



**IAIS**

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INTERNATIONAL ASSOCIATION OF  
INSURANCE SUPERVISORS

## **ISSUES PAPER**

# **APPROACHES TO GROUP CORPORATE GOVERNANCE; IMPACT ON CONTROL FUNCTIONS**

**OCTOBER 2014**

## **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 in nearly 140 countries. 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. In addition to active participation of its Members, the IAIS benefits from input in select IAIS activities from Observers representing international institutions, professional associations and insurance and reinsurance companies, as well as consultants and other professionals.

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), founding member and co-parent of the Joint Forum, along with the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO), 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.

## **About IAIS Issues Papers**

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This paper was prepared by the Governance Working Group in consultation with IAIS Members and Observers.

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## Contents

Terminology used in the Issues Paper .....	4
1. Introduction .....	5
1.1. <i>Background and objectives of the Issues Paper</i> .....	5
1.2. <i>Relationship of the Issues Paper with ICPs and ComFrame</i> .....	5
2. The Corporate governance framework, structures and models .....	6
2.1. <i>Governance approaches and organizational structures</i> .....	6
2.2. <i>Focus on governance within centralized and decentralized models</i> .....	7
2.3. <i>Legal structures and management structures</i> .....	8
3. Key characteristics relevant to good governance in more centralized and more decentralized groups .....	9
3.1. <i>Roles and key players within the corporate governance of an entity</i> .....	9
3.2. <i>Checks and balances within a group</i> .....	11
3.3. <i>Key characteristics</i> .....	13
3.4. <i>Industry practice relating to governance models</i> .....	14
Example 1: more decentralized model .....	14
Example 2: collaborative model – in between centralized and decentralized .....	14
Example 3: more centralized model .....	15
Example 4: more decentralized conglomerate with a more centralized insurer holding company .....	15
Example 5: more centralized insurer .....	16
Example 6: hybrid mutual group .....	16
4. How challenges to good governance and control within groups can be addressed ....	17
4.1. <i>Challenges in a more centralized and in a more decentralized group</i> .....	18
4.2. <i>Setting objectives and strategies for achieving those objectives of the group (including setting risk appetite)</i> .....	21
4.3. <i>Appropriate allocation of oversight and management responsibilities</i> .....	23
4.4. <i>Policies and processes at the group and entity level</i> .....	24
4.5. <i>Risk management and compliance</i> .....	25
4.6. <i>Control Functions – Risk Management, Compliance, Internal Audit, Actuarial</i> ...	27
5. Supervisory review and cooperation .....	28
6. Conclusions .....	30

## Terminology used in the Issues Paper

Generally, capitalized terms used in this Paper are defined terms in the IAIS Glossary. For convenience some of those terms are included here as well as other more general terms defined for the purposes of this paper:

- a) "Board" means the Board of Directors of any entity within the group, and may be comprised of both executive and non-executive members who fulfil the oversight and management roles within the entity;<sup>1</sup>
- b) "ComFrame" means Common Framework for the Supervision of Internationally Active Insurance Groups;
- c) "Control Functions" mean properly authorised functions, whether in the form of a person, unit or department, serving a control or checks and balances function from a governance standpoint and which carry out specific activities including risk management, compliance, actuarial matters, and internal audit;<sup>2</sup>
- d) "Entity" means "legal entity";
- e) "Governance" means "Corporate governance" (systems, such as strategies, policies, processes and controls, through which an entity is managed and controlled);<sup>3</sup>
- f) "Group" means "insurance group";<sup>4</sup>
- g) "Group level" means that the roles and key players of the group will be centralized somewhere within the group. The term 'group level' does not necessarily mean the legal entity at the level of the head of the group. Especially Group Control Functions could be placed within an entity anywhere else in the group;
- h) "Group-wide governance" means the governance of the head of the group and the group-wide application of the group governance framework to all material activities and entities of the group;<sup>5</sup>
- i) "Group-wide supervisor" means the supervisor(s) responsible for promoting effective and coordinated supervision of an insurance group including coordinating the input of insurance legal entity supervisors in undertaking the supervision of an insurance group on a group-wide basis, as a supplement to insurance legal entity supervision;<sup>6</sup>
- j) "IAIG" means Internationally Active Insurance Group;
- k) "Key persons in controls functions" means persons responsible for heading Control Functions;<sup>7</sup>
- l) "Model" means a more centralized or a more decentralized model; and
- m) "Senior management" means the individuals or body responsible for managing the business on a day-to-day basis in accordance with strategies, policies and procedures set out by the Board.<sup>8</sup>

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<sup>1</sup> See IAIS Glossary and ICP 7, Introductory Guidance 7.0.5 and 7.0.6

<sup>2</sup> See IAIS Glossary.

<sup>3</sup> See IAIS Glossary.

<sup>4</sup> Definition under review, to be inserted in IAIS Glossary once adopted.

<sup>5</sup> Joint Forum Principles for the supervision of financial conglomerates: Explanatory comment 10.3.

<sup>6</sup> See IAIS Glossary.

<sup>7</sup> See IAIS Glossary.

# 1. Introduction

## 1.1. *Background and objectives of the Issues Paper*

1. This Issues Paper illustrates the different approaches to governance structures of insurance groups – whether more centralized or more decentralized – and analyses the various challenges such structures can present as well as possible practices to address these challenges.
2. The need for this paper arose due to the growing awareness of the variety of approaches to governance adopted within Insurance groups, and the different impact and demands those approaches can have on Control Functions which form a key element of the corporate governance framework of the group. Irrespective of the governance approach chosen, the sound and prudent management and oversight of a group through its corporate governance framework is a fundamental requirement that applies to any Insurance group.
3. The objectives of this Issues Paper are to create awareness for insurers and supervisors of the challenges of centralized and decentralized governance approaches and possible solutions for these challenges, which should be taken into account when setting up and assessing the corporate governance framework of an Insurance group. For that purpose the Issues Paper:
  - a) identifies, to the extent possible, key characteristics relevant to good governance in different models;
  - b) identifies challenges or risks to good governance arising from more centralized or more decentralized models adopted within an Insurance group, including the impact a particular model adopted within a group can have on the effectiveness of its Control Functions;
  - c) provides practices to insurers and supervisors which could help to achieve, within different models, the outcomes intended by applicable standards and objectives of good governance. These suggested practices should be in the context of the aims of an Issues Paper and not be regarded as new standards.<sup>9</sup>

## 1.2. *Relationship of the Issues Paper with ICPs and ComFrame*

4. The Insurance Core Principles (ICPs) which are most relevant to the subject of the Issues Paper are ICPs 7 and 8. ICP 7 requires insurers to establish and implement a corporate governance framework with the aim of ensuring sound and prudent management and oversight of the insurer's business and to protect the interests of policyholders. ICP 7 standards identify qualitative requirements that should be met (in a proportionate manner<sup>10</sup>) by an insurer with respect to its corporate governance framework. The key aspects of these are: policies that set and oversee the implementation of the strategy and objectives of the insurer; appropriate allocation of oversight and management responsibilities, including responsibility and accountability at the group and entity level as relevant; appropriate systems and functions for risk management and overall internal controls; and clear channels of communication, including lines of reporting between Boards and Senior Management within a group.

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<sup>8</sup> See IAIS Glossary.

<sup>9</sup> See explanation of IAIS Issues Paper on page 2.

<sup>10</sup> Proportionality is included in the Introductory Guidance to ICP 7 (Guidance 7.0.4).

The different aspects of the corporate governance framework support and enhance the ability of the Board of Directors, Senior Management and Key Persons in Control Functions to fulfil their respective obligations and/or tasks under the corporate governance framework.

5. ICP 8 focusses on the qualitative elements relating to risk management and internal control systems and functions. It requires “an insurer to have, as part of its overall corporate governance framework, effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters and internal audit”. Its guidance provides special considerations for insurers within groups, such as groups having and implementing group-wide governance policies for their subsidiaries.<sup>11</sup>
6. In addition to ICPs 7 and 8, other ICPs relevant to approaches to group corporate governance include ICP 23<sup>12</sup>, which deals with the scope of and supervision of groups, and ICP 25, which deals with supervisory cooperation and coordination.<sup>13</sup>
7. ComFrame builds upon the ICPs and elaborates on the requirements and guidance currently set out in the ICPs, which generally apply on both a legal entity and group-wide level, to IAIGs. As sound governance of IAIGs is a key element of ComFrame, ComFrame expands on the ICP requirements to such groups in a comprehensive manner, covering both qualitative and quantitative measures that are needed to address risks to sound and prudent governance arising within group structures.

## **2. The Corporate governance framework, structures and models**

### **2.1. Governance approaches and organizational structures**

8. The corporate governance framework is intended to effectively support and enhance the ability of key players (Board, Senior Management and Control Functions) to manage the business of the insurance group soundly and prudently. It can be organized through using varying governance approaches. The elements which generally determine the way in which the corporate governance framework within an insurance group is arranged, are:
  - a) the degree of authority or autonomy given to the group level of the insurance group and to different entities within the group;
  - b) the allocation of responsibilities and accountabilities of key players within the insurance group;
  - c) the functions at different levels of the insurance group, and their relationship to each other and to the group.
9. The governance approaches should be differentiated from the "organizational structure"<sup>14</sup> of a company or insurance group. The latter is not the subject of this Issues Paper. Insurance groups can use different organizational structures: one insurance group may choose to organize itself as stock or shareholder company, whilst others may choose mutual or other forms of incorporation or

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<sup>11</sup> See ICP 8, Introductory Guidance 8.0.8.

<sup>12</sup> ICP 23 is undergoing revisions during the drafting of this Issues Paper.

<sup>13</sup> There may be other parts of the ICPs which are relevant. Therefore, the parts referred to here should not be considered as necessarily comprehensive.

<sup>14</sup> The term "organizational structure" is used in this Issues Paper to cover the various terms used in the ICPs. ICP 4, Standard 4.3 uses the terms "corporate or group structure" and ICP 8, Introductory Guidance 8.0.8 uses "organizational or operational structures" (referred to here as "management structures").

association. In doing so, insurance groups may choose to have a simple structure (i.e. only a parent and a subsidiary) or to arrange a very complex structure with a holding company and many subsidiaries and business lines. Another organizational choice is to adopt a centralized or decentralized structure. The level within insurance groups at which governance is organised and by whom decisions are made may differ between groups depending upon the structures adopted. It is, however, vital for the insurance group to have an effective corporate governance framework.

## **2.2. Focus on governance within centralized and decentralized models**

10. This Issues Paper analyses how good governance can be ensured when an insurance group pursues a more centralized model or a more decentralized model. For the purposes of this Issues Paper approaches to group governance within insurance groups are only characterized as being either more centralized (a "top-down" model) or as more decentralized (a "bottom-up" model). In practice few insurance groups will adopt in their entirety a purely centralized or a purely decentralized model and will, in practice, follow a hybrid approach somewhere between the two extremes. Sometimes both more centralized and more decentralized approaches are used within an insurance group. However, the two extremes provide a useful basis to illustrate these approaches and to analyse the governance challenges faced by insurance groups.
11. The assessment of the centralized or decentralized character of the insurance group is based on judgment of the characteristics of the group. The main characteristic of the more **centralized approach** is that there is more comprehensive authority available to the Board and Senior Management at the group level<sup>15</sup>. It could be expected that there is more comprehensive direction by the group level of the insurance group, including centrally set overall business objectives of the insurance group; strategies to achieve those objectives and common policies and procedures. This allows for the development of a common and consistent approach across the insurance group. Consistency within the insurance group could be further enhanced by a group risk appetite; a common risk and compliance culture; and centralized control functions at the group level of the insurance group.<sup>16</sup> A variation of a centralized model is where a group sets its overall objectives and strategies at the group level but individual entities are given considerable latitude about how those are put into practice.
12. Within a more **decentralized approach** greater autonomy and authority will rest with the Boards and Senior Management at the entity level. It could be expected that there is more comprehensive direction at entity level, including the setting of business objectives of the entity; strategies to achieve those objectives and policies and procedures at the entity level. This allows for setting appropriate business objectives and strategies that take full account of the relevant business needs of entities and therefore would be able to respond quickly to changes in local conditions. Alignment with the local perspective would be further enhanced by setting the risk appetite, and risk and compliance culture at the entity level and by having extensive responsibilities for control functions of entities. Decentralization at the extreme would be where group-wide objectives and strategies are little more than an amalgamation of the objectives and strategies of the individual entities within the group.

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<sup>15</sup> The term "group level" means that the roles and key players of the group will be centralized somewhere within the group. Therefore the term "group level" does not necessarily mean the legal entity at the level of the head of the group. Especially group control functions could be placed within an entity anywhere else in the group.

<sup>16</sup> A centralized approach does not presuppose that the central level of the group has been granted full control over each entity within the group.

13. However, as noted before in paragraph 10, many varieties between the completely top-down and bottom-up models exist. The degree of centralization or decentralization of or within a group will be affected by factors such as the jurisdictions in which the entities are located<sup>17</sup>, the business model of the group,<sup>18</sup> the homogeneity of the group, as well as the individual expertise available at the respective levels, particularly among Board members, Senior Management and Key Persons in Control Functions. As these factors can be highly variable in practice, it is unlikely that purely centralized or purely decentralized models would exist in practice. As a consequence, groups adopt hybrid structures between the spectrum of pure centralization and pure decentralization.
14. Most organizational structures can accommodate both models. For example, an insurance group using the cooperative or mutual structure could have a centralized or decentralized approach to its governance. However, when branches are set up within an insurance group, this will usually be done with the aim to have a more centralized approach. Branches are legally not separate entities and critical governance and oversight functions of the branch are generally located in the head office. Although in general the representative of a branch in a host jurisdiction will perform management functions and/or represents the insurer with regard to the branch's operations, generally the representative will not have the same legal obligations as those of the Board Members in terms of governance.<sup>19</sup> Most jurisdictions do not require a branch to have its own Board because a branch is not a legal entity.<sup>20</sup>
15. This Issues Paper is based on the premise that regardless of the particular model an insurance group adopts, good governance is achievable, provided the challenges or risks to good governance arising from the particular model used are effectively addressed. This is in alignment with the ICPs, which provide guidance for insurers within groups<sup>21</sup>, but do not include specific governance requirements relating to the structure of groups. No specific model is therefore prescribed. ComFrame, like the ICPs, is not intended to require a specific model of governance within an IAIG. It explicitly states that "IAIGs do not have purely centralized or decentralized structures and ComFrame does not favour any particular structure but sets out outcomes to be achieved".<sup>22</sup> ComFrame expects that an IAIG's governing body will have some degree of oversight of the group as a whole and will have in place group-wide objectives, strategies and policies that it will be able to monitor and enforce. How these outcomes are achieved in practice will depend on the approach to governance used by the IAIG.
16. Therefore, this Issues Paper should not be read as advocating any preference for a specific model. Instead, the analysis undertaken is designed to identify how, within the possible variables that can prevail in these models, good governance standards can be effectively achieved. This recognizes that each model has not only benefits, but also its own challenges and risks.

### **2.3. Legal structures and management structures**

17. This Issues Paper presupposes that an insurance group<sup>23</sup> will be composed of a number of entities. These will each have a separate legal personality and may take different forms as allowed for by the legal requirements of the jurisdiction(s) in which they operate. References throughout the paper to governance arrangements

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<sup>17</sup> E.g. in some jurisdictions, groups have limited authority over subsidiaries.

<sup>18</sup> E.g. insurance only or mixed financial group; life insurance and/or non-life insurance; and geographical spread.

<sup>19</sup> See Issues Paper on supervision on cross-border operations through branches, October 2013, para 34.

<sup>20</sup> IAIS Issues Paper on supervision of cross-border operations through branches (October 2013), par 33-35.

<sup>21</sup> See ICP 7, Introductory Guidance 7.0.3, and ICP 8, Introductory Guidance 8.0.8.

<sup>22</sup> Cornerstones of ComFrame, section 5.

<sup>23</sup> See definition of "group" in section 2.

(including to the role of Boards and Control Functions) will be to the arrangements within entities. In many cases insurance groups will consist of both regulated insurance entities and unregulated entities (such as claims handling and policy administration companies) and we would expect that the governance arrangements of the insurance group will extend to these entities.<sup>24</sup> Supervisors will generally focus their work at the entity level. However, many insurance groups will have some management activities undertaken by business unit/area or line of business. Such management structures may cut across entity boundaries. It is important that both insurance groups and their supervisors are aware of the risks that might arise from any division of authority between entity and business line management and that insurers ensure that such risks are adequately mitigated.<sup>25</sup>

### **3. Key characteristics relevant to good governance in more centralized and more decentralized groups**

18. This section first describes the role of effective checks and balances in the corporate governance framework of an individual entity and the key players that perform these roles. It goes on to describe the application of the model of an individual entity in the context of a group, in order to identify some key characteristics for good governance of groups. Finally this section provides several examples of how groups can be organised in a more centralized or more decentralized way.

#### **3.1. Roles and key players within the corporate governance of an entity**

19. Governance refers to systems through which an entity is managed and controlled. Such systems enable the insurer to be flexible and transparent; to take appropriate and timely decisions and to ensure that powers are not unduly concentrated.<sup>26</sup> To that end, the systems provide for checks and balances within an *individual entity*, which are achieved by a division of roles. There are four main *roles* which should be appropriately separated:<sup>27</sup> strategy and direction (setting and implementing of objectives and strategies for achieving those objectives, risk appetite and general policy); oversight (supervising Senior Management); day-to-day management (including setting and implementing policies and procedures); and independent controls (risk management, other control functions and internal audit). It is recognized that while there may be various degrees of separation and/or cooperation among the

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<sup>24</sup> Joint Forum Principles for the supervision of financial conglomerates, Principle 10: Supervisors should seek to ensure that the financial conglomerate establishes a comprehensive and consistent governance framework across the group that addresses the sound governance of the financial conglomerate, including unregulated entities, without prejudice to the governance of individual entities in the group.

<sup>25</sup> See also ICP 8, Introductory Guidance 8.0.8: Groups may adopt different types of organisational or operational structures (referred to here as "management structures"), sometimes centralized, and sometimes decentralized. The supervisor should take the management structure of the group into consideration in evaluating its governance. Particularly when the management structure differs from the legal entity structure, it is not sufficient to address governance or risk only at the legal entity level. In such a case, it is important that appropriate governance exists across the group and that risks are being identified, assessed, monitored and managed appropriately also on a group-wide basis.

<sup>26</sup> ICP 7, Introductory Guidance 7.0.2: 'Corporate governance is often referred to as a system of "checks and balances". This recognises that an insurer has to be flexible and responsive to developments affecting its operations in making timely decisions, while at the same time being transparent and having appropriate systems, controls and limits to ensure that powers are not unduly concentrated and are used in the best interest of the insurer as a whole and its stakeholders.'

<sup>27</sup> ICP 7, Standard 7.2 and Guidance 7.2.1

different roles, there are certain key principles which underlie effective checks and balances to promote good governance.

20. Checks and balances are premised on the roles to be performed by different *key players*, particularly the Board as a whole, Senior Management, and Key Persons in Control Functions.<sup>28</sup> Within such a structure:

- a) the role of setting or ultimately approving the strategy and giving direction is allocated to the Board<sup>29</sup>;
- b) the role of oversight of the Senior Management to ensure that they carry out the day-to-day management of the insurer in accordance with the aforementioned objectives and strategies is also attributed to the Board,<sup>30</sup>
- c) day-to-day management of the business is the role of Senior Management; and
- d) Control Functions perform the role of independent control. They have a number of different functions. In the case of the head of risk management, the role is to identify and then mitigate, remove or otherwise manage the risks to which the insurer is exposed. In the case of the head of compliance, the role is to monitor and address any gaps in compliance. In the case of internal audit, the role is to provide assurance that internal systems and controls operate as intended. The internal auditor has the additional responsibility of periodically auditing or reviewing other Control Functions. In the case of the actuary, the role is to provide assurances relating to the adequacy of provisioning.

21. In the diagram below the different roles and the interaction between those roles in an individual entity are shown.

**Blue arrow:** input (e.g. day-to-day management gives input to the Board for the strategy)

**Green arrow:** direction (e.g. the Board gives direction to Internal Audit function)

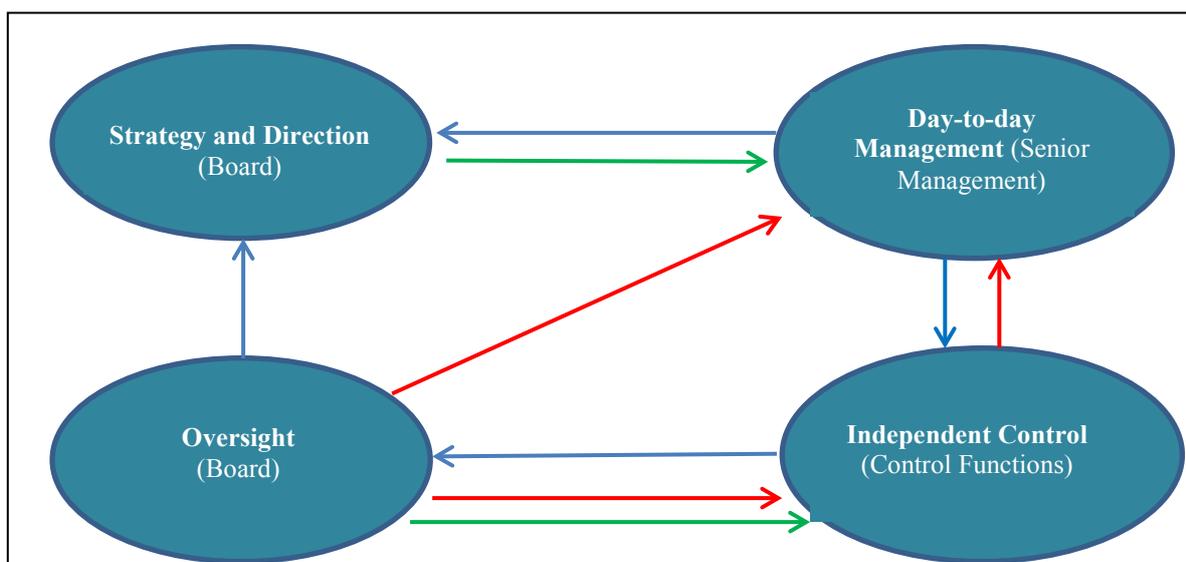
**Red arrow:** oversight / control (e.g. the Board oversees the day-to-day management and, the Control Functions provide control over the business).

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<sup>28</sup> ICP 7, Guidance 7.2.2 and ICP 8, Guidance 8.1.16.

<sup>29</sup> It is understood that local legislation, culture and practices differ with regard to governance of groups. Accordingly, the analyses and recommendations in the paper may need to be read in the context of local law, culture and procedures. For example, in some jurisdictions, Senior Management traditionally performs functions that the Board does in other jurisdictions.

<sup>30</sup> ICP 7



### 3.2. Checks and balances within a group

22. Group-wide governance not only involves governance at the group level, but also applies group-wide to all material activities and entities of the group.<sup>31</sup> A group may comprise many entities and organise its business through business lines. There can also be different business sectors within a group and the different entities may have different or even conflicting interests from the group level. This inherent complexity requires a balance of powers and a balance of interests at each level of the group.<sup>32</sup> The corporate governance framework should ensure that this balance is achieved. To achieve this aim, the four roles noted above and the division of responsibilities between the key players will have to be arranged at the group level as well as at the entity level in a manner that does not detract from the effectiveness of the relevant roles.<sup>33</sup>

23. Within a simplified centralized model, checks and balances that would need to be built into the group corporate governance framework would need to reflect the structure set out in the diagram below.

**Blue arrow:** input (e.g. Board at entity level give input to the Board at the group level on strategy and direction)

**Green arrow:** direction (e.g. the Board at the group level gives direction to the Board at entity level)

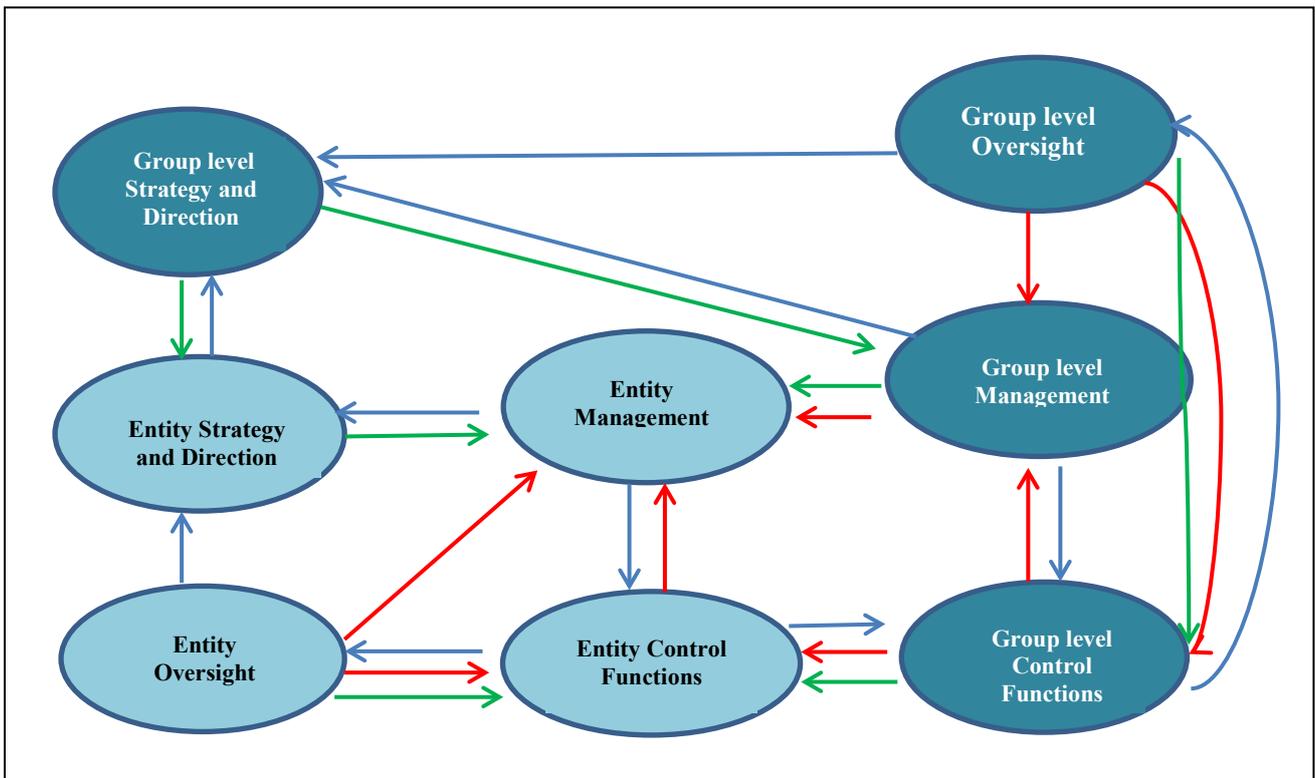
**Red arrow:** oversight / control (e.g. group Control Functions<sup>34</sup> oversee the entity Control Functions).

<sup>31</sup> Joint Forum Principles for the supervision of financial conglomerates: Explanatory comment 10.3.

<sup>32</sup> ICP 7, Introductory Guidance 7.0.8

<sup>33</sup> See also De Vuyst, Internal Governance bij financiële conglomeraten, para. 927.

<sup>34</sup> As mentioned in the definition of 'group level' on page 4, the Group Control Functions are not necessarily placed at the head of the group.



24. However, in practice the organizational structure of a group, and therefore the corporate governance framework, can be more complex and contain variations due to a number of reasons:

- a) First, the diagram above is based on a simplified centralized model. As noted before, groups usually adopt hybrid structures, in which the allocation of roles and responsibilities, and therefore the degree of autonomy and authority at different levels could vary.
- b) Second, although group-wide policies and processes would be designed to achieve group-wide objectives and strategies, they may not align easily with all strategies and objectives, risks, market conditions and applicable laws <sup>35</sup> at the entity level. Therefore, the group corporate governance framework would need to have a group and local perspective.
- c) Third, groups can have complex matrix structures, especially in case of diversified businesses or when the legal structure is not aligned with the business units, product lines or geographic footprint.
- d) Last, a group can evolve over time due to factors such as mergers and restructuring, market developments, legal changes and the maturity of the group.

<sup>35</sup> See also Joint Forum Principles for the supervision of financial conglomerates: Explanatory comment 10.4: "In the event the local corporate governance requirements applicable to any particular material entity in the financial conglomerate are below the group standards, the more stringent group corporate governance standards should apply, except where this would lead to a violation of local law."

### 3.3. Key characteristics

25. While group models cannot be strictly defined, a set of key characteristics, which cover the roles and key players within a group as described above, can be identified as forming the essential elements to promote good governance within groups. When implementing these essential elements, the nature, scale and complexity of the group should be taken into account.
26. These are:
- a) setting group-wide objectives and strategies to achieve a coherent and common view across the group;
  - b) having clearly defined responsibilities and accountability at both group level and entity level, including oversight of Senior Management;
  - c) having comprehensive and well-coordinated policies and processes at the group and entity level, including standards for reporting, controls and performance;
  - d) risk management having the ability to act both flexibly and in a timely manner to manage risks and compliance being able to ensure adherence to the legal and regulatory obligations, including laws applicable at the group and entity level. Risk management and compliance should also have the ability to promote a sound risk<sup>36</sup> and compliance culture across the group. The culture across a group is determined by the 'tone at the top' at every level within the group. Conflicting cultures within a group may undermine the good governance of the group; and
  - e) Control Functions undertaking risk management -, compliance -, internal audit - and actuarial functions at the group and entity level, with appropriate authority and accountability to carry out their roles.
27. Effective communication and an adequate flow of information are necessary for all these key characteristics. Pressure on the corporate governance framework might arise from the need to react in a timely and flexible way to developments both at the group and entity level, while at the same time requiring the corporate governance framework to be transparent and contain appropriate systems, controls and limits. An adequate and timely flow of management information and communication top down and bottom up is therefore a prerequisite for the effectiveness of the roles and responsibilities identified in paragraphs 19 and 20.<sup>37</sup>
28. To fulfil their respective roles Board Members, Senior Management, and Key Persons in Control Functions should have sufficient competence and integrity.<sup>38</sup> The level of knowledge, skills and expertise should be commensurate with the governance structure.<sup>39</sup> This does not imply for example that in a certain model the Board at the group level or at the level of the entity could be less fit or proper, but only that different knowledge or expertise could be required at different levels. The fit and proper requirements should therefore be applied by the appropriate supervisor(s) to *all* key players at *all* levels. Therefore, although fitness and propriety are essential for good governance, it is not a key characteristic in relation to the discussion on centralized or decentralized models.

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<sup>36</sup> Guidance on the need and promotion of risk culture can be found in the FSB consultative paper '[Guidance on Supervisory Interaction with Financial Institutions on Risk Culture](#)' (18 November 2013) and the report of the G30, 'A new paradigm' (October 2013).

<sup>37</sup> ICP 8, Introductory Guidance 8.0.9: To facilitate informed decision-making within a group, it is important that material information is delivered to all relevant Boards and Senior Management in a timely manner on a group-wide basis as well as on a legal entity or line of business basis.

<sup>38</sup> ICP 5. See also ICP 7, Standard 7.3 and ICP 8, Guidance 8.2.20.

<sup>39</sup> ICP 7, Standard 7.3.

### **3.4. Industry practice relating to governance models**

Examples of group models from insurers worldwide are set out below to illustrate the differences between models with varying degrees of centralization of control and management. These examples, while not exact replications of a model adopted by a particular insurer, are designed to reflect the practices among groups, and focus on the challenges and risks arising within such structures as discussed above. There are many variations and many more models than are described below, thus these examples should therefore not be considered as exhaustive.

#### **Example 1: more decentralized model**

**An insurer/reinsurer group with subsidiaries in over 20 countries, with reinsurance operations throughout the world of \$35 billion in annual premiums in auto insurance, personal property insurance and in many commercial lines for small, medium and large companies.**

At the group level, there is a Board and management, which have the task of looking at the enterprise as a whole. The CEO is the Board chairman and the majority of the Board members at the group level are independent. The Board at the group level has a Compensation Committee, an Investment Committee, an Audit Committee, a Risk Committee and a Nominations and Governance Committee. The group manages its business through "strategic business units", depending on the line of insurance being written. There are several legal entities under each strategic business unit and they are the conduits for providing coverage and related services subject to local law. Overall, each strategic business unit has what it needs to operate on its own with its centralized oversight, subject to group-wide oversight. Investments are managed centrally by the group through a separate unit.

There is a corporate actuary primarily responsible for setting reserves for run-off business and for coordinating actuaries throughout the group. Each of the strategic business unit has its own actuarial function responsible for setting reserves and pricing for all entities under the unit. Each strategic unit actuary reports quarterly to the actuary at the group level. There are compliance officers in the strategic business units and corporate compliance officers that provide service to entities. The internal audit function is also performed by unit auditors and they report up to the group's head of internal audit, not to operations managers.

In conclusion, this group operates primarily through its strategic business units subject to overall guidance from the Board and management at the group level. Investments are an exception because they are managed separately. The critical Control Functions all exist but are also largely managed at the strategic business unit level with reporting up to the head of the function at the group level.

#### **Example 2: collaborative model – in between centralized and decentralized**

**Small workers compensation insurer (less than \$50 million in annual premium) that is a wholly owned subsidiary of a large Group**

The subsidiary has its own Board of Directors largely made up of officers of the holding company. The subsidiary is responsible for its "front line" compliance, including compliance with all the applicable governance standards. However, it is subject to the group's global compliance policies. Accordingly, it has its own Control Functions, Compliance Committee and CFO. However, the (external) audit function is performed by a firm that is retained by the group. The system is described as "collaborative" between the group and the subsidiary.

The holding company states that it has a Board with the necessary independent directors. The Board Chairman and CEO jointly set the agenda, style and tone of the Board

discussions and make sure that Board members have the information they need to effectively make informed decisions. The Board has an audit committee, a nominating/governance committee and a compensation committee.

The governance guidelines for the group state that each “principal operating units is organized under an independent legal entity with its own Board of directors and governance structures... [the holding company] delegates to each operating unit sufficient authority to practice decentralized management and respects the autonomous structure thereof, subject to appropriate monitoring and oversight by the Subsidiary Board, the Board of the Holding company and management.” Further, the subsidiaries are to adopt appropriate policies and procedures for governance (including an active Audit Committee and Compensation Committee) and to submit for prior approval by the group its five-year plan, Senior Management and compensation. The CEO of the subsidiary must meet with the Board of Directors at the group level at least annually and the CEO at the group level must report annually to the Board of Directors at the group level on the composition and performance of subsidiary Boards.

### ***Example 3: more centralized model***

***Global primary insurer and reinsurer with significant operations throughout the world. It has total annual premiums in excess of \$14 billion.***

At the group level, the Board of Directors has an Investment Committee, a Risk and Capital Committee, a Remuneration Committee, an Audit Committee and an Executive Committee composed of a majority of non-executive directors. The group has a Chief Risk Officer, Chief Actuary, and a general counsel and head of compliance who deal with group compliance issues, and internal and external audit functions at the group level. The Board structure including committees, officers and functions are duplicated at the holding company level. So, for example, each holding company has a Chief Risk Officer, a Chief Legal Officer who may be responsible for compliance, a Chief Actuary and external and internal audit functions.

Effective control by the group is maintained in several ways. First, a director at the group level usually sits on each holding company Board. Second, each of the critical functions exists at both the group and holding company level and the compliance function at the group level assures compliance with group policies. At the same time, because each holding company has the full panoply of officers and functions, full compliance with local regulation is also assured. The head of function at the group level, for example the Chief Risk Officer at the group level, meets periodically with the holding company Chief Risk Officer and provides over-all supervision. The same is true for the heads of other functions. Third, there is regular reporting up and down in functional areas.

### ***Example 4: more decentralized conglomerate with a more centralized insurer holding company***

***Within a larger conglomerate there is a global reinsurer and its holding company. The reinsurer collects about \$2 billion annually in premiums.***

The insurance holding company is part of a conglomerate. At the top of the conglomerate is an entity that exists primarily to set financial targets and does not engage in insurance or reinsurance operations. The insurance holding company is allowed to manage its affairs subject to meeting its financial targets.

The insurance holding company has a Board of Directors that includes some independent directors, along with officers of the conglomerate. The holding company has a Compensation Committee and an Audit Committee which are composed solely of independent directors. The Audit Committee meets frequently and hears reports from the outside independent auditor, the Chief Risk Officer, the internal audit department, among

others. The holding company reports up to the conglomerate, which has its own Audit Committee.

The reinsurer has a Board of Directors composed of the CEO, CFO and the CRO function, which mostly functions by writing and unanimous consent. It has a CEO, CFO, CRO, internal audit function and the General Counsel and CRO, who are responsible for compliance. The reinsurer has designated the holding company's Audit Committee as its own and the top management of the reinsurer also serves on the holding company's Audit Committee. The CFO of the reinsurer is the financial controller of the holding company. Each of the other subsidiaries has its own Board of Directors made up of executives.

Under this example, the structures in the holding company and reinsurer reflect each other and are very comprehensive. Control is assured by officers serving in key positions in both the holding company and reinsurer and by continuous reporting.

### ***Example 5: more centralized insurer***

***Insurer has annual premium exceeding \$30 billion and subsidiaries and branches of various levels of importance in multiple regions around the world.***

The holding company of this group has a 100% independent Board of Directors with no management or executive members on it. The Chairman and CEO positions by definition are fully separate. The Board of Directors has active audit, risk, remuneration and other committees to help it carry out its work effectively and provide oversight of the entire group. The heads of the Control Functions (including Internal Audit, Risk Management, and Compliance) of the group report independently to the relevant committees of the Board of Directors and such functions have group-wide authorities and responsibilities. The management of the group is done through a separate Executive Board led by the CEO at the group level and comprising the most senior executives at the group level. This Board is also subject to certain internal governance rules, including on it makes decision as a body.

The top subsidiaries of the group also have independent Board of Directors members, though the Boards of Directors of most other subsidiaries are occupied by members of management from within the group. However, even at the entity level there are Control Functions that also report in most cases to these various Boards of Directors and help provide checks-and-balances.

The group would not define itself as "centralized" but as having the needed degree of central leadership, policies, processes and controls for the group to be effective and for group-wide interests to be appropriately pursued, all while allowing subsidiaries to be close to their markets, to innovate and to make decisions consistent with the needs of those markets.

### ***Example 6: hybrid mutual group***

***Mutual group, consisting of two central parallel mutuals (one for life and one for non-life insurance) and a network of 19 more (regional) non-life mutuals. The group is almost exclusively active in its home market and writes a premium volume of approximately \$2 billion.***

This is a hybrid insofar as the basis of its group treatment under current national legislation is based on:

- the identity of the Management Board of the two central parallel mutuals;
- the ownership by the central non-life mutual of the guarantee capital of all other group mutuals; and

- contractual relationships within the group on centralized services, on branding and marketing, the development of products and, importantly, an agreement on financial stability with the aim of meeting solvency requirements and targets for the whole group.

The central life and non-life mutuals have identical Management Boards, called "the group Board". In these two, a two-tier system is in place; the respective Supervisory Boards are different as they are elected by the annual general meetings of policy-holder members of the individual mutuals. In line with current and future requirements, the non-life mutual is seen as the "head" of the group. In addition to the identity of the Management Board, tight coordination is secured through the creation of a "Cooperation Committee of the Supervisory Boards" consisting of the chairs and their deputies of the Supervisory Boards. Their coordinating role is defined in the articles of each mutual.

The Cooperation Committee has set up an audit and a remuneration committee to assist the Coordination Committee in its coordination and controlling duties. The legislation in the jurisdiction of the head of the group requires a "responsible actuary" in every single undertaking. The life mutual has its own in-house actuarial function while the non-life mutuals have a joint function (in the central non-life mutual) with responsible actuaries from that function appointed to each of the non-life mutuals. The risk management and compliance functions for life and non-life activities are centralized in joint independent units, providing services for all companies in the group.

At the regional level, there are 19 non-life mutuals underwriting only retail, non-obligatory (i.e. not motor third party liability, not workers' compensation) insurance. The roll-out of the group model of the existing mutual group to include these is an ongoing project and not all details and practises are yet defined. Representatives from the group "head" may be sent to sit on the regional mutuals' Boards, but this option may be reserved for exceptional circumstances only. The central non-life mutual holds guarantee capital in all other mutuals of the group. In addition to the coordination role of the governance structures and the bond created through the signing of guarantee capital by the central non-life mutual (the "head" of the group), there exist the contractual relationships as described.

#### **4. How challenges to good governance and control within groups can be addressed**

29. The analysis and industry examples set out above highlight that there are no easily definable models of governance and control within groups. As noted in paragraph 24, different groups adopt models with divergent levels of centralization and decentralization, based on their own business objectives and needs, such as centres of excellence/expertise (e.g. risk management) or product lines (as in the case of industry Example 1). This section explores how good governance and control can be achieved, regardless of the differences in the models adopted.
30. In order to achieve good governance and control within groups, the challenges that can arise within group models need to be properly identified and addressed. In a more centralized approach there is more comprehensive authority at the group level, while in a decentralized approach the entities have more autonomy. From a group perspective the challenges of each approach therefore differ. First this section identifies the challenges for a more centralized model and a more decentralized model. After identifying the challenges, this section then goes on to describe from a group perspective the essential elements of good governance for each key characteristic of governance identified under paragraphs 25 and 26, and to identify practices which could be used to address the challenges for each model in respect of

these key characteristics. There are many variations of hybrid models, thus the practices mentioned below should therefore not be considered as exhaustive. Besides the principle of proportionality could be taken into account when taking measures to address the identified challenges.

#### **4.1 Challenges in a more centralized and in a more decentralized group**

31. From a group perspective a more centralized approach could contribute to a common and consistent approach at the group level. This could better facilitate alignment with centrally set objectives, strategies, policies and to enable timely response to risks at the group level. For example, more centralized risk management has the potential advantage of aggregation and analysis of data at the group level, enabling effective assessment and mitigation of risks across the group. This could contribute to consistency of risk management at the group level and to flexible and timely reaction to risks at the group level. More centralized Control Functions may also have economies of scale that will enable them to be undertaken more efficiently.
32. However, such a more centralized approach relies on there being comprehensive authority and control at the group level; sufficient regard of local obligations and risks; and strong lines of communication. This raises the following challenges (per key characteristic) for group-wide governance from a group perspective:

##### *Group-wide objectives and strategies*

- a) to ensure alignment of centrally set objectives, policies or measures with local requirements, circumstances or cultural aspects;

##### *Clearly defined responsibilities and accountability key players, including oversight*

- b) to have clear allocation of responsibilities and accountability of the management body of the entities vis-à-vis group management;
- c) to ensure effective oversight of Senior Management in individual entities;

##### *Comprehensive and well-coordinated policies and processes*

- d) to ensure effective implementation of group-wide policies and the common approach of the group by all entities;

##### *Control functions*

- e) to ascertain by Control Functions at the group level the extent to which the common approach of the group is being followed in practice. For example, it may be difficult for the compliance function at the group level to monitor and enforce locally compliance of entities with centrally set policies or requirements. Or it could be difficult for the risk management function to ensure a common risk culture or consistency of risk management;
- f) Limited authority and ability of Control Functions at entity level to take responsibility for issues at the group level. This could affect implementation or compliance at the entity level;

##### *Risk management and Compliance*

- g) to ensure risk tolerance levels of the group take into account the risk tolerance capacity of entities within the group. Entities may have different risk tolerance capacity depending on factors such as the line of business and the locality of their operations;

- h) to ensure the risk culture at the group level sets effectively the example for all levels in the group;
- i) to ensure effective implementation of group governance requirements by all entities;
- j) to ensure the compliance culture at the group level sets effectively the example for all levels in the group;

*Communication and information*

- k) to effectively communicate the common approach (e.g. centrally set objectives, strategies, risk culture and policies) in a timely manner across the group and to ensure that these are understood at the entity level;
- l) to obtain information in a timely manner on a group-wide basis as well as on an entity basis<sup>40</sup> and to respond in a timely manner to this information. Within a centralized approach the challenge could be to take into account the problems and risks at entity level when setting group objectives or policies, because reporting lines are longer and more complex. Decision making within groups requires a flow of material information to and from all Boards and to Senior Management within entities in the group. If this is not ensured, problems and concerns at entity level could not be relayed to the group level in time for it to react quickly or effectively to opportunities and threats that emerge at entity level. Timely information is also a necessary requirement for Control Functions at each level of a group to fulfil their responsibilities effectively.

33. In a group that adopts a **more decentralized approach** from a group perspective a more decentralized approach could contribute to clear responsibility and accountability and shorter reporting lines at the entity level. This could better facilitate compliance with local regulatory requirements and changes and enable timely response to market changes and opportunities at entity level. For example, prime responsibility of the Control Functions at the entity level enables them to focus on (and put in place mitigating actions for) those issues and risks that might impact on the entity. This could contribute to aligning risk management better with the risks arising at the entity level, thereby enabling the entity to react flexibly and in a timely manner to such risks. A more decentralized approach may also facilitate oversight over Senior Management of the entity, as the prime responsibility would lie with the management body of the entity.
34. However, to achieve group-wide objectives and to manage risks at the group level a certain degree of group-wide coordination and consistency is required. Therefore a decentralized approach raises the following challenges (per key characteristic) for group-wide governance from a group perspective:

*Group-wide objectives and strategies*

- a) to ensure that the objectives and strategies (including risk appetite) set at entity level are effective from a group-wide perspective. Different entities of the group may pursue strategies that conflict with the overall group requirements;

*Clearly defined responsibilities and accountability key players, including oversight*

- b) to have clear allocation of responsibility and accountability at the group level;
- c) to coordinate the accountability of the entities;
- d) to coordinate the oversight of Senior management of the entities;

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<sup>40</sup> ICP 8 Introductory Guidance 8.0.9.

*Comprehensive and well-coordinated policies and processes*

- e) to coordinate effective implementation of group-wide policies and to ensure a common approach of the group by all entities;

*Control functions*

- f) to ensure that the Control Functions at entity level are sufficiently independent from the business of the entities;
- g) to ascertain by Control Functions at the group level the extent to which the common approach of the group is being followed in practice. For example, it may be difficult for the compliance function at the group level to monitor and enforce locally compliance of entities with centrally set policies or requirements. Or it could be difficult for the risk management function to ensure a common risk culture or consistency of risk management;

*Risk management and Compliance*

- h) to ensure risks are treated consistently across the group and that the group-wide risks are properly identified, aggregated and mitigated. Policies and processes of entities may not be aligned with centrally set policies and processes at the group level, which could create operational problems (e.g. IT problems) or a lack of overview at the group level. Risk tolerance levels of entities may not be consistent with the risk tolerance capacity of the group;
- i) to ensure a group-wide consistent risk culture in all entities and an adequate group oversight of compliance obligations;
- j) to ensure an adequate group oversight of compliance obligations;
- k) to ensure a group-wide consistent compliance culture in all entities;

*Communication and information*

- l) to adopt, communicate and implement group-wide policies and to ensure communication to the group level of issues at entity level which may impact on the group as a whole; and
- m) to obtain information on entities in a timely manner which may impact on the group as a whole. In a decentralized model the challenge could be to aggregate all data of the entities and to get an adequate overview of all issues and risks which have to be dealt with at the group level. This could mean that problems and concerns at entity level are not relayed to the centre in time for it to react quickly to opportunities and threats that emerge at entity level.

35. From the paragraphs above it can be concluded that, although the challenges from a group perspective all relate to potential conflicts between group-wide and entity level interests, the focus of the challenges of each approach differ. In a centralized model, the focus of the challenges is the balance which needs to be struck between effective direction at the group level on the one hand and sufficient regard for local obligations, risks and circumstances on the other. In a decentralized model sufficient information and authority for group key players and autonomy for the key players at entity level are needed to achieve good governance. In a more decentralized group the focus of the challenges is on the implementation of group governance requirements and the coordination of the objectives and policies of the entities to ensure that the entities and their key players take sufficiently into account the group perspective, without which there might be a risk of entities pursuing separate and incompatible goals and taking risks that the group would find unacceptable. Therefore to achieve effective governance within such a group, sufficient coordination and oversight from the group level and adequate information flows are needed.

36. The challenges for both more centralized and more decentralized models described above stem mainly from the following four factors:
1. division of authority and responsibilities of key players at the group and entity level;
  2. effective group-wide direction and coordination;
  3. proper consideration of both entity and group perspective;
  4. effective communication within the group and availability of adequate information at all levels.
37. These four factors are thus also relevant for the measures which could address the identified challenges. To identify these, this paper focusses on each key characteristic of governance set out in paragraphs 25 and 26 above. For each key characteristic it is explained which elements are essential for a good governance structure. The paper also provides examples of practices which could address the likely challenges.
38. Although they are considered separately, it should be noted that the key characteristics have to be considered as integrated and interactive elements that underpin the group corporate governance framework as a whole. For example, a more decentralized group may use mechanisms to strengthen other governance elements (e.g. board, control functions, or reporting requirements) to address risks to effective group-wide governance arising from the autonomy of management at the entity level. Such a holistic view also helps solve the challenges arising within particular models. As the degree of centralization and decentralization varies, a case-by-case analysis of the effectiveness of the checks and balances of the governance framework is necessary. This also implies that there are varying solutions to different models.

#### **4.2. *Setting objectives and strategies for achieving those objectives of the group (including setting risk appetite)***

39. The establishment of specific objectives and strategies for achieving those objectives across the group is a responsibility of the Board.<sup>41</sup> These objectives and strategies should be adequately documented and properly communicated to Senior Management and Control Functions at all levels of the group. Setting the risk appetite and risk tolerance limits for the group is an integral part of developing the group's business objectives and strategies for achieving those objectives.
40. Regardless of whether a centralized or decentralized approach is used, a good governance framework would include elements which promote:
- a) to the greatest extent possible, clearly and centrally set overall business objectives and strategies (reflecting the group's risk appetite and risk tolerance levels). This recognizes that every group is set up with specific business objectives and generally to gain advantages of synergy and economies of scale arising within groups, even in more decentralized groups. To do so, they need overall group-wide objectives and strategies, even if they are set at a more general and less detailed level than in a more centralized model. The objectives and strategies may be set for different lines of business or geographic locations/divisions within the group, or across the whole group, as appropriate to the manner in which the governance and control of the group is structured;

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<sup>41</sup> As stated previously, in some jurisdictions senior management may be involved in setting the strategy and objectives.

- b) proper alignment between the group-wide objectives and strategies and the objectives and strategies of individual entities or business lines within the group;
- c) clear allocation of responsibilities and clear accountability at all levels regarding the setting and implementation of the strategy and objectives;
- d) the ability and accountability at the group level to identify and address any conflicting objectives and strategies between group-wide objectives and strategies and those at the entity level. Such measures may include removing those conflicts or providing mechanisms for mitigating the adverse impact of such conflicts;
- e) effective and close communication between the group level and individual entities in order to successfully implement the objectives and strategies, within parameters of risk appetite and risk tolerance levels applicable at the group level and/or at the entity level, as appropriate; and
- f) adequate information flows for setting the objectives and strategies, both at the group level and at entity level, including when setting risk appetite and risk tolerance levels, and for effective monitoring.

41. As explained above each group structure, whether it is more centralized or more decentralized, presents particular challenges in setting and implementing objectives and strategies. Measures to address these challenges apply equally when setting risk appetite and risk tolerance levels of the group for the purposes of setting its overall objectives and strategies.

42. Regardless of whether the model is more centralized or more decentralized, there are some common practices which could address the likely challenges arising in a group. These may enhance a group's ability to have well-coordinated and cohesive objectives and strategies for the group. These practices, arranged in the 4 categories mentioned above, include:

*Authority and responsibilities of key players group-wide*

- a) where the group adopts objectives and strategies along business lines or geographic locations/divisions, allocating to the relevant business units and their respective Senior Management the responsibilities and accountability for setting the objectives and strategies for specific products. Group-wide oversight could help to align of the objectives and strategies for specific products with the objectives and strategies adopted by the group.

*Group-wide direction and coordination*

- b) adequate representation of entities at the Board of the group level and representation of the group level at the Boards of (major) entities to enhance communication between the group level and the respective entities. This could enhance the knowledge of conditions, needs and requirements of each level are properly taken into account when setting and reviewing objectives and strategies; and
- c) A governance memorandum for the group could describe the group-wide objectives and strategies, and to the extent those differ from any entity specific objectives or strategies, such variations and the rationale.

*Consideration of both entity and group perspective*

- d) each entity submitting its long term and annual business plans for review or approval by the group to promote better alignment of the entity level business objectives and strategies with those at the group level.

#### *Communication and information*

- e) establishing effective channels of communication between risk officers at the group and entity level to exchange information to facilitate setting and monitoring the group and entity objectives and strategies, as well as their risk appetites.

### **4.3. *Appropriate allocation of oversight and management responsibilities***

- 43. Oversight of the Senior Management to ensure that they are carrying out the day-to-day management of the relevant entities is a key function of the Boards at both group and entity level. It is particularly important because the Senior Management has the primary executive responsibility in respect of risk, compliance and related areas.
- 44. Regardless whether a more centralized or more decentralized approach is used, a good governance structure would include elements which promote:
  - a) clear allocation of responsibilities and clear accountability at all levels;
  - b) effective oversight of the Senior Management of the entities by the respective Boards and the Board at the group level; and
  - c) satisfactory and timely communication and reporting across the group to ensure that all levels have the necessary information to fulfil their roles.
- 45. Regardless of whether the model is more centralized or more decentralized, there are some common practices which could address the likely challenges arising in a group. These practices, arranged in the 4 categories mentioned earlier, include:

#### *Authority and responsibilities of key players group-wide*

- a) clearly defining, allocating and documenting responsibilities and accountabilities at all levels. For this purpose, a *governance memorandum* could document the way the group is organised, managed and overseen; and the division of key tasks and responsibilities between the group and entity levels;
- b) requiring the composition of the Senior Management at entity level to be subject to prior approval by the Board at the group level; and
- c) within a decentralized group, it would be especially important to establish clear responsibilities at the Board at the group level with regard to monitoring and oversight of the entities. This would provide a balance against the higher degree of authority and autonomy of the Boards and Senior Management at the entity level.

#### *Group-wide direction and coordination*

- d) requiring the Board of the entity to indicate and document how its decisions and policies are related to group-wide decisions and policies;
- e) providing for direct access of the Board of the entity / group to the Board at the group / entity level; and
- f) (especially for decentralized models) providing an incentive for the Board of the entity to be more involved with the development and implementation of group policies, and to align policies at entity level with the group-wide policies.

#### *Consideration of both entity and group perspective*

- g) having representatives of the entities on the executive management committee at the group level to facilitate that interests and objectives of the entity are adequately taken into account at the group level. Or having representatives of the

group on the executive management committee at the entity level to ensure interests and objectives of the group are adequately taken into account at the entity level;

- h) having some common Board members at the group and entity level;
- i) having a sufficient number of independent Board members at entity level, so that they can take interests and objectives of the entity adequately into account at the entity level; and
- j) (especially for decentralized models) establishing a group role, with clear responsibility for providing oversight of the Senior Management of entities, subject to the overall guidance of the head of the group. For this purpose, each entity within the group could be required to submit to the group role its long term plans and proposed compensation arrangements for assessment as to whether they are consistent with the group-wide objectives and strategies.

#### *Communication and information*

- k) having a procedure for escalating issues arising at the entity level to the Board or audit or risk committee at the group level, including where there are conflicts of interest between group level and entity level;
- l) requiring regular reporting by the entities within the group to the Board at the group level, including annual meetings of the CEO of entities with the Board at the group level. This could facilitate proper communication and escalation of issues which arise at the entity level to the group level, thereby influencing the attention at the group level to such issues; and
- m) requiring annual reports of the CEO at the group level to the Board at the group level covering the composition and performance of entity level Boards.

#### **4.4. Policies and processes at the group and entity level**

- 46. Policies and procedures applicable to the Board, Senior Management, Control Functions and other staff are an important element of the internal controls system. Examples of such key policies and procedures are standards for reporting, policies and procedures for outsourcing and compensation policies. These policies and procedures have the aim of managing risks and contributing to the proper functioning of the group and the entities within the group.
- 47. Regardless whether a more centralized or more decentralized approach is used, a good governance structure would include elements which promote:
  - a) a group-wide approach in terms of policies and procedures;
  - b) effective and timely communication of policies and procedures group-wide;
  - c) effective implementation of group-wide policies and procedures at entity level; and
  - d) a proper alignment of group-wide policies and procedures with local circumstances and cultural aspects.
- 48. Regardless of whether the model is more centralized or more decentralized, there are some common practices which could address the likely challenges arising in a group. These practices, arranged to the 4 categories mentioned earlier, include:

#### *Authority and responsibilities of key players group-wide*

- a) Senior Management of the entities having specific responsibility (key performance measures built into their employment contracts) to ensure the implementation of group-wide policies and processes; and
- b) Control Functions, especially internal audit, at the entity level having the responsibility of supporting Senior Management at the group level in order to ensure the implementation of group-wide policies.

*Group-wide direction and coordination*

- c) having representatives of the entities on the executive management committee at the group level to ensure the implementation of group policies;
- d) compliance and audit at the group level reviewing whether policies of entities fit within group-wide policies and that the group-wide procedures are followed at entity level;
- e) entities adopting appropriate policies and procedures for governance (including an active audit committee and compensation committee) and submitting these for prior approval at the group level; and
- f) a person or a function being designated to support the advancement, coordination and/or management of the overall internal controls system on a more regular basis (the internal controls system manager).<sup>42</sup> This would help to achieve appropriate documented controls for the appropriate areas and at the appropriate levels, locally and on a group-wide basis.

*Consideration of both entity and group perspective*

- g) members of the audit committee at the group level also being members of the audit committees at entity level.

*Communication and information*

- h) internal audit staff at the group and entity level having regular exchanges of information with regard to new policies and monitoring results in order to achieve proper application and monitoring of the group-wide policies and processes;
- i) the internal audit function at entity level reporting jointly with audit at the group level to the audit committee or the Board at the group level;
- j) internal audit officers and compliance officers at entity level having the responsibility to identify relevant group decisions and practices that impact on the entity and to report these to the Board of the entity;
- k) having a regular line of communication below Board level between group level and entity management and Control Functions to achieve mutual understanding and good working relationships to facilitate understanding of the risks faced at different levels; and
- l) an external auditor assessing the effectiveness of the policies and procedures, and reporting on major findings to the Board or audit committee at both the group and the entity level (including to the external auditor at the group level).

## **4.5. Risk management and compliance**

49. Management of risks (including compliance risks) at the group level as well as at the entity level is key to effective control and proper management of every group. Group-wide risks may affect entities within a group, while risks at entity level could also have

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<sup>42</sup> ICP 8 Guidance 8.2.7

ramifications for the risk profile of the group as a whole, and (some or all) other entities within the group.

50. All groups, whether more centralized or more decentralized, are required to comply with both local laws and regulations while also meeting the requirements applicable to groups. For this purpose, amongst other things, they need to promote a strong compliance culture at all levels.
51. Regardless of whether a more centralized or more decentralized approach is used, a good governance structure would include elements which promote:
- a) a common risk and compliance culture across the group;
  - b) effective assessment and consistent management of risks across the group;
  - c) timely reporting to group level to ensure good overview of risks;
  - d) availability of adequate aggregated information about all risks at the group level;
  - e) timely reaction to risks at the group and entity level;
  - f) local circumstances and requirements being taken into account at the group level; and
  - g) adequate communication of risk management and compliance approach within the group.
52. Regardless of whether the model is more centralized or more decentralized, there are some common practices which could address the likely challenges arising in a group. These practices, arranged to the 4 categories mentioned earlier, include:

*Authority and responsibilities of key players group-wide*

- a) clearly defining, allocating and documenting responsibilities and accountabilities at all levels.

*Group-wide direction and coordination*

- b) development and implementation of manuals setting out common risk management procedures across the group to promote consistency of risk management;
- c) having consistent policies and oversight procedures so that a better overview and quicker identification of risks arising at entity level can be made to address them adequately;
- d) ensuring representation of the head of the group on entity risk committees to promote better alignment with the group-wide risk management and compliance; and
- e) ensuring that compliance personnel at the group level are members of entity compliance oversight committees or their equivalent to contribute to developing a common compliance culture and adequate group compliance.

*Consideration of both entity and group perspective*

- f) Having representatives of the entities on the risk and compliance committee at the group level to take risk and compliance issues at entity level adequately into account at the group level.

*Communication and information*

- g) setting clear reporting requirements to report locally identified risks (including compliance risks) in a timely and comprehensive way at the group level;

- h) providing for a CRO or other person at entity level, who is responsible for regularly reporting the CRO at the group level;
- i) on-going reporting by Control Functions at entity level to Control Functions at the group level to make it possible for the head of the group to identify risks emerging at entity level in a timely manner;
- j) representation of risk officers at the group level at risk committees of entities to contribute to effective communication of the group risk approach to entities; and
- k) ensuring that compliance personnel at the group level are members of entity compliance oversight committees or their equivalent to contribute to developing a common compliance culture and adequate group compliance.

#### **4.6. Control Functions – Risk Management, Compliance, Internal Audit, Actuarial**

53. Control Functions are essential for providing expertise, leadership, objectivity and independence with regard to the management of risks. Therefore, it is essential that all groups have in place robust Control Functions that are capable of identifying, aggregating and taking action to mitigate the risks faced by the group.

54. As noted before, the way in which groups choose to organise these functions vary according to the organizational structure of the group with some organisations adopting a more centralized and others a more decentralized approach. Regardless of whether a more centralized or more decentralized approach is used, a good governance structure would include elements which promote:

- a) the establishment of group level Control Functions (risk management, compliance, internal audit and actuarial functions) which are sufficiently strong so as to be able to properly identify and address risks that impact on the group as a whole;
- b) timely and adequate action being taken at all necessary levels;
- c) adequate monitoring of implementation of group-wide policies and actions;
- d) timely and accurate information flow within the group, bottom-up and top-down;
- e) effective communication of group objectives, strategies and policies to Control Functions of the entities or to entities; and
- f) a group-wide common risk and compliance culture.

55. Regardless of whether the model is more centralized or more decentralized, there are some common practices which could address the likely challenges arising in a group. These practices, arranged to the 4 categories mentioned earlier, include:

##### *Authority and responsibilities of key players group-wide*

- a) Control Functions at the group level having clear responsibility and authority to be able to undertake overall group-wide supervision;
- b) officers holding key positions at both group and entity level having clear lines of accountability to achieve effective control of the group and implementation of group-wide policies and strategies;

##### *Group-wide direction and coordination*

- c) Control Function at the group level having the responsibility for coordinating Control Functions across the group;

- d) Control Functions at entity level providing sufficient and timely information to the group Control Functions, to achieve group-wide objectives and to manage risks at the group level; and
- e) outsourcing activities of the entity Control Functions to the Control Functions at the group level.
- f) *Consideration of both entity and group perspective* having full panoply of officers and functions at entity level with sufficient authority to achieve that the Control Functions operate effectively at entity level. This could, for example, strengthen the position of the compliance functions at entity level to achieve effective compliance with local laws and safeguarding and achieving entity based interests;
- g) requiring the annual external audit to be conducted by an independent auditor approved or chosen by the head of the group to include an assessment whether the entity complies with the applicable group-wide policies;

#### *Communication and information*

- h) having regular periodic meetings between Control Functions at the group level and Control Functions at entity level to communicate group-wide objectives and policies easily and properly downwards and to inform Control Functions at the group level better so they can carry out their roles effectively;
- i) continuous reporting of Control Functions at entity level to Control Functions at the group level to help to ensure adequate and timely information at the group level (bottom-up), and to promote independence of Control Functions at entity levels; and
- j) Control Functions at the group level providing services and advice to entities and/or Control Functions at entity level, as it contributes to developing a common risk/compliance culture.

## **5. Supervisory review and cooperation**

56. ICP 25 provides that the group supervisor should put in place adequate coordination arrangements with other involved supervisors in order to facilitate the comprehensive oversight of individual entities within the group and the group as a whole. Coordination mechanisms might include supervisory colleges and memoranda of understandings between supervisors.

57. Adequate governance, including risk management and internal controls, should be in place within a group. ICP 8 requires that this should be assessed by the supervisor on a group-wide basis as well as on a legal entity basis so as to have a group-wide view and enhance the assessment of the entities.<sup>43</sup> Supervisors have to take into account the management structure of the group in evaluating the effectiveness of its governance. ICP 8 states:

*"Particularly when the management structure differs from the legal entity structure, it is not sufficient to address governance or risk only at the legal entity level. In such a case, it is important that appropriate governance exists across the group and that risks are being identified, assessed, monitored and managed appropriately also on a group-wide basis."*<sup>44</sup>

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<sup>43</sup> ICP 8 Introductory Guidance 8.0.7

<sup>44</sup> ICP 8 Introductory Guidance 8.0.8

58. As can be seen from the above analysis, both more centralized and more decentralized models of governance present challenges for the supervision of groups. Ensuring that Control Functions operate effectively within a group is a core concern for supervisors.
59. In a group with a **more centralized approach** to governance, a major concern that is likely to arise is whether the Control Functions at the entity level are effective. However, in more centralized groups, supervisors at the group level have a clear single point of contact for dealing with the issues linked to the group level. While a more centralized group has the benefit of common standards across the group, it would be a challenge for the supervisors to ascertain the extent to which these are being followed in practice at entity level. Supervisors of individual entities may also not be fully aware of group-wide issues and may not be able to assess the adherence by entities with group-wide standards.
60. In a group with a **more decentralized approach** to governance, a major concern that is likely to arise is whether there is effective assessment and control of group-wide risks at entity level. While a more decentralized group may facilitate supervision of issues at the entity level, group supervisors may not have clear visibility of the strategies which are being pursued by individual entities. Similarly, while host supervisors are likely to have clear visibility about the effectiveness of Senior Management's oversight within specific entities, they may not have the ability to relate this to the overall group approach. Conversely, group supervisors may not be able to ascertain the extent to which group-wide policies are being implemented at the entity level.
61. The Board of the Head of the Group is responsible for ensuring the establishment of comprehensive and consistent group governance. However, supervisors have an important role to assess whether appropriate governance arrangements are in place and are being operated effectively regardless of the group structure. To achieve this objective, it is important for supervisors to:
- a) establish, implement and maintain a comprehensive framework of risk-based minimum prudential standards
  - b) ensure standards are clear in their application to various entities of the group;
  - c) provide guidance to groups on expectations for sound governance taking account of the structure of the group. It should be possible to apply such guidance to more centralized as well as more decentralized models of governance, including any variations thereof;
  - d) share industry best practice and alert groups to emerging risks; and
  - e) ensure that remedial action is taken where weaknesses are identified.
62. In a group context, it is important that supervisors work together to arrange adequate cooperation and coordination at all levels as appropriate. The exchange of information and good communication between supervisors is especially important in case of cross-border groups. ICP 25 requires supervisors to put in place adequate coordination arrangements with other relevant supervisors and authorities. When doing so, the supervisors should take into account the nature, scale and complexity of the group. In order to achieve the effective group supervision described and the effective coordination and cooperation between the group supervisor and other involved supervisors, supervisors should ensure that:<sup>45</sup>

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<sup>45</sup> This section is based upon the principles set out in section II of the 'Principles for the supervision of financial conglomerates' issued by the Joint Forum in September 2012. The principles are as applicable to the supervision of insurance groups as to financial conglomerates.

- a) a clear process is in place for coordinating various roles and responsibilities with clearly delineated responsibility for ensuring effective and comprehensive group-level supervision, including a coordination process to identify a group-level supervisor (this should result in a single group-level supervisor with responsibility for effective group-level supervision and for facilitating coordination between relevant supervisors to enable effective group-wide supervision).
- b) measures are taken to establish coordination arrangements in order to enable effective group-wide supervision, including, as appropriate, sharing information, participating in supervisory colleges, drafting memoranda of understanding, cooperating in on-site and off-site supervision and stress testing, and taking enforcement actions. A host supervisor can provide information on local obligations and circumstances to the home supervisor<sup>46</sup>, while the home supervisor can give input to a host supervisor in case a branch is established in a foreign jurisdiction<sup>47</sup>.
- c) a sound understanding of the operations of groups is developed and maintained through undertaking a range of appropriate supervisory activities. These should include:
- The collection, review and analysis of relevant information from the group as a whole and its constituent entities, including where relevant, unregulated entities;
  - Review of the group's own assessment of its risks at the appropriate levels within the group;
  - Sufficient interaction with the Board and Senior Management of the head of the group and of material and relevant entities within the group; and
  - On-site and off-site supervision of entities within the group and assessment of compliance with the prudential framework.
- d) supervisory tools are used, when appropriate, to compel timely corrective actions and/or enforce compliance with the prudential framework. Supervisors will do this by imposing sanctions on or require corrective actions to be taken by the group or its constituent entities, subject to appropriate due process.

## 6. Conclusions

63. The checks and balances included within a group corporate governance framework should contain sufficient systems and controls, including policies and procedures, which enable the group to be flexible and transparent, to take timely decisions and to ensure that powers are not unduly concentrated. For this purpose, group-wide systems and controls should have an adequate and appropriate division of responsibilities (for strategy and direction; management and oversight) within the group, with a clear allocation of responsibilities to key players within the corporate governance framework.
64. This paper has been developed due to the growing awareness of the variety of approaches to group governance adopted within groups, and the possible impact those approaches can have on Control Functions which form a key element of good governance. While both ICPs and ComFrame require individual insurers and groups

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<sup>46</sup> ICP 4 Guidance 4.1.2

<sup>47</sup> ICP 4 Standard 4.4 and 4.5

to put in place an appropriate corporate governance framework, neither of them recommends or mandates a centralized or decentralized model. Consistent with that approach, this Issues Paper also does not advocate any particular model of governance, but has instead tried to identify how good governance standards can be effectively achieved within different models.

65. The paper analyses how good governance can be ensured when an insurance group pursues a more centralized model or a more decentralized model. In practice groups will adopt more hybrid models between centralized and decentralized, which cannot be strictly defined. However, a set of key characteristics has been identified in this paper, which form the essential elements of good governance regardless of the model chosen. Although they are considered separately for the purpose of this paper, these key characteristics are integrated and interrelated elements of the corporate governance framework:
- a) setting of objectives and strategies;
  - b) allocation and oversight of management responsibilities;
  - c) setting policies and procedures at both group and entity level;
  - d) risk management and compliance; and
  - e) operation of Control Functions.
66. There is a need for strong governance at all levels within a group but specific challenges or issues might arise depending on the model adopted by a group. To illustrate this, the paper has considered the challenges and issues that might arise from more centralized or more decentralized models of governance, while recognizing that in practice most groups will adopt a hybrid approach somewhere along the spectrum between purely centralized and purely decentralized. A group with a more centralized approach has the advantage of a common culture, policies and processes which will help secure effective governance of the group. However, such an approach may constrain its ability to effectively monitor management at entity level and react to risks arising at the entity level, which could impact on the group as a whole. On the other hand, in a group adopting a more decentralized approach, there is typically more autonomy and authority at the legal entity level which generally means that it will be more responsive to changing local requirements. However, in such a model, it may be more difficult to achieve implementation and monitoring of compliance with group requirements and managing of group risks.
67. As there are varying degrees of centralization and decentralization in terms of management and control of groups, a tailored approach based on a case-by-case analysis and understanding of the group and its structure would be needed to identify and address challenges to good governance that may arise within its model.
68. The Issues Paper identifies the challenges for centralized and decentralized models and the main elements of each key characteristic needed to ensure good governance within groups. To address the challenges identified, the paper describes practices, deriving from industry examples or supervisory experience that may be applied to promote good governance within groups, whether a more centralized or more decentralized model is adopted. These practices should only be considered as examples, as the varying hybrid models and the principle of proportionality require a case-by-case analysis. The main factors underlying the challenges and suggested practices are:
- a) division of authority and responsibilities of key players at the group and entity level;
  - b) effective group-wide direction and coordination;

- c) proper consideration of both entity and group perspective; and
  - d) effective communication within the group and availability of adequate information at all levels.
69. Insurance groups should look carefully at those factors, when setting up or assessing their corporate governance framework. The factors should be considered also by supervisors in applying the ICPs and ComFrame.
70. Supervisors are responsible for setting requirements and assessing the establishment of comprehensive and consistent group governance. Approaches to governance reflected in a group model present challenges to the supervisors of groups. Effective Control Functions within a group are a core concern for supervisors and assessing the effectiveness of these requires appropriate supervisory cooperation and coordination. Regardless of whether a more centralized or more decentralized model (or any variation thereof) is adopted in a group, supervisors should assess whether appropriate governance arrangements are in place to allow the group to be operated effectively and in a transparent manner.
71. Effective communication and exchange of information between supervisors are essential for the supervision of cross-border groups. Supervisors should have a clear process in place for coordinating various roles and responsibilities of home and host supervisors; they should provide guidance to groups on expectations for sound governance taking account of the model of the group. Supervisory cooperation through memoranda of understanding, through supervisory colleges or other arrangements is key to supervisors' understanding of groups and the governance approaches they use.

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