

# AIDA Questionnaire on the Corporate Governance of Insurers

## World Congress, Rio, 2018

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### I. General

1. In your jurisdiction, what corporate governance models are available to insurance companies? In case multiple models are available, describe the main differences and the allocation of management and monitoring powers among the relevant bodies/committees and which model is generally or ideally adopted by insurance companies.

REPLY:

In accordance with the positive legislation of the Republic of Serbia insurance companies have an obligation to establish a two-tier or dual management. Namely, the Law on Insurance of the Republic of Serbia<sup>1</sup> as *lex specialis* defines the two-tier management system as an imperative, with certain specifics in the part of management and control. The structure of the bodies consists of: (1) the Assembly, (2) the Supervisory Board and (3) the Executive Board. The common notion of Management comprises the Supervisory and Executive Boards.

When considering the legal nature of the Supervisory Board's competence, on one hand a circle of affairs related to the management of the company can be noticed, while on the other hand it includes supervisory powers derived from the nature of this body and which are of importance for the lawful business of insurance companies. It should be highlighted that the supervisory power of this body correlates to risk management in the insurance company.

2. What are the main sources of regulation addressing corporate governance of companies (and in particular of insurance companies)? e.g., statutes, regulations, other rules/recommendations issued by national and supranational supervisors/regulators, self-regulation, codes of best practice, codes of ethics.

REPLY:

The main sources of law relating to corporate governance (insurance companies, in particular) are: the Insurance Law, the Companies Act, Decisions and other Acts of the National Bank of Serbia as regulatory and supervisory body for the insurance sector, the guidelines of the National Bank of Serbia referring to the area of corporate governance and risk management, the Code of Corporate Governance, the Corporate Charter, the Articles of Association, etc.

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<sup>1</sup> Insurance Law (the Official Gazette of the RS no. 139/2014).

3. In your jurisdiction, are you aware of any insolvency or distress of an insurer directly attributable to poor corporate governance standards or practices or failure to adequately implement and apply such principles? If so, please identify the main triggers of the insolvency.

REPLY:

In the period from 2004 to 2012, a number of insurance companies licenses were revoked and a bankruptcy and / or liquidation procedures were initiated, due to poor standards of corporate governance, as well as inadequate implementation of the principles of corporate governance.

4. In your jurisdiction, is corporate governance regulation applied according to the nature, scale and complexity of an insurer's business? If yes, please describe any significant differences and rationale for the differences.

REPLY:

Pursuant to the Insurance Law, the management system in the insurance company is based on the proportion principle. In addition, assessing each individual risk profile of a particular insurance company and its risk propensity is the starting point and the main guidance for the application of the principle of pro rata.

The management system is adjusted to the size and organizational structure of the company, the scope of activities and types of insurance that the company carries out and forms part of a comprehensive corporate governance system. It should be kept in mind that the system includes the mandatory structure of the company's bodies, their responsibilities, powers and the risk management system. The establishing of a risk management system is an obligation of every insurance company and involves the organization of the following key functions: (1) risk management, (2) internal audit, (3) actuarial valuation and (4) control of legality. Thereat, the National Bank of Serbia, as a regulatory body, prescribes in detail the manner of regulating the management system and the conditions for entrusting certain activities of the company to third parties, as well as the manner of supervising the performance of entrusted tasks by the service provider.

The scrutiny of the public register of insurance business entities in the Republic of Serbia showed that there are differences in the number of members of the Executive and Supervisory Board in insurance companies. Thus, many insurance companies have more members of the Executive and Supervisory Boards than the legal minimum.

The data concerning the individual organization of the internal control system and the specifics in organizing this system in insurance companies are not publicly available.

5. Please provide specific examples of corporate governance structures and practices that are better implemented through self-regulation rather than through legal or supervisory requirements.

REPLY:

The structure of corporate governance in terms of the body of the company is defined by the imperative norms of the Law on Insurance, which prescribes the mandatory minimum number of members of the bodies as well as the necessary conditions for appointment of members of the company management and includes the prior approval of the National Bank of Serbia as a supervisory and regulatory body for the appointment of the Management. Therefore, all insurance companies have an identical corporate governance structure in terms of established bodies of company. There are differences in the structure of the bodies of the company, concerning the number of members of executive, non-executive and independent members and are subject to the internal regulations of the company.

6. In case your jurisdiction was recently requested to implement domestically certain corporate governance principles set forth by supranational regulations, describe the main obstacles and problems (if any) that resulted from such process.

REPLY:

Since 2015, a new Insurance Law has been introduced incorporating the principles contained in the EU Solvency II Directive.

According to the report of the supervisory and regulatory body of the Republic of Serbia, the willingness and capacity of the companies for the implementation of Solvency II as well as the previous implementation of the second pillar and the comprehensive readiness of the companies for the implementation of Solvency II have been analyzed. Analysis of the second pillar implementation has been examined through the establishment of key functions and the quality of the companies' own risk and solvency assessment (ORSA), where it has been established that there is an adequate level of readiness and capacity for Solvency II implementation in this segment. By analyzing the overall willingness of companies to implement Solvency II, it has been established that the insurance sector in Serbia has put a significant emphasis on the implementation of Solvency II, that the management of companies is, as a rule, involved in its implementation, and that most companies consider Solvency II to have a positive effect on their business.

In insurance companies they consider that employees do not have sufficient knowledge of Solvency II and that there is a great need for capacity building, with the expected support of parent companies from the European Union and the National Bank of Serbia. A number of companies, as part of European Union groups, have already had some experience in applying Solvency II, with the company emphasizing the complexity of the first pillar that relates to quantitative requirements.

Based on the conducted analyzes, it has been established that there are quality prerequisites for the implementation of Solvency II in Serbia. A significant test of the readiness of the domestic insurance sector for the implementation of Solvency II will be the implementation of a quantitative impact study envisaged for the second phase of the Strategy,

which is currently being prepared at the National Bank of Serbia.

7. Are there any significant differences between general corporate governance rules and the specific rules governing insurance companies?

REPLY:

There are significant differences in the selection of governance models between general rules of corporate governance and specific regulations governing the activity of insurance companies. Unlike the Companies Act ruling, as *lex generali*, where there are two systems, one-tier or two-tier, as alternatives, the Insurance Law establishes a compulsory two-tier management system for insurance companies.

There are also differences regarding the issue of independent members of the Supervisory Board. The Insurance Law contains more stringent rules regarding the number of independent members. In accordance with the general rules, the joint stock company, according to its free assessment, determines the number of independent directors. However, in the conditions of existence of public joint stock companies, the Companies Act sets the minimum standards by defining that they have at least one independent director, while the Insurance Act as *lex specialis* raises this standard, requiring insurance companies to have at least one third of the members of the Supervisory Board in the status of an independent member.

Regulating the firm structure of the insurance company's bodies under the Insurance Act, as well as the membership structure with a number of additional requirements, a special regulation significantly limits the degree of discretionary powers of the Insurance Company in relation to other economic entities.

## **II. Fitness and Propriety of Board Directors**

1. Are there any laws or regulations already adopted or any proposals in your jurisdiction, relating to the qualification and composition of board directors in an insurance company? If so, please explain.

REPLY:

The regulations that primarily apply to the qualification and the composition of the insurance company's Management are the provisions of the Insurance Law, the decisions of the National Bank of Serbia, as the by-laws and internal acts of the company. The provisions of the Law on Business Companies are applied accordingly.

Legal provisions are of mandatory nature. Namely, the candidate for a member of the Management must have a good business reputation and appropriate professional qualifications, knowledge and experience needed to perform the function of a member of the Management. The prescribed criteria are applied in the process of appointment of a member of the Management after the previously obtained approval of

the National Bank of Serbia. The insurance company may set additional conditions with its by-laws.

2. In your opinion, what factors, conditions, or incentives might weaken the independence of the board of directors or individual members of the board?

REPLY:

The existence of an information asymmetry due to failure to timely, completely, continuously report to the members of the Supervisory Board and / or denial of important information by the Executive Board may weaken the independence of the Board of Directors or individual members of the Board.

The correct understanding and comprehending of the importance of independent members by the company's shareholders who are responsible for the appointment of the Supervisory Board are an important factor for objective and efficient decision making within the insurance company. This implies a careful selection of independent members, irrespective of the impact of the policy and the essential understanding of the need to appoint independent members, and not the fulfillment of only the formal requirements laid down by law.

3. How does an insurance company ensure that individual board members and the board collectively have enough knowledge to monitor and oversee the activities of the insurer appropriately, particularly where specific expertise is needed?

REPLY:

The insurance company ensures that individual Management members and the Management collectively have sufficient knowledge to monitor and supervise the activities of the insurer in an appropriate manner, by carefully and responsibly selecting and proposing only those persons who fulfill the statutory requirements as a minimum standard. This includes the choice of persons with integrity and professional qualifications as well as expert knowledge in the key areas of the company's business, as well as timely, complete, and continuous reporting by the Executive Board.

4. Are there significant differences in terms of requirements and duties between executive and non-executive members of the board of directors of an insurer?

REPLY:

According to the law of the Republic of Serbia, the Management consists of the Supervisory and Executive Boards.

The provisions of the Insurance Law, the decisions of the National Bank of Serbia and the Companies Act as sources of law apply to the conditions for appointment of Management members of the insurance company. In an identical manner, the Insurance Law identifies the conditions for appointment and the function of a Management member (executive and non-executive members), as well as revoking of the approval for

performing the function of a member of the Management. Additional requirements are set for the appointment of members of the Executive Board, as follows: (1) the mandatory requirement is a full-time employment in an insurance company, and (2) a notice on business intentions in the management of a company for the period during which a member of the Executive Board is appointed, evaluated by the National Bank of Serbia in the process of giving prior consent to the appointment of a member.

The Company's Articles of Association determines the total number of members of the Executive Board (the minimum legal requirement is 2 members) and the Supervisory Board (the legal minimum is three members). The members of the Executive Board are appointed and dismissed by the Supervisory Board.

There are differences in the part of the obligations and responsibilities of executive and non-executive members. Thus, the role of the Supervisory Board is managerial and supervisory, which stems from the nature of the authority of this body. The members of the Executive Board are de facto executive members of the Management and have the authority and responsibilities in managing the Company's operations and performing daily supervision over the activities of employees in the company, that is, they are responsible for organizing the activities of the insurance company.

5. In your jurisdiction are there any black letter rules or general principles that enable directors to rely upon external opinions when addressing issues or aspects where specific expertise is needed?

REPLY:

Pursuant to the provisions of the Companies Act, the members of the Management may base their actions on the information and opinions of the persons skilled in the relevant field, who they reasonably believe acted conscientiously<sup>2</sup> in that case.

6. Describe the extent and scope of supervisors'/regulators' intervention with reference to the qualifications and to the activities of the board of an insurer.

REPLY:

The National Bank of Serbia, as a supervisor and insurance policy maker, prescribes with its regulations more detailed conditions for the election of members of the Supervisory and Executive Boards. At the same time, under the conditions laid down by the Law, it may withdraw the consent to perform the function of a member of the Management for elected persons, if in the procedure of direct and / or indirect supervision it determines irregularities and / or illegalities in the work of the company.

The decision on the implementation of the Insurance Law related to the

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<sup>2</sup> Companies Act (the Official Gazette of the RS no. 36/2011, 99/2011, 83/2014-oth. Act and 5/2015), Article 63, p. 4.

issuance of a license to carry out insurance / reinsurance business and certain approvals of the National Bank of Serbia regulates in detail the requirements in terms of the eligibility of persons managing / supervising companies in accordance with Solvency II and the EIOPA guidelines.

7. Are there any special rules and regimes applicable to the governance of subsidiaries belonging to an insurance group, also in terms of information flows?

REPLY:

The National Bank of Serbia, as a regulatory and supervisory body for the insurance sector, cooperates with supervisory and other trusted authorities in the Republic and abroad, as well as with international organizations in performing its activities in accordance with the Law on Insurance. Therefore, the National Bank of Serbia may conclude cooperation agreements, or exchange data obtained in the exercise of supervision over the performance of insurance activities and other tasks determined by law, provided that these bodies or organizations are obliged to keep the confidentiality of such data in the manner prescribed by law.

There is a legal obligation for legal persons with qualified participation (10%) in the equity of the insurance company to provide the National Bank of Serbia with data and information on (1) newly appointed members of the management bodies, (2) persons who acquire qualified participation in such persons or become closely related to them, as well as (3) any status change - at the latest within 30 days from the day of the knowledge of the future status change.

The National Bank may request the communication of other information from qualified acquirers related to them themselves and / or to persons with whom they are closely related to and which is important for the clarification or interpretation of data and information or for determining whether the conditions, under which the authorized acquisition, that is, the increase in the qualifying holding in the stock company for insurance, have altered.

The Insurance Law contains certain provisions that shall apply after the accession of the Republic of Serbia to the European Union.

According to the information of the National Bank of Serbia<sup>3</sup>, it is necessary to establish the group supervision framework in accordance with the new rules and to harmonize the requirements related to the termination of the work of the company within the European Union.

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<sup>3</sup> Published:

<https://www.nbs.rs/internet/latinica/scripts/showContent.html?id=11274&konverzija=yes>.

### III. Risk Management

1. In your opinion, what is the biggest risk challenge (e.g. regulation, capital standard, pricing, interest rate, cyber, terrorism, etc.) facing the insurance industry today in your jurisdiction?

REPLY:

"In 2017, the National Bank of Serbia, in accordance with its function as the supervisor of the insurance sector, carried out the second successive stress test of the insurance sector in Serbia in order to continuously monitor the risk exposure of individual insurance / reinsurance companies ..." "The results of stress tests indicate that the insurance sector even after the stress test, i.e. in the case of the realization of extreme and low probability shocks, remained stable and highly capitalized, and that capital adequacy would not be endangered."<sup>4</sup>

The presence of operational risks should certainly be emphasized, that the employees in insurance companies do not have sufficient knowledge of Solvency II, and also that there is a great need for capacity building.

2. What specific laws or regulations, actual or pending in your jurisdiction, will present significant implementation risk challenge toward the insurance industry?

REPLY:

When considering the issue of the risk management system in insurance companies, it should be pointed out that, in accordance with the EU accession process, the phase implementation of Solvency II in Serbia is planned based on the level of compliance that has been achieved so far. Namely, the Law on Insurance, which has been in implementation since 2015 according to the Report of the National Bank of Serbia, qualitative requirements of the second pillar of Solvency II were implemented. The next phases of implementation will rely on the level of compliance that has been achieved so far, the expected development of the insurance sector in Serbia, and the analysis of the effects of the Solvency II implementation on the domestic insurance market.

For the first time in the Republic of Serbia the qualitative Solvency II requirements, including key functions (risk management, internal control system, actuarial function and internal audit), ORSA (companies for the first time performed their own solvency risk assessment in 2015) and the entrustment of operations to third parties, were defined in the Decision on the management system in the insurance / reinsurance company.

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<sup>4</sup> Published:

<https://www.nbs.rs/internet/latinica/scripts/showContent.html?id=11854&konverzija=yes>.



#### IV. Ethics and Corporate Social Responsibility

1. Please provide any concrete examples where business ethical standards and/or corporate social responsibility standards have been applied and have changed the behaviors of the insurance company.

REPLY:

Insurance companies in the Republic of Serbia, which are owned by large insurance groups operating around the world, have adopted ethical standards contained in the Code of Conduct. It remains to be seen how much the adopted standards *de facto* changed the behavior of the insurance company.

2. In your jurisdiction, are there any specific laws or regulations already adopted or any proposals, or any arrangements in place in the governance system, relating to the protection of policyholders' and/or financial consumers' interests?

REPLY:

Under the law of the Republic of Serbia, the insurance company as well as other subjects of supervision in the insurance business are obliged to provide protection of the rights and interests of insured persons, policyholders, insurance beneficiaries and third injured parties **in accordance with regulations, professional rules and good business practices.**

The Insurance Law defines the protection of financial services users through specific rules and obligations of insurance companies related to the provision of information to these persons both at the conclusion of the insurance contract and during the life of the insurance contract. Therefore, the Solvency II requirements have been implemented by prescribing the minimum content of such notification with regard to the obligation of the companies to adequately inform the policyholder before concluding the insurance contract and during its validity.

Also, in accordance with the Insurance Law, members of the Management are obliged to take measures to prevent illegal and inappropriate actions and impacts which are harmful or not in the best interest of the insurance joint stock company and its shareholders and which are performed by persons closely related to the company - in order to protect insurance services users.

3. In your jurisdiction, is an insurance company required to produce an annual Corporate Social Responsibility (CSR) report or a Global Sustainability Initiative (GSI) report? If so, what context needed to be disclosed in these reports?

REPLY:

The insurance company has no obligation to submit either a Corporate Social

## **V. Disclosure**

1. In your opinion, what mechanisms shall be in place or considered in an insurance company to ensure the transparency of its governance structure? (e.g., the articles of association, the organization chart, any existing committees, the major shareholders, the ethical standard, corporate social responsibility, etc.)

REPLY:

According to the law of the Republic of Serbia, through imperative norms, requirements regarding certain mechanisms of disclosure of the management structure of the company have been defined, through the obligatory content of the Article of Association.

The National Bank of Serbia maintains a register of data on insurance companies with data on founders, qualified holders and members of the management of these companies.

There is also a register of companies in which data on qualified holders and members of the management of insurance companies are entered as well as changes of these data. If the supervision measures are pronounced to qualified holders, the members of the management of the company, the National Bank shall notify the competent register of companies, in order to record that measure. Also, data on the introduction and cessation of judicial management in the insurance company are recorded in the register of the competent authority.

Special regulations of the National Bank of Serbia provide for the management at insurance companies.

Simultaneously, there are codes of professional ethics that are incorporated into a number of insurance companies in the form of standards, especially in companies that are part of insurance groups operating on the European Union market and around the world.

2. Are there any governance practices that, in your opinion, can best be achieved through disclosure rather than through specific supervisory requirements? Which governance practices should be mandatory for an insurance company?

REPLY:

Under the law of the Republic of Serbia there are management practices whose application is mandatory at insurance companies.

3. What is the interplay between market abuse regulations and other disclosure/transparency rules applicable to listed insurers and industry specific rules applicable only to insurance companies?

REPLY:

There are certain additional rules regarding the reporting of financial market regulators and the public when it comes to public companies.

There are numerous reporting rules by insurance companies that are carried out continuously and in accordance with the requirements laid down by the Insurance Law and by-laws issued on the basis of this Law.

## **VI. Outlook**

In respect of the corporate governance of insurers, please describe your criticisms on the system in your jurisdiction, any recommendations for the future, and/or the main challenges which insurance undertakings encountered.

REPLY:

Corporate governance can be viewed as a complex and multi-layered system in continuous development and movement, and whose architecture is based on the established hierarchy of the organs of company and organizational structures that are permeated by the various established relationships, both within and outside company. The complexity of the different relationships and processes that are based on management requires primarily the existence of certain management strategies that pave the way for the company to move and develop in the pursuit of the strategic goals. The multi-layeredness of this system is characterized by a series of subsystems with vertically and horizontally established connections, which are determined by it and which are its basic constituents. Within the framework of the set strategy of the company's operations and strategic goals, the company strives to identify and examine the essential risks to which the company is exposed and / or will be exposed to *pro futuro*.

The insurance company, following the rules of corporate governance and certain specific business principles, which are the imperative of their business, has the task and obligation to ensure the protection of the interests of the company, shareholders, and above all the protection of the interests of the users of its services. In addition, the focus of the regulatory framework is the interest of financial services users and their protection. A major challenge for insurance companies can be the question of how the interests of company and users of services will be reconciled as naturally opposed, since they represent two sides of the obligation, that is, the insurance contract. The answer to this question will largely depend on the responsible and conscientious and lawful actions of both the Insurance Company's Management and the Supervisory Authority.

Considering the question of how the Management will protect the interests of insurance service users if they are contrary to the interests of the company, the answer lies precisely in the fact that the user of the insurance service is the entity from whose presence and decisions to conclude an insurance

agreement depends the survival of the insurance company. Therefore, under conditions of free competition, it will be necessary to dedicate more attention to the needs of clients and their requirements. Such a constellation of relationships necessarily leads to the approximation of the opposing interests and the establishment of an integrated Management System for all the risks that the company is exposed to in its business. The principle of legality / compliance of business operations and its materialization through the institute of compliance with the regulations as its material substrate represent, among other things, a strong cohesion role in overcoming possible conflicting issues and achieving the goal of lawful and conscientious actions in protecting the users of the insurance services and their interests. Namely, at the core of the principles of legality, the institute of business compliance, as its external manifestation, is materialized by the activities of the Management of the company. Therefore, legitimate business *per se* implies the creation of a culture of respecting positive legal regulations with the consistent application of both company's external and internal acts and represents the imperative obligation and responsibility of the Insurance Company's Management. It is precisely the consistent application of the said principle that ensures the integrity of the company and its bodies in the performance of its functions in the long-term, and protects the company from the loss of operating license, as well as financial losses due to violation of regulations.

However, in the new legal solutions, some abstraction is evident as well as uncertainty in regulating risk management approaches and the management system, which opens up space for different interpretations and understanding of the Management System. Thus, the Insurance Law states "an efficient management system", "an efficient risk management system", "an efficient system of internal controls" and the like. The uncertain approach to the management system defining is contrary to the principle of legal certainty and predictability of regulations, and legal certainty as a standard to be pursued. Taking into account the above, it is necessary to think of the need for certain precision, with a view to *de lege ferenda* further development of the regulations in this field.

A new legal solution in the law of the Republic of Serbia regarding the obligation of selecting independent members seems to be justified and we believe that it can contribute to the improvement of corporate governance, provided that it is appropriately implemented, with good work conditions for independent members and disabled information asymmetry.

It can be noted that the regulatory solutions of the Republic of Serbia, especially for insurance business, are heading in a good direction, or treading on a safe path towards the establishment of prudent management, which creates the previous conditions and greater chances for the successful functioning and development of companies. In doing so, particular attention should be paid to the new regulatory requirements for a risk-based management.

The positive values of the Law in the regulation of business principles at the level of general business standards should also be highlighted. However, since the rules of business conduct are not clearly dimensioned or defined, it is extremely significant for the business practice of the Republic of Serbia to adopt the new Code of Conduct for Insurance Companies by the Association of Serbian Insurers.

The management system governed by Community law with the greatest number of principles is incorporated into our legal system. Namely, the law is based on imperative and prohibiting rules, which may be of importance to our legal system *de lege lata*, due to the fact that the Republic of Serbia has not yet emerged from the transition process. Therefore, such a system can have an important impact on greater legal certainty in the application of the norm.