

Report No. 56 of the Director of Audit — Chapter 6

HONG KONG EXPORT CREDIT INSURANCE CORPORATION

Summary

1. The Hong Kong Export Credit Insurance Corporation (ECIC) was established in 1966 under the ECIC Ordinance (Cap. 1115). It aims to encourage and support Hong Kong's export trade by providing exporters of goods and services with insurance protection against non-payment risks arising from commercial and political events. The Commerce and Economic Development Bureau (CEDB) has the overall policy responsibility for the ECIC's work. As at 31 December 2010, the ECIC had 115 staff, headed by a Commissioner appointed by the Secretary for Commerce and Economic Development under the delegated authority of the Chief Executive. The Audit Commission (Audit) has recently conducted a review of the ECIC.

Corporate governance

2. *Governance structure of the ECIC.* An Advisory Board (the Board) was established under the ECIC Ordinance to advise the ECIC in the conduct of its business. An Investment Committee (the Committee) was established as a sub-committee of the Board to advise the ECIC in the conduct of its investment matters. As at 31 December 2010, the Board had 12 members and the Committee had 5 members. The Government monitors the work and performance of the ECIC mainly through: (a) representation in the Board by a Principal Assistant Secretary of the CEDB and the Commissioner of Insurance or his representative; (b) half-yearly housekeeping meetings between the CEDB and the ECIC; and (c) the ECIC's annual report, which is approved by the Secretary for Commerce and Economic Development before it is tabled in the Legislative Council. Audit considers that there is a need for the Government to regularly review the ECIC's governance and the CEDB's monitoring mechanism, because: (a) the ECIC's business volume has grown substantially; and (b) given that the Board's role is limited, the CEDB plays an important part in monitoring the work and performance of the ECIC and overseeing its governance. *Audit has recommended that the Secretary for Commerce and Economic Development should, in collaboration with the Commissioner, ECIC, regularly review the ECIC's governance and the CEDB's monitoring mechanism over the ECIC's work and performance.*

3. **Strategic planning.** The ECIC does not prepare any strategic plan covering a medium to long-term period setting out its strategic objectives and direction. *Audit has recommended that the Commissioner, ECIC should consider drawing up a strategic plan covering a medium to long-term period to set out the ECIC's mission, vision, strategic objectives and key result areas to be achieved.*

4. **Board and Committee meetings.** Audit found that: (a) non-routine agenda items were submitted to the Board/Committee solely at the discretion of the Commissioner; and (b) the attendance of some members at Board/Committee meetings was on the low side. *Audit has recommended that the Commissioner, ECIC should: (a) in consultation with the Secretary for Commerce and Economic Development, consider establishing guidelines for determining the types of issues (and the proper time frame) for submission to the Board (and its sub-committees) for endorsement; and (b) take measures to improve the attendance of members at Board/Committee meetings.*

Capital and reserves

5. **Increase in capital and reserves.** As at 31 March 2010, the ECIC's capital and reserves amounted to \$1,256.77 million. As early as May 1996, the CEDB approved a plan for the usage of the ECIC's surplus. According to a consultancy study commissioned in 2008, the total value of capital and reserves held by the ECIC as at 31 March 2007 was more than sufficient to meet the solvency requirements. After another consultancy study commissioned in 2009, the consultant proposed a new method for determining the required amount of contingency reserve. In December 2010, the CEDB approved the ECIC's adoption of the new method. Under this method, the required contingency reserve as at 31 March 2010 would be reduced and the surplus increased by a considerable amount. *Audit has recommended that the Secretary for Commerce and Economic Development should, in consultation with the Commissioner, ECIC, review the plan on how best the surplus of the ECIC should be put into optimum use.*

Export credit insurance

6. **Policy underwriting.** An exporter is required to complete a proposal form to apply for an insurance cover. The ECIC will issue a quotation if the proposal conforms to the ECIC's requirements. On acceptance of the quotation by the prospective policyholder, an insurance policy will be issued. Audit found that: (a) in 8 of 10 quotations which were accepted by the prospective policyholders 60 days or more after the validity period, documentation was not available showing the justifications for agreeing to the acceptance

after the validity period; (b) in 5 of 11 proposals in which the estimated amounts of the turnover were adjusted downwards, no documentation was available showing that clarification with the prospective policyholders was made; and (c) in all 20 policies examined, there was no documentation of the justifications for the ratings given by ECIC staff in determining the premium loadings. *Audit has recommended that the Commissioner, ECIC should ensure that: (a) quotations are accepted by prospective policyholders within the validity period; (b) ECIC staff clarify with the prospective policyholders and document the results before making adjustments to the information provided in their proposals; and (c) proper documentation is always kept to support the assessment to determine the premium loading.*

7. ***Credit limit management.*** In 7 of 10 long outstanding credit limit applications (CLAs), there were delays in the actions taken by ECIC staff to obtain the required information. The ECIC carries out monthly reviews of the processing of CLAs. Of 198 CLAs examined, the process reviews of 16 CLAs were performed by the staff who approved the applications, and 25 CLAs were approved by the senior management but the process reviews were carried out by staff of a lower rank. *Audit has recommended that the Commissioner, ECIC should ensure that: (a) ECIC staff process CLAs in a timely manner; and (b) process reviews of CLAs are carried out independently by staff at the appropriate level.*

8. ***Insurance claims.*** According to the ECIC's guidelines: (a) for dispute cases, the ECIC will consider whether the dismissal of the buyer's claims is justified, and if a case is well justified, approval from the senior management will be sought before making claims payment; and (b) for cases in which policyholders fail to declare any of their insurable transactions, once omission of declarations is accepted by the ECIC, the case will be monitored to check if the omitted shipments have subsequently been declared. Under the terms and conditions of the ECIC's insurance policy, a policyholder has to notify the ECIC immediately when he becomes aware of the occurrence of any event likely to cause loss, and to report the amounts which remain unpaid for more than two months from the due date for payment. Audit examined 30 claims cases and found that: (a) in 4 of 11 dispute cases, the staff did not obtain approval from senior management before the claims were paid; (b) in 15 of the 30 claims cases, the policyholders were late in reporting overdue payments; and (c) in 3 of 8 cases involving accepted omissions of declarations, the claims were paid in 2009-10 but the omitted shipments were not yet declared up to October 2010. *Audit has recommended that the Commissioner, ECIC should ensure that: (a) the guidelines for obtaining prior approval are followed before making any claims payments for dispute cases; (b) policyholders report overdue payments according to the terms and conditions of the insurance policy; (c) policyholders declare all insurable transactions in a timely manner; and (d) omitted shipments are subsequently declared.*

9. **Recoveries.** According to the ECIC's guidelines: (a) all outstanding recovery cases should be reviewed by the end of March every year to ascertain the progress and prospect of the recovery; and (b) default/repudiation cases should be followed up every six months. Audit examined 20 outstanding recovery cases and found that: (a) no documentation was available showing that reviews had been carried out to ascertain the recovery progress and prospect for each outstanding recovery case; (b) there was no documentation indicating that 8 of 12 default/repudiation cases examined had been followed up every six months; and (c) in 2 of 7 cases involving resale of distressed merchandise, the ECIC did not follow up on the resale in a timely manner. *Audit has recommended that the Commissioner, ECIC should: (a) regularly review all outstanding recovery cases according to the guidelines; (b) take prompt follow-up actions in pursuing recoveries; and (c) closely follow up on the resale of distressed merchandise.*

10. **Reinsurance.** According to the ECIC's guidelines, internal reviews on the provisions of the reinsurance treaties and reinsurance arrangement should be conducted to examine the optimum proportion of buyer risks to be retained by the ECIC. Audit found that no documentation was available showing that the ECIC had conducted detailed reviews of its optimum ceding ratio. *Audit has recommended that the Commissioner, ECIC should ensure that regular reviews of the optimum ceding ratio of reinsurance are conducted in accordance with the ECIC's guidelines.*

11. **Scope of insurance services.** Section 9(3) of the ECIC Ordinance provides that the ECIC shall not enter into contracts of insurance against risks that are normally insured with commercial insurers. According to the ECIC, there were seven commercial insurers which provided export credit insurance cover in Hong Kong. Audit noted that some of the exporters did not renew their policies with the ECIC because they had switched their covers to the commercial insurers. The ECIC informed Audit that it provided a wider standard insurance cover such as non-payment risk arising from the buyer's refusal to take delivery of goods and country risks, which were not normally offered by commercial insurers. *Audit has recommended that the Secretary for Commerce and Economic Development should assess, including seeking legal advice, the implications of section 9(3) of the ECIC Ordinance on the services currently provided by the ECIC and, if necessary, take measures to rectify the situation.*

Human resource management

12. **Staff turnover.** The staff turnover rate of 14.2% in 2008-09 increased significantly to 21.8% in 2009-10. Because of the high staff turnover, the ECIC had to incur a larger amount of expenditure and deploy staff resources in recruiting and training new staff, and the quality of services might have been affected. *Audit has recommended that the Commissioner, ECIC should investigate the reasons for the high staff turnover and devise measures to address the problem.*

13. **Staff recruitment.** Audit examined 10 recruitment exercises. In one exercise, before offering an appointment, it was discovered that the selected candidate should not have been shortlisted. In all the 10 exercises, the shortlisting criteria were not clearly set out and documented. *Audit has recommended that the Commissioner, ECIC should promulgate guidelines for shortlisting of candidates in staff recruitment exercises. In particular, the guidelines should specify that the shortlisting criteria are clearly set out in each exercise.*

14. **New remuneration system.** The ECIC's staff remuneration system was delinked from that of the civil service with effect from 1 April 2008. However, similar to the arrangement in the civil service, the ECIC paid acting allowances of some \$550,000 and \$295,000 to its staff in 2008-09 and 2009-10 respectively. The Commissioner is given free use of the ECIC's car for home-to-office return journeys. However, such use was not included in the Commissioner's Memorandum of Conditions of Service approved by the CEDB. *Audit has recommended that the Commissioner, ECIC should, in consultation with the Secretary for Commerce and Economic Development: (a) conduct a review of the payment of acting allowance, taking into account the market practice; and (b) review the practice of giving the Commissioner the free use of the ECIC's car for home-to-office return journeys.*

Financial and administrative issues

15. **Financial budget.** The ECIC's financial budget only provides six items of expenditure without greater details on the components of the expenditure estimates. In 2008-09 and 2009-10, the actual amounts for some expenditure items exceeded the amounts in the budgets endorsed by the Board. However, the ECIC did not seek the Board's endorsement for the expenditures which exceeded the budgeted amounts. *Audit has recommended that the Secretary for Commerce and Economic Development should require the ECIC to: (a) provide the Board with more details of the components of the expenditure items included in the financial budget; and (b) obtain the Board's endorsement for expenditures which exceed the budgeted amounts.*

16. **Management of outsourcing contracts.** In 2007-08, the ECIC awarded seven outsourcing contracts (Contracts 1 to 7) to a company in the Mainland (Company A). The contracts were either completed or early terminated before October 2009. Total payment made to Company A was \$12.3 million. In August 2007, after Contract 1 was awarded to Company A, the ECIC appointed a person (Person A) to assess the manpower and technical knowledge of Company A's staff in developing the pilot design of the new IT systems in Contract 1. In his assessment report, Person A recommended the ECIC to conduct a further study on the design planning of the IT systems. Based on this recommendation, the ECIC awarded Contract 2 to Company A for the provision of consultancy service for developing

the IT systems. Audit found that: (a) no tendering exercise was conducted for selecting Company A and the ECIC did not assess Company A's ability before awarding the contracts to it; (b) the independence of Person A and the reliability of his assessment were highly doubtful because his appointment was based on a referral by Company A; (c) it appeared that Person A had created Contract 2 for himself because he was subsequently employed by Company A for providing the consultancy service under Contract 2; and (d) the seven contracts were not legally vetted, and six of them did not include the standard elements such as the scope of work, key deliverables and key project milestones. *Audit has recommended that the Commissioner, ECIC should ensure that: (a) contracts are awarded through tendering exercises; (b) if a third party's advice on the service quality or ability of the service providers is required, he should be an independent person; and (c) contracts are prepared with sufficient details and are properly vetted by legal professionals.*

Response from the Administration and the ECIC

17. The Secretary for Commerce and Economic Development and the Commissioner, ECIC agree with the audit recommendations.

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