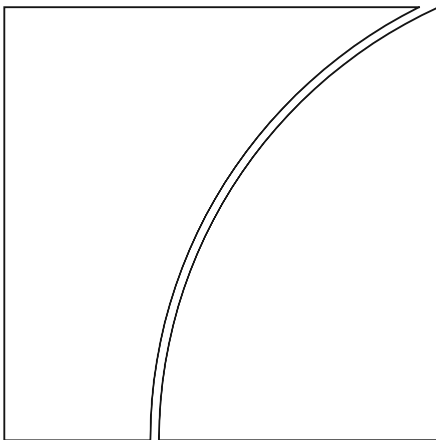
Financial Stability Institute

FSI Insights
on policy implementation
No 25



Bank boards – a review of post-crisis regulatory approaches

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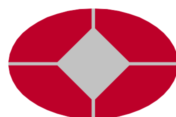
March 2020

JEL classification: G20, G21, G28, G30, G38

Keywords: Bank, bank governance, bank boards, board composition, board committees, board structure, bank directors, corporate governance, fit and proper, independent directors, INED



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ISSN 2522-2481 (print)
ISBN 978-92-9259-340-7 (print)

ISSN 2522-249X (online)
ISBN 978-92-9259-341-4 (online)

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Bank boards – a review of post-crisis regulatory approaches[1]

Executive summary

The corporate governance of banks differs from that of non-financial firms, due to the vital role they play in an economy. Banks intermediate funds from depositors to businesses and consumers, spurring economic growth. Their safety and soundness is therefore key to supporting the needs of the real economy and in fostering financial stability. Banks differ from non-financial firms in other ways too, such as their high leverage and heavy reliance on depositors and debt holders to fund their activities. How banks conduct their activities thus affects a broad range of society.

The Great Financial Crisis (GFC) exposed shortcomings in banks' corporate governance practices. Investigations by national authorities and international organisations found that bank boards were constrained by "groupthink", deferred excessively to senior management, allocated insufficient time to oversee the firm and lacked experience and knowledge. Other weaknesses included ineffective board structures and poorly designed compensation frameworks that led to excessive risk-taking.

Following the GFC, standard-setting bodies have tightened bank governance standards. In 2015, the Basel Committee on Banking Supervision and the OECD issued updated guidelines on corporate governance principles. In 2017, the Financial Stability Board conducted a corporate governance thematic review, focusing on how their members have applied the OECD Principles to listed financial institutions.

This study takes stock of specific aspects of the post-crisis regulatory approaches used in 19 jurisdictions to strengthen board oversight at banks. In particular, this paper reviews the "fitness and propriety" (F&P) assessments that these jurisdictions use to ensure that bank board members are suitably qualified. It also surveys guidance on board composition and structure.

While all jurisdictions have imposed the F&P criteria, some authorities have no regulatory approval powers or do not require prior regulatory approval of board members in all cases. Three surveyed jurisdictions either have no powers to approve board candidates, or despite having such powers, do not require prior regulatory approval. In a few countries, only certain key directors are subject to regulatory approval, or prior regulatory approval is required only if the bank is in a troubled condition.

Of the two F&P criteria, the "fitness" criterion is more difficult to assess and the level of prescriptiveness varies across jurisdictions. In all surveyed countries, the "fitness" criterion contains at least four elements: general expertise; practical banking experience; time commitment; and conflicts of interest. Differences arise in the detailed definition of these factors. Some authorities prefer a principles-based approach, while others have issued more explicit guidance to shape their supervisory decisions. As one aspect of the fitness criterion, several jurisdictions are prescriptive on time commitment, by limiting the number of external directorships that board members can hold. Some countries also include an 'independence of mind' concept within the 'fitness' criterion, which considers the candidate's ability to challenge directors and senior management, mitigating the risk of "groupthink".

Interviews are used in several jurisdictions as part of the F&P assessment. Authorities that conduct interviews usually do so on a case-by-case basis, focusing primarily on key positions, such as the chief executive officer (CEO) or the board chair.

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Regulatory requirements on the board selection process are limited and, when guidance is provided, it is largely principles-based. Authorities may consider whether more prescriptive guidance is warranted, particularly where suboptimal governance outcomes continue to be observed.

As independent non-executive directors (INEDs) play a critical role on bank boards, all jurisdictions provide some guidance on independence. In determining independence, all surveyed jurisdictions specify when a director is not considered independent, by focusing on the relationship between a bank and a director. While the details vary, many jurisdictions prescribe at least a two-year time limit within which a person must not have engaged in such relationships. In addition, most countries have made the independence assessment time-bound by restricting the period a director can remain on a bank's board and still be considered independent.

Board composition is an area where authorities impose requirements to facilitate more effective representation. Nearly all authorities require the CEO and chair to be separate, with most requiring the chair to be either a non-executive director (NED) or an INED. Many countries also specify the number or percentage of the board that must be either INEDs or NEDs, while others mandate tenure limits for NEDs. Lastly, several countries set expectations on board diversity, with some establishing quotas to ensure sufficient female representation, and others requiring employee representation.

Minimum requirements for committee structures are prescribed. Authorities typically require banks to establish risk, audit and remuneration committees, while ethics and culture committees are rare. Variations exist in the level of prescription and composition of each committee.

The review of F&P assessment approaches identifies practices that may be useful for supervisory authorities. Authorities might consider, where appropriate, the following aspects: seek regulatory powers to approve board candidates; and determine whether aspects of the fitness criterion can be enhanced to help support desired outcomes. These include clarifying the "expertise" requirements of board candidates, particularly the board chair and the chair of board subcommittees; assessing the time commitment of board candidates, considering their outside obligations; incorporating the "independence of mind" concept, which goes beyond determining whether candidates have a conflict of interest; and outlining the role of interviews in the assessment process. In determining formal independence, supervisory assessments might be improved by defining more concrete attributes for an INED; establishing maximum INED tenure limits; and monitoring how often INEDs dissent from the majority opinion.

The stock-take also provides insights on the methods authorities use to enhance board composition and structure. Several initiatives may be contemplated, such as: clarifying the role of the CEO and Chair, including the circumstances when dual hatting are possible; specifying the desired percentage of NEDs and INEDs on boards and their committees; articulating mandated board committees and who can chair such committees, given their critical role in supporting board decisions; outlining the maximum tenure of NEDs; and delineating expectations on board diversity, to help mitigate against 'group think' and to expand the board's focus to a broader range of stakeholders.

While regulatory guidance on corporate governance is applicable to all banks, authorities differentiate expectations through the use of proportionality. In terms of the F&P criteria, the "fitness" component is where proportionality is applied, given that the expertise and time needed to serve on bank boards may vary according to the bank's risk, size and complexity. Some jurisdictions also apply proportionality in determining board composition and committee structures.

Lastly, it remains an open question whether proportionality is the best mechanism for addressing the unique corporate governance challenges that may arise from differences in bank ownership structures. In this context, state-owned banks and banks with diversified and concentrated ownership raise distinct corporate governance issues; and authorities may consider whether existing regulatory guidance is sufficient to address these challenges.

Section 1 – Introduction

1. **Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders that provides the structure for setting corporate objectives, the means for attaining those objectives and the process for monitoring performance.**[2] Sound corporate governance practices are an essential component of an effective and efficient banking sector, which, in turn, helps to support the needs of the broader economy and to reduce systemic vulnerabilities. Therefore, how banks manage their day-to-day activities is critical to their financial health.

2. **Banks are, and should be, held to higher standards than non-financial companies due to the unique role that they play in an economy and the nature of their stakeholders.** Banks perform a critical role in an economy by intermediating funds from depositors to borrowers. Their safety and soundness is therefore crucial to the economy and in fostering financial stability, particularly in the case of systemically important banks. Additionally, banks differ from non-financial entities because of the complexity of their business activities and their multiple stakeholders. Unlike non-financial companies, shareholder equity represents only a small fraction of a bank's aggregate funding needs, with most bank financing drawn from a broad range of depositors and creditors, even though shareholders still control the entity. This creates a diverse set of stakeholders with an interest in the bank's financial health.[3]

3. **Given the central role that banks play in underpinning financial stability and supporting the needs of society, they have traditionally been subject to stringent regulatory and supervisory oversight.** This need for additional regulation extends beyond regulatory capital and liquidity requirements. It also includes requirements that bank directors and senior management be held to higher standards than those that apply to other commercial enterprises. Beyond the initial fit and proper assessments of bank boards and senior management, this also requires supervisors to continuously monitor bank governance practices.

4. **Failures in corporate governance were one of the key factors that contributed to the Great Financial Crisis (GFC).** Numerous post-GFC investigations found poor governance practices at the banks in the centre of the crisis.[4] These failures included insufficient challenge of senior management by directors as well as ineffective risk appetite and compensation frameworks, which failed to incentivise senior management to deliver prudent outcomes. In addition, some directors did not dedicate sufficient time to understand business models, resulting in inadequate oversight of material risk exposures.[5]

5. **Since the GFC, the global standard-setting bodies have tightened standards for bank governance.** In September 2012, the Basel Committee on Banking Supervision (BCBS) issued revised *Core principles for effective banking supervision* (BCPs), updating the 2006 BCPs. A new Core Principle was added as part of this revision to provide greater emphasis on the importance of sound corporate governance practices. In 2013 and in 2017, the Financial Stability Board (FSB) issued two reports in a thematic review on risk governance and corporate governance, as part of its series of peer reviews. The OECD Principles of

[2] The OECD Principles of Corporate Governance, first published in 1999 and updated in 2015, are designed to help policymakers evaluate and improve legal, regulatory and institutional frameworks for corporate governance with a view to supporting economic efficiency, sustainable growth and financial stability.

[3] See Brandt and Georgiou (2016) for a broader discussion on shareholder versus stakeholder capitalism. See also Mehran et al (2011) for a discussion on why banks' corporate governance is different from that of non-financial firms.

[4] See Financial Stability Board (2013).

[5] A key and ongoing challenge for senior executives is adequate board reporting, ie presenting the necessary information in a concise and timely manner so that non-executive board members are provided with sufficient material to help guide their decision-making.

Corporate Governance, first published in 1999, were updated in 2015. Similarly, in July 2015, the BCBS issued revised *Guidelines on the corporate governance principles for banks*, updating the 2010 principles to incorporate key lessons from the GFC.

6. **This paper provides insights on the regulatory approaches adopted by supervisory authorities to improve two important features of corporate governance practices at banks.** In particular, the scope is limited to an examination and comparison of the regulatory frameworks related to the fitness and propriety (F&P) assessment criteria as well as board composition and structure[6] across the surveyed jurisdictions. It is based on a survey of 19 jurisdictions, covering both BCBS and non-BCBS member jurisdictions, extending the FSB's earlier work.[7] Supporting reference material was provided with the survey responses and additional research based on publicly available material was undertaken to provide additional context.

7. **This paper is structured as follows.** Section 2 explores the regulatory architecture as it relates to corporate governance for banks. Section 3 looks at the concept of fitness and propriety, examining the role that supervisory authorities play in determining who can be a bank director. Section 4 assesses the supervisory expectations for board composition and their respective subcommittees, including the roles of the chair and of independent directors. Annex 1 describes the approaches taken in China, the European Union and the United States, while Annex 2 includes various tables on jurisdictions' regulatory requirements on director time commitment, board composition and committee structures. Annex 3 outlines the jurisdictions surveyed.

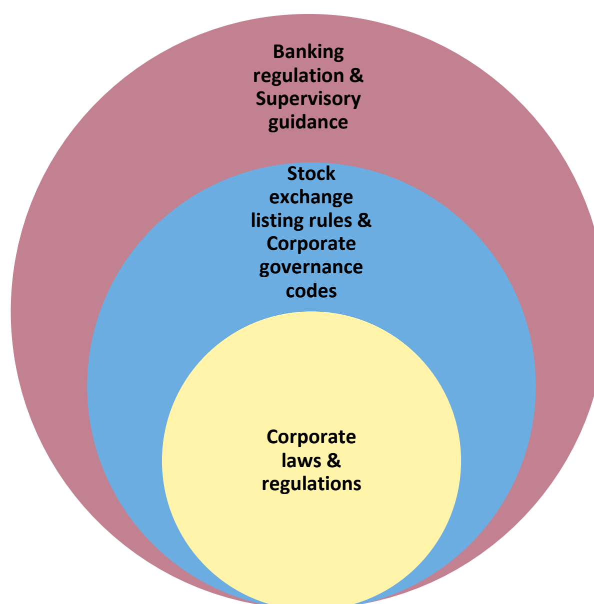
Section 2 – Regulatory architecture

8. **Corporate governance practices are based on a set of legal, regulatory and institutional frameworks comprising legislation, regulation, standards, self-regulatory arrangements, voluntary commitments and other business practices.** How these frameworks are formulated is shaped by global standard-setting bodies in combination with country- and industry-specific circumstances including history and tradition. Company law in a bank's operating jurisdiction provides the basis, including rules related to the establishment of a company, shareholder rights and directors duties. These legal requirements are often supplemented by corporate governance codes that apply to the largest companies listed on domestic stock exchanges and listing rules that specify various disclosures according to the principles set out in these codes, often on a "comply or explain" basis.

[6] This paper does not assess either the role or importance of proactive supervisory practices in ensuring that banks implement sound corporate governance practices, or of individual accountability regimes implemented post-crisis in some jurisdictions. Various regulatory mechanisms have been established in all surveyed jurisdictions in order to drive improvements in accountability in the banking sector. These include the individual accountability mechanisms recently established in the United Kingdom, Hong Kong SAR and Australia; improvements in supervisory expectations for sound remuneration practices; more traditional legal mechanisms established in company law that impose certain obligations on directors, and finally supervisory powers to remove or disqualify individuals from holding key positions in banks. In preparing this paper, we remain aware that no single model or framework can guarantee that banks operate with robust corporate governance practices at all times.

[7] See FSB (2017), which focuses on how FSB member jurisdictions have applied the OECD Principles to listed financial institutions. In addition, this paper differs from the FSB thematic review in its detailed coverage of the F&P assessment criteria and their linkage to board composition requirements across the surveyed jurisdictions as a means of reviewing the regulatory requirements for bank boards.

Figure 1: Regulatory architecture on corporate governance



Source: FSI.

9. **In the context of the banking sector, the Basel Framework requires supervisory authorities to determine whether banks have robust corporate governance policies and processes commensurate with their risk profile and systemic importance.** The BCPs,[8] which set the minimum standards for the sound prudential regulation and supervision of banks, note that this will require the implementation of bank-specific legal and regulatory frameworks which clearly articulate the corporate governance responsibilities of a board of directors and its senior management. The proportionality concept of the BCPs is reflected in a general principle that supervisory expectations should be commensurate with a bank's risk profile and systemic importance.

10. **The BCPs also state that supervisory authorities should establish guidance to ensure that banks have robust corporate governance policies and practices.** While company law, accounting standards, corporate governance codes and listing requirements may set governance standards in a particular jurisdiction, they are generally intended for all or a subset (in case of listing rules) of firms operating in that country; and these standards may not necessarily be sufficient to address the specific corporate governance needs of banks. When considered from a safety and soundness perspective, it is reasonable to expect some additional layers of regulation for banks.

11. **To the extent that governance standards for banks are set by various (non-supervisory) bodies, the additional complexity may create risks for banks and supervisors.** For banks, additional layers of regulation heighten their exposure to compliance risk. For supervisors, the risk is most evident where gaps and overlaps exist between regulatory frameworks, as administered by different authorities within a particular jurisdiction (ie the listing requirements of stock exchanges versus prudential requirements), and when questions arise around the boundaries within which bank supervisory authorities operate. Such approaches require enhanced cooperation among supervisory authorities.

12. **In some jurisdictions, key elements of the regulatory architecture for banks' corporate governance are set out in the corporate governance codes (and elsewhere) and do not fall expressly within the mandate of the banking supervisory authority.** These components variously include definitions for assessing the formal independence of a director, the expectations regarding the

[8] See Basel Committee on Banking Supervision (2012).

establishment of board subcommittees, and details concerning the composition of a board of directors and its subcommittees.

13. **Regardless of where aspects of the regulatory architecture reside in each jurisdiction, supervisors are ultimately responsible for the ongoing oversight of a bank's board and senior management.** In this context, BCP 14[9] – which outlines the minimum prudential requirements on corporate governance in banks – requires supervisors to determine that board members are qualified and effective; and to ascertain if the process for appointing and nominating board members and senior management, the composition of board membership, and board committee structures are commensurate with a bank's risk profile.

14. **Therefore, supervisors need to carefully ensure in their respective bank-specific regulatory frameworks that banks are held to a higher standard of governance without unnecessarily increasing the regulatory burden.** The potential weaknesses are particularly evident where expectations reside solely in corporate governance codes that apply only to listed banks, and even then generally only on a "comply or explain" basis. In these circumstances, it remains incumbent upon the respective supervisory authorities to review their regulatory toolkit and, at a minimum, actively engage with other relevant regulatory bodies to ensure that gaps or overlaps do not undermine the overall regulatory framework applicable to banks.

15. **The fitness and propriety of key decision-makers, the structure and composition of boards and their subcommittees are some of the common regulatory elements which provide a sound basis for the effective corporate governance of banks.** These elements also include the mechanisms that have been established to hold individuals to account when adverse risk and customer outcomes materialise.

Figure 2: Key elements of regulatory requirements for boards of directors

Source: FSI.

[9] For additional details, see Basel Committee on Banking Supervision (2012).

Section 3 – Fitness and propriety

16. **To help implement the applicable BCP on corporate governance, the BCBS issued guidelines that boards should have a clear and rigorous process for identifying, assessing and selecting board candidates.**[10] The selection process should include reviewing whether board candidates possess the knowledge, skills,[11] experience, integrity and good repute to adequately undertake their duties. Consideration should also be given to understanding whether prospective directors have sufficient time to fully carry out their responsibilities and whether they can promote smooth interactions between other board members and members of senior management. The time commitment is particularly relevant for troubled banks, given the heightened regulatory and supervisory scrutiny placed on such entities.

17. **These requirements are known as "fitness and propriety" (F&P) rules.** Such requirements act as a gatekeeper by preventing those who are unfit for office from holding senior positions in a bank. The ultimate responsibility for ensuring the F&P of directors and senior managers resides with the bank, regardless of the role that the supervisory authority may play in the formal approval process. Importantly, the F&P obligations apply at all times, not just on a person's initial appointment to a role.

Selection process

18. **Company laws prescribe the legal processes by which a person can become a director of a company.** This will ordinarily require the approval of shareholders. However, most company laws also allow the board itself to appoint a director, with subsequent approval by a shareholder general meeting. The Organisation of Economic Cooperation and Development (OECD) Principles[12] place emphasis on the need for a company's board to ensure that transparent procedures are established for the nomination and election of directors.

19. **Many boards have established a nominations subcommittee to oversee these processes.** Such a committee is not mandated by all surveyed jurisdictions as part of bank-specific regulation, with half relying on corporate governance codes which apply to listed companies in general, and usually only on a comply or explain basis (see Table 9 for further details).

20. **Given the importance of ensuring the board and senior management of a bank have the optimal mix of skills and experience, nominations committees are often tasked with the development of skills matrices.** This tool can help identify candidates that meet the specific needs of the bank and support the assessment of those candidates against the criteria set out by the regulatory authorities. But the initial and ongoing assessment of a person's individual suitability is the bank's responsibility.

21. **Open search processes for director roles have become increasingly important.** The OECD Principles note that there are increasing expectations that board positions extend to a broad range of people. The United Kingdom Corporate Governance Code published by the Financial Reporting Council (FRC)[13] also provides guidance that open advertising and/or an external search consultancy should

[10] See Basel Committee on Banking Supervision (2015).

[11] In this context, identifying prospective board members with sufficient expertise on technology-related matters has become particularly relevant.

[12] See OECD (2015a).

[13] See United Kingdom (2018). The FRC's Corporate Governance Code emphasises the value of good corporate governance to sustainable success, with the principles established therein operating on a "comply or explain" basis.

generally be used for the appointment of the chair and non-executive directors. Established market practice is understood to be largely consistent with these expectations in more mature jurisdictions.[14]

22. **Regulatory requirements and supervisory expectations regarding the selection process for directors are limited and are largely principles-based across surveyed jurisdictions.** When guidance is provided, it is generally high-level and focuses on the need for the board to establish processes to ensure that its directors individually and collectively have the skills and experience necessary for the bank's effective operation. Corporate governance codes in many jurisdictions also set an expectation for boards to ensure that processes are established to secure the balance of knowledge, skills, experience, diversity and independence a board needs in order to fulfil its governance and oversight responsibilities.[15]

23. **Supervisory authorities may wish to consider whether more prescriptive guidance regarding selection processes is warranted, particularly where suboptimal governance outcomes continue to be observed.** Such guidance may be particularly useful in expanding the pool of suitable board candidates, which, in turn, can help to diversify bank boards beyond the "usual suspects". An added benefit is that regulatory guidance on the selection process may also affirm and/or provide a direct linkage to expectations set out in relevant corporate governance codes that seek to drive improvements in board composition, including in relation to gender diversity (see Box 3 for further details).

Powers of authority

24. **The BCBS guidelines on corporate governance principles state that supervisory authorities should evaluate the processes and criteria used by banks in the selection of board members and senior management.**[16] Where necessary, supervisors should seek to obtain further information about the expertise and character of such persons to ensure that they are deemed appropriate to undertake key bank functions.

25. **How supervisory authorities have approached this task varies across the surveyed jurisdictions.** While all jurisdictions have defined "fit and proper" criteria for use by banks in the selection process that are consistent with the BCBS Guidelines, Australia,[17]Chile[18] and Germany[19] do not require director appointments to be subject to formal regulatory approval processes.

26. **Most jurisdictions do incorporate the formal approval of directors as part of the regulatory framework.** Table 1 shows the jurisdictions where the supervisory authority undertakes its own assessment of the F&P of a proposed bank director. This process generally involves the submission of a detailed application to the relevant authority, providing salient information about the background, skills

[14] See Financial Stability Board (2017) for board nomination processes in FSB member jurisdictions.

[15] See King IV (2016). The King IV Code published by the Institute of Directors in South Africa sets out the philosophy, principles, practices and outcomes which serve as the benchmark on corporate governance in South Africa. The principles detailed in King IV are less prescriptive than in the predecessor versions of this Code, but they have moved to an "apply and explain" approach from the more commonly used "comply or explain" approach adopted in many jurisdictions, while incorporating the principle of proportionality.

[16] See Basel Committee on Banking Supervision (2015).

[17] Australia requires directors to be registered with the supervisory authority in accordance with the provisions of the Banking Act.

[18] Chile requires banks to notify the supervisory authority of the appointment of directors.

[19] Germany requires formal notification of appointment (executive directors before appointment and non-executive directors post-appointment) and retains the power to demand a person's dismissal, prohibiting them from undertaking such a role where it is found or if it can be inferred that they do not or no longer meet the applicable fit and proper requirements. For significant institutions in Germany under direct supervision by the ECB, the formal approval process is applied as described in the Annex.

and experience of the proposed director, the specific role that the bank intends this candidate to play in its governance structure and an explanation of how the candidate's skills match the bank's requirements given the nature of its operations and risk profile.

27. **Coverage of the requirements for approval also varies across jurisdictions.** In the United Kingdom, not all directors require the prior approval of authorities,[20] while in India approval is only required for the chair and for executive directors. In South Africa, approval is required where a director resigns and is reappointed after 12 months; and in the United States[21] approval is required in certain prescribed circumstances, mainly linked to the supervisory assessment of the bank. For the European Central Bank (ECB), while approval of directors is required, this sometimes occurs post-appointment, given differences in the national legal frameworks.

28. **Most jurisdictions that require prior regulatory approval of incoming directors, also set comparable requirements for the renewal of director positions.** Where such mechanisms exist for directors seeking another term of appointment, they follow a similar process to a new application, noting that the person in question would already be known to authorities as a result of prior approval processes and ongoing supervisory engagement.

[20] In the context of the board, the United Kingdom requires prior regulatory approval of the board chair, the chairs of the risk, audit, remuneration and nominations committees, and the senior independent director; the appointment of other directors only requires notification.

[21] The United States requires regulatory approval where a bank is not in compliance with minimum capital requirements or is deemed to be in a "troubled condition".

Appointment of directors

Regulatory powers Table 1

Jurisdiction	Prior approval (initial appointment)			Approval for renewal		
	Not required	Required for all banks	Required in some cases	Not required	Required for all banks	Required in some cases
Australia	✓			✓		
Bahrain		✓			✓	
Belgium		✓		✓		
Brazil		✓			✓	
Chile	✓			✓		
China		✓			✓	
ECB			✓			✓
Germany	✓			✓		
Hong Kong SAR		✓		✓		
India		✓			✓	
Malaysia		✓			✓	
Netherlands		✓				✓
Nigeria		✓			✓	
Philippines		✓				✓
Russia		✓		✓		
South Africa		✓				✓
Thailand		✓			✓	
United Kingdom			✓	✓		
United States			✓			✓

Brazil – Central Bank approval not required for directors of five federal public institutions.

Source: FSI survey.

29. **The involvement of supervisory authorities in approving senior management appointments at banks depends largely on the function that a candidate will undertake.** In jurisdictions that operate with a dual-board structure,[22] candidates for the management board are subject to substantially the same regulatory approval processes as those for board directorships. In jurisdictions that operate with a single board structure, regulatory approval for a senior management appointment is likely to be required only where a candidate is also a board member.[23]

30. **Although most supervisory authorities play a key role in the approval of the appointment of bank directors, many have indicated that it is less common for applications to be formally rejected.** In circumstances where supervisory concerns about a candidate become evident during the review of an application, these jurisdictions have indicated that it is more common for the bank (and the

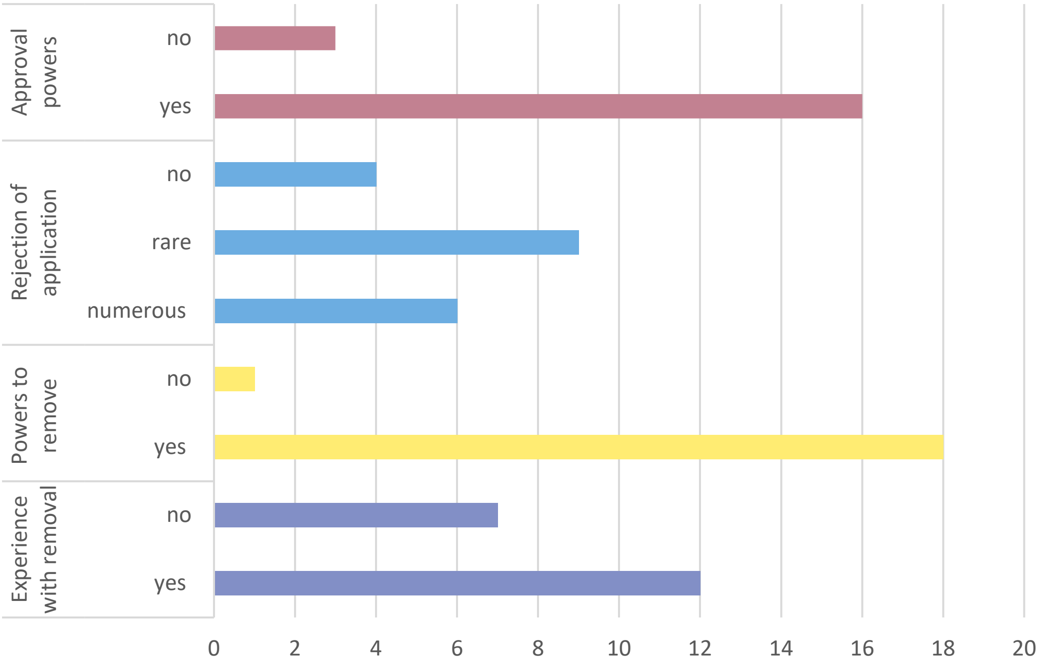
[22] Some countries use a formal two-tier board structure, where there is both an executive/ management board and a supervisory board. The supervisory board, generally appointed by shareholders, typically has no executive functions. The management or "executive" board is commonly comprises the company's senior-level employees and is often appointed by the supervisory board. Other countries use a one-tier structure, in which the board of directors has a broader role and includes a mix of both executive and non-executive directors.

[23] Jurisdictions such as Australia, Hong Kong SAR and the United Kingdom have implemented specific legislative regimes dealing with senior manager appointment processes.

individual concerned) to withdraw an application rather than have it formally declined by the supervisory authority.

31. **Almost all jurisdictions have powers to remove or disqualify existing board directors before their term expires, and most have experience with supervisory removal.** The BCPs note the importance for a supervisory authority to have the power to require changes in the composition of the bank's board when it believes that a director is not fulfilling his or her duties. Figure 3 shows that all but one jurisdiction have regulatory powers to remove directors. Given the legal and administrative complexities that can sometimes be associated with a formal declaration that a person is not fit and proper, a number of jurisdictions have indicated that the activation of powers to remove a director of a bank is not common.[24] Many banks tend to address supervisory concerns by instituting internal processes to remove individuals who have come under the scrutiny of the regulatory authorities. Where the authorities do formally make a decision to disqualify a person, recording the name of the person on a public register is a useful mechanism to mitigate the risk of that person from being appointed to a similar position in another bank.

Figure 3: Powers of authority



Source: FSI survey.

Fit and proper criteria

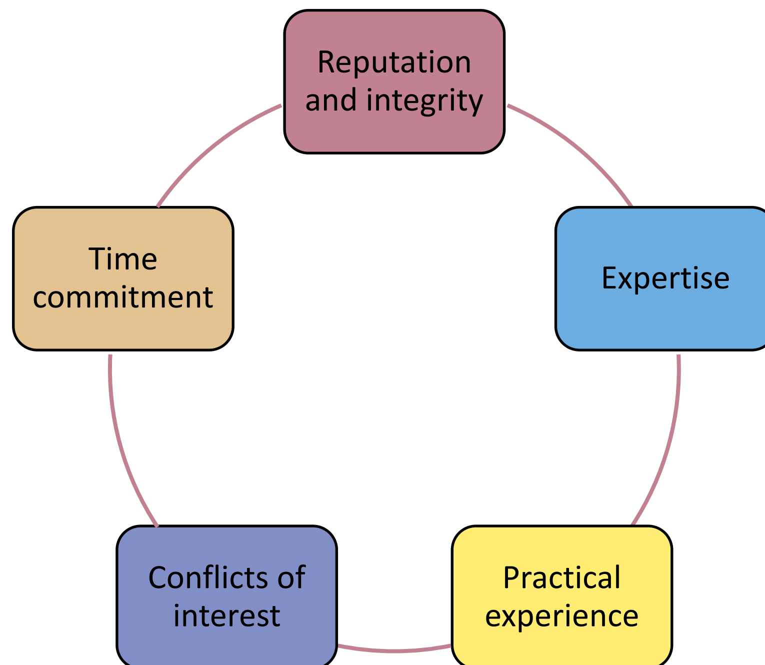
32. **The fit and proper assessment rests on a combination of principles-based and prescriptive guidance across surveyed jurisdictions.** This approach is taken whether or not the supervisory authority

[24] There are usually various complex steps to formally declare a board director "unfit". Where a supervisory authority has the power to disqualify an individual, justice or fairness obligations will apply given that it is an administrative decision. Authorities will likely need to provide the individual with an opportunity to respond to the proposed decision through a "show-cause" process before any decision is made. After any decision, there is also likely to be an appeals process where the individual can seek a further administrative review of the decision and also possibly a judicial review of any subsequent decision. If all of this still results in the person being disqualified, the company may need to seek shareholder approval to remove that director as, depending on the operative provisions of the company's by-laws, only shareholders can remove a director.

has the power to approve an appointment. The various methodologies that have been adopted across jurisdictions can be broken down into a number of subcomponents as depicted in Figure 4.

33. **Of the two criteria, the "propriety" element is where regulatory requirements are more prescriptive.** It seems easier to clearly define when a person is not considered "proper" to be appointed as a director or senior manager of a bank than whether an individual is "fit" for the position. In the fitness space, given the degrees of supervisory judgment involved, authorities typically follow softer "guided discretion" approaches for judging certain subcomponents of the fitness criterion, such as expertise, practical experience and time commitment.

Figure 4: Components of fitness and propriety



Source: FSI.

Propriety

34. **For the purposes of this report, we have classified the propriety subcomponent under the reputation and integrity assessment.** The definition of propriety is consistent across the surveyed jurisdictions and rests on a consideration of whether the person has:

- been convicted of any crime that relates to dishonesty and/or integrity;
- been the subject of an adverse finding in a civil action by any court;
- been adjudged bankrupt;
- been disqualified by a court or other competent body as a director or manager of a corporation;
- been a director of a company which has been wound up by a court on the application of creditors;
- failed to satisfy a judgment debt under a court order resulting from a business relationship; and
- a record of non-compliance with statutory codes as well as a record of disciplinary or other supervisory actions.

Fitness

35. **In most surveyed jurisdictions, the criteria in the fitness component of the F&P assessment incorporate expertise, practical experience, conflicts of interest, and time commitment.** For each of

these subcomponents, the level of detail provided in regulatory guidance varies across jurisdictions; this ranges from high-level principles such as "a director must have relevant experience to undertake the role" to prescriptive requirements such as the minimum number of years of experience in banking and finance related-roles that a candidate must have to be considered for approval by the supervisory authority. In addition to the assessment of fitness on an individual basis, there is also an assessment of the board on a collective basis to make sure the board is capable of discharging its duties (see also paragraph 46).[25]

36. **When considering expertise, supervisory authorities examine the candidate's education and theoretical knowledge.** Supervisors conduct this examination in the context of candidate's prospective role. They assess the educational qualifications relevant to banking and financial services and the theoretical knowledge covering banking and financial markets, regulatory and legal requirements, strategic planning, risk management, accounting and the ability to interpret financial information, governance, oversight and controls. In addition, knowledge of technology is also increasingly being assessed.

37. **When assessing a candidate's practical experience, supervisors focus on the candidate's current and previous business positions.** This will include the candidate's length of service, the nature and size of the business, the responsibilities held, the number of subordinates, and the reporting lines and delegated authorities. Other more generic skills gained through management experience would also be assessed under this criterion.

38. **The jurisdictions that consider a time commitment factor as part of the F&P test restrict the number of external directorships that a person may hold.** When considering time commitments, factors such as the number of directorships held, the size, nature, scale and complexity of the institutions where those directorships are held and the existence of any other professional or personal commitments and circumstances form part of the regulatory assessment process. This is pertinent given the growing expectations regarding the amount of time that directors must commit. Given the increasing complexity of the banking business, jurisdictions may find value in enhancing their regulatory expectations and guidance in this area (see Annex 2, Table 4 for information on jurisdictions that impose limits on external directorships).

39. **Supervisory expectations and guidance on conflicts of interest typically note that banks are responsible for identifying any actual or potential conflicts.** The criteria for assessing conflicts of interest are similar to the criteria for determining whether a person is formally independent; that is, the existence of personal or professional relationships, or prior employment, which may act to impede the exercise of independent judgment. Other aspects to be considered include the candidate's economic interests and any financial relationship with a bank,[26] relationships with material customers or suppliers to the bank and any political relationships. Supervisory guidance also notes the importance for conflicts of interest to be adequately disclosed, managed via a person who is not a party to relevant discussions and avoided where significant. Importantly, these aspects apply to all directors at all times, not only in relation to assessing formal independence.[27]

40. **Proportionality is only applied with respect to the fitness component of the F&P test.** This typically covers the expected skills and experience of a person as relevant to a particular role in a specific

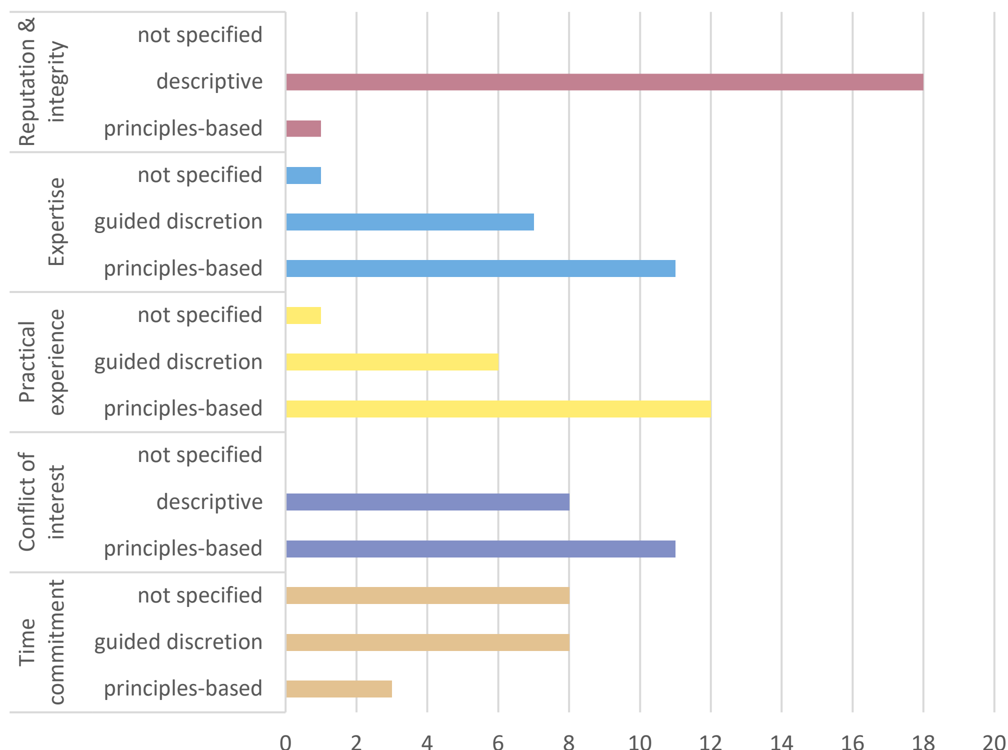
[25] Independent, non-executive directors (INEDs) may, for example, not necessarily have experience in banking and finance when they are appointed, such as professors, industrialists, technologists or other professionals, but such INEDs may still be needed to enhance the board's diversity and overall capability.

[26] Financial relationships that may act to create a conflict of interest do not extend to a person using standard banking products transacted on an arms-length basis or owning equity in the bank, provided that the exposure is not considered material, both from the perspective of the bank and the individual concerned.

[27] Depending on the specific ownership structure, the assessment of formal independence or at a minimum conflict of interest becomes more important (see Box 2).

bank. Importantly, proportionality principles do not apply to matters regarding the propriety of a director or senior manager, where supervisory expectations are applied uniformly and consistently.

Figure 5: Fitness and propriety: principles-based, guided discretion or descriptive criteria



Source: FSI survey.

Independence of mind

41. **Company laws place the onus on directors to act in the interests of a company at all times, exercising independent judgment in discharging their obligations.** This expectation applies whether or not a director is an executive of the company, has been appointed by a significant shareholder or is classified as independent in line with regulatory requirements and guidance material.

42. **Some jurisdictions reference "independence of mind" within supervisory guidance material as an element of the F&P criteria.** By considering the candidate's character, supervisory authorities form a view on his or her ability to constructively engage with fellow directors and senior management and, where necessary, mitigate the risk of "groupthink". For example, the joint European Banking Authority (EBA) and European Securities and Markets Authority (ESMA) Guidelines[28] include this important concept as a key component underpinning the F&P assessment process.[29] In accordance with these guidelines, independence of mind is examined with reference to a candidate's behavioural attributes and the existence of relationships between the candidate and the bank in order to identify any factors which may act to impede them from taking an impartial perspective in discharging their responsibilities. An explicit rather

[28] In 2017, the EBA and ESMA published guidelines on the assessment of the suitability of members of the management body and key function holders under Directive 20113/36/EU and Directive 2014/65/EU. These guidelines provide a set of common criteria to assess the individual and collective knowledge, skills and experience of members of the management body as well as the good repute, honesty and integrity, and independence of mind.

[29] The ECB-SSM provides guidance on criteria to be assessed when considering independence of mind including behavioural attributes such as courage, conviction and strength to effectively assess and challenge proposed decisions; and the existence of any conflicts of interest to an extent that would impede a candidate's ability to perform duties independently and objectively.

than implicit linkage to related-party transactions requirements would likely strengthen this aspect of the framework.

Interviews

43. **As part of the F&P process, 10 surveyed authorities conduct interviews of a prospective applicant.** This helps supervisors to clarify certain aspects of an application or where more information is considered necessary. Interviews are typically conducted where the candidate is being considered for the position of board chair, chair of a board subcommittee or CEO/managing director.

44. **Interviews conducted as part of regulatory approval processes assess the individual's fitness and contribution to the overall functioning of the board.** In particular, interviews focus on the candidate's practical experience, their depth of knowledge about the bank and their understanding of industry and market developments. Interviews are also used to ascertain the candidate's awareness of their responsibility to treat customers fairly and their broader responsibilities towards ensuring the bank's safety and soundness and prudent risk management. Lastly, interviews help to explore issues of integrity and propriety or in verifying facts to gain additional assurance about specific elements of a candidate's fitness and propriety. For the supervisory authority, an interview provides a valuable opportunity to sound out a candidate's understanding of the supervisory expectations for board members. (see Box 1).[30]

[30] Interviews let supervisors clarify any concerns arising from the desktop review or vetting, and allow the candidate to be heard if there are concerns that might lead to a refusal of regulatory approval.

Box 1

The Netherlands Bank's approach to fitness and propriety interviews

The Netherlands Bank (DNB) is mandated to ensure that financial institutions act soundly and ethically and can meet their obligations to customers. The Netherlands Authority for the Financial Markets (AFM) is responsible for market conduct supervision and seeks to promote fair and transparent financial markets. DNB and the AFM work closely together in assessing members of banks' management and supervisory boards.

The responsibility for conducting interviews as part of the F&P assessments depends on whether the entity is considered a Significant Institution (SI) or a Less Significant Institution (LSI). For SIs, supervision is under the purview of the ECB and ECB officers are responsible for running the interview and assessment process in collaboration with DNB (see Annex 1 for further details).

LSIs operating in the Netherlands must seek the approval of DNB to appoint any candidate to the management or supervisory board of a financial institution. DNB assesses the fitness and propriety of a candidate based on the information submitted by a financial institution/candidate and any other information DNB may have at its disposal. DNB interviews the candidate where additional information is required, or where the position sought is the board chair, CEO, CRO or chair of a board subcommittee. The use of interviews is risk-based, in line with the principles of proportionality. It is generally expected that a financial institution will help its nominee prepare for an interview. Via its website, DNB also provides background information about these processes, including sample questions on the topics likely to be covered in an interview.

Interviews are conducted as an open dialogue, with a series of questions to assess the candidate's background, skills and experience as well as their understanding of the institution including its size, complexity, risk profile, corporate culture and the composition and functioning of its board. Questions focus on the specific nature of the role that will be performed. In addition to functional and competency-based questions, candidates are generally asked to provide examples of instances where desirable behavioural traits such as intellectual curiosity and constructive challenge have been demonstrated in order to assess their propensity to bring independence of mind to board deliberations. As part of this process, DNB will also assess how the candidate is expected to contribute to the collective suitability of the governing body. Importantly, the interview process gives the supervisor an initial insight into the personal qualities that a person is likely to bring to their role as a member of a management or supervisory board and provides an opportunity to ensure that the candidate understands the ongoing supervisory expectations for persons performing such roles.

The interview process is managed by the ECB (if SI) and/or a specialist from DNB's Expert Centre on F&P Testing together with one or two of the institutions' regular supervisors. A representative from the AFM will also participate where relevant to its mandate. Representatives from DNB's Expert Centre on Governance, Behaviour and Culture may assist in the preparation of specific questions for the interview where DNB is aware of issues relating to the culture or conduct of a particular financial institution, but the Centre is not involved in the F&P interview process itself. DNB has also recently piloted the use of external experts, consultants and senior industry practitioners to assist in the interview process. This pilot was designed to provide a peer perspective on the fitness and propriety of prospective candidates while affording an additional degree of independence to the assessment.

A further interview will be convened where the initial processes have not provided a sufficiently clear and comprehensive view of the candidate to support an informed decision. Where this occurs, the candidate is advised why a second interview is deemed necessary and the interview is conducted by different DNB officers, including a senior manager.

The interview informs DNB's decision on whether to approve a candidate for a position as a member of management or a supervisory board. Where DNB is inclined to reject a candidacy, the candidate is advised of the reasons for the decision and has a right of appeal through an administrative and legal process.

Box 2

Governance frameworks and ownership structure

While unique corporate governance challenges arise from different bank ownership structures, the basic principles underlying sound corporate governance should be consistently applied to all banks, subject to the principles of proportionality. Below, we outline three ownership structures, setting out the respective governance challenges:

- **Banks with diversified share ownership:** listed banks may have a diverse range of shareholders, with no single controlling shareholder. Shareholders may be represented by large mutual fund companies, who act on their behalf. Mutual funds with a passive strategy (such as index funds) or a diversified investment strategy may have insufficient "skin in the game", potentially reducing their willingness to vote against the interests of bank management. On the other hand, mutual funds with a more active investment strategy may consider corporate governance as an evaluation criterion when selecting bank stocks. In general, the corporate governance challenge for dispersed share ownership structures is that bank executives – by taking advantage of the diversified ownership structure and the informational advantage they hold over the owners – may not run the company in the best interests of the shareholders. While the board of directors should provide oversight of managers on behalf of the firm's owners, there is a risk that, over time, the CEO will start to influence the board and therefore be in a position to subvert the board's efforts to oversee management.
- **Banks with concentrated ownership:** concentrated share ownership may be present in either privately held or listed entities that are controlled by an individual or a group of related parties or family members. In these cases, the controlling shareholder has much greater authority to appoint executive officers and directors (subject to regulatory approval). A controlling shareholder may also be involved in, or have greater awareness of, the bank's day-to-day operations, increasing the likelihood that the bank's resources can be diverted to serve his/her own personal interests. The corporate governance challenge in this case is to ensure, through various governance mechanisms, that the controlling shareholder(s) act in the bank's best interests.
- **State-owned banks (SOBs):** SOBs may have specific governance challenges when pursuing the dual objectives of carrying out banking business and fulfilling a public policy role, which may be subject to political influence. In many cases, proposed directors may be political appointees, who may not have the experience to supervise bank management. In this regard, the OECD Guidelines on Corporate Governance of State-Owned Enterprises set out a number of principles for sound governance practices.① Governance structures and regulatory frameworks are recommended that are similar to the oversight arrangements prescribed for private banks.

The jurisdictions surveyed in this study noted that regulatory requirements and supervisory guidance are largely consistent across the banking sector, with proportionality applied based on the size and complexity of a bank and its operations, and not primarily in relation to its ownership structure. The exception was in relation to SOBs, many of which operate under a separate and distinct legislative regime. While these requirements are described as akin to that applied to privately owned banks, they are also subject to a layer of government or ministerial oversight and approval sitting above that of the supervisory authority.

Thus, supervisors may find it difficult to address specific governance challenges arising from various ownership structures with a "one-size-fits-all" regulatory guidance, especially if the guidance is largely principles-based but subject to a proportionate application. Consequently, there may be benefits in tailoring guidance on fitness and propriety and on board composition to banks with varying ownership structures. This, in turn, may help supervisors to push for improved corporate governance practices across the banking sector.

Source: ① See OECD (2015b). These guidelines are the internationally agreed standard on how governments should exercise the state ownership function to avoid the pitfalls of both passive ownership and excessive state intervention.

Section 4 – Board composition and structure

Board diversity

45. **A board's composition and diversity are critical to its effectiveness.** Effective corporate governance requires a board of directors to listen, contribute, challenge and, when necessary, push back against senior management. A board should comprise a mix of executive directors (EDs), non-executive directors (NEDs) and independent non-executive directors (INEDs), so that it can draw on a depth and breadth of insights, perspective and experience. Ideally, diversity will encompass more than gender, age, and ethnicity, adding a broad range of skills, competencies, philosophies and life experience that will bolster the board's strategic and risk-decision making capacities.

46. **Regulatory requirements for board composition are mainly principles-based but vary across surveyed jurisdictions.** The board and its nominations committee are responsible for ensuring that the board of directors collectively has the necessary skills, experience and expertise. Regulatory guidance on board composition and the ideal mix of directors remains largely principles-based, except in jurisdictions that specify minimum criteria for the number of NEDs and INEDs and set out the roles that boards and their committees must perform.

47. **Supervisors usually apply proportionality to their expectations for the composition of boards and committees.** The board's composition, including the minimum number of INEDs as well as the types of committee required, varies across jurisdictions, according to a bank's size and the nature of its business operations.

48. **Most jurisdictions specify a minimum of three to five directors for a bank, with few specifying a maximum number.** There is no definite guidance on what constitutes the optimal size for a board of directors and this will necessarily depend on the nature and scope of its business operations. While larger boards can draw on a broader range of skills, capabilities and perspectives, smaller boards may find decision-making more efficient, thereby providing more time for strategic discussion. In either instance, the role of the chair remains pivotal.

49. **The representation requirements for INEDs varies significantly across survey jurisdictions.** While all jurisdictions set specific requirements or guidance that boards should include INEDs, the representation requirements vary markedly, with some specifying a majority, others one third and still others requiring a specific number only. Similar regulatory requirements and supervisory expectations were reported in the 2017 FSB Thematic Review on Corporate Governance Peer Review Report,[31] notwithstanding differences in actual board structures across jurisdictions (see also Table 5).[32]

50. **Most jurisdictions also require boards to formulate a succession plan.** A succession plan should ensure that the collective knowledge, skills and expertise of the board remain appropriate for both the current and future needs of a bank, given its strategic objectives and risk profile. A regular self-assessment may help to retain board diversity and collective board expertise.

[31] See FSB (2017). This report noted the need to strengthen corporate governance frameworks, as well as the related rules and the practices of listed financial institutions in member jurisdictions. Similar to our survey results, all FSB member jurisdictions had specific guidance for boards to include INEDs, but the representation requirements for independent directors varied significantly.

[32] Some countries use a two-tier structure, where the supervisory function of the board is performed by a separate entity known as a supervisory board, which has no executive functions. Other countries, by contrast, use a one-tier structure in which the board has a broader role.

51. **Some jurisdictions also set specific limits on the maximum tenure of an NED, to ensure that boards benefit from fresh perspectives.**[33] For example, India mandates a maximum consecutive term of eight years for NEDs other than the chair, for whom no limit is prescribed. The Netherlands specifies a maximum of two terms of four years each for an NED (with a further two-year extension permitted exceptionally) and Nigeria prescribes a maximum of three terms of four years each. Such mechanisms are seen as promoting independence of mind and constructive challenge, but care is needed to manage the succession process smoothly to ensure that sufficient corporate experience is preserved.

52. **Several jurisdictions have regulatory requirements or supervisory expectations for gender diversity.**[34] These are contained primarily within the respective corporate governance codes, most of which operate under a "comply or explain" rule, with disclosure and explanation required where an institution departs from the defined principles. For most jurisdictions, the guidance within these codes remains principles-based, obliging the board to establish targets and disclose progress towards meeting them annually (see Box 3). In some jurisdictions where a dual board structure has been adopted, including China, Germany and the Netherlands, requirements also exist for employee representation of 33% on the supervisory board (or a higher proportion, depending on the company's size).

53. **Recent public debate has focused on a perceived need for boards to consider the interests of a wider range of stakeholders, while recognising the primacy of the shareholder relationship.** Greater diversity might help boards to move in this direction. In fact, the fiduciary requirement for directors to act in the best interests of a company should encourage boards to consider the impact of decisions on a broad range of stakeholders. In August 2019, the Business Roundtable representing the CEOs of leading US companies formally recognised this by committing its signatories to delivering value to all stakeholders.[35] The performance of a sample of banks in the aforementioned jurisdictions in delivering sound financial, risk and customer outcomes might reveal some insights into the value-added (or otherwise) of enhancing supervisory guidance in respect of gender diversity and/or employee representation on bank boards.

54. **Overly prescriptive requirements for board composition, however, may inadvertently restrict qualified board candidates to become member of a board.** This may result in a board that collectively may not have a sufficiently detailed understanding of the bank's operations.[36] Overly prescriptive requirements, if they result in a "tick the box" mentality or shrink the pool of potential board candidates could be counterproductive. Supervisory authorities should monitor the effectiveness of the regulatory framework to ensure that it continues to help advance corporate governance practices.

[33] These limits are different from the limits on assessing independence of board members.

[34] See OECD (2019).

[35] The Business Roundtable committed itself to delivering value to customers, investing in employees, dealing fairly and ethically with suppliers, supporting communities and delivering long-term value to shareholders.

[36] A recent report from Kiel Advisory noted that despite the best efforts and intentions of NEDs, detachment from day-to-day operations, limited direct industry experience, and increasingly complex and evolving environments can collectively hinder them from understanding the businesses they are responsible for overseeing.

Box 3

Initiatives to promote diversity

Whether directors can collectively challenge, supervise and guide senior management depends in part on their diversity. This can take various forms in a boardroom, including skills, background, expertise, experience, gender, age and ethnicity. In a 2018 IMF paper, the presence of women and a higher share of women on bank boards appears to be associated with greater financial resilience.①

BCBS Guidelines state that a board should comprise individuals with a balance of skills, diversity and expertise that are commensurate with the size, complexity and risk profile of the bank. The G20/OECD Principles also recognise the importance of bringing diversity of thought to board discussions, stating that "countries may wish to consider measures such as voluntary targets, disclosure requirements, boardroom quotas and private initiatives that enhance gender diversity on boards and in senior management".

Regulatory reforms have also encouraged, specifically, gender diversity on boards, with several jurisdictions adopting measures to promote gender diversity through either voluntary targets or in some instances, by imposing specific requirements. These requirements are typically contained within the national corporate governance codes. In contrast, supervisory expectations remain principles-based and rely on boards to establish diversity targets.

The European Commission (EC), in 2013, proposed improving the gender balance among listed company directors by setting a binding target for women of 40% among non-executive directors (NEDs). Some European countries have also legislated gender quotas. To promote gender diversity in banks, the EBA has set expectations for diversity policies at significant institutions (SIs), by requiring SIs to quantify the participation of the underrepresented gender and specify an appropriate timeframe within which the target should be met and how it will be met.②

Among the countries with prescriptive quotas, Belgium requires women to comprise at least 33% of listed company boards, making the nomination committee responsible for ensuring an appropriate gender balance.③ Germany's corporate governance code requires listed companies to implement a gender target for the management board and a minimum of 30% for each gender in the supervisory board.④

In South Africa, the Corporate Governance King IV code proposes that each company set and publish race and gender targets for board membership.⑤ The code suggests that the board should promote diversity to enhance decision-making and governance, including field of knowledge, skills and experience, age, culture, race and gender. Specifically, the code now requires disclosing targets for race and gender representation on board membership. Another enabler of diversity has been the Broad-Based Black Economic Empowerment Act, which sets black economic empowerment within the context of a national empowerment strategy focused on historically disadvantaged groups, particularly black people, women, youth, disabled people and rural communities. A gender quota was introduced in South Africa's Women Empowerment and Gender Equality Bill 2013, which required companies and government departments to ensure that their decision-making bodies were at least 50% female by 2017.⑥

Malaysia has set a target of 30% female board representation by 2020 at the top 100 listed companies. To reach this target, it has "named and shamed" companies that have failed to appoint more women to their boards.⑦

In the United Kingdom, the Davies review reported that female representation on the FTSE 100 companies had more than doubled in less than five years, to 26%, by October 2015 and proposed increasing the voluntary target for the boards of FTSE 350 companies to a minimum of 33%, to be achieved over the next five years.⑧

Sources: ① The IMF staff discussion note "Women in Finance: A case for closing gaps" showed that more women on bank boards is positively associated with bank stability, higher capital buffers and higher profitability. ② The Explanatory Memorandum accompanying the EC Directive on improving the gender balance among NEDs of listed companies noted that the under-utilisation of highly qualified women constitutes a loss of economic growth potential. ③ In July 2011, the Belgian Companies Code was amended to require that women should account for at least 1/3 of the board membership of state-owned and publicly traded companies, starting six years after the adoption of the law. ④ While the German Corporate Governance Code operates on a "comply or explain" basis, the requirements for minimum gender representation must be observed for filling board positions from 1 January 2016. ⑤ The King IV Code in South Africa notes that diversity is essential for the board to effectively and objectively discharge its responsibilities. ⑥ South Africa's Broad-Based Black Empowerment Act no 46, 2013, provides for the empowerment of women as well as the appointment and representation of women in decision-making positions and structures. ⑦ The Malaysian Corporate Governance Code requires disclosure of gender diversity targets and sets an expectation that the boards of large companies must have at least 30% women directors. ⑧ The Davies report noted that business should continue its efforts to increase female representation further and more women should be progressing to chair and senior independent director positions.

The chair

55. **The board chair is arguably the most important position in a board and the separation of this position from that of the Chief Executive Officer (CEO) continues to be actively debated in some jurisdictions.** The OECD Principles state that such separation is generally regarded as good practice and most, but not all, jurisdictions surveyed have specified this in their respective regulatory frameworks, supervisory guidance material or corporate governance codes. Most jurisdictions surveyed for this paper require that the chair be an NED, with several specifying that this role must be filled by an INED.

56. **Whether or not the board chair's role is separated from the CEO's, trade-offs exist.** A combined chair/CEO can provide in-depth knowledge of a bank, but a separate chair is more likely to support robust challenge of management. The New York Stock Exchange Corporate Governance Guide[37] discusses this debate in some detail, referencing a survey which noted that, in light of increasing investor pressure, 69% of respondents agreed that splitting the chair and CEO roles results in more favourable proxy advisory recommendations, 64% agreed that doing so offers more independence of thought within board discussions, and 60% affirmed that it makes for more effective CEO evaluations.[38]

57. **A number of jurisdictions retain the power to approve the dual-hatting of the chair and CEO positions.** However, they generally restrict this discretion to limited circumstances assessed on a case-by-case basis with any approval restricted to a short period of time. The role of a lead independent director is seen in these jurisdictions, and in those where the chair does not need to be an INED, as providing an additional control aimed at ensuring a proper balance of power; with this role also expected to be involved in assessing the chair's performance as part of an annual board performance assessment.

58. **Most authorities have issued guidance on their expectations for board chairs given the nature of the role and its influence on the effectiveness of corporate governance.**[39] This incorporates expectations relating to providing leadership to the board, the structure and function of board meetings, the preparation of meeting agendas, the provision of timely and accurate papers for consideration by directors and the encouragement of open and effective communications with senior management and regulatory authorities.

59. **Where supervisory authorities have issued detailed guidance on the requisite expertise, practical experience and time commitments that a director must satisfy to meet the F&P test, the expectations regarding the position of chair are incrementally higher as well.** Of note, Thailand[40] specifically limits the number of positions that a chair may hold in other business groups to a maximum of three. In addition, the ECB requires more experience of prospective board chairs in relation to other board nominees. In jurisdictions where regulatory approval is required for a person to become a bank director, authorities have indicated that they are also more inclined to conduct an interview of a prospective chair as part of the assessment process, with the 'fitness' assessment specifically taking into consideration the nature and scope of the role.

[37] See New York Stock Exchange (2014).

[38] The 2014 Corporate Board Member/Spencer Stuart "What Directors Think" survey is a long-running annual study based on the input of public company directors nationwide.

[39] The chair has a key role for the overall functioning of the board. The chair should encourage and promote constructive challenge amongst directors and with senior management in order to ensure that decisions are taken on a sound and well informed basis. The BCBS Guidelines note that the chair should possess the requisite experience, competencies and personal qualities in order to fulfil this important role. In order to effectively promote checks and balances in board deliberations, the chair should be an independent or non-executive director.

[40] The Bank of Thailand's Notification 10/2561 was issued to improve corporate governance practices and to ensure that directors have relevant knowledge, capability, and experience to ensure at all times.

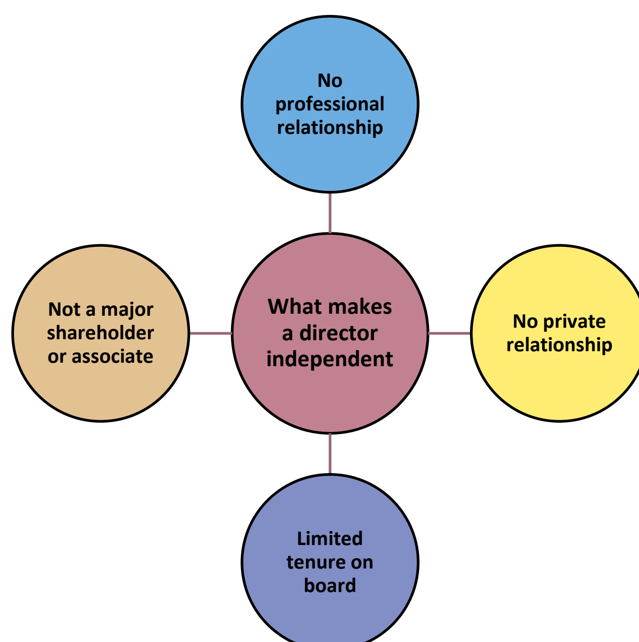
Independent directors

60. **Most existing legal and regulatory definitions of an independent director are based on negative criteria, ie defining when an individual would not be regarded as independent.** The OECD Principles note that such definitions could usefully be complemented by examples of the positive qualities that would support effective independence in the corporate governance processes. Our survey indicates that authorities continue to rely largely on negative criteria in determining independence, such as determining whether a prospective candidate has had a professional or private relationship with the bank, its shareholders, directors and senior management. At issue, is whether authorities should provide criteria to help supervisors to assess whether the prospective candidate is willing and able to act independently, even in the absence of any formal professional or personal relationship.

61. **The surveyed jurisdictions provide some guidance, through either banking regulations or via company laws or corporate governance codes, as to what criteria a candidate must meet to be an independent director.** We have categorised these criteria under the general headings of private relationships, professional relationships, shareholder relationships and length of tenure of directorship (see Figure 6).

62. **Determining the independence of a director is initially, and for a few jurisdictions solely, a matter for the board and its nominations committee to consider in light of regulatory rules and guidance.** In most jurisdictions where the supervisory authority formally approves a person as a director of a bank, the supervisory process of considering any application will formally or otherwise consider the designation of independence against the defined criteria and broader board composition requirements as part of that assessment.

Figure 6: Key elements for determining independence



Source: FSI.

63. **Definitions of independence focus on the nature of the relationships between a director and a bank.** Most definitions prescribe a period of at least two years within which a person must not have been employed in an executive capacity, been a material shareholder, professional adviser, consultant, supplier or a customer/client of the bank. Where a person is a family member or is otherwise related to a material shareholder or to the senior management of a bank, this also prevents that person from being considered independent.

64. **Many jurisdictions have also made the assessment of independence time-bound, by limiting the period that a director can spend on the board of a particular bank while remaining independent.** This ranges from six to 12 years, with an average of nine years (see Table 2). The expiry of the time period within which a director is considered independent does not necessarily prevent a director from continuing on the board of a particular bank, only that the person is no longer considered independent.

65. **Supervisory requirements concerning independence will have the greatest impact where these incorporate the need for a certain percentage of directors on a board to be independent.** In a number of jurisdictions, the chair of the board and/or its committees are required to be independent and tenure often also restricts this designation (see Figure 7).

Independent directors

Classification and defining attributes Table 2

	Definition		Who determines independence		Criteria for determining independence				
Jurisdiction	Bank regulation	Company law/code	Bank	Supervisor	Tenure*	Private relationship	Professional relationship	Shareholder	Time**
Australia	✓		✓				✓	✓	2 yrs
Bahrain	✓	✓	✓	✓		✓	✓	✓	-
Belgium		✓		✓	12 yrs	✓	✓	✓	3 yrs
Brazil		✓	✓			✓	✓	✓	-
Chile		✓	✓			✓	✓	✓	1.5 yrs
China	✓			✓	6 yrs	✓	✓	✓	-
ECB	✓			✓		✓	✓	✓	3 yrs
Germany		✓	✓			✓	✓	✓	2 yrs
Hong Kong SAR	✓	✓		✓	9 yrs	✓	✓	✓	1-3 yrs
India		✓	✓		8 yrs	✓	✓	✓	2 yrs
Malaysia	✓		✓	✓	9 yrs	✓	✓	✓	2 yrs
Netherlands		✓		✓	12 yrs	✓	✓	✓	1 yr
Nigeria	✓			✓	8 yrs	✓	✓	✓	5 yrs
Philippines	✓	✓	✓	✓	9 yrs	✓	✓	✓	3 yrs
Russia	✓	✓		✓	7 yrs	✓	✓	✓	3 yrs
South Africa	✓			✓	9 yrs	✓	✓	✓	3 yrs
Thailand	✓			✓	9 yrs	✓	✓	✓	2 yrs
United Kingdom	✓	✓	✓		9 yrs	✓	✓	✓	3 yrs
United States	✓	✓	✓			✓	✓	✓	3 yrs

ECB – without prejudice to applicable national laws.

Russia – the Moscow Stock Exchange determines director independence in accordance with its listing rules.

Germany – applicable for banks listed on a stock exchange.

* Tenure refers to the maximum period that an INED can serve on a bank board and still be considered independent.

** Time refers to the gap between any given relationships and becoming a director; in some jurisdictions, the minimum period of time varies depending upon the type of relationship. For Hong Kong SAR, the time period for being employed as an executive or director (other than INED) of a bank or any of its shareholder controllers, group companies and/or subsidiaries is three years, whereas for other relationships relating to professional or immediate family members, the minimum time is one year.

Source: FSI survey.

66. **To supplement the work of supervisors, several jurisdictions have established regulatory mechanisms to help them monitor the role that INEDs play on bank boards.** In Malaysia, corporate governance policies applicable to banks require written approval from the supervisory authority prior to an institution removing an INED or where an INED intends to resign from his/her position on the board.[41] For its part, the China Securities Regulatory Commission (CSRC) requires board members of publicly traded companies to disclose when they dissent from the majority opinion of the board.[42]

Board committees

67. **Specialised board committees are an accepted practice for increasing efficiency and allowing a deeper focus in specific areas.** The number and nature of committees that are established will depend on many factors, including the size of the bank and its board, the nature of its business, its risk profile and regulatory requirements. The BCBS Guidelines specifically mention the establishment of an audit committee, a risk committee and a compensation (or remuneration) committee, noting that the mandate of each should be established in a formal charter and that the chairs should each be an INED.[43] These guidelines also recommend that a nominations committee and an ethics committee be established. Stock exchange listing requirements and corporate governance codes also provide requirements for a board to establish certain subcommittees in a number of jurisdictions.

68. **In most, but not all of the surveyed jurisdictions, banks are required to establish risk, audit and remuneration committees.** Bank-specific regulatory requirements mandating the establishment of nomination committees are less common, with this committee often only being required for larger institutions and encouraged under the various (non-mandatory) corporate governance codes. Some jurisdictions also require the establishment of other specialised board subcommittees, including China and the Philippines, which both require committees to oversee related-party transactions, Nigeria, which requires a credit committee, and India, which requires a "shareholders' redressal committee" (see Table 3).[44]

69. **Currently, two jurisdictions require banks to establish an ethics or culture committee.** In Hong Kong SAR, boards are expected to form a standalone culture committee that is chaired by an INED; or alternatively the board must ensure that another committee, chaired by an INED, has defined responsibilities for reviewing the effectiveness of a bank's measures to promote a sound corporate culture. South Africa also requires the establishment of an ethics committee. Given the societal and regulatory interest in business and risk culture and the manner in which culture is understood to affect the prudent operation of a bank, there may be opportunities for other jurisdictions to consider the merits of mandating an ethics or culture committee to advise the board on such matters.

[41] See Bank Negara Malaysia (2016). Corporate Governance policy section 10.13 excludes where the removal of the INED is for regulatory reasons such as disqualification.

[42] See Khanna et al (2013). They note that in 2001, China moved to independent boards and passed laws requiring board members of publicly traded companies to disclose when they dissent from the majority board opinion and to provide an explanation for their decision.

[43] See BCBS (2015).

[44] In the last 10 years, India has strengthened its corporate governance framework through changes in regulation (eg approval by majority of minority shareholders on related-party transactions), which in particular addresses the governance concerns of minority shareholders (see eg Institutional Eye (2016)).

Board committees

Regulatory requirements Table 3

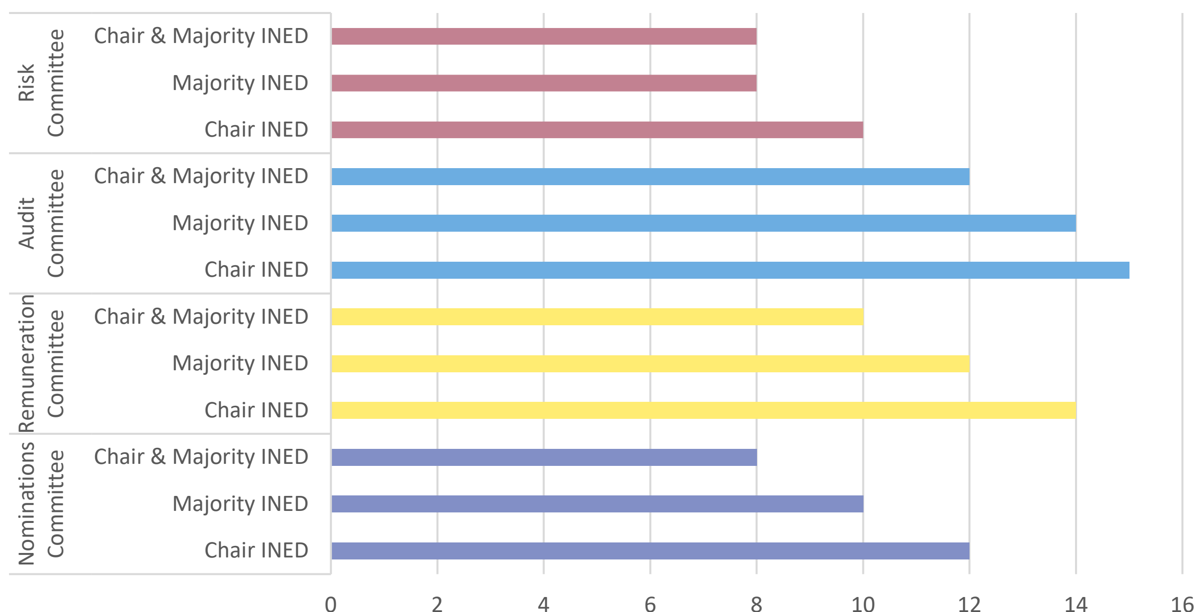
Jurisdiction	Risk	Audit	Compensation	Nomination	Ethics/ culture	Other
Australia	✓	✓	✓	✓		
Bahrain	✓	✓	✓	✓		
Belgium	✓	✓	✓	✓		
Brazil	✓	✓	✓			
Chile		✓				
China	✓	✓	✓	✓		✓
ECB	✓	✓	✓	✓		
Germany	✓	✓	✓	✓		
Hong Kong SAR	✓	✓	✓	✓	✓	
India	✓	✓	✓	✓		✓
Malaysia	✓	✓	✓	✓		
Netherlands		✓	✓	✓		
Nigeria	✓	✓	✓	✓		
Philippines	✓	✓	✓	✓		✓
Russia		✓	✓	✓		
South Africa	✓	✓	✓	✓	✓	
Thailand	✓	✓	✓	✓		✓
United Kingdom	✓	✓	✓	✓		
United States	✓	✓	✓	✓		

Source: FSI survey.

70. **Variations exist in the level of prescription around the composition requirements of the requisite committees.** This includes the mix of INEDs and NEDs and as to who should be the chair. This naturally aligns with regulatory requirements for board composition. It is interesting to note that some jurisdictions which do not require the chair of the board to be an INED do require that the audit, risk or compensation committees be chaired by an INED. Where authorities have specified that the chair of the requisite subcommittees must be an INED, it is also commonly stated that the chair of the board cannot be the chair of any of these committees, although he or she may be a committee member (see Annex 2, Tables 6–9 for further details).

71. **Most surveyed jurisdictions require the chair of the respective subcommittees to be an INED.** In addition, most also require a majority of the members of the subcommittees to be INEDs. This is the case for all subcommittees, with most jurisdictions setting such expectations for the audit committee in particular. In contrast, fewer jurisdictions specify such INED requirements for the risk committee (see Figure 7).

Figure 7: Structure and composition of mandated board committees



Source: FSI survey.

72. **Most of the surveyed jurisdictions set specific regulatory requirements for the composition of board audit committees.** Some jurisdictions provide guidance as to the skill sets required by directors to ensure the effectiveness of this committee, given its accounting-focused role. The relative maturity of regulatory frameworks for audit committees is largely to be expected, given their long-standing role in engaging with internal and external auditors and providing oversight for financial reporting processes.

73. **In contrast, there is less clarity on the important role that INEDs have in other committees.** Given the weaknesses in risk oversight highlighted in the aftermath of the GFC, there is more work to do in some jurisdictions to clarify the role that INEDs can play in improving the oversight of bank risk management. There is also less specific regulatory guidance available on the specific competencies expected of directors who sit on risk, compensation and nominations committees. Most jurisdictions rely on the general principle that committees should comprise directors with the experience, knowledge and skills that are individually or collectively required for the respective committee.

74. **Regulatory guidance specifies the matters that the designated board committees should address within their respective mandates.** This guidance is consistent with the principles set out in the BCBS Guidelines, which cover the responsibilities of the audit, risk and compensation committees.

75. **In distributing the work of a board amongst its committees, it is important that robust communication processes are established with the board and between each committee.** The goal is to ensure clarity of roles and responsibilities and that no information gaps are inadvertently created. The BCBS Guidelines specifically note the need for the risk committee and the audit committee to establish protocols to facilitate the exchange of information; and for the compensation committee to work closely with the risk committee in evaluating the incentives created by the remuneration system.

76. **The guidelines issued by most jurisdictions note the importance of protocols for information-sharing and communication between board subcommittees.** In Hong Kong SAR,[45] guidance specifically notes the importance of effective communication between the audit and risk committees. The EBA Guidelines on internal governance of 2017[46] note that board subcommittees should not comprise the same directors but that cross-participation by the chairs of each subcommittees is a constructive way to ensure that salient matters are referred to, and discussed across, committees as may be relevant to their respective mandates.

77. **There is evidence for deficiencies in the functional relationships between and across a board and each of its committees.** Notwithstanding the existence of some high-level regulatory guidance, as noted for example in the Prudential Inquiry into the Commonwealth Bank of Australia,[47] weaknesses in communication between board committees and between senior management and the board contributed to the corporate governance problems faced by that bank. Similar issues were also noted in the 2017 investigation report into sales practices at Wells Fargo.[48] A recent report by the Australian Securities and Investments Commission[49] also noted observed weaknesses in communication practices between board subcommittees and between these committees and the board itself. Proper and timely board reporting by executive management in combination with informal board meetings might help to alleviate this particular challenge.

Section 5 – Concluding remarks

78. **Bank standards on corporate governance are more stringent in relation to non-financial companies.** Banks play a critical role in financing the needs of the real economy, by channelling the savings of depositors and creditors to consumers and businesses. The safety and soundness of banks, especially systemically important banks, is key to financial stability. Thus, the manner in which banks conduct their activities is critical to the well-being of society. As such, both bank borrowers and their depositors and creditors have a vested interest in ensuring that banks operate in a safe and sound manner. Therefore, bank directors and senior management, collectively and individually, bear a particularly important responsibility and should consider the needs of a broader range of stakeholders, beyond solely their shareholders.

79. **Bank-specific legal and regulatory frameworks set out the responsibilities of a board of directors and its senior management with respect to corporate governance practices.** Bank-specific governance frameworks are particularly important where national laws, regulations, codes or listing

[45] The HKMA Supervisory Policy Manual CG-1 notes that there should be effective communication and coordination between the audit committee and the risk committee to facilitate the exchange of information and effective coverage of all risks, including emerging risks, and any needed adjustments to the risk governance arrangements.

[46] The EBA Guidelines on internal governance under Directive 2013/36/EU reinforce the governance requirements for institutions by, among other things, specifying the tasks, responsibilities and organisation of the management body.

[47] In May 2018 the Australian Prudential Regulation Authority (APRA) published a report on the Prudential Inquiry into the Commonwealth Bank of Australia. The report noted the existence of a number of weaknesses in governance practices and accountability mechanisms, which had contributed to a series of issues that damaged the bank's reputation.

[48] In April 2017, the Independent Directors of Wells Fargo published a report following an investigation into improper sales practices in the bank. The report identified the root cause of these problems as being related to distortions in the sales culture and performance management systems, a decentralised structure that provided too much autonomy to senior leadership, and management reports to the board and its committees that did not accurately convey the scope of the problem.

[49] ASIC's report noted that designing and implementing systems that effectively identify and escalate issues to the board is a challenge facing many institutions and that seeking to address the root cause of weaknesses in information flows would likely prove more effective than developing new structures or implementing new frameworks to address this issue.

requirements regarding corporate governance – which are intended for all companies in a particular jurisdiction and not solely banks – may not address their unique corporate governance needs.

80. **In some jurisdictions, bank-specific regulatory frameworks on governance may not be sufficiently developed.** The potential weaknesses in bank-specific regulatory governance frameworks are particularly evident where governance expectations reside solely in corporate governance codes that only apply directly to listed banks, and generally even then only on a "comply or explain" basis. In these circumstances, authorities may need to determine whether these standards should be supplemented by bank-specific prudential regulation, and whether all or a subset of banks should be subject to such standards.

81. **The F&P assessment criteria help to strengthen board oversight by preventing candidates who lack the desired qualities from holding senior positions in a bank.** While all surveyed jurisdictions have set F&P criteria, a few have no regulatory approval powers and, in cases where powers do exist, not all authorities mandate prior regulatory approval for all directors in all cases.

82. **Of the two F&P criteria, the fitness component is more complex and often drives supervisory assessments.** The fitness criterion is a multi-dimensional assessment and requires board nomination committees and supervisors to make judgments on a candidate's educational background, practical experience, time commitment and conflicts of interest, relating these factors to the nature, scale and complexity of both the candidate's proposed position and the bank itself. Some authorities provide prescriptive guidance on aspects of the fitness criterion to help guide the judgments of supervisors; others outline principles-based standards to provide flexibility to supervisory teams.

83. **As one aspect of the fitness criterion, many jurisdictions have imposed explicit guidance on the time commitment of directors.** Factors such as the number of directorships held, the size, nature, scale and complexity of the institutions where those directorships are held and the existence of any other professional or personal commitments and circumstances are a key part of the F&P test in these jurisdictions. Some jurisdictions that set limits on external directorships vary the number based on whether the outside directorship is an ED or NED role.

84. **The regulatory approaches used in the F&P assessment provide a useful reference for supervisory authorities.** Based on jurisdiction-specific circumstances, authorities may consider whether the fitness criterion can be further enhanced, particularly if suboptimal outcomes are observed. Specifically, authorities may consider whether guidance/practices with respect to the "qualifications/experience" and "time commitment" aspects of the fitness criterion can be improved by applying more prescriptive criteria. A more difficult challenge is to determine if all prospective directors have the ability and will to exercise independent judgment, even in the absence of any formal conflicts of interest. In this context, interviews of prospective board candidates may be considered, particularly for key board positions.

85. **The composition of the board of directors may warrant further supervisory attention in some jurisdictions.** National authorities could consider providing further guidance in relation to their expectations for overall board composition (ie the mix between EDs, NEDs and INEDs) and diversity, including on board subcommittees. Collectively, this could help to mitigate "groupthink" and to expand the board's focus to a broader range of stakeholders. In addition, clearer definitions of independence could also be beneficial, by clarifying the important differences between NEDs and INEDs.

86. **Requirements are not always clearly set out for the skill sets of directors in general, and INEDs in particular, who sit on key board subcommittees.** There is less regulatory guidance available on the specific competencies expected of directors who sit on risk, compensation and nominations committees, with most jurisdictions relying on the general principle that committees should comprise directors with the experience, knowledge and skills required for the respective committee. In addition, the collective skill sets of directors also need to keep pace with the evolving banking and regulatory landscape (eg expertise in technology).

87. **While there are official requirements for the establishment of board committees, there is little guidance on the functional relationships between the board and each committee.** Audit, risk remuneration and nomination committees are common at larger banks, while only two jurisdictions require either an ethics or culture committee. Given the ongoing examples of bank misconduct in several jurisdictions, authorities may consider the merits of mandating an ethics/culture committee, at least at large banks. In addition, authorities may explore the need for further guidance on roles and responsibilities in, and communication between, each subcommittee and the full board, such that no information gaps are inadvertently created.

88. **The various regulatory requirements for corporate governance are subject to a proportionate application.** Proportionality is most often applied with respect to the fitness criterion of the F&P assessment. Some jurisdictions also take a proportionate approach in determining the requirements for board composition and committee structures.

89. **Notwithstanding the application of proportionality, the corporate governance challenge of banks may differ based on their ownership structure.** While requirements are often tailored to a bank's size, risk profile or complexity, ownership structure may not necessarily be taken into account. Authorities might therefore consider whether specific regulatory guidance is needed to address the unique corporate governance challenges of state-owned banks and those with diversified and concentrated ownership, to augment the proportionality approaches taken by supervisors.

90. **Post-crisis, there has been a clear demand for supervisors and banks to respond to the heightened public interest in governance.** Standard-setting bodies have further developed regulatory requirements and banks increasingly take account of broader stakeholder interests. Additionally, recent public debate in the areas of ethics, sustainability and climate-related risks as well as diversity has intensified the need for boards to consider the interests of a wider range of stakeholders, while continuing to respect the primacy of the relationship with shareholders. Although this debate may be considered overdue, the fiduciary requirement for a director to act in the best interests of a company should, in fact, encourage boards to consider the impact of their decisions on a broad range of stakeholders.

91. **In this context, a broader consideration is whether the public interest can be advanced if authorities gain powers to appoint an independent, non-voting board attendee at troubled banks.** The overwhelming majority of bank funding is drawn from depositors and creditors, who stand to benefit from taxpayer-funded bailouts if the bank fails. An independent non-voting regulatory board appointee could provide useful insights to supervisors at an earlier stage to help rehabilitate the bank and to rectify governance shortcomings. This, in turn, might help to better protect the interests of depositors and creditors.

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Annex 1 – Governance requirements in China, the European Union and the United States

China

The main functions of the China Banking and Insurance Regulatory Commission (CBIRC) that are relevant to the scope of this paper are to:

- Formulate supervisory rules and regulations governing banks;
- Authorise the establishment, changes, termination and business scope of banks;
- Conduct fit-and-proper tests on the senior managerial personnel of banks; and
- Conduct on-site examination and off-site surveillance of banks.

Regulatory requirements and supervisory expectations; authorisation criteria

One of the ways in which the CBIRC delivers on its mandate relates to its role in approving the appointment of directors to the board of a commercial bank. For this purpose, the CBIRC has established a fit-and-proper test which involves examination of application materials to determine whether a candidate satisfies the relevant qualification requirements. In reviewing this information, the CBIRC may also make inquiries about the candidate from previous employers, review its regulatory information systems, solicit opinions from other authorities, test the candidate for expertise and capability and conduct interviews for candidates for particular positions such as the chair. Similar requirements apply in relation to the approval of directors seeking a further term of appointment to the board of a commercial bank.

Regulations also exist which state that a person is not eligible to be a director of a commercial bank where a criminal offence has been committed, bankruptcy/liquidation proceedings have resulted in personal liability, business licences have been revoked and where a person has large amounts of overdue personal debts.

To supplement these processes, the CBIRC has the power to remove an existing director from the board of a commercial under certain circumstances, either relating to irregularities in the initial application and approval process or otherwise where deemed necessary.

Board structure

Other than in relation to defined criteria specific to certain functions, the CBIRC's expectations for the broad structure and composition of a bank board and its committees are largely principles-based. The overriding principle is that the bank, with the support of its nominations committee, should determine the number of directors and the composition of its board based on its size and the nature of its business and that directors should have the expertise and experience commensurate with the position held.

The CBIRC does require that boards of commercial banks comprise a mix of executive, non-executive and independent directors; the latter being persons who are not related to the commercial bank or any principal shareholder thereof in a manner that may affect their objective judgment. Guidelines also provide that the cumulative terms of office of an independent director may not exceed six years and that such directors are able to devote at least 15 working days per year to the business of the bank. There is no prescription however about the minimum number of independent directors or the number of non-executive directors that must be on a board (or its committees).

The CBIRC stipulates that the chair of the board must be a separate position from that of the Chief Executive Officer (President) and that a person holding the position of chair shall possess professional knowledge and expertise in at least one of the fields of accounting, auditing, finance or law.

Commercial banks are required to set up a number of specialised committees to deal with specific matters, depending on the nature of their operations and the principle of proportionality. These include a strategy committee, audit committee, risk management committee, affiliated transaction control committee, nomination committee, and compensation committee. Specific principles are articulated in the Guidelines on the Corporate Governance of Commercial Banks for the roles and responsibilities of each of these committees. Other than in respect of the strategy committee and the risk committee, these committees need to be chaired by independent directors; with the requirement that at least 25 working days per year are able to be devoted to the business of the bank for these specific roles.

Board responsibilities and functions

The CBIRC has established a number of principles-based expectations whereby the board of directors retains the ultimate responsibility for the bank's risk management practices. These principles require the board to establish comprehensive risk management strategies, policies and procedures, identify the major risks facing the bank and set appropriate risk tolerance and risk appetite. The board must also provide effective oversight of senior management to ensure that the business effectively identifies, measures, monitors, and controls the various risks facing the bank consistent with the established appetite.

Accountability and remuneration

Regulations exist to hold directors (and senior management) accountable, including in relation to the violation of any law or regulation, or the bank's bylaws, which results in losses being incurred by the commercial bank. These provisions apply equally to all directors and senior management. The CBIRC can also impose fines and other penalties on individuals in certain prescribed circumstances.

The CBIRC has also articulated a number of principles which apply to the remuneration structures of commercial banks. These principles require the board of directors and its compensation committee to establish objective and rational compensation mechanisms for senior management that are associated with the development of strategy, risk management, overall benefits, post duties, social responsibility, and the corporate culture of the bank. The remuneration framework is expected to fully capture the relationships between all kinds of risks and costs and address the coordination between short-term and long-term incentives, with performance evaluation indicators including profitability, risk, costs control and social responsibilities. The CBIRC requires that at least 40% of variable compensation be deferred for a period of three years or longer, with pro-rata vesting and provisions for claw-back where required.

European Union

The European Central Bank (ECB) has the exclusive competence for certain supervisory tasks in cooperation with the National Competence Authority of its member states (NCA) under the operation of the Single Supervisory Mechanism (SSM). The Capital Requirements Regulation (CRR), the Capital Requirements Directive (CRD) as well as the European Banking Authority's rules/guidelines and the revised Basel Committee's BCPs form the foundation for the SSM's regulation, supervision, governance and risk management of the banking sector.

Regulatory requirements and supervisory expectations; authorisation criteria

For significant institutions (SIs) under its direct supervision, the ECB has the competence to take decisions on the appointment of directors, both in their management function (executive directors) and supervisory function (non-executive directors), as well as on the appointment of key function holders. Jointly with the assistance of the NCA, the ECB carries out the Fit and Proper assessment (FAP). When conducting a FAP, the ECB is applying national law transposing Article 91 of the CRD IV.

The applicable FAP criteria are the same irrespective of a banks shareholder structure. However, specificities regarding the legal form, governance structure, business model and shareholder structure are

taken into account in the assessment. Therefore, in all cases the assessment will come down to individual analysis and a case-by-case review including the exercise of supervisory judgment. Fitness and propriety are assessed against five criteria; knowledge, skills and experience; reputation; conflicts of interest and independence of mind; time commitment; and collective suitability.

In general, new appointments are notified to the NCA, who initiates the FAP procedure. Depending on national legislation, renewal/re-appointments and change of roles are potential triggers for these procedures. As FAP criteria have to be complied with on an ongoing basis, any new fact that might impact on the suitability of an appointee could also trigger a re-assessment. The timing of a FAP assessment is subject to national law and therefore the procedure varies from ex-ante approvals to ex-post notifications.

The ECB takes a proportionate and risk-based approach to the use of interviews in the FAP process, with distinctions made between the types of entity and position, and between mandatory interviews, discretionary interviews, informative interviews and specific interviews. Interviews are mandatory in case of new appointments for CEO and chair positions.

FAP assessments are concluded with a formal ECB decision, which can be positive or negative. The ECB might include ancillary provisions (conditions, obligations and recommendations) imposed on the supervised entity in order to satisfy the applicable fit and proper assessment criteria. The use of ancillary provisions follows the principle of proportionality, meaning that the least intrusive measures to overcome suitability concerns are applied.

The ECB ultimately has the power to take a decision to remove a director at any time where it has been determined that a person is no longer fit and proper. FAP assessments also feed into the yearly Supervisory Review Examination Programme (SREP).

The FAP also takes into account the specific position. Therefore, the criteria for presuming adequate experience are higher in particular for the following positions:

- CEO: 10 years of recent practical experience in areas related to banking or financial services. This should include a significant proportion at senior level managerial positions.
- Non-executive chair: 10 years of recent relevant practical experience. This should include a significant proportion in senior-level managerial positions and significant theoretical knowledge in banking or a similar relevant field.

Board structure and composition

With regard to Board composition, the ECB considers having independent members and non-independent members in the board of directors in its supervisory function to be good practice. When determining the sufficient number of independent members, the principle of proportionality is taken into account; with an expectation that the chair of the Board and the respective chairs of the Audit and the Risk committees should be independent. Formal independence is only assessed within the FAP procedure if required by substantive national law.

The board of directors as a whole should possess adequate collective knowledge, skills and experience to be able to understand the bank's activities, including the main risks. It is the primary responsibility of the bank to appoint members to the Board that are suitable and have the knowledge, skills and experience necessary for its prudent and effective management. While the FAP assessment reflects on how an appointee contributes to the collective suitability of the board of directors as a whole, assessing collective suitability forms a key component of ongoing supervision.

The ECB also requires that the chair of the board of directors in its supervisory function must not exercise simultaneously the functions of a chief executive officer (CEO) within the same entity, unless justified by the entity and authorised by the competent authorities on a case-by-case basis under exceptional circumstances.

Board responsibilities

In accordance with Article 88 CRD IV, the ECB requires the management body of a bank to be responsible for the institution and to approve and oversee the implementation of the strategic objectives, risk strategy and internal governance practices. In discharging these responsibilities, it should constructively challenge and critically review proposals, explanations and information when exercising its judgment and taking decisions.

Accountability and remuneration

Accountability for any failure in governance resides with the board of directors as a collective body, Reliance is placed on exercising the laws and regulations within national jurisdictions under the requisite legal processes where it is considered necessary or appropriate for an individual to be held accountable for such a failure.

With regard to remuneration policy, the ECB-SSM remuneration expectations of the members of the board in its management function should be consistent with their powers, tasks, expertise and responsibilities. Fixed remuneration should be permanent, predetermined, non-discretionary and irrevocable, while variable remuneration should be based on performance. The CRD requires that at least 50% of variable remuneration comprise a balance of shares, equivalent ownership rights, share-linked or equivalent non-cash instruments, in the case of non-listed institutions. At least 40% of variable remuneration is subject to deferral arrangements. The variable component shall not exceed 100% and only with special approval up to but not to exceed 200% of the fixed component of the total remuneration for each individual.

United States[50]

The roles and responsibilities of boards of directors of banks in the United States are defined by various government agencies and other authorities that have concurrent or overlapping jurisdiction. The overall framework includes federal and state laws and regulations governing banking, securities regulation, and corporations, as well as stock exchange listing requirements, non-governmental organisation member requirements, and supervisory guidance. Banking organisations may be subject to different requirements based on a variety of factors including, but not limited to, their size, place of incorporation, corporate form, organizational structure, financial condition, whether they are publicly traded or privately held, and the nature and character of their business.

Regulatory requirements and supervisory expectations; authorisation criteria

Except for the circumstances described below, existing directors may be re-nominated for another term and new directors may join the board of a banking organisation without obtaining prior approval from the Federal Reserve. However, prior regulatory approval is required when a banking organisation is not in compliance with minimum capital requirements or is deemed to be in a "troubled condition". In these circumstances, the banking organisation must provide the Federal Reserve with 30 days' prior written notice of proposed changes in directors or senior executive officers, including cases in which an existing senior executive officer is proposed to fill a different management position or to assume new responsibilities in their current position.

In addition, the Federal Reserve would review and assess proposed directors when reviewing an application involving the formation of a bank holding company or savings and loan holding company.

[50] The description of regulatory and supervisory requirements on bank governance are based on information provided by the Board of Governors of the Federal Reserve System. Their views should not necessarily be construed to represent the regulatory requirements or supervisory practices of other US banking agencies, including the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency.

When reviewing applications involving other kinds of transactions such as the merger or acquisition of existing banks or holding companies, the Federal Reserve generally would not review directors proposed to join the board unless warranted by the specific circumstances. For example, proposed directors might warrant additional scrutiny if the institution being acquired is in less-than-satisfactory condition and the individuals proposed to join the acquirer's board were previously affiliated with the target institution and are considered to have contributed to its condition, or if the acquiring institution has existing management weaknesses resulting in heightened concerns that the proposed directors could exacerbate those weaknesses.

When evaluating a proposed director, the Federal Reserve considers the competence, experience and integrity of the proposed director; and assesses potential conflicts of interest and the proposed directors' ability to direct the policies of the bank in a safe and sound manner in light of the circumstances and plans of the organisation. The Federal Reserve would also consider whether the proposed director demonstrates an ability to act in the best interests of both the depositors and the public. The Federal Reserve may also include the nature and extent to which the individual has financial institution and other business experience, proposed duties and responsibilities, personal and professional financial responsibility, reputation for honesty and integrity and familiarity with the economy, financial needs and the general character of the community in which the bank will operate.

Where a bank is considered "significantly undercapitalised", the Federal Reserve has broad authority to require the bank to undertake remedial actions, including requiring the bank to elect new directors or to dismiss any director holding office for more than 180 days before the bank became undercapitalised. The Federal Reserve may also remove a director before the expiration of their term regardless of the banks condition; this power is generally reserved for severe cases of dishonesty, criminal behaviour, or a blatant disregard for safety and soundness. Where the Federal Reserve has acted to remove a board member, this action has been publicised on the Federal Reserve website. In its capacity as receiver for failed depository institutions (with the support of Federal Reserve), the Federal Deposit Insurance Corporation also has powers to initiate legal actions against individual directors when they are found to have failed to exercise the fiduciary duties of loyalty and care.

Board structure and composition

Board structure and composition requirements differ among institutions based on their characteristics such as size. Larger banks, however, are subject to more prescriptive governance requirements, such as having to establish a risk committee that is chaired by an independent director and includes at least one director with experience in identifying, assessing, and managing risk exposures of large, complex firms.

The Federal Reserve does not, however, specifically define the requirements for an independent director or impose specific or different "fit and propriety" requirements for independent directors. Other federal statutes and stock exchange listing rules mandate that boards be composed of a certain number of independent directors. For example, the NYSE listing requirements require that independent directors comprise a majority of the board and that the board's nomination, audit, and compensation committees be composed of independent directors only. There are no restrictions limiting the chair of the board from also serving as part of the bank's senior management. In those cases, the Federal Reserve would generally expect that the board would also have a "lead independent director" invested with certain authorities intended to provide a counterweight to the chair's authority.

In 2017, the Federal Reserve proposed certain principles addressing the supervisory expectations for boards of directors of large financial institutions. In the proposal, the Federal Reserve expressed its view that boards are most effective when they focus on their core responsibilities, which include establishing a firm-wide corporate strategy and setting the types and levels of risk it is willing to take (referred to as risk tolerance), making certain that senior management effectively carries out that strategy within the firm's risk tolerance and holding management accountable for its actions, including effective risk management and compliance with laws and regulations. The guidance, which has not yet been

finalised, identified key attributes of effective boards. The Federal Reserve avoided establishing process-oriented supervisory expectations as they do not directly relate to the exercise of the board's core responsibilities.

Board responsibilities and functions

The Federal Reserve's proposed principles-based guidance states that effective boards (and their committees) maintain a clearly articulated corporate strategy and institutional risk appetite. The proposed guidance notes that effective boards set the direction and provide oversight of revenue and profit generation, risk management and control functions, and other areas essential to sustaining the organisation.

Accountability and remuneration

Directors who fail to discharge their duties and responsibilities or who are negligent in protecting the interests of depositors or shareholders may be subject to removal from office, criminal prosecution, civil money penalties imposed by securities regulators and bank regulators, as well as civil liability. Although there may be jurisdictional differences based on where the company is incorporated, all directors would be equally subject to potential criminal or civil liability.

The Federal Reserve (along with the other federal banking agencies) has also issued principles-based guidance on incentive compensation establishing the supervisory expectation that the banking organisation's policies do not encourage imprudent risk-taking and are consistent with the safety and soundness of the bank. The guidance also includes the expectation that the variable remuneration of senior management should be reduced in response to adverse risk management outcomes. Similar to the circumstances which require prior regulatory approval of new directors, federal law and regulations restrict "golden parachute payments" to institution-affiliated parties when an institution is deemed to be in "troubled condition". In addition, the Federal Reserve's guidance includes the expectation that compensation be adjusted for risk and that firms impose individual accountability when excessive risk is taken, or when risk is inappropriately managed.

Annex 2 – Additional data tables

Directors – other requirements

Limitations on the number of external directorships — Table 4

Jurisdiction	Limitations on the number of director positions that can be held
Australia	Not specified
Bahrain	Maximum of 2 mandates in banks inside Bahrain; cannot be in the same category
Belgium	1x ED and 2x NED mandates; OR 4x NED mandates
Brazil	Not specified
Chile	Directors should not hold a mandate in another financial institution
China	2x INED
ECB	1x ED and 2x NED mandates; OR 4x NED mandates
Germany	1x ED and 2x NED mandates; OR 4x NED mandates (1 additional NED mandate for < $15b assets
Hong Kong SAR	Not specified
India	Maximum of 8 mandates in listed companies, reducing to 7 from April 2020
Malaysia	Not specified
Netherland	1x ED and 2x NED mandates; OR 4x NED mandates
Nigeria	2 mandates in institutions regulated by CBN
Philippines	5x NED mandates in publicly listed companies
Russia	Not specified
South Africa	Bank must have a policy; supervisor will review on a case by case basis
Thailand	Chair – maximum of 3 other NED roles; other directors – maximum of 5 other mandates
United Kingdom	1x ED and 2x NED mandates; OR 4x NED mandates
United States	In general, directors should not hold a position in another financial institution

ECB – applicable for CRD IV significant institutions.

Source: FSI survey.

Board composition

Minimum requirements — Table 5

Jurisdiction	Number of members	INEDs and NEDs
Australia	Minimum 5	Majority INED
Bahrain	Maximum 15	Minimum 50% NED, at least 3 NEDs should be INED
Belgium	Minimum 5 (2 ED)	Majority of NED, of which at least 2 INED
Brazil	Minimum 3	Not specified
Chile	Minimum 5/Maximum 11	At least 1 INED
China	Minimum 3/Maximum 19	33% INED
ECB	Not specified	Sufficient INED; According to national laws
Germany	Minimum 3	Not specified
Hong Kong SAR	Minimum 3	33% INED or minimum of 3
India	Minimum 3/Maximum 15	At least half NED, at least 33% INED, at least 1 female
Malaysia	Minimum 2	Majority INED
Netherlands	Minimum 4	50% INED
Nigeria	Dependent on type of bank	Majority NEDs
Philippines	Minimum 5/Maximum 15	33% INED or minimum of 2, Majority NED
Russia	Minimum 5	Maximum 25% ED, Minimum 33% INED
South Africa	Minimum 3	Majority NED; sufficient number of INED
Thailand	Minimum 3	33% INED or minimum of 3
United Kingdom	Minimum 3	Minimum 50% INED (listed)
United States	Minimum 3	Majority INED

NOTE: in some jurisdictions, minimum NED and INED requirements apply only to significant or systemically important institutions and/or those listed on a stock exchange and recommended or encouraged for other institutions in accordance with proportionality principles.

Source: FSI survey.

Board committee composition – Risk Committee

Regulatory requirements — Table 6

Jurisdiction	Supervisory authority	Company law/code	Minimum number of members	Chair	Composition
Australia	✓		3	INED – chair of board cannot chair committee	Majority INED (only NED)
Bahrain	✓		3	INED	Majority INED
Belgium	✓	✓	3	INED – chair should not chair any other committee (recommended)	Only NED/ Minimum 1 INED (Law); Majority INED (recommended)
Brazil	✓		3	Chair should be independent and cannot chair a committee	Majority INED
Chile			N/A	N/A	N/A
China	✓		Not specified	Not specified	Not specified
ECB	✓		3	INED – chair should not chair any other committee	Majority INED for significant institutions / sufficient number for others
Germany		✓	3	NED	Only NED
Hong Kong SAR	✓		Not specified	INED – chair should not chair any other committee or be board chair	Majority INED
India	✓		Not specified	Member of the Board of Directors	Majority from the Board of Directors with members of Senior Management
Malaysia	✓		3	INED – chair of board cannot chair committee	Majority INED (only NED)
Netherlands			N/A	N/A	N/A
Nigeria	✓		Not specified	NED – chair of board should not be on any committee	Not specified
Philippines	✓		3	INED – chair should not chair any other committee or be board chair	Majority INED
Russia			N/A	N/A	N/A
South Africa	✓		3	INED	Majority NED
Thailand	✓		3	INED or NED	Majority INED or NED
United Kingdom	✓		Not specified	NED	Only NED
United States		✓	Not specified	Not specified	At least 1 INED

NOTE: in some jurisdictions, requirements apply only to significant or systemically important institutions and/or those listed on a stock exchange and recommended or encouraged for other institutions in accordance with proportionality principles.

Source: FSI survey.

Board committee composition – Audit Committee

Regulatory requirements — Table 7

Jurisdiction	Supervisory authority	Company law/code	Minimum number of members	Chair	Composition
Australia	✓		3	INED – chair of board cannot chair committee	Majority INED (only NED)
Bahrain	✓		3	INED	Majority INED
Belgium	✓	✓	3	INED – chair should not chair any other committee (recommended)	Majority INED (only NED)
Brazil	✓		3	Not specified	Independent directors only required for listed banks and state owned banks
Chile	✓		2	INED	INEDs, professionals with relevant experience, plus audit firm representative
China	✓		Not specified	INED	NED/INED
ECB	✓		3	NED	1 INED
Germany		✓	3	INED for listed companies (NED for others)	Only NED
Hong Kong SAR	✓		Not specified	INED – chair should not chair any other committee or be board chair	Majority INED (only NED)
India		✓	3	INED	2/3rds INED
Malaysia	✓		3	INED – chair of board cannot chair committee	Majority INED (only NED)
Netherlands		✓	Not specified	Not specified – chair of board cannot be the chair, former member of the management board cannot be the chair	Majority INED
Nigeria	✓		Not specified	NED – chair of board should not be on committee	NED/INED
Philippines	✓		3	INED – chair should not chair any other committee or be board chair	Majority INED (only NED)
Russia		✓	Not specified	INED	Only INED
South Africa	✓	✓	3	INED – chair of board should not be on committee	Only INED
Thailand	✓		3	INED – chair cannot chair any other committee or be board chair	Only INED
United Kingdom	✓		3	INED – chair of board should not be on committee	Only INED
United States		✓	3	INED	Only INED

NOTE: in some jurisdictions, requirements apply only to significant or systemically important institutions and/or those listed on a stock exchange and recommended or encouraged for other institutions in accordance with proportionality principles.

Source: FSI survey.

Board committee composition – Remuneration Committee

Regulatory requirements — Table 8

Jurisdiction	Supervisory authority	Company law/code	Minimum number of members	Chair	Composition
Australia	✓		3	INED	Majority INED (only NED)
Bahrain	✓		3	INED	Only INED or NED with majority INED
Belgium	✓	✓	3	INED (recommended)	Only NED/ Minimum 1 INED (Law); Majority INED (recommended)
Brazil	✓		3	Not specified	At least 1 non- executive
Chile		✓	3	N/A	Majority INED
China	✓		Not specified	INED	Not specified
ECB	✓		3	INED	Majority INED
Germany		✓	3	NED	Only NED
Hong Kong SAR	✓		Not specified	INED	Majority INED
India		✓	3	INED	Only NED/ half INED, 1 director from RMC
Malaysia	✓		3	INED – chair of board cannot chair committee	Majority INED (only NED)
Netherlands		✓	Not specified	Not specified – chair of board cannot be the chair, former member of the management board cannot be the chair	Majority INED
Nigeria	✓		Not specified	NED – chair of board should not be on any committee	NED/INED
Philippines	✓		3	INED	Majority INED (only NED)
Russia		✓	Not specified	INED – chair of board cannot chair committee	Only INED (listed banks) / no ED (all banks)
South Africa	✓	✓	Not specified	INED	Only NED
Thailand	✓		3	INED	Only INED or NED
United Kingdom		✓	3	INED	Only INED
United States		✓	More than 1	INED	Only INED

NOTE: in some jurisdictions, requirements apply only to significant or systemically important institutions and/or those listed on a stock exchange and recommended or encouraged for other institutions in accordance with proportionality principles.

Source: FSI survey.

Board committee composition – Nominations Committee

Regulatory requirements Table 9

Jurisdiction	Supervisory authority	Company law/code	Minimum number of members	Chair	Composition
Australia		✓	3	INED	Majority INED
Bahrain	✓		3	INED	Only INED or NED with majority INED
Belgium	✓	✓	3	INED (recommended)	Only NED/ Minimum 1 INED (Law); Majority INED (recommended)
Brazil			Not specified	Not specified	Not specified
Chile			N/A	N/A	N/A
China	✓		Not specified	INED	Not specified
ECB	✓		3	INED	Majority INED for significant institutions/ sufficient number for others
Germany		✓	3	NED	Only NED
Hong Kong SAR	✓		Not specified	INED	Majority INED
India		✓	3	INED	Only NED/ half INED, 1 director from RMC
Malaysia	✓		3	INED – chair of board cannot chair committee	Majority INED
Netherlands		✓	Not specified	Not specified	Not specified
Nigeria	✓		Not specified	NED – chair of board should not be on any committee	Not specified
Philippines	✓		3	INED	Majority INED (all NED)
Russia		✓	Not specified	Not specified	Majority INED
South Africa	✓		Not specified	INED	Only NED
Thailand	✓		3	INED	Only INED or NED
United Kingdom		✓	Not specified	Not specified	Majority INED
United States		✓	Not specified	INED	Only INED

NOTE: in some jurisdictions, requirements apply only to significant or systemically important institutions and/or those listed on a stock exchange and recommended or encouraged for other institutions in accordance with proportionality principles.

Source: FSI survey.

Annex 3 – Jurisdictions covered by the study

Regional classification

Table 10

Jurisdiction	Region	Jurisdiction	Region
Nigeria	Africa	Philippines	Asia-Pacific
South Africa	Africa	Thailand	Asia-Pacific
Brazil	Americas	Belgium	Europe
Chile	Americas	ECB	Europe
United States	Americas	Germany	Europe
Australia	Asia-Pacific	Netherlands	Europe
China	Asia-Pacific	Russia	Europe
Hong Kong SAR	Asia-Pacific	United Kingdom	Europe
India	Asia-Pacific	Bahrain	Middle East
Malaysia	Asia-Pacific		