ACCOP Paper No. 7/2000

Specific Financial Requirements for the Assessment of a Certification Authority

Introduction

This paper explores the merits of introducing a number of specific financial requirements for the assessment of a certification authority (CA) under the voluntary CA recognition scheme, with a view to enhancing objectivity and transparency of the assessment.

Background

2. Section 21(4) of the Electronic Transactions Ordinance (Cap. 553) (the Ordinance) sets out the matters that the Director of Information Technology Services (the Director) shall take into account in determining whether an applicant is suitable for recognition as a recognized CA under the Ordinance. Amongst the matters, the Director shall consider –

(a) whether the applicant has the appropriate financial status for operating as a recognized CA in accordance with the Ordinance and the Code of Practice for Recognized Certification Authorities (the Code of Practice) (section 21(4)(a)); and

(b) the arrangements put in place or proposed to be put in place by the applicant to cover any liability that may arise from its activities relevant for the purposes of the Ordinance (section 21(4)(b)).

3. The assessment of these financial aspects is elaborated in the Guidance Note on Compliance Assessment of Certification Authorities (the Guidance Note). The assessor is required to review the CA's financial projection for the next 12 months in respect of the CA's operation relevant under the Ordinance. More specifically, the assessor should state in the assessment report –

(a) whether the accounting policies upon which the projection is based are consistent in all material respects with those normally adopted by the CA and conform with the generally accepted accounting principles employed in the Hong Kong Special Administrative Region or equivalent principles accepted internationally; and

(b) whether the financial projection has been properly compiled in all material respects in accordance with the assumptions made by the CA. If any of the assumptions made, or omitted to be made, by the CA appears to the assessor to be unrealistic or inappropriate based on the assessor's experience and professional judgement, the assessor should include an appropriate comment in the assessment report.

(*The Guidance Note will be amended to include the phrase "and, where applicable, having regard to the information as disclosed in the latest audited financial statements of the CA company" in the above bullet point after "professional judgement".*)

4. In respect of the CA's management of its potential liabilities, the assessor is required to express an opinion as to the reasonableness of the assertions made by the CA that it has implemented and maintained effective procedures to determine and manage its potential liabilities. The assessor should also ascertain and report information regarding –

(a) the potential liabilities of the CA;
(b) insurance or other appropriate forms of cover for the liabilities; and
(c) claims received by the CA or filed against the CA's insurance policies.

Specific financial requirements

5. The assessment in respect of the financial projection and liabilities of a CA currently relies mostly upon the professional judgement of the assessor based on information supplied by the CA. To enhance objectivity and transparency of the assessment, a number of specific financial requirements could be considered.

Minimum working capital

6. Minimum working capital is required in other jurisdictions as part of their regulatory control of CAs (see Annex). The requirement of minimum working capital will be helpful in ensuring the on-going operation of a CA for a certain period of time.

7. In accordance with paragraph 11.5 (a) of the Code of Practice, a recognized CA shall inform the Director of its intention to terminate service at least 90 days before the termination of its service. In view of such a requirement, it would be reasonable to require a recognized CA to maintain working capital

sufficient to cover at least 90 days of its CA operation relevant under the Ordinance. In the event that the CA notifies the Director of its intention to terminate service 90 days in advance, the minimum working capital will enable the CA to sustain its CA operation during the 90-days period.

Liability cover in respect of reliance limit

8. Section 42(2) of the Ordinance states that unless a recognized CA waives the application of this subsection, the recognized CA is not liable in excess of the amount specified in the certificate as its reliance limit, for a loss caused by reliance on any information –

(a) that the recognized CA is required to confirm according to the certification practice statement and the Code of Practice; and
(b) which is misrepresented on that recognized certificate or in a repository,

if the recognized CA has, in relation to that certificate, complied with the requirements of the Ordinance and the Code of Practice.

9. Paragraph 8.2 of the Code of Practice states that a recognized CA shall arrange suitable insurance or other forms of cover to ensure that it is capable of covering its liability for claims up to the reliance limit set for the recognized certificates that it issues. To be more specific, a recognized CA should be required to arrange for liability cover with an amount no less than the reliance limit set on the recognized certificates that it issues. The CA may provide the liability cover by insurance or in other forms.

Minimum limit of indemnity

10. Section 42(3) of the Ordinance stipulates that the limitation of liability under section 42(2) does not apply if the fact was misrepresented due to the negligence of the recognized CA or it was intentionally or recklessly misrepresented by the recognized CA. In general, a CA is exposed to potential liabilities that may arise due to breach of its duty, negligence, error or omission of the CA, its officers, employees or agents. A CA should have cover at all times against such potential liabilities, the extent of which will not be known in advance.

11. The requirement of liability cover in relation to claims arising from error or omission on the part of a CA exists in other jurisdictions (see Annex). Such liability cover will help minimize the possibility that a claim against the CA due to its error or omission would unduly affect the financial stability of the CA and hence the viability of its on-going operation.

12. To prevent undue financial disruption to the operation of CAs recognized under the Ordinance, we propose that a recognized CA should acquire insurance cover against claims arising from error or omission of the CA, with a minimum limit of indemnity in relation to each and every single claim during the period of insurance of not less than –

(a) 10 times the reliance limit specified by the CA on its certificates; or
(b) $200,000;

whichever is higher.

13. Moreover, the total insurance cover for aggregate claim amount in any one insurance period of 12 months should be set at 10 times the amount arrived at in paragraph 12.

14. The liability cover set out in paragraphs 12 and 13 should be in place at all times and should be arranged for each type, class or description of recognized certificates issued by the CA. Should the CA choose to put in place other forms of liability cover, the same minimum limit of indemnity should be provided for.

Implementation of the financial requirements

15. If any of the financial requirements discussed in this paper is to be adopted, the requirements should be stipulated in the Code of Practice in addition to existing assessment requirements, and should come into effect 6 months after their publication.

16. We invite Members' comments in respect of the above suggestions.

Information Technology Services Department
September 2000

Annex

Financial Requirements in Other Jurisdictions for the Regulation of Certification Authorities

Jurisdiction	***Minimum Working Capital***	***Insurance***
Singapore		Must be insured against liability for loss of not less than S$1 million (approx. HK$4.5 million) for each claim arising out of any error or omission on the part of the applicant, its officers or employees.
Utah (USA)	Written acknowledgement stating that the applicant has working capital reasonably sufficient to conduct business for a period of one year and no less than US$10,000 (approx. HK$78,000) in working capital.	
North Carolina (USA)		A CA shall obtain indemnity insurance coverage (e.g. errors and omissions) not less than US$100,000 (approx. HK$780,000) per occurrence and not less than US$ 1 million (approx. HK$7.8 million) for all occurrences.
Minnesota (USA)	Working capital is considered sufficient if current assets minus current liabilities exceeds US$50,000 (approx. HK$390,000).	