



CORPORATE GOVERNANCE GUIDELINE

1.0 INTRODUCTION

The Central Bank of Barbados (Bank), in furtherance of its responsibility for the regulation and supervision of licensees under the Financial Institutions Act CAP. 324A (FIA) and the International Financial Services Act CAP. 325, (IFSA) has revised its Corporate Governance Guideline issued in October 2006 to update guidance to licensees on their obligations as it relates to corporate governance.

The Guideline¹ sets out the Bank's expectations in relation to the minimum standards for corporate governance practices by all licensees. It will form an integral part of the framework used by the Bank in assessing the effectiveness of corporate governance practices. In this regard, the Bank will not undertake a check-box approach but rather will seek to establish that licensees have robust corporate governance policies and processes covering, inter alia, strategic direction, group and organisational structure, the control environment, responsibilities of the Board and Senior Management, compensation, and generally that the Board is carrying out its oversight responsibilities in an effective and efficient manner.

This Guideline is based on the international standards established by the Basel Committee on Banking Supervision (Committee). Specifically the *Principles for Enhancing Corporate Governance*² and informed by the *Core Principles for Effective Banking Supervision*, which were most recently revised in September 2012.

The Bank recognises that there may be differences in the approaches adopted by institutions. Licensees are expected to design a governance framework, taking account of the:

- i. Nature and scale of the business;
- ii. Complexity, volume and size of transactions; and
- iii. Degree of risk associated with each area of operation.

Where material deviations from this Guideline are contemplated, licensees should demonstrate to the Bank that the alternative measures have at least an equivalent effect of ensuring sound corporate governance.

The Guideline contains both advisory and obligatory requirements. Advisory matters are expressed by way of the phrase "*the licensee or licensees may*" and financial institutions are permitted to implement alternative but effective measures in these circumstances. Mandatory requirements are expressed using the phrase "*the licensee or licensees should*".

¹ Requirements should be considered in the full context of obligations contained in the Companies Act CAP. 308, FIA, IFSA and the *Money Laundering and Financing of Terrorism (Prevention and Control) Act CAP. 129 (MLFTA)*. The Guideline should also be read in conjunction with the Basel Committee on Banking Supervision – Principles for Enhancing Corporate Governance.

² Most recently updated in October 2010.



2.0 APPLICATION

This Guideline applies to all entities that are incorporated in Barbados and that are licensed under the Financial Institutions Act, CAP. 324A and the International Financial Services Act, CAP. 325. Licensees should ensure that, at a minimum, this Guideline is also implemented in their branches and subsidiaries abroad, and where permitted in the host country, ensure that these operations apply the higher of local and host standards. Licensees should inform the Bank if the local applicable laws and regulations prohibit the implementation of this Guideline.

3.0 CORPORATE GOVERNANCE

Corporate Governance refers to the processes, structures and information used for directing and overseeing the management of an institution. A good corporate governance framework establishes the mechanisms for achieving accountability between the Board, Senior Management and shareholders, while protecting the interests of relevant stakeholders. It also sets out the structure through which the division of power in the organisation is determined.

Given the importance played by licensees in financial intermediation, corporate governance is of great relevance both to individual licensees and to the financial system as a whole. The legislative framework recognises this crucial role and the risk of malfeasance, by inter alia:

- i. Restricting access to the industry;
- ii. Defining grounds for revoking a licence, including where the conduct of business is detrimental to the public interest or the interest of depositors;
- iii. Defining types of individuals who cannot serve as directors or officers of a licensee;
- iv. Imposing large exposure restrictions on lending and investment; and
- v. Requiring regular reporting to the Bank, annual audits by independent auditors and public disclosure of financial performance.

4.0 THE BOARD OF DIRECTORS

The Board has overall responsibility for the quality of governance of the licensee, including approving and overseeing the implementation of the strategic objectives, risk strategy, corporate governance framework and corporate values. The Board is also responsible for providing oversight of Senior Management.

The Board has an oversight role designed to ensure that the licensee:

- i. Is managed in a way that safeguards its safety and soundness; and
- ii. Is in compliance with all relevant laws and regulations.



The Board is expected inter alia to:

- a. Oversee the selection of competent Senior Management to assume the day-to-day management of the organisation and determine their compensation;
- b. Define and document formally its role vis-à-vis that of management. This should provide for clarity in what functions and authorisations have been delegated to management;
- c. Determine the risk tolerance/appetite of the business;
- d. Assure itself that the organisational structure lends itself to effective management and to the achievement of the organisation's goals;
- d. Assess and approve the business objectives, corporate values and strategic direction. The Board should inter alia:
 - i. Document standards that address unethical behaviour;
 - ii. Assess whether the strategy is realistic in the context of the prevailing environment and the resources available to implement the strategy;
 - iii. Review, approve and monitor annual business plans and budgets; and
 - iv. Review the associated risk and returns associated with new products and services.
- e. Understand the risks that the licensee faces, discuss and approve the policies to mitigate these risks and obtain regular assurances from management that appropriate processes of risk assessment, management and internal controls are in place. The policies must be consistent with the institution's long-term strategic plans. By adopting clearly written policies, including for new activities, the Board is able to define what practices and what level and types of risk are acceptable;
- f. Ensure that Senior Management implements the licensee's strategy and ethical standards;
- g. Approve outsourcing arrangements, (including intra-group), and satisfy itself that written service level agreements outlining the responsibilities of the respective parties, etc. are completed before the arrangement begins;
- h. Receive and analyse reports prepared by management, including up-to-date information on:
 - i. Significant risks and the effectiveness of risk management processes;
 - ii. The financial consequences of material exceptions to policies and controls;
 - iii. Competition and market share; and
 - iv. Key strategic issues and possible acquisition targets.



- i. Monitor performance against agreed benchmarks;
- j. Assure itself of the integrity of financial reporting;
- k. Receive, discuss and follow up reports prepared by the internal and external auditors and by regulators;
- l. Ensure that the governance system enables the licensee's operations to be conducted within the framework of all relevant laws, including the Companies Act Cap. 308, regulations and guidelines; and
- m. Have adequate professional indemnity insurance in place for Directors when discharging their fiduciary duties in good faith.

In discharging these responsibilities, the Board should take into account the legitimate interests of shareholders, depositors and other relevant stakeholders. It should also ensure that the licensee maintains a good relationship with its regulators.

The Board is ultimately responsible for all acts and omissions including compliance with legal and regulatory obligations. It is imperative that licensees communicate to the Bank any breaches or other material issues that may impact the safety, soundness or reputation. The Boards of Directors should meet periodically with the Bank to discuss the operations the licensee.

4.1 CORPORATE VALUES AND CODE OF CONDUCT

The licensee should have a corporate culture in place that supports and provides appropriate norms and incentives for professional and responsible behaviour. In this regard, the Board should take the lead in establishing the "tone at the top" and in setting professional standards and corporate values that promote integrity for itself, Senior Management and other employees.

The code of conduct should at a minimum include guidelines on the following:

- Compliance with the applicable laws
- Conflicts of interest
- General statement of business principles
- Outside business interest
- Dealing with confidential information
- Investment activity
- Outside employment
- Entertainment, gifts and favours
- Use of the organisations property
- Conduct of former Directors and Senior Management

The licensee's corporate values should recognise the critical importance of timely and frank discussion and elevation of problems to higher levels within the organisation. In this regard, employees should be encouraged and able to communicate, with protection from reprisal, legitimate concerns about illegal, unethical or questionable practices.



The Board should ensure that appropriate steps are taken to communicate throughout the licensee, the corporate values, professional standards or codes of conduct it sets, together with supporting policies and procedures, such as the means to confidentially report concerns or violations to an appropriate body.

4.1.1 CONFLICTS OF INTEREST

The Board should have a formal written conflicts of interest policy and an objective compliance process for implementing the policy. The policy should include:

- A Director's duty to avoid, to the fullest extent possible, activities that could create conflicts of interest or the appearance of conflicts of interest;
- A review or approval process for Directors to follow before they engage in certain activities (such as serving on another Board) so as to ensure that such activity will not create a conflict of interest;
- A Director's duty to disclose any matter that may result, or has already resulted, in a conflict of interest;
- A Director's responsibility to abstain from voting on any matter where the member may have a conflict of interest or where the member's objectivity or ability to properly fulfill duties to the licensee may be otherwise compromised;
- Adequate procedures for transactions with related parties to be made on an arms-length basis; and
- The way in which the Board will deal with any non-compliance with the policy.

Examples of situations of conflict may be included in the policy.

The Board should ensure that appropriate public disclosure is made, and information is provided to supervisors, relating to the licensee's policy on conflicts of interest and potential conflicts of interest. This should include information on the licensee's approach to managing material conflicts of interest that are not consistent with policy; and conflicts that could arise as a result of the licensee's affiliation or transactions with other entities within the group.

4.1.2 CONTROLLING SHAREHOLDERS

Where there are controlling shareholders with power to appoint Directors, it is useful to bear in mind that Board members have responsibilities to the licensee itself. In cases where there are Board members appointed by a controlling shareholder, the Board may set out specific procedures or conduct periodic reviews to ensure the appropriate discharge of responsibilities by all Board members.

4.2 OVERSIGHT OF SENIOR MANAGEMENT

In accordance with Section 4.0, the Board should oversee the selection and, when necessary, replacement of Senior Management, and have an appropriate succession plan in place.



The Board should provide oversight of Senior Management as part of the overall system of checks and balances. In so doing, the Board should:

- Establish fit and proper standards for the selection of Senior Management;
- Monitor that Senior Management's actions are consistent with the approved strategy and policies, including risk tolerance/appetite;
- Meet regularly with Senior Management;
- Question and critically review explanations and information provided by Senior Management;
- Set formal performance standards for Senior Management consistent with the long-term objectives, strategy and financial soundness of the licensee, and monitor Senior Management's performance against these benchmarks; and
- Ensure that Senior Management's knowledge and expertise remain appropriate given the nature of the business and the licensee's risk profile.

4.3 RESPONSIBILITY OF BOARD MEMBERS

Directors are appointed or elected to direct and oversee the affairs of the licensee. The members of the Board should exercise their "duty of care" and "duty of loyalty"³ to the licensee in accordance with applicable laws and supervisory standards. This includes actively engaging in major matters, keeping abreast of material changes in the licensee's business and the external environment, as well as acting to protect the interests of the licensee.

The individual responsibilities of Board members include:

- a. Maintaining an awareness of the licensee's internal and external environment including local, regional and international financial trends and any statutory and regulatory changes affecting the licensee;
- b. Diligently performing the following :
 - i. Attending Board meetings regularly and actively participating in discussions. Directors who are unable to fulfil these obligations should not sit on a licensee's Board;
 - ii. Preparing in advance of meetings by reviewing the relevant background material, including management reports;
 - iii. Requiring explanations of any unfamiliar activities;
 - iv. Reviewing the reports of internal and external audits and supervisory reports; and
 - v. Attending meetings when requested by the Bank.

³ The OECD (OECD glossary of corporate governance-related terms in "Experiences from the Regional Corporate Governance Roundtables", 2003, www.oecd.org/dataoecd/19/26/23742340.pdf.) defines "duty of care" as "The duty of a Board member to act on an informed and prudent basis in decisions with respect to the company. Often interpreted as requiring the Board member to approach the affairs of the company in the same way that a 'prudent man' would approach their own affairs. Liability under the duty of care is frequently mitigated by the business judgement rule." The OECD defines "duty of loyalty" as "The duty of the Board member to act in the interest of the company and shareholders. The duty of loyalty should prevent individual Board members from acting in their own interest, or the interest of another individual or group, at the expense of the company and all shareholders."



- c. Exercising independent judgement and not permitting themselves to be unduly influenced by another Director, by management, or by outside interests. A critical evaluation of the issues before the Board is essential to the effectiveness of each member of the Board. Directors must ask management questions to satisfy themselves that management's recommendations are feasible and in the best interest of the licensee. If a Director disagrees with Board action, the Director should say so, and ensure that the minutes reflect such dissent; and
- d. Avoiding conflicts of interests by inter alia:
 - i. Respecting the confidentiality of information received during their tenure as Directors;
 - ii. Transacting their personal business with the institution at arm's length; and
 - iii. Fully disclosing to the Board any interests, direct or indirect, they may have in loans, contracts, etc. to which the licensee is or may become a party. This does not mean that Directors may not conduct business with the institution but they should not be involved in the decision making on such transactions.

4.3.1 QUALIFICATIONS

Board members should possess, both at the individual and the collective levels, appropriate experience, competencies and personal qualities, including professionalism and personal integrity to enable them to exercise their duties of care and loyalty.

4.3.2 TRAINING/AWARENESS

In order to assist Board members in acquiring, maintaining and deepening their knowledge and skills and fulfilling their responsibilities, Directors should have access to tailored programmes for initial (e.g. induction) and on-going awareness and education on relevant issues. The Board should dedicate sufficient time, budget and other resources for this purpose.

4.3.3 SELF-ASSESSMENT

The Board should conduct periodic self-assessment geared at ensuring that objectives and responsibilities (at both the individual and collective levels) are being met. Results of these assessments should be made available to the Bank, upon request.

4.4 BOARD STRUCTURE AND OPERATIONS

The size, composition, and committee structure of the Board will vary with each institution according to the size of the institution, the level of risk to third parties and the need for monitoring of risk and effective decision-making.



4.4.1 SIZE OF BOARD

The Board of Directors should comprise at least three (3) persons. Boards with this low number of Directors will only be permitted where the level of assets (on and/or off balance sheet), is less than BDS\$50 million and there are no third-party funds involved.

The size of the Board should be adequate to cope with a member or members having to absent themselves from decision making because of potential conflicts of interest. The Board should periodically review its own size and determine the size most effective for making decisions and future operations. To ensure compliance with this requirement for at least three persons, licensees should consider having more than the minimal requirement.

The Bank reserves the right to require an increase in the size of the Board if it believes that persons with different skills would enhance Board effectiveness.

4.4.2 COMPOSITION

Board members and their alternates, and Senior Management must be approved by the Bank. As such, the licensee is required to notify the Bank of any changes to its Directors and Senior Management within 14 days of the change.

Board members should be of such diverse backgrounds and experiences that can contribute to the effective governance of the institution. Directors should not sit on more than one Board of non-affiliated institutions where the institutions compete in the same market for the same business. The Bank may relax this Guideline where the licensees are not competing, but the Bank may disallow a Director if it considers his/her involvement will not contribute to enhanced governance on account of his/her myriad of interests and directorships absorbing much of his/her time and attention.

4.4.3 BOARD INDEPENDENCE⁴

To fulfil its oversight responsibilities, the Board should include a balance of executive and non-executive directors (including independent directors) to ensure that neither management nor any other individual or group of individuals dominate the Board's decision making. It is recommended that, where a licensee accepts third party funds whether as a deposit, for asset management or in trust:

- a. At least 51% of Board members should not hold executive positions with the licensee; and
- b. At least 40% of the Board should be independent of the licensee or its affiliates.

⁴ Definitions of what constitutes "independence" for Board members vary across different legal systems, and are often reflected in exchange listing requirements and supervisory standards. The key characteristic of independence is the ability to exercise objective, independent judgment after fair consideration of all relevant information and views without undue influence from executives or from inappropriate external parties or interests. *BCBS – Principles for Enhancing Corporate Governance*



In determining whether a Director qualifies as independent, consideration should be given to whether that person:

- i. Was employed by the institution or an affiliate of that institution within the last three years; or
- ii. Had a material relationship with the institution either directly, or indirectly e.g. as an adviser, partner, shareholder or senior employee of a body that has or had such a relationship with the institution within the last three years; or
- iii. Received or receives additional remuneration or deferred compensation from the licensee other than Director's fees; or
- iv. Is a member of the immediate family of any person described at item ii above.

In determining materiality of a body, the Bank will consider inter alia, a shareholding of 10% or more, 50% or more of the voting rights, and dominant influence on the Board.

4.5 ORGANISATIONAL STRUCTURE OF THE BOARD

- The functions of the Board may, depending on the size and complexity of the institution, be discharged directly or indirectly through Board committees. Such specialised committees may assist the Board in its oversight function while economising on the limited resources available to monitor specific areas of the institution's activities.
- The Board should determine the type of committee structure that would adequately meet its needs and establish the responsibility, authority and accountability requirements of the committees. However, the Bank reserves the right to mandate the creation of an audit committee.
- Each committee should have a charter or mandate, which should clearly set out the objectives, responsibilities and powers of the committee. It should distinguish those issues for which the committee has authority to act on behalf of the Board, and those for which the committee can only examine and make recommendations to the Board. The charter or mandate should also include the size of the committee, qualifications for membership, any restrictions on the number of Executive Directors, the frequency of meetings, the requirements for a quorum and committee practices.
- The committees should periodically provide the Board with reports of their activities together with recommendations for discussion and approval by the full Board. Minutes of committees should be circulated to the full Board as soon as possible following committee meetings. The work of each committee should be co-ordinated with that of the Board and other committees.
- The Board, when it deems it necessary, may retain the services of independent professional consultants to assist the various committees and to provide valued input to the decision making process.



- Except when a licensee accepts no third party funds, the inclusion of members of management on these committees should be the exception rather than the rule. However, management may be invited to attend meetings as needed to provide input to the discussion.

4.5.1 ROLE OF THE CHAIR

The Chair of the Board plays a crucial role in its proper functioning by providing leadership and fostering a relationship of trust with and among Board members and to this end, the Bank expects the role of the chair to be an established position. The Chair should possess the requisite experience, competencies and personal qualities in order to fulfil these responsibilities.

Except when a licensee accepts no third party funds, the Chair should be a non-executive Director. Where a licensee does not have this separation and particularly where the roles of the Chair of the Board and Chief Executive Officer (CEO) are vested in the same person, it is important for the licensee to have measures in place to minimise the impact on checks and balances. The Bank reserves the right to require the licensee to separate the role of the Chair and Executive Officer.

4.5.2 BOARD COMMITTEES

To increase efficiency and allow deeper focus on specific areas, licensees may establish certain specialised Board committees, e.g. credit, audit, human resources, risk management, asset and liability management, etc. The number and type of committees depends on many factors, including the size of the licensee and its Board, the nature of business areas and its risk profile, however for large and/or complex licensees, an audit committee and a risk committee should be established.

4.5.2.1 Audit Committee

This committee should inter alia:

- Be comprised all non-executive Directors, the majority of whom are independent;
- Be responsible for overseeing the licensee's financial reporting process, including its financial disclosure obligations;
- Oversee the internal and external audit functions, including approving the respective audit plans and engagement letters;
- Meet with and receive reports from the licensee's internal and external auditors; and
- Monitor management's response to regulatory, internal and external audit reports/letters ensuring timely and appropriate resolution of all matters.

4.5.2.2 Risk Committee

The Risk Committee is responsible for advising the Board on the overall current and future risk tolerance/appetite and strategy, and for overseeing Senior Management's implementation of



that strategy. This should include strategies for capital and liquidity management, as well as for credit, market, operational, compliance and reputational risk. Large and/or complex licensees with substantial cross-border activity should establish such a committee, which should receive formal and informal communication from the licensee's risk management function and Chief Risk Officer (CRO), and should, where appropriate, have access to external expert advice, particularly in relation to proposed strategic transactions, such as mergers and acquisitions.

4.6 BOARD MEETINGS

Board meetings serve as a key forum for Executives and Directors to share information on the performance, plans and policies of the licensee. The Boards of licensed institutions should meet with such frequency that reflects the complexity and volume of activity and the condition of the licensee. Institutions should meet at least quarterly.

Board meetings should, inter alia, review:

- i. The adequacy of capital;
- ii. Financial condition and earnings;
- iii. The investment portfolio;
- iv. Loan activity, including past-due and non-accrual loans, charged off or recovered loans and loans to related parties;
- v. Assets under management/administration portfolio;
- vi. Compliance with regulatory requirements;
- vii. Audit, compliance and examination reports; and
- viii. Any other matters of material impact to the licensee, including liquidity, market and operational risk, litigation, fraud, etc.

The Board should maintain in good condition, complete records of the matters discussed at both Board and committee meetings⁵, the decisions taken and any dissenting views or abstentions. These requirements apply whether the meeting is held face to face or by tele-conference.

5.0 SENIOR MANAGEMENT⁶

Under the direction of the Board, Senior Management should ensure that the licensee's activities are consistent with the business strategy, risk tolerance/appetite and policies approved by the Board.

Senior Management is responsible for the day-to-day operations of the business, serving as a link between the Board and staff. The Senior Management is responsible for:

⁵ These records include the Board papers presented for discussion.

⁶ Senior Management consists of a core group of individuals who are responsible and should be held accountable for overseeing the day-to-day management of the licensee. These individuals should have the necessary experience, competencies and integrity to manage the businesses under their supervision as well as have appropriate control over the key individuals in these areas. *BCBS – Principles for Enhancing Corporate Governance*



- a. Setting the “tone at the top” along with the Board;
- b. Providing adequate oversight of those they manage, and ensuring that the licensee’s activities are consistent with the business strategy, risk tolerance/appetite and policies approved by the board;
- c. Keeping Directors adequately informed about the performance of the institution through financial and management reports and such other reports prepared for example by internal auditors, external auditors and the compliance officer;
- d. Advising the Board on the appropriate organisational structure, and ensuring that the quantity and quality of staff resources are available to carry out all tasks, including internal audit and compliance;
- e. Implementing and maintaining risk management systems appropriate to the scale, nature and complexity of the institution;
- f. Delineating and documenting the areas of responsibility for each staff member. Reporting lines must be clear and appropriate in the context of the scale, nature and complexity of the licensee;
- g. Communicating the strategic direction, reporting lines and risk tolerances throughout the organisation; and
- h. Overseeing management information systems to enable timely and accurate dissemination of information to the Board, regulators and other stakeholders.

6.0 GOVERNANCE OF GROUP STRUCTURES⁷

Where licensees are part of a group structure, the Board has the overall responsibility for implementing an adequate consolidated corporate governance framework.

6.1 Board of Parent Company

The Board of the parent licensee should be aware of all material risks that may ultimately affect it, even when these risks might arise in subsidiaries. It is the parent Board’s responsibility to determine the Board structure that best contributes to an effective chain of oversight, enabling the parent, the subsidiary and branches to meet their respective statutory and compliance responsibilities. In fulfilment of this, the Board of the parent licensee should, inter alia:

- Establish a governance structure which contributes to the effective oversight of subsidiaries, and takes into account the nature, scale and complexity of different risks;
- Assess the governance structure periodically to ensure it remains appropriate in light of growth, increased complexity, geographic expansion etc.;
- Approve a group-wide corporate governance policy for its subsidiaries, which includes the commitment to meet all applicable governance requirements; and,
- Have appropriate means to monitor each subsidiary’s compliance with applicable governance requirements.

⁷ Licensees should also refer to the Bank’s Consolidated Supervision Guideline for further discussion on the types of group structures allowed.



6.2 Board of Regulated Subsidiary

The corporate governance responsibilities are broadly similar for parent entities and subsidiaries. Generally, while there may be some overlap of Directors on the parent and subsidiary Boards, each Board must satisfy the requirements of this Guideline. While parent Boards should exercise oversight over the activities of subsidiaries, the Board of the subsidiary entity retains its overall corporate governance responsibilities for the legal entity.

Intra-group outsourcing of operational functions does not absolve the licensee of its responsibility to establish and maintain adequate oversight. Matrix and business line management structures must be in line with the licensee's corporate governance responsibilities.

The Bank expects that:

- i. The minutes of the meetings of the parent licensee will reflect discussion on performance and the risks facing its subsidiaries and branch operations inside and outside of Barbados;
- ii. Parent entities should pay particular attention to the performance, and activities of subsidiaries that require specialist expertise or that may give rise to material reputation, legal or regulatory risks;
- iii. Senior Officers and Directors of subsidiaries will have an understanding of the specific risks facing the subsidiary, even where functional reporting exists within the group.

Where a licensee is a branch of a foreign bank, the Senior Management is expected to:

- Ensure group policies are customised to the local environment;
- Provide reports to their Head Office in line with the requirements set out in this note and generally satisfy the requirements under 5.0;
- Ensure compliance with local laws, regulations and guidelines; and
- Provide the Bank with such information and in such form as would enable the Bank to satisfy itself that the local operations are subject to adequate oversight.

7.0 COMPLEX CORPORATE STRUCTURES

Where licensees have a number of related legal entities included in its structure, i.e. units, branches, and subsidiaries, the Board and Senior Management should have a clear understanding of the legal and operational risks that may be inherent in the structure.

The Board and Senior Management should understand the interconnections and intra-group transactions in order to identify oversee and manage the potential risks to the licensee. Therefore, sound and effective measures and systems should be put in place to facilitate the generation and exchange of information within the group, and with regulators.



Licensees should avoid structures that impede transparency, as these will not be approved by the Bank. Further, the Bank reserves the right to require a license to alter its structure to ensure effective supervision of the group.

8.0 RISK MANAGEMENT AND INTERNAL CONTROLS

Licensees should have an effective internal control system and risk management function in place with adequate authority, stature, independence, resources and access to the Board.

8.1 Risk Management

Risk management includes the following practices:

- Identifying key risks to the licensee;
- Assessing these risks and measuring the licensee's exposure;
- Monitoring the risk exposure and determining the corresponding capital needs on an on-going basis;
- Monitoring and assessing decisions to accept particular risks, risk mitigation measures and whether risk decisions are in line with the Board-approved risk tolerance/appetite and risk policy; and
- Reporting to Senior Management, Risk Committee or the Board, as appropriate.

8.2 Internal Controls

Internal controls should, inter alia:

- Be designed to ensure that each key risk has a policy, process or other measure, as well as a control to ensure that such policy, process or other measure is being applied and works, as intended;
- Help ensure process integrity, compliance and effectiveness; and
- Provide comfort that financial and management information is reliable, timely and complete and that the licensee is in compliance with its various obligations, including applicable laws and regulations.

In order to avoid breaches of authority or fraud, internal controls should also place reasonable checks on managerial and employee discretion. Key management decisions should be made by more than one person ("four eyes principle") and internal control reviews determine the extent of compliance with policies and procedures, as well as with legal and regulatory requirements.

8.3 Chief Risk Officer (CRO)

Depending on the nature, scale and complexity of its business, a licensee may establish this role or equivalent position, and may with the Bank's prior approval, outsource the function to its parent company, in accordance with the Bank's Outsourcing Guideline.



Large and/or complex licensees with substantial cross-border activity should have an independent senior executive with distinct responsibility for the risk management function and the institution's comprehensive risk management framework, on a solo and group basis. While it is noted that some of these larger institutions may use a different title for the officer responsible for risk management and, reporting lines may vary from licensee to licensee, the role of the officer should be independent from other executive functions and business line responsibilities.

Continuous monitoring and identification of risk are necessary to ensure that risk management and internal control frameworks remain aligned to changes in the licensee's business model. For risk management and internal controls to be effective, robust internal communication about risk is required, throughout the entity and in reporting to the Board and Senior Management.

8.4 Internal Audit

Depending on the nature, scale and complexity of its business, a licensee may assign the task of monitoring the appropriateness and effectiveness of its systems and controls to an internal audit function. The internal auditors should report regularly to the Audit Committee, where it exists, or directly to the full Board where there is no audit committee. As part of their fiduciary duty, non-executive Board members should also have the right to meet regularly, in the absence of Senior Management, with the internal and external auditors, compliance personnel and the Bank. The Board or, where applicable, its Audit Committee should inter alia:

- i. Be actively involved in the selection of the head of internal audit;
- ii. Require that those persons responsible for conducting the internal audit functions are independent from the operations under review;
- iii. Review and approve the mandates and organisational structures of the internal control functions;
- iv. Satisfy itself that the internal audit function is adequately staffed and personnel have skills that are commensurate with the business activities and risks of the institution;
 - i. Seek assurances that work programmes are appropriate in light of the risks faced by the licensee; and
 - ii. Ensure the timely resolution of audit findings and control deficiencies.

The Bank recognises that the creation of an Internal Audit Department may not be practical for some small licensees. The Bank accepts that, where the licensee is part of a larger financial or non-financial group, internal audit services can be outsourced to affiliates within the group. Where this is not possible, a licensee may, subject to the Bank's agreement, outsource the function to a person or firm that is not involved in the auditing or accounting function of the licensee.

8.5 External Audit

Licensees have a statutory obligation to appoint an external auditor. The auditors should conduct an audit of the financial statements of the licensee and, accordingly, review the accounting records and internal controls and report to the Board or Audit Committee (where



applicable) on material deficiencies. The external auditors should meet periodically with the internal auditors, the Audit Committee and Senior Management to discuss the findings of their reports. They should have access to the Board to discuss their management letter and other related issues. Non-executive Board members should have the right to meet, in the absence of Senior Management, with the external auditor and Heads of the internal audit and compliance functions, as deemed necessary.

The Board should require that they are provided with management letters, without undue delay, together with management's action plan to deal with identified deficiencies.

9.0 COMPENSATION

Compensation systems play a key role in the overall financial performance of the licensee, and also contribute to the risk-taking of institutions. It is therefore imperative that compensation practices and compensation systems as a whole are sound and are a key component of governance and risk management.⁸

Depending on the nature, scale and complexity of its business, a licensee may develop a compensation system that seeks to incentivise, attract and retain employees, while at the same time maintain profitability. Therefore, it is essential that the Board ensures that compensation systems are sufficiently aligned to support the licensee's risk appetite and risk management framework.

The Board should oversee the compensation system's design and operation, and monitor and review such to ensure that they are operating as intended and do not provide for excessive risk-taking. Employee compensation should be effectively aligned with prudent risk taking, and the following factors should be observed:

- Compensation should be adjusted for all types of risk;
- Compensation outcomes should be symmetric with risk outcomes;
- Compensation pay-out schedules should be sensitive to the time horizon of risks; and
- The mix of cash, equity and other forms of compensation should be consistent with risk alignment.

10.0 DISCLOSURE AND TRANSPARENCY

Transparency is vital for shareholders, depositors, and other relevant stakeholders to monitor and make an assessment of a licensee. Transparency plays an important role in good corporate governance and as such, licensees should disclose all relevant and useful information in this regard.

⁸ Licensees should consider the Financial Stability Board's *Principles for Sound Compensation Practices and Implementation Standards* and observe those specific principles applicable to the nature of their business.



Depending on the nature, scale, complexity, risk profile and economic significance of the institution, disclosure should include, but not be limited to, material information on the institution's objectives, organisational and governance structures, and risk management practices and policies.

11.0 ROLE OF THE BANK

A key role of the Bank is to ensure that licensees practice good corporate governance in a way that is consistent with the objectives discussed in this Guideline. An important element of supervisory oversight of safety and soundness is an understanding of how corporate governance affects a licensee's risk profile.

11.1 Examinations

The Bank will undertake periodic onsite and offsite examinations of a licensee's corporate governance practices. Licensees should be aware that these examinations are designed to determine a rating for the quality of risk management as discussed in the Bank's "*Supervisory Framework 2012 and Beyond*" document.

The examinations will, inter alia, include a review of:

- i. The minutes of meetings of the Board, its committees and Senior Management;
- ii. All policies and procedures on risk management practices;
- iii. The quality of reporting to the Board and to the parent, where relevant;
- iv. Compliance with laws, regulations, guidelines and internal policies;
- v. Qualitative reports including internal audit reports, risk assessments, Management letters; and
- vi. Discussions with select persons such as independent Directors, the Chair of the Audit Committee, Senior Management, and those responsible for the audit, compliance and control functions.

In relation to item iii above, the Bank will pay particular attention to transactions between Directors or their related interests and the licensee to ensure that such transactions are concluded on an arm's length basis and that conflicts of interest have been disclosed.

11.2 Remedial Action

The Bank requires effective and timely remedial action by licensees to address material deficiencies in its corporate governance framework. Enforcement powers are drawn from provisions in the FIA, IFSA and the MLFTA. Specific details may be sought from the Bank's *Intervention Policy Framework: 2012:02* published in April 2012.



11.3 Supervisory Cooperation

The Bank has a framework in place that allows for cooperation with other relevant supervisors locally, regionally and internationally regarding the supervision of corporate governance policies and practices. This framework for cooperation includes memoranda of understanding, supervisory colleges and periodic meetings among supervisors.