



12th December 2012

Dear Stakeholders:

Re: The Banks and Deposit Companies Act 1999: Corporate Governance Related Amendments to Regulatory Framework for Banks and Response to Consultation Comments

With the passing of the Banks and Deposit Companies Amendment Act 2012, a specific corporate governance related licensing criterion has been added to the Second Schedule of the Banks and Deposit Companies Act 1999. The Authority's interpretation of the new criterion is provided in amendments to the statutorily prescribed Statement of Principles ("SoP") and the newly issued underlying Corporate Governance Policy ("Policy"). The Authority will take into consideration compliance with the SoP and the Policy when assessing whether an institution meets the corporate governance criterion.

In addition to the amendment of the SoP, there is an additional consequential amendment to the policy framework for banks and deposit companies. The Authority's May 2007 paper *The Bermuda Monetary Authority's Relationship with Auditors and Reporting Accountants of Banks and Deposit Companies* has been amended to ensure consistency with the new Policy paper. Detailed provisions relating to Internal Controls, originally in Annex C of this paper, have now been added as an Annex to the new Policy paper. It should be noted that no additional provisions have been added to this new Annex.

A draft version of the Policy paper was published for industry consultation in December 2011. The Authority would like to thank all respondents for their comments.

Authority's Response to Corporate Governance Policy Consultation Comments:

1. Clarification was sought as to whether the board of directors may delegate powers.

The Authority agrees that the board of directors may delegate its powers; however, such delegation does not resolve the board from its ultimate responsibilities. In this regard, appropriate amendment to the guidance to Principle 1 has been made to aid clarity.

2. Clarification was sought as to the use and interpretation of "risk appetite" and "risk tolerance" in the paper.

The terminology "risk tolerance" has been removed from the Policy paper and replaced with "risk appetite," which is defined as "the level of aggregate risk that the bank's board is willing to assume and manage in the pursuit of the bank's business objectives."

3. Clarification was sought as to the meaning of "significant."

Determination of significance will reflect the size, complexity, structure and risk profile of an individual bank or group and may vary between different institutions. Appropriate amendment to the Policy has been made to aid clarity.

4. It was suggested that the majority of board members should not only be non-executive directors, as stated in guidance to Principle 2, but also independent. The rationale for this additional requirement was to ensure consistency with the board membership requirements applicable to subsidiaries under Principle 4.

The Authority does not agree with this suggestion. The two Principles have slightly different purposes, with the guidance under Principle 2 having general applicability in comparison to that under Principle 4, which addresses board composition in the context of a Bermuda bank that is a subsidiary of a group. The requirement for independence under Principle 4 seeks to address the risk of a lack of independence from a parent company and “an adequate number” of independent directors is required. Such a subsidiary would still be required to comply with Principle 2 and the underlying guidance.

5. A concern was raised with respect to the “occasional rotation of membership and chairmanship” of board committees suggested by the guidance under Principle 3. It was noted that such rotation may prove costly and impractical for Bermuda banks given the relatively limited pool of qualified and available candidates.

The Authority notes the concern raised, but would highlight that guidance merely suggests rotation should be a consideration, i.e. there is no hard requirement, and that it is further suggested that rotation should be avoided if it might “impair the collective skills, experience and effectiveness of these committees”. Moreover, in addressing the broader composition of the board, the guidance under Principle 2 states that board members should be drawn from a sufficiently broad population of candidates, but only “to the extent possible given the bank’s size, complexity and geographic scope.”

6. Clarification was sought as to whom certain board committee disclosures, described in the guidance to Principle 3, should be made?

Disclosure should be public.

7. Clarification was sought as to the level of detail required with respect to board committees.

Disclosure should, at a minimum, include the names of committees, a summary of each committee’s purpose, and role and information with respect to composition (i.e. number of executive, non-executive and independent directors).

8. It was highlighted that the proposal for the audit committee to comprise entirely of independent Non-Executive Directors (“NEDs”) is more stringent than the standard set by the Basel Committee’s Principles.

The Authority will align this requirement with the international standard. The guidance will be amended to require a “sufficient number” of independent NEDs.

9. Clarification was sought as to the scope of Principle 4 and its underlying guidance.

This Principle relates to deposit taking institutions licensed in Bermuda, either as a parent company of a group of companies or a subsidiary of another company. An appropriate clarificatory amendment has been made to the Policy.

10. Clarification was sought as to the definition of “senior management.”

Senior management includes, at a minimum, the chief executive officer and senior executives as defined under section 7 of the Banks and Deposit Companies Act 1999.

11. Clarification was sought as to whom senior management should be accountable.

Senior management is accountable to the board of directors.

12. It was commented that the guidance to Principle 7 could be interpreted to place an unreasonable burden on non-executive directors to assume certain operational responsibilities of senior management.

The Authority does not agree with this interpretation and confirms that the role of the board should be one of oversight as opposed to one of day-to-day management. The aforementioned amendment to the guidance to Principle 1 reinforces this point.

13. Clarification was sought as to whether the proposal of robust internal pricing of risk under Principle 7 was applicable to all banks.

As stated in the introduction to the consultation paper, implementation of the guidance “will reflect the size, complexity, structure and risk profile of an individual bank.” The principle of proportional implementation applies to this proposal and an amendment has been made to the Policy to add clarity.

14. It was suggested that the guidance under Principle 10 in relation to remuneration was ambiguous and lacked clarity.

The Authority has amended the wording of the guidance to enhance clarity without seeking to change the spirit of the guidance nor introduce prescriptive requirements.

15. Several comments received expressed concern at the level of proposed public disclosure under the Policy and the potential risk of the release of competitively sensitive proprietary information.

The Authority is sensitive to this concern and, similar to the Pillar 3 framework, there is no requirement to disclose commercially sensitive information. Appropriate amendment has been made to the Policy to clarify this point.

16. It was further suggested that the proposals for disclosure were overly excessive and exceeded the recommendations of the Basel Committee.

It should be noted that the Policy is in line with the Basel Committee recommendation which calls for banks to apply the disclosure and transparency provisions of section 5 of the OECD Principles of Corporate Governance.

17. Clarification was sought as to the disclosure requirements with respect to board members under section 13.3.

The Authority confirms that the information with respect to individual board members as specified under section 13.3 should be disclosed, but that the requirement to disclose information with respect to the board member selection process may be restricted to a description of the general process as opposed to the circumstances of an individual member’s selection.

18. Confirmation was sought as to whether the Policy places a requirement on licensed deposit taking institutions to publish an annual report containing the information specified in Principle 13 and its supporting guidance.

There is no such requirement. Disclosure may be made via other media as suggested in the Policy.