Hartford Life Limited

RESPONSE TO THE FINANCIAL REGULATOR'S CONSULTATION PAPER 41

CORPORATE GOVERNANCE REQUIREMENTS FOR CREDIT INSTITUTIONS AND INSURANCE UNDERTAKINGS

TABLE OF CONTENTS

INTRODUCTION 3

1 BACKGROUND 6

2 LEGAL BASIS 6

3 GENERAL REQUIREMENTS 7

4 COMPOSITION OF THE BOARD 8

5 CHAIRMAN 12

6 CHIEF EXECUTIVE OFFICER 13

7 INDEPENDENT NON-EXECUTIVE DIRECTORS 13

8 ROLE OF THE BOARD 13

9 APPOINTMENTS 14

10 RISK APPETITE 14

11 MEETINGS 14

12 RESERVED POWERS 16

13 CONSOLIDATED SUPERVISION 16

14 COMMITTEES OF THE BOARD 17

15 GENERAL REQUIREMENTS OF COMMITTEES 17

16 TERMS OF REFERENCE OF COMMITTEES OF THE BOARD 18

17 AUDIT COMMITTEE 18

18 RISK COMMITTEE 18

19 REMUNERATION COMMITTEE 19

20 NOMINATION COMMITTEE 19

21 COMPLIANCE STATEMENT 19

CONCLUSION 21

Introduction

On 27 April 2010 the Irish Financial Regulator (the "FR") issued Consultation Paper 41 ("CP41"). CP41 outlines the corporate governance requirements that the FR intends to impose on credit institutions and insurance undertakings (the "Institutions"). The guidelines that the FR will produce following receipt of responses to CP41 will be directly binding upon Institutions. Therefore these requirements will be directly binding upon Hartford Life Limited ("HLL").

The purpose of this submission is to provide input into the consultation process. HLL welcomes the opportunity to comment on the need to effect change in the governance of Institutions. The aim of this change is to create real improvements in the performance of Institutions. This document provides comment on various paragraphs of CP41 as outlined. These comments are based on consideration of current governance programmes, reports and guidance, particularly the Walker Report[1], the UK Combined Code for listed companies[2] and associated guidance, as well as experience garnered from operating within the financial services sector.

Overall observations of CP41 are as follows:

1. The requirements represent a significant deviation from the "comply or explain" approach advocated by governance disclosure methods adopted by the UK Combined Code for listed companies. The requirement to seek prior consent from the FR to adjust an Institution's approach to certain governance matters interferes with the Board's establishment of governance measures that are suitable given the size and complexity of an entity. The proposed prescriptive approach to governance will lead to a lack of qualitative improvement in the activities of

---

[1] The Walker Report – " A review of corporate governance in UK Banks and other financial industry entities" Final Recommendations 26 November 2009
http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf

[2] The UK Combined Code 2008. Financial Reporting Council, Corporate Governance guidance for UK Listed Companies.
http://www.frc.org.uk/documents/pagemanager/frc/Combined_Code_June_2008/Combined%20Code%20Web%20Optimized%20June%202008(2).pdf

Boards as it veers towards, rather than away from, a "tick the box" approach. If this is the prevailing underlying theme of the approach, then it is difficult to see how that approach can create the culture of good corporate governance that is desired.

2. The limitations imposed on executive director involvement in certain Board activities, such as Committee membership, encourages the development of a two-tier supervisory Board structure, with a clear wedge being driven between the Executive and the Board of Institutions. This will impact communication between Board members and between the Executive and the Board. In addition, it is likely to create inefficiencies in Board decision making. Two-tier Board structures have been tested in other jurisdictions and widely criticised. In practice it ignores the fact that the Executive within a company can enhance the decision making process and that their participation on the Board and the relevant Committees is beneficial due to their intricate knowledge of the relevant Institution.

3. The application of time commitments as a prescriptive approach to the activities of the Board deviates from the approach adopted by the Committee of European Insurance and Occupational Pensions Supervisors ("CEIOPS") Solvency II requirements. CEIOPS emphasise the matters to be reserved for assessment and decision making purposes by the Board. By highlighting the key areas of regulatory concern, CEIOPS have endeavoured to produce guidelines as to what Boards should look at rather than how they should look at it. Production of evidence that these areas are being properly managed is then the responsibility of the Board. It is respectfully submitted that this more closely aligns responsibility to ultimate accountability than the method proposed in CP41.

4. As CEIOPS have taken a fundamentally different approach in their guidance[3] on corporate governance for insurance companies, it seems likely that the combined effect of CEIOPS and FR guidance will lead to parallel and conflicting guidance on corporate governance for insurance companies. The guidance does not address

---

[3] CEIOPS' Advice for Level 2 Implementing Measures on Solvency II: System of Governance http://www.ceiops.eu/media/files/consultations/consultationpapers/CP33/CEIOPS-L2-Final-Advice-on-System-of-Governance.pdf

how insurance companies are expected, practically speaking, to reconcile these two different approaches to corporate governance (e.g. which approach to corporate governance is to be given priority where any such conflict exists).

1 Background

Paragraph 1.3

Some of the main changes that have been suggested are more onerous than those recommended by the Walker Report, or measures currently in place under the UK Combined Code without any concrete justification for imposing such onerous requirements. Specific examples are considered below.

It is stated that advice from CEIOPS on Solvency II requirements have been considered. Again, there are significant deviations from the requirements set out from the guidance given in these respects without concrete justification for such deviation.

Paragraph 1.4

The FR considers that the requirements shall be binding on all Institutions. While the full extent of the requirements will apply to major Institutions, those Institutions with lesser economic significance or lower risk activities may benefit from a proportionate implementation of the requirements.

CP41 does not provide a definition of "economic significance", and therefore it is difficult to assess the extent to which any of the requirements could be implemented proportionately by any Institution which is not deemed to be a major Institution.

Paragraph 1.5

The definition of "Director Independence" states that individual's "political interests" or "inappropriate outside interests" must be taken into account when assessing whether or not they are independent. However, the criteria set down for assessing independence do not touch upon either of these elements. This should be clarified.

2 Legal Basis

The legal basis for the requirements outlined in CP41 is rooted in a designated enactment and are therefore enforceable by the FR. The potential penalties seem appropriate in light of enormity of some of the governance failures that have been identified in recent time.

Paragraph 2.4

The imposition of an obligation to submit an annual compliance statement to the FR does not indicate the format for the compliance statement. In the interest of assisting Institutions to submit the annual compliance statement in an easily digestible and assessable format, it is suggested that the compliance statement adopt, or is included as an element of, the Form 23 Directors Compliance Certificate which is submitted to the FR as part of the Annual Insurance Return.

3 General Requirements

Paragraph 3.1

The indication that the requirements outlined in CP41 shall be the minimum requirements that an Institution shall meet contradicts Paragraph 1.4 above which advocates that the requirements will apply in full to major Institutions only.

Paragraph 3.2

It is important to note that the responsibility for an appropriate system of governance lies with the Board of Directors (the "Board").

Paragraph 3.3

It is stated that the system of governance shall be subject to a "regular review". What constitutes "regular" is not defined. It is suggested that an annual review of the system of governance in an organisation would be reasonable and would not unduly interfere with the effective operation of the business (i.e. talking about governance rather than actually governing). This is in line with current CEIOPS guidance on the issue.

Paragraph 3.6

The corporate governance structure should be communicated to all "relevant staff". What constitutes "relevant staff" is not elaborated upon. Given the overall thrust of CP41, it is assumed that this means communication between the Board and the Executive of Institutions but clarification would be welcome.

Paragraph 3.7

The "whistle blowing" obligations set out in paragraph 3.7 extend only to Directors. This restricted application disregards the benefits that could be obtained from encouraging whistle blowing from other sources such as employees of an Institution.

No protection has been noted as being afforded to any whistle blower. Without this protection any whistle blowing provision is highly likely to be largely ineffective. Where an individual is being asked to inform any authority about his peers, it must be acknowledged that this will cause particular personal difficulties for that individual. Failure to acknowledge this, which presents itself here by a failure to articulate any protections that will be afforded, illustrates a lack of pragmatism that will doom such provisions to fail in practice. Indeed, this failure ignores protective legislation in place in other jurisdictions such as the UK, which make the act of whistle blowing less devastating to the life of the person making a qualifying disclosure in good faith.[4]

Paragraph 3.8

An effective system of governance at group level is not sufficient. Each Institution within a group must illustrate adherence to the governance guidelines. The provision is difficult to reconcile with Paragraph 13.0, which is discussed in greater detail below.

4 Composition of the Board

Paragraph 4.1

[4] The Public Interest Disclosure Act 1998 provides protection to whistle blowers who make a qualifying disclosure in relation to financial malpractice, dangers to health and safety and miscarriages of justice.

The Board of an Institution shall have a minimum of five directors, the majority of whom shall be Independent Non-Executive Directors (an "INED").

No provision is made for a situation where a director retires suddenly. It is suggested that a period of grace (e.g. three months) should be specifically allowed in these circumstances to allow companies to fill a vacancy on the Board with a candidate of suitable knowledge, skill and experience.

Where an Institution is a subsidiary of an entity that is regulated by the FR or by an equivalent competent authority then there must be a majority of non-executive directors.

It is unclear what is considered by the FR as an "equivalent competent authority". In the current fitness and probity assessment, references are not sought for applicants who are authorised by a financial regulator operating within the EEA. Clarification is therefore sought of the definition of "equivalent competent authority".

It is equally unclear what the FR feels is a "balance between independent and other directors" in the context of the group exception set out in paragraph 4.1. Does a balance mean that an Institution Board must consist of at least 50% independent non executive directors or would, for example, a Board with two independent non executive directors (one of which acts as Chairman), two non executive directors (e.g. two directors from within the group of companies) and one executive director be considered by the FR to represent a balanced Board? Clarification on this point is particularly important as, in the absence of such clarification, a perception exists that groups that have invested in Institutions in Ireland are losing control of their investment. Equally important is that companies that may invest in Irish Institutions in the future are clear on the extent of the control that they will be able to exert on an ongoing basis over their investments. Failure to be absolutely clear in this regard will be detrimental to both existing and potential foreign investment. Creating barriers for investment due to unduly onerous corporate governance requirements is undesirable, but were these barriers to exist due to a lack of clarity in the requirements it would be inexcusable.

Paragraph 4.2

The requirement to maintain a majority of non-executive directors at each meeting of the Board of Directors will have significant implications for the ability of Institutions with smaller Boards to meet the quorum necessary to conduct the business of a meeting. In the absence of any allowance for exceptional circumstances, this will cause undue delay in the decision making of Institutions; a position which is contrary to good governance.

Paragraph 4.4. – 4.6

The method of limiting the number of directorships set out in paragraphs 4.4, 4.5 and 4.6 will, in practise prove difficult to adhere to and implement due to the broad way in which the restriction is framed. The limitations proposed present a very real threat to reducing the quality of Boards in Institutions. It should be acknowledged that responsibility for discharging the duties of directorship lie personally with each and every director.

In light of this responsibility, it seems reasonable that the number of directorships that any one individual should hold be limited. Where an individual holds a directorship with a regulated company (note that regulated companies need not be financial services companies only) then further restrictions could apply. Taking a base number of 250 working days in a calendar year, the following time would be allocated towards each particular type of directorship:

		COMPANY TYPE				
		Regulated Company or Public Limited Company			Non-Regulated Company	
	Company Size[5]	Micro or Small	Medium	Large	Micro, Small or Medium	Large
Directorship Type[6]	Executive	150 days	200 days	200 days	50 days	100 days
	Non-Executive	20 days or 30 days if Chair	25 days or 35 days if Chair	30 days or 40 days if Chair	10 days	10 days
Committee Membership (per committee)		5 days	5 days	5 days	N/A	N/A

Paragraph 4.6 provides that where an individual holds more than 5 directorships, that person creates a rebuttable presumption that the director has insufficient time available to fulfil his role. In certain instances this presumption also extends to persons holding less than 5 directorships. It is suggested that, rather than creating such a caveat, the rebuttable presumption should occur where the total time commitment of a director, as outlined in letters of appointment and including committee memberships, is greater than 250 working days. It is important to bear in mind that difficulties arise where a director does not have sufficient time to dedicate to their directorships and that the time required to adequately discharge a director's duties can vary widely from company type to company type.

Using the above table as a guide, any directorship which will bring a person in excess of, say, 210 working days in a year may require the individual director to

[5] Based on the definitions provided in 2003/361/EC Commission Recommendation concerning the definition of micro, small and medium-sized enterprises
[6] The number of days proposed in this table is based on statutory requirements outlined by Company Law, and the time commitment recently advocated by the Walker Report.

provide evidence to the FR that they are capable of discharging their duties in each directorship.

In practice, the size of a company may be only one element of an assessment of the time commitment required for each director. Development of a definition of "economic significance" could provide further criteria relevant to establishing a suitable time commitment. However, as highlighted above, there is no guidance on what the FR's definition of "economic significance" is at the present time.

As it stands, however, the "one size fits all" approach to restraints on a director's time would appear to be inappropriate and it is difficult to discern the logic justifying the proposed "broad stroke" restrictions.

Paragraph 4.7

It is suggested that the requirement for non-executive directors to ensure they have sufficient time to fulfil their roles apply to all directors.

Paragraph 4.8

It is suggested that the requirement for the Board to satisfy itself of the appropriateness of each non-executive director be applied to all directors.

5 Chairman

Paragraph 5.1

It is noted that the requirement to appoint a Chairman to the Board of every Institution reflects the approach currently adopted by the majority of listed companies under the UK Combined Code.

No provision is made for certain instances where, in exceptional circumstances, the amalgamation of the role of Chairman and CEO would be to the company's benefit. This exception is an existing feature of the UK Combined Code.

Paragraph 5.3

It is currently unclear what shall be deemed to constitute the "financial background" necessary to meet this requirement. Alternatively, it is suggested that the Chairman be submitted to the same obligation as outlined for independent non-executive directors in Paragraph 7.4 which requires incumbents of the role to have the "relevant skills, experience and knowledge".

Paragraph 5.8

It is stated that a Chairman must obtain prior FR approval before taking up any other directorship. This may prove a deterrent to suitably qualified candidates to take up the position of Chairman in order to avoid this limitation. Application of a time limit as outlined in Paragraph 4.4 – 4.6 would avoid this scenario.

6 Chief Executive Officer

Paragraph 6.3

It is currently unclear what shall be deemed to constitute the "financial background" necessary to meet this requirement. Alternatively, it is suggested that the CEO be submitted to the same obligation as outlined for INEDs in Paragraph 7.4 which requires incumbents of the role to have the "relevant skills, experience and knowledge".

7 Independent Non-Executive Directors

Paragraph 7.6

The points outlined for assessing the independence of non-executive directors do not reflect all provisions outlined in Paragraph 1.0. It is suggested that the provisions of Paragraph 1.0 provides a more comprehensive test of independence, though the shortcomings of the current definition of Director Independence noted above should again be borne in mind.

8 Role of the Board

The role of the Board is not changed by section 8.

9 Appointments

Paragraph 9.1

It is suggested that the Board responsibility to endorse "the appointment of people who may have a material impact on the risk profile of the Institution" be amended to create a responsibility for the Board to endorse the appointment of a candidate to a function that has a material impact on the risk profile of the Institution.

10 Risk Appetite

Paragraph 10.2

To facilitate the communication of an Institution's risk appetite definition, a definition of stakeholder is required. It is suggested that providing risk appetite information to all stakeholders regardless of interest in the Institution would prove a difficult task to successfully execute for Institutions.

It is also suggested that this obligation should include a caveat confirming that nothing in this section requires the disclosure of information if the disclosure would, in the opinion of the directors, be seriously prejudicial to the interests of the Institution. This reflects the approach adopted in the risk reporting requirements of the Annual Report imposed by EU Directive[7] which obliges companies of a certain size to include in their Annual Report details of the principal risks facing a company.

Equally, the public disclosures required of insurance companies under Solvency II may satisfy the requirement to inform all stakeholders. If this is the case an express acknowledgement of this would be welcomed.

11 Meetings

Paragraph 11.1

[7] EU Directive 83/349/EEC as amended

The prescriptive requirement to have a Board meeting on a monthly basis reflects a "one size fits all" approach with a requirement appropriate to large, complex, multi-national companies being used a minimum requirement. In addition, specific concerns stem from the following:

- Emphasis is placed within the consultation paper on the distinction between INEDs and non-executive directors with a vested interest in the Institution. By imposing a requirement to meet on a monthly basis for Board meetings, to meet separately for Audit Committee meetings and Risk Committee meetings, as well as to have separate and regular meetings with an Institution's executive management, the benefit of independence would appear to be eroded to the point of being superficial. The requirements are such that INEDs would be verging on forming part of the executive function of an Institution. Ignoring the reality that personal relationships will develop in these circumstances and that these personal relationships will run contrary to the theory underpinning the necessity to have INEDs will result in the proposals being far less effective than they might otherwise be.

- The obligation to discharge the duties of a director lies with each director in their personal capacity. While some guidance as to what level of director involvement is expected by the FR would be welcomed, imposing minimum conditions that may be appropriate to major Institutions on all Institutions covered by the guidance would appear to ignore the personal duty that exists. In many instances the requirements will be entirely inappropriate for non-executive directors and will simply represent an unwelcome and unnecessary compliance burden. It should be borne in mind that compliance with the requirements will not simply require a director's time, but will also represent a significant drain on an Institution's resources. While a lack of resources should never be used by an Institution as an excuse for non-compliance, the contra-responsibility of those imposing requirements is to ensure that unnecessary requirements are not imposed which draw resources away from where they are needed or to create unnecessary requirements that require additional unnecessary resources.

- The leading modern guidance on corporate governance invariably stops short of imposing requirements such as those proposed. For example:

  - The Walker Report states that "major bank boards" in the UK should require non-executive directors to commit 30 to 36 days to discharging their duties;

  - CEIOPS guidance on implementation of Solvency II standards does not impose any minimum time requirement *per se*. Instead, CEIOPS set out what they will require those at the top of the governance structure (i.e. directors in Ireland's case) to understand and decide upon. Companies will then have to be able to show what was considered and when in order to prove that they have complied with Solvency II requirements.

- The obligation to seek prior written approval from the FR to reduce the number of meetings held per annum also indicates a significant deviation from the "comply or explain" approach advocated by the UK Combined Code. Obliging persons to seek prior approval suggests compliance with the provision would become a box-ticking exercise, rather than encouraging directors to qualitatively assess the time commitment necessary to discharge their duties.

12 Reserved Powers

A schedule of the powers that are specifically reserved to the Board enhances the clarity of a system of governance and is therefore welcomed.

13 Consolidated Supervision

Paragraph 13.1

The requirement imposed here is a dramatic departure from both a legal and an administrative perspective. The very concept of separate legal entity is being

challenged and arguably ignored, as is the notion that Institutions are governed company by company, as set out in paragraph 3.8. Either a Board of an Institution is responsible for that Institution's activities or those activities are the responsibility of the group of companies. The broad, undeveloped nature of the sweeping statement in paragraph 13.1 is unhelpful.

At its most fundamental level, this approach fails to align accountability with responsibility. Not only will this make the provision impossible to work in practice as it undermines the power of Boards to make decisions, it is also likely to prove impossible to enforce as it creates a an entirely unacceptable degree of legal uncertainty.

Having said the above, the idea of consolidated supervision itself seems reasonable if properly applied. Indeed, it is important to recognise the benefits of aligning the corporate objectives of companies within groups.

14 Committees of the Board

It is understood that the aim of the Committees is to ensure that certain issues, primarily audit and risk, are discussed on at least two separate occasions. It is also assumed the requirement for the CEO and Chairman to have a "financial background" will mean that the annual reports of Institutions will be subject to two separate rigorous reviews at Committee and Board level prior to publication.

Allowing risk and audit issues to be discussed by Committees may also assist the Board in reserving time to consider all other relevant issues at Board meetings and to prevent issues such as risk and audit dominating discussions to the detriment of other areas.

Due to the above reasons, the underlying idea behind section 14 is welcomed, subject to the comments below.

15 General Requirements of Committees

Clarification of the general requirements of Committees is welcomed.

16 Terms of Reference of Committees of the Board

Written terms of reference for each committee type will assist in clarifying where responsibility for any given issue lies and the provision is welcomed. Equally, there will be a need for review of these documents to keep pace with both the ongoing development of the business of an Institution and to reflect the continually developing nature of a system of governance. A requirement for ongoing review of this document is therefore also welcomed.

17 Audit Committee

Paragraph 17.2

It is suggested that the requirement for the Committee to be composed mainly of non-executive directors be aligned to the exemptions set out in paragraph 4.1.

It is further suggested that the membership of the Committee should be extended to include certain senior managers, such as the Chief Financial Officer, with a significant involvement in the business of the Committee. While such additional members should be strictly limited, the purpose of these additional members would be to enhance the effectiveness and oversight of the Committee by ensuring persons with knowledge of the details being examined are present to respond to any queries raised by non-executive members of the Committee. The inclusion of senior management would provide non-executive directors with the opportunity to enhance their understanding of the business. Furthermore, the experience gained as a Committee member by senior management would provide relevant experience that would enhance the skill and experience of senior managers for Board succession planning purposes.

18 Risk Committee

Paragraph 18.2

It is suggested that the membership of the Committee should be extended to include certain senior managers, such as the Chief Risk Officer, with a significant involvement in the business of the Committee. While such additional members should be strictly limited, the purpose of these additional members would be to enhance the effectiveness and oversight of the Committee by ensuring persons with knowledge of the details being examined are present to respond to any queries raised by non-executive members of the Committee. The inclusion of senior management would provide non-executive directors with the opportunity to enhance their understanding of their company's day-to-day business. Furthermore, the experience gained as a Committee member by senior management would provide relevant experience that would enhance the skill and experience of senior managers for Board succession planning purposes.

19 Remuneration Committee

The existing limited requirement for a Remuneration Committee is welcomed as it will not be appropriate to all Institutions.

20 Nomination Committee

The existing limited requirement for a Nomination Committee is welcomed as it will not be appropriate to all Institutions.

21 Compliance Statement

Paragraph 21.1

The requirement to submit a Compliance Statement is not expanded upon sufficiently to indicate the format that this Statement would adopt. It is suggested that the Compliance Statement Form 23 which is submitted as part of the Annual Insurance Return to the FR could be modified to include a statement of compliance to the requirements.

It is further suggested that where an Institution has not complied with a requirement that they use the Compliance Statement to justify non-adherence.

Conclusion

Attempts to emphasise the importance of good corporate governance are vital to the ongoing stability of Institutions and, indeed, to all company types. Many of the proposed ideas are welcomed and while this document is necessarily critical in nature, it recognises that the general ambit of the consultation paper provides welcome guidance on the FR's approach to governance requirements in the future.

It stands to reason that any effort to regulate corporate governance needs to be a considered, consistent approach firmly rooted in an underlying logic. With this in mind, the inconsistencies that exist in CP41 create difficulties in implementing the provisions and clarification on this matter is necessary to ensure a considered approach is adopted.

Furthermore, failing to take proper account of the corporate governance requirements soon to become binding on insurance companies through the Solvency II Directive will lead to practical difficulties, both in terms of implementation and enforcement of these provisions.

HLL acknowledges recent FR commitments[8] to avoid a "one size fits all" approach to regulation. Concerns arise that establishing a system of corporate governance that is appropriate to a large, complex multi-national company and applying this as a minimum standard to all companies will detrimentally impact the considered approach to regulation the FR is seeking to adopt.

Furthermore, the prescriptive approach to corporate governance regulation described in CP41 is detrimental to the effective governance of Institutions and will actively hinder the development of a culture of good governance.

In short, the provision of guidelines as to what the FR considers as being good corporate governance is welcomed. However, certain elements of the proposals

[8] "Banking Supervision – our new approach." Press Release 21 June 2010 http://www.financialregulator.ie/press-area/press-releases/Pages/CentralBankPublishesnewStrategicapproach.aspx

outlined in the CP41 need to be remedied prior to implementation of the requirements to ensure that the proposals are not only workable, but that they truly provide for enhancements to the corporate governance in Institutions within the framework of a considered regulatory approach advocated by the Financial Regulator.