**Risk Committee — Guidance Note on Corporate Governance**

**Background**

GN 10 (Guidance Note on the Corporate Governance of Authorised Insurers) aims at strengthening corporate governance within the Hong Kong insurance industry.

On 7 October 2016, the Office of the Commissioner of Insurance (OCI) issued a revised GN10 in light of the recent developments in the Hong Kong insurance industry and taking into account the best practices adopted in other jurisdictions.

**Key changes to note**

1) An insurer is required to have a Board level Risk Committee, which should be separated from the Audit Committee.

2) The minimum proportion of independent non-executive directors (INEDs) on the Board has increased from one-fifth to one-third.

3) The Audit Committee should be chaired by an INED.

4) The Chairman should not be the chief executive or the appointed actuary.

5) Senior management is accountable for carrying out day-to-day operations and implementing systems and controls.

6) An authorised insurer should establish a prudent and effective remuneration policy which should not induce inappropriate or excessive risk taking. The revised GN10 states that sound remuneration practices are an important element to sound corporate governance.

7) Insurers must have policies and procedures to identify, prevent, detect and mitigate cyber threats.

8) An insurer should maintain business continuity policy and business continuity plans.

9) GN10 now applies to all overseas incorporated insurers which have total annual gross premium income pertaining to Hong Kong insurance business in excess of 50%, (previously 75%).

10) For the requirements on the minimum number of INEDs, the establishment of a Risk Committee and the requirements on remuneration matters, this Guidance Note shall take effect from 1 January 2018. For the rest of the requirements, the commencement date will be 1 January 2017.

**Risk Committee**

One of the key changes is the mandatory requirement for insurers to establish a Board level Risk Committee. It will be important for an insurer to define its risk appetite and establish a proper risk management system, which are necessary for the proper functioning of the Risk Committee.
1. Responsibilities

The Risk Committee should be established by the Board to provide focused support and advice on risk management, and is responsible for:

- Independently overseeing the establishment and operation of risk management systems;
- Advising the Board on the current and future risk appetite;
- Overseeing senior management’s implementation of the risk appetite statement;
- Reviewing the adequacy and effectiveness of the risk management policies for material risks (such as pricing, capital management, market, liquidity, operation and compliance);
- Ensuring sufficient resources are in place for risk management; and
- Overseeing the roles and responsibilities of the Chief Risk Officer (“CRO”).

The risk management function should have a direct reporting line to the Board/Risk Committee to ensure its independent assessment and prompt reporting of risks.

The Risk Committee’s work should include oversight of the strategies for capital and liquidity management as well as for all relevant risks, including operational and reputational risks.

The Board, with senior management and the CRO, should establish the risk appetite and oversee adherence to the risk appetite statement, risk policy and risk limits.

2. Composition

The Risk Committee should comprise an appropriate number of directors preferably with a majority of INEDs. Members should collectively possess adequate knowledge and experience in risk management. In our experience a Risk Committee generally needs a minimum of three members; at least one of whom should be an INED.

3. Industry Observations

Some of our observations in the industry are as follows:

- Many insurers only have a management level Risk Committee, whereas some rely on the Group Risk Committee.
- Some insurers agree that there is a lack of independence on the current risk management function.
- Some insurers have not yet developed a risk appetite statement, or such statement is not regularly reviewed by the Board.
- A number of insurers, particularly those small and medium size general insurers agree that there is room for improvement of their current risk management systems.
- Some of the Bermuda incorporated insurers are comparing GN 10 and the new Bermuda regulation and are seeking to establish an optimal model that complies with both regulations.

We expect some insurers will have to establish a Board level Risk Committee in the coming year in response to the revised GN.

If reliance is placed on the Group Risk Committee, an assessment has to be made by the Board to ascertain that the authorised insurer’s risks have already been thoroughly covered by the Group Risk Committee. In essence, the Board retains the ultimate accountability for the risk oversight.

It is expected that many insurers will review the effectiveness of their risk management systems and the validity of their risk appetite.

4. Risk management system

A proper risk management system helps provide better governance of an insurer. This helps to define clear risk roles and responsibilities and enables clear risk communication and risk reporting. In addition, it is more likely that any issues will be identified and managed before they become serious business problems.
PwC has observed that leading insurers’ risk management systems extend the governance, processes, and analytics of managing risk into how the business is executed along multiple dimensions of the business model.

A robust risk management system should help towards improved business performance, lowered cost, enhanced levels of compliance, and optimised risk exposure.

5. Risk Appetite

Risk appetite is the level of risk that an insurance company’s senior management and Board define as acceptable in pursuit of the organisation’s objectives. When used effectively, risk appetite provides a structure within which opportunities can be pursued by setting out which, why and how much risk the company is willing to take.

In our view, a risk assessment exercise should be conducted by insurers as early as possible to enable them to highlight risks threatening the achievement of their objectives. In addition, this should enable the insurer to build appropriate and consistent Risk Mitigation Plans aligned with its risk appetite and objectives.

As with most journeys which involve defining the risk appetite of an organisation, PwC anticipates that companies will go through the following processes:

- A sound and reliable risk appetite must be documented and aligned with the company’s strategy and agreed with senior management;
- Both qualitative and quantitative measurement should be considered;
- Risk appetite must be cascaded down through each objectives of all business units; and
- Management expectations in terms of risk exposures should be validated by assessing the potential mismatch level compared to the current risk profile.

6. Typical areas where assistance is required

Based on our experience in other markets and jurisdictions, Boards sometimes need assistance in dealing with the following when setting up a Risk Committee:

i) Assess and enhance the risk management governance structures (e.g. roles, policies and procedures, charters and committees);

ii) Develop and establish a robust, sustainable risk management framework;

iii) Develop a risk appetite statement/framework and identify the risks involved in implementing/not implementing strategies;

iv) Assess risks and level of risk taking, develop risk responses and implement action plans, design and implement controls to address these risks;

v) Develop key risk indicators (KRIIs) and key performance indicators (KPIIs). Develop risk reporting dashboards and establish risk monitoring and escalating procedures;

vi) Providing support in developing methodologies, policies and procedures to help run risk processes; and

vii) Supporting Risk Committees (at management or Board levels) including developing their terms of reference.
Contacts:

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