

Response to feedback received

Corporate Governance

Introduction

The Bank today finalised for issuance the policy document on *Corporate Governance* for financial institutions, incorporating the proposals from the concept paper issued in March 2016 and taking into account feedback received during the consultation period.

The Bank received written responses from 52 respondents, including financial institutions, associations and two regulatory bodies during the consultation period. An engagement session with directors was also conducted to allow for a more focused and in-depth discussion on the proposed requirements.

Key comments received and the Bank's responses are provided in the following sections. Other comments and suggestions for clarification have been incorporated in the final policy where appropriate.

Bank Negara Malaysia
3 August 2016

1. Board composition

- 1.1 The concept paper proposed measures to strengthen board composition, including through a higher minimum ratio of independent directors, limits on common directorships between certain affiliates, and strengthened rules on executive presence on the board.
- 1.2 A number of industry respondents highlighted potential challenges in meeting the requirements. Key concerns raised include the significant demands to source new talent, and the potential impact on existing arrangements that serve to promote greater group-level alignment and synergy. The respondents sought clarity on the circumstances under which greater flexibility may be considered, particularly with respect to the presence of executive directors from the group. Some respondents further commented that the strengthened presence of independent directors would be sufficient to preserve good governance.
- 1.3 The requirements have been largely preserved in the policy document, in line with evidence from the Bank's supervisory observations which indicate a strong relationship between board composition arrangements and board effectiveness. The broadened definition of executive directors to include group executives also reflects evolving operating models that have seen a growing dispersion in management responsibilities across the group.
- 1.4 Flexibility is however provided where compensating factors exist to promote board effectiveness. In this regard, the final policy document clarifies some key factors that will be considered for allowing a financial institution to have more than one executive director (refer to paragraph 11.4 of the policy document).
- 1.5 The transition arrangements provided for key board composition requirements (refer to Part G of the policy document) are intended to address immediate constraints that may be faced in the ability to source suitable talent for boards. The Directors' Register maintained by FIDE Forum will further contribute towards addressing talent constraints. Financial institutions are expected to take measures to gradually move towards meeting the requirements during the transition period. In particular, for new appointments and re-appointments during this period, any application to retain additional executive directors on the board will be assessed against the considerations in paragraph 11.4 of the policy document. In addition, the board must already comprise a majority of independent directors.

2. Alternative means of attendance

- 2.1 The concept paper proposed that alternative means of attendance to board meetings must remain the exception rather than the norm.
- 2.2 A number of respondents sought greater flexibility in allowing the use of electronic means of attendance, such as tele- and video-conferencing. The respondents noted that these means of attendance were more cost-efficient and convenient, particularly for directors who were based abroad. In addition, some respondents viewed that any risks arising from such forms of attendance could be managed through safeguards to preserve the confidentiality of board deliberations.
- 2.3 The policy document affirms the Bank's view that directors should commit to attend board meetings in person. Considerations underpinning this requirement extend beyond concerns on information security. Physical presence remains important to the formation of strong professional relationships among individual directors. This in turn improves board chemistry and the quality of deliberations, and encourages greater candour, which is important to maintain robust deliberations by the board. Physical presence at board meetings is also an important way for directors to interact with management and other directors to obtain a good pulse on the organisation and its key challenges.

3. Remuneration

- 3.1 The concept paper proposed enhanced principles and practices for remuneration to promote a sound risk culture in line with prudent risk-taking and long-term viability. The proposals built on remuneration requirements in the policy document on *Risk Governance* by providing further clarity on the Bank's expectations, and expanding the scope of coverage to include material risk-takers.
- 3.2 A number of respondents viewed that effective implementation of the requirements may be operationally demanding, particularly those which are more granular. Additionally, it was highlighted that financial institutions should retain the discretion in determining remuneration practices. Some respondents also sought greater clarity on the rationale of applying the requirements on foreign-owned financial institutions, where remuneration practices are subject to group-wide oversight.
- 3.3 The Bank accepts that remuneration practices will vary across financial institutions to reflect differences in objectives, activities and culture. At the same time, incentives play a significant role in influencing behaviour and by extension, risk-taking by the financial institution. The policy document addresses elements of remuneration design that encourage excessive risk-taking and does not set out to dictate remuneration policy or practices of individual financial institutions. Financial institutions continue to have the discretion to pursue a range of remuneration approaches, provided that risk

considerations are adequately reflected in line with the requirements in the policy document.

- 3.4 Taking into account the operational challenges highlighted by the industry, the final policy document provides a three-year transition period for financial institutions to implement the more detailed requirements (refer to Part G of the policy document).
- 3.5 In respect of locally-incorporated foreign-owned financial institutions, responsibilities for implementing a sound remuneration system that is aligned with prudent risk-taking remain squarely with the local board and senior management. While such a system may be aligned with group-wide arrangements, the local board and senior management must discharge their legal and governance responsibilities in respect of the financial institution as a separate entity. This is elaborated in paragraph 21.1 of the policy document.

4. Internal policy on external professional commitments

- 4.1 The concept paper proposed for the board to maintain a policy on the maximum number of external professional commitments that a director may have. A number of respondents sought greater clarity on the nature of professional commitments that should be considered as part of the policy.
- 4.2 The underlying objective of the requirement is to ensure that directors have sufficient time to perform their duties. The Bank expects the board to exercise its own judgment in determining the nature and number of commitments that should be captured by the internal policy, having regard to the demands on the board and specific challenges facing the financial institution.