



FINANCIAL REGULATOR  
*Rialtóir Airgeadais*



**CORPORATE GOVERNANCE GUIDELINES FOR  
REINSURANCE UNDERTAKINGS**

**April 2006**

**CONSULTATION PAPER CP18**

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# 1 Introduction

## 1.1 Scope of this Consultation Paper

As the reinsurance sector in Ireland moves to formal regulation following the publication of Council Directive 2005/68/EC (“Reinsurance Directive”) on the 9<sup>th</sup> of December 2005, corporate governance standards within reinsurance undertakings will be subject to regulatory oversight. The Irish Financial Services Regulatory Authority (“Financial Regulator”) is issuing this paper to outline to the sector how this issue will be dealt with in practice between individual reinsurance undertakings and the Financial Regulator.

The Financial Regulator developed its proposals contained in this paper, having considered the results of a pre-consultation through the reinsurance industry’s representative body. Submissions received via the Financial Regulator’s pre-consultation process have been addressed mainly through the frequently asked questions attached in Appendix 1.

The International Association of Insurance Supervisors (“IAIS”) has developed standards for the supervision of reinsurance undertakings. These standards are regarded as the minimum standards to be applied to supervision of reinsurance in most developed economies, including EU jurisdictions, the US, Canada and Australia. As part of these standards, the IAIS has devised principles on corporate governance. The proposals set out by the Financial Regulator in this paper are based mainly on the IAIS principles (available at [www.iaisweb.org](http://www.iaisweb.org)).

These proposals should be interpreted in conjunction with existing Company Law requirements to which a reinsurance undertaking is subject. The scope of this paper refers to life, non-life, and captive reinsurance undertakings who are currently authorised or due to be authorised by the Financial Regulator.

According to the Reinsurance Directive, a reinsurance undertaking means an undertaking which has received official authorisation in accordance with Article 3 of the Directive.

According to the Reinsurance Directive, Article 2 - Definitions 1.(b):

“Captive reinsurance undertaking means a reinsurance undertaking owned either by a financial undertaking other than an insurance undertaking or reinsurance undertaking or group of insurance or reinsurance undertakings to which Directive 98/78/EC applies, or by a non-financial undertaking, the purpose of which is to provide reinsurance cover exclusively for the risks of the undertaking or undertakings to which it belongs or of an undertaking or undertakings of the group of which the captive reinsurance undertaking is a member”

A recital in the same Directive, numbered (11) in the introduction further states that:

“Captive reinsurance undertakings do not cover risk deriving from the external direct insurance or reinsurance business of an insurance or reinsurance undertaking belonging to the group. Furthermore, insurance undertakings or reinsurance undertakings belonging to a financial conglomerate may not own a captive undertaking.”

For the avoidance of doubt, the Financial Regulator interpretation of the Reinsurance Directive definition is that a reinsurance undertaking that covers any element of third party risk is not a captive reinsurance undertaking within the meaning of the Directive. In this context, coverage for third party risks shall mean reinsurance cover issued to a party other than the undertakings of the group of which the captive reinsurance undertaking is a part and where the beneficiary of any recovery under the reinsurance contract is a party other than the undertakings of the group of which the captive reinsurance undertaking is a part.

## **1.2 Corporate Governance**

The OECD defines corporate governance as *“a set of relationships between a company’s management, its board, its shareholders, and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining these objectives and monitoring performance are determined, good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently.”*

Thus, corporate governance encompasses the means by which members of the board and senior management of a company are held accountable and responsible for their actions. Corporate governance requires corporate discipline, transparency, independence, accountability, responsibility, fairness and social responsibility. Timely and accurate disclosure on all material matters regarding the reinsurance undertaking, including the financial situation, performance, ownership and governance arrangements, is part of a corporate governance framework. Corporate governance also includes compliance with legal and regulatory requirements.

The Financial Regulator expects a reinsurance undertaking to have five levels of oversight in operation provided by:

- The Board of Directors and its subcommittees;
- Independent non-executive directors;
- Senior Management;
- Compliance; and
- Audit (both internal and external) functions

Sections 3 to 8 inclusive set out in greater detail the duties and responsibilities attaching to each of the four levels of oversight.

### **1.3 Approach of Financial Regulator**

One of the Financial Regulator's high level goals (as defined in its strategic plan 2004-2006<sup>1</sup>) is to have a regulatory system which fosters safe and sound financial institutions while operating in a competitive and expanding market of high reputation. The Financial Regulator aims to deliver this balance through operating a mainly principles-based supervisory system.

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<sup>1</sup> Goal 2: Having a regulatory system that fosters safe and sound financial institutions while operating in a competitive and expanding market of high reputation.

Strategy:

- Adopt a principles-based approach to supervision, with technical rules as appropriate
- Require financial service providers to assume their responsibilities
- Make best use of supervisory resources
- Implementing sector specific initiatives

The Strategic Plan is available on the Financial Regulator's website –<http://www.financialregulator.ie>

The Financial Regulator's approach to ensuring an adequate and efficient corporate governance regime for reinsurance undertakings, will be based on the following overarching principles:

**a) Proportionality:** The Financial Regulator's assessment of a reinsurance undertaking's corporate governance regime will be proportionate to the risk-profile of the reinsurance undertaking, subject to the minimum standards and provisions of the Reinsurance Directive and the IAIS; and

**b) Importance of ongoing dialogue:** Irrespective of size and risk profile of the reinsurance undertaking, representatives of reinsurance undertakings are encouraged to continue to communicate with their respective supervisor within the Financial Regulator; and

**c) Demonstrable use:** The Financial Regulator expects the responsibilities of the reinsurance undertaking's corporate governance regime to be closely integrated into the day-to-day management process of the reinsurance undertaking. The onus is firmly on the reinsurance undertaking to demonstrate compliance with this regulatory framework.

### 1.3.1 Fitness and Probity

The reinsurance undertaking is required to demonstrate to the Financial Regulator the fitness and probity of directors and key management in accordance with the procedures set out in Consultation Paper 11 (Consultation on the Fit and Proper Test). This requires the submission of documentation illustrating knowledge, experience, skills and integrity. The knowledge and experience required depends on the position and responsibility of the individual within the reinsurance undertaking.

The Financial Regulator's views on this matter are set out in Consultation Paper 11, available at [www.financialregulator.ie](http://www.financialregulator.ie). A revised draft Consultation Paper 11 issued on 10<sup>th</sup> February 2006.

### 1.3.2 Compliance Statements

The Financial Regulator's main focus of attention regarding Compliance Statements is on the enabling provision in Section 25 of the Central Bank Act, 1997 (Section 25 of

CBA) as substituted by Section 26 of the Central Bank and Financial Services Authority of Ireland, Act, 2004, whereby the Financial Regulator can require regulated financial service providers to prepare Compliance Statements.

The Financial Regulator intends to engage with industry bodies and other interested parties vis-à-vis Compliance Statements, during consultation on Section 25 of CBA, upon its consideration of the final outcome of the Company Law Review Group of Section 45 of the Companies (Auditing and Accounting) Act, 2003.

## **1.4 Implementation**

It is intended that reinsurance undertakings will be required to have corporate governance structures and internal governance mechanisms in place which are commensurate with the guidance laid out in herein by no later than 12 calendar months from the date of publication of the final guidance issued by the Financial Regulator.



## 2 Heart & Mind

In the case of a reinsurance undertaking whose registered office is located in the State, its head office or ultimate decision-making organs shall also be in the State. This means that at least the strategic direction, decision-making, control, and accountability shall be located in the State.

Consultation Closed



## 3 Board of Directors

The Board of Directors is the focal point of the corporate governance system. It is ultimately accountable and responsible for the performance and conduct of the reinsurance entity. Delegating authority to board committees or management does not in any way mitigate the discharge by the Board of Directors of its duties and responsibilities. In the case of a policy established by the board, the board would need to be satisfied that the policy has been implemented and that compliance has been monitored.

### 3.1 Responsibilities of the Board of Directors

Insofar as corporate governance is concerned, the Board of Directors is responsible for

- Setting out the corporate governance principles that will apply to the reinsurance undertaking, and
- Ensuring that the reinsurance undertaking is run in a manner consistent with those principles.

In developing appropriate corporate governance principles, the Board of Directors will take account of many factors, including the agreed strategy and business plan for the firm, the nature of the activities of the firm and its size and complexity. In particular, the Directors should formally establish the risk appetite of the reinsurance undertaking, commensurate with its capital strength and ensure that the business undertaken by the firm is consistent with the agreed risk appetite. Any material change to the formal risk appetite of the reinsurance undertaking should be notified to the Financial Regulator.

The following is intended as a guideline to the concerns and activities of a typical Board of Directors. It is not an exhaustive checklist.

- a. Set out the corporate governance principles appropriate to the reinsurance undertaking.
- b. Set out its specific responsibilities and commitments in respect to those principles.
- c. Have thorough knowledge, skills, experience and commitment to oversee the reinsurance undertaking effectively.

- d. Establish policies and strategies, the means of attaining them, and procedures for monitoring and evaluating the progress toward them. Adherence to the policies and strategies must be reviewed regularly, and at least annually.
- e. Satisfy itself that the reinsurance undertaking is organised in a way that promotes the effective and prudent management of the institution and the board's oversight of that management. In this context, the Board of Directors has in place and monitors independent risk management functions that monitor the risks related to the type of business undertaken. The Board of Directors establishes audit functions, actuarial functions, strong internal controls and applicable checks and balances.
- f. Distinguish between the responsibilities, decision-making, interaction and cooperation of the Board of Directors, chairman, chief executive and senior management. Where the Board of Directors delegates responsibilities and establishes decision-making processes. The entity must have a clear division of responsibilities that will ensure a balance of power and authority, so that no one individual has unfettered powers of decision.
- g. Establish standards of business conduct and ethical behaviour for directors, senior management and other personnel. These include policies on private transactions, self-dealing, preferential treatment of favoured internal and external entities, covering trading losses and other inordinate trade practices of a non-arm's length nature. The reinsurance undertaking must demonstrate that it has an on-going, appropriate and effective process of ensuring adherence to those standards.
- h. Establish procedures for the appointment, disciplinary procedures and dismissal of senior management. It must establish a remuneration policy that is reviewed periodically. The remuneration policy should not include incentives that would encourage imprudent behaviour. This policy must be made available to the Financial Regulator on request.
- i. Collectively ensure that the reinsurance undertaking complies with all relevant laws, regulations and any established codes of conduct. The Board of Directors identifies a Compliance Officer with responsibility for monitoring compliance with relevant legislation and required standards of business conduct and who reports to the Board of Directors at regular intervals to enable the Board to ensure compliance.
- j. Not be subject to undue influence from management or other parties.

- k. Communicate and meet with the Financial Regulator as deemed appropriate, as required or when requested.

## **3.2 Sub-Committees of the Board**

The Financial Regulator considers it necessary for all reinsurance undertakings to have in place such committees of directors and management as well as other management structures as are necessary to ensure that the business of the reinsurance undertaking is being managed, conducted and controlled in a prudent manner and in accordance with sound administrative and accounting standards. As part of their responsibilities, and in proportion to the size and complexity of the organisation, the Board of Directors may establish committees with specific responsibilities such as a compliance committee, compensation committee, or risk management committee. The Financial Regulator considers the existence of an audit committee to be an essential element of an effective control environment.

## **3.3 Board Composition**

The following criteria shall be adhered to in relation to the composition of the Board of Directors:

- The Board of Directors should be such that it provides for the effective, prudent and efficient administration of the activities of the reinsurance undertaking;
- The Board of Directors of a reinsurance undertaking should be of sufficient size and expertise to oversee adequately the operations of the reinsurance undertaking;
- The Board of Directors of a reinsurance undertaking should have a minimum of two independent Non-Executive Directors (see section 4 below);
- The balance between executive and independent non-executive directors must be evidenced by the composition of the members of the Board of Directors present and eligible to vote at each Board of Directors meeting;
- Each member of the Board of Directors should have sufficient time to devote to the role of director of a reinsurance undertaking. This is particularly important in the case of non-executive directors. Each independent non-executive director should ensure that they have adequate time to give to the role; and
- On an individual basis, directors should not participate in any decision making/discussion where a conflict of interest exists.

## 4 Independent Non-Executive Directors

### 4.1 Definition

The Financial Regulator requires that there should be a sufficient number of Independent Non-Executive Directors to ensure that the independent element of the Board of Directors can be effective, subject to a minimum of two. Independent Non-Executive Directors represent one of the key layers of oversight of the activities of a reinsurance undertaking. To be considered independent by the Financial Regulator a non-executive director should be independent of management, large shareholders and not have any business relationship or other relationship that could interfere with the exercise of independent judgement.

### 4.2 Functions

It is a function of the Board of Directors of a reinsurance undertaking to bring an independent perspective to the reinsurance undertaking from that of management. Furthermore it is essential for Independent Non-Executive Directors to bring a third party viewpoint to the deliberations of the Board of Directors, that are objective and independent of the activities of the management of a reinsurance undertaking.

### 4.3 Proposals for Captive Reinsurance Undertakings

The Financial Regulator's proposals in relation to the appointment of Non-Executive Directors will be proportionate to the risk-profile of the captive reinsurance undertaking (as defined by the Reinsurance Directive). Where a captive reinsurance undertaking issues reinsurance cover where only the undertakings of the group, of which the captive reinsurance undertaking is a part, can be the beneficiary of any recovery under the reinsurance cover, the Financial Regulator would not consider the appointment of Independent Non-Executive Directors as essential. However, the captive reinsurance undertaking may wish to appoint Independent Non-Executive Director(s) in order to reap the obvious benefits of external perspectives and independent oversight. In any event, the captive reinsurance undertaking's Board members should demonstrate independence.

## 5 Senior Management

### 5.1 Responsibilities of Senior Management

Senior management responsibilities are expected to include:

- overseeing the operations of the reinsurance undertaking and providing direction to it on a day-to-day basis, within the objectives and policies set out by the Board of Directors, as well as to legislation;
- providing the Board of Directors with recommendations, for its review and approval, on objectives, strategy, business plans and major policies that govern the operation of the reinsurance undertaking; and
- providing the Board of Directors with comprehensive, relevant and timely information that will enable it to review business objectives, business strategy and policies, and to hold senior management accountable for its performance.

### 5.2 General Manager

Except for a captive reinsurance undertaking, the Financial Regulator requires that all other reinsurance undertakings directly employ a designated senior manager responsible for the overall prudent and efficient operation of the business of the reinsurance undertaking, herein referred to as a General Manager.

## 6 Internal control

A system of internal control is critical to effective risk management and a foundation for the safe and sound operation of a reinsurance undertaking. It provides a systematic and disciplined approach to evaluating and improving the effectiveness of the operation and assuring compliance with laws and regulations. It is the responsibility of the Board of Directors to develop a strong internal control culture within its organisation, a central feature of which is the establishment of systems for adequate communication of information between levels of management.

Internal controls should be designed to ensure and demonstrate that the firm is being operated within the parameters set by the Board of Directors. These controls should be adequate for the nature and scale of the business and proportional to the size and complexity of the business. The oversight and reporting systems must be sufficient to allow the board and management to monitor and control the operations. The onus will be on the Board of Directors to ensure that such systems are applicable to the reinsurance undertaking and that such systems meet their ongoing corporate governance duties and responsibilities.

### 6.1 Purpose of Internal Control

The purpose of internal control is to verify that

- a. the business of an reinsurance undertaking is conducted in a prudent manner in accordance with policies and strategies established by the board of directors
- b. transactions are only entered into with appropriate authority
- c. assets are safeguarded
- d. accounting and other records provide complete, accurate, verifiable and timely information
- e. management is able to identify, assess, manage and control the risks of the business and hold sufficient capital for these risks.

The Financial Regulator will review the internal controls and will check their adequacy to the nature and the scale of the business. It reserves the right to require strengthening

of these controls where necessary. The Board of Directors is ultimately responsible for establishing and maintaining an effective internal control system.

## **6.2 Elements of an Internal Control Regime**

The Internal Control Regime should seek to address both operational and business risks. The following list of internal controls is set out as guidance for reinsurance undertakings as to the actions that the Financial Regulator would be expecting to find in a control regime. It is not an exhaustive checklist. The Boards of Directors may consider that some or all of these controls and possibly additional controls are necessary to the good governance of their reinsurance undertaking. The Board of Directors should consider a Internal Control Regime that is adequate for the nature and scale of the reinsurance undertaking and proportional to the size and complexity of the business written by the reinsurance undertaking.

## **6.3 Risk Management**

The Board of Directors must provide suitable prudential oversight and establish a risk management system that includes setting and monitoring policies so that all major risks are identified, measured, monitored and controlled on an on-going basis.

The Financial Regulator must be satisfied that comprehensive risk management systems commensurate with the nature, scale and complexity of all the reinsurance undertaking's activities are in place, incorporating continuous measuring, monitoring and controlling of risk, accurate and reliable management information systems, timely management reporting and thorough audit and control procedures.

### **6.3.1 Operational Risks**

Operational risk management, within each reinsurance undertaking, is expected to include the following, at a minimum:

- Board of Directors receive regular reporting on the effectiveness of the internal controls;
- Any identified weakness should be reported to the Board of Directors as soon as detected and appropriate action taken;



- There are clear arrangements for delegating authority and responsibility, and the segregation of duties;
- There are checks and balances in business processes (e.g. cross-checking, dual control of assets, double signatures);
- There are established controls to check the accuracy and compliance of accounting procedures, reconciliation of accounts, control lists and information for management;
- The internal and external audit, actuarial and compliance functions are part of the framework for internal control, and must test adherence to the internal controls as well as to applicable laws and regulations;
- Where the appointment of an actuary is warranted by the nature of the reinsurance undertaking's operations, the actuary has direct access to the Board of Directors or a committee of the board. The actuary reports relevant matters to the Board of Directors on a timely basis. The Financial Regulator requires that actuarial reports be made to the board and to management and be made available to the Financial Regulator upon request;
- There are controls, including oversight and clear accountability for all outsourced functions as if these functions were performed internally and subject to the normal standards of internal controls.

### **6.3.2 Business Risks**

Given the specific nature of the reinsurance business, reinsurance undertakings should have appropriate policies and procedures covering the conduct of business, including:

#### **6.3.2.1 Underwriting**

Policies should be in place identifying the lines of business and types of risks to be assumed by the reinsurance undertaking by geographical area. Appropriate procedures for implementing and monitoring the policies should be established. They should include a review of the terms and conditions of the reinsurance contracts to ensure that they are accurate and clearly understood. The underwriting guidelines should, where appropriate, require the reinsurance undertaking to obtain sufficient information on the cedants with whom it deals to assess their integrity, management and business policy.

#### **6.3.2.2 Accumulations of exposures**

(e.g. catastrophe exposure such as storm, quake, flood, hail and man made disasters)

The reinsurance undertaking should identify, monitor, and measure any concentration of risk on the underlying lines of business and on the portfolio as a whole due to one and the same event. It should set limits on the whole portfolio and, where appropriate, per line of business to limit the effect of a situation where several lines are hit by the same event or the same underlying cause. Where necessary, there should be risk assessment models for catastrophes and supervisors should have the capability, either with in-house staff or by engaging external experts (who may be subject to confidentiality and conflicts of interest requirements), to assess the controls over a reinsurance undertaking's catastrophe exposures.

#### **6.3.2.3 Provisioning**

Reinsurance undertakings should have policies and procedures in place for establishing technical provisions. They should adequately address the specific challenges faced by reinsurance undertakings, particularly with respect to establishing IBNR and IBNER provisions.

#### **6.3.2.4 Statement of Actuarial Opinion**

The Financial Regulator will require a Statement of Actuarial Opinion ("SAO") for reinsurance undertakings. There will be exemptions to this requirement granted on a limited, but yet to be determined, basis. Current Financial Regulator thinking suggests a similar regime in line with current non-life insurance undertakings. Exemptions from the SAO requirement for non-life insurance companies are on the basis of underwriting:

- No third party business; and/or
- No motor, liability or financial guarantee business

#### **6.3.2.5 Retrocession**

(cover and security)

Like primary insurance undertakings, reinsurance undertakings should define and document their strategy for retrocession management, identifying the procedures for:

- the retrocession to be purchased
- how retrocessionaires will be selected, including how to assess their security
- any limits on retrocession to any one retrocessionaire
- what collateral, if any, is required at any given time
- how the retrocession programme will be monitored (i.e. the reporting and internal control systems).

In their strategy for retrocession management, reinsurance undertakings should take into account that there may be situations where the reinsurance undertaking finds itself unable to place retrocession with a retrocessionaire with an acceptable level of security.

#### **6.3.2.6 Contract conditions**

The reinsurance undertaking should identify, monitor and control any special retrocessional contract conditions, such as aggregates, that will affect the amount recoverable from a retrocessionaire.

#### **6.3.2.7 Contracts**

Reinsurance undertakings should establish a process whereby contracts are reviewed and approved on a timely basis. The Financial Regulator considers transparency a key feature of such a process. All material facts and considerations (e.g. commissions, potential conflicts of interests) must be fully disclosed.

#### **6.3.2.8 Investments**

A reinsurance undertaking's investment policy should reflect the global nature of the business and specifically deal with asset/liability management, asset diversification, liquidity, and cash flow, considering the group structure. It should identify approved investments, set limits by asset class, describe what assets are considered to be suitable matches for the long tail and the short tail business and how various risks will be managed such as what the reinsurance undertaking does to manage currency risk when it insures risks in several countries. The investment policy should have concentration limits, such as limits for investments in companies or groups and limits on investments in particular industry sectors. The reinsurance undertaking should have procedures in place to monitor and control its investment policy against the limits approved by the Board of Directors and within regulatory constraints, if any.

# 7 Audit Function

## 7.1 Internal Audit

Internal audit is part of the ongoing monitoring of the reinsurance undertaking's system of internal controls and of its internal capital assessment procedure, because internal audit provides an independent assessment of the adequacy of, and compliance with, the reinsurance undertaking's established policies and procedures. As such, the internal audit function assists senior management and the Board of Directors in the efficient and effective discharge of their responsibilities.

In principle, the Financial Regulator requires all reinsurance undertakings to have an ongoing internal audit function. In some situations the nature, scale and complexity of the reinsurance undertaking may warrant the fulfilment of that function by group internal audit. In any event, senior management, and ultimately the Board of Directors, are responsible for seeing that regular independent assessments are carried out and that resulting recommendations are addressed and also for determining who is responsible for implementing them.

Each reinsurance undertaking shall give the Financial Regulator access to reports of the internal audit function of such reinsurance undertaking, as required.

## 7.2 Status of Internal Audit in individual firms

The Financial Regulator attaches particular importance to the role that the internal audit function plays. Accordingly, the Financial Regulator, in assessing the effectiveness of the internal audit function in any firm will have regard to the following criteria:

- **Independence** – the personnel employed in the internal audit department must be independent of the activities audited;
- **Objectivity and Impartiality** – internal audits must be conducted by personnel that are objective and impartial;
- **Authority** – the Board of Directors must ensure that the importance of the internal audit function is communicated throughout the reinsurance undertaking and that it has appropriate standing to enable it to perform its role effectively,

this may be done by compiling an internal audit charter which documents the scope authority and objectives of the internal audit function;

- **Access** – internal audit should have access to all activities and subsidiaries of a reinsurance undertaking;
- **Reporting** – Internal Audit should be able to report directly to the Board of Directors or the Audit Committee without other members of senior management being present. The Financial Regulator would expect that the Internal Auditor report to the Board of Directors or the Audit Committee on a regular basis;
- **Remuneration** – the remuneration of internal audit personnel must not be determined by any member of management that is subject to internal audit;
- **Resources** – the internal audit function should be adequately resourced;
- **Scope** – the work of the internal audit department should include an evaluation of the internal controls and a review of the adequacy of policies and procedures approved by the Board;
- **Key Findings** – the internal audit function should prepare annual audit plans, compile reports on their findings, report findings to the Board of Directors or the Audit Committee and follow-up on the resolution of audit findings;
- **New Products** – internal audit should be regularly updated in relation to new products offered by the reinsurance undertaking to ensure that any new risks to the business are subject to their review; and
- **Competence** – the internal audit function should contain sufficient competence to perform an audit on any of the activities of the reinsurance undertaking.

### 7.3 External Audit

While not part of the reinsurance undertaking, external auditors have an important role in re-enforcing the corporate governance of reinsurance undertakings further to the work undertaken in the audit of financial statements. The obligations of auditors of regulated financial service providers are as outlined in the Reinsurance Regulations and Part IV of the Central Bank Act 1989.

The Financial Regulator places a great deal of importance on the independence of external auditors and the added value of their opinion on the annual financial statements. A great deal of importance is also placed on the various reports provided by external auditors and the Financial Regulator regards them as one of the key levels of oversight of the operations of a reinsurance undertaking.

## 8 Compliance Function

The Financial Regulator requires that each authorised reinsurance undertaking nominate an individual office holder as Compliance Officer. Reflecting the size and complexity of some reinsurance undertakings, the Compliance Officer may simultaneously hold other offices within a company (e.g. Appointed Actuary, Company Secretary, General Manager etc). In appropriate circumstances, a single individual could also be a Compliance Officer for more than one reinsurance undertaking (e.g. in the case of captives managed by the same management company).

The appointment of a Compliance Officer is designed to supplement, not supplant, the responsibility of the Board of Directors and of senior management to ensure compliance with legislation and applicable requirements. Each reinsurance undertaking should notify the Financial Regulator of the name of the designated Compliance Officer. Any change in the nominated Compliance Officer should be notified to the Financial Regulator as soon as possible.

### 8.1 Functions of Compliance Officer

The functions of the Compliance Officer encompass the following tasks:

- To ensure the entity is kept up to date with the Financial Regulator's compliance standards;
- To obtain the approval of the Board of Directors for a policy statement on compliance with the Insurance Acts and Regulations, with requirements issued by the Financial Regulator and with other applicable legislation;
- To monitor the implementation of compliance and to report periodically to the senior management and to the Board of Directors thereon;
- To review products, procedures and systems on a planned basis from the viewpoint of effective compliance and to advise as to steps necessary to ensure compliance; and
- To review staff training processes so as to ensure appropriate compliance competencies.

# APPENDIX I: Frequently Asked Questions

## A. INTRODUCTION

- 1. In a paper issued in October 2002, the IAIS stated: “where captives only insure risks of their owners and are part of the same organisation they may not pose the same risk to the financial system and separate regulations may be established recognising this reduced risk”. Will this position be reflected in the corporate governance proposals for reinsurers to be implemented?*

The corporate governance proposals as set out in the paper from the Financial Regulator are based upon the basic principles on corporate governance as set out by the IAIS. The Financial Regulator is currently participating in a Captive Working Group with industry to assess whether any derogations are warranted for the captive sector.

- 2. When will the second consultation on the Fit and Proper Test issue?*

10th February 2006.

- 3. What happens if the Financial Regulator and the Board of Directors differ on the fitness of director?*

There will be an appeals process including right of reply at the earliest stage in the process (minded to refuse) available to the Board of Directors in the event of a dispute over the fitness of an individual to serve as a director. Please see CP11 and previous comment above.

- 4. Are key management limited to CEO, CFO, CUO, and CIO?*

The Financial Regulator believes that the Board of Directors of the reinsurance undertaking are best suited to determining who the key management are based upon the size and complexity of the business written by the operating entity.



## **B. HEART & MIND**

### ***5. What is time requirement for other aspects of EU Directive such as solvency?***

The timetable for implementation of the EU Directive for existing reinsurance undertakings operating in Ireland is detailed in the consultation paper titled “Transitional Requirements for Non-Life Reinsurance Undertakings”. For new reinsurance undertakings, the Financial Regulator will implement the EU Directive requirements as well proposals for corporate governance, once finalised.

## **C. BOARD OF DIRECTORS**

### ***6. Could the parent of the reinsurance undertaking be responsible for establishing corporate governance principles and for the monitoring of compliance to the principles set?***

If, in the opinion of the Board of Directors, the principles set by the parent are sufficient to meet the minimum standards on corporate governance as set down by the Financial Regulator and the parent of the reinsurance undertaking has sufficient experience and resources to ensure compliance, then the parent’s standards and processes may be adopted by the Board. However, that decision is the responsibility of the Board. Adopting the standards and processes of the parent of the reinsurance undertaking does not in any way mitigate or dissipate the discharge by the Board of Directors of its duties and responsibilities. The Financial Regulator recommends that the Board of Directors receive regular written reports from any service performed by the parent confirming their compliance to the standards as set down by the Board of Directors.

### ***7. Does the guideline requiring the Board of Directors not to be subject to undue influence from management or other parties apply to the parent of the reinsurance undertaking?***

Yes.

### ***8. For a captive reinsurance undertaking, could a professional third party service provider be responsible for establishing corporate governance principles and for the monitoring of compliance to the corporate governance principles set?***

It is for the Board of Directors to establish the corporate governance principles of the captive reinsurance undertaking it is responsible for and not a third party.

***9. Does a captive reinsurance undertaking have to set up an audit committee?***

It is up to the Board of Directives to determine whether a captive reinsurance undertaking requires an audit committee based upon the size and complexity of the business written by the captive reinsurance undertaking.

***10. What are the Financial Regulator expectations regarding “sufficient size” for the Board of Directors?***

The Financial Regulator believes that the principle of proportionality should apply when considering the number of individuals who will sit on the Board of Directors. The Financial Regulator’s view is that the size and complexity of the business written by the reinsurance undertaking should be considered when deciding upon the correct number of directors for the composition of the Board of Directors to ensure compliance with the Financial Regulators’ standards and the OECD principles on corporate governance.

***11. What balance between executive and independent non-executive directors is sufficient, and can a board meeting only take place if two independent directors are present?***

The balance between executive and independent non-executive directors is a matter for consideration given the size and complexity of the business written, or the business proposed to be written, by the reinsurance undertaking. The Board of Directors should consider the agenda items under consideration and follow a prudent approach when determining whether a particular meeting of the Board of Directors can take place in the absence of one of the independent non-executive directors. Each meeting of the Board of Directors must have at least one independent non-executive director present.

**D. INDEPENDENT NON-EXECUTIVE DIRECTORS**

***12. Does the Financial Regulator consider an employee of the parent of the reinsurance undertaking to be independent?***

The Financial Regulator's view is that such an employee does not qualify as independent as defined due to his or her employment by the shareholder of the reinsurance undertaking.

***13. Can an independent director of the parent entity also act as an independent director of the subsidiary reinsurance undertaking?***

Yes, once independence has been confirmed at parent level this can follow through to subsidiary reinsurance undertaking level.

***14. Does the Financial Regulator consider an employee of a professional third party service provider such as a captive manager contracted to the reinsurance undertaking to be independent if that employee is not directly involved in the provision of services under the contract with the reinsurance undertaking?***

The Financial Regulator's view is that such an employee does not qualify as independent as defined due to the business relationship between the professional third party service provider and the reinsurance undertaking.

***15. Please clarify whether an independent non-executive director must have (re)insurance experience or would somebody with broader experience from legal/accounting/tax/financial services be sufficient?***

The Financial Regulator does not consider reinsurance or insurance experience to be a prerequisite for an independent non-executive director. The Board of Directors must ensure that the individual is a competent professional with the experience to act on a fully informed basis, in good faith, with due diligence and care. The Financial Regulator would prefer the individual to have experience in the broader financial services industry in Ireland or abroad if possible.

***16. Can an independent non-executive director work for a number of reinsurance undertakings?***

The Financial Regulator's view is that such an individual can work for a number of reinsurance undertakings provided there is no actual or potential conflict of interest between the different positions and the individual can devote a sufficient time to each position. For the avoidance of doubt, the Financial Regulator would consider there to be a conflict of interest if there was any business relationship between the

two reinsurance undertakings or other relationship that could interfere with the exercise of independent judgement.

***17. What in the Financial Regulator's view on the issue of joint and several liability between non-executive directors and executive directors?***

The Financial Regulator believes that this is an issue for the reinsurance undertaking and its legal advisors.

**E. SENIOR MANAGEMENT**

***18. Is a captive required to employ a General Manager?***

No, a captive as defined in the Reinsurance Directive is exempt.

***19. Could a professional third party service provider contracted by a reinsurance undertaking undertake the responsibilities expected of the senior management?***

No. However, a General Manager may, with the prior approval of the Board of Directors, outsource certain accounting, administrative, and/or reinsurance services to a professional third party provided he or she can ensure competent oversight of the outsourced services in accordance with the responsibilities expected of senior management. Such outsourcing to a third party in no way mitigates the discharge by the General Manager of his or her duties and responsibilities, nor indeed the Board of Directors of their duties and responsibilities. The Financial Regulator should be approached by any reinsurance undertaking proposing to outsource certain accounting, administrative, and/or reinsurance services to a professional third party.

***20. Could an employee of a professional third party service provider such as a captive manager contracted to a reinsurance undertaking act as a General Manager for the same reinsurance entity?***

No. A General Manager of a reinsurance undertaking must be a direct employee of the reinsurance undertaking. A member of a management company that has a business relationship with the reinsurance undertaking is a direct employee of that management company and would not be sufficiently independent to be the General

Manager. The Financial Regulator is of the opinion that such a situation creates a potential for a conflict of interest.

***21. Could a Director fulfil the General Manager role required by the Financial Regulator?***

Current Financial Regulator thinking suggests that the role of a director is quite distinct from that of a General Manager. Notwithstanding this, the Financial Regulator agrees that the General Manager could be a member of the Board of Directors. The role of the Board of Directors is strategic while the role of the General Manager is that of operation management and control. The Financial Regulator requires that the General Manager be a direct employee of the reinsurance undertaking who is responsible for the day-to-day operations as distinct from an individual who provides strategic input on a quarterly basis. Current Financial Regulator thinking suggests that if for some reason the General Manager is not a Director, then any professional third party service provider should not be permitted to provide an employee as a Director as this could lead to a situation where the General Manager is potentially sidelined in the decision making process.

***22. What are the qualities and duties of a General Manager?***

The following is a non-exhaustive list of qualities and duties of a General Manager:

- be a competent individual with the experience to act on a fully informed basis, in good faith, with due diligence and care; and
- be entitled to perform the duties and exercise the powers that are vested onto him or her by the Board of Directors; and
- be accountable and responsible for the duties vested onto him or her on behalf of the reinsurance undertaking; and
- be employed on the basis of devoting such time and attention sufficient to ensure the prudent and efficient operation of the business of the reinsurance undertaking; and
- be independent of any undertakings who have a business relationship with the reinsurance undertaking or other relationship with the reinsurance undertaking that could interfere with the exercise of independent judgement.

***23. May a General Manager hold multiple appointments?***

Notwithstanding that the role of the General Manager role in a fully staffed reinsurance undertaking writing exclusively third party business is a full-time position, the Financial Regulator acknowledges that this could pose potential difficulties for some reinsurance undertakings. For these reinsurance undertakings, there may be circumstances where multiple appointments are warranted. The Financial Regulator proposes that such applications for multiple appointments are examined on a case-by-case basis, subject to incorporation of the following in the application:

- A clear justification for the application. (This submission must be signed by at least one member of the Board of Directors of the reinsurance undertaking);
- Such applications should clearly demonstrate compliance with the IAIS principles;
- A clear timeline of commitments held, by the individual, for each reinsurance undertaking. Such a timeline should incorporate crisis scenarios for each reinsurance undertaking; and
- Details of the procedures in place to deal with conflicts or potential conflicts of interest.

Notwithstanding the above, the Financial Regulator may refuse to permit such an application to proceed if it is of the opinion that this is in the best interest of the prudential supervision of the reinsurance undertaking.

#### ***24. What qualifications are required for a General Manager?***

The Board of Directors must ensure that the individual is a competent individual with the experience to act on a fully informed basis, in good faith, with due diligence and care. The Financial Regulator would prefer the individual to have relevant reinsurance or insurance experience to perform their duties but if such an individual could not be found the Financial Regulator would be prepared to consider an individual with relevant experience and expertise in the broader financial services industry in Ireland or abroad, who the Board of Directors believe to be capable of performing the required duties and in taking on the required responsibilities, given the nature of the business being written by the company.

#### ***25. What about a “de minimus” rule in relation to “third party” business?***

The Financial Regulator wishes to clarify that there will be no “de minimus” rule in relation to ‘third party’ business for captive reinsurance undertakings.

***26. What is the situation where a reinsurance undertaking is in runoff?***

The Reinsurance Directive does not apply to reinsurance undertakings that are in runoff. The Financial Regulator will be issuing separate guidelines covering reinsurance undertakings that are in runoff, in due course.

***27. What is the situation where a reinsurer wants to set up a captive to cover its own group risks?***

Under the Reinsurance Directive, the definition of a captive specifically disallows an insurance or a reinsurance company from owning a captive.

**F. INTERNAL CONTROL**

***28. Could the parent of the reinsurer or the parent of a captive take responsibility for the internal control regime of a company?***

The Board of Directors is responsible for the adoption of a formal internal control regime of the reinsurance undertaking as determined by the board and is accountable as such. The Board of Directors may determine that the internal control systems of the parent are sufficient to monitor and control the operations of the reinsurance undertaking. The onus will be on the Board of Directors to ensure that such systems meet their ongoing corporate governance duties and responsibilities.

***29. By what mechanism will Financial Regulator review internal controls?***

The Financial Regulator may ask the Board of Directors to demonstrate that the internal control regime as set out by the board is sufficient for the reinsurance undertaking given the size and complexity of the business written. They should also be in a position to demonstrate that the internal control regime has been implemented and is being monitored.

***30. Can the Financial Regulator define the format and frequency of internal control reporting required?***

The Board of Directors should determine the format and frequency of reporting required from the internal control regime given the size and complexity of the



business written by the reinsurance undertaking in order to comply with their ongoing corporate governance duties and responsibilities in a prudent manner.

***31. Does the list of operational risks also apply to captives?***

The Board of Directors should consider each of the risks and determine the applicable risks to its operation given the size and complexity of the business written by the reinsurance undertaking. The internal control regime adopted by the Board of Directors should consider the applicable risks so that they comply with their ongoing corporate governance duties and responsibilities in a prudent manner.

***32. Can the Financial Regulator clarify which captives are exempt from the SAO requirement?***

Current Financial Regulator thinking is that only those captives that exclusively write reinsurance cover where only the undertakings of the parent group, of which the captive is a part, can be the beneficiary of any recovery under the reinsurance cover will be exempt. The Financial Regulator is currently participating in a Captive Working Group with industry to assess whether any derogation are warranted for the captive sector.

***33. Can reinsurance companies who follow the cedents' reserves be exempt from the SAO requirement?***

Notwithstanding that the Financial Regulator is in the process of developing a SAO for reinsurance its current thinking suggests that they cannot be exempt unless the cedants' reserves are covered by an SAO issued by a member of the SAI in the format required by the Financial Regulator. In the interim, reinsurance undertakings are required to calculate their figures on a best estimate basis with gross and net technical provisions shown separately.

***34. Would an SAO written by a European or US Actuary be acceptable?***

Current Financial Regulator thinking suggests a similar regime to current Non-Life certifications whereby the Society of Actuaries in Ireland could provide certification for Reinsurance Actuaries who have qualified outside Ireland.

***35. Does a standard underwriting policy preclude a reinsurance undertaking from reacting to changing market conditions?***

The Board of Directors is responsible for setting the underwriting policy of the reinsurance undertaking and for ensuring that it is notified to the Financial Regulator. Any significant deviation from such a policy has to be notified to the Financial Regulator prior to its initiation. The Financial Regulator stresses the benefit, in terms of reacting to changing market conditions, of regular contact between the company and their respective supervisor on this and all other corporate governance issues.

***36. Can the Financial Regulator expand on the term “contracts”?***

In general, a contract can be considered as an agreement between two or more competent parties in which an offer is made and accepted, and each party benefits. The Financial Regulator is aware that many reinsurance relationships are characterised by minimal documentation such as slips and cover notes. The Financial Regulator believes that sound corporate governance dictates that all business relationships should be governed by clear, precise and detailed legal signed contracts. The Financial Regulator is fully supportive of the FSA initiative on contract certainty in the UK Market. The Financial Regulator therefore strongly encourages all reinsurance undertakings to push for increased contract certainty in all of their business relationships and strongly urges all reinsurance undertakings to agree and sign reinsurance contracts in a timely manner.

***37. Can there be an exemption for small and medium size reinsurers that are restricted from loaning assets back to their parent?***

No, the Financial Regulator will follow the conditions as set by the Reinsurance Directive for all reinsurance undertakings operating within the EU. This issue is dealt with in more detail in the Transitional paper.

**G. INTERNAL AUDIT FUNCTION**

***38. Would an internal audit function at group level satisfy the internal audit function as outlined?***

If, in the opinion of the Board of Directors, the standards set by the parent are sufficient to meet the standards on internal audit as set down by the Financial Regulator and the parent of the reinsurance undertaking has sufficient experience and resources to ensure undertake an internal audit, then yes. Delegating authority to

the parent of the reinsurance undertaking should not in any way mitigate or dissipate the discharge by the Board of Directors of its duties and responsibilities.

**39. How frequently does the Financial Regulator require an internal audit?**

It is for the Board of Directors to determine how often an internal audit is required in order that they can discharge their duties and responsibilities in a prudent manner.

**40. Can the Financial Regulator clarify the issue of competence where the parent is a non-insurance entity and where parent is in different country?**

If, following the assessment by the Board of Directors, the parent is not sufficiently competent to perform the internal audit function in terms of local legislation or aspects of reinsurance or aspects of internal control/corporate governance, then the Board of Directors should delegate this function to an entity with sufficient experience in the field.

## **H. COMPLIANCE FUNCTION**

**41. What is the timeline for appointment of a compliance officer?**

A compliance officer should be appointed in each reinsurance undertaking to ensure a sufficient lead-time for the implementation of the standards by the Financial Regulator.

**42. Can the same compliance officer oversee an insurer and a reinsurer within the same group?**

Yes

**43. Can the same compliance officer oversee a number of different reinsurance undertakings?**

Yes, provided the individual does not have any conflict of interest in performance of his or her duties in the different companies. For the avoidance of doubt, the Financial Regulator would consider there to be a conflict of interest if there was any business relationship between the individual and the different reinsurance undertakings or other relationship that could interfere with the exercise of independent judgement.

**44. Will compliance officer need to be pre-approved by the Financial Regulator?**

No, it is up to the Board of Directors to assess the suitability of an individual to be a compliance officer, as set out in CP11.

**45. Can the Financial Regulator clarify “report periodically”?**

The frequency of reporting required should be in proportion to the business written by the reinsurance undertaking and should be determined by the Board of Directors to ensure they can meet their ongoing corporate governance duties and responsibilities.

Consultation Closed



FINANCIAL REGULATOR  
*Rialtóir Airgeadais*

Please clearly mark your submission 'Consultation on Corporate Governance Guidelines for Reinsurance Undertakings'

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All submissions should be made on or before 31 May 2006