



FINANCIAL REGULATOR
Rialtóir Airgeadais

Corporate Governance for Reinsurance Undertakings

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1 Introduction

1.1 Scope

As the reinsurance sector in Ireland moves to formal regulation following the publication of Council Directive 2005/68/EC (“Reinsurance Directive”) on the 9th of December 2005, corporate governance standards within reinsurance undertakings will be subject to regulatory oversight. Following transposition of the Reinsurance Directive in Ireland via Statutory Instrument 380 of 2006 (“S.I. 380”), signed into Irish law on the 15th of July 2006, the Irish Financial Services Regulatory Authority (“Financial Regulator”) is issuing this paper to outline to the sector how Corporate Governance will be dealt with in practice between individual reinsurance undertakings and the Financial Regulator.

The International Association of Insurance Supervisors (“IAIS”) has developed standards for the supervision of reinsurance undertakings. These standards are regarded as the minimum standards to be applied to supervision of reinsurance in most developed economies, including EU jurisdictions, the US, Canada and Australia. As part of these standards, the IAIS has devised principles on corporate governance. The standards set out by the Financial Regulator in this paper are consistent with the IAIS principles (available at www.iaisweb.org).

These standards should be interpreted in conjunction with existing Company Law requirements to which a reinsurance undertaking is subject. The scope of this paper refers to life, non-life, composite and captive reinsurance undertakings that are currently deemed authorised or due to be authorised by the Financial Regulator. This paper does not apply to Special Purpose Reinsurance Vehicles (SPRVs).

1.2 Corporate Governance

The OECD defines corporate governance as ***"a set of relationships between a company's management, its board, its shareholders, and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining these objectives and monitoring performance are determined, good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently."***

Thus, corporate governance encompasses the means by which members of the Board of Directors and senior management of a company are held accountable and responsible for their actions. Corporate governance requires corporate discipline, transparency, independence, accountability, responsibility, fairness and social responsibility. Timely and accurate disclosure on all material matters regarding the reinsurance undertaking, including the financial situation, performance, ownership and governance arrangements, are part of a corporate governance framework. Corporate governance also includes compliance with legal and regulatory requirements.

A reinsurance undertaking must have levels of oversight in operation that are consistent and proportionate to the size and complexity of the reinsurance undertaking and must consider at a minimum, subject to the requirements herein, each of the following six levels:

- 1) The Board of Directors and its sub-committees;
- 2) Independent Non-Executive Directors;
- 3) Senior Management;
- 4) Internal Controls;
- 5) Audit (both internal and external) functions; and
- 6) Compliance.

Chapters 3 to 8 of this paper set out in greater detail the duties and responsibilities attaching to each of the six levels of oversight.

1.3 Financial Regulator's Approach

One of the Financial Regulator's high level goals is to set and monitor standards for the running of sound financial service providers and fair markets¹. The Financial Regulator's approach to ensuring an adequate and efficient corporate governance regime for reinsurance undertakings, will be based on the following overarching principles:

a) Proportionality: The reinsurance undertaking's corporate governance regime should be proportionate to the risk-profile of the reinsurance undertaking, subject to the minimum standards and provisions of the Reinsurance Directive, S.I. 380 and the IAIS standards;

b) Importance of ongoing dialogue: Irrespective of size and risk profile of the reinsurance undertaking, representatives of reinsurance undertakings are encouraged to continue to communicate with their respective supervisor within the Financial Regulator; and

c) Demonstrable use: The Financial Regulator expects the responsibilities of the reinsurance undertaking's corporate governance regime to be closely integrated into the day-to-day management process of the reinsurance undertaking. The onus is firmly on the reinsurance undertaking to demonstrate compliance with this regulatory framework.

A reinsurance undertaking must comply with the fit and proper requirements of the Financial Regulator as outlined in the paper Fit And Proper Requirements². At a minimum the reinsurance undertaking is required to demonstrate to the Financial Regulator the fitness and probity of each director and the key executive manager (whether CEO, General Manager, or otherwise). This requires the submission of documentation

¹ See Strategic Plan 2008 – 2010 available at Financial Regulator's website www.financialregulator.ie

² Please refer to the paper "Fit and Proper Requirements", dated November 2006 (or any subsequent amended or updated papers that may supersede the November 2006 paper) and is available on the Financial Regulator's website www.financialregulator.ie

illustrating knowledge, experience, skills and integrity. The knowledge and experience required depends on the position and responsibility of the individual within the reinsurance undertaking. From time to time, the Financial Regulator may specifically request other officers (as defined in Regulation 3 of S.I. 380) of a reinsurance undertaking to submit to the fit and proper requirements.

1.4 Implementation

Reinsurance undertakings will be required to have corporate governance structures and internal governance mechanisms in place, which are commensurate with the standards laid out herein by no later than the 30th of June 2008, except for the implementation date as specified in 3.3 herein.

1.5 Legal Basis

This paper states the opinion of the Financial Regulator for the purposes of Regulation 20 of S.I. 380 as to its subject matter. Accordingly, this paper outlines the corporate governance that, in the opinion of the Financial Regulator, can be considered to be sound and adequate for the purposes of Regulation 20 with respect to the matters discussed.

References in this paper to the "Board of Directors" include, as appropriate, any director who is a member of the Board of Directors.

Chapter 8 contains a requirement under Regulation 71(1) of S.I. 380 to notify the Financial Regulator of the identity of the Compliance Officer.

This paper may be amended or supplemented by the Financial Regulator from time to time. Failure by a reinsurance undertaking to comply with the above provisions of S.I. 380, or requirements laid down in this paper, may be the subject of an administrative sanction under Part IIIC of the Central Bank Act 1942 and may constitute an offence, in accordance with S.I. 380.

2 Heart and Mind

A reinsurance undertaking whose registered office is located in the State must ensure it has sufficient resources available to it to conduct its business and that the strategic direction, decision-making, control, and accountability of the reinsurance undertaking is located in the State.

3 Board of Directors

The Board of Directors is the focal point of the corporate governance regime. It is ultimately accountable and responsible for the performance and conduct of the reinsurance undertaking. Delegating authority to board committees or management does not in any way relieve the Board of Directors of its duties and responsibilities. In the case of a policy established by the Board of Directors, the Board of Directors must be satisfied that the policy has been implemented and that compliance has been monitored.

3.1 Responsibilities

Insofar as corporate governance is concerned, the Board of Directors is responsible for setting out the corporate governance principles that will apply to the reinsurance undertaking, and ensuring that the reinsurance undertaking is run in a manner consistent with those principles.

In developing appropriate corporate governance principles, the Board of Directors must take account of many factors, including the agreed strategy and business plan for the reinsurance undertaking, the nature of the activities of the reinsurance undertaking and its size and complexity. In particular, the directors must formally establish the risk appetite of the reinsurance undertaking commensurate with its capital strength and ensure that the business undertaken by the reinsurance undertaking is consistent with the agreed risk appetite. Any material change to the formal risk appetite of the reinsurance undertaking must be notified to the Financial Regulator.

The following non-exhaustive checklist is intended as a guideline to the key duties of a Board of Directors specifically relating to its operation as a reinsurance undertaking:

- a) Ensure the appropriate knowledge, skills, experience and commitment exists within the Board of Directors to oversee the reinsurance undertaking effectively.
- b) Set out the corporate governance principles, responsibilities, and commitments appropriate to the reinsurance undertaking and ensure they are communicated throughout the reinsurance undertaking.
- c) Establish policies and strategies to ensure compliance with principles, responsibilities, and commitments and to establish procedures for monitoring and evaluating the progress towards them. Adherence to the policies and strategies must be reviewed regularly, at least annually.
- d) Establish standards of business conduct and ethical behaviour for directors, senior management and other personnel. These include policies on conflicts of interest, insider dealing, and professional secrecy.
- e) Establish procedures for the appointment, disciplinary procedures and dismissal of senior management, including the establishment of a remuneration policy that is reviewed periodically. Such a remuneration policy must not include incentives that would encourage imprudent or reckless behaviour.
- f) Satisfy itself that the reinsurance undertaking is organised in a way that promotes the effective and prudent management of the undertaking and the Board of Director's oversight of that management. In this context, the Board of Directors must satisfy itself as to the existence of a risk control function, proportionate to the nature, scale and complexity of the reinsurance undertaking's business, that monitors the risks related to the type of business undertaken. In the absence of such a separate risk control function, the full Board of Directors must carry out this duty.

- g) Establish an appropriate audit function, actuarial function, internal control function and establish the applicable checks and balances for each function.
- h) Distinguish between the responsibilities, decision-making, interaction and cooperation of the Board of Directors, Chairman, Chief Executive/General Manager and other senior management. The undertaking must have a clear division of responsibilities that will ensure a balance of power and authority, so that no one individual has unfettered powers of decision without adequate consultation.
- i) Collectively ensure that the reinsurance undertaking complies with all relevant laws, regulations and any established codes of conduct. The Board of Directors must identify a Compliance Officer whose function is to monitor compliance with all of the relevant legislation and required standards of business conduct and who reports to the Board of Directors at regular intervals to enable the Board of Directors to ensure compliance.
- j) Ensure an open and transparent communication with the Financial Regulator.

3.2 Sub-committees

The Financial Regulator considers it necessary for all reinsurance undertakings to have in place such sub-committees of directors and management as well as other management structures as are necessary to ensure that the business of the reinsurance undertaking is being managed, conducted and controlled in a prudent manner and in accordance with sound administrative and accounting standards. As part of their responsibilities, and in proportion to the size and complexity of the organisation, the Board of Directors may establish sub-committees with specific responsibilities such as a compliance, compensation, risk management, etc. The Financial Regulator considers the existence of an audit committee to be an essential element of an effective control environment.

3.3 Board Composition

The following criteria must be adhered to in relation to the composition of the Board of Directors:

- 1) The Board of Directors must be such that it provides for the effective, prudent and efficient administration of the activities of the reinsurance undertaking;
- 2) The Board of Directors must be of sufficient size and expertise to oversee adequately the operations of the reinsurance undertaking;
- 3) The Board of Directors, except for the exemption in 3.3.1 herein, must have a minimum of two independent Non-Executive Directors;
- 4) The balance between executive and independent Non-Executive Directors must be evidenced by the composition of the members of the Board of Directors present and eligible to vote at each Board of Directors meeting;
- 5) Each member of the Board of Directors must have sufficient time to devote to the role of director of a reinsurance undertaking. This is particularly important in the case of non-executive directors. Each non-executive director must ensure that they have adequate time to give to the role; and
- 6) On an individual basis, directors must not participate in any decision where a conflict of interest may exist.

The Financial Regulator acknowledges that 3) and 4) of the above criteria may be difficult for some reinsurance undertakings to apply in the short term and that a period of transition is required. Therefore, full compliance with 3) and 4) above must be demonstrated by no later than the 30th of June 2010. The Financial Regulator does require a reinsurance undertaking to consider these criteria within the context of its overall

corporate governance regime and to develop an action plan for the implementation of this requirement within the timeframe set herein. Upon request by the Financial Regulator, a reinsurance undertaking will be required to demonstrate progress towards the criteria in 3) and 4).

3.3.1 Captive Reinsurance Undertaking

A captive reinsurance undertaking, as defined in S.I. 380, that exclusively carries on reinsurance where only one or more undertakings of the group (including the employees of an undertaking), of which the captive reinsurance undertaking is a part, are the beneficiaries of any recovery under the reinsurance cover (e.g. no third party claimants unrelated to the group), need not appoint a minimum number of independent Non-Executive Directors as required by criteria 3) and 4) in 3.3 herein.

4 Independent Non-Executive Directors

Independent Non-Executive Directors (INED) represents one of the key layers of oversight of the activities of a reinsurance undertaking. There must be a sufficient number of independent Non-Executive Directors to ensure that the independent element of the Board of Directors can be effective, subject to criteria set in 3.3 herein.

4.1 Definition

It is essential for independent Non-Executive Directors to bring a third party viewpoint to the deliberations of the Board of Directors, that are objective and independent of the activities of the management of a reinsurance undertaking

An independent Non-Executive Director must be a non-executive director who is independent of the management and major shareholders of the reinsurance undertaking, with no actual or potential conflicts of interest. The Financial Regulator considers there to be a conflict of interest if there was any business relationship or other relationship that could interfere with the exercise of independent judgement.

Furthermore, in reviewing a director's independence regard must be given to the following:

1. any financial or other obligation the individual may have to the reinsurance undertaking or its directors;
2. whether the individual has been employed by the reinsurance undertaking or a group undertaking in the past and if so, in what capacity;

3. circumstances where the individual has acted as an independent non-executive director of the reinsurance undertaking for extended periods; and
4. any additional remuneration received in addition to the director's fee, related directorships or shareholdings in the reinsurance undertaking.

5 Senior Management

5.1 Responsibilities

Senior management responsibilities should include:

- overseeing the operations of the reinsurance undertaking and providing direction to it on a day-to-day basis, within the objectives and policies set out by the Board of Directors, and as required by legislation;
- providing the Board of Directors with recommendations, for its review and approval, on objectives, strategy, business plans and major policies that govern the operation of the reinsurance undertaking; and
- providing the Board of Directors with comprehensive, relevant and timely information that will enable it to review business objectives, business strategy and policies, and to hold senior management accountable for its performance.

5.2 General Manager

A reinsurance undertaking, except for a captive reinsurance undertaking (as defined in S.I 380), must directly employ a designated senior manager responsible for the overall prudent and efficient operation of the business of the reinsurance undertaking, herein referred to as a General Manager.

The Board of Directors must ensure that the individual is a competent individual with the experience to act on a fully informed basis, in good faith, with due diligence and care. The following is a non-exhaustive list of qualities and duties of a General Manager:

- be a competent individual with the experience to act on a fully informed basis, in good faith, with due diligence and care; and
- be entitled to perform the duties and exercise the powers that are vested in him or her by the Board of Directors; and

- be accountable and responsible for the duties vested in him or her on behalf of the reinsurance undertaking; and
- be employed on the basis of devoting such time and attention sufficient to ensure the prudent and efficient operation of the business of the reinsurance undertaking; and
- be independent of any undertakings who have a business relationship with the reinsurance undertaking or other relationship with the reinsurance undertaking that could interfere with the exercise of independent judgement.

6 Internal Controls

A robust internal controls system is critical to effective risk management and a foundation for the safe and sound operation of a reinsurance undertaking. It provides a systematic and disciplined approach to evaluating and improving the effectiveness of the operation and assuring compliance with laws and regulations. It is the responsibility of the Board of Directors to develop a strong internal control culture within its organisation, a central feature of which is the establishment of systems for adequate communication of information between levels of management.

Internal controls must be designed to ensure and demonstrate that the firm is being operated within the parameters set by the Board of Directors. These controls must be adequate for the nature and scale of the business and proportional to the size and complexity of the business. The oversight and reporting systems must be sufficient to allow the Board of Directors and management to monitor and control the operations. The onus will be on the Board of Directors to ensure that such systems are applicable to the reinsurance undertaking and that such systems meet their ongoing corporate governance duties and responsibilities.

The Financial Regulator may ask the reinsurance undertaking for a detailed description of the internal control system to assess its adequacy in relation to the nature and the scale of the business. The Board of Directors is ultimately responsible for establishing and maintaining an effective internal control system.

6.1 Purpose

The purpose of a system of internal controls is to verify, inter alia, that

- a) the business of a reinsurance undertaking is conducted in a prudent manner in accordance with policies and strategies established by the Board of Directors;
- b) transactions are only entered into with appropriate authority;
- c) assets are safeguarded;
- d) accounting and other records provide complete, accurate, verifiable and timely information;
- e) management is able to identify, assess, manage and control the risks of the business and hold sufficient capital for these risks.

6.2 Risk Management

The Board of Directors must provide suitable prudential oversight and provide for a risk management system that includes setting and monitoring policies so that all material risks are identified, measured, monitored and controlled on an on-going basis.

The Board of Directors must be satisfied that comprehensive risk management systems commensurate with the nature, scale and complexity of all the reinsurance undertaking's activities are in place, incorporating continuous measuring, monitoring and controlling of risk, accurate and reliable management information systems, timely management reporting and thorough audit and control procedures.

At a minimum, the risk management system must address operational risk and business risk. Operational risk in this context means the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Business risk in this context refers to the inherent uncertainties that arise in carrying on the business of the reinsurance undertaking.

The following non-exhaustive list of internal controls is set out as guidance for reinsurance undertakings as to the actions that the Financial Regulator would expect to find in a risk management regime:

6.2.1 Operational Risk

Operational risk management, within each reinsurance undertaking, must include the following, at a minimum:

- Board of Directors receives regular reporting on the effectiveness of the internal controls;
- Any identified weaknesses are reported to the Board of Directors as soon as detected and appropriate action taken;
- There are clear arrangements for delegating authority and responsibility, and the segregation of duties;
- There are checks and balances in business processes (e.g. cross-checking, dual control of assets, double signatures);
- There are established controls to check the accuracy and compliance of accounting procedures, reconciliation of accounts, control lists and information for management;
- The internal and external audit, actuarial and compliance functions are part of the framework for internal control, and must test adherence to the internal controls as well as to applicable laws and regulations;
- There are controls, including oversight and clear accountability for all outsourced functions as if these functions were performed internally and subject to the normal standards of internal controls.

6.2.2 Business Risk

Given the specific nature of the reinsurance business, reinsurance undertakings must have appropriate policies and procedures covering the conduct of business, including but not limited to:

6.2.2.1 Underwriting

Policies must be in place clearly identifying the lines of business, types of risks and geographical regions of the risks to be assumed by the reinsurance undertaking and the approvals required to bind the reinsurance undertaking. Appropriate procedures for implementing and monitoring the policies must be established.

6.2.2.2 *Concentration Risk*

The reinsurance undertaking must identify, monitor, and measure any concentration of risk on the underlying lines of business and on the portfolio as a whole due to a single event and exposure. Limits on the whole portfolio must be set relative to the capital resources available to the reinsurance undertaking.

6.2.2.3 *Provisioning*

Reinsurance undertakings must have policies and procedures in place to ensure a timely establishment of appropriate technical provisions. These policies and procedures must adequately address the specific challenges faced by reinsurance undertakings, particularly with respect to establishing provisions such as incurred but not reported (IBNR) and incurred but not enough reported (IBNER). Incurred but not reported (IBNR) provisions are for claims arising from events that have occurred but have not been reported as at the report date. Incurred but not enough reported (IBNER) provisions are for claims arising from events which have occurred and been reported as at report date, but the amount reported may be understated.

6.2.2.4 *Actuarial Certification*

Reinsurance undertakings must have policies and procedures in place to ensure a timely preparation and submission to the Financial Regulator of any actuarial certification required by the Financial Regulator.

6.2.2.5 *Retrocession Strategy*

Reinsurance undertakings must define and document their strategy for retrocession management, identifying the procedures for the retrocession to be purchased, how retrocessionaires will be selected, how retrocessionaires' security will be assessed, the limits per retrocessionaire, the collateral (if any) required, and how the retrocession programme will be monitored (i.e. the reporting and internal control systems) on an ongoing basis.

6.2.2.6 *Contracts*

Reinsurance undertakings must establish a process whereby contracts are reviewed and approved on a timely basis. Any process must include a regular review of the wording of the reinsurance contracts commonly used by the reinsurance undertaking to ensure that reinsurance documentation accurately and transparently represents the substance of the transaction. All material facts and considerations (e.g. commissions, potential conflicts of interests) must be fully disclosed to all parties to the contract.

6.2.2.7 *Investments*

A reinsurance undertaking's investment policy must reflect the nature of the business and specifically deal with asset/liability management, asset diversification, liquidity, and cash flow, considering the group structure. It must identify approved investments, set limits by asset class, describe what assets are considered to be suitable matches for the long tail and the short tail business and how various risks will be managed such as the management of currency risk. The investment policy must have concentration limits, such as limits for investments in companies or groups and limits on investments in particular industry sectors. The reinsurance undertaking must have procedures in place to monitor and control its investment policy against the limits approved by the Board of Directors and within regulatory constraints, if any.

7 Audit Function

7.1 Internal Audit

Internal audit is part of the ongoing monitoring of the reinsurance undertaking's system of internal controls and of its internal capital assessment procedure, because internal audit provides an independent assessment of the adequacy of, and compliance with, the reinsurance undertaking's established policies and procedures. As such, the internal audit function assists senior management and the Board of Directors in the efficient and effective discharge of their responsibilities.

In principle, the Financial Regulator requires all reinsurance undertakings to have an ongoing internal audit function. In some situations the nature, scale and complexity of the reinsurance undertaking may warrant the fulfilment of that function by group internal audit or by an outsourced provider of internal audit services. In any event, senior management, and ultimately the Board of Directors, are responsible for ensuring that regular independent assessments are carried out and that resulting recommendations are addressed in a timely manner.

The Financial Regulator attaches particular importance to the role that the internal audit function plays. Accordingly, the reinsurance undertaking, in assessing the effectiveness of the internal audit function in any firm, must have regard to the following criteria:

- **Independence** – the personnel employed in the internal audit department must be independent of the activities audited;
- **Objectivity and Impartiality** – internal audits must be conducted by personnel that are objective and impartial;
- **Authority** – the Board of Directors must ensure that the importance of the internal audit function is communicated throughout the reinsurance undertaking and that it has appropriate standing to enable it to perform its role effectively. This may be

done by compiling an internal audit charter which documents the scope, authority and objectives of the internal audit function;

- **Access** – internal audit must have access to all activities and subsidiaries of a reinsurance undertaking;
- **Reporting** – internal audit must be able to report directly to the Board of Directors or the Audit Committee without other members of senior management being present. An internal audit report must be provided to the Board of Directors or the Audit Committee on a regular basis;
- **Remuneration** – the remuneration of internal audit personnel must not be determined by any member of management that is subject to internal audit;
- **Resources** – the internal audit function must be adequately resourced;
- **Scope** – the work of the internal audit department must include an evaluation of the internal controls and a review of the adequacy of policies and procedures approved by the Board;
- **Key Findings** – the internal audit function must prepare annual audit plans, compile reports on their findings, report findings to the Board of Directors or the Audit Committee and follow-up on the resolution of audit findings;
- **New Products** – internal audit must be regularly updated in relation to new products offered by the reinsurance undertaking to ensure that any new risks to the business are subject to their review; and
- **Competence** – the internal audit function must contain sufficient competence to perform an audit on any of the activities of the reinsurance undertaking.

7.2 External Audit

While not part of the reinsurance undertaking, external auditors have an important role in re-enforcing the corporate governance of reinsurance undertakings further to the work undertaken in the audit of financial statements. The obligations of auditors of regulated financial service providers are as outlined in S.I. 380 and in the Central Bank Act 1997 as amended in Part 3 of the Central Bank and Financial Services Authority of Ireland Act 2004.

The Financial Regulator places a great deal of importance on the independence of external auditors and the added value of their opinion on the annual financial statements. A great deal of importance is also placed on the various reports provided by external auditors and the Financial Regulator regards them as one of the key levels of oversight of the operations of a reinsurance undertaking.

8 Compliance Function

The appointment of a Compliance Officer is designed to supplement, not supplant, the responsibility of the Board of Directors and of senior management to ensure compliance with legislation and applicable requirements.

An authorised reinsurance undertaking must appoint an individual to act as Compliance Officer. Reflecting the size and complexity of some reinsurance undertakings, the Compliance Officer may simultaneously hold other offices within a company (e.g. Company Secretary, General Manager etc). In appropriate circumstances, a single individual could also be a Compliance Officer for more than one reinsurance undertaking (e.g. in the case of captives managed by the same management company).

Pursuant to Regulation 71(1) of S.I. 380, the Financial Regulator hereby requires that a reinsurance undertaking notify the Financial Regulator of the name of the its Compliance Officer, promptly following (i) his or her appointment, and (ii) any replacement (including any replacement on a temporary basis).

8.1 Functions of Compliance Officer

The functions of the Compliance Officer must encompass the following tasks:

- To ensure the reinsurance undertaking is kept up to date with the Financial Regulator's compliance standards;
- To obtain the approval of the Board of Directors for a policy statement on compliance with the regulations in S.I. 380, with the requirements of the Financial Regulator and with any other applicable legislation;
- To monitor the implementation of compliance and to report periodically to the senior management and to the Board of Directors thereon;

- To review products, procedures and systems on a planned basis from the viewpoint of effective compliance and to advise as to steps necessary to ensure compliance;
- To monitor anti-money laundering policies and procedures for effectiveness and ensure any suspicions are reported to the relevant authorities; and
- To review staff training processes so as to ensure appropriate compliance competencies.

9 Frequently Asked Questions

The Financial Regulator's approach to the development of a corporate governance regime for reinsurance in Ireland has been guided by two principles. Firstly to devise a regulatory framework for corporate governance that is robust, credible and competitive and secondly to develop the regime transparently, with extensive consultation with the reinsurance industry to assist an orderly transition to full regulation.

In furtherance of our approach, two consultations have been conducted, which sought the views of the reinsurance industry, its representative groups as well as the Financial Services Industry Panel. Attention is drawn to questions received as part of these consultations and the Financial Regulators' responses which are reflected in the frequently asked questions (FAQs) in the appendix to this paper. The Financial Regulator considers that the publication of these FAQs provides important information for a full understanding of how corporate governance will be dealt with in practice between individual reinsurance undertakings and the Financial Regulator.

APPENDIX - FREQUENTLY ASKED QUESTIONS

1) What happens if the Financial Regulator and the Board of Directors differ on the fitness of a director or other senior officer?

The Fit and Proper Requirements were published in November 2006 and are available on the Financial Regulator's website

(www.financialregulator.ie)

2) Are key management limited to Chief Executive Officer (CEO), Chief Financial Officer (CFO), Chief Underwriting Officer (CUO), and Chief Investment Officer (CIO)?

The Financial Regulator view is that the Board of Directors of the reinsurance undertaking are best suited to determine who the key management are based upon the size and complexity of the business written by the operating entity.

3) Could the parent of the reinsurance undertaking be responsible for establishing corporate governance principles and for the monitoring of compliance with the principles set?

If, in the opinion of the Board of Directors, the principles set by the parent are sufficient to meet the minimum standards on corporate governance as set down by the Financial Regulator and the parent of the reinsurance undertaking has sufficient experience and resources to ensure compliance, then the parent's standards and processes may be adopted by the Board of Directors. However, that decision is the responsibility of the Board of Directors. Adopting the standards and processes of the parent of the reinsurance undertaking does not relieve the Board of Directors of its duties and responsibilities.

4) For a captive reinsurance undertaking, could a professional third party service provider be responsible for establishing corporate governance principles and for the monitoring of compliance with the corporate governance principles set?

No, it is for the Board of Directors to establish the corporate governance principles of the captive reinsurance undertaking it is responsible for and not a third party.

5) Does a captive reinsurance undertaking have to set up an audit committee?

It is up to the Board of Directives to determine whether a captive reinsurance undertaking requires an audit committee based upon the size and complexity of the business written by the captive reinsurance undertaking. However, the Financial Regulator regards the appointment of such a committee as an essential element of an effective control environment. If an audit committee is not established, the full board must put in place measures to consider issues arising from internal and external audit.

6) What are the Financial Regulator expectations regarding "sufficient size" for the Board of Directors?

The Financial Regulator believes that the principle of proportionality should apply when considering the number of individuals who will sit on the Board of Directors. The Financial Regulator's view is that the size and complexity of the business written by the reinsurance undertaking should be considered when deciding upon the appropriate number of directors for the composition of the Board of Directors to ensure compliance with the Financial Regulators' standards and the OECD principles on corporate governance.

7) What balance between executive and independent non-executive directors is sufficient, and can a board meeting only take place if two independent directors are present?

The balance between executive and independent non-executive directors is a matter for consideration given the size and complexity of the business written, or the business proposed to be written, by the reinsurance undertaking. The Board of Directors should consider the agenda items under consideration and follow a prudent approach when determining whether a particular meeting of the Board of Directors can take place in the absence of one of the independent non-executive directors. The Financial Regulator is of the view that at least one independent non-executive director should be present at every Board of Director meeting.

8) Does the Financial Regulator consider an employee of the parent of the reinsurance undertaking to be independent?

The Financial Regulator's view is that such an employee does not qualify as independent as defined due to his or her employment by the shareholder of the reinsurance undertaking. However, the Financial Regulator will consider, upon formal request, senior executives of the parent such as a Group Compliance Officer, Group Legal officer, or a Group Internal Auditor as an alternative to one independent non-executive director as an interim measure provided that the reinsurance undertaking can demonstrate the individual's independence from the day-to-day operation and management of the reinsurance undertaking.

9) Can an independent director of the parent entity also act as an independent director of the subsidiary reinsurance undertaking?

Yes, once independence has been confirmed at parent level this can follow through to subsidiary reinsurance undertaking level.

10) Does the Financial Regulator consider an employee of a professional third party service provider such as a captive manager contracted to the reinsurance undertaking to be independent if that employee is not directly involved in the provision of services under the contract with the reinsurance undertaking?

The Financial Regulator's view is that such an employee does not qualify as independent as defined due to the business relationship between the professional third party service provider and the reinsurance undertaking.

11) Please clarify whether an independent non-executive director must have (re)insurance experience or would somebody with broader experience from legal/accounting/tax/financial services be sufficient?

The Financial Regulator does not consider reinsurance or insurance experience to be a prerequisite for an independent non-executive director. The Board of Directors must ensure that the individual is a competent professional with the experience to act on a fully informed basis, in good faith, with due diligence and care.

12) Can an independent non-executive director work for a number of reinsurance undertakings?

The Financial Regulator's view is that such an individual can work for a number of reinsurance undertakings provided there is no actual or potential conflict of interest between the different positions and the individual can devote sufficient time to each position.

13) Could a professional third party service provider contracted by a reinsurance undertaking undertake the responsibilities expected of the senior management?

No. However, a General Manager may, with the prior approval of the Board of Directors, outsource certain accounting, administrative, and/or reinsurance services to a professional third party provided he or she can ensure competent oversight of the outsourced services in accordance with the responsibilities expected of senior management. Such outsourcing to a third party in no way mitigates the discharge by the General Manager of his or her duties and responsibilities, nor indeed the Board of Directors of their duties and responsibilities. The Financial Regulator should be consulted by any reinsurance undertaking proposing to outsource critical accounting, administrative, and/or reinsurance services to a professional third party.

14) Could an employee of a professional third party service provider such as a captive manager contracted to a reinsurance undertaking act as a General Manager for the same reinsurance entity?

No. A General Manager of a reinsurance undertaking must be a direct employee of the reinsurance undertaking. A member of a management company that has a business relationship with the reinsurance undertaking is a direct employee of that management company and would not, in the Financial Regulator's view, be sufficiently independent to be the General Manager.

15) Could a Director fulfil the General Manager role required by the Financial Regulator?

Yes

16) May a General Manager hold multiple appointments?

In exceptional circumstances, the Financial Regulator will consider such multiple appointments. Applications for multiple appointments will be considered on a case-by-case basis and subject to the following requirements:

- A clear justification for the application. (This submission must be signed by at least one member of the Board of Directors of the reinsurance undertaking);
- Demonstration of compliance with the IAIS principles;
- A clear timeline of commitments held, by the individual, for each reinsurance undertaking. Such a timeline should incorporate crisis scenarios for each reinsurance undertaking; and
- Details of the procedures in place to deal with conflicts or potential conflicts of interest.

17) What about a "de minimus" rule in relation to "third party" business?

The Financial Regulator wishes to clarify that there will be no “de minimus” rule in relation to ‘third party’ business for captive reinsurance undertakings, as per the definition of a captive in the Reinsurance Directive and S.I. 380.

18) What is the situation where a reinsurer wants to set up a captive to cover its own group risks?

Under the Reinsurance Directive and S.I. 380, the definition of a captive specifically disallows an insurance or a reinsurance company from directly owning a captive.

19) Could the parent of the reinsurer or the parent of a captive take responsibility for the internal control regime of a company?

The Board of Directors is responsible for the adoption of a formal internal control regime of the reinsurance undertaking as determined by the board and is accountable as such. The Board of Directors may determine that the internal control systems of the parent are sufficient to monitor and control the operations of the reinsurance undertaking. The onus will be on the Board of Directors to ensure that such systems meet their ongoing corporate governance duties and responsibilities.

20) By what mechanism will Financial Regulator review internal controls?

The Financial Regulator may ask the Board of Directors to demonstrate that the internal control regime as set out by the Board of Directors is sufficient for the reinsurance undertaking given the size and complexity of the business written. They should also be in a position to demonstrate that the internal control regime has been implemented and is being monitored.

21) Can the Financial Regulator define the format and frequency of internal control reporting required?

The Board of Directors should determine the format and frequency of reporting required from the internal control regime given the size and complexity of the business written by the reinsurance undertaking in order

to comply with their ongoing corporate governance duties and responsibilities in a prudent manner.

22) Does the list of operational risks also apply to captives?

The Board of Directors should consider each of the risks and determine the applicable risks to its operation given the size and complexity of the business written by the captive reinsurance undertaking. The internal control regime adopted by the Board of Directors should consider all material risks so that they comply with their ongoing corporate governance duties and responsibilities in a prudent manner.

23) Does a standard underwriting policy preclude a reinsurance undertaking from reacting to changing market conditions?

The Board of Directors is responsible for setting the underwriting policy of the reinsurance undertaking and for ensuring that it is notified to the Financial Regulator. Any significant deviation from such a policy must be notified to the Financial Regulator prior to its initiation. The Financial Regulator stresses the benefit, in terms of reacting to changing market conditions, of regular contact between the company and their respective supervisor on this and all other corporate governance issues.

24) Would an internal audit function at group level satisfy the internal audit function as outlined?

If the size and complexity of the reinsurance undertaking is such that the establishment of its own internal control function is neither practicable nor effective, and if, in the opinion of the Board of Directors, the standards set by the parent are sufficient to meet the standards on internal audit as set down by the Financial Regulator and the parent of the reinsurance undertaking has sufficient experience and resources to ensure it can undertake an internal audit, the group internal audit function may be used. Delegating authority to the parent of the reinsurance undertaking will not in any way relieve the Board of Directors of its duties and responsibilities.

25) How frequently does the Financial Regulator require an internal audit?

It is for the Board of Directors to determine how often an internal audit is required in order that they can discharge their duties and responsibilities in a prudent manner.

26) What is the timeline for appointment of a compliance officer?

A compliance officer should be appointed in each reinsurance undertaking to ensure a sufficient lead-time for the implementation of the standards required by the Financial Regulator.

27) Can the same compliance officer oversee an insurer and a reinsurer within the same group?

Yes, so long as it can be demonstrated that the compliance officer has sufficient expertise and resources to carry out his or her functions.

28) Can the same compliance officer oversee a number of different reinsurance undertakings?

Yes, provided the individual does not have any conflict of interest in performance of his or her duties in the different companies and so long as it can be demonstrated that the compliance officer has sufficient expertise and resources to carry out his or her functions. For the avoidance of doubt, the Financial Regulator would consider there to be a conflict of interest if there was any business relationship between the individual and the different reinsurance undertakings or other relationship that could interfere with the exercise of independent judgement.

29) Will the Compliance Officer need to be pre-approved by the Financial Regulator?

No, unless the Financial Regulator specifically requests that the Compliance Officer be submitted to the Fit and Proper requirements. The identity of the Compliance Officer must be notified to the Financial Regulator.

30) Can the Financial Regulator clarify "report periodically"?

The frequency of reporting required should be in proportion to the business written by the reinsurance undertaking and should be determined by the Board of Directors to ensure they can meet their ongoing corporate governance duties and responsibilities.



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