PART 1: INTRODUCTION 1

PART 2: PRINCIPLES OF CORPORATE GOVERNANCE, MINIMUM STANDARDS AND SPECIFIC REQUIREMENTS 5

Principle 1: Every Licensed Institution should be headed by an effective board, which assumes specific responsibilities. The vision, strategy and corporate values of the Licensed Institution should be clearly specified and understood..... 5

Principle 2: There should be an effective board composition, with a strong independent element where no individual or small group of individuals should be allowed to dominate the board's decision making..... 11

Principle 3: There should be a clear division of responsibilities at the helm of a Licensed Institution, which will ensure a balanced and clear lines of role, responsibility, authority and accountability throughout the Licensed Institution 15

Principle 4: There should be a formal and transparent process for the appointment of directors to the board and the appointment of CEO..... 17

Principle 5: Directors must be persons of calibre, credibility and integrity with the necessary skills and experience and be able to devote time and commitment 21

Principle 6: Board should meet regularly and be duly furnished with complete and timely information 23

Principle 7: There should be a formal and an ongoing assessment of the effectiveness of the board as a whole, the directors and the CEO 25

Principle 8: There should be a formal and transparent procedure for fixing the remuneration packages of board members, CEO and senior management and the remuneration policies and practices should be in line with the Licensed Institution's ethical values, objectives and culture 25

Principle 9: Persons empowered with decision-making authority (including directors) should exercise care to avoid situations that may give rise to a conflict of interest situation 27

Principle 10: There should be clear separation between shareholders and management so as not to impede sound corporate governance..... 28

Principle 11: There should be robust auditing requirements and the auditor, board and management need to maintain professional and objective relationships 28

Principle 12: Licensed Institution should engage in regular, effective and fair communication with shareholders/stakeholders 30

Principle 13: Conducting corporate governance in a transparent manner can reinforce sound corporate governance 31

Principle 14: Board is collectively responsible and accountable for the veracity of disclosures and management of risk 33

PART 3: APPLICATION PROCEDURES 34

PART 4: APPENDICES 35

APPENDIX 1 35

APPENDIX 2 36

APPENDIX 3 41

PART 1: INTRODUCTION

OVERVIEW AND OBJECTIVE OF THE GUIDELINES

1.01 The primary objective of the "Guidelines on Corporate Governance for Licensed Institutions" (the Guidelines) is to promote the adoption of effective and high standards of corporate governance practices by Licensed Institutions and holding companies.

In these guidelines, the term:

Holding company refers to a company which holds 51% or more interest in the shares of an institution licensed under the Banking and Financial Institutions Act 1989 (BAFIA) and, other companies as may be approved by Bank Negara Malaysia.

Licensed Institutions refers to institutions which are licensed under BAFIA, namely, commercial banks and investment banks.

1.02 The Guidelines set out broad principles and minimum standards as well as specific requirements for sound corporate governance, which are expected of Licensed Institutions and holding companies.

IMPORTANCE OF CORPORATE GOVERNANCE

1.03 The adoption of sound corporate governance standards and practices ensures that Licensed Institutions are managed safely and soundly where risk-taking activities and business prudence are appropriately balanced so as to maximise shareholders' returns and protect the interests of all stakeholders. In a liberalised and more competitive environment where there is constant pressure for management to deliver required bottomline, strong corporate governance becomes critical safeguards against all kinds of mismanagement and fraudulent activities. Effective corporate governance practices that enhance corporate accountability are key elements in the working of market discipline and transparency.

1.04 Corporate governance is defined as the process and structure used to direct and manage the business and affairs of the institution towards enhancing business prosperity and corporate accountability with the ultimate objective of realising long-term shareholder value, whilst taking into account the interests of other stakeholders[1]. It involves a set of relationships between an institution's management, its board, its shareholders and other stakeholders[2]. As per the BIS Guidelines on "Enhancing Corporate Governance for Banking Organisations", corporate governance involves the manner in which the business and affairs of an individual institution are governed by its board of directors and senior management, affecting how an institution:

- sets corporate objectives, including generating economic returns to owners;
- runs the day-to-day operations of the business;
- considers the interests of recognised stakeholders[3];
- aligns corporate activities and behaviours with the expectation that the institution will operate in a safe and sound manner, and in compliance with applicable laws and regulations; and
- protects the interests of depositors.

[1] Finance Committee Report on Corporate Governance, February 1999.
[2] OECD Principles of Corporate Governance, revised April 2004.
[3] "Stakeholders" include employees, customers, suppliers and the community. Due to the unique role of banks in national and local economies and financial systems, supervisors and governments are also stakeholders.

ALIGNMENT WITH OTHER CORPORATE GOVERNANCE CODES

1.05 The broad principles, standards and requirements under the Guidelines are aligned with the principles enshrined in:

- The Malaysian Code on Corporate Governance;
- The BIS Guidelines on "Enhancing Corporate Governance for Banking Organisations"; and
- Other international best practices on corporate governance.

APPROACH

1.06 The Guidelines are formulated based on the fundamental concepts of **responsibility, accountability and transparency,** with greater emphasis on the role of the board and management. The Guidelines highlight the principles of corporate governance that are translated into minimum standards and specific requirements.

1.07 The Guidelines contain broad principles dealing with:

(i) Board matters;
(ii) Management oversight;
(iii) Accountability and audit; and
(iv) Transparency.

1.08 The Guidelines should be read together with BAFIA, the Companies Act 1965 and other relevant regulations, guidelines or circulars relating to corporate governance that Bank Negara Malaysia may issue from time to time.

APPLICABILITY

1.09 The Guidelines are applicable to the following institutions:

(i) Licensed Institutions;
(ii) Holding companies; and
(iii) Any other institution specified by Bank Negara Malaysia.

1.10 **For holding companies**, the following specific requirements under the Guidelines are applicable:

(i) Establishment of Nominating and Remuneration Committee (including all requirements relating to the functions and responsibilities of the Nominating and Remuneration Committee);
(ii) Requirements on independent directors (definition, responsibilities, composition, resignation and removal of independent directors); and
(iii) Appointment of directors, Chairman and CEOs (approval requirement from Bank Negara Malaysia, separation of the role of CEO and Chairman, appointment procedure, fit and proper criteria, and terms of appointment).

1.11 To facilitate the monitoring and continuous assessment of financial groups, Bank Negara Malaysia may impose certain reporting requirements on holding companies as and when necessary.

COMPLIANCE REQUIREMENTS

1.12 All Licensed Institutions are expected to:

(i) comply and observe the Guidelines; and

(ii) disclose in the annual report, any non-observance of the Guidelines and provide explanation and alternative measures taken to comply with the principles of the Guidelines.

LEGAL PROVISION

1.13 These Guidelines are issued pursuant to Sections 56, 57 and 126 of the BAFIA.

EFFECTIVE DATE

1.14 These Guidelines come into effect on 19 June 2013.

PART 2: PRINCIPLES OF CORPORATE GOVERNANCE, MINIMUM STANDARDS AND SPECIFIC REQUIREMENTS

Principle 1: Every Licensed Institution should be headed by an effective board, which assumes specific responsibilities. The vision, strategy and corporate values of the Licensed Institution should be clearly specified and understood

2.01 The board plays a critical role in ensuring sound and prudent policies and practices of its Licensed Institution. The board needs to perform its oversight role effectively and understands its overall responsibilities to stakeholders. While the board is not involved in the day-to-day operations of the institution, it provides effective check and balance mechanism in the overall management of the Licensed Institution.

2.02 The board carries ultimate responsibility for the proper stewardship of its Licensed Institution. It has the responsibility in ensuring the maximisation of shareholders' value and safeguarding the stakeholders' interests. This could be done through rigorous and diligent oversight over the Licensed Institution's affairs, establishing, amongst others, the corporate values, vision and strategy that will direct the activities of the Licensed Institution, and to be aware of the types of material financial activities the Licensed Institution intends to pursue.

2.03 The board has a fiduciary responsibility to act in the best interest of its Licensed Institution and to protect it from inappropriate actions or influences of dominant or controlling shareholders that are detrimental or not to the best interest of the Licensed Institution and its other shareholders and stakeholders.

2.04 The board should collectively have sound and sufficient knowledge and expertise to enable effective governance and oversight. The board should continue to develop and maintain an appropriate level of expertise as the Licensed Institution grows in size and complexity.

BOARD RESPONSIBILITIES

LEGAL OBLIGATIONS OF DIRECTORS

2.05 Under the Companies Act 1965, a director shall at all times act honestly and use reasonable diligence in the discharge of his duties.

2.06 A director's fiduciary duties towards the Licensed Institution include:

- to act *bona fide* and in the interests of the Licensed Institution as a whole;
- not to act beyond the power conferred by the Licensed Institution;
- to avoid/guard against conflict of interest situation; and

- to apply such degree of skills, care and diligence as may reasonably be expected of a person of his knowledge and experience.

2.07 In addition, directors should also be aware of their responsibilities and liabilities under the BAFIA and other applicable laws, guidelines and regulations. Section 106 of the BAFIA provides that where any offence against any provision of the BAFIA has been committed by any institution, any person who at the time of the commission of the offence was a director, officer, or controller of the institution or was purporting to act in any such capacity, or was in any manner or to any extent responsible for the management of any of the affairs of such institution, or was assisting in such management, shall be guilty of that offence unless he proves that the offence was committed without his consent or connivance, and that he had exercised all due diligence to prevent the commission of the offence as he ought to have exercised, having regard to the nature of his functions in that capacity and to all the circumstances.

Director's Responsibilities

2.08 For the board to be effective, it is crucial for its board members to understand and appreciate their roles and responsibilities. This serves as an important control mechanism to ensure that the board functions objectively, independently and effectively.

2.09 Generally, a director's responsibilities include:

- to be aware of the Licensed Institution's operating environment and promote safety and soundness of the licensed institution;
- to be diligent in undertaking his duties and avoid conflict of interest situation;
- to be able to exercise independent judgement in decision making and provide sound and objective advice;
- to understand his oversight role and 'duty of loyalty' to the Licensed Institution, its shareholders and other stakeholders;
- to objectively question management;
- to devote adequate time and attention to discharge his duties and responsibilities effectively; and
- to contribute actively to the functions of the board and be able to provide special expertise to the board.

Major Responsibilities of the Board

2.10 The major responsibilities of the boards of Licensed Institutions include:

- **Review and approve strategies, business plans and significant policies and monitor management's performance in implementing them**

  An institution should clearly establish its strategic objectives, which takes into account the institution's risk appetite and its risk management capabilities, and devise a business strategy and plans for achieving them. The board should approve these objectives, strategies and business plans, and ensures that

performance against plans is regularly reviewed and monitored. The board should also establish key performance indicators (KPIs) to define, measure and monitor the performance and progress towards achieving organisational goals. The KPIs established should reflect the goals of the Licensed Institution, be measurable and allow for corrective actions if things go wrong. KPIs should complement overall business targets, relate to its core activities and be balanced between short and long-term objectives and strategies.

- **Set corporate values and clear lines of responsibility and accountability that are communicated throughout the organisation**[4]
  The board should set the "tone at the top" that establishes a culture of high ethical standards and integrity, professional conduct and approve corporate values for itself, senior management and other employees and clear lines of responsibility and accountability, which are communicated throughout the organisation. The consistent practice of high ethical standards will benefit the Licensed Institution, as these practices will enhance the Licensed Institution's credibility and trustworthiness in its day-to-day and long-term operations.

- **Ensure competent management**
  The board should ensure that there is a managed and effective process to select and appoint key senior management officers that are qualified, professional and competent to administer the affairs of the Licensed Institution, approve succession planning policy and effectively monitor senior management's performance on an ongoing basis.

- **Ensure that the operations of the Licensed Institution are conducted prudently, and within the framework of relevant laws and policies**
  While the management is responsible for running the institution on a day-to-day basis, the board should ensure that the internal control systems of the Licensed Institution are effective and that the Licensed Institution's operations are properly controlled. The board should make use of external and internal auditors in reviewing the adequacy of the internal controls. The Licensed Institution should maintain an effective compliance function that routinely monitors compliance with policies approved by the board and relevant laws and regulations. Directors should be familiar with relevant laws, related regulations and guidelines and must exercise diligence to see that these are not violated.

- **Ensure that the Licensed Institution establishes comprehensive risk management policies, processes and infrastructure, to manage the various types of risks**
  The board should have a sound understanding of the Licensed Institution's business operating environment and its associated risks. It is important that the

[4] Refer to Principle 3

Licensed Institution has in place effective and comprehensive risk management policies, processes and infrastructure to identify, measure, monitor and control the various types of risks undertaken by the Licensed Institution. The board should approve and periodically review the risk management capabilities of the Licensed Institution to ensure that they are able to support the Licensed Institution's business expansion. The board should also ensure there is reliable and adequate management information systems that cover the full range of the Licensed Institution's activities.

- **Set up an effective internal audit department, staffed with qualified internal audit personnel to perform internal audit functions, covering the financial and management audit[5]**
  Adequate internal controls and strong risk management system within the Licensed Institution must be supplemented by an effective internal audit function that provides an independent evaluation on the adequacy of, and compliance with the established policies and procedures. 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.

- **Establish procedure to avoid self-serving practices and conflicts of interest including dealings of any form with related entities[6]**
  The board should establish policies and procedures governing related party transactions and conflicts of interest situations. The Companies Act 1965 and the BAFIA subject the directors to disclosure requirements in respect of their other business interests. The board should ensure that the senior management implements policies that prohibit activities and relationships that diminish the quality of corporate governance, such as conflicts of interest situations, corruption and bribery, and providing preferential treatment to related parties and other favoured entities. The board should approve a set of ethical corporate values, preferably in the form of code of conduct that are communicated throughout the Licensed Institution. Such values should stress the importance of accountability, professionalism and integrity throughout the Licensed Institution.

- **Establish and ensure the effective functioning of various board committees**
  Refer to 2.17, 2.18 and **Appendix 2**.

- **Ensure that the Licensed Institution has a beneficial influence on the economic well-being of its community**
  The board has a continuing responsibility to the community to ensure that the Licensed Institution's activities are conducive towards promoting the economic

[5] To also refer to Principle 11
[6] To also refer to Principle 9

well-being of its community and are in line with the government's economic objectives.

Licensed Institution as Part of a Larger Group

2.11 Group dimension affects to a certain extent the corporate governance structure and activities of both parent and subsidiary boards. The corporate governance responsibilities at both the parent and subsidiary should be respected and thus, in carrying out its responsibilities, parent board should not prejudice or diminish the corporate governance responsibilities of the board and senior management of the subsidiary.

2.12 Where the Licensed Institution is a holding company, the board of the Licensed Institution should be aware of the material risks and issues that may affect the constituent entities of the group and should, therefore, exercise adequate oversight over the activities of the subsidiaries. The board of the Licensed Institution and its senior management are expected to set the general strategies and policies of the group and its subsidiaries and for determining the governance structure for its subsidiaries that would best contribute to an effective chain of oversight for the group as a whole.

2.13 Where the Licensed Institution is not a holding company, broad strategies and policies may be set by the holding company. However, the board of the Licensed Institution is not absolved of responsibility and accountability for actions that are directed by the holding company as they are ultimately responsible and accountable for the proper stewardship of the Licensed Institution and should retain its corporate governance responsibilities. The board of the Licensed Institution should review holding company policies that apply to the institution. If the board is not satisfied with the appropriateness of the policies, it should notify and discuss with the holding company.

Locally Incorporated Foreign Banks

2.14 While for a locally incorporated foreign bank, it is acknowledged that the strategies and policies are driven by the parent company in order to be consistent with its own global strategies, the local board is expected to:

- discuss, evaluate and provide input on strategies and policies to suit local environment; and
- deliberate and approve major issues and decisions.

2.15 Although major decisions are normally made by the parent company, the local board still needs to evaluate the issues and endorse the policies before adopting them, as they will be ultimately held accountable. The policies adopted should adhere to the laws of Malaysian jurisdiction and regulations and Memorandum and Articles of Associations of the Licensed Institution.

Functional Matrix Reporting

2.16 With regard to the functional matrix reporting structure, the Licensed Institution's board and management should ensure that such matrix and business line management structures are consistent with the Licensed Institution's corporate governance responsibilities. The board should ensure that:

- it provides active oversight on the overall operations and performance of the Licensed Institution; and
- the management remains accountable in the running of the Licensed Institution's business operations.

BOARD COMMITTEES

2.17 The board needs to establish specialised board committees to oversee critical or major functional areas and to address matters, which require detailed review or in-depth consideration. Although the board may delegate certain duties to the board committees, it remains responsible for the decisions of the committees.

2.18 The board is required to establish the following committees:

- Nominating Committee;
- Remuneration Committee;
- Risk Management Committee; and
- Audit Committee.

(Details of the various board committees are attached in **Appendix 2**)

Principle 2: There should be an effective board composition, with a strong independent element where no individual or small group of individuals should be allowed to dominate the board's decision making

BOARD COMPOSITION

2.19 The number of directors constituting a board is an important factor in determining the effectiveness of the board in providing direction and guidance to the management of the Licensed Institution and in performing its oversight role effectively. To be effective, the board of a Licensed Institution must have an appropriate number of directors that commensurate with the complexity, the size, the scope and operations of the Licensed Institution. The board should comprise of directors who as a group provide a mixture of core competencies such as finance, accounting, legal, business management, information technology and investment management.

2.20 The board should determine the appropriate size of the board and in determining the size, consideration should be given to enable an efficient and effective conduct of board deliberation.

2.21 The participation of non-executive directors enables a balanced and objective consideration of issues and enhance accountability in the decision–making process. Thus, a higher proportion of non-executive directors could mitigate any possible conflict of interest between the policy-making process and the day-to-day management of the Licensed Institution.

2.22 The presence of suitably qualified independent directors can help to provide the necessary checks and balances in ensuring the Licensed Institution operates in a safe and sound manner. Such members can also bring new perspective from other businesses that may enhance the effectiveness of the board.

TYPES OF DIRECTORS

2.23 **Executive director:** a staff of a Licensed Institution who is on the Licensed Institution's payroll and employed under a service contract, and is involved in the Licensed Institution's day-to-day management responsibilities.

2.24 **Non-executive director:** not a staff of a Licensed Institution and not under the Licensed Institution's payroll. He is not involved in the daily management of the Licensed Institution.

2.25 **Independent director:** a director who is independent of management and free from any business or other relationship, which could interfere with the exercise of independent judgement or the ability to act in the best interest of the Licensed Institution.

2.26 An independent director shall not:

- have more than 5% equity interest directly or indirectly in the Licensed Institution or in its related companies;
- be connected[7] to a substantial shareholder of the Licensed Institution or under an obligation to act in accordance with the substantial shareholder or any other person;
- be employed in an executive position in the Licensed Institution or its related companies, at least two years prior to his appointment date;
- have an immediate family member who is, or has been in the past two years, employed by the Licensed Institution or any of its related company 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;
- engage in any transaction, or have been engaged in any transaction within the last two years with the Licensed Institution, whether with other persons or through a firm or a company of which he is a partner, director or major shareholder, the value of which exceeds RM1 million. However, "transactions" as stated above shall exclude the following transactions:
  - for personal use of the said director;
  - for personal investment of the said director except for the purpose of carrying on a trade or business; or
  - normal banking transactions other than loans and advances

  provided that such transactions are on normal commercial terms. A director of a Licensed Institution will still be deemed independent if the company in which he is also a director, has loans with the Licensed Institution, provided he is not a substantial shareholder of the company, or a guarantor of the loan and is not involved in the deliberation and decision-making process;
- be engaged as a professional adviser by the Licensed Institution or any related company of the Licensed Institution, either personally or through a firm or company of which he is a partner, director or major shareholder, as the case may be; and
- have served the board for a period which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interest of the Licensed Institution.

The Nominating Committee of the Licensed Institution shall determine annually whether a director is independent.

[7] A person is connected to a substantial shareholder (that is holds >5% of the equity interest) if he is:

- spouse, parent, brother, sister, child (including adopted or step child) and the spouse of such brother, sister or child, of the substantial shareholder;
- under an obligation, whether directly or indirectly, to act in accordance with the instructions or directions of the substantial shareholder; or
- any other person deemed by Bank Negara Malaysia to be connected with the substantial shareholder.

Maximum Number of Executive Directors

2.27 As the function of the board is to provide effective oversight over management, the number of executive directors on the board should be kept to the very minimum. In this regard, there should **not be more than one** executive director on the board of a Licensed Institution. However under exceptional circumstances, Bank Negara Malaysia may allow, up to a maximum of two executive directors. This requirement does not preclude the board of the licensed institution from inviting other senior management officers to attend board meetings to provide inputs as and when necessary.

2.27A Where directors on the board of a Licensed Institution also include executives from the parent or related institution (e.g. regional office), the board of the Licensed Institution must be able to demonstrate that an effective separation between oversight and management is maintained in the overall balance between executive directors and non-executive directors on the board. This should take into account the extent to which the executives from the parent or related institutions assume accountability for decisions and actions within the Licensed Institution directly or indirectly, through reporting and decision making structures. Where such accountability is assumed, compensating measures must be put in place such as by having a higher balance of independent directors on the licensed institution's board to ensure effective oversight.

Minimum Number of Independent Directors

2.28 Licensed institutions are required to ensure that **at least one-third** of their board members are independent directors. However, in cases where Bank Negara Malaysia has concerns on the effective functioning of the board, a higher proportion of independent directors may be specified by Bank Negara Malaysia. In addition, all resignations and removal of independent directors from the board can only take effect after the respective board has cleared the resignation and removal of the independent directors with Bank Negara Malaysia. This is to ensure the effective functioning of independent directors.

Responsibilities of Independent Directors

2.29 Independent directors should ensure a strong element of independence on the board, both in thought and actions.

2.30 The effective participation of independent directors enhances accountability in the board's decision-making process. The responsibilities of an independent director should therefore include the following:

- to provide and enhance the necessary independence and objectivity to the board;
- to ensure effective checks and balances on the board;
- to mitigate any possible conflict of interest between the policy-making process and the day-to-day management of the Licensed Institution;

- to constructively challenge and contribute to the development of business strategy and direction of the Licensed Institution; and
- to ensure that adequate systems and controls to safeguard the interests of the Licensed Institution are in place.

2.31 In addition to the rights accorded to directors, independent directors may request that their views, comments and stance are minuted to enable them to effectively discharge their duties.

2.32 With the increasing responsibilities and expectations on independent directors, their remuneration level should commensurate with the level of expertise, experience and responsibilities undertaken and contribution to the effective functioning of the board.

Sharing of Independent Directors Within a Group

2.33 Sharing of independent director within a group is allowed provided the director gives a declaration on his independence and that he is not taking instructions from any person including the parent company of the Licensed Institution. In such a situation, the Nominating Committee is required to assess the independence of the director.

Principle 3: There should be a clear division of responsibilities at the helm of a Licensed Institution, which will ensure a balanced and clear lines of role, responsibility, authority and accountability throughout the Licensed Institution

2.34 There should be a clear division of responsibilities at the helm of a Licensed Institution, to ensure a balance of power and authority, such that no one individual or group of individuals dominates the decision-making process. There should also be a properly documented and well-communicated reporting structure in the organisation that clearly shows lines of reporting responsibility and authority so that each employee fully understands his job functions, and hence accountability and integrity of operations in the Licensed Institution will be preserved. Unspecified lines of accountability or confusing, multiple lines of responsibility may worsen a problem through slow or diluted responses.

2.35 The organisational structure of a Licensed Institution should include four important forms of oversight in order to ensure appropriate checks and balances:

- Oversight by the board of directors;
- Oversight by individuals not involved in the day-to-day management of the different business areas;
- Direct line supervision of various business areas; and
- Independent risk management, compliance and audit functions.

2.36 Senior management consists of a core group of individuals responsible for the day-to-day management of a Licensed Institution and they contribute a major element of the Licensed Institution's sound corporate governance. Senior management is responsible for delegating responsibilities to the staff, establishing a management structure that promotes accountability and overseeing line managers and officers carrying out their functions in specific business areas and activities consistent with policies and procedures set by the Licensed Institution's board of directors. They should have the necessary skills, knowledge and expertise to manage the business under their supervision and they are ultimately responsible to the board for the performance of the Licensed Institution.

CHAIRMAN AND CEO

2.37 There shall be **clear separation** between the roles of Chairman and CEO, to ensure an appropriate balance of role, responsibility, authority and accountability. The Chairman of the board should be in a **non-executive** capacity and should not have an executive position or responsibility at the parent or related institutions. The non-executive Chairman assumes an important role in encouraging a healthy debate on critical issues and brings to the board the required level of independence and professional scepticism.

Role of Chairman

2.38 The key role of a Chairman is to ensure, among others:

- the smooth functioning of the board, the governance structure and inculcating positive culture in the board;
- guidelines and procedures are in place to govern the board's operation and conduct;
- all relevant issues are on agenda for board meeting and all directors are able to participate fully in the board's activities;
- board debates strategic and critical issues;
- board receives the necessary information on a timely basis from the management;
- avenues are provided for all directors to participate openly in the discussion; and
- that he provides leadership to the board and is responsible for the developmental needs of the board.

Role of CEO

2.39 The key role of a CEO, among others, includes:

- developing the strategic direction of the Licensed Institution;
- ensuring that the Licensed Institution's strategies and corporate policies are effectively implemented;
- ensuring that board decisions are implemented and board directions are responded to;
- providing directions in the implementation of short and long-term business plans;
- providing strong leadership that is, effectively communicating a vision, management philosophy and business strategy to the employees;
- keeping board fully informed of all important aspects of the Licensed Institution's operations and ensuring sufficient information is distributed to board members; and
- ensuring the day-to-day business affairs of the institutions are effectively managed.

Principle 4: There should be a formal and transparent process for the appointment of directors to the board and the appointment of CEO

Legal Requirements

2.40 The appointment of directors and CEOs of a Licensed Institution requires the prior written consent of Bank Negara Malaysia pursuant to Sections 55(1) and 57(2) of the BAFIA respectively.

Appointment of Chairman

2.41 Licensed Institutions are required to obtain the prior written approval of Bank Negara Malaysia for the appointment of Chairman of the board.

Chief Executive Officer

2.42 The sound operation of a Licensed Institution depends critically on its CEO. Thus, he must be able to devote his full attention and time to be able to discharge his duties and responsibilities effectively and diligently.

2.43 Bank Negara Malaysia holds the CEO directly responsible for the day-to-day operations of the Licensed Institution. He must be familiar with the operations of the Licensed Institution, the state of internal controls, requirements of regulations, as well as current issues and policies affecting the industry in general. He must also have the necessary knowledge and professional competence in the conduct of the Licensed Institution's business.

2.44 In the absence of its CEO, a Licensed Institution is required to inform Bank Negara Malaysia of the person who will be directly responsible for the overall running of the Licensed Institution. This is necessary for Bank Negara Malaysia to consult him on matters of policy and day-to-day operations. The acting person should be fully acquainted with the Licensed Institution's affairs, and should be able to act promptly, with authority, on matters affecting the Licensed Institution.

Appointment Procedure

2.45 A documented and transparent procedure for the appointment of CEO and directors to the board is important to protect the integrity of the board. The policy and procedure for appointments should be approved by the board. The Nominating Committee of the Licensed Institution shall make recommendations to the board on all board appointments, reappointments and resignations (refer to roles and responsibilities of Nominating Committee in **Appendix 2**).

2.46 In processing the applications, a rigorous vetting is conducted to ensure that the proposed director or CEO is a 'fit and proper' person. Similar vettings are also conducted for their reappointments. Upon expiry of the term and until Bank Negara Malaysia grants the approval for the renewal of the term of the director or CEO, the director or CEO is not deemed as director or CEO pursuant to the requirements

under the BAFIA and thus is not allowed to perform his role as director or CEO of the said Licensed Institution.

2.47 Licensed Institutions should ensure that the appointment procedure as prescribed by Bank Negara Malaysia is adhered to.

2.48 Licensed Institution must refrain from making any public announcement about any proposed changes of CEO or director before it obtains the written consent of Bank Negara Malaysia for the proposed changes.

Fit and Proper Criteria

2.49 Directors and CEO have to be persons of high calibre as they are entrusted by the shareholders and other stakeholders with the management of the affairs and ensuring the sound operations of a Licensed Institution. They must possess the minimum qualifications, experience and qualities, which will enable them to effectively perform their duties.

2.50 The board is responsible for developing formal policies defining 'fit and proper' standards for directors and senior management of the Licensed Institution and monitoring compliance with these standards on continuing basis. These standards should address, at a minimum, the 'fit and proper' criteria as set out in the Guidelines. In determining if an individual is 'fit and proper' to hold the position of director or CEO, the following shall be taken into consideration:

(a) His probity, diligence, competence and soundness of judgement;
(b) His reputation, character, integrity (including financial integrity) and honesty;
(c) His history of offence(s) involving fraud, dishonesty and violence;
(d) Whether he has been engaged in deceitful, oppressive or improper business practices or any practices which would discredit him;
(e) Whether he has been engaged, associated or had conducted himself in a manner which may cast doubt on his fitness, competence and soundness of judgement;
(f) Whether he has contravened any provision made by or under any written law appearing to Bank Negara Malaysia to be designed for protecting members of the public against financial loss due to dishonesty, incompetence or malpractice; and
(g) Whether he has been declared a bankrupt.

Bank Negara Malaysia may prescribe other criteria as and when necessary.

Terms of Appointment

2.51 The terms of appointment of directors and CEO need to be set, which among others, shall include roles and responsibilities, tenure and maximum age limit. The terms of

the appointment should also provide an avenue for the removal of a director or CEO who is ineffective, errant or negligent in discharging his responsibilities.

Re-election

2.52 All directors should be required to submit themselves for re-election at regular intervals.

2.53 Licensed Institutions are required to submit fresh application to Bank Negara Malaysia to reappoint the retiring director for approval. For directors whose 2-year term of office as approved by Bank Negara Malaysia has not expired at the time of the Annual General Meeting (AGM), but are required to retire either by rotation or by age limit pursuant to Section 129(6) of the Companies Act 1965 and are eligible for re-election, Licensed Institutions are not required to obtain approval from Bank Negara Malaysia to reappoint them at the AGM. However, Licensed Institutions are required to inform Bank Negara Malaysia within two weeks from the date of the AGM, the directors' names, tenure of appointment and date of AGM at which they are re-elected.

2.54 For directors whose term of office is not subject to the 2-year requirement but are due for retirement either by rotation or by age limit pursuant to Section 129(6) of the Companies Act 1965, Licensed Institutions are required to submit fresh application for reappointment of the director at least **six months** prior to the date of the AGM. Licensed institutions are also required to conduct the usual vettings as in the case of initial appointment and reappointment of director.

Alternate Directors

2.55 Directors of licensed Institutions are **not allowed** to appoint alternate director, as they should commit personally to the board. 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. However, for practical reasons, directors who are not residents of Malaysia (except Singapore), Bank Negara Malaysia may allow them to appoint alternates.

Negative List

Practising Accountants and Lawyers

2.56 Practising accountants may be appointed as directors of a Licensed Institution provided they are not employed or are not partners in an accounting firm, which has been engaged to conduct audit or consultancy work for that particular Licensed Institution. Practising lawyers who are partners in a legal firm, which is on the panel of lawyers of that particular Licensed Institution (and not receiving remuneration on a regular basis), may be appointed to the board of the Licensed Institution. The lawyers are required to disclose the relationship that they have with the Licensed Institution so as to address any potential issue of conflict of interest that may occur.

Politicians

2.57 Individuals who are active in politics cannot be appointed as directors of Licensed Institutions in order to avoid the risk of politicians encountering conflict of interest situations between their role as directors of a Licensed Institution and obligations to their constituents. A person is considered politically active if he is a Member of Parliament, State Assemblyman, Supreme Council Member of a political party or member who holds a position at divisional level in a political party.

Disqualification of Directors and CEO

2.58 Nominating Committees are responsible for assessing, on an annual basis, that the directors and key senior management officers are not disqualified under Section 56 of the BAFIA and continue to comply with the 'fit and proper' standards, and recommend to the board the removal of director or senior management if they are ineffective, errant or negligent in discharging their responsibilities.

The Appointment of Deputy CEO and Chief Financial Officer (CFO) [or other equivalent designations whatever they may be called]

2.59 Deputy CEO and CFO (or other equivalent designations whatever they may be called) are critical positions in a Licensed Institution and both positions are delegated with significant powers by the board. Therefore, it is of crucial importance for a Licensed Institution to appoint a qualified person to hold the position.

Principle 5: Directors must be persons of calibre, credibility and integrity with the necessary skills and experience and be able to devote time and commitment

2.60 Directors provide leadership on matters of strategic importance to the future direction of a Licensed Institution. They are also expected to bring sound judgement to bear on difficult issues. As the expectations on directors are high, they must be competent, experienced and knowledgeable and have sound judgement to exercise their responsibilities that include being able to question and provide advice to management. They need to have sound understanding of their Licensed Institution's business, the nature of risks undertaken by the Licensed Institution and its strategic direction.

Minimum Qualifications

2.61 To ensure that the board of a Licensed Institution has the required mix of skills and experience to discharge its duties, members of the board should be from diverse backgrounds, with knowledge and experience in different pertinent disciplines which may include finance, accounting, legal, business management, information technology and investment management. Members of the board should also have certain level of academic qualifications and/or experience at managerial level. Shareholders of a Licensed Institution should strive to appoint board members with strategic thinking and leadership skills who are dynamic and responsive to the business environment.

2.62 The Nominating Committee should establish the minimum requirements on the skills and core competencies of a director and should undertake an **annual review** of 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. Qualifications and experience of each director should be disclosed in the Licensed Institution's annual report.

Training Requirements

2.63 A Licensed Institution is required to develop in-house orientation and education programmes for its newly appointed directors to familiarise them with the industry and the Licensed Institution within **three months** of the appointment. The programme should cover at a minimum the nature of business, the corporate strategy of the licensed institution, responsibilities and duties of the board as a whole, an overview of the risks of the businesses, the risk management strategy of the Licensed Institution, legal requirements and financial overview of the Licensed Institution.

2.64 The Licensed Institution should ensure that it sets up structured training programmes for its directors to better enable them to fulfil their responsibilities. The Nominating Committee should ensure that all directors receive continuous training in order to keep abreast with latest developments in the industry, particularly on relevant new laws, regulations and the changing risk factors from time to time.

Interlocking Directorships

2.65 To avoid conflicts of interest situations in the management of two or more banking groups, Bank Negara Malaysia would only allow a common director for institutions which are related companies to the licensed institution or institutions that are not within the same sector with the Licensed Institution.

Directorships Held by the CEO

2.66 Being a full-time staff of a Licensed Institution, the CEO has the moral and professional obligations to devote his attention and commitment principally to the day-to-day operations of the Licensed Institution. In this regard, the CEO of a Licensed Institution must adhere to the following parameters with regard to the holding of other directorships:

a) The CEO of a Licensed Institution is only allowed to hold directorships in the holding company, subsidiaries, sister companies and their subsidiaries subject to the following conditions:

(i) sister companies and their subsidiaries are limited to financial institutions only, for example, commercial banks, investment banks, insurance companies, and other companies that have synergies with the respective Licensed Institutions;

(ii) the number of directorships that can be held by a CEO either in the holding company, subsidiaries, sister companies and their subsidiaries should not be more than **five** posts at any one time,

(iii) the CEO of a Licensed Institution is **not** allowed to hold any executive position in another corporation. However, the CEO may be allowed to become Group CEO on a case-by-case basis, provided the responsibilities at the group level are confined to strategies and that the holding company's activity is insignificant. Otherwise, a separate CEO should be appointed at the group level to ensure that the CEO of the Licensed Institution is able to devote his full attention to the Licensed Institution. The responsibilities of the Group CEO should be clearly defined.

b) The CEO of a Licensed Institution is allowed to hold directorships in institutions/organisations to represent the interest of the financial industry, non-profit organisations and statutory bodies/government-owned companies as listed in **Appendix 3** and the number of such directorships will not be taken into account in computing the maximum limit of five**.** To ensure the CEO's attention to the operations of the Licensed Institution is not affected, the board is required to determine the appropriate limit for the total number of directorships that can be held by the CEO in those organisations.

c) The CEO of a licensed institution is also **not** allowed to hold directorships in an associate company and family-owned company. However, exemption to hold one directorship in a family-owned company may be considered if there is a strong justification from the CEO for the appointment.

Directorships Held by Directors Other than CEO

2.67 To ensure full commitment and sufficient time is given to the affairs of a Licensed Institution, the board shall determine the appropriate limit for directorships that can be held by directors.

2.68 Executive directors are only allowed to hold directorships in holding company, subsidiaries and sister companies and their subsidiaries in non-executive capacity.

2.69 When a director has multiple board representations, he must ensure that sufficient time and attention are given to the affairs of each institution. Internal guidelines should be adopted that address the competing time commitments that are faced when directors serve on multiple boards.

Principle 6: Board should meet regularly and be duly furnished with complete and timely information

BOARD MEETINGS

2.70 The board is collectively responsible for the overall control and performance of a Licensed Institution, and by meeting frequently enough, the board will receive sufficient information from the management to monitor the financial condition and enable the board to deliberate and discuss important strategic issues. Circular resolution cannot be a perfect substitute for board meetings since they do not offer the opportunity for board members to actively debate the issues circulated and to raise immediate questions or resolutions, which may lead to inappropriate decisions being made.

Frequency of Meetings and Attendance

2.71 Meetings should be held sufficiently frequent to ensure that:

- the board is kept sufficiently in touch with the business of the Licensed Institution; and
- the operations of the Licensed Institution are not adversely affected because of the difficulty in securing board's approval for policy and decision.

2.72 Board meetings should be held preferably on a monthly basis, but in any event no less than **once every two months**. Individual directors are expected to contribute actively to the function of the board and to allocate adequate time and effort to discharge his duties effectively. Individual directors must attend **at least 75%** of the board meetings held in each financial year. If necessary, the participation of the director can be facilitated by means of video or telephone conferencing with the Chairman's approval.

2.73 The number of board meetings held in the year, as well as the attendance of every board member should be disclosed in the Licensed Institution's annual report.

Minimum Quorum

2.74 In order to form a quorum in respect of a board meeting, there shall be a minimum of 3 attendees or 50% of total board members (whichever is higher).

Minutes of Meetings

2.75 Licensed Institutions shall keep full minutes of all board meetings. The Chairman should ensure that all directors are briefed on issues arising at board meetings. The minutes should record the decisions and their rationales. It is of utmost importance that any concerns or dissenting views raised by any director (including independent directors) are discussed and minuted. The minutes should also facilitate the performance evaluation of the board and individual directors.

Information to the Board

2.76 In order to fulfil their responsibilities, board members should be provided with complete, adequate and timely information prior to board meetings and on an ongoing basis. The Licensed Institution should set up broad parameters of information to be supplied to the board. Management has an obligation to supply the board with complete, well-focused and adequate information in a timely manner.

2.77 Information provided should include background or explanatory information relating to matters to be brought before the board, financial performance, and other major types of information relating to the activities of the Licensed Institution that the board should know and be informed of.

2.78 The board should regularly review the information it receives from management and assess the qualifications of the information of those it relies on by asking questions and obtaining answers about the processes used and about the substance of the advice and reports received by the board.

2.79 In addition to that, the board should have a procedure for directors (either individually or as a group) to have access to independent professional advice, at the expense of the Licensed Institution. The board should also have separate and independent access to senior management and company secretary at any point of time.

Company Secretary

2.80 The role of the company secretary should be clearly defined and should include responsibility for ensuring that board procedures are followed and that applicable rules and regulations are complied with. The company secretary should attend all board meetings and should maintain accurate and adequate records of any action deliberated during board meetings.

Principle 7: There should be a formal and an ongoing assessment of the effectiveness of the board as a whole, the directors and the CEO

Board Performance

2.81 There should be a procedure for a regular assessment of the board as a whole as well as the performance of each individual director and the CEO to ensure their effectiveness. Therefore, the board should implement a process through the Nominating Committee, for an annual assessment of the effectiveness of the board as a whole and its various board committees as well as the contribution of each director and the CEO, based on objective performance criteria, in line with the established KPIs.

Evaluation of the Board

2.82 Inherent in the board evaluation is the need to have prescribed objectives and a defined role against which the performance of the board can be measured. Licensed Institution should formulate key results indicators which can be derived from the strategic plans and objectives and use them to measure the board's performance.

Evaluation of Individual Directors

2.83 A director should be both assessed against the defined role and functions of the board, and relatively against the perceived performance of the director's peers. As part of the improvement process and in addition to formal evaluation process, continuous feedback of an informal nature should be carried out. The Chairman should have the opportunity to speak privately and frankly with each director about his contribution and performance on an ongoing basis.

Evaluation of CEO

2.84 The board should establish criteria to evaluate and assess the performance of the CEO of a Licensed Institution. The criteria established in assessing the performance of the CEO may include, among others, the financial and business performance of the Licensed Institution and the accomplishment of long-term strategy, capacity building and business plan.

Bank Negara Malaysia's Access to Assessment Report of Board and Individual Directors

2.85 On periodic basis, Bank Negara Malaysia may require the assessment of the board's performance or individual directors' report. Bank Negara Malaysia may also meet the board or individual directors from time to time to provide avenues for the board or directors to give feedback and views to Bank Negara Malaysia.

Principle 8: There should be a formal and transparent procedure for fixing the remuneration packages of board members, CEO and senior management and the

remuneration policies and practices should be in line with the Licensed Institution's ethical values, objectives and culture

2.86 The policy on the remuneration of directors, CEO and senior management should be developed under conditions of objectivity and transparency. The levels of remuneration should be sufficient to attract and retain directors of calibre, but at the same time, should also be balanced against the need to ensure that the Licensed Institution's funds are not used to subsidise excessive remuneration packages and not compromising the ongoing viability, solvency and reputation of the Licensed Institution.

2.87 Remuneration Committees should be responsible for developing a clear policy and framework on the remuneration of directors, CEO and senior management. In setting the remuneration packages, the committee should consider the following:

- ensure that the remuneration policy support the Licensed Institution's objectives, culture and strategy;
- remuneration and employment conditions of the industry;
- the Licensed Institution's relative performance;
- the performance-related elements of remuneration should form a significant proportion of the total remuneration package of executive directors. However, salary scales should be within the scope of the general business policy and not be solely based on short-term performance to avoid incentives for excessive risk-taking;
- the remuneration of non-executive directors should be appropriate to the level of contribution, taking into account factors such as effort and time spent, and responsibilities of the directors. In addition, the remuneration of each board member may differ based on their level of expertise, knowledge and experience; and
- to cover all aspects of remuneration including director's fees, salaries, allowances, bonuses, options and benefits-in-kind and termination benefits.

2.88 Bank Negara Malaysia may require the submission of the detailed formula or parameter on remuneration package of directors and CEO. Details of the remuneration (including benefits-in-kind) of the CEO and individual directors should be submitted together with the submission of the annual financial reports of the Licensed Institution to Bank Negara Malaysia.

Principle 9: Persons empowered with decision-making authority (including directors) should exercise care to avoid situations that may give rise to a conflict of interest situation

2.89 The directors, officers and employees of a Licensed Institution must conduct their business with the highest level of ethical values. Conflict of interest situation call into question the ability of the person involved in the conflict to act objectively in the best interest of the Licensed Institution.

2.90 Section 64 of the BAFIA subjects Licensed Institution's directors to disclosure requirements in respect of their other business interests. Such disclosures shall be duly recorded in the minutes of the board meeting at which the disclosure was made or at which it was brought up and read. Directors shall not be at the board meeting where the material transaction or material arrangement is being deliberated by the board of directors.

2.91 The board should establish procedures to address a conflict of interest situation and should ensure that senior management implement policies to identify, prevent or appropriately manage and disclose potential conflicts of interest situations that may arise. Such policies should ensure that the Licensed Institution's activities that may give rise to conflicts of interest are carried out with sufficient degree of independence from each other. This could be done by, for example, ensuring appropriate segregation of duties so that employees are not assigned potentially conflicting responsibilities, providing for separate reporting lines and internal controls and establishing information barriers between different activities.

2.92 Conflicts of interest may also arise when a Licensed Institution is part of a larger group structure, whereby reporting lines and information flow between the Licensed Institution, its parent and/or other subsidiaries of the parent can lead to the emergence of conflicts of interest situations. As such, the board should also ensure that policies are in place to identify, prevent or manage and disclose conflicts of interest which arise as a result of such affiliation with other entities within the group.

2.93 Directors, officers and employees of a Licensed Institution are required to observe the "Guidelines on Code of Ethics" (BNM/GP7) issued by Bank Negara Malaysia, which set out the minimum standards of conduct expected of directors, officers and employees of licensed institutions. Under the said Guidelines, staff (including directors and CEO) must not engage directly or indirectly in any business activity that competes or conflicts with the Licensed Institution's interests. Apart from the Guidelines, Licensed Institution may formulate a more comprehensive set of rules in maintaining ethical standards for the Licensed Institution.

2.94 The board should also ensure that related party transactions are made on an arm's length basis. The board should establish policies and procedures on related party

transactions, which include how the Licensed Institution defines related party, limits applied, terms of transactions and procedures for approving and monitoring these transactions. The established policies and procedures should not be overridden to accommodate any party. The Audit Committee should review all related party transactions and these transactions should be monitored with particular care. Appropriate steps should also be taken to control or mitigate the risks of exposures to connected parties and ensuring compliance with Section 62 of the BAFIA and BNM/RH/GL 001-25 on "Guidelines on Credit Transactions and Exposures with Connected Parties". The Audit Committee should keep the board informed of these transactions.

Principle 10: There should be clear separation between shareholders and management so as not to impede sound corporate governance

2.95 Shareholders should not be involved in the running of a Licensed Institution. They should hold the board accountable in overseeing the management of the Licensed Institution and rely on management to run the day-to-day operations of the institution. There should be a clear separation between the controlling[8] shareholders and the management function, such that these shareholders should not hold any senior management position in the Licensed Institution. The CEO should derive power and authority only from the board. As such, the CEO and senior management should operate within the mandate given by the board and should not take directive from any other person other than the board. This is to protect the Licensed Institution from inappropriate actions or influences of dominant or controlling shareholders or any other person.

Principle 11: There should be robust auditing requirements and the auditor, board and management need to maintain professional and objective relationships

2.96 The role of independent, competent and qualified auditors is vital to the corporate governance process. These include identifying problems with the Licensed Institution's risk management and internal control systems and ensuring that the Licensed Institution's financial statements fairly represent the financial position and performance of the Licensed Institution in all material aspects. Internal and external auditors are important agents for the board and their work could be utilised as an independent check on the information received from management on the operations and performance of the Licensed Institution. The effectiveness of the board and senior management can be enhanced by:

- recognising the importance of the audit process and communicating such importance throughout the Licensed Institution;

[8] Controlling shareholders are those who hold 50% or more voting shares or single largest shareholder

- taking measures that enhance the independence and stature of auditors;
- ensuring that auditors understand their duty to the Licensed Institution and its stakeholders to exercise due professional care in the conduct of audits;
- utilising, in a timely and effective manner, the findings of auditors; and
- requiring timely correction by management of problems identified by auditors.

Audit Committee

2.97 The board is required to establish an Audit Committee to provide independent oversight of the Licensed Institution's internal and external audit function, internal controls and ensuring checks and balances within the Licensed Institution.

(Details of the roles and responsibilities of Audit Committee are provided in **Appendix 2**).

Internal Audit

2.98 The internal audit function is an important part of any effective internal control and risk management system because it provides an independent assessment of the adequacy of, and compliance with, established policies and procedures. In addition, internal auditors should review and evaluate the reliability, adequacy and effectiveness of the Licensed Institution's internal control. The scope of internal audit should cover both financial and management audit. The nature of the internal audit role makes it critical that internal audit personnel is independent from the day-to-day activities of the Licensed Institution, and have unrestricted access to all activities conducted by the Licensed Institution. Direct accountability to the board facilitates the proper functioning of corporate governance by enabling the internal auditor to provide the board with information that is not biased as a result of interference by line or senior management. The importance of the internal audit function to the corporate governance process also requires it to be adequately resourced and staffed with competent and well-trained officers.

2.99 The internal audit function should be well placed to undertake investigation on behalf of the Audit Committee, thus internal auditors should have an appropriate standing within the institution and be placed under the direct authority and supervision of the Audit Committee. The internal auditors should have access to the Audit Committee at all times. Since the internal auditors are held accountable to the Audit Committee, their performance and remuneration package should be evaluated and decided by the Audit Committee.

2.100 Licensed Institutions are required to observe the "Guidelines on Internal Audit Function of Licensed Institutions" (BNM/RH/GL 013-4) issued by Bank Negara Malaysia, which outline the minimum standards for the internal audit function.

External Auditor

2.101 External auditors play a crucial role in the corporate governance structure. Apart from fulfilling the legal obligation to give a true and fair view on the financial statement, external auditors can provide inputs to the board in enhancing the board's oversight role.

2.102 Appointment of external auditor of Licensed Institutions requires Bank Negara Malaysia's approval pursuant to Section 40 of the BAFIA. The duties, responsibilities and obligations of external auditors are highlighted in the provision.

2.103 External audit should be conducted by fully independent auditors whose business connection with the Licensed Institution should not be such as to compromise the auditor's objectivity and independence. The board/Audit Committee should review the independence of external auditors annually and ensure that other non-audit work shall not be in conflict with the functions of external auditors. In ensuring their independence, there shall be a mandatory rotation of engagement partner after a period of 5 years (refer to "Guidelines on Appointment of External Auditors by Banking Institutions" issued by Bank Negara Malaysia).

2.104 The board should ensure that it receives the management letter from the external auditors without undue delay. Detailed consideration of the management letter may be delegated to Audit Committee. Appropriate actions should be taken to deal with control or other weaknesses identified in the management letter.

Principle 12: Licensed Institution should engage in regular, effective and fair communication with shareholders/stakeholders

2.105 The board must maintain an effective communication policy that enables both the board and management to communicate effectively with its shareholders, the stakeholders and the public either through disclosure or AGM.

2.106 The AGM is a crucial mechanism in shareholder communication as it gives direct public access to the board. Licensed Institutions should encourage greater shareholder participation at AGM and allow shareholders the opportunity to communicate their views on various matters relating to the licensed institution. The chairperson of board committees should be present and available to address questions at general meetings. The external auditors should also be present to assist directors in addressing any relevant query by shareholders.

2.107 Licensed Institutions should regularly convey pertinent information, gather views or inputs, and address shareholders' concerns. In disclosing information, Licensed Institutions should be as descriptive, detailed and forthcoming as possible. Licensed Institutions should disclose information on a timely basis.

Principle 13: Conducting corporate governance in a transparent manner can reinforce sound corporate governance

Comprehensive Disclosure Requirement

2.108 To facilitate market discipline and sound corporate governance, appropriate disclosure is required so that shareholders, other stakeholders and market participants can effectively have an understanding of the financial and management position of the Licensed Institution, particularly in relation to its safety and soundness as part of its annual report. Components of the corporate governance disclosure shall, at a minimum, comprise the following:

1) Board as a whole

- The composition of the board (including the name, designation and the independence of directors);
- Roles and responsibilities of the board;
- The frequency and conduct of board meetings;
- The attendance of each director at board meetings;
- Key information and background of director (such as qualifications and experience, shareholding);
- The performance criteria used to assess the effectiveness of the board as a whole and on individual director; and
- Resignation of members during the year.

2) Nominating Committee

- Membership and composition of Nominating Committee;
- Terms of reference of Nominating Committee;
- Functions and responsibilities of Nominating Committee;
- Number of Nominating Committee meetings held in that year. Licensed institutions are encouraged to disclose information on the number of meetings attended by each member of the committee; and
- A statement on the committee's assessment on the mix of skills, experience and other qualities of directors.

3) Remuneration Committee

- Membership and composition of Remuneration Committee;
- Terms of reference of Remuneration Committee;
- Functions and responsibilities of Remuneration Committee; and
- Number of Remuneration Committee meetings held in that year. Licensed Institutions are encouraged to disclose information on the number of meetings attended by each member of the committee.

4) Risk Management Committee

- Membership and composition of Risk Management Committee;
- Terms of reference of Risk Management Committee;
- Functions and responsibilities of Risk Management Committee;
- Number of Risk Management Committee meetings held in that year. Licensed Institutions are encouraged to disclose information on the number of meetings attended by each member of the committee; and
- A statement on the Licensed Institution's risk management framework.

5) Audit Committee

- Membership and composition of Audit Committee;
- Terms of reference of Audit Committee;
- Functions and responsibilities of Audit Committee; and
- Number of Audit Committee meetings held in that year. Licensed Institutions are encouraged to disclose information on the number of meetings attended by each member of the committee.

6) Risk management

- A discussion of the institution's risk management strategies and policies (the policies should include policy for hedging each major type of forecasted transaction) and should include the following:
  - An explanation on the nature of the risk and activities within the institution that gives rise to that risk as well as the composition of the exposures that arise;
  - A description of the methods used to identify, monitor, manage and control each risk (for example, avoidance of undue concentration of risk, requirements for collateral to mitigate credit risk, hedging of risk exposures), in particular, whether and how derivatives are used to manage risk;
  - The presence of any other risk that could materially impair the institution's ability to meet its corporate objectives and business strategies; and
  - The nature and frequency of any review and assessment conducted in respect of the institution's risk management system, including a statement on whether the reviews and assessment referred to were conducted by an independent external party to the institution, as well as outlining the key recommendation of the review.
- Comparative analysis of previous year's data should also be provided to give a perspective on trends in the underlining exposures. The qualitative and quantitative information must be meaningful and sufficient to help users understand the nature and magnitude of these risk exposures.

7) Internal Audit and Control Activities

- A review of the effectiveness of the key internal control policies and procedures established for managing daily activities and the changes made to

the policies and procedures during the year to ensure that they remain relevant;

- The review should include the internal audit structure put in place to provide an independent assessment of the adequacy of, and compliance with established policies and procedures, the lines of reporting of the internal audit division, the functions, role and responsibilities of the internal audit division as well as the scope and nature of audit work; and
- Discussion should also include the procedures used to report internal control deficiencies or breaches, any potential trends identified on the control issues and any preventive actions that were taken.

8) Related Party Transactions

- Nature and extent of transactions with affiliates and related parties (including any matter relating to the Licensed Institution whereby board members or senior management have material interests either directly, or on behalf of third parties).

9) Management Reports

- A discussion on the systems and procedures put in place to enable directors to keep abreast with the performance of the Licensed Institution against plans, including the types of reports received and the frequency of the reports.

10) Non-adherence to Guidelines

- Any non-adherence to the Guidelines; and
- Explanations and alternative measures taken to comply with the principles of the Guidelines.

Principle 14: Board is collectively responsible and accountable for the veracity of disclosures and management of risk

2.109 The board is responsible for ensuring that the Licensed Institution has systems in place to monitor and adequately control the Licensed Institution's material risks and that there is adequate and effective operational procedures, internal controls for assessing, measuring, controlling, monitoring and reporting of risks. It is strongly encouraged that a brief statement of board's responsibilities be provided in the annual report.

PART 3: APPLICATION PROCEDURES

1. Forms to be submitted to Bank Negara Malaysia for the appointment and re-appointment of Chairman / Director and Chief Executive Officer (CEO) of Licensed Institutions and Holding Companies.

Form	Type of Appointment		
	Chairman/ Director	CEO	CEO cum Director / Executive Director
FORM BNM/DIR Latest List of Directors and Assessment on Appointee	✔	✔	✔
FORM BNM/APP Personal Information on Appointee	✔	✔	✔
FORM BNM/EXPAT For CEOs who are expatriates to facilitate the issuance of work permit by the Immigration Department of Malaysia		✔	✔
FORM BNM/ACK Acknowledgement of receipt of application by Bank Negara Malaysia	✔	✔	✔

These forms are downloadable in Attachment 1.

2. To expedite the processing of applications, Licensed Institutions and Holding Companies are required to ensure that all the forms, including Form BNM/APP are properly completed, before submitting to Bank Negara Malaysia.

PART 4: APPENDICES

APPENDIX 1

List of related guidelines

Guidelines on Credit Transactions and Exposures with Connected Parties (BNM/ RH/GL 001-25)	1 January 2008
Guidelines on Code of Ethics (BNM/GP7)	11 April 1994
Guidelines on Internal Audit Function of Licensed Institutions (BNM/RH/GL 013-4)	1 July 2010
Guidelines on Appointment of External Auditors by Banking Institutions (BNM/RH/CIR 001-7)	1 January 2008

APPENDIX 2

Details on Board Committees

NOMINATING COMMITTEE

Objective

1. To provide a formal and transparent procedure for the appointment of directors and CEOs as well as assessment of effectiveness of individual directors, board as a whole and performance of CEO and key senior management officers.

Composition

2. The Nominating Committee shall consist of a **minimum of five** members, of which **at least four must be non-executive directors**. The committee should 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 involving him.

Roles and Responsibilities

3. The Nominating Committee is responsible for:
    - establishing minimum requirements for the board that is, required mix of skills, experience, qualification and other core competencies required of a director. The committee is also responsible for establishing minimum requirements for the CEO. The requirements and criteria should be approved by the full board;
    - recommending and assessing the nominees for directorship, board committee members as well as nominees for the CEO. This includes assessing directors for reappointment, before an application for approval is submitted to Bank Negara Malaysia. The actual decision as to who shall be nominated should be the responsibility of the full board;
    - overseeing the overall composition of the board, in terms of the appropriate size and skills, and the balance between executive directors, non-executive directors and independent directors through annual review;
    - recommending to the board the removal of a director or CEO from the board or management if the director or CEO is ineffective, errant and negligent in discharging his responsibilities;
    - establishing a mechanism for the formal assessment on the effectiveness of the board as a whole and the contribution of each director to the effectiveness of the board, the contribution of the board's various committees and the performance of the CEO and other key senior management officers. Annual assessment should be conducted based on objective performance criteria. Such performance criteria should be approved by the full board;
    - ensuring that all directors receive an appropriate continuous training programme in order to keep abreast with the latest developments in the industry;

- overseeing the appointment, management succession planning and performance evaluation of key senior management officers;
- recommending to the board the removal of key senior management officers if they are ineffective, errant and negligent in discharging their responsibilities; and
- assessing, on an annual basis, to ensure that the directors and key senior management officers are not disqualified under Section 56 of the BAFIA

4. The committee should not be delegated with decision-making powers but should report its recommendation to the full board for decision. The full committee should meet as and when required, **at least once a year** to deliberate on the above responsibilities.

REMUNERATION COMMITTEE

Objective

5. To provide a formal and transparent procedure for developing remuneration policy for directors, CEOs and key senior management officers and ensuring that compensation is competitive and consistent with the licensed institution's culture, objectives and strategy.

Composition

6. The Remuneration Committee shall comprise **only non-executive directors**, with **at least three members** and should 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 involving him.

Roles and Responsibilities

7. The Remuneration Committee is responsible for:
    - recommending a framework of remuneration for directors, CEOs and key senior management officers for the full board's approval. The remuneration framework should support the licensed institution's culture, objectives and strategy and should reflect the responsibility and commitment, which goes with board membership and responsibilities of the CEO and senior management officers. There should be a balance in determining the remuneration package, which should be sufficient to attract and retain directors of calibre, and yet not excessive to the extent the licensed institution's funds are used to subsidise the excessive remuneration packages. The framework should cover all aspects of remuneration including director's fees, salaries, allowances, bonuses, share options and benefits-in-kind; and
    - recommending specific remuneration packages for executive directors and the CEOs. The remuneration package should be structured such that it is competitive and consistent with the licensed institution's culture, objectives and strategy. 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. In addition, the remuneration of each board member may differ based on their level of expertise, knowledge and experience.

8. The full committee shall meet **at least once a year** to review the remuneration packages of the directors, CEOs and key senior management officers.

RISK MANAGEMENT COMMITTEE

Objective

9. To oversee senior management's activities in managing credit, market, liquidity, operational, legal and other risk and to ensure that the risk management process is in place and functioning.

Composition

10. The Risk Management Committee should comprise **only non-executive directors** with **at least three members**. The committee should be **chaired by an independent director**.

Roles and Responsibilities

11. The Risk Management Committee is responsible for:
    - reviewing and recommending risk management strategies, policies and risk tolerance for board's approval;
    - reviewing and assessing adequacy of risk management policies and framework in identifying, measuring, monitoring and controlling risk and the extent to which these are operating effectively;
    - ensuring infrastructure, resources and systems are in place for risk management that is, ensuring that the staff responsible for implementing risk management systems perform those duties independently of the licensed institutions' risk taking activities; and
    - reviewing management's periodic reports on risk exposure, risk portfolio composition and risk management activities.

12. The committee should hold regular meetings, at least **once every quarter** and should report regularly to the full board.

AUDIT COMMITTEE

Objective

13. To provide independent oversight of the licensed institution's financial reporting and internal control system and ensuring checks and balances within the licensed institution.

Composition

14. The Audit Committee shall comprise **only non-executive directors** with **at least three members**, of which the **majority** should be **independent directors**. The committee should be **chaired by an independent director**. At least one member should have **accounting expertise or experience in the field of finance**.

Roles and Responsibilities

15. The Audit Committee should have explicit authority to investigate any matter within its terms of reference, full access to and co-operation by management and full discretion to invite any director or executive officer to attend its meetings, and reasonable resources to enable it to discharge its functions properly. The Audit Committee should have full and unrestricted access to information and be able to obtain independent professional advice. Duties of Audit Committee, among others, are as follows:

<u>Fair and transparent reporting</u>

- Ensure fair and transparent reporting and prompt publication of the financial accounts.

<u>Effectiveness of Internal Audit</u>

- Oversee the functions of the Internal Audit department and ensuring compliance with *BNM/ RH/GL/013-4* requirement;
- Review the scope of the internal audit programme, internal audit findings and recommend actions to be taken by management; and
- Appoint, set compensation, evaluate performance and decide on the transfer and dismissal of the Chief Internal Auditor.

<u>Internal Controls</u>

- Review the effectiveness of internal controls and risk management processes.

<u>External Auditors</u>

- Select external auditors for appointment by board;
- Recommend not only the appointment but also the removal of auditors;
- Assess objectivity, performance and independence of external auditor (for example by reviewing and assessing the various relationships between the external auditor and the licensed institution or any other entity);
- Review the external auditor's management letter and response;
- Approve the provision of non-audit service by the external auditor;

- Ensure that there are proper checks and balances in place so that the provision of non-audit services does not interfere with the exercise of independent judgement of the auditors;
- Regularly review the audit findings and ensuring that issues are being managed and rectified appropriately and in a timely manner; and
- Have direct communication channels with the external auditors and able to meet with the external auditor without the presence of management, at least annually.

Related Party Transactions

- Review all related party transactions and keep the board informed of such transactions.

16. The committee should hold regular meetings, at least **once every quarter** and should report regularly to the full board.

APPENDIX 3

List of directorships or committee members that are exempted from the limit of directorships for Chief Executive Officer of a licensed institution

A Organisations in the banking industry

(i) Cagamas Berhad
(ii) Malaysian Electronic Payments System (1997) Sdn. Bhd.
(iii) Credit Guarantee Corporation
(iv) Asean Finance Corporation Limited (Singapore)
(v) AFC Holdings (M) Sdn. Bhd. (Subsidiary of AFC Ltd)
(vi) Asean Fund Limited
(vii) Asean Supreme Fund Limited
(viii) BCF Holdings Sdn. Bhd.
(ix) ABM-MCD Holdings Sdn. Bhd.
(x) Financial Park (Labuan) Sdn. Bhd.
(xi) Kuala Lumpur Currency Clearing House
(xii) Islamic Development Bank
(xiii) ERF Sdn. Bhd.
(xiv) Financial Mediation Bureau
(xv) Bursa Malaysia
(xvi) Other international banking associations

B Professional bodies and non-profit organisations

(i) Association of Banks in Malaysia
(ii) Association of Finance Companies of Malaysia
(iii) Association of Merchant Banks in Malaysia
(iv) Association of Discount Houses in Malaysia
(v) Financial Information Services Sdn. Bhd.
(vi) Institut Bank-Bank Malaysia
(vii) BIMB Institute Research and Training Sdn. Bhd. (the Islamic training institute)
(viii) Malaysian Institute of Certified Public Accountants
(ix) Malaysian Institute of Accountant
(x) Malaysian Accounting Standards Board
(xi) Financial Repository Foundation
(xii) Chambers of Commerce
(xiii) Association of Islamic Banking Institution of Malaysia
(xiv) Islamic Banking and Finance Institute Malaysia
(xv) Institut Kefahaman Islam Malaysia
(xvi) Accounting and Auditing Organization for Islamic Financial Institutions

	(xvii) International Institute of Islamic Thought and Civilization (xviii) AFCM Training Services Sdn. Bhd. (xix) FIS Data Link Sdn Bhd
C	**Government bodies and companies that are controlled by Government** (i) Kumpulan Wang Simpanan Pekerja (ii) Perbadanan Usahawan Nasional Berhad (iii) Permodalan Nasional Berhad (PNB) and other subsidiaries of PNB which are non-profit organisations (iv) Majlis Amanah Rakyat (v) Yayasan Pembangunan Ekonomi Islam Malaysia (vi) Amanah Ikhtiar Malaysia (vii) International Islamic University Malaysia and other Malaysian government universities (viii) Yayasan Dakwah Islam Malaysia (ix) Baitulmal Majlis Agama Islam, Wilayah Persekutuan (x) Pertubuhan Kebajikan Islam Malaysia (xi) Malaysia External Trade Development Corporation (xii) Multimedia Development Corporation Sdn Bhd

Note: The above list of institutions and organisations is not exhaustive. Holding of positions in other similar institutions or organisations requires the specific prior approval from Bank Negara Malaysia.