

Licensed Insurers' Corporate Governance Code

THE GUERNSEY FINANCIAL SERVICES COMMISSION (the Commission), in exercise of its powers conferred on it by section 78 of The Insurance Business (Bailiwick of Guernsey) Law, 2002, as amended, (the Law), hereby issues the Licensed Insurers' Corporate Governance Code.

1. Introduction

- (a) Corporate Governance refers to the manner in which a Licensee's business is directed and controlled. It encompasses the means by which the Board and Senior Management are held accountable and responsible for their actions and includes corporate discipline, transparency, independence, accountability, responsibility, fairness and social responsibility.
- (b) This Code applies to all Licensees where the Commission is the primary regulator and sets out principles of practice relating to Corporate Governance. The principles contained within this Code take account of the relevant Insurance Core Principles issued by the International Association of Insurance Supervisors in October 2003.
- (c) It is the responsibility of the Board to determine which specific provisions of this Code should be applied taking into account the size, nature and complexity of the business of the Licensee.
- (d) The Annual Return of the Licensee, as required under section 33 of the Law, shall include a summary of the extent of adherence to the Corporate Governance principles set out in the Code that have been adopted by the Board.
- (e) The Commission will routinely check compliance with the Code when performing on-site visits.

2. Responsibilities of the Board

- (a) The Board shall:
 - (i) define the strategic objectives and policies of the Licensee, including underwriting and investment strategies;
 - (ii) specify the means of attaining these strategic objectives and policies; and
 - (iii) establish procedures for monitoring and evaluating the progress made towards achieving these strategic objectives and policies.

- (b) The Board must ensure that collectively it has sufficient knowledge, skills, experience, commitment and independence to oversee the Licensee effectively taking into account the size, nature and complexity of the business of the Licensee. It should be noted that all Licensees are required to appoint at least one Director that meets the requirements of section 5 of Schedule 7 of the Law.
- (c) The Board must satisfy itself that the Licensee is organised in a way that promotes the effective and prudent management of the Licensee.
- (d) The Board is responsible for appointing and dismissing Senior Management, which includes executive Directors if applicable. Senior Management may be employed by the Licensee itself, or where a licensed insurance manager has been appointed, may be employed by the licensed insurance manager.
- (e) The Board must establish high standards of business conduct and ethical behaviour for Directors and Senior Management, including policies on private transactions, self dealing and preferential treatment of favoured internal and external entities, and must require any actual or potential conflicts of interests to be declared to the Board as and when these arise.
- (f) The Board must ensure it is not subject to undue influence from Senior Management or other parties and that it has access to all relevant information about the Licensee.
- (g) The Board must ensure that Senior Management is sufficiently accountable to the Board and must establish a decision-making process and a division of responsibilities that will ensure a balance of power and authority so that no one individual has unfettered powers of decision.
- (h) The Board must establish and maintain an effective internal control system that is adequate for the size, nature and complexity of the business of the Licensee and allows the Board and Senior Management to monitor and control the operations.
- (i) The Board must provide suitable prudential oversight and establish a risk assessment and management system that includes setting and monitoring policies so that all significant risks are identified, measured, monitored and controlled effectively on an on-going basis.
- (j) The Board must establish an appropriate remuneration policy for Senior Management, which is made available to the Commission upon request. Where appropriate, the remuneration policy should have regard to the performance of Senior Management as well as that of the Licensee and should not include incentives that would encourage imprudent behaviour.
- (k) Where the Licensee employs a licensed insurance manager, the Board must ensure that the duties, responsibilities and authorities of the licensed insurance manager are clearly set out in a written management agreement.

- (l) Where appropriate, the Board may establish sub-committees with specific responsibilities, such as an audit committee or risk management committee, or to act on a particular issue.
- (m) The Board is responsible for ensuring that the Licensee complies with all relevant legislation and must appoint a Compliance Officer to ensure such compliance at all times. The Board shall remain responsible for compliance with all relevant legislation notwithstanding the appointment of a Compliance Officer.
- (n) The Board must oversee the market conduct activities where the Licensee is dealing directly with the general public.
- (o) Where the Licensee appoints an actuary under Section 40 of the Law or has taken any actuarial advice in respect of its business, the Board must ensure that actuarial reports are made available to both Senior Management and the Board.
- (p) In the case of a Licensee conducting long term business, the Board must ensure that an actuary appointed under section 40 of the Law is granted direct access to the Board and to all relevant information.
- (q) The Board must communicate with the Commission and provide information and documents as required and meet with the Commission when requested.

3. Internal Control and Risk Assessment and Management Systems

- (a) The purpose of an internal control system is to ensure that:
 - (i) the business of the Licensee is conducted in a prudent manner in accordance with the strategies and policies established by the Board;
 - (ii) transactions are only entered into with appropriate authority;
 - (iii) assets are safeguarded;
 - (iv) records provide complete, accurate and timely information; and
 - (v) risks faced by the Licensee are assessed and managed effectively.
- (b) The internal control system established by the Board shall include:
 - (i) establishing appropriate divisions of responsibilities between the Board, Senior Management and third party service providers, to include clear delegation of authority, decision-making procedures and segregation of duties;

- (ii) establishing procedures for monitoring the assets of the Licensee to ensure they are being managed in accordance with the investment strategy as well as in compliance with legal, accounting and regulatory requirements;
 - (iii) establishing effective procedures and controls to deter, detect, record and promptly report fraud to the appropriate authorities;
 - (iv) overseeing the custody and banking arrangements put in place to safeguard the assets of the Licensee and to review, where appropriate, the internal controls of any third party service providers;
 - (v) establishing appropriate accounting procedures, including the reconciliation of accounts, the use of procedural and review checklists and the production of information for management;
 - (vi) monitoring the adequacy of the Licensee's resources to ensure compliance at all times with the Licensee's minimum capital and margin of solvency requirements and to enable any breaches to be identified and reported to the Commission within 7 days;
 - (vii) establishing an internal audit function of a nature and scope appropriate to the business of the Licensee;
 - (viii) considering the findings of any internal or external audit and actuarial reports;
 - (ix) establishing appropriate procedures to ensure the Licensee is operating in compliance with all relevant legislation and to enable any compliance breaches to be identified, reported and rectified in a timely manner;
 - (x) regular reporting on the effectiveness of the internal controls to ensure that any internal control deficiencies are identified, reported and addressed promptly; and
 - (xi) establishing clear accountability for all outsourced functions as if these functions were performed internally and subject to the normal standards of internal controls.
- (c) The risk assessment and management system established by the Board shall:
- (i) be appropriate for the size, nature and complexity of the business of the Licensee;
 - (ii) identify, measure, monitor and control effectively all significant risks of the business on an on-going basis;
 - (iii) enable the prompt reporting of risk assessment and management issues; and

(iv) be regularly reviewed by the Board.

Specific risk assessment and management requirements and guidance are set out in the Appendices.

- (d) Licensees must be able to demonstrate to the Commission that adequate operational procedures are in place. This may be satisfied, at the Board's discretion, by reliance upon the procedures manuals adopted by a licensed insurance manager, modified if necessary. Where the insurance manager's procedures manual is relied upon, the insurance manager shall advise the Board of significant changes no later than the next board meeting.
- (e) Where a Licensee with a head office in the Bailiwick of Guernsey (the Bailiwick) conducts business overseas, the Board must ensure that there are systems and controls in place to maintain a sound and verifiable system of reporting to its head office. Where prudential records are held outside the Bailiwick, there should be systems in place to ensure that an adequate summary of those records is remitted periodically to the Board which is sufficient, together with prudential records kept in the Bailiwick, to demonstrate at any time its compliance with the relevant legislation.

4. Annual Review

At least annually, the Board shall:

- (a) review the strategic objectives and policies and either amend or readopt them as appropriate;
- (b) evaluate the progress made towards achieving the strategic objectives and policies;
- (c) review the composition of the Board to ensure that collectively it has sufficient knowledge, skills, experience, commitment and independence to oversee the Licensee effectively taking into account the size, nature and complexity of the business of the Licensee;
- (d) require the Directors and Senior Management to confirm to the Board that any conflicts of interest have been declared throughout the year as required under section 2 (e);
- (e) review compliance with the underwriting and investment strategies;
- (f) review the risk assessment and management system to ensure that all significant risks are being adequately measured, monitored and controlled;

- (g) review the internal control system to ensure it is operating effectively and that any reported deficiencies have been adequately addressed;
- (h) require the Compliance Officer to report to the Board regarding compliance with the relevant legislation;
- (i) review the remuneration policy for Senior Management;
- (j) require each Director to confirm that they have advised the Commission of any material changes to information filed with the Commission on their Personal Questionnaire; and
- (k) document the extent of adherence of the Licensee with the corporate governance principles set out in the Code.

5. Commencement Date

The provisions of this revised Code must be complied with by 30 September 2008.

6. Definitions

- (a) **Board** – the Board of Directors of the Licensee or, where the Licensee is a limited partnership, the General Partners or the Management Committee to which the General Partners have delegated their powers, discretions and responsibilities.
- (b) **Code** – the Licensed Insurers’ Corporate Governance Code.
- (c) **Director** – refer to the definition contained in Schedule 5 of the Law.
- (d) **Licensed insurer** – refer to the definition contained in Schedule 5 of the Law.
- (e) **Licensee** – a licensed insurer.
- (f) **Senior Management** – Senior Management is responsible for overseeing the operations of the Licensee and providing direction to it on a day-to-day basis, subject to the objectives and policies set out by the Board and relevant legislation. Senior Management is also responsible for providing the Board with recommendations for its review and approval on objectives, strategy, business plans and major policies that govern the operation of the Licensee as well as providing the Board with comprehensive, relevant and timely information that will enable the Board to review such objectives, strategy, business plans and policies, and to hold Senior Management accountable for its performance.
- (g) **Strategic objectives** – the purpose of the Licensee expressed as long term objectives in qualitative and or quantitative terms.

Appendix I – Risk Assessment and Management

Licenses must as a minimum address the risks associated with underwriting, reserving and investments, including derivatives and similar commitments, set out in sections 1 to 3 below. Licenses must regularly review the market environment in which they operate, draw appropriate conclusions as to the risks posed and take appropriate actions to manage adverse impacts of the environment on the Licensee's business. Licenses should also consider the guidance on other risks set out in Appendix II.

1. Underwriting Risk (including reinsurer credit risk)

- (a) Underwriting risk is the normal trading risk, arising out of contracts of insurance and reinsurance that Licenses are exposed to in their day-to-day operations.
- (b) Licenses should establish an underwriting strategy, including pricing policies, which is approved and reviewed annually by the Board, that enables the Licensee to evaluate the risks being underwritten and establish and maintain an adequate level of premium.
- (c) The underwriting strategy, which is used to control underwriting risk, should also cover:
 - (i) the establishment of appropriate systems by which Senior Management control and monitor expenses relating to premiums and claims, including claims handling and administration expenses;
 - (ii) the establishment of a strategy to mitigate and diversify risks, where appropriate, by defining limits on the amount of risk retained and obtaining appropriate reinsurance or other risk transfer arrangements; and
 - (iii) the establishment and regular monitoring and review by the Board of a reinsurance strategy, including reinsurer credit risk and diversification policies, and regular review of the recoverability of amounts due from reinsurers, including reinsurance technical provisions.

2. Reserving Risk

- (a) Reserving risk is the risk of a significant business impact, financial loss or breach of regulatory requirements arising from incorrect, inappropriate and/or insufficient calculation of technical provisions and other liabilities.
- (b) Licenses should establish adequate technical provisions and other liabilities and make appropriate allowance for reinsurance recoverables to enable the Board to ensure that sufficient assets are available to meet these liabilities.
- (c) Reserving risk should be controlled by:

- (i) the establishment of adequate technical provisions and other liabilities based as appropriate on sound accounting and actuarial principles and evaluation by legal advisers and claims adjusters;
- (ii) the establishment by the Board and Senior Management of appropriate reserving policies; and
- (iii) stress testing the adequacy of capital resources on a regular basis for a range of adverse scenarios where appropriate in case technical provisions have to be increased.

3. Investment Risks (including derivatives and similar commitments)

- (a) Investment risks encompass the various risks, including credit, market, liquidity and custody risks, which are directly or indirectly associated with the Licensee's investment activities and can adversely affect the performance, returns, liquidity and structure of a Licensee's investments if not properly managed and controlled. Such risks can have a substantial impact on the Licensee's overall liquidity and can potentially lead to the Licensee being over indebted or insolvent.
- (b) Licensees should establish an investment strategy, which is approved and reviewed annually by the Board, that addresses the following, where applicable:
 - (i) the risk profile of the Licensee;
 - (ii) the determination of the strategic asset allocation (asset mix over the main investment categories);
 - (iii) the establishment of limits for the allocation of assets by geographical area, markets, sectors (industries), counterparties and currency;
 - (iv) the extent to which the holding of some types of assets is restricted or disallowed (by laws or regulations);
 - (v) the conditions under which the Licensee can pledge or lend assets;
 - (vi) clear accountability for all asset transactions and associated risks; and
 - (vii) the establishment of a contingency plan to mitigate the effects of deteriorating market conditions.
- (c) The investment monitoring procedures established by the Board should ensure appropriate segregation between those who measure, monitor, settle and control investments, including derivatives, and those who initiate transactions. These procedures ultimately remain the responsibility of the Board, regardless of the extent to which the associated investment activities and functions are delegated or outsourced.

- (d) Licensees should establish effective procedures for monitoring and managing the asset / liability position to ensure that the investment activities and asset positions are appropriate to the liability and risk profiles. The Board should establish guidelines as appropriate with regard to the acceptability and extent of any mis-match between the assets and liabilities of the Licensee.
- (e) Where appropriate, regular resilience testing for a range of market scenarios and changing investment and operating conditions should be undertaken in order to assess the suitability of the asset allocation limits.
- (f) The Board should ensure that key staff involved in the investment activities have the appropriate level of skills, experience and integrity.
- (g) The risk assessment and management system must address the risks associated with investment activities, where these are significant, which include:
 - (i) credit risk;
 - (ii) market risk;
 - (iii) liquidity risk; and
 - (iv) custody risk.

Further guidance on the management of these risks is provided in Appendix II below.

- (h) Where the Board wishes to invest in derivatives (including similar commitments), it should establish an appropriate policy for their use which is reviewed annually. The Board should ensure that internal controls over derivatives and other complex investment instruments have been implemented and are adequate to ensure that risks are properly assessed, regularly reviewed in the light of changing market conditions and experience, and consistent with the Licensee's activities, overall investment strategy, asset and liability management strategy and risk tolerance. The policy for the use of derivatives should include:
 - (i) the purpose of using derivatives;
 - (ii) appropriately structured exposure limits for derivatives;
 - (iii) restrictions on the use or amount of certain types of derivatives; and
 - (iv) the establishment of individual responsibility and a framework of accountability for derivatives transactions.
- (i) Where the Board wishes to invest in derivatives, it shall ensure that:
 - (i) the Directors collectively have sufficient expertise and understanding of the proposed investments;

- (ii) only individuals or corporate counterparties who are suitably qualified and competent are responsible for conducting and monitoring derivatives activities;
- (iii) controls are in place to verify the pricing of the derivative instruments and ensure that the pricing follows market convention; and
- (iv) the Licensee has in place risk management systems to ensure that the risks arising from derivatives transactions can be analysed and monitored individually and in aggregate, and monitored and managed in an integrated manner with similar or correlated risks arising from non-derivative activities so that exposures can be considered on a consolidated basis.

Appendix II – Guidance on Other Risks to be considered

The following is guidance only in relation to specific elements of investment risk and in relation to other risks, which may be significant to Licensees.

1. Credit Risk

- (a) Credit risk is the risk of financial loss arising from default or movement in the credit quality of counterparties with whom the Licensee has an exposure, which can have an impact upon a Licensee's ability to meet its claims as they fall due. Credit risk includes:
 - (i) default risk- the risk that a Licensee will not receive in full the cash flows or assets to which it is entitled due to the default of the underlying counterparty;
 - (ii) downgrade risk- the risk that changes in the probability of future default by a counterparty will adversely affect the present value of the contract with the counterparty today; and
 - (iii) concentration risk- the risk of increased exposure to losses due to concentrations of exposures to one or limited counterparties.
- (b) When determining the investment strategy, the Board should consider:
 - (i) controlling the Licensee's credit exposure to single or limited counterparties by spreading investments; and
 - (ii) the implications of credit exposures to one or limited counterparties and the effect this will have on the Licensee's solvency position.
- (c) The use of The Insurance Business (Asset and Liability Valuation) Regulations, 2008 will help to ensure that assets are reduced by the expected defaults of certain counterparties.
- (d) In valuing securities and collective investment schemes at market value, due account is taken of the market expectations as to the credit worthiness of the counterparty.
- (e) The Board should be aware that the Commission may change the valuation basis for any asset (or liability) where they consider it necessary for prudential purposes. Although such situations would be rare, two examples are given for guidance:
 - (i) where there are heavy concentrations of exposure to one or limited counterparties; and

- (ii) where the Licensee has issued letters of credit substantially above outstanding losses, such that the “free assets” of the Licensee do not cover or undermine other insurance obligations.

2. Market risk

- (a) Market risk is the risk of financial loss arising from adverse movements in the level or volatility of market prices. Market risk includes:
 - (i) interest rate risk- the risk of losses arising from movements in interest rates;
 - (ii) currency risk- the risk of losses arising from movements in exchange rates; and
 - (iii) equity and other asset risk- the risk of losses arising from movements of market values of equities and other assets.
- (b) This risk may be managed by the appointment of a regulated investment manager. However, there should be suitable control procedures over a Licensee’s use of an investment manager, which should include:
 - (i) a requirement for the establishment of clear terms of reference between the Licensee and its investment managers;
 - (ii) a requirement for the Board to perform regular reviews of its investment managers to ensure that they are acting in accordance with their terms of reference;
 - (iii) controls over the appointment of suitably qualified and competent investment managers;
 - (iv) regular reconciliations of asset movements between opening and closing positions; and
 - (v) regular comparisons of actual result with benchmark, budgeted, forecast, or expected results.

3. Liquidity risk

- (a) Liquidity risk is the risk that a Licensee, though solvent, has insufficient liquid assets to meet its liabilities when they fall due.
- (b) The Board shall develop appropriate systems and controls to deal with liquidity management issues in relation to a Licensee’s investment activities. These should include those arising under normal market conditions, and those with stressed or extreme situations arising from general market turbulence or firm specific difficulties.

(c) The main sources of liquidity risk in relation to investment activities include:

(i) Asset liquidity

The Board should consider how to identify and monitor significant concentrations within its asset portfolio so as to reduce the sources of liquidity risk.

(ii) Marketable assets

The Board should consider how to assess the marketability of its assets, and the appropriateness of the marketability or realisability of its assets. In this assessment it may consider:

- (a) the speed with which the assets may be realised;
- (b) the expected date of maturity, redemption, repayment or disposal;
- (c) the credit ratings of the assets; and
- (d) the assessment of an asset's value and liquidity under a variety of different situations.

4. Custody risk

- (a) Custody risk is the risk of asset or investment losses due to inadequate controls over the safekeeping of assets.
- (b) Licensees should maintain adequate controls over their physical assets and the documents of title for investments and other assets. Segregation of duties between physical control of and authority to transact in assets is a basic management technique for custody risk. Licensees should use the services of recognised banks and specialist custodian services to safeguard their investments and other assets as appropriate.

5. Legal risk

- (a) Legal risk relates to the loss arising from legal action against a Licensee and from inadequate, incomplete or otherwise unsound legal documentation and practices that prevent a Licensee from enforcing a contract.
- (b) Legal action could arise from a dispute with a third party over a transaction or because of poorly prepared legal documentation granting a charge over a security.
- (c) The Board should consider the Licensee's exposure to legal risk and determine the action necessary to identify, monitor and control this risk.

6. Business risk

- (a) For a market based Licensee, business risk would be assessed in the context of its far and near business environments. Risk analysis should consider potential threats or other risks from the following sources:
 - (i) Far environment:
 - (a) Political factors
 - (b) Economic factors
 - (c) Sociological factors
 - (d) Technological factors
 - (ii) Near environment:
 - (a) Existing competitors
 - (b) Potential competitors
 - (c) Customers
 - (d) Suppliers

7. Regulatory risk

Regulatory risk is the risk of being involved in compliance breaches. For example, breaches of the insurance laws and regulations, other Guernsey financial services sector laws and regulations (banking, investment business and fiduciary business), money laundering and data protection laws.

8. Crime risk

Crime risk is the risk of being involved in compliance breaches, as above, but to an extent that an offence is committed. Crime risk also includes the risk of involvement in other criminal activity and offences including fraud (both by staff and third parties).

9. Systems and operations risk

Systems and operations risk is the risk of systems and operations not working as intended and an error or omission occurring as a result. This risk is mitigated by adequate operational procedures being set out in the procedures manual and appropriate training being given to managers and staff, in relation to procedures set out in the manual and office skills generally.

10. Information and communications technology risk

Information and communications technology risk is the risk of loss from failure or interruption of service in computer and communications systems (including phone, fax, Internet etc.). Information and communications technology systems design, infrastructure and external connections should meet operational needs and be robust. Proper backup and restore procedures should be in place and tested regularly.

11. Business continuity / disaster risk

Business continuity / disaster risk is the risk of loss (whether financial, reputational or otherwise) from business interruption due to any event, emergency or disaster, whether technology based or otherwise. Consideration should be given to putting a properly constructed business continuity plan in place.

12. Reputational risk

Reputational risk is the risk of loss of reputation for any reason other than as dealt with above, including for example, publicised complaints. Consideration should be given to reputational risk when accepting clients and to establishing public relations contingency plans.