DIMA

Prudential Policy Unit
International Credit Institutions
Financial Regulator
PO Box 9138
College Green
Dublin 2

30th June 2010

Re: Corporate Governance – CP41

Dear Sir/Madam

DIMA (the Dublin International Insurance and Management Association) welcomes this opportunity to comment on the proposals put forward by the Financial Regulator in its consultation paper CP41 “Corporate Governance Requirements for Credit Institutions and Insurance Undertakings”. DIMA represents the interests of almost 70 re/insurance entities and captive managers, all engaged in cross-border activities. In 2008, the DIMA membership posted premium income in excess of €25bn, and Ireland is an acknowledged global centre for this type of business. This submission represents the overall views of the DIMA membership; however, in response to the invitation from the Financial Regulator in paragraph 6.2 of the introductory proposal in CP41 for specific proposals from the captive industry, we have identified these expressly within this submission as Appendix A.

DIMA wholly supports the Financial Regulator’s aim of enhancing the corporate governance regime in Ireland, particularly in the light of risk management and corporate governance failures in domestic institutions. The lack of such a regime to date for certain sectors of the financial services industry no doubt contributed to the problems experienced in Ireland, and it is important to use this opportunity to establish criteria which are apposite, responsive and relevant. What is required is a state-of-the-art regime which focuses on risks, principles and excellence.

In particular, this is an opportunity to establish a regime delineating the different risk profiles of retail and wholesale businesses. While the problems experienced in the Irish economy have been issues for certain retail businesses, by contrast wholesale entities of the type represented by DIMA have played an important role globally in assisting stabilisation. The core principle of insurance and reinsurance is the spread of risk, enabling diversification and reducing systemic exposures. The contribution of this tenet to

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
tel: +353 1 775 9448 fax: +353 1 775 9409 email: executive@dima.ie web: www.dima.ie
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the stabilisation of the global system has been highlighted in a number of reports issued by global bodies following the financial crisis.

DIMA members typically are subsidiaries of larger financial groups with a single member shareholder structure, engaged in business-to-business wholesale risk exposures, with well-managed professional and financial expertise. The retail and systemic exposures seen within the domestic context are not a typical feature of DIMA members' risk profiles. In addition, there is a well-established and long lead-in time for the running off of insurance and reinsurance liabilities which does not crystallise losses in the same way as in the banking sector, and allows companies to manage their liabilities in an orderly manner, reducing the possibility of economic turmoil and minimising systemic risk.

A large proportion of the DIMA membership has in recent years been subject to corporate governance requirements following the implementation of the Reinsurance Directive, as detailed in the Financial Regulator's document "Corporate Governance for Reinsurance Undertakings" issued in December 2007. DIMA and the reinsurance industry in Ireland consulted meticulously on the development of this particular document, which details a corporate governance structure directed specifically to what may be described as the wholesale, cross-border model. DIMA has always recognised and strived to advocate the importance of regulatory reputation to Dublin as an international re/insurance centre and for its members, and this position was central to its input into the reinsurance corporate governance regime. Thus DIMA would encourage the Financial Regulator to revisit this set of corporate governance requirements with a view to extending the existing regime to other areas of insurance business. This sector has proven to be resilient in the face of the international financial crisis, and has not indicated any systemic exposures to date for the Irish economy or further afield. The International Association of Insurance Supervisors has identified that: "For most classes of insurance… there is little evidence of insurance either generating or amplifying systemic risk, within the financial system itself or in the real economy."[1]

As it currently stands, CP41 appears to propose corporate governance procedures which are in line with the "Combined Code" extant in the UK. (It is worth noting that since CP41 was issued by the Financial Regulator, the Combined Code has been updated and very recently reissued as the UK Corporate Governance Code.) This code was developed to systematise the relationship between shareholders and listed companies in particular, which in Ireland would align with domestic institutions with a systemic element to their operations. To this end, the full application of this type of code is inappropriate as a framework for DIMA members and similar entities within the international financial services arena in Ireland, particularly where they are part of larger

[1] *International Association of Insurance Supervisors (IAIS) position statement on key financial stability issues, 4 June 2010*

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
tel: +353 1 775 9448 fax: +353 1 775 9409 email: executive@dima.ie web: www.dima.ie
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international groups, regulated at group level in another jurisdiction, and are involved in wholesale, non-systemic activities.

More specifically, CP41 does not include reinsurance undertakings in the paper, even when detailing the legal basis of the requirements (section 2.1), which leads logically to the conclusion that reinsurers will continue to be regulated under the existing corporate governance requirements.

DIMA would counsel the Financial Regulator that with the current state of development of Solvency II, and the pending finalisation of Level 2 implementing measures which will include corporate governance requirements, the Irish regulatory system should not try to anticipate – perhaps erroneously – the final form of the future European regulatory requirements, particularly since corporate governance requirements already exist for a large proportion of the marketplace in Ireland. It is widely accepted that the Solvency II implementation project is already highly demanding on resources and is highly challenging in terms of timeline, and it would be regrettable if what proves to be an interim corporate governance system in Ireland conflicts with the final shape and implementation of Solvency II.

In addition, in the period since the Financial Regulator issued CP41, the European Commission has issued a Green Paper entitled “Corporate governance in financial institutions and remuneration policies” (COM(2010) 284 final, 2 June 2010). This document draws on the recommendations of the Larosière report[2] and states that the options outlined in the paper are likely to supplement and accompany legal provisions for strengthening the financial system and supervisory architecture, specifically citing Solvency II. The Green Paper is at a higher, more conceptual, level than CP41, and asks general questions from interested parties for response by the beginning of September. The European Commission will take a decision on its next steps on the basis of responses received. DIMA urges the Financial Regulator not to act in anticipation of the European Commission’s development of a new, as yet undefined, European corporate governance regime.

Thus the logical conclusion would be to extend the current corporate governance requirements for reinsurers to insurance entities, in particular those which operate in the wholesale market and are not systemic in nature.

The general thrust of the CP41 is clearly aimed at retail institutions which are systemically important in Ireland, with derogations potentially available from the Financial Regulator. While DIMA welcomes these requirements for entities which are categorised as retail and systemic, it recommends that the Financial Regulator develop

[2] *Report of the High-Level Group on Financial Supervision in the EU published on 25 February 2009. Jacques de Larosière was chairman of the group.*

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
tel: +353 1 775 9448 fax: +353 1 775 9409 email: executive@dima.ie web: www.dima.ie

a scale for assessing the level of corporate governance requirements for any institution, based on proportionality and taking into account the nature, scale and complexity of the operation. This would include issues such as:

- wholesale/retail;
- participation in a group regulated in another jurisdiction;
- whether the entity is regulated by the Financial Regulator at group or subsidiary close to group level; and
- systemic and economic significance of the company.

Such a scale would comprise a range of options, with boards of directors fulfilling their essential role of establishing the appropriate level of corporate governance application commensurate with the entity's risk profile.

CP41 emphasises the role of directors, in particular independent non-executive directors, and the regulated entities' responsibility to report to the Financial Regulator. This is an issue which should be addressed in an updated "Fit and Proper" regime. In addition, the reliance placed on independent non-executive directors, and the limitations on their appointments, may cause issues for entities which are part of a large group, where non-executives of the group itself may be as appropriately able to perform the same role. At the same time, artificial restrictions on the number of directorships held by an individual could adversely impact the quality of decision-making at board level and should be applied on a proportional rather than absolute basis.

There is potential for tension between the proposals in CP41 and the rights of the parent of a company within a group and its shareholders. This is particularly evident in the proposal for an independent chairman of an institution which is a subsidiary. It is a premise of good governance and good business practice that a group company can and should exercise control over its subsidiaries. The requirement for an independent chairman of the subsidiary will prevent such control. It would also be usual for the parent to make appointments to a subsidiary board and to appoint the CEO. Governance requirements that weaken a parent's governance of its subsidiary could lessen the parent's confidence in the subsidiary, and could reduce shareholders' confidence in the group accordingly.

In summary, the main aspects of DIMA's response are:

- reinsurance remains outside the scope of this paper, and wholesale insurance should be explicitly descoped, and the existing reinsurance corporate governance regime extended to wholesale insurance. Any other DIMA comments in this response should not be interpreted as diluting this fundamental DIMA position;

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
tel: +353 1 775 9448 fax: +353 1 775 9409 email: executive@dima.ie web: www.dima.ie

- general rules should be set at a level appropriate for the majority of regulated entities and exceptional rules be set for exceptional cases. If this is not the case, the Financial Regulator will be left with an overly onerous workload in dealing with requests for exemptions which would likely lead to delayed and compromised decisions and too much uncertainty for regulated entities or for groups considering Ireland as a domicile for a new entity;

- the paper is clearly and properly concerned with the board's oversight of management's discharge of duties. However, in addressing this concern the paper is leaning towards duplication of the role of senior executives at the level of the board, for example in mandating monthly board meetings. The paper should recognise the complementary role played by the Financial Regulator's "Fit and Proper" requirements and these "Fit and Proper" requirements should be extended as necessary to address concerns.

PROPOSAL

1.1 The consultation paper states: "… one of the causes of the international financial crisis was inadequate oversight of credit institutions and insurance companies." DIMA disagrees with this contention; there is no evidence that the regulated activities of insurance companies have contributed to creating the international financial crisis. Indeed, a recent report from the Geneva Association cited that "in the U.S. as of mid-2009 only three insurance companies had taken TARP [Troubled Asset Relief Programme] funds. At the time 592 banks had accessed the programme."[3] The issue of AIG is often incorrectly cited as an insurance-related problem within the international financial crisis. In fact, these losses were the result of credit default swap exposures in AIG's non-regulated activities within its Financial Products division, and were not the result of its insurance activities.

Overall, the Geneva Association identified: "Banks and insurers played markedly different roles in the financial crisis: not only were banks, not insurers, the source of the crisis, banks were also much harder hit by it. Excluding those insurers with large quasi-banking operations, insurers received less than USD 10 billion in direct State support during the crisis, compared with over USD 1 trillion given to banks.

"The insurance business model—encompassing both insurers and reinsurers—has specific features that make it a source of stability in the financial system. Insurance is funded by upfront premiums, giving insurers strong operating cash-

[3] *"Systemic Risk in Insurance - An analysis of insurance and financial stability, Special Report of The Geneva Association Systemic Risk Working Group", March 2010*

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flow without requiring wholesale funding. Insurance policies are generally long-term, with controlled outflows, enabling insurers to act as stabilisers to the financial system. During the crisis, insurers maintained relatively steady capacity, business volumes and prices."[4]

These facts do not provide evidence to support the Financial Regulator's statement, but instead indicate that the re/insurance industry provided stability during the crisis.

DIMA agrees with the Financial Regulator's comment that "enhanced corporate governance requirements will improve the long term sustainability of financial firms" since there has been an absence of such requirements for certain sectors of financial services, but advises that any requirements should direct to specific institutions through the principle of proportionality, i.e. the nature, scale and complexity of the organisation, rather than a simplistic "one size fits all" approach.

1.4 This paragraph states that the standards within the consultation paper "propose minimum standards that institutions shall meet in this area." Although there are references to possible derogations later in the consultation paper, by taking such an approach at this point in the document the Financial Regulator appears to be signalling its intention that the standards detailed are at a baseline rather than top line level. These standards are disproportionate to wholesale re/insurance business; the full scale of proposed requirements should be explained at the outset of the paper. In addition, if proportionality and its application are not clearly established from the outset, the Financial Regulator is likely to find itself facing a heavy administrative burden from regulated entities specifically seeking derogations from the proposed level of corporate governance requirements.

DIMA strongly agrees with the view that the paper should "align corporate governance requirements with recent international regulatory initiatives in the governance field" but urges the Financial Regulator not to implement an interim regime which will be superseded by European regulatory and legislative changes, including Solvency II, while there currently exists an appropriate corporate governance regime for reinsurance undertakings which could be extended to wholesale insurance entities.

2.1/2 These paragraphs do not include any reference to legislation or guidance relating to reinsurance entities. SI 380 of 2006 and Financial Regulator guidelines require reinsurance companies to submit compliance statements and returns, including Statements of Actuarial Opinion and audit management letters.

[4] *Ibid*

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
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There is also no reference in this paragraph to company law requirements in place already for operations in Ireland. Re/insurance companies incorporated in the State are obliged to comply with Irish company law and operate within the parameters of their memoranda and articles of association. As Irish companies, they are policed by the Office of the Director of Corporate Enforcement, in accordance with the Companies Acts 1963 to 2009.

DIMA recommends that reinsurers should not be included within the scope of the paper on the basis that they are covered by existing requirements, and that existing governance requirements for reinsurers should be extended to cover wholesale insurance entities.

2.4 Re/insurance entities currently submit a compliance statement within their annual regulatory returns to the Financial Regulator. This statement should be sufficient to fulfil the obligation in this section; if the current compliance statement does not fulfil the requirements, it should be updated accordingly, rather than requiring a duplication of effort. If changes are to be made to the compliance statement, a consultation with industry would be encouraged.

2.5 Any amendment or supplementing measures taken by the Financial Regulator should be subject to consultation and be implemented within a reasonable timeframe.

2.6 There may be circumstances in which regulated entities inadvertently and immaterially contravene these requirements, in which case an administrative sanction would seem unduly harsh. In order to prevent the possibility of such an outcome, DIMA recommends the Financial Regulator inserts the words “wilful or material” before “contravention”.

3.1 Again, reinsurers are not specified within the scope of the consultation paper according to this paragraph and currently are under the auspices of the existing corporate governance requirements. DIMA recommends that those requirements should be extended to wholesale insurance entities.

4.2 There are several issues raised by this proposal. Firstly, there may well be “deviations” which are not within the control of the institution but reside elsewhere, such as with individual directors. Secondly, DIMA recommends the paragraph is amended to read “material” deviation. Thirdly, the timeline may be insufficient for an institution to ascertain whether there is a “deviation” or not; the timeline should be amended to a two-step process, with a five-day deadline for basic notification and a further 25 days for background and remedial action notification.

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
tel: +353 1 775 9448 fax: +353 1 775 9409 email: executive@dima.ie web: www.dima.ie

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5.1 The experience of the reinsurance industry in implementing corporate governance requirements (as per the December 2007 guidance) would indicate that a longer timeline for transitional arrangements will be required. Since some of the proposals in this consultation paper would limit the number of independent non-executive directorships to be taken by an individual, there may be added complications in that board members may be required to stand down from existing positions since they have exceeded their “allocation” of independent non-executive directorships. Again, the transitional period could be extended or limited depending upon the systemic nature of the institution.

6.2 This paragraph does not refer to reinsurance entities. DIMA proposes they not be included within the consultation on the basis that existing corporate governance requirements are in place for reinsurers. In addition, DIMA proposes the existing governance requirements be extended to wholesale non-systemic insurers.

It is vital that the Financial Regulator recognises the different characteristics of credit institutions, insurance companies and investment firms, and develops corporate governance requirements appropriate to the different sectors, rather than a “one size fits all” approach. This approach should embody proportionality and reflect other characteristics such as wholesale/retail, systemic/non-systemic.

Re/insurers are facing a considerable demand on their resources from the implementation of Solvency II over the next few years. Although there have been attempts to quantify the costs of the proposals in CP41, it has proved challenging to calculate. What is clear, however, is that there would be a substantial increase in the cost of engaging independent non-executive directors (due to the limitation in the number of positions each would be allowed to hold), as well as an increase in the number of such directors on each board. It is estimated that the additional number of directors required by the proposals as they stand at the moment will add in excess of €100,000 in costs to each organisation. In addition, the increase in direct costs and administration of organising a minimum of twelve board meetings per annum plus other committees of the board will be a substantial additional burden. A further concern is that the imposition of monthly board meetings will increase risk as management’s focus will necessarily be drawn from the day-to-day business to preparing for, and following up on, board meetings.

6.3 Please see Appendix 1 for DIMA’s response specifically relating to captive insurers, as prepared by DIMA’s captive sub-committee. It is paramount that the principle of proportionality is being brought to bear – a principle, as it relates to captives, which is still being debated at European level with respect to the development of Solvency II. It is important to note here that proportionality is a principle which should be applied across the range of regulated entities.

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
tel: +353 1 775 9448 fax: +353 1 775 9409 email: executive@dima.ie web: www.dima.ie

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CONSULTATION ITEMS

1.1 Please see earlier comments on the minimal contribution of insurance companies to the financial crisis. In particular, with respect to government support as a response to the financial crisis, the Geneva Association has estimated that excluding insurers with large quasi-banking operations, insurers received less than $10bn in state support in the crisis, compared with more than $1trn given to banks[5].

1.4 The statement in this paragraph that "the Financial Regulator considers that the requirements in this document are applicable to all credit institutions and insurance undertakings" does not align with other statements outlining minimum standards, albeit the presence of the qualification that the Financial Regulator recognises differences in the nature of business and risk characteristics of different institutions. The wording of this paragraph could be interpreted so as to result in an inappropriate burden of governance requirements being applicable to re/insurers which are part of larger international groups.

DIMA, as stated earlier in this submission, proposes that the Financial Regulator continues to apply the current corporate governance regime for reinsurers, extending its scope to wholesale, non-systemic insurance entities. If CP41 is to continue to be applied to these types of entities, there needs to be a distinction in the proportional application of the scope to different types of institutions, which themselves would need to be distinguished. These distinctions could include:

- institutions whose business exposure is not regulated under consumer protection regulation;
- institutions whose business structure is wholesale in nature (business-to-business);
- institutions which have a parent undertaking subject to equivalent governance requirements in another jurisdiction;
- institutions which are regulated under specific industry requirements (e.g. corporate governance requirements for reinsurance undertakings); and
- institutions which do not present a systemic risk.

1.5 DIMA proposes the addition of "finance function" under the list of control functions. This will include the financial operations of an institution and provide clarity that there is responsibility for the finance function to demonstrate control and engagement under corporate governance requirements.

[5] *"Systemic Risk in Insurance - An analysis of insurance and financial stability, Special Report of The Geneva Association Systemic Risk Working Group", March 2010*

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Should reinsurers and wholesale insurance entities be included within the scope of CP41, it is unclear what would constitute “large international activities”. This would require clarification.

In defining the criteria for directors’ independence, DIMA recommends the criterion for a past employee’s eligibility as an independent director be “in the recent past”, rather than “in the past” for practicality and to maintain consistency with the requirement of individuals who have been providers of professional services to the financial institution.

2.0 See previous comments on legal scope of CP41. This does not currently include reinsurance entities within its scope. For reasons given elsewhere in this paper, reinsurers and should remain outside the scope of the paper, subject as they are currently to existing corporate governance requirements, and the existing requirements should be extended to wholesale insurance entities.

3.2 DIMA would like to see the concept of corporate governance assimilated at all levels of an organisation, with appropriate levels of protection such as whistleblowing provisions.

3.7 DIMA supports in principle the spirit of this proposal. In order to make this workable, however, the concept of “material concern” should be embodied within the proposal, to ensure that directors do not feel under obligation to report any concerns irrespective of their immateriality. In addition, the director should seek to resolve any matter with the board in advance of approaching the Financial Regulator. This could be more appropriate for revised Fit and Proper requirements rather than these corporate governance proposals. Further, whistleblowing protection should be developed for director protection.

DIMA proposes that the Financial Regulator provides guidance on best practice for review and reporting breaches of corporate governance, and the methods of communication between the undertaking and the Financial Regulator.

4.1 DIMA welcomes the recognition by the Financial Regulator that if an undertaking is a subsidiary of a group which is similarly regulated by an equivalent competent authority, then non-executive directors need not all be independent. In addition, DIMA welcomes that non-executive directors can be sourced from group companies as long as they are not executives or senior officers of the undertaking or its subsidiaries, and that group independent non-executive directors can be appointed independent non-executive directors of the local entity.

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
tel: +353 1 775 9448 fax: +353 1 775 9409 email: executive@dima.ie web: www.dima.ie

However, where these exceptions do not apply, there are balance issues emanating from the Financial Regulator's proposed board composition:

- a minimum board of five with the majority being independent non-executive directors (INEDs) results in a minimum of three INEDs and two other directors (which could be non-executive and/or executive);
- there is a requirement for "balance" between INEDs and other directors, which implies that with a minimum of three INEDs, a further three directors would be required which would be a mix of non-executive directors (NEDs) and executive directors. Since the CEO would need to sit on the board, and likely the Finance Director as well, this would leave only one NED position, which could result in an increase in NED positions in order to strike "balance" which would in turn result in an increase in INED positions, and so the cascading could continue.

Alongside the obvious problems this engenders, from the position of wholesale businesses which generally are a subsidiary of a larger group which constitutes a single shareholding entity, such board composition is disproportionate. There is no consumer exposure, and the influence and control exhibited by shareholders are ensured by a group representative acting as chairman rather than an INED. For those institutions covered by section 4.1(a), a non-executive chairman deriving from the group would challenge the executive director, representing the shareholder's interest. In addition the word "appropriate" should be inserted before balance so it now reads: "an appropriate balance between independent and other directors", again to ensure proportionality is enshrined within the guidance.

DIMA does not agree with the assertion that there must be a majority of independent non-executive directors in the instance of a private single shareholder wholesale business. Such an institution's risk appetite is typically aligned with its group shareholder risk appetite, and it is counterintuitive to suggest that shareholders would be willing to forego their shareholder rights of oversight and control over their capital investment to a majority board of independent non-executive directors.

Further, the requirement to unnecessarily appoint extra independent non-executive directors could lead to pressures on the limited pool of experienced professionals in the local market, with consequent extra strain on resources and the potential requirement to appoint independent non-executive directors from outside Ireland.

DIMA believes the existing corporate governance requirements for reinsurers appropriately address wholesale, single shareholder structures.

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
tel: +353 1 775 9448 fax: +353 1 775 9409 email: executive@dima.ie web: www.dima.ie

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4.2 The Memorandum and Articles of Association of each company specify the quorum and the voting rights for board members. This is the basic structure to enable effective decision-making and control over the entity's activities and interests. In this context, DIMA recommends that this paragraph be amended to read: "The appropriate balance between executive and non-executive directors…"

4.3 Due to the international nature of the DIMA membership and the legislative and regulatory need in many cases for the majority of directors to be present in Ireland for board meetings, such meetings are carefully arranged with plenty of notice to ensure that all directors, both local and overseas, can attend meetings whether in person, by telephone or other media, or through written unanimous resolution, in accordance with the company's Articles of Association. The cross-border nature of the DIMA membership's business means that directors and senior executives are frequently travelling overseas, thus have limited availability. Under these circumstances, DIMA requests that the Financial Regulator indicates its view of what constitutes "short notice", what formats such a meeting could take, for example teleconferencing, and how an institution could enforce such a requirement.

4.4 It is unclear how an institution would be able to enforce the requirement that "each member of the board should have sufficient time to devote to the role of director and associated responsibilities." This is more appropriate a responsibility for each director, and covered in Fit and Proper requirements rather than the corporate governance requirements.

4.5 This paragraph proposes that individuals be limited to a maximum of three directorships for credit institutions and insurance undertakings. While DIMA welcomes the removal of the restriction for multiple directorships within a financial services group, the general premise of fixing an absolute number on directorships disregards the principle of proportionality and does not address the issue of the variety of entities operating in the sector. The role of a director in a large systemically important credit institution is not comparable to that of a director in a specialised re/insurance company, with lower commensurate time requirements for the latter. For companies for which time commitments would be lower than a systemic retail institution, it would be increasingly difficult to source directors willing to "use up" some of their "directorship allowance". At the same time, the pool of suitable independent non-executive directors in Ireland is already limited for what is, essentially, a specialised business, thus an artificial limitation such as this would increase the hurdles to companies being able to establish an appropriately qualified and experienced board of directors. A further consequence could be that companies would be forced to appoint directors with less appropriate

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
tel: +353 1 775 9448 fax: +353 1 775 9409 email: executive@dima.ie web: www.dima.ie

backgrounds, potentially with less to contribute to the board, if this limitation were to be enforced.

Within a financial services group, if a director is appointed to the board of an external company to the group representing the group's shareholding interest, the director should be able to maintain this position on evidence that it does not impair or conflict with their existing responsibilities.

DIMA proposes that this paragraph be amended to state that directors should ensure they have sufficient time, ability and experience to fulfil their obligations, and that this is expressly covered in the amended Fit and Proper regime, as proposed in our response to paragraph 4.4.

4.6 The restrictions being proposed by the Financial Regulator on the number of directorships held by an individual outside credit institutions and insurance undertakings does not take account of the nature of those directorships. For example, would voluntary positions within charities, other not-for-profit organisations, housing management bodies, etc, be within the remit of the proposed limited number of directorships? This could detract from an important contribution made by such individuals at a social responsibility level, discouraging involvement in community-related bodies among others.

In addition, the Financial Regulator has not indicated how it will limit directorships of funds, which are outside the remit of CP41, for individuals holding directorships in credit institutions and insurance undertakings.

It is more appropriate that the onus is placed on directors as part of a revised Fit and Proper regime to demonstrate that they have sufficient time and ability to fulfil the requirements of roles that they hold, rather than impose an arbitrary number on their appointments.

4.12 This paragraph recommends that board review be conducted at least once every three years. This is reasonable and appropriate for stock-listed large organisations with retail exposures, as is the proposal that if a board member sits for nine years or more, the board must document the rationale and advise the Financial Regulator. However, within private single shareholder wholesale entities, employees of the company who are board directors typically are contracted on open-ended contracts until retirement. Such contracts are standard in the industry globally.

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
tel: +353 1 775 9448 fax: +353 1 775 9409 email: executive@dima.ie web: www.dima.ie

DIMA recommends that proportionality should be applied to this paragraph and that the Financial Regulator should not apply unnecessary requirements which are contrary to industry practice.

5.0 The role of chairman as detailed in this section is appropriate for listed companies. In the case of a single shareholder subsidiary of a listed parent, the role of chairman is fulfilled at group level; thus, the chairman does not need to be an independent non-executive director since the shareholder interests are represented by a non-executive appointment.

Furthermore, in the case of subsidiaries within a Group construct, or subsidiaries which are 100% owned by the parent company, it is arguable that the imposition of an independence requirement on the chairman may reduce rather than enhance the proper functioning of the board. Within a Group construct, and particularly if strategy is determined at group level, there are de facto limits to the effect and power of an independent chairman at a subsidiary level and thus such an imposition may deliver an illusory form of governance without altering the substance of how the entity is governed. The scope of an independent chairman may therefore solely achieve the appearance of control.

In contrast to the intention of this section of the consultation paper, the requirement for an independent chairman could, in fact, result in less effective governance for subsidiaries. In many instances, the chairman of the board is an important link to the group and facilitates important two-way communication as an executive within the group. However, if the chairman were required to be independent, the extent of this communication would be necessarily limited. Thus the independence requirement in this instance could produce less effective governance for some entities. DIMA recommends that the requirement for the chairman and, where relevant, deputy chairman to be independent should be lifted in these circumstances.

The requirement that the chairman shall have a financial background would restrict the disciplines and business experience that a chairman could bring to the board of directors, for example from a legal, business development, change management or human resources perspective, particularly if there is lack of clarity around what would constitute “relevant and timely comprehensive training”.

Proportionality should be applied to the proposed restriction that an individual could only hold one chairmanship at a time, taking into account the wholesale nature of the institution and the experience and competence of the individual. It also should be applied to the time restriction on the appointment of the position, currently proposed to be limited to election or reappointment on an annual basis.

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
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While it is wholly appropriate that the commitment for large systemic retail institutions would be such as to entail a single chair position for an individual, other entities would not require the same degree of significant time commitment and thus the restriction should be lifted as long as the individual can prove their ability to undertake more than one role to satisfactory standards. This should also apply to the deputy chairman position where relevant. In addition, the proportionality principle should also be extended to the proposal that a chairman require Financial Regulator approval in advance of taking on other directorships.

5.9 For the reasons cited previously regarding the role of the chairman within single shareholder companies, the requirement regarding the limitation of any individual who has been CEO, executive director or member of senior management during the previous five years for appointment as chairman of the board, should be removed for such structures. In addition, the sole shareholder may wish to appoint a previous executive, CEO or member of senior management as chairman as a group-internal move as well as for business continuity purposes.

6.0 The role of chief executive officer as detailed in this section is appropriate for listed companies. In the case of certain structures in Ireland, such as dual company structures comprising sister insurance and reinsurance entities, the management team may be duplicated across organisations, including the role of chief executive officer. DIMA recommends that this proposal be amended so that chief executive officers who are able to demonstrate their ability to manage all roles appropriately within the same financial group are not restricted to a single role.

The requirement that the chief executive officer shall have a financial background would restrict the disciplines and business experience that a chief executive officer could bring to the board of directors, for example from a legal, business development, change management or human resources perspective, particularly if there is lack of clarity around what would constitute “relevant and timely comprehensive training”.

Currently, a chief executive officer typically has a permanent contract; the proposal to move such positions to five-year reviewable contracts may have legal and human resource ramifications which could prove difficult to surmount, and in general would be out of step with practice in other financial services centres.

7.0 DIMA recognises the importance of the independent non-executive director role, but, as stated previously, asserts that the non-executive director role plays an important part in the running of single parent wholesale entities.

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
tel: +353 1 775 9448 fax: +353 1 775 9409 email: executive@dima.ie web: www.dima.ie

The statement that independent non-executive directors “shall comprise individuals with relevant skills, experience and knowledge (including accounting, auditing and risk management knowledge” could imply that the Financial Regulator requires that the company needs INEDs with these specific skills, potentially limiting the individuals capable of being appointed to this function, and discouraging diversity on the board.

The provision of “dedicated support” for INEDs is unclear; in particular in the case of wholesale and non-systemic entities, it could be disproportionate to have a resource solely dedicated to the support of INEDs.

8.2 The role and responsibilities of the board are multidimensional and the documentation relating to this includes Powers of Authority, board-approved policies, frameworks, committees, etc. It is impractical to prescribe a requirement to collate all such information into a single document, which could lack clarity and context.

9.7 It is unclear whether the Financial Regulator intends this paragraph to capture circumstances in which an individual has resigned or moved in other circumstances from the position of head of a Control Function.

The deadline proposed of five working days is particularly tight if the Financial Regulator is requiring a clear articulation. DIMA proposes that a two-step process be applied, with an initial notification in five days, with a further 25 days within which to provide clear articulation.

10.0 DIMA welcomes the principles embodied in section 10 of the consultation paper. There are concerns, however, that this may effectively implement an accelerated application of the Own Risk and Solvency Assessment (ORSA) as required under Solvency II, since CP41 is more prescriptive in terms of risk appetite than is currently embodied in “Corporate Governance for Reinsurance Undertakings” paper. It is widely acknowledged that the timeline for implementing Solvency II of end 2012 is challenging. A premature implementation of part of Solvency II would place even greater pressures on companies currently in the process of implementing wide-ranging and reaching changes. DIMA recommends that the Financial Regulator implements such measures as part of the proposed Solvency II programme and not separately in an accelerated programme.

10.4 DIMA proposes the Financial Regulator amend this paragraph to read “material deviation” to preclude the most minor of deviations, with no materiality, from being communicated to the Financial Regulator.

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
tel: +353 1 775 9448 fax: +353 1 775 9409 email: executive@dima.ie web: www.dima.ie

11.1 DIMA agrees that the board “shall meet as often as is appropriate to fulfil its responsibilities effectively and prudently, reflective of the nature, scale and complexity of the institution”. However, this aim is immediately negated by the following requirement that the board meet monthly as a minimum. The critical issue here is that the board addresses appropriate issues in a timely manner and the subject matter, nature, length and quality of meetings, representation of directors and non-board executives as documented in agendas and minutes is appropriate. DIMA recommends that the Financial Regulator adopts a proportional approach, with frequency of meetings ranging from quarterly to monthly dependent upon the nature, scale and complexity of the regulated entity.

13.1 DIMA recommends that the interests of a single owner subsidiary wholesale undertaking be fully taken into account in the light of the control and oversight that the parent exerts in the interests of its shareholders. Most group shareholders are regulated entities in their own right in jurisdictions which have equivalent regulatory controls to those that exist in Ireland. Recognition of equivalent governance treatment would settle shareholders’ concerns about the change or diminishing of their control and interests.

14.1 The majority of DIMA members are part of a larger financial group with well-established relationships with group audit, nomination and risk committees which directly influence the peer review of the Irish undertaking. Thus it may be appropriate for the board to take on these functions directly and use group committees, provided these committees provide a robust, complementary and resourceful provision of services such as to meet the operational needs of the organisation.

17.2 The proposals in this paragraph that the audit committee shall be composed of non-executive directors, the majority of whom are independent, in reality would increase the number of independent non-executive directors as detailed previously. Such an approach is appropriate for retail systemic entities, but disproportionate for other types of entities. DIMA proposes that the Financial Regulator recognises that where entities with a group internal audit function maintains a regular audit review of the local subsidiary, this is appropriate under the corporate governance requirements. In addition, for those undertakings with a local audit committee function, the independent majority of directors and independent chairman requirements be removed.

18.1 Paragraph 14.1 states that at a minimum, a separate risk committee must be established, however this paragraph gives an opt-out in relation to companies of lesser risk exposures. Other companies, however, as described in the DIMA response to paragraph 14.1, should also have access to this derogation.

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
tel: +353 1 775 9448 fax: +353 1 775 9409 email: executive@dima.ie web: www.dima.ie

18.2 DIMA proposes that this paragraph is reworded to read: "The risk committee shall have an appropriate balance of non-executive and executive directors…"

18.5 Please see comments under 10.0.

19.0 & 20.0

Both nomination and remuneration functions typically are undertaken by the respective group committees for those entities which are part of an international group. Thus DIMA recommends that the requirement for remuneration and nomination minimum requirements for entities which are subsidiaries of single shareholders be maintained as they currently exist under the corporate governance for reinsurance undertakings.

21.1 All DIMA members are already required to submit compliance statements. DIMA contends that the current compliance statements are sufficient to fulfil the proposals.

In conclusion, DIMA welcomes in general the aims of this consultation paper, but advocates the proportional and appropriate application of corporate governance requirements, particularly on a sector which has weathered the financial crisis and has proved non-systemic. As re/insurance entities are developing their Solvency II-compliant structures and processes, it is imperative that the Financial Regulator does not attempt to implement a regime in advance of that which will be required of all European re/insurance entities at the end of 2012. To these ends DIMA strongly recommends that the Financial Regulator descopes reinsurance and wholesale insurance from this paper, and that the existing reinsurance corporate governance regime extended to wholesale insurance.

DIMA is willing to meet with the Financial Regulator to explain any of the issues raised in this paper.

Yours faithfully

Sarah Goddard
CEO

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
tel: +353 1 775 9448 fax: +353 1 775 9409 email: executive@dima.ie web: www.dima.ie

DUBLIN INTERNATIONAL INSURANCE & MANAGEMENT ASSOCIATION LTD.

Appendix A

DIMA Captive response

We would like to take this opportunity to welcome the issuance of Consultation Paper CP41 on the Corporate Governance Requirements for Credit Institutions and Insurance Undertakings (CP41). The recent financial crisis has demonstrated the interdependencies within the financial system with the bankruptcy of a financial institution, particularly a bank, causing a domino effect and leading to the bankruptcy of other financial institutions. This has highlighted the need for a robust and effective corporate governance regime which is proportionate to the nature and business risks of an institution.

In the spirit of proportionality we note that the Financial Regulator in its introductory proposal to CP41 outlines that it is minded not to apply the full requirements set out in CP41 to the vast majority of captive insurers and has sought comment from the captive community as to what elements of CP41 might be appropriately disapplied.

In the "Updated Operational Guidance Applicable to Captive Insurance Undertakings" issued by the Financial Regulator in November 2009, it sets out that a captive insurer must cover only the risks of its parent or of entities that are part of the group in order to avail of the differentiated supervisory approach.

Given a captive can only cover group risks to avail of the differentiated supervisory approach as outlined in the "Updated Operational Guidance Applicable to Captive Insurance Undertakings", we know that the Financial Regulator appreciates the influence the parent company will need to have on the captive insurer, such as board membership, so as to meet its own regulatory rules (if based outside of Ireland) and to derive the benefits of setting up a captive in Ireland in the first instance.

The influence of the parent company is also acknowledged in the application process whereby the Financial Regulator requires the captive insurer to outline the following:

- the anticipated benefits, from a group perspective, of setting up an Irish captive company;
- the ability and willingness of proposed qualifying shareholders to support the captive with additional funds if needed for the development of its activities or in the case of financial difficulty; and
- the influence of the qualifying shareholder on the financial position (including dividend policy), the strategic development and the allocation of resources to the captive.

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
tel: +353 1 775 9448 fax: +353 1 775 9409 email: executive@dima.ie web: www.dima.ie

In light of the intrinsic relationship between the captive insurer and its parent we propose that the detailed requirements relating to the composition of the board, the chairman, the chief executive officer, independent non-executive directors, the requirement for twelve board meetings and the requirement for committees of the board as currently set out in CP41 are unnecessary and unworkable for captives, and are not cost-effective for parent companies in terms of the number of directors required and the requirement for a majority to be independent non-executive directors. We therefore seek a formal derogation from these requirements for the captive industry in Ireland.

The rationale and the proposed alternatives are set out below.

Board Composition and Independent Non-Executive Directors

The Financial Regulator's guidance paper on "Corporate Governance for Reinsurance Undertakings" issued in December 2007 sets out specific exemptions for captive reinsurance undertakings that exclusively carry out reinsurance only for one or more undertakings of the group:

- the captive is not required to appoint a minimum number of independent non-executive directors (INED);
- the captive need not directly employ a general manager.

The guidance issued in December 2007 reflects the Financial Regulator's understanding of:

- the unique nature of captives, which are designed to cover group risk and therefore have no direct exposure to the retail market place (in other words a captive is a wholesale business); and
- the nature, scale and complexity of captives, which more often than not do not employ direct employees and instead are run by a board of directors and a captive manager.

While we appreciate that this guidance was issued prior to the current financial crisis and that the thinking around what constitutes effective corporate governance has changed since then, we would suggest that the banking sector as opposed to the insurance sector (with the exception of Quinn) has raised the need for more stringent measures.

Nevertheless, we appreciate that no financial institution is immune from failure and in the spirit of ensuring an appropriate corporate governance framework is put in place which reflects the nature, size and complexity of the risks associated with that business, we propose that for captives, the board structure should be made up of a minimum of three directors. Given the nature of a captive is to cover group risk and as such does not have any direct exposure to the retail marketplace, we believe that a captive should be exempt from the requirement to appoint an independent non-executive director (as defined in

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
tel: +353 1 775 9448 fax: +353 1 775 9409 email: executive@dima.ie web: www.dima.ie

CP41). In this regard, we also need to be mindful that the parent company of many Irish captives will be subject to its own regulatory rules in relation to corporate governance and will consequently have a role to play in the board composition of the Irish captive subsidiary.

We would be concerned with the limit on the number of directorships to be held by directors. Given the role of the captive manager in the captive company, it is usual for the captive manager to provide a director, normally at senior staff level, who sits on the captive board. This is a positive contribution, given the typically low number of employees in a captive. However, the limit on the number of directorships as currently set out in CP41 would mean that a director provided by a captive manager could only hold a maximum of three such directorships. Given the number of captives in Ireland and the number of captive managers, this limit is neither workable nor in the best interests of the captive industry in Ireland. We would propose that this limit is removed.

We note that the Financial Regulator will not impose a restriction on multiple directorships within a financial services group. However, where directorships are held outside of a credit institution/insurance undertaking then a director can only hold up to five directorships. For directorships relating to captives, this limit of five is not irrelevant and should be disapplied.

In many cases the parent of a captive is not a credit institution/insurance undertaking, however it is not unusual for a director of a captive to also hold directorships of other group companies and in many instances this number would exceed five. A restriction of five directorships is contrary to Section 45 of the Companies (Amendment) No. 2 Act 1999 which states that a person shall not be a director of more than 25 companies with an exception for group companies which can be treated as one company.

We appreciate that a director must have sufficient time available to fulfil his/her role and functions as a director of the captive undertaking, however we believe it is not appropriate to impose a maximum restriction on the number of such directorships a person can hold, particularly in light of the gap between the maximum currently set out in CP41 and in the Companies Act, the pool of persons available to act in the capacity of director, and the need to consider the size and complexity of each organisation where the person is holding such directorships.

We believe it should be up to the individual director to provide the Financial Regulator with a detailed rationale and supporting documentation as to why he/she considers that the number of directorships he/she holds does not constitute an inordinate constraint on their time, and that such a director is best placed to determine that they have such time as opposed to the captive undertaking seeking to appoint that person to the board.

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
tel: +353 1 775 9448 fax: +353 1 775 9409 email: executive@dima.ie web: www.dima.ie

Chairman

Our experience in the captive industry in Ireland is that due to the nature, scale and complexity of the companies, it is not necessary to have a formal appointed dedicated chairman. On a practical basis, it is often the most senior director who is available and in Ireland who acts as the chairman at a particular meeting. The restrictions noted in CP41 regarding the criteria that must be satisfied in order to be the appointed chairman are not workable for captives and should be disapplied.

Chief Executive

As outlined earlier, the Financial Regulator's guidance paper on "Corporate Governance for Reinsurance Undertakings" issued in December 2007 has set out a specific exemption for captive reinsurance undertakings whereby the captive need not directly employ a general manager (which could be deemed the equivalent of a chief executive).

It is usual for many captive undertakings not to employ a general manager as due to size, nature and scale of the business it is deemed more appropriate and more efficient to appoint a captive manager instead. To date this model has worked very effectively for the captive industry in Ireland. If it were mandatory for a captive undertaking to appoint a general manager/chief executive this would pose an unnecessary burden on such captive undertakings which could encourage the parent company to look at establishing the captive in another jurisdiction outside Ireland, but potentially elsewhere in the European Union.

We strongly believe that captives should be exempt from the requirement to appoint a chief executive.

Board Meetings

The requirement for the board to meet once in each calendar month is excessive, particularly in the context of subsidiaries of international financial services groups and will lead to valuable resources, both executive and administrative, of the undertaking being spent on the preparation and attendance at board meetings instead of on the management and efficient operation of the business of the undertaking.

We would propose as an alternative to the current requirements in CP41 that an Irish captive should have a minimum of two board meetings per annum with the board allowed the flexibility to determine if more meetings are required.

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
tel: +353 1 775 9448 fax: +353 1 775 9409 email: executive@dima.ie web: www.dima.ie

Committees of the Board

While we can appreciate the merit of establishing a sub-committee structure for larger organisations, such as having a separate audit committee and risk committee, we cannot see the benefit of such a sub-committee structure for a captive undertaking given the nature and scale of captives, and because captives are required to report to the board of the parent on such matters. To ensure the efficient operation of the captive board we believe captive undertakings should be exempt from the requirement to establish a sub-committee structure. Instead the onus should be on the board of the captive to determine, based on the nature, scale and complexity of the risks being written by the captive, whether or not a sub-committee structure such as a separate audit committee or a risk committee is required to allow the board operate more efficiently.

We would also suggest that in relation to audit committee requirements as currently set out in CP41, it is important to ensure that such requirements do not conflict with Irish and EU obligations of institutions with respect to the establishment and operation of an audit committee. In the event of a conflict between the relevant provisions it should be clarified that the legal provisions will prevail.

Compliance Statement

With respect to the requirement to prepare and submit an annual compliance statement, we note that there is already a requirement in place for a "Director's Compliance Certificate" (Insurance) and a "Compliance Statement" (Reinsurance). We recommend that these requirements, as they stand, are appropriate for captives. Alternatively we would suggest that greater clarity is needed as to what the proposed compliance statement will include.

Pavilion House, 31/32 Fitzwilliam Square, Dublin 2, Ireland.
tel: +353 1 775 9448 fax: +353 1 775 9409 email: executive@dima.ie web: www.dima.ie