



**PROTECTING
OKLAHOMA**

JOHN D. DOAK
INSURANCE COMMISSIONER

**OKLAHOMA
INSURANCE
DEPARTMENT**

2012 DOMESTIC CONFERENCE



Oklahoma Domestic Insurance Conference

- **Corporate Governance**
McGladrey
- **Risk Focused Exam Process**
AGI Services
- **Accreditation Process**
Bostick/Crawford Consulting Group

Corporate Governance

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McGladrey



Why Important?

- Assures that insurers remain strong and healthy and act as good corporate citizens
- Good for policyholders
- Good for insurers operating in the State
- Effective corporate governance can prevent failures and abuses
- Sound and responsible insurers are good for Oklahoma and its citizens

Goals

- Primary goal of OID: protect and promote the market for the benefit of Oklahoma citizens
- Promote good and fair regulation
- Hold insurers accountable and responsible for being good corporate citizens
- Potential liability if not appropriately governed
- Help insurers succeed and grow responsibly
- Understand OID expectations

Board of Director Responsibilities

- Establish corporate governance standards
- Fulfill fiduciary duty
 - Duty of care
 - Duty of loyalty
 - Business judgment rule
- Ensure oversight procedures and tools exist

Board of Director Responsibilities

- Failure to fulfill fiduciary duties
 - Potential claims and liabilities
 - Receivers and creditors look to the Board
 - E&O coverage/indemnity issues
 - Practical realities of being sued

Effective Corporate Governance Structure

- Proactive independent board of directors
- Senior management oversight
- Risk management framework in place
- Effective business structure

Effective Corporate Governance Structure

- Strong management experience and industry competency
- Effective internal control structure to assure compliance with laws and regulations
- Adequate and timely risk management, monitoring and management information processes

Effective Corporate Governance Structure

- Adequate and clear policies, authorization limits and procedures
- Independence between risk control functions and business line functions
- Comprehensive management oversight and internal controls, including internal communication and lines of reporting

Effective Corporate Governance Structure

- Processes that accurately and timely monitor compliance with internal policies and limits and laws and regulations
- Effective internal audit function that identifies and assesses key areas of risk
- Segregation of duties
- Code of Ethics and Conduct

Understanding Corporate Governance Structure

Understand the Company & Identify Key Functional Activities to be Reviewed

1. Understanding the Company

2. Understanding the Corporate Governance Structure

3. Assessing the Adequacy of the Audit Function

4. Identifying Key Functional Activities

5. Prospective Review for Indications of Future Solvency Concerns

Source: NAIC Financial Condition Examiners Handbook

Benefits of Corporate Governance Assessment

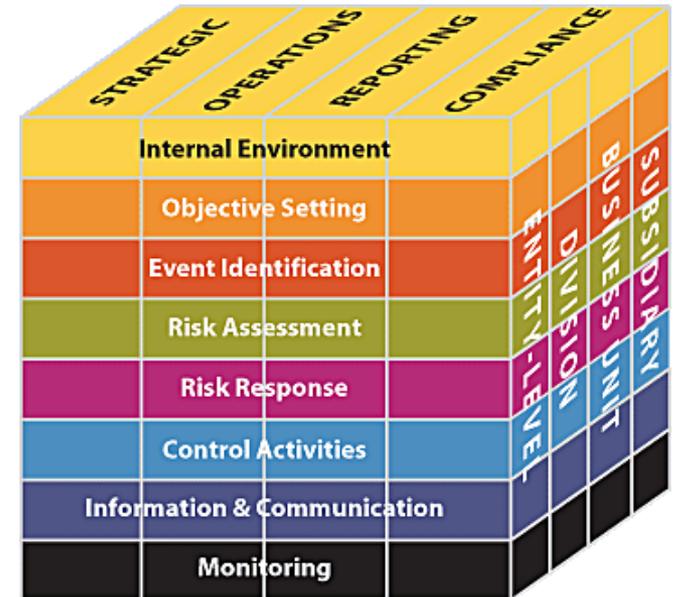
- Enhances the regulator's understanding of company management and operations
- Provides better evaluation of key solvency risk areas:
 - Financial reporting
 - Business, operational and strategic risks
 - Prospective risks

Corporate Governance Assessment

- Conduct interviews with C-level employees
- Assess effectiveness of:
 - Board
 - Organizational structure
 - Assignment of authority and responsibility
 - Management
 - Risk management process/function

Importance of Strong Corporate Governance to Prospective Risks

- Presence of an ERM framework addresses and mitigates risks
- Effective corporate governance contributes to entity level controls
- Board of directors involvement



COSO Enterprise Risk
Management Framework
September 2004

Model Audit Rule Requirements

- Improves regulator's surveillance of financial condition of insurers
 - Annual financial statement audit
 - Internal control communications
 - Management's report of internal control over financial reporting
 - **Audit Committee requirements**
- Most insurers subject to MAR with some exceptions

Audit Committee Requirements

- Audit Committee required for insurers filing an annual audited financial report
- Audit Committee members must be on the Board
- Independent auditor must report directly to the Audit Committee

Audit Committee Requirements

- Responsible for appointment, compensation and oversight of auditor's preparation and issuance of the audited financial report
- No consulting, advisory or other compensatory fees other than from role on Committee

Audit Committee Requirements

Independence requirements:

Prior Calendar Year Direct Written and Assumed Premiums		
\$0 - \$300M	\$300M - \$500M	Over \$500M
No minimum requirements for independence	Majority ($\geq 50\%$) of members shall be independent	Supermajority ($\geq 75\%$) of members shall be independent

NAIC Own Risk & Solvency Assessment (ORSA) Model Law

- Comment period closes 5/11/12
- Upon state adoption of model law--effective 1/1/2015
- Applies to U.S. insurers and their holding company groups
- Confidential self-examination of risks and capital adequacy on annual basis, inclusive of affiliates that are not insurance entities

NAIC Own Risk & Solvency Assessment (ORSA) Model Law

- Must maintain an annual ORSA process
- Exemptions:
 - Annual direct written and unaffiliated assumed premium is less than \$500 million, and/or
 - Insurance group's annual direct written and unaffiliated assumed premium is less than \$1 billion

Corporate Governance Failures

MF Global (2011) - DeAngelis vs. Corzine et al, U.S. District Court, Southern District of New York, No. 11-07866

- **Root cause** - Board was ineffective in its financial statement oversight and investment trade transaction approval standards

UnitedHealth Group (2006) - UnitedHealth Group Inc. PSLRA Litigation [Private Securities Litigation Reform Act], Case No. 06-CV-1691 (D. Minn.)

- **Root cause** - Board breached Code of Conduct and Ethics relative to backdating of stock options

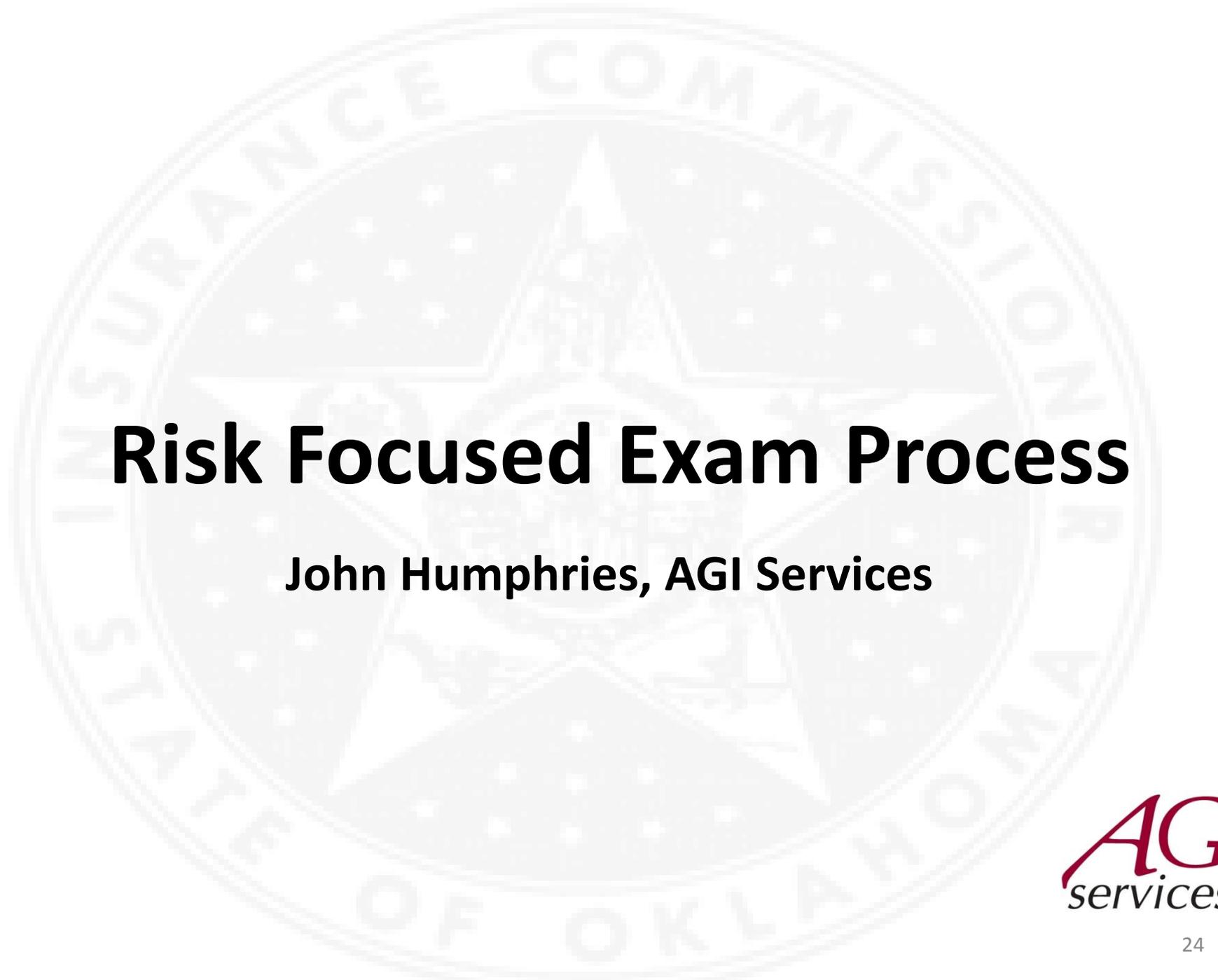
HealthSouth (2003) - SEC vs. HealthSouth Corporation and Richard M. Scrushy

- **Root cause** - Board and Audit Committee management and financial statement oversight were ineffective relative to accounting earnings fraud

Corporate Governance

Thank you for your attention.

Please submit questions on provided form or email to OIG.

The background of the slide features a large, faint watermark of the seal of the Oklahoma State Insurance Commissioner. The seal is circular and contains the text "INSURANCE COMMISSIONER" at the top and "STATE OF OKLAHOMA" at the bottom. In the center, there is a five-pointed star with a smaller star inside it, and a central emblem that appears to be a building or a similar structure.

Risk Focused Exam Process

John Humphries, AGI Services



Risk Focused Exams

- History
 - Prior Approach – Specific Risk Analysis (SRA)
 - Implemented in the early '90s
 - Focused on financial reporting issues
 - Discussed risk, but the focus was on audit risk
 - Balance sheet focused

Risk Focused Exams

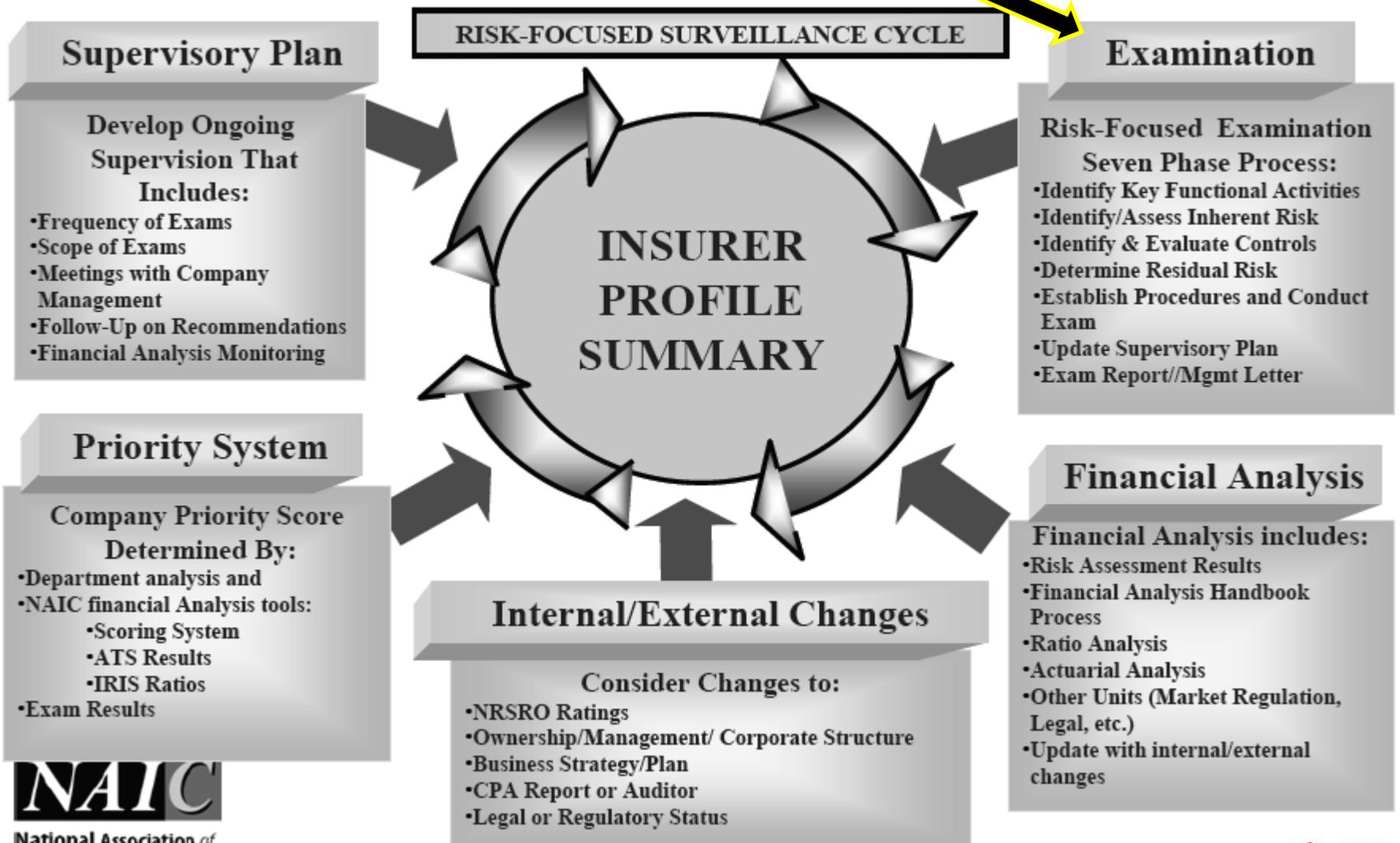
- Reasons for Change
 - Needed a broader, organization-wide assessment
 - Gain a better understanding of the Company
 - Business Model
 - Risk Profile
 - Management / Corporate Governance
 - Prospective Risks

Risk Focused Exams

- Reasons for Change
 - Address strategic and operations risk
 - Better documentation and communication of issues for ongoing surveillance
 - Better use of resources – focus on highest risk

Risk Focused Exams

- Implementation
 - Risk Focused Approach adopted in 2004
 - Accreditation Standard
 - Traditional Companies – January 1, 2010
 - Risk Retention Groups – January 1, 2011
- So, how does it work?



National Association of Insurance Commissioners



Risk Focused Exam Process

- Seven Phase Process

Planning

1. Understand Company / Identify Key Activities
2. Identify and assess Inherent Risk in the Activities
3. Identify and assess risk mitigation/controls
4. Determine Residual Risk
5. Establish and conduct examination procedures
6. Update Prioritization / Supervisory Plan
7. Draft Report and Management Letter

What to Expect

- Significantly more emphasis on:
 - Discussions with Management
 - Processes and controls
 - Statutory Audit Work
 - Prospective risk
 - Highly tailored examination procedures for high risk areas

What to Expect

- Significantly less emphasis on:
 - Routine examination procedures
 - Substantive / detail procedures
 - Lower risk items or areas

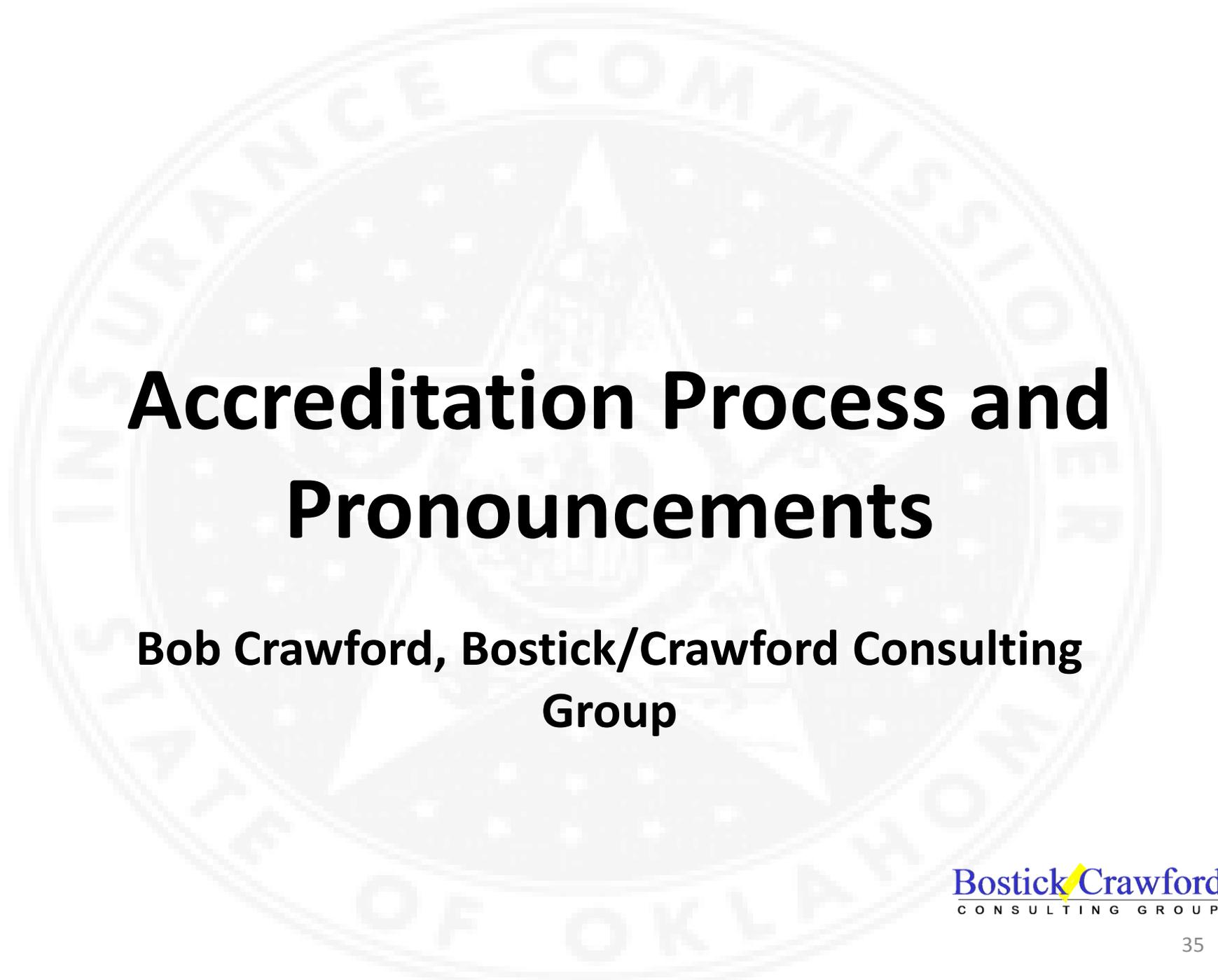
End Result

- Focus on prospective risks that could affect future results (forward looking)
- Better quality examination that targets the most important issues
- Better communication of important issues for ongoing surveillance

Risk Focused Exam Process

Thank you for your attention.

Please submit questions on provided form or email to OI.D.



Accreditation Process and Pronouncements

**Bob Crawford, Bostick/Crawford Consulting
Group**

History of Accreditation

- Timeframe – Late 1980's
 - Several insurance insolvencies
 - Inconsistent, sometimes ineffective state oversight
- NAIC Accreditation Program
 - Adopted standards in June 1989
 - Adopted certification program in June 1990
 - Currently all states, D.C. and Puerto Rico are Accredited

Accreditation – Standards

Part A: Laws and Regulations

- Exam Authority
- Capital & Surplus
- NAIC Accounting
- Corrective Action
- Investment Valuation
- Holding Company
- Risk Limitation
- Investment Diversification
- Liabilities & Reserves
- Reinsurance Ceded
- CPA Audits
- Actuarial Opinions
- Receivership
- Guaranty Funds
- Filings with NAIC
- Producer Controlled
- MGA Act
- Reins Intermediary Act
- Licensing/Change of Control

Accreditation – Standards

Part B: Regulatory Practices & Procedures

- **Financial Analysis**
 - Sufficient Qualified Staff
 - Internal Communication
 - Supervisory Review
 - Priority-Based
 - Depth of Review
 - Documented Procedures
 - Material Adverse Findings
 - Reporting
 - Action
- **Examination**
 - Sufficient Qualified Staff
 - Internal Communication
 - Use of Specialists
 - Supervisory Review
- Use of Guidelines
- Risk-Focused Exam Procedures
- Scheduling of Exams
- Exam Reports
- Adverse Findings
 - Reporting
 - Action
- **Information Sharing/Troubled Companies**
 - Ability to share information with other regulators
 - Follow NAIC Troubled Company Handbook

Accreditation – Standards

Part C: Organizational & Personnel Practices

- Professional Development
- Education & Experience
- Retention of Personnel

Accreditation – Standards

Part D: Licensing & Change in Control

- Qualified Staff
- Sufficient Staff
- Primary Application Procedures
- Form A Filing Procedures
- Use of Form A Database
- Documentation of Work

Accreditation – Certification

- Interim Annual Reviews
 - Focuses on changes in laws and regulation, and practices at Department
 - Based on information provided by Department
- Pre-Accreditation Review
 - Approximately one year prior to full review
 - Based on information provided by Department
- Full Accreditation Review
 - Generally once every five years
 - Based on onsite review

Accreditation

Why Should the Industry Care?

- NAIC guidance
 - Exam statutes says that states may accept examination reports from **Accredited** states
 - Promotes regulatory efficiency by allowing reliance on work performed by accredited states.
 - Enhances state-based regulation of insurance.

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