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Corporate Governance in Insurance Companies

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Corporate governance in all companies, including insurance companies, includes the rules, regulations and institutions that regulate the way in which the governance and control of these companies is performed and implemented in practice. The basic requirement of development and implementation of corporate governance is the improvement of all of the economic indicators, primarily the long-term sustainable development in the interests of the owners and all other stakeholders, including policyholders, creditors, employees, government and the wider community. The aim of the paper is to analyse the application of corporate governance in the insurance in the world and in Serbia. Since there is no generally accepted framework for standardisation of corporate governance, as it differs depending on the specifics of each individual insurance company, the subject of the research in the paper is a general framework of corporate governance applicable to all insurance companies with necessary calibration to the level of individual companies. In the paper we first point out the importance of the application of corporate governance in the insurance and specifics of the legal framework of corporate governance in insurance companies in Serbia and then analyse the quality of corporate governance, reporting on the implementation of corporate governance and international principles.

Keywords: insurance, insurance companies, corporate governance, principles, Serbia.

1. Introduction

The emergence of corporate governance can be associated with the emergence of the first international companies in the 16th and 17th century, such as the East India Company, the Levant Company or Hudsons Bay Company.¹ The East India Company was the first company marked by the division between ownership and governance. The term 'director' was generally used for the first time at the end of the 17th century in the Bank of England and the Bank of Scotland.² From the historical perspective, the application of corporate governance in its initial stages of development is primarily linked to major companies, but in modern business, it necessarily refers to all forms of business organization. However, the analysis of historical development of corporate governance is associated with major companies, whereby two market crashes in France and Great Britain and adoption of the law in the 18th century in Great Britain which prohibits establishment of new companies³ are very important since they crippled the development of initial and earliest beginnings of modern corporate governance. Also, up to the late 19th century, the entrepreneurial form of organization and partnership was predominant even though the concept of risk spreading through joint ownership has had its application since the 17th century. The stated factors conditioned the specific development of corporate governance even though the full development took place between the two world wars, especially after the Second World War. The key initiator for the development of corporate governance was a dispersion of ownership and strengthening the role of professional management. However, the true development of corporate governance is linked to the end of the 20th century and the new millennium. It has become embedded in the regulations of insurance companies.⁴ In view of the fact that corporate governance in the USA became "modern" in the 1970s while it gained its international dimension during the 1990s of the 20th century, Cheffins emphasizes that the history of corporate governance is primarily American and then international.⁵

Corporate governance is a set of rules and behaviour that determine the manner in which the companies are managed and controlled, strategically managing the relations between the managers, members of the Su-

pervisory Authority and the Board of Directors, members / shareholders and other stakeholders.⁶ A relatively broad definition of corporate governance stated above implies the rules that enable an improvement of business which is beneficial for all stakeholders, and which is applied when functions of ownership and governance are set apart. The main goal is to provide a long-term sustainable maximization of stock value, i.e., a long-term sustainable profitable business. The document of the Organisation for Economic Co-operation and Development (OECD) that defines the principles of corporate governance states that corporate governance involves “a set of relationships between a company’s management, its board, its shareholders and other stakeholders”⁹. Also, it is stated that corporate governance is a key element in improving economic efficiency and growth and in enhancing investor confidence. The development of corporate governance, conditioned by the division between the owners of capital and professional managers, has enabled the creation of a clear demarcation line between modern and traditional capitalistic economic and social systems. In addition, corporate governance suffered significant changes. Namely, the traditional perception of corporate governance focused mainly on shareholders. The primary focus of modern corporate governance, however, is a regulation of the relation between the owner and management as well as the relation toward the employees, clients, competitors, the state and society at large, i.e., all stakeholders of legitimate interests.

In 2012, much was done concerning the modernization of the existing framework of corporate governance in Serbia. These changes determined the actuality of research analysed in this paper. Through detailed examination of literature, it was concluded that, with the exception of a few scientific papers, the subject of corporate governance in Serbia was not significantly presented, especially in the light of the latest changes in insurance industry. The above stated results as well as the significance of corporate governance in general, especially for insurance, as a specific activity, justify the necessity of analysis of corporate governance application in insurance industry. The goal of the research presented in the paper is to point at the key aspects of corporate governance in insurance companies in Serbia with the analysis of the existing international consensus as regards corporate governance in the field of insurance and uniform future framework in the European Union, which will, in the future, define the framework for corporate governance in insurance companies in Serbia. This paper firstly points out the significance of corporate governance application in insurance and the specifics of legal framework of corporate governance in insurance companies in Serbia. Then, it deals with the analysis of corporate governance quality, reporting on the implementation of corporate governance and international principles.

2. Importance of corporate governance in insurance industry

Traditionally different values, culture and history concerning economic development and business practice also produce differences in the corporate governance between particular countries. Factors decisively influencing the differences in the development and characteristics of corporate governance between countries also include the differences between the structure and functioning of financial systems⁸, such as bank- versus market-driven, governance role of owners versus stake holders and the political governance of the economy in terms of state-directed, associational or market-driven economies. In addition, specific differences in corporate governance practice can be observed between particular industries and individual subjects within such industries. However, the main principles and goals such as transparency and long-term sustainable profitability are generally applicable independently of the differences existing in different legal systems or industries. This is also where main benefits of corporate governance lie, including better performance, easier access to capital markets, more favourable conditions for capital raising, and better universal reputation⁹.

The transformation of social and economic systems in Serbia has taken place in the last twenty years. This was the period of corporate governance development which actually started from the scratch. At present, the role and quality of corporate governance in this country is not satisfactory. Namely, according to the World Economic Forum 2012-2013¹⁰, out of 144 countries included in the Competitiveness Index, Serbia ranks relatively low, as the 95th country. However, according to particular single parameters, this is dramatically adverse (for example, in property rights protection Serbia takes the 130th place, in corporate ethics it ranks 132nd, in the efficacy of corporate boards it ranks 141st and regarding the protection of minority shareholders’ interests, it ranks poorly, as 143rd).¹¹ In addition to the transformation of social and economic systems which has occurred relatively lately, the reasons for corporate governance underdevelopment lie in numerous other factors, primarily in the current organisation of companies. Namely, family companies

are predominant in Serbia and account for more than 90% of the total number of companies.¹² They are managed rather by intuition of their owners who are, at the same time, the directors. The aforementioned is supported by the fact that out of the total number of 389005 legal entities in Serbia, including the non-commercial sector, 56.3% are entrepreneurs.¹³ Such circumstances in economy are the result of inadequate corporate governance, since the lack of separation between ownership and governance was recorded in the majority of companies, and such separation is the major precondition for the corporate governance development. Nevertheless, the newly adopted Draft of Corporate Governance Code enables the implementation of good corporate governance practices in family companies.

Global issues of corporate governance have particularly gained importance in the last twenty years, especially in view of the fact that poor governance and internal controls have been directly linked with big corporate affairs, one of them being the case of Enron company which, in 2001, filed for bankruptcy despite being the seventh ranked company in the USA by its size. Corporate governance relates to the system of financial and other governance rules and controls and it generally regulates relationships between the boards of directors, senior management and shareholders. Despite the fact that the main goal of corporate governance is to protect shareholders from company mismanagement, in financial institutions, particularly in insurance industry, it has a big importance in the regulation of relationships and care for not only the shareholders but also the insureds, employees, creditors, government and other stakeholders.

The application of generally accepted principles and standards from a good practice of corporate governance does not guarantee a complete business success, since the business success of insurance companies depends on numerous factors which are not only of internal character and which are beyond the direct control and influence of management bodies. However, the existence of good, high-quality corporate management in insurance companies is necessary to attract investors' capital and the most qualified and most productive human resources. Market mechanisms, particularly those of labour and capital markets, will evaluate the application of quality corporate governance creating two key preconditions for the business success of insurance companies.

Insurance is an industry of special social interest, having in mind its different functions in a society. The main aim of the modern insurance industry is to minimize the risk by association of the insured into the institutionalized risk communities, i.e., insurance companies, and to ensure direct economic protection against negative effects of risk actuation through indemnity. The aforementioned represents the main function of insurance. However, in addition to this primary function, insurance carries out other numerous functions both for individual insureds and the society at large, such as: credit improvement, exchange and trade, mobilization of funds, effective capital allocation and social function.¹⁴ Successful conduct of insurance industry involves a continuous maintenance of public trust in the insurance institution which is achieved by maintaining solvency, adequate investment policy and prudent underwriting. Analysing the said insurance functions it can be concluded that successful management of this industry is crucial for all stakeholders and entire community in which insurance companies operate. Undeniably, the quality corporate management which enables successful, long-term, sustainable conduct of insurance industry is not only important for shareholders but also for all other stakeholders. However, having in mind the aforementioned, it was recorded that quality corporate governance, which creates the framework for a successful organisation and management of insurance companies, has a relatively higher importance than in other industries. The extreme importance of corporate governance in insurance companies is particularly pronounced when big insured events occur, such as natural and technological disasters that cause huge material losses and also when companies may suffer significant financial losses under the third party liability insurance for personal data theft or asbestos pollution.

In addition, the importance of corporate governance in insurance industry is supported by the fact that insurance companies increasingly become the members of financial conglomerates and by the threat from negative effects that may result in the actuation of systemic risk. Despite the fact that the danger of systemic risk is higher in case of banks while insurance industry is properly and legally regulated¹⁵, the problems of a USA company, the American International Group, in 2008¹⁶ have undoubtedly demonstrated that insurance companies are likely to cause problems in the entire financial system owing to inadequate corporate governance, notably in the aggregate risk management.

Corporate governance largely relates to the rules and structure of company management. However, it also includes the rules for business supervision. The importance of supervision is particularly pronounced in case of financial institutions, including insurance companies. Internal control or internal supervision of operations of insurance companies is carried out by internal auditors and actuaries, whereas external supervision is carried out by government bodies and external auditors. The actuarial science and audit are complementary approaches to the state supervision, whereby the internal and external audit reports and actuarial opinions should be the basis for state supervision.¹⁷ Having in mind the great importance and benefits from corporate governance in insurance companies, supervisory bodies should encourage its application. One of the examples for improvement of corporate governance in banking was the Basel Committee on Banking Supervision which developed the guidelines to help banks and supervisory bodies assess the quality of corporate governance, highlighting, in the area of supervision, the role of supervisory authority, individuals not included in daily bank operations, direct supervisions of different business areas and independent functions of risk management, compliance and audit.¹⁸ In the insurance industry in Serbia, the state supervisory body, the National Bank of Serbia, plays a significant role. It is perceived as extremely positive that the National Bank of Serbia has defined the guidelines for insurance supervision, including the Guidance Paper on Corporate Governance in Insurance Companies, which shall be analysed further in the text.

3. Specifics of corporate governance framework in insurance companies in Serbia

The legal framework of corporate governance application is constituted of regulations adopted at different levels that define governance implementation. In Serbia, in terms of insurance companies and all other companies, the key elements of the corporate governance legal framework are the Law on Companies, the Corporate Governance Code issued by the Serbian Chamber of Commerce, the Guidance Paper on Corporate Governance in Insurance Companies issued by the National Bank of Serbia, the Instrument of incorporation, articles of association, the Code of Corporate Governance and other acts of individual insurance companies.

The Law on Companies is considered to be a framework of a highest level for the implementation of corporate governance. The Law regulates the legal status of companies, that is, the issues concerning their incorporation, management, status changes, changes of legal forms, dissolution and other issues of relevance for their status. In Serbia, an attempt was made to put corporate governance into the legal framework by the adoption of the Law on Companies in 2004.¹⁹ The key aspects that characterized the application of this Law were the existence of managing boards as the fundamental elements of corporate governance and issues caused by privatization in terms of the relations between major and minor owners, i.e., shareholders, instead of the usual issue between the owner and the management.

For the purpose of improvement of corporate governance efficiency, the increase of director's responsibility as well as safeguarding of interests of minority shareholders, the National Assembly of the Republic of Serbia adopted the New Law on Companies that shall relate to the entrepreneurs as well, save for the period up to March 2013 when it shall not relate to partnership companies. This Law was promulgated in May though it came into effect in June 2011. However, its application was initially postponed until the following year. Namely, in accordance with the Article 600 of the Law²⁰, the same shall be applied as of February 1st 2012, though the Article 344 Paragraph 9 and Article 586 Paragraph 1 item 8) shall be applied as of January 1st 2014. The New Law shall outlaw the old one save for the part that relates to the companies and management of companies in the privatization process and up to the finalization of that process.

The Law on Insurance²¹ as a *lex specialis* law, defines all important issues concerning incorporation, business and dissolution of insurance companies in Serbia. Contrary to the banking sector where the Law on Banks²² to a large extent defines the specific aspects of corporate governance²³, the Insurance Law, where it relates to the company bodies, considerably refers to the law that regulates the legal status of companies. However, the Insurance Law specifies the conditions that should be met by some members of management, including also the requirements in terms of educational qualification, qualifications and professional experience. The issues concerning the operation of insurance companies which is handled differently as compared to the other companies and which relate to company bodies are regulated by the Articles 47-55 of the Insurance Law. According to the provisions hereof, the National Bank of Serbia is entitled to approve and withdraw a given approval for carrying out the function of a member of management and a member of

the supervisory authority. Obligations and responsibilities of board members and the jurisdiction of the Supervisory Authority are determined as well.

The current Insurance Law stipulates the existence of Boards of Directors while the draft of the Insurance Law by the National Bank of Serbia is in accordance with the new Law on Companies. Namely, all companies which, in accordance with the previous Law on Companies, had a Board of Directors as the managing body in their organizational structure are obliged to abolish it and to choose one of the two models of corporate governance – a one-tier or a two-tier corporate governance systems. In accordance with the Article 198 of the Law on Companies, the one-tier system of governance shall imply the existence of two bodies, i.e., the Shareholders' Assembly and one or more directors, while the two-tier system shall mean the existence of three governing bodies, the Shareholders' Assembly, the Supervisory Authority and one or more directors. The selection of a governing system shall be defined by the Article of Association. The Law stipulates that up to the moment of harmonization of organizational structure, managing boards should function as, namely, should have the jurisdiction of the Board of Directors. The one-tier system of corporate governance is characteristic of small companies and the Shareholders' Assembly should appoint and dismiss a director or directors, monitor their performance and adopt their reports. In the two-tier governance system, characteristic of big companies, the Shareholders' Assembly appoints, and dismisses the Supervisory Authority members and determines their remuneration while the Supervisory Authority appoints and dismisses the director, i.e., directors. In this situation, directors have less authorization and responsibilities when compared to the one-tier system. Even though the Managing Boards are abolished by the Law, they still continue to exist in public companies on the basis of application of the Law on Public Enterprises and the Performance of Activities of General Interest.²⁴ These changes have adjusted the regulation of corporate governance to the ruling trends in developed market economies.

The Law defines persons with special duties to a company: partners and general partners, members of a limited liability company or shareholders with a significant or controlling share capital, directors, Supervisory Authority members, representatives, procurators and liquidators. For the above mentioned persons, special duties and lawsuits are defined if they breach their duty. Special duties of the aforementioned persons shall include: duty of care, duty to report transactions involving personal interest, duty to avoid conflict of interest, duty to keep trade secrets and duty of non-competition. In the one-tier or the two-tier governance systems, the work of the director may be supported by the work of committees. The Law stipulates the obligatory formation of the Audit Committee by the Board of Directors while it is allowed that the Nominating Committee, the Compensation Committee as well as other Committees be established according to the Company needs, if provided by the Company's Articles of Association. Also, a company may have a secretary. A company secretary shall be appointed and his/her remuneration and other entitlements shall be set by the Board of Directors, or the Supervisory Authority if a company has a two-tier management system. Even though the Law on Companies refers to different forms of company's organization, the provisions of Law for insurance companies in Serbia relating to a joint-stock company are of utmost importance, since all insurance companies in Serbia are incorporated as shareholding companies. Finally, the section of the Law relating to internal and external monitoring, i.e., control of operations is very important. In public joint-stock companies, at least one person in charge of internal audit must comply with the eligibility requirements for internal auditors laid down by the law governing accounting and auditing. The Law stipulates certain responsibilities of internal audit and obligatory annual external audit of financial statements.

The key legal document that, together with the Law, constitutes a legal framework for the application of corporate governance in insurance companies in Serbia is the Corporate Governance Code²⁵ adopted by the Serbian Chamber of Commerce in September 2012. The Corporate Governance Code is compatible with the provisions of the new Law on companies; it represents its supplement and it enables concretization of its own kind, i.e., the explanation and adjustment of dispositive rules of the Law in the business practice of insurance companies. By adoption of this Code, the Code of Chamber of Commerce of 2005 became invalid. The main goal of the new Corporate Governance Code of the Serbian Chamber of Commerce is the improvement of corporate governance system in all companies in Serbia. Contrary to the previous one, the new Code is intended for all companies, especially the ones where corporate governance has been neglected so far – family companies, small and medium enterprises and state-owned companies. The rules of the Code are not binding but are highly recommended and can be applied directly, while all companies may apply the other Corporate Governance Code, though they should inform the Chamber of Commerce about that. Essentially, this document represents the starting point for making an individual code of corpo-

rate governance suitable for a company, i.e., an insurance company. It consists of two sets of rules: recommendations that should be accepted and followed and suggestions that are considered to be a desirable practice in the field of corporate governance. The Code Structure is oriented towards determination of principles that should be the basis for work of the members and the Shareholders' Assembly, the Board of Directors and the Supervisory Authority, internal auditing, reporting and relations with stakeholders. The rules for all companies were the first to be determined and they are divided into three parts that include all companies, additional principles and recommendations for big companies and public joint-stock companies and additional principles and recommendations for public joint-stock companies. Then, additional principles and recommendations for family companies were defined and the third part includes additional principles and recommendations for companies in state ownership.

Given the importance of the insurance sector, one specific quality of insurance companies in relation to other companies is the supervision conducted by the National Bank of Serbia. Considering the observed problems in corporate governance when supervising the insurance companies and with a view to „aligning the activities of insurers' bodies with the complexity, volume and level of risk to which insurers are exposed"²⁶, the National Bank of Serbia has drafted the Guidance Paper on Corporate Governance in Insurance Companies. Abroad, it is usual for banking and insurance sectors to supplement legal provisions with guidelines which are not binding as a rule but present the best practice. Also, it is usual, in spite of the fact that they are not binding, that regulatory bodies make their best efforts to accept guidelines in business practice of insurance companies, which is the case in Serbia, as well. Namely, the Guidance Paper states that its wording is not binding, that the National Bank of Serbia shall not control whether the Guidance Paper is applied in insurance companies or not, however, it is expected that insurance companies organize their corporate governance so that it does not affect adversely the overall risk exposure and risk profile in the long term and does not prevent or hamper the attainment of business goals, business strategy and operating plans. Also, it is stated that the application of guidelines may significantly improve a company's operations, competitiveness and reputation and prevent some monitoring measures. The Guidance Paper defines the shareholders' rights in detail and it gives them the greatest responsibility in terms of governance and monitoring operation of insurance company. In addition, it gives recommendations to insurance companies on ensuring the equal treatment of shareholders, protection of interests of other stakeholders, above all, insureds, beneficiaries, claimants and the state. The Guidance Paper has specially stated the methods of adequate disclosure and transparency in order to comply with the international corporate governance principle, to determine the accurate market value and to protect the solvency and activity of the members of Managing Board and Supervisory Authority. This Guidance Paper was drafted in accordance with the Insurance Law and the previous Law on Companies which is why it is not completely harmonized with the new Law, primarily concerning the prediction of managing board existence. Taking this into account, it is possible to expect partial amendments to the Guidance Paper in the following period, so it can be completely harmonized with the economic reality of business operations in Serbia, as well as amendments to the Insurance Law whose draft will be adopted in the future.

Apart from the above mentioned general documents for corporate governance, i.e., documents that are applicable to all insurance companies operating in a particular market, acts of individual insurance companies are of great importance as well. These acts primarily include Articles of Association, while the Code of Corporate Governance is of special significance since it explicitly arranges specific and actual issues concerning corporate governance in relation to a specific insurance company. The Instrument of Incorporation of a company appeared because the practice needed to determine the difference between the legal status and the responsibility of the founder and of other shareholders. According to the Article 11 of the Law on Companies, an Instrument of Incorporation shall be a constitutive act of a company made in the form of a decision on incorporation if a company is set up by one person or in the form of a memorandum of association if a company is started by more than one person. An Instrument of Incorporation may regulate numerous issues including the registered name and seat, business activity, share capital, data on shares, governance method and governance bodies and other issues according to the Law on Companies. Regarding the issue of corporate governance, the Instrument of Incorporation may include a specific and selected system of corporate governance, a one-tier or a two-tier system, and governing bodies of insurance companies may be included as well. The same article of the Law on Companies regulates the Articles of Association, which is, together with the Instrument of Incorporation, characteristic of joint-stock companies. Namely, the Articles of Association is a document that regulates the governance of a company and other issues according to the Law on Companies. The Articles of Association includes systematized rules of behaviour in governing and

rules and controlling methods of insurance companies' operations. The Law on Companies regulates the general issues of structure and modifications of the Instrument of Incorporation and the Articles of Association as well as the nullity of the Articles of Association. However, the structure of these documents is defined by individual insurance companies which is why the structure is usually very similar to the aforementioned though the contents differ depending on the insurer. In the field of corporate governance, the Articles of Association usually define the rules and procedures relating to the representation and representatives, proxy i.e., business procurement, internal monitoring, internal audit, persons having special duties and their duties and governing with special and detailed elaboration of issues relating to particular governing bodies including the Shareholders' Assembly (its constitution, participation in operations, competence, voting, method for establishment of quorum, decision making and the like), the Supervisory Authority (constitution, appointment of members, a member's term, method for establishment of the quorum, competence and the like.), the method of the Audit Committee operation and other Committees a company has a right to establish according to the Law on Companies, the Executive Board (competence and responsibilities, members' term, method of operation and the like), the General Manager and the Company Secretary. Finally, the document which directly and to a large extent relates to the issue of corporate governance is the Corporate Governance Code which usually and to a large extent regulates the issues of mutual relations of specific governing bodies in insurance companies and the transparency and publicity of their work. It is about a document which directs the activities of governance and control but which is to a large extent based on the Articles of Association of a specific company and the Corporate Governance Code issued by the Serbian Chamber of Commerce. This document elaborates the goals and basic principles of business, governing bodies and specifics concerning their work in a particular insurance company, the disclosure, issues regarding the auditing and the relation towards the stakeholders of a company, though it may as well include issues of managing and the method of acquisition of own shares and managing of classified information.

4. Quality of corporate governance in insurance and reporting

Quality corporate governance includes organising and conducting management and control activities in insurance companies, which enables the implementation of the strategy and the business objectives, i.e., a high efficiency in daily operations, competitiveness, solvency, stable reputation and a long-term sustainable profitability. Quality corporate governance will provide the insurance companies with the possibility to positively evaluate market mechanisms thus enabling them to attract capital under favourable conditions, notably in terms of acquisition price as the share prices tend to rise with the improvement of corporate governance whereas the interests on debt instruments issued by companies drop. They will also be able to attract and retain the employees with the best references, continuously attract new and retain the existing customers/insureds and achieve the satisfaction of all other stakeholders in their business. Quality corporate governance is the basis of long-term sustainable business of all economic entities, including insurance companies. It gains the importance with the shift to market-driven business practice and owing to the changes in the legal framework which is the basis for its application. The application of quality corporate governance improves the business efficiency and competitiveness on the market of products and services that are the subject of core business of entities, which, observed at the level of the entire national economy, enables a strong economic growth.

When ensuring a quality corporate governance it is crucial that the framework clearly defines the roles, responsibilities and authorisations of particular governance bodies as well as appropriate controls. Quality corporate governance is undeniably important for business success and is determined by several factors. Namely, compliance with the mentioned legal framework is the precondition for the application of quality corporate governance in actual business operations of insurance companies in Serbia. It notably requires a high level of investor protection, full protection of their rights in the process of business management and supervision, and the provision of equal treatment of all investors as well as high protection level of all other stakeholders, primarily insureds, insurance beneficiaries, third parties and the state. In addition, a proper and transparent work of the Supervisory Authority is important in order to ensure the implementation and objective disclosure of key corporate governance objectives and transparency in the entire business process, which includes the disclosure of all relevant information on company business and performance. Finally, the work of the Board of Directors and the General Manager is of particular importance.

The entire business success will be largely dependant on the quality of work of the Board of Directors. Quality corporate governance normally involves highly qualified managers, some of whom are independent from the business management and shareholders, which enables the improvement of decision-making quality since the decisions can be made after the interests of all shareholders and other stakeholders have been properly considered. This is of particular importance in insurance, having in mind the specific characteristics of this industry which is based on the trust of not only investors but also the insureds, insurance beneficiaries and third parties. The role of the Board of Directors is to “balance” the interests of different stakeholders in an insurance company. The interests of, for example, shareholders and insureds, are largely balanced, since the profit from insurance business leads to the reduction of costs for the provision of original services, favourable conditions for ceding the risk into reinsurance or achievement of favourable results when investing, which is a win-win situation for all. However, there are situations where the conflicts of interest are obvious. For example, it is in the interest of capital owners that surplus of capital in the insurance company should be reduced to the minimum in order to avoid its unprofitable employment, whereas the insureds are interested in the safest possible business of insurance companies which, as a rule, involves capital surplus, i.e., the lowest ratio between the collected premiums and the available capital. Despite the fact that it is necessary to have in place the procedures for the prevention of the conflicts of interest, the members of the Board of Directors must be capable of fulfilling their authorisations and responsibilities and effectively resolve potential conflicts of interest in accordance with the requirements of the profession and interests of all stakeholders. The members of the Board of Directors certainly need different knowledge in life and non-life insurance companies. The decision on acceptance of the so-called major risks, i.e., the risks the actuation of which may produce considerable damage to the insurer, to solvency, investments, co-insurance and reinsurance and mergers and acquisitions with other companies are but a few examples of the complexity of decision-making and the necessity to have highly qualified members of the Board of Directors in terms of their managerial skills, specific characteristics of insurance, and insurance market and capital market operations. Finally, the Board of Directors must provide all preconditions for an efficient conduct of internal controls with the aim to improve the business efficiency and for an independent external audit which will provide its opinion on the capital and financial standing of an insurance company based on the analysis of financial statements.

When assessing the quality of corporate governance it is necessary to analyse the definition of relationships of the Board of Directors, the Supervisory Authority and owners, i.e., the Shareholders' Assembly in case of joint-stock companies, both within the legal framework and in reality. It is necessary to analyse numerous factors which include the method of decision-making, convening meetings, defining objectives, the daily business management, appointment of members, the members' mandate, the scope of competences and responsibilities etc. It is particularly important to evaluate the extent to which insurance companies operate in accordance with regulations, particularly in the area of risk management and solvency provision. The conclusion on the quality of corporate management can be made based on the comparison between the actual state and the standard one. Table 1 shows the criteria of Standard and Poor's for the assessment of corporate governance quality in business entities and insurance companies. The criteria below are used by this Agency for establishing the credit rating, whereby the impact of corporate governance quality can be neutral or negative, since the Agency considers that the connection between quality corporate governance and higher rating cannot be precisely established, whereas it is possible to identify the negative impact.

Table 1: Criteria for the assessment of corporate governance quality in insurance companies

	Neutral impact	Negative impact
Effectiveness of the Board of Directors	The Board of Directors maintains sufficient independence from management and retains control as the final decision-making authority with respect to all risks, compensations and/or conflicts of interests.	The Board manifests a lack of independence from management and scrutiny of all risks, compensations and/or conflicts of interest.
Entrepreneurial or controlling ownership	Management and the Board of Directors have professional, independent members who are capably engaged in risk oversight on behalf of all stakeholders, including minority interests. The influence of controlling shareholders is offset by risk-aware professional management that effectively serves the interests of all stakeholders.	Controlling ownership negatively influences decision-making to promote the interests of the controlling owners above those of other stakeholders.
Management culture	Management is responsive to all stakeholders' interests, appropriately balances those interests, and acknowledges that the Board of Directors is the ultimate decision-making authority.	Management's own interests or those of a narrow group of stakeholders are its primary concern, where dissent in the executive suite is generally not tolerated or where management proves incapable of managing conflicts of interest arising between different stakeholder groups. Excessive management turnover can be an indicator of a governance deficiency in management culture. Alternatively, management dominates the Board of Directors.
Regulatory, tax or legal infractions	The enterprise generally remains free of regulatory, tax or legal infractions and has stable relationships with regulatory authorities.	The enterprise has a history of infractions beyond an isolated episode, representing a significant risk.
Communication of messages	The enterprise generally communicates consistent messages to all constituencies.	The enterprise communicates conflicting information to different stakeholders on significant issues.
Internal controls	The enterprise's internal control environment is not viewed as deficient.	The enterprise's internal control environment is viewed as deficient based on available evidence, such as restatements or delays in filings.
Financial reporting and transparency	Accounting choices are usually reflective of the economics of the business.	Financial statements obfuscate the true intent or the economic drivers of transactions or the financial statements are insufficient to allow typical users of the financial statements to understand the intent and the economic drivers.

Source: *General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers*, Standard and Poor's, New York, NY, 2012.

Transparency is one of the main preconditions of the quality corporate governance. Disclosure of information, as the key mechanism of transparent business, mainly relates to financial business reporting. However, the idea to include the reporting on application i.e., quality of corporate governance in the annual operating reports is increasingly advocated. To that extent, amendments have been made to the new Law on Companies. Namely, Article 368 of this Law²⁷ stipulates that the Statement of Application of the Corporate Governance Code is incorporated in annual operating reports of public joint-stock companies. In addition, the Guidance Paper No. 2 on corporate governance in insurance companies of the National Bank of Serbia contains the provision relating to the need of an insurance company to adopt adequate corporate management policies and practices and publish annual reports on corporate governance.

The Statement i.e., the Report on Corporate Governance Quality publishes the information on the implementation of corporate governance practices in a particular annual period. The Statement on the application of corporate governance code i.e., the report on corporate governance quality mainly indicates the key aspects of corporate governance and reports on the comparison between the actual and the standardized conditions, identified deficiencies or confirmation if the corporate governance complies with the corporate governance code. It is customary that this Statement of application of the Corporate Governance Code contains reference to the application of code which is publicly available and the results of internal supervision regarding organisational compliance and actions in accordance with the Corporate Governance Code as well as special segments relating to the work of the Shareholders' Assembly, the Supervisory Authority, the Executive Board and the General Director, own actions, public disclosure of information, privileged information, stakeholders and audit. In accordance with the Law, this Statement must contain the following: 1) A reference to the corporate governance code a company applies and the place where the text of that code is publicly available, 2) All relevant information concerning the corporate governance practice implemented by a company, including in particular any practices that are not specifically required under the law; 3) Any deviations from corporate governance rules referred to in item 1) of this paragraph and justification for such deviations.

5. International principles of corporate governance in insurance

Even though the corporate governance appeared in the 16th and the 17th centuries while the first Law on joint-stock companies was drafted in 1844, the appearance of international standards, i.e., internationally aligned principles is more recent. Namely, the first internationally aligned principles were adopted by the Organisation for Economic Co-Operation and Development (OECD) in 1999 and they were revised in 2004. To the greatest extent, these principles were created due to the necessity to avoid a repetition of corporate scandals which appeared during the 1990s. The principles were revised when the same scandals appeared again in the new millennium. Even though primarily intended for member countries, these principles are applied in other countries as well. The legal framework of corporate governance in Serbia is mainly aligned with these principles that are the integral part of the Law on Companies and the Corporate Governance Code issued by the Serbian Chamber of Commerce. The principles are not binding standards and they are an example of good business practice. Apart from the principles, the document contains implementation guidelines, which can be adjusted to specific characteristics of certain countries, of an economic sector and the companies within the sector. Even though they primarily relate to the companies whose shares are traded on an organized stock exchange, these principles are equally applicable to all companies. The OECD principles of corporate governance include the following:²⁸

- 1) ensuring the basis for an effective corporate governance framework (The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.),
- 2) the rights of shareholders and key ownership functions (The corporate governance framework should protect and facilitate the exercise of shareholders' rights.),
- 3) an equitable treatment of shareholders (The corporate governance framework should ensure an equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.),
- 4) the role of stakeholders in corporate governance (The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage an active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.),

- 5) disclosure and transparency (The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.) and
- 6) the responsibilities of the board (The corporate governance framework should ensure an strategic guidance of the company, an effective monitoring of management by the board, and the board's accountability to the company and the shareholders.).

Apart from the OECD principles, the principles of corporate governance adopted by the International Association of Insurance Supervisors (IAIS) are of great importance for insurance companies. This Association was established in 1994 and represents regulators and insurance monitoring bodies from more than 200 jurisdictions²⁹ including the National Bank of Serbia. This Association does not act as a regulatory body nor has a legal jurisdiction over the insurance companies but it still affects the national regulators and monitoring bodies by issuing principles, standards, guidelines; it provides training and organizes meetings and seminars. The first international insurance monitoring principles were issued by the IAIS in 2000 which were later revised and expanded to include 28 principles in 2003. Modifications were done in 2011 while the last version of the document relating to key principles, standards, guidelines and methodology of insurance assessment consists of 26 principles and was issued in October 2012. These international principles relate to all insurance companies and every statement on a key principle is presented together with the standards and guidance materials for support in terms of hierarchical structure on three levels: a) statements – prescribe the essential elements that must be present in the supervisory regime, b) standards – set out high level requirements that should be met by a supervisory authority and c) guidance material – provides detail on how to implement a statement or standard.

Since the consideration of the governance and decision-making processes of insurance companies is a key component of insurance supervision,³⁰ the IAIS made a core principle that addresses corporate governance specifically. Even though it is not explicitly stated, apart from this core principle, other principles relate to corporate governance including:³¹ 1) the principle relating to suitable persons (Supervisory bodies require board members, senior management, key persons in control functions and significant owners of an insurer to be and remain suitable to fulfil their respective roles.), 2) the principle relating to changes in control and portfolio transfers (Supervisory approval is required for proposals to acquire significant ownership or an interest in an insurer that results in that person, legal or natural, directly or indirectly, alone or with an associate, exercising control over the insurer. The same applies to portfolio transfers or mergers of insurers.), 3) the principle relating to risk management and internal controls (The supervisor requires an insurer to have, as part of its overall corporate governance framework, effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters and internal audit.) and 4) the principle relating to public disclosure (The supervisor requires insurers to disclose relevant, comprehensive and adequate information on a timely basis in order to give policyholders and market participants a clear view of their business activities, performance and financial position).

The basic principle of corporate governance relates strictly to corporate governance in insurance companies. It is the 7th principle that indicates that the supervisor requires insurers to establish and implement a corporate governance framework which provides for sound and prudent management and oversight of the insurer's business and adequately recognises and protects the interests of shareholders.³² In accordance with the requirements of this principle, the corporate governance framework for insurance companies should: a) promote the development, implementation and effective oversight of policies that clearly define and support the objectives of the insurer, b) define the roles and responsibilities of persons accountable for the management and oversight of an insurer by clarifying who possesses legal duties and powers to act on behalf of the insurer and under which circumstances, c) set requirements relating to how decisions and actions are taken including documentation of significant or material decisions, along with their rationale, d) provide for communicating, as appropriate, matters relating to the management, conduct and oversight of the insurer to shareholders and e) provide for corrective actions to be taken for non-compliance or weak oversight, controls or management.

The application of the principle sets differences between the one-tier and the two-tier forms of corporate governance, governance in joint-stock and mutual companies, governance in group structures and branch operations and it emphasizes the significance of remuneration policy and practices. In view of the fact that detailed analysis of this principle would require a separate research project, we shall point at the key issues

of corporate governance that relate to this principle and that include the following:³³ 1) *objectives and strategies of the insurer* (the supervisor requires the Board to set and oversee the implementation of the business objectives and strategies for achieving those objectives, including its risk strategy and risk appetite, in line with the insurer's long term interests and viability.), 2) *appropriate allocation of oversight and management responsibilities* (the supervisor requires the Board to ensure that the roles and responsibilities allocated to the Board, Senior Management and Key Persons in Control Functions are clearly defined so as to promote an appropriate separation of the oversight function from the management responsibilities and provide adequate oversight of the Senior Management), 3) *structure and governance of the Board* (the supervisor requires the insurer's Board to have, on an on-going basis: a) an appropriate number and mix of individuals to ensure that there is an overall adequate level of knowledge, skills and expertise at the Board level commensurate with the governance structure and the nature, scale and complexity of the insurer's business, b) appropriate internal governance practices and procedures to support the work of the Board in a manner that promotes an efficient, objective and independent judgment and decision making by the Board; and c) adequate powers and resources to be able to discharge its duties fully and effectively), 4) *duties of individual Board members* (the supervisor requires the individual members of the Board to: a) act in good faith, honestly and reasonably, b) exercise due care and diligence, c) act in the best interests of the insurer and policyholders, putting those interests of the insurer and policyholders ahead of his/her own interests, d) exercise independent judgement and objectivity in his/her decision making, taking due account of the interests of the insurer and policyholders; and e) not use his/her position to gain undue personal advantage or cause any detriment to the insurer), 5) *risk management and internal control systems and functions* (the supervisor requires the insurer's Board to provide oversight in respect of the design and implementation of sound risk management and internal control systems and functions), 6) *remuneration policy and practices* (the supervisor requires the insurer's Board to: a) adopt and oversee an effective implementation of a remuneration policy, which does not induce excessive or inappropriate risk taking, is in line with the identified risk appetite and long-term interests of the insurer, and has proper regard to the interests of its stakeholders; and b) ensure that such a remuneration policy, at a minimum, covers those individuals who are members of the Board, Senior Management, Key Persons in Control Functions and other employees whose actions may have a material impact on the risk exposure of the insurer) 7) *reliable and transparent financial reporting* (the supervisor requires the insurer's Board to ensure there is a reliable financial reporting process for both public and supervisory purposes which is supported by clearly defined roles and responsibilities of the Board, Senior Management and the external auditor), 8) *transparency and communications* (the supervisor requires the insurer's Board to have systems and controls to ensure the promotion of appropriate, timely and effective communications with the supervisor and relevant stakeholders on the governance of the insurer), 9) *duties of Senior Management* (the supervisor requires the insurer's Board to have appropriate policies and procedures to ensure that Senior Management: a) carries out the day-to-day operations of the insurer effectively and in accordance with the insurer's strategies, policies and procedures, b) promotes a culture of sound risk management, compliance and fair treatment of customers, c) provides the Board with adequate and timely information to enable the Board to carry out its duties and functions including the monitoring and review of the performance and risk exposures of the insurer, and the performance of Senior Management; and d) provides to the relevant stakeholders and the supervisor the information required to satisfy the legal and other obligations applicable to the insurer or Senior Management and 10) *supervisory review* (the supervisor has the power to require the insurer to demonstrate the adequacy and effectiveness of its corporate governance framework).

Conclusion

Corporate governance includes the set of rules which enable long-term sustainable business operations. By definition, it involves separation of ownership and management and was originally applied with the aim to protect the interests of owners but lately it has been used to protect the interests of all stakeholders, i.e., owners of capital, managers, employees, suppliers, buyers, depositors, creditors, insureds and other persons interested in the operations of a company, state and a society at large. A long-term survival, growth and development are not possible without the application of quality corporate governance. With the aforementioned in mind, general economic development is not possible without a proper corporate governance incorporated in the organisation of business activities.

Bearing in mind that insurance is an industry of special social interest which provides financial security, reduces social costs when insured events occur and improves the entire level of capital accumulation directly influencing economic growth, the application of quality corporate governance in insurance companies gains a particular importance. Namely, generally speaking, poor corporate governance means the incapability of company management to attain the set business objectives. Market mechanisms are strict and, as a rule, tend to eliminate those business entities that are not able to achieve a continual growth i.e., to attract financial and human resources, maximize yield for shareholders or take care of employees, business partners and the society in general. The main requirement of quality corporate governance is continuous improvement of organisation of business activities, notably in the area of risk management, management and supervision activities aimed at improvement of operation efficiency, i.e., performance, and achievement of a long-term sustainable market positioning. It is necessary to develop a corporate governance framework, however, long-term sustainable success cannot be achieved without a proper application and control of actual vs. standardized conditions.

At an international level, the OECD Principles of Corporate Governance were adopted for the improvement of corporate governance. This represented the first internationally unified standard and the basis for improvement of corporate governance both in member countries and beyond. For insurance industry, in the context of international application, corporate governance principles adopted by the International Association of Insurance Supervisors are of particular importance. In Serbia, corporate governance is at quite a low level in comparison with other countries. The reason for this is of historical nature, i.e., the consequence of social and economic development to date. Lately, however, lot of effort has been put into creation of the framework for improvements in the area of corporate governance in all companies, including insurance companies. A completely new institutional and regulatory framework was created to enable insurance companies in Serbia to implement a one-tier or a two-tier system of corporate governance. It is highly likely that the majority of insurance companies will opt for the two-tier model which involves the participation of the following management bodies: the Shareholders' Assembly, the Supervisory Authority and Directors or the Board of Directors. The regulatory framework of corporate governance in the Serbian insurance industry are the Law on Companies, the Corporate Governance Code of the Serbian Chamber of Commerce, the Guidance Paper on Corporate Governance in Insurance Companies of the National Bank of Serbia, the Instruments of Incorporation, the Articles of Association and the corporate governance codes of individual insurance companies. In the improvement of corporate governance transparency, the Statement of Application of the Corporate Governance Code has a very important role. Generally, it represents a report on the method of application of corporate governance which, in the past practice of insurance companies, has not been an integral part of annual operating reports.

In view of the above, it is almost certain that insurance companies in Serbia will follow the patterns of the insurance companies in developed countries and improve their own corporate governance, acting in the interest of all stakeholders. In addition, owing to the fact that quality corporate governance improves business and that business so improved is the foundation of economic growth, the application of quality corporate governance is of general interest and the basis of the future accelerated economic growth in Serbia.

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