



Supervisory Policy Manual

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Corporate Governance of Locally Incorporated Authorized Institutions

V.1 – 21.09.01

This module should be read in conjunction with the [Introduction](#) and with the [Glossary](#), which contains an explanation of abbreviations and other terms used in this Manual. If reading on-line, click on blue underlined headings to activate hyperlinks to the relevant module.

Purpose

To set out the minimum standards which the HKMA expects locally incorporated AIs to adopt in respect of their corporate governance

Classification

A statutory guideline issued by the MA under the Banking Ordinance, §7(3)

Previous guidelines superseded

Guideline 3.1.1 "Appointment of Alternate Directors" dated 16.11.95;
Guideline on "Corporate Governance of Locally Incorporated Authorized Institutions" dated 19.05.00

Application

To all locally incorporated AIs

Structure

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1. Introduction

1.1 Importance of corporate governance

- 1.1.1 Corporate governance, as far as the banking industry is concerned, signifies the manner in which the business and affairs of individual AIs are directed and managed by their Board of Directors and senior management. It also provides the structure through which the objectives of an AI are set, the strategy for attaining those objectives is determined and the performance of the AI is monitored.
- 1.1.2 Rapid changes in the business environment have intensified risks in the banking sector. Such changes include globalisation, liberalisation of financial markets, innovations in financial products and technological advances.
- 1.1.3 AIs differ from other companies in that most of the funds they use to conduct their business activities belong to third parties, particularly their depositors. There is also the risk that problems in one AI may spread to others through contagion. Thus the failure of an AI not only affects its own stakeholders¹ but may also have systemic impact on the stability of the banking system as a whole.
- 1.1.4 Because of the above factors, a high quality of corporate governance is expected of AIs.

1.2 Implications of non-compliance

- 1.2.1 §7(1) of the Banking Ordinance provides that the principal function of the MA shall be to promote the general stability and effective working of the banking system. The MA therefore has a strong interest in ensuring that there is effective corporate governance in AIs.
- 1.2.2 While this module does not have the force of law, failure to adhere to the standards set out in it may call into question whether an AI continues to satisfy the minimum criteria for authorization in the Banking Ordinance.

¹ The stakeholders of an AI normally include its shareholders, directors, depositors, creditors, employees and others such as regulators.



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1.2.3 Such failure may also cast doubt on the fitness and propriety of individual directors and shareholder controllers of the AI.

1.2.4 Where the standards set out in this module are not met, it may nonetheless be acceptable for the AI to demonstrate that it has put in place alternative measures which have the equivalent effect of ensuring sound corporate governance.

1.3. Types of directors

1.3.1 There are two types of directors²: executive directors and non-executive directors (which include independent directors).

1.3.2 "Executive directors" means directors who have definable management responsibilities in addition to their functions as directors.

1.3.3 "Non-executive directors" means directors other than executive directors, i.e. they are not employees of an AI and do not hold any other office in the AI in conjunction with their office as directors.

1.3.4 "Independent directors" means non-executive directors who are independent of management and free from any business or other relationship that could materially affect their independent judgement. Some non-executive directors may represent the interests of the AI's shareholders or have some form of connection with the AI, which means that they cannot be considered as independent.

1.3.5 Non-executive directors and independent directors are appointed to the Board to provide effective checks and balances on the powers of executive directors and management and to give objective advice on activities of the AI and decisions taken by the Board.

² The word "director" is defined in the Banking Ordinance to include any person who occupies the position of director, whatever the title of his office.



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1.3.6 Occasionally, a person may act as an alternate to a director. The HKMA is of the view of that “alternate directors” have all the obligations imposed on the primary directors. In particular, if an alternate director attends a directors’ meeting at which decisions are taken, that alternate director would share the responsibility for such decisions. The HKMA accordingly considers that the definition of “director” in the Banking Ordinance includes alternate directors and that they are therefore subject to the approval requirement under §71 of the Ordinance.

2. Responsibilities of the Board of Directors

2.1 General

2.1.1 The Board of Directors is ultimately responsible for the operations and the financial soundness of the AI. In meeting its overall responsibilities to stakeholders, the Board, among other things, should:

- ensure that the AI's management is competent (subsection 2.2);
- approve and monitor the AI's objectives, strategies and business plans (subsection 2.3);
- ensure that the AI's operations are conducted prudently and within the framework of laws and policies (subsection 2.4); and
- ensure that the AI conducts its affairs with a high degree of integrity (subsection 2.5).

2.1.2 The Board should also bear in mind the need for transparency. That is, the Board should carry out its responsibilities in such a way that parties such as external auditors and supervisors can see how it does so and hence form a judgement on the quality of its work. For example:

- policies approved by the Board should be documented in writing;



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- records (e.g. Board minutes) should be maintained of decisions and the grounds therefor; and
- the assignment of duties and responsibilities among members of the Board should be clearly documented.

2.2 Ensuring competent management

2.2.1 Competent management is perhaps the most important element for ensuring a soundly and efficiently run AI. The Board needs to:

- appoint a chief executive (including an alternate chief executive) with integrity, technical competence and experience in banking business which enables him to administer the AI's affairs effectively and prudently;
- oversee the appointment of other senior executives³ (see [CG-2](#) "Systems of Control for the Appointment of Managers") and ensure that they are fit and proper to manage and supervise the AI's key business and functions;
- approve the management succession policy of the AI; and
- supervise senior management's performance effectively and on a continuing basis.

2.2.2 The Board should also clearly define the authorities and key responsibilities of both directors and senior management and provide checks and balances to senior management. Senior managers should in turn exercise adequate oversight with respect to line managers in specific areas and activities and ensure that clear reporting lines are in place.

2.3 Approving and monitoring objectives, strategies and business plans

³ Such as the chief financial officer, division or department heads and the head of internal audit.



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- 2.3.1 An AI should clearly establish its objectives and formulate business strategies and plans for achieving them.
- 2.3.2 The Board should approve these objectives, strategies and business plans and ensure that performance against plans is regularly reviewed, with corrective action taken as needed.
- 2.3.3 The annual budgeting exercise is an integral part of the short-term planning and performance monitoring process. The Board should also approve annual budgets and review performance against these budgets.

2.4 Ensuring prudent conduct of operations within laws and policies

- 2.4.1 While management is responsible for running the AI on a day-to-day basis, the Board should ensure that the internal control systems in place are effective and that the AI's operations are properly controlled and comply with policies approved by the Board as well as applicable laws and regulations. See subsection 6.2 below for more detailed guidance.
- 2.4.2 The Board and senior management should also demonstrate consistently through their actions and behaviour that they have a strong commitment to implementing an effective control environment throughout the AI.

2.5 Ensuring and monitoring integrity in AI's conduct of affairs

- 2.5.1 An AI is entrusted with the public's money. Its reputation is probably its most valuable asset. It is therefore in the AI's commercial interest to ensure that in its dealings with the public it observes a high standard of integrity. This means that particular care should be taken to comply with applicable laws and regulations (such as the Personal Data (Privacy) Ordinance, Prevention of Bribery Ordinance, etc.), prevention of money laundering legislation, industry standards (such as the Code of Banking Practice) and regulatory guidelines issued by the HKMA and other relevant regulatory authorities.



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- 2.5.2 AIs which are exempt dealers or MPF intermediaries should ensure, in particular, that their securities and MPF-related activities are conducted honestly, fairly and with integrity at all times and in close adherence to the standards prescribed under the respective codes of conduct issued by the Securities & Futures Commission and the Mandatory Provident Fund Schemes Authority.
- 2.5.3 There should be controls to prevent directors and employees from benefiting from the improper use of confidential information or otherwise from advantages offered to them which may lead to unfair, improper or, in the extreme, illegal behaviour.
- 2.5.4 Listed AIs should adopt a policy on insider trading no less comprehensive than that provided for in the model code for listed companies issued by the Stock Exchange of Hong Kong Limited (“SEHK”). An AI should have adequate procedures and systems in place to enable the Board to monitor compliance with these policies and to ensure that deviations are reported to an appropriate level of management.
- 2.5.5 The Board should ensure that the AI's remuneration policy is consistent with its ethical values, objectives, strategies and control environment. If the AI fails to link financial incentives to the business strategy, it may cause or encourage employees to book business based on volume or short-term profitability with little regard for long-term risk consequences. Over-reliance on short-term performance, e.g. short-term trading gains, may provide an incentive for excessive risk-taking and, at worst, deliberate falsification of positions and concealment of losses.
- 2.5.6 The Board should approve a set of ethical values which are communicated throughout the AI, for example in the form of a code of conduct, to educate and guide its staff in discharging their duties. Such values should stress the importance of standards of conduct and integrity. In particular, it is important that corruption and bribery are prohibited in corporate activities, both in internal dealings and external transactions.



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2.5.7 The Board should establish policies and procedures to ensure compliance with ethical values. For example, every AI should prepare a code of conduct for its staff and appoint at least one senior officer to handle queries from staff and other matters relating to the code (see [CG-3](#) “Code of Conduct”). This may also be supplemented by specific training for staff on ethical issues.

3. Legal obligations of directors

3.1 General

3.1.1 Directors, including non-executive directors, share joint responsibility as members of the Board for the proper direction and management of an AI. Operational functions will be delegated to management but the directors remain accountable for ensuring that management discharges these functions in a prudent, professional and competent manner and in conformity with the law.

3.1.2 Directors have many legal obligations, either imposed by common law or statutes. Some of these are highlighted below.

3.2 Common law

3.2.1 Common law imposes two main duties on a director:

- fiduciary duty; and
- duty of care.

3.2.2 The fiduciary duty, in practical terms, means that a director:

- shall act honestly and in good faith for the benefit of the AI;
- must not act beyond the power conferred by the AI;
- must guard against a conflict of interests in dealing with the AI;
- shall not use the property of the AI or any privileged access to information by virtue of his position for his personal advantage; and



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- must apply such degree of skill, care and diligence as may reasonably be expected of a person of his knowledge and experience.

3.2.3 In terms of duty of care, directors are expected to administer the affairs of the AI diligently.

3.3 Banking Ordinance

3.3.1 Directors are ultimately responsible for ensuring that their AI complies with all laws and regulations, in particular the Banking Ordinance. Areas that merit special attention include:

- limitations on loans by and interests of the AI;
- capital adequacy and liquidity ratios;
- unsafe and unsound banking practices; and
- reporting requirements.

3.3.2 In relation to limitations on loans by and interests of the AI, directors' attention is drawn specifically to §83 of the Ordinance, which limits unsecured lending to connected parties and their relatives (see section 2 of [CR-G-9](#) "Connected Lending"). The prudential reason for putting statutory limits on connected lending is that such transactions tend, or are often seen, to be not at arm's length. The HKMA regards compliance with this section as of utmost importance and expects directors to exercise adequate oversight of such lending (see subsection 6.3 below).

3.3.3 Under the Banking Ordinance, directors are held personally accountable for non-compliance with many of its requirements. Breaches of statutory requirements may lead to prosecution and to penalties of imprisonment or fines. A summary of these obligations is provided in Annex A.

3.3.4 To discharge these responsibilities, many AIs have appointed compliance officers or formed committees to develop management systems and controls to ensure compliance with the requirements under the Banking Ordinance, assess the impact of new laws and regulations



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on operations and procedures and provide guidance on compliance issues as new products are developed. Als that have not done so should consider doing the same.

3.3.5 §126(1) of the Banking Ordinance provides that in proceedings for an offence under the Ordinance, it shall be a defence for the person charged to prove that he took all reasonable precautions and exercised all due diligence to avoid the commission of such an offence by himself or any person under his control. This defence is not available, however, in relation to all offences provided for in the Ordinance. §126(2) contains a list of offences⁴ in respect of which the defence is not available. Directors' attention is specifically drawn to §72A on knowingly providing the MA with false information. An offence under §72A(4) is not subject to the protection of §126.

3.3.6 Under §71 of the Banking Ordinance, the MA has the power to approve directors. The fitness and propriety of directors is also an authorization criterion under the Seventh Schedule to the Ordinance. Thus if a director fails to satisfy the MA that he is fit and proper for the position, one or both of the following could ensue:

- consent granted under §71 may be withdrawn; and
- the power to revoke an AI's authorization may become exercisable.

3.4 Other laws and regulations

3.4.1 Directors should also be aware of and fulfil their legal obligations under all other applicable laws and regulations, including but not limited to:

- the Companies Ordinance;
- the Securities Ordinance;
- the Personal Data (Privacy) Ordinance;
- the Drug Trafficking (Recovery of Proceeds) Ordinance;

⁴ §§46(8), 47(2) or (3), 50(6), 64(5), 72A(4), 73(2), 97(1), 117(7), 118(5), 120, 123 and 124.



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- the Organised and Serious Crimes Ordinance; and
- the Prevention of Bribery Ordinance.

4. The use of specialised committees

- 4.1 The Board is ultimately responsible for the conduct of an AI's affairs. Instead of involving the full Board in handling every matter, however, it may be beneficial for supervision of major functional areas to be delegated to certain specialised committees. At the same time the Board should be conscious that it remains ultimately responsible for such committees' decisions.
- 4.2 All such committees should be established with clearly defined objectives, authorities, responsibilities and tenure. Written terms of reference of each committee should be maintained and updated appropriately. These committees should report regularly to the Board. The Board should ensure that the number of such committees and the structure of each committee are suitable, having regard to the AI's size and business, the Board's composition and individual directors' expertise.
- 4.3 Typical specialised committees are described below:

Type of committee	Description
Executive Committee	The Executive Committee usually handles matters which require the Board's review, but arise between full board meetings and is used most commonly in large banking institutions. It can relieve the full Board of detailed review of information and operational activities. Generally, all major functions of the AI will be subject to review and approval by this Committee, and the work of the other board committees will be coordinated by it.
Credit Committee	The Credit Committee ensures that the AI's lending policies are adequate and lending activities are conducted in accordance with established policies and relevant laws and regulations. It also serves the vital role of monitoring loan portfolio quality and ensures that management follows adequate procedures to identify problems early, recognise adverse trends, take appropriate corrective actions and maintain adequate provisions for loan losses. It should pay particular attention to the procedures for monitoring compliance with statutory lending limits. In some AIs, it also participates in evaluating credit applications and making credit



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Type of committee

Description

decisions.

Asset and Liability Committee (“ALCO”)

The ALCO is an important feature in the effective management of the assets and liabilities of an AI. The most fundamental function of ALCO is to oversee the AI’s operations relating to interest rate risk and liquidity risk and in particular to ensure that the AI has adequate funds to meet its obligations. Other functions of ALCO will be dependent on the AI’s size and assets/liabilities mix. It is essential to have a balanced representation in ALCO to represent both the assets and liabilities sides of the balance sheet. The ALCO is therefore composed of the senior staff of the AI including usually the chief executive, the chief financial officer, the treasurer, the chief credit officer and the officer in charge of deposit-taking. Other members such as division heads of corporate and retail banking may also be found in ALCOs of larger banks.

Remuneration Committee

The Remuneration Committee provides oversight of remuneration of senior management and other key personnel and ensures that remuneration is consistent with the AI’s culture, strategy and control environment. It should make recommendations to the Board on the AI’s remuneration policy framework and specific remuneration packages for each of the senior executives and key personnel. Executive directors should preferably play no part in decisions on their own remuneration to avoid conflicts of interest. The full Board should approve the relevant remuneration policies and packages based on the Committee’s recommendations.

Nomination Committee

The Nomination Committee ensures that only the most competent individuals, who can contribute to the AI and discharge their responsibilities in the interests of all shareholders, are appointed to the Board and key management positions. It is responsible for making recommendations to the Board on all new appointments of directors and senior executives such as the chief executive, alternate chief executive, chief financial officer, etc. Since the Committee is involved in recommending appointments of senior executives, it should have a majority of non-executive directors on it to assure its independence. The full Board should make appointments based on the Committee’s recommendations.

Audit Committee

The Audit Committee is one of the most important committees of the Board. It serves as the Board’s “eyes and ears” in monitoring compliance with the policies approved by the Board and other internal and statutory regulations. It provides



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Type of committee

Description

oversight of the AI's internal and external auditors and thereby assists the Board in providing independent review of the effectiveness of the financial reporting process and internal control systems of the AI.

5. The use of auditors

5.1 General

- 5.1.1 All AIs should have an external auditor and an internal audit function.
- 5.1.2 The Board should recognise the importance of the audit process and communicate this throughout the AI. It should also review carefully and make use of, in a timely and effective manner, the findings of both internal and external auditors. The deliberations of the Board on whether or not the auditors' recommendations are accepted should be documented so that audit recommendations are properly dealt with. Where the review is carried out by an Audit Committee, key issues should be brought to the full Board's attention.
- 5.1.3 Management should be required to report periodically on the AI's progress in resolving problems raised by auditors.

5.2 External audit

- 5.2.1 External auditors play an important role in the corporate governance structure. Apart from fulfilling the legal obligation to give a statutory opinion on financial statements, external auditors can provide the Board with a third party opinion on the adequacy of management systems, accounting controls and financial information.
- 5.2.2 The Board, not management, should control the selection of external auditors.

5.3 Internal audit

- 5.3.1 Internal auditors also have an important role to play. They are usually more familiar with the operations of the AI than



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external auditors. They normally assist the Board on a continuing basis by performing the following duties:

- reviewing operating procedures to ensure that they incorporate adequate controls and comply with policies approved by the Board;
- reviewing and testing operations regularly to ensure that internal controls are functioning properly; and
- helping management develop appropriate solutions to problems.

5.3.2 Internal auditors should have a direct reporting line to the chairman and unfettered access to the Board or its Audit Committee, so that they can report their findings directly.

5.3.3 The Board should approve the appointment, resignation or dismissal of the head of internal audit.

6. Specific requirements

6.1 General

6.1.1 The HKMA expects the Board of Directors of locally incorporated AIs to adhere to the following specific requirements in addition to fulfilling those obligations and responsibilities mentioned above.

6.2 Risk management process

6.2.1 The Board of Directors should ensure that the AI establishes policies, procedures and controls to manage the various risks the AI faces, including the risks identified by the HKMA for the purposes of risk-based supervision⁵.

6.2.2 As banking becomes more complex, it is all the more important that AIs have in place a comprehensive risk management process to identify, measure, monitor and

⁵ In moving increasingly towards a risk-based supervisory approach, the HKMA will focus more attention on the quantity of the various types of risk faced by the AIs and the quality of the systems used for managing these risks. For this purpose, the HKMA has identified eight major categories of risk: credit, interest rate, market, liquidity, operational, reputation, legal and strategic. See [SA-1](#) "Risk-based Supervisory Approach".



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control the various types of risk with which the AI is faced and, where appropriate, to hold capital against them.

- 6.2.3 It is the responsibility of the Board to approve and periodically review the risk management strategies and policies of the AI to ensure that they remain adequate and consistent with the AI's operating environment. This should not be done merely for form's sake (i.e. simply to satisfy the requirements of the regulator). Rather, such policies should dictate how the day-to-day operations of the AI are actually managed in practice.
- 6.2.4 Senior management is responsible for implementing the strategies approved by the Board and for developing the policies and procedures for managing the various types of risk.
- 6.2.5 AIs should ensure that the risks of new products and activities are identified and subject to adequate procedures and controls before being introduced.
- 6.2.6 Specialised board committees (see section 4 above), such as the Audit Committee or a risk management committee, may have a role to play in reviewing the adequacy of risk management policies and systems and the extent to which these are operating effectively. They should report regularly to the full Board.
- 6.2.7 Major functional areas for which policies should be established include balance sheet management, including capital adequacy and liquidity, lending, and trading and investments.
- 6.2.8 Management of the AI's balance sheet is critical to its well being. The policies approved by the Board should at least include:
- the composition of assets and liabilities, including those off-balance sheet;
 - maintaining an appropriate minimum capital adequacy ratio;
 - maintaining adequate liquidity to meet expected and unexpected cash needs;



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- limiting exposure to maturity mismatch, and to interest rate, foreign exchange rate and other market risks; and
- limiting concentrations of exposures, both to individual borrowers, and to economic sectors.

6.2.9 The Banking Ordinance imposes limits in relation to many of these risks. Directors should be fully aware of these limits and update themselves on any changes. Statutory limits are, however, absolute minima or maxima (depending on the nature of the limit) and are not necessarily indicative of the level of risks an AI should take⁶. A prudently managed AI will set norms which are appropriate for its own particular circumstances and require exceptional justification before these norms are breached. Excesses should be reported to the Board with reasons.

6.2.10 The Board should regularly review the development of the balance sheet and other financial indicators of the AI against performance and the established risk targets.

6.2.11 Investments in assets other than in the ordinary course of banking business, such as property, subsidiaries or affiliates, should be sanctioned by the Board, where these exceed pre-determined minima. Similarly, proposals to open branches overseas or establish or acquire overseas subsidiaries or associates should be approved by the Board. Management should provide appropriate justification and information to enable these decisions to be properly taken by the Board. Again, the Board should be familiar with the limits set in the Banking Ordinance.

6.2.12 Where the AI is also a holding company, many of the areas set out above should be directed by the AI's Board on a group basis. An AI may have to support its subsidiaries over and above its direct legal liability. The

⁶ For example, a statutory minimum capital adequacy ratio of 8% does not mean that such a ratio is appropriate for a particular AI. Nor does a statutory large exposure limit of 25% mean that such an exposure would be appropriate in relation to a particular counterparty.



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AI's capital adequacy, liquidity and risk exposures should all be considered with this in mind.

6.2.13 It is recognised that the Board of an AI which is a subsidiary of another banking institution may operate in an environment which is different from that of an independent AI. Key functions and policies may be determined and centralised at the holding company level. As the subsidiary AI is a separate legal entity, however, its directors are not absolved from the responsibility for policies and actions that are applied by the holding company to the AI. The Board should be ultimately responsible for the approval and monitoring of the implementation and effectiveness of all group policies applied to the AI. The Board should therefore review such policies as if they were its own. If the Board is not satisfied that the policies are appropriate to its circumstances, it should notify the holding company and discuss appropriate modifications.

6.2.14 The Board's primary responsibility is to protect the interests of the AI which it serves. If, therefore, the holding company is engaging in practices which may, in the Board's opinion, harm the AI, or if the holding company does not respond adequately to the concerns raised by the Board, the Board should dissent on the record and consider actions to protect the AI and, more importantly, its depositors. In such a situation, the Board may consider seeking independent professional advice or raising the issue with the HKMA.

6.3 Oversight of connected lending

6.3.1 The Board should ensure that the AI fully understands the provisions of §83 of the Banking Ordinance on connected lending and establishes a policy on such lending. The policy, and any changes thereto, should be submitted to the HKMA. See subsections 3.1 and 3.2 of [CR-G-9](#) "Connected Lending" for the detailed requirements.

6.3.2 AIs should be aware that a breach of §83, which limits the unsecured advances of an AI to its connected parties, is a serious offence. Examples in the past have demonstrated



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the extent of damage that connected lending can do to banks where the control on such lending is inadequate.

6.4 Review of management letters

- 6.4.1 The Board should ensure that it receives the management letter from the external auditors without undue delay, together with the comments of management. Normally this should be received within four months of the financial year-end. If prolonged delay is experienced, the Board should ask for an explanation from management.
- 6.4.2 Detailed consideration of the management letter may be delegated to the Audit Committee, which should report material areas of concern to the full Board. The Board or the Audit Committee should ensure that appropriate action is taken to deal with control or other weaknesses identified in the management letter. A copy of the letter should also be given to the HKMA so that it can monitor follow-up actions.

6.5 Number of independent directors

- 6.5.1 The Board of Directors of AIs, whether listed or unlisted, should maintain an appropriate level of checks and balances against the influence of management and shareholder controllers in order to ensure that decisions are taken with the AI's best interests in mind.
- 6.5.2 Independent directors play an important role in corporate governance. They help to provide the necessary checks and balances to ensure that an AI operates in a safe and sound manner and that its interests are protected. Independent directors can also assist by bringing in outside experience and providing objective judgement. They are particularly useful in a monitoring role, e.g. as members of the Audit Committee.
- 6.5.3 For this purpose, the HKMA considers that the Board of Directors of banks should include at least three independent directors in order to provide a sufficient pool of independent resources. The HKMA will allow, on an exceptional basis, those banks that can provide valid justification (e.g. the bank is undergoing restructuring or a



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merger) not to meet this requirement on a temporary basis. They will, however, be expected to comply with the requirement within a reasonable timeframe.

6.5.4 The roles of the chairman and the chief executive of a bank are distinct. In cases where the chairman is also the chief executive, there should be a strong independent element on the Board. This may require more than three independent directors.

6.5.5 The above requirements regarding independent directors do not apply in full to deposit-taking companies and restricted licence banks. Such AIs are expected to include an appropriate number of independent, or at least non-executive, directors on their Board. The appropriate number of such directors will vary on a case-by-case basis, depending on the size of the AI, the total number of directors on the Board and whether the AI is majority-owned by a bank incorporated in or outside Hong Kong.

6.5.6 AIs should notify the HKMA of the names of the directors who are considered to be independent. In assessing the independence of such directors, the HKMA will take account of various factors such as their direct or indirect financial or other interest in the business of the AI⁷ and their relationship, if any, with significant shareholders of the AI, taking into account relevant international standards and local rules such as the Listing Rules of the SEHK.

6.5.7 The HKMA may require an AI to appoint additional directors who can be regarded more fully as independent if it is not entirely satisfied that there is an adequate independent element on the Board.

6.6 Formation of Audit Committee

6.6.1 The Board of each bank should establish an Audit Committee with written terms of reference specifying its authorities and duties (see para. 4.3 above for a

⁷ Any banking relationship between an AI and a director of the AI (or company connected with that director) should be on an arm's length basis and on normal commercial terms. Where such a relationship is significant to either the AI or the director (or company connected with that director), the AI should consider whether that may prevent the director from being considered independent.



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description of the Audit Committee's key functions). The Audit Committee should be made up of non-executive directors, the majority of whom should be independent⁸.

6.6.2 This requirement does not apply to deposit-taking companies and restricted licence banks which are majority-owned by a bank incorporated in or outside Hong Kong and where the internal and external audit functions of the AI are subject to the direct supervision of the Audit Committee of its parent.

6.6.3 In the case of other deposit-taking companies or restricted licence banks, the AI itself should have an Audit Committee made up of non-executive directors, of which at least one should be independent.

6.7 Frequency of board meetings

6.7.1 Board meetings of an AI should be held preferably on a monthly basis but in any event no less than once every quarter. The Board should ensure that it receives sufficient information from management to enable it to fulfil its responsibilities.

6.7.2 The Board is collectively responsible for the overall leadership and control of the AI. It can only fulfil its responsibility if it meets frequently enough and receives sufficient information from its management to enable it to monitor the financial condition and performance of the AI. Otherwise, a leadership vacuum will be created. This vacuum may be filled by major shareholders becoming directly involved in running the AI's affairs or by the executive management. In either case, the Board of Directors is bypassed and checks and balances are lost, in particular through the inability of independent directors to play an oversight role.

⁸ Where a bank is majority-owned by an immediate holding company, the bank may appoint the Audit Committee of that holding company to act on its behalf, provided that the Audit Committee has the degree of independence specified above. In such cases banks should consult the HKMA.



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6.7.3 Some Als' circumstances may justify a lower meeting frequency. Board meetings should, however, be held no less than once every quarter under any circumstances.

6.7.4 Als should keep full minutes of all board meetings for the purposes of record and future reference. They should provide the HKMA with a record of the number of board meetings held in the previous financial year no later than one month after each financial year-end.

6.8 Attendance by directors

6.8.1 Individual directors of an AI should attend at least half of the board meetings held in each financial year. In addition, directors should make every effort to attend board meetings where major issues are to be discussed.

6.8.2 Directors, including non-executive or independent directors, are expected to contribute actively to the work of the Board in order to discharge their responsibilities. The Banking Ordinance requires individual directors to be fit and proper for the particular position that they hold. This requires individual directors to possess the necessary skills, knowledge, experience and soundness of judgement to fulfil their responsibilities properly.

6.8.3 Directors should also fulfil their responsibilities diligently. It is therefore important that each individual director should allocate adequate time and effort to discharge his responsibilities. This can only be achieved if the director attends a sufficient number of board meetings.

6.8.4 If necessary, the participation of directors in board meetings can be facilitated by means of video or telephone conferencing⁹.

6.8.5 In order to enable the HKMA to monitor the performance of individual directors, Als should provide it with the attendance records of individual directors in the previous financial year no later than one month after each financial year-end.

⁹ Participation in board meetings by means of video or telephone conferencing is regarded as attendance and should be recorded as such.



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6.9 Meetings with HKMA

6.9.1 The HKMA will meet the full Board of Directors of each bank every year. This is because the HKMA considers it important to establish a formal and direct channel for communicating with the Board of Directors of banks.

6.9.2 During the meeting, the HKMA will provide an assessment of:

- the performance of the bank during the previous financial year;
- the bank's current financial position; and
- the quality of the bank's risk management and internal controls

and communicate any major supervisory concerns.

6.9.3 The Board will also be able to use the meeting to communicate its own views and concerns to the HKMA.

6.9.4 It is not the intention of the HKMA to participate in board meetings but rather to aim at strengthening communication between the HKMA and banks at the highest level through these meetings.

6.9.5 Such meetings do not replace the existing prudential interviews and tripartite meetings with banks.



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Annex A: Breaches of provisions of the Banking Ordinance for which directors of AIs may be individually liable

Section No.	Description
11	Carrying out banking business without a valid banking licence
12 and 14	Breach of restrictions on business of taking deposits of restricted licence banks and deposit-taking companies
16	Breach of conditions attached to the AI's authorization
18	Breach of conditions attached to the MA's consent to the AI continuing to hold a deposit after variation of authorization
20	Failure to provide information as required by the MA for maintaining a register of AIs etc.
22	Breach of conditions attached to the MA's consent to the AI continuing to hold a deposit after revocation of authorization
24	Breach of conditions attached to the MA's consent to the AI continuing to hold a deposit during the period of temporary suspension of authorization
25	Breach of conditions attached to the MA's consent to the AI continuing to hold a deposit during the period of suspension of authorization
44 and 49	Failure to obtain the MA's approval for the opening of local branches or overseas branches or representative offices
50	Failure to provide information on overseas branches or representative offices as required by the MA
51A	Failure to obtain the MA's approval for the establishment, acquisition or maintenance of overseas banking corporations
52, 53B, 53C, 53H and 56	Breach of requirements or restrictions imposed on the AI under Part X of the Banking Ordinance
59	Failure to conduct annual audit and commission reports as required by the MA on the AI's state of affairs, profit and loss or systems of control
59A	Failure to notify the MA of the removal or cessation of duties of auditor
60	Failure to exhibit and lodge audited financial statements etc. in the manner required by the MA
60A	Failure to disclose information relating to financial affairs of the AI (this section will come into effect as soon as practicable)



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Section No.

Description

	subject to the conversion of the existing guidelines on financial disclosure into subsidiary legislation.)
63	Failure to submit returns etc. or reports on accuracy of returns and control systems as required by the MA
64	Failure to provide information (name, business address and nature, etc.) on the AI's connected companies to the MA
65	Failure to notify the MA of alteration in constitution of the AI
66	Failure to notify the MA of cessation of business of taking deposits or banking business
67	Failure to notify the MA of the AI's inability to meet obligations or payment
69	Failure to notify the MA of the sale or disposal of the business of taking deposits or banking business etc. and obtain MA's approval for such changes
70C	Failure to notify the MA of any directions or instructions given by a prohibited indirect controller
70D	Issuing shares or making payments in contravention of restrictions imposed by the MA under §70B(3)
72A	Failure to notify the MA of changes in controllers, directors, chief executive etc. and knowingly providing the MA with false information
73	Failure to obtain the MA's consent on prohibited person specified in this section acting as an employee of the AI
74	Failure to appoint a chief executive and alternate chief executive(s)
80	Breach of restrictions on granting advances etc. against the security of the AI's own shares etc.
81, 83 and 85	Breach of limitations on maximum exposure to individual entities or groups of entities and on advances to directors etc. as well as employees
86	Breach of restrictions imposed by the MA on moneys placed with foreign bank
87, 87A, 88, and 90	Breach of limitations on shareholding, acquisition of share capital, interest in land and aggregate holdings under §§83, 87 and 88
91	Failure to provide a proof of compliance with §§80, 81, 83, 85, 86, 87, 88 or 90



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Section No.	Description
95	Non-compliance with the notice served by the MA in respect of false advertisements etc. by the AI
96	Making prohibited representations etc. in any manner that the AI has been approved by the HKSARG, the Financial Secretary or the MA
99, 100, 103 and 104	Failure to notify the MA of breach of the minimum capital adequacy and liquidity ratios and take remedial action as required by the MA to restore the ratios
106	Breach of the 5% rule of limitation on creation of charges over the AI's assets without the MA's approval and failure to notify the MA of material civil proceedings against the AI
117 and 118	Failure to cooperate with the inspector as appointed by the Financial Secretary under §117
123	Deliberate deception by wilfully making false entry in any book of records, etc.
124	Receipt of gift, commission etc., for personal benefit etc., for procuring for any person any loans etc., from the AI
132	Failure to use English or Chinese language and Arabic system of numerals in books, accounts, returns etc.

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