

**GUIDELINE  
ON  
THE CORPORATE GOVERNANCE OF  
AUTHORIZED INSURERS**

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## **1. Introduction**

1.1 This Guideline is issued pursuant to section 133 of the Insurance Ordinance (Cap. 41) (“the Ordinance”) taking into account the Insurance Core Principles, Standards, Guidance and Assessment Methodology (“ICP”) promulgated by the International Association of Insurance Supervisors. It sets out the minimum standard of corporate governance that is expected of an authorized insurer and the general guiding principles of the Insurance Authority (“IA”) in assessing the effectiveness of the corporate governance of an insurer. Specific references are:

- (a) ICP 7 stipulates that the supervisor should require 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 recognizes and protects the interests of policyholders.
- (b) ICP 8 stipulates that the supervisor should require insurers to have, as part of their overall corporate governance framework, effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters and internal audit.

1.2 Corporate governance refers to systems through which an authorized insurer is managed and controlled. It is also a system of “checks and balances”. Accordingly, the corporate governance framework of an authorized insurer should:

- (a) promote the development, implementation and effective oversight of policies that clearly define and support its objectives;
- (b) define the roles and responsibilities of persons accountable for management and oversight;
- (c) set out requirements relating to how decisions and actions are taken;
- (d) provide for effective means of communicating matters relating to the management and oversight of the insurer;
- (e) provide for sound remuneration practices which promote the

alignment of remuneration policies with the long term interests of the insurer to avoid excessive risk taking; and

- (f) provide for corrective actions for non-compliance or weak oversight, management and control.

1.3 The IA believes that a high standard of corporate governance established by authorized insurers is important for protecting policyholders' interests. Also, it is an essential step in instilling the confidence of the insuring public and encouraging more stable and long term development of the insurance market of Hong Kong. An insurance industry with a high standard of corporate governance will also help enhance the status of Hong Kong as an international financial centre.

## **2. Interpretation**

2.1 In this Guideline, unless the context otherwise specifies:

- (a) “associate” in relation to any person, means:
  - (i) the wife or husband or minor child (including a step-child) of that person;
  - (ii) any body corporate of which that person is a director;
  - (iii) any person who is an employee or partner of that person;
  - (iv) if that person is a body corporate:
    - (aa) any director (other than an independent non- executive director) of that body corporate;
    - (bb) any subsidiary of that body corporate;
    - (cc) any director (other than an independent non-executive director) or employee of any such subsidiary;
- (b) “chief executive” has the meaning assigned to it by section 9(2) of the Ordinance;
- (c) “controller” has the meaning assigned to it by section 9 of the Ordinance, but does not include a Manager appointed pursuant to section 35(2)(b) thereof;
- (d) “director” includes any person occupying the position of director by whatever name called;

- (e) “group of companies” has the meaning assigned to it under section 2 of the Companies Ordinance (Cap. 622);
- (f) “key person in control functions” has the meaning assigned to it by section 13AE(12) and (13) of the Ordinance;
- (g) “senior management” refers to individuals, headed by the chief executive, responsible for managing the business of an authorized insurer on a day-to-day basis in accordance with strategies, policies and procedures set out by the board of directors; and
- (h) “small authorized insurer” refers to an authorized insurer whose annual gross premium income in and total gross insurance liabilities as at the end of the immediate preceding financial year are both less than HK\$20 million. In this context, total gross insurance liabilities mean:

- (i) General business insurer

Total of the gross figures of unearned premiums, unexpired risks provision, outstanding claims provision (including claims incurred but not reported and the outstanding expenses of settling claims) and other insurance liabilities as per items (q)(i) and (q)(ii) under paragraph 16 of Part 4 of the Schedule 3 to the Ordinance.

- (ii) Long term business insurer

Total of the gross figures of long term business funds (excluding the amount required to be maintained under rule 11 of the Insurance Companies (Margin of Solvency) Rules), claims admitted but not paid and other insurance liabilities as per items (q)(i) and (q)(ii) under paragraph 16 of Part 4 of the Schedule 3 to the Ordinance.

- (iii) Composite insurer

The aggregate of total gross insurance liabilities from its general business and long term business as defined in (i) and (ii) above respectively.

### **3. Application**

3.1 In general, authorized insurers incorporated in Hong Kong are

required to comply with this Guideline except:

- (a) insurers authorized to carry on general insurance business which have ceased accepting new and renewal business and are in the course of running off their liabilities; and
- (b) insurers authorized to carry on long term insurance business which have ceased accepting new business and are in the course of running off their liabilities, provided that the annual gross premium income arising from any renewal business of the insurer concerned is less than HK\$20 million.

3.2 For an authorized insurer incorporated outside Hong Kong (“overseas insurer”), where 50% or more of the annual gross premium income pertains to its Hong Kong insurance business (“applicable overseas insurer”), it is required to observe this Guideline, unless written consent for exemption has been obtained from the IA. Irrespective of the proportion of its Hong Kong insurance business, the IA expects an overseas insurer authorized in Hong Kong to strictly observe the applicable guidelines on corporate governance promulgated by its home regulatory authority. Where such guideline is of comparable standard to this Guideline, an applicable overseas insurer may apply in writing to the IA for exemption therefrom and furnish the IA with the particulars of the relevant guideline for consideration.

3.3 Captive insurers are encouraged to adopt this Guideline as appropriate.

#### **4. Governance Structure**

4.1 There should be clear lines of reporting and division of responsibilities within the organizational structure of an authorized insurer. Special attention should be paid to the governance structure as follows:

##### ***4.2 Board of Directors***

- (a) The board of directors of an authorized insurer (“Board”) should comprise a suitable number of directors that enables it to carry out its functions effectively and efficiently. It should review its size from time to time taking into account the activities and business

volume of the insurer. In general, there should be a minimum of five directors (excluding any alternate director(s)). For small authorized insurers, the minimum number of directors should be three.

- (b) The Board should have sufficient knowledge and relevant experience of insurance business to guide the authorized insurer and oversee its activities effectively. In this regard, at least one-third<sup>1</sup> of the directors should possess such knowledge and experience. In addition, in view of the wide spectrum of professional knowledge required in administering the business and affairs of an authorized insurer, it is advisable for the Board to have an adequate spread and level of expertise in areas as appropriate to the insurer’s business, such as underwriting, claims, actuarial, finance, and investment.
  
- (c) To enable the Board to make sound decisions in the best interests of the authorized insurer, independent and objective opinions are essential. It is necessary for the Board to maintain appropriate checks and balances against the influence of the management and controllers. A sufficient number of independent non-executive directors (“INEDs”) on the Board will help achieving this purpose. As a general principle, at least one-third<sup>1</sup> of the Board should be composed of INED(s). For small authorized insurers which have less than five directors, the Board should be composed of at least one INED. Under exceptional circumstances where the number of INEDs has to be lowered temporarily, the insurer should seek approval from the IA for temporary exemption with valid justification. The exemption period will be determined on a case-by-case basis. The INEDs should be individuals with sufficient calibre and breadth of experience to perform the balancing function. They should be independent of the management and free from any business or other relationships with the insurer which could materially affect the exercise of their independent judgement.
  
- (d) The IA is not likely to be satisfied that a director is an INED of an authorized insurer if:

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<sup>1</sup> Illustrative Examples

Total Number of Directors	Minimum Number of Directors Possessing Sufficient Insurance Knowledge & Experience	Minimum Number of INEDs
3*	1	1
4*	2	1
5 - 6	2	2
7 - 9	3	3
10 - 12	4	4

\* *Applicable to small authorized insurers only*

- (i) he is an employee of that insurer or of a company within the same group of companies as that of the insurer, or has been such an employee within the last three years;
- (ii) he is a director, other than an INED, of a company within the same group of companies as that of the insurer;
- (iii) he is a controller<sup>2</sup> of that insurer or of a company within the same group of companies as that of the insurer;
- (iv) he is an associate of a director or controller of that insurer;
- (v) he is a director or controller<sup>2</sup> of a corporation that has significant financial interests with that insurer or any companies within the same group of companies as that of the insurer. For example, he is a major service provider of the insurer; or
- (vi) he has significant financial association with that insurer or with a company within the same group of companies as that of the insurer that could affect the impartiality of his independent judgement. For example, he has significant loans due from or to that insurer. For the avoidance of doubt, remuneration for a director generally does not constitute significant financial association.

### 4.3 *Senior Management*

- (a) Whilst the Board has the ultimate responsibility for setting the business objectives, strategies and policies for the authorized insurer (which is further elaborated in section 5), senior management is accountable for carrying out the day-to-day operations of the insurer and implementing systems and controls in accordance with the corporate culture, business strategies, policies and procedures set out by the insurer. The composition of senior management, which is headed by the chief executive, may vary from one authorized insurer to another. The Board should authorize the appointment of individuals as senior management and to clearly set out their roles and responsibilities supported by formal documentation for the delegation of authority.

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<sup>2</sup> For controller of a corporation other than an authorized insurer, it refers to the equivalent office bearer of controller as defined in section 9 of the Ordinance.

- (b) Senior management may delegate some of its responsibilities to, for example, key persons in control functions, with clear lines of accountability and reporting established and documented.
- (c) Senior management should have appropriate reporting line to the Board and provide relevant and accurate information, on a timely basis, to the Board to facilitate its oversight of the management of the authorized insurer. Adequate systems of control should be put in place for the Board to assess the performance of senior management against the performance objectives set by the Board on a continuous basis.

#### 4.4 *Chairman and Chief Executive*

- (a) The Chairman, as the head of the Board, plays an important role in ensuring the effective governance of an authorized insurer. As for the chief executive, he is, under the immediate authority of the Board, responsible for the conduct of the whole of the insurance business of the insurer concerned. It is essential that there is a balance of power and authority of the Chairman and the chief executive so that neither one has unfettered powers of decision. As such, a person should not play the dual role of Chairman and chief executive.
- (b) In case the chief executive of an authorized insurer is temporarily precluded from carrying out his duties as the chief executive because of sickness, absence from Hong Kong or for any other exceptional reasons, the Board should ensure the proper functioning of the business operations of the insurer. Notwithstanding paragraph 4.4(a), the Chairman or a director may be entrusted to take charge of the affairs of the insurer in the interim given that proper control measures are in place.

#### 4.5 *Appointed Actuary*

To avoid conflicts of interest and to enable an Appointed Actuary to fulfil his obligations independently and effectively, he should not be the Chairman or the chief executive.

#### 4.6 *Key Persons in Control Functions*

- (a) This section is applicable to those authorized insurers having key persons in control functions under their governance structure.

- (b) Key person in control functions of an authorized insurer refers to an individual who is solely or jointly responsible for the performance of one or more of the control functions of the insurer. Control functions here include actuarial, financial control, internal audit, compliance, risk management, intermediary management and other function(s) specified by the Financial Secretary<sup>3</sup>. Insurers should satisfy themselves that all key persons in control functions appointed are fit and proper persons.
- (c) Control functions are part of an effective system of risk management and internal controls. They provide additional governance checks and balances of the authorized insurer and support the Board in fulfilling its oversight duties. Therefore, the Board should set appropriate authority and independence for each control function to enable them to carry out their functions effectively. Adequate reporting lines to the Board, board committees or senior management should be appropriately set to avoid any conflicts of interest that may arise. Should any conflicts of interest arise and not be resolved, this should be brought to the Board for its attention and resolution.

## **5. Role and Responsibilities of the Board**

### **5.1 *The Board***

- (a) The Board plays a pivotal role in setting the strategic plan and policy of an authorized insurer and in monitoring its management. The main responsibilities of the Board are expected to include:
  - (i) Setting business objectives and strategies which take into account the long term financial soundness of the insurer, the legitimate interests of its stakeholders, as well as fair treatment of policy holders.
  - (ii) Ensuring appropriate allocation of responsibilities with the presence of the following:
    - (aa) a well-defined governance structure which provides for an effective separation between oversight and management functions;

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<sup>3</sup> Under section 13AE(14) of the Ordinance.

- (bb) a clear allocation of roles and responsibilities, including clear reporting lines of the Board, board committees, senior management and key persons in control functions;
  - (cc) adequate checks and balances for the avoidance of undue concentration of powers and conflicts of interest;
  - (dd) an effective oversight of the senior management and key persons in control functions; and
  - (ee) adequate policies and procedures relating to the engagement, dismissal and succession of the senior management and key persons in control functions.
- (iii) Setting risk appetite and strategy which should be in line with the long term interests of the insurer and are embedded in the corporate culture of the entity as well as the group to which the insurer belongs.
- (iv) Providing appropriate risk management and internal control systems and ensuring their effective operation.
- (v) Adopting and overseeing remuneration policy and practices (details of which are set out in section 9 - Remuneration Matters) which do not induce excessive or inappropriate risk taking; are in line with the risk appetite and long term interests of the insurer; and cover directors, senior management and key persons in control functions.
- (vi) Providing a reliable and transparent financial reporting system which include:
- (aa) an Audit Committee for oversight function. (details of Audit Committee's function are set out in paragraph 8.4 below); and
  - (bb) prompt rectification of weaknesses identified in the financial reporting system.
- (vii) Establishing adequate policies and procedures for the appointment of external auditor to ensure that:
- (aa) the terms of engagement are clear and appropriate;
  - (bb) its independence by, for example, periodic rotation;
  - (cc) evaluation of its effectiveness is in place; and
  - (dd) prompt communication to the Board can be made when it is aware of any internal control weaknesses or deficiencies.

(viii) Promoting transparency on the governance by disclosing timely, appropriate and useful information to the public and within the company. Such disclosure should also take account of the applicable legal requirements.

(b) Where an authorized insurer belongs to a group, it may adhere to the group policies and procedures. The Board of the insurer should ensure the group policies and procedures are appropriate to uphold the sound and prudent operation of the insurer. If the group policy is unable to cover the circumstances of the Hong Kong operation, or does not satisfy the principles set out in this Guideline, the Board should consider establishing a separate policy thereof.

## 5.2 *Individual directors*

(a) In general, individual directors owe fiduciary duties and duties of care and skill to the authorized insurer. As such, they should:

(i) act in good faith, honestly and reasonably;

(ii) exercise due care and diligence;

(iii) act in the interests of the insurer and protect the interests of policy holders, and put their interests ahead of his own interests;

(iv) exercise independent judgement and maintain objectivity in the decision making; and

(v) not use his position to gain undue personal advantage or cause any detriment to the insurer.

(b) Individual Board members are expected to discharge their responsibilities properly and make every effort to attend all Board meetings.<sup>4</sup>

(c) Where a director also has directorships in entities other than the subject authorized insurer, the director should ensure that sufficient time and attention should be allocated to the insurer to discharge his responsibilities effectively.

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<sup>4</sup> Participation of directors in Board meetings may be facilitated by electronic means (e.g. telephone or video conferencing) and the attendance should be documented.

### 5.3 *INEDs*

INEDs mainly provide an independent perspective to and a broader outlook on the decision-making of the authorized insurer, such as assisting the executive directors to set the corporate objectives and strategies, scrutinizing the approach of the management or attending to the affairs of the committees (e.g. the Audit Committee).

### 5.4 *Chairman of the Board*

While the Board as a whole is responsible for the stewardship of the authorized insurer, the Chairman of the Board has the leading role to ensure the Board's proper and effective functioning. To promote checks and balances, the Chairman should not be the chief executive or the Appointed Actuary; and preferably not serve as chair of any board committee.

## **6. Board Matters**

6.1 The proper handling of Board matters is a prerequisite for the sound and prudent management of an authorized insurer. The major Board matters include:

### 6.2 *Appointment*

- (a) Authorized insurers should satisfy themselves that all of the directors, controllers and key persons in control functions are fit and proper persons.
- (b) A formal, documented and transparent process, preferably overseen by a Nomination Committee, should be in place for the nomination, selection, appointment, removal as well as succession of directors, controllers and key persons in control functions. Details of a Nomination Committee are set out in paragraph 8.7.

### 6.3 *Conflicts of Interest*

Individual Board members should act in the best interests of the authorized insurer and to avoid actual, potential and perceived conflicts of interest. Where there is inevitable circumstance that conflicts of interest may arise, such conflicts should be effectively managed by clear and well defined procedures such as disclosure to

the Board, abstention and prior approval by the Board or shareholders.

#### 6.4 *Information and Resources*

- (a) All directors should be provided and updated on a timely basis with accurate and relevant information (e.g. financial statements, budgets, market statistics and legislation) to enable them to fulfil their responsibilities effectively. They should also have power to access relevant persons within the organization directly for obtaining such information.
- (b) The directors should also have recourse to independent professional advice at the expense of the authorized insurer when performing their duties.
- (c) A newly appointed director or chief executive should be provided with suitable induction to enable them to discharge their duties properly. Existing directors and the chief executive should also be provided with appropriate training so that they are kept abreast of, amongst other things, the legislative and market developments.

#### 6.5 *Meetings*

As the Board is collectively responsible for the overall strategic planning and management of the authorized insurer, the directors should meet from time to time to discuss the corporate affairs so as to respond to the market changes by devising suitable strategies. To effectively and efficiently discharge its functions, the Board should convene a minimum of four meetings annually at approximately quarterly intervals. At least two of those meetings should be participated by the directors and not “paper” meetings or meetings by circulation. Full minutes of Board meetings should be kept for record and reference purposes.

#### 6.6 *Delegations*

- (a) The Board should, as appropriate to the authorized insurer’s functional activities<sup>5</sup>, delegate some of the activities or tasks associated with its own roles and responsibilities to designated committees or groups of persons. Notwithstanding such delegations,

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<sup>5</sup> Functional activities include but are not limited to compliance, risk management, underwriting, investment, nomination and remuneration.

the Board retains the ultimate responsibility. Details of functions of certain committees are set out in section 8. Where the Board makes any delegations, it should ensure that the delegation:

- (i) is appropriate with regard to tasks and parties and without leading to any undue concentration of powers;
- (ii) is made under a clear mandate with well-defined terms and is supported by adequate resources; and
- (iii) can be effectively monitored and assessed and withdrawn if the delegated tasks are not properly carried out.

## 6.7 *Evaluation*

The Board should review the delegated committees, at least annually, to ascertain members of the committees collectively and individually remain effective in discharging their respective roles and responsibilities. The Board should implement appropriate measures, including training programme for directors, to address any identified inadequacies and improve performance of the Board.

## 7. **Risk Management and Internal Control Systems**

7.1 Sound risk management and internal control systems are vital to effective corporate governance as they oversee the proper conduct of an authorized insurer's business and affairs. They help ensure the completeness of accounting records, the accuracy of financial information, the prevention of fraud and the prudent management of risks, etc. The Board should ensure that sound risk management and internal control systems are in place and the relevant procedures are properly followed.

7.2 The risk management and internal control systems of an authorized insurer should include the following aspects:

### 7.3 *Checks and Balances*

- (a) An authorized insurer should, institute policies and procedures such as requiring the separation of critical functions (for example but are not all inclusive, risk management, underwriting, investments, claims handling, internal audit and compliance with statutory

regulations and rules), cross-checking of documents, dual control of assets and double signatures on certain documents, etc., to ensure checks and balances within the company. Allocation of responsibilities and authority, as well as the reporting line should be clear and well defined.

- (b) To promote a culture of sound risk management and compliance, including a robust system of checks and balances, there should be measures to avoid conflicts of interest of particularly key persons in each control function in performing their respective functions.

#### 7.4 ***Risk Management***

- (a) An authorized insurer should devise and implement a comprehensive risk management policy which strikes an appropriate balance of returns and risks that the insurer is willing and able to take. The policy should also help to identify, quantify, prevent and control the various types of risk that the insurer faces. Examples of such risks are underwriting risk, credit risk, market risk, operational risk and liquidity risk. As a basic principle, adequate measures should be taken to guard against the concentration of risks in a particular aspect or country. Where an authorized insurer belongs to a group, attention should be paid to the risks associated with the intra-group transactions, as well as the inter-relationship and interdependence of risks among group members.
- (b) An authorized insurer may designate responsible person(s) to take charge the operations of risk management function. The risk management function should have direct reporting line to the Board and/or Risk Committee to ensure its independent assessment and prompt reporting of risks of the insurer. Also, the role of the designated responsible persons for risk management should be distinct from other executive functions to avoid conflicts of interest and ineffectiveness in carrying out its risk management functions.<sup>6</sup>

#### 7.5 ***Underwriting***

An authorized insurer should adopt a prudent underwriting policy and should not underwrite any risks that are beyond its financial capacity or insurance expertise. Where necessary, independent professional valuation or advice should be sought for an assessment

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<sup>6</sup> As a best practice, the chief risk officer should not report to the chief financial officer, or vice versa.

of the risks in the underwriting process. The premiums should also be set at a level that corresponds with the level of risks underwritten.

## 7.6 *Reserves for Insurance Liabilities*

- (a) An authorized insurer should employ suitable methodology and assumptions to compute and make provision for its insurance liabilities. Such methodology and assumptions should take into account the business volume, claims experience, industry practice, types of insurance product and the trend of court awards, if applicable. As such, it is essential for the insurer to build up a database that consists of the historical claims data; and an actuarial system that determines the liabilities of insurance business and ensures a prudent and satisfactory relationship between the nature and term of the assets and the nature and term of its liabilities, if applicable.
- (b) For an authorized insurer that carries on employees' compensation and/or motor insurance businesses, it is also required to observe the Guideline on Actuarial Review of Insurance Liabilities in respect of Employees' Compensation and Motor Insurance Businesses ("GL9") and arrange for the reserves of those classes of business to be subject to actuarial review as appropriate.
- (c) Any reserving assumptions made should be periodically reviewed to ensure that due recognition has been given to changes in the composition of the business portfolio, market and legislative developments, etc.

## 7.7 *Investments*

- (a) An authorized insurer should have a written investment policy appropriate for its capital, surplus, types of business and liquidity needs. The Board has the core responsibility for formulating and assuring implementation of the investment policy. In formulating the investment policy, the Board should also consider investment risks and measures to mitigate such risks e.g. diversification of investments. The insurer is required to observe the Guideline on Asset Management by Authorized Insurers ("GL13"). Besides, it should establish and implement investment procedures to ensure that:
  - (i) the relevant staff and any investment professionals engaged are competent, and that they fully understand the corporate

investment objectives and adhere to the investment policy;

- (ii) periodic evaluations are conducted to assess effectiveness of the investment policy and strategies;
  - (iii) timely actions are taken to identify any significant investment losses and make provision for them;
  - (iv) the cash inflows from invested assets is regularly reviewed so that it is adequate to meet the cash outflows due for settling liabilities under different economic conditions; and
  - (v) any engagements of investment tools such as derivatives should be closely monitored.
- (b) Where an authorized insurer, in the course of carrying on its business, also manages funds on behalf of its customers, it should take practicable steps to ensure that the customers' funds are prudently managed and the relevant investment particulars are accurately recorded. A separate set of books and accounts for customers should be maintained for the purpose.

## 7.8 *Asset Management and Valuation*

An authorized insurer must take every practicable step to safeguard its assets and ensure that the value of its assets is not less than the aggregate of the amount of its liabilities and the applicable level of solvency under the Ordinance. Besides, the insurer should maintain a buffer above the statutory solvency margin at all times for prudent risk and capital management.

## 7.9 *Claims Settlement*

An authorized insurer should set out policies and procedures for the settlement of claims. Any claims reported are promptly recorded and the relevant reserves are provided for accordingly. The amounts of estimated and actual claims should be compared from time to time to ensure that adequate provisions are made for outstanding claims. The Board and senior management should also be notified of large or fraudulent claims and take timely actions as appropriate.

## 7.10 *Reinsurance*

An authorized insurer should make adequate reinsurance arrangements for the risks underwritten. Through such arrangements, the exposures of the insurer's business portfolio to huge losses owing to individual large risks and accumulations of losses could be reduced. The insurer should clearly understand its underwritten risks in order to look for suitable reinsurance products and determine the appropriate retention amounts, reinsurance limits, scopes of coverage and the participating reinsurers, etc. It should also assess the security of the participating reinsurers and periodically review the collectability of the amounts due from them.

#### 7.11 *Audit*

- (a) An authorized insurer should have ongoing audit function (both internal and external) of a nature and scope appropriate to the nature and scale of its business. This includes ensuring compliance with all applicable policies and procedures and reviewing whether the insurer's policies, practices and controls remain sufficient and appropriate for its business.
- (b) An authorized insurer may designate responsible person(s) to take charge the operations of internal audit function.
- (c) The internal auditor should:
  - (i) have unfettered access to the authorized insurer's entire business lines and support departments;
  - (ii) be independent from the day-to-day operation and have status within the insurer to ensure that the Board and senior management are responsive to his recommendations and take timely actions thereon;
  - (iii) have sufficient resources and suitable staff of appropriate qualification and training; and
  - (iv) have direct reporting line and prepare internal audit report to the Audit Committee.
- (d) Where the authorized insurer is part of a group of companies, it is acceptable for its internal audit function to be performed by the group's internal auditor.

- (e) Small authorized insurers are exempted from establishing the internal audit function.
- (f) The external auditor should have an effective channel of communication with the internal auditor, the Board and the Audit Committee.
- (g) The Board should give due consideration to the opinions and findings of both the internal and external auditors and should take timely actions on the recommendation(s). The Board should also monitor the progress in redressing any problems raised by the auditor(s). In case the Board's views are different from the auditor(s)' opinion, this should be documented.

#### 7.12 *Accounting Matters*

An authorized insurer should clearly set out its policies and procedures on accounting matters, including the reconciliation of accounts, the preparation of control lists and the provision of other relevant information to facilitate the management's decision-making process.

#### 7.13 *Declaration of Dividends*

An authorized insurer should establish policy on the declaration of dividends, if applicable, to shareholders and participating policy holders. Such dividend policy should comply with the relevant statutory requirements, fulfil the reasonable expectations of shareholders and participating policy holders, conform with the terms of any relevant insurance policies and be fair and equitable.

#### 7.14 *Actuarial Matters*

- (a) An authorized insurer that carries on long term business must appoint an actuary pursuant to section 15(1)(b) of the Ordinance and comply with any regulations, rules or guidelines issued by the IA in connection with the appointed actuary system.
- (b) An authorized insurer that carries on employees' compensation and/or motor insurance businesses, if applicable, is required to observe GL9 and engage an actuary to review the reserves in respect of those classes of business.

### 7.15 *Suspicious Transactions*

An authorized insurer should have formal procedures to identify potential suspicious transactions. In this regard, an authorized insurer that carries on long term business is required to pay particular attention to the Guideline on Anti-Money Laundering and Counter-Terrorist Financing (GL3), for preventing and identifying any suspicious money laundering activities. There should also be established lines of communication for reporting any suspicious transactions or activities to the Board, the senior management and/or the law enforcement authorities.

### 7.16 *Proper Books and Records*

- (a) Pursuant to section 16 of the Ordinance, an authorized insurer is required to keep proper books of accounts which sufficiently exhibit and explain all transactions entered into by the insurer in the course of any business carried on by it. These books and records must be kept for not less than seven years from the end of the financial year to which the last entry made or matter recorded therein relates. Also, the IA may require an authorized insurer to provide it, within a specified period, any books of accounts that are required to be kept by section 16 of the Ordinance.
- (b) Authorized insurers are also required to comply with any regulations, rules or guidelines issued by the IA in connection with record keeping and should have a proper documentation system in place.
- (c) Books and records include contracts, agreements, vouchers or recorded business details in the form of written as well as digital/electronic data like sound track, visual image, email and message, tape, disc, etc. For the sake of clarity, records here include those forms and statements required under any applicable Guidelines. Proper books and records should be either in a legible form or in a non-legible form capable of being reproduced in a legible form. Those digital/electronic data embodied in any devices should also be capable of being reproduced.

### 7.17 *Cyber Security*

- (a) With the increased incidents of cyber attack and its increasing sophistication, strong cyber resilience is important for an authorized insurer to protect the personal information of its policy holders, and

digital/electronic data of its business to ensure continuity of the business operations. An authorized insurer should have policies and procedures, which are commensurate with the scale and complexity of its business, to identify, prevent, detect and mitigate cyber security threats.

- (b) An authorized insurer should identify cyber security threats arising from network, email and relevant devices. It would be more optimal to prevent and detect such threats rather than to deal with the consequences of the cyber security threats. Mitigation measures should be in place to prepare for possible cyber security threats. There should be periodic testing on the mitigation measures to ensure their capability to deal with the cyber security threats timely and effectively.
- (c) An authorized insurer should regularly review and assess the cyber security policies and procedures, as well as monitor their implementation. It should also communicate the relevant policies and procedures to its staff and as appropriate to other users of the cyber security system concerned.

#### 7.18 ***Business Continuity Planning***

- (a) An authorized insurer should maintain business continuity policy and business continuity plans (“BCP”)<sup>7</sup> for both going-concern and gone-concern situations. The policy and plan should include identification of viable measures and actions the insurer can take to continue and restore its position or business activities under different stressed conditions or in advance as precautionary measures.
- (b) The business continuity policy covers the governance structure, identification of plausible disruptions and the impacts to the authorized insurer and approach to continue and restore the business activities. BCP covers more detailed actions and procedures, including contingency plan, identification of critical business activities, roles and responsibilities of different parties, succession plan of critical staff, communication plan, recovery target timeline and technology recovery and support.
- (c) The business continuity policy and BCP should be commensurate with the nature, scale and complexity of the business and the risk

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<sup>7</sup> Notwithstanding here refers to business continuity policy and BCP, these can be combined in a single document.

position of the authorized insurer, and should be properly documented. They should be regularly updated and tested to ensure their effectiveness.

- (d) If an authorized insurer in any circumstances needs to activate the BCP, it has to inform the IA promptly, and provide information of the disruptions, actions taken, potential impacts and the recovery target timeline. Progress reports should be provided thereafter until the position or business activities are restored to or resumed normal.

#### 7.19 ***Compliance with Laws , Regulations and Rules***

- (a) The Board is responsible to ensure compliance with all the relevant laws, regulations, rules, guidance notes, guidelines and codes issued by the relevant regulators; and standards and codes issued by the industry bodies.
- (b) An authorized insurer is encouraged to designate responsible person(s) to take charge of the operations of the compliance function. The responsible person(s) should report the compliance status and remedial actions for any non-compliance to the Board at regular intervals.

7.20 The Board should review the internal control system from time to time to ensure that it is adequate for the nature and scale of the relevant authorized insurer's business.

7.21 The Board shall, upon the IA's request, submit detailed information on the internal control system of the authorized insurer to the IA and strengthen such system if required by the IA.

### **8. Committees<sup>8</sup>**

8.1 Where committees are established, they should have clearly defined mandates, appropriate authority, and appropriate independence and objectivity to carry out their functions. If the functions of any committees are combined, the Board should ensure such a combination does not compromise the integrity or effectiveness of the functions combined. In all cases, the Board remains ultimately responsible for matters delegated to any committees.

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<sup>8</sup> Committees refer to Board level committees. However, authorized insurers may establish other Board level or management level committees for different functions.

8.2 The Board should at the minimum establish an Audit Committee and a Risk Committee.<sup>9</sup> It may consider establishing other specialized committees to assist it in performing its functions. The functions of other specialized committees are set out in paragraphs 8.6 to 8.11. The types of committees to be set up should be commensurate with the size of the authorized insurer, its business activities and practical needs. The relevant committees should comprise an appropriate number of directors possessing the necessary knowledge and expertise. To avoid undue concentration of powers, rotation of membership may be considered.

8.3 An authorized insurer may rely on group committees for certain functions, provided that these group committees take account of the matters in respect of the insurer and the principles set out in this Guideline appropriately. Otherwise, the Board should establish its own committees for carrying out the functions effectively. The reliance of Group Audit Committee and Group Risk Committee are set out in paragraphs 8.4(c) and 8.5(b) respectively.

#### 8.4 *Audit Committee*

- (a) The precise duties of the Audit Committee may vary from one authorized insurer to another. Its principal function is however to assist the Board in fulfilling the latter's responsibilities by providing an independent review of the effectiveness of the financial reporting process and internal control system of the insurer. The Audit Committee should also make recommendations<sup>10</sup> on the appointment, re-appointment and removal of external auditors.
- (b) To enable the Audit Committee to perform its functions independent of the management, the Audit Committee should comprise a minimum of three directors, including at least one INED, and preferably INEDs in majority. The Audit Committee should be chaired by an INED. In view of the nature of work of the Audit Committee, the majority of its members need to have financial, accounting or auditing knowledge.
- (c) Where an authorized insurer is part of a group of companies which has established a Group Audit Committee to perform the same

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<sup>9</sup> Audit Committee and Risk Committee are two separate committees.

<sup>10</sup> The Audit Committee may take account of, amongst others, integrity, independence, objectivity, competency and performance of the external auditor when making recommendations.

function, it may not be necessary for the insurer concerned to separately establish its own Audit Committee.

- (d) Small authorized insurers are exempted from establishing an Audit Committee.

## 8.5 *Risk Committee*

- (a) The Risk Committee oversees the establishment and operation of the risk management system independently. The majority of its members is preferably to be INEDs. Its duties include advising the Board on the authorized insurer's risk appetite, reviewing the adequacy and effectiveness of the risk management policies for material risks (such as pricing, capital management, market, liquidity, operation and compliance) on a regular basis and ensuring sufficient resources are in place for risk management. The Risk Committee should have access of information provided by the senior management of the insurers and key person(s) in the risk management function. Its members should collectively possess adequate knowledge and experience in risk management for discharging their responsibilities effectively.
- (b) Where an authorized insurer is part of a group of companies which has established a Group Risk Committee to oversee the risk of the insurer as well, the insurer may rely on the Group Risk Committee for the oversight of the risk management system. However, where the IA considers the Group Risk Committee does not take into account the risk profile of the insurer, the insurer should establish its own Risk Committee.
- (c) Small authorized insurers are exempted from establishing a Risk Committee.

## 8.6 *Investment Committee*

The Investment Committee sets out the investment policy and strategies and oversees the investment portfolio of the authorized insurer. It should monitor the investment results of the insurer, regularly review and revise its investment strategies in the light of changes of the market environment. It should also give due consideration to matching the assets of the insurer with its liabilities as appropriate. It is required to observe GL13.

## 8.7 *Nomination Committee*

The Nomination Committee nominates suitable candidates for appointment of the directors and senior management of the authorized insurer. In making a nomination, it should ensure, amongst other things, that the qualifications and experience of the nominee meet the relevant requirements. Where the Nomination Committee is established, the Nomination Committee should comprise at least one INED.

## 8.8 *Remuneration Committee*

- (a) The Remuneration Committee reviews and recommends the remuneration of directors, senior management, key persons in control functions and material risk-taking employees. It should ensure that the remuneration package recommended for each person should be commensurate with, amongst others, his personal performance, the authorized insurer's business results, business strategies, corporate culture, risk appetite and the prevailing market condition.
- (b) Where the Remuneration Committee is established, the Remuneration Committee should comprise directors including INEDs, and be chaired by an INED. The members should be competent and able to exercise independent judgement on remuneration policy and practices. The Committee should work closely with other relevant committees such as the Risk Committee to assess the impact of the remuneration policy on the authorized insurer's risk-taking behavior. Details of the remuneration matters are set out in section 9.

## 8.9 *Underwriting Committee*

The Underwriting Committee formulates the underwriting policy of the authorized insurer. It sets out the criteria for assessing various types of insurance risks and determines the pricing policy of different risks. It should regularly review the underwriting and pricing policies of the insurer with due regard to relevant factors such as its business portfolio and the market development.

## 8.10 *Claims Settlement Committee*

The Claims Settlement Committee devises the claims settling policy of the authorized insurer. It oversees the claims position of the insurer and ensures that adequate claims reserves are made. It should pay particular attention to significant claims cases or events which will give rise to a series of claims. The Committee should determine the circumstances under which claims disputes should be brought to its attention and decide how to deal with such claims disputes. It should also oversee the implementation of the measures for combating fraudulent claims cases.

#### 8.11 ***Reinsurance Committee***

The Reinsurance Committee ensures that adequate reinsurance arrangements are made for the authorized insurer's business. It peruses the proposed reinsurance arrangements prior to their execution, reviews the arrangements from time to time and, subject to the consent of the participating reinsurers, makes appropriate adjustments to those arrangements in the light of market development. It also assesses the effectiveness of the reinsurance programme for future reference.

### **9. Remuneration Matters<sup>11</sup>**

9.1 Sound remuneration practices are vital to sound corporate governance of an authorized insurer. The insurer should establish a prudent and effective remuneration policy which should not induce inappropriate or excessive risk taking. Also, the policy should be in line with the insurer's objectives, business strategies and long-term interests.

#### 9.2 ***Remuneration Policy***

(a) A written remuneration policy covering all directors and employees should be established and maintained. The policy should have specific regard to the following personnel:

- (i) Directors, including INEDs;
- (ii) Senior management;

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<sup>11</sup> Section 9 does not cover agents, whose remuneration are commission based and who do not have employment contract entered with the authorized insurers.

- (iii) Key persons in control functions – who are responsible to perform one or more of the control functions including actuarial, financial control, internal audit, compliance, risk management and intermediary management; and
  - (iv) Material risk-taking employees<sup>12</sup> – whose duties or activities involve the assumption of material risk or the taking on of material exposures on behalf of the authorized insurer. They could be either individual employees or groups of employees whose activities in the aggregate may expose the insurer to material amounts of risks.
- (b) To ensure remuneration policy supports the risk management framework and does not bring any adverse impact to the risk profile of the authorized insurer, in addition to directors and senior management, key persons in risk management function should be involved in the remuneration policy setting and monitoring process. Their involvement can be in the form of joint meetings, being members of the Remuneration Committee, acting as observers in the meeting on remuneration matters or maintaining a close dialogue with the Remuneration Committee.
  - (c) The remuneration policy should motivate directors and employees to pursue the long-term growth and success of the authorized insurer and demonstrate a clear relationship between performance and remuneration. Remuneration for INEDs should be set at a level that does not compromise their independence and is commensurate with their time and efforts contributed.
  - (d) Where the authorized insurer is part of a group of companies, it can make reference to the remuneration policy of the group<sup>13</sup>.

### 9.3 ***Board Oversight***

- (a) The Board should review and approve the remuneration policy and practices. The Board may establish a Remuneration Committee as described in paragraph 8.8, whilst the Board retains the ultimate responsibilities of the oversight.
- (b) The Board should ensure that in structuring, implementing and

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<sup>12</sup> For example, they may include staff authorized to make decision on underwriting activities or investment activities.

<sup>13</sup> Please also refer to paragraphs 5.1(b) and 8.3.

reviewing the authorized insurer's remuneration policy, the decision-making process will identify and manage conflicts of interest and is properly documented. No director should be placed in a position of actual or perceived conflicts of interest in respect of remuneration decisions.

- (c) The Board should monitor and review the implementation of the policy regularly to ensure its adequacy and effectiveness.

#### 9.4 ***Remuneration Structure***<sup>14</sup>

- (a) Good remuneration structure should have the following elements:

##### *Fixed and Variable Components*

- (b) There should be an appropriate proportion of fixed and variable components, where the variable components could be allocated among cash and other forms of remuneration, such as shares. A variable component linked to performance that is disproportionately high relative to the fixed component may make it difficult for an authorized insurer to reduce or eliminate variable remuneration in a poor financial year.
- (c) Consideration should be given to variable remuneration as follows:
  - (i) based on individual and/or group performance;
  - (ii) subject to prudent limits that are consistent with an authorized insurer's capital management strategy and its ability to maintain a sound capital base taking account of its targets or regulatory capital requirements. For example, an insurer may cap the total variable remuneration to a percentage of the net profits; and
  - (iii) major part of any variable remuneration should be deferred for an appropriate period. The deferral period<sup>15</sup> usually varies on the level of seniority<sup>16</sup>, responsibility of the individual, and the nature and time horizon of the risks undertaken by the

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<sup>14</sup> For the purpose of paragraph 9.4, variable remuneration is not applicable to INEDs.

<sup>15</sup> As a point of reference, Implementation Standards (No. 7) for the Financial Stability Board Principles for Sound Compensation Practices suggest a minimum deferral period of three years.

<sup>16</sup> As a point of reference, Implementation Standards (No. 6) for the Financial Stability Board Principles for Sound Compensation Practices suggest the proportion of variable remuneration subject to deferral be set at 40%-60% for senior executives and other employees whose actions have a material impact on the risk exposure of the company; and over 60% for most senior management and most highly paid employees.

individual. The objective is to allow an authorized insurer to observe the risks and performance over a longer period of time and to make adjustment before payment, if necessary. Under exceptional circumstances and subject to Board's approval and proper documentation, an authorized insurer may exercise discretion to pay remuneration within the deferral period.

- (d) Where variable remuneration comprises share-based elements (such as shares and share options), the following safeguards should be implemented to align the long-term incentives of an authorized insurer:
  - (i) Vesting restrictions – include vesting conditions and vesting schedules where shares should be vested over a period of at least three years after their award;
  - (ii) Holding restrictions – share options should be exercisable for a minimum period of at least three years after their award; and
  - (iii) Retention restrictions – an appropriate proportion of the shares should be retained after vesting or exercise. Retention portion and period set should take account of factors including seniority level, nature and time horizon of risks undertaken, and the relevant vesting period or holding period of shares.
- (e) Guaranteed bonuses should generally not be offered, as they are not consistent with sound risk management and performance-based principle.
- (f) There should be malus provisions for the unvested portion of the deferred remunerations and preferably clawback provisions for the vested portion of the deferred remunerations, if the financial performance of the authorized insurer or the circumstances under which the performance is measured has been proved not genuine in case of, for example, misstatement of data, fraud, malfeasance or violation of policies, etc.

## 9.5 *Criteria for Performance Measurement*

- (a) In measuring the performance of an individual, judgement may be exercised by the authorized insurer on top of predetermined performance criteria. The performance criteria applicable to the variable remuneration should promote a complete assessment of

risk-adjusted performance, and should have the following characteristics:

- (i) clearly defined, pre-determined and objectively measurable;
- (ii) include both financial and non-financial factors<sup>17</sup> as appropriate;
- (iii) based on performance of both individual, business unit, the overall results of the insurer and its group, as appropriate;
- (iv) set in multi-year framework<sup>18</sup> (e.g. three to five years) to allow adjustments for material current and future risks and/or performance, as appropriate. This approach can align the remuneration with long term performance and prevent short term gains by taking greater risks; and
- (v) not adopt growth or volume as an isolated criterion.

#### 9.6 ***Key Persons in Control Functions***

- (a) In order to mitigate the potential conflicts of interest that may compromise the integrity and objectivity of the key persons in control functions, their remuneration should be:
  - (i) based on the effective achievement of the objectives appropriate to such control functions;
  - (ii) not solely linked to the performance of any business units which are subject to their control or oversight; and
  - (iii) be adequate to attract and retain staff with the requisite skills, knowledge and expertise to discharge those control functions effectively.
- (b) Where the control function is outsourced, the remuneration payable to the service provider should be consistent with the authorized insurer's remuneration policy and objectives. In this connection, reference should be made to the Guideline on Outsourcing (GL14).

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<sup>17</sup> Examples of financial factors include net profits, underwriting results, business growth, etc. Commonly used non-financial factors include compliance with regulations, rules and internal rules, effectiveness of risk management, customer satisfaction, etc.

<sup>18</sup> For example, a moving average of financial results is a measure that takes multi-year performance of the authorized insurer into account.

## 9.7 *Severance Payments (also known as ‘golden parachutes’)*

Where an authorized insurer provides discretionary payouts on termination of employment, such payment should be in line with the financial condition and performance over certain time horizon. Discretionary severance payments should not be paid in case of failure or threatened failure of the insurer, particularly to an individual whose actions have contributed to the failure or potential failure of the insurer.

## 10. **Servicing of Customers**

10.1 Insurance products have become more sophisticated and are now commonly used as one of the tools for financial planning by the policy holders. Fair treatment of customers is an important concept and should form an integral part of an authorized insurer’s business culture, business strategies as well as internal controls.

10.2 Authorized insurers should exercise due care and diligence in servicing the customers before an insurance contract is entered into and through to the point at which all obligations under that contract have been satisfied, with due regard to the groups of customers and the types of products provided.

10.3 The Board has the ultimate responsibility for fair treatment of customers. The authorized insurer should clearly set out proper policies and procedures regarding servicing of customers, including in particular disclosure of policy benefits, risks and responsibilities, pricing of insurance policies, handling of customers’ complaints and settling of insurance claims, etc. Such policies and procedures should be made available to the IA upon request.

10.4 Implementation of the policies and procedures dealing with fair treatment of customers should be monitored and evaluated. Deficiencies identified should be properly remedied.

### 10.5 *Provision of Information*

- (b) To better serve customers, authorized insurers should enhance transparency of their products and improve customers’ awareness of their rights and obligations under their insurance policies.

- (c) Adequate and clear information should be made available to customers before, during and after the point of sale. Information relating to any changes during the term of the insurance contracts (e.g. early cancellation of a policy) should also be clearly communicated to the customers.
- (d) Product features, policy terms and conditions should be clearly presented to enable policy holders to understand the coverage, limitations and exclusions. Technical terms in a policy should be elaborated clearly.

## 10.6 *Complaints Handling*

Authorized insurers should establish clear complaints handling policy and procedures, including but not limited to accessibility, record keeping, time frame and monitoring, to ensure all complaints are properly handled. Appropriate reporting mechanism to the Board and senior management should be in place, particularly for those relating to operational issues. Where a dispute arises, the insurer should ensure resolving dispute in a fair manner and document the dispute resolution process properly. The policy and procedures should be communicated to customers.

## 11. **Implementation**

11.1 This Guideline, except those requirements specified in paragraph 11.2 below, shall take effect from 26 June 2017.

11.2 For the requirements on the minimum number of INEDs (paragraph 4.2(c)), the establishment of a Risk Committee (paragraphs 8.2 and 8.5) and the requirements on remuneration matters (section 9), this Guideline shall take effect from 1 January 2018.

**June 2017**