Corporate Governance Code for Credit Institutions and Insurance - Undertakings

On 8 November 2010, the Central Bank of Ireland (the “Central Bank”) issued the Corporate Governance Code for Credit Institutions and Insurance Undertakings (the “Code”) which sets out minimum statutory requirements on how banks and insurance companies should organise the governance of their institutions.

1. Scope

The Code applies to:

- a bank licensed under Section 9 of the Central Bank Act 1971;
- a building society authorised under the Building Societies Act 1989;
- a credit institution registered as a designated credit institution under the Asset Covered Securities Act 2001;
- an insurance undertaking holding an authorisation within the meaning of paragraph (a) of the definition of ‘authorisation’ in Article 2(1) of the European Communities (Non-Life Insurance) Framework Regulations 1994 or Article 2(1) of the European Communities (Life Assurance) Framework Regulations 1994; and
- a Reinsurance undertaking as defined in Article 3 of the European Communities (Reinsurance) Regulations, 2006. (The Code does not apply to Captive Insurance undertakings and Special Purpose Reinsurance Vehicles).

The Code does not apply to foreign incorporated subsidiaries of an Irish institution.

Institutions which are subject to the Code (“Institutions”) are required to disclose in their annual report that they are subject to the Code and whether they are required to comply with the additional requirements for Major Institutions. Institutions must also submit an annual compliance statement to the Central Bank.

Major Institutions

Entities designated by the Central Bank as “Major Institutions” will face further requirements to ensure appropriate and robust corporate governance arrangements.

A “Major Institution” is an Institution that, in the Central Bank’s view, has any or all of the following features:

- a significantly large presence in the local market; and/or
- carries on significant international activities outside the State; and/or
- is significant (including, but not limited to, by reference to size, substitutability, and reputation).

In forming a view as to whether or not a credit institution is a Major Institution, the Central Bank will consider the nature, scale and complexity of the Institution and take account of any or all of the following:

- its business profile (e.g. whether retail or wholesale);
- its asset size including off balance sheet business;
- size of loan portfolio;
- the degree of risk involved in its business;
- its capital position;
- its turnover;
- its funding profile;
- its ownership structure;
- the number of its employees;
- whether it is a publicly listed company, a private company or a private company that is a subsidiary of a publicly traded company.

In forming a view as to whether or not an insurance undertaking is a Major Institution, the Central Bank will consider the nature, scale and complexity of the Institution and will take account of any or all of the following:

- its business profile (e.g. whether wholesale or retail);
- its asset size;
- number of contracts;
- the degree of risk involved in its business (e.g. involvement in riskier business such as variable annuity business) and liability;
- its technical provisions;
- its premium income;
- its capital position;
- its ownership structure;
- the type/class of insurance provided;
- the number of its employees;
- whether it is a publicly listed company, a private company or a private company that is a subsidiary of a publicly traded company.

2. Requirements of the Code

The Code sets out provisions on the membership of the board of directors of an Institution, the role and responsibilities of the Chairman and other directors and the operation of various board committees.

The board retains primary responsibility for corporate governance within an Institution at all times. Senior management also plays an important part in ensuring effective governance and is therefore responsible for operating effective oversight consistent with board policy. No one individual may have unfettered powers of decision.

Any director who has any material concern about the overall corporate governance of an Institution must report the concern without delay to the board in the first instance and if the concern is not satisfactorily addressed by the board within 5 business days, the director must promptly report the concern directly to the Central Bank advising of the background to the concern and any proposed remedial action. This provision is without prejudice to the director’s ability to report directly to the Central Bank.
3. Composition of the Board of Directors

The board of an Institution must be of sufficient size and expertise to oversee adequately the operations of the Institution and must have a minimum of five directors (seven directors in Major Institutions).

The majority of the board must be Independent Non-Executive Directors (“INEDs”). However, in the case of Institutions that are subsidiaries of groups, the majority of the board may be group non-executive directors provided that in all cases the subsidiary Institution shall have at least two INEDs or such greater number as is required by the Central Bank.

The board of an Institution must satisfy itself as to a director’s independence prior to his or her appointment.

The following criteria must be considered and given reasonable weight by an Institution when determining if a director is independent:

- any financial or other obligation the individual may have to the Institution or its directors;
- whether the individual is or has been employed by the Institution or a group company in the past and the post(s) so held;
- whether the individual is or has been a provider of professional services to the Institution in the recent past;
- whether the individual represents a significant shareholder;
- circumstances where the individual has acted as an independent non-executive director of the Institution for extended periods;
- any additional remuneration received in addition to the director’s fee, related directorships or shareholdings in the Institution; and
- any close business or personal relationship with any of the company’s directors or senior employees.

Each member of the board must have sufficient time to devote to the role of director and associated responsibilities. The board must indicate a time commitment expected from directors in letters of appointment. The Central Bank has set limits on the number of directorships that can be held by directors of an Institution.

The Central Bank considers that an individual holding more than five directorships of credit institutions and insurance undertakings or more than eight directorships in respect of non financial directorships creates a rebuttable presumption that the director has insufficient time available to fulfil his or her role and functions as a director of an Institution. Where it is proposed that a director of an Institution holds more than five directorships of credit institutions and insurance undertakings or more than eight directorships in respect of non financial directorships, the Institution must satisfy itself as to whether this is appropriate and seek the prior approval of the Central Bank.

For Major Institutions, the number of directorships of credit institutions and insurance undertakings held by a director must not exceed three where one of the directorships held is in a Major Institution. This restriction does not apply to multiple directorships within a financial services group. For directorships in respect of non financial directorships, the Central Bank
considers that an individual holding more than five directorships in a non-financial institution creates a rebuttable presumption that the director has insufficient time available to fulfil his or her role and functions as a director of an Institution. Where it is proposed that a director of an Institution hold more than five directorships, the Institution must satisfy itself as to whether this is appropriate and seek the prior approval of the Central Bank.

Institutions must review board membership at least once every three years and must formally review the membership of the board of any person who is a member for nine years or more. The Institution must document its rationale for any continuance and advise the Central Bank of this in writing.

An Institution must ensure that a majority of its directors are reasonably available to the Central Bank at short notice, if required.

4. Role of the Board

The Code sets out the role of the board of an Institution requiring it to understand the risks to which the Institution is exposed and establishing a documented risk appetite for the Institution. The board must clearly document its role and responsibilities and also establish a formal schedule of matters specifically reserved to it for decision.

The board must ensure that the Institution’s remuneration practices do not promote excessive risk taking and must design and implement a remuneration policy to meet that objective and evaluate compliance with this policy.

The board of each Institution is responsible for:

- the effective, prudent and ethical oversight of the entity;
- setting the business strategy for the Institution; and
- ensuring that risk and compliance are properly managed in the Institution.

The board must be able to explain its decisions to the Central Bank

The board must formally review its overall performance and that of individual directors, relative to the board’s objectives, at least annually. This review must be documented.

In respect of Major Institutions, every three years, an evaluation by an external evaluator shall be undertaken. Where the external evaluation is critical of the performance of the board, the frequency of subsequent evaluations must be increased to annually until acceptable performance is noted. Any evaluation carried out must be provided to the Central Bank.

The removal from office of the head of a Control Function (this includes internal audit, risk management, compliance and actuarial functions) must be subject to prior board approval. Any decision to remove the head of a Control Function must be reported within 5 working days to the Central Bank with clear articulation of the underlying rationale for the removal. The Code prohibits an Institution from entering into any agreement with a head of Control Function that would purport to preclude, or would dis-incentivise, the provision of information to the Central Bank by the head of the Control Function.

The Code also sets out detailed requirements for the position of Chairman, Chief Executive Officer (“CEO”), Directors and INEDs.
5. Meetings

Board members must attend each board meeting unless they are unable to attend due to circumstances beyond their control (for example, due to illness) and their attendance and eligibility to vote at each meeting must be evidenced in the minutes of each meeting.

The board must meet as often as is appropriate to fulfil its responsibilities effectively and prudently, reflective of the nature, scale and complexity of the Institution. In any event, the board must meet at least quarterly. In the case of Major Institutions, the board must meet at least 11 times a year and at least once per calendar month for 11 months of the year.

A detailed agenda of items for consideration at each board meeting together with minutes of the previous board meeting must be circulated in advance of meetings to allow all directors adequate time to consider the material and detailed minutes of all board meetings must be prepared with all decisions, discussions and points for further actions being documented. Dissensions or negative votes must be documented in terms acceptable to the dissenting person or negative voter.

The minutes of meetings must provide sufficient detail to evidence appropriate board attention, the substance of discussions and their outcome and must be agreed at the subsequent board meeting. Minutes must also document the attendance or non-attendance of members of the board.

The board must establish a documented conflicts of interest policy for its members and where conflicts of interest arise, the board must ensure that it is noted in the minutes.

6. Chairman

The Chairman must have relevant financial services expertise, qualifications and background or be required to undertake relevant and timely comprehensive training. There is a prohibition on an individual who has been a CEO, director or senior manager during the previous five years from becoming Chairman of that Institution and the roles of Chairman and CEO must be separate.

The Chairman must be an INED except in the case of a subsidiary where the Chairman may be a group director and the Chairman must be proposed for election or reappointment on an annual basis.

The prior approval of the Central Bank is required prior to the Chairman taking on any other directorships (other than within the group).

The Chairman must not hold the position of Chairman or CEO of a credit institution or insurance undertaking for more than one Institution at any one time.

7. Chief Executive Officer (“CEO”)

The CEO is the top executive responsible for the Institution with ultimate executive responsibility for the Institution’s operations, compliance and performance. The CEO must have relevant financial services expertise, qualifications and background or be required to undertake relevant and timely comprehensive training.

The CEO must not hold the position of CEO of a credit institution or insurance undertaking of more than one Institution at any one time.

The CEO’s contract must be reviewed at least every 5 years.
8. Independent Non-Executive Directors (“INEDs”)

INEDs must be identified clearly in the Institution's annual report.

INEDs must have a knowledge and understanding of the business, risks and material activities of the Institution to enable them to contribute effectively and must comprise individuals with relevant skills, experience and knowledge (such as accounting, auditing and risk management knowledge) who must provide an independent challenge to the executive directors of the board.

9. Non Executive Directors and Executive Directors

The role of the non-executive directors, under the Chairman’s leadership, is:

- to ensure that there is an effective executive team in place;
- to participate actively in constructively challenging and developing strategies proposed by the executive team;
- to participate actively in the board’s decision-making process;
- to participate actively in board committees (where established);
- to exercise appropriate oversight over execution by the executive team of the agreed strategies, goals and objectives and to monitor reporting of performance.

The role of executive directors, led by the CEO, is to propose strategies to the board and following challenging board scrutiny, to execute the agreed strategies to the highest possible standards.

10. Committees

At a minimum, the board of an Institution must establish an audit and a risk committee. Where the board comprises only 5 members, the full board may act as the audit and/or the risk committee.

Where an Institution is part of a wider group which has a group audit committee and a group risk committee, it may rely on those committees provided that the board is satisfied that they are appropriate to the specific circumstances of the Institution.

Where appropriate, the board should also consider the appointment of a remuneration committee and/or nomination committee. Major Institutions must establish audit, risk, remuneration and nomination committees.

Audit

An audit committee must be composed of non-executive directors, the majority of directors being independent.

Audit committee meetings must be held at regular intervals and, where appropriate, should coincide with important financial reporting dates. They must usually only be attended by the Chairman and members of the audit committee. However, members may also request the attendance of key individuals such as the external auditor, head of internal audit and the finance director.

The responsibilities of the audit committee must include at least the following:
• monitoring the effectiveness and adequacy of the Institution's internal control, internal audit and IT systems;

• liaising with the external auditor particularly in relation to their audit findings;

• reviewing the integrity of the Institution’s financial statements and ensuring that they give a “true and fair view” of the financial status of the Institution;

• reviewing any financial announcements and reports and recommending to the board whether to approve the Institution’s annual accounts (including, if relevant, group accounts); and

• assessing auditor independence and the effectiveness of the audit process.

Risk

The board must establish a risk committee separately from the audit committee with responsibility for oversight and advice to the board on the current risk exposures of the entity and future risk strategy.

The role of the risk committee must be to advise the board on risk appetite and tolerance for future strategy, taking account of the board’s overall risk appetite, the current financial position of the Institution and, drawing on the work of the audit committee and the external auditor, the capacity of the Institution to manage and control risks within the agreed strategy. The risk committee must oversee the risk management function.

The risk committee must ensure the development and on-going maintenance of an effective risk management system within the Institution that is effective and proportionate to the nature, scale and complexity of the risks inherent in the business.

11. Non Compliance

Failure to comply with the requirements of the Code may be subject to supervisory action and disciplinary procedures by the Central Bank including:

• the imposition of an administrative sanction under Part IIIC of the Central Bank Act 1942;

• the prosecution of an offence;

• the refusal to appoint a proposed director to any pre-approval controlled function where prescribed by the Central Bank pursuant to Part 3 of the Central Bank Reform Act 2010; and/or

• the suspension, removal or prohibition of an individual from carrying out a controlled function where prescribed by the Central Bank pursuant to Part 3 of the Central Bank Reform Act 2010.

Any Institution that becomes aware of a material deviation from the Code must report the deviation to the Central Bank within 5 business days. The Institution must advise of the background of the deviation and the proposed remedial action.

11. Timeframe

The Code applies to existing directors and boards of Institutions from 1 January 2011. Those Institutions which may need time to implement changes to systems and structures to become compliant will be given until 30 June 2011 to do so. Where changes to the Board are necessary,
this period will be extended to 31 December 2011 to identify and assess suitable candidates with appropriate experience and diversities.

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