



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Corporate Governance Concept Paper

Applicable to:

1. Licensed banks
2. Licensed investment banks
3. Licensed Islamic banks
4. Licensed insurers
5. Licensed takaful operators
6. Financial holding companies

This Concept Paper sets out the Bank's proposals on corporate governance for licensed persons and financial holding companies.

The Bank invites written feedback on the proposed regulatory requirements, including suggestions on areas to be clarified and alternative proposals that the Bank should consider. The written feedback should be supported with clear rationale, accompanying evidence or illustrations, as appropriate to facilitate effective review of this Concept Paper.

Responses must be submitted to the Bank by 13 May 2016 to the following:

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PART A OVERVIEW

1 Introduction

- 1.1 The adoption of sound corporate governance standards and practices by financial institutions serves to protect the critical role of financial institutions in intermediating funds to support the real economy. It ensures that financial institutions are managed in a sound and prudent manner, with due regard to the interests of depositors, policy owners and participants. This policy document sets out the Bank's expectations for financial institutions to have in place effective corporate governance arrangements consistent with the long-term viability of a financial institution.
- 1.2 A financial institution's corporate governance arrangements represent a fundamental component of the Bank's supervisory assessments and are a key factor in determining the level of supervisory intensity applied to a financial institution. The board should have the competence, confidence and objectivity to challenge senior management and hold it to account. Accordingly, this policy document sets out strengthened expectations on directors' oversight responsibilities and the composition of the board. In turn, senior management is responsible and accountable for the sound and prudent day-to-day management of the financial institution in accordance with the direction of the board.
- 1.3 Good corporate governance also needs to be rooted in a corporate culture that reinforces ethical, prudent and professional behaviour. This begins with the right "tone from the top", where the example set by the board and senior management shape the core values for the financial institution.
- 1.4 The Bank expects financial institutions to implement the minimum standards set out in this policy document and be able to demonstrate that their governance arrangements are operating effectively and remain appropriate given their size, nature of business, complexity of activities, structure and systemic importance. Financial institutions should also strive to continuously enhance these arrangements to reflect changing conditions and emerging sound practice, as appropriate. The Bank expects each financial institution to discharge its own legal and governance responsibilities as a separate entity, notwithstanding any group-wide arrangements that the financial institution may be relying on.

2 Applicability

- 2.1 This policy document is applicable to financial institutions as defined in paragraph 5.2.
- 2.2 For financial institutions operating as a foreign branch in Malaysia, the requirements in this policy document shall apply in respect of the Malaysian operations of the branch with the following modifications:
 - (a) Parts B, E and F shall not apply;

- (b) any reference to the board in this policy document shall refer to the governing body of the licensed person or any of its committees; and
- (c) any reference to senior management in this policy document shall refer to the chief executive officer (CEO) of the branch and officers of the licensed person performing a senior management function in respect of the branch operations.

3 Legal provisions

- 3.1 This policy document is issued pursuant to—
- (a) sections 47(1), 58(4) and 60(1) of the Financial Services Act 2013 (FSA); and
 - (b) sections 29(2), 57(1), 67(4) and 69(1) of the Islamic Financial Services Act 2013 (IFSA).

4 Effective date

- 4.1 This policy document comes into effect on [date of publication of final policy document], subject to the transitional arrangements set out in Part G.

5 Interpretation

- 5.1 The terms and expressions used in this policy document shall have the same meanings assigned to them in the FSA or IFSA, as the case may be, unless otherwise defined in this document.

- 5.2 For purposes of this policy document—

“S” denotes a standard, an obligation, a requirement, specification, direction, condition and any interpretative, supplemental and transitional provisions that must be complied with. Non-compliance may result in enforcement action;

“G” denotes guidance which may consist of statements or information intended to promote common understanding and advice or recommendations that are encouraged to be adopted;

“active politician” refers to an individual who is a member of any national or state legislative body, or who holds a leadership position in a political party, including a position at the divisional level;

“affiliate”, in relation to an entity, refers to any corporation that controls, is controlled by, or is under common control with, the entity;

“apex entity” refers to a financial institution that—

- (a) is not a subsidiary of another financial institution; or

- (b) is a subsidiary of a financial institution, and has at least one subsidiary that is a licensed insurer or licensed takaful operator¹;

“board” refers to the board of directors of a financial institution;

“board committee” refers to any committee of the board that is required to be established under paragraph 12.1;

“control function” refers to a function that has a responsibility independent from the business to provide objective assessments, reporting or assurance, and this includes the compliance function, risk management function, and internal audit function;

“compensation” includes salary and benefits of any kind;

“executive” refers to any individual who has management responsibilities in the financial institution or any of its affiliates²;

“executive director” refers to a director of a financial institution who has management responsibilities in the financial institution or any of its affiliates;

“external auditor” refers to an auditor of a financial institution that has been appointed pursuant to section 67 or 68 of the FSA, or section 76 or 77 of the IFSA;

“financial institution” refers to—

- (a) a licensed person, except for a licensed international Islamic bank and a licensed international takaful operator; and
- (b) a financial holding company;

“fit and proper requirements” refer to the requirements set out in the policy document on *Fit and Proper Criteria*;

“foreign branch” refers to the Malaysian operations of a licensed person that is established as a branch in Malaysia;

“independent director” refers to a director who is independent in character and judgement and is free from any association or circumstances that may impair the exercise of independent judgement;

“internal control framework” refers to the set of rules and controls governing a financial institution's organisational and operational structure, including reporting processes and control functions;

¹ This will be the entity heading an insurance/takaful sub-group.

² For the avoidance of doubt, this definition will include individuals with any responsibility for making or implementing management decisions (whether or not he is an officer of the financial institution or any of its affiliates).

a person is **“linked”** to another person where—

- (a) one person is accustomed to represent, or take instructions from, the other person;
- (b) they are relatives; or
- (c) one person is an entity, and the other person is a partner, shareholder, director, officer of that entity or its affiliate;

“other material risk taker” refers to an officer who is not a member of senior management and who—

- (a) can materially commit or control significant amounts of the financial institution’s resources or whose actions are likely to have a significant impact on its risk profile; or
- (b) is among the most highly remunerated officers in the financial institution;

“risk appetite” is the aggregate level and types of risk a financial institution is willing to assume, decided in advance and within its risk capacity, to achieve its business objectives and strategies;

“senior management” refers to the CEO and senior officers;

“substantial shareholder” refers to a person that holds an aggregate interest in shares of a financial institution of 5% or more.

6 Related legal instruments and policy documents

- 6.1 This policy document should be read together with the following policy documents:
- (a) *External Auditor*;
 - (b) *Fit and Proper Criteria*; and
 - (c) *Risk Governance*.

7 Policy documents superseded

- 7.1 This policy document supersedes the guidelines and circulars listed in **Appendix 2**.

PART B THE BOARD

8 Key responsibilities

- G** 8.1 This policy document should be read together with section 56 of the FSA and section 65 of the IFSA which set out the duties of the board of a financial institution.
- S** 8.2 The board must have a board charter that sets out the mandate, responsibilities and procedures of the board and the board committees, including the matters reserved for the board's decision.
- S** 8.3 The board has overall responsibility for promoting the sustainable growth and financial soundness of a financial institution, and ensuring reasonable standards of fair dealing, without undue influence from any party. These must consider the short-term and long-term implications of the board's decisions on the financial institution and its customers³, officers and the general public. In fulfilling this role, the board must—
- (a) approve the risk appetite, business plans and other initiatives which would, singularly or cumulatively, have a material impact on the financial institution's risk profile⁴;
 - (b) oversee the selection, performance, compensation and succession plans of the CEO, control function heads and other members of senior management, such that the board is satisfied with the collective competence of senior management to effectively lead the operations of the financial institution;
 - (c) oversee the implementation of the financial institution's governance framework and internal control environment, and periodically review whether these remain appropriate in the light of material changes to the size, nature and complexity of the financial institution's operations;
 - (d) promote, together with senior management, a sound corporate culture within the financial institution which reinforces ethical, prudent and professional behaviour;
 - (e) oversee and approve the recovery and business continuity plans for the financial institution to restore its financial strength, critical operations and critical services when it comes under stress; and
 - (f) promote timely and effective communications between the financial institution and the Bank on matters affecting or that may affect the safety and soundness of the financial institution.

9 Board meetings

- S** 9.1 The chairman, in leading the board, is responsible for the effective overall functioning of the board. In fulfilling this role, the chairman must—
- (a) ensure that appropriate procedures are in place to govern the board's

³ In accordance with section 56(3) of the FSA and section 65(3) of the IFSA.

⁴ This may include initiatives which affect the financial soundness, reputation or key operational controls of the financial institution.

- operation;
- (b) ensure that decisions are taken on a sound and well-informed basis, including by ensuring that all strategic and critical issues are brought to the board's attention, and that directors receive the relevant information on a timely basis;
- (c) encourage healthy discussion and ensure that dissenting views can be freely expressed and discussed; and
- (d) lead efforts to address the board's developmental needs.

- S** 9.2 A director must devote sufficient time to prepare for and attend board meetings, and maintain a sound understanding of the business of the financial institution as well as relevant market and regulatory developments. This must include a commitment to on-going education.
- S** 9.3 A director must attend at least 75% of the board meetings held in each financial year and must not appoint another person to attend or participate in a board meeting on his behalf.
- S** 9.4 Where permitted, alternative means of attendance must remain the exception rather than the norm and appropriate safeguards must be in place to preserve the confidentiality of deliberations.
- S** 9.5 The quorum for board meetings must require that at least half of the board members be present.
- S** 9.6 The board must ensure that clear and accurate minutes of board meetings are maintained to record the decisions of the board, including the key deliberations, rationale for each decision made, and any significant concerns or dissenting views. The minutes must indicate whether any director abstained from voting or excused himself from deliberating on a particular matter.
- S** 9.7 The board must be provided with access to advice from third party experts on any matter deliberated by the board as and when required, and the cost of such advice shall be borne by the financial institution.

10 Board appointments and removals

- S** 10.1 A director must fulfil the minimum requirements set out in paragraphs 10.2 to 10.5 at the time of his appointment and on a continuing basis.
- S** 10.2 A director must not be disqualified under section 59(1) of the FSA or section 68(1) of the IFSA, and must have been assessed by the nominations committee to have complied with the fit and proper requirements.
- S** 10.3 A director must not have competing time commitments that impair his ability to discharge his duties effectively. The board must maintain a policy on the maximum number of external professional commitments that a director may have, commensurate with the responsibilities placed on the director, as well as the nature, scale and complexity of the financial institution's operations.

- S** 10.4 A director of a financial institution must not be an active politician.
- S** 10.5 Where a firm has been appointed as the external auditor of a financial institution, any of its officers directly involved in the engagement and any partner of the firm must not serve or be appointed as a director until at least two years after–
- (a) he ceases to be an officer or partner of that firm; or
 - (b) the firm last served as an auditor of the financial institution.
- S** 10.6 The board must establish and regularly review succession plans to promote board renewal and address unplanned vacancies.
- S** 10.7 The board must establish a rigorous process for appointing, reappointing and removing directors. Such a process must involve the assessment of candidates against the minimum requirements set out in paragraphs 10.2 to 10.5. Direct engagements between a candidate and the board nominations committee are an important way to ascertain the suitability of each candidate for the board.
- S** 10.8 Each director must be assessed against the minimum requirements set out in paragraphs 10.2 to 10.5 at least annually, and as and when the board becomes aware of any circumstance that suggests that the director is ineffective, errant or otherwise unsuited to carry out his responsibilities. It is the responsibility of each director to immediately disclose to the board any circumstance that may affect his ability to meet the minimum requirements.
- S** 10.9 The board must ensure that each director receives the terms of his appointment and reappointment, which must include–
- (a) the roles and responsibilities of the director, including those arising from his membership of any board committee;
 - (b) the tenure of the appointment; and
 - (c) provisions for the director's removal in the event that he no longer meets the minimum requirements set out in paragraphs 10.2 to 10.5, or has been assessed to be ineffective, errant or otherwise unsuited for carrying out his responsibilities.
- S** 10.10 A financial institution must not make an application to the Bank to appoint or reappoint a director⁵ unless the board is wholly satisfied, based on its objective assessment, that the candidate meets the minimum requirements set out in paragraphs 10.2 to 10.5, understands the expectations of the role and is able to meaningfully contribute to the board.
- S** 10.11 Unless the written approval of the Bank has been obtained⁶–
- (a) a financial institution must not publicly announce the proposed appointment or reappointment of a candidate; and
 - (b) a director whose tenure has expired must immediately cease to hold office and act in such capacity, including participating in board meetings or holding himself out to be a director.

⁵ Pursuant to section 54(3) of the FSA or section 63(3) of the IFSA.

⁶ Pursuant to section 54(2) of the FSA or section 63(2) of the IFSA.

- S** 10.12 A financial institution must submit an application to the Bank for the appointment or reappointment of a director in the manner set out in Appendix 3.
- S** 10.13 A financial institution must obtain the prior approval of the Bank before the removal or resignation of an independent director takes effect. Accordingly, a financial institution must also notify the Bank as soon as it becomes aware of any proposal by a shareholder to remove an independent director.

11 Composition of the board

- S** 11.1 The board and the board committees must be of a size that promotes effective deliberation, encourages the active participation of all directors and allows the work of the various board committees to be discharged without giving rise to an over-extension of directors that are required to serve on multiple board committees.
- S** 11.2 The board must develop and document the criteria and skill sets required of its members. The criteria and skill sets must reflect the fit and proper requirements and specific market or business knowledge required on the board. It is important that the criteria and skill sets be reviewed regularly to ensure alignment with the strategic direction and emerging challenges faced by the financial institution. This must also take into account supervisory concerns highlighted by the Bank that require specific expertise on the board.
- S** 11.3 The chairman of the board must not be an executive of the financial institution, and must not have served as CEO of the financial institution in the past five years.
- S** 11.4 The board of a financial institution must not have more than one executive director, unless the Bank approves otherwise in writing.
- G** 11.5 Executive directors bring to the board technical expertise and useful insights about the financial institution's operations. However, it is important that their representation on the board does not reduce the board's ability to objectively scrutinise the proposals and performance of management.
- S** 11.6 The board must have a majority of independent directors, unless the Bank approves otherwise in writing.
- S** 11.7 The board must determine whether an individual to be appointed as independent director is independent in character and judgement, and free from associations or circumstances that may impair the exercise of his independent judgement. An individual must not be considered to be an independent director if he or any person linked to him—
- (a) has been an executive in the last two years;
 - (b) is a substantial shareholder of the financial institution or any of its affiliates; or
 - (c) has had a significant business or other contractual relationship with the financial institution or any of its affiliates within the last two years.

- S** 11.8 For the purpose of paragraph 11.7, the board must clearly define what constitutes a “significant business or other contractual relationship”, taking into account the nature, size and complexity of the financial institution’s operations.
- S** 11.9 The board must set and disclose a policy on the tenure for which an individual can serve as an independent director, to promote independent oversight by the board. The Bank expects that tenure limits for independent directors should generally not exceed nine years, except under exceptional circumstances or as part of transitional arrangements towards full implementation of the succession plans of the financial institution.
- S** 11.10 An independent director must immediately disclose to the board any change in his circumstances that may affect his status as an independent director. In such a case, the board must reconsider his designation as an independent director and notify the Bank of its decision.
- G** 11.11 A financial institution should limit the number of directors who are also board members of its affiliates. While such directors are well-positioned to exercise group oversight and promote greater alignment with the group’s strategy given their broad perspective of the group’s business, inordinate overlaps in board membership can raise conflicts in deliberations of an issue that affects both the financial institution and its affiliate in different ways. This may likely occur where the two entities operate within different business segments. A limit on common directorships would serve to ensure that group interests are appropriately balanced against the fiduciary and statutory duties that directors owe towards each legal entity they serve.
- S** 11.12 The board of a financial institution must comprise no more than a minority of directors who also hold directorships in an affiliate, where—
- (a) the affiliate is a holding company or subsidiary of the financial institution, and is itself a financial institution;
 - (b) one entity is a licensed insurer and the other is a licensed takaful operator;
 - (c) one entity is a licensed bank or licensed investment bank, and the other is a licensed Islamic bank; or
 - (d) there are strong operational dependencies between the financial institution and the affiliate.

12 Board committees

- S** 12.1 A financial institution must establish the following board committees:
- (a) board nominations committee;
 - (b) board compensation committee;
 - (c) board risk management committee; and
 - (d) board audit committee.
- G** 12.2 A financial institution may combine its board nominations committee and board compensation committee.

- S** 12.3 Each board committee must–
- (a) have at least three directors;
 - (b) have a majority of independent directors;
 - (c) be chaired by an independent director; and
 - (d) comprise directors who have the skills, knowledge and experience relevant to the responsibilities of the board committee.
- S** 12.4 To promote robust and open deliberations by the board on matters referred by the board committees, the chairman of the board must not chair any of the board committees.
- S** 12.5 With the exception of the board nominations committee⁷, board committees must not have any executive director in its membership.
- S** 12.6 Each board committee must assume the specific responsibilities enumerated for it in Appendix 1.
- S** 12.7 The board remains fully accountable for any authority delegated to the board committees.
- S** 12.8 The board must ensure that the mandate and operating procedures for each board committee are set out in the board charter and clearly–
- (a) delineate the areas of authority delegated to the board committee; and
 - (b) define reporting arrangements for keeping the board informed of the board committee's work, key deliberations and decisions on delegated matters.
- S** 12.9 Board committees must be provided with sufficient support and resources required to investigate any matter within their mandates.

13 Board evaluations and development

- S** 13.1 The board must carry out annual board evaluations to objectively assess the effectiveness of the board, board committees and individual directors. This is important to enable the board to identify areas for professional development and process improvements, having regard for the changing needs of the financial institution.
- G** 13.2 The board should periodically engage third party experts to assist in and lend objectivity to these evaluations.
- S** 13.3 The board must dedicate sufficient resources toward the on-going development of its directors. This must include dedicating an adequate budget, having in place development plans for directors and regularly updating such plans to ensure that each director possesses the knowledge and skills necessary to fulfil his responsibilities.

⁷ For the avoidance of doubt, a combined board nominations and compensation committee must not have any executive director in its membership.

14 Conflicts of interest

- S** 14.1 The board must establish a written policy to address directors' actual and potential conflicts of interest. At a minimum, the policy must–
- (a) identify circumstances which constitute or may give rise to conflicts of interests;
 - (b) clearly define the process for directors to keep the board informed on any changes in his circumstances that may give rise to a conflict of interest;
 - (c) identify those responsible for maintaining updated records on each director's conflicts of interest; and
 - (d) articulate how any non-compliance with the policy will be addressed.
- 14.2 Section 58 of the FSA and section 67 of the IFSA require a director to disclose to the board the nature and extent of his interest in a material transaction or material arrangement, and, if such material transaction or material arrangement is being deliberated during a board meeting, to be absent from the meeting during such deliberations.
- S** 14.3 For the purpose of section 58 of the FSA and section 67 of the IFSA–
- (a) an existing or proposed transaction or arrangement will be considered "material" if it is one which a director is required to declare under section 131 of the Companies Act 1965⁸, unless the director or any person linked to him cannot reasonably be expected to derive a benefit or suffer detriment from the transaction or arrangement in a way that will place the director in a position of conflict; and
 - (b) an interested director must make the disclosure by way of a written notice to all members of the board and the company secretary–
 - (i) as soon as is practicable after being aware of his interest in the material transaction or arrangement; and
 - (ii) if the material transaction or arrangement is being deliberated at a board meeting, before the commencement of that deliberation.
- S** 14.4 Where a director is required to be absent from board deliberations on a particular matter in accordance with section 58 of the FSA or section 67 of the IFSA, he may only be counted to make the quorum for the other parts of the meeting.

15 Company secretary

- S** 15.1 The company secretary is responsible for supporting the effective functioning of the board. In discharging this role, the company secretary provides counsel to the board on governance matters and facilitates effective information flows between the board, the board committees and senior management.

⁸ For the avoidance of doubt, this would include instances where the other directors are already aware of the interest.

- S** 15.2 Unless the Bank approves otherwise in writing, the company secretary of a financial institution must devote the whole of his professional time to the affairs of the financial institution or its affiliates that are also financial institutions⁹.
- S** 15.3 The appointment and removal of the financial institution's company secretary must be approved by the board.
- S** 15.4 The company secretary must meet the fit and proper requirements relating to—
(a) probity, personal integrity and reputation; and
(b) competence and capability.

⁹ This does not preclude the company secretary from carrying out other responsibilities for the financial institution or its affiliates that are also financial institutions, where these responsibilities do not conflict with his responsibilities to the board.

PART C SENIOR MANAGEMENT

16 Key responsibilities

- S** 16.1 The CEO, in leading senior management, bears primary responsibility over the day-to-day management of the financial institution. This includes the responsibility of senior management to—
- (a) implement the business and risk strategies, compensation and other policies in accordance with the direction given by the board;
 - (b) establish a management structure that promotes accountability and transparency throughout the financial institution's operations, and preserves the quality and independence of control functions;
 - (c) promote, together with the board, a sound corporate culture within the financial institution which reinforces ethical, prudent and professional behaviour;
 - (d) address actual or suspected breaches of regulatory requirements or internal policies in a timely and appropriate manner; and
 - (e) regularly update the board with the material information it needs to carry out its oversight responsibilities, particularly on matters relating to—
 - (i) the performance, financial condition and operating environment of the financial institution;
 - (ii) internal control failures, including breaches of risk limits; and
 - (iii) legal and regulatory obligations, including supervisory concerns and the remedial actions taken to address them.

17 Senior management appointments and removals

- S** 17.1 A member of senior management must fulfil the minimum requirements set out in paragraphs 17.2 to 17.4 at the time of his appointment and on a continuing basis.
- S** 17.2 A member of senior management must not be disqualified under section 59(1) of the FSA or section 68(1) of the IFSA, and must have been assessed to have complied with the fit and proper requirements.
- S** 17.3 The benefits of a separation between ownership and management are reinforced by the ability of shareholders to rely on an effective board to oversee senior management in running the day-to-day operations in line with the broader responsibilities of the financial institution, including its obligations to depositors, investment account holders, policy holders and participants. As such, a substantial shareholder must not hold a senior management position.
- S** 17.4 Unless the Bank approves otherwise in writing, a CEO must devote the whole of his professional time to the service of the financial institution¹⁰. The Bank

¹⁰ Pursuant to section 55(3) of the FSA and section 64(3) of the IFSA. The Bank's approval is not required for a CEO to hold a non-executive position in a professional body, industry association, statutory body, charitable body or other non-commercial public-interest entity, unless the Bank specifies otherwise.

may allow a CEO to assume a position of responsibility outside the financial institution where the proposed position does not–

- (a) create substantial conflicts of interest or demands on the CEO's time; and
- (b) result in the CEO holding directorships in more than five entities other than the financial institution.

- S** 17.5 A financial institution must have a robust succession plan for senior management and clearly defined processes for–
- (a) the appointments and removals of the CEO, chief compliance officer, chief internal auditor, chief risk officer and, where relevant, the appointed actuary by the board; and
 - (b) the assessment of candidates against the minimum requirements set out in paragraphs 17.2 to 17.4.
- S** 17.6 Each member of senior management must be assessed against the minimum requirements set out in paragraphs 17.2 to 17.4 at least annually, and as and when the board becomes aware of any circumstance that suggests that an individual is ineffective, errant or otherwise unsuited to carry out his responsibilities. It is the responsibility of each member of senior management to immediately disclose to the board any circumstance that may affect his ability to meet the minimum requirements.
- S** 17.7 A financial institution must not make an application to the Bank to appoint or reappoint the CEO¹¹ unless the board is wholly satisfied, based on its objective assessment, that the candidate meets the minimum requirements set out in paragraphs 17.2 to 17.4.
- S** 17.8 Unless the written approval of the Bank has been obtained¹²–
- (a) a financial institution must not publicly announce the proposed appointment of a candidate; and
 - (b) a CEO whose tenure has expired must immediately cease to hold office and act in such a capacity, including by holding himself out to be the CEO.
- S** 17.9 A financial institution must submit an application to the Bank for the appointment or reappointment of the CEO in the manner set out in Appendix 3.

¹¹ Pursuant to section 54(3) of the FSA or section 63(3) of the IFSA.

¹² Pursuant to section 54(2) of the FSA or section 63(2) of the IFSA.

PART D CULTURE AND COMPENSATION

18 Culture

- S** 18.1 A financial institution must adopt a code of ethics¹³ which provides guidelines on appropriate conduct and addresses issues of confidentiality, conflicts of interest, integrity in reporting, and the fair treatment of customers. Breaches of the code of ethics must be dealt with in a manner that upholds high standards of integrity.
- S** 18.2 A financial institution must establish a whistleblowing policy that sets out avenues for legitimate concerns to be objectively investigated and addressed. Individuals must be able to raise concerns about illegal, unethical or questionable practices in confidence and without the risk of reprisal. To this end, a financial institution must–
- (a) clearly indicate the parties to whom concerns can be escalated within the financial institution and ensure that individuals are made aware of other avenues for whistleblowing to regulators or law enforcement agencies;
 - (b) communicate the whistleblowing policy to third parties such as contractors, consultants and interns and allow them to report their concerns; and
 - (c) designate a non-executive director to be responsible for the effective implementation of the policy.

¹³ In establishing the code of ethics, a financial institution should consider established professional and ethical standards recommended by standard-setting bodies such as that issued by the Financial Services Professional Board.

19 Compensation

- S** 19.1 The compensation policy of the financial institution must be approved by the board annually.
- S** 19.2 The compensation for each director, member of senior management and other material risk taker must be approved by the board each year. A financial institution must maintain and regularly review a list of officers who fall within the definition of “other material risk takers”.
- S** 19.3 The overall compensation system for the financial institution must–
- (a) be subject to board’s active oversight to ensure that the system operates as intended;
 - (b) be in line with the business and risk strategies, corporate values and long-term interests of the financial institution;
 - (c) promote prudent risk-taking behaviour and encourage individuals to act in the interests of the financial institution as a whole, taking into account the interests of its customers; and
 - (d) be designed and implemented with input from the control functions and the board risk management committee to ensure that risk exposures and risk outcomes are adequately considered.
- G** 19.4 Without sustained board attention, the operation of well-designed compensation systems may change in ways that are inconsistent with the spirit of the system design. To achieve effective governance of compensation systems, substantial expertise on the part of the most-involved board members will be required. Such individuals should be independent, non-executive directors. Because sensitivity of compensation to risk will be essential, the board should have enough risk-measurement expertise to grasp the essence of the issues relating to compensation practices that reflect risks. The board should also have enough sense of the history of risk realisations to mediate disputes about how compensation should change during periods of high losses.
- S** 19.5 Compensation for individuals within the financial institution must be aligned with prudent risk-taking. Hence, compensation outcomes must be symmetric with risk outcomes. This includes ensuring that–
- (a) compensation is adjusted to account for all types of risk, and must be determined by both quantitative measures and qualitative judgement;
 - (b) the size of the bonus pool is linked to the overall performance of the financial institution;
 - (c) incentive payments are linked to the contribution of the individual and business unit to the overall performance of the financial institution;
 - (d) bonuses are not guaranteed, except in the context of sign-on bonuses;
 - (e) for members of senior management and other material risk takers–
 - (i) a portion of compensation consists of variable compensation and be paid on the basis of individual, business-unit and institution-wide measures that adequately assess performance; and
 - (ii) the variable portion of compensation increases along with the individual’s level of accountability.

- S** 19.6 Compensation payout schedules must reflect the time horizon of risks and take account of the potential for financial risks to crystallise over a longer period of time. As such, a financial institution must–
- (a) adopt a multi-year framework to measure the performance of its officers; and
 - (b) for members of senior management and other material risk takers–
 - (i) defer payment of a portion of variable compensation to the extent that risks are realised over long periods, with these deferred portions increasing significantly along with the individual's level of accountability;
 - (ii) calibrate an appropriate mix of cash, shares, share-linked instruments, and other forms of compensation to reflect risk alignment; and
 - (iii) adjust the vested and unvested portions of variable compensation (through malus, clawbacks and other reversals or downward revaluations of awards) in the event of bad performance attributable to the individual or if he commits a serious legal, regulatory or internal policy contravention.
- S** 19.7 To ensure that officers respond to sound incentives created by compensation–
- (a) variables used to measure risk and performance outcomes of an officer must relate closely to the level of accountability of that officer;
 - (b) the determination of performance measures and variable compensation must consider that certain indicators (such as share prices) may be influenced in the short term by factors like market sentiment or general economic conditions, not specifically related to the financial institution's performance or an officer's actions, and financial institutions must exercise care to ensure that the use of such indicators does not create incentives to take on excessive risk in the short term; and
 - (c) a financial institution must ensure that members of senior management and other material risk takers commit not to undertake activities (such as personal hedging strategies and liability-related insurance) that will undermine the risk alignment effects embedded in their compensation arrangements.
- S** 19.8 To safeguard the independence and authority of officers engaged in control functions, the compensation of such officers must be based principally on the achievement of control functions objectives, and be determined in a manner that is independent from the business lines they oversee.

PART E GROUP GOVERNANCE

20 Responsibilities as a holding company

- S** 20.1 A financial institution is responsible for exercising adequate oversight over its subsidiaries while respecting the independent legal and governance responsibilities that might apply to them.
- S** 20.2 An apex entity has overall responsibility for ensuring the establishment and operation of a clear governance structure appropriate to the nature, size and complexity of the group and its entities. In promoting the adoption of the sound corporate governance principles set out in this policy document throughout the group, the board and senior management of an apex entity must–
- (a) ensure that the group governance framework clearly defines roles and responsibilities for the oversight and implementation of group-wide policies;
 - (b) ensure that the differences in the operating environment, including the legal and regulatory regime, for each jurisdiction in which the group has presence, are properly understood and reflected in the group governance framework;
 - (c) have in place reporting arrangements that promote understanding and management of material risks and developments that may affect the apex entity and its subsidiaries;
 - (d) assess whether the internal control framework of the group adequately addresses risks across the group, including those arising from intragroup transactions; and
 - (e) ensure that there are adequate resources to effectively monitor compliance of the apex entity and its subsidiaries with all applicable legal and regulatory requirements.
- G** 20.3 Group structures can substantially increase the complexity of the organisation of a financial group. Complex structures involving a large number of legal entities can exacerbate group-wide risks including operational risks introduced by interconnected and complex funding structures, intra-group exposures, trapped collateral and counterparty risk.
- S** 20.4 An apex entity must take appropriate action to ensure that the group structure does not undermine its ability to exercise effective oversight. The board and senior management must know and understand the group structure and be able to identify and manage all material risks arising from the structure. The apex entity must also ensure that regular independent reviews are carried out to evaluate risks associated with the group structures. This should include an evaluation of whether group controls and policies are adequate to address those risks.
- S** 20.5 An apex entity must establish a clearly defined process for approving the creation of new legal entities and other structures. This should serve to ensure that the proposed structure fulfils a legitimate business purpose and its associated risks are understood and managed.

21 Responsibilities as a subsidiary

- S** 21.1 A financial institution must discharge its own legal and governance responsibilities as a separate entity, even if it is a subsidiary of another financial institution or of a foreign entity which is subject to prudential regulation. Accordingly, the board and senior management of a financial institution must–
- (a) validate that the objectives, strategies, plans, governance framework and other policies set at the group level are fully consistent with the regulatory obligations and the prudential management of the financial institution and ensure that entity-specific risks are adequately addressed in the implementation of group-wide policies; and
 - (b) in the case of locally-incorporated foreign financial institutions, ensure timely engagement with the Bank on strategic and regulatory developments at the group level that may significantly impact the Malaysian operations of the financial institution.

PART F TRANSPARENCY

22 Corporate governance disclosures

- S** 22.1 A financial institution must disclose information on its corporate governance policies and practices. Such disclosures must include—
- (a) the information set out in Appendix 4;
 - (b) the particulars of, and the reasons for, any gaps in relation to the requirements set out in this policy document; and
 - (c) a description of the measures taken, or that will be taken, to address the gaps.
- G** 22.2 In respect of paragraph 22.1, an apex entity may disclose information relating to a centralised group-wide framework on behalf of its subsidiaries.
- S** 22.3 An apex entity must provide quantitative disclosures of compensation, as described in Appendix 4, for the following categories of individuals, in respect of their aggregate compensation from all entities within the group:
- (a) members of senior management with group-wide responsibilities;
 - (b) officers who can materially commit or control significant amounts of the group's resources or whose actions are likely to have a significant impact on the group-wide risk profile; and
 - (c) officers who are among the most highly remunerated officers within the group.
- G** 22.4 A financial institution will be deemed to have complied with paragraph 22.1 to the extent that it has disclosed the information required in that paragraph in accordance with other laws or legal requirements.
- S** 22.5 The board must ensure that the corporate governance disclosures are accurate, clear and presented in a manner that is easily understood by its shareholders, customers and other relevant stakeholders.
- S** 22.6 A financial institution must ensure that the corporate governance disclosures are—
- (a) laid before its annual general meetings as an appendix to the directors' report;
 - (b) published on its website; and
 - (c) in the case of a financial institution that is publicly listed, published in its annual report.
- S** 22.7 A financial institution must additionally publish its articles of association and board charter¹⁴ on its website.

¹⁴ Paragraphs 8.2, 9.5, and 12.8 set out minimum expectations on what should be included in the board charter.

PART G TRANSITIONAL ARRANGEMENTS

- S** 31.1 Financial institutions will be given a transitional period after the publication of this policy document for phasing in the implementation of the following requirements:
- (a) three years for limit on executive directors¹⁵;
 - (b) three years for limit on common directors¹⁶;
 - (c) three years for independent directors to make up at least half of the board membership; and
 - (d) five years for independent directors to make up a majority of the board membership¹⁷.

¹⁵ As required under paragraph 11.4 based on the definition of “executive director” set out in paragraph 5.2.

¹⁶ As required under paragraph 11.12.

¹⁷ As required under paragraph 11.6.

APPENDIX 1 BOARD COMMITTEE RESPONSIBILITIES

Board nominations committee

1. Support the board in carrying out its functions in the following matters concerning the board, senior management and company secretary:
 - (a) appointments and removals;
 - (b) composition;
 - (c) performance evaluation and development; and
 - (d) fit and proper assessments;as set out in paragraphs 10, 11, 12, 13, 14 and 17.

Board compensation committee

2. Support the board in actively overseeing the design and operation of the financial institution's compensation system as set out in paragraph 19.
3. Periodically review the compensation of directors on the board, particularly on whether compensation remains appropriate to each director's contribution, taking into account the level of expertise, commitment and responsibilities undertaken.

Board risk management committee

4. Support the board in meeting the expectations on risk management as set out in the policy document on *Risk Governance*.
5. In assisting the implementation of a sound compensation system, examine whether incentives provided by the compensation system take into consideration risks, capital, liquidity and the likelihood and timing of earnings, without prejudice to the tasks of the board compensation committee.

Board audit committee

6. Support the board in ensuring that there is a reliable and transparent financial reporting process within the financial institution.
7. Oversee the effectiveness of the internal audit function of the financial institution. At a minimum, this must include—
 - (a) reviewing and approving the audit scope, procedures and frequency;
 - (b) reviewing key audit reports and ensuring that senior management is taking necessary corrective actions in a timely manner to address control weaknesses, non-compliance with laws, regulatory requirements, policies and other problems identified by the internal audit and other control functions;
 - (c) noting significant disagreements between the chief internal auditor and the rest of the senior management team, irrespective of whether these have been resolved, in order to identify any impact the disagreements may have on the audit process or findings; and
 - (d) establishing a mechanism to assess the performance and effectiveness of the internal audit function.
8. Foster a quality audit of the financial institution by exercising oversight over the external auditor, in accordance with the expectations set out in the policy

document on *External Auditor*. At a minimum, this must include–

- (a) making recommendations to the board on the appointment, reappointment, removal and compensation of the external auditor;
- (b) monitoring and assessing the independence of the external auditor including by approving the provision of non-audit services by the external auditor;
- (c) monitoring and assessing the effectiveness of the external audit, including by meeting with the external auditor without the presence of senior management at least annually;
- (d) maintaining regular, timely, open and honest communication with the external auditor, and requiring the external auditor to report to the board audit committee on significant matters; and
- (e) ensuring that senior management is taking necessary corrective actions in a timely manner to address external audit findings and recommendations.

- 9. Review and update the board on all related party transactions.
- 10. Review the accuracy and adequacy of the chairman's statement in the directors' report, corporate governance disclosures, interim financial reports and preliminary announcements in relation to the preparation of financial statements.
- 11. Monitor compliance with the board's conflicts of interest policy required under paragraph 14.1.
- 12. Review third-party opinions on the design and effectiveness of the financial institution's internal control framework.

APPENDIX 2 LIST OF GUIDELINES AND CIRCULARS SUPERSEDED

1. *Guidelines on Corporate Governance for Licensed Institutions* issued on 19 June 2013
2. *Minimum Standards for Prudential Management of Insurers (Consolidated)* issued on 24 December 2010
3. *Prudential Framework of Corporate Governance for Insurers* issued on 19 June 2013
4. *Guidelines on Corporate Governance for Licensed Islamic Banks* issued on 19 June 2013
5. *Guidelines on Directorship for Takaful Operators* issued on 8 June 2011
6. *Guidelines for Audit Committees and Internal Audit Department (Part A)* issued on 4 July 2007
7. *Code of Ethics: Guidelines on Code of ethics and conduct for Directors, Officers and Officers in the Banking Industry (Part I only)* issued on 31 October 1988

APPENDIX 3 APPLICATION PROCEDURES FOR DIRECTOR AND CEO APPOINTMENTS

1. Section 54(3) of the FSA and section 63(3) of the IFSA require financial institutions to submit a written application to the Bank when seeking to appoint or reappoint a director or CEO.

The role of the board nominations committee

2. The board nominations committee will be the Bank's main point of contact for the application process.

Elaboration on assessment

3. A financial institution must include in its application for a prospective director an elaboration of the board's assessment of the candidate, and—
 - (a) describe the board's assessment of how the candidate is expected to address any gaps in the specific skills, knowledge or experience of the existing board members, if any;
 - (b) in the case of a candidate who lacks specific skills, knowledge or experience, provide a description of the gaps and steps that will be taken to support the candidate in addressing the gaps; and
 - (c) in the case of a reappointment, set out objective assessments of the candidate's past performance on the board.
4. A financial institution must include in its application for a prospective CEO an elaboration of the board's assessment of the candidate and the contribution expected from him, having regard to the strategies, objectives and business plans of the financial institution.

Electronic or physical submission

5. A financial institution may submit an application either electronically or physically, as follows:
 - (a) Electronic submissions may be made over the FI@KijangNet portal.
 - (b) Physical submissions may be made by completing the attached Director and CEO Applications forms and sending them to the director of the relevant supervisory department of the Bank.

Additional submission for investment banks

6. When submitting an application to the Bank, a licensed investment bank is expected to concurrently inform the Securities Commission of the proposed appointment or reappointment via the Electronic Licensing Application (ELA).

Timeline

7. A financial institution should submit an application to the Bank at least three months before it expects the individual to assume his proposed responsibilities. In the case of a reappointment, applications should be submitted three months prior to the expiry of the individual's existing term.

APPENDIX 4 CORPORATE GOVERNANCE DISCLOSURES

Board of directors

<i>Composition</i>	• Name and designation (i.e. independent, non-independent non-executive, executive, chairman) of each director • Key personal details and background of each director including relevant experience, any shareholding in the financial institution and significant external commitments • Chairman and members of each board committee • Appointments, resignations and removals of directors during the financial year; • Description of training and education provided to the board • Number of meetings convened by the board and each board committee A financial institution must ensure that information on its website concerning board composition remains updated to reflect the current composition of the board.
<i>Function and conduct</i>	• Roles and responsibilities of the board and the board committees • Attendance of each director at board and board committee meetings during the financial year

Internal control framework

<i>Overview</i>	• Main features of the internal control framework, and the nature and frequency of any review and assessment conducted on the internal control framework • Key policies and procedures of the internal control framework, including any changes made to these policies and procedures during the financial year
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Compensation

<i>Qualitative disclosures</i>	Information relating to the design and structure of the compensation system, including– • an overview of the key features and objectives of the compensation policy • a description of the scope of the compensation policy (such as by regions or business lines), including the extent to which it is applicable to foreign subsidiaries and branches • a description of the types of officers considered as senior officers and as other material risk takers, including the number of officers in each group • an overview of the findings, recommendations and actions taken with respect to any review and assessment conducted on the compensation system during the financial year • a discussion of measures taken to ensure that officers in control functions are compensated independently of the businesses they oversee
	Description of the ways in which current and future risks are taken into account in the compensation processes, including– • an overview of the key risks that the financial institution takes into account when implementing compensation measures • an overview of the nature and type of the key measures used to take account of these risks, including risks that are difficult to measure (values need not be disclosed) • a discussion of the ways in which these measures affect compensation • a discussion of how the nature and type of these measures have changed over the financial year, reasons for the changes, and the impact of these changes on compensation
	Description of the ways in which the financial institution seeks to link performance during a performance measurement period with levels of compensation, including– • an overview of the main performance metrics for the financial institution, top-level business lines and officers • a discussion of how amounts of individual compensation are linked to institution-wide and individual performance • a discussion of the measures that will be taken to adjust compensation in the event that performance metrics are weak, including the financial institution's criteria for determining "weak" performance metrics
	Description of the ways in which the financial institution seeks to adjust compensation to take account of longer-term performance, including– • a discussion of the financial institution's policy on deferral and vesting of variable compensation and, if the fraction of variable compensation that is deferred differs across officers or groups of officers, a description of the factors that determine the fraction and their relative importance

	• a discussion of the financial institution's policy and criteria for adjusting deferred compensation before vesting and after vesting through clawback arrangements Description of the different forms of variable compensation that the financial institution utilises and the rationale for using these different forms, including– • an overview of the forms of variable compensation offered (such as cash, shares and share-linked instruments¹⁸) • a discussion of the use of the different forms of variable compensation and, if the mix of different forms of variable compensation differs across officers or groups of officers), a description the factors that determine the mix and their relative importance
<i>Quantitative disclosures</i>	Breakdown of the total amount of compensation awards for the CEO and directors for the financial year, disclosed individually for the CEO and each director, to show– • fixed and variable compensation • deferred and non-deferred compensation • the different forms of compensation used (such as cash, shares and share-linked instruments) Compensation information in two broad categories, namely in respect of senior management and other material risk takers, as follows: • breakdown of the total amount of compensation awards for the financial year as exemplified in Table A, to show– - fixed and variable compensation - deferred and non-deferred compensation - the different forms of compensation used (such as cash, shares and share-linked instruments) • number of officers having received a variable compensation during the financial year • number and total amount of guaranteed bonuses awarded during the financial year • number and total amount of sign-on awards made during the financial year • number and total amount of severance payments made during the financial year • total amount of outstanding deferred compensation, split into cash, shares, share-linked instruments and other forms • total amount of deferred compensation paid out during the financial year • the officers' exposure to implicit (such as fluctuations in the value of shares or performance units) and explicit adjustments (such as malus, clawbacks or similar reversals or downward revaluations of awards) of deferred compensation and retained compensation, including–

¹⁸ A description of other forms of variable compensation, if any, must be provided.

	• total amount of outstanding deferred compensation and retained compensation exposed to ex-post explicit and implicit adjustments; • total amount of reductions during the financial year due to ex-post explicit adjustments • total amount of reductions during the financial year due to ex-post implicit adjustments
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Table A		
Total value of compensation awards for the financial year	Unrestricted	Deferred
Fixed compensation		
• Cash-based	x	x
• Shares and share-linked instruments	x	x
• Other	x	x
Variable compensation		
• Cash-based	x	x
• Shares and share-linked instruments	x	x
• Other	x	x