

BERMUDA MONETARY AUTHORITY
INSURANCE DEPARTMENT

GUIDANCE NOTE #12

CORPORATE GOVERNANCE

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GUIDANCE NOTE: CORPORATE GOVERNANCE

BACKGROUND

- 1.1 In October 2003, the International Association of Insurance Supervisors (“IAIS”) adopted revised Insurance Core Principles (“ICPs”). The 28 core principles offer new guidance for the effective operation of supervisory systems. Since consideration of the governance and decision-making processes of insurance companies is a key component of insurance supervision, a core principle addressed corporate governance specifically. Several other core principles also impact directly on corporate governance.
- 1.2 The requirement to promote good corporate governance is receiving increased international attention.
- 1.3 The Insurance Division of the Bermuda Monetary Authority (the “Authority”) is continually evolving its supervisory regime to reflect changes in the Bermuda market, and to recognize and to incorporate into its supervisory and regulatory model, as appropriate for the Bermuda market, international best practices for the supervision of insurance.
- 1.4 The Authority wishes to provide guidance to boards of directors and management of insurers about the Authority’s expectations on corporate governance and related matters. This guidance includes specific recommendations contained with IAIS Core Principles of Supervision.
- 1.5 The Authority’s approach to the supervision of insurance is a risk-based approach. This means that the Authority, to the extent possible, identifies, assesses, prioritizes, and minimizes the likelihood of events or circumstances occurring with might prevent the Authority from achieving its objectives. Further to this the Authority assesses the risks posed by an insurer by gaining an understanding of a licensed insurer’s operations, the risks it faces and how it deals with these risks. The consideration of the governance and the decision-making and control processes of an insurer is a key component of this assessment process. This approach to supervision is in contrast to a transaction-oriented review.
- 1.6 In implementing this approach the Authority aims to use its resources to focus attention on insurers and activities where there is a greater likelihood of a risk crystallizing and its impact having repercussions for policyholders and the continued development of a viable, competitive and innovative Bermuda insurance market. Additionally, the Authority aims to be proportionate in its approach to supervision and to consider the costs and benefits of its regulatory and supervisory processes.
- 1.7 Any guidance issued for corporate governance should be principle based, such that it can be adapted according to the nature of an insurer’s customer and the characteristics

of the risks assumed. It is the responsibility of the Board to determine which specific provisions of this guidance should be applied taking into account the size, nature, complexity and risk profile of the business of the insurer. When as part of its supervisory process, the Authority assesses the effectiveness of an insurer's corporate governance, the degree of applicability and weighting of individual elements in this guidance will depend on the size, nature, complexity and risk profile of each insurer. For example, the Authority recognizes:

- that a wholly owned insurer who conducts primarily or exclusively related party business using an insurance manager will not require the same systems as a publicly traded Class 4 company;
- that where an insurer who conducts primarily related party business is managed by an insurance manager, the manager may provide oversight and guidance to the insurer;
- that insurers or reinsurers which only insure the risks of their owners and are part of the same organization (e.g. captive insurance companies) may pose less risk to the public than other insurers and reinsurers, and that it may be appropriate for the corporate governance structure for these entities to be less complex;¹
- that Bermuda has many licensed insurers which are administered by management companies in Bermuda and that the corporate governance structure for these insurers will be different than for insurers not administered by management companies.

1.8 For references in these Guidance Notes with respect to the changes in legislation contained in the Insurance Amendment Act 2004 insurers must take immediate steps to ensure they are in compliance with the Act. In relation to other matters contained in the Guidance Notes, the Authority encourages insurers to come into compliance as soon as possible and, in any event, not later than 31st December 2005 or a later date as may be agreed with the Authority in a particular case.

¹ As stated in the IAIS Principles on Minimum Requirements for Supervision of Reinsurers approved in October 2002 “where captives only insure the risks of their owners and are part of the same organization they may not pose the same risk to the financial system and separate regulations may be established recognizing this reduced risk.” This approach is also consistent with International best practices as described by the International Association of Insurance Supervisors, which recognize that the principles adopted in a jurisdiction should take into account the domestic context and industry.

INTRODUCTION

- 2.1 Insurers must be prudently managed. The prime responsibility for the sound and prudent management of an insurer rests with the board of the insurer. Corporate governance refers to the rules and procedures put in place within a corporation for the management and control of its business and affairs. What makes structures and policies work in practice are a knowledgeable and competent board, with a clear understanding of its role and strong commitment to, carrying it out.
- 2.2 Individual insurers will adopt different approaches to corporate governance, taking into account the nature, scope, complexity, and risk profile of its organization. The supervisory process will take this into consideration in the evaluation of individual insurers.
- 2.3 This guideline provides information to boards of directors and management of insurers about the expectations of the Authority on corporate governance and related matters, and the factors that the Authority will take into account in assessing the quality of governance of each insurer.
- 2.4 The Bermuda Monetary Authority (the “Authority”) recognizes the need for clarity as to the scope and implementation of the provisions of the Act ² if the regulatory system is to command the confidence of insurers and policyholders. It seeks, therefore, to ensure that those operating in Bermuda have a good understanding of the nature of the requirements and of the Authority’s approach in implementing the Act.
- 2.5 While the Authority aims to provide clarity as to its approach, this Guidance Note is not intended to be exhaustive. The Authority will do its best through this and other guidance notes to set out its understanding of the legal provisions affecting corporate governance, and to provide additional information about the Authority’s regulatory approach and expectations regarding these matters. ³
- 2.6 Other guidance issued by the Authority may contain additional information on corporate governance or related matters. ⁴

² The insurance legislation is comprised of the Insurance Act 1978 (as amended by the Insurance Amendment Acts, 1981, 1983, 1985, 1995, 1998 and 2001) and the regulations promulgated under that Act (the “Regulations”). The Regulations are the Insurance Accounts Regulations 1980 (as amended by The Insurance Accounts Amendment Regulations 1981, 1985 and 1989) and the Insurance Returns and Solvency Regulations 1980 (as amended by The Insurance Returns and Solvency Amendment Regulations 1981, 1985 and 1989). References herein to the “Act” are to the Insurance Act 1978 (as amended) and the Regulations.

³ The legislative summary in this Guideline is not intended to be a substitute for provisions of the Act. The reader is advised to refer to the provisions of the Act and not to rely on the interpretation of those provisions contained in this Guideline.

⁴ The Authority has issued separate guidance notes on a number of subject matters directly impacting on corporate governance and the decision making process, including risk management and internal controls, investments, and insurance activities.

- 2.7 The Authority's guidance is of general application and seeks to take account of the wide diversity of institutions that may be licensed under the Act. There is likely to be a need for the Guidance to be revised and developed over time. Material changes in the Guidance will be published, generally through the issue of a revised version.

APPLICATION

- 3.0 High standards of corporate governance are important for all registered insurers. In managing its affairs, an insurer should have regard to such principles of good corporate governance, as it reasonably considers applicable to it. It is the responsibility of the Board to determine which specific provisions of this Guidance should be applied taking into account the size, nature, complexity and risk profile of the business of the licensed insurer.
- 3.1 As part of its supervisory process, the Authority will look for indications that, overall, processes or procedures for effective corporate governance are in place, that they are appropriate to the individual insurer, and that they are operating effectively. The Authority will formulate its overall judgment on the effectiveness of an insurer's corporate governance based on a variety of indicators. The degree of applicability and weighting of individual elements in this guidance will depend on the nature, scope complexity and risk profile of each insurer.
- 3.2 All registered insurers are expected to comply with the standards in this Guidance.
- 3.3 The Authority recognizes that security commissions, stock exchanges, governments and international bodies, and others have issued laws, guidance or best practices on corporate governance ("other standards"), and that these other standards are evolving rapidly in many areas of corporate governance. The Authority expects registered insurers to be aware of other emerging and in-force standards that are applicable to their organizations (which may depend, for example, on whether the institution is a publicly-traded entity⁵) and to consider and, where appropriate, incorporate these into the institution's governance practices. The Authority also recognizes that these other standards may overlap or exceed some of the expectations for corporate governance described in this and other guidance issued by the Authority, and that developments in these other standards may have an implication for insurers with respect to time and effort involved in meeting these other standards.
- 3.4 The Authority's supervisory approach is forward-looking (the Authority seeks to be preventative) and risk-based. The Authority's guidance for corporate governance is principle based and is of general application. Where other standards for corporate

⁵ For example, management of Securities and Exchange Commission ("SEC") registrants are required to evaluate and report on internal control over financial reporting under Section 404 of the Sarbanes-Oxley Act of 2002.

governance are consistent with the Authority's expectations for corporate governance as described in this and other guidance, and where the Authority can rely on an insurer's compliance with these other standards, it is not the intention of the Authority to require a company to undergo additional costs in order to comply with both the Authority's guidance as well as the other standards.

DEFINITIONS

- 4.1 **Board** – The term board refers to either the entire board of directors of the insurer or, where applicable, to a committee of the board that has been delegated a particular element of board oversight.
- 4.2 **Management** comprises either persons employed by an insurer who exercise senior management responsibilities or the Insurance Manager for an insurer. Senior management responsibilities means having primary responsibility for one or more of the following:
- High-level decision-making;
 - implementing strategies and policies approved by the board;
 - developing processes that identify, manage and monitor risks incurred by the insurer;
 - monitoring the appropriateness, adequacy and effectiveness of the risk management and internal control system.

EFFECTIVE CORPORATE GOVERNANCE

- 5.0 The board is ultimately accountable and responsible for the performance and conduct of the insurer. It should have a balance of appropriately skilled, experienced and qualified individuals who can apply informed and independent judgment to the governance of the licensed entity. It should ensure that the insurer is effectively directed and managed, and its business is conducted in a sound and prudent manner with integrity, due care and professional skills appropriate to the nature and scale of its activities. In seeking to ensure that the objectives of this Guidance are met, the insurer must exercise its judgement in determining an effective approach to corporate governance, taking into account the nature, scope, complexity, and risk profile of its organization, and also having regard to the cost effectiveness of the rules and procedures.
- 5.1 Corporate governance encompasses the means by which directors and management of an insurer are held accountable for their actions and for the establishment and implementation of oversight functions and processes. The value of good corporate governance lies in its contribution to both the prosperity and accountability of the insurer. There is no one standard model of corporate governance. A corporate

governance framework specifies the distribution of rights and responsibilities among different participants in management of the company and sets out the rules and procedures [practices] for making decisions, and for the management and control of the insurer's business and affairs. Corporate governance includes corporate discipline, transparency, independence, accountability, and responsibility. Corporate governance also includes compliance with legal and regulatory requirements.

- 5.2 Risk management and internal controls systems are integral parts of a corporate governance framework. Risk management and internal control systems and practices may also differ depending on the size and complexity of the insurer, and the nature of the insurer's risk exposures.⁶
- 5.3 Best practices for governance practices are continuously evolving. The Authority expects the board to be aware of emerging best practices that are applicable to their institution, and will look for indications that these have been considered and, where appropriate, incorporated into the institution's governance practices.

EFFECTIVE BOARD PERFORMANCE

Structure of the Board

- 5.4 In addition to complying with the Companies Act 1981, the board of an insurer shall comprise a suitable number of directors that enables it to carry out its functions effectively and efficiently, taking into account the activities and business volume of the insurer. Collectively board members should have the appropriate breadth of experience, ability and integrity to conduct the business of the insurer, taking account of potential conflicts of interest.
- 5.5 To enable the board to make sound decisions in the best interests of the insurer, independent and objective opinions are essential. While certain governance structures, including those described in this guideline, can encourage independence, the Authority does not view any one structure as guaranteeing independence. What matters is that a particular structure and the board's behaviour are effective, taking into account the ownership structure and particular circumstances of the financial institution, such as whether the insurer is a wholly-owned subsidiary or is a non wholly-owned entity. Independence is normally a matter of the board demonstrating its ability to act independently of management when appropriate.

Oversight Responsibilities

- 5.6 The following is a list of basic oversight responsibilities that the board should consider when establishing and assessing the effectiveness of an insurer's corporate governance

⁶ As discussed in footnote 2, the Authority has issued a separate guidance note for risk management and internal controls.

framework. The degree of applicability of these oversight responsibilities will depend on the nature, scope, complexity and risk profile of each insurer:

- 1) clearly setting out its responsibilities toward, and commitment to the principles of good corporate governance principles in respect of the licensed entity;
- 2) satisfying itself that the insurer is organized in a way that promotes the effective and prudent management of the institution and the board's oversight of that management;
- 3) approving and reviewing the broad business strategies and significant policies of the insurer, including the means of attaining them, and procedures for monitoring and evaluating the progress toward them. Adherence to the policies and strategies are reviewed regularly, and at least annually;
- 4) as appropriate, having in place and monitoring independent risk management functions that identifies and monitors the material risks related to the type of business undertaken. As appropriate, the board of directors establishes and monitors audit functions, actuarial functions, strong internal controls and applicable checks and balances;
- 5) where applicable, distinguishing between the responsibilities, decision-making, interaction and cooperation of the board, chairman, chief executive and management;
- 6) requiring a clear division of responsibilities to ensure a balance of power and authority, so that no one individual has unfettered powers of decision;
- 7) appointing and dismissing management. The board must ensure that management are fit and proper, and compensated in a manner that is consistent with appropriate incentives;
- 8) having access to accurate, relevant and timely information. Where stakeholders participate in the corporate governance process, they should have access to relevant information;
- 9) where the insurer writes domestic business, providing oversight of the market conduct activities of the insurer, including setting out policies that address conflicts of interest, fair treatment of customers and information sharing with stakeholders, and reviewing these policies regularly;
- 10) where appropriate, establishing standards of business conduct and ethical behaviour for directors, management and other personnel. These include policies on private transactions, self-dealing, preferential treatment of favoured internal and external entities, covering trading losses, and other inordinate trade practices of a

non-arm's length nature. This includes ensuring that the insurer has an on-going, appropriate and effective process of ensuring adherence to those standards; and

- 11) collectively ensuring that the insurer complies with all relevant laws, regulations, guidance notes, industry standards and any established codes of conduct. As applicable, this may include identifying an officer or officers with responsibility for ensuring compliance with relevant legislation and required standards of business conduct, and who reports to the board of directors at regular intervals.

Responsibilities of Management

5.7 Management is responsible for:

- overseeing the operations of the insurer and providing direction to it on a day-to-day basis, subject to the objectives and policies set out by the board of directors and in compliance with applicable laws and regulations.
- providing the board of directors with recommendations, for its review and approval, on objectives, strategy, business plans and major policies that govern the operation of the insurer.
- facilitating the board's oversight role, by providing accurate, relevant and timely information to the board, enabling the board to review business objectives, strategy and policies, to hold management accountable for its performance, and to determine whether the insurer is operating in an appropriate control environment. Management also facilitates effective oversight through fostering candid and robust board discussions.
- ensuring that the independent oversight functions, such as internal audit, actuarial, compliance and risk management, have the resources and support to do their work and the capacity to offer objective opinions and advice to the board and to management.

Insurance Managers

5.8 Where the company employs a registered insurance manager, the board shall ensure that the duties, responsibilities and authorities of the registered insurance managers are clearly set out in the management agreement or contract of employment under which they or any nominated employee are appointed and that they are clear as to the requirements of the preceding paragraphs.

5.9 A licensed insurance manager, where employed, shall be charged by the board to deal with issues of compliance relating to relevant laws and standards of business conduct.

RELATIONSHIP BETWEEN THE BOARD AND THE AUTHORITY

- 6.0 An insurer and its board and management are expected to deal with the Authority in an open and cooperative manner. There is a need for candour and cooperation in an insurer's relationship with the Authority. Insurers are required to advise the Authority promptly of any matter that might reasonably be expected to affect their authorisation to carry on business in Bermuda or might materially affect the interests of the policyholders of the Bermuda entity.
- 6.1 Where a Bermuda insurer conducts insurance business outside Bermuda, it should notify the Authority in writing if its right to conduct that business ceases, or if the insurer's right to conduct insurance business has been limited or otherwise adversely affected under a law of the jurisdiction in which the business is being conducted. Notification must be provided with 14 days of the event occurring.

ASSESSMENT OF CORPORATE GOVERNANCE

- 7.0 The Authority will formulate its overall judgment on board effectiveness and quality of governance of an insurer based on a variety of indicators, the most important of which are findings from off-site monitoring and on-site examinations. As part of its supervisory process, the Authority will look for indications that, overall, processes or procedures are in place, that they are appropriate to the individual institution, and that they are operating effectively.
- 7.1 When assessing the board's effectiveness in guiding the insurer and overseeing its activities effectively, the Authority may consider whether the board members and management have the level of competence for their roles, and whether they have the appropriate ability and integrity to conduct insurance business, taking account of potential conflicts of interests. Additionally, the Authority will consider the collective breadth of experience and the caliber of the board. Appropriate ability can generally be judged from the level of a person's professional or formal qualifications or relevant experience within the insurance and financial or other related businesses. The knowledge and experience required depends upon the position and responsibility of the functionary within the insurer.
- 7.2 Bermuda's approach to the supervision of insurance is risk-based. In contrast to a transaction-oriented review, this approach focuses on understanding the quality and reliability of an insurer's governance programs, risk management processes and controls, internal controls; and independent and effective oversight (e.g. via audit and compliance) of business and operational activities and methodologies. Through the on-site visits, this approach aims at raising the level of dialogue between the Authority and the insurer, and enhancing the Authority's understanding of the insurer's governance umbrella, respective roles and accountability, and the "tone at the top".

End of guidance note.

If you have questions on this or other guidance from the Insurance Department please email info@bma.bm . Please put "Insurance Guidance" in the title of your email.