

December 17, 2018



Mr. Jonathan Dixon  
Secretary General  
Dr. Victoria Saporta  
Chairperson  
International Association of Insurance Supervisors  
Centralbahnplatz 2  
CH-4051 Basel  
Switzerland

Re: IAIS Draft Application Paper on Proactive Supervision of Corporate Governance

Dear Mr. Dixon and Dr. Saporta:

The Institute of International Finance (IIF) and its insurance members appreciate the opportunity to comment on the International Association of Insurance Supervisors' (IAIS) Draft Application Paper on Proactive Supervision of Corporate Governance (the Corporate Governance Application Paper) issued on November 8, 2018. The IIF and its members have commented on related materials, including our August 13, 2018 comments on the IAIS Draft Application Paper on the Composition and the Role of the Board, our January 31, 2018 comments on the IAIS Consultation on Revised ICPs 8, 15 and 16, and Related ComFrame material, our June 1, 2017 comments on the Consultation on ComFrame Material Integrated with ICPs 5, 7 and 8, our June 1, 2017 comments on the Consultation on ICPs 3 and 25 and ComFrame Material Integrated with ICP 25, and our May 31, 2017 comments on the Consultation on ICP Introduction and Assessment Methodology and ComFrame Introduction. We appreciate the additional opportunity to address further corporate governance issues, particularly as they relate to the role of supervisors in promoting sound corporate governance.

#### Overarching Comments on Application Papers in General

In line with previous IIF comments, we have an overarching comment regarding the objectives of an IAIS Application Paper and how those objectives would not be met by the release of an Application Paper prior to a full consultation on, and finalization of, the primary supervisory material that the Application Paper is designed to help elaborate. According to the IAIS:

*“Application Papers provide additional material related to one or more ICPs, ComFrame or G-SII policy measures, including actual examples or case studies that help practical application of supervisory material.”<sup>1</sup>*

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<sup>1</sup> Draft Application Paper on Proactive Supervision of Corporate Governance, IAIS, 8 November 2018.

With a number of the ICPs and ComFrame subject to further amendment, and the Holistic Framework for Systemic Risk (Holistic Framework) under development until November 2019, the premature adoption of Application Papers relevant to these primary supervisory materials does not meet the stated objective of Application Papers (i.e. to help practical application of primary supervisory material) and risks creating inconsistencies between the primary supervisory materials and the Application Papers, which would give rise to significant confusion and differences of interpretation among members and stakeholders. Accordingly, we suggest postponing the development of additional supporting materials, including Application Papers, until the ICPs, ComFrame, the Holistic Framework, or other any other primary supervisory materials are finalized and adopted. To do otherwise simply is not a proper and efficient phasing of the work.

Moreover, the Corporate Governance Application Paper sets new supervisory expectations, which is not the objective of an Application Paper. The Corporate Governance Application Paper raises supervisory expectations through the use of the word “should,” which implies a limited scope of acceptable supervisory practices and exceeds the stated objective of providing “actual examples or case studies that help practical application.” We believe the Application Papers would better serve the stated purpose of providing implementation examples or case studies to help the practical application of the supervisory material if the word “should” was replaced with “could” or “may.”

#### Overarching Comments on the Corporate Governance Application Paper

The IIF and its members appreciate the careful consideration of our comments on the Draft Application Paper on the Composition and Role of the Board. We applaud the shift in focus away from supervisory involvement in the composition, governance and functioning of the board that was evident in that paper and the move towards a more proportional and flexible approach to corporate governance in the Corporate Governance Application Paper. We endorse the IAIS’s statement in the Corporate Governance Application Paper that there is no one-size-fits-all approach to proactive supervision and that proactive supervision should be carried out proportionately to the issues identified, using an approach customized to the circumstances, including relevant supervisory objectives, laws and regulations. The Application Paper should state clearly that proactive supervision should be carried out in a manner that reflects the insurer’s corporate structure, board structure and governance, business strategy, risk appetite and risk tolerance, and the lines of business or activities in which the insurer is engaged.

However, we continue to perceive a lack of recognition in the Application Paper of different board structures and governance processes among insurers. This is a point that we have raised previously (see e.g. our August 13, 2018 letter) and we strongly believe the recognition of different board structures (e.g. a single versus a tiered board structure) and governance processes among insurers needs to be reflected in a properly balanced Corporate Governance Application Paper. A failure to recognize different board structures and governance processes runs counter to the stated goal of avoiding a one-size-fits-all approach and may also run counter to jurisdictional requirements, including those of the public company authorities.

In particular, the recognition of differences in board structure and governance processes needs to be reflected in any effort to encourage peer grouping exercises that are intended to facilitate supervisory

comparisons of companies and/or benchmarking (see Paragraph 22 of the Corporate Governance Application Paper), in order to avoid comparisons that fail to acknowledge the broad range of practices that are consistent with sound corporate governance and/or that practices that well suit one insurer may be inappropriate for another. Similarly, the Corporate Governance Application Paper should acknowledge that corporate culture may differ among insurers, reflecting different business models, management styles and jurisdictional norms, and that diversity in corporate cultures should not be perceived negatively by supervisors.

To these points, we continue to advocate for revisions to the sections of the Corporate Governance Application Paper that direct supervisors to involve themselves in aspects of governance that are the responsibility of the insurer's board or management. Specifically, we would encourage the IAIS to preface the material in Section 1.4, Willingness to act, with language that reflects the need to balance proactive supervision with a careful consideration of whether supervisory action or intervention is warranted. This balancing language should state that corporate governance is the responsibility of the insurer's board and senior management, not the supervisor and, that absent a compelling concern that the manner in which the company is being governed is likely to lead to material and significant risk to the insurer or its policyholders, the supervisor should not intervene.

Further, the Corporate Governance Application Paper should acknowledge that it is not the role of the supervisor to supersede corporate decision-making or direct the insurer about an appropriate business strategy or risk appetite. Indeed, excessive supervisory involvement in corporate governance could have a deleterious impact on board functioning, stifling active discussion and debate in favor of acquiescence to supervisory views and priorities, a result directly inapposite to what is intended. Additionally, in line with the comments we made in the Draft Application Paper on the Composition and the Role of the Board (June 2018), we would like to reiterate that proactive supervision should not be expanded to include subjective aspects of governance, including informal interpersonal relationships and aspects of individual and group psychology. The involvement of supervisors in subjective aspects of governance is not necessary to achieve supervisory objectives, exceeds the core competencies of supervisors, and involves supervisors inappropriately in corporate governance and the roles and responsibilities of the board and senior management.

#### Specific Comments on the Corporate Governance Application Paper

In addition to the overarching points noted above, we have specific concerns with several Paragraphs and Sections of the Corporate Governance Application Paper.

The approach to discussing corporate governance with firms through mechanisms such as the feedback loops and support structures with special investigation or intervention units, as outlined in Paragraphs 19 and 26, would be counterproductive and would place firms in an inappropriately defensive posture vis-à-vis their supervisors, thereby impeding the necessary and appropriate dialogue between insurers and their supervisors. We recommend deletion of the final bullet in Paragraph 19. A more appropriate and balanced approach to addressing these issues is provided in the third bullet of this Paragraph, which includes as remedies for any "blind spots" dedicated corporate governance experts who can identify, and

help staff address, emerging governance issues. We would recommend a corresponding deletion of the second bullet of Paragraph 26.

The establishment of a formal “early warning system” outlined in Paragraphs 32 through 36 also raises concerns as it could lead to premature and unnecessary supervisory action. The yellow and red flags described in the Corporate Governance Application Paper could be helpful to supervisors in designing training programs for staff and in highlighting potential sources of corporate governance concerns but the presence of a flag at an insurer should not automatically translate to supervisory action. Rather, the presence of a flag should be evaluated in light of the totality of the circumstances and the materiality of the risks posed to the insurer and its policyholders. For example, a flag may arise from the turnover of board members, senior managers or key persons in control functions but the reason for that turnover may be a realignment of the insurer’s business strategies or business plan. A rigorous and literal application of the yellow and red flags is likely to result in excessively intrusive and over-zealous supervision of well managed insurers.

We understand the need, as expressed in Paragraph 28, for the supervisor to have relevant and timely information to proactively identify potential corporate governance-related issues and to carry out proactive supervision. However, the Corporate Governance Application Paper would benefit from a caution against duplicative requests to insurers for meetings, supplemental reporting or other information, which is especially a concern when an insurer is part of an insurance group or has operations in multiple jurisdictions. Proactive supervisory practices should be efficient and effective (for example, through use of the supervisory college mechanism) but not overly burdensome on insurers.

We appreciate the range of approaches for gathering relevant information set forth in Paragraph 30 but believe that this Paragraph should contain an explicit acknowledgement of the need to properly balance the interests of supervisors with burden on companies. In Paragraph 30, we would also point out that, in many jurisdictions, non-public information may not be obtained directly from other supervisors, but must be requested via the lead or group-wide supervisor, and there may be limitations on the ability of the lead or group-wide supervisor to share that information. We therefore propose that the IAIS amend the text of the third bullet of Paragraph 30 to include at the end of that bullet the wording, “provided and to the extent that information sharing is permissible under applicable laws and regulations.” Moreover, in many jurisdictions external auditors are not at liberty to provide the supervisor with information obtained in the course of their regular assurance work. We therefore suggest that the IAIS delete the reference to external auditors in the sixth bullet of Paragraph 30 or further qualify this statement by adding at the end of the first sentence of that bullet the wording, “subject to laws and regulations governing the ability of external auditors to share information with the supervisor.”

The Corporate Governance Application Paper should acknowledge that supervisors have different philosophies, mandates and legislative or regulatory authority, which will impact their ability and willingness to utilize the various tools described in the paper. The IAIS should provide for flexibility in supervisors’ use of supervisory tools or techniques and recognize that different aspects of corporate governance may be emphasized across IAIS member jurisdictions. In Section 1.2, we appreciate the IAIS’s recommendation to supervisors to equip their staff with the appropriate analytical and technical skills needed to analyze corporate governance information from insurers and draw appropriate conclusions.

We believe this section should be enhanced with an outline of the particular supervisory skills that are needed.

Finally, as we have expressed in the past and noted above, we would encourage the IAIS to avoid excessive prescriptiveness in the language used in the Corporate Governance Application Paper by avoiding the use of the word “should” and instead using the word “may.” For example, we ask the IAIS to insert the word “may” in the lead in to the bulleted text under Paragraph 19 (“Methods to remedy or minimize such blind spots **may** include:...”). Similarly, the first sentences of Paragraphs 14, 26 and 27 and the second sentence of Paragraph 22 should be rephrased to use the word “may” instead of “should.” The purpose of an Application Paper is to discuss a range of good practices, which may or may not be appropriate for adoption in a particular jurisdiction, rather than to set forth an expectation or a standard and, as such, the use of the word “may” is more appropriate.

We appreciate the IAIS’s consideration of our comments and the dialogue between the IIF and the IAIS on these important topics. We stand ready to provide further input and engage in dialogue with IAIS members to advance policy initiatives related to corporate governance. Should you wish to discuss this response, please contact Mary Frances Monroe ([mmonroe@iif.com](mailto:mmonroe@iif.com)) or Ningxin Su ([nsu@iif.com](mailto:nsu@iif.com)).

Very truly yours,

A handwritten signature in black ink, appearing to read "Mary Frances Monroe", with a long horizontal flourish extending to the right.

Mary Frances Monroe  
Senior Advisor and Insurance Lead  
Institute of International Finance