TRADE UNION ADVISORY COMMITTEE
TO THE ORGANISATION FOR ECONOMIC
COOPERATION AND DEVELOPMENT
COMMISSION SYNDICALE CONSULTATIVE
AUPRÈS DE L'ORGANISATION DE COOPÉRATION
ET DE DÉVELOPPEMENT ÉCONOMIQUES
www.tuac.org

www.uniglobalunion.org

Public Consultation on Draft revised OECD Guidelines on Insurer Governance

Submission by TUAC and UNI Finance

Paris, 22 October 2010

TUAC and UNI Global Union Finance welcome the opportunity to comment on the draft proposal of revision of the OECD Guidelines on Insurer Governance. In partnership with UNI Finance – the global union federation of trade unions in the banking, insurance and other financial service sectors – the TUAC submits the following comments and marked-up for consideration by the OECD Insurance and Private Pensions Committee and the Secretariat.

Table of contents

The role of workers in the governance and risk management structure

With a very few exceptions (on compensation and whistle-blowing) the current draft is silent on the role and rights of workers. As it reads, it is as if insurers are operating without employees to sale their products, to manage client relationship, or to maintain back office operations. And yet workers are recognised generic rights in the corporate governance of companies as outlined in various OECD guidelines, including:

- The rights of stakeholders in corporate governance, including workers, are "established by law or through mutual agreements" (OECD Principle IV.A of Corporate Governance Principle), the latter implicitly refers to workers' right to collective bargaining with their employers;

- "Performance-enhancing mechanisms for employee participation should be permitted to develop", (OECD Principle IV.C of Corporate Governance Principle), the annotations of which specify inter alia "employee representation on boards" and "governance processes such as works councils that consider employee viewpoints in certain key decisions".

- "If employee representation on the board is mandated, mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the board skills, information and independence" (OECD Guideline VI.D on the corporate governance of state-owned enterprises). The annotations specify that "Employee representation on […] boards should not in itself be considered as a threat to board independence" and that employee representation "work will also require acceptance and collaboration by other members of the board as well as by the SOE management".

Accordingly – and contrary to the assertion made in the introduction, the current draft is not consistent with other relevant OECD guidance, including the OECD Principles of corporate governance.

In addition to their generic rights in corporate governance, workers also have a specific role in the governance and risk management of financial institutions, including insurance companies and mutuals. Employees in insurance companies are stakeholders with a long-term interest in the company. They and their representative bodies have specific knowledge of the company including how daily and routine practices can impact system- or company-wide exposure to risk. They can constructively challenge the views of management in designing risk management policies. Proper implementation of sound risk policies requires continuous monitoring and where needed adjustments in cooperation with the employees and their representatives bodies.

And yet, the current draft considers risk management from a purely top-down, or "tone at the top" perspective. This is not consistent with best practices among insurance companies that value their employees and their representative bodies in the internal governance structures. The draft should recognise the need for a "bottom-up" approach to risk management and control by making use of existing mechanisms for representation, information and consultation mechanisms of the workforce, as reflected in the Model Charter on Responsible Sales of Financial Products which was adopted by UNI Finance Steering Group in June 2010. These include works councils, employee representation at the board of directors and at the board's risk committee, as well as reporting to and dialogue with insurance supervisory authorities.

The risk management policy should also emphasise the role of well-designed employee remuneration and incentive structures in preventing predatory sales practices to customers. The 2009 Good Practices on Financial Education and Awareness Relating to Credit (Role of credit market players, para. 27) state that "consumers should receive objective and relevant explanations and advice commensurate with their degree of sophistication and needs. Sales staff or agents should be adequately qualified and trained in this respect, and their remuneration and incentive structure should be designed accordingly".

Accordingly, TUAC and UNI Finance recommend the following amendments:

Guideline I.A.1 (Key duties)
- "Board members should take into account the interests of policyholders in their decision-making and~~, as relevant,~~ other stakeholders<u>, including employees</u>."

Guideline I.A.2.c (Governance system)
- "<u>If employee representation on the board is mandated, mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the board skills, information and independence</u>".

Guideline I.A.2.e (Risk management, internal controls, and control functions)

- "The board should establish a comprehensive and well-defined risk management framework or strategy that defines the insurer's approach to risk, sets out the methods employed by the insurer to mitigate risk, <u>including risk awareness among employees,</u> clearly identifies those responsible for implementation, and reflects expected prudent behaviour on the part of the insurer.

- "The board should establish and oversee a comprehensive risk management and internal control system. The board should monitor the implementation of this system and ensure its effectiveness, soundness, and integrity. Employees should be an integrated part of the risk management framework. Their views and experience should be represented in board risk committees and other internal risk management-related governance structures including through the effective use of employee representative bodies as mandated by law or collective agreement"

Guideline I.A.2.h (Compensation)

- "The board should establish compensation arrangements for board members, management, and employees, including through collective agreement, that promote prudent behaviour consistent with the insurer's long-term interests and fair conduct toward consumers and policyholders".

Guidelines I.A.3.b (independence)

- "There should be a sufficient number of non-executive board members (at least a majority) to provide the basis for independent decision-making. Non-executive board members should be free of any influences that might limit their capacity to act in accordance with their key duties and provide objective oversight. Employee representation on boards as mandated by law or collective agreement should not in itself be considered as a threat to board independence."

Guidelines I.A.5 (Accountability)

- "Board members are accountable to shareholders (and member-policyholders) for their performance and the general direction, management, and performance of the insurer. Board-level employee representatives are accountable to the workforce that elected them"

Guideline II.D (Management Structures)

- "The structures include employee participation mechanisms as mandated by law or through collective agreement, including employee representation on boards and governance processes such as works councils that consider employee viewpoints in certain key decisions.

Guideline II.C (compensation):

- "The risk management and internal control system should consider any risks arising from compensation arrangements and incentive structures. Sales staff or agents should be adequately qualified and trained to meet the needs of consumers, and their remuneration and incentive structure should be designed accordingly."

Guideline I.B.2 (Responsibilities and functions)

- Key executives should […] Establish sound internal governance practices and effective internal organisational structures, including through employee participation mechanisms as mandated by law or collective agreement ; […] Promote effective human resource management, including through recruitment policies and activities, collective bargaining, training, and succession planning

Guideline I.B.4. (Reporting)

- "Key executives should report to the board and any of its committees on a regular basis and, to this end, should provide accurate, relevant, and timely information to the board and to employee representation bodies (such as works councils) as mandated by law or collective agreement in a clear and intelligible manner and ensure that this information is well understood."

Guidelines IV.D. (Know customer)

- "Insurers should assess the level of prospective clients' understanding of insurance products and risks. This assessment should apply in particular to contracts that are complex, involve commitments that are long-term or represent a substantial proportion of current and future income, or involve an important transfer of risks <u>to clients or</u> to policyholders."
- "~~Where appropriate~~ in light of the nature and complexity of the contract, insurers should ~~seek to~~ understand the needs, risk tolerance, and risk capacities of their customers <u>and adapt their sales policies and human resource policy accordingly</u>."

Alignment with best practices of corporate governance

The draft suffers from a few misconceptions about corporate governance. This is the case of the notion of independence, which in the text is defined as independence from the management and from the company. However, the OECD Principles of corporate governance defines independence vis-à-vis the management of the company, but not the company (or group) itself. In some countries, independence is extended to consider controlling shareholders.

The text also lacks behind with regard to the separation of CEO and chair functions. The current draft includes a copy pasted reference to the OECD Principles of corporate governance according to which such separate "may be regarded as good practice". This is not in line with more recent guidelines (including the above mentioned OECD Guidelines corporate governance of state-owned enterprises) and does not fit with the aspirational nature of the draft.

Whistleblowing happens rather rarely in a company's life. As such, there definitely is a risk that mistakes are made in handling the case which may not be easy to repair. These mistakes may harm the whistleblower but may also result in collateral damage for other people, like persons named in the investigation who in turn do not have full access to recourse and redress. Accordingly, the draft should stress that a whistleblowing case always be handled by a properly trained department. In addition, it should stress that people that have complaints or an appeal relating to the investigation should be able address their grievances to a separate body (or committee) that is independent from the team that carries the investigation itself.

Other concerns relate to the right of workers to privacy and collective representation (in the case of risk control functions), ill-defined expressions ("tone at the top"), misconceptions about corporate values and objectives, and specific consideration for two-tier board systems (regarding separation of CEO and chair functions).

Accordingly, TUAC and UNI Finance recommend the following amendments:

Guideline I.A.2 (Responsibilities and functions)

- "Board members should ~~set the "tone at the top" by~~ establish~~ing~~ and promot<u>e</u>~~ing~~ a proper risk culture and an ethical and sound control environment ~~and by leading by example~~."

Guideline I.A.2.a (Values and objectives)

- "Board members should establish the fundamental values and objectives of the insurer, consistent with <u>relevant regulations including insurance regulation,</u> ~~the expected role and activities of insurers in the financial system~~ and, in some countries, the social security system. These values and objectives should be communicated widely throughout the insurer."

Guideline I.A.3.b (Independence)

- (grey box) "In order to promote greater independence of decision-making in a group structure, a substantive proportion of non-executive board members should be independent of ~~the group and~~ its management.
  ~~Separation of~~ the positions of chair and chief executive officer should be separated ~~may be regarded as good practice~~. In the case of two-tier board systems, the head of the lower board (management board) should not become the Chair of the Supervisory Board on retirement."

Guideline I.B.5 (Accountability)

- "Key executives are accountable to the board for their performance and the direction, management, and performance of the insurer".

Guideline II.B

- "The control functions should be able to access any persons or documents within the insurer and obtain any other information relevant for their responsibilities. Proper safeguard mechanisms and rules should be in place to protect the right of employees to privacy and to collective representation."

Guideline II.F (Whistle-blowing)

- "Appropriate mechanisms should be established within an insurer so that employees, their representative bodies, and outside stakeholders can bring matters to the attention of the board or to the supervisory authority with respect to inappropriate actions and behaviour within the insurer".

- "Those providing this information should enjoy adequate protections and confidentiality to assure the effectiveness of such disclosure or "whistleblowing" mechanisms. Full anonymity of whistle-blowers must be ensured and the rights of those named in the investigation should be fully ensured."

- "These mechanisms should imply a properly trained entity to handle cases and a dedicated point of contact, independent of the one handling the initial investigation, where any party (whisteblower, persons named in the investigation) can address grievances regarding the handling of the investigation."

Readability and clarity of the text

There remains considerable room for improvement of the current draft to ensure better readability and clarity of the text. There are repetitions in the text that could be avoided. As an illustration bullet points 3 and 4 of Guideline I.A.2.e "Risk management, internal controls, and control functions" could usefully be consolidated in bullet points 1 and 2. In addition, it is not clear to us why a distinction is made between the core text of the document and the "specifications" highlighted in the grey boxes. The Guidelines themselves are not numbered which we believe will not be helpful for any future assessment or peer review exercises on the implementation of the text. The style and wording of the text could be simplified and the use of adverbs such as "well-defined" and "clearly" should be avoided because they are a given and hence do not add value to the draft. Also, standard practice at the OECD is for the annotations to be structured along side the guidelines themselves (ie. one guideline or principle correspond to one annotation section) which does not seem to be the case here.

Accordingly, TUAC and UNI Finance recommend:

- Eliminating repetitions between the individual guidelines and un-necessary wording in the text;

- Eliminating the distinction between the core text and the “specifications” in the grey inboxes or explaining why such distinction is made;

- Numbering of the guidelines and paragraphs;

- Structuring the annotations alongside the guidelines.