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INTERNATIONAL ASSOCIATION OF  
INSURANCE SUPERVISORS

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# **Application Paper on the Composition and the Role of the Board**

**November 2018**

## About the IAIS

The International Association of Insurance Supervisors (IAIS) is a voluntary membership organisation of insurance supervisors and regulators from more than 200 jurisdictions. The mission of the IAIS is to promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders and to contribute to global financial stability.

Established in 1994, the IAIS is the international standard setting body responsible for developing principles, standards and other supporting material for the supervision of the insurance sector and assisting in their implementation. The IAIS also provides a forum for Members to share their experiences and understanding of insurance supervision and insurance markets.

The IAIS coordinates its work with other international financial policymakers and associations of supervisors or regulators, and assists in shaping financial systems globally. In particular, the IAIS is a member of the Financial Stability Board (FSB), member of the Standards Advisory Council of the International Accounting Standards Board (IASB), and partner in the Access to Insurance Initiative (A2ii). In recognition of its collective expertise, the IAIS also is routinely called upon by the G20 leaders and other international standard setting bodies for input on insurance issues as well as on issues related to the regulation and supervision of the global financial sector.

**Application Papers** provide additional material related to one or more ICPs, ComFrame or G-SII policy measures, including actual examples or case studies that help practical application of supervisory material. Application Papers could be provided in circumstances where the practical application of principles and standards may vary or where their interpretation and implementation may pose challenges. Application Papers can provide further advice, illustrations, recommendations or examples of good practice to supervisors on how supervisory material may be implemented.

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## 1 Introduction

1. The outcome of the Self-Assessment and Peer Review (SAPR) conducted by the IAIS in 2014 showed a need for more proactive supervision of corporate governance by the insurance supervisors. The most common challenges to full observance of some of the standards concerning supervision of the Board activities were the robustness and frequency of the supervisor's assessments of some aspects of the Board's performance. Some of the issues identified in the SAPR were addressed by revision of ICP 7 (Corporate Governance), finalised in November 2015. The IAIS also noted from the SAPR that some challenges related to supervision of the Board's composition and functioning should be addressed by providing supervisors with good practices and tools.

2. Considering particular challenges for achieving effectiveness in supervision of the Board, this Application Paper aims to provide additional material to help with the practical interpretation and application of selected standards and guidance of ICP 5 (Suitability of Persons) and ICP 7. This Application Paper is based on input from the members of the Governance Working Group – in terms of challenges and possible solutions – and feedback received from the broader IAIS membership and stakeholders.

3. The IAIS recognises that Boards may be structured in various ways depending on, among other things, jurisdictional corporate law (such as one-tier or two-tier Boards). This Application Paper applies to the Board as referred to in the context of the ICPs (in particular ICP 7), which is a body of elected or appointed individuals ultimately responsible for the governance and oversight of the insurer, regardless of the Board structure. Another factor influencing the insurer's governance is its corporate structure, such as stock companies, mutuals or co-operatives. This Application Paper refers to a specific organisational structure when some of the challenges or proposed supervisory responses are more relevant for a particular structure. However, it is recognised that a particular issue and the most relevant supervisory response depend on a number of factors and specific characteristics of a particular case.

4. The ICPs describe the proportionality principle by indicating that: "supervisory measures should be appropriate to attain the supervisory objectives of a jurisdiction and should not go beyond what is necessary to achieve those objectives."<sup>1</sup> The terms "nature, scale and complexity" subsequently provide the perspectives for considering proportionality. The proportionality principle in the ICPs gives room for tailored solutions to achieve the desired outcome or objective of the relevant Principle Statement or Standard when carrying out supervision of the Board's functioning. However, it should be kept in mind that the considerations leading to a proportionate application of a Principle or Standard should give due consideration to the desired outcome of that Principle or Standard.

5. The Board is responsible for providing the overall strategy and direction for the insurer and overseeing its proper overall management, while leaving the day-to-day management of the insurer to Senior Management.<sup>2</sup> One of the roles of the Board is to provide leadership, direction and oversight of the insurer's business within an effective system of risk management and internal controls and functions to address the key risks it faces and for the key legal and regulatory obligations that apply to it.<sup>3</sup> The effectiveness

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<sup>1</sup> Paragraph 8 of the Introduction to ICPs.

<sup>2</sup> ICP 7.1.1.

<sup>3</sup> See ICP 7.3.1 and ICP 8.0.1.

of the Board, as the body ultimately responsible and accountable for the sound and prudent management of the insurer, is pivotal to an insurer's long-term success and sustainability.<sup>4</sup> An effective Board develops and promotes its collective vision of the insurer's purpose, its culture, its values and the behaviours it wishes to promote in conducting its business. The Board's own culture has an impact on the whole organisation. For this reason, the Board should consider from time to time whether or not its own dynamics and culture pose any particular risks to the organisation.

6. From a supervisory perspective, the desired outcome of an effective Board may be summarised as one that:

- Establishes a sustainable business model and a clear strategy;
- Articulates and oversees a clear and measurable statement of risk appetite against which major business options are actively assessed; and
- Meets its regulatory obligations, is open and proactively engages the supervisor and sets a culture that fosters prudent management.<sup>5</sup>

7. Given the key function that the insurance sector plays in absorbing risks from the real economy, it is critical that the Board of an insurer and its supervisor make a long-term commitment to build and sustain closer, trust-based relations founded on open communication. This requires the use of formal and informal channels between supervisors, the whole Board, the Chair, and the chairs of key Board committees. The interaction should be two-way with supervisors contributing their views and suggestions on the range of key issues they think Board members should consider.

8. For a Board to be effective, two aspects may be deemed essential:

- Formal aspects, such as suitability<sup>6</sup>, composition, allocation and delegation of responsibilities;
- Behavioural aspects, such as dominance and too much influence, skills to challenge and to cooperate, capacity for change and openness to diversity.

In the sections below, these two aspects will be further elaborated and good practices for supervision will be suggested.

9. Each section of the paper is structured, to the extent possible, in the following way: a description of problems or potential challenges for the supervisor followed by proposals for supervisory tools and good practices to remedy the problem or challenge.

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<sup>4</sup> 'A company's board is its heart and as a heart it needs to be healthy, fit and carefully nurtured for the company to run effectively', J. Solomon and A. Solomon, *Corporate Governance & Accountability*, John Wiley & Sons 2004, p. 65.

<sup>5</sup> Prudential Regulation Authority, *Corporate governance: Board responsibilities*, March 2016, p. 5, <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2016/ss516.pdf?la=en&hash=FAC29DDE01AD00BF8E45222374D55F64468D18AE>

<sup>6</sup> As regards suitability, this Application Paper focuses mainly on competence.

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## 2 Competence of Board members

10. According to ICP 7.3: “The supervisor requires the insurer’s Board to have, on an on-going basis, an appropriate number and mix of individuals to ensure that there is an overall adequate level of competence at the Board level commensurate with the governance structure”. This requirement is reinforced by the Principle Statement of ICP 5: “The supervisor requires the Board Members, Senior Management, Key Persons in Control Functions and Significant Owners of an insurer to be and remain suitable to fulfil their respective roles”. ICP 5.2 further specifies that: “The supervisor requires that in order to be suitable to fulfil their roles, Board Members (individually and collectively), Senior Management and Key Persons in Control Functions possess competence and integrity”.

11. Assessing the overall level of competence of the Board is intrinsically linked to the members’ individual and collective suitability as well as the appropriateness of their mix and composition to adequately assume their roles and responsibilities. Supervisors can be faced with various challenging situations when trying to measure the capability of a Board to fulfil its responsibilities.

12. The supervisor may experience a number of challenges related to the competence of Board members, such as those described below.

### 2.1 The selection process for future members is informal or undocumented

13. This situation may occur, for example, where the selection<sup>7</sup> process of the insurer is limited to identifying candidates from past work experiences of current members, networking activities and/or the business community in their region. In these cases, the supervisor could request the insurer to develop a formal Board-approved nomination policy and/or the creation of a Board nomination committee, which could be supported by the human resources department or external consultants. This may assist the Board to make the link between the Board’s composition and the insurer’s strategy, which encompasses succession planning to ensure that the diverse ranges of needed skills are present.

14. Furthermore, the supervisor could ask for biographical summaries of all newly selected members and the documentation resulting from the Board’s review within a reasonable time after their appointment, as well as the succession plan and a draft of a profile of new candidates. Together the documents may provide a useful basis for a discussion between the supervisor and the insurer about concerns that the selection process is informal or undocumented. Some supervisors consider it good practice to interview candidates or persons nominated for the position of the Chair of the Board, in order to gather information for the assessment of fitness and propriety and to determine whether there are supervisory concerns.

### 2.2 The Board is not competent collectively

15. If the Board is not competent collectively, the supervisor may suggest enhancing the succession plan for the Board’s membership to include the identification, mentorship and development of future members and to help improve the Board’s collective competence. The Board’s succession plan could be linked to a Board composition grid (see example in Annexes 1 and 2) and reviewed periodically so that any gaps in the collective or individual expertise of

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<sup>7</sup> In this Application Paper “selection” covers recruitment and election, depending on a legal form of an insurer.

the Board are identified and taken into account when considering the selection of new members.

16. It may also be appropriate for the supervisor to challenge the adequacy of the size of the Board, subject to jurisdictional legal requirements or corporate rules, regarding the minimum number or percentage<sup>8</sup> of members sitting on the Board. In certain cases, it could be an opportunity for the supervisor to encourage the insurer to have Board members with necessary skills, knowledge or expertise.

### 2.3 The relevant expertise of the financial sector and specifically the insurance industry (e.g. actuarial, investment) is not collectively held by the Board

17. This problem occurs in insurers where there are no criteria or indicators predetermined and documented by the Board to judge the appropriate level of experience and professional qualifications needed to hold a position on the Board of an insurer.

18. A Board composition grid could align both members' names with the desired/needed skills, experience and attributes (mentioned above in Section 2.2). Any identified important gap pertaining to competence or qualifications should be encouraged (or required) to be filled.

19. The supervisor should assess whether the Board makes the proposed Board members aware of expectations regarding the time to be allocated for the function, their commitment and their contribution relating to their competence.

20. The supervisor assesses whether the Board reflects relevant key characteristics, such as:

- Members have industry and/or functional experience and expertise which can be applied to the business and strategy of the insurer;
- Members bring diverse backgrounds and perspectives that enrich Board discussions, analysis, insights and problem solving.

### 2.4 The competence of the Board members does not evolve to keep up with the changes in the insurer's business or environment in which an insurer operates

21. After changes in the risk profile of an insurer, Board members may find themselves not having the necessary skills to understand, monitor and control the new risks arising<sup>9</sup>. Board members may not be able to follow the pace of regulatory changes, which could lead to inadequate performance.

22. To help deal with the pace of changes, the Board should offer proper training for its members. Board members should have access to and participate in on-going training on issues relating to matters of interest for the members, especially for those with more limited skills or knowledge. The supervisor could assess whether appropriate funding and time is devoted to such training.

23. The supervisor should encourage the establishment of internal arrangements for periodic, staged rotation of its members so as to invigorate its capabilities by introducing members with new expertise and perspective while retaining valuable knowledge, skills and

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<sup>8</sup> In certain mutuals, a specific percentage of the mutual's members must sit on the Board.

<sup>9</sup> See W. McDonnell, *Managing Risk: Practical lessons from recent "failures" of EU insurers*, Occasional Paper Series, FSA, December 2002, p. 15-16, <http://www.fsa.gov.uk/pubs/occpapers/op20.pdf>.

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experience and maintaining continuity. However, for certain positions within the Board (e.g. Chair of the Audit Committee), requiring a specific skill-set or background, like accounting/audit, rotations may not be necessary.

24. Furthermore, the supervisor may request and obtain the insurer's talent management and mentoring programmes for the Board members in order to assess how talent and leadership is managed.

### **3 Diversity of competencies of the Board**

25. The diversity of the Board in its broadest sense can be an essential driver of the Board's effectiveness, creating a breadth of perspectives among members and breaking down a tendency towards "groupthink"<sup>10</sup>. It may also help increase the quality of group performance, creative thinking and may lead to better decision-making. Diversity can be considered in the context of various issues such as gender, race, and ethnicity, but also skills, backgrounds, personalities, opinions, and experiences.<sup>11</sup> This Application Paper focuses only on diversity of competencies, such as knowledge and expertise.

26. According to ICP 5.3.6: "When assessing the competence of the Board Members, regard should be given to respective duties allocated to individual members to ensure appropriate diversity of qualities and to the effective functioning of the Board as a whole." According to the last sentence of ICP 7.3.1: "While certain areas of expertise may lie in some, but not all, members, the collective Board should have an adequate spread and level of relevant competencies and understanding as appropriate to the insurer's business."

27. The supervisor may experience a number of challenges related to the composition of the Board in terms of its diversity of competencies, such as those described below.

#### **3.1 The Board as a whole might not possess the relevant competencies and understanding of the insurer's business because of an imbalance in diversity**

28. The Board should assess how members are selected in order to foster a diversity of competencies and to facilitate understanding by the Board of specific characteristics of the insurer's business. In addition the Board should assess the need to replace members lacking relevant knowledge, skills or experience with others who have an appropriate level of competence in areas assessed to be critical for the insurer.

29. Additionally, succession planning, described in more detail in Section 2, may help facilitate diversity within the Board. The supervisor should assess whether the insurer's Board or a nominations committee considers the need for diversity as part of succession planning.

30. The supervisor should review whether the Board has in place self-assessment/independent review processes not only on the performance of each Board member, but also on the Board's structure, composition and diversity.

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<sup>10</sup> Financial Reporting Council, Guidance on Board Effectiveness, March 2011, para. 1.3.

<sup>11</sup> For example, Boards composed only of men, the coming in the workforce of the Millennials or the necessity to understand Fintech or cybersecurity matters.

31. As suggested in Section 2.2, an insurer's Board composition grid could be used by the supervisor to assess the degree of diversity found amongst Board members. It could be also used to identify potential gaps in the collective and individual skill-set of the Board.

### 3.2 Unconscious or unquestioned sharing of common assumptions may take place in a Board that is not diverse enough

32. This situation may preclude the Board from taking into account different and new perspectives on the risks, consequences and possible implications of Board decisions. A lack of diversity may also result in poor discussions or limited analysis, paving the way for possible inadequate decisions.

33. For the supervisor, the infrequency or lack of difficult questions raised by Board members and pursued with Senior Management regarding plans or performance could be an indicator of an unconscious bias or not enough challenges of difficult issues.

34. Independence from Senior Management and experience and stature of Board's members are other important factors the supervisor should take into account in assessing the capacity of a Board to challenge Senior Management.

35. The supervisor may encourage the insurer to implement a decision-making process to ensure the Board takes into account different and new perspectives on risks when the Board lacks diversity. Even though the responsibility remains within the Board, the expertise from outside the Board may be retained to help facilitate this process.

36. Interviews with members of the Board could be conducted to the extent necessary to identify and assess the "tone at the top" relative to diversity. Examination of minutes of the Board and committee meetings could also be indicative of the openness to different views when dealing with difficult decisions.

## **4 Allocation of the roles and responsibilities**

37. According to ICP 7.1: "The supervisor requires the insurer's Board to:

- ensure that the roles and responsibilities allocated to the Board, Senior Management and Key Person in Control Functions are clearly defined so as to promote an appropriate separation of the oversight function from the management responsibilities; and
- provide oversight of the Senior Management."

38. The allocation of the roles and responsibilities between the Board and Senior Management is one of the critical governance decisions made by the Board.

39. The respective roles of the Board and Senior Management and the resulting allocation of responsibilities are a fundamental aspect of corporate governance<sup>12</sup>. If the balance is not

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<sup>12</sup> The Financial Stability Board (FSB) recognised the strengthening of individual responsibility and accountability as one of the overarching issues in strengthening corporate governance aimed at mitigating misconduct risk. See FSB, *Strengthening Governance Frameworks to Mitigate Misconduct Risk: A Toolkit for Firms and Supervisors*, 20 April 2018, <http://www.fsb.org/wp-content/uploads/P200418.pdf>, p. 22 and next.

appropriate, the governance structure within the insurer may not operate correctly and may lead to poor governance outcomes and ultimately poor performance.

40. The supervisor may encounter challenges in supervising the allocation of the roles and responsibilities within the insurer, such as those described below.

#### 4.1 Improper allocation of tasks

41. An insurer's Board and Senior Management may have no clear allocation of responsibilities or an allocation of roles and responsibilities that does not allow for clear-cut distinction between oversight and day-to-day management of the business<sup>13</sup>. The Board may spend too much time "managing" and insufficient time "directing". This situation may result from a lack of proper planning and discussion between the leadership of the Board and the leadership within Senior Management in respect of the allocation of the roles and responsibilities – for example, adopting off-the-shelf role and responsibility guidelines with no regard to the insurer's specific circumstances and unique governance structure. In other cases, the allocation of roles and responsibilities within the insurer is informal and not sufficiently documented, such as in a Board approved roles and responsibilities framework or matrix. Furthermore, in some cases the allocated roles and responsibilities do not seem to be regularly assessed or reviewed by the Board to reflect the changes within the insurer.

42. In respect of the above-mentioned pitfalls, a jurisdiction's legislation may address the roles and responsibilities of the Board, Senior Management and Key Persons in Control Functions. The supervisor should provide guidance on key roles and responsibilities of the Board and Senior Management in an insurance context. The FSB suggests the development of a short description of the significant functions or a statement of the activities for which each senior manager is responsible, which could be used to devise a "responsibilities map" showing how key responsibilities are allocated across the firm<sup>14</sup>. The supervisor may request and obtain such a framework or matrix and validate this against, for example, the CEO key performance contract, the Board's evaluation assessment or the strategy. The supervisor can use this responsibility map and performance assessments as an indicator of the overall effectiveness of the Board members individually and collectively. When deemed necessary, the supervisor can request the Board to perform a regular assessment of the effectiveness of a proper allocation of tasks by comparing the new situation with the old situation.

43. The supervisor may also conduct interviews with the Board to ascertain the process that the insurer implemented to allocate roles and responsibilities within the insurer.

44. In addition, the supervisor may request and obtain internal audit reports if an internal audit review was conducted in respect of the roles and responsibilities of the Board and Senior Management. If no such internal audit was conducted, the supervisor may consider directing the insurer to conduct such an internal audit review.

45. In some jurisdictions, the supervisor reviews the Board documentation to understand the respective roles and responsibilities of the Board and Senior Management. Where there is an overlap between the roles and responsibilities of the Board and Senior Management,

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<sup>13</sup> See ICP 7.1.4, which describes activities to be taken by the Board necessary to provide effective oversight of the Senior Management.

<sup>14</sup> FSB, *Strengthening Governance Frameworks to Mitigate Misconduct Risk: A Toolkit for Firms and Supervisors*, 20 April 2018, p. 26.

resulting in governance concerns, the supervisor should require the insurer to address these concerns and to demonstrate how this overlap was addressed.

46. Additionally, the supervisor may also obtain a copy of the Board's work plan to ascertain whether its roles and responsibilities framework or matrix is regularly assessed and reviewed by the Board.

## **5 Delegation of activities and tasks of the Board**

47. The Board may delegate some of the activities or tasks associated with its own roles and responsibilities. Notwithstanding such delegations, the Board as a whole retains the ultimate responsibility for the activities or tasks delegated.<sup>15</sup>

48. Whenever the Board delegates activities or tasks within the Board structure, it should promote independent judgement within the Board. Such delegation should not have a negative impact on the balance of power within the Board or on the effective discharge of the Board's duties.

49. An insurer should have adequate internal control systems and reporting to assist its Board, or its delegated activities and tasks, in the fulfilment of its responsibilities for oversight of the insurer's risk management framework.

50. Any delegation of activities or tasks should be clearly documented and specify, among other things: the exact activity or task being delegated; the authority of recipients to further delegate the activity or task; and the restrictions placed on the exercise of delegated activities or tasks. The insurer should also have adequate monitoring systems to ensure that the delegated activities are properly controlled.

51. The supervisor may encounter challenges in terms of supervising delegation of activities and tasks by the Board, such as those described below.

### 5.1 The delegation is informal and not documented.

52. In accordance with ICP 7.3.4, the Board should have appropriate practices and procedures for its own internal governance, and ensure that these are followed and periodically reviewed to assess their effectiveness and adequacy. Adequate documentation should be part of these practices. Where the delegation process is informal and not documented, the supervisor should direct the insurer to formalise it.

### 5.2 There is a Board approved delegation policy, but the policy is not monitored and reviewed on a regular basis.

53. The supervisor should obtain a copy of the delegation policy of the insurer and assess whether the policy clearly articulates the delegations and accountability structures within the insurer. Furthermore, the supervisor should have an understanding of how the delegation policy interlinks with the overall governance framework of the insurer.

54. The supervisor may review Board minutes to assess whether the delegation policy is regularly reviewed by the Board and amended to align to the changing internal and external

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<sup>15</sup> ICP 7.3.13.

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environment of the insurer. It may happen that the policy is not monitored, reviewed and amended on a regular basis, in times of crises or when changes occur in the Board and Senior Management.

55. In addition, the supervisor may review relevant internal audit reports that provide the Board with assurance that the delegation framework set out in the delegation policy is being followed or not.

## **6 Combining the roles of the Chair and CEO**

56. The supervisor may encounter various challenges when the roles of the Chair and CEO are combined. In jurisdictions where the positions of the Chair and CEO may be combined, the supervisor should request mitigation measures to ensure “a clear distinction between accountability for oversight and management.”<sup>16</sup>

57. Mitigating measures should be oriented to enhance the checks and balances, to foster objective decision-making and to avoid concentration of powers in the hands of one person. For example, the supervisor may require the insurer to have a clear division of responsibilities between the Chair and CEO, which should be in writing and agreed by the Board.

58. Additionally, the Board may be required to include some, or even a majority, of independent members in order to encourage challenge and facilitate an objective decision-making process. In some jurisdictions there is a requirement to appoint a “lead independent director”<sup>17</sup>. The role of a lead independent director is mainly to provide leadership to independent directors, with the aim of ensuring a proper power balance and independence of the Board.

## **7 Being a Board member of multiple entities within the same group**

59. An individual can be a member of more than one Board within a group (for example a Board member of the parent company also being on the Board of a subsidiary). Many jurisdictions allow individuals to be members of two or more Boards within a group as it is recognised that there are advantages from this. For example, it may help create a common culture and consistent management across the group and may lead to long-term synergies in strategy setting and talent management.

60. An individual being a member of more than one Board may give rise to potential conflicts of interest between different parts of the group and to being overstretched if that individual is unable to devote sufficient time to responsibilities within each entity.

61. In order to address the above mentioned challenges, it is good practice to put in place mitigants (either within general corporate governance requirements or within insurance regulation) so that this does not give rise to conflicts of interest between different entities within the group. The supervisor should consider how a Board of the head of the group ascertains limits for itself, taking into account the nature, size, and complexity of the entities within the

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<sup>16</sup> ICP 7.1.1. See also OECD Guidelines on Insurer Governance, 2017 Edition.

<sup>17</sup> “Independent Director” or “Senior Independent Director” are also used.

group and of the roles undertaken by Board members who may have multiple Board positions. The supervisor should discuss with the Chair on a regular basis how the Chair has obtained comfort on the independence of Board members with multiple Board positions within the group (on their initial appointment and on an ongoing basis). The supervisor should also consider taking measures that could include:

- Requiring or recommending some, or even a majority, of Board members to be non-executive;
- Requiring specific permission from the supervisor for multiple Board positions to be held within the same group;
- Requiring insurers to have clearly set out policies for dealing with conflicts of interest including provision for potential conflicts to be declared; or
- Determining a maximum number of mandates to be held by persons who already perform a similar role in other entities within the same group.

## **8 Access to information**

62. Board members may be unable to effectively execute their roles and responsibilities because they do not receive all necessary information or take part in all relevant discussions. Conversely, Board members may receive an excessive amount of information that makes it difficult to review and analyse. Missing information or context may be caused by ineffective management information systems and Board reporting tools in addition to a lack of information sharing across Board committees.

63. It may happen that the Board members do not receive all pieces of background information necessary to make a well-informed and prudent decision when they receive a proposal or recommendation from the Senior Management or a committee.

64. A similar situation may arise when the Chair and the CEO have separate discussions and exchange of information with selected Board members on important matters, such as strategic planning or changes in the organisational structure. Other Board members may not be aware of those issues or do not have the knowledge necessary to execute effectively their oversight role and responsibilities. This scenario is contrary to good governance as no single Board member or a selective group of Board members should have unfettered powers of decision and control where the Board acts collectively. Furthermore this type of behaviour may sow division among Board members who should normally act as a leadership team.

65. The above-mentioned scenarios may be extremely difficult for the supervisors to notice unless one of the Board members alerts the supervisor. Where the supervisor is of the opinion that the Board members do not receive comprehensive, risk focused and relevant information, the supervisor may take measures, such as:

- conduct interviews with all Board members individually to ascertain the Board decision-making process and the quality of information that is provided to the Board members in considering and making decisions, and to assess their level of understanding as to how key metrics presented to the Board are constructed;

- instruct the insurer's internal audit function or a suitable external party to conduct a review and assessment on the Board's decision-making processes, in terms of access to relevant information; or
- obtain copies of Board evaluations (self-assessments or external assessments) or member peer assessments/reviews to assess whether the unfettered power resides with an individual or group of members, or request a Board evaluation to be conducted (in case there is none).

66. In order to facilitate involvement of all members of the Board in the decision-making process, it is a good practice for the supervisor to require the Board to develop and have documentation (such as Board charters, mandates or terms of reference) that details the Board's functions and responsibilities to ensure that the members have free discussions and impartial judgment in the Board and committee meetings. Such documentation should highlight, for example, the division or balance of responsibilities between the Chair of the Board, the lead/senior non-executive director, if any, and the CEO. In some jurisdictions the separation of the roles and responsibilities of the CEO and the Chair is documented under shareholder resolutions.

67. The supervisor should review whether Board documentation includes all relevant information and is available for decision-making and whether discussions on matters of importance to the Board are held in order to enable them to play an active role in the decisions that are made.

68. The supervisor should also encourage the Board to assess the process of preparing information for the Board, including who is involved in this process and who decides which information is or is not presented to the Board, what checks and balances are used to avoid the withholding of information or the delivery of partial or delayed information. In order to make sure that the Board receives all relevant information necessary to make well-informed decisions, the supervisor should encourage the Board to make sure that the internal governance below the Board level (at the management level) is organised in a proper way, so the decisions made below the Board are made in an informed and objective way, and information provided to the Board is objective, balanced, relevant and timely.<sup>18</sup>

69. Reviewing minutes of Board meetings may help the supervisor to assess and verify that the Board makes decisions within the confines and boundaries of the governance prescripts as contemplated in terms of Board documentation. In this respect, minutes of the Board meetings may enable the supervisor to assess whether deliberations and decision-making of the Board are within their scope. In addition, the supervisor may conduct interviews with Board members to validate and corroborate that the minutes are an accurate reflection of the Board discussions and decision-making.

70. Given the critical nature of minutes to both the insurer and the supervisor, the supervisor may consider providing guidance on how to draft minutes, in particular expectations on the level of detail. For example, the Central Bank of Ireland stipulates the following in respect of the Board minutes:

“Detailed minutes of all board meetings shall be prepared with all decisions, discussions and points for further action being documented. Dissensions or

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<sup>18</sup> See G. Shawn Vargas, *Internal governance: The next frontier*, 2017, available at: <https://ethicalboardroom.com/internal-governance-the-next-frontier/>

negative votes shall be documented in terms acceptable to the dissenting person or negative voter. The minutes of meetings shall provide sufficient detail to evidence appropriate board attention, the substance of discussions and their outcome and shall be agreed at the subsequent board meeting.”<sup>19</sup>

## 9 Behavioural aspects of the Board’s functioning

71. In addition to the supervision of formal arrangements related to the role and composition of the Board, supervisors should be aware of potential challenges that may be posed by behavioural aspects of the functioning of the Board. The supervisor may find it difficult to assess those aspects of functioning of the Board and to determine when and what measures should be taken. Such developments within the Board are often intangible and may be subject to supervisory judgement.

72. The supervisor should consider ways to assess behavioural aspects, such as developing indicators for assessing the Board functioning. For example, De Nederlandsche Bank (DNB) uses the following risk indicators of behavioural factors in assessment of the Board’s decision making in the supervised institutions<sup>20</sup>.

Behavioural and culture focus in decision making	Indicators
Impeding group patterns	<ol style="list-style-type: none"> <li>1. Strain for consensus. What is the level of dissent? Do group members take minority views? Do they maintain these views when facing an opposing majority?</li> <li>2. Information-sharing bias. Do group members contribute previously unshared and unique information?</li> <li>3. Conflict. Is the group conflict prone? What is the nature of the conflict: task or emotional? Are there group norms about how to deal with conflicts? Is the group confident with respect to solving conflicts?</li> </ol>
Quality of challenge	<ol style="list-style-type: none"> <li>1. Structure. Did the group use deliberate process interventions to enhance constructive challenge?</li> <li>2. Leadership style. Did the leader create a facilitating climate and encouraged others to participate? Did the leader invite others to speak up? Or did he or she impose his or her preferred solution, while dismissing other's input.</li> <li>3. Level of dissent. What is the level of dissent? Do group members take minority point of views? Do they maintain these views when faced with an opposing majority? 4. Depth of discussion. Did the discussion evolve around a selection of topics, thereby leaving other important information out of consideration? Was the frame of the problem and its potential positive and negative consequences discussed?</li> </ol>

<sup>19</sup> Central Bank of Ireland, Corporate Governance Requirements for Insurance Undertakings, 2015, p. 32.

<sup>20</sup> De Nederlandsche Bank, Supervision of Behaviour and Culture. Foundations, practice and future developments, p. 117, [https://www.dnb.nl/binaries/Supervision%20of%20Behaviour%20and%20Culture\\_tcm46-334417.pdf](https://www.dnb.nl/binaries/Supervision%20of%20Behaviour%20and%20Culture_tcm46-334417.pdf)

73. Supervisors should take into account a broad range of potential behavioural conditions. A. Brown and B. Balasingham identified the following common root caused leadership issues (at the Board or Senior Management level) that led ultimately to failures, distress and impairments of some insurers<sup>21</sup>:

Hubris	Extreme pride or arrogance. The desire to be the best led to new risk and approaches outside the insurer's expertise, an overestimation of one's own competence or capabilities, especially when the person exhibiting it is in a position of power.
Myopia	No real vision, blindly following the market practice. Diverging from strategy so as to have the latest and best.
Abuse of power/ Lack of courage	Using power and authority for personal interest at the cost of other stakeholders. Extreme pressure often led to poor decision making, and often less ethical practices.
Stuck in the past	Lack of desire to change or accept the need to change despite overwhelming evidence.
Cronyism	Blind trust – people put in senior roles and kept in roles even if wrong fit for the role or situation.

74. The supervisor may encounter challenges related to behavioural aspects of the functioning of the Board, such as those described below.

#### 9.1 Overly-dominant personality of the Chair or CEO

75. In some cases one person can dominate the discussions and decision-making process of an insurer in a negative way. This may arise not necessarily because of combining functions or certain flaws of the governance structure, but because of an overly-dominant personality. This situation may be difficult to be observed by the supervisor, and it may be challenging to respond in a proper way.

76. The supervisor should consider how to respond to situations where it observes an overly-dominant personality in a Chair or CEO, such as:

- Engaging the Chair or CEO to convey the supervisor's observations and expectations, in order to foster an internal dialogue within the insurer, with the proper involvement of all relevant parties;
- Assess whether relevant Key Persons in Control Functions have direct access to the Board and respective Board committees, to achieve open communication and effective challenge, and whether they make use of this direct access in reality;
- Conduct dialogues with Board members, including non-executive directors and selected management members (can be one-on-one engagement), to understand the dynamics of the Board and Senior Management;

<sup>21</sup>A. Brown and B. Balasingham, *Leadership and Life Insurance failures – What can we learn about Financial Leadership*, Paper presented to the Actuaries Institute Actuaries Summit, 21-22 May 2013, Sydney, <https://www.actuaries.asn.au/Library/Events/SUM/2013/Sum2013PaperAndrew%20Brown%20Bimal%20Balasingham.pdf>

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- In jurisdictions where appropriate, attend Board meetings as an observer and review the agendas and minutes. This may help the supervisor to assess the way in which the Board operates and the level of challenge within the Board and from the Board members to Senior Management. Alternatively, the supervisor could have an independent behavioral expert attend a Board meeting as an observer to provide an assessment.
  - Conduct on-site inspections with the purpose of determining whether the problems with an overly-dominant personality is applicable for a particular insurer;
  - Require the insurer to undertake a board effectiveness review and consider making improvements to the way that the Board operates and makes decisions. The supervisor should review whether the insurer implements the recommendations of such reviews;
  - Mount increased supervisory challenges on material matters (e.g. ask for the rationale and challenge the Board's thinking on why they do certain things);
  - Review the insurer's whistleblowing policy framework for its employees or any other persons to raise genuine concerns about possible improprieties at the earliest opportunity, and in an appropriate way; or
  - Conduct exit interviews with Board members who resign, retire or otherwise exit the insurer.

## 9.2 Involvement of the Chair or CEO in the Board Committee functioning

77. ICP 7.3.5 stipulates: "it is good practice for the Chair of the Board to be a non-executive Board member and not serve as chair of any Board committee". Even if the Chair or CEO does not serve as chair of Board committees, or even if he/she is not a member of a committee, it may happen that he/she attends all meetings of a selected or all Board committees, for the entire duration of the meetings.

78. It may also happen that Chairs or CEOs inappropriately involve themselves during the committees' meetings; for example, going beyond presenting information and answering questions and inserting views and opinions into the discussions. As a result of dominating the discussions by the Chair or CEO, committee members may not be able to discuss freely without the influence of the Chair or CEO, and may be discouraged from taking any active participation in the discussions. In these circumstances, the balance of power and decision-making may shift to this individual.

79. The supervisor may address the above mentioned challenges in a variety of ways, such as:

- Require the insurer to set out clear policies on the membership and functioning of Board and its committees. If such policies already exist, the supervisor should review them to assess whether they may prevent the Chair or CEO from dominating the discussions within the Board committees. The supervisor may obtain copies of the Board and Board committee attendance schedules and minutes to assess whether the discussion at the meetings is dominated by a particular individual. Alternatively, if they have the authority to do so, the supervisor may instruct the Board that the Chair or CEO cannot be a member of the Board committees;

- Require or recommend the Board and its committees to have a majority of non-executive directors;
- Require or recommend the Board committees to be chaired by a non-executive director;
- Require at least some members of a Board committee (in particular the chair) to have expertise in the subject matter covered by the committee (e.g. audit/finance experience for the audit committee);
- Attend the Board committee's meetings, or monitor them on the basis of their agendas and minutes, to assess if they are being dominated by the Chair or CEO; or
- Conduct on-site inspections with the purpose of determining whether the problems described above are applicable to a particular insurer;
- Discuss functioning of the Board committees with the Board members and Senior Management.

### 9.3 Interference in the Board's responsibilities by the owner or founder

80. In some smaller insurers and family owned insurers, the founder and major shareholder may act as CEO or a Board member, disregarding the Board as well as the roles and responsibilities framework or matrix approved by the Board. In other cases the founder (and owner) may perform various conflicting roles within the insurer and justify it by having "skin in the game". This type of informal interference may be difficult to be handled appropriately by the Board. In such a situation, even if all relevant formal arrangements are in place, the balance of power within the insurer will be tilted to one specific individual.

81. The supervisor should examine the conflicts of interest policy of the insurer. In a number of jurisdictions, the supervisor provides standards on the roles and responsibilities of the lead independent director<sup>22</sup>. In these jurisdictions where the above-mentioned conflicts of interest or potential conflicts of interest may arise in respect of the Chair, the lead independent director should preside at the Board meetings or perform functions that cannot be performed by the Chair.

### 9.4 "Groupthink" tendency

82. The "groupthink" tendency is a behavioral aspect that may have negative consequences on the functioning of the Board. This social constraint consists of the members' strong wish to preserve the harmony of the group, which inclines them to avoid creating any discordant arguments or schisms. In some cases, this "groupthink" tendency may occur when particular members of the Board are considered as "experts" in the area of their responsibility, and their views or opinions are not challenged by other members. When this social constraint is dominant, the group members engage in self-censorship of their doubts about whatever policy position seems to be preferred by the leader or by the majority of the group<sup>23</sup>.

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<sup>22</sup> For example, in the United States, publicly listed companies with a non-independent Chair are required to elevate one of their independent directors to the position of lead director.

<sup>23</sup> Irving Lester Janis, *Crucial Decisions: Leadership in Policymaking and Crisis Management*, 1989, The Free Press, p. 58 and next.

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83. Determining the existence of “groupthink” is not easy. In order to do so, the supervisor should consider different means of identifying “groupthink”, such as:

- Attending the meetings of the Board to assess how the members interact with each other;
- Organising face-to-face meetings with the Board members and paying attention to behavioural aspects during those meetings.

84. The supervisor may address challenges related to “groupthink” tendency by recommending or requesting the insurer to assess the following:

- Diversity of the Board not only in terms of formal qualifications and education, but also in terms of thinking tendency, perspectives and approaching the problem;
- Maximum duration of the term of the Board member;
- Composition of the Board, consisting also of a proper number of independent directors.

#### 9.5 Trust deficit at the Board level

85. A trust deficit may arise for instance when the Chair does not trust the ability of the appointed CEO, or when the Chair is a previous CEO and struggles to make the transition from the CEO to the Chair’s position. Such a lack of trust may lead to a disregard of the distinction between the oversight and management roles as defined in the insurer’s roles and responsibilities framework.

86. From a supervisory perspective, as mentioned under Section 4.1, the supervisor should highlight its expectations for the key roles and responsibilities of the Board and Senior Management. In some jurisdictions, the supervisor has the authority to remove a Chair or CEO and replace him/her with a more appropriate person.

87. The supervisor may request and obtain copies of the Board’s meeting minutes and the Senior Management’s meeting minutes. In reviewing these minutes, the supervisor should assess whether the Chair is providing leadership to the Board and the CEO is providing leadership to the insurer. If the Chair is also providing leadership to the insurer by directing day-to-day operations of the insurer, resulting in the overall balance of power residing with the Chair, the supervisor should discuss the situation with the Board and take appropriate measures, if necessary. Suspending, dismissing or disqualifying the Chair, either directly or by ordering the insurer to take these measures, may also be considered.

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## Conclusion

88. For a Board to be effective, two aspects may be deemed essential:

- Formal aspects, such as suitability, composition, allocation and delegation of responsibilities;
- Behavioural aspects, such as dominance and too much influence, skills to challenge and to cooperate, capacity for change and openness to diversity.

89. As described in the Application Paper, the practices and tools for supervising these two aspects can differ.

90. Depending on the problems encountered, the supervisor should consider encouraging insurers to apply tools such as: policies (succession, conflicts of interest, recruitment, delegation), diversity, self-assessments, profile for new candidates, processes (for recruitment, Board functioning), roles and responsibilities map, independent Board members, suitability matrix, information flows.

91. Regarding the formal aspects, supervisors could make use of supervisory requirements and off-site monitoring or on-site visits, while for the behavioural aspects on-site visits, dialogues, interviews or observing Board meetings may be more effective.

92. Tools supervisors may use in the context of behavioural aspects of the Board functioning include: review policies, minutes and processes, dialogues/interviews, Board effectiveness review, guidance, attend Board meetings, recommendations (e.g. majority of independent members, individual and collective suitability).

## Annex 1: Sample Board composition grid: What skills and attributes does your Board need?

### Sample board composition grid: What skills and attributes does your board need?

	Director names								
<i>Desired/Needed skills, experience, attributes</i>	A	B	C	D	E	F	G	H	I
International expertise	X								
Technology/Digital media expertise				X	X			X	
Risk management expertise			X			X		X	X
Financial expertise		X	X		X				
Marketing expertise									X
Legal expertise		X							
Human resources expertise									
Operational expertise	X	X	X			X	X		
Industry expertise		X	X		X			X	X
Gender diversity				X			X		
Racial diversity				X					X
Geographic diversity		X				X			
Regulatory expertise	X		X			X	X		

In assessing their composition, boards and their nominating and governance committees need to think critically about what skills and attributes the board currently has, and how they tie to oversight of the company. As companies' strategies change and their business models evolve, it is imperative that board composition be evaluated regularly to ensure that the right mix of skills are present to meet the company's current needs. Many boards conduct a gap analysis that compares current director attributes with those that it has identified as critical to effective oversight. They can then choose to fill any gaps by recruiting new directors with such attributes or by consulting external advisors. Some companies use a matrix in their proxy disclosures to graphically display to investors the particular attributes of each director nominee.

(Source: Loop, Paula & Denicola, Paul, PricewaterhouseCoopers, "Investors and Board Composition", Harvard Law School Forum on Corporate Governance and Financial Regulation, May 26, 2016); <https://corpgov.law.harvard.edu/2016/05/26/investors-and-board-composition/#more-72983>

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## **Annex 2: The DNB template for a matrix to assess the collective competence of members of the management body**

This suitability matrix is designed to provide a collective assessment of the knowledge, skills and experience of the management body as a whole. A low score attributed to certain items under analysis does not necessarily impact the individual assessment of a member. It is expected that in a collegiate body there are appointees with different characteristics, including different levels of knowledge, and different professional experiences.

The explanation of the matrix can be found under the following link: [‘Template for a matrix to assess the collective competence of members of the management body’](#)

The table below presents an example of one of the modules. The entire matrix includes the following modules:

- A. Governance
- B. Competence of risk management, compliance and audit
- C. Managerial competence
- D. Products, services and markets within the institutions scope of activities
- E. Sectoral and Financial Competence
- F. Balanced and consistent decision-making
- G. Overall picture of the collective suitability

**A. Governance**

*This section is meant to map how the responsibilities are divided within the management body in its management function or in its supervisory function. This section can be tailored to the responsibilities within the organisation.*

Please fill in a score for each member as follows:

L (Low) = is at a minimum aware of the subject

M (Medium) = has good understanding of the subject but is not expert

H (High) = can make a balanced independent judgement on the subject (expert)

	Name											
Is capable of assessing the setup and functioning of the administrative organisation and internal control (AO and IC)												
Is capable of setting up the compliance function and/or assessing its setup, functioning and effectiveness												
Is capable of setting up the internal audit function and/or assessing its setup, functioning and effectiveness												
Is capable of setting up the risk management function and/or assessing its setup, functioning and effectiveness												
Is capable of understanding and implementing the remuneration policy (either to the members of the management body in its management function or institution-wide) and using incentives to influence behaviours												
Is capable of understanding and implementing the policy on outsourcing												
Is capable of assessing whether the careful treatment of clients has been safeguarded												
Is capable of implementing a succession planning												
Is capable of assessing the setup and functioning of Human Resources												