Response to feedback received
Concept Paper on Risk Governance

Introduction

The Bank today finalised for issuance the policy document on Risk Governance for commercial, investment, and Islamic banking institutions as well as insurers, takaful operators and development financial institutions. The policy document incorporate the proposals from the Concept Paper issued in February 2012, while also taking into account feedback received during the consultation process.

The Bank received written responses from the industry during the consultation process which were generally supportive of the proposals set out in the Concept Paper. Key comments received on the Concept Paper and the Bank's responses are set out in the remaining parts of this document. Other comments received and suggestions for clarification have been incorporated in the final policy document.

Bank Negara Malaysia
1 March 2013

1. Separation of actuarial staff supporting the risk management function from business line or operational responsibilities

1.1. A large number of respondents supported the Bank's proposal that actuarial staff supporting the risk management function should not be responsible for other actuarial work (e.g. reserving and pricing duties). This is to ensure the objectivity and independence of the assessments performed by the actuarial staff (e.g. capital provisioning) and mitigate the risk of a conflict of interest with the roles and responsibilities of the operational and business units. Nonetheless, these respondents also raised concerns on the existing shortage of actuarial talent in the market.

1.2. Meanwhile, a smaller group of respondents believe that the separation between actuarial staff supporting risk management function and those involved in other actuarial work is unnecessary. Such a separation would reduce the opportunity for actuaries in the risk management function to gain better understanding of the business by performing other actuarial work which may subsequently assist in risk assessments. It was also highlighted by several respondents that actuaries are duty bound by their professional membership's standards of practice and code of conduct to ensure that risks are adequately priced for.

1.3. The Bank maintains its view that actuarial expertise should be embedded in the risk management function of an insurer or takaful operator and that this expertise should be separated and independent of other actuarial work. This expectation has been incorporated in paragraph 49 of the final policy. Insurers/takaful operators that require additional time to meet the requirements may write in to request for an extension of timeline, which should be accompanied by relevant plans for achieving compliance.

2. Structure of financial institutions' remuneration practices

2.1. The Concept Paper proposed for remuneration to be aligned with prudent risk taking and appropriately adjusted for risks. The Concept Paper requested for financial institutions to share with the Bank the extent to which their current remuneration practices incorporates the expectations set out in the Concept Paper.

2.2. Industry responses indicated that financial institutions are at different levels of sophistication and progress in adopting sound remuneration practices, ranging from basic and undifferentiated remuneration structures to those that have already incorporated expectations on prudent risk behaviour into key performance indicators (KPIs) or scorecards for measuring or rewarding performance.

2.3. The Bank supports the efforts of financial institutions to continue developing and refining the remuneration framework to be in line with international standards. In this regard, the Bank expects to issue more detailed guidance on risk-adjusted remuneration in the future that will provide further elaboration of supervisory expectations on these practices.

3. Dual hatting of Chief Risk Officer (CRO) with other executive functions

3.1. The Concept Paper proposed that in general, there should be no dual hatting of the Chief Risk Officer function with other executive functions (e.g. where the chief risk officer is also serving as the chief operating officer, chief financial officer or other senior management). However, the proposal provides for more proportionate treatment for smaller, less complex financial institutions, where flexibility may be given for the CRO's function to be combined with another control function (other than internal audit), subject to satisfactory compensating arrangements to maintain sound control environment such as additional group oversight requirements.

3.2. Most respondents are supportive of the proposed restriction on dual hatting. However, there were suggestions that dual hatting arrangements for CROs of smaller, less complex financial institutions should not be limited to other non-control functions but to also include functions with less direct business line responsibility, such as the COO. Additionally, clarification was also sought on whether, for insurance companies, the holding of the CRO and Appointed Actuary (AA) position by the same individual would constitute a breach of the dual hatting restriction.

3.3. The Bank maintains the view that the independence of the chief risk officer should not be compromised. However, the Bank will consider the circumstances and will look for satisfactory compensating safeguards to be in place that ensures that the overall control environment is not compromised before granting any flexibility. Similarly, dual hatting arrangement between CRO and AA may be allowed so long as they do not give rise to potential conflict of interest.

4. Application of global risk management practices for subsidiaries of regional/global companies

4.1. Several respondents suggested that financial institutions which are subsidiaries of regional/global financial groups should be allowed to adopt the group risk management policies, without the need for review by the local board.

4.2 The Bank allows the adoption of group risk management policy where it is relevant in the context of the local financial institution. However, it remains the responsibility of the local board to establish the relevance of such group risk management policies for local adoption. Among others, the local board should take into consideration the business and risk profile of the local subsidiary, as well as the local business environment and regulatory requirements.