Corporate Governance, Control and Compliance – Doing it Better

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Supervisory role

- The financial crisis has highlighted the importance of corporate governance principles
- Provide supervisory guidance on expectations for sound corporate governance
- Regular supervisory assessment of if effective and implemented
- Assess if soundly and prudently managed - primary responsibility of the companies
- The competence of the board members and senior managers is critical – assessed by supervisors but responsibility of the company
Building-blocks of sound standards and practices

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Clear lines of responsibility and accountability

- Define the authorities and key responsibilities for board of directors and senior management
- Create an accountability hierarchy for the staff
- Different responsibilities require different persons being responsible, otherwise no accountability (conflicts of interest)
- Take into consideration that the ultimate responsibility stays with the board
Separation of duties and checks and balances

**Delegation:** Authorities and duties, with a range of actions and limits

**Control:** Monitoring, reporting, review and revision

- Shareholders
- Board of Directors
- Senior Management
- Line Managers
- Staff

Reporting line
Available accountability models

- Several models of the accountability hierarchy are available but there are two main key functions
  - Overall strategy and oversight
  - Execution and management
- One-tier system with board and senior management
- Two-tier system with Executive and Oversight board, where the latter consists of independent members (not employees, owners or other stakeholders)
- Committees of the board with different responsibilities (audit, remuneration, compliance, investment, risk management, etc)
- Elaborate systems of control can make decision-making more complicated, time consuming and expensive
- Could also provide a pseudo-comfort about risk – many risks are uncertain and do not fit easily into control frameworks
Strategic objectives and corporate values

- Define a well articulated corporate strategy
- Create a corporate climate that prevents corruption and fraud (start from the top)
- Safeguard the interests of key stakeholders
- Create a system to avoid conflicts of interest
- Put systems in place to control lending and other forms of self-dealing
- Ban preferential treatment also to related parties and other favoured parties
Quality, awareness, independence and knowledge

- Understand oversight role and duty of loyalty
- Understand the fiduciary duty to policyholders
- Avoid conflicts of interest
- Not participate in day-to-day management (sufficient number of non-executives)
- Give objective advice and recommend sound practices
- Have adequate knowledge and experience relevant to each of the material financial activities
- Have power and structure to question management (information, size, frequency, standing, evaluation etc.)
- Be robust enough to deal with crisis situations
- Meet regularly with senior management and internal audit
- Assess own and others’ performance and take corrective actions
Oversight by senior management

- Oversight consistent with board policy
- Be involved in key decisions (should be made by more than one person)
- Should however not be too involved in business-line decisions (policy defining the limits and responsibilities)
- Exercise control over key employees
- Have the necessary knowledge and experience
Know-your-structure

- Board and senior management should understand the operational structure of the company/group (also SPVs etc)
- Also when operating in jurisdictions and through structures that impede transparency - can supervisors impose better structures or additional requirements and *living wills*?
- Ensure that risks are assessed and managed appropriately and that local rules are followed
Proper use of internal auditors and the internal control function

- Internal audit’s task is to examine and evaluate the adequacy and effectiveness of the insurer’s systems, and internal control processes and reporting procedures
- Recognise the importance of the audit process and communicate it throughout the company
- Take measures to enhance their independence
- Provide access to business and support areas
- Utilise findings effectively and in a timely manner
- Have external audit verify internal controls
- Correct problems identified by auditors
- Use auditors as independent check of information from management – direct reporting
Other control functions

- Independent risk management function, including a CRO or equivalent, with sufficient authority, stature and resources
- *Appointed* or *responsible* actuary (protect the interests of the policyholders)
- Different committees (can never replace the Board)
- Compliance *officer* (otherwise internal audit function)
- (Whistle-blowing= confidential way of reporting)

Direct access to the board in principle
Compliance

- Risk of legal or regulatory sanctions, material financial loss or loss of reputation
- Observing proper standards of market conduct
- Managing conflicts of interest
- Treating customers fairly and ensuring the suitability of customer advice
- Typically include specific areas, eg prevention of money-laundering and terrorist financing (*know-your-customer*), observance of tax laws etc
- Part of the culture of the organisation, not just the responsibility of specialist compliance staff – can be organised in different ways but is part of the overall corporate governance structure (oversight of the board and senior management responsibility)
- Advice – keeping senior management informed on developments in the area
- Guidance and education – educating staff on compliance issues and act as contact point for queries
- Pro-active identification and assessment of compliance risk (new business etc)
- Assess the appropriateness of the compliance procedures and follow-up identified deficiencies, formulate proposals for amendments etc
- Same independent status and reporting requirements as the internal audit function
The role of the compensation policy

- Smart people who are doing stupid things are often being paid for it (system of incentives that rewards excessive risk taking)
- Active board oversight of the compensation system’s design and operation
- Creating the right incentives and being consistent with
  - Ethical values
  - Long-term objectives and strategy of the company
  - Prudent risk-taking
  - Control environment
- Should only risk taking be rewarded, not risk avoidance and control? – How to remunerate control functions?
Supervisory tools

- Initial and on-going assessment of fit-and-proper – licensing, reporting and on-site review
- Follow-up on important changes in companies (e.g. the CRO is leaving)
- Boardroom performance: Minutes of board
  - Information provided to the board
  - Minutes of board committees, where relevant
- Quality of audit and control functions
  - Reports of internal auditors to be discussed with audit staff and staff in affected areas
  - Reports of external auditors
- Effects of group structures and how they are being managed and controlled
- Supervisors should require effective and timely remedial action – by the board if material deficiencies