cutting through complexity

Basel Committee on Banking Supervision - Guidelines on the corporate governance principles for banks

Basel Committee on Banking Supervision Guidelines on the corporate governance principles for banks ("Basel guidelines")

Corporate governance does not stand still as evidenced by the increasing number of new codes, guidelines and revisions thereto. The Basel Committee on Banking Supervision issued Guidelines: Corporate governance principles for banks dated July 2015 ('Basel guidelines'). Whilst much of the content is being applied in some form or another in South Africa, and our supervisory bodies and financial institutional framework is well regulated, these guidelines will serve for good reference and comparison when South Africa's King IV Code is released in 2016.

This is a high level and abridged summary of the principles, recommendations and considerations sourced directly from the Basel guidelines, unless otherwise stated. For a full text refer to the BIS website (www.bis.org).

Introduction

The primary objective of corporate governance should be safeguarding of stakeholders' interest in conformity with public interest on a sustainable basis. The guidelines reinforce the board's responsibilities for oversight and in particular risk governance.

The implementation of these principles should be commensurate with the size, complexity, structure, economic significance, risk profile and business model of the bank.

Principle 1: Board's overall responsibilities

"The board has overall responsibility for the bank, including approving and overseeing management's implementation of the bank's strategic objectives, governance framework and corporate culture."

The board should establish and be satisfied with the bank's organisational structure. Members of the board should exercise their "duty of care" and "duty of loyalty" to the bank. The board should ensure that transactions with related parties are reviewed and the board should reinforce 'the tone at the top'.

The board is responsible for overseeing a strong risk governance framework, including review of key policies and controls, and should be active when it comes to defining the risk appetite and ensuring alignment thereof within the bank. It should ensure the efficacy of the risk management, compliance and internal audit functions. The board should select the CEO and provide oversight of senior management.

Principle 2: Board qualifications and composition

"Board members should be and remain qualified, individually and collectively, for their positions. They should understand their oversight and corporate governance role and be able to exercise sound, objective judgment about the affairs of the bank."

Composition

The board should have a composition that facilitates effective oversight and be comprised of individuals with a balance of skills, diversity and expertise. The board should be comprised of a sufficient number of independent directors.

An independent director, as stated in the Basel guidelines glossary, is a director who:

- "Is a non-executive member of the board who does not have any management responsibilities within the bank and is not under any other undue influence, internal or external, political or ownership that would impede the board member's exercise of objective judgment."

Unless required otherwise by law, the board nominates candidates and promotes appropriate succession planning of board members. The bank should have a nomination committee or similar body, comprised of independent board members to identify and nominate candidates. Where there are shareholders with power to appoint board members, the board should ensure that such individuals understand their duties. The board should ensure that members participate in induction programmes.

Qualifications

In assessing the collective suitability of the board, the following should be taken into account:

- Board members should have a range of knowledge and experience in relevant areas and have varied background to promote diversity of views. Relevant areas of competence may include, but are not limited to capital markets, financial analysis, financial stability issues, financial reporting, information technology, strategic planning, risk management, compensation, regulation, corporate governance and management skills;
- The board collectively should have a reasonable understanding of local, regional and, if appropriate, global economic and market forces and of the legal and regulatory environment. International experience, where relevant, should also be considered; and
- Individual board members' attitude should facilitate communication, collaboration and critical debate in the decision-making process.

Principle 3: Board's own structure and practices

"The board should define appropriate governance structures and practices for its own work, and put in place the means for such practices to be followed and periodically reviewed for ongoing effectiveness."

The board should structure itself in terms of leadership, size and use of committees. It should maintain and update its rules and carry out regular assessments of itself as a whole, its committees and its individual board members. The board should keep appropriate records. The board chairman should be an independent or non-executive board member.

Board committees

A board may establish certain specialised board committees. The committees should be created and mandated by the full board. The number and nature of committees depends on many factors, including the size of the bank and its board, the nature of the business areas of the bank, and its risk profile.

The committees may include an:

- Audit committee
- Risk committee
- Compensation committee
- Other specialised committees such as Nomination/human resources/governance committee, and Ethics and compliance committee are recommended.

A committee chair should be an independent non-executive board member.

Audit committee

An audit committee should be required for systemically important banks and is strongly recommended for other banks based on an organisation's size, risk profile and complexity.

Audit committee membership

- To be made up entirely of independent or non-executive board members
- Have a chair who is independent, and not the chair of the board or any other committee
- Include members who have experience in audit practices, financial reporting and accounting.

Roles and responsibilities of the audit committee

The audit committee is, in particular responsible for:

- Framing policy on internal audit and financial reporting, among other things;
- Overseeing the financial reporting process;
- Providing oversight of and interacting with the bank's internal and external auditors;
- Approving or recommending to the board or shareholders for their approval, the appointment, remuneration and dismissal of external auditors;
- Reviewing and approving the audit scope and frequency;
- Receiving key audit reports and ensuring that senior management is taking necessary corrective actions in a timely manner to address control weaknesses, non-compliance with policies, laws and regulations, and other problems identified by auditors and other control functions;
- Overseeing the establishment of accounting policies and practices by the bank; and
- Reviewing the third-party opinion on the design and effectiveness of the overall risk governance framework and internal control system.

Risk committee

A risk committee should be required for systemically important banks and is strongly recommended for other banks based on an organisation's size, risk profile and complexity.

Risk committee membership

- Should include a majority of members who are independent
- Have a chair who is independent, and not the chair of the board or any other committee
- Include members who have experience in risk management issues and practices.

Roles and responsibilities of the risk committee

The risk committee should:

- Discuss all risk strategies and make recommendations on these and the risk appetite to the board;
- Review the banks risk policies at least annually;
- Oversee management's processes to ensure adherence to the risk policies.

Compensation committee

A compensation committee is required for systemically important banks. It should support the board in overseeing the remuneration system and in ensuring that it is appropriate for the bank, its performance, control environment and in compliance with any regulatory and/or legal requirements.

Conflicts of interest

The board should ensure and oversee that there are conflicts of interest policies, as well as be satisfied with the process of public disclosure and/or information to supervisors.

Principle 4: Senior management

"Under the direction and oversight of the board, senior management should carry out and manage the bank's activities in a manner consistent with the business strategy, risk appetite, remuneration and other policies approved by the board."

Senior management consists of a core group of individuals responsible and accountable to the board for the sound and prudent day-to-day management of the bank.

Principle 5: Governance of group structures

"In a group structure, the board of the parent company has the overall responsibility for the group and for ensuring the establishment and operation of a clear governance framework appropriate to the structure, business and risks of the group and its entities. The board and senior management should know and understand the bank group's organisational structure and the risks that it poses."

Guidance is provided to parent company boards, subsidiary boards and where there are complex or opaque structures.

Principle 6: Risk management function

"Banks should have an effective independent risk management function, under the direction of a chief risk officer (CRO), with sufficient stature, independence, resources and access to the board."

This function is a key component of the bank's second line of defence and is responsible for overseeing risk-taking activities.

Large, complex and internationally active banks, and other banks, based on their risk profile and local governance requirements, should have a senior manager (CRO or equivalent) with overall responsibility for the bank's risk management function.

Appointment, dismissal and other changes to the CRO position should be approved by the board or its risk committee. It should be disclosed publicly if the CRO is removed from his/her position. The reasons for such removal should be discussed with the bank's supervisor.

Principle 7: Risk identification, monitoring and controlling

"Risks should be identified, monitored and controlled on an ongoing bank-wide and individual entity basis. The sophistication of the bank's risk management and internal control infrastructure should keep pace with changes to the bank's risk profile, to the external risk landscape and in industry practice."

Substantial guidance is provided on the risk identification, measurement and management processes.

Principle 8: Risk communication

"An effective risk governance framework requires robust communication with the bank about risk, both across the organisation and through reporting to the board and senior management."

Guidance on risk communication, information, reporting and the risk systems is provided.

Principle 9: Compliance

"The bank's board of directors is responsible for overseeing the management of the bank's compliance risk. The board should establish a compliance function and approve the bank's policies and process for identifying, assessing, monitoring and reporting and advising on compliance risk."

An independent compliance function is a key component of the bank's second line of defence and is responsible for ensuring that the bank operates with integrity and in compliance with applicable laws, regulations and internal policies.

Principle 10: Internal audit

"The internal audit function should provide independent assurance to the board and should support board and senior management in promoting an effective governance process and the long-term soundness of the bank."

An effective and efficient internal audit function constitutes the third line of defence in the system of internal control. The internal audit function should have a clear mandate, be accountable to the board and be independent of the audited activities. It should be publicly disclosed if the chief audit executive is removed from his or her position and the reasons should be discussed with the bank's supervisor.

Principle 11: Compensation

"The bank's remuneration structure should support sound corporate governance and risk management."

The board, or by its delegation, the compensation committee, is responsible for the overall oversight of management's implementation of the remuneration system for the entire bank, including the review of outcomes relating to the incentives that the remuneration system is creating.

Principle 12: Disclosure and transparency

"The governance of the bank should be adequately transparent to its shareholders, depositors, other relevant stakeholders and market participants."

All banks should as a minimum disclose annually the recruitment approach for board member selection and board composition, and whether the bank has board committees and how often key standing committees have met.

In general, banks should apply the disclosure and transparency section of the OECD principles.

Key points concerning its risk exposures and risk management strategies without breaching necessary confidentiality should be disclosed. For material and complex or non-transparent activities adequate information on their purpose, strategies, structures and related risks and controls should be disclosed.

Disclosure should be accurate, clear and timely.

Principle 13: The role of supervisors

"Supervisors should provide guidance for and supervise corporate governance at banks, including through comprehensive evaluations and regular interaction with boards and senior management, should require improvement and remedial action as necessary, and should share information on corporate governance with other supervisors."

Supervisors should establish guidance on expectations for sound corporate governance.

They should conduct comprehensive evaluations of a bank's corporate governance.

Supervisors should interact with directors and senior management.

They should require improvement and remedial action by a bank.

Supervisors should cooperate and share corporate governance information with other relevant supervisors.

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