Governance Thematic Review

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Reserve Bank of New Zealand
Te Pūtea Matua

FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TĀTAI HOKOHOKO

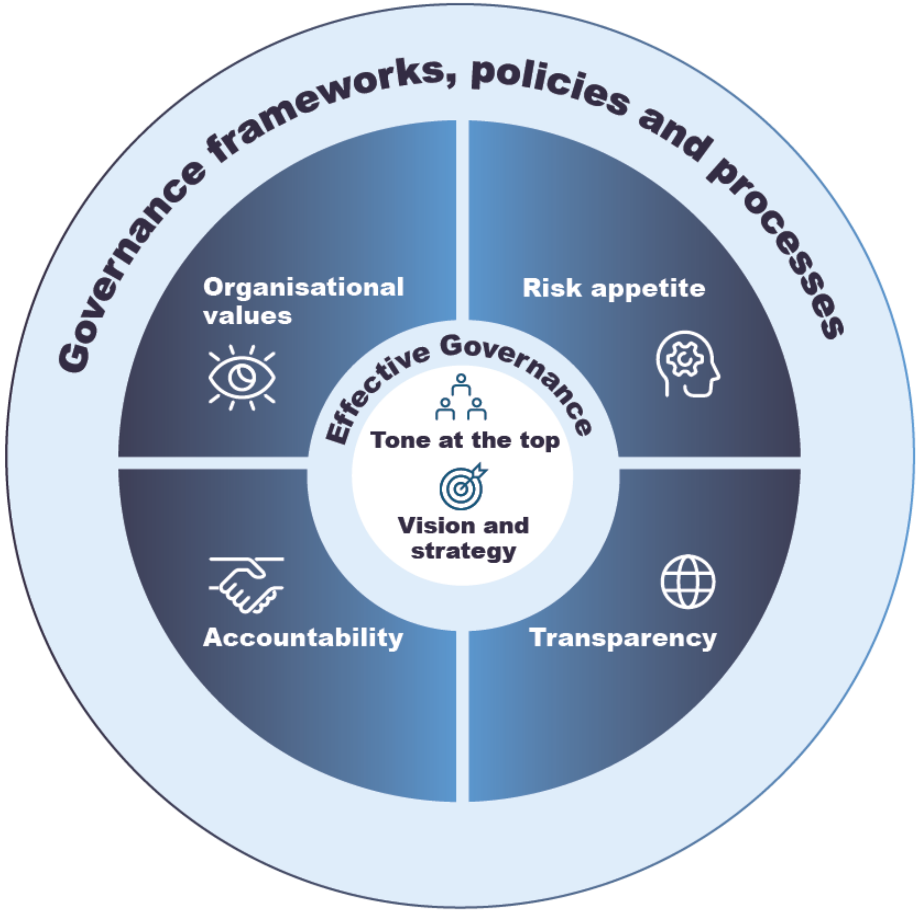
Agenda

- Overview
- Thematic findings
- Recommended principles
- Feedback
- Next steps
- Q&As

Overview

Governance

- Definition
- Role of boards
- Importance to regulation



Objectives

- Alignment with regulatory requirements and guidance
- Understand how boards provide oversight
- Highlight good practice and areas for improvement

Key areas of focus

- Roles and responsibilities of the board
- Board and committee structure and composition
- Conflicts of interest
- Board capacity
- Challenge
- Performance evaluation
- Board and committee meetings

Approach

- Sample - 29 entities across financial services, varying size and structure
- Desk-based reviews
- Interviews
- Analysis and Thematic Report writing
- Independent review
- Publication of findings
- Supervisory follow-up

Thematic findings

Overall findings

- Variety of governance practices
- Embed good practices
- Be future focused
- Continuous improvement

Good practices

- Strategic planning and formulation
- Appointment processes for directors
- Majority independent directors

Good practices - cont'd

- Succession planning for senior management
- Conflicts of interest
- Annual planning and work plans
- Regular training

Areas for improvement

- Selection of chair and committee members
- Board succession planning
- Performance evaluation

Areas for improvement - cont'd

- Capacity assessment
- Diversity
- Ongoing training

Recommended principles

Recommended principles

- Clear and appropriate roles and responsibilities
- Skills and experience
- Succession planning

Key Principles - cont'd

- Sufficient independence
- Actively consider diversity - policy and targets
- Effective and appropriate challenge
- Regular performance evaluation and continuous improvement

Next steps

Next steps

Non-participating entities

- Self-assessment
- Boards to discuss outcome and action plan

Policy considerations

- Upcoming policy reviews

Q&As

Is any regulatory action being taken following the governance review?

The governance review was not a compliance review, rather a review of governance practices and processes undertaken by boards. There were no issues that required us to take any formal regulatory action. Instead, the participating entities received direct feedback from RBNZ and FMA on our findings, which they can use to improve their governance practices going forward.

The report mentions that you saw a lot of good practices but in many cases, these were not documented. Why do you think that is?

This may be due to a few factors, but the most likely reason could be the lack of ongoing focus on maintaining and regularly reviewing governance frameworks. Undertaking holistic reviews of these frameworks are important to pick up any changes in practices that have not already been documented.

Documenting good practice is important because it creates sustainability and ensures transparency and accountability.

Why do you feel the need for all practices and processes to be documented?

Documenting all processes shows a disciplined approach and is essential for setting yourself up for future success, which was one of the key themes of this review. It takes extra time and effort but is core to good governance.

Documentation assists when reviewing processes and can help identify weaknesses and solutions, which can then be catalogued for future reference. In the long term it saves time and effort. Not just documenting, there also needs to be reflection on an ongoing basis on whether processes and practices are still fit for purpose.

What number of board roles do you consider as being reasonable?

When it comes to determining the number of board roles, there's no set number. Entities should consider this on a case-by-case basis, taking into account each director's capability, knowledge, experience and time commitments, as well as their availability in a time of crisis. Holding multiple board roles does increase the risk of directors having insufficient time or capacity to be effective in each role, which in turn puts the boards they serve at risk. Balancing the benefits and risks of holding multiple board roles needs to be considered when assessing director capacity both at the time of appointment and on an ongoing basis.

Is having a majority of independent directors appropriate for all entities, particularly smaller entities, some with close ties to shareholders?

Some of our regulated entities are required to have a certain number of independent directors as part of their regulatory conditions, whereas others do not. The report highlights the importance of independence of mind, judgement and diversity of thought when it comes to effective decision making. Each firm needs to ensure they are reviewing the composition of their board and consider what is appropriate for them, taking into account factors such as the size and nature of the business. Good practice we have seen both locally and internationally is to maintain a majority of independent directors on the board.

In the report there are a number of the key principles that all Boards should consider. Can you reflect on how these relate to small companies with perhaps one or two directors who are the principals of the company?

The key principles in the report are outcomes that we would like entities to achieve, and we recognise that the way to achieve these outcomes and what is fit for purpose may be different for each entity, whether because of their size, nature, complexity or other factors.

What is your view on the role of current directors in making recommendations to shareholders/members in director elections?

The review highlights that the selection and appointment of board members is crucial in ensuring the board has the right people appointed. The full board needs to be part of the process, and the decision collectively agreed. Larger entities usually have a committee responsible for the selection and appointment process or a nominations committee.

Many of the organisations you reviewed are member owned. How do you manage ensuring diversity and the right skill set around the board table when directors are appointed by election?

This is a challenge for member-based entities leading to the risk that the board does not have the skills and experience it needs. We have seen some good practices where member-based entities have a nominations or appointments committee to focus on selection and appointments.

Some member-based entities have rules that allow co-opted directors, who are appointed by the board rather than elected by members. In addition, many of these entities actively seek suitable member candidates and highlight to their members the fit and proper/suitability requirements for directors before nominations are made.

You mentioned that independence of directors can change over time. Can you please expand on this and comment on how boards should be looking at this on an ongoing basis?

There is a risk that as an independent director's tenure increases, they will reach a point where it is likely to impair their independence. There is a balance between maintaining independent judgement and the knowledge and experience of a director, as well as the relationships that have been built up with the board and management. International guidance suggests that independence may be impaired if a director has been on the board for more than nine years. We ask entities to consider whether the length of service on the board impacts a director's ability to be truly independent. However, tenure is not the only factor to consider when assessing independence, and boards should regularly assess each directors' independence using criteria they have developed.

Did you find any variation in the period of director appointments?

We found many entities did have tenure limits for non-executive directors and that most non-executive directors were appointed for three terms, totalling nine years. In circumstances where independent directors remain beyond their tenure limit, good practice we saw was for the board to undertake an annual assessment of the director's independence, including whether the reason for the extension was still valid.

After assessing against the report, we plan to take a measured approach to close any gaps identified. However, we know of consultants out there trying to generate a sense of panic that you have to fix everything now.

Entities involved in the review were given specific detailed feedback letters. For those entities who did not participate in the review, it is important to assess their governance arrangements against the principles, expectations and good practices outlined in the report. Where gaps are identified, entities can apply their own timeline as to when these gaps will be remedied. Entities are welcome to talk to their supervisor or designate to discuss their plans.

Has the governance thematic report introduced a new regulatory burden on firms?

The review aligns with international best practices and acknowledges the changing regulatory environment. The intention was to produce a thematic document to share observations of good practice and areas where improvements could be made to help drive good governance outcomes. The document was designed to be collaborative and collegial, and we hope it has served its purpose well.

Will you be following up in a more formal manner with regulated entities that did not participate in the review?

We will engage with all licensed entities and ask them whether they have reviewed the findings of this review. Although we're not following up with all licensed entities individually, we will be sharing our findings with the boards when we engage with them during normal supervisory work. We are committed to sharing this information and promoting good governance practices across all of our licensed entities.

What was the biggest positive surprise from the review?

While not a surprise, one of the biggest positives we encountered during this review was the high level of engagement from both the participating entities and their boards. We conducted almost 400 interviews in an open and constructive way, and we were very pleased with the quality of the information we received. The main objective of this review was to improve governance maturity across sectors, and it was the engagement of everyone involved that made this possible.

Does the review provide any lessons for directors of non-financial firms?

We feel the review provides lessons for all boards. We have shared insights from the review with the Institute of Directors and engaged with the Australian Prudential Regulation Authority (APRA), Australian Securities and Investments Commission (ASIC), The Australian and New Zealand Stock Exchanges (ASX & NZX) to ensure that our findings are well documented and applicable to a broader audience. These insights will provide value for all boards, regardless of their industry or location.

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