INTRODUCTION

1. Under the Financial Sector Masterplan, one of the major strategies envisaged for the development of effective and efficient development financial institutions (DFIs) is enhancing the corporate governance practices of these institutions. Good corporate governance practices are particularly important to DFIs which are policy-based institutions entrusted with responsibilities for carrying out development of priority sectors and management of public funds. It is therefore incumbent on DFIs to conduct their affairs and operations consistent with the professional standards and prudence. In this regard, the board of directors of a DFI must comprise technically competent persons of integrity with a strong sense of professionalism, fostering and practising the highest standards of banking and finance in the country. While the directors may delegate the day-to-day conduct of the DFI's business to the full-time employees of the DFI, the board is ultimately responsible for all activities of the institution.

2. This guideline is aimed to assist the DFIs and their stakeholders in instituting effective governance structure and oversights of board of directors. This guideline states the duties and responsibilities of the board and incorporate a set of rules governing appointment of directors and chief executive officer, directorship in other corporations, composition of the board and board committees.

A. DUTIES AND RESPONSIBILITIES OF THE BOARD

3. The specifications of the duties and responsibilities of the board of directors in this guideline are in line with best practices for effective and strong corporate governance. This will ensure that the board of directors assume responsibilities for the overall management of the DFI effectively. In essence, the board of directors plays the role of 'mini regulators' to ensure the institution operates efficiently and effectively within the ambit of applicable laws and regulations and achieves its mandated roles.

4. The duties and responsibilities of the board of directors are as follows:

(a) **Select and appoint senior executive officers who are qualified and competent to administer the affairs of the institutions effectively and soundly**. The management team must be professional at all times in carrying out their duties and the board of directors must ensure at all times the effectiveness and competence of their staff. The directors must also ensure that their staff are conversant with the corporate mission, strategies, programmes and the various schemes and funds promoted by the Government and Bank Negara Malaysia.

(b) **Ensure that the DFI's strategic focus is clearly defined and is in line with the DFI's mandated roles.** Directors are responsible to direct and steer the institution to provide those financial services and facilities for which the institution was established for and to provide specialised advisory and technical support activities to the targeted sectors of the economy.

(c) **Supervise the affairs of the DFI and to be fully informed of the DFI's condition and management policies in ensuring that the institution is soundly managed**. The directors of a DFI are entrusted to play the role of supervising and overseeing the DFI. Consequently, the supervisory commitment and oversight required from them entail a higher degree of wisdom, prudence, good business judgement and competence. They should commit sufficient time to be fully informed of the condition of the business, the direction they are steering the institution to, and to apply immediate remedial measures when the need arises. The board should meet regularly, preferably not less than once a month, to deliberate on the performance of the DFI and to provide policy direction and guidance for the management. Although directors may delegate certain authority to senior officers, it is their responsibility to supervise the DFI to ensure sound management and to deal with all problems. Apart from retaining a record of the minutes of board meetings, a record of supervisory actions by directors should also be kept.

(d) **Adopt and follow sound policies and objectives which have been fully deliberated.** The directors must provide clear objectives and policies within which senior executive officers are to operate. These should cover all aspects of operations, including strategic planning, credit administration and control, asset and liability management encompassing the management of liquidity risk, interest rate risk and market risk, accounting system and control, service quality, information systems and automation plan, prevention of money laundering, profit planning and budgeting, adequacy of capital and human resource development. Clear lines and limits of authority for all levels of staff should be established. The seriousness of infringing the authority limit as provided in Section 32 of the Development Financial Institutions Act 2002 (DFIA) should be emphasised to staff at all levels.

(e) **Establish and ensure the effective functioning of an Audit and Examination Committee, Remuneration Committee, Nomination Committee and Risk Management Committee.**

(f) **Set up an effective internal audit department, staffed with qualified internal audit personnel to perform internal audit functions, covering the traditional function of financial audit as well as the function of management audit**. Management audit, which contributes directly to the attainment of corporate goal, is an *audit of management* rather than an audit for management. To enhance the independence of the internal auditors in achieving their audit objectives, the board should ensure that the internal auditors have full access to all records, and are given an appropriate standing in the organisation's hierarchy. In this regard, the internal auditors should be placed under the direct authority and supervision of the Audit and Examination Committee. Since the internal auditors are held accountable to the Audit and Examination Committee, their performance should be evaluated by the Audit and Examination Committee.

(g) **Observe relevant laws, rulings and regulations.** Directors must be familiar with the relevant laws, related regulations, interpretative rulings and notices, and must exercise due diligence to see that these are not violated. This duty may involve a personal financial responsibility for losses arising out of illegal actions. There are also laws pertaining to certain restrictions, prohibitions and liabilities of directors.

(h) **Avoid self-serving practices and conflicts of interest.** Once their appointments take effect, directors assume a fiduciary role and must display the utmost good faith towards the DFI in their dealings with it or on its behalf. DFIA and other relevant laws subject directors to disclosure requirements for outside business interests. Under DFIA, a DFI is prohibited from lending to its directors or director-interested firms and corporations. The directors must also avoid making any personal profit, acquiring personal benefit or retaining any commission, bonus or gifts for performing their official function of granting approval to financing arrangements or the use of particular services.

B. MINIMUM QUALIFICATION STANDARD AND TRAINING REQUIREMENTS FOR DIRECTORS

5**.** This minimum qualification standard and training requirements for directors aim to ensure that board of directors of DFIs possess the necessary qualifications, skills, experience and core competencies to enable them to effectively discharge their governance responsibilities. Relevant training will enable directors of DFIs to have a robust understanding on the nature of business and to keep them abreast with current issues and regulatory changes in their identified targeted sectors. This minimum standard stipulates the minimum training requirement for directors of DFIs in view of the importance of training to further strengthen their ability to meet the governance responsibilities.

Applicability

6. This minimum standard includes prescriptive requirements and best practice requirements. Prescriptive requirements must be complied with by all DFIs. Best practice requirements are not mandatory but DFIs are encouraged to adopt them as part of the effort to raise their corporate governance practices in line with the international best practices.

B1. Minimum qualification requirements

(a) Prescriptive requirements

7. The nominating committee[1] is required to carry out an annual assessment to evaluate the effectiveness of each individual director in developing the DFIs, and regular assessments on the required mix of skills, experience and core competencies within the board as well as to ascertain the 'fit and proper' criteria of each director as defined under the Schedule of the DFIA. This is to ensure directors continuously contribute towards the achievements of corporate objectives and fulfil their fiduciary responsibilities. DFIs should require their directors to make a quarterly declaration, using a standard format, that they are not disqualified under the relevant law and fulfil the 'fit and proper' criteria.

8. At least two members of the board of a DFI should be qualified in finance-related disciplines, which at a minimum should be at a university degree level, or have at a minimum five years of working experience at managerial level in these disciplines. For the purpose of this minimum standard, finance-related disciplines include banking, insurance, takaful and investment.

[1] Requirements on composition, responsibilities and other information on nominating committee are prescribed in paragraph 35-39, page13-15.

(b) Best practices

9. To ensure that the board of a DFI has the required mix of skills and experience to discharge its duties, the members of the board should be from diverse backgrounds, with knowledge and experience in relevant disciplines such as legal, accounting, marketing, information technology, business administration and investment management. All members of the board of a DFI should also have some form of educational qualification and/or working experience at managerial level in finance-related disciplines, in addition to the qualifications and experience in their respective disciplines. A DFI should strive towards appointing board members with strategic thinking and leadership skills who are dynamic and responsive to the business environment.

B2. Training requirements

(a) Prescriptive requirements

10. The nominating committee of a DFI is required to ensure that the board members receive continuous training programmes. The nominating committee is required to develop in-house orientation and education programmes for its newly appointed directors to familiarise them with the DFI and identified target sectors within three months of the appointment. The orientation and education programmes should cover at a minimum, the nature of business, the corporate strategy of the DFI, responsibilities and duties of a director and the board as a whole, an overview of risks of the business and the risk management strategy of the DFI, legal requirements and compliance controls of the DFI and a financial overview and health of the DFI. New directors or reappointed directors who have yet to attend the mandatory training programmes prescribed by the Kuala Lumpur Stock Exchange (KLSE) for listed companies, or Suruhanjaya Syarikat Malaysia (CCM) must attend the programme within six months of their appointment.

11. On an on-going basis, DFIs should notify the board of all guidelines and circulars (excluding administrative circulars) issued by Bank Negara Malaysia within one month of the date of issuance of the guidelines or circular.

(b) Best practice

12. Directors should attend training programmes to enable them to have robust understanding of the nature of the DFI's business and keep abreast with new regulatory and business developments.

C. APPOINTMENT OF CHIEF EXECUTIVE OFFICER AND DIRECTORS

(a) Chief Executive Officer

13. The sound operation of a DFI depends critically on its chief executive officer. The candidate for the chief executive officer's post must be suitably qualified with appropriate experience. He must be a person of high calibre and impeccable integrity. The 'fit and proper' criteria for appointment are laid down in the Schedule in DFIA while the policies and procedures for verification by Bank Negara Malaysia for appointment as directors and chief executive officer are as outlined in the circular on appointment of directors and chief executive officers for DFIs issued on 20 August 2002.

14. Bank Negara Malaysia holds the chief executive officer directly responsible for the day-to-day operations of a DFI. He must be familiar with the operations of the DFI, the state of internal controls, requirements of regulations, as well as current issues and policies affecting the DFIs in general. He must also have the necessary knowledge and professional competence in the conduct of the business of the DFI.

15. A DFI is required to inform Bank Negara Malaysia of the person who will be directly responsible for the overall running of the DFI when the chief executive officer is overseas, on leave or otherwise absent. This is necessary for Bank Negara Malaysia to consult the nominated person on matters of policy and day-to-day operations. The person so nominated should be fully acquainted with the affairs of the DFI, and should be able to act promptly, with authority, on matters affecting the DFI.

(b) Alternate Directors

16. Appointment of alternate directors is discouraged. This is to ensure that the directors are committed personally to the board in directing the management of the DFI. An alternate director, in his capacity as a proxy for a director, may not be able to contribute effectively to the deliberations of the board.

(c) Practising Lawyers and Accountants

17. To enable DFIs to tap the expertise of lawyers and accountants, practising lawyers may be appointed as directors of a DFI provided that they are not employed by or are not partners in a legal firm, which is on the panel of lawyers of that particular DFI. Similarly, practising accountants may be directors provided they are not employed by or are not partners in an accounting firm which is engaged to conduct audit of or consultancy work for that particular DFI.

18. The practising lawyers and accountants who are appointed as directors of DFIs are expected to exercise the highest degree of integrity and professionalism. They must always be mindful of the need to avoid being involved or seen to be involved in any self-serving practices and conflict of interest situations in the conduct of their profession while serving as directors of a DFI.

D. DIRECTORSHIP IN OTHER CORPORATIONS

(a) Executive Post in Other Corporations

19. The chief executive officer of a DFI is not allowed to hold any executive position in another corporation. This is to ensure that the chief executive officer devotes his attention and commitment principally to the day-to-day operations of a DFI.

(b) Number of Directorship Held by Chief Executive Officer

20. The chief executive officer may hold directorships in subsidiaries and associate companies of the DFI. The directorships in these companies however should not exceed five at any one time.

21. The chief executive officer may hold directorships in non-profit social organisations, institution/organisation which represents the DFI's interests, statutory bodies and Government-owned corporations. Directorships in these institutions are not included in the five posts. The Board is required to set a reasonable limit for the number of directorships that are allowed to be held by the chief executive officer in these institutions/organisations, to ensure the devotion of his attention and commitment principally to the operations of the DFI.

(c) Directorships Held by Staff Other than CEO of DFI

22. Staff other than the CEO of a DFI may be appointed as directors in subsidiaries and associate companies of the DFI. However, the Board should set policies on the number of directorships that can be held by staff and the number should not exceed the limit set for the CEO. This is to ensure the devotion of attention and commitment by these staff to their executive roles in the DFIs.

(d) Non-Executive Directors

23. Non-executive directors are required to attend at least 75% of the Board meetings. This is to ensure that the non-executive director participates and actively involves in the management and affairs of the DFIs.

E. SIZE AND COMPOSITION OF THE BOARD

(a) Minimum Number of Directors

24. Each DFI must have a minimum of <u>seven</u> directors. This is to ensure there are adequate number of directors to represent the interest of the various stakeholders of the DFIs. The quorum for a Board meeting should not be less than <u>five</u> directors.

(b) Independent Directors

25. The DFI should appoint a sufficient number of independent directors to ensure representation of interests of various stakeholders including minority stakeholders of the DFIs, to provide a balanced view and opinion in the Board. Sufficient number of

independent directors is essential to avoid the same independent director sitting on the various committees established by the Board.

26. An *independent director* is a director who represents the interest of the general public or the shareholders other than the controlling shareholders. An independent director should also not:

(i) have more than 5% equity interest directly or indirectly in the DFI or in its related corporations;

(ii) be employed in an executive position in the DFI or its related corporations at least two years prior to his appointment date;

(iii) have an immediate family member who is, or has been in any of the past two financial years, employed by the DFI or any of its related companies as a key senior officer. For this purpose, an 'immediate family member' means the spouse, parent, brother, sister, child (including adopted or step child) and the spouse of such brother, sister or child, of the independent director;

(iv) be engaged as a professional adviser by the DFI or any related corporations of the DFI, either personally or through a firm or company of which he is a partner, director or major shareholder, as the case may be; and

(v) be engaged, in any transaction, or has been engaged in any transaction within the last two years with the DFI, whether with other persons or through a firm or a company of which he is a partner, director or major shareholders, as the case may be, the value of which exceeds RM1 million. However, "transactions" as stated above shall exclude transactions entered into:

a. For personal use of the said Director; or

b. For personal investment of the said Director except for the purpose of carrying on a trade or business,

provided that such transactions are on normal commercial terms.

Responsibilities

27. The primary responsibility of independent directors is to protect the interest of minority shareholders and the general public. Therefore, independent directors should provide effective oversight and ensure a strong independent element on the board, for it to function effectively and exercise objective judgments independently. The effective participation of independent directors enables a balanced and enhanced accountability in the board's decision-making process. The responsibilities of an independent director should therefore include the following:

(i) to provide and enhance the necessary independence and objectivity to the board from the executive arm of the DFI;
(ii) to mitigate any possible conflict of interests between the policy-making process and the day-to-day management of the DFI;
(iii) to constructively challenge and contribute to the development of strategy of the DFI;
(iv) to ensure that the board uses adequate systems and controls to safeguard the interests of the DFI;
(v) to serve as a 'check and balance' function to the board; and
(vi) to provide an objective view on the performance of executive directors and management in meeting agreed goals and objectives, and monitor the reporting performance.

In view of the increasing responsibilities expected to be borne by an independent director, his remuneration level should commensurate with the level of responsibilities undertaken and contribution to the effective functioning of the board.

(c) Maximum Number of Executive Directors

28. Only a maximum of two senior officers may be allowed to serve on its board. This is to ensure that the non-executive directors form the majority of total board members at any time. This would render the necessary independence to the board from the executive arm of the DFI, and help mitigate any possible conflict of interest between the policy-making process and the day-to-day management of the DFI.

F. TERMS OF REFERENCE OF THE BOARD COMMITTEES

F1. Audit and Examination Committee

Objective

29. The board should establish an Audit and Examination Committee (AEC) to review the financial condition of the DFI, its internal controls, performance and findings of the internal auditors, and to recommend appropriate remedial action regularly, preferably at least once in three months.

Composition

30. The AEC should consist of not less than three board members, none of whom should be full-time executive directors of the DFI. The majority of the AEC members should be independent directors. The AEC members should elect a Chairman among them who is an independent director. Alternate directors are not allowed to be appointed as members of the AEC.

Minimum qualification requirements and best practices

31. At least one member of the board who sits in the AEC of the DFI should have working experience or knowledge in accounting, auditing practices and financial reporting requirements. To ensure the committee is able to collectively discharge its duties, as the best practice, all members of the AEC should be able to understand the financial reporting process and be financially literate[2]. In addition, in view of the important role of the committee in ensuring that there is check and balance in the internal audit process, AEC members should also be familiar with areas included in the scope of internal audit including risk management, underwriting, investments and claims management. At least one member of the AEC should be a member of a recognised accounting professional body, such as the Malaysian Institute of Accountants.

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[2] Financial literacy is defined as the ability to read and understand fundamental financial statements, including a company's balance sheet, income statement and cash flow statement.

Responsibilities

32. The primary responsibilities of the AEC are as follows:

(i) Ensure that the accounts are prepared in a timely and accurate manner with frequent reviews of the adequacy of provisions against contingencies, and bad and doubtful debts. Review the balance sheet and profit and loss account for submission to the full board of directors and ensure the prompt publication of annual accounts;

(ii) Review internal controls, including the scope of the internal audit programme, the internal audit findings, and recommend action to be taken by management. The reports of internal auditors and AEC should not be subject to the clearance of the chief executive officer or executive directors. The AEC should also evaluate the performance and decide on the remuneration package of the internal auditors;

(iii) Review with the external auditors, the scope of their audit plan, the system of internal accounting controls, the audit reports, the assistance given by the management and its staff to the auditors and any findings and actions to be taken. The AEC should also select external auditors for appointment by the Board each year; and

(iv) Review any related party transactions that may arise within the DFI group.

Meeting

33**.** The full committee shall meet regularly preferably at least once in three months.

34. The external and internal auditors of a DFI should have free access to the AEC. The auditors should be allowed to attend and be heard at any meeting of the AEC. Upon request of the auditors, the Chairman of the AEC should convene the meeting to consider any matter that the auditors believe should be brought to the attention of the directors or shareholders.

F2. Nominating Committee

Objective

35. The primary objective of the nominating committee is to establish a documented, formal and transparent procedure for the appointment of directors, chief executive officer and key senior officers, and to assess the effectiveness of individual directors, the board as a whole and the various committees of the board, the chief executive officer and key senior officers.

Composition

36. The board of directors of a DFI shall appoint a committee of directors, consistig of at least five board members comprising minimum four non-executive[3] directors, to perform the role of the nominating committee. The committee must be chaired by an independent director. In order to avoid conflict of interest, a member of the committee shall abstain from participating in discussions and decisions on matters directly involving him.

Responsibilities

37. The nominating committee is responsible for:

(i) establishing minimum requirements for the board and the chief executive officer to perform their responsibilities effectively. It is also responsible for overseeing the overall composition of the board in terms of the appropriate size and skills, the balance between executive directors, non-executive and independent directors, and mix of skills and other core competencies required, through annual reviews;

(ii) recommending and assessing the nominees for directorship, the directors to fill board committees, as well as nominees for the chief executive officer position. This includes assessing directors and the chief executive officer proposed for reappointment, before an application for verification is submitted to Bank Negara Malaysia;

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[3] A non-executive director is a director who is not an employee of the DFI and not under the institution's regular payroll.

(iii) establishing a mechanism for formal assessment and assessing the effectiveness of the board as a whole, the contribution by each director to the effectiveness of the board, the contribution of the board's various committees and the performance of the chief executive officer;

(iv) recommending to the board on removal of a director/chief executive officer if he is ineffective, errant or negligent in discharging his responsibilities;

(v) ensuring that all directors undergo appropriate induction programmes and receive continuous training; and

(vi) overseeing appointment, management succession planning and performance evaluation of key senior officers, and recommending to the board the removal of key senior officers if they are ineffective, errant and negligent in discharging their responsibilities.

The procedures for appointment and assessment must be approved by the full board and disclosed to the shareholders of the DFI in the annual report. The committee should not be delegated with decision-making powers but should be obliged to report its recommendations to the full board for decision.

Meeting

38. The full nominating committee should meet as and when required, at a minimum once a year to deliberate the above responsibilities.

Disclosure

39. The activities of the committee and its assessments should be briefly disclosed in the Directors' Report of the DFI's annual report under the heading "Corporate Governance Disclosure" which should include the following:

(i) the membership of the committee;

(ii) the responsibilities of the committee;

(iii) the number of committee meetings held in a year. DFIs are encouraged to disclose information on the number of meetings attended by each member of the committee; and

(iv) a statement on the assessment of the mix of skills, experience and other qualities of directors.

F3. Remuneration Committee

Objective

40. The primary objective of the remuneration committee is to provide a formal and transparent procedure for developing a remuneration policy for directors, chief executive officer and key senior officers and ensuring that compensation is competitive and consistent with the DFI's culture, objectives and strategy.

Composition

41. The board of directors of a DFI shall appoint a committee of non-executive directors to perform the role of the remuneration committee. The committee must consist of at least three members and must be chaired by an independent director. In order to avoid conflict of interest, a member of the committee shall abstain from participating in discussions and decisions on matters directly involving him.

Responsibilities

42. The remuneration committee is responsible for:

(i) recommending a framework of remuneration for directors, chief executive officer and key senior officers. The remuneration policy should:

- be documented and approved by the full board and any changes thereto should be subject to the endorsement of the full board;
- reflect the experience and level of responsibility borne by individual directors, the chief executive officer and key senior officers;
- be sufficient to attract and retain directors, chief executive officer and key senior officers of calibre needed to manage the DFI successfully; and
- be balanced against the need to ensure that the funds of the DFI are not used to subsidise excessive remuneration packages.

(ii) recommending specific remuneration packages for directors, chief executive officer and key senior officers. The remuneration packages should:

- be based on an objective consideration and approved by the full board;
- take due consideration of the assessments of the nominating committee of the effectiveness and contribution of the director, chief executive officer or key senior officers concerned;
- not be decided by the exercise of sole discretion of any one individual or restricted group of individuals; and
- be competitive and is consistent with the DFI's culture, objective and strategy.

The remuneration packages for executive directors should be structured to link rewards to corporate and individual performances to encourage high performance standards. Salary scales drawn up should be within the scope of the general business policy and not be dependant on short-term performance to avoid incentives for excessive risk-taking. As for non-executive directors and independent directors, the level of remuneration should be linked to their level of responsibilities undertaken and contribution to the effective functioning of the board.

43**.** As the chief internal auditor is one of the key senior officers, his remuneration package should be decided by the remuneration committee.

Meeting

44. The full remuneration committee shall meet at least once a year to review the remuneration packages of the directors, chief executive officer and key senior officers.

Disclosure

45. The activities of the committee and its assessments should be briefly disclosed in the Directors' Report of the DFI's annual report under the heading "Corporate Governance Disclosure" which should include the following:

(i) the membership of the committee;

(ii) the responsibilities of the committee; and

(iii) the number of committee meetings held in a year. DFIs are encouraged to disclose information on the number of meetings attended by each member of the committee.

F4. Risk Management Committee

Objective

46. The primary objective of the risk management committee is to oversee the senior management's activities in managing the key risk areas of the DFI and to ensure that the risk management process is in place and functioning effectively.

Composition

47. The board of directors of a DFI shall appoint a committee of non-executive directors to perform the role of the risk management committee. The committee must consist of at least three members and must be chaired by an independent director.

Responsibilities

48. The risk management committee is responsible for:

(i) formulating strategies to manage the overall risks associated with the DFI's activities;

(ii) recommending appropriate risk management policies, procedures and processes in key risk areas such as market risk, credit risk, underwriting risk, investment risk and operational risk;

(iii) reviewing the adequacy of risk management policies and systems and the extent to which these are operating effectively;

(iv) promoting an integrated approach to evaluate and monitor interrelated risks;

(v) ensuring that the infrastructure, resources and systems are in place to identify, measure, monitor and control risks;
(vi) reviewing management's periodic information on risk exposures and risk management activities; and
(vii) formulating business continuity plans.

Meeting

49. The committee should hold regular meetings and should report regularly to the full board.

Disclosure

50. The activities of the committee and its assessments should be briefly disclosed in the Directors' Report of the DFI's annual report under the heading "Corporate Governance Disclosure" which should include the following:

(i) the membership of the committee;
(ii) the responsibilities of the committee;
(iii) the number of committee meetings held in a year. DFIs are encouraged to disclose information on the number of meetings attended by each member of the committee; and
(iv) a statement on the DFI's risk management framework.

Implementation Date

51. DFIs under the purview of DFIA are required to comply with the requirements as follows:

	Subject	Compliance
A.	Duties and responsibilities of the Board	Immediate effect
B.	Minimum qualification standards and training requirements for directors	Immediate effect
C.	Appointment of chief executive officer and directors	Immediate effect
D.	Directorship in other corporations	By 31 March 2004

E. Size and composition of the Board	By 31 March 2004
F. Board committees	
• Establishment	By 31 October 2003
• Compliance with terms of reference	By 31 March 2004