



HONG KONG MONETARY AUTHORITY  
香港金融管理局

Our Ref: B9/149C

14 December 2016

The Chief Executive of all Authorized Institutions and  
Directors of the Board of all Locally-Incorporated Authorized Institutions

Dear Sir / Madam,

**Empowerment of Independent Non-Executive Directors (INEDs) in the  
Banking Industry in Hong Kong**

Further to the consultation conducted earlier this year I am writing to provide further guidance on the empowerment of INEDs in the banking industry in Hong Kong.

**Background**

The financial crisis which began in 2008 exposed governance weaknesses at financial institutions around the world. In many cases, boards and individual directors proved unable to understand the risks that their institutions were exposed to and hence failed to ensure that those risks were effectively managed or mitigated. This has led to a greater emphasis on the role of the board, and in particular the role of INEDs, what is expected of them and the knowledge, expertise and – not least – personal qualities they must possess in order to do their jobs effectively. These considerations are no less relevant in Hong Kong than they are in other developed financial centres internationally.

In light of these developments, in July 2015, the Hong Kong Monetary Authority (HKMA) commissioned a small group comprising members with wide-ranging expertise and experience in the area of corporate governance, with particular reference to the banking sector, to undertake a study of the role of INEDs in the local banking sector and to provide with their observations and recommendations to help empower INEDs. The group submitted its report to the HKMA in December 2015 and an industry consultation was carried out on the group's recommendations in early 2016.

### Guidance

The guidance is set out in the Annex, covering the role of INEDs, practices of locally-incorporated authorized institution (AIs) with regard to INEDs, and proposed measures to be taken by AIs to ensure that there are sufficient suitably qualified people willing to serve as INEDs on the boards of AIs. It should also be read in conjunction with the HKMA's Supervisory Policy Manual on corporate governance, in particular module CG-1, which follows the Guidelines on "Corporate governance principles for banks" published by the Basel Committee on Banking Supervision in July 2015.

### Implementation

AIs should aim to implement the guidance within one year of the date of this circular. In the event of an AI having difficulty in complying with specific requirements, they should contact the HKMA through their usual point of contact to discuss whether any flexibility may be considered.

Should you have any questions on this circular, you may contact Mr Trevor Keen of Banking Conduct Department at [tnkeen@hkma.gov.hk](mailto:tnkeen@hkma.gov.hk). You may also approach your usual supervisory contacts at the HKMA regarding implementation issues.

Yours faithfully,

Norman T.L. Chan  
Chief Executive

Encl.

c.c. The Hong Kong Association of Banks  
The DTC Association

**Empowerment of Independent Non-Executive Directors (INEDs)  
in the Banking Industry in Hong Kong**

**I - Constituting the Board and its Committees**

1. The boards of all AIs should have at least one INED from a background in accounting, banking or other relevant financial industry and those of licensed banks or of any other AI designated by the Monetary Authority (MA) under §3S or §3U of the Banking (Capital) Rules as systemically important should have at least two INEDs with such a background.
2. The board of each AI<sup>1</sup> should establish an audit committee which should be distinct from any other committee and made up of non-executive directors, the majority of whom should be independent. The chair should be an INED with a background in accounting, banking or other relevant financial industry.<sup>2</sup> To ensure independence, the chair of the audit committee should not also be the chair of the board or of any other committee.
3. The board of each licensed bank and any other AI designated by the MA under §3S or §3U of the Banking (Capital) Rules as systemically important should also establish a risk committee, a nomination committee and a remuneration committee. These committees should be constituted as follows:
  - (a) The risk committee should be distinct from the audit committee, and it should be chaired by an INED with a background in accounting, banking or other relevant financial industry or expertise in risk management. The chair of the risk committee should not be the chair of the board or of any other committee. The majority of the members of the risk committee should be INEDs. The members of the committee should collectively possess relevant technical expertise and experience in risk disciplines that are adequate to enable them to discharge their responsibilities effectively.

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<sup>1</sup> A restricted licence bank or deposit-taking company (other than one designated by the MA under §3S or §3U the Banking (Capital) Rules as systemically important) may be exempted from setting up an audit committee if it is majority-owned by a licensed bank and the internal and external audit functions of the restricted licence bank or deposit-taking company, as the case may be, are subject to the direct supervision of the audit committee of that licensed bank.

<sup>2</sup> For restricted licence banks and deposit-taking companies which are not designated by the MA under §3S or §3U of the Banking (Capital) Rules as systemically important and which have a limited number of INEDs, their audit committees should be made up of non-executive directors, of whom at least the chair should be independent with a background in accounting, banking or other relevant financial industry.

- (b) The remuneration committee should be chaired by an INED. Members should be INEDs, or, where executive directors are members, the committee should comprise a majority of INEDs.
  - (c) The majority of the nomination committee members (including the chair) should be INEDs.
4. Apart from licensed banks and other AIs designated by the MA under §3S or §3U of the Banking (Capital) Rules as systemically important, it is also good practice for other AIs to establish risk, remuneration and nomination committees, depending on the size, scope and complexity of their businesses.

## **II - INEDs of AIs**

### Roles

5. While directors have a duty to protect the interests of shareholders, it should be recognised that banks perform functions and provide services that are essential to the maintenance of financial stability and the wider public interest. INEDs therefore play a role in protecting the interests of shareholders, depositors and customers and ensuring that the AI conducts its business in a manner most conducive to ensure its continued stable operations in the wider public interest. This is particularly relevant to the AI's governance.
6. INEDs are generally expected to sit on or chair board committees.
7. It should be recognised that INEDs' actions and votes in board meetings are in the service of the duty they owe to the AI as a whole and the wider public interest, and not to any particular interest.

### Qualities and background

8. AIs should appoint persons as INEDs who have experience and expertise that will enable them to fulfil their roles effectively, having regard to the nature, scale and complexity of the AI's business.
9. INEDs must be persons of integrity with extensive professional or business experience. They need not be from a banking background, but should have skills and knowledge that are relevant to their role, including broad experience of identifying and managing operational, financial, reputational

and other risks. Relevant backgrounds include, but are not limited to, banking, law, accounting or finance, industry, general business, regulatory and government (but see paragraph 26 below).

10. INEDs must have the necessary personal qualities and commitment to enable them to acquire a good understanding of the AI's business and to consider objectively the management's decisions and proposals.
11. INEDs should act towards the AI at all times with honesty, integrity and candour and use due care, skill and diligence in performing their functions. They should approach their duties with due professionalism.

#### Time commitment

12. A person who is approached with a view to being appointed as an INED of an AI should be reminded to consider carefully the amount of time he or she will need to devote to the role in light of other commitments. In principle, an INED should be prepared to attend all meetings of the board in person and any committees on which he or she sits and should only miss meetings in exceptional circumstances with reasons being provided and documented. Where attendance in person is impossible for any reason, the INED may consider taking part by video or teleconferencing. At a minimum, the INED should submit written views on items to be discussed ahead of the meeting in case he or she is not able to attend the meeting via any means.
13. In addition to the time required to prepare for and attend meetings of the board and committees, INEDs should also be prepared to devote time to other meetings with management of the AI and to training or briefings on the AI's business and developments in the banking sector in general and regulatory requirements. Such commitments are likely to be significant, especially for INEDs from non-banking backgrounds.

### **III - Independence and tenure**

14. The key characteristic of independence is the ability to exercise objective, independent judgement after fair consideration of all relevant information and views, without undue influence from executives or from external parties.
15. The following factors should be considered in assessing the independence of a director.

Where he or she:

- (a) holds more than 1% of the shares of the AI.
- (b) has been an employee, executive or director (other than an INED) of the AI or any of its majority or minority shareholder controllers as defined in the Banking Ordinance, group companies or subsidiaries within three years before appointment to the board.
- (c) receives any significant compensation from the AI or any of its majority or minority shareholder controllers, group companies or subsidiaries, except for remuneration for service as an INED.
- (d) has any material business relationship with the AI or any of its majority or minority shareholder controllers, group companies or subsidiaries<sup>3</sup>.
- (e) has an immediate family member who (i) is, or has been within three years before the director's appointment to the board, employed in a senior management role by the AI or any of its majority or minority shareholder controllers, group companies or subsidiaries, or (ii) has a material business relationship with the AI or any of its majority or minority shareholder controllers, group companies or subsidiaries<sup>4</sup>.
- (f) has close family ties, other than those described in (e), with any of the AI's directors or senior employees or the directors or senior employees of its majority or minority shareholder controllers, group companies or subsidiaries<sup>5</sup>.
- (g) holds cross directorships or has significant links with other directors through involvement in other companies or bodies that could give rise to conflicts of interest in the proposed role as INED<sup>6</sup>.

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<sup>3</sup> The relationship may be material either to the director (or any company connected with that director) or to the AI or any of its majority or minority shareholder controllers, group companies or subsidiaries. Any banking relationship should be at arm's length and on normal commercial terms. Materiality will have to be assessed in each case, but the AI should consider whether the relationship could prevent the director from being considered independent.

<sup>4</sup> "Immediate family members" include any person cohabiting with the director as a spouse, children (including adopted children), step children, siblings or step-siblings, parents and step-parents.

<sup>5</sup> The Listing Rules state that parents-in-law, grandparents, sons and daughters-in-law, grandchildren, aunts, uncles, nephews and nieces may be regarded as connected persons in certain circumstances. While it is difficult to give precise guidance, AIs should ask INEDs for information on any such relatives who have employment or other connections with the AI or any of its majority or minority shareholder controllers, group companies or subsidiaries and consider whether such connections could call into question the independence of the INED.

<sup>6</sup> Not including charities or government boards and other public bodies provided they do not give rise to a conflict of interest.

- (h) has served on the board for more than 9 years.
  - (i) is, or has been within one year immediately prior to the date of his or proposed appointment as INED, an employee, director, partner or principal of a professional adviser which currently provides, or has within one year immediately prior to the date of his or her proposed appointment, provided professional services to the AI or any of its majority or minority shareholder controllers, group companies or subsidiaries. The period should be three years if the person involved was the engagement partner of the professional firm that provided the services.
16. The above factors are not intended to be exhaustive and AIs will need to exercise judgement in the selection and appointment of INEDs. The fact that a person falls within one of the above cases may not automatically disqualify them from serving as an INED but will indicate a need for careful consideration, and the boards of AIs should establish and oversee the implementation and operation of effective policies to identify actual and potential conflicts of interest so that they can be appropriately managed. Nevertheless, persons covered by item (d) of paragraph 15 will not normally be considered independent. The suitability of INEDs may need to be reviewed if the AI becomes aware of information after appointment which might call their independence into question.
17. Where a proposed or existing INED falls within one or more of the above cases, the nomination committee (or the board, if there is no nomination committee) should consider the appropriateness of the INED concerned and make a recommendation to the board.
18. INEDs of AIs that are listed companies are also required to comply with the Listing Rules, which set out requirements for independence and factors that may call the independence of a director into question.

#### **IV - Remuneration of INEDs**

19. Remuneration of INEDs should adequately reflect their responsibilities and the time and effort they are expected to devote to their role. Fees should be in the form of a cash payment and additional fees should be paid to reflect additional responsibilities, such as membership or chairing of board committees.
20. INEDs should not receive remuneration based on any measure of the performance of the AI, including share options, since this could compromise their independence.

21. The remuneration of INEDs should be subject to a regular review mechanism to ensure that it is adjusted broadly in line with inflation and as required to maintain competitiveness within the banking sector and against other sectors.
22. Having reviewed the practice of banks and listed companies in Hong Kong and of public companies in other major financial centres, it is considered that a basic fee of at least HK\$400,000 per year, coupled with additional payments for membership or chairing of board committees, would be appropriate for INEDs and commensurate with their responsibilities and workload.

## **V - Board practices in relation to INEDs**

23. AIs should arrange appropriate insurance cover in respect of legal action against their directors. Such insurance should adequately reflect the legal and other risks they are exposed to by serving as directors in a regulated industry. It is good practice for AIs to review the scope of insurance annually to ensure that coverage matches the scale and type of the AI's business and associated risks.
24. AIs should facilitate attendance by INEDs at board and other meetings as far as possible, including by planning meeting schedules well in advance in consultation with directors. The best practice is to schedule all the meeting dates for a year before the year commences. Meeting dates should be changed only when genuinely necessary because of unforeseen circumstances and, wherever possible, at least two weeks' prior notice of a change should be given.
25. AIs should establish policies and procedures to encourage physical attendance at meetings by directors. In this connection, AIs should facilitate participation via remote means such as video or teleconferencing in case a director is unable to attend the meeting in person.
26. Where a prospective INED has previously served with a government or regulatory agency, in Hong Kong or elsewhere, he or she is likely to be subject to requirements relating to post-service employment. Such requirements may include cooling-off or sanitisation periods or a requirement to obtain permission to undertake employment (whether paid or not) after leaving the government or regulator. The prospective INED should be asked to obtain written confirmation from the relevant government department or agency, or the relevant regulator that all requirements have been met and any necessary permission obtained. This



should be done in all cases, but is especially important in cases where the government department or agency or the regulator have responsibility for the financial sector including the AI or any of its group companies or affiliates in any jurisdiction.

27. Where an INED has served on the board of an AI for nine years, questions may arise about his or her continued independence. The Listing Rules require the reappointment of INEDs of listed companies to be subject to a separate resolution to be approved by shareholders. For non-listed AIs, the nomination committee (or the board if there is no nomination committee) should consider whether the director should continue to be regarded as independent and make a recommendation to the board. Where the director is re-appointed as an INED, the reasons why the board considers the person can continue to be independent should be recorded.
28. Appointment of alternates for directors should be generally discouraged. Alternates may be appointed for executive and non-executive directors, on a strictly temporary basis, in certain circumstances such as where a director is unable to attend meetings due to ill health. In any event, alternates should not be appointed for INEDs.
29. AIs should ensure that board papers and related materials are clear and properly structured to facilitate understanding and decision-making. As far as possible, overly technical language should be avoided and papers should be drafted as far as possible in non-technical terms to facilitate understanding by persons from non-banking backgrounds. Papers should be circulated sufficiently in advance of meetings to allow members to read them and seek further information if required. As far as possible, papers should reach members at least one week before the meeting at which they are to be discussed.
30. It is good practice for INEDs to be briefed on complex matters at pre-meetings ahead of board or committee meetings.
31. INEDs should have access to independent professional advice as and when needed, to be paid for by the AI.
32. Minutes of board and committee meetings should be comprehensive and accurate. In particular, when one or more INEDs express a view that dissents from the views or proposals of management or the majority of the board, the dissenting views and the management's responses should be accurately recorded in sufficient detail.

33. The chairs of board committees should ensure that the full board, and especially INEDs that do not sit on their committees, are briefed on the committees' discussions and receive copies of committee minutes within a reasonable time after the meeting. The briefings should not focus just on the decisions of the relevant committee, but should also highlight the key concerns, if any, expressed by individual members and the management's responses.
34. It is good practice for the board chair to hold separate, regular meetings with INEDs. Where the chair is not an INED, it is good practice for a senior INED to convene meetings of the INEDs, at least once a year, without the presence of executives or other representatives of the AI to discuss whether there are issues they wish to raise at the board.
35. In addition to having a right to request separate meetings with auditors, it is good practice for INEDs to meet separately, without the presence of other executive directors or management, with the internal audit function, and where necessary, the compliance and the risk management functions, at least once a year. Such meetings should be separate from regular meetings of the audit and risk committees (which are generally attended by other directors or management) and may be conducted with the different functions together or, where necessary, with each one of them separately.
36. Meetings between the HKMA and INEDs will continue be held as a channel for discussion of issues affecting the individual AI or the banking industry generally.
37. AIs should conduct evaluations of the performance of the board and individual directors at least once a year. Such evaluations may be done by AIs themselves or by way of engaging professional advisers, or a combination of the two (for example, the AI may conduct annual evaluations and engage an external adviser every few years). Peer reviews, whereby individual directors evaluate the performance and contribution of all other directors, are particularly useful.

## **VI - Training and development requirements for INEDs**

38. While INEDs are not expected to have the same level of knowledge and expertise as executive directors with regard to the details of the AI's business and day-to-day operations, they should equip themselves with knowledge of the AI's business and the banking sector in general that is reasonably sufficient to enable them to fulfil their role.

39. INEDs should be offered appropriate and adequate induction and continuing training to be paid for by the AI and undertaken either by external providers or as part of in-house programmes organised by the AI.
40. Effective training and coaching are essential to enable INEDs, especially for those from non-banking backgrounds, to understand the business of the AI sufficiently well to enable them to fulfil their function. Such training should cover, at a minimum:
  - The operations and business of the AI and its main income drivers
  - The regulatory regime and regulatory focuses, and key concerns on the AI raised by the regulatory authorities
  - Types of risk the AI is exposed to
  - The AI's risk-management and compliance frameworks including its anti-money laundering and counter-terrorist financing arrangements
  - IT and payment systems and their importance to the AI
  - Internal audit functions and coverage
  - Treating customers fairly as a matter of ethics
41. In addition to induction training, regular presentations and briefings should be given to INEDs on the operations and risk management of individual business areas and departments of the AI so that INEDs are able to gain a fair understanding of the AI's operations and risk management over time. Such presentations and briefings may be organised at the initiative of the AI or at the request of individual INEDs.
42. Regular briefings on developments in the industry and regulatory requirements should be provided for INEDs.
43. Given the time pressures on many INEDs and differences in their backgrounds and areas of expertise, formal 'class room' sessions may not always be the best way to deliver information. Other methods such as on-line resources and small-group briefings or discussions with specialists should also be considered.