

Our Ref: CMCD/SS

10th June, 2011

Governance, Accounting and Auditing Policy Division,
Policy and Risk Directorate,
Central Bank of Ireland,
PO Box 559,
College Green,
Dublin 2.

10th of June 2011

Re: Response to Consultation Paper 53- Corporate Governance Code for captive Insurance and Reinsurance Undertakings (CP53)

Dear Sir/ Madam,

We welcome both the introduction of a tailored Corporate Governance Code for Captive Insurance and Reinsurance Undertakings ('Captives') and the Central Bank's engagement with the industry and request for submissions in relation to this proposed Code. We believe that a comprehensive Corporate Governance Code is necessary for the effective regulation and supervision of Captives going forward. In drafting our response, we have looked to the unique nature of Captives and have sought feedback from clients on the proposed Code and any questions they may have in relation to specific aspects of the Code. We have also compared the proposed Code with international standards and consulted with colleagues within the international network of Deloitte firms to gauge the requirements in play in other jurisdictions.

We have divided our response into two parts. In Part A, we will review the conceptual framework of the Code and CP53; the reasons for the introduction of the Code and the underlying general principles that govern the Code. Part B comprises our comments and questions on individual aspects of the proposed Code appended to CP53.

PART A: CONCEPTUAL FRAMEWORK

Why propose a separate Code for Captives?

When the Central Bank issued the Corporate Governance Code for Insurance Undertakings and Credit Institutions ('the 2010 Code'), Captives were specifically excluded from the ambit of that Code. Therefore, the Central Bank has acknowledged the unique nature of Captives in terms of their business model and their risk in terms of their nature, size and complexity and has adopted a proportional risk-based approach in drafting the proposed Code for Captives.

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The approach of the Central Bank, of proportionate risk-based supervision, is the central principle on which the proposed Code has been developed. Corporate Governance rules are required to ensure that risk is monitored and minimised and that effective policies and procedures are in place to combat risks where they arise. The rules also ensure that no one individual or class of individuals exercise undue influence on the Board or have unfettered discretion in the decision-making and management roles. Independence is safe-guarded through the employment of independent non-executive directors (though not specifically required under the proposed Code, required under SI 220 of 2010) and other supervisory and reporting obligations. The Code reflects these principles and has tailored the requirements of the 2010 Code to better reflect the unique nature of Captives within the insurance market.

The need for proportionality

When new regulatory requirements are introduced, it is important that obligations imposed on firms are proportionate and necessary for the protection of consumers and the economy. The measures should not be disproportionately burdensome in terms of cost, resources and time when compared with the aim to be achieved through better regulation. Furthermore, the impact of the new measures on the market should be considered in drafting any proposed regulatory requirements. We will refer to this requirement of proportionality throughout our response.

Comparison with other jurisdictions' approach

Because of Ireland's size, it is crucial that in introducing new requirements, rules and regimes in operation in other European and parallel jurisdictions are considered. It is important that Ireland remain an attractive domicile for Captives and that Irish-licensed Captives are not subjected to more stringent standards than those in other jurisdictions, so as to inhibit their operations within the market. In Ireland Captives represent a significant portion of the Insurance market. Matthew Elderfield highlighted this earlier this month when he said that of the 308 licensed insurance undertakings in Ireland, 110 of those are Captives. It is therefore important that undertakings are not discouraged from establishing a Captive in Ireland because our regulatory requirements are more burdensome (and therefore costly) than those in other Member States and parallel jurisdictions.

The obligations under the proposed Code are additional to other existing obligations

According to Section 3.6.1, the proposed Code is supplemental to all existing regulatory requirements for Captives. Examples of such requirements include all existing company law requirements, the obligations set out in Directive 2006/43/EC (Statutory Audits Directive'). Affected firms would benefit from further guidance from the Central Bank on how the proposed Code will interact with other existing regulatory requirements. The Code will, however, replace the 2007 Corporate Governance Requirements for Reinsurance Undertakings in so far as they relate to Captives. Obligations under Directive 2009/138/EC ('Solvency II'), which is to come into effect on 31st of October 2012, will also affect Captives although it remains to be seen to what extent. Whilst, therefore, the Code appears to reflect a proportionate risk-based approach to Captives, when considered in conjunction with other requirements this may be diluted.

Requirements relating to the function of Chief Executive Officer ('CEO') and to Sub-Committees

The Code does not specifically require a Captive to appoint a sub-committee or a CEO but where the Captive chooses to do so, there are onerous additional obligations imposed in respect of such an appointment. We welcome your comments as to why these obligations are specifically detailed in the Code in circumstances where these functions are not obligatory? Are there any particular instances when a Captive will be required by the Central Bank to appoint either a CEO or a sub-committee?

Timelines

The Central Bank proposes a transition period of 6 months from the date the Code is issued. We believe that this is a short timeline for full implementation of the Code. We would propose tiered timelines for implementation of different aspects of the Code. For example, the Corporate Governance Code for Insurance Undertakings and Credit Institutions ('the 2010 Code') provided 7 months for implementation of the majority of the Code but provided 13 months for the implementation of certain provisions relating to the Board. We welcome your comments on this. If an obligation already exists under another regulatory requirement, which is re-iterated in the Code, then the original timeline under that other requirement continues to apply to the Captive.

PART B: DETAILED COMMENTS AND OBSERVATIONS

This part of our response takes individual provisions of CP53 and documents comments on those provisions.

Question/ Rationale	Comments
<p>Section 1.2: In what circumstances may the Central Bank impose additional requirements on a Captive?</p> <p>(Rationale: Clarity of powers of Central Bank)</p>	<p>Is this reference similar to the concept of a 'major institution' under the 2010 Code? CP53 states that further requirements may be imposed based on the size, nature and complexity of the Captive. Further guidance on this issue is requested, particularly; will the additional requirements be temporary or permanent in nature, will they be unilaterally imposed by the Central bank or in consultation with the Captive and what matters would lead to such requirements being imposed (providing examples might better assist firms in understanding this power).</p> <p>When will a Captive be notified that they are subject to additional requirements and what will</p>

	<p>be the timeframe for complying with any such additional requirements?</p>
<p>Section 3.7: In what circumstances can the Central Bank refuse to appoint a proposed director to a Pre-Approval Controlled Function ('PCF') as a result of a breach of the proposed Code?</p> <p>(Rationale: Proportionality, fairness)</p>	<p>Further guidance is required on the power of the Central Bank to refuse to appoint an individual to a PCF. Particularly, we require guidance on how the proposed Code will interact with CP51 and the proposed Fitness and Probity Regime in Part 3 of the Central Bank Reform Act 2010.</p>
<p>Section 4.2: What constitutes a 'material deviation' from the proposed Code? At what stage does a Captive become aware' of such a deviation? Is 5 business days sufficient time to report the matter to the Central Bank?</p> <p>(Rationale: To clarify a term not defined under the Code and to clarify reporting obligations)</p>	<p>The term 'material deviation' is not defined. We note that in the recently published 'Corporate Governance Code for Credit Institutions and Insurance Undertakings-Frequently Asked Questions', the Central Bank advises that the Board is to decide what is material in relation to that Code. Is a similar interpretation envisaged for the term 'material' under the proposed Code for Captives?</p> <p>At what stage is a Captive deemed to become aware of a deviation? There will be governance and reporting structures in place which will feed information to senior management. Is the Captive 'aware' of a deviation once any member of staff is aware of a deviation or only when it is brought to the attention of senior management? Does 'aware' mean actual knowledge or is there an element of implied or constructive knowledge?</p> <p>There is an obligation to report the matter to the Central Bank, together with the background and any remedial action, within 5 business days. Is this sufficient time to allow for an investigation into the deviation and for a remedial plan to be approved by the Board and conveyed to the Central Bank? What level of details would be required in any remedial plan? These matters should be addressed in order that firms will better understand their reporting obligations under the Code.</p>
<p>Section 6.3: How regularly must the governance and risk management procedures be reviewed?</p> <p>(Rationale: To clarify obligations under the Code)</p>	<p>Further guidance on how regularly a review must be undertaken would assist firms in complying with their obligations. For example, will larger more complex firms be required to conduct more regular reviews than other smaller firms? Is an annual review sufficient in advance of the</p>

	Compliance Statement or should more regular reviews be undertaken? Is an internal or external review required?
<p>Section 6.7 What constitutes a ‘material concern’ about the corporate governance of the Captive?</p> <p>(Rationale: To clarify a term not defined under the Code and reporting obligations)</p>	There is an obligation on a director to report any material concern to the Board and if the concern is not satisfactorily addressed within 5 business days to report the matter to the Central Bank. Again, further clarification is required of what interpretation of ‘material’ will be applied by the Central Bank in respect of this Code in order to better guide directors in complying with their obligations. (See comments above re: section 4.2 above).
<p>Section 7.2: What constitutes ‘attendance’ at a Board meeting?</p> <p>(Rationale: To clarify obligations under the Code)</p>	We request confirmation from the Central Bank as to whether a Director must be physically present at Board meetings or whether he may attend via electronic means, for example by dialing in to a conference call, in situations where it is not possible for him to be physically present at the meeting (for example, when a flight is cancelled, or a Director is ill etc).
<p>Section 7.4: What time commitment will be expected from Directors of Captives?</p> <p>(Rationale: To clarify obligations under the Code)</p>	Each Director must have sufficient time to devote to the role of Director and associated responsibilities. We request guidance on what time commitment will be expected by the Central Bank in relation to this requirement.
<p>Section 7.5(b): Why is the upper limit on the number of directorships that may be held set at 25?</p> <p>(Rationale: To clarify the underlying principles of the Code)</p>	We seek further information as to how the Central Bank decided on this number as the upper limit for the amount of directorships any one individual can hold (subject to the exemptions in the Code). We note this is significantly higher than that under the 2010 Code.
<p>Section 7.10: What constitutes a ‘reasonably perceived conflict of interest’?</p> <p>(Rationale: To clarify a term not defined under the Code and obligations under the Code)</p>	The Code prohibits Directors from participating in any decision making / discussion where a reasonably perceived conflict of interest exists. Further guidance is required as to what this concept means. Does this cover a situation where any member of staff perceives such a conflict or only when other directors do? There appears to be both an objective (reasonably) and subjective (perceives) aspect to this and further clarification is required on the matter.
<p>Section 8.1: Is it necessary to require the appointment of a Deputy Chairman?</p> <p>(Rationale: Proportionality)</p>	The Code requires all Captives to have a minimum of three directors. Where a Captive has three directors, we question whether it is necessary that a Deputy Chairman be appointed. We believe this

	<p>to be a disproportionate measure when viewed in light of the nature of Captives and the general principles outlined in the Code.</p>
<p>Section 8.3: Should the requirement for a Chairman to have financial services expertise/experience be removed from the Code?</p> <p>(Rationale: Proportionality)</p>	<p>In the case of Captives, we believe the Chairman needs to understand the extent and nature of the risk taken on by the Captive and that this will often include an understanding of the inherent risks in the underlying commercial business.</p> <p>However, in our view, ‘financial services qualifications, expertise and background’ is less relevant to the role of a Chairman of a Captive than to the Chairman of other undertakings under the 2010 Code and we therefore question whether such financial services experience should be mandated in this Code at all, in light of the nature and business of Captives.</p>
<p>Section 8.4 and Section 9.3: What does the term ‘necessary personal qualities, professionalism and integrity’ include?</p> <p>(Rationale: To clarify a term not defined under the Code and obligations under the Code, proportionality)</p>	<p>A Chairman and CEO must have the necessary personal qualities, professionalism and integrity to carry out his function. What comes within the scope of this term? Does it cover, for example, financial soundness, bankruptcy, previous arrests/convictions, professional/disciplinary matters or personal issues that reflect negatively on a person’s character? Does it include allegations of the conduct in question or what level of proof is required?</p> <p>This could be very far-reaching and we believe a definition or further guidance are required in order to assist firms in meeting the required standard when appointing a Chairman and to protect the rights of the individual concerned.</p>
<p>Section 10.1(b): Review of this requirement in light of the commercial reality in most Captives.</p> <p>(Rationale: Review of Code to reflect commercial reality in Captives)</p>	<p>In many Captives, strategies are proposed at board or often at group level. Therefore, we believe the requirement for directors to challenge and develop the strategies proposed by Captive Managers should be reviewed to better reflect the commercial reality of the management and governance of Captives.</p> <p>We also believe that it is more appropriate for the Board to consider underwriting and reinsurance programmes.</p>

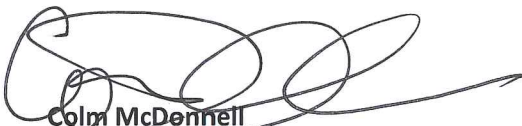
<p>Section 12.1: What does the term ‘appropriate integrity’ mean?</p> <p>(Rationale: To clarify a term not defined under the Code and to clarify obligations)</p>	<p>A Captive Manager must have appropriate integrity to carry out that function. Per our comments above, further guidance is also required in relation to what this term encompasses.</p>
<p>Section 12.2: What does the Central Bank consider to be a ‘material impact’ on the risk profile of the Captive?</p> <p>(Rationale: To clarify a term not defined under the Code and to clarify obligations)</p>	<p>The Board is responsible for endorsing and monitoring any person appointed to the Captive Manager who may have a material impact on the risk profile of the firm. Further guidance is required as to what interpretation of ‘material’ will be applied by the Central Bank in order that the Board can properly monitor and supervise the relevant individual(s). (See also comment on section 4.2 above)</p> <p>What individuals come within the scope of this obligation? Does the term ‘people’ include employees or outsourced providers or directors, for example? Further guidance is required to clarify the position.</p>
<p>Section 13.1: We request that revised examples of risk appetite metrics be issued by the Central Bank.</p> <p>(Rationale: To clarify obligations under the Code)</p>	<p>The examples of risk appetite metrics appear to be more relevant to credit institutions than to insurance undertakings. We suggest that the examples in the Code should be revised to include examples of metrics specific to Captives.</p> <p>We also suggest it is more appropriate for the Board to consider underwriting and reinsurance programmes.</p>
<p>Section 13.4: What constitutes a ‘material deviation’ from the defined risk appetite of a Captive?</p> <p>(Rationale: To clarify a term not defined under the Code and to clarify obligations)</p>	<p>Within 5 business days of becoming aware of any material deviation from the risk appetite of the Captive, the Board must report the matter to the Central Bank. Further guidance is required on what interpretation will be applied by the Central Bank to the term ‘material’ and when is the Board deemed to be ‘aware’ of such a deviation (see our comments on section 4.2 above).</p>
<p>Section 13.5: Is an internal audit function required under the Code?</p> <p>(Rationale: To clarify obligations under the Code)</p>	<p>Many Captives may not currently have an internal audit function. The Code does not specifically require that such a function be established but yet refers to it as a ‘key control function’. Clarification is required as to whether the Code requires Captives to establish an internal audit function.</p>
<p>Section 201.1(c): What will be deemed to be ‘regular intervals’?</p>	<p>Where an Audit Committee is appointed, meetings must be held at regular intervals. We note that</p>

<p>(Rationale: To clarify obligations under the Code)</p>	<p>these meetings should coincide with important financial reporting dates but further guidance is required as to what the Central Bank will consider to be regular intervals.</p>
<p>Section 22: What details are required in the annual Compliance Statement?</p> <p>(Rationale: To clarify reporting obligations under the Code)</p>	<p>Captives are required to submit an annual compliance statement to the Central Bank. The proposed Code states that any material deviations and remedial actions must be outlined in the statement. Further guidance is required on what should be included in the compliance statement to ensure firms comply with the reporting requirements under the Code.</p> <p>For example, under section 12.5 the Board must review its performance on at least an annual basis. Is this review of the Board’s performance required to be submitted to the Central Bank or will it be referred to in the Annual Compliance Statement?</p>

In conclusion, we agree with the Central Bank that a proportionate risk-based approach to regulation and supervision is in the interests of all parties; regulated firms, regulators, consumers and the economy generally. We also believe that engagement with the industry is central to developing comprehensive, proportionate regulatory policies and requirements. We would therefore welcome any opportunity to liaise further with you on this matter in the future. In order to allow regulated firms to comply with their requirements under the proposed Code it is important that, where appropriate, terms be defined with sufficient clarity so that firms can structure their operations and procedures in compliance with their obligations under the Code. It is also important that the Code remains proportionate to the nature and scale of Captives, when considered in conjunction with other existing obligations.

We look forward to receiving your comments and responses to our submissions in due course.

Yours faithfully,



Colm McDonnell
Partner