

## Response to IAIS consultation on draft application paper on supervision of control functions

### Comments on Section 1 Introduction

#### Comment on paragraph 1

The Global Federation of Insurance Associations (GFIA) represents through its 41 member associations and 1 observer association the interests of insurers and reinsurers in 64 countries. These companies account for 89% of total insurance premiums worldwide, amounting to more than \$4 trillion. GFIA is incorporated in Switzerland and its secretariat is based in Brussels. GFIA would first note that during the financial crisis and the COVID-19 pandemic, the corporate governance of insurers has demonstrated resilience and sustainability and that more prescriptive supervisory mandates have not been shown to be necessary.

The purpose of the application paper is not to add supervisory mandates, yet there are many provisions that go beyond current standards. The paper should state more prominently the importance of supervisory authorities recognising the fact that every insurer is different in terms of its business profile (eg, size, risk profile, business model) and resources/capacity.

While the paper appropriately focuses on the role of control functions in managing risks, it puts too strong an emphasis on the internal design of the corporate governance systems. Instead, supervisors should ensure that outcomes of governance and other insurance operations are consistent with law. However, the paper, in its detail, introduces excessive supervisory intervention into the internal operations of (re)insurers. GFIA also notes that there are already many laws and regulations concerning governance and it wants to ensure the prevention of duplicate supervisory mandates.

#### Comment on paragraph 2

Corporate governance depends on a company's profile, structure and size. GFIA is therefore against any overly detailed and prescriptive approaches by supervisors that would result in an undue burden for insurers and that would be difficult to implement. GFIA believes that the IAIS should limit itself to recommending voluntary guidance by supervisors in this regard and establish a clear line between the supervisors and the supervised entities.

#### Comment on paragraph 5

GFIA welcomes all proportionality considerations that allow the supervisory authorities to adapt ICPs to the specific characteristics of the business of supervised entities. Proportionality should not just be a general international principle but should rather be effectively applied at jurisdictional level by supervisors.

### Comments on Section 2 Role of control functions

#### Comment on paragraph 12

The application paper has an entire section devoted to the three-lines model, but it is not part of the ICPs and therefore the paper should not view this model in the same way as an IAIS standard. The model was recently updated by the Institute of Internal Auditors, with the update emphasising the need for coordination, collaboration



GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

and cooperation. These themes are not reflected in the paper. GFIA suggests introducing measures of proportionality for small businesses, especially in relation to the combination of key functions.

#### **Comment on paragraph 13**

GFIA suggests elaborating on the principle of proportionality, in particular in relation to the combination of key functions (except the internal audit function) for small businesses. The second sentence gives the false impression that unseparated lines of defence will not be able to fulfil their function, which goes beyond what ICP 8 and standard 8.3 provide. Indeed, ICP guidance 8.3.10 explicitly refers to the possibility of insurers combining certain control functions. In short, this paragraph and others stress the separation of responsibilities within the three-lines model, with a defensive mindset. The focus should be on the allocation of responsibilities, with a collaborative mindset.

#### **Comment on paragraph 14**

GFIA suggests further elaborating on the definition of outsourcing and limiting requirements on outsourcing to essential/critical outsourced functions. The definition of outsourcing should not be too broad and include any “use” of third-party services.

#### **Comment on paragraph 16**

GFIA suggests focusing on activities or essential/critical functions.

#### **Comment on paragraph 18**

There is an overemphasis on independence and stature, which should not be ends in themselves and are highly subjective. There seems to be a presumption that control functions enter into the picture after initiatives have been completed by the first line, which is not how insurers operate. The emphasis should be on outcomes created by an effective control function, not the independence and stature of the function.

### **Comments on Section 3 Independence of control functions**

There is an overemphasis on independence and stature, which should not be ends in themselves and are highly subjective. There seems to be a presumption that control functions enter into the picture after initiatives have been completed by the first line, which is not how insurers operate. The emphasis should be on outcomes created by an effective control function, not the independence and stature of the function.

#### **Comment on paragraph 22**

On the third bullet point, GFIA suggests specifying that the term “staff” refers to “senior” staff.

On the fourth bullet point on internal staff moves, the reference to time-limit restrictions should be deleted. While the identification and mitigation of potential conflicts of interest is important, a time restriction is not always an effective measure. Time restrictions have the downside of actually blocking changes in position that could compromise the proper functioning of the control function at issue, while a conflict of interest might be mitigated by a more tailored solution.

#### **Comments on paragraph 25**

With regard to the last bullet point, the dominant personality is too subjective a concept on which to base a governance framework or supervisory practice. What matters is the fitness and propriety of the Key Function holders, not the personality of their counterparts.

### **Comment on paragraph 31**

GFIA suggests deleting this paragraph: the IAIS should not prohibit the combination of key functions, especially for small companies. There are cases where control functions such as the risk control function are part of senior management or even of the board itself (eg, chief risk officer). Control functions should be implemented at a higher corporate level to ensure independence, positioning, direct reporting lines to the management board and all of the other conditions mentioned in the paper under section 3.

### **Comment on paragraph 32**

Remuneration is a function that should be left to company management. Supervisors should be limited to asking questions in cases where the remuneration system incentivises a pattern of behaviour inconsistent with applicable legal standards.

### **Comment on paragraph 34**

This paragraph is highly prescriptive. GFIA disagrees with the notion in the first subparagraph that control functions must be totally independent of achieving financial results and ask that the subparagraph be deleted. The second subparagraph strikes the right balance, while the third subparagraph is highly subjective and involves the regulator/supervisor too much in internal company operations.

## **Comments on Section 4 Stature of control functions**

GFIA has significant concerns with this section. While, as a general principle, control functions should have the authority they need to remain quasi-independent, this section involves the supervisor too much in the internal workings of the company.

Again, there is an overemphasis on independence and stature, which should not be ends in themselves and are highly subjective. There seems to be a presumption that control functions enter into the picture after initiatives have been completed by the first line, which is not how insurers operate. The emphasis should be on outcomes created by an effective control function, not the independence and stature of the function.

### **Comment on paragraph 35**

As an example of the concern expressed in the comment above, this paragraph puts the supervisor in a position of making subjective judgments about whether the control functions have the “skills, competence, knowledge, experience and level of authority to effect change”. Hiring and firing of competent personnel is the role of company management, and management is accountable if the enterprise fails.

### **Comment on paragraph 36**

See the comment above, which is equally applicable to this paragraph.

### **Comment on paragraph 37**

GFIA suggests replacing the word “evidence”, which appears to be excessive, with the word “information”.

### **Comment on paragraph 40**

While the paragraph is currently limited to setting priorities for staffing control functions in succession planning, any further intrusion into succession planning should be avoided. This paragraph appropriately encourages supervisors to pay attention to whether an insurer properly prioritises control functions in relation to staffing and does not look into the content of the succession plan. It is GFIA’s view that succession planning is the unique responsibility of management, not the supervisor.

**Comment on paragraph 42**

This section, in total and in its individual parts, provides too much opportunity for intervention in a company's internal operations, including the pre-approval of key persons. Accordingly, GFIA believes it should be thoroughly reconsidered.

The observation of board meetings is also very intrusive and is over-stepping by regulators, in our view. Such intrusion could stifle discussion and be harmful. Likewise, involving the supervisor in candidate recruitment or interviewing is an inappropriate mixing of the role of the supervisor with that of company management and the board.

**Comment on paragraph 44**

GFIA notes that staffing is highly dependent on the size of the undertaking.

**Comment on paragraph 47**

Meeting minutes are not prepared for the benefit of supervisors and their level of detail vary by jurisdiction for legal reasons. Therefore, meeting minutes are not necessarily appropriate for assessing control functions.

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**Comment on paragraph 54**

This paragraph on the supervisor's attendance at board meetings should be deleted. Its benefit is not sufficiently justified. GFIA notes that it can be justified only in extreme circumstances, for example when the viability of the company is seriously challenged.

**Comments on Section 5 Internal audit function****Comment on paragraph 65**

GFIA does not generally agree that supervisors should be able to direct internal auditors and considers that such directions should be made in extreme cases only.

**Comments on Section 6 Combination of control functions****Comment on paragraph 68**

GFIA supports the IAIS's recognition of the need for smaller insurers to combine certain control functions.

**Comment on paragraph 73**

This paragraph should also recognise the benefit of a vertical combination in facilitating harmonisation throughout a group. For example, the election of an audit committee at parent level could serve as the audit committee for the subsidiaries.

**Comment on paragraph 74**

GFIA appreciates the recognition of the need for proportionality in Sections 6.2 and 6.3. However, the term “operational functions” should be defined. It notes that the possibility of combining operational and control functions should not be limited to smaller insurers.

#### **Comment on paragraph 78**

It is also important to recognise that the operational and control functions must ultimately be merged at the top, either at board or senior management level. In fact, an observed good practice is to implement control functions at a high level to ensure effectiveness. This paragraph should recognise that a conflict can only arise when a person holds the senior management position in addition to certain control functions (eg, the risk-taking function).

### **Comments on Section 7 Outsourcing of control functions**

GFIA appreciates the recognition that control functions may need to be outsourced.

#### **Comment on paragraph 83**

Subparagraph four raises some questions about how it would be applied and how independence could be assured.

#### **Comment on paragraph 84**

Regarding outsourcing, GFIA suggests applying the supervisory requirements only to outsourcing of essential or critical activities or functions. In addition, GFIA finds this paragraph to be too detailed and intrusive; for example, giving the supervisor the authority to interview the outsourced service providers.

### **Comments on Section 8 Group-wide control functions**

#### **Comment on paragraph 85**

The paper should appropriately highlight the importance of the group entity’s discretion over the design of its own system of governance. The head of the group should not impair the responsibilities of the board of each entity in the group when setting up their own system of governance. GFIA suggests taking into consideration national company legal standards, especially regarding company (subsidiary) liability to the parent company.

#### **Comment on paragraph 86**

GFIA suggests modifying the fourth bullet point in this paragraph to acknowledge that there are cases in which group-wide harmonisation is not appropriate. Companies should be able to have the most appropriate policies for the respective levels within the group. Group-wide harmonisation of methods, for example, can jeopardise the independence of the control functions at the individual legal entity level. In addition, the size, risk profile and business model of the individual entities are different, so harmonisation would not be in line with the principle of proportionality. GFIA suggests making the following changes:

*“Reviewing the documented roles and responsibilities of the group-wide control functions, including how the group-wide and insurance legal entities’ control functions are meant to interact, how the group-wide control functions, in their own fields, ensure the harmonisation of the group’s methods, **as far as is possible and permissible taking into account the differences in size, risk profile, business model and legal framework of the individual legal***



GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

*insurance entities, and assess the proper implementation of policies defined at group level, and compare them with observed practices. If inadequate, requiring more comprehensive policies;”*

#### **Comment on paragraph 87**

Paragraph 87 and the following paragraphs should recognise the possibility for international groups to apply group-wide policies on a comply-or-explain basis, meaning that a single entity can choose not to comply with the group policies, but should explain why.

#### **Comment on paragraph 92**

The general statement that a combination of a control function at group level and at legal-entity level could create conflicts of interest should be removed. The paper does not specify what conflicts of interest may arise in such cases. On the contrary, such a combination can facilitate harmonisation throughout a group, which paragraph 86 notes. For example, the ability of an audit committee at the parent level to serve as audit committee for subsidiaries, should be permitted.

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