

Strengthening the role of INEDs in the banking sector

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Background

The global financial crisis in 2008 highlighted weaknesses in banks' corporate governance. As part of the global response to the crisis, policymakers and regulators have been working to improve and enhance corporate governance within banks, including measures regarding corporate culture, risk management frameworks and internal controls.

The Hong Kong Monetary Authority (HKMA) recently issued guidance on the *Empowerment of Independent Non-executive Directors (INEDs) in the Banking Industry in Hong Kong* ("the Guidance"). The Guidance supplements the HKMA's *Supervisory Policy Manual on Corporate Governance of Locally Incorporated Authorized Institutions* (CG-1) and covers the role of INEDs, board practices relating to INEDs, and suitable qualifications of INEDs on the board. The Guidance is expected to be implemented by 14 December 2017.

Highlights and implications

- The demand for suitably skilled and experienced INEDs, in particular those with a finance background, is likely to increase.
- INEDs' independence is being defined more closely, and could result in the reduction of potential candidates.
- Responsibilities, duties and involvement of INEDs, and the related time demands, should be expected to increase. This should be reflected in increased remuneration.
- There are more prescriptive requirements for D-SIBs. These requirements are considered best practice for other banks.

The Guidance

The key points of the six main sections of the Guidance are summarised below:

Constitution of the board and its committees

- At least one INED must have a background in accounting, banking or finance (two INEDs if the bank is systemically important).
- Systemically important banks are required to establish four separate board committees (audit, risk, nominations and remuneration). This is considered good practice for all banks.
- The chairs of the audit and risk committees should be INEDs with a background in accounting, banking or finance, and they should not chair the board or any other committees.
- Risk committee members "should collectively possess relevant technical expertise and experience in risk disciplines".

INEDs

- INEDs are expected to sit on or chair board committees.
- INEDs from authorised institutions (AIs) have a wider role than protecting the interests of shareholders. They must also protect the interests of other stakeholders (e.g. depositors) and the wider public interest.
- Although INEDs do not need to have a banking background, they must have skills and knowledge relevant to the role, including broad experience in identifying and managing risk.
- A certain time commitment is considered necessary and is likely to be significant.

Independence

Careful consideration of independence is required if certain factors are present. These factors include:

- Material business relationships with the bank, other group companies or entities/persons who control the bank (individuals meeting this criterion are presumed not to be independent)
- An immediate family member who within the last three years has been a member of senior management of the bank, other group companies, or entities which control the bank
- An immediate family member with a material business relationship with the bank, other group companies, or entities/persons who control the bank
- Employment at a professional services firm which has provided services to the bank, other group companies or entities/persons who control the bank in the last year (or last three years if the person involved was the engagement partner for the services provided).

Remuneration

- The director's fee should be at least HKD 400,000 per annum, with additional fees for membership or chairing board committees.
- Fees should reflect the work done and should be subject to regular review.

Board practices

- Physical attendance at meetings should be encouraged.
- The appointment of alternate directors is discouraged, except in exceptional circumstances.
- Board papers should be clear, and must be circulated one week before meetings.
- INEDs should be briefed on complex matters ahead of board or committee meetings.
- Communication between INEDs should be enhanced, with regular separate meetings and briefings on matters discussed at various board committees.
- Banks must conduct an annual evaluation of the board and individual directors.

Training and development

- The bank is responsible for providing appropriate and adequate induction and ongoing training.
- INEDs will be given regular briefings on operations and risk management regarding different areas of the bank, as well as on wider industry and regulatory developments.

How KPMG can help

Review of corporate governance framework

Corporate governance is an evolving area, particularly in banks, as policymakers and regulators expect a higher standard. KPMG China can provide an independent assessment of your current corporate governance framework against HKMA regulations and emerging best practice.

This will provide assurance on the design and operation of your corporate governance framework, including the role of INEDs, as well as provide practical recommendations to strengthen your framework.

Board effectiveness reviews

KPMG China can help facilitate an independent review of board effectiveness and an evaluation of directors' performances to meet the Guidance requirement for an annual evaluation.

Our methodology and structured approach to assessing board effectiveness, drawing on our experience with multiple clients, will provide you with a report setting out areas where the board is performing well and areas which need the attention of INEDs.

Training and development

An effective INED needs to be briefed and trained on the latest developments. Critical topics for banks include the various financial and non-financial risks that a bank faces, and how they are managed.

KPMG China has developed modules on director training which can be studied at a director's own pace. We can also help develop and deliver specific training to INEDs, covering industry and regulatory developments and risk management in the banking sector.

Sourcing of INEDs

KPMG China's Executive Recruitment practice can assist your institution in the search for candidates to fill INED roles. Our team in Hong Kong can help your search, utilising our existing candidate lists as well as our connections with suitable candidates in our alumni network, and among our clients and contacts in the wider business community.

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