



GUIDELINES TO ISLAMIC BANKS

GUIDELINES NO. BU/G-2/2017/6

GUIDELINES ON CORPORATE GOVERNANCE FOR ISLAMIC BANKS

1. **INTRODUCTION**

- 1.1. These Guidelines on Corporate Governance for Islamic Banks (“The Guidelines”) provides guidance on best practices that Islamic Banks should strive to achieve in relation to their corporate governance practices.
- 1.2. The Guidelines in **ANNEX 1** are issued pursuant to section 127 of the Islamic Banking Order, 2008 and applies to all Islamic Banks in Brunei Darussalam (hereinafter referred to as “Banks”).
- 1.3. The Guidelines should be read in conjunction with the provisions of the Islamic Banking Order, 2008 and the Companies Act (Cap. 39) as the case may be, as well as any other notices, directives or guidelines which the Authority may issue from time to time.
- 1.4. The broad principles and standards under the Guidelines are aligned with the OECD Principles of Corporate Governance and the July 2015 Basel Committee Corporate Governance Principles for Banks, along with other regional best practices on corporate governance.
- 1.5. The Guidelines shall take effect from 1st January 2018.
- 1.6. Autoriti Monetari Brunei Darussalam (“the Authority”) expects the Banks to embrace the spirit of the Guidelines and adhere to them on a “comply or explain” basis.



2. BACKGROUND

- 2.1. Corporate governance is defined as the process and structure used to direct and manage the business and affairs of a Bank towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long term shareholder value whilst taking into account the interests of other stakeholders.
- 2.2. In an increasingly complex business environment influenced by globalization and other rapid changes in the financial sector, good corporate governance is crucial to ensure that the business of a Bank is managed in a safe and sound manner where risk-taking activities and business prudence are appropriately balanced to maximize shareholders' returns and protect the interest of recognized stakeholders.
- 2.3. Corporate governance involves a set of relationships between a Bank's management, its board, its shareholders and other stakeholders. It also involves the manner in which the business and affairs of an individual Bank are governed by its board of directors and senior management, affecting how a Bank sets its corporate objectives, including generating economic returns to owners as well as running its day-to-day operations. Weak governance of a particular Bank can undermine public confidence as well as the financial system and markets in which it operates.
- 2.4. Given the above and in line with the Authority's objectives in ensuring a stable financial system along with fostering and developing a sound and progressive financial services sector, the Guidelines place a strong emphasis on public interest.
- 2.5. Effective corporate governance is critical to the proper functioning of the banking sector and the economy as a whole. Banks perform a crucial role in the economy by intermediating funds from savers and depositors to activities that support enterprise and help drive economic growth. Banks' safety and soundness are key to financial stability, and the manner in which they conduct their business, therefore, is central to economic health. Governance weaknesses at Banks that play a significant role in the financial system can result in the transmission of problems across the banking sector and the economy as a whole.
- 2.6. The primary objective of corporate governance should be safeguarding stakeholders' interests in conformity with public interest on a sustainable basis. Among stakeholders, particularly with respect to retail Banks, shareholders' interest would be secondary to depositors' interest.



- 2.7. Corporate governance determines the allocation of authority and responsibilities by which the business and affairs of a bank are carried out by its board and senior management, including how they:
- i. set the Bank's strategy and objectives;
 - ii. select and oversee personnel;
 - iii. operate the Bank's business on a day-to-day basis;
 - iv. protect the interests of depositors, meet shareholder obligations, and take into account the interests of other recognised stakeholders;
 - v. align corporate culture, corporate activities and behaviour with the expectation that the Bank will operate in a safe and sound manner, with integrity and in compliance with applicable laws and regulations; and
 - vi. establish control functions.
- 2.8. The Organisation for Economic Co-operation and Development's widely accepted and long-established principles aim to assist governments in their efforts to evaluate and improve their frameworks for corporate governance and to provide guidance for participants and regulators of financial markets. Bank supervisors such as the AMBD have a keen interest in sound corporate governance, as it is an essential element in the safe and sound functioning of a Bank and may adversely affect the Bank's risk profile if not operating effectively. Well governed Banks contribute to the maintenance of an efficient and cost-effective supervisory process, as there is less need for supervisory intervention.
- 2.9. Sound corporate governance may permit the supervisor to place more reliance on the Bank's internal processes. In this regard, supervisory experience underscores the importance of having the appropriate levels of authority, responsibility, accountability, and checks and balances within each Bank, including those of the board of directors but also of senior management and the risk, compliance and internal audit functions.
- 2.10. The Basel Committee's Principles for enhancing corporate governance represent long-standing efforts to promote sound corporate governance practices for banking organisations. The principles reflect key lessons from the global financial crisis that began in 2007, and enhance how banks govern themselves.



- 2.11. The Principles outlined in these Guidelines draw on the Basel Committee Principles and the lessons learnt from the Global Financial Crisis. They emphasise the oversight and risk governance responsibilities of the board. They emphasise the key components of risk governance such as risk culture, risk appetite and their relationship to a Bank's risk capacity. They provide extensive guidance on the specific roles of the board, board risk committees, senior management and the control functions, including the Chief Risk Officer and internal audit. Another key emphasis is strengthening Banks' overall checks and balances and the critical role of the board and the board risk committees in strengthening a Bank's risk governance. This includes greater involvement in evaluating and promoting a strong risk culture in the organisation; establishing the organisation's risk appetite and conveying it through the risk appetite statement (RAS); and overseeing management's implementation of the risk appetite and overall governance framework.
- 2.12. The increased focus on risk and the supporting governance framework includes identifying the responsibilities of different parts of a Bank for addressing and managing risk. Often referred to as the "three lines of defence", each of the three lines has an important role to play. The business line – the first line of defence – has "ownership" of risk, whereby it acknowledges and manages the risk that it incurs in conducting its activities. The risk management function is responsible for further identifying, measuring, monitoring and reporting risk on an enterprise-wide basis as part of the second line of defence, independently from the first line of defence. The compliance function is also deemed part of the second line of defence. The internal audit function is charged with the third line of defence, conducting risk-based and general audits and reviews to provide assurance to the board that the overall governance framework, including the risk governance framework, is effective and that policies and processes are in place and consistently applied.
- 2.13. Among their other responsibilities, directors and senior management are expected to define conduct risk based on the context of the Bank's business. Cases of misconduct have been identified as stemming from:
- i. the mis-selling of financial products to retail and business clients;
 - ii. the violation of national and international rules (tax rules, anti-money laundering rules, antiterrorism rules, economic sanctions, etc); and
 - iii. the manipulation of financial markets – for instance, the manipulation of Libor rates and foreign exchange rates.



- 2.14. The board should set the “tone at the top” and oversee management’s role in fostering and maintaining a sound corporate and risk culture. Management should develop a written code of ethics or a code of conduct. Either code is intended to foster a culture of honesty and accountability to protect the interest of its customers and shareholders.
- 2.15. The principles are intended to guide the actions of the board and senior management, including any person who is heading a control function within the Bank. The implementation of these principles should be commensurate with the size, complexity, structure, economic significance, risk profile and business model of the Bank and the group (if any) to which it belongs. This means making reasonable adjustments where appropriate for Banks with lower risk profiles, and being alert to the higher risks that may accompany more complex and publicly listed institutions. The board and senior management at each Bank have an obligation to pursue good governance.
- 2.16. One fundamental corporate governance issue is shareholder rights. The principles recognise the importance of shareholder rights and of responsible shareholder engagement, particularly when certain shareholders have the right to have a representative on the board. In such cases, the suitability of the appointed board member is as critical as their awareness of the responsibility to look after the interests of the Bank as a whole, not just of the shareholders.

**MANAGING DIRECTOR
AUTORITI MONETARI BRUNEI DARUSSALAM**

Date: 3 Jamadilakhir 1438 / 2 March 2017