of any fiscal quarter falling in such a 12-month period. Such person or immediate family member of such person is not independent until one year after his/her compensation from the risk retention group falls below the threshold.

(ii) A relationship with an auditor as follows: a director or an immediate family member of a director who is affiliated with or employed in a professional capacity by a present or former internal or external auditor of the risk retention group is not independent until one year after the end of the affiliation, employment or auditing relationship.

(iii) A relationship with a related entity as follows: a director or immediate family member of a director who is employed as an executive officer of another company where any of the risk retention group’s present executives serve on that other company’s board of directors is not independent until one year after the end of such service or the employment relationship.
(2) Service Provider Contracts The term of any material service provider contract with the risk retention group shall not exceed five (5) years. Any such contract, or its renewal, shall require the approval of the majority of the risk retention group’s independent directors. The risk retention group’s board of directors shall have the right to terminate any service provider, audit or actuarial contracts at any time for cause after providing adequate notice as defined in the contract. The service provider contract is deemed material if the amount to be paid for such contract is greater than or equal to five percent (5%) of the risk retention group’s annual gross written premium or two percent (2%) of its surplus, whichever is greater.

(a) For purposes of this standard, “service providers” shall include captive managers, auditors, accountants, actuaries, investment advisors, lawyers, managing general underwriters or other party responsible for underwriting, determination of rates, collection of premium, adjusting and settling claims and/or the preparation of financial statements. Any reference to ‘lawyers’ in the prior sentences does not include defense counsel retained by the risk retention group to defend claims, unless the amount of fees paid to such lawyers are ‘material’ as referenced in Section (1)(B) above.

(b) No service provider contract meeting the definition of "material relationship" contained in Section (1)(B) shall be entered into unless the risk retention group has notified the Commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto and the Commissioner has not disapproved it within such period.

**Drafting note:** For the sake of clarity, the domestic Commissioner’s authority is included in this subpart. Some states may prefer the Commissioner’s authority as included in this subpart be enacted in Section 11 “Administrative and Procedural Authority Regarding Risk Retention Groups and Purchasing Groups.”

(3) Written Policy The risk retention group’s board of directors shall adopt a written policy in the plan of operation as approved by the board that requires the board to:

(a) assure that all owner/insureds of the risk retention group receive evidence of ownership interest;

(b) develop a set of governance standards applicable to the risk retention group;

(c) oversee the evaluation of the risk retention group’s management including but not limited to the performance of the captive manager, managing general underwriter or other party or parties responsible for underwriting, determination of rates, collection of premium, adjusting or settling claims or the preparation of financial statements;

(d) review and approve the amount to be paid for all material service providers; and

(e) review and approve, at least annually:
Model Risk Retention Act

(i) risk retention group’s goals and objectives relevant to the compensation of officers and service providers;

(ii) the officers’ and service providers’ performance in light of those goals and objectives; and,

(iii) the continued engagement of the officers and material service providers.

(4) Audit Committee The risk retention group shall have an audit committee composed of at least three independent board members as defined in Section (1). A non-independent board member may participate in the activities of the audit committee, if invited by the members, but cannot be a member of such committee.

(a) The audit committee shall have a written charter that defines the committee’s purpose, which, at a minimum, must be to:

(i) assist board oversight of (1) the integrity of the financial statements, (2) the compliance with legal and regulatory requirements, and (3) the qualifications, independence and performance of the independent auditor and actuary;

(ii) discuss the annual audited financial statements and quarterly financial statements with management;

(iii) discuss the annual audited financial statements with its independent auditor and, if advisable, discuss its quarterly financial statements with its independent auditor;

(iv) discuss policies with respect to risk assessment and risk management;

(v) meet separately and periodically, either directly or through a designated representative of the committee, with management and independent auditors;

(vi) review with the independent auditor any audit problems or difficulties and management’s response;

(vii) set clear hiring policies of the risk retention group as to the hiring of employees or former employees of the independent auditor;

(viii) require the external auditor to rotate the lead (or coordinating) audit partner having primary responsibility for the risk retention group’s audit as well as the audit partner responsible for reviewing that audit so that neither individual performs audit services for more than five (5) consecutive fiscal years; and

(ix) report regularly to the board of directors.
(b) The domestic regulator may waive the requirement to establish an audit committee composed of independent board members if the risk retention group is able to demonstrate to the domestic regulator that it is impracticable to do so and the risk retention group's board of directors itself is otherwise able to accomplish the purposes of an audit committee, as described in Section (4)(a).

**Drafting Note:** As an alternative to subsection four “Audit Committee”, the state may substitute the NAIC audit provisions applicable to traditional insurers.

**Drafting Note:** As an alternative to Section 4(b), the state may substitute “If an audit committee is not designated by the insurer, the insurer’s entire board of directors shall constitute the audit committee.”

(5) Governance Standards The board of directors shall adopt and disclose governance standards, where "disclose" means making such information available through electronic (e.g., posting such information on the risk retention group’s website) or other means, and providing such information to members/insureds upon request, which shall include:

(a) a process by which the directors are elected by the owner/insureds;

(b) director qualification standards;

(c) director responsibilities;

(d) director access to management and, as necessary and appropriate, independent advisors;

(e) director compensation;

(f) director orientation and continuing education;

(g) the policies and procedures that are followed for management succession; and

(h) the policies and procedures that are followed for annual performance evaluation of the board.

(6) Business Conduct and Ethics The board of directors shall adopt and disclose a code of business conduct and ethics for directors, officers and employees and promptly disclose to the board of directors any waivers of the code for directors or executive officers, which should include the following topics:

(a) conflicts of interest;

(b) matters covered under the corporate opportunities doctrine under the state of domicile;

(c) confidentiality;

(d) fair dealing;

(e) protection and proper use of risk retention group assets;
(f) compliance with all applicable laws, rules and regulations; and

(g) requiring the reporting of any illegal or unethical behavior which affects the operation of the risk retention group.

(7) Reporting Non-Compliance The captive manager, president or chief executive officer of the risk retention group shall promptly notify the domestic regulator in writing if either becomes aware of any material non-compliance with any of these governance standards.

Drafting Note: RRA 1986 allows for the chartering state to apply the full range of its insurance laws to a risk retention group wishing to charter in that state, except for requiring participation in the guaranty fund. The language of this section is derived from Product Liability RRA 1981 Section 3(a)(1) (which was not amended by RRA 1986 as it relates to this issue). The function of the office of the National Association of Insurance Commissioners shall be solely to provide administrative services for its member states and territories. Although RRA 1986 specifically requires that the phrase “Risk Retention Group” be included in the name, the chartering state is not precluded from prohibiting the use of deceptive or misleading words, designations or phrases in the name. Further, a state may require a risk retention group it charters and licenses to locate books and records or administrative functions within that state to the same extent it imposes those requirements on its domestic insurers.