

AIDA Questionnaire
Corporate Governance of Insurers

World Congress, Rio, 2018.

Mexico

Nader, Hayaux y Goebel, S.C.

Yves Hayaux du Tilly

Luciano Perez

Julian Rodriguez

Carolina Castañeda

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.

The Insurance and Bonding Companies Law (*Ley de Instituciones de Seguros y de Fianzas*) ("**LISF**"), which entered into effect in 2015, sets forth a single corporate governance model similar to that under Pillar II of Solvency II (qualitative requirements). Based on such model, insurance companies must implement an effective corporate governance system, which requires the creation and implementation of effective systems and guidelines relating to internal controls, risk management, internal audit, actuarial and outsourcing, among others.

Also, insurance companies must maintain a transparent and appropriate organizational structure, a clear and adequate distribution of functions, and effective mechanisms for the disclosure of information and reporting.

The LISF provides a single-tier system, where the Board of Directors is the main responsible to implement and supervise the corporate governance system of the insurance company. The Board of Directors must create at least four advisory committees to assist it in the creation, implementation and surveillance of the different areas that comprise the corporate governance system of the insurance company: **(i)** Audit Committee, **(ii)** Investment Committee, **(iii)** Reinsurance Committee, and **(iv)** Anti-Money Laundering Committee. The Board of Directors may create additional advisory committees if it deems convenient.

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.

The LISF and the Sole Insurance and Bonding Regulation (*Circular Única de Seguros y Fianzas*) ("**CUSF**"), set forth the main regulation on corporate governance of insurance companies.

Pursuant to the LISF, insurance companies must be incorporated as Mexican limited liability companies (*sociedades anónimas*). The General Law of Business Companies (Ley General de Sociedades Mercantiles) ("**Business Companies Law**"), which sets forth the requirements of incorporation and minimum corporate governance of *sociedades anónimas*, is applicable to insurance companies as long as it does not contradict the provisions set forth in the LISF.

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.

Insurance companies are highly supervised by the Insurance and Bonding National Commission (*Comisión Nacional de Seguros y Fianzas*) ("**CNSF**"). Insurance companies must provide the CNSF with several reporting regarding its corporate governance and operations, and the CNSF is very active in sanctioning and requiring the correction of any violation to the law or the corporate governance standards of insurance companies.

Usually, the sanctions imposed by the CNSF are monetary and the insurance sector complies with the corrections and adjustments requested by the CNSF; however, the CNSF has initiated proceedings for the revocation of licenses and has revoked the licenses in cases of serious violations to Mexican law, mainly in cases where the insurance company has not maintained its solvency requirements or minimum capital. These violations usually are related to a poor implementation of corporate governance principles under the LISF.

There are various examples of insurance companies in Mexico that have been recently declared in liquidation per instructions of the CNSF, as a consequence of different factors, and to a certain extent, due to their poor corporate governance standards. These companies are Istmo México, Compañía de Reaseguros, S.A. de C.V., Neo Saud Seguros, S.A. de C.V., Nezter Seguros, S.A. de C.V., and Seguros Priza, S.A. de C.V.

Most of these cases were triggered by a poor financial condition and deficits in capital requirements of the insurance companies; however, it may be implied that poor corporate governance standards and practices contributed to delays in the CNSF taking regulatory actions as a consequence of the poor financial condition of the insurance companies to the detriment of the market.

Due to the confidential nature of the dissolution process, it is not possible to identify the failures of the companies in meeting adequate corporate governance standards.

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.

Yes. Insurance companies must create a corporate governance system proportionate to the volume of its operations, the nature and complexity of its activities and line of business, observing at all times the minimum standards set forth in Mexican law. The Board of Directors is responsible for creating the corporate governance system.

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.

(a) Internal audit, control and compliance are key functions in the corporate governance system of insurance companies. The rationale is that insurance companies should be responsible for the adequate compliance of the applicable regulation and the correction of any violation without the intervention of the authority. For such purpose, Mexican law permits insurance companies to submit to the CNSF "self-correction programs" in case the corresponding insurance company detects a violation to applicable regulation. The incentive for the insurance company is that the CNSF would not sanction any violation that was "self-corrected" by the insurance company through this program. Insurance companies usually implement internal control and compliance standards above those required under Mexican law, among others, to detect any violation to the applicable regulation and avoid sanctions by the CNSF.

(b) As part of the corporate governance structure, it is common that insurance companies create additional advisory committees, such as the Risk Committee and the Corporate Governance Committee, with the main purpose of supervising internal areas related to key functions (risk, compliance, corporate governance, internal control, among others). Insurance companies that have implemented these additional standards, have improved its compliance with respect to other insurance companies.

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.

The LISF became effective on 5 April 2015, superseding the former Mexican insurance law. A key objective of the new regulation was to finalize the implementation of Solvency II mechanisms similar to those under Directive 2009/138/EC (Solvency II), which main pillars or basic principles are: **(i)** measure of assets, liabilities and capital (quantitative requirements); **(ii)** supervision (qualitative requirements); and **(iii)** disclosure, transparency and market volatility requirements.

The LISF provides the basic legal framework required to fully and completely implement the solvency, stability and prudential security measures to be applied under Solvency II, providing the mechanisms required by the insurance companies to develop their internal models, determine their solvency capital requirements pursuant to their respective risk profile, and not having to apply a single model determined by the regulator applicable to all insurance companies, although insurance companies will be allowed (or required) to apply such single model until they develop (and the CNSF approves) their own model. In practice, to the date hereof, insurance companies have been required to continue applying the single model determined by the CNSF, and have not yet been approved to apply their own models. It is uncertain how and when the CNSF will allow insurance companies to apply their own models.

The entry into effect of the LISF and the CUSF was accompanied by two years of preparation and adjustments within the insurance companies operating in Mexico and its implementation culminated in 2017. Implementation of the new regulation raised questions and concerns among the Mexican insurance market and internationally, as with any other new law, the natural adjustments caused anxiety, uncertainty and raised controversies in the manner in which the new regulations is construed and applied.

Also, the new regulation means additional burden due to its additional regulatory requirements. Small insurance companies, which usually have limited financial and

human resources compared to large companies, are more affected. For example, small insurance companies will have limited resources to develop internal models for solvency requirement; therefore, these companies would have to follow the model set forth by the CNSF which will likely require more capital.

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

The Business Companies Law sets forth the general legal framework of corporate governance rules applicable to corporations (*sociedad anonimas*). Insurance companies must be incorporated as a corporation (*sociedad anónima*) and therefore, these corporate governance rules apply to insurance companies.

The Business Companies Law and the LISF are complimentary; on the understanding that if there is any contradiction in corporate governance requirements for insurance companies, the provisions of the LISF apply.

As an example, the Business Companies Law provides that *sociedades anónimas* may be managed by a Board of Directors (without specifying minimum-maximum members) or by a sole manager, where in the case of insurance companies, there are strict requirements regarding the composition of the Board of Directors (see Section II below), and it is not possible to have a sole manager.

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 of directors in an insurance company? If so, please explain.

Yes. The LISF sets forth the requirements and qualifications of the Board of Directors of insurance companies and its members.

Board of Directors should have at least five and up to fifteen proprietary members, and each of them may have its corresponding alternate. There is currently a discussion on whether it is mandatory for proprietary members to have an alternate. The CNSF have argued it is mandatory to appoint alternate members to the board. We argue that the foregoing is not consistent with Mexico's corporate laws and regulation and best corporate practices applicable in Mexico and therefore, that it may not be deemed mandatory to appoint alternate members to the board.

The majority of the directors (both proprietary and alternates) should reside in Mexico, and at least 25% of the members shall be non-executive members. Non-executive members are individuals that have no relevant relationship with the insurance company or its management team, and must comply with the independency requirements set forth in the CUSF.

Board of Directors shall meet at least every quarter in a board meeting. A quorum of 51% is required to hold a meeting, and at least one of the members attending the meeting should be a non-executive member.

Members of the board shall refrain from participating in any discussion or vote that implies for him/her a conflict of interest. Board members shall maintain strict confidentiality of all the acts, facts and information related to the Company and on their discussions within Board of Director's meetings.

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

Remuneration schemes where management intervenes in the remuneration of non-executive members may create a conflict of interest for the directors in the surveillance obligations of management and reporting to the shareholders. It is advisable that the discussion and resolutions on the compensation of non-executive members is made by the shareholders in duly convened Shareholders' Meetings rather than in Board Meetings.

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?

Insurance Companies have the obligation to verify that Board members comply with the requirements to be a board member set forth in the LISF and CUSF. Furthermore, Board members are required to have sufficient knowledge and experience to perform his/her obligations. For such purpose, insurance companies must maintain a file of each member evidencing his/her capacity, experience, honorability and credit history, including, the curriculum vitae, proof of bachelor, master and other degrees evidencing his/her technical or professional studies and an affidavit signed by the member certifying its knowledge and capacity, among others.

Insurance Companies must verify that the information provided by the Board member is accurate, and must update the corresponding file each year.

Notice is given to the CNSF on all appointments of Board members with affidavits confirming that these comply with the requirements in the LISF and CUSF to be appointed members of the 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?

Board members should have sufficient knowledge and expertise in the financial, legal and management areas, should maintain satisfactory credit history and be honorable, at the discretion of the insurance company. Individuals that are employees of the insurance company (except the CEO and main officers) close family members, individuals that have a pending litigation with the insurance company, insolvent or individuals that committed crimes, among others, may not be appointed members of the Board.

Furthermore, non-executive members must have at least five years of prior experience in high decision-making positions related to finance, legal, management or insurance matters, and must not fall within any of the restrictions set forth in the CUSF, among others, they must not be: **(i)** employees or managers of the insurance company, **(ii)** individuals holding 2% or more of the capital equity of the insurance company, **(iii)** shareholders or employees of a relevant services provider of the insurance company, **(iv)** relevant clients, providers, services providers, debtors, creditors or their shareholders or employees, or **(v)** insurance agents.

Pursuant to Mexican law, executive and non-executive members have similar obligations and responsibilities.

A non-executive member must chair the Audit Committee of the insurance company, and non-executive member have the duty to report to the shareholders any default of the insurance companies' management team.

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?

No, although there are no restrictions for the Board of Directors or its members to request advise and opinions on specific matters. This is a practice that is being developed and used by boards to rely on expert opinions in decisions they make.

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.

The CNSF, in its capacity as authority responsible of the supervision and inspection of insurance companies, has broad authority to review and supervise the activities of the Board of Directors.

Within this authority the CNSF may impose sanction to insurance company and members of their Board of Directors for any violation to the obligations of the Board of Directors, including the obligations to supervise the implementation of the corporate governance system in the insurance company.

The CNSF has also authority to revoke or suspend the appointment of any of the Board members for serious violations or in case the member does not comply with the requirements set forth in Mexican law.

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?

The LISF does have certain special rules applicable to the governance of insurance companies' subsidiaries, such as the obligation to prepare consolidated Financial Statements, restrictions on contracting with related parties, and limitations and special requirements on investments in subsidiaries that may in certain cases require the prior authorization of the CNSF. As a general rule, subsidiaries of insurance companies are subject to the supervision of the CNSF.

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?

The additional burden on compliance and capital requirements represent the biggest challenge for the insurance sector, especially to small insurance companies.

The increase of cost related with the new regulation and the new solvency model implemented by the CNSF under the LISF imply that insurance companies may not be able to meet their capital requirements. The CNSF has implemented stricter criteria in

certain obligations regarding corporate governance and determination of the model for solvency requirements that increase this burden and the costs to operate.

In addition, non-admitted insurance performed by non-authorized entities have increased in the recent years, which result in unfair competition to the highly regulated insurance sector.

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

The new National Anti-Corruption System ("**SNA**") that entered into effect in 2017, brings new obligations and responsibilities to the private sector, including insurance companies.

The SNA is in the process of being implemented and we consider it will take time to fully be exercised by the authorities. Insurance companies must prepare and place the corresponding controls and compliance measures to be in compliance with the obligations of the SNA.

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.

One of the main concerns for the insured/contractor of a policy is that the insurance company pays the claim in an expedite manner. In Mexico, the view of the public in general is that insurance companies operating in certain line of business do not want to pay claims. A major insurance company in Mexico has recently adopted additional standards addressing this concern by creating an ombudsman for the insured/contractor, which main function is to review and resolve claims.

The ombudsman is an employee of the insurance company, however, it operates on an independent basis and its decisions are voluntarily observed by the insurance company. The implementation of this figure has significantly lowered the claims in courts against this 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?

The National Commission for the Protection and Defence of Users of Financial Services (*Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros*) ("**CONDUSEF**"), is the governmental body created to protect the interests and the rights of the consumers of financial services. It is regulated by the Law for the Protection and Defence of Financial Services Users ("**CONDUSEF Law**") (1999).

The protection of the consumers is considered to be a matter of public concern, and therefore, the rights set forth in the CONDUSEF Law may not be waived.

The main objectives of the CONDUSEF are the promotion, assistance, protection, and defence of the rights and interests of users of financial services against financial

institutions (including insurance companies), dispute resolution in an impartial manner, and the promotion of equity in the relationship between consumers and providers of financial services. The CONDUSEF also operates and maintains various registries that may be access by the public, including, the registry of financial institution, the registry of standard-form insurance agreements, and the registry of sanctions imposed to financial institutions.

In addition to the protection of users of financial services through the CONDUSEF, the LISF and CUSF require all insurance companies to form a special insurance fund (*fondos especiales de seguros*) for life, non-life and annuities, respectively, that may be used in case they need financial support to comply with their obligations with contracting parties, insureds, and beneficiaries under insurance policies.

Finally, the LISF and the CUSF provides also disclosure and transparency obligations that have as a purpose the protection of the insured, such as the obligation to register standard-form insurance products, the obligation to provide complete documentation to the policyholder, the obligation to disclose commission paid to intermediaries, among others.

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?

No. Insurance companies in Mexico are not required to produce an annual Corporate Social Responsibility (CSR) report or a Global Sustainability Initiative (GSI) report.

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.)

The LISF and the CONDUSEF Law provide mechanisms to ensure transparency within its governance structure. The governance structure is part of the articles of incorporation and by-laws of insurance companies, and the Board of Directors and advisory committees must be created as from its incorporation and operate as from the date the insurance company initiates operations.

Additional transparency within the governance structure may be achieved by implementing ethical and corporate social responsibility standards, that include clear examples of conflicts of interest among the different officers and bodies of the insurance companies and a code of conduct. Also, additional transparency (and policies) are required to maintain the shareholders informed of all the relevant operations and risks of the insurance companies.

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?

Insurance companies must disclose information that is relevant for the contractor or insured under the policies, such as, templates of the insurance policies, commissions paid to the intermediaries, sanctions imposed to the insurance companies, financial statements, rating requirements, risk profile, capitalization, among others.

Most of this information is made public through the public registries operated by the CNSF and the CONDUSEF; however, these registries are usually incomplete and without updated information.

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?

In Mexico, there is no specific regulation applicable to insurance companies listed in the Mexican Stock Exchange, other than the market abuse regulations established in the Stock Market Law (*Ley del Mercado de Valores*) ("**LMV**") that are applicable to all listed companies. If an insurance company decides to be listed, it must comply with the market abuse regulations in addition to the obligations established in the LISF and CUSF.

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.

The insurance sector in Mexico is overregulated and the foregoing is counterintuitive in a seriously underinsured market.

The implementation of Solvency II brought additional and burdensome regulation, with the main purpose of securing the sufficiency of capital of insurance companies; however, the former law and its regime already achieved such purpose. It is not clear what improvements have been brought to the sector with the new set of regulation nor the manner in which the LISF contributes to increase penetration of insurance and financial inclusion in Mexico.

It is most unfortunate that the LISF does little to improve penetration of insurance in Mexico, and to the contrary, it creates additional burdens and costs to insurance companies.

Current corporate governance regulation is aimed to secure sufficiency of the capital based on the particular risk of each insurance company; however, it does not include new mechanisms that will help to create and develop additional channels for the distribution of insurance products, not mechanisms to improve penetration and financial inclusion in a market in need of penetration and financial inclusion such as the Mexican market.