

# **OFFSHORE GROUP OF INSURANCE SUPERVISORS**



**SUPERVISORY PRINCIPLES PAPER  
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**CORPORATE GOVERNANCE FOR CAPTIVE  
INSURANCE COMPANIES**

# **OFFSHORE GROUP OF INSURANCE SUPERVISORS**

## **PRINCIPLES PAPER**

### **Corporate Governance For Captive Insurance Companies**

#### **Introduction**

The purpose of this paper is to provide guidance to the Members and Observers of the Offshore Group of Insurance Supervisors on best practice with respect to corporate governance for captive insurance companies.

This guidance applies to 'pure' captives, writing exclusively the risks of the parent, and 'broad' captives, which write additional risks, not related to the parent. It also applies to Protected Cell Companies (PCCs), Segregated Account Company's (SAC) and the like.

Corporate Governance is concerned with promoting corporate fairness, accountability and transparency. It is embodied through systems of direction and control that are implemented through rules and procedures so that decisions on corporate affairs can be made.

Corporate governance currently enjoys a high profile, arising from a succession of corporate failures where directors have failed to identify weaknesses in corporate management. Different countries have responded to these failures in different ways. The USA enacted the Sarbanes-Oxley Act whilst the UK government commissioned the Higgs Report, which will apply to UK listed companies.

Captive insurance companies are not immune from mismanagement, nor the associated reputational and financial risks. Indeed it could be argued that the risk of corporate governance failure is higher in a captive, due to the fact that the only investor may be the parent and accounts are frequently not scrutinised by independent rating agencies.

Ultimately however, it should be the decision of the Board to determine which corporate governance provisions should apply. Consideration should be given to the size, nature and complexity of business written by the captive, and the potential for that business to generate a reputational risk for the offshore jurisdiction.

Whilst corporate governance failures for captives cannot be totally eliminated, effective procedures can minimise specific risks.

Additionally a captive with good corporate governance may benefit when being reviewed by ratings agency. For example S&P are currently progressing with a ‘Corporate Governance Score’ whilst Moody’s are intending to include a corporate governance section in research reports.

Corporate governance is the subject of one of the International Association of Insurance Supervisors (IAIS) Core Principles, whilst an OGIS paper on these principles (September 2000), encourages supervisors to “take an active interest in corporate governance” and insurers “to adhere to corporate governance principles”

## **1) The Board of directors**

Effective corporate governance flows from the Board of directors to the captive insurance company.

### **1.1. Function**

The function of the Board should be clearly prescribed. The Board’s objectives should be stated and private transactions, self dealing, preferential treatment of favoured entities, covering of trading losses and other inordinate practices of a non-arms length basis, not entered into, without prior approval of the Board.

Management should be aware that they take instructions from the Board, and not individual directors (unless the Board has ratified that instruction).

### **1.2. Composition**

The Board should ensure it has sufficient expertise to understand the issues involved in operating and controlling the captive. Furthermore it should ensure those responsible for the daily running of the captive have the necessary skills, qualifications and competence.

The Board should include at least one person who is independent of both the captive’s parent and the insurance manager.

The composition of the Board should be considered at least every three years, and the Memorandum and Articles should clearly set out procedures for the appointment, removal and retirement of directors.

### **1.3. Duties of the Board**

#### **1.3.1. Risk identification**

The Board should be responsible for the identification of all operational risks. Such risks would include (but not be limited to) underwriting, credit, market, liquidity, legal, business, regulatory, crime, systems and operations, information and communications technology, disaster and reputational risks. Procedures should be in place to monitor, control and report on these risks.

Any new risks should be promptly brought to the Board's attention as and when they are identified, and procedures developed to accommodate them.

### **1.3.2. Internal controls**

The Board should establish internal procedures for

- Controlling operational risks.
- Monitoring capital / solvency requirements.
- Appointment of a Money Laundering Reporting Officer and Compliance Officer. In the case of a captive administered by an insurance manager, the Compliance Officer role could be fulfilled by the corporate appointment of the insurance manager.
- Dealing with the public, if appropriate.
- Dividing responsibility between the captive's management and third party service providers.
- Custody arrangements, including bank mandates.
- Internal audit procedures and the formation of an audit committee.

Such controls should be documented in a procedures manual, which should be checked for accuracy and breadth by insurance supervisors.

The Board should also maintain documents relating to cases where the captive's corporate governance principles have failed.

### **1.3.3. Investment strategy**

The Board should develop, implement and minute an investment strategy. Such a strategy should be carefully monitored and controlled.

The investment strategy should have due regard to the issues of mismatch between assets and liabilities. Consideration should be given to the size, nature and complexity of the insurer's business. Scenario / resilience testing should be considered, to model a variety of market scenarios and changing investment and operating conditions on the captives performance.

### **1.3.4. Supervisory functions**

The Board should ensure that the duties, responsibilities, authorities and remuneration of the licensed insurance manager (if employed) are clearly defined in the management agreement, which should be reviewed at least every three years. In addition, the Board should satisfy itself that any remuneration paid to the insurance manager reflects the work required to operate the captive insurance company.

For managed captives, the corporate governance procedures of the manager are clearly important, and the regulator should review these as part of its onsite visits.

### **1.3.5. Annual review**

The Board should review its corporate governance procedures on an annual basis.

Consideration should be given to the formation of an audit committee, reporting to the independent directors of the Board.

## **2) Complaints procedures**

Where a captive is issuing policies to third parties, a complaints procedure must be in operation. Such a procedure, at the very least must advise of the complaints hierarchy existing in the captives' jurisdiction. Complaints should in the first instance be addressed by the insurance manager (or management if the captive is self managed) and ultimately progressed to the regulator and / or the ombudsman. The customer should be advised of their options at all times, and provided with the relevant contact information to progress their complaint.

The captive should maintain a record of all complaints.

## **3) The role of the regulator**

The regulator must approve the individual members and composition of the Board of a captive insurance company. This approval is dependant on the provision of sufficient information, as to allow the regulator to confirm the fitness and propriety of the proposed directors of the Board.

Any changes to the Board composition should require regulator approval.

Should information become available to the regulator which alters the regulators perception of the board, then the regulator should have the ability to alter the composition of the Board, and exercise this when necessary.

The regulator should review the corporate governance procedures of captives licensed in their jurisdiction and ensure they are satisfied with the corporate governance procedures in place. Ideally the corporate governance requirements should be enshrined in the law, so that penalties can be imposed for failure to comply.

Frequently the corporate governance procedures of the parent will be adopted by the Board of the captive. The regulator should be comfortable with this arrangement, and that the corporate governance standards of the parent are of an equivalent or higher standard than that of the jurisdiction.