IFSC INSURANCE GROUP

Regulatory Sub-Group

Submission on Consultation Paper 41 – "Corporate Governance Requirements for Credit Institutions and Insurance Undertakings"

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1. Regulatory Sub-Group

This Submission has been prepared by the Regulatory Sub-Group, which is a sub-group of the Taoiseach's IFSC Insurance Group. The members of the Regulatory Sub-Group are:

- Dermot Corry
- Stephen Devine
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- James Grennan
- Pat Healy
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This Submission has been reviewed by the industry members of the Taoiseach's IFSC Insurance Group and also had their endorsement. The public sector members of the Group have expressed no view on this Submission.

2. Some Abbreviations

For convenience, the following abbreviations are used throughout this Submission:

"**CP41**", Consultation Paper 41 on the Subject of Corporate Governance for Credit Institutions and Credit Undertakings;

"**CGP**", **Corporate Governance Paper**, we use this term to refer to the paper on corporate governance which we expect the Financial Regulator to publish having reviewed the various submissions made in relation to CP41;

"**CBRB 2010**", the Central Bank Reform Bill 2010;

"**Institutions**", credit institutions and insurance undertakings (being the subject of CP41);

"**RSG**", Regulatory Sub-Group referred to in paragraph 1;

"**SPRV**", Special Purpose Reinsurance Vehicle (as defined by the European Communities (Reinsurance) Regulations 2006).

3. Introduction

The financial crisis in Ireland was caused both by international and domestic factors. Corporate governance shortcomings have been identified as contributing to the crisis. It is therefore entirely appropriate and timely that the Financial Regulator should embark on a consultation process before determining what additional corporate governance requirements should be imposed on Institutions and their boards. The RSG welcomes the publication of CP41 and is pleased to have the opportunity to comment on its proposals, many of which are welcome. In providing our comments, we firstly make some general observations on CP41 and then go on to comment on specific sections.

Given the mandate of the IFSC Working Groups the focus of the RSG in preparing this Submission has been on those aspects of CP41 that most directly impact on insurance and reinsurance companies that are predominantly owned by groups that are not headquartered in Ireland and whose business focus is on markets other than Ireland.

4. General Observation

4.1 Solvency II

As the Financial Regulator is aware, Solvency II will be introduced at the end of 2012 and will apply to all European incorporated insurance and reinsurance companies. It is therefore important that any requirements introduced now are consistent with the requirements of Solvency II. Articles 41-49 of the Solvency II Directive set the framework for the governance of insurance and reinsurance companies. The detailed requirements are still being developed. However, at this stage the Solvency II requirements are at a high principle level rather than at the level of detail contained in CP41. For example Article 41 of Solvency II states that:

"Member States shall require all insurance and reinsurance undertakings to have in place an effective system of governance which provides for sound and prudent management of the business."

and

"The system of governance shall be proportionate to the nature, scale and complexity of the operations of the insurance or reinsurance undertaking."

Further indications on the direction of EU policy in this area are included in the recently published EU Green Paper on corporate governance in financial institutions and remuneration policies. This paper outlines some thoughts which will influence the implementing measures associated with Solvency II. This Green Paper is considering many of the same issues as CP41. It is important that the direction adopted by the Financial

Regulator is consistent with the direction chosen by the EU. The current direction of EU policy (as outlined in the Green Paper) seems to less prescriptive than CP41 and instead is based on ensuring that Boards have appropriate skill sets, clear responsibilities, avoiding conflicts of interest, clarity on roles and expectations of directors, and appropriate levels of independence together with ongoing evaluation of board performance. The RSG is of the view that CP41 should take a similar approach.

4.2 Proportionality

The RSG's greatest concern with the proposals in CP41 is that the principle of proportionality, although recognised as relevant by Section 1.4,[1] is not further developed by CP41. Consequently, an Institution cannot meaningfully assess the consequences of the proposals in CP41 for its own organisation. Many companies (particularly wholly owned subsidiaries of international groups – see further below) would believe that in relying on the proportionality principle, key parts of CP41 should not apply to them. However, insufficient guidance is currently provided by CP41.

Furthermore, in a number of instances in CP41 (e.g. Section 10.4, Section 11.1, Section 18.1), it is suggested that an Institution can make a submission to the Financial Regulator for derogation from certain provisions of CP41. The RSG submits that this would be a cumbersome and inefficient way to handle such issues and that such an approach will absorb valuable resources within the Financial Regulator unnecessarily. Instead the RSG submits an alternative approach in addressing these issues:

- Categorisation of Institutions

  The CGP should acknowledge that Institutions can be divided into one of three categories:

  - Category 1 Institutions: This category would constitute only "major Institutions" (the term is used in CP41, but not defined). However, the term might apply to a comparatively small number of Institutions, such as the domestic banks and a small number of insurance companies and banks whether internationally owned or otherwise whose failure could have significant systemic or reputational damage for the financial services industry in Ireland;[2]

  - Category 2 Institutions: This category would constitute companies which may be sophisticated but do not present a systemic risk and would represent the majority of Institutions operating in the international market in Ireland. Generally

[1] Though somewhat contradictorily, Section 3.1 of CP41 states that the requirements are the minimum requirements that an Institution must meet in the interest of promoting strong and effective governance.

[2] These types of Institutions were referred to by Matthew Elderfield, the Financial Regulator, in a speech given to the Irish Insurance Federation on 26 May 2010, where he referred to the criteria for a company whose failure would create systemic risk, such characteristics being size, interconnectedness and substitutability. These criteria, he stated were, appropriate in order to weigh the level of systemic risk that it may pose and to calibrate the right level of supervisory response.

they will be owned by (and therefore will receive support from) larger international financial services groups and will be subject to their internal standards with regard to corporate governance (assuming that they at least meet EC standards);

- Category 3 Institutions: This category would constitute low risk Institutions such as most captives, SPRVs and certain (re)insurance companies that are in run-off though it is acknowledged that the mere fact that a company is in run-off should not in itself cause the company to fall within Category 3.

The RSG submits that the benchmark that CP41 has set out should only be applicable to Institutions in Category 1. Instead, the RSG submits that the CGP should set the benchmark at a level that is appropriate to Category 2 Institutions. Additional requirements can be imposed as appropriate on Category 1 Institutions because of the nature scale and complexity of the risks they write. This can either be done on a case-by-case basis or by including in the CGP a section containing requirements and guidelines (the distinction is explained below) that would apply only to Category 1 Institutions.

- Requirements and Guidelines

Furthermore, the RSG submits that the CGP should contain both requirements and guidelines. Requirements should constitute obligations with which all Institutions should comply (though some might not be applicable to Category 3 Institutions). Failure by an Institution to comply with a requirement applicable to it could leave the Institution liable to administrative sanction under Part IIIC of the Central Bank Act, 1942 (though those should not necessarily be an offence also).

The CGP should also include a series of guidelines with which it is suggested that Institutions should comply. However, it would not be obligatory for Institutions to comply with such guidelines but Institutions would, however, be required to explain any non-compliance with the guidelines. This would be done by way of a comprehensive analysis being undertaken by the board of the Institution as to the appropriateness of each of the guidelines, having regard to the nature, scale and complexity of the business of the Institution in question. The board's deliberations in this regard (and in particular its reasons for deciding to explain rather than comply) would be minuted and the minutes would be available for inspection by the Financial Regulator. The Financial Regulator would have the right to challenge a board as to its analysis and could, in extreme circumstances, use its statutory powers to force individual Institutions to comply with certain aspects of the guidelines.

Another reason why it is important to categorise Institutions according to their risk profile and to split the CGP between requirements and guidelines is that the structure currently envisaged by CP41 would require many companies to seek derogations from a benchmark.

It may be the view of many multi-national groups and their shareholders that there is a stigma associated with a subsidiary within such a group that seeks derogation from a "best of breed" regulatory condition or obligation. Thus, Irish subsidiaries that are obliged to seek derogations to certain aspects of CP41 may be unjustifiably perceived as falling short of appropriate regulatory standards.

The splitting of requirements and guidelines would also serve to ensure that requirements specified are fit for purpose and are actually enforceable.

4.3 Interaction with new Fitness and Probity Regime

Part 3 of the Central Bank Reform Bill 2010 envisages an overhaul of the current Fitness and Probity Regime. This would involve the creation of a "controlled persons" concept and would also enhance the Financial Regulator's powers to suspend and disqualify individuals. It is also noted that in Section 1.3 of the Introductory Paper accompanying CP41 that the Financial Regulator has indicated that it proposes to revise the current Fitness and Probity Framework in due course. In light of the terms of the CBRB 2010, we submit that those aspects of CP41 that limit the number of directorships that an individual may hold (see Section 4.1), and many of the provisions of Section 5 (dealing with the role of the Chairman), should be dealt with in the context of the revised Fitness and Probity Regime rather than in a Corporate Governance Paper. Many of the proposals in CP41 are directly relevant to the individual rather than to the Institution itself. Therefore it would be difficult for an Institution to monitor the number of directorships that individual directors hold (particularly where the individual accepts an appointment to another board after the individual has accepted an appointment onto the board of the Institution in question). It would also raise practical difficulties as to how an Institution should deal with a situation where it discovers that a director has more than the maximum number of directorships identified in CP41. Which directorships should the individual resign from? How can the Institution determine this?

4.4 Ireland as a Centre for International Insurance and Reinsurance

The International Financial Services Sector is an enormously important component of Ireland's financial services industry. What was the IFSC has become a cluster of successful international insurance and reinsurance companies that have chosen to establish in Ireland primarily to avail of passporting provisions under the various insurance and reinsurance directives. Ireland is regarded as one of the most significant insurance centres in the world.

The RSG would be concerned that some of the specific measures proposed by CP41 would act as a disincentive to companies wishing to establish an insurance base in Ireland – not because of raising of corporate governance standards (a development we believe that will be generally welcome by international companies where it is in accordance with international initiatives) – but because some of the requirements seem to be unnecessarily prescriptive,

thereby inhibiting legitimate business activity. For example, the proposal that certain Institutions should have a majority of independent non-executive directors (INEDs) on its board will create an unacceptable risk for many international financial services groups that they could lose control of their Irish subsidiaries because of a decisions taken by a majority of independent non-executive directors.

As noted above, Section 2.6 of CP41 states that a contravention would be liable to administrative sanction under Part IIIC of the Central Bank Act 1942 and would also be an offence. This creates grave consequences for institutions and directors that fail to comply with the terms of the CGPs. However, certain of the current provisions in CP41 are unclear as to their requirement (particularly having regard for the fact that CP41 acknowledges the principal of proportionality). This could expose well-managed and well-intentioned companies whose judgement on the application of a particular paragraph of CP41 differs from that of the Financial Regulator to administrative sanctions and possible criminal sanction. This creates a legal risk for institutions. For this reason, a company choosing to establish in Ireland may be disincentivised from doing so given the legal risks that a CGP introduced on the terms of CP41 could create.

4.5 Application of CP41 to the reinsurance sector

It is noted that CP41 makes no reference to reinsurance companies and, on its face, does not apply to reinsurance companies. However it has been suggested that the intent is that CP41 should have applied to reinsurance companies and that the CGP will apply to reinsurance companies. The RSG believes that such an outcome would not be appropriate for the following reasons:

- There are already corporate governance requirements that apply specifically to reinsurance companies. These requirements were introduced by the Financial Regulator following the transposition of the Reinsurance Directive (Directive 2005/68/EEC) into Irish law. These requirements are contained in the Corporate Governance for Reinsurance Undertakings Paper dated December 2007. This Paper sets out detailed requirements with which reinsurance companies must comply. Consequently over the last number of years reinsurance companies have been amending their policies and procedures so as to ensure compliance with the terms of this Paper. CP41 espouses no compelling reason as to why the requirements of the Reinsurance Corporate Governance Paper should be replaced with a new set of requirements with which reinsurance companies will now have to comply;

- Upon the Solvency II Directive (2009/138/EC) being implemented into Irish law the Corporate Governance requirements applicable to reinsurance

companies will have to change so as to comply with Solvency II. Accordingly it seems unnecessary to require reinsurers to have to overhaul their Corporate Governance Framework at this juncture;

- Although some sources within the reinsurance industry were aware of the fact that the Financial Regulator had indicated that CP41 would apply also to reinsurance companies, there are likely to be many stakeholders in the Irish reinsurance industry who are not aware of this fact. Those stakeholders may not have participated in the consultation process on the assumption that it was of no relevance to reinsurance companies. Consequently, the consultation process would be deficient as far as the reinsurance sector is concerned given that there is no general awareness of the proposals applying to reinsurance companies.

5. Specific Comments

This section contains the RSG submissions in relation to the individual sections of CP41.

5.1 CP41 – Section 1.0: Background, Section 2.0: Legal Basis, Section 3.0: General Requirements

As noted above, the RSG welcomes the Financial Regulator's initiative to improve the quality of corporate governance within Institutions. In particular it welcomes the fact that the Financial Regulator is drawing on research and guidance from international associations as identified in Section 1.3.

However, as noted above at Section 4.2, the "benchmark" for appropriate corporate governance should be set by reference to the Category 2 Institutions with additional requirements for major Institutions.

The RSG also welcomes the fact that a clear legal basis will underpin the introduction of a Corporate Governance Paper. It is important that Institutions with persons connected to their management have absolute clarity in their understanding of their legal obligations and the legal basis on which the Financial Regulator will be introducing such enhanced requirements. However, it is extremely important, given the fact that legal consequences will follow due to a breach (both for Institutions and directors and managers) that the Corporate Governance Paper delineates between obligatory requirements and guidelines of best practice.

It is noted that Section 2.4 refers to an annual compliance statement which would be imposed by notice under Section 25 of the Central Bank Act, 1997. It is also observed that insurance companies and reinsurance companies are already required to submit annual

compliance statements. It is preferable for companies to file a single compliance certificate annually rather than a multiplicity of compliance certificates.

In particular, many of the provisions of Section 3 are to be welcomed. It is certainly worthwhile to restate the legal position regarding the board's primary responsibility for corporate governance within an Institution. In particular we welcome the affirmation that no one individual may have unfettered powers of decision although this has not been an issue of concern to the international insurance or reinsurance sector in the past. The RSG considers it helpful to have the position affirmed from a regulatory perspective.

It is also helpful that CP41 acknowledges that group policies and procedures can be accommodated within the revised framework so long as such policies and procedures meet with the requirements of the Corporate Governance Paper.

However the RSG is concerned at the statement contained in Section 3.7 to the effect that if any director has any concern with the overall corporate governance of an institution, he or she shall report those concerns promptly to the Financial Regulator. The RSG considers that, in the absence of a comprehensive legislative framework to protect whistleblowers, it would be inappropriate to oblige a director in all circumstances (and to sanction the director with an administrative sanction procedure and possibly criminal sanction for failure to do so) to report a concern about the corporate governance of an Institution. While directors may wish to raise concerns with the Financial Regulator there may be legal and other considerations that would make it difficult for the director to share such concerns with the Financial Regulator in the absence of adequate legal protection. At most, directors should be encouraged to notify their concerns to the Financial Regulator, though it would be important for the Financial Regulator to prepare a set of protocols by which such concerns could be shared.

5.2 CP41 – Section 4.0: Composition of the Board; Section 5.0: Chairman; Section 6.0: Chief Executive Officer and Section 7.0: Independent Non-Executive Directors

The RSG has an overall concern that the requirements of Sections 4 through 7 may operate as a disincentive to large multi-nationals (which may already have strong group governance controls and functions) looking to establish European platforms in Ireland, on the basis of expense, operating inefficiencies and the potential difficulty in sourcing appropriate candidates.

On a related point, the RSG submits that the exception to this requirement in Section 4.1(a), where the Irish institution is a subsidiary of an entity regulated by the Financial Regulator or an equivalent competent authority, should be expanded and clarified:

- First, to clarify (given the large number of Bermudian and US operations in Ireland, whether the Bermudian Monetary Authority, relevant US authorities or indeed other non-EEA authority such as Switzerland's FINMA) are to be regarded as "equivalent authorities". (It would have to be consolidated with any Solvency II equivalence that might be granted, else Ireland could get to the position of granting equivalence to its fellow EC Member States).

- Second, to consider whether restricting the exception to "subsidiaries" only is unduly narrow - many multi-nationals with multiple regulated group entities do not "stack" those entities, but hold them under a common holding entity which itself may not be regulated (but which group will be subject to group supervision as well as to stringent group corporate governance and relevant public listing/exchange rules).

The RSG also notes the additional restriction under Section 4.6 that no director of an Institution may sit on the board of more than 3 (non-related) Institutions, nor (as a general rule) may that director hold more than 5 company directorships in total. Given: (i) that the public registers show approximately 230 Institutions which may come within the scope of these rules; (ii) the size of the Irish market; (iii) the limited, albeit growing, pool of experienced people available; (iv) the additional requirements (under Section 7) that that independent non-executives must have accounting, auditing and risk management knowledge; and (iv) the additional drain on that pool from November 2010 (when "public-interest entities" must establish an audit committee and appoint to it two independent non-executive directors (at least one of whom has competence in accounting or auditing))[3]; there is a real danger that there will not be a sufficient number of suitable candidates to take up office, and that the very large Institutions, which can bear much higher fees, effectively will price smaller Institutions out of the market, and relevant remuneration costs will rise significantly. In addition, this provision may not take account of the availability of a number of professional fulltime non-executive directors, who would have ample time to devote to more than three institutions (particularly if these are smaller and less complex).

The RSG is opposed to the "one size fits all" approach taken by CP41 to capping the number of directorships that an individual can hold. Instead the RSG submits that this issue should be considered on an individual basis under the new Fitness & Probity regime envisaged by the CPRB 2010.

[3] European Communities (Statutory Audits) (Directive 2006/43/EC) Regulations, 2010

However it might be useful to require Institutions to put an engagement letter in place with all non-executive directors, which engagement letter would outline the time commitment expected of the non-executive director. In this way, the Financial Regulator would be in a position to assess whether or not a non-executive director will have the necessary time to devote to the role.

Section 4.2 requires that the majority of directors present at all board meetings must be non-executives; the RSG anticipates that this will create significant logistical and operating difficulties for Institutions that may need to pass relevant ordinary-course resolutions at short notice– e.g., approving entry into particular contracts or treaties, opening bank accounts and executing bank-standard mandates, etc. The RSG submits that further flexibility is needed here. When coupled with Section 11.1 below (minimum of 12 board meetings unless a derogation applies), there is a concern that this transforms the non-executive position to a quasi-executive role (and commensurate remuneration).

Section 4.12 requires a review of board memberships every 3 years; presumably this is not to suggest a requirement or presumption that the directors of an Institution will step down after three years, only that the review be carried out.

Section 5 deals with the Chairman, and the RSG feels that an important distinction must be drawn between the role of Chairman of a Category 1 Institution or listed parent entity, and that of Chairman of the various group subsidiaries (including, again, the typical Category 2 multi-national European platform) which are in any event bound by group policy.

Section 5.6 requires that in all cases, the Chairman be an independent, non-executive director; Section 5.10 restricts him or her to one Chairmanship only, and Section 5.8 requires the Regulator's prior approval to his or holding any other directorships (since "the required time commitment for a Chairman may be significant...and to ensure that [he/she] has sufficient time to devote to his responsibilities as Chairman". This seems unduly restrictive, particularly since it seems to include directorships of other group companies.

The role envisaged here (in terms of time commitment) is more of an executive role, rather than the typical chairmanship role required in a subsidiary group entity, and as such, the RSG recommends that a more proportionate approach should be taken where an Institution is a subsidiary within a regulated financial group. In those circumstances, and based on the typical experience of multi-nationals setting up regulated subsidiaries in Ireland, the prohibition on the Chairman's holding other chairs or directorships (including within the same group) seems excessive, as does the requirement that he/she be fully independent, even in circumstances where the group is itself regulated.

Furthermore, Section 5.3 requires that the Chairman have a "financial background" (are accounting qualifications required?). This is also unduly restrictive and unnecessary, particularly in the context of the (re)insurance sector.

5.3 CP41 – Section 8.0: Role of the Board; Section 9.0: Appointments and Section 10.0: Risk Appetite

Section 8.2 requires that the role and responsibilities of the board should be clearly documented. However, the role and responsibilities of the board are already set out in a company's Articles of Association and in company law. For this reason separate documentation of the responsibilities should not be necessary. Furthermore, the Financial Regulator is required to approve initial Articles of Association and any changes thereto so that it can prevent a company from amending the role and responsibilities to a large extent.

The RSG agrees, however, that it is appropriate to document the responsibilities of Board committees and of senior management.

Section 9.7 proposes the introduction of a new reporting requirement arising from the "removal from office of the head of a Control Function". The envisaged timeline to report this matter "with clear articulation of the underlying rationale for the removal" is, we submit, too tight. We would submit that the notification of the removal should be notified within 5 business days but that up to 20 business days should be available to the company to provide the "clear articulation" of the removal and the reasons for it. Often such a removal will either be preceded by or followed by legal proceedings and it will be important that any communication between the institution in question and the Financial Regulator should not prejudice the company's position in those proceedings.

We would also observe that the term "head of Control Function" is not defined so clarity is required in relation to exactly which functions the description is intended to cover.

We also note that the notification is required only in the event of removal but not in the event of a voluntary resignation or reassignment to another position of the head of Control Function (though the latter may require a separate notification under Fit and Proper requirements). We agree with this distinction.

Finally the RSG agrees that a removal of a head of Control Function should be a board decision and that no impediment should be put in the way of a head of control function providing information to the Financial Regulator.

The RSG welcomes in principle, the underlying requirements specified in Section 10. However, assuming this paper is approved for purpose within the next 6 months, there is a concern that this Section, excluding Section 10.7, considerably accelerates the Own Risk & Solvency Assessment (ORSA) process required under Solvency II. With companies already

under significant pressure to meet Solvency II project timelines, this will introduce a further stream of work into an already challenging Solvency II implementation timeline. The RSG would suggest that the Financial Regulator consider amending the requirements and the timeline for implementation of this section to align with Solvency II. Since these aspects will be addressed by Solvency II very shortly and since we are not aware that other European jurisdictions will introduce similar requirements ahead of Solvency II, some aspects of this paper are likely to undermine the Irish (re)insurance industry's competitiveness if we attempt to bring in elements of Solvency II ahead of time and perhaps not in a consistent manner. Such an approach would lead to the need for (re)insurance companies to run a parallel project stream to address this paper as well as Solvency II.

Section 10.1 specifies quantitative measures which the RSG submits are more appropriate for banks than for insurance companies. The RSG believes that it is not necessary to specify the actual quantitative measures. Boards should ensure that the measures adopted are appropriate for their particular businesses.

In relation to Section 10.4 the RSG believes that deviations from a defined risk appetite measure may occur from time to time and that not all such deviations should require reporting to the Financial Regulator. There should be a materiality threshold for such reporting.

5.4 CP41 – Section 11.0: Meetings; Section 12.0: Reserved Powers and Section 13.0: Consolidated Supervision

In relation to Section 11.0 the RSG believes that it is not the case that requiring monthly board meetings would raise standards of corporate governance. The RSG believes that the requirement for monthly board meetings would result in such meetings becoming more akin to management meetings with less strategic content and less oversight capability. Furthermore, requiring board meetings of this frequency may also lead to a weakening of the representation on Irish boards within large groups as senior group executives may not have the time available to attend monthly meetings.

Furthermore, the RSG's belief is that as a general rule for Category 2 and Category 3 Institutions monthly board meetings would simply be unnecessary.

Therefore the RSG suggests that the first sentence of Section 11.0, which clearly puts the onus on the Board to ensure that they meet as often as appropriate, is in practice sufficient on its own merits, without the need to be prescriptive. As per comments outlined under "Categorisation of Institutions" in Section 4.2 of this Submission, we would suggest that monthly board meetings may be required for Category 1 Institutions and a range of quarterly board meetings on a rising scale would be sufficient for Category 2 & 3 Institutions. Again, this would be a more practical implementation framework as opposed to having to apply to

the Financial Regulator for a reduction in the requirement which results in heavy administrative burden for the Regulator.

Furthermore the Section outlines some features of best practice guidance for board meetings but we believe that it is unnecessary and impracticable to give this practical guidance the force of law.

On the issue of reserved powers as contained in Section 12.0, the RSG agrees that the board should identify a schedule of matters specifically reserved to it for decision and that the schedule should be documented and updated from time to time.

Section 13.0 deals with consolidated supervision. It makes a general comment that an entity which is a holding company should exercise control and oversight over its subsidiaries yet it does not address the more common situation in Ireland where the Irish entity is itself a subsidiary of an entity which is the subject of consolidated supervision. It does not address, for example, how the Board should interact with the parent entity and its responsibilities to respond to oversight and control from that parent. This is an area where the FR could usefully contribute guidance to boards of entities in Ireland.

5.5 CP41 – Section 14.0: Committees of the Board: Section 15.0: General Requirements of Committees, Section 16.0: Terms of Reference of Committees of the Board; Section 17.0: Audit Committee, Section 18.0: Risk Committee: Section 19.0: Remuneration Committee and Section 20.0: Nomination Committee

Section14.1 requires all companies to establish both an Audit Committee and a Risk Committee. While it is clearly important that these issues should be addressed by entities, perhaps the CGP should allow for the possibility that these committees may be merged in the context of Category 2 and Category 3 Institutions. The requirements for Remuneration and Nomination committees should be limited to Category 1 Institutions.

For certain industry sectors, regulatory requirements have allowed for the recognition of Group Committees where proportionate to the risk held by the undertaking e.g. Corporate Governance for Reinsurance Undertakings. This principle of proportionality has worked well for entities which form part of larger scale groups. Large international financial groups regulated in their home jurisdiction can be subject to sophisticated corporate governance requirements at group level. For smaller entities that form part of larger international groups, it may be appropriate for the Board to utilise Group Committees provided these Committees offer a robust, complimentary and resourceful provision of services to meet the operational needs of the organisation comparative to the risks assumed and provided this approach does not compromise the role of the board having ultimate responsibility for oversight of the Institution.

Section 17 sets out the requirements for an Audit Committee. The RSG believes that these requirements are too restrictive for subsidiaries of international companies. For example there is a requirement that the Chairmen of both the company and the Audit Committee should be independent non executive directors. There is also a requirement for a majority of the members of the audit committee to be independent. Even with an audit committee comprising just three members, this will require a minimum of three independent directors – Chair of the company, Chair of the Audit Committee and at least one other member of the audit committee. Even at this level it would be difficult to obtain an appropriate balance of membership of different committees. We would suggest that in the case of Category 2 and Category 3 Institutions, greater flexibility should be provided as to the composition of the Audit Committee as long as a majority of members are non executive.

Sections 17.4 and 17.5 set very detailed rules for the operation of the Audit Committee. The RSG believes that the underlying principles are appropriate but that the application in practice should be left to the individual companies.

Section 17.5 states that monitoring of the risk management systems should be a function of the Audit Committee. If there are to be separate Audit and Risk Committees then this function seems more appropriate to the Risk Committee.

Section 18.1 requires the Board to seek prior approval from the Financial Regulator if it wishes to have the Board itself perform the functions on the Audit Committee. In line with our comments in section 4 above, we would propose that the CGP contains clear differentiation in regard to the requirements for different categories of companies. This requirement might be mandatory for Category 1 Institutions, guidance for Category 2 and not required for Category 3. Therefore Category 2 Institutions would need to explain why they do not consider a separate committee to be appropriate in this case.

6. Conclusion

The RSG hopes that the above comments are of help and wishes to reiterate its support for the Financial Regulator's initiative in forwarding and developing high standards of corporate governance.

CP41 is not explicit as to the further steps to be followed by the Financial Regulator following the closure of the consultation process. However, the RSG would be available to meet with the Financial Regulator to discuss any of the above comments or the proposal more generally.

In particular and as advised to the Financial Regulator's representatives at the IFSC Insurance Group meeting on 14 June 2010, the RSG would be keen to meet with the Financial Regulator to discuss the comments raised in this paper.

30 June 2010