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Circular Letter No. 13-2002

To : **All Life Insurance Companies, Non-Life Insurance Companies, Professional Reinsurers and Insurance Intermediaries**

Subject : **Corporate Governance**

Pursuant to the national policy to institute corporate governance reforms in order to achieve policyholder and market investor confidence; sustain the growth of the insurance industry, thereby contributing to country's economic well-being; this Code of Corporate Governance is hereby promulgated for adoption and compliance by all insurance companies and intermediaries authorized to do business in the Philippines.

The primary objective of this Code is to enhance the corporate accountability of insurers and intermediaries and promote the interests of their stakeholders specifically those of the policyholders, claimants and creditors.

Consistent with a disclosure-based approach to implementation and enforcement, all concerned are required to make a general disclosure of their corporate governance practices briefly describing the manner in which the various issues enumerated above have been addressed particularly the following:

A. Board Composition & Responsibility
B. Management Accountability
C. Corporate Independence
D. Internal Controls and Operational Risk Management
E. Public Accountability
F. Financial Reporting

INSURANCE COMMISSION
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16 AUG 2002
GEN. RECORDS

The report to be prepared under the heading "Corporate Governance" shall be submitted thirty (30) days after every end of a calendar year. The first report is expected not later than 30 January 2003.

For strict compliance.

EDUARDO T. MALINIS
Insurance Commissioner

12 July 2002

CODE OF CORPORATE GOVERNANCE FOR INSURANCE COMPANIES & INTERMEDIARIES

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CODE OF CORPORATE GOVERNANCE FOR INSURANCE COMPANIES & INTERMEDIARIES

Pursuant to the national policy to institute corporate governance reforms in order to achieve policyholder and market investor confidence; sustain the growth of the insurance industry, thereby contributing to country's economic well-being; this Code of Corporate Governance is hereby promulgated for adoption and compliance by all insurance companies and intermediaries authorized to do business in the Philippines.

The primary objective of this Code is to enhance the corporate accountability of insurers and intermediaries and promote the interests of their stakeholders specifically those of the policyholders, claimants and creditors.

A. Definitions

1. *Corporate Governance* - refers to a system whereby shareholders, creditors and other stakeholders of a corporation ensure that management enhances the value of the corporation as it competes in an increasingly global market place.

2. *Board of Directors* - refers to the collegial body that exercises the corporate powers of all corporations formed under the Corporation Code. It conducts all business and controls or holds all properties of such corporations.

3. *Independent Director* - refers to a person other than an officer or employee of the corporation, its parent or subsidiaries, or any other individual having any relationship with the corporation, which would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. This means that apart from the director's fees and shareholdings, he should be independent of management and free from any business or other relationship which could materially interfere with the exercise of his independent judgment.

4. *Management* - refers to the body given the authority to implement the policies determined by the Board in directing the course/business activity/ies of the corporation.

5. *Executive Director* - refers to a director who is at the same time appointed to head a department/unit within the corporate organization.

6. *Non-Executive Director* - refers to a Board member with non-executive functions.

7. *Internal Control* - refers to the process effected by a company's Board of Directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the effectiveness and

efficiency of operations, the reliability of financial reporting, and compliance with applicable laws, regulations, and internal policies.

8. *Independence* - refers to that environment which allows the person to carry out his/her work freely and objectively.

9. *Objectivity* - refers to unbiased mental attitude that requires the person to carry out his/her work in such manner that he/she has an honest belief in his/her work product and that no significant quality compromises are made. Objectivity requires the person not to subordinate his/her judgment to that of others.

10. *Stakeholders* - refers to the group of company owners, officers and employees, policyholders, suppliers, creditors and the community.

B. Board of Directors

1. ***Composition and Board Size***

☞ The Board shall be composed of at least five (5) but not more than fifteen (15) members elected by shareholders.

☞ The Board shall include a balance of executive and non-executive directors, including independent non-executive directors having a clear division of responsibilities such that no individual or small group of individuals can dominate the Board's decision making.

☞ The non-executive directors shall be of sufficient qualifications, stature and number to carry significant weight in the Board's decisions. Non-executive directors considered by the Board to be independent shall be identified in the annual report.

2. ***Qualifications & Age Limit***

☞ Directors sitting on the board of insurance entities shall be possessed of the necessary skills, competence and experience, in terms of management capabilities, and preferably in the field of insurance or insurance-related disciplines. In view of the fiduciary nature of insurance obligations, directors shall also be persons of integrity and credibility.

☞ The Board may require that directors shall own more than the qualifying common share in the corporation.

☞ The Board shall establish a fixed retirement policy for directors.

3. ***Election***

- ☞ The stockholders shall elect the Board of Directors.

- ☞ It is the Board's responsibility to nominate directors. The Board nominates a slate, which shall include at least two members who shall be experienced in insurance or insurance-related disciplines, and other individuals with diverse talents, backgrounds and perspectives, and who can work effectively as a team, with each able and willing to add value and contribute meaningfully to board decisions.

- ☞ Each director shall represent all shareholders and shall be in a position to participate independently and objectively.

- ☞ Cumulative voting, which results in some directors representing specific sectoral interests is not recommended where it fosters factionalism and partisanship within the Board.

4. ***Orientation and Training***

- ☞ The corporation shall provide for an adequate orientation process for new directors

- ☞ The Board shall assess the adequacy of director development and education for individual directors and for the Board as a team.

5. ***Chairman and CEO***

- ☞ Considering that the insurance business is imbued with public interest, the roles of Chairman and Chief Executive Officer shall as a general rule not be combined to ensure a balance of power and authority such that no one person has unfettered decision-making powers. Accordingly, the Chairman of the Board should be a non-executive director.

6. ***Multiple Board Seats***

- ☞ The Board shall consider guidelines on the number of directorships for its members. Such guidelines shall be subject to exceptions in a few cases. In general, however, the CEO and other executive directors shall submit themselves to a low indicative limit (four or lower) on membership in other corporate boards. The same low limit shall apply to non-executive directors who serve as full-time executives in other corporations. There can be a higher indicative limit (five or lower) for other directors who hold non-executive positions in any corporation.

7. ***Independence of Directors***

- The corporation shall ensure that majority of the directors are independent of management.

- An independent director shall be one who has not been an officer or employee of the corporation.

- He or she is not related to an officer in a senior management position of the corporation.

- He or she does not provide services, and receives no significant income for other professional services to the corporation.

- The Board shall disclose any relationship that can compromise a director's independence.

C. Mission & Responsibility of the Board of Directors

- Approving corporate philosophy and mission.

- Reviewing and approving management's strategic and business plans.

- Reviewing and approving the corporation's financial objectives, plans and actions.

- Overseeing the conduct of the business to ensure proper management and fair and equitable dealings with the policyholders, claimants and creditors.

- Identifying key business risks, establishing operational risk-taking limits commensurate with financial capacity and technical capabilities for the corporation's core activities, specifically underwriting, reinsurance and investment, taking into consideration the pertinent provisions of the Insurance Code, and insuring the implementation of appropriate systems to manage risks within said limits.

- Approving corporate policies on major areas of operations, including underwriting, investments, reinsurance and claims management.

- Monitoring corporate performance against the strategic and business plans.

- Reviewing performance of senior management, and succession planning including the replacement, appointment, training and remuneration of senior executive officers.

- ☞ Ensuring the adequacy and effectiveness of internal control and management information systems, and compliance with applicable laws, rules and regulations and the corporation's own articles of incorporation and by-laws.

- ☞ Assessing its own effectiveness in fulfilling its responsibilities.

- ☞ Performing other functions prescribed by law or assigned to the Board in the corporation's articles of incorporation and by-laws.

- ☞ In sum, fostering the long-term success of the corporation in a manner consistent with its fiduciary responsibility, which it exercises in the best interest of the corporation and its shareholders.

D. **Board Authority**

- ☞ The Board shall formally establish and adopt a schedule of matters and authorities specifically reserved for its decision as a safeguard against the risk of misjudgment or deliberate illegal or irregular practices.

- ☞ The schedule shall include the following matters:

  - ■ acquisitions and disposal of assets of the insurance corporation or of its subsidiaries that are material in nature;

  - ■ related-party transactions of a material nature;

  - ■ authority levels for core functions of the insurance corporation;

  - ■ organizational structure, job description and authority limits for the Chief Executive Officer, including any changes thereto;

  - ■ corporate policies on investment, underwriting, reinsurance, claims management; and

  - ■ outsourcing of core business functions.

E. **Board Committees**

- ☞ An executive Committee can act in behalf of the full Board on matters defined by the Board, and submitted by management for action, when the Board cannot meet.

- ☞ An Audit Committee shall be made up mainly of independent, outside directors, who shall be free to hire independent advisers when necessary. Its main responsibilities include: recommend the appointment of external auditors, whose report they review; monitor the system of internal controls and corporate compliance with laws; regulations and code of ethics; serve as direct channel of communication to the Board for the internal auditors, compliance officers, and the general counsel.

- ☞ Governance Committee shall also be made up mainly of independent directors. It is charged with responsibility for advising the Board on corporate governance matters. It shapes the policy on the size and composition of the Board as well as its internal functioning. It may serve as the mother committee for the nomination sub-committee (to review possible candidates for board membership); the compensation sub-committee (to ensure that a system of compensation provides performance-oriented incentives to management, is in place); the monitoring and performance evaluation sub-committee (to perform board and senior management evaluation). These sub-committees can become full committees, when the volume of work calls for them becoming so, provided that they too are made up of independent directors.

F. Corporate Independence

a) ***Group Structure***

- ☞ Corporate independence shall as much as possible be maintained so as not to compromise the interests of policyholders, claimants, creditors and minority shareholders. Controlling or substantial interests shall be disclosed to the Boards, and the latter shall ensure compliance with the provisions of Title 20 Chapter III of the Insurance Code on Holding Companies.

- ☞ Overlapping interests in the insurance entity shall be disclosed to the Board and any material transaction involving such interests shall be similarly disclosed.

b) ***Related-Party Transactions***

- ☞ Related-party transactions shall be conducted on terms that are at least comparable to normal commercial terms in order to safeguard the best interests of the insurance corporation and its policyholders, creditors and claimants. In all cases, the provisions of Title 20, Chapter III of the Insurance Code shall be complied with.

- Related-party transactions shall be disclosed fully to the Board. Prior Board approval shall be obtained for related-party transactions that are material in nature.

G. Board Meetings

- Boards shall meet as frequently as needed in order for directors to discharge their responsibilities properly. Typically, depending on the size of corporate operations, Boards meet from 4 to 12 times a year, with 8 meetings a year becoming the standard for large corporations.

- There shall be an opportunity for the board to meet, at least annually, without the CEO and other inside directors present.

- Directors shall have the duty of rigorously preparing for board meetings, giving undivided attention and actively participating in meetings.

H. Board Remuneration

a) ***Level of remuneration***

- A Board and its compensation committee shall set compensation levels adequate to attract and retain qualified directors.

- Compensation for directors shall be competitive and take into account the duties and other commitments imposed upon them.

- Boards may include a significant percentage of the compensation package for directors to be in the form of stock ownership.

b) ***Composition of remuneration***

- The Board shall pay directors solely in the form of equity or cash.

- Increasingly, the equity portion of board compensation is becoming more significant in modern corporations.

- Stock options and registered stock awards shall be integrated with other elements of compensation to ensure that the package for director is competitive and appropriate in light of financial rewards to senior management, employees and shareholders.

I. Financial Reporting Transparency and Internal Control

a) *Financial Reporting*

- The Board shall ensure timely and accurate disclosure on all material matters, including the financial condition, performance, ownership and governance of the corporation.

- Fair timely and cost-efficient access to relevant information shall be provided for all parties with a legitimate interest in the corporation. Key financial information should be readily and easily accessible to shareholders, policyholders, creditors and claimants.

- The Board and senior management shall receive regular reports on all key aspects of the operations of the insurance corporation, which shall include an analysis of premium growth, underwriting performance, investment results, claims management and credit control, to provide a sound basis for assessing financial performance and condition, identifying real and potential problems and formulating appropriate policies and strategies.

- The Board shall ensure faithful compliance with the financial and other reportorial requirements under the Insurance Code.

b) *Transparency*

- Disclosure shall include material information on the financial and operating results of the corporation.

- It shall also include any material foreseeable risks for the corporation.

c) *Internal Control*

- The Board shall assure that an effective system of controls is in place for safeguarding the corporation's assets.

- Major risks facing the corporation which are likely to affect the performance and financial condition of the corporation (including underwriting risk, reinsurance risks, investment risk, geographical risk, operational risk and legal risk) and the approach taken by management in dealing with these risks, shall be reported to the Board to enable the latter to effectively address said risks.

- The Board shall ensure that reports accurately reflect the financial condition of the corporation and the results of corporate operations.

- The Board shall regularly review the system for securing adherence to key internal policies as well as to significant laws and regulations that apply to it. An effective and comprehensive internal audit of the corporation's internal control system shall be carried out by operationally independent and competent staff, and audit findings and recommendations reported to the Board and the senior management of the corporation.

- One of the most important missions of the Board is to protect shareholder value through adequate financial controls. The Board shall foster and encourage a corporate environment of strong internal control, fiscal accountability, high ethical standards and compliance with the law and code of conduct.

J. Public Accountability

- As custodian of public funds, insurance corporations shall ensure that their dealings with the public are always conducted in a fair, honest and equitable manner. Accordingly, officers of insurance corporation shall avoid conflicts of interest and not engage in any unfair or deceptive acts or conduct that constitute unfair trade practices to the detriment of policyholders and claimants, including but not limited to:

  - Misrepresentations through false; deceptive or misleading statements, which include misrepresentations as to terms and benefits of insurance policies, the financial condition of the corporation and information about competitors for the purpose of inducing a policyholder to lapse, forfeit or surrender his policy;

  - Entering into any agreement to commit any act of boycott, coercion or intimidation resulting in a market monopoly of insurance business;

  - Knowingly committing or performing as a general business practice unfair claims settlement practices as defined in Section 241 of the Insurance Code.

K. Responsibility for Good Governance

- Good corporate governance is the responsibility and concern, not only of the Board of Directors and management, but also of each and every employee of the corporation. The Board of Directors shall see to it that a system of rules and regulations is in place defining the duties and responsibilities of each and every officer and employee to accomplish this objective.

L. Implementation & Enforcement

Insurers and intermediaries are enjoined to strive towards the best practice applications over time to raise their corporate governance practices to international standards.

Consistent with a disclosure-based approach to implementation and enforcement, insurers are required to make a general disclosure of their corporate governance practices briefly describing the manner in which the various issues enumerated above have been addressed particularly the following:

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