



BANGKO SENTRAL NG PILIPINAS

**OFFICE OF THE DEPUTY GOVERNOR
SUPERVISION AND EXAMINATION SECTOR**

MEMORANDUM NO. M-2012- 032

To: ALL BSP SUPERVISED FINANCIAL INSTITUTIONS

Subject: Frequently Asked Questions on Circular No. 749

To facilitate the implementation of Circular No. 749 dated 27 February 2012, as amended, on the Guidelines in Strengthening Corporate Governance in BSP Supervised Financial Institutions, the following clarifications are hereby issued:

I. Section 1. Qualifications of the Board of Directors

Minimum qualifications

1. What are the expectations from a bank in determining whether a person is fit and proper for the position of a director?

A bank should have board-approved policies setting-out its standards for a person to be considered as fit and proper for the position of a director. These standards should cover among others, the following: integrity/probity, physical/mental fitness, competence, relevant education/financial literacy/training, diligence and knowledge/experience. The extent to which these standards were adhered to in the selection process and how they manifest in the performance of the members of the board in their individual capacity and as a full board, will be evaluated by the BSP.

Independent directors

2. What was the rationale for increasing the requirement on the minimum number of independent directors in the board from two (2) to having at least 20 percent but not less than two (2) members of the board of directors?

The increase in the required minimum number of independent directors is aimed at strengthening the exercise of objective judgment in the board. Since independent directors are not involved in the management of the financial institution's operations, they are expected to lend impartial views on the assumptions, recommendations and reports submitted by management. They are also expected to render unbiased decisions on matters that pose

potential conflict of interest (e.g. transactions with related parties). Moreover, this policy amendment is seen to strengthen the check and balance system in the financial institution considering the independent directors' roles in ensuring the integrity of financial reports and improving the disclosure and transparency practices of the financial institution.

3. How do you implement the 'rounded up' rule in computing for the required minimum number of independent directors?

"Rounded up" means rounding-up to the nearest whole number any fractional result in applying the required minimum proportion. For example, an 11-member board should have at least three (3) independent directors ($11 \times 20\% = 2.2$; rounded-up to nearest whole number).

4. During the two (2)-year cooling-off period of independent directors, can they serve as a regular director?

No. The "cooling off" period is intended to strengthen the independence and objective judgment of independent directors by disassociating the director from the affairs of the bank for a period of two (2) years. Hence, allowing such director to serve as regular director during that period is not consistent with the objective of the said term break.

5. Is there a need for the bank's board of directors to submit additional documentary requirements to BSP relative to the re-election of the independent directors for their second term after the two-year cooling-off period?

A re-certification that they meet the requirements relative to the re-election of the concerned independent directors should be submitted along with other reportorial requirements for directors (e.g., biographical data, duties and responsibilities etc.) to facilitate BSP confirmation.

6. After the independent director served for two (2) terms following the 5-2-5 rule, can such director be elected as a regular member of the board of directors?

Yes. The circular does not prohibit the independent director from holding a regular director position after serving the maximum term allowed for independent directors. The 5-2-5 rule is consistent with the provisions of SEC Memorandum Circular No. 9 dated 5 December 2011 on Term Limits for Independent Directors.

II. Section 2. Duties and Responsibilities of the Board of Directors

Related party transactions

7. What are examples of related party transactions?

Related party transactions are not limited to lending and may include, among others, investments, purchases or sales of goods, purchases or sales of property and other assets, rendering or receiving of services, agency arrangements, leasing arrangements, transfer of technology, fund transfers, and guarantees. These also cover the credit exposures of the financial institution with its DOSRI (directors, officers, shareholders and related interest).

Related party transactions, similar to DOSRI transactions, are not prohibited provided that these are approved by the appropriate authority and conducted at arm's length basis.

8. How do you define significant transactions?

Significant transactions refer to dealings that could pose material risk to the bank. However, determination of what is 'significant' may vary from one bank to another depending on the transactions' size and potential impact on the operations of the bank.

9. What types of transactions are excluded from the reporting requirement on related party transactions?

Transactions concerning deposit operations, regular trade transactions involving purchases and sales of debt securities traded in an active market and credit card availments except those with credit card lines with amounts falling under the definition of "significant transactions", are excluded from the reporting requirement on related party transactions.

10. How should a bank report lease contracts or other recurring transactions between related parties that are covered by one contract/agreement?

Lease contracts and other similar contracts with recurring payment transactions should only be reported once, upon approval of said transaction by the board of directors.

11. How should a related party transaction between two (2) BSP supervised financial institutions be reported?

In case the parties involved in the transactions are both supervised by the BSP, only the lessor, in case of a lease contract, or the party engaging/requesting for the services of the other financial institution, in case of other contracts, shall submit the report.

Board-level committees

12. Do thrift, rural and cooperative banks need to seek prior approval from the BSP to be classified as non-complex banks?

No. Thrift, rural and cooperative banks are automatically considered as non-complex banks under Circular No. 749. Said types of banks only need to inform their respective Central Points of Contact (CPCs) if they intend to maintain the audit committee as the only board level committee.

13. For non-complex banks, do they need to amend their by-laws if they choose to maintain only the audit committee?

If the by-laws of a bank provide for the creation of the various board-level committees on a mandatory basis then the bank should amend the same if it chooses to maintain only the audit committee. On the other hand, if the provisions in the by-laws merely grant the board of directors the authority or discretion to adopt certain number of board-level committees then there is no need to amend the provisions of the by-laws.

14. In case a universal or commercial bank would like to be classified as having "simple" operations and therefore qualified for the reduced minimum requirement on the constitution of board committees, which department should the application be addressed?

Applications of universal or commercial banks to avail of the minimum requirement on the constitution of board committees should be addressed to their designated CPCs. The application should include a valid justification on why the concerned bank should be classified as non-complex.

15. What is the rationale for the change in the composition of the members of the three (3) board-level committees: (i) audit committee; (ii) risk oversight committee; and (iii) corporate governance committee?

The changes in the composition of the members of the three (3) board-level committees particularly the designation of independent directors as members or as chairperson of these committees are intended to strengthen the exercise of objective judgment and check and balance system in the board. (Please refer to reply in Item No.1) .

Other matters

16. Is the Chairman of the Board prohibited from becoming the CEO of the Bank?

No. The Circular does not prohibit the Chairman to hold either the CEO or COO position. It only requires that a clear definition and delineation of the lines of responsibility that he concurrently holds should be established.

17. Are Banks required to get the services of an external party to assess the performance of the board?

Banks are not required to avail the services of an external party to assess the performance of their board. However, banks are encouraged to consider the benefits that they may obtain from availing said services from an external party, such as having an expert and objective assessment of their board's performance, vis-à-vis the cost implications of the engagement. Otherwise, the corporate governance committee, in the case of complex banks, may conduct the assessment. In the case of non-complex banks, on the other hand, the board may create a group within the bank for this purpose.

18. What are the expectations from banks relative to the requirement "...The board of directors shall also report to the Bangko Sentral ng Pilipinas any plan to create additional group structures."

The concerned bank should submit a letter to their designated CPCs to inform the BSP of its plans to create additional group structures and the schedule for implementation of said plan. Any changes from the plan submitted should likewise be reported to their designated CPCs.

III. Section 5. Risk Management Function

19. Are thrift, rural and cooperative banks required to appoint a Chief Risk Officer (CRO)?

No. Thrift, rural and cooperative banks may however, consider the appointment of a CRO or any equivalent position depending on their size and complexity of operations, subject to the independence and qualification requirements applicable to CROs of UBs and KBs.

IV. Section 6. Reports

20. To which department should the required reportorial requirements be submitted?

Reports should be submitted to their designated CPCs.

21. Who are required to submit the reports on conglomerate structures and intra-groups transactions?

Reports on conglomerate structures and intra-groups transactions are exclusively required for universal and commercial banks.

22. Who will submit the conglomerate reports if there are two (2) banks within the structure?

The bank which has the larger amount of total resources should submit the report. However, both banks are held accountable to ensure the completeness of the information provided.

V. Section 7. Applicability to Branches of Foreign Banks

23. Are branches of foreign banks required to create the board-level committees?

No. The governance principles embodied in the Circular should be complied with by branches of foreign banks in their alternative arrangements given their unique organizational structure.

24. Are branches of foreign banks classified as universal/commercial banks considered compliant with the requirement of a CRO in case a CRO sits in the Head Office and functions through a global risk management team that covers the Philippine branch?

Yes. This arrangement is considered compliant with the requirement.

25. Are branches of foreign banks required to comply with the following requirements: (1) Secretary's Certificate attesting the approval of the board of directors of the changes in the bank's policies aligning the same with the provisions of this Circular; and (2) Acknowledgement receipt of copies of specific duties and responsibilities of the board of directors and of a director and certification that they fully understand the same?

Yes. The Circular explicitly provides that branches of foreign banks shall comply with the governance policies, practices and systems of the head office as well as meet the applicable standards, principles and requirements set forth under said issuance, which are applicable to the branch. However, given the organizational set up of branches of foreign banks, the General Manager or Country Manager is the principal officer that will oversee the implementation of the governance principles embodied in Circular No. 749.

In this regard, (1) the general manager/country manager will certify that the governance policies in the branch have been changed to align the same with the provisions of Circular No. 749. If the existing governance policies more than comply with what is expected under existing regulations, then a certification to that effect should be issued; and (2) the general manager/country manager should acknowledge receipt of the duties and responsibilities applicable to him as "lead implementor" of the governance policies in the branch, provided that the general manager/country manager has properly communicated said action to the head office prior to the issuance of the said certification.

VI. Section 9. Transition Rules

26. How will the prospective implementation of the 5-2-5 rule for independent directors be applied?

Application of such rule is prospective. The terms already served by the existing independent directors prior to the effectivity of the Circular are not included.

For information and guidance.


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