FINANCIAL STABILITY INSTITUTE

BANK FOR INTERNATIONAL SETTLEMENTS

Corporate Governance, Control and Compliance – Doing it Better

Regional Seminar for Supervisors in Africa on Risk-based Solvency and Supervision

Mombasa, Kenya, 14-17 September 2010

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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

Hierarchy with clear lines of responsibility and accountability	Strategic objectives and corporate values	Quality, awareness, knowledge and independence of board members	Appropriate oversight by senior management
Know-your-structure	Proper use of internal auditors and internal control functions	Proper compensation policy	Disclosure of information and market discipline

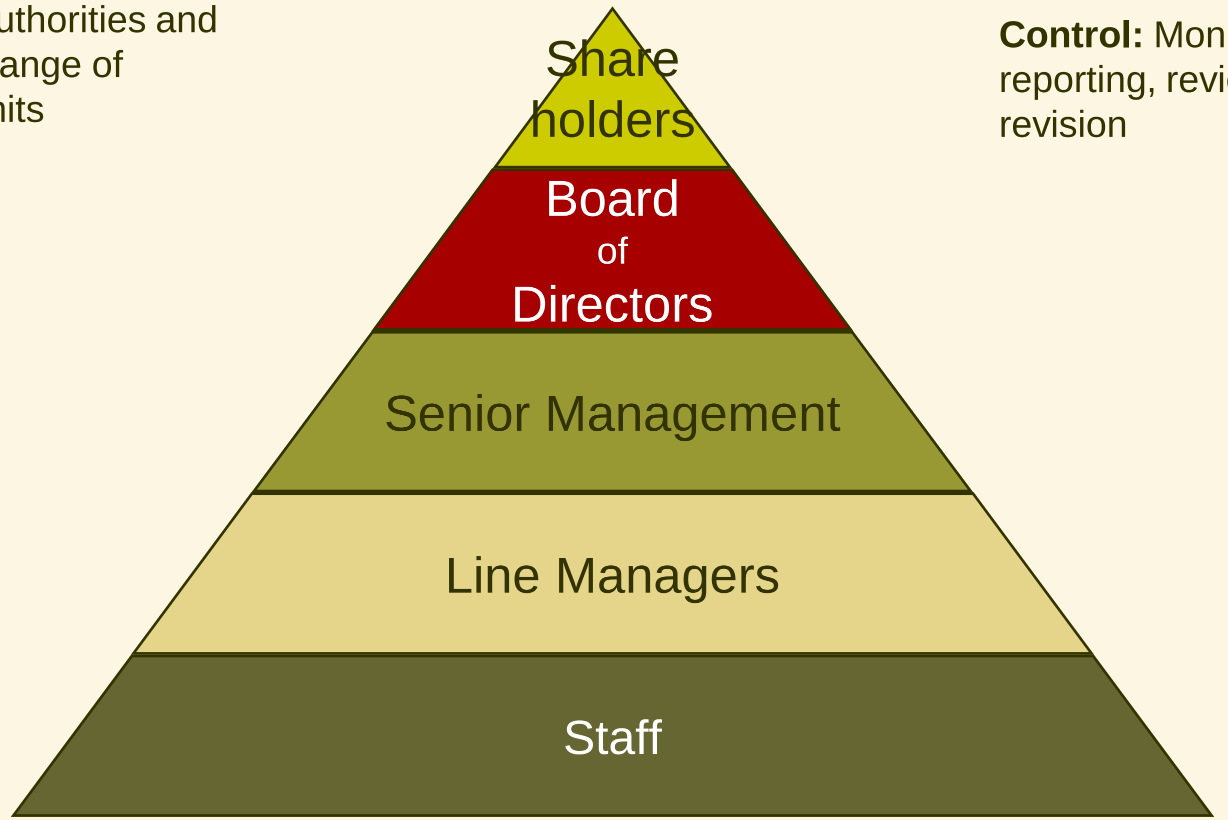
Clear lines of responsibility and accountability

- 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



Reporting line

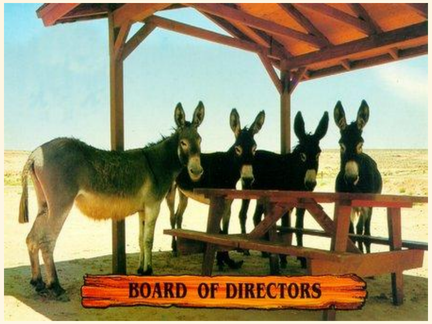
Available accountability models

- 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 (eg 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