



**Massachusetts Division of Insurance
Examination of Compliance with Compensation
Policies and Practices**

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Commissioner of Insurance

Acknowledgements

This report was prepared by the management of the Financial Surveillance Unit with assistance from Field Examination management of the Massachusetts Division of Insurance (“Division”).

In accordance with Massachusetts General Laws, Chapter 175, Section 4 and other applicable statutes, a targeted examination was made of the compensation practices of the Massachusetts domestic insurance industry (“MA Domestic Industry”). This examination was initiated for the purpose of reviewing the Industry’s compliance with the applicable statutes as of December 31, 2011. These statutes included M.G.L. c. 175, §§25 and 35; M.G.L. c. 175, §206C(u)(1); M.G.L. c.176E, §§8 and 11; M.G.L. c.176F, §§8 and 11; M.G.L. c. 176G, § 28(t) and M.G.L. c. 176G, §10 as well as Massachusetts regulation 211 CMR 43.00.

The Division makes all appropriate efforts to check the completeness and consistency of data reported by insurance companies.

INTRODUCTION

There are 89 Massachusetts-domiciled insurance companies including 2 Fraternal Benefit Societies, 11 Health Maintenance Organizations, 3 Hospital Service Plans, 17 Life Insurance Companies, 55 Property & Casualty Insurance Companies, 1 Title Insurance Company, 4 residual market mechanisms and 2 guaranty funds (all hereafter collectively referred to as the “Company” or “Companies”). The following information (see below) was requested from the Companies, as all were placed under examination. This documentation request led to thousands of pages of submittals being reviewed as part of this examination.

COPIES OF THE FOLLOWING COMPANY DOCUMENTS FOR THE YEARS 2010 and 2011 WERE REQUESTED AND REVIEWED:

- Any and all minutes, supplemental materials, reports or similar documents from any meeting of the Company’s Compensation Committee or similar Company committee that reviews, examines or comments upon, in any way, compensation issues.
- Any and all minutes, supplemental materials, reports or similar documents from any meeting of the Company’s Board of Directors, Board of Trustees or similar body where a review, examination or comments were made with respect to compensation issues, including but not limited to any meeting where a vote was held to specifically authorize any compensation amount for any person.
- Any and all Company bylaws, including any committee charter or bylaws, specific to compensation as of the current examination date, noting any changes since the prior examination date.
- List(s) of each and every member of the Company’s Board of Directors, Board of Trustees, or any similar body, including the titles, business affiliations, and total compensation amount received by each person from the Company represented on these bodies.
- List(s) of each and every officer of the Company, with their respective titles and total compensation.
- List(s) of all managerial and non-managerial employees of the Company whose individual total compensation was greater than \$100,000.
- Copies of the NAIC “Supplemental Compensation Exhibit” and internal Company documentation that describes the process used to complete this exhibit. If applicable, address whether employees who left the Company prior to the end of the calendar year were included on the exhibit.

HISTORY

Prior to the December 31, 2007 Annual Statement filings, the Division did not require its domestic insurers to submit the Supplemental Compensation Exhibit as part of the Annual Statement filings. The domestic insurers were required to maintain the Supplemental Compensation Exhibit at their offices and were required to provide it upon request of the Division. During 2007, the Massachusetts Commissioner of Insurance (the “Commissioner”) changed that policy, requiring that as of the December 31, 2007 Annual Statement filings, all

domestic insurers must submit the Supplemental Compensation Exhibit to the Division as part of the Annual Statement filings. The Supplemental Compensation Exhibit is a public document subject to significant attention and scrutiny; the Division was interested to understand how the MA Domestic Industry has been completing this document in the five years since its submittal became required.

SCOPE OF EXAMINATION

The scope of the examination included all matters associated with the processes utilized by each company, residual market mechanism, and guaranty fund for determining and reporting employee, officer, director, and trustee compensation, as well as any other materials and information the Commissioner deemed prudent and in the interests of policyholders and the public. Additionally, the examination reviewed the processes utilized by the MA Domestic Industry relating to completing and filing the Supplemental Compensation Exhibit as required by the Division. Lastly, the examination collected data on compensation at the holding company level, including mutual holding companies.

INDIVIDUAL COMPONENT TESTING

Determining Compensation

M.G.L. c. 175 §35 requires that each Massachusetts-domiciled insurance company issued a Certificate of Authority under M.G.L. c. 175 shall not pay any salary or compensation to its five most highly compensated officers, trustees or directors or to any additional officers, trustees or directors whose salary or compensation exceeds \$150,000, unless such payment is first authorized by a vote of its board of directors, trustees or a committee thereof. In its examination, the Division applied this threshold to the MA Domestic Industry. It was determined that in the aggregate, all MA domestic insurance companies subject to this statute were in compliance and the vast majority of the other entities tested had a process in place that would comply with this requirement.

M.G.L. c. 175 §35 also requires that each Massachusetts-domiciled insurance company issued a Certificate of Authority under M.G.L. c. 175 shall not make any payment of an amount in excess of 12.5 percent of any annual salary, compensation or emolument, or a larger percentage from Company funds to an individual's deferred compensation plan, unless this level of payment has been approved by the Commissioner. In this examination, the Division applied this threshold to the MA Domestic Industry. There were 34 companies that disclosed a deferred compensation plan which included company contributions. Of that total, 32 companies disclosed that company fund contribution thresholds were lower than the threshold set forth in statute.

Reporting Compensation

The National Association of Insurance Commissioners ("NAIC") provides a schedule entitled "Supplemental Compensation Exhibit" as part of the Annual Statement format provided by the NAIC to all insurers. Since 2007, Massachusetts has required the Supplemental Compensation Exhibit filings for each Massachusetts-domiciled insurance company be submitted with the Annual Statement filings on March 1 each year. Massachusetts-domiciled insurance companies include all health maintenance organizations (HMO's), Blue Cross Blue Shield of

Massachusetts, all Dental Service Corporations, all Fraternal Benefit Societies, and all Vision Service Plans, as well as Life, Title, and Property & Casualty insurers.

The instructions provided by the NAIC require several items. The NAIC instructions are shown in the box which follows:

SUPPLEMENTAL COMPENSATION EXHIBIT

Each reporting entity shall file with its state of domicile and any state that requests it in writing a Supplemental Compensation Exhibit for such directors, officers, and employees and in such manner as provided below.

The Exhibit shall be filed as a supplement to each reporting entity's annual statement to the domiciliary Department on or before March 1. The purpose of the Exhibit is to provide information to the regulator concerning payments to senior management and directors that could negatively impact a reporting entity's financial condition.

Insurers that are part of a group of insurers or other holding company system may file amounts paid to officers and employees of more than one insurer in the group or system either on a total gross basis or by allocation to each insurer.

Compensation shall consist of any and all remuneration paid to or on behalf of an officer, employee, or director covered by this requirement, including, but not limited to, wages, salaries, bonuses, commissions, stock grants, gains from the exercise of stock options, and any other emolument.

Supplemental Compensation Exhibit

- A table disclosing the total of all compensation paid to the named officers shall be provided.
- The table shall cover a three-year period, although companies may phase in the required disclosures over the first three years of reporting.

Part 2

Officer and Employee Compensation

Reporting entities shall disclose the compensation of:

1. The chief executive officer and the four most highly paid other executive officers, regardless of compensation; and
2. The next five highly compensated employees whose individual total compensation exceeds \$100,000.

Part 3

Director Compensation

Reporting entities shall also disclose all compensation paid to or on behalf of all directors, other than full-time officers and employees of the reporting entity whose total compensation included service as a director and is disclosed under Part 2. Amounts disclosed must include all compensation paid for services on board and committees as well as any other compensation for any other activity or service, such as consulting agreements

For the purposes of this examination as it relates to the Supplemental Compensation Exhibit, there were several areas that were reviewed:

- 1.) Each Company is required to file the Supplemental Compensation Exhibit on or before March 1 as a supplemental submittal to the company's Annual Statement filing. It was determined that there were several companies that filed the Supplemental Compensation Exhibit late. Many of the companies that filed late indicated that they were not aware that the Exhibit was a required filing.
- 2.) Although the purpose of the Supplemental Compensation Exhibit is to disclose information to the person reading the Exhibit regarding compensation made to senior management and directors, the examination concluded that this section of the instructions was interpreted in many ways by the Companies. In many instances, the list of officers was incomplete, as was the list of directors. The filings were subsequently amended to come into compliance.
- 3.) The Supplemental Compensation Exhibit instructions allow those companies that are a part of a group of insurers to file the Supplemental Compensation Exhibit showing amounts paid to officers and employees of more than one insurer in the group or system either on a total gross basis or by allocation to each insurer. The examination uncovered that this language was interpreted several different ways by the Companies, which led to variations on allocation methodology. While each instance of allocation appeared to be correct (after some research), the allocation methodology was not clearly disclosed.
- 4.) The Supplemental Compensation Exhibit instructions state that compensation shall consist of any and all remuneration paid to or on behalf of an officer, employee, or director covered by this requirement, including, but not limited to, wages, salaries, bonuses, commissions, stock grants, gains from the exercise of stock options, and any other emolument. Discussions with several companies indicated that nevertheless, there was some confusion as to what should be included as compensation.
- 5.) The Supplemental Compensation Exhibit instructions require a table be provided to disclose the total of all compensation. The instructions further state that the table cover a three-year period. Several companies indicated that they were not sure how to handle changes in managers within the three-year period as well as how to handle those employees that left employment with the company during the three-year period.
- 6.) The Supplemental Compensation Exhibit Instructions require reporting entities disclose the compensation of the chief executive officer ("CEO") and the four most highly compensated executive officers regardless of compensation. Several companies did not fill this portion out as the instructions require because of their interpretation of the term CEO or the term "executive officers".

- 7.) The Supplemental Compensation Exhibit instructions further require reporting entities to disclose the compensation of the next five highly compensated employees each of whose total compensation exceeds \$100,000. When the examination team compared the list of all managerial and non-managerial employees of the Company whose individual total compensation was greater than \$100,000 to what was provided on the Supplemental Compensation Exhibit, it was evident that there were several companies that did not correctly complete this section.
- 8.) The Supplemental Compensation Exhibit instructions require that reporting entities disclose all compensation paid to or on behalf of all directors that are not full-time officers or employees whose compensation has already been disclosed. Director compensation should include any compensation paid to directors for services on the board and committees as well as any other compensation for any other activity or service, such as consulting agreements. When the examination team compared the Supplemental Compensation Exhibit information to the information requested from the MA Domestic Industry, it was clear that this section was interpreted different ways by many companies.

SUMMARY

The requested documentation provided by each Company was reviewed for completeness. Incomplete information was subsequently corrected by the individual company as part of the process.

Based upon the documentation provided by the Companies, the vast majority of the companies examined do have a process in place whereby the board of directors, or some committee appointed by the board, reviews executive compensation. In some cases, the board, or committee thereof, reviews all employee compensation. There was evidence of board votes for those companies that followed that process. Some of the smaller companies, however, did not follow the above process.

Based upon the documentation provided by the Companies, it would appear that most companies under examination that are required to file the Supplemental Compensation Exhibit were in compliance with the filing requirements. Although there were some minor areas that required additional information, no major concerns or findings resulted from the targeted examination.

During the review of the Supplemental Compensation Exhibits filed during 2010 and 2011, there were several inconsistencies noted in the way those filings were being made. As a result of those observations, there were changes made to the filing instructions posted on the Division's website to clarify the filing methodology required by the Division. After carefully reviewing all of the Supplemental Compensation Exhibits filed for 2012, it was determined that these additional instructions should be made known directly to each Company. An email was sent to the senior financial officer for each insurer that contained a document specifying the instructions that each company should follow when filing the Supplemental Compensation Exhibit for 2013. See Exhibit 1 for a copy of that document.

Lastly, for those holding companies where compensation documentation was requested, the documentation was received in the format requested. Although there were some minor areas that required additional information, no major concerns or findings resulted from the targeted examination.

CONCLUSION

Based upon the documentation provided by the Companies, there does appear to be a process followed by each company for the approval of executive compensation as well as the reporting of compensation on the Supplemental Compensation Exhibit. While not every company follows the same internal guidelines, each company appears to have a working process in place.

RECOMMENDATION

M.G.L. c. 175 § 35 was first enacted in 1907 and was most recently amended in 2000. Based upon the fact, as evidenced by the results of the Division's targeted examination, that there appears to be some confusion amongst the MA Domestic Industry as to the Statute's requirements there may be a need for further amendments to be made. For example, the deferred compensation component of M.G.L. c. 175, § 35 appears to have been enacted well before the advent of the plethora of individual deferred compensation options available today. As such, the Division could review the individual components set forth in M.G.L. c. 175, § 35 and consider whether the Statute should be updated to bring it more in line with current industry standards.

The Division requests the Supplemental Compensation Exhibit as part of the Annual Statement filings every March. The NAIC Annual Statement process allows each state to have the ability to modify or expand the instructions to the NAIC exhibits. In the case of the Supplemental Compensation Exhibit, the Division should expand the instructions to clarify the data required and manner of presentation. This should provide more consistent and informative reporting.

Exhibit 1

Dear CFO/Treasurer,

As you prepare for the December 31, 2013 Annual Statement Filings that are due March 3, 2014, I thought it would be appropriate to have a brief email discussion about the NAIC Supplemental Compensation Exhibit and the various versions. Our review of last year's filings noted that not all of them were consistent with the NAIC Annual Statement Filing Instructions as published.

After a detailed review of last year's filings, the following observations regarding the Supplemental Compensation filings were made:

- 1.) Not all companies used the correct Supplemental Compensation Exhibit form when they filed. Please be sure that your company (s) uses the correct form. The instructions posted on the Division's web site include a link to the appropriate form.
- 2.) Not all companies that used a compensation allocation protocol between companies in a group explained the allocation methodology as required in Question 1 of the Part 1 Interrogatories.
- 3.) Not all companies completed the director section correctly. Some examples are shown below:
 - a. Unpaid directors were not included on the Supplemental Compensation Exhibit.
 - b. The director's principal occupation column information was not provided.
 - c. Other Compensation information was not provided.

As your Company prepares this schedule for this year, please keep in mind the NAIC Annual Statement Instructions as published and the guidance provided on the Division website (below).

2013 Annual Statement Filing Checklist Notes

Note 1

Supplemental Compensation Exhibit (Domestic Companies Only)

All Massachusetts domestic insurance companies are required to file this exhibit with the Massachusetts Division of Insurance as part of their Annual Statement filing. Each domestic insurer shall file the most recent version of the exhibit, as provided by the National Association of Insurance Commissioner: [Supplemental Compensation Exhibit](#) 

Exhibit 1

Instructions specific to “PART 1 – INTERROGATORIES”:

Question 1 – If there is an allocation to each insurer within the group, provide a description of the allocation methodology on the exhibit.

Question 2 – If the answer is “Yes”, provide the commission as part of “All Other Compensation” reported in Column 5 of Part 2, or Column 3 of Part 3 on the exhibit.

Question 3 – If the answer is “Yes”, provide a description of any salary, compensation or emolument that will extend beyond a period of 12 months of the date of the agreement on the exhibit.

Instructions specific to “PART 2 – OFFICERS and EMPLOYEES COMPENSATION”:

The reporting insurer shall provide compensation information for the chief executive officer (or similar title) and the next four most highly compensated other officers of the company. Any former officer or employee whose total compensation meet this criterion shall be included on this exhibit, even if such officer or employee was not an officer or employee of the company at year-end. Any former officers or employees included on the exhibit shall be identified as “Former”.

The reporting insurer shall also provide compensation information for the next five most highly compensated employees of the company whose individual pre-allocation total compensation exceeds \$100,000.

Instructions specific to “PART 3 – DIRECTOR COMPENSATION”:

All persons who serve as a Director of the reporting insurer during the reporting year, whether compensated or uncompensated, shall be provided in Part 3, including employees who served as a Director during the reporting year. The Director’s name and principal position or occupation shall be provided on the exhibit.