



HONG KONG MONETARY AUTHORITY  
香港金融管理局

*Banking Policy Department*

Our Ref.: B1/21C  
B1/20C  
B1/15C

3 August 2012

The Chief Executive  
All Locally Incorporated Authorized Institutions

Dear Sir/Madam,

**Supervisory Policy Manual (SPM)**  
**CG-1 “Corporate Governance of Locally Incorporated Authorized Institutions”**  
**(Revised)**

I am writing to inform you that, following consultation with the two industry Associations, the Monetary Authority is issuing a revised version of the SPM module on “Corporate Governance of Locally Incorporated Authorized Institutions” as a statutory guideline under section 7(3) of the Banking Ordinance. The guideline will be published by notice in the gazette today.

The revised module seeks to strengthen supervisory guidance and requirements for sound corporate governance within authorized institutions (AIs) by, incorporating new international standards developed in response to the lessons of the global financial crisis, including in particular the Basel Committee on Banking Supervision’s *Principles for Enhancing Corporate Governance* (issued in October 2010).

*Major changes introduced*

Building upon the general principles set out in the existing module, the revised module strengthens governance requirements in respect of board and senior management oversight, in a number of areas including:

- the role of the board in risk governance, in particular in relation to approving and overseeing the overall risk strategy and firm-wide risk management framework of an AI. This includes approving a risk tolerance / appetite that is commensurate with the AI’s operations and strategic goals and the sophistication of its risk management systems;

- the board's responsibilities for appointing and overseeing senior management. This includes the drawing up of a formal document setting out the role, responsibilities, accountability and reporting relationship of senior management and the board's role in monitoring senior management performance; and
- the board's role in setting corporate values and standards, in particular a culture of ethical behaviour at both the institutional and individual staff level. This includes the need to adopt effective policies governing conflicts of interest to ensure that the AI's business is conducted with integrity, prudence and the appropriate degree of professional competence.

The revised module also provides additional guidance in relation to the functioning and organisation of the board, including:

- the appropriate composition of the board with sufficient independence<sup>1</sup> and collective expertise for effective and objective decision-making, and the formation of nomination committees and risk management committees to help the board in the discharge of its responsibilities;
- the role of the chair in leading the board and ensuring that board decisions are taken on a sound and well-informed basis and in the best interests of an AI;
- the importance of the commitment of board members to contribute actively to the work of the board or of board committees to which they are appointed;
- the provision of tailored orientation and ongoing training for board members to familiarize them with their role and responsibilities and with the AI's business strategy and operations, governance and internal control framework; and
- the undertaking of regular assessments of the effectiveness of the board as a whole and the contribution of each individual director, as well as of the board's own governance practices and procedures.

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<sup>1</sup> In the case of licensed banks, either one-third or three of their board members, whichever is higher, should be independent non-executive directors. Other AIs are strongly encouraged to appoint at least three independent non-executive directors to their board, but in any case their board is expected to include an appropriate number of independent, or at least non-executive, directors.

The other changes to the module relate mainly to:

- the holding of face-to-face meetings, where considered appropriate, between the HKMA and candidates for appointment to an AI's board or as its chief executive or alternate chief executive as the case may be, to enable the HKMA to assess first-hand whether the candidate is fit and proper to carry out the role for which they are being considered. Given the on-going nature of the "fit and proper" criterion applicable to members of an AI's board or senior management, the HKMA may likewise conduct meetings with serving directors or members of senior management where necessary;
- expectations regarding the familiarity of board members and senior management with the structure of their AI and ensuring that organisational complexity does not prevent effective control of the AI's activity in its entirety;
- requirements to put in place adequate controls on structures established by an AI on behalf of its customers (e.g. special purpose vehicles); and
- requirements for the public disclosure of information on key areas of corporate governance and risk.

### *Implementation*

AIs are expected to take steps to bring their corporate governance policies and practices into line with the guidance set out in the revised module as soon as practicable. In particular, AIs should identify gaps and implement plans for enhancing their corporate governance frameworks within 6 months of the issue date of the module, with a view to bringing their practices into line with the guidance which it contains within 12 months of the issue date. If individual AIs need more time to initiate changes for the implementation of specific aspects of the guidance, they should discuss and agree an implementation plan and timetable with the HKMA for the various aspects concerned. The HKMA will monitor AIs' implementation progress.

As set out in our circular letter of 17 June 2011 on "Communication of Supervisory Standards to Boards of Directors", we would be grateful if you could arrange for a copy of this letter to be provided to your board members for the purpose of advising them of the key requirements of the revised module and supervisory expectations on the role and responsibilities of the board and its members in ensuring the sound corporate governance of AIs.

On-line access to the module is available under the icon for “Supervisory Policy Manual” on the HKMA’s public (<http://www.info.gov.hk/hkma>) and private (<http://www.stet.finnet.hk>) websites.

Should you have any questions regarding this module, please feel free to contact Miss Samantha Yau on 2878-8284 or Mr Keith Ho on 2878-1909.

Yours faithfully,

Richard Chu  
Acting Executive Director (Banking Policy)

Encl.

c.c. The Chairman, The Hong Kong Association of Banks  
The Chairman, The DTC Association  
FSTB (Attn. Mr Jackie Liu)