



**Opening Remark at the
Corporate Governance Program
for Directors of AIs organized by
the Hong Kong Institute of Bankers**

Hong Kong Monetary Authority

4 September 2013



The global financial crisis that began in 2008 has highlighted concerns in many areas, including failings in risk governance by the boards of some financial institutions



G20 Financial Stability Board (FSB) report “*Thematic Review on Risk Governance*” published in February 2013, highlighting problems at board level at some institutions in the crisis

- **“The recent global financial crisis exposed a number of governance weaknesses that resulted in firms’ failure to understand the risks they were taking.”**
- **“... many boards had directors with little financial industry experience and limited understanding of the rapidly increasing complexity of the institutions they were leading.”**
- **“Too often ... directors were too deferential to senior management.”**
- **“... many boards did not pay sufficient attention to risk management or set up effective structures ... to facilitate meaningful analysis of the firm’s risk exposures and constructively challenge management’s proposals and decisions.”**



HKMA requirements on corporate governance

- **HKMA requirements are set out in our Supervisory Policy Manual (SPM) CG-1 “*Corporate Governance of Locally Incorporated Institutions*”**
- **Revised in 2012 to include, among other things, a requirement that boards should contain 3 or one third Independent Non-Executive Directors (INEDs)**
- **Sets out responsibilities of the board, requirements on organisation and functioning, composition of the board, appointment of directors, qualifications and training and performance evaluation**
- **Requires Als to provide “tailored orientation or induction courses and with ongoing training”**



Survey of directors' training

- **HKMA conducted a survey on training made available to directors in September 2012**
- **Found that AIs do provide training but the scope, extent and resources available vary**
- **Larger AIs clearly have more resources**
- **Some AIs did not have structured ways to identify training needs or evaluate effectiveness**
- **Suggests that guidance and more resources for the industry as a whole would be useful**



HKIB programmes

- **HKIB primary provider of professional education to the industry**
- **HKIB programmes intended as a resource for the industry**
- **Not a requirement. Many AIs provide high-quality in-house programmes and there are other providers, both commercial and professional bodies**
- **No minimum hours requirement**



Director Development Advisory Group

- **Led by HKMA at ED level**
- **Members with wide experience of the industry**
- **To advise on the content of director development programmes and the types of activity that should be counted as continuing development**
- **To start work later in the year**



Follow-up

- **HKMA has issued a circular requiring locally incorporated AIs to submit records of the development activities undertaken by directors**
- **Advisory Group will advise on the types of activity. Not just classroom training. Participation in industry/professional seminars, publication of articles etc. Would like to see senior directors sharing their experience**
- **Records will be taken into account in HKMA's assessment of AIs' governance arrangements**



Face-to-face meetings with director and CE/ACE candidates

- **Launched in August 2012**
- **Supplements existing paper-based assessments for MA's consent under section 71 of the BO**
- **Allows us to get a better impression of candidate's experience, skills and personality; get to know those we have not met before; and communicate the HKMA's expectations**
- **Selective based on systemic importance of the AI, whether the candidate is new or already known to us. Particularly interested in meeting INEDs**



Face-to-face meetings with director and CE/ACE candidates

- **Still at an early stage**
- **Candidates generally well-qualified. There is a pool of talent here and overseas**
- **Larger banks tend to have better access**
- **3 or one third INEDs requirement both increasing demand and leading to more diversity**
- **Need to keep the pool refreshed**



How can directors fulfil their responsibilities in the current regulatory environment?

- **The global financial crisis highlighted areas not adequately covered by banks' risk-management frameworks or by regulatory standards**
- **Recent international regulatory reforms reflect what regulators believe is necessary to address these areas**
- **Directors need to understand all the material risks affecting their institutions and ensure risk management is effective**
- **A core competency at board level**



Key perspectives of risk management

- **Firm-wide**
- **Stress**
- **Systemic**
- **Conduct**



Firm-wide perspective

- **Risk-management frameworks must be able to identify and manage all major risks, whatever their nature**
- **At a minimum, directors must keep abreast of HKMA SPMs on risk management**
- **Directors should seek to go beyond this and support best practices**
- **Directors should be directly involved in determining risk tolerance and ensuring it is adhered to**



Stress perspective

- **RM frameworks must include realistic, “severe but plausible” scenarios – severe and long financial shocks**
- **What could get us into trouble?**
- **Keep analysis up to date**
- **Role of management/CFO, but directors should challenge**



Systemic perspective

- **Risks spread fast and hard in a crisis**
- **Not just direct exposures – contagion effects as well**
- **Basel III and other measures to address inter-connectedness**
- **But the first line of defence is institutions' own RM frameworks and boards need to understand risks**



Conduct perspective

- **HKMA Conduct Department set up in April 2010 in the wake of Lehman Brothers and Minibonds**
- **Banks are in a privileged position and enjoy the trust of customers**
- **If customers feel they are not treated fairly, the long-term interests of banks will suffer**
- **Boards must balance legitimate profit motive against reputation and other risks**



AML/CFT

- **AMLO enacted in 2012 and HKMA issued new guidance**
- **Increasing attention with high-profile cases in Hong Kong and overseas**
- **HKMA sees this as a board-level issue. Directors should ensure controls will protect AIs against legal and reputation risks**



Conclusion

- **The role of directors is to ensure proper governance and risk management**
- **Tone from the top is crucial**
- **If you feel you don't have adequate information, insist that management gives it to you**
- **If you feel you need to develop skills and knowledge in new areas, ask management to arrange it**
- **Ask difficult questions and challenge management**