

Market Environments and Regulations

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Market Environments

Overview

The Korean insurance market has experienced huge changes in various issues including operation systems, market structures, and supervision systems in recent years, especially due to the financial crisis in the end of 1997. In the process of reform, insurance companies confronted a wide variety of difficulties such as overwhelming lapses, short liquidities, and staggering deficits.

Fortunately, the insurance industry recovered from the recession in 1999, due to the improved national economic status and successful insurance industry reform.

The per capita insurance premium, which represents insurance density, amounted to KRW 1,306,223 (USD 1,023) as of 1999, ranking 22nd highest in the world, while total insurance premiums reached KRW 61,207 billion (USD 47.9 billion), ranking 7th largest in the world. However, total insurance premium dropped significantly in 1998, mainly due to a severe recession in wake of the financial crisis.

Insurance Density: Premiums per capita

unit	1997			1998			1999		
	Life	Non-life	Total	Life	Non-life	Total	Life	Non-life	Total
KRW(000)	1,064	355	1,419	999	307	1,306	998	308	1,306
USD	929	303	1,232	769	265	1,034	761	262	1,023

Sources: 1) National Statistics Office, Korean Statistics Yearbook, various issues.

2) Swiss Re, *Sigma*, various issues.

Expenditure for insurance as the percent of personal income, which represents insurance penetration, reached 11.3 percent in 1999, ranking 4th highest in the world after South Africa (16.5 percent), U.K. (13.4 percent), and Switzerland (12.8 percent). The high insurance penetration rate in Korea was attributed to the brisk sales of savings-type life insurance policies.

Insurance Penetration: Premiums in percent of GDP

(%)

	1997			1998			1999		
	Life	Non-life	Total	Life	Non-life	Total	Life	Non-life	Total
Korea	11.6	3.8	15.4	10.3	3.6	13.9	8.4	2.9	11.3
World	4.2	3.1	7.3	4.3	3.0	7.3	4.6	3.0	7.6

Source: Swiss Re, *Sigma*, various issues.

Life insurance subscription ratio of household for the conventional life insurance companies has increased constantly since the 1980s, and recorded over 80 percent in 2000. It is lower than the 93 percent of Japan but higher than the 76 percent of the United States. However, in the case of considering the mutual sector such as post office and agricultural association, the rate had risen from 57.8 percent in FY 1994 to 73.7 percent in FY 1997 and further up to 86.2 percent in 2000. If these rates continue to grow, the total life insurance subscription ratio in Korea will be close to those of the more developed countries soon.

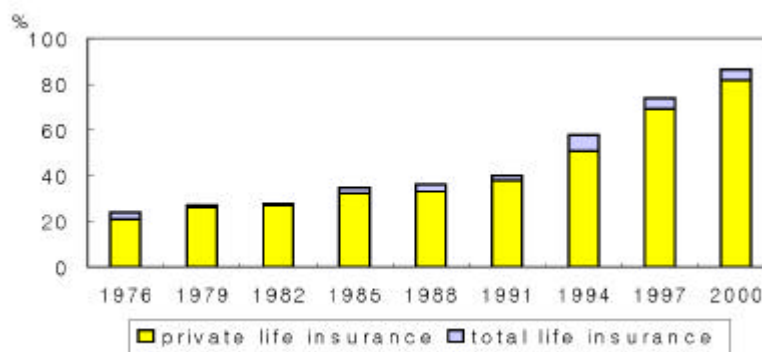
Life Insurance Subscription Ratio: Per Household

(%)

	1982	1985	1988	1991	1994	1997	2000
Private Life Insurance	26.6	32.4	32.8	37.8	50.9	69.2	81.9
Mutual by Post Office	-	1.2	2.8	3.2	2.9	4.1	6.4
Mutual by Agricultural Association	1.4	1.9	2.3	2.4	7.2	7.9	9.9
Total	27.5	34.5	36.4	40.3	57.8	73.7	86.2

Source: Korea Life Insurance Association, *Consumers' Survey*, various issues.

Trends in Subscription Rate per Household(Life Insurance)



Total Premium Incomes and Assets

The volume of insurance business in Korea showed a sharp increase for the past thirty-five years. However, the Korean insurance industry was depressed by the effects of the financial crisis of 1997 and its total insurance premium incomes fell by 7.1 percent in FY 1998.

This was the first drop in premiums since 1980s. It was mainly caused by a sharp 12.7 percent in non-life insurance business in FY 1998, while there was only a 5.2 percent decrease in the life insurance sector. The main reason for the non-life insurance business decline was the catastrophic failure of the guaranty insurance market and increased lapse in long-term policies.

After overcoming the severe recession, the Korean insurance industry gradually regained its past growth rates. The insurance companies wrote KRW 61,207 billion in premiums in FY 1999, an increase of 0.9 percent compared to the previous year.

Among the total premium incomes, the life insurance companies wrote KRW 46,755 billion, while the non-life insurance companies wrote KRW 14,452 billion in FY 1999. Their premium incomes increased by 0.8 percent and 1.4 percent compared to the previous year, respectively.

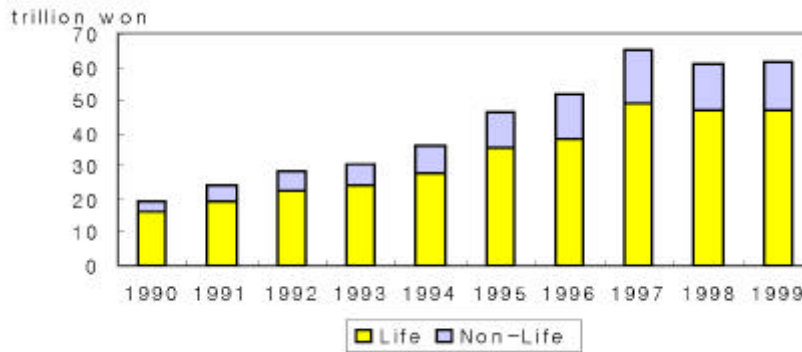
Premium Income

(KRW billion, %)

	1995	1996	1997	1998	1999
Life	35,288 (27.2)	38,163 (8.1)	48,956 (28.3)	46,390 (-5.2)	46,755 (0.8)
Non-Life	10,924 (31.4)	13,466 (23.3)	16,318 (21.2)	14,254 (-12.7)	14,452 (1.4)
Total	46,212 (28.1)	51,629 (11.7)	65,274 (26.4)	60,644 (-7.1)	61,207 (0.9)

Note: round brackets indicate the growth rate compared to the previous year.

Trends in Total Premium Incomes



Total assets of the insurance industry in Korea have increased continuously since 1980s and reached KRW 136,766 billion in FY 1999. Largely affected by the economic recovery, FY 1999 was marked by a sharp 19.2 percent increase in assets both in life insurance and non-life insurance business.

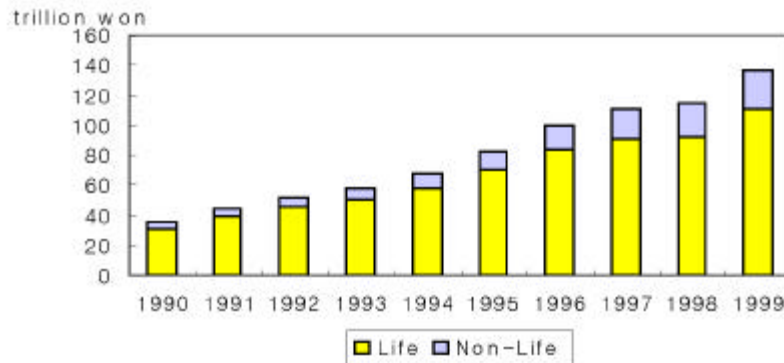
Total Assets

(KRW billion, %)

	1995	1996	1997	1998	1999
Life	69,677 (20.8)	83,289 (19.5)	90,921 (9.2)	92,298 (1.5)	110,295 (19.5)
Non-Life	12,711 (32.6)	16,228 (27.7)	19,944 (22.9)	22,430 (12.5)	26,471 (18.0)
Total	82,388 (22.5)	99,517 (20.8)	110,845 (11.4)	114,728 (3.5)	136,766 (19.2)

Note: Figures in the round brackets indicate the growth rate compared to the previous year.

Trends in Total Assets



Market Structure

The number of Korean insurance companies increased abruptly from twenty-three to forty-six due to the liberalization in the 1990s. As the entry barriers were lowered, many new entrants including local companies, joint-ventures, and foreign companies entered the Korean insurance market and total market players numbered fifty in FY 1997.

However, the financial crisis of 1997 forced supervisory authorities to restructure those insurance companies in order to regain the confidence of the market. Since the reform of the life insurance industry began in FY 1998, business rights of four life insurance companies have been withdrawn and six companies have been sold off because of their poor performances. As a result, the total number of life insurance companies decreased to twenty-three during the period.

Looking at the non-life insurance industry, Korea Guarantee Insurance Co. and Hankuk Fidelity and Surety Co. merged into Seoul Guarantee Insurance Co. in 1998. A branch of Royal & Sun Alliance

started business in 2000. Therefore, the number of non-life insurance companies in the market did not change.

In summary, eleven insurance companies disappeared and a foreign branch entered the market since 1997. Thereby, forty insurance companies operated in the market in the end of December 2000: twenty-three life insurers and seventeen non-life insurers, including a guarantee insurance company and a reinsurance company.

Number of Insurance Companies

Classification		1988	1990	1991	1997	1998	2000
Life	Domestic	6	20	20	21	18	14
	Joint-Ventures	0	5	6	7	6	2
	Foreign	2	4	4	5	5	7
	Sub Total	8	29	30	33	29	23
Non-Life	Domestic	13	14	14	14	13	13
	Foreign	2	2	2	3	3	4
	Sub Total	15	16	16	17	16	17
Total		23	45	46	50	45	40

Note: the end of the year basis

During the market opening in the 1990s, the number of foreign subsidiaries, branches, and joint-ventures operating in Korea has increased from four to thirteen.

In addition, with the acquisition of First Life Insurance Co. by Allianz Group, the market share of foreign companies rose by 2.7 percent in FY 1999. Total insurance premium incomes of these expatriate companies amounted to KRW 2,441 billion in FY 1999, which accounted for 4.35 percent of the total insurance premium in

Korea.

Despite their small sizes, the foreign life insurance companies operate profitably and stably in Korea. While most domestic insurers suffered from the shrink of premium incomes and the shortage of liquidities in the late 1990s, their foreign counterparts' market share increased in the Korea's insurance market.

Foreign Insurers' Premium Income

(KRW billion, %)

	1998			1999		
	Life	Non-Life	Total	Life	Non-Life	Total
Foreign	470 (1.01)	44 (0.31)	514 (0.85)	1,953 (4.68)	53 (0.36)	2,006 (3.58)
Joint-Ventures	1,880 (4.05)	-	1,880 (3.10)	435 (1.05)	-	435 (0.77)
Total	2,350 (5.06)	44 (0.31)	2,394 (3.95)	2,388 (5.73)	53 (0.36)	2,441 (4.35)

Note: round brackets indicate the market share in terms of premium incomes.

On the other hand, the Korean insurance market has been concentrated more significantly during the financial crisis, especially driven by the "flight to quality" phenomenon. The concentration is more evident in the life insurance market than in the non-life insurance market.

In the life insurance market, the three leading companies account for 80.6 percent of total market premiums, while the three leading companies have 54.8 percent of total market premiums in the non-life insurance industry. Considering the top-five, the figures increase to 86.3 percent and 75.2 percent, respectively.

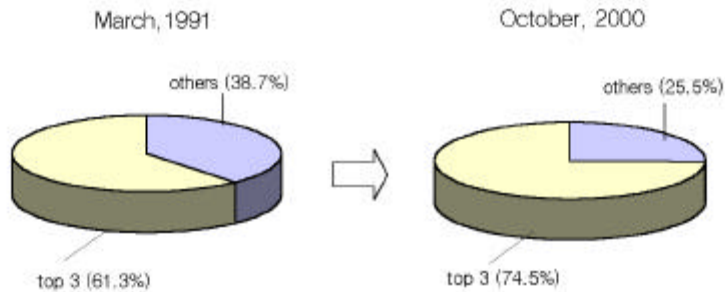
Moreover, the market concentration is not expected to stop as long as the restructuring process continues. In particular, the implementation of the partial deposit insurance system, which is scheduled in 2001, will force policyholders to seek large insurance companies and speed up the market concentration.

Market Concentration(As of the end of October 2000)

(%)

Life Insurance Business		
Ranking	Company Name	Market Share
1	Samsung Life Insurance Co.	42.0
2	Kyobo Life Insurance Co.	20.8
3	Korea Life Insurance Co.	17.8
4	Allianz First Life Insurance Co.	3.3
5	Hungkuk Life Insurance Co.	3.0
Market Share of Top Three : 80.6		
Market Share of Top Five : 86.8		
Non-Life Insurance Business		
Ranking	Company Name	Market Share
1	Samsung Fire & Marine Insurance Co.	27.4
2	Hyundai Marine & Fire Insurance Co.	14.1
3	Dongbu Fire & MarineInsurance Co.	13.3
4	LG Fire & MarineInsurance Co.	12.8
5	Oriental Fire & Marine Insurance Co.	7.6
Market Share of Top Three : 54.8		
Market Share of Top Five : 75.2		

Concentration of Total Insurance Premiums



Savings by Financial Services Sector

In Korea, total volume of savings by the financial institutes including banks, securities, and insurers reached KRW 1,002 trillion in FY 1999. During the mid-1990s, the proportion of insurance industries has not changed at about 11 percent since 1990s, while the proportions of bank's deposits and securities have increased by 9.4 percent points and 8.4 percent points, respectively.

Especially, the proportion of equities increased significantly from 8.1 percent in FY 1995 to 14.1 percent in FY 1999, while investment trust becomes more important in the non-depository sector, accounting for 19.9 percent of the total savings in FY 1999. This implies that the preference of financial consumers has been moving to investment-linked products.

Trends in Savings by Financial Services Sector

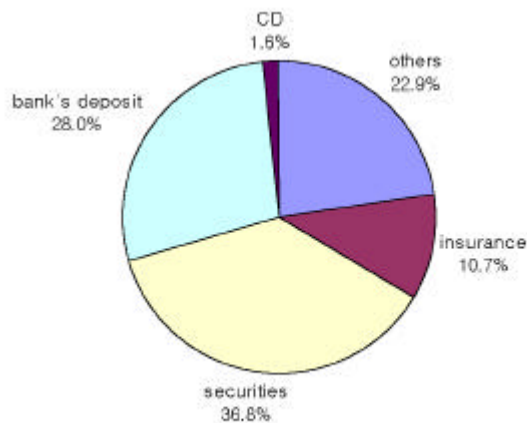
(KRW billion, %)

	1995	1996	1997	1998	1999
Bank's Deposits	116,122 (18.6)	138,637 (18.2)	166,106 (19.3)	217,075 (23.9)	280,900 (28.0)
Certificate of Deposits	28,372 (4.5)	31,175 (4.1)	26,066 (3.0)	16,178 (1.8)	15,755 (1.6)
Securities	177,801 (28.4)	213,794 (28.1)	241,600 (28.1)	291,664 (32.1)	368,855 (36.8)
Equities	50,561 (8.1)	55,630 (7.3)	58,786 (6.8)	72,260 (8.0)	140,859 (14.1)
Insurance	68,611 (11.0)	83,424 (11.0)	96,984 (11.3)	96,654 (10.6)	107,051 (10.7)
Others	364,894 (37.5)	444,962 (38.6)	498,354 (38.3)	558,307 (31.6)	501,913 (22.9)
Investment Trust	61,860 (9.9)	69,417 (9.1)	85,028 (9.9)	203,904 (22.5)	199,104 (19.9)
Total	625,389 (100.0)	761,231 (100.0)	859,164 (100.0)	908,091 (100.0)	1,001,797 (100.0)

Note: Figures in round brackets indicate the proportion of the total.

Source: Ministry of Finance & Economy, *Financial Statistics Bulletin*, 2nd quarter, 2000.

The Share of Savings by Financial Sector(1999)



Regulations

Insurance Business Law and Related Laws

Insurance related laws in Korea are the Insurance Business Law and its enforcement regulations. The Law was promulgated on 15 January 1962 and amended in 1971, 1977, 1980 1988, 1994, 1995, 1997, 1998, 1999, and 2000.

In 1977, insurance related laws were consolidated into the Insurance Business Law. The Insurance Business Law consists of administrative supervision regulations for the private insurance industry, regulations on the organization and business activities of persons conducting insurance business, insurance soliciting, and other insurance related matters.

For the last three years, 1998 through 2000, Korean insurance market changed fast from a highly regulated market to a relatively free market. The Insurance Business Law have been amended fourteen times since 1980; seven times since 1998. All these changes focused on the deregulation and reform of the insurance industry and were accelerated by rapidly changing environments, especially after the financial crisis in 1997. It was to cope with globalization and financial convergence, which were the key factors in understanding financial market trend.

The Financial Supervisory Commission (FSC) was established in 1998. The Financial Supervisory Services (FSS) was also established as an executive arm of the FSC in 1999. In fact, the FSS replaced three supervisory bodies that used to regulate the banking, insurance, and securities industries.

In 2000, Laws and regulations allowed all types of financial

institutions to form business alliances to move into so-called "non-core business" of other financial institutions. The non-core insurance businesses include developing insurance products, determining premium rates, health checkups, automatic premium transferring, and loss assessment. It was the first step toward a full convergence of financial institutions in Korea.

Also, financial holding company was introduced by the Ministry of Finance and Economy (MOFE) and the FSC. A financial holding company can have a pyramid-shaped ownership structure whereby subsidiaries of financial holding companies are also permitted to own their own subsidiaries.

Insurance Supervisory Authorities

In recent years, the main responsibilities for insurance regulation have shifted from the MOFE to FSC. Until 1997, the regulatory authorities in Korea were the MOFE and the Insurance Supervisory Board (ISB) that conducted a routine supervision of the insurance industry. However, the authority of the MOFE was reduced to the establishing and modifying of insurance policies and related laws, and the ISB merged into the FSS as an insurance division in 1998.

The responsibilities of FSC, in relation to insurance, include:

- Enactment and amendment of regulations concerning supervision of the insurance companies,
- Authorization of the operation of insurance institutions,
- Inspection and sanction of insurance institutions.

Under the guidance of the FSC, the functions of the FSS include:

- Support towards the FSC's regulatory functions,
- Inspection of operations and financial status of the insurance institutions,
- Arbitration of insurance related conflicts

Compulsory Insurance

Insurance is compulsory for the following business lines of non-life:

- Third Party Liability for motor vehicle, gas accident, sports, and recreational facilities, and ferry,
- Fire insurance for specified types of buildings such as hospitals, hotels, and apartment blocks,
- Nuclear energy risks,
- Worker's compensation,
- D&O (Director and Officer's) liability

There are no compulsory insurances in life and benefits, other than the national pension and medical schemes.

Deregulation

Premium Rate Liberalization

Non-life insurers should follow tariff rates calculated by the Korean Insurance Development Institute (KIDI) and enforced by the FSC (the MOFE before 1998). The only non-tariff rate line was Package All Risks (PAR) which was also called Industrial All Risks. The rate of PAR was generally determined at globally competitive levels.

However, the KIDI's rates driven regime has been undergoing a gradual process of liberalization. The KIDI provides only risk-premium (net premium) rates for auto and general insurance products nowadays. In fact, non-life insurers are scheduled to quote KIDI's risk-premium on a banded basis until 2002. They have determined their own expense loadings since April, 2000, therefore, KIDI's rates will become reference rates, not compulsory, after 2001.

On the other hand, no tariffs apply to life insurance and long-term products of non-life insurance. The banded basis premium rating system with maxima and minima assumptions applying for life insurance was abolished in April, 2000. The life insurers are to calculate their own rates including interest rates, expense loadings, and mortality/morbidity.

Rate Liberalization

Non-life (savings-type line excluded)		Range
General	Personal line	KIDI Rate \pm 15%
	Commercial line	KIDI Rate \pm 30%
	Cross-border Applied	KIDI Rate \pm 30%
Auto	Private Use	KIDI Rate \pm 6%
	Business Use	KIDI Rate \pm 10%
	Commercial Use	KIDI Rate \pm 20%

Note: 1. KIDI rate is a risk-premium rate which does not include expense loadings.

2. After March 2002, KIDI rate will not be compulsory.

Products Filing

The FSS strictly regulated all insurance products to be sold after

giving prior approval for it. However, the approval system on insurance products was abandoned as a part of deregulation measures to promote autonomy of the insurance business in 1993. The regulation on insurance products has been converted to classifying insurance products into three categories: "File and Use", "Use and File", and "No File".

"File and Use" products are to be filed with the FSS in the case of insurance products having a substantial influence on the national economy such as auto insurance. Such products are deemed approved on the date 20 days after the date of filing.

"Use and File" products are to be approved automatically through their filing with the FSS within 15 days (non-life) or 3 months (life) after the sale of products.

Products of which the contents are the same as products that are already approved by the FSS and being sold by other insurance companies have been stipulated to be sold freely as "No File" product.

Focus on Financial Strength

Solvency Margin Test and Reserve Valuation Standard

The insurance supervisory authorities gradually strengthened their prudential regulations. All the life and non-life insurance companies must satisfy the newly established statutory solvency test. Today, any insurer, which fails to meet a hundred percent solvency margin ratio and a certain level of CAMELS rating, will be automatically given Prompt Corrective Actions.

Solvency Margin Test and Prompt Corrective Action

Classification	Solvency Margin Test	Prompt Corrective Action
Normal	more than 100%	-
Abnormal	50% ~ 100%	Management Improvement Recommendation
	0% ~ 50%	Management Improvement Requirement
	below 0%	Management Improvement Order

Note: Solvency Margin Test: $\frac{\text{actual solvency margin}}{\text{required solvency margin}} > 100\%$,
Normal Condition

CAMELS

Classification	Quantitative Factors
Capital Adequacy	Solvency Margin Test
Asset Quality	Ratio of weighted non-performing assets, Ratio of risk-weighted assets to total assets
Management	N/A
Earnings	Earning indicators: loss ratio, net operating expense ratio, return on invested assets (non-life) ratio of death benefits to risk premium, ratio of actual operating expense to expense loadings, ratio of investment return on total assets to average assumed interest rate (life)
Liquidity	Liquidity indicators: liquid asset ratio, cash flow ratio

Note: CAMELS considers qualitative factors as well as quantitative factors.

These actions include operation suspension, liquidation or merger through a three-step process of recommendations, requirements, and final orders to either suspend operations or to implement a more rigorous restructuring program. The FSC has ordered eleven life companies to suspend their operations or to transfer their portfolios since 1998.

In addition, the Standard Valuation of life policy reserves was introduced with the liberalization of assumed interest rates. Its purpose is to prevent the inadequacy of policy reserves of life insurers. It assigns the ceiling of interest rates, which discount the reserves to cover all claims in the event of accidents. The life insurers abandoned the Cash Surrender Value Reserve Method in 1997 and has complied with the Net Premium Reserve Method since then.

Investment and Forward Looking Criteria

Other important measures taken to improve the soundness of insurers are the progressive strengthening of asset classification standards and provisioning requirements, culminating in the introduction of the Forward-Looking Criteria (FLC) in 1999. Under the new standards, insurance companies have to classify assets based on the customers' future, not present, capacity to pay. They have thus far valued assets based on a backward-looking system, which takes into account the customers' past record of debt service.

Asset Quality: Forward Looking Criteria

	FLC	Minimum Allowances
Normal	No risk of jeopardizing collection - loan arrears by less than 1 month	0.5% of Book Value
Precautionary	Potential weakness - loan arrears by 1 month through 3 months	2% of Book Value
Substandard	Considerable risk of jeopardizing collection - loan arrears by no less than 3 months	20% of Book Value
Doubtful	Significant risk of jeopardizing collection	75% of Book Value
Estimated loss	Serious risk of jeopardizing collection	100% of Book Value

The insurance supervisory authorities have maintained the positive and quantitative approaches to investments of an insurer so that maximum or minimum ratios of various investments to total assets are set by the supervisory authorities. Each insurer should comply with these ratios. However, the degrees of quantitative restrictions on investments and the limits on the range of investments have been alleviated. For example, the available investments without any restrictions increased from 2 percent to 5 percent of total assets. For the equity investments, 40 percent of total assets is allowed while the previous level was 30 percent. However, there is no limit on debt investment.

Limit on Investments of Insurance Companies

Type of Investment	Limited Ratios to Total Assets	Remarks
Stocks	40%	- unlisted stocks : limited to the insurer's equity capital
Bonds	unlimited	
Real Estate	15%	
Currency, securities, real estate of foreign country	10%	
Securities of - affiliated groups - same affiliated group - same company - small and medium size company	2% 5% 10% 1%	- excluding venture capitalists
Loan to non-policyholders	40%	
Loan to - single person - affiliated groups - same affiliated group	3% 2% 5%	
Large loan	20%	- large means more than 1% of total assets
Futures Trading	3%	

Enhanced Transparency

Accounting and Reporting

In recognition of the interdependency between corporate and financial sectors, the supervisory authorities implemented corporate sector reform in tandem with financial sector reform. On the financial side, the FSC has adopted international best-practices in accounting and disclosure standards and strengthened the penalties and sanctions enforced against inappropriate accounting practices in order to protect the rights of market participants.

On the corporate side, the FSC have focused on three key areas in order to enhance overall management transparency: strengthening the role of the board of directors in companies, ending intra-group transactions that decrease value for shareholders, and defining more clearly the roles of government, shareholder litigation, and market forces in enforcing shareholder's rights.

Insurance industry traditionally followed the Statutory Accounting Practices (K-SAP) for regulators. There were not any insurance-related accounting principles in K-GAAP (Korean Generally Accepted Accounting Principles) itself for investors and then, in so far as the insurance industry, K-SAP also represented K-GAAP. However, the FSC revised K-GAAP, in line with international best-practices, in order to settle the functions of market evaluation and market surveillance of corporate management and set up new accounting principles for the insurance industry or Insurance-specific Working Rules of Accounting in 1998. However, a dichotomy regime of insurance accounting, K-GAAP and K-SAP, has been formulated, with the working rules influenced greatly the K-SAP. It is then difficult to distinguish the K-SAP from the working rules of K-GAAP. For example, the working rules adopted the amortization of insurance contract acquisition costs (new business

costs) and the K-SAP followed it. Acquisition cost is not a period cost any longer.

Both principles value assets at market and classify securities by holding period, such as trading-for-sale securities and long-term investment securities. They make it compulsory for the insurers to classify account receivables such as normal, precautionary, substandard, doubtful, and estimated loss, based on the debtors' future capacity to pay. The principles also require insurers accumulate minimum allowances progressively by the classification for bad debt accounts. In addition, they introduce the additional reserve system with premium deficiency expected in life insurance, and make the contingency reserve compulsory in non-life insurance to prevent profit manipulation. By the way, a separate (or special) accounting system applies to pension products (corporate and individual) and long-term policies of non-life insurance.

Every insurer must submit an annual report to the FSC within three months of the balance date ending on 31 March and a quarterly report within two months of every quarter ending on 30 June, 31 September, and 31 December. In addition, on a monthly basis (no later than the end of the following month), each insurer must provide detailed statements of asset utilization (investment), balance sheet, and summary of business.

Lifted Entrance Barriers

An entity that intends to engage in the insurance business should obtain a license from the FSC, and the persons eligible to obtain such

a license are limited to stock companies, mutual companies, and foreign insurers. No insurance business is allowed to commence unless it has at least KRW 30 billion or more in paid-in-capital or foundation funds. In the case of conducting insurance business as a single line insurer, KRW 10 or 20 billion is to be paid-in depending on the type of the insurance line. An insurer should deposit funds in the FSS for the protection of policyholders. The deposit fund should be 30 percent of the paid-in capital or the foundation fund prior to commencing its business.

In the case of a foreign branch office starting an insurance business in Korea, the foreign insurer should also operate insurance business in its home country. It should retain at least KRW 3 billion in paid-in-capital and deposit adequate protection in accordance with the requirements mentioned above.

Corporate Governance

An insurer with total assets of at least KRW 2 trillion as of the end of the latest fiscal year must appoint outside directors to its board of directors (BOD). The number of outside directors should be 50 percent or more of the total number of directors and at least three of outside directors must be seated on the BOD.

An insurer in question must establish an audit committee of which two-thirds of the total number should be comprised of outside directors. The insurer must appoint a compliance officer through the resolution of BOD and respond faithfully to the information requested by the compliance officer conducting his or her duty.