

Independent Non-Executive Directors - The Case for Hong Kong Insurers Article

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Introduction

In the wake of a series of corporate scandals involving directors and/or chief executives, the importance of the integrity, competence and professionalism of the Board of Directors (“Board”), which is the cornerstone of sound corporate governance, has come into the spotlight since the last decade.

People usually consider that good corporate governance is a matter of more relevance and concern to listed companies. Whilst insurers, local and foreign alike, are mostly non-listed companies, the solvency of an insurer, and in turn the interests of the existing and potential policy holders, may be adversely affected should the insurer concerned practise poor corporate governance. Insurance regulators worldwide have therefore devised rules and regulations to govern the standard of insurers’ corporate governance under their regime.

The Insurance Authority (“IA”), being the insurance regulator in Hong Kong, believes that a high standard of corporate governance established by authorized insurers is essential in instilling the confidence of the insuring public and maintaining the healthy development of the insurance market in Hong Kong. To enhance the well being of the local insurance industry, the IA promulgated the Guidance Note on the Corporate Governance of Authorized Insurers (“Guidance Note”) in August 2002. The Guidance Note has become operational since 1 September 2003. It sets out the minimum standard of corporate governance that is expected of an authorized insurer. The basic principles of good corporate governance include, among others, a competent Board comprising an appropriate number of independent non-executive directors.

Importance of Independent Non-Executive Directors (“INEDs”)

Prior to the commencement of the Guidance Note, there was no requirement for

authorized insurers to appoint INEDs. The majority of the authorized insurers, particularly those incorporated in Hong Kong, are small or medium private companies. In the past, their Boards operated in similar manner as other ordinary private companies.

With more and more people reckon that independent and objective opinions are essential to enable the Boards of listed companies to make sound decisions, the same holds true for an authorized insurer. It is because insurance contracts are basically the payment of insurance premiums in return for promises for the delivery of service in the future. To act in the best interests of an authorized insurer and its stakeholders, it is necessary for the Board to maintain appropriate checks and balances against the influence of the management and controllers. A suitable number of INEDs on the Board will help achieve this purpose.

Requirements about INEDs

For an authorized insurer to whom the Guidance Note applies, at least one-fifth of its Board should be composed of INEDs.

The prerequisite for INEDs is that they must be fit and proper persons. Besides, they should be individuals with sufficient calibre and breadth of experience to perform the balancing function. They should also be independent of the management and free from any business or other relationships with the authorized insurer which could materially affect the exercise of their independent judgement. The “independence” of INEDs is emphasized because of their balancing role in the Board. It is noteworthy that pursuant to the Guidance Note, there must be at least one INED in the Audit Committee. The purposes are to enable the Audit Committee to perform its functions independently and guard against any irregularities.

To assist authorized insurers to determine the suitability of candidates to be INEDs, the Guidance Note specifies the circumstances in which a person would unlikely be considered an INED of an authorized insurer if :-

- he is an employee of that authorized insurer or of a company within the same group of companies as that of the authorized insurer;
- he is a director, other than an INED, of a company within the same group of companies as that of the authorized insurer;
- he is a controller of that authorized insurer or of a company within the same group of companies as that of the authorized insurer;

- he is an associate of a director or controller of that authorized insurer; or
- he has significant financial association with that authorized insurer that could affect the impartiality of his independent judgement. For example, he has significant loans due from or to that authorized insurer. For the avoidance of doubt, remuneration for a director generally does not constitute significant financial association.

According to a survey conducted by the IA in September 2003 i.e. the commencement month of the Guidance Note, while there were a small number of authorized insurers that had slight deficiencies in appointing suitable INEDs, the authorized insurers were generally able to comply with the Guidance Note and had appointed INEDs as required. The appointed INEDs include renown persons, solicitors, accountants, etc. For those insurers with slight deficiencies, they had subsequently rectified the position.

Training and Guidelines

The Guidance Note encourages the directors, including INEDs of authorized insurers, to receive training as and when necessary. In this regard, a variety of training programmes are available in the market. In particular, the Hong Kong Institute of Directors (“Institute”) organizes various courses, workshops and forums from time to time.

The INEDs of authorized insurers are also encouraged to make reference to some non-statutory guidelines in discharging their duties. Examples of these guidelines include The General Principles of Directors’ Duties issued by the Companies Registry of Hong Kong, the Guidelines for Directors and the Guide for Independent Non-Executive Directors both issued by the Institute.

Conclusion

The practise of good corporate governance by authorized insurers continues to be one of the IA’s main focus on the stable and healthy developments of the Hong Kong insurance industry. The IA will keep close watch on the effectiveness of INEDs in balancing the Board of the authorized insurers and will review and revise the aforesaid requirements as appropriate in light of operational experience as well as market and regulatory developments.