INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

EXTRACT FROM RECOMMENDATIONS ON CORPORATE GOVERNANCE:

MAIN ELEMENTS OF INSURERS' CORPORATE GOVERNANCE

25 SEPTEMBER 2007

Appendix 3

Main Elements of Insurers' Corporate Governance

Contents

Introduction

1. This note contains general and high level elements of corporate governance for insurers. It is drafted based on the stock take of relevant requirements described in a number of documents adopted by international bodies such as the OECD, the Basel Committee on banking Supervision, the World Bank and the International Association of Insurance Supervisors (IAIS) itself. Also, the best practices described in papers published by private sector organisations were considered. The documents reviewed during the stock take are listed in Appendix 2 of the recommendation to the Technical Committee.

2. The documents included in the stock take approach corporate governance with a varying level of detail. The object of this note is to provide a synthesis of high level elements which are drawn from the documents reviewed. It reflects the best practice identified in the documents included in the stock take. While the focus of the note is on aspects of corporate governance applicable to insurers and seen in a supervisory perspective, it is not intended to issue new IAIS requirements. Thus, in IAIS terminology the note is not a supervisory paper or a supporting paper. It is reference material for the IAIS and for future work of Technical Committee working parties. This note is drafted by the Corporate Governance Task Force in response to the mandate given by the Technical Committee. The Task Force has not sought to develop further but to synthesise the high level principles which have been distilled from the stock take. Any prescriptive language used in the paper reflects the language used in the underlying documents.

General

3. This note applies to a corporate governance structure composed of a board of directors and senior management. It is however recognised that jurisdictions have differences with respect to the structures and functions of the board of directors and senior management. Some jurisdictions with a two-tier/bicameral structure have assigned the supervisory/oversight role of the board of directors to a separate supervisory body with no executive responsibilities but with an oversight responsibility. Therefore, in these structures the board of an insurer (sometimes referred to as “management board”) is accountable and responsible for the governance of the insurer whereas a “supervisory board” is accountable and responsible for the monitoring of the insurer’s performance as well as for supervising “the management board”. On the other hand, jurisdictions with a one-tier structure provide the board of directors with a broader responsibility comprising both governance and oversight. In these structures the board of directors is composed of both executive and non-executive members. Variations of these structures also exist.

4. Therefore, the terminology “board of directors” and “senior management” used in this paper may not per se lend itself for application to the same terms used in a national, and/or legal context but needs to be applied to the respective oversight and governance functions within the insurer.

5. The corporate governance elements included in this note need not necessarily be reflected in insurance supervision legislation and regulation as such. They could be contained in other legal instruments such as company law or other general regulation or guidance from industry associations.

Governance structure

Structure: one-tier or two-tier/bicameral structure

6. As mentioned in paragraph 3, there are different practices and conventions for corporate governance arrangements in jurisdictions including one-tier and two-tier/bicameral structures. Whilst no view is taken as to which arrangements are superior it is expected that whatever form is taken, the broader elements of good corporate governance are applicable.

7. Corporate governance structures and arrangement should be transparent both to internal and external stakeholders and ensure that there is effective oversight and accountability of the board of directors and senior management of the insurer. Details of such structures and arrangements including terms of reference for any committees should be accessible to stakeholders.

Establishment of committees

8. Dependent on the size, nature and complexity of the insurer it may be appropriate to have committees dedicated to particular functions. In particular, in most cases, it would be considered appropriate to have an independent audit committee. It may also be appropriate to establish separate committees for risk management, remuneration of board members, nomination of board members and for ethics.

Stakeholders

9. Insurers need to consider the interests of all stakeholders including their policyholders as a specific group of stakeholders. This applies to any form of insurer, shareholder owned insurers as well as mutuals etc. Insurers should ensure that the board of directors represents all categories of stakeholders whether they be shareholders, members or policyholders. In the case of mutual insurers, policyholders will, in principle, also have certain membership rights or entitlements with respect to the insurance association which need to be recognised.

Functions and responsibilities of the board of directors

Description of the responsibilities of the board of directors

10. The board of directors is accountable and responsible for the direction, control and governance of the insurer. Delegation of authority to board committees does not absolve the board of directors from its responsibilities.

11. The board of directors is expected to develop policies and strategies for the insurer including the means of attaining them and procedures for monitoring and evaluating the progress towards them. In so doing, the board of directors has to consider stakeholders' interests.

12. The board of directors ensures that the insurer complies with all relevant laws, regulations and any applicable codes of conduct.

13. The board of directors delegates the day-to-day managerial authority of the insurer to senior management. It oversees and controls senior management. Senior management is appointed and dismissed by the board of directors.

Functions and responsibilities of senior management

14. Senior management is responsible for the day-to-day business of the insurer. It provides recommendations regarding objectives, strategy, business plans and major policies to the board of directors.

Business values, corporate culture and alignment of behaviour

15. The board of directors applies high ethical standards and establishes standards of business conduct and ethical behaviour for the members of the board of directors, senior management and other personnel. The board of directors ensures an on-going, appropriate and effective process of adherence to those standards. The board of directors sets the standard for corporate values.

Internal control and risk management

16. To monitor the risks undertaken by the insurer, the board of directors establishes an internal control system and risk management including independent risk management functions appropriate to the size, nature and complexity of the business.

Internal audit

17. The board of directors ensures the existence of an internal audit function which performs objective, independent and risk-oriented audits of the processes and structure of the company and which reports all relevant matters on a timely basis to the board or one of its committees.

18. The board of directors and any relevant committees should receive and review regular and ad hoc internal audit reports.

Management information

19. The board of directors asks, receives and reviews all information necessary to fulfil its function in setting the direction, control and governance of the insurer. Senior management ensures that the board of directors has access to all relevant information concerning the insurer to ensure that the board of directors is informed in a timely manner of important and relevant events and developments.

Composition of the board of directors

Size and composition of the board of directors

20. The size and composition of the board of directors must be sufficient to ensure that collectively they provide thorough knowledge, skills, experience, commitment and independence to carry out their functions and responsibilities effectively, taking into account the size, nature and complexity of the business.

Terms of office of board members

21. Procedures concerning election, re-election, removal and retirement of members of the board of directors should be set out and documented. Membership of the board of directors is subject to periodic re-election.

Qualifications

Adequate knowledge of group structure, organisational structure, processes and products

22. The board of directors and senior management should understand the operational structure of the insurer in all jurisdictions in which the insurer operates. They should also have a general undestanding of the lines of business and products of the insurer.

23. The board of directors should particularly seek to develop and maintain an appropriate level of expertise and knowledge as the insurer grows in size and complexity.

24. Board members should be in a position to dedicate sufficient time and commitment to fulfilling their responsibilities.

25. The board of directors of a parent company should understand the material risks and issues that affect group entities.

Fit and proper criteria

26. Board members, senior management and key functionaries of an insurer should be fit and proper to fulfil their roles. This requires that they have appropriate integrity, competency, experience and qualifications. They should also have a clear understanding of their role in corporate governance and be able to exercise sound judgment about the

affairs of the insurer. Breaches by members of the board of directors of the duty of integrity should be considered as grounds for their dismissal from the board of directors.

Qualifications for significant owners or controlling shareholders

27. Significant owners or controlling shareholders should be suitable to fulfil their roles. This requires that they, at a minimum, have integrity and appropriate qualifications and a sound financial position. Proposed owners must have the resources to provide the minimum capital required.

Conflicts of interest

28. Members of the board of directors and senior management must avoid conflicts of interest, or perceived conflicts of interest, that might prevent them from proper discharge of their functions, with their role as either a member of the board of directors or senior management of the insurer and their other activities and commitments.

29. The board of directors should set out policies that address conflicts of interest and review these policies regularly. These policies should include a procedure for members of the board, management and staff to report potential conflicts. The board should ensure that senior management implements these policies.

Incompatibilities

30. Members of the board of directors and senior managers should not simultaneously hold two positions in the same insurer (i.e. in the same legal entity) where this could result in a material conflict.

31. Separation of the position of chairman of the board of directors and chief executive officer is considered good practice. Where these positions are combined in one person appropriate controls shall be in place to ensure that management is sufficiently accountable to the board of directors.

Remuneration and benefits

32. The remuneration policy for members of the board of directors and senior management should have regard to the performance of the person as well as that of the insurer. The remuneration policy should not include incentives that would encourage imprudent behaviour.

33. The board of directors should ensure that senior management implements policies that prohibit (or appropriately limit) activities, relationships or situations that might diminish the quality of corporate governance, such as lending to members of the board of directors or controlling shareholders.

Disclosure and transparency

34. Insurers are required to disclose information on their financial position and the risks to which they are subject. The disclosed information should be relevant, timely, accessible, comprehensive and meaningful, reliable, comparable and consistent over time.

35. This information includes quantitative and qualitative information on the financial position and financial performance and a description of the corporate governance.

36. Insurers should produce, at least annually, audited financial statements and make them available to stakeholders.

37. The board of directors should disclose their policies that address conflicts of interest, fair treatment of customers and information sharing with stakeholders.

38. Also, a mechanism for redress should be disclosed to policyholders.

The Actuary

Appointment or assignment of the actuary

39. The insurer should nominate an actuary who reports to the board of directors and senior management – at least in the case of a life insurance entity. This actuarial function should preferrably be performed by an appointed actuary[1]. It may also be performed by a manager of the insurer who should have the possibility to report directly to the board, or by an external consultant.

Independence of the actuary

40. The actuary should act in an independent way to avoid possible conflicts of interests. Actuaries should be disallowed from from simultaneously holding two positions in an insurer where this could result in a material conflict.

Qualifications

41. The actuary should be subject to strict qualification and suitability standards adopted by professional bodies and should be subject to appropriate ethics standards and disciplinary proceedings.

Access to board, audit committee and external auditor

42. The actuary should have direct access to the board of directors or a committee of the board, such as any audit committee. The actuary should report relevant matters to the board of directors, on a timely basis and provide to the board with all relevant reports.

1 In some jurisdictions where use is made of an actuary in the supervisory system, this use is referred to as an 'appointed actuary' or a 'responsible actuary' system.

43. The actuary should be able to report to and communicate with the external auditor on issues relevant to the performance of their respective responsibilities.

Reporting to the supervisor

44. All reports and supporting documentation by the actuary should be accessible to the supervisor.

The external auditor

Appointment

45. The external auditor should be appointed at a general meeting of the shareholders or members of the insurer. The external auditor should certify the insurer's accounts at least on an annual basis.

Independence

46. The external auditor should be independent from the insurer, its board of directors and its management.

47. Insurance audit partners should rotate on a periodic basis.

Qualifications

48. The external auditor should be subject to strict qualification and suitability standards adopted by professional bodies and to appropriate standards on ethics and disciplinary proceedings.

Access to board and audit committee

49. The external auditor should have direct access to the board of directors or a committee of the board, such as an audit committee. The external auditor should report relevant matters to the board of directors on a timely basis and provide to the board all relevant reports.

Reporting to the supervisor

50. All reports and supporting audit documentation by the external auditor should be accessible to the supervisor.

51. The external auditor should alert the supervisor promptly of any event that could seriously affect the insurer's financial position, its accounting or provisioning or the organisation of its administration and of any criminal violations and material irregularities.

Supervision

52. The supervisor should consider corporate governance as an element of policyholder protection.

53. The supervisor should have the power to provide guidance on sound corporate governance for insurers. In developing guidance, supervisors should recognise that insurers may adopt different approaches to corporate governance that are appropriate to the size, nature, complexity, structure and risk profile of the insurer. The supervisory process should take this into account in evaluating the insurer's corporate governance.

54. The supervisor should require and verify compliance by the insurer with applicable corporate governance principles and standards. It should determine whether the insurer has adopted and effectively implemented sound corporate governance policies and practices.

55. The appointment of external auditors and actuaries may be subject to supervisory review. Non-admission or removal may be required where the external auditor or the actuary do not comply with fit and proper requirements or fails to perform adequately the required functions and duties.

56. The supervisor should review the risk management and internal controls of the insurer and check their adequacy having regard to the size, nature and complexity of the business and require the strengthening of the risk management and internal controls, where necessary.

57. The supervisor should approve or reject proposals to acquire significant ownership or any other interest in an insurer that results in that owner directly or indirectly, alone or with associate(s), exercising control over the insurer.

58. The supervisor should monitor the information disclosed by insurers and take necessary action to ensure compliance with disclosure requirements.

59. The supervisor should require that the structure of the financial groups containing potential and actual controlling owners of insurers be sufficiently transparent so that supervision of the insurance groups will not be hindered.

60. The supervisor should bring any problems they detect through their supervisory activities to the the attention of the board of directors and senior management and require that corrective measures be taken in a timely manner.