

Notice of Rulemaking
Corporate Governance

In 2019, the Arizona Legislature adopted the NAIC Corporate Governance Annual Disclosure Model Act at Arizona Revised Statutes (“ARS”) by enacting the Corporate Governance Act at Title 20, Chapter 2, Article 16 (Laws 2019, 1st Reg. Sess., Ch. 180, § 1). The Department of Insurance (“Department”) seeks to adopt the correlate Corporate Governance Annual Disclosure Model Regulation. ARS § 20-492.02 allows the Department to adopt rules to carry out the Act upon notice and an opportunity to be heard. The Legislature has exempted the Department from Title 41, Chapter 6 for one year after the effective date of the Act. (Laws 2019, 1st Reg. Sess., Ch. 180, § 2.)

On October 30, 2019, the Department submitted its proposed rulemaking to the Arizona Secretary of State and anticipates publication in the Arizona Register at the earliest on November 15, 2019. Because the Department would like to publish the rule prior to the end of calendar year 2019 for accreditation purposes, it is allowing only a short comment period of **10 days**. However, the Department will accept comments beginning November 1, 2019, and up to the end of the comment period. Also, regardless of the Department’s desire to publish the final rule before the end of the year, it will schedule a public hearing if it receives a request to schedule one.

Public comments or a request for hearing may be submitted to the Department through e-mail to: public_comments@azinsurance.gov.

Or by mail to: Mary E. Kosinski
Arizona Department of Insurance
100 N. 15th Ave., Suite 102
Phoenix, Arizona 85007-2624

The text of the proposed rulemaking follows:

TITLE 20. COMMERCE, FINANCIAL INSTITUTIONS AND INSURANCE

CHAPTER 6. DEPARTMENT OF INSURANCE

ARTICLE 3. FINANCIAL PROVISIONS AND PROCEDURES

Section

R20-6-310. Corporate Governance

R20-6-310.01. Definitions

R20-6-310.02. Filing Procedures

R20-6-310.03. Contents of CGAD

R20-6-310.04. Severability Clause

ARTICLE 3. FINANCIAL PROVISIONS AND PROCEDURES

R20-6-310. Corporate Governance

The purpose of sections R20-6-310.01 through R20-6-310.03 is to set forth procedures for filing and the required contents of the Corporate Governance Annual Disclosure (CGAD) deemed necessary by the Director to carry out the provisions of Title 20, Chapter 2, Article 16 on Corporate Governance.

R20-6-310.01. Definitions

The definitions in A.R.S. § 20-492 and this Section apply to Sections R20-6-310.02 through R20-6-310.04.

“CGAD” means Corporate Governance Annual Disclosure.

“NAIC” means National Association of Insurance Commissioners.

“Senior Management” means 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.

R20-6-310.02. Filing Procedures

- A. **Deadline to file.** An insurer, or the insurance group of which the insurer is a member, required to file a CGAD by Title 20, Chapter 2, Article 16 shall, no later than June 1 of each calendar year, submit to the Director a CGAD that contains the information described in Section R20-6-310.03.
- B. **Attestation.** The CGAD must include a signature of the insurer’s or insurance group’s CEO or corporate secretary attesting to the best of that person’s belief and knowledge that the insurer or insurance group has implemented the corporate governance practices and that the copy of the CGAD has been provided to the insurer’s or insurance group’s Board of Directors or appropriate committee of the Board of Directors.
- C. **Format of the CGAD.** The insurer or insurance group shall have discretion regarding the appropriate format for providing the information required and is permitted to customize the CGAD to provide the most relevant information necessary to permit the Director to gain an understanding of the corporate

governance structure, policies and practices utilized by the insurer or insurance group.

D. Insurer or insurance group to determine level of reporting.

1. 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 on how the insurer or insurance group has structured its system of corporate governance.
2. The insurer or insurance group is encouraged to make the CGAD disclosures at:
 - a. The level at which the insurer's or insurance group's risk appetite is determined,
 - b. The level 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
 - c. The level at which legal liability for failure of general corporate governance duties would be placed.
3. If the insurer or insurance group determines the level of reporting based on the criteria in subsection (D)(2), it shall indicate which of the three criteria was used to determine the level of reporting and explain any subsequent changes in the level of reporting.

E. CGAD completed at the insurance group level. Notwithstanding Subsection A and as outlined in A.R.S. § 20-492.01, 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 NAIC's Financial Analysis Handbook 2018 Annual/2019 Quarterly, pp. 771 through 774, and no future editions. In these instances, a copy of the CGAD must also be provided, upon request, to the chief regulatory official of any state in which the insurance group has a domestic insurer.

- F. Reference to other existing documents. 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 R20-6-310.03. 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 Director.
- G. Subsequent filings of the CGAD. 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 to the previously filed CGAD. The filing shall also state if no changes are made to the information or activities previously reported by the insurer or insurance group.

R20-6-310.03. Contents of CGAD

- A. Inclusion of attachments. 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. Board. 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 its various committees 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 the Chief Executive Officer (CEO) and Chairman of the Board within the organization.

C. Senior Governing Entity. The insurer or insurance group shall describe the policies and practices of the most senior governing entity and its significant committees, 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 of 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. Senior Management. 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 Director 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 to 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. Oversight. 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 the 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 Director 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 submitted pursuant to A.R.S. § 20-491.03);
 - 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.

R20-6-310.04. Severability Clause

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