Consultation Paper on
Corporate Governance and Risk Management

Appendix One

International Association of Insurance Supervisors
Insurance Core Principles
Excerpts Related to Governance and Risk Management (Principles 7, 9, 10 and 18)
h. The supervisory authority imposes additional requirements, conditions or restrictions on an applicant where the supervisory authority considers this appropriate. This might include restrictions on non-insurance activities.

i. The supervisory authority assesses the application and makes a decision within a reasonable time. No licence is issued without its approval. The applicant must be informed of the decision without delay and, if the licence is denied or conditional, be provided with an explanation.

j. The supervisory authority refuses to issue a licence where it considers the applicant not to have sufficient resources to maintain the insurer’s solvency on an on-going basis, where the organisational (or group) structure hinders effective supervision, or where the application is not in accordance with the licensing criteria.

k. As necessary, after an insurer has been licensed, the supervisory authority evaluates and monitors the degree to which the insurer satisfies the relevant licensing principles and requirements of the jurisdiction.

ICP 7 Suitability of persons

The significant owners, board members, senior management, auditors and actuaries of an insurer are fit and proper to fulfil their roles. This requires that they possess the appropriate integrity, competency, experience and qualifications.

Explanatory note

7.1. An important element of the supervision of insurers is the initial and on-going assessment of the fitness and propriety of an insurer’s significant owners and key functionaries such as board members, senior management, auditors and actuaries. In the case of significant owners, fit and proper requirements relate to the persons and their financial soundness. A significant owner is defined as a person (legal or natural) that directly or indirectly, alone or with an associate, exercises control over the insurer (refer to ICP 8 EC a). The main responsibility for assessment of the fitness and propriety of key functionaries lies with the insurers themselves.

7.2. The supervisory authority should be satisfied that significant owners and key functionaries have the level of competence for their roles, and should ascertain whether they have the appropriate ability and integrity to conduct insurance business, taking account of potential conflicts of interests. Appropriate ability can generally be judged from the level of a person’s professional or formal qualifications or relevant experience within the insurance and financial industries or other related businesses.

Essential criteria

a. Legislation identifies which key functionaries must meet fit and proper requirements. The key functionaries identified may differ depending on the legal form and governance structure of the insurer.

b. In cases where significant owners no longer meet fit and proper requirements, the supervisory authority must be able to take appropriate action, including requiring that the owners dispose of their interests.

c. The supervisory authority disqualifies the appointment of key functionaries including auditors and actuaries of insurers that do not comply with fit and proper requirements.
d. The insurer should be required to demonstrate to the supervisory authority the fitness and propriety of key functionaries by submitting documentation illustrating their knowledge, experience, skills and integrity upon request, or where there are changes in key functionaries. The knowledge and experience required depends on the position and responsibility of the functionary within the insurer.

e. The supervisory authority exchanges information with other authorities inside and outside its jurisdiction where necessary to check the suitability of persons. The supervisory authority uses this information as an additional tool to effectively assess the fitness and propriety of, or to obtain information on, a key functionary of an insurer (refer to ICP 5).

f. The supervisory authority disallows actuaries, auditors, directors and senior managers, from simultaneously holding two positions in an insurer where this could result in a material conflict.

g. Where the insurer becomes aware of circumstances that may be relevant to the fitness and propriety of its key functionaries, it is required to notify the supervisory authority as soon as possible.

Advanced criteria

h. Criteria to assess the fitness and propriety of auditors’ and actuaries’ include qualifications, professional proficiency, appropriate practical experience and updated knowledge on developments within their profession and membership of professional bodies.

i. In the case of auditors and actuaries, the supervisory authority may give regard to or rely on professional bodies that set and enforce standards of professional conduct.

ICP 8 Changes in control and portfolio transfers

The supervisory authority approves or rejects proposals to acquire significant ownership or any other interest in an insurer that results in that person, directly or indirectly, alone or with an associate, exercising control over the insurer.

The supervisory authority approves the portfolio transfer or merger of insurance business.

Explanatory note

8.1. The supervisory authority must be able to grant or deny approval to a person (legal or natural) that wants to acquire significant ownership or a controlling interest in an insurer, whether directly or indirectly, alone or with an associate. The concepts of significant ownership or control should be defined in legislation.

8.2. Notification should be required for changes in ownership or control according to the percentages of an insurer’s issued shares. These established percentages typically range between 5 and 10 percent. Where supervisory approval is required in addition to notification, specific thresholds (equal to or higher than those for notification) should be set.

8.3. The supervisory authority must require that the proposed owners have the resources to provide the minimum capital required as well as the ability to provide further capital or other support for the insurer when needed.
g. The supervisory authority rejects applications of proposed owners to control insurers if facts exist from which it can be deduced that their ownership will be unduly prejudicial to policyholders. The supervisory authority should know who is the intended beneficial owner.

h. To assess applications for proposed acquisitions or changes in control of insurers the supervisory authority establishes requirements for financial and non-financial resources.

**Advanced criteria**

i. Upon request insurers provide the supervisory authority with information on their shareholders and any other person directly or indirectly exercising control. The supervisory authority determines the content and format of this information.

**Portfolio transfer**

**Essential criteria**

j. The supervisory authority requires that insurers get approval from the authority before they transfer all or any part of their insurance business.

k. The supervisory authority establishes requirements to assess insurers’ applications to transfer all or any part of their insurance business.

l. The supervisory authority requires that the interests of the policyholders of both the transferee and transferor be protected when insurance business is transferred (refer to ICP 15 EC c).

**ICP 9 Corporate governance**

The corporate governance framework recognises and protects rights of all interested parties. The supervisory authority requires compliance with all applicable corporate governance standards.

**Explanatory note**

9.1. Insurers must be managed prudently. Corporate governance refers to the manner in which boards of directors and senior management oversee the insurers’ business. It encompasses the means by which members of the board and senior management are held accountable and responsible for their actions. Corporate governance includes corporate discipline, transparency, independence, accountability, responsibility, fairness and social responsibility. Timely and accurate disclosure on all material matters regarding the insurer, including the financial situation, performance, ownership and governance arrangements, is part of a corporate governance framework. Corporate governance also includes compliance with legal and regulatory requirements.

9.2. The board is the focal point of the corporate governance system. It is ultimately accountable and responsible for the performance and conduct of the insurer. Delegating authority to board committees or management does not in any way mitigate or dissipate the discharge by the board of directors of its duties and responsibilities. In the case of a policy established by the board, the board would need to be satisfied that the policy has been implemented and that compliance has been monitored. Similarly the board needs to be satisfied that applicable laws and regulations have been complied with. The responsibilities of the governing body must be consistent with the rules on governance structure established in the jurisdiction. Where the posts of chairman and chief executive are combined in one
person, the supervisory authority will verify that appropriate controls are in place to ensure that management is sufficiently accountable to the board of directors.

9.3. In most jurisdictions corporate governance rules exist for general purpose corporations; these likely also apply to insurers. Often, however, it is necessary to establish additional requirements, through the insurance legislation, that deal with the matters of specific concern and importance to insurance supervisors. These matters are described in the criteria below. As the supervisory authority may not have the power to specify the details of general corporate governance rules or to enforce compliance, several criteria under this principle refer to the responsibility of the board of directors rather than requirements from the supervisory authority.

### Essential criteria

| a. | The supervisory authority requires and verifies that the insurer complies with applicable corporate governance principles. |
| b. | The board of directors: |
|   | - sets out its responsibilities in accepting and committing to the specific corporate governance principles for its undertaking. Regulations on corporate governance should be covered in general company law and/or insurance law. These regulations should take account of the size, nature and complexity of the insurer. |
|   | - establishes policies and strategies, the means of attaining them, and procedures for monitoring and evaluating the progress toward them. Adherence to the policies and strategies are reviewed regularly, and at least annually. |
|   | - satisfies itself that the insurer is organised in a way that promotes the effective and prudent management of the institution and the board’s oversight of that management. The board of directors has in place and monitors independent risk management functions that monitor the risks related to the type of business undertaken. The board of directors establishes audit functions, actuarial functions, strong internal controls and applicable checks and balances. |
|   | - distinguishes between the responsibilities, decision-making, interaction and cooperation of the board of directors, chairman, chief executive and senior management. The board of directors delegates its responsibilities and establishes decision-making processes. The insurer establishes a division of responsibilities that will ensure a balance of power and authority, so that no one individual has unfettered powers of decision. |
|   | - establishes standards of business conduct and ethical behaviour for directors, senior management and other personnel. These include policies on private transactions, self-dealing, preferential treatment of favoured internal and external entities, covering trading losses and other inordinate trade practices of a non-arm’s length nature. The insurer has an on-going, appropriate and effective process of ensuring adherence to those standards. |
|   | - appoints and dismisses senior management. It establishes a remuneration policy that is reviewed periodically. This policy is made available to the supervisory authority. |
|   | - collectively ensures that the insurer complies with all relevant laws, regulations and any established codes of conduct (refer to EC f). |
|   | - has thorough knowledge, skills, experience and commitment to oversee the insurer effectively (refer to ICP 7). |
|   | - is not subject to undue influence from management or other parties. The board of directors has access to information about the insurer, and asks and receives additional information and analyses that the board sees fit. |
|   | - communicates with the supervisory authority as required and meets with the supervisory authority when requested. |
|   | - sets out policies that address conflicts of interest, fair treatment of customers and information sharing with stakeholders, and reviews these policies regularly (refer to ICP 25). |
c. Senior management is responsible for:
   - overseeing the operations of the insurer and providing direction to it on a day-to-day basis, subject to the objectives and policies set out by the board of directors, as well as to 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 insurer.
   - providing the board 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.

Advanced criteria

d. The board of directors may establish committees with specific responsibilities like a compensation committee, audit committee or risk management committee.

e. The remuneration policy for directors and senior management has regard to the performance of the person as well as that of the insurer. The remuneration policy should not include incentives that would encourage imprudent behaviour.

f. The board of directors identifies an officer or officers with responsibility for ensuring compliance with relevant legislation and required standards of business conduct and who reports to the board of directors at regular intervals (refer to EC b).

g. When a “responsible actuary” is part of the supervisory process, the actuary has direct access to the board of directors or a committee of the board. The actuary reports relevant matters to the board of directors on a timely basis.

ICP 10 Internal control

The supervisory authority requires insurers to have in place internal controls that are adequate for the nature and scale of the business. The oversight and reporting systems allow the board and management to monitor and control the operations.

Explanatory note

10.1. The purpose of internal control is to verify that:
   - the business of an insurer is conducted in a prudent manner in accordance with policies and strategies established by the board of directors (refer to ICP 9)
   - transactions are only entered into with appropriate authority
   - assets are safeguarded (refer to ICP 21)
   - accounting and other records provide complete, accurate, verifiable and timely information
   - management is able to identify, assess, manage and control the risks of the business and hold sufficient capital for these risks (refer to ICP 18 and 23).

10.2. A system of internal control is critical to effective risk management and a foundation for the safe and sound operation of an insurer. 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.
10.3. It is an essential element of an internal control system that the board of directors receive regular reporting on the effectiveness of the internal control. Any identified weakness should be reported to the board of directors as soon as possible so appropriate action can be taken.

**Essential criteria**

a. The supervisory authority reviews the internal controls and checks their adequacy to the nature and the scale of the business and requires strengthening of these controls where necessary. The board of directors is ultimately responsible for establishing and maintaining an effective internal control system.

b. The framework for internal controls within the insurer includes arrangements for delegating authority and responsibility, and the segregation of duties. The internal controls address checks and balances; e.g. cross-checking, dual control of assets, double signatures (refer to ICP 9 EC b).

c. 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.

d. The board of directors must provide suitable prudential oversight and establish a risk management system that includes setting and monitoring policies so that all major risks are identified, measured, monitored and controlled on an on-going basis. The risk management systems, strategies and policies are approved and periodically reviewed by the board of directors (refer to ICP 18).

e. The board of directors provides suitable oversight of market conduct activities.

f. The board of directors should receive regular reporting on the effectiveness of the internal controls. Internal control deficiencies, either identified by management, staff, internal audit or other control personnel, are reported in a timely manner and addressed promptly.

g. The supervisory authority requires that internal controls address accounting procedures, reconciliation of accounts, control lists and information for management.

h. The supervisory authority requires oversight and clear accountability for all outsourced functions as if these functions were performed internally and subject to the normal standards of internal controls.

i. The supervisory authority requires the insurer to have an on-going internal audit function of a nature and scope appropriate to the business. This includes ensuring compliance with all applicable policies and procedures and reviewing whether the insurer’s policies, practices and controls remain sufficient and appropriate for its business.

j. The supervisory authority requires that an internal audit function:
   - has unfettered access to all the insurer’s business lines and support departments
   - assesses outsourced functions
   - has appropriate independence, including reporting lines to the board of directors
   - has status within the insurer to ensure that senior management reacts to and acts upon its recommendations
   - has sufficient resources and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing
employs a methodology that identifies the key risks run by the institution and allocates its resources accordingly (refer to ICP 18).

k. The supervisory authority has access to reports of the internal audit function.

l. Where the appointment of an actuary is called for by applicable legislation or by the nature of the insurer's operations, the supervisory authority requires that actuarial reports be made to the board and to management.

5. **On-going supervision**

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<td>Making use of all available sources, the supervisory authority monitors and analyses all factors that may have an impact on insurers and insurance markets. It draws conclusions and takes action as appropriate.</td>
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**Explanatory note**

11.1. In order to achieve its objectives, the supervisory authority supervises the financial soundness of individual insurers and contributes to financial stability of the insurance market. Both require an analysis of individual insurers and insurance groups as well as the market and the environment in which they operate.

11.2. In today’s globalised financial markets and rapidly integrating financial systems, economic developments and policy decisions of one jurisdiction may affect many other jurisdictions. Similarly, developments in the economy as a whole, or in one part of the financial sector, may impact the business operations and financial stability of the insurance market. To enable an assessment of financial data, it will be necessary to have an understanding of the basis of financial reporting in relevant jurisdictions.

11.3. In-depth market analysis helps identify risks and vulnerabilities, supports prompt supervisory intervention as referred in ICP 14 and strengthens the supervisory framework with a view to reducing the likelihood or severity of future problems. It is recognised that in-depth market analysis requires skilled resources.

11.4. A quantitative analysis of the market could include, for example, developments in the financial markets generally; the number of insurers and reinsurers subdivided by ownership structure whether a branch, domestic or foreign; the number of insurers and reinsurers entering and exiting the market; market indicators such as premiums, balance sheet totals and profitability; investment structure; new product developments and market share; distribution channels; and use of reinsurance.

11.5. A qualitative analysis could include, for example, reporting on general developments which may impact insurance markets, companies and clients; new or forthcoming financial sector and other relevant legislation; developments in supervisory practices and approaches; and reasons for market exits.

**Essential criteria:**

a. The supervisory authority conducts regular analysis of market conditions.
The supervisory authority may deny or withdraw the license when the organisational (or group) structure hinders effective supervision (refer to ICP 6 and ICP 15).

6. Prudential requirements

15. This section sets out six principles addressing prudential requirements. Their common goal is to ensure that insurers have the ability under all reasonably foreseeable circumstances to fulfil their obligations as they fall due.

ICP 18 Risk assessment and management

The supervisory authority requires insurers to recognise the range of risks that they face and to assess and manage them effectively.

Explanatory note

18.1. An insurer should identify, understand, and manage the significant risks that it faces. Effective and prudent risk management systems appropriate to the complexity, size and nature of the insurer’s business should identify and measure against risk tolerance limits the risk exposure of the insurer on an on-going basis in order to indicate potential risks as early as possible. This may include looking at risks by territory or by line of business.

18.2. Some risks are specific to the insurance sector, such as underwriting risks and risks related to the evaluation of technical provisions. Other risks are similar to those of other financial institutions, for example market (including interest rate), operational, legal, organisational and conglomerate risks (including contagion, correlation and counter-party risks).

18.3. Supervisors play a critical role in the risk management process by reviewing the monitoring and controls exercised by the insurer. The supervisory authority develops prudential regulations and requirements to contain these risks. While the supervisor puts such requirements in place with the intention of ensuring enhanced practices by insurers, the ultimate responsibility for the development of best practices and the proper operation of the insurer must always rest with the board of directors.

Essential criteria

a. The supervisory authority requires and checks that insurers have in place comprehensive risk management policies and systems capable of promptly identifying, measuring, assessing, reporting and controlling their risks (refer to ICP 10 EC d).

b. The risk management policies and risk control systems are appropriate to the complexity, size and nature of the insurer’s business. The insurer establishes an appropriate tolerance level or risk limit for material sources of risk.

c. The risk management system monitors and controls all material risks.

d. Insurers regularly review the market environment in which they operate, draw appropriate conclusions as to the risks posed and take appropriate actions to manage adverse impacts of the environment on the insurer’s business.
**Advanced criteria**

c. Larger insurers establish a risk management function and a risk management committee.

**ICP 19   Insurance activity**

Since insurance is a risk taking activity, the supervisory authority requires insurers to evaluate and manage the risks that they underwrite, in particular through reinsurance, and to have the tools to establish an adequate level of premiums.

**Explanatory note**

19.1. Insurers take on risks and manage them through a range of techniques including pooling and diversification. Every insurer should have an underwriting policy that is approved and monitored by the board of directors.

19.2. Insurers use actuarial, statistical, or financial methods for estimating liabilities and determining premiums. If these amounts are materially understated, the consequences for the insurer can be significant and in some cases fatal. In particular, premiums charged could be inadequate to cover the risk and costs, insurers may pursue lines of business that are not profitable, and liabilities may be understated, masking the true financial state of the insurer. There is a need to ensure that embedded options have been identified, properly priced and an appropriate reserve has been established.

19.3. Insurers use a number of tools to mitigate and diversify the risks they assume. The most important tool to transfer risk is reinsurance. An insurer should have a reinsurance strategy, approved by its board, that is appropriate to its overall risk profile and its capital. The reinsurance strategy will be part of the insurer’s overall underwriting strategy.

**Essential criteria**

a. The supervisory authority requires insurers to have in place strategic underwriting and pricing policies approved and reviewed regularly by the board of directors.

b. The supervisory authority checks that insurers evaluate the risks that they underwrite and establish and maintain an adequate level of premiums. For this purpose, insurers should have systems in place to control their expenses related to premiums and claims, including claims handling and administration expenses. These expenses should be monitored by management on an on-going basis.

c. The supervisory authority is able to review the methodology used by the insurer to set premiums to determine that they are established on reasonable assumptions to enable the insurer to meet its commitments.

d. The supervisory authority requires that the insurer has a clear strategy to mitigate and diversify risks by defining limits on the amount of risk retained and taking out appropriate reinsurance cover or using other risk transfer arrangements consistent with its capital position. This strategy is an integral part of the insurer’s underwriting policy and must be approved and regularly monitored and reviewed by the board of directors.

e. The supervisory authority reviews reinsurance arrangements to check that they are adequate and that the claims held by insurers on their reinsurers are recoverable. This includes that: