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PRC CORPORATE GOVERNANCE RULES FOR INSURERS

In another sign of the increased regulatory scrutiny of PRC insurance companies, China Insurance Regulatory Commission has issued several new regulations aimed at enhancing the corporate governance of PRC insurers. Partner Niranjan Arasaratnam and Senior Associate Troy Zhang provide an overview of the recent developments.

New CIRC regulations to increase corporate governance scrutiny of PRC insurers

HOW DOES THIS AFFECT YOU?

- PRC insurers will need to undertake considerable work to review their existing governance practices to bring them into line with the China Insurance Regulatory Commission requirements. This would include amending their articles of association and formulating by-laws so that their corporate governance and internal control rules more clearly define the functions and duties of directors, board committees and management.
- This creates a significant opportunity for foreign investors to participate in the PRC insurance market given their more developed experience and knowledge of corporate governance in the international context.

CIRC RULES ON INSURERS' GOVERNANCE

To date, the China Insurance Regulatory Commission's (**CIRC**) regulatory priorities have focused on solvency, product supervision and the investment guidelines of insurers (see AAR *Focus: China - Insurance* – February 2007). The development of corporate governance regulations represents a new aspect of regulatory oversight in the Chinese insurance industry.

In April 2007, CIRC issued the following implementing regulations giving detailed guidance on the application of broad corporate governance principles that were issued by CIRC last year in its *Guiding Opinions on Regulating the Corporate Governance of Insurance Companies (Trial)* (the **Guiding Opinions**):



- the *Interim Measures on the Administration of Connected Transactions of Insurance Companies* (effective as of 6 April 2007);
- the *Interim Measures on the Administration of Independent Directors of Insurance Companies* (effective as of 6 April 2007);
- the *Guidelines on Risk Management of Insurance Companies (Trial)* (effective from 1 July 2007); and
- the *Guidelines on Internal Auditing of Insurance Companies (Trial)* (effective from 1 July 2007).

The new corporate governance principles and rules provide guidance for insurers and insurance funds managers licensed in the PRC concerning:

- the appointment and responsibilities of independent directors; and
- the role of independent internal audit, risk management and compliance functions.

These regulations reflect CIRC's willingness to embrace international standards on corporate governance and risk management in order to address potential risk issues as the Chinese insurance market grows. This development represents a strong signal by CIRC as to the maturing regulatory framework in China and its views on best practice for corporate governance in the insurance industry. CIRC has taken a pragmatic approach by generally not setting a timeframe for PRC insurers to adopt and implement the best practice rules. Rather, CIRC appears to be acknowledging that there is no 'one size fits all' approach to corporate governance.

INDEPENDENT DIRECTORS

The *Interim Measures on the Administration of Independent Directors of Insurance Companies* requires a minimum number of independent directors to sit on the board of each insurer in the PRC. This requirement is the only rule that contains a specific deadline. Insurers must implement (in two stages) the requirement that:

- there are at least two independent directors on the board by 30 June 2007; and
- at least one-third of all directors to be independent by 30 December 2007 (for insurers with more than RMB 5 billion in total assets at the end of 2006), or (in respect of the other companies) within a year after their total assets reach RMB 5 billion.

Independent directors should be elected by the shareholders and can only be dismissed by shareholders holding at least two-thirds of the votes held by all shareholders attending a general meeting. Independent directors may serve consecutive terms but the aggregate term should not be more than six years. The responsibility of independent directors includes reviewing and reporting to the shareholders' general meeting, at least annually, on the following:

- any material connected transactions;
- the nomination for the appointment, election and dismissal of directors and senior management, as well as their remuneration;
- profit distribution schemes;
- material investments, leases, purchases and sales, guarantees and other transactions not contemplated by the insurer's business plans; and
- all other matters that may have a material impact on the company, its minority shareholders and insureds.

An independent director should chair the audit committee (discussed below) as well as the nomination and remuneration committee of the board.

The *Interim Measures on the Administration of Independent Directors of Insurance Companies* also sets out rules on criteria, nomination, remuneration, and other requirements of independent directors and the performance of their duties.

INTERNAL CONTROL (INCLUDING INTERNAL AUDIT)

The CIRC guidelines mandate each PRC insurer to establish:

- An audit committee comprising a committee of the board. The audit committee should be responsible for reporting to the board on internal audit and internal control matters on at least a half-yearly basis. The audit committee should comprise at least three non-executive directors and must be chaired by an independent director.

- An independent audit department and a position called 'person responsible for audit' (essentially the chief auditor). The board has the power to appoint the chief auditor. The chief auditor is not permitted to concurrently hold any financial or business position within the company, in order to ensure his/her independence. The chief auditor needs to report to the audit committee, as well as management, on a quarterly basis at a minimum.

Also, an insurance company must submit to CIRC an internal control assessment report, as approved by its board, by 30 April of every year.

RISK MANAGEMENT

The CIRC guidelines contemplate the establishment of a risk management committee. However, if an insurer does not have a risk management committee, then its risk management responsibilities must be undertaken by the audit committee.

In addition, the guidelines contemplate the establishment of:

- an optional risk management coordination team comprising senior management or department heads, headed by the general manager or his/her appointee; and
- a risk management department, either as a stand-alone department or under the risk management coordination team. The risk management department must report to the management, as well as the board, on an annual basis at a minimum.

Life insurers are required to have a chief actuary who is accountable to management and the board mainly on risk management, the development of new products, and solvency issues. A PRC insurance company must also establish a position named 'person responsible for compliance' (presumably a head of compliance) and a compliance department independent from the business and financial departments. The chief actuary and head of compliance are required to report to the CIRC on material risks and non-compliance activities respectively.

CONNECTED TRANSACTIONS

Connected transactions refer to those between an insurer and its connected parties that basically include:

- its shareholders holding more than five per cent of its shares or voting power, their affiliates and the subsidiaries of the insurer, and each of their chairpersons and general managers;
- its directors, supervisors and senior management of the head office, their close relatives, and entities controlled by any of the above individuals; and
- other parties capable of materially influencing the insurer.

In principle, all connected transactions can only be made on an 'arm's length' basis and material connected transactions are required to be approved by the board of directors and/or shareholders where the connected directors and/or shareholders abstain from voting. Such transactions are required to be reported to CIRC within 15 working days after their occurrences. Also, insurance companies need to formulate by-laws relating to connected transaction and submit such by-laws to the CIRC.

The *Interim Measures on the Administration of Connected Transactions of Insurance Companies* sets out the thresholds for a material connected transaction, types of connected transactions, definitions of relevant terms such as close relative, control and material influence (for the purpose of identifying affiliates and subsidiaries mentioned above).

We will continue to monitor changes in the PRC regulatory environment.

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