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28 May 2002

Mr. Benjamin Tang,
Commissioner of Insurance,
Office of the Commissioner of Insurance,
21/F., Queensway Government Offices,
66 Queensway,
Hong Kong.

Dear Mr. Tang,

Guidance Note on the Corporate Governance of Authorised Insurers

I am writing in response to your invitation to comment on the draft Guidance Note on the Corporate Governance of Authorised Insurers and further to the Society's letter to you of 13 March 2002.

We thank you for inviting the Society's views. We welcome the Insurance Authority (IA)'s efforts to promote high standards of corporate governance in the insurance sector and support the proposal to provide guidance on minimum standards of corporate governance for authorised insurers. We believe that companies in the regulated sector, amongst others, are those that should be looked towards to set benchmarks for best practice in Hong Kong. Given also that financial services is one of the main areas of overseas investment in Hong Kong, it is particularly important we should be seen to be achieving international standards of corporate governance in that sector.

The Society has the following suggestions to make in relation to the detailed contents of the draft Guidance Note:

General

- a. We note that there is no indication of the consequences of non-compliance with the proposed Guidance and we would suggest that the issue of enforcement needs to be considered further (paragraphs 6-7 of the draft Guidance Note).

Board of directors

- b. While we note that not all insurers are public companies, we believe that in principle in the regulated sector, and particularly given that insurers will generally be in receipt of premiums from the public, there should be no substantial difference in the corporate governance standards expected of both public and private companies. Under the circumstances, while we appreciate the potential difficulties of finding a large number of

independent non-executive directors (INEDs) of suitable background and experience, particularly given the specialised nature of the industry, we nevertheless believe that, in order to ensure that sufficient weight is given to the views of independents, it would be preferable to have a minimum of two independent non-executive directors (INEDs) on the board, rather than one (plus one additional INED for every five directors), as proposed in the draft Guidance Note. As indicated above, the issue of enforcement is also important here and it should be made clear that the IA is able to take appropriate action to rectify the situation if it is considered that there is insufficient independence on the board (paragraph 8(a)(iii)).

- c. The example given in the fourth bullet point under paragraph 8(a)(iv), i.e. that a director “has significant loans due from or to that authorised insurer”, does not appear to be very commonplace situation for insurers. Perhaps a more relevant example could be found.
- d. Insurers should be required to provide the IA with information on the number of board meetings held during the previous financial year paragraph 11(c)(i), together with the attendance record of individual directors at board meetings held during the year (paragraph 8(a)(iii)).
- e. We agree that board meetings should be attended by directors and should not be mere “paper” meetings or meetings by circulation. However, you may wish to make it clear that participation by video or telephone conferencing would be permissible if necessary (paragraph 8(a)(iii)).
- f. In relation to reviewing the remuneration of directors (paragraph 9(f)), we would suggest that you cross-reference this with the paragraph dealing with the remuneration committee (paragraph 12(d)) and indicate that if no specialised committee is formed then, as a minimum, non-executive directors should play a greater role in the remuneration review (see also item (k) below).

Role of chief executive

- g. We agree that it is preferable that the positions of chairman and chief executive should not be occupied by the same individual. We note that it is also recommended that the appointed actuary and the chief executive should not be the same person, but where both positions are held by one individual, “sufficient safeguards” must be built into the authorised insurer’s internal control system. This statement is very general. We believe that it would be beneficial if either more explicit guidance could be provided as to what is expected (e.g. under the section on internal controls, at paragraph 14(l)) or, as a minimum, the authorised insurer is required to inform the IA as to what additional safeguards have been implemented (paragraph 8(c)).

Specialised committees

- h. We would refer you to our comments in paragraph (b) above and would suggest that the audit committee should ideally comprise at least two INEDs and the chairman should be an INED. It is desirable that all the members should be non-executive directors and that the majority of them should be INEDs (paragraph 12(a)). In this connection we would refer you the recommendations contained in our publication, "A Guide for Effective Audit Committees" (February 2002, paragraph 23).
- i. The audit committee should be required to report regularly to the board (paragraph 12(a)).
- j. It may be worthwhile to acknowledge that much of the investment process may be outsourced to third parties.
- k. We would suggest that there should be a requirement for the remuneration and nomination committees, if any, to include INEDs and that, in relation to the issue of remuneration, a statement be included to the effect that, in order to avoid conflicts of interest, executive directors should in principle not play a major role in determining their own remuneration (paragraphs 12(c) and (d)).

Internal controls

- l. We would suggest that either the heading of Part VIII of the draft Guidance Note should be revised, as, for example, "Internal Controls and External Audit", or that there be a separate Part on external audit. The present draft tends to give the impression that the external audit is part of the system of internal control and, presentationally, does not distinguish it clearly from the internal audit function.
- m. We suggest that in paragraph 14(a) should include reference to reconciliation and analytical controls, which may be more effective than some of the controls mentioned.
- n. In relation to risk management, the approach taken should be one of total enterprise risk management, where strategic and operational risks, as well as market risks are addressed. We would suggest that paragraph 14(b) be appropriately redrafted to ensure that a broad perspective is taken.
- o. One of the matters to be considered by the board should be the management letter from the external auditors. The audit committee may be tasked with looking at the details of the management letter and reporting any significant areas of concern to the board. It is suggested that consideration be given to indicating in the Guidance Note that the IA

may also ask for a copy of the letter for any follow-up action (paragraph 14(i)).

This paragraph should also make it clear that the internal audit function need to be appropriate to the insurer on a local stand-alone basis (regardless of group activities and resources elsewhere).

Servicing of clients

- p. We would suggest that the board should be advised to consider developing a code of ethical conduct for staff, to assist in the promulgation of and to supplement the policy regarding the fair treatment of clients (paragraph 21).

Transparency

- q. We recommend including a general statement in the Guidance Note to the effect that transparency is part and parcel of good corporate governance and that the board should bear this in mind when documenting policies, decisions, records of meetings, etc.

We hope that you will find the above comments to be helpful. We would also like to direct your attention to the Society's various publications on different aspects of good corporate governance, copies of which were enclosed with our letter of 13 March 2002.

If you have any questions in relation to the Society's comments, please feel free to contact me at 2287 7084.

Yours sincerely,

PETER TISMAN
DEPUTY DIRECTOR
(BUSINESS & PRACTICE)
HONG KONG SOCIETY OF ACCOUNTANTS

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