

# **Risk Governance and Risk Based Supervision A Perspective from the Middle East Region**

Prasanna Haran

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- The Ten Principles of Good Corporate Governance
    - Purpose, Design, and Expectations
  - Application of the Principles
    - Board of Directors including the Audit and Risk Committees
    - Risk Management Infrastructure
    - Financial Accounting and Reporting Infrastructure
    - The organisation as a whole
  - The View from the Region
    - Findings from the GCC Board Directors Institute survey of Board Effectiveness
    - Priority Items for the Industry
  - The QFC Regulatory Authority's approach in practice
  - Qatar's National Corporate Governance Development Strategy

Corporate Governance Principles

# **PURPOSE, DESIGN, AND EXPECTATIONS**

# A few basic definitions

- **Governance:** The framework of authority for an organization within which its institutional objectives are pursued and within which risk management operates.
- **Risk:** Unknown future circumstances that alter the value or well-being of an organization or system.
- **Risk Event:** The realization of a specific circumstance that decreases (but could unexpectedly increase) the value or well-being of an organization or system.
- **Risk Management:** The process of evaluating the potential impact of risk events and shaping business decisions in light of this evaluation.
- **Board of Directors:** A body of elected or appointed members who jointly oversee the activities of a company or organisation

- Cross-cultural norms which provide Boards of Directors, Audit Committees and senior executives with a standard framework for effective governance.
- Seek to provide regulators and auditors with an evaluation tool to ensure that effective governance is in place.
- Best practice governance and risk management do **not** attempt to eliminate risk, but serve to transform uncertainty - which is unmanageable and unmeasurable - into risk, which can be identified, assessed and (may be) measurable.

# Design of the Principles

- 
- Decision-making is predicated on a belief in potential rewards, balanced with the knowledge, understanding and appreciation of all of the risks taken to pursue those potential rewards.
  - The key individuals involved in governance and risk management have a responsibility to stakeholders, including the general public, as well as to financial stability.
  - They must ensure that they do not give disproportionate weight to personal gain, or to the benefit of the organisation, to the detriment of public good and of financial stability.

# **THE TEN PRINCIPLES OF GOOD CORPORATE GOVERNANCE**

# The Ten Principles of Good Corporate Governance



Key Competencies

Resources and Processes

Ongoing Education and Development

Compensation Architecture

Independence of Key Parties

Risk Appetite

External Validation

Clear Accountability

Disclosure and Transparency

Trust, Honesty, and Fairness of Key People



# The principles and their respective expectations

## Key Competencies

- Employees have adequate knowledge, skills and expertise to perform the tasks assigned to them.
- Competencies can be gained through professional qualification or by experience in role.

## Resources and Processes

- Adequate levels of resource shall be in place to enable the organisation to operate effectively.
- The business and technological processes shall be fit for purpose.

# The principles and their respective expectations

## Ongoing Education and Development

- Encourage all employees to keep abreast of the latest developments in their particular areas of expertise, through courses, conferences, journals and other education channels and shall make adequate resources available to enable this to occur.

## Compensation Architecture

- Employees should be remunerated adequately for the roles that they perform.
- 'Adequately' is defined using external references and benchmarks, and in a framework which is consistent with the type of risk-taking behavior expected of the employee.

# The principles and their respective expectations

## Independence of Key Parties

- Key checks and balances are in place at all times to assure effective governance.
- Audit and Risk Management are independent and do not report directly to those for whom they serve as a check and balance.

## Risk Appetite

- The Board of Directors shall determine, and officially record, its appetite for each category of risk within its published risk framework. And cascade of this approach throughout the organization.
- Appetite must be expressed in a measurable way that can inform decisions at lower levels in the organization.

# The principles and their respective expectations

## External Validation

- All aspects of the governance framework periodically validated by an independent external body to ensure appropriateness and consistent with the stated policies and public representations made by the organisation.

## Clear Accountability

- Individuals should be clearly advised of their own accountabilities and of the consequences of not fulfilling them in a timely and appropriate manner.

# The principles and their respective expectations

## Disclosure and Transparency

- The Board of Directors and senior management shall adopt an approach of disclosure and transparency consistent with their stated policies and ensure that this approach is followed at all levels throughout the organisation

## Trust, Honest and Fairness of Key People

- The key people involved in the application of good governance and risk management must be trustworthy and honest and treat others fairly at all times.
- in the organization.

# APPLICATION OF THE PRINCIPLES

- The essence of good corporate governance is a deliberate and sustained effort to adhere to the ten principles. These principles are applied in the following areas:
  - Board of Directors including the Audit and Risk Committees
  - Risk Management Infrastructure
  - Financial Accounting and Reporting Infrastructure
  - The organization as a whole

# Boards of Directors, including Audit and Risk Committees, must:

- 
- Be aware of the business structure and environment in which the organization operates.
  - Understand the design of the Risk Management Infrastructure to address the risks encountered.
  - Ensure such that sufficient independence and expertise exists to enable competent evaluation of the business structure and environment.
  - Define the organization's risk appetite and articulate this clearly to senior management
  - Set a policy for compensation and targets which supports the Board of Directors' commercial strategy and which encourages employees to operate within its risk appetite
  - Thoroughly review compensation plans of potentially "highly compensated positions" for consistency with corporate risk appetite, competitive market conditions and fiduciary responsibility to shareholders
  - Delegate formal responsibility for understanding, and for reporting the Risk Management Infrastructure to the Board of Directors / Committee on the effectiveness of that Infrastructure.
  - Continually review the application of the these Principles to the Risk Management , financial accounting and reporting infrastructure and the organization as a whole.
  - Be fully accountable to shareholders and work to the benefit of public good and of financial stability



# The Risk Management Infrastructure must:

- 
- Be independently staffed and report to a member of the Executive Committee
  - Possess sufficient funding, intellectual and technological capacity to understand and communicate risks
  - Avoid silos of control and oversight
  - Include financial risk management, compliance and external reporting;
  - Define risk management as articulated by the Board in unmistakable terms
  - Implement and maintain an approval process which ensures that the organization's compensation and targets policy does not compromise the risk management framework and risk appetite policies
  - Have a budget established by a subset of the Executive Committee or Board, excluding the influence of individual business-unit leaders
  - Provide a clear organization wide Escalation Policy, for employees to escalate matters of concern without the threat of adverse impact
  - Provide ongoing professional development for risk management staff and require them to be committed to standards of best practice, conduct and ethics in their work
  - Provide, in the organisation's Annual Report to Shareholders, a detailed description of the Risk Management Infrastructure

# The Financial Accounting and Reporting Infrastructure must:

- 
- represent accurately, and in a timely manner, the current financial condition of the organisation
  - Only use those off-balance sheet transactions which have a legitimate economic, tax, risk transfer or risk mitigating purpose. All such transactions must be reported completely, equally, clearly and visibly (i.e. not be buried in the footnotes)
  - Provide to the Board and Audit Committee an auditable Annual Statement of Compliance with the Board's publicly stated Standards of Corporate Governance

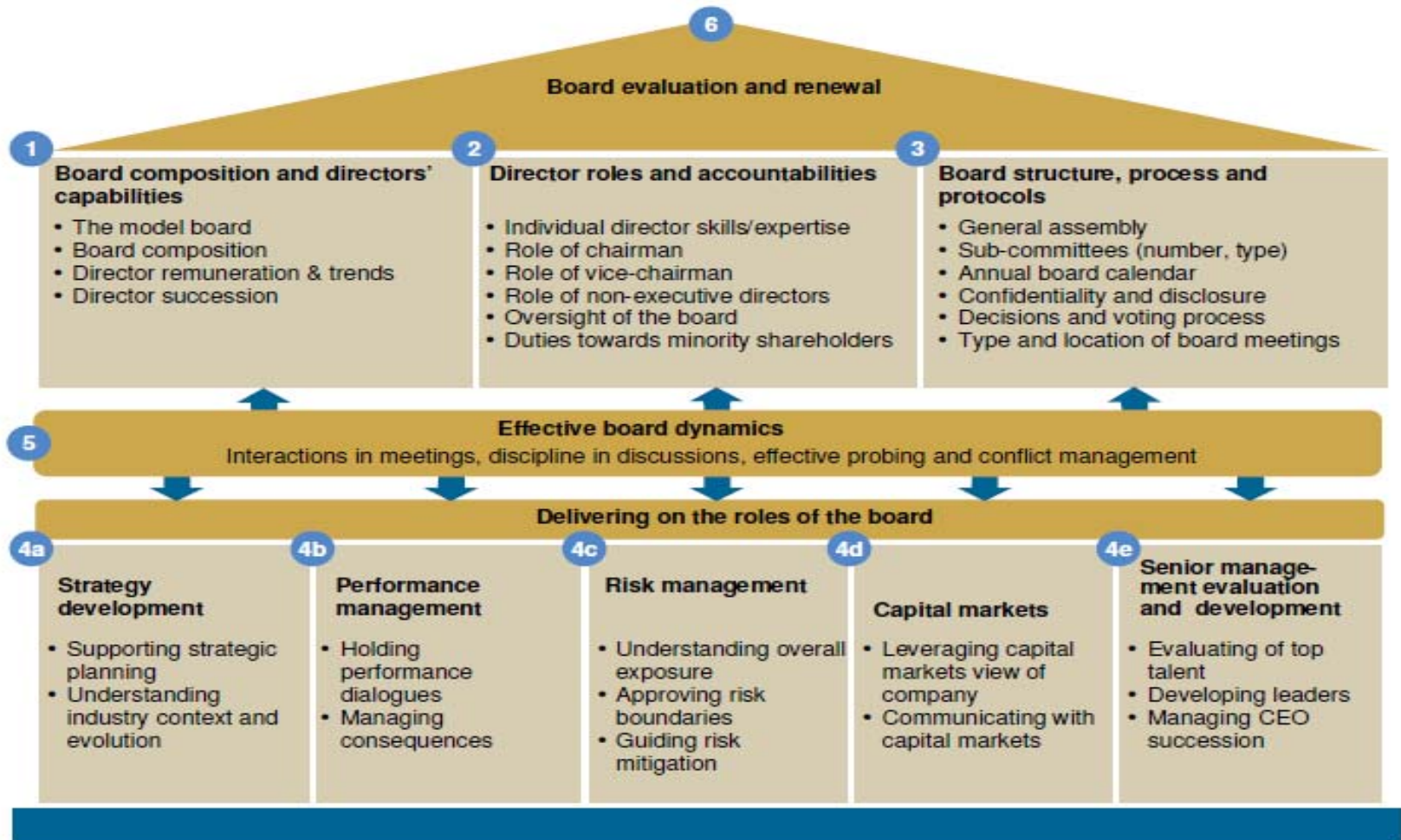
# The Organisation as a whole must:

- 
- Provide ongoing education and training to all employees on the role of risk management and corporate governance in the organisation
  - Provide an environment in which a Risk Escalation Policy can be effective
  - Enforce corporate governance policies
  - Comply fully with local laws, regulations, and customs, to the extent that such customs do not conflict with local laws and regulations
  - Publish an external auditor's opinion that the organisation is in compliance with the Board's publicly stated Standards of Corporate Governance
  - Work within a policy for compensation and targets which supports the Board of Directors' commercial strategy and its risk appetite policies
  - Ensure that there is a good flow of employees between business functions and governance and risk management functions
  - Ensure that the organisation establishes and maintains a risk culture throughout the organisation

# A REVIEW OF BOARD EFFECTIVENESS IN THE GULF FINDINGS FROM THE GCC BOARD DIRECTORS INSTITUTE

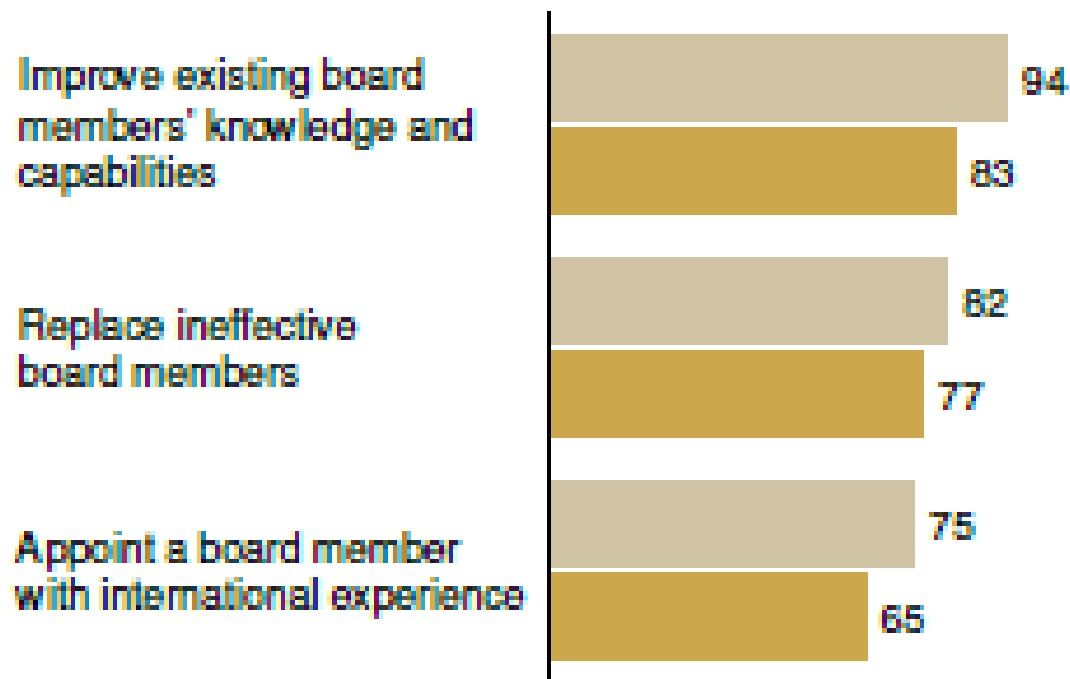
## **THE SURVEY SAYS....**

# Board Effectiveness Framework



# Knowledge and expertise remains the most important barrier to Board effectiveness.

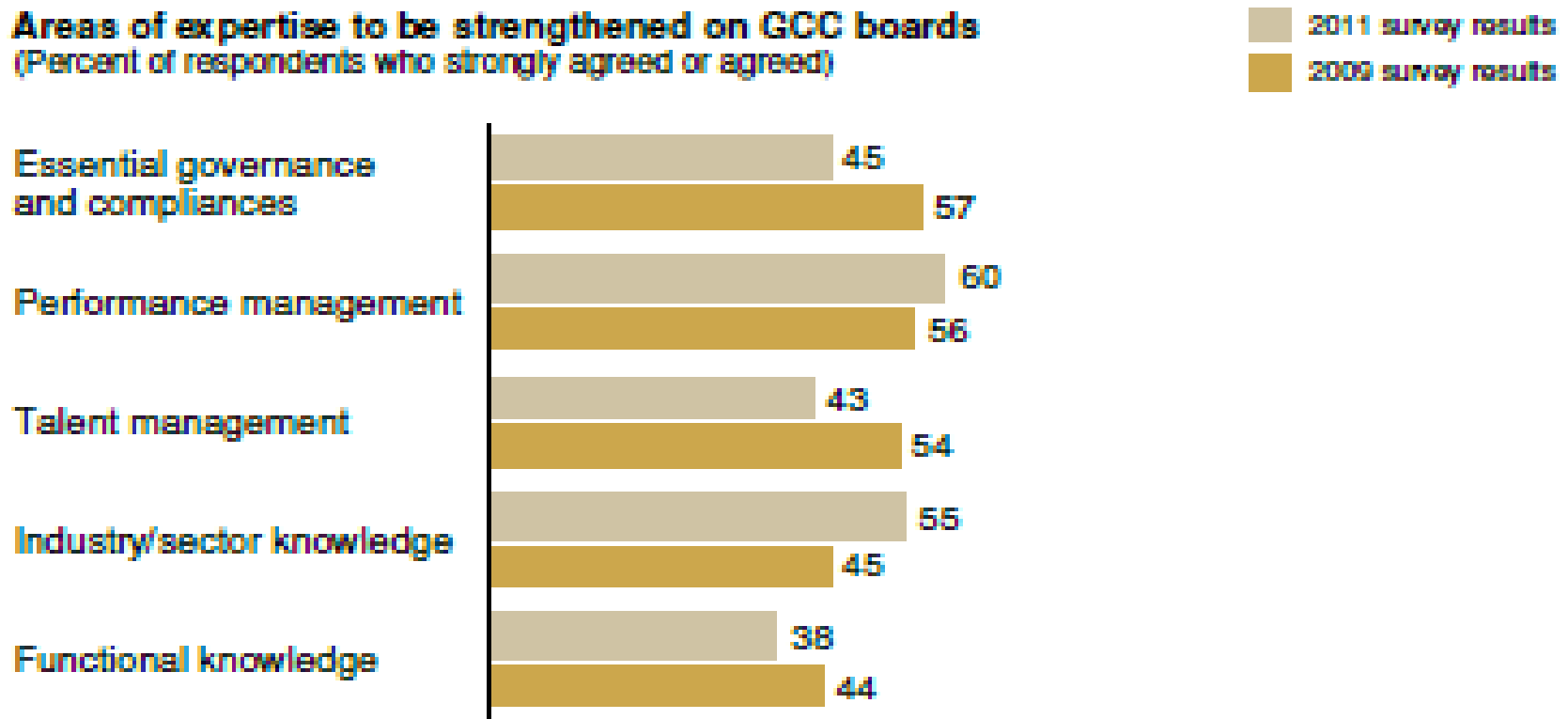
## Percent of respondents who agree or strongly agree



Source: GCC Board Directors Institute – 2009 survey, 2011 survey

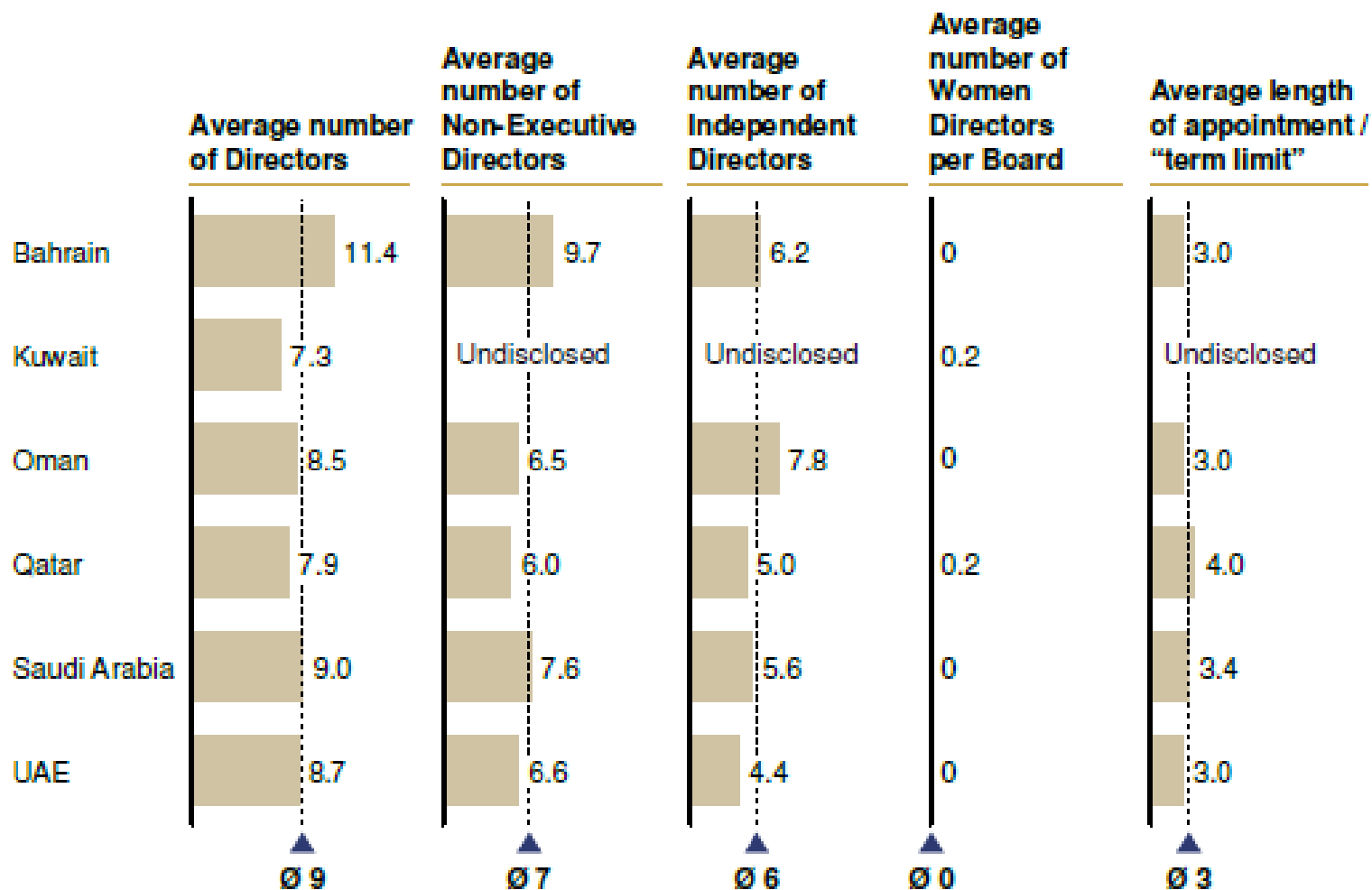
# Performance management and industry knowledge need most improvement

## Areas of expertise to be strengthened on GCC boards (Percent of respondents who strongly agreed or agreed)



Source: GCC Board Directors Institute – 2009 survey, 2011 survey

# Board composition needs improvement

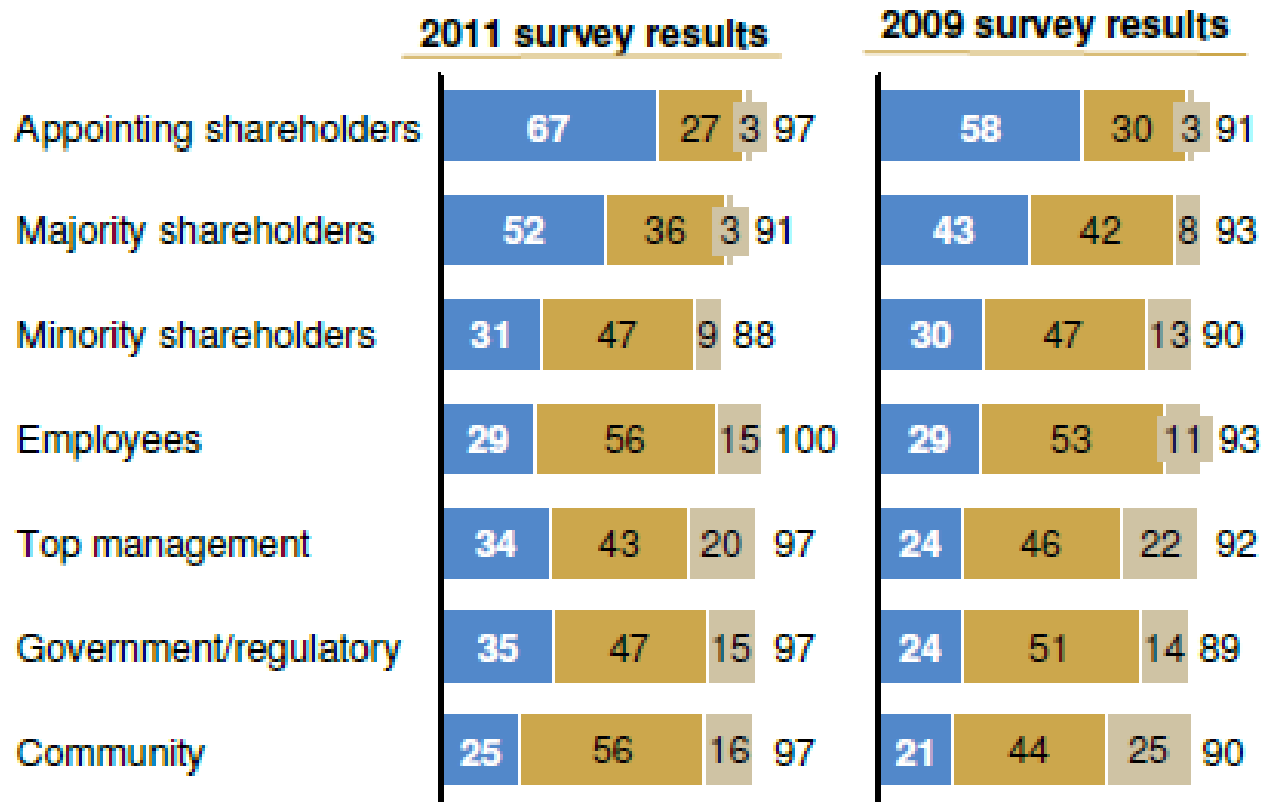




# More recognition of board member responsibility towards stakeholders, yet still a strong bias towards appointing and majority shareholders

## Level of board member responsibility towards stakeholders Percent

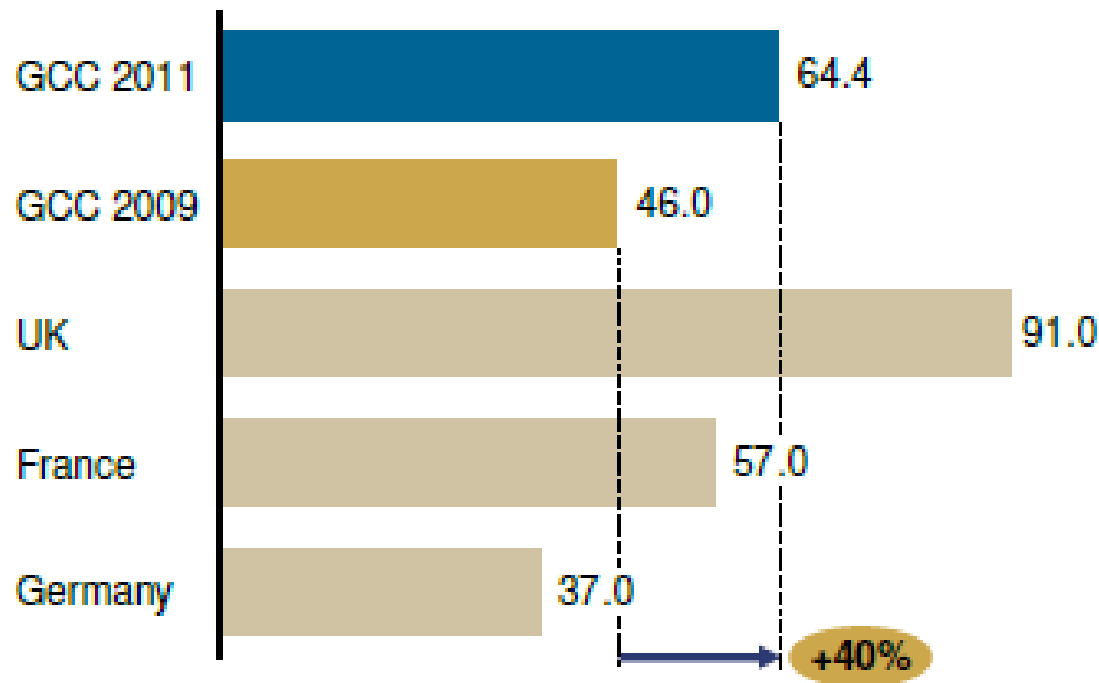
■ Owe most duty to  
■ Owe duty to  
■ Owe some duty to



Source: GCC Board Directors Institute – 2009 survey, 2011 survey

# Average number of independent Board members has substantially increased in last two years

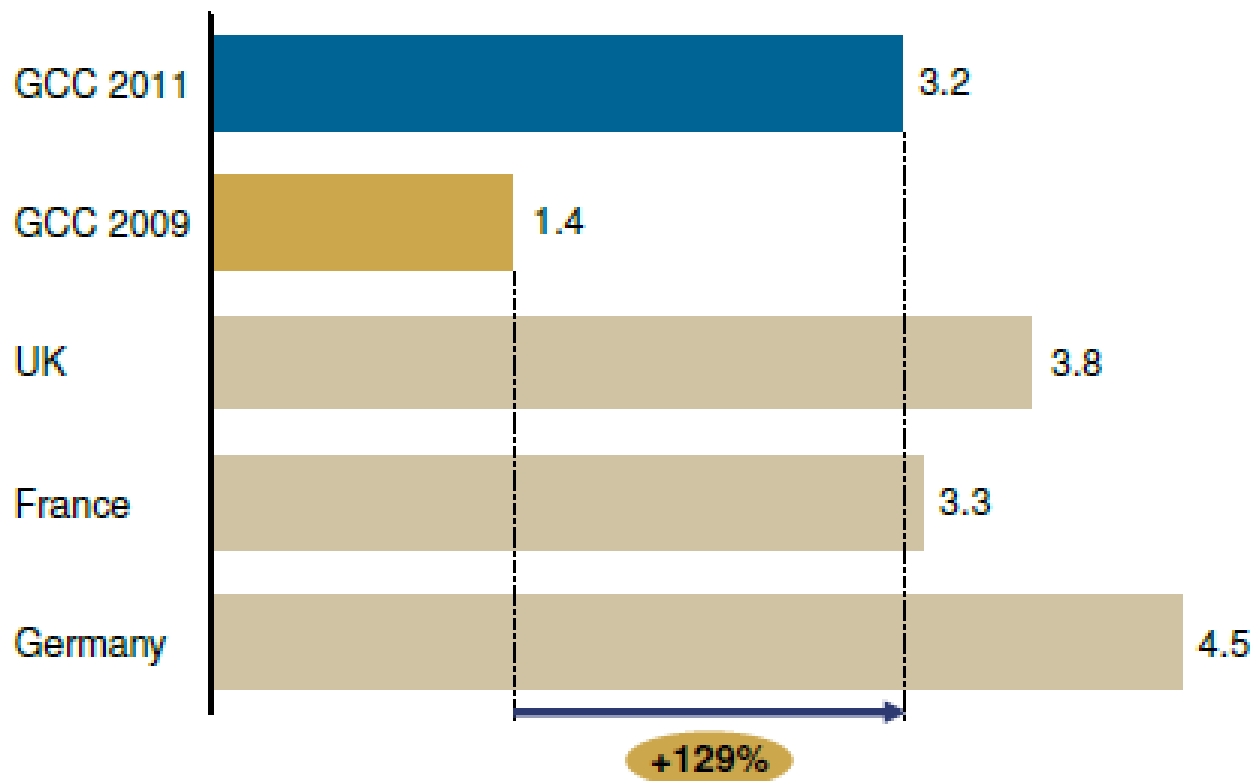
## Number of independent board members, expressed as %



Source: GCC Board Directors Institute – 2009 survey, 2011 survey; Heidrick & Struggles, Boards in Turbulent Times – Corporate Governance Report 2009

# GCC Boards have doubled the number of committees

## Average number of committees on the board\*

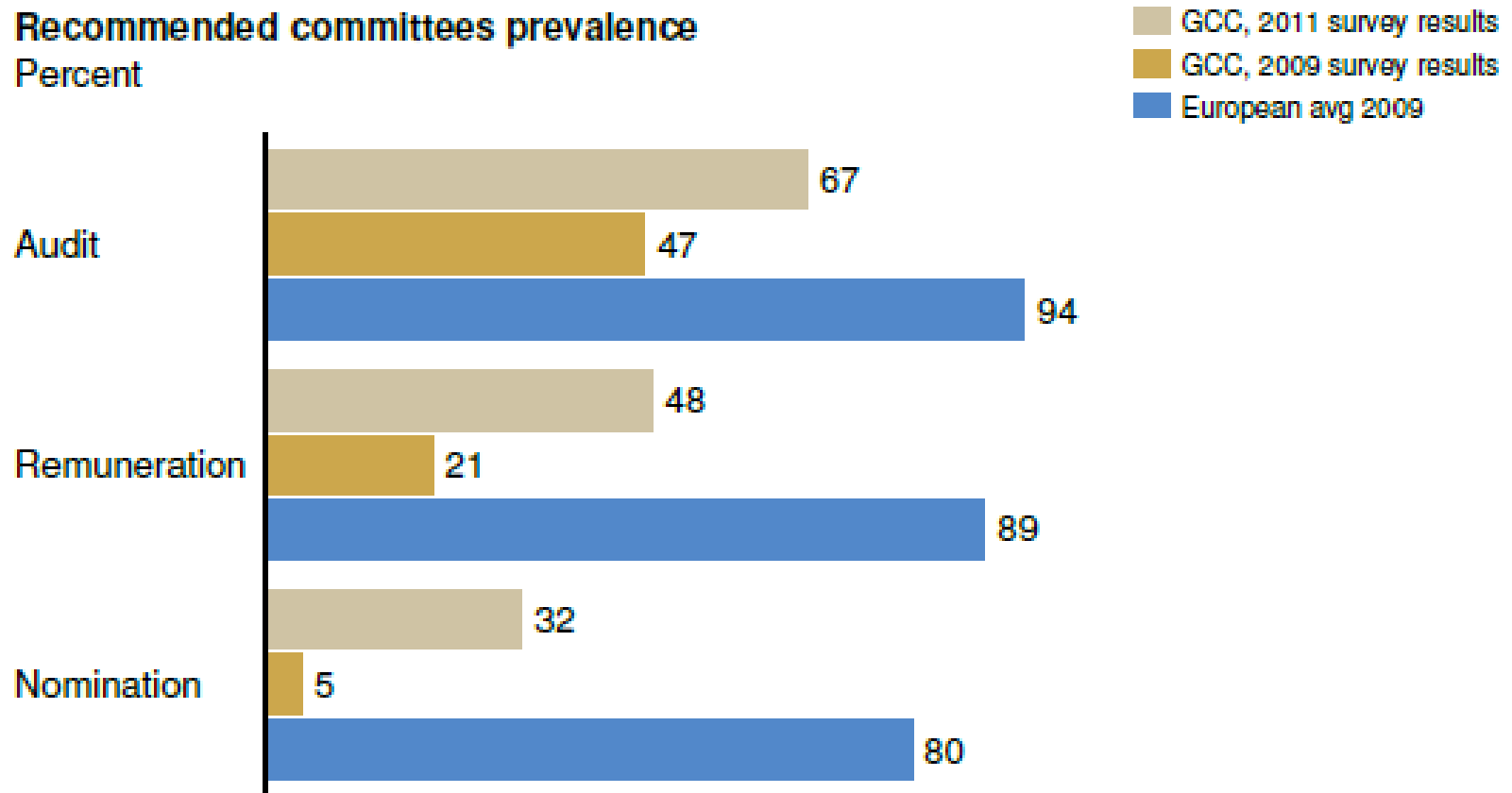


\*Excluded companies which did not disclose committees. Could result in an overestimation of committees

Source: GCC Board Directors Institute – 2009 survey, 2011 survey; Hedrick & Struggles, Boards in Turbulent Times –2009

# Recommended committees more prevalent on Boards

## Recommended committees prevalence Percent

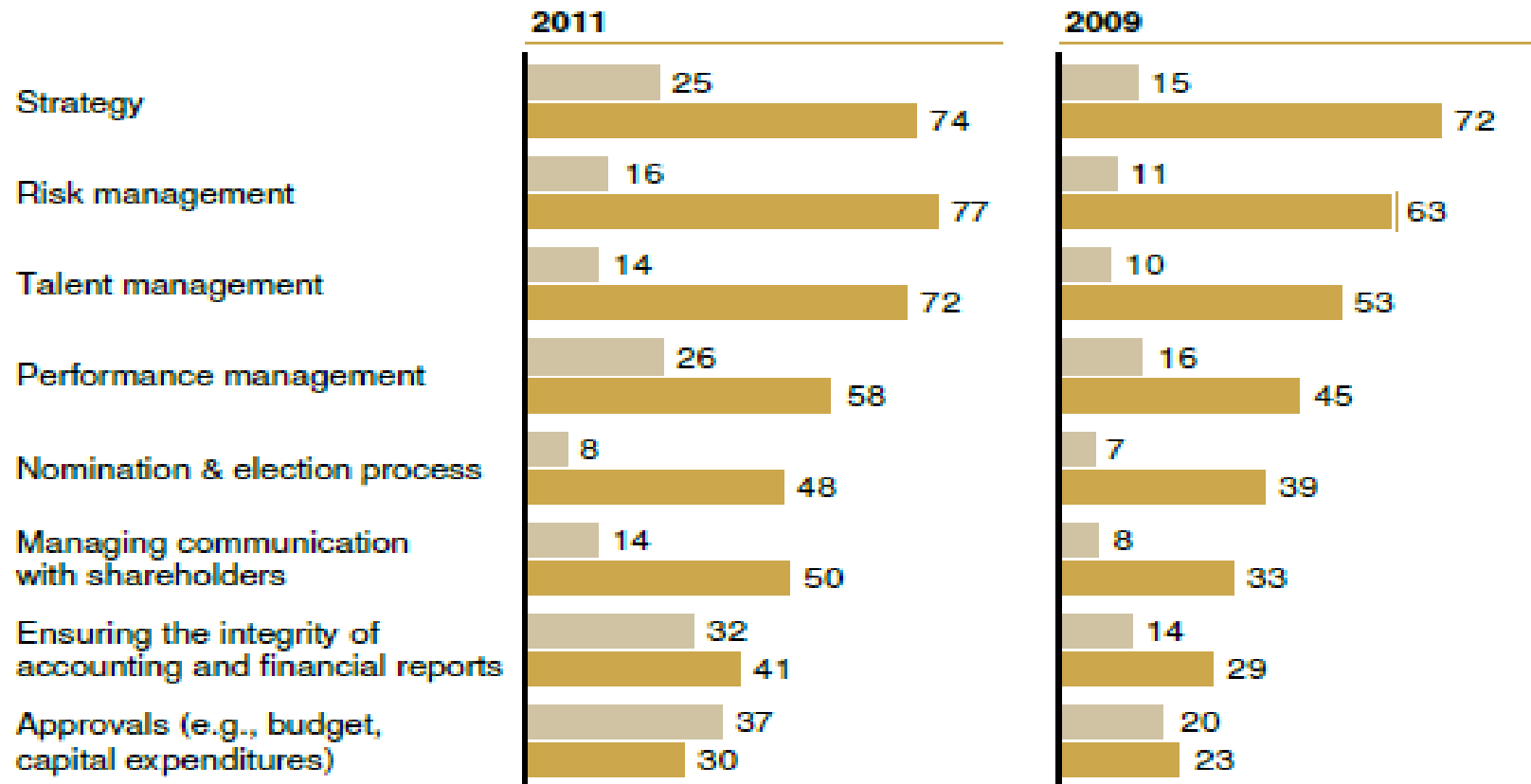


Source: GCC Board Directors Institute – 2009 survey, 2011 survey, Hedrick & Struggles, Boards in Turbulent Times – Corporate Governance Report, 2009

# Majority want to spend more time on all Board issues

## Desired split of board time vs. current split Percent

■ Current % of time  
■ % who want to spend more time on topic

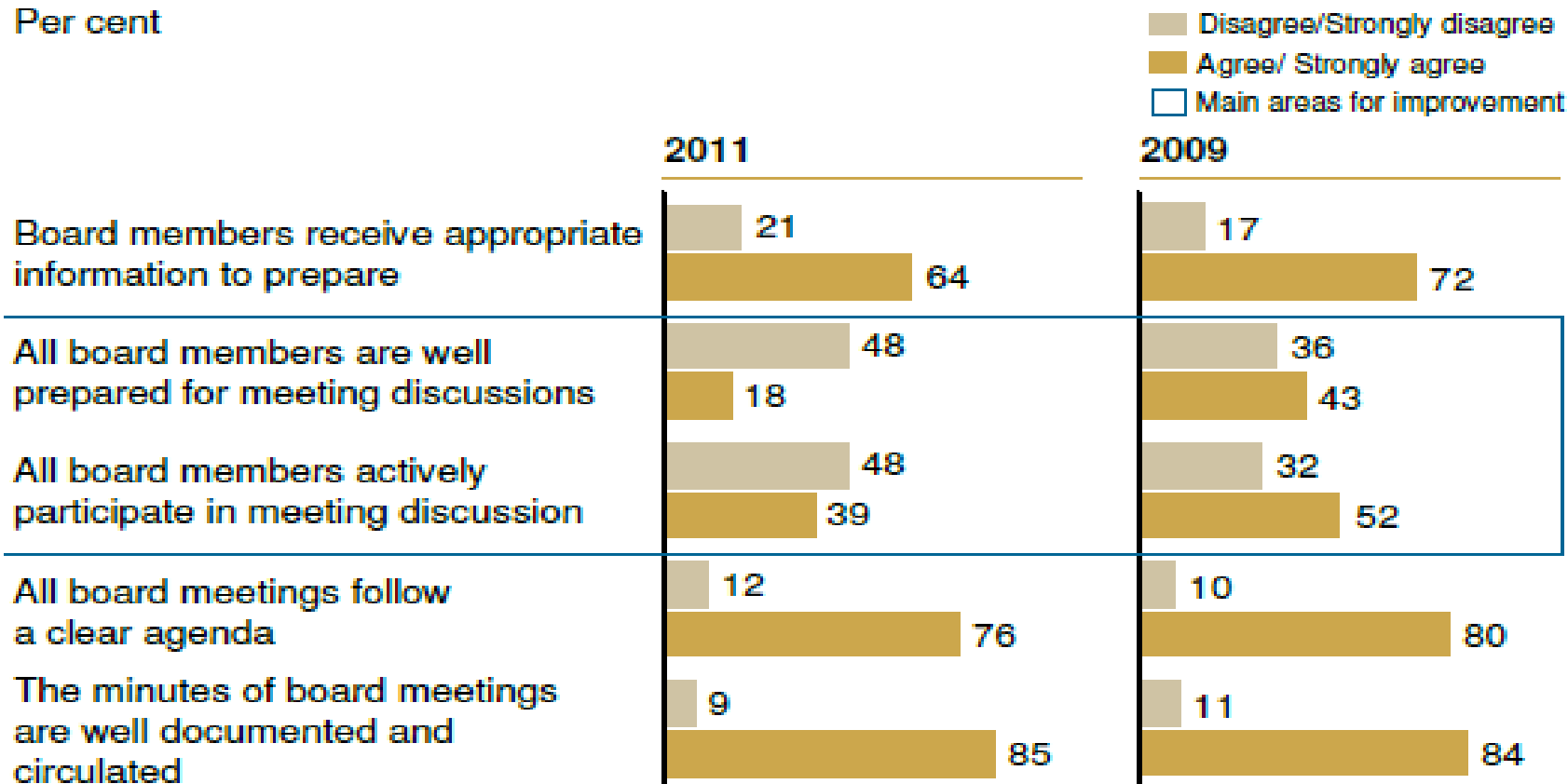


Source: GCC Board Directors Institute – 2009 survey, 2011 survey

# Effectiveness could be improved through better preparation and more involvement

## Evaluation of board effectiveness across the 5 elements of meeting dynamics

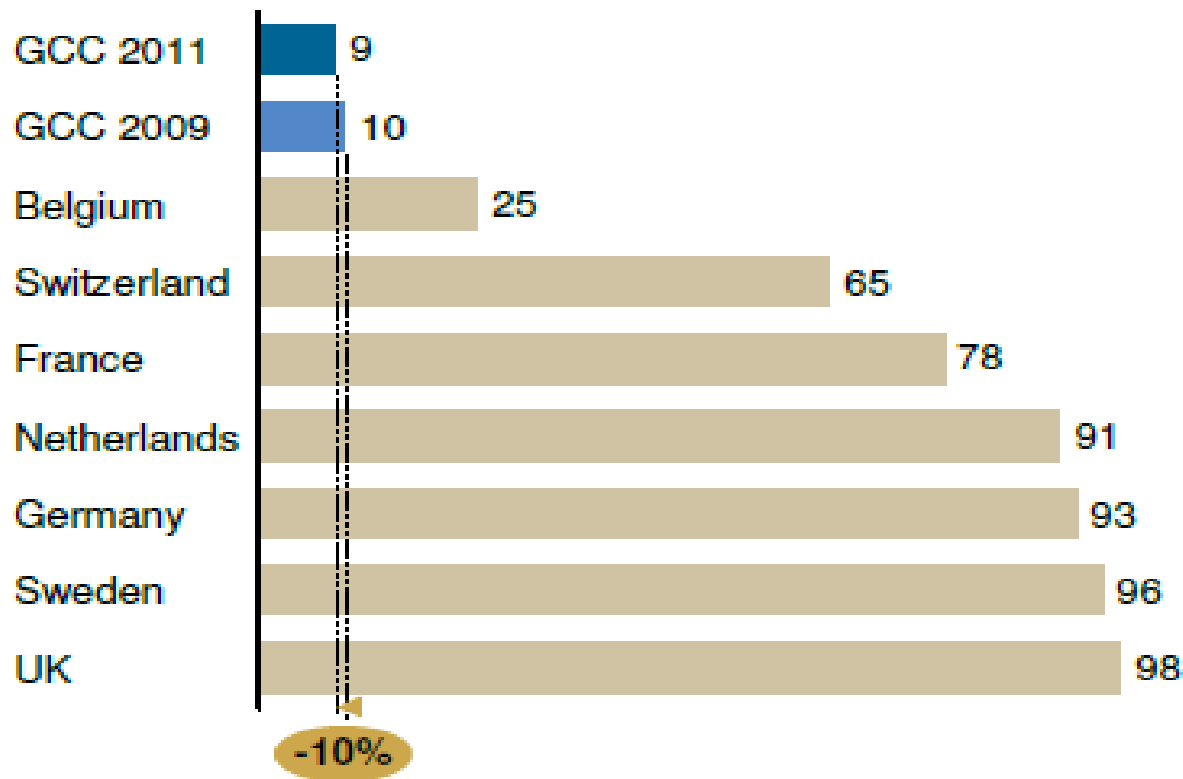
Per cent



Source: GCC Board Directors Institute – 2009 survey, 2011 survey

# Board evaluations remain an exception rather than the norm

## Share of boards conducting a formal evaluation process Percent



Source: GCC Board Directors Institute – 2009 survey, 2011 survey; Hedrick & Struggles, Boards in Turbulent Times – Corporate Governance report, 2009

PRIORITY AREAS FOR IMPROVEMENT

# **THE INDUSTRY AGENDA**

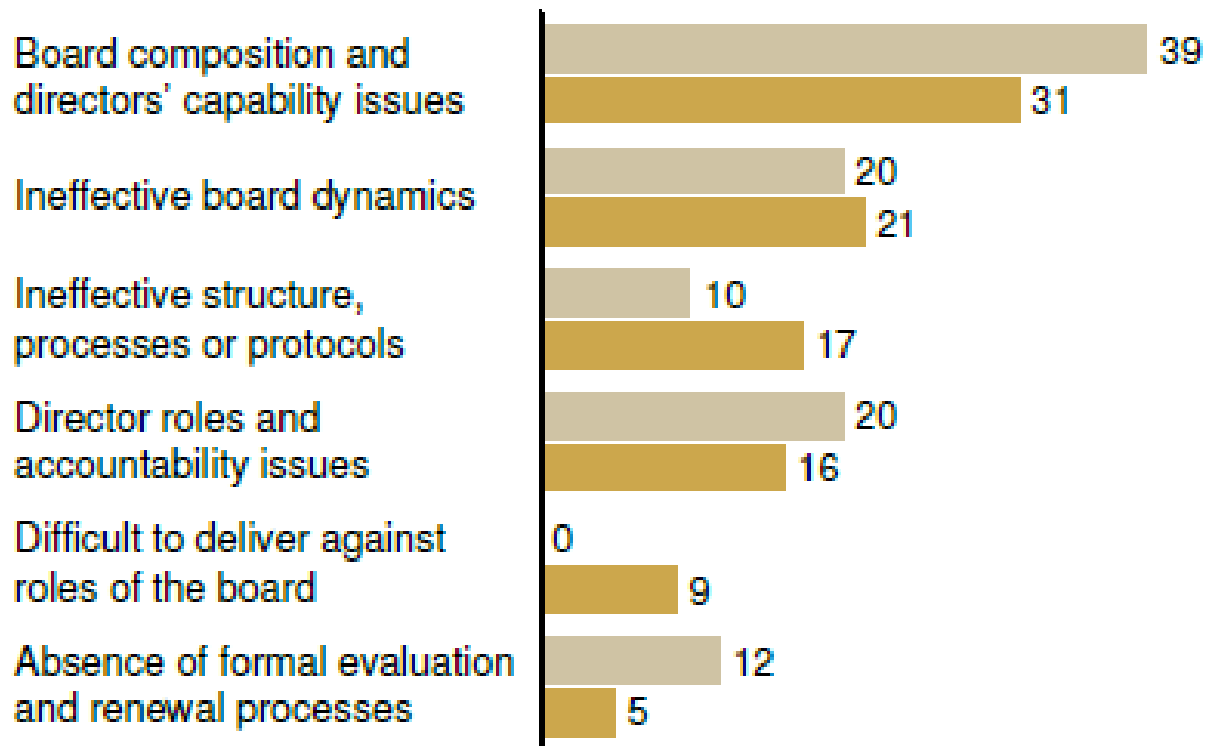


# Areas to target to improve Board effectiveness

## Most significant barriers to board effectiveness

Percent

■ 2011 survey results  
■ 2009 survey results



Source: GCC Board Directors Institute – 2009 survey, 2011 survey

# TOP 10 PRIORITY IMPROVEMENT AREAS

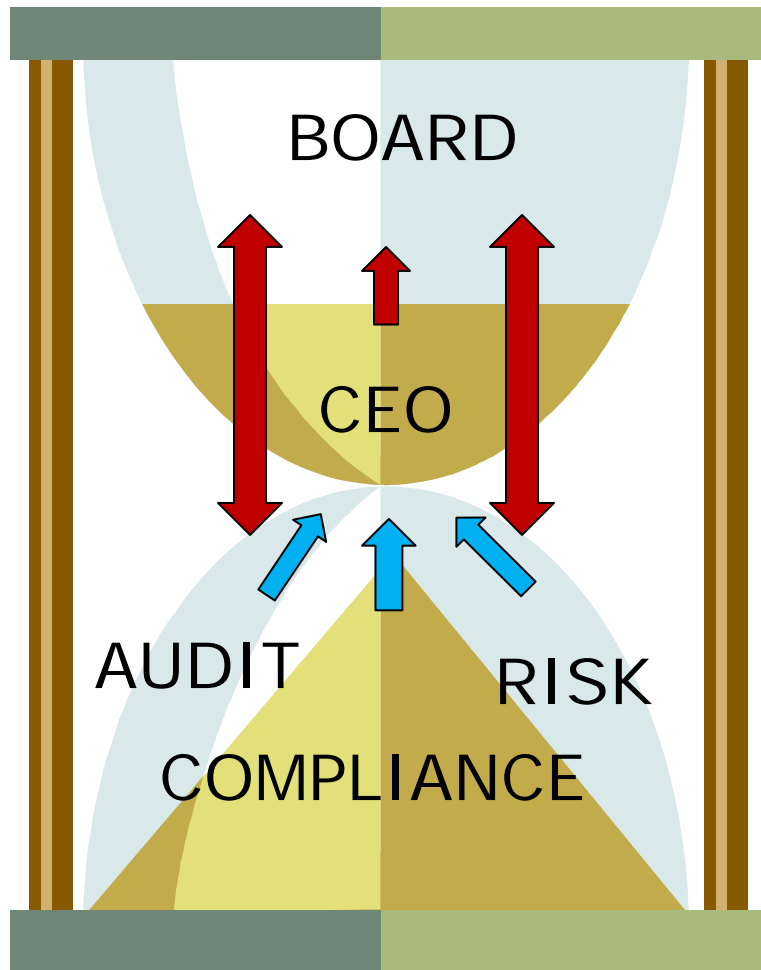
1. Ensure each board member adds value
2. Consistently invest in development opportunities for board members
3. Increase board diversity by recruiting more international directors
4. Define roles and responsibilities and properly communicate them
5. Use committees to improve effectiveness but revisit the need for and role of an executive committee
6. Spend more time on 'core issues' (risk, strategy, and talent management)
7. Re-think approval limits of management to lighten the burden on the board
8. Recognize chairman's role in improving board dynamics
9. Ensure robust follow-up mechanisms are in place
10. Formalize and implement a performance evaluation process for the board as a whole and, in time, individual directors

The Qatar Financial Centre Regulatory Authority's approach to overseeing and enforcing the governance framework

# **THE REGULATORY AGENDA**

# The Regulatory Authority's Approach...

- 
- Providing the overall legal and regulatory regime with appropriate incentives and sanctions for good corporate governance.
  - Providing independent judicial and regulatory structures with appropriate enforcement mechanisms.
  - Aligning its approach to Basel Principles and relevant global developments, while being mindful of regional idiosyncrasies.
  - Incorporating corporate governance as a criteria for authorization.
  - Developing and implementing relevant and appropriate rules/guide for market sectors: Banks, Asset Managers, Insurance.
  - Engaging in active dialogue with Boards on ways of strengthening standards of corporate governance



- What we look for:
  - Experienced directors
  - Committee structures
  - Qualified independent outside directors
  - Active participation
- Approved Individuals
  - Specific Controlled Functions
  - Interview
  - Approval process
  - Responsibilities as an Approved Individual

- *A Guide to Corporate Governance for QFC Authorised Firms* to assist firms in benchmarking their governance frameworks.
- The scope of corporate governance principles that are outlined in the Guide comprises "*the system of rules, procedures, values and relationships by which corporate leadership of these firms is exercised and their responsibility towards key stakeholders is prudently discharged.*"
- Draws on global standards and principles issued by international organisations -- OECD, the BIS, IOSCO and the IAIS. Also takes account of governance standards developed by other financial regulators in the region and relevant regulatory bodies in the State of Qatar -- QFMA and the QCB.
- Ensuring an appropriate level of harmonisation of corporate governance principles among the various financial regulators in Qatar will be a critical part of developing a common approach for firms operating in Qatar.

- Guide comprised of Principles commensurate with the size, structure and risk profile of business in the QFC, and is primarily directed towards limited liability companies:
  - conducting banking and investment business (Category 1);
  - conducting activities as insurers or reinsurers; and
  - Focused in Islamic business (Category 5).
- Recognises limited application to the structure of branches operating in the QFC. Expectation is for branches to demonstrate alignment with those principles of the Guide that are relevant to their operations at the QFC; and that the guidelines will be broadly consistent with existing guidelines in the home jurisdiction of the firm's parent.
- The Guide is also relevant to:
  - persons applying to be authorised or approved by the QFC Regulatory Authority;
  - persons providing compliance, internal audit, risk management and internal control services to authorised firms;
  - persons providing or proposing to provide legal, accounting and auditing services within the QFC; and
  - other financial services regulators in the GCC and abroad.

- Adherence to the principles contained in the Guide is voluntary and non-binding. The Regulatory Authority will review the status of the Guide after it has been in use for a period of time, to determine if compliance with any of its principles should become mandatory by the establishment of specific rules.
- Shariah boards – The Regulatory Authority advises such firms to assess their level of compliance with the *Guiding Principles on Shariah Governance Systems* issued by the Islamic Financial Services Board. Firms should also monitor on a regular basis any other guidelines or codes relevant to Shariah-compliant operations that are published at the national level in Qatar.
- The Regulatory Authority is mindful that firms may require flexibility in demonstrating adherence to the principles of the Guide to more accurately reflect the nature, scale, and complexity of their business operations and the risks to which they are exposed.



# NATIONAL CORPORATE GOVERNANCE FRAMEWORK

Adapted from The Director's Counsel

# QATAR'S NATIONAL DEVELOPMENT STRATEGY

- 
- The Directors Counsel
    - Launched as a corporate governance consultancy in alliance with leading international advisory firms
    - To bring world-class specialization in formulating corporate governance policy and practice to businesses in Qatar and other parts of the GCC region.
  - The objective is to offer GCC board directors a 'single window' to access the full spectrum of board and corporate governance related services including:
    - diagnostic evaluation & gap analysis;
    - board remuneration structure;
    - independent director search;
    - board effectiveness enhancement; and,
    - continuing professional development programs.

# Working towards an integrated Corporate Governance Framework.....

## Fragmented

- QCB on the banking sector
- QFMA on listed companies (financial services sector & services / industrial companies)
- QFCRA on QFC resident companies

## Piecemeal

- Current focus is on listed companies and / or financial services sector companies
- No guidelines for large unlisted companies
- Public sector remains largely untouched by corporate governance guidelines

## Needs updates

- QCB Guidelines (March 2008) – Update to include lessons learned from the financial crisis
- QFMA Code (2009) – Considering changes to making certain of its provisions 'mandatory' and issuing supporting 'standardised reporting guidelines'
- QFCRA Guide on the way



## Key Objectives of the National Governance Framework

- An integrated 'National' approach towards corporate governance to assist in the achievement of Qatar's NDS targets
- As close as possible to 'international best practice' in the context of local factors in Qatar (and the GCC in general)
- Not just issuance of another "Code"; Look at the full value chain
  - \* Code / Guidelines
  - \* Education / consensus development
  - \* Enforcement/Supervisory responsibilities.
  - \* Implications of non-compliance

# Close coordination between various regulatory bodies and with other governmental bodies

## REGULATORY BODIES

Qatar Central Bank  
QFC Regulatory Authority  
Qatar Financial Markets  
Authority

## COORDINATION CHALLENGE BECAUSE OF DIFFERENT

Decision Making Processes  
Starting Points  
Target Audience

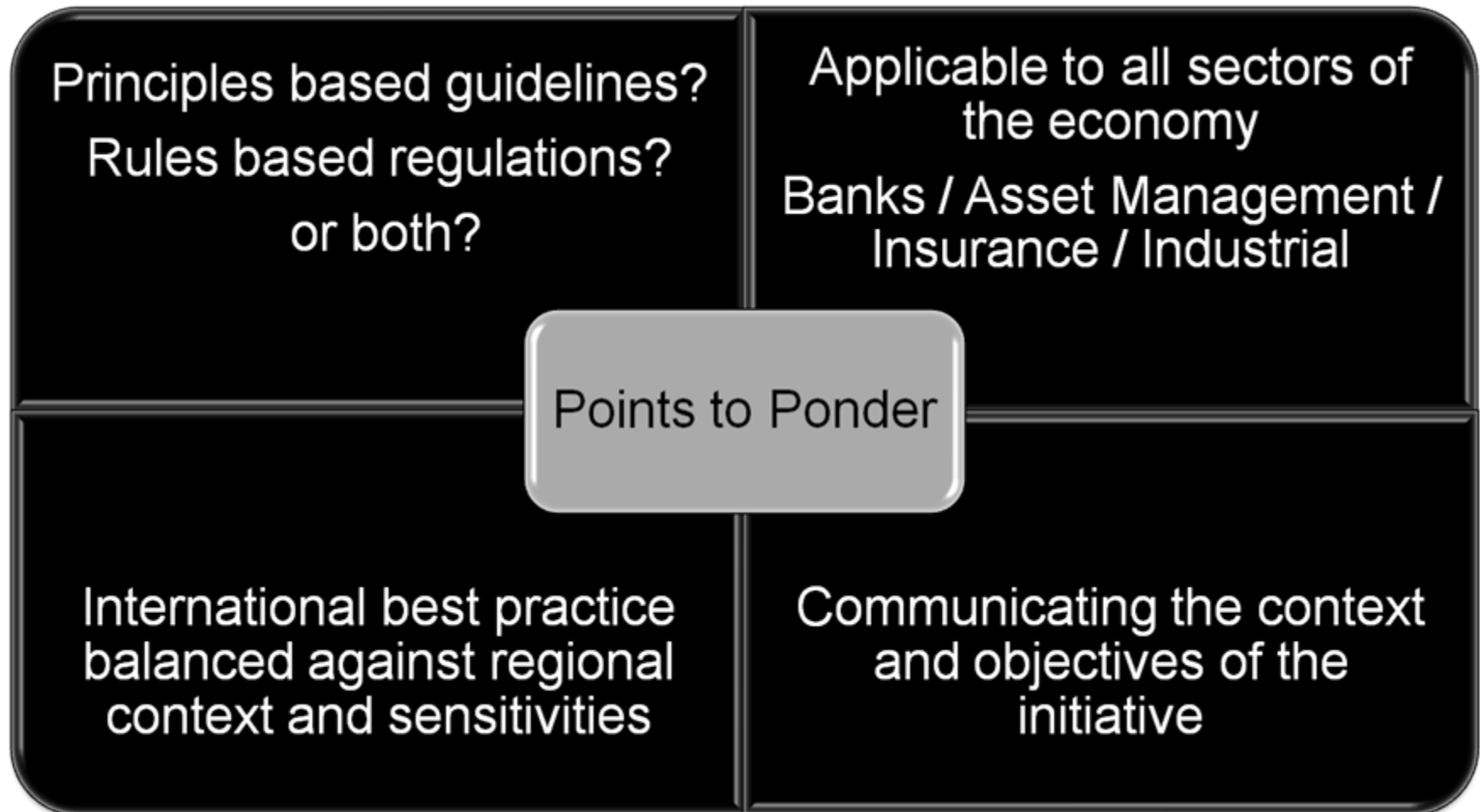
## GOVERNMENT BODIES

Qatar General Secretariat  
for Development Planning  
Ministry of Commerce

## SUPPORTING INITIATIVES

New Governance Regulatory  
Body for Public Sector  
Entities?  
New Companies Act?

# Issues that require further consideration in the development of the National Corporate Governance Framework



# Issues that require further consideration in the development of the National Corporate Governance Framework

## Enforcement

Who is responsible?

Process for independent verification

## Supervisory

Clear articulation of agency roles

Who for unlisted public sector companies?

## Non-compliance

Implications for :  
Listed / Unlisted  
Pvt./Public sector

Steps in the escalation process

# Proposed approach

## Phase 1

- Developing the draft framework
  - Best practice review
  - Draft integrated National Regulations
  - Supervision / Enforcement framework

## Phase 2

- Public consultation process

## Phase 3

- Finalization and Launch of National Code on Corporate Governance



# SUMMING UP....

# Summing up....

- 
- Principles are good guide, but must remain mindful of regional characteristics, local business environment, and idiosyncrasies.
  - Must be understood and applicable to the entire organisation.
  - Fine tune approach to effectively oversee and enforce the governance framework.
  - Enhance engagement with Boards / education / outreach.
  - An integrated Corporate Governance Framework.