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**Governance Standards
For Risk Retention Groups**

1) 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.

   A) 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 risk retention group'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 or its owners/insureds 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.

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3) <u>Written Charter</u> The risk retention group's board of directors shall have a written policy in the Bylaws 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;

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

   E) review and approve, at least annually:

      i) the 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) <u>Audit Committee</u> 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, (3) the qualifications, independence and performance of the independent auditor and actuary, and (4) 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;

      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

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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).

5) Governance Standards The risk retention group 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) management succession; and

   H) annual performance evaluation of the board.

6) Business Conduct and Ethics The risk retention group 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) corporate opportunities;

   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 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 the risk retention group's governance standards.

8) Enforcement The risk retention group's domestic regulator may take appropriate regulatory action against any director or officer of the risk retention group or its captive manager, pursuant to its laws and regulations, if the risk retention group or captive manager violates these governance standards.

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