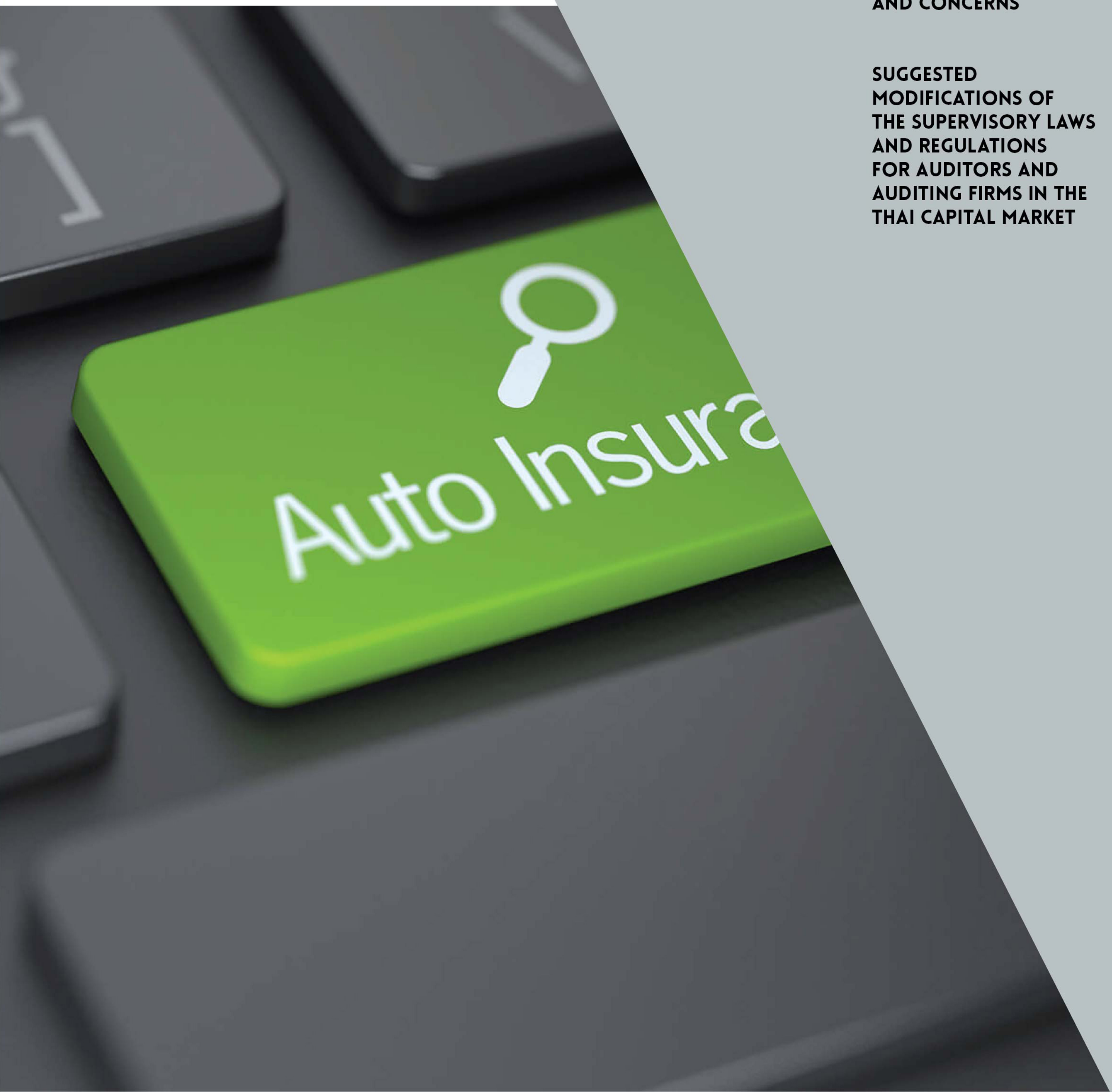
TDRI QUARTERLY REVIEW

THAILAND DEVELOPMENT RESEARCH INSTITUTE

VOL.36 NO.2
JUNE 2021

THE RISE OF INSURTECH IN THAILAND: OPPORTUNITIES AND CONCERNS

SUGGESTED MODIFICATIONS OF THE SUPERVISORY LAWS AND REGULATIONS FOR AUDITORS AND AUDITING FIRMS IN THE THAI CAPITAL MARKET



TDRI

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THE RISE OF INSURTECH IN THAILAND: OPPORTUNITIES AND CONCERNS*

Pontakorn Vorapamorn
Nonarit Bisonyabut

1. WHAT IS INSURTECH?

"InsurTech," or insurance technology, involves the use of technology to innovate improvements in current insurance systems. A clear definition of this term has been coined by Valentino Ricciardi, insurance and InsurTech expert for McKinsey & Company. He defines InsurTech as "the ecosystem of focused, innovation-based companies that generate value for clients and/or insurance incumbents by disrupting or solving problems across the insurance value chain through the engagement of technology by following a lean and user-centric approach."[1]

InsurTech can improve the insurance industry in three ways:

1. **Basic improvements**: using technology for better efficiency; for example, reducing the use of paperwork and process.

2. **Accessibility**: using technology to expand the customer base and their access to coverage; for example, expanding distribution channels through online platforms.

Mr. Pontakorn Vorapamorn is Researcher and Dr. Nonarit Bisonyabut is Senior Research Fellow, Macroeconomic Policy and Applied Economics, Thailand Development Research Institute.

[1] *Sabine L.B VanderLinden, Shân M. Millie, Nicole Anderson, and Susanne Chishti. (2016). The INSURTECH Book: The Insurance Technology Handbook for Investors, Entrepreneurs and FinTech Visionaries, p. 8.*

3. **Advanced improvements**: implementing advanced technology, such as Big Data, Artificial Intelligence (AI), Cloud Technology, or the Internet of Things (IoTs), to enhance insurance systems.

Given that InsurTech will be adopted progressively by insurance companies, insurance practices will be changed over time. On one hand, technological advancement will significantly improve the quality of the system, which will benefit both the insurance companies and consumers. On the other, however, the use of technology might create some negative effects. For example, consumers could be exploited owing to the complexities of new insurance products, consumers' privacy could be invaded as InsurTech will thrive on personal data, or large companies might take advantage of their financial strength to excel in the development of InsurTech, thus creating unfair competition.

This article is aimed at introducing new insurance practices developed from the use of InsurTech; it also discusses issues that need to be of concern to the Office of Insurance Commission (OIC), insurance companies, and consumers.

2. NEW INSURANCE PRACTICES

Several insurance companies, especially in the United States and China, have already pushed the boundary of insurance practices by using InsurTech. Most of these practices are being implemented through the integrated use of the Internet and smartphones in relation to various insurance products. Thus, they are operated under a "user-centric approach" – an insurance system in which customers directly manage their coverage instead of having to involve traditional insurance agents or brokers to do that for them. For example, many insurance companies and brokers now offer online insurance, which enables customers to purchase coverage by using their smartphone or computer, choose and customize their preferred plans, and purchase insurance policies through digital payments.

Moreover, with advances in Big Data and AI, insurance product development tends to be focused more on a "tailor-made" product, which concentrates on a specific target group or individuals instead of offering "one-size-fits-all" or generalized plans that broadly cover the majority of risks. Some examples are health insurance for diabetes, car insurance for good driving behavior, or usage-based car insurance through which the user can control the number of minutes being used.

In this regard, some new insurance practices that could emerge from InsurTech may be summarized, as follows:

(1) Online platforms

An online platform supports insurance operations by focusing on providing customers with information, advertising, and communication through a website or mobile application. Currently, this practice has been adopted by most insurance companies, either by developing their own platforms or using third-party platforms, such as Facebook, LINE, or Twitter.

In Thailand, the OIC has authorized the operations of 80 insurance companies.[2] All of them have their own website, set up according to regulations. For other online platforms, which are mostly third-party, Facebook has been adopted by

[2] *The 80 companies are composed of 23 companies offering life insurance and 57 offering non-life insurance [as of 2020].*

Table: Online platforms adopted by Thailand's insurance industry

Types of insurance	Mobile application	Facebook	LINE	Twitter
Life insurance (23 companies)	18 (78.2%)	22 (95.6%)	15 (65.2%)	16 (69.5%)
Non-life insurance (57 companies)	23 (40.3%)	48 (84.2%)	32 (56.1%)	19 (33.3%)
Total (80 companies)	**41 (51.2%)**	**70 (87.5%)**	**47 (58.7%)**	**35 (43.7%)**

Source: Authors.

87.5 percent; LINE, 58.7 percent; and Twitter, 43.7 percent.

Life insurance companies invest considerable resources in creating their platforms; also, because they need users' health data, 78.2 percent of them have their own mobile applications. Customers are asked to fill in information on their health condition, and the application also tracks the users' activities, such as walking a certain distance within a given period. The compiled data are then used to calculate the premium for each individual; some benefits may be provided apart from insurance-related ones, such as a price reduction for the purchase of food or other services. However, non-life insurance companies, especially car insurers, use their mobile application platforms mostly for communication between the customer and the company, especially in the case of accident claims in order to reduce the cost of face-to-face interactions. Thus, these non-life companies usually use third-party platforms to save on operational costs.

In the future, the use of online platforms is expected to grow further as there is a high possibility that third-party platforms will become further developed, and be adopted by large demographics. For example, popular photo or video-sharing platforms, such as Instagram or TikTok, may be used for insurance marketing. Moreover, car insurers are currently using and developing AI and mobile phone cameras to help evaluate accident damage. Therefore, the process for making a claim for car accident damage will become more convenient and faster over time.

(2) Comparing price and coverage

Comparing price and coverage can assist in digital distribution through online channels. Each distributor[3] compiles information on insurance products available from their partners (insurance companies) and provides customers with that information, enabling them to compare prices and coverage offered by various insurance companies for similar products. Customers can also customize their preferences with individual data, such as their age, occupation, medical condition, car model, driving history, and preferred coverage. With advances in technology and widespread adoption of the Internet, the system now operates through online platforms, such as a website or mobile application, and uses preferential algorithms or AI to help determine suitable products.

[3] *These distributors are insurance agents or brokers. Some of them are subsidiaries of traditional insurance companies.*

In Thailand, there are currently more than 30 companies providing price and coverage comparisons. This type of service will tend to grow as it does not require much investment, and traditional insurance companies are likely to collaborate with them in order to boost their sales. However, price and coverage comparison platforms are being used probably more for acquiring information on insurance products by customers than purchasing them.[4]

The types of coverage compared in price and coverage comparison services, including online insurance purchases, are currently dominated by car insurance companies, followed by those offering travel, and health insurance. In the future, however, the types of insurance may be expanded further in line with advancements in InsurTech.

(3) Data collecting devices for insurance products

Currently, data collecting devices are used mostly for "usage-based"[5] car insurance. In using a device called "Telematics,"[6] which is connected to the customer's car for collecting data and information on his or her driving behavior, the data collected can be utilized to calibrate risk premiums and customize the policy for each customer. The data may be used for calculating the premium or providing the customer with extra benefits. For example, the coverage may offer protection only for the time when the vehicle is moving, and the premium may be reduced according to the frequency of usage, or changed according to driving locations, or, if the driver practices safe driving behavior, he or she may receive a discount.

As smartphones and wearable devices, such as "smartwatches," become more common, this practice might be further developed through the implementation of such smart devices for tracking activities. For example, people who walk for 30 minutes per day may be presumed to have a healthy behavior and therefore be given a premium reduction.

In Thailand, life insurers have adopted this technology for limited purposes, as only two products currently use InsurTech. The first product is health insurance for people with diabetes; it involves a "blood sugar test kit" with a mobile phone application through which users can submit their test results. If users have lower sugar levels, which are deemed as healthy, the premium is reduced. The second product is a mobile phone application that tracks users' behavior, such as their walking distance or the time spent exercising, for which they are given points that can be used to redeem privileges, such as a premium reduction or a price reduction for goods and services offered by one of the insurer's partners.

For non-life insurers, four insurers use InsurTech; all of them are car insurers. These practices share a similarity: either implementing

[4] *The coronavirus pandemic causing COVID-19 disease has significantly increased the number of online insurance purchases, according to the OIC. Because of this, it is likely that customers' behavior will change, and they probably will purchase more such products in the future using online platforms.*

A total of 8.5 million COVID-19-related insurance policies were sold in a two-month period at the outbreak of the pandemic. For more information, see https://www.oic.or.th/sites/default/files/content/90774/2020-04-24-bthwiekhraaah-covid.pdf [accessed 10 June 2021].

[5] *Usage-based insurance or UBI is an insurance product that, instead of providing full-time coverage, protects the customer for a specific period. The customer can customize his or her preferred coverage times; the premium may be reduced according to the time used.*

[6] *Vehicle Telematics is a tracking and data-collecting device that car insurers adopt to collect data on driving behavior.*

a special tracking device for a car (Telematics) or using the global positioning system (GPS) on a smartphone for collecting data. These products offer premium reductions for "good driving behavior" and according to periods of usage.

In the future, despite more insurance products being offered that utilize smartphones and wearable devices, insurance companies have voiced some concern that this might not be the case in Thailand, as their data show that the user base for such products is small. Thus, this type of insurance is offered mainly for marketing purposes, by using smart devices or unconventional technology to gain customers' attention.

(4) Products for a specific target group or individuals

The advancement of data usage enables the insurance industry to discover new market opportunities, and it can create coverage for specific groups or individuals. In the United States, there is even health insurance designed specifically for those undertaking adventurous activities. In China, special coverage is available to cover illness from such diseases as avian influenza (bird flu), or pollution protection for people wanting to visit areas with bad-quality air.

In Thailand, there are no insurance products for individuals yet, and products for specific groups are still limited, because Big Data is not sufficient and the cost-benefit is too low. The products that have already been produced are, for example, health insurance for people with diabetes who are likely to be rejected by companies offering standard health insurance, and insurance for ladies, which adds specific coverage related to women's health, such as policies covering cervical cancer, breast cancer, or plastic surgery.

In the future, Big Data will likely lead to a greater number of insurance products being made available. However, insurance companies have speculated that, due to insurance products being highly specific, the profits might not be good as those produced by traditional forms of insurance because the target groups are small. Thus, current products for a specific group are designed primarily for marketing purposes – to attract more customers to the company in the hope that they might grow interested in other products.

(5) Peer-to-peer insurance

The peer-to-peer (P2P) financial model[7] is becoming more popular lately, and its use is expanding in the insurance industry. The P2P insurance model works as an insurance provider that creates a risk-sharing network, by pooling people with similar traits into a group which can be composed of people who know each other or who are randomly chosen by algorithms. The premiums and risks are calculated and adjusted separately according to the activities of the group unlike traditional insurance that pools every insured person together. Moreover, the group with a low number of claims may get a premium reduction or be given a cash rebate.

Given that P2P insurers operate as matchmakers that manage risks for a group, this operation can neglect traditional insurance practices, such as using human agents or brokers. Hence, this model relies

[7] *In terms of finance, the peer-to-peer platform matches people and groups them together for financial purposes. Most of the activities in this type of platform appear as P2P lending, where the platform matches lenders and borrowers, and facilitates contracts, transfers, and payments.*

more on digital technologies, especially Big Data and AI, to manage each group.

In the United States, P2P insurance now includes renters' insurance, homeowners' insurance, or even pet insurance. This type of insurance is likely to be further developed as an alternative to policies that mainstream insurers offer, using rebates and P2P groups to attract customers.

In Thailand, due to existing regulations, P2P insurance has not yet been authorized. However, there have been attempts to implement a grouping system similar to P2P for an insurance product, using an insurance regulatory "sandbox" for experiments. Examples are car insurance that pools drivers with good driving behavior and gives a discount to the group, or car insurance that uses social network platforms to create a group.

3. OPPORTUNITIES OFFERED BY INSURTECH

People's attitudes toward insurance have changed. The provision of COVID-19-related coverage that surged during the pandemic proved that customers are willing to manage their risk using insurance and are open to purchasing new types of products. Therefore, the insurance industry can take these opportunities to expand their customer base further through InsurTech. The opportunities can be summarized as follows:

(1) Advantages of online platforms

Unlike traditional insurance practices, online platforms enable insurance companies to operate beyond physical limitations; for example, there is no need for face-to-face interaction between customers and agents, and more flexible office hours can be created. Because of this, insurance companies can take advantage of InsurTech to reach more customers than was possible previously.

Advertising that uses online platforms also produced great benefits for insurance companies. With social media advertising algorithms that track people's needs simultaneously, advertisements can now automatically respond to an individual instead of general audiences that might not be interested.

Given that new popular online platforms, such as TikTok, will grab the public's attention, adopting it may result in innovative ways of communication and advertising.

(2) Discovering new risks and customers

Big Data and AI will become the next industrial standards for many business sectors. The OIC has tried to push the industry standard by centralizing data through its "insurance bureau system" and "OIC gateway."[8]

With better-quality data, the insurance industry can discover new risks that could emerge and can evaluate its characteristics more precisely. This will lead to new products that could respond to customers' demands, for example, COVID-19-related insurance coverage that emerged amid the pandemic.

Moreover, given that the government sectors also developed their databases, the OIC may ask for collaboration to bridge data that could be used for insurance. For example, a database controlled

[8] *The Insurance Bureau System or IBS is a central insurance database that bridges data from insurance companies; it can be used by the industry for many purposes, such as tracking fraud, understanding market and customer behavior, and examine loss payments. The OIC gateway is another central insurance database that is focused on customers, enabling them to review their insurance subscription status.*

by the Ministry of Finance on low-income people may be used to create a product that supports people who cannot afford or access traditional insurance products, by identifying people who need protection, then calculating and adjusting the premium according to their risks and income.[9]

(3) Office of Insurance Commission regulatory sandbox

Given that not every InsurTech innovation will succeed due to differences in Thailand's context and readiness, the OIC has created an insurance regulatory sandbox as a place for insurance companies to experiment with unconventional insurance products using new technologies. Insurance companies may benefit from joining the sandbox program.

First, a company may request the OIC to hold off some regulations that disallow the use of InsurTech or hinder the development of new products. As insurance is a function related to finance, it is regulated intensively to prevent negative issues that could occur; thus, many current regulations may limit innovation. A sandbox, however, allows an insurance company to be innovative by helping push the boundaries of regulations.

Second, a company can test customers' response to new products. Because customers may hesitate to purchase an unconventional product, the sandbox will be a great place to understand how new products will be perceived.

Third, a company can control the risk of using unconventional practices for insurance purposes. As the product in the sandbox is operated under real but limited circumstances, the company can test its creativity while limiting the potential for damage in case the experiments go wrong.

Successful experiments may result in a new product that provides plenty of benefits to the insurance industry and customers, as innovations are waiting to be discovered.

4. WHAT MATTERS SHOULD BE OF CONCERN?

Despite the benefits and opportunities for the insurance industry and customers, InsurTech also has negative aspects. In this regard, there are important issues that needed to be discussed, as follows:

(1) Indirect marketing schemes

In the past, insurance companies were directly responsible for producing advertising and obliged to comply with advertising regulations enforced by the OIC. However, advertising strategies – not only for the insurance industry – currently have changed in line with the rise of "social media influencers." These Internet personalities can present products to their followers in the form of indirect marketing. Hence, this type of marketing is difficult to regulate because it is impossible to know whether the advertiser has been contracted by the company to make an advertisement, or actually uses that product.

Moreover, due to the nature of social media that allows people to "Like", "Share", or state their opinions, anyone may be the subject of indirect marketing through those features. A posting on

[9] *In Thailand, current insurance products for low-income people are referred to as "micro insurance," insurance policies with small premiums that are focused on specific or only important risks. For example, "200 insurance" – a 200 baht per year premium – covers only death and events that lead to disabilities. However, this type of product is a traditional insurance product; InsurTech may help improve the ability of companies to reach low-income people.*

social media about an insurance product that receives a high number of Likes or Shares, as well as positive or negative comments, could lead to misunderstanding on the part of the general public.

The current advertising regulations of the OIC still cannot cover such online activities, as the practices do not directly involve insurance companies. Because of this, consumers needed to be wary of any information that they obtain from the Internet.

(2) Complexities of InsurTech

Unlike traditional insurance, InsurTech will make insurance activities become more user-centric. For example, customers will purchase insurance through digital channels instead of in a face-to-face meeting with an insurance agent, the so-called know-your-customer process will use digital interaction instead of a paper document,[10] AI or a chatbot[11] may be used to answer customers' questions, and the damage-claiming process will likely use the camera on a smartphone to take and then send pictures and other information instead of having a human damage surveyor perform that function.

Furthermore, InsurTech will likely generate additional insurance products, many of which may be unconventional, such as usage-based insurance that covers the customer at a specific time; customers will thus need to be aware of the period of time when they are covered by the insurance. With behavioral-based insurance, such as P2P, customers' specific behavior will affect the premium.

Because of these aspects, customers will need to be more concerned about how InsurTech operates, as there will be less involvement by human agents to give them assistance, and customers will have to comprehend specific conditions of such new insurance products.

(3) Privacy issues

Most InsurTech operates through Big Data and AI, and customers' data will be required. However, in this data-intensive era, privacy is becoming a concern; hence, the Public and Personal Data Protection Act (PDPA) was enacted to manage these matters. The use of personal data for innovation and personal data protection therefore needs to be balanced in order to provide each party involved with the best benefits.

Because of these aspects, the OIC as a regulator will need to revise the insurance regulations related to personal data to conform to the PDPA in order to ensure that data practices in the insurance industry do not violate customers' privacy. Moreover, as many people are already concerned about privacy issues, they may be discouraged from giving out personal information. The OIC needs to disclose to the public the direction of data use in the industry to ensure that the data will be used properly for innovation purposes.

5. CONCLUSION AND RECOMMENDATIONS

InsurTech brings benefits to insurance companies by improving efficiency for the companies and creates new market opportunities for them, while customers will obtain new and improved

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[10] *The know-your-customer process identifies the customer's identity, mostly using a face-to-face meeting with identity-related documents. This process corresponds to the Anti-Money-Laundering Act.*

[11] *Chatbots are AI software used to simulate digital conversations and interactions with users. They involve the use of a natural language through various media, such as websites, and mobile phone and messaging applications.*

insurance products that are more suited to their needs and preferences and are more convenient. However, on the other side of these improvements, there also are several issues that are of concern.

To promote the sustainable development of the insurance industry using InsurTech, and to protect customers from associated risks, the following recommendations are made to the OIC, insurance companies, and customers:

Recommendations for the Office of Insurance Commission

- The insurance practices using InsurTech will change rapidly. The OIC needs to be more flexible about its regulations as the process of law-making will not likely catch up with the pace of change, which may hinder development. Hence, regularly revising the regulations to cover changes is necessary. Having a special division of InsurTech experts would be important for supporting the management of InsurTech and related regulations.
- Unfair competition may stem from a financial limitation of medium or small-sized companies. The OIC needs to support the use of innovation to prevent such limitation by giving such companies suggestions on new InsurTech directions and pointing out the issues that need to be tackled.
- As the insurance landscape will rapidly change, the OIC needs to help protect customers by providing public disclosure on the problems that occur as fast as possible. Online media are a great tool for this.

Recommendations for insurance companies

- Due to the different consuming cultures of Thailand, some technologies may not succeed. Using OIC's insurance regulatory sandbox for experimentation should be a good start.
- For medium and small-sized companies, InsurTech will massively affect the insurance industry, which might lead to problems of forcing out some companies from the industry or their being taken over by larger companies. Hence, these companies need to understand the consumer market and InsurTech in order to maintain competitiveness, which is important for the sustainability of the industry and to give people alternatives.
- Insurance as an industry relies on transparency. Because of InsurTech's complexities, insurance companies need to be genuine in supplying information on products and practices in order to assure customers that they will be protected by the insurance companies.

Recommendations for customers

- Insurance activities using InsurTech will involve fewer human agents than is currently the case. Customers need to be aware of the complexities of InsurTech and be more cautious about details.
- With the popularity of social media platforms and indirect marketing schemes, consumers need to be careful about "secondary sources of information" that could give incorrect information. Examples are messages with a high volume of "Likes," information shared by the public, and comments from strangers on the Internet.

SUGGESTED MODIFICATIONS OF THE SUPERVISORY LAWS AND REGULATIONS FOR AUDITORS AND AUDITING FIRMS IN THE THAI CAPITAL MARKET*

*Aurapat Wongsaroj***

INTRODUCTION

Auditors in the capital market have an important role to play in developing and promoting the economic expansion of Thailand since they act as intermediaries who help in assuring that a company's financial statements are reliable and have been prepared according to accepted accounting standards. Such functions build trust in financial information and turn the wheel of the capital market system; in addition, they attract more investors to participate in the market. This in turn positively contributes to the development of the overall national economy.

However, the current legislation to regulate auditors and auditing firms in Thailand might have some loopholes and unclear legal frameworks with regard to overseeing the regulated entities. Also, some legal provisions might create red-tape and unnecessary burdens for the approved auditors, thus preventing them from entering the market. At the same time, the current sanctions system imposed by the Securities and Exchange Commission (SEC) upon the regulated auditors and auditing firms might not be proper or appropriate anymore in terms of the current economic situation.

It is the main objective of this report to analyze the prevailing problems and provide readers with some recommendations to deal with those problems. Following this introduction, this report will be divided into five topics: (1) the current market structure of auditors and auditing firms in Thailand; (2) the current regulatory measures to supervise and control auditors and auditing firms in Thailand's capital market; (3) review of some international best practices in supervising auditors and auditing firms; (4) some recommendations on the improvement of measures to supervise auditors and auditing firms in Thailand's capital market; and (5) the conclusion.

1. THE CURRENT MARKET STRUCTURE OF AUDITORS AND AUDITING FIRMS IN THAILAND

Based on the 2020 study of auditors and auditing firms in Thailand, it was found that the market is greatly influenced by four key auditing firms (also collectively known as the "Big 4") comprising PricewaterhouseCooper (PwC); Deloitte; Ernst & Young (EY); and KPMG. These four large professional service network firms are playing major

** The article summarizes the "Study on the Regulatory Framework Governing Auditors and Audit Firms for Listed Companies." The report was presented to the Securities and Exchange Commission, Thailand, in 2020. Researchers are Dr. Kiratipong Naewmalee, Ms. Aurapat Wongsaroj, Mr. Khemmapat Trisadikoon, and Ms. Artinuch Nuamsantia.*

*** Ms. Aurapat Wongsaroj is Researcher, Law for Development, Thailand Development Research Institute.*

Table 1: Market share of the Big 4 and Non-Big 4 companies

(Percentage of market share measured by market value)

Office	2014	2015	2016	2017	2018
KPMG	43	40	35	37	36
EY	27	29	28	25	27
PwC	10	13	15	16	15
Deloitte	9	8	14	15	16
Others	11	10	8	7	6

Source: *SEC, various years, "Report on Inspection of Audit Performance Quality."*

Table 2: Number of registered auditors and auditing firms from the Big 4 and Non-Big 4 (2018)

Type of office	Number of auditing firms	Number of registered auditors
Big-4 firms	4	140
International firms without a global network	5	14
Local firms	19	85
Total	**28**	**239**

Source: *SEC, 2018, "Report on Inspection of Audit Performance Quality."*

roles in business in terms of the share market and the number of approved/registered auditors in the Thai capital market.

Regarding market share during the period 2014-2018, the Big 4 had a total market share of more than 90 percent, which tends to rise continuously every year (Table 1). In the meantime, upon consideration of the number of SEC approved/registered auditors in the capital market, it was found that most of the auditors also come from the Big 4. More precisely, while 140 auditors are from the Big 4, only 85 registered auditors are from 19 local firms (Table 2). Thus, it can be concluded that the market structure of auditor and auditing firms in the Thai capital market is highly concentrated in a small number of auditing firms.

Although it is generally acknowledged that the Big-4 firms have more advantages than the local firms in various aspects, such as readiness in terms of capital, technology, personnel ability, and networks, the law on the supervision of auditing firms in Thailand's capital market seems to favor the Big 4 over non-Big 4 counterparts, especially the medium and small-sized auditing firms which cannot bear the cost of meeting the compliance obligations as demanded by the law compared with the Big-4 companies. This problem may create barriers for newcomers from medium and small-sized auditing firms trying to enter the market.

In addition, the existing inspection and penalty systems for auditors and auditing firms in the capital market do not truly reflect the actual costs that could effectively deter the regulated auditors and auditing firms from adopting bad habits or making errors. Therefore, it is definitely important for the SEC to review and analyze the problems connected with the law on supervision of auditors and auditing firms in the capital market.

2. THE CURRENT REGULATORY MEASURES TO SUPERVISE AND CONTROL AUDITORS AND AUDITING FIRMS IN THAILAND'S CAPITAL MARKET

The Securities and Exchange Act, B.E. 2535 (1992), mandated that the auditors of listed companies shall be under the supervision of the SEC. To be eligible, certified auditors must first be approved by the SEC in order to become auditors in the capital market.[1]

In October 2010, the SEC issued the Notification on the Approval of Auditors in the Capital Market as a measure to supervise auditors in the capital market.[2] Based on that Notification, there are three key supervising and controlling legal mechanisms to ensure that SEC-approved auditors and auditing firms are committed to providing their clients with high-quality services and performing their tasks according to sound moral and ethical principles.

2.1 Approval/registration of auditors and auditing firms

To become SEC-approved auditors, candidates must demonstrate that they have signed expressions of opinion in corporate audits for at least three companies up to the latest year prior to making their submission for SEC approval, provided that those companies do not operate the same or similar businesses.[3]

While aiming to ensure that the auditors have enough experience in performing audits on listed companies, such a strict condition creates problems for those auditors coming from small-sized auditing firms which may have limited capacity to audit large companies in many different industries. Such a requirement could potentially create barriers for newcomer auditors from small and medium-sized auditing firms wanting to enter the market. This problem could lead to the risk of monopoly formation among large auditing companies.

Unlike the case of an individual auditor, Thai law currently does not directly regulate auditing firms since the SEC does not require firms to apply for a license to operate. Even though there is no direct control over SEC-approved auditing firms, an auditing firm failing to pass firm-level performance inspections by the SEC might be regarded as an un-

[1] *Securities and Exchange Act B.E. 2535, Section 61.*

[2] *Notification of the Office of the Securities and Exchange Commission No. Sor Shor. 39/2553 Re: Approval of Auditors in the Capital Market, dated September 23, 2010, Clause 7.*

[3] *Notification of the Office of the Securities and Exchange Commission No. Sor Shor. 39/2553 Re: Approval of Auditors in the Capital Market, dated September 23, 2010, Clause 10(5).*

qualified auditing firm, which would bar its affiliated auditors from performing their duties since they are not working with a qualified auditing firm that can maintain the quality standards governed by the Thai Standard on Quality Control 1 (TSQC1).[4]

2.2 Supervision of the performance of auditors and auditing firms in the capital market after the approval/registration stage

Besides granting approval to auditors working in the capital market, the SEC's role also emphasizes the inspection of audit performance by both auditors and auditing firms working for listed companies. The SEC examines the performance of the auditors and inspects the quality control system of the auditing firms to see whether the system conforms to the determined auditing standards and TSQC1.

Inspection by the SEC is generally conducted periodically, depending on the size and the nature of risks of the business operation of the relevant auditing firms. Large auditing firms are normally inspected once a year while medium and small-sized firms are inspected once every 2-3 years.

Although the inspection systems are aimed at ensuring that both auditors and auditing firms still provide services at the determined quality standards, certain areas of assurance activity remain problematic, including (a) the required disclosure of information on the inspection result of the auditor's performance and the quality control system carried out by the auditing firms; (b) implementing auditing quality standards established by the Thailand Federation of Accounting Professions for the auditors and auditing firms in the capital market; and (c) the requirements concerning auditor independence.

As for the first aspect, it was found that the required disclosure of the inspection result is quite limited and does not require identifying the name of the auditors or auditing firms that engaged in fraud or made errors. Owing to the absence of such information, investors and company management teams may face some difficulties in detecting the identity of auditors and auditing firms that engaged in accounting fraud.

Regarding the second issue, it has been claimed that, due to limited expertise in the capital market, the auditing standards established by the Federation of Accounting Professions might not be aligned with the complexity and changing business environment envisaged by the listed companies. It is therefore critical to incorporate the viewpoint of the SEC.

For the last aspect, it was found that the current laws and regulations regarding auditor independence are simply focused on only a few issues, such as the auditing standards, the code of conduct of the accounting professionals, and the rotation of the auditors of listed companies. However, there are some other important aspects about which auditing firms should be aware, such as the nature and maximum limit of prohibited non-auditing work that can lead to conflicts of interest; these are not clearly stipulated in the legislation.

2.3 Penalties for transgressions by auditors and auditing firms in the capital market

This part of SEC supervision is another measure for scrutinizing the behavior of auditors and auditing firms in the capital market. As for sanctions

[4] *Notification of the Office of the Securities and Exchange Commission No. Sor Shor. 39/2553 Re: Approval of Auditors in the Capital Market, dated September 23, 2010, Clause 11.*

on SEC-approved auditors, these are governed by criminal penalties imposed under the Securities and Exchange Act, B.E. 2535 (1992).[5] Any individual auditor violating the said law will be subject to imprisonment for up to two years and a monetary fine of up to 500,000 baht, or both, provided that the auditors of listed companies in the capital market: (a) failed to perform an audit by expressing opinions on the financial statements under the law on audits and any additional requirements determined by the SEC; and (b) failed to report or disclose material facts about the financial statements in the auditor's report whenever the auditor found any inconsistencies or incompleteness in such financial statements.

In addition to the above-mentioned criminal penalties, the transgressing auditors could be subject to administrative punishments which include the suspension or revocation of the approval of auditors in the capital market in the event that: (a) the SEC-approved auditors lack professional conduct, or (b) they fail to comply with the law on accounting professions and any other additional requirements determined by the SEC; and (c) intentionally present misstatements or disclose any material facts, which have to be expressed or concealed to the public or to be submitted to the SEC,[6] respectively. However, the auditing firm may propose an enforceable undertaking to an affiliated auditor who contravenes the laws to accept internal punishment following terms and conditions mutually agreed in order to achieve the desired outcomes.

Unlike individual auditors, there is currently no punishment specifically determined for auditing firms in the capital market, a situation which fails to maintain the quality control system required under TSQC1. Despite the absence of a penalty, the affiliated auditors would be disqualified from conducting auditing work for clients since they are working with an auditing firm failing to comply with the auditing standards and code of conduct of auditing professionals, which resulted in damage to a third party. Practically, auditing firms in the capital market will receive only warning letters from the SEC notifying them of certain problems and requesting correction of such misconduct. However, in the case of serious damage to a third party, the maximum punishment that the SEC is empowered to impose is suspension or revocation of the approval of all affiliated auditors of the auditing firm, which would cause a shortage of approved/registered auditors of that firm capable of continuing to provide auditing services.

There are a number of limitations and loopholes in the current legal penalty system. For example, the punishment of auditors in the capital market still lacks variety because the SEC can impose only criminal and administrative penalties on individual SEC-approved auditors through suspension or revocation of approval/registration. Similarly, the penalty on the auditing firms in the capital market is also restricted as only a warning letter from the SEC can be issued, which may not be sufficiently effective to correct misbehavior.

Although the SEC has the power to revoke all auditors in the capital market who work for a relevant auditing firm because of the disqualification as the auditors in that firm not meeting the quality standard as required by law, such measures are viewed as excessively severe, affecting not only the auditing firm and the affiliated auditors but also

[5] *Security and Exchange Act, B.E. 2535 (1992), Section 287.*

[6] *Notification of the Office of the Securities and Exchange Commission No. Sor Shor. 39/2553 Re: Approval of Auditors in the Capital Market, Clause 16.*

creating excessive burdens for listed companies seeking to hire new auditors to replace the previous ones whose license was revoked. The problem is being more acute in areas that have a shortage of qualified auditors.

3. REVIEW OF SOME INTERNATIONAL BEST PRACTICES IN SUPERVISING AUDITORS AND AUDITING FIRMS

An effective system to supervise and control the quality of performance of auditors and auditing firms is an important component in fostering confidence in a listed company's financial reporting and ultimately trust in the domestic capital market. In this respect, regulators in many countries have continuously developed appropriate supervising and controlling systems to ensure that the registered auditors and auditing firms perform their duties in accordance with the governing standards.

Based on the study of laws and mechanisms governing the supervision of auditors and auditing firms for listed companies in five best-practice countries, namely Australia, Malaysia, Singapore, the United Kingdom, and the United States, some key characteristics can be summarized as follows:

3.1 The process of approval/registration of auditors and auditing firms in the capital market

Upon consideration of the relevant laws in those five sample countries, it was commonly found that the auditing firms in the capital market, as with the auditors, must be approved/registered with the country's supervisory agency. The most important reason why auditing firms in the capital market must be approved/registered with the regulatory body is because the quality of the auditing work depends largely on the auditing firm's internal auditing policies. Thus, the supervision should be focused not only on the quality of work of an individual auditor, but also on the working systems of the auditing firms to determine whether they observe appropriate quality control standards. If the auditing firms fail to monitor or scrutinize quality control, this would result in accounting faults or errors, and the auditing firms would have to take responsibility because such failures would affect the overall reliability of the auditing work in the capital market.

To be a qualified auditor for listed companies, it was generally found that the applicant in those surveyed countries needs to possess basic qualifications, have relevant work experience, and be what is generally considered a fit and proper auditor. As is the case in other countries, Thailand's SEC has also continued assessing these factors when considering the granting of licenses. However, when assessing the fitness and propriety of an applicant, all of the best practice countries similarly base their assessment on at least three audited financial statements that adequately reflect the level of difficulty and complexity of audited publicly listed companies. In considering the case of Thailand, while the applicant must submit evidence to prove that he/she must be a signing partner or at an equivalent level in auditing financial statements of at least three entities, he/she must also demonstrate that the audited accounts were from different types of businesses.

To be regarded as a qualified auditing firm in the capital market, the laws of the sample countries similarly require that approved/registered auditing firms must possess the following qualifications: (a) they must have principals who can demonstrate leadership and possess/comply with capable, and fit and proper qualifications; (b) they must have a quality control system in accordance with the International Standard on Quality Control 1 (ISQC1); (c) they must bear propriety liability for damage wrongfully caused a client through the provision of their auditing services, the maximum liability for which is limited by the client contract fee; (d) they maintain the independence of the affiliated auditors by determining the shareholding/partnership structure of the auditing firms in which two-thirds of all shareholders/partners are auditors (moreover, the auditing firms must determine business conduct which does not affect the independence of the auditors and the discretion of the auditors); and (e) they have at least two auditors and the head of the auditing firm must be an approved auditor in the capital market.

All of the countries concerned similarly grant lifetime licenses for their approved auditors, with an annual fee being charged.

3.2 Supervision of the performance of auditors and auditing firms in the capital market after the approval/registration processes

According to the previously mentioned study, it was found that the measures carried out by the regulators in all best-practice countries in terms of supervising the performance of auditors and auditing firms in the capital market after approval/registration are similar to those of Thailand. For example, in terms of the scope of auditor performance and quality control inspection of auditing firms in the capital market, they also have adopted the compliance standard based on ISQC1.

However, there is divergence in some key areas among the surveyed countries, namely (a) disclosure of the inspection results of approved auditors' performance and inspection results of the quality control system of the auditing firms. While the United States case study revealed that all inspection results are to be disclosed to the general public, the United Kingdom legislation requires the disclosure report to be submitted directly to the Audit Committee of the listed companies; (b) with regard to the establishment of relevant professional standards for the auditors and auditing firms carrying out auditing work for listed companies, while Thai standards rely mainly on the governing rules set up by the Thailand Federation of Accounting Professions, advanced countries, such as the United States, authorize the supervisory body in the capital market to create the rules because the activities related to the capital market are complicated and greatly affect the economic market; and (c) in respect of a set of measures to ensure the independence of the auditors and auditing firms in performing auditing work in the capital market in addition to the general conditions and rotation of auditors in the capital market, the laws of some countries, such as the United States, also implement a comprehensive set of measures to ensure the independence of auditors so that their auditing work will not be compromised by self-interest and adversely affect the quality of the audit. The rules to mitigate conflicts of interest are, for instance, the provision of a sample list of prohibited non-auditing services provided for audited clients, the requirement for firm rotation, a determined cooling-off period, and determination of the maximum amount of fees that auditing firms can collect for non-auditing work.

3.3 Penalties imposed on auditors and auditing firms for transgressions in the capital market

According to the previously mentioned study of laws and supervising mechanisms in the sample countries, it was found that the United States, the United Kingdom, and Malaysia have all established similar specific penalty schemes for auditing firms in the capital market. There are various forms of regulatory sanctions, which heavily emphasize administrative penalties over criminal punishment. Some forms of administrative penalties include, for example, probation, public complaints, monetary punishment, restriction of business operations (e.g., limitation of the number of customers, suspension of auditing work, and prohibition from entering the management stratum of auditing firms), and suspension or revocation of approval.

4. SOME RECOMMENDATIONS ON THE IMPROVEMENT OF MEASURES TO SUPERVISE AUDITORS AND AUDITING FIRMS IN THAILAND'S CAPITAL MARKET

The SEC has the mission of supervising and developing a reliable, effective and accessible capital market which enables market participants to compete on a level playing field. Therefore, to promote a sustainable capital market, the SEC has developed comprehensive legal instruments by taking into account the efficiency, transparency and proportionality of the measures and the ability of the relevant parties to comply with the determined standards.

In considering the role of the SEC, it is advisable to amend the Securities and Exchange Act, B.E. 2535 (1992), and its by-laws in relation to its supervision and control over the performance of the auditors and auditing firms in the capital market. This is to ensure that the controlling and monitoring systems of the SEC are efficient, up to date and can effectively promote fair competition within the industry. Some recommended actions are as follows:

4.1 Approval/registration of auditors and auditing firms in the capital market

Based on in-depth interviews and information obtained from stakeholder meetings, it was found that the governing rules concerning the qualification requirements for becoming an approved auditor for listed companies have created an excessive burden which may prevent new auditors from entering the market. Onerous requirements could lead to a shortage of SEC-approved auditors.

To solve this problem, the SEC should consider amending requirements on the approval/registration of auditors in the capital market by relaxing certain criteria. This would allow new potential auditors to apply more easily for approval/registration to work on capital market auditing. For example, instead of demonstrating that the applicants must have experience in signing the financial statements of at least three entities from different types of businesses, it should be enough for the applicant to show that he/she possesses sufficient experience in terms of the quantity of auditing transactions that truly reflect his/her necessary capabilities and competency to undertake auditing work.

For auditing firms in the capital market, it was found that the auditing firms which applied for approval/registration in the surveyed countries are similarly required to be approved/registered by the country's supervisory agency just like the auditors in Thailand's capital market. Since the auditing work must be performed by a team, the inspection should be focused not only on individual auditors' performance, but also on the auditing firms' internal quality control system.

Therefore, to improve supervision to be acceptable at the international level, the SEC should revise the existing laws. As for the qualifications of auditing firms in the capital market, the auditing firms applying for approval should have a quality control system that meets the TSQC1 standard. This is to ensure that the auditing firm has an internal quality control system which can effectively scrutinize and monitor the auditing work of the affiliated auditors. The SEC should also notify the auditing firms of the result in detail of its consideration regarding the characteristics, qualifications, duties, and other practices.

4.2 Determination of penalties for transgressions by auditors and auditing firms in the capital market

Based on the study of the laws of the sample countries, it was found that the supervisory agency in each of the five countries has adopted a wide range of sanction approaches for auditors who contravene the country's laws. Such sanctions include probation, public complaints, monetary punishment, restriction of business operations (e.g., limitation of the number of customers, suspension of auditing work, and prohibition from entering the management stratum of auditing firms), and the suspension or revocation of approval.

However, in considering the case of Thailand, it was found that the SEC has a very limited choice of sanctions and penalties to bring about desired outcomes. In addition, the measures in place are not well designed to reflect the severity of the offences. These problems make it difficult for an oversight body, such as the SEC, to discourage bad behavior by auditors and auditing firms. To make penalties more effective and appropriate, certain forms of administrative punishment are suggested. Moreover, the SEC should change the laws to include a wide variety of punishment alternatives, which the oversight body can use depending on the circumstances and severity of the offenses. These include probation, public complaints, monetary punishment, restriction of business operations through limitations on the number of customers the firm can serve, suspension of auditing work, and prohibition from entering the management stratum of the auditing firm, and the suspension or revocation of approval. Moreover, determination of the various penalties will make the auditors in the capital market more careful in the performance of their work in accordance with international accounting standards and those related to professional conduct, leading to greater reliability of audited financial statements in Thailand.

For the auditing firms in the capital market, the results of the study suggest that the work of such auditors requires a team effort, and given the fact that the auditing firms' role is to ensure that the performance of their affiliated auditors complies with TSQC1 requirements as well as other related rules on accounting and professional conduct, accounting laws and additional professional requirements determined by the SEC. Therefore, in cases when damage is attributed to auditing errors, the auditing firms in the capital market should be jointly liable for the occurrence of such errors unless it can be demonstrated that the damage would still have occurred even though the auditing firm had already fulfilled its obligations stipulated under TSQC1. In such a case, the auditing firm may not be liable for such errors.

For determination of the penalties to be imposed on auditing firms in the capital market, the punishments to be enforced should be administrative penalties which prescribe the rules and different level of penalty amounts to suit the severity of the offence(s). However, the Securities and Exchange Act, B.E. 2535 (1992), does not determine the administrative penalties and the Act also applies to other professions as well as accounting. Therefore, for the sake of consistency, amendment of the Act should be done by taking into account its applicability to other professions.

5. CONCLUSIONS

Auditing failures occur when there is a serious distortion of the financial statement(s) that is not reflected in the auditing reports and when the auditors make serious errors in conducting an audit. In considering the problem of legal loopholes and the clarity of governing laws, oversight bodies in many countries have expressed strong commitment to implement reforms in order to ensure that governing legislation and by-laws are up to date and effective in promoting competition and delivering audits of acceptable quality.

In the case of Thailand, the SEC is the main supervisory body for overseeing and penalizing SEC-approved auditors and auditing firms conducting auditing work for SET-listed companies. However, based on the study by TDRI, it was found that there are still some legal loopholes and a lack of clarity about the market regulator's role in governing SEC-approved auditors and auditing firms in the capital market, a situation that could cause problems and adversely affect the credibility of auditing standards.

Based on the study, the following amendments are proposed on some key aspects of the SEC's governing laws:

- **Approval/registration of auditors**: relaxing some onerous requirements on demonstrated proof of knowledge and expertise that unnecessarily prevent auditors from medium and small-sized auditing firms from entering the market.
- **Approval/registration of auditing firms in the capital market**: amending the laws requiring those firms to apply for a license from the SEC, so they will become liable for penalties and annulment of their license in case of errors etc.
- **Conflicts of interest**: splitting auditing and non-auditing services, ending the renewal of contracts and introducing cooling-off periods.
- **Penalties**: increasing the variety of sanction measures and enhance the SEC's authority to penalize auditing firms for poor accounting practices, so that they will be more cautious about the quality of work done for their clients.

The proposed amendments are pragmatic and designed to deliver solutions to mitigate the risk from poor auditing and the shortage of qualified auditors working in the capital market. As a package, this will help Thailand uplift the quality of auditing to international standards and reduce the risk of corporate failure, which ultimately will improve the competitiveness of capital market in Thailand.