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Our Ref JL/NPCA
Your Ref CP69

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CP69: RESPONSE TO CONSULTATION ON THE REVIEW OF THE CORPORATE GOVERNANCE CODE FOR CREDIT INSTITUTIONS AND INSURANCE UNDERTAKINGS

Dear Sirs

William Fry is pleased to participate in the consultation process relating to CP69: *Consultation on the Review of the Corporate Governance Code for Credit Institutions and Insurance Undertakings* (the "**Consultation**"). We welcome the Consultation, as it provides a timely opportunity for constructive engagement between the Central Bank of Ireland (the "**Central Bank**") and industry on the application of the *Corporate Governance Code for Credit Institutions and Insurance Undertakings* (the "**Code**"). While it does appear to us that the Code is operating effectively, in our view the Consultation is justifiable nonetheless. As an opening remark, we should also state that the comments in this letter are made solely from the perspective of the (re)insurance sector.

In our view, the Code appears to be serving its purpose (in the words of the Central Bank[1]) of ensuring that robust governance arrangements are in place so that appropriate oversight exists to avoid or minimise the risk of a future crisis. Regularly, we handle queries from our clients in the Irish (re)insurance sector regarding the application of the Code. This strongly suggests to us that institutions are aware of the requirements of the Code and of the importance of complying with it.

As the Central Bank will be readily aware, in 2011, at the time of the Code's implementation, the Irish banking industry faced significant challenges. The Irish (re)insurance sector did not, however, face comparable challenges. In our view, this remains the case. As the Central Bank will no doubt appreciate, the Irish (re)insurance sector is busy preparing for the implementation of Solvency II (including the imminent arrival of the so-called "**Solvency II interim measures**"). In this regard, as a general observation we would submit that the Central Bank should not revise the Code in a way which could result in Irish (re)insurers being subjected to corporate governance obligations that are incompatible with the Solvency II interim measures or that are more burdensome on them, relative to those that are being faced by their peers in other EEA Member States.

We have set out below our commentary on a number of the more significant proposed amendments to the Code.

[1] Central Bank press release of 8 November 2010

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Risk Committee (Section 23) – proposal that the risk committee of an institution be comprised of a majority of non-executive directors (including the requirement that the Chairman be a non-executive director)

We are of the view that proposed amendments concerning the constitution of the risk committee are unnecessarily prescriptive. In this regard, we would note that the Code already requires institutions to effectively manage risk in a number of ways, including, in particular, the:

- requirement that the risk committee has an appropriate representation of non-executive and executive directors;
- general requirement that non-executive directors (in particular, independent non-executive directors) play a leading role in the risk committee;
- requirement to have a documented risk appetite statement; and
- duty of the board to ensure that risk is properly managed.

In our view, while institutions should be free to constitute their risk committee in accordance with the manner proposed by the Central Bank, it should not be mandatory for them to do so.

Regarding this proposal, based on our experience, we would have the following particular reservations:

- the Code currently allows a reasonable amount of flexibility regarding the composition and the role of the risk committee. We have observed that some of our clients have risk committees that meet immediately before or after the board meeting. In many cases, we have also noted that the risk committee meets more regularly between scheduled board meetings. Such a variation in approach is a legitimate exercise by institutions of the discretion available to them under the Code. In our view, this particular proposal will force institutions to adopt a more formal structure around their risk committees. Moreover, we are of the view that it may also reduce the frequency with which risk committees meet (in view of the requirement of the non-executive director majority membership);
- as noted above, the Code currently requires "appropriate representation" of non-executive and executive directors on risk committees. By the Central Bank instead requiring that risk committees be comprised of a majority of non-executive directors (including the proposal that the Chairman of the risk committee must be a non-executive director), in our view this will result in those non-executive directors who are on the risk committee becoming more involved in the day to day activities of the institution, thereby compromising their objectivity and, in the case of independent non-executive directors, their independence.

Chief Risk Officer (Section 12) – proposal that an institution appoints a Chief Risk Officer

Regarding the proposed requirement that institutions appoint a Chief Risk Officer ("**CRO**"), we welcome the Central Bank's appreciation that given the nature, scale and complexity of the operations of a particular institution, the requirement to have a dedicated and exclusive CRO function may not be warranted in every case. We would suggest, however, that the Central Bank could introduce greater proportionality under the Code regarding the CRO function, in particular in the following ways:

- the Central Bank could introduce a "comply or explain" option (as discussed more generally below) for Medium-Low Impact and/or Low Impact institutions as, in our view, given the nature, scale and complexity of their operations, many of those institutions would not need to have (even on a part-time basis) a CRO;

- without prejudice to the generality of the foregoing, we would note that there are a number of small Irish (re)insurers with limited underwriting activity on their books (e.g. they may only have a small number of reinsurance treaties with affiliates or have a small number of clients or they may be in run-off). Having regard for the nature, scale and complexity of the business of such institutions, we are of the view that they should not be required under the Code to appoint a CRO (especially in view of the existing requirement to have a risk committee under the Code). Therefore, the Central Bank should, in our view, exempt these institutions from being required to have a CRO;

- as the Central Bank will be aware, in the case of many life insurers, their risk function is handled (at least partly) by the role of their Appointed Actuary. In our view, it would appear unnecessary in the case of those institutions to mandate that they also must also appoint a CRO.

Board Meetings (Section 16) – timing of board meetings for non-High Impact institutions

We welcome the Central Bank's proposal to permit non-High Impact institutions to tailor the timing of their board meetings and to hold one board meeting per half year with the balance of meetings to be scheduled as the board deems appropriate (while maintaining a minimum of four meetings per annum).

Chief Executive Officer (Section 9) – holding of two additional positions as Chief Executive Officer

We welcome the Central Bank's proposal to permit the Chief Executive Officer ("**CEO**") of a Medium-Low Impact institution or a Low Impact institution to hold, subject to certain conditions, up to two additional CEO roles in other credit institutions, insurance undertakings or reinsurance undertakings.

Committees of the Board (Section 19) – cross committee membership of Chairmen

We are of the view that the proposed amendment requiring that the Chairman of the audit committee must be a member of the risk committee and that the Chairman of the risk committee must be a member of the audit committee should apply to High-Impact institutions only. To apply it more generally would, in our view, be unnecessarily prescriptive. While we appreciate the Central Bank's view that cross-committee membership can, in particular, broaden and deepen understanding of key board committees, we have observed that many of our clients already have cross-committee membership in place. In our view, while institutions should be free to arrange their audit and risk committees in the manner proposed, it should not be mandatory for them to do so.

Additional Reform to the Code – introducing the principle of "comply or explain"

We note that the principle of "comply or explain" does not currently feature in the Code. However, we would note that it is a well-established principle existing under other corporate governance codes (e.g. the UK Corporate Governance Code, the German Corporate Governance Code and the Dutch Corporate Governance Code as well as the approach taken for Irish regulated investment funds).

In our view, the Central Bank should consider introducing this principle to the Code (in particular in relation to provisions such as the proposed requirement to have a CRO in the case of Medium Low Impact or Low Impact institutions). This principle would avoid the need for such institutions to have to make individual notifications or submit derogation applications to the Central Bank. It would also relieve Central Bank staff from the need to deal with routine queries from institutions at the lower end of the PRISM scale. Certain other 'non-core' provisions under the Code (e.g. regarding the appointment of the CRO function in non-High Impact institutions; and the cross-committee membership of the Chairmen of the audit committee and the risk committee) could be classified by the Central Bank as being agreed 'best practice'. An institution which decided not to adopt such a provision(s) in accordance with agreed best practice could be required by the Central Bank to give a full explanation in its annual compliance statement of why it had chosen to deviate from best practice. Having considered the

explanation given, the Central Bank would of course be entitled to challenge the institution if it disagreed with the approach taken.

We are of the view that the Code is successfully serving its stated purpose, as was first set out in November 2010 by the Central Bank. As the Code has now been in existence for almost 3 years, its requirements are well embedded in the mind-set of credit and (re)insurance institutions. As is often the case with new regimes, it is only with the benefit of the passage of time that potential modifications and improvements can be identified. In this regard, the Consultation is timely. We welcome many of the proposed amendments. However, as we have explained above regarding certain proposed amendments, it would be preferable in our view to ensure that the revised Code does not include unnecessary prescriptiveness.

Yours sincerely

William Fry

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