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By email and by post

Ms. Carmen Chu,  
Executive Director (Banking Conduct),  
Hong Kong Monetary Authority,  
55<sup>th</sup> Floor, Two International Finance Centre,  
8 Finance Street, Central,  
Hong Kong.

Dear Ms. Chu,

**Consultation on Empowerment of Independent Non-Executive Directors in the Banking Industry in Hong Kong**

1. Thank you for seeking the views of the Hong Kong Institute of CPAs ("the Institute") on the above consultation. Generally, we are supportive of the proposed approach and consider that the consultation paper ("CP") helps to clarify the roles and expectations of independent non-executive directors ("INEDs") of authorised institutions ("AIs") from the perspective of the Hong Kong Monetary Authority ("HKMA"). Our more specific observations are provided below.

Constituting the board and its committees

2. In terms of finding the appropriate persons to be INEDs, this will obviously be a challenge in a specialised industry, such as banking. INEDs who may not be familiar with the regulations and operations of the banking sector will have quite a steep learning curve. They should be given sufficient support in terms of induction and ongoing training by the AIs concerned.
3. It is also suggested that the HKMA could play an active role in communicating information to INEDs, such as giving regular updates. The HKMA could also consider organising periodic forums where INEDs of AIs could gather to understand and discuss common concerns and challenges among their peer group, as well as from the HKMA's standpoint, and share good practices, which could be adopted in their respective AIs.
4. We agree with reference to the proposal that there should be at least one INED on the board with an accounting or financial background and that the audit committee/ risk committee chair should have such a background (paragraphs 2-5 of the CP). Financial expertise is fundamental and industry knowledge also valuable. The specifics can be addressed when particular candidates are being considered.
5. Paragraphs 4-5 of the CP indicate that AIs may have separate audit and risk committees. This may be beneficial for banks, which have specialised accounting and regulated risk dimensions. For other companies, notwithstanding the workload implications for the committee, there are often synergies and efficiencies in having audit committee oversight of risk assessment, both because of considerable risks related to accounting, controls, financial management practices and financial reporting, and also because of the inter-relations among management (especially financial), internal auditors, and external auditors, for



which the audit committee serves as an informed nexus. Thus, on balance for most companies, there may be advantages in combining the accounting and risk oversight roles in the audit committee. As such, a more complete discussion of the appropriate forms of risk management oversight for AIs may be helpful.

6. Where there is a separate risk management committee, it seems to us that it may not be necessary or appropriate for the committee to be comprised entirely of NEDs. While we would support the proposal that a majority of the committee be INEDs (incidentally it is not clear from the wording of the proposals whether the chairman is excluded or included in calculating the majority), it would make sense for a risk management committee to allow for or one or more executives that deal with risk management issues on a day-to-day basis also to be able to join as members.
7. Regarding paragraph 7 of the CP, AIs listed in Hong Kong will need to follow the stock exchange listing rules. Under the Corporate Governance Code at Appendix 14 to the Main Board listing rules ("CG Code"), Provision A.5.1 requires that issuers establish a nomination committee which is chaired by the chairman of the board or an INED and comprises a majority of INEDs. Provision A.5.2 states that, among other things, the nomination committee should be established with specific written terms of reference which deal clearly with its authority and duties.
8. In our view the above requirements should apply not only to listed banks but all banks in Hong Kong. The study group recommendations simply state that, where an AI has established a nomination committee, it should be chaired by an INED, who may be the chair of the main board. Therefore, in the case of an unlisted bank, while the committee may be chaired by an INED, the remainder of the members may be executive directors. This could lend the nomination arrangements the appearance, without the substance, of objectivity and independence, and also potentially place the chair in an invidious position. Hence our proposal to extend to all banks the listing rule requirements referred to above.

#### Qualities and background

9. With regard to paragraph 12 of the CP, while it is reasonable and non-controversial to recommend that "AIs should appoint 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", we would also agree, that suitable persons from outside the banking industry may also be considered for appointment, as indicated in paragraph 13 of the CP. Such persons may be able to provide fresh input and insights on the governance of banks.

#### Time commitment

10. As AIs are likely to be complex financial organisations, there would be an onus upon INEDs to obtain and keep up to date their knowledge of the industry. As indicated in paragraph 2, above, AIs also need to take some responsibility for making information and opportunities available to INEDs to develop and maintain their industry knowledge.
11. Paragraphs 16-17 of the CP on time commitment are correct in emphasising the considerable time required to perform INED roles properly, attend all board meetings, and join other meetings and briefings. However, no guidance is provided regarding the number of boards an individual may serve while observing these standards. Certainly, some boards are more demanding than others, and

the time commitment will depend on an INED's background, experience, and familiarity with the company and industry. Even so, as of today, web-site.com lists 57 directors who serve on seven or more boards and 14 Hong Kong directors who serve on ten or more boards each (one serves on 16). In addition, it lists over ten thousand directors who serve on only one board. Some guidance and leadership would be helpful to place reasonable upper bounds on the number of other boards that an INED serves and, depending on the size and complexity of the AI seeking board candidates, to observe possible benefits from appointing directors who have a range or depth of experience, albeit they may at the time serve on only one small board or on none other at all.

#### Independence and tenure

12. Regarding independence considerations, whilst the factors identified in the CP could and should be considered, they may not be sufficient to determine the independence of INEDs. More general principles in respect of independence requirements may need to be set out. It should also be recognised that independence is fundamentally a matter of the mindset and attitude of the person in question, which are qualities that are inherently difficult to assess. In this regard, we believe it is important for the HKMA to continue reminding INEDs and emphasising, on an ongoing basis, the importance of forming views and making decisions independently and that INEDs are expected to be able to demonstrate this attitude in carrying out their responsibilities.
13. The area of conflict of interests may need to be covered more explicitly. It is quite likely that some INEDs will previously have been working at competitors of the AI for which they are being considered, and in this regard, the principles may also need to refer to the avoidance of actual and perceived conflicts of interest. Another example in the context of a regulated industry might be where a former senior official from the regulatory body which regulated the AI subsequently becomes an INED of the AI. This could be perceived as a conflict of interest, particularly in the absence of a reasonable "sanitisation period" between leaving the regulator and joining the AI.

#### Remuneration of INEDs

14. With respect to remuneration, while it is helpful to try to establish some sort of baseline for INEDs' remuneration, this is a difficult area as the size and complexity of different AIs can vary significantly. Therefore, if a specific figure is quoted, the underlying principles need to be carefully enunciated to allow for the possibility of remuneration significantly in excess of the baseline. The baseline could be pitched as the minimum proposed level of remuneration for any AI, including relatively small and simple AIs. If it is considered necessary to stipulate fees, alternatively, consideration could be given to specifying a range of fee levels for different types/size of AIs, which could be updated periodically.

#### Board practices in relation to INEDs

15. We agree that AIs should arrange insurance cover to reflect the risks to which INEDs are exposed on the board of regulated entities. The principles could elaborate on what is regarded as "appropriate insurance". While the public would expect boards, ultimately, to be accountable for the decisions that they make, directors should, nevertheless, be able to obtain protection against legal action where they are discharging their responsibilities in good faith.

16. With reference to paragraph 31 of the CP, giving advice on the use of language and structure of board/committee papers may be seen as impinging too far on the detailed operational arrangement of AIs. It is up to INEDs to ensure that they understand the key parts of materials provided and to ask for more explanations if they do not. This goes back to the question of ensuring that people with the right qualities (not just an appropriate background and experience) are appointed to the important position of INED on the board of an AI.
17. Where the board chairman is not an INED (paragraph 36 of the CP; see also Question B above), consideration could be given to appointing a "senior INED", who could, among other things, be charged to take the lead to convene and chair separate meetings of INEDs.
18. Paragraph 38 of the CP refers to the ongoing dialogue between INEDs and the HKMA. In the context of an AI, should the principles also recognise that INEDs may, under certain circumstances, have a duty to raise matters with other regulators or to ensure that they are so raised?
19. Regarding paragraph 39 of the CP, more extensive and practical guidance may need to be given in relation to conducting evaluations of the performance of the board and individual directors, as this is not an area that is currently very well developed in Hong Kong.

#### Training and development requirements for INEDs

20. With regard to consultation question 3, on supply of suitable persons to take up INED roles, the HKMA may consider encouraging or supporting bodies like the Institute, the Hong Kong Institute of Directors and Hong Kong Institute of Bankers to organise training sessions to help prospective INED candidates familiarise themselves with banking industry regulations, operations and developments in order to ensure a sufficient and ongoing supply of INEDs in the banking sector. That said, in the short term, it is quite possible there will still be challenges in sourcing a sufficient number of people who are ready and able to serve as INEDs on the boards of all AIs in the Hong Kong market.
21. Consideration could also be given to encouraging AIs to pool resources to provide some general industry training for INEDs.

#### Other matters

22. As noted in the CP and above, listed AIs will need to comply with the listing rules. The CG Code (Principle A2) requires that there be a clear division of responsibilities between the management of the board and the day-to-day management of business, to ensure a balance of power and authority, so that power is not concentrated in any one individual. Code Provision 2.1 requires that the roles of chairman and chief executive should be separate and should not be performed by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established and set out in writing.

We would suggest that, in principle, similar requirements should also be applicable to unlisted banks in Hong Kong, given their systemic importance to the financial system, an importance acknowledged by the inclusion of all AIs within the proposed resolution regime under the Financial Resolution Bill, currently being considered by Legislative Council.



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

Should you have any questions on this submission, please feel free to contact me at the Institute, on 22877084 or by email at [peter@hki CPA.org.hk](mailto:peter@hki CPA.org.hk).

Yours sincerely

Peter Tisman  
Director, Advocacy & Practice Development

PMT/vc



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