IUA OF LONDON
INTERNATIONAL UNDERWRITING ASSOCIATION
ESTABLISHED 1999
A DECADE OF SERVICE

25 September 2009

feedback@walkerreview.org

Dear Sir,

Review of Corporate Governance in UK Banks and other Financial Industry Entities
The Walker Review – Comments from the International Underwriting Association

Thank you for inviting comments on the Review of Corporate Governance in UK Banks and other Financial Industry Entities.

The International Underwriting Association (IUA) represents insurance and reinsurance companies in the international insurance and reinsurance market working in and through London. Our membership, consisting of 41 general insurers and reinsurers, makes up approximately 95% of the company market. For further information about our organisation and its membership please visit our website, www.iua.co.uk under the section 'About the IUA'.

Our primary focus is upon the impact of the proposals on the provision of wholesale non-life insurance. Whilst the Walker Review concentrates on the functioning of corporate governance in the banking sector and other complex financial institutions there is obvious potential read across into (re)insurance which could therefore impact our members. We propose to make some general comments on the review findings before more specifically addressing some of the key principles and recommendations.

Executive Summary

- There should not be automatic read across of rules intended for banking and large financial institutions to insurance unless it is proportionate to do so and those rules are applied flexibly taking into account the differing size, business transactions and risk strategies of insurance firms;

- Due consideration should be given to existing and recent regulatory measures impacting corporate governance. A consistent and co-ordinated approach to governance should, wherever possible, be pursued;

- Many of the recommendations in the Review, and principles underpinning them, succeed in providing greater transparency in the decision making processes of firms and improving corporate governance standards at Board level.

- However, care has to be taken not to be overly prescriptive if provisions are read across to insurance. The proposals on the expected time commitments of NEDs and the Board Chairman, on the Risk Management Committee and on remuneration and long-term incentives may be suitable for banks but are less so for insurance companies and need to be interpreted accordingly.

General Comments

Banking and general insurance are fundamentally different financial transactions and risks and the perceived necessity for review caused by corporate governance failings in banking should not automatically be applied to all financial services, at least without consideration as to whether

proposals are necessary or proportionate. That said, in this case the core governance principles outlined are generally applicable across financial services and we support the intent of the review and the rationale behind it. It was the correct time to undertake the review and we feel that, overall, the recommendations represent a step forward in promoting effective corporate governance and increasing Board standards. It is important that companies have established governance structures in place and, equally importantly, have controls in place to adhere to them within a proportionate and risk based assessment framework.

The Walker Review needs to be considered in light of the myriad of other initiatives addressing corporate governance, particularly FSAs recently published Remuneration Code of Practice, the Turner Review consultation and subsequent enhanced approved person's regime. Further afield, we are aware of other relevant developments, particularly on remuneration at CEIOPS and from other European regulators such as BaFin, the German regulator. It is important for insurers that the various proposals are, wherever possible, consistent and co-ordinated to avoid uncertainty and the possibility of regulatory arbitrage. Thus we welcome that the key principles underpinning the Walker Review, and the majority of the recommendations therein, have also been raised elsewhere.

We continue to support the view taken (in the review) that there is nothing fundamentally wrong with the current corporate governance regime and that any recommendations, in the main, should be applied through revisions to the Combined Code or other FRC mechanisms. The 'comply or explain' approach works well and forms the key tenet of a sound and flexible governance structure. We welcome the recognition in the review that it is primarily company's practices, rather than the corporate governance structure itself, where the significant problems have arisen.

Finally, whilst corporate governance codes can help maintain and improve decision making processes and corporate practice, the treatment of systemic risk should remain within the remit of the regulator as best placed to assess the impact of practices on the wider economy at a macro level. Systemic risk should therefore be primarily dealt with by the FSA and at the EU level by the newly established European Systemic Risk Council and not catered for within corporate governance initiatives.

Specific Comments

Board Size, Composition and Qualification

We support the recommendations proposed in relation to Board size and constitution. As minimum, non-executive directors (NEDs) should devote sufficient time to their role and be given the requisite information, training and performance testing to ensure suitable performance levels. However, care has to be taken not to inadvertently reduce the number of talented professionals willing to undertake the role. Whilst 30-36 days work per annum is not an unreasonable undertaking for a NED appointed to a large bank, it may be less proportionate for other financial entities, including insurers.

In the insurance sector there are real concerns that the increased pressures and prescriptive rules on NEDs may cause the 'talent pool' to shrink. Recommendation 5 has essentially been implemented through the FSA enhanced approved persons requirements and extension to the scope of Controlled Functions. Though the new procedures are bedding in, experience of the revised regulatory approach has been that more in-depth interviews have been initiated in some cases but certainly not for all NED appointments and not, as yet, in an obviously targeted or necessarily proportionate approach. Clearly in this regard there are longer term costs and personnel issues for FSA to consider.

In summary we support the key principles, though care has to be taken to adopt a flexible and proportionate approach to ensure that the stricter requirements do not actually hinder the appointment of good NEDs and thus be potentially counter-productive to good governance and board diversity.

Functioning of the Board and Evaluation of Performance

We would expect recommendation 7, on the Chairman's time management, to be interpreted flexibly, dependent on the size and complexity of the company. There is also a risk in requiring a significantly greater time commitment of the Chairman that they may become too dominant in their position, almost acting in an executive capacity, to the potential detriment of good governance. The enhanced requirements on NEDs will help temper this and it occurs that the role of the Senior Independent Director (SID) will become even more important, particularly in communication with institutional investors. Thus, it would be worth further promoting the importance, availability and role of SIDs in future Combined Code revisions beyond the general provisions of recommendation 11. This would be particularly apt given that the review heavily promotes interaction between the Board and institutional shareholders.

Recommendations 6, 8 and 9 appear to reemphasise the existing Combined Code rules and are supported. With specific regard to NED scrutiny of executive strategy (recommendation 6), there is a danger that the work of the non-executive may stray into that of the executive director in that a much more in-depth working knowledge of complex financial issues might need to be acquired by the NED, who may be bringing a broader range of skills and perspective to the position beyond financial industry expertise, to be able to challenge the executive. Whilst the possibility should be there to challenge the executive we would expect in most scenarios that the core decisions on risk management and commercial strategy should remain with the executive with input from the Board on items such as corporate values, remuneration, audit and nominations.

Finally, we submit that the proposed evaluation statement suitably provides increased governance whilst allowing sensitive information on a company's processes to be withheld.

The Role of Institutional Shareholders: Communication and Engagement

Institutional shareholders have an important role to play in monitoring and challenging the Board and proposals to improve the engagement and transparency between the two entities are welcomed. It should, however, be emphasised that enhancing the role of institutional shareholders does not take away from the general principle that the running of the company is the ultimate responsibility of the Board. On a practical level, it is also difficult to see how applying specific rules on institutional investors might be effectively monitored and enforced.

Recommendation 14, on material changes in the Share Register, appears reasonable, albeit seemingly in line with existing rules on notifying the public company when a shareholder holds 3% share capital and 1% holding changes thereafter. There are also the notification thresholds outlined in the Transparency Directive. Thus, it is not immediately apparent what this recommendation adds to the existing regime.

With regard to recommendation 15, we have no problem with FSA contacting major shareholders to understand their motivation for selling their shareholding and also contacting Boards for their views. However, we would not support further FSA activity in individual cases if shareholders are acting in

accordance with regulatory rules. We presume that the FSA request for information from major shareholders would be with a view to considering systemic risks.

We agree that the remit of the FRC should be extended to cover the development of principles regarding engagement with institutional investors and fund managers (recommendation 16). However, we would maintain the Statement of Principles within the Combined Code, as the Code is well established and a single document would be preferable.

Finally, on disclosure of voting records, we tentatively agree that voting policies should be made freely available, though hold some reservations that the main impact of this may be to increase minority shareholder activism, which might not always be in the best interests on the company as a whole.

Governance of Risk

It is fundamental that the Board receives adequate information on the risk areas a company faces, its risk appetite, and the measures in place to mitigate and control risk. Clearly in the banking sector there have been deficiencies in ensuring that risk is integral to business decisions and oversight. Rectifying these failures is paramount to improving consumer and investor confidence. Particularly crucial is ensuring that the Board receives adequate risk information in an accessible format, rather than in more complex documents such as internal capital assessments. As far as insurance is concerned, we believe that the proposed Solvency II rules will provide a sufficient emphasis on adopting a risk management focus and suitable strategies.

To our mind, it is less important through what mechanism is used, whether it is through a risk management committee, audit committee or other entity. Any mechanism should have established regular links to the Board, ideally permanent representation, with the ability to raise items for consideration and, where relevant, block major decisions. Therefore, it would be preferable to link the recommendation on risk management to outlining the objectives being sought rather than prescribing how it should be done. It should be left for individual firms to put in place their own processes according to their size, existing structures and lines of business. It should also be emphasised that risk management remains the ultimate responsibility of the Board, however core functions are delegated.

We agree that the Board assessment of risk should be clearly outlined to shareholders in an easily accessible format. As above, though, we would leave it for individual Boards to consider how this should be disseminated.

Remuneration

We recently responded to the FSA consultation paper on remuneration (CP09/10) where we argued that the proposed Code of Practice for remuneration should not apply to general insurance and reinsurance business or should at least be interpreted flexibly and proportionately. We emphasised that throughout the financial crisis the core (re)insurance business functioned well and that FSA should ensure that the application of remuneration rules from the banking to insurance sector did not adversely impact the competitiveness of the London market and the quality of professionals available to UK firms. Our key position remains that remuneration should be aligned to outcomes developed in a risk management framework and subject to suitable internal controls and governance. By and large insurance operates to this principle and has not seen the fundamental problems experienced in the banking sector.

OF LONDON
International
Underwriting Association
Established 1999
A Decade Of Service

In line with the point on competitiveness, there is also the wider debate about who should lead on regulating remuneration (if anyone). In addition to the Combined Code and EU Member State regulatory activity, there has been activity at OECD and, more importantly, at CEIOPS within the Solvency II Framework Regulation. It is crucial for industry that there is consistency in this area and that, if rules are EU-based measures, they are not gold-plated into UK law.

We submit that the existing FSA SYSC rules relating to effective management of risk and sound and prudent management provide a flexible start point for consideration of firms' remuneration policies. As highlighted by FSA and in the Review, we would expect this to be underpinned by long-term incentives for management performance and considered bonus payments and severance conditions for senior executives and Board members. There has to be a degree of flexibility for firms to apply any principles. For example, a start-up business may need to provide greater or guaranteed short-term rewards to attract professionals from an established company. Also, in the insurance sector some classes of business are long-tail in nature, thus measuring performance against outcomes may only develop over a long period. Thus, a one size fits all approach will not work effectively and firms need to be able to set remuneration policies within their own requirements.

We are supportive of recommendation 29 on remuneration committee involvement in non-Board level senior executive's remuneration, though recognise that this may significantly increase the workload of the committee. There are also possible complications if the remuneration committee remit extends across a group enterprise. In the case of the remuneration committee of a small UK part of an international group, there may be issues of intra-group differences on remuneration policy according to the needs of each group member in their own jurisdiction.

We find recommendation 30, on disclosure, to be sensible in that it outlines the controls in place. However, care has to be taken that a 'league table' approach to remuneration is not inadvertently created at competitive cost (recommendation 31) and particularly that measures in this area should not be a prelude to individual disclosures in the future. As noted the key item is to ensure that oversight and controls are in place, rather than disclosure, and it may be preferable that the policy is disclosed may be sufficient. CEIOPS suggest *'The Remuneration policy should be transparent internally and adequately disclosed externally (Principle 6)'*, which seems sufficiently flexible.

We recognise and support the rationale for the proposals on long-term variable incentives in recommendation 33. However, the deferral of 50% of the award after 5 years seems excessive and goes further than the Code of Practice proposed by FSA. Moreover, prescriptive rules of this nature again lead to a one size fits all approach. FSA note in their draft Code of Practice that remuneration committees should have the skills and experience to reach an independent judgment on the suitability of the policy, including its implications for risk and risk management and also specifically on long-term awards that the vesting period of the deferred element should be appropriate to the nature of the business and its risks. We think this less prescriptive approach is preferable.

We hope our comments are useful in finalising the guidance and recommendations on corporate governance. We would be pleased to clarify or expand upon our comments as required.

Yours faithfully,

Christopher Jones
IUA Market Services Manager

International Underwriting Association of London Limited
3 Minster Court, Mincing Lane, London EC3R 7DD
Tel 020 7617 4444 Facsimile 020 7617 4440