AN INSURANCE REGULATOR'S PERSPECTIVE ON CORPORATE GOVERNANCE

Ms Potjanee Thanavaranit[1]
Director-General, Insurance Commissioner
Department of Insurance, Ministry of Commerce, Thailand

In recent years, the international financial and insurance institutions have paid more attention to corporate governance agenda than other topics. A series of events over the last two decades has placed corporate governance issues as a top concern for both the international public and private sectors. Spectacular business failures such as the Bank of Credit and Commerce International scandal, such as the United States savings and loan crisis; the collapse of HIH Insurance Group; and the gap between executive compensation and corporate performance drove the demand for change in developed countries. More recently, the United States corporate accounting scandals, financial crises and institutional failures in Russia, Asia and the United States have brought corporate governance issues to a significant role in developing countries, transitional economies, and emerging markets. These incidents illustrate that the lack of corporate governance enables insiders, whether they be company managers, company directors or public officials, to take advantage of companies or public assets at the expense of shareholders, creditors and other stakeholders. It is critical that persons who have the proper amount of authority and misuse this authority, could greatly damage the organisation and the respective industry as a whole.

Corporate governance can be referred to as the mechanisms through which corporations, whether private, publicly traded, or state-owned, and their management are governed. It involves a set of relationships between a company's management, its board, its shareholders, and its other stakeholders, and also provides the structure through which the objectives and the monitoring of performance are determined. Good corporate governance entails the pursuit of objectives by the board and management that represent the interests of a company and its shareholders including effective monitoring and efficient use of resources. Good corporate governance is influenced by a number of factors, primary among which is the nature of the overall institutional and legal framework that has been established by governments to affect such good governance.

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Since the first negotiation involving the insurance sector under the World Trade Organization, the insurance sector is a major and increasingly prominent sector of the financial services industry. The increasing liberalisation of markets has resulted in much deregulated supervision of products and tariffs. On the insurance distribution front, Bancassurance is an alternate channel to distribute insurance products through banks, which have a good relationship with customers. The distribution of insurance products through banks is a cost-effective means for an insurance company compared to the traditional agent channel. Increasing numbers of insurance companies have already tied up with banks to explore the potential of the channel that has been a success story in Europe, and legislations are also in place.

The concentration and internationalisation of insurance companies has necessitated greater mutual understanding and closer co-operation between supervisory authorities in the different countries. Moreover, the supervisory authorities have to meet the challenge represented by increased convergence between the different financial sectors such as banks, insurance, securities and pensions. Consequently, the insurance supervisors and other financial sectors' supervisory authorities have designed the risk management and corporate governance for insurance groups and financial conglomerates. In addition, insurance supervisors have to take into account the new emerging risks and the protection of the insured by introducing general funds for the protection of policyholders.

Over the past few decades, the insurance and financial companies have acquired effective new tools such as securitisation and derivatives to manage financial risk. The securitisation helps a firm manage the risk of a concentrated exposure by transferring some of that exposure outside the firm. By pooling assets and issuing marketable securities, firms obtain liquidity and reduce funding costs. As a result, moving assets off the balance sheet and into special purpose entities generates its own risks and reduces transparency unless the firm takes additional steps to enhance disclosure.

An insurance company is subject to risks inherent in the insurance industry and risks of a more general nature such as incompetent or dishonest management, and poorly managed growth. In addition, the insurance sector is a major contributor to risk management and financial stability in an increasingly liberal and international environment. In the insurance business, the key competence relates to risk. Competence in this case is about identifying, understanding and managing risk. Although the insurance companies are expert in technical insurance risk, this technical competence is not always enough. The real competence is best demonstrated by ensuring that all sources of risk, including operational and market risk as well as insurance risk, are fully understood and controlled. There are some factors that wider competence has been including. These have included good systems and good personnel as follows:

- `The existence of an effective financial sector policy and an appropriate institutional and legal framework is necessary to ensure the stable and efficient operation of the financial system.

- The legal system must provide support in honouring and enforcing insurance contracts.
- Insurance supervisory systems and practices must be continually upgraded to cope with the developments in insurance and insurance-linked financial activities.
- The insurance companies must have adequate modelling of possible adverse scenarios, including the problems arising from guaranteed rates not covered by falling interest rates.
- Fit and proper of systems and controls of insurance companies are needed, particularly over underwriting standards.
- Insurance brokers and agents must provide good quality advice to consumers to minimise subsequent demands for compensation and redress. This reflects the competence at the level of the adviser and management for understanding the risk and to ensure that it is well managed.

All countries where corporate governance is being developed tend to incline towards the same direction, that is, in order to strengthen a country's competitiveness, it is established that one needs to set up a micro-policy to have a good system of corporate governance and good personnel. It serves as a framework for domestic companies to follow in developing their own appropriate forms in line with the circumstances and constraints they face, taking into account the globalisation trend.

Upon entering the new century in which international competition is intense, Thailand needs advanced measures and new initiatives to secure long-term capital and economic stability for its survival. In addition to the economic factors, credibility, and the country's law enforcement, an internationally accepted structure of corporate governance is therefore highly essential.

The Royal Thai Government has paid high attention to the encouragement and promotion of corporate governance with an objective to create a transparent investment environment in Thailand. The year 2002 was designated as the "*Year of Good Corporate Governance.*" In this connection, the cabinet has set up the National Corporate Governance Committee (NCGC) to set out policies, measures, and schemes to upgrade the level of corporate governance in Thai business. The National Corporate Governance Committee, which is chaired by the Prime Minister, appointed a Sub-committee on 'Improvement of Corporate Governance of Commercial Banks, Finance Companies, and Insurance Companies', which is one of six sub-committees, to set out the principles for raising the standards of corporate governance. The Governor of the Bank of Thailand chairs this Sub-committee and the Director-General of the Department of Insurance is one of the six members. So far, new laws and regulations have been enacted, covering investments, the system of property ownership for non-residents and new taxation schemes. In addition, all these practices are geared toward the promotion of transparency and disclosure of information to upgrade the level of corporate governance among institutions, associations, corporations and government agencies in the financial services busines-

Good governance is based on the principles of justice, honesty, transparency, accountability, efficiency and effectiveness, and participation.

The corporate governance and decision-making processes of insurance companies are key components of insurance supervision. In the insurance industry, the *Insurance Core Principle number 9 of* the International Association of Insurance Supervisors (IAIS) *Insurance Core Principles and Methodology (October 2003) states:*

> "The corporate governance framework recognises and protects the rights of all interested parties. The supervisory authority requires compliance with all applicable corporate governance standards."

The application of this core principle is the important framework for the Department of Insurance's promotion of good corporate governance. The strength of insurance companies depends on the power not only of companies to pay all claims and liabilities, but also the role of legal and regulatory structures to protect policyholders and promote the development of insurance companies and the industry. Consequently, the Department of Insurance has encouraged higher corporate governance standards in all aspects of insurance business in Thailand. The Department clearly sees the individual insurers, the General Insurance Association, the Thai Life Assurance Association, the Insurance Brokers Association and the Thai Life Underwriters Association as being responsible for developing and implementing improved governance standards.

The Department of Insurance has implemented several initiatives and measures since 2002, which will pave the way to good corporate governance, as follows:

- Amendment to laws in order that the working procedures of insurance companies shall attain the level of effectiveness, efficiency and transparency;
- Review of companies' financial reports to ensure that they present true and fair value, and provide adequate information to shareholders;
- Prohibition on an insurance company from investing in a related company, which would produce conflict of interest;
- Review of the adequacy and effectiveness of companies' internal control system and internal audit functions to ensure their effectiveness and proper risk management;
- Appointment of a Committee on the Promotion and Improvement of Corporate Governance in the Insurance Business, which is chaired by the Director-General / Insurance Commissioner. The Committee's members are from public and private sectors including the General Insurance Association, the Thai Life Assurance Association, the Insurance Brokers Association and the Thai Life Underwriters Association as being responsible people for setting guidelines and measures of corporate governance for the insurance business;

- The development of a Code of Best Practice in conjunction with the General Insurance Association and the Thai Life Assurance Association;
- The 'Best Insurance Company of the Year Award' for life and non-life insurance companies, based on criteria for financial stability, managing the business with integrity, public benefit, and intentions to create new effective products and quality services;
- Revising the Department's working practices to improve both the efficiency and transparency of its operations.

The Department of Insurance has acknowledged the challenges faced by the insurance industry today. Therefore, improving the overall financial strength of insurers and promotion of good corporate governance are clearly on our agenda so as to enhance public confidence in the insurance business as a professional risk taking institution where accountability and fiduciary duty of parties concerned become everyday practice.

I do believe that the future co-operation among Asia-Pacific Insurance Supervisors should be further developed. The improvement of regional corporate governance standards and practices will play its role in an integrated financial and insurance market. As a result, the insurance industry will be developed as a core component of the financial sector in the Asia-Pacific region.