



CORPORATE GOVERNANCE GUIDELINE

1. INTRODUCTION

The Central Bank of Barbados (Bank), in furtherance of its responsibility for the regulation and supervision of licensees under the Financial Institutions Act, 1996-16 and the International Financial Services Act, 2002-5, has developed this guideline to provide guidance to licensees on their obligations as it relates to corporate governance.

The Guideline¹ sets out the Bank's expectations in relation to the minimum standards for corporate governance practice by all licensees. It will form an integral part of the framework used by the Bank in assessing the effectiveness of the corporate governance provided by the Board of Directors (Board) and senior management of Barbados licensed financial institutions. In this regard, the Bank's focus will not be simply on a mechanistic adherence to the Guidelines. Instead, the Bank will seek to establish that, overall, processes appropriate to the institution are in place and operating effectively and that the Board is able to carry out and carries out its oversight responsibilities in an effective and efficient manner.

The Bank recognises that there may be differences in the approaches adopted by institutions. Licensees are expected to design a governance framework that satisfies the needs of their institution, taking account of:

- i. The nature and scale of the business;
- ii. The complexity, volume and size of transactions; and
- iii. The degree of risk associated with each area of operation.

Where material deviations from this Guideline are contemplated, licensees should demonstrate to the Bank that the alternative measures have at least an equivalent effect of ensuring sound corporate governance.

2. APPLICATION

This Guideline on corporate governance applies to all entities that are incorporated in Barbados and that are licensed under the Financial Institutions Act, 1996-16 and the International Financial Services Act, 2002-5.

¹ This note is intended to complement the obligations for directors and management already encoded in the Companies Act Cap. 308, the *Financial Institutions Act 1996-16* and the *International Financial Services Act 2002-5* and the *Money Laundering and Financing of Terrorism (Prevention and Control) Act CAP. 129*. It should be read in conjunction with the draft Corporate Governance Principles for Caribbean Countries which are located at – www.ecseonline.com



3. CORPORATE GOVERNANCE

Corporate Governance refers to the processes, structures and information used for directing and overseeing the management of an institution. A good corporate governance framework establishes the mechanisms for achieving accountability between the Board, senior management and shareholders, while protecting the interests of relevant stakeholders. It also sets out the structure through which the division of power in the organisation is determined.

The role and importance of banks in the financial system and the way banks are funded underscores the need for a framework for corporate governance for licensed banks. The legislative framework for banks recognises this crucial role and the risk of malfeasance by inter alia:

- i. Restricting access to the industry;
- ii. Defining grounds for revoking a license, including where the conduct of business is detrimental to the public interest or the interest of depositors;
- iii. Defining types of individuals who cannot serve as directors or officers of a licensee;
- iv. Imposing large exposure restrictions on lending and investment; and
- v. Requiring regular reporting to the Bank, annual audits by independent auditors and public disclosure of financial performance.

3.1. THE BOARD OF DIRECTORS

The Board has ultimate responsibility for the quality of governance of a licensee. The Board has an oversight role designed to ensure that the licensee:

- i. Is managed in a way that safeguards its safety and soundness; and
- ii. Is in compliance with all relevant laws and regulations.

The Board is expected inter alia to:

- a. Oversee the selection of competent senior management to assume the day-to-day management of the organisation and determine their compensation;
- b. Define and document formally its role vis a vis that of management. This should provide for clarity in what functions and authorisations have been delegated to management;
- c. Assure itself that the organisational structure lends itself to effective management and to the achievement of the organisation's goals; and
- d. Assess and approve the business objectives, corporate values and strategic direction of the licensee. The Board should inter alia:



- i. Document standards that address unethical behaviour;
 - ii. Assess whether the strategy is realistic in the context of the prevailing environment and the resources available to implement the strategy;
 - iii. Review, approve and monitor annual business plans and budgets; and
 - iv. Review the associated risk and returns associated with new products and services.
- e. Understand the risks that the licensee faces, discuss and approve the policies to mitigate these risks and obtain regular assurances from management that appropriate processes of risk assessment, management and internal controls are in place. The policies must be consistent with the institution's long-term strategic plans. By adopting clearly written policies, including for new activities, the Board is able to define what practices and what level and types of risk are acceptable;
- f. Ensure that senior management implements the licensee's strategy and ethical standards;
- g. Approve outsourcing arrangements, including intra-group, and satisfy itself that written service level agreements that, outline the responsibilities of the respective parties, etc. are completed before the arrangement begins;
- h. Receive and analyse reports prepared by management, including up-to-date information on:
- i. Significant risks and the effectiveness of risk management processes;
 - ii. The financial consequences of material exceptions to policies and controls;
 - iii. Competition and market share; and
 - iv. Key strategic issues and on possible acquisition targets.
- i. Monitor performance against agreed benchmarks;
- j. Assure itself of the integrity of financial reporting;
- k. Receive, discuss and follow up reports prepared by the internal and external auditors and by regulators; and
- l. Ensure that the governance system enables the licensee's operations to be conducted within the framework of all relevant laws, including the Companies Act Cap. 308, regulations and guidelines.

3.2 RESPONSIBILITY OF BOARD MEMBERS

Directors are appointed or elected to direct and oversee the affairs of the licensee. In conducting his duties, a director is required to exercise the degree of care, skill and diligence of a reasonable diligent person with both the knowledge and experience



expected of a director in their position and also any specific knowledge or skills that they may have.

Board members' individual responsibilities include:

- a. Maintaining an awareness of the licensee's internal and external operating environment including local, regional and international financial trends and any statutory and regulatory changes affecting the licensee; and
- b. Diligently performing the job by:
 - i. Attending Board meetings regularly and participating actively in Board discussions. Directors who are unable to fulfil these obligations should not sit on a licensee's Board;
 - ii. Preparing in advance of meetings by reviewing the relevant background material, including management reports,
 - iii. Requiring explanations of any unfamiliar activities;
 - iv. Reviewing the reports of internal and external audits and supervisory examinations; and
 - v. Attending meetings when requested by the Bank.
- c. Exercising independent judgement and not permitting themselves to be influenced by another director, by management, or by outside interests. A critical evaluation of the issues before the Board is essential to the effectiveness of each member of the Board. Directors must ask management questions to satisfy themselves that management's recommendations are feasible and in the best interests of the institution. If the director disagrees with Board action, the director should say so, and ensure that the minutes reflect the dissent;
- d. Avoiding conflicts of interests by inter alia:
 - i. Respecting the confidentiality of information received during their tenure as directors;
 - ii. Transacting their personal business with the institution at arm's length; and
 - iii. Fully disclosing to the Board any interests, direct or indirect, they may have in loans, contracts, etc. to which the licensee is or may become a party. This does not mean that directors may not conduct business with the institution but they should not be involved in the decision making on such transactions.



3.3 SENIOR MANAGEMENT

The bank's senior management is responsible for the day-to-day operations of the business, serving as a link between the board and staff. The senior management is responsible for:

- a. Implementing the bank's strategic plan;
- b. Keeping directors adequately informed about the performance of the institution through financial and management reports and the reports prepared by internal auditors, external auditors and the compliance officer;
- c. Advising the Board on the appropriate organisational structure, and ensuring that the quantity and quality of staff resources are available to carry out all tasks, including internal audit and compliance;
- d. Implementing and maintaining risk management systems appropriate to the scale, nature and complexity of the institution;
- e. Delineating and documenting the areas of responsibility for each staff member. Reporting lines must be clear and appropriate in the context of the scale, nature and complexity of the bank;
- f. Communicating the bank's strategic direction, reporting lines and risk tolerances throughout the organisation; and
- g. Overseeing management information systems to enable timely and accurate dissemination of information to the Board and regulators.

4. BOARD STRUCTURE AND OPERATIONS

The size, composition, and committee structure of the Board will vary with each institution according to the size of the institution, the level of risk to third parties and the need for monitoring of risk and effective decision-making.

4.1 SIZE OF BOARD

The Board of Directors should comprise at least 3 persons. Boards with this low number of directors will only be permitted where the level of assets on and/or off balance sheet is less than \$50 million and there are no third party funds involved.

The size of the Board should be adequate to cope with a member or members having to absent themselves from decision making because of potential conflicts of interest. The Board should periodically review its own size and determine the size most effective for making decisions and future operations. To ensure compliance with this requirement for at least three persons, licensees should consider having more than the minimal requirement.



The Bank reserves the right to recommend an increase in the size of the Board if it believes that persons with different skills would enhance Board effectiveness.

4.2 COMPOSITION

Board members must be approved by the Bank. Board members should be of such diverse backgrounds and experiences that can contribute to the effective governance of the institution. Directors should not sit on more than one board of non-affiliated institutions where the institutions compete in the same market for the same business. The Bank may relax this Guideline where the banks are not competing, but the Bank may disallow a director if it considers his involvement will not contribute to enhanced governance on account of his myriad interests and directorships absorbing much of his time and attention.

4.3 BOARD INDEPENDENCE

To fulfil its oversight responsibilities, the Board should include a balance of executive and non-executive directors (including independent directors) to ensure that neither management nor any other individual or group of individuals dominate the Board's decision making. It is recommended that, where a licensee accepts third party funds whether as a deposit, for asset management or in trust:

- a. At least 51% of board members should not hold executive positions with the licensee; and
- b. At least 20% of the board should be independent of the licensee or its affiliates.

In determining whether a director qualifies as independent, consideration should be given to whether that person:

- i. Was employed by the institution or an affiliate of that institution within the last three years; or
- ii. Had a material relationship with the institution either directly, or as an adviser, partner, shareholder or senior employee of a body that has or had such a relationship with the institution within the last three years; or
- iii. Received or receives additional remuneration or deferred compensation from the bank other than director's fees; or
- iv. Is a member of the immediate family of any person described at ii. above.

For the purposes of this note, a shareholding of ten percent or more in the corporate body will be considered material.



4.4 THE ORGANISATIONAL STRUCTURE OF THE BOARD

The functions of the Board may, depending on the size and complexity of the institution, be discharged directly or indirectly through Board committees. Such specialised committees may assist the Board in its oversight function while economising on the limited resources available to monitor specific areas of the institution's activities.

The Board must determine the type of committee structure that would adequately meet its needs and establish the responsibility, authority and accountability requirements of the committees. However, the Bank reserves the right to mandate the creation of an audit committee.

Each committee should have a charter or mandate, which should clearly set out the objectives, responsibilities and powers of the committee. It should distinguish those issues, which the committee has authority to act on behalf of the Board and those for which the committee can only examine and make recommendations to the Board. The charter or mandate should also include the size of the committee, qualifications for membership, any restrictions on the number of executive directors, the frequency of meetings, the requirements for a quorum and committee practices.

The committees should periodically provide the Board with reports of their activities together with recommendations for discussion and approval by the full board. Minutes of committees should be circulated to the full Board as soon as possible following committee meetings. The work of each committee should be co-ordinated with that of the Board and other committees.

The Board, when it deems it necessary, can retain the services of independent professional consultants to assist the various committees and to provide valued input to the decision making process.

Except when a licensee accepts no third party funds, the inclusion of members of management on these committees should be the exception rather than the rule. However, management may be invited to attend meetings as needed to provide input to the discussion.

4.5 BOARD MEETINGS

Board meetings serve as the key fora where executives and directors share information on the performance, plans and policies of the licensee. The Boards of licensed institutions should meet with such frequency as reflects the complexity and volume of activity and the condition of the licensee. Institutions should meet to discuss the business of the bank at least quarterly.

Board meetings should, inter alia, review:

- i. The bank's capital adequacy;



- ii. Statements showing the bank's financial condition and earnings;
- iii. The investment portfolio;
- iv. Loan activity, including past-due and non-accrual loans, charged off or recovered loans and loans to related parties;
- v. Assets under management portfolio;
- vi. Compliance with regulatory standards and laws;
- vii. Audit and examination reports; and
- viii. Any other matters of material impact to the licensee, including liquidity, market and operational risk, litigation, fraud, etc.

The Board must maintain in good condition complete records of the matters discussed at Board and committee meetings², the decisions taken and any dissenting views or abstentions. These requirements apply whether the meeting is held face to face or by tele-conference.

5. OVERSIGHT FUNCTIONS

In fulfilment of its oversight responsibilities, the Board should establish appropriate oversight functions. The Board should support these functions and ensure that they are independent, have the authority to carry out their responsibilities and have direct access to the board.

5.1 AUDIT COMMITTEE

Depending on the nature, scale and complexity of its business, a licensee may elect to create an audit committee. This committee should inter alia:

- i. Be comprised of non-executive directors;
- ii. Be responsible for overseeing the licensee's financial reporting process, including its financial disclosure obligations;
- iii. Oversee the internal and external audit functions, including approving the respective audit plans;
- iv. Meet with and receive reports from the licensee's internal and external auditors; and
- v. Monitor management's response to regulatory, internal and external audit reports/letters.

5.2 INTERNAL AUDIT

Depending on the nature, scale and complexity of its business, a licensee may assign the task of monitoring the appropriateness and effectiveness of its systems and controls to an internal audit function. The internal auditors should report regularly to the Audit

² These records include the board papers presented for discussion at these meetings.



Committee, where it exists, or directly to the full Board where there is no audit committee. The Board should inter alia:

- i. Be actively involved in the selection of the head of internal audit;
- ii. Require that those persons responsible for conducting the internal audit functions be independent from the operations under review;
- iii. Review and approve the mandates and organisational structures of the internal control functions;
- iv. Satisfy itself that the internal audit function is adequately staffed; and
- v. Seek assurances that work programmes are appropriate in light of the risks faced by the licensee.

The Bank recognises that the creation of an Internal Audit department may not be practical for some small licensees. The Bank accepts that, where the licensee is part of a larger financial or non-financial group, internal audit services can be outsourced to affiliates within the group. Where this is not possible, a licensee may, subject to the Bank's agreement, outsource the function to a person or firm that is not involved in the auditing or accounting function of the licensee.

5.3 EXTERNAL AUDIT

Licensees have a statutory obligation to appoint an external auditor. The auditors should conduct a review of the accounting records and internal controls of licensees and report to the Board and the CEO on their assessment of the control environment. The external auditors should meet periodically with the internal auditors, the audit committee and senior management to discuss the findings of their reports. They should have access to the Board to discuss their management letter and other related issues. The Board should require that management letters are provided without undue delay, together with management's action plan to deal with deficiencies that were identified to the Board.

6. GOVERNANCE OF AFFILIATES

The Board should be aware of all material risks that may ultimately affect it, even when they might arise in subsidiaries. It is the parent board's responsibility to determine the Board structure that best contributes to an effective chain of oversight, enabling the parent, the subsidiary and branches to meet their respective statutory and compliance responsibilities.

The corporate governance responsibilities are broadly similar for parent banks and subsidiaries. Generally while there may be some overlap of directors on the parent and subsidiary Boards, each Board must satisfy the requirements of this Guideline. While parent boards should exercise oversight over the activities of subsidiaries, the Board of the subsidiary bank retains its corporate governance responsibilities for the bank. Intra-group outsourcing of operational functions does not absolve the bank of its responsibility



to establish and maintain adequate oversight. Matrix and business line management structures must be in line with the bank's corporate governance responsibilities.

The Bank expects that:

- i. The minutes of the meetings of the parent bank or holding company will reflect discussion on performance and the risks facing its subsidiaries and branch operations outside Barbados;
- ii. Parent banks will pay particular attention to the performance, and activities of subsidiaries that require specialist expertise or that may give rise to material reputation, legal or regulatory risks for the licensee;
- iii. Senior officers and directors of subsidiaries will have an understanding of the specific risks facing the subsidiary, even where functional reporting exists within the group.

Where a licensee is a branch of a foreign bank, the senior management is expected to:

- i. Ensure group policies are customised to the local environment;
- ii. Provide reports to their Head Office in line with the requirements set out in this note and generally satisfy the requirements under 3.3;
- iii. Ensure compliance with local laws; and
- iv. Provide the Bank with such information and in such form as would enable the Bank to satisfy itself that the local operations are subject to adequate oversight.

7. ROLE OF THE BANK

The Bank undertakes periodic inspections of a licensee's corporate governance practices. Licensees should be aware that this inspection is designed to provide an understanding of the licensee's corporate governance practices and their effectiveness. The inspection will, inter alia, include a review of:

- i. The minutes of meetings of the Board, its committees and senior management;
- ii. All policies and procedures on risk management practices;
- iii. Level of reporting to the Board and to the parent Board where relevant; and
- iv. Compliance with statutory and regulatory rules and internal policies.

In relation to iii. above, the Bank will pay particular attention to transactions between directors or their related interests and the licensee to ensure that such transactions are concluded on an arm's length basis and that conflicts of interest have been disclosed.

The Board is ultimately responsible for all acts and omissions of the licensed entity, which include compliance with legal and regulatory obligations. It is imperative that licensees communicate any breaches to the Bank and that the Boards of Directors meet



periodically with the Bank to discuss the performance and/or concerns about the licensee.