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CIRCULAR LETTER

TO : **ALL INSURANCE COMPANIES, INSURANCE BROKERS, REINSURANCE BROKERS, MUTUAL BENEFIT ASSOCIATIONS AND TRUSTS FOR CHARITABLE INSTITUTIONS AUTHORIZED TO TRANSACT BUSINESS IN THE PHILIPPINES**

SUBJECT : **CORPORATE GOVERNANCE PRINCIPLES AND LEADING PRACTICES**

This Circular on the Code of Corporate Governance Principles and Leading Practices replaces an earlier issuance for adoption and compliance by all insurance companies and intermediaries authorized to do business in the Philippines.

The key features of the code are the new definitions of the role of the board, the chairman and the non-executive directors; a more rigorous procedure for the appointment of directors and the formal evaluation of the performance of the board and individual directors.

Included in the new Corporate Code of Governance is the Self-Assessment Questionnaire on the observance of the different principles of good governance for submission to the Insurance Commission within one (1) month after each semester.

For strict compliance.

BENJAMIN S. SANTOS
Insurance Commissioner

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CORPORATE GOVERNANCE PRINCIPLES AND LEADING PRACTICES

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 the country's economic well-being.

The objectives of this Circular are to enhance the corporate accountability of insurers and intermediaries, promote the interests of their stakeholders specifically those of the policyholders, claimants and creditors.

I. Definitions

1. ***Corporate Governance*** – is the system by which companies are directed and managed. It influences how the objectives of the company are set and achieved, how risk is monitored and assessed, and how performance is optimized.

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. ***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.

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

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

6. ***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 could 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 that could materially interfere with the exercise of his independent judgment.

7. ***Control*** – exists when the parent owns directly or indirectly through subsidiary more than one half of the voting power of an enterprise unless, in exceptional circumstance, it can be clearly demonstrated that such ownership does not constitute control. Control may also exist even when ownership is one half or less of power of an enterprise when there is:

    a) power more than one half of the voting rights by virtue of an agreement with other stockholders; or

    b) power to govern the financial and operating policies of the enterprise under a statute or an agreement; or

c) power to appoint or remove the majority of the members of the board of directors or equivalent governing body; or

d) power to cast the majority votes at meetings of the board of directors or equivalent governing body; or

e) any other arrangement similar to any of the above.

8. ***Internal Control*** - refers to the process effected by a company's Board of Directors, management and other personnel, designated 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 control policies.

9. ***Internal Control Environment*** – refers to the framework under which internal controls are developed, implemented, alone or in concert with other policies or procedures, to manage and control a particular risk or business activity, or combination of risks or business activities, to which the company is exposed.

10. ***Business Risk*** – the threat an event or action will adversely affect an organization's ability to achieve its business objectives and execute its strategies successfully.

11. ***Actuarial Risk*** – risk which an insurance underwriter covers in exchange for premiums.

12. ***Risk Management*** – procedure to minimize the adverse effect of a financial loss by (a) identifying potential sources of loss; (b) measuring the financial consequences of a loss occurring; and (c) using controls to minimize actual losses or their financial consequences.

13. ***Internal Auditing*** – refers to an independent, objective assurance and consulting activity designed to add value and improve an organization's operation. It helps an organization accomplish its objectives by bringing a systematic, and disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

14. ***Internal Audit Department*** – refers to a department, division, tram of consultants, or other practitioner(s) that provide independent, objective assurance and consulting services designed to add value and improve an organization's operation.

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

16. ***Objectivity*** – refers to an unbiased mental attitude that requires a 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 subject his/her judgment to that of others.

17. ***Standards for the Professional Practice Internal Auditing (SPPIA)*** – refers to the criteria by which the operations of an internal auditing department are evaluated and measured. They are intended to represent the practice of internal auditing as it should be, provide a framework for performing and promoting a broad range of value-added internal audit activities and foster improved organizational processes and operations.

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

19. ***Parent*** – is a corporation who has control over another corporation directly or indirectly through one or more intermediaries.

20. ***Related company*** – means another company which is: (a) its parent or holding company; (b) its subsidiary or affiliate; or (c) a corporation where an insurance company or its majority stockholder owns such number of shares which allow/enable him to elect at least one (1) member of the board of directors or a partnership where such majority stockholder is a partner.

21. ***Substantial or major shareholder*** – shall mean a person, whether natural or juridical, owning such number of shares that will allow him to elect at least one (1) member of the board of directors of an insurance company or who is directly or indirectly the registered or beneficial owner of more than ten percent (10%) of any class of its equity security.

22. ***Majority stockholder or Majority shareholder*** – means a person, whether natural or juridical, owning more than fifty percent (50%) of the voting stock of an insurance company.

23. ***Subsidiary*** – means a corporation more than fifty percent (50%) of the voting stock of which is owned or controlled directly or indirectly through one or more intermediaries by an insurance company.

24. ***Affiliate*** – is a juridical person that directly or indirectly through one or more intermediaries, is controlled by, or is under common control with the insurance companies or its affiliates.

25. ***Related interests*** – shall mean individuals related to each other within the fourth consanguinity or affinity, legitimate or common law, and two or more company owned or controlled by a single individual or by the same family group or the same group of persons.

II. The Board

Principles:

Every company should be headed by an effective Board to lead and control the company and ensure its success.

- provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enable risks to be assessed and managed.
- set the companies' strategic aims.
- ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance.
- set the companies' values and standards
- ensure that its obligation to shareholders and others are understood and met.

Essential standards:

1. The Board shall meet regularly to discharge its duties efficiently.
2. The company shall, in its annual report include a statement of how the Board operates, types of decisions to be followed by the board and those that are to be delegated to management.
3. The company's annual report shall identify the chairman, the vice-chairman (if there is one), the independent director and the chairmen and members of the nomination, audit and remuneration committees.
4. The company's annual report shall also disclose the number of meetings of the Board as well as those of the committees and attendance by its directors.
5. The Chairman of the Board shall hold meetings with the non-executive director without the executives presence to evaluate the executives performance.
6. The non-executive directors, led by the independent director, shall meet annually without the chairman's presence to appraise the chairman's performance and on other such occasions deemed appropriate.
7. All concerns of the directors about running the company shall be recorded in the minutes of the Board.

8. The company shall arrange for an appropriate insurance cover with respect to legal action against its directors in relation to their official functions.

A. Responsibilities of the Board

Essential standards

The Board shall:

1. review and adopt a strategic plan for the company.

2. oversee the conduct of the company's business to ensure that the business is being properly managed and dealings with policyholders, claimants and creditors are fair and equitable.

3. identify principal business risks and ensure the implementation of appropriate risk management systems to specifically manage the underwriting, reinsurance, investment, financial, and operational risks of the company.

4. approve corporate polices in core areas of operations, specifically underwriting, investments, reinsurance and claims management.

5. plan succession, including appointing, training, fixing the compensation of, and where appropriate, replacing senior management.

6. develop and implement an investor relations program or adopt shareholder communications policy for the company.

7. review the adequacy and the integrity of the company's internal control systems and management information systems including systems for compliance with the Insurance Code and other applicable laws, regulations, rules, directives and guidelines.

8. select and appoint officers who are qualified to administer insurance affairs soundly and effectively and to establish an adequate selection process for all personnel.

9. apply fit and proper standards on personnel. It must have integrity, technical expertise and experience in the institution's business, either current or planned, which should be the key considerations in the selection process.

10. establish an appropriate compensation package for all personnel that are consistent with the interest of all its stakeholders.

11. review and approve material transactions not in the company's ordinary course of business.

12. establish a system of check and balance which applies to the Board and its members.

13. have an appropriate reporting system so that the Board can monitor, assess and control the performance of Management.

14. present to all its members and shareholders a balanced and understandable assessment of the company's performance and financial condition.

15. appoint a Compliance Officer who shall be responsible for coordinating, monitoring and facilitating compliance with existing laws, rules and regulations.

16. the Board shall be entitled to the services of a Corporate Secretary who must ensure that all appointments are properly made, that all necessary information are obtained from directors, both for the company's own records and for the purposes of meeting statutory obligations, as well as obligations arising from the requirements of the Insurance Commission and other regulatory agencies.

B. Constitution of an Effective Board

Essential standards:

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

2. The corporation shall ensure that there are at least two (2) independent directors in the Board.

3. The Board shall endeavor to include a balance of executives and non-executive directors, such that, no individual or small group of individuals can dominate the Board's decision making.

4. Considering that the insurance business is imbued with public interest, the role of the Chairman and Chief Executive Officer shall in principle be separate, to ensure an appropriate balance of power, increased accountability and greater capacity of the Board for independent decision making.

5. Where the roles are combined, there shall be a strong independent element on the Board. Check and balance shall be clearly provided for, to help ensure that independent outside views, perspectives and judgments are given proper hearing on the Board. The Chairman of the Board shall be a non-executive director.

6. Non-Filipino citizens may become members of the Board of Directors of an insurance company to the extent of the foreign participation in the equity of said insurance company. Provided, that pursuant to Section 23

of Corporate Code of the Philippines (BP Blg. 68) a majority of the directors must be residents of the Philippines.

C. Board Balance and Independence

Board Balance

Essential standards:

1. The Board shall include a balance of executive directors and non-executive directors (particularly independent non-executive directors) such that no individual or small group of individuals can dominate the Board's decision making.

2. Only the Committee Chairman and members are entitled to be present at the nomination, audit or remuneration committee meetings but others may attend at the invitation of a particular committee.

3. The Board shall identify in its annual report any non-executive director it considers to be independent.

4. The Board shall determine whether a director is independent in character and judgment or there are relationships or circumstances which are likely to affect the director's judgment.

Multiple Board Seats

Essential standards:

1. The optimum number of directorships shall be generally related to the capacity of a director in performing his duties diligently.

2. The CEO and other executive directors shall submit themselves to a low indicative limit (four or lower) on membership in other corporate boards.

3. The same low limit also applies to independent non-executive directors who serve as full-time executives in other corporations.

4. There can be a higher indicative limit (five or lower) for other directors who hold non-executive position in any corporation. In any case, the capacity of directors to serve with diligence shall not be compromised.

D. Appointments to the Board

Essential standards:

1. There shall be a formal, rigorous and transparent procedures for the selection and appointment of new directors to the Board.

2. Appointments to the Board shall be made on merit and against subjective criteria.

3. Careful deliberation and consideration shall be done to ensure that appointees have enough time for the job. This is particularly important in the case of Chairmanship.

4. Plans shall be in place for orderly succession to the Board and that of the senior management level in order to maintain a balance of appropriate skills and experiences within the company.

5. To constitute the following committees:

   a. Nomination Committee

      a.1. Shall be composed of at least three (3) members of the board of directors, one of whom must be independent.

      a.2. Shall review and evaluate the qualifications of all persons nominated to the Board as well as those nominated to other positions requiring appointment by the Board of Directors. It should prepare a description of the roles and capabilities required of a particular appointment.

      a.3. For the appointment of the Chairman, it should prepare job specifications, including an assessment of the time commitment expected of him, recognizing the need for his availability in the event of crisis. The Chairman's other significant commitments shall also be disclosed to the Board before his appointment and included in the annual report. Any change thereof shall be reported to the Board and included in the next annual report.

      a.4. The terms and conditions of appointment of non-executive directors shall be made available for inspection. The letter of appointment shall specify the expected time commitment. They shall undertake sufficient time to meet and do what is expected of them. Their other significant commitments shall be disclosed to the Board before appointments, indicating the time lines and in any case, the Board shall be informed of subsequent changes.

      a.5. The Nomination Committee shall consider the following guidelines in the determination of the number of directorship for the Board:

         1. The nature of the business of the corporation, where he is a director;

         2. Age of the director;

3. Number of directorships/active memberships and officerships in other corporations or organizations; and

4. Possible conflicts of interest.

a.6. Generally, the optimum number shall be proportional to the capacity of a director to perform his duties diligently.

b. The Audit Committee:

b.1. Shall be comprised of independent board members, preferably with accounting and finance experiences.

b.2. Provides oversight of the institution's internal and external auditors.

b.3. It shall be responsible for the setting-up of internal audit department, and the appointment of the internal auditors as well as of independent external auditors.

b.4. It shall monitor and evaluate the adequacy and effectiveness of the internal control system of the company.

c. The Remuneration Committee

c.1. Compensation or Remuneration Committee is composed of at least three (3) members, one of whom is an independent director.

c.2. It shall judge or make plans where to position the company relative to other companies. But such comparisons shall be used with caution in view of the risk of an upward ratchet of the level of remuneration with no corresponding improvement in performance.

c.3. It shall delegate responsibilities for setting up remunerations for all executive directors and chairman, including pension rights or any compensation payments.

c.4. It shall also recommend and monitor the level and structure of salaries including remunerations for senior management. The definition of senior management for this purpose shall be determined by the Board but would normally include first level management below Board level.

E. Members of the Board

Essential standards:

1. All directors shall make decisions objectively in the interests of the company.

2. Non-executive director shall scrutinize the performance of management in meeting agreed goals and objectives and monitor the performance report.

3. Non-executive directors shall constructively challenge and help develop strategic proposals for the company.

4. Non-executive directors shall satisfy themselves of the integrity of financial informations and financial controls as systems of risk management are robust and defensible.

A. Qualifications

1. Directors

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

- Every director shall own at least one (1) share of the capital stock of the corporation whose share should be in his name and recorded in the books of the corporation.

- Each director shall be at least twenty-five (25) years of age at the time of his appointment.

- Each director must have attended a special seminar on corporate governance conducted be a training provider accredited by the Insurance Commission.

- The Board may establish a fixed retirement age policy for directors.

2. Independent Directors

- An independent director shall be one who has not been an officer or employee of the corporation, its subsidiaries or affiliates or related interests for at least three (3) years immediately preceding his term or incumbency;

- He or she is not related within the fourth degree of consanguinity or affinity, legitimate or common-law of any director, officer or majority shareholder of the company or any of its related companies;

- He or she is not a director or officer of the related companies of the institution's majority shareholders;

- He or she is not a majority shareholder of the company, any of its related companies, or of its majority shareholder;

- He or she is not acting as nominee or representative of any director or substantial shareholder of the company, any of its related companies, or any of its substantial shareholders; and

- He or she is free from any business or other relationships with the institution or any of its major stockholders which could materially interfere with the exercise of his judgment, i.e., has not engaged and does not engage in any transaction with the institution, or any of its related companies or any of its substantial shareholders, whether by himself or with other persons or through a firm of which he is a partner director or a shareholder.

B. Disqualification

1. Permanently Disqualified

Directors/officers/employees permanently disqualified from holding a director position:

- Persons who have been convicted by final judgment of the court for offenses involving dishonesty or breach of trust such as estafa, embezzlement, extortion, forgery, malversation, swindling and theft;

- Persons who have been convicted by final judgment of the court for violation of insurance laws;

- Persons who have been judicially declared insolvent, spendthrift or unable to enter into a contract; or

- Directors, officers or employees of closed insurance companies or any insurance intermediaries who were responsible for such institution's closure as determined by the Insurance Commission.

2. Temporarily Disqualified

Directors/officers/employees disqualified from holding a director position for a specific/indefinite period of time:

- Persons who refuse to fully disclose the extent of their business interests when required pursuant to a provision of law or of a circular, memorandum or rule or regulation of the Insurance Commission. This disqualification shall be in effect as long as the refusal persists;

- Directors who have been absent or who have not participated for whatever reasons in more than fifty percent (50%) of all meetings, both regular and special of the Board of Directors during their incumbency, or any twelve (12) month period during said incumbency. This disqualification applies for purposes of the succeeding elections;

- Persons convicted for offenses involving dishonesty, breach of contract or violation of insurance laws but whose conviction has not yet become final and executory;

- Directors and officers of closed insurance companies and insurance intermediaries pending clearance from the Insurance Commission;

- Directors disqualified for failure to observe/discharge their duties and responsibilities prescribed under existing regulations. This disqualification applies until the lapse of the specific period of disqualification by the Insurance Commission;

- Directors who failed to attend the special seminar on corporate governance. This disqualification applies until the director concerned had attended such seminar;

- Persons dismissed/terminated from employment for cause. This disqualification shall be in effect until they have cleared themselves of involvement in the alleged irregularity;

- Those under preventive suspension;

- Persons with derogatory records with the NBI, court, police, Interpol and insurance authorities of other countries (for foreign directors) involving violation of any law, rule or regulation of the government or any of its instrumentalities adversely affecting the integrity and/or ability to discharge the duties of an insurance director. This disqualification applies until they have cleared themselves of involvement in the alleged irregularity;

- Persons who are delinquent in the payment of their obligations as defined hereunder:

    a. Delinquency in the payment of obligations means that obligations of a person with the insurance company or its related companies where he/she is a director or officer; or at least two obligations with other insurance companies, under different credit lines or loan contracts;

b. Obligations shall include all borrowings from an insurance company, or its related companies obtained by:

1. A director or officer for his own account or as the representative or agent of others or where he/she acts as a guarantor, endorsers, or surety for loans from such institutions;

2. The spouse or child under the parental authority of the director or officer;

3. Any person whose borrowings or loan proceeds were credited to the amount of, or used for the benefit of a director or officer;

4. A partnership of which a director or officer, or his/her spouse is the managing partner or a general partner owning a controlling interest in the partnership; and

5. A corporation, association or firm wholly-owned or majority of the capital is contributed by any or a group of persons mentioned in the foregoing items 1, 2, and 4:

This disqualification should be in effect as long as the delinquency persists.

C. Duties and Responsibilities

1. Directors and Independent Directors shall:

➢ Conduct fair business transaction with the insurance company to ensure that personal interest does not bias board decisions.

➢ Directors, whenever possible, avoid situations that would give rise to a conflict of interest. If transactions with the institutions cannot be avoided, it should be done in the regular course of business and upon terms not less favorable to the institution than those offered to others. The basic principle to be observed is that a director shall not use his position to make profit or to acquire benefit or advantage for himself and/or his related interests. He shall avoid situations that would compromise impartiality.

➢ Act honestly, in good faith, and with loyalty to the best interest of the institution, its stockholders, (regardless of the amount of their stockholdings) and other stakeholders such as its policyholders, investors, borrowers, other clients and the general public. A director must always act in good faith with care which an ordinarily prudent man would exercise under similar circumstances, while a director shall always strive to promote the interest of all stockholders. He shall also give due regard to the rights and interests of other stakeholders.

- Devote time and attention necessary to properly discharge their duties and responsibilities. Directors shall devote sufficient time to familiarize themselves with the institution's business. They must constantly be aware of the institution's condition and be knowledgeable enough to contribute meaningfully to the board's work. They must attend and actively participate in board and committee meetings, request and review meeting materials, ask questions and request explanations. If a person cannot give sufficient time and attention to the affairs of the institution, he should neither accept his nomination nor run for election as member of the board.

- Act judiciously. Before deciding on any matter brought before the board of directors, every director shall thoroughly evaluate the issues, ask questions and seek clarifications when necessary.

- Exercise independent judgment. A director shall view each problem/ situation objectively. When a disagreement with others occur, he shall carefully evaluate the situation and state his position. He shall not be afraid to take a position even though it might be unpopular. Corollarily, he shall support plans and ideas that he thinks will be beneficial to the institution.

- Have a working knowledge of the statutory and regulatory requirements affecting the institution, including the contents of its articles of incorporation and by-laws, the requirements of the Insurance Commission, and where applicable, the requirements of other government agencies. A director shall also keep himself informed of the industry developments and business trends in order to safeguard the institution's competitiveness.

- Observe confidentiality. Directors must observe the confidentiality of non-public information acquired by reason of their position as directors. They may not disclose said information to any other person without the authority of the Board.

- Insurance companies shall furnish all of their directors a copy of the specific duties and responsibilities of the Board of Directors as well as the specific duties and responsibilities of a director within thirty (30) working days, in case of incumbent directors and at the time of election in case of directors elected after the issuance of the Corporate Governance Code.

- The directors concerned shall each be required to acknowledge receipt of the copies of such specific duties and responsibilities and shall certify that they fully understand the same.