



Bank of Papua New Guinea

**BANKING PRUDENTIAL STANDARD BPS300: CORPORATE
GOVERNANCE**

Issued under Section 27 of the *Banks and Financial Institutions Act 2000*

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OVERVIEW

Sound corporate governance of financial institutions in Papua New Guinea (PNG) is a key element of depositor protection, public confidence in individual institutions and financial stability as a whole. In the aftermath of the 2008/2009 Global Financial Crisis (GFC) and investigations into bank failure, it is clear that while capital is a necessary buffer, it is not a substitute for strong oversight and management, clear understanding of the real business risks, sound judgement and effective internal controls.

Corporate governance may be considered in two parts: the set of relationships between a Board, management and other stakeholders; and the system by which the strategy and performance objectives of the institution are developed, controlled, monitored and achieved.

The Central Bank of Papua New Guinea (BPNG) recognises that corporate governance practices will differ between Authorised Institutions (AIs) depending on a range of factors including size, sophistication and organisational structure; ownership structure; nature, scope and complexity of operations; corporate strategy; and risk profile. Nevertheless, BPNG expects every AI to implement an appropriate and sound governance framework, operate with a high degree of integrity and work to improve continuously a strong governance culture.

Part I: PRELIMINARY

1. Short Title

BPS300: Corporate Governance

2. Authorisation

The BPNG is authorized to issue prudential standards under Section 27 of the *Banks and Financial Institutions Act (BFIA) 2000* in relation to prudential matters to be complied with by all AIs.

3. Application

- a) This prudential standard applies to banks and licensed financial institutions authorised under the BFIA 2000, collectively referred to as Authorised Institutions (AIs) for the purpose of this prudential standard.
- b) This prudential standard also applies to AIs that have a common Board for the parent and the subsidiary.
- c) This prudential standard forms part of the series dealing with Corporate Governance and must be read in conjunction with:
 - i) BPS310: Fit and Proper Requirements; and
 - ii) BPS320: Compliance Function Requirements.

4. Definitions

- a) For the purposes of this prudential standard¹:
 - i) Board of Directors or the Board - the body that supervises management.
 - ii) Control functions - those functions that have responsibility independent from management to provide objective assessment, reporting and/or assurance. This includes the risk management function, the compliance function and the internal audit function.
 - iii) Corporate governance - a set of relationships between a company's management, its Board, its shareholders and other stakeholders which provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance. It helps define the way authority and responsibility is allocated and how corporate decisions are made.
 - iv) Executive director - a member of the Board who also has management responsibilities within the AI.
 - v) Independent director - a non-executive director who is free from any business or other association, including those arising out of a substantial shareholding², involvement in past management or as a supplier, customer or advisor, or in a business relationship that could materially interfere with the exercise of their independent judgement. If the Board of the AI is in doubt about a director's independence for the purposes of this prudential standard, the AI should refer the matter to BPNG for guidance. See attachment A for added clarification.
 - vi) Internal control system - a set of rules and controls governing the AI's organisational and operational structure, including reporting processes, functions for risk management, compliance and internal audit.

¹ Definitions taken from BCBS publication, Corporate governance principles for banks (July 2015), Bank for International Settlements (BIS)

² Substantial shareholding is greater than 5% of the shares.

- vii) Non-executive director - a director who is not a member of the AI's management or its subsidiaries but may include Board members or senior managers of any parent entity or of the parent entity's subsidiaries.
 - viii) Risk governance framework - part of the overall corporate governance framework, through which the Board and management establish and make decisions about the AI's strategy and risk approach; articulate and monitor adherence to risk appetite and risk limits vis-à-vis the AI's strategy; identify, measure, manage and control risk.
- b) For the purposes of this standard *dealing in securities* includes:
- i) Any acquisition or disposal of, or agreement to acquire or dispose of any of the securities;
 - ii) Entering into a contract (including a contract for variation) the purpose of which is to secure a profit or avoid a loss by reference to fluctuations in the price of any of the securities;
 - iii) The granting, acceptance, acquisition, disposal, exercise or discharge of any option (whether for the call, or put or both) to acquire or dispose of any of the securities;
 - iv) Entering into, or terminating, assigning or novating any stock lending agreement in respect of the securities;
 - v) Using as security, or otherwise granting a charge, lien or other encumbrance over the securities;
 - vi) Exercise of any discretion such as conversion of securities;
 - vii) Any transaction, including a transfer for nil consideration, or the exercise of any power or discretion effecting a change of ownership of a beneficial interest in the securities; or
 - viii) Any other right or obligation, present or future, conditional or unconditional, to acquire or dispose of any securities;

but not:

- ix) Undertakings or elections to take up entitlements under a rights issue or other offer (including an offer of securities in lieu of a cash dividend);
- x) The taking up of entitlements under a rights issue or other offer (including an offer in lieu of a cash dividend);
- xi) Allowing entitlements to lapse under a rights issue or other offer (including an offer of securities in lieu of a cash dividend); and
- xii) Undertaking to accept, or the acceptance of, a takeover offer.

Part II: STATEMENT OF POLICY

5. Purpose

- a) This prudential standard sets out minimum foundations for good governance. It is based largely on the Basel Committee on Banking Supervision (BCBS)³ principles for enhancing corporate governance. It also reflects recent trends in prudential regulation to provide more explicit guidance on supervisory expectation for corporate governance including the Financial Stability Board's (FSB)⁴ principles for sound compensation practices. The key requirements include:

³ BCBS (Oct 2010). Enhancing corporate governance for banking organisations, Bank for International Settlements (BIS)

⁴ Based in Basel, Switzerland, the FSB is an international body that monitors and makes recommendations about the global financial system. It was established after the 2009 G-20 London summit in April 2009 as a successor

- i) Expectations for Board size and composition;
- ii) That the chairperson of the Board must be an independent director;
- iii) Expectations regarding responsibilities and governance arrangements between the Board and senior management;
- iv) Blackout periods for dealing in securities;
- v) Establishment of a Board Audit Committee or Board Audit and Risk Committee for smaller institutions;
- vi) Overseeing the AI's overall risk strategy, including its risk tolerance and appetite;
- vii) A policy on Board development, renewal and procedures for assessing Board performance;
- viii) Establishment of a Board Remuneration Committee and requirements for a Remuneration Policy that aligns remuneration with risk management;
- ix) A dedicated internal audit function;
- x) Compliance with the Fit and Proper Requirements prudential standard (see BPS310); and
- xi) Compliance with the Compliance Function Requirements prudential standard (see BPS320).

6. Scope

This prudential standard applies to all Boards and senior management of AIs.

Part III: PRINCIPLES AND PRUDENTIAL REQUIREMENTS

7. Responsibility of the Board

- a) The Board is responsible for ensuring the sound prudential management of the AI.
- b) The Board must have a formal Board Charter that sets out the roles and responsibilities of the Board including its primary functions with respect to:
 - i) Short and long-term enterprise-wide business objectives, strategy and plans, including the Risk Management Framework (RMF) (**see Annex B**);
 - ii) Significant strategic initiatives, such as mergers and acquisitions;
 - iii) Internal controls framework;
 - iv) Code of Conduct;
 - v) Maintaining of an up-to-date Register for recording and managing conflicts of interest;
 - vi) Selection, appointment, and performance review of the Chair, the Board, each of the Board committees including board renewal and succession planning;
 - vii) Fees and expenses of the Chair and directors;
 - viii) On-going training and development of directors and senior management;
 - ix) Appointment, performance review and compensation of the Chief Executive Officer (CEO) and other members of senior management;
 - x) Succession plans with respect to the Board, the CEO and other members of senior management, including the heads of key oversight functions such as the Chief Risk Officer and Company Secretary or equivalent;
 - xi) Independent and adequate resourcing of the internal audit functions; and
 - xii) External audit plan, including audit fees and the scope of the audit engagement.

to the Financial Stability Forum (FSF). The Board includes all G-20 economies, FSF members and the European Commission.

- c) As part of the governance framework, the Board will establish both specialised oversight committees (for example, Audit Committee or Audit & Risk Committee) and management committees (for example, ALCO⁵). Each committee requires its own documented charter with clear responsibilities, reporting requirements and delegated authorities as appropriate. The establishment of a Committee or delegation of authority does not relieve the Board of its responsibilities on any matter under law or policy.
- d) Where an AI has been identified to be systematically important⁶, the AI should have separate board committees for Audit and Risk.
- e) The Board should ensure that there is effective oversight of the performance of senior management which may include inviting management to attend Board meetings and presenting business unit reports.
- f) The Board Charter and clarity around Board responsibilities and responsibilities of its Committees or any delegated authority must extend as far as possible to any subsidiary or joint venture operations to ensure that the parent Board can meet its responsibilities.
- g) Where an AI utilises policies, charters, authorities or other systems and processes of a parent or sibling entity, it must be able to demonstrate to BPNG that they have been tested and appropriately tailored to meet the AI's business and risks in PNG and any other jurisdictions in which it operates.
- h) The AI can adopt its parent's code of conduct, committees and other such structures provided the AI is able to prove to BPNG that these arrangements as a minimum satisfy the intent of these requirements.
- i) In addition to the primary functions identified in Clause 7 (b), the Charter and associated policies and procedures must make clear the Board's guidance and oversight role with respect to management responsibilities including:
 - i) Significant operational and business policies and procedures;
 - ii) Business and financial performance relative to the Board-approved business strategy and RMF;
 - iii) The compensation (remuneration and benefits) policy; and
 - iv) Implementation of internal controls, including assurance of the adequacy and effectiveness of those controls.

8. Responsibilities of Senior Management

- a) Senior management of the AI are responsible for the implementation of the policies and procedures and for ensuring that all operations are conducted within the risk appetite and tolerance levels and risk management frameworks approved by the Board. The skills, competence, integrity and experience of senior management are critical to the safety and soundness of the AI.
- b) Under the leadership of the CEO, the senior management of the AI must have clear responsibility and delegated authority as appropriate to:
 - i) Direct and oversee the effective management of the AI to ensure that it operates in full compliance with all applicable laws, regulations and prudential standards as well as the policies and procedures established by the Board;
 - ii) Provide the Board with sound advice on the organisational objectives, strategy, structure and significant policies of the AI. Senior management is expected to set out and analyse options for the Board's consideration, identify

⁵ Assets & Liabilities Committee

⁶ An AI whose failure or collapse is likely to trigger a financial crisis in an economy.

- potential trade-off of each option, and make and supports recommendations. Senior management provides relevant context and information on the operations of the AI to enable the Board to take informed decisions;
- iii) Facilitate the Board's oversight role by providing relevant, accurate and timely information, with all board papers and supporting documentation distributed at a reasonable time in advance of regular board meetings to enable the Board members time to effectively read and understand the board papers. This enables the Board to oversee the management and operations of the AI, assess policies and effectiveness of internal controls. Senior management must also provide assurances to the Board that policies, processes and controls are adequate, that they are operating effectively, and that risk is appropriately controlled;
 - iv) Ensure that oversight functions such as credit risk, the compliance function and internal audit have the resources and support to complete their duties; are sufficiently independent of operational management; and have the capacity to offer objective opinions and advice to the Board and to senior management; and
 - v) Engage skilled and competent staff and support them with training and development opportunities to sustain the delivery of short and long term business objectives, the risk management framework and protect the reputation of the AI.

9. Board Oversight of Internal Controls

- a) The Board has the responsibility to approve the overall internal control framework and monitor its effectiveness. The internal control framework (or internal controls encompasses all the personnel, policies, processes, limits, culture and other aspects of the AI that combine to achieve the management of the risks associated with the business objectives. Internal controls support the integrity of operations, contribute to effective risk management, assist compliance with applicable laws and regulations, and strengthen the AI's capacity to respond appropriately to business opportunities and challenges.
- b) The Board and its Committees must receive regular reports on the operations of the AI. It must also receive regular reports on the AI's financial condition, compliance with policies and procedures, the performance of risk management and other control systems and any ineffectiveness or significant breaches of controls, policies, and code of conduct as well as any breaches of laws, regulations and prudential standards.
- c) The Board must utilize the internal and external auditors to test and to provide the Board with assurance that the internal controls are in place and are operating effectively, and that the internal control framework stays adequate and appropriate on an enterprise-wide basis to meet changing risks and business activities. The Board must also satisfy itself that any deficiencies or weaknesses are escalated appropriately to management and the Board's attention and that any weaknesses in one part of the group are not a risk in other parts of the AI's activities.
- d) The Board must ensure that management tests the internal controls, takes prompt action to escalate as appropriate and correct any material deficiencies or breaches and monitors reports on remediation efforts and residual risks.
- e) The internal audit function is one of the key means by which the Board can receive assurance that the internal control framework is in place, is adequate and is operating

effectively. The Board must ensure that the Audit Committee utilizes the internal audit function to provide the Board with an appropriate level of assurance.

- f) The Chairman and the CEO must attest to BPNG on an annual basis the AI's continued effectiveness and appropriateness of internal controls as part of the annual sign off. This sign off may only be made with the approval of the entire Board, and the approval must be supported by an appropriate assurance framework or other due diligence.

10. Board Composition

- a) The Board of an AI must have a minimum of five directors at all times. The chairperson of the Board of an AI must be an independent director. A subsidiary can apply to BPNG for an exemption from this requirement to allow for the chairman to be a non-executive director.
- b) A majority of directors present and eligible to vote at all Board meetings must be nonexecutive directors or independent directors.
- c) The Board must have a majority of independent directors at all times subject to the following:
 - i) Where the AI is a subsidiary of an overseas parent and can prove to BPNG that it is subject to equivalent prudential regulation, the AI must have a majority of non-executive directors, at least two of whom are independent, in addition to an independent Chairperson. Where exemption is granted by BPNG under paragraph 10(a), an AI must have at least two independent directors;
 - ii) Where the AI is a subsidiary of a parent (regardless of the country of incorporation), the Board must have a majority of independent directors which may include independent directors of the parent entity; and
 - iii) Where the AI is a joint venture, independent directors of the joint venture partners will be recognised for the purpose of appointment as independent directors of the AI.
- d) The Chairperson of the Board cannot have been the appointed CEO of the AI any time during the previous 3 years. The Chairperson may serve as an acting CEO for a period of up to 90 days with the approval of the Board. Such arrangements are expected to be unusual and temporary only. Any extension beyond 90 days or re-appointment by the Board of the Chairperson to the acting CEO position must be approved by BPNG.
- e) The Chairperson must not sit in or be a member of any of the board committees.
- f) The Chairperson must be available to meet with BPNG on request and except as agreed with BPNG, must be a resident in PNG.
- g) Where the AI is locally owned, a majority of directors must be ordinarily residents in PNG.
- h) Where the AI is a foreign owned subsidiary, at least two of the directors must be ordinarily resident in PNG, at least one of whom must also be independent.
- i) A director must not be a director in more than 2 BPNG regulated institutions.
- j) A director must not be a director in more than 1 BPNG regulated entity within the same industry or sector.

11. Board Skills, Qualifications and Effectiveness

- a) The Board must ensure that directors and senior management of the AI have collectively the full range of skills and experience needed for its effective and prudent operation. Further, that each director has the skills, knowledge and

experience to understand the risks, financial, legal and prudential obligations and to make an effective contribution to Board deliberations and processes. This does not preclude the Board from supplementing its skills and knowledge by engaging external consultants and experts to serve on committees of the Board. All Board members must be available to commit effectively to the director role and attend Board and Committee meetings.

- b) The Chairman plays a crucial role in the proper functioning of the Board. The Chairman must demonstrate strong leadership, independence of thought and the ability to include all Board members in all deliberations.
- c) The Board of each AI must implement an independent Board evaluation process. While the nature of the process will reflect the activities, complexity and size of the AI, at a minimum, the evaluation process must include:
 - i) Competency assessment for the Board and each of the Board committees. For example, incorporating tools such as a competency matrix to be satisfied the Board covers the full range of required skills and expertise to be able to operate effectively as the Board of an AI and can clearly identify the necessary skills training or the need for additional external support;
 - ii) Annual evaluation process of the Board and its Committees relative to the Charters and business objectives;
 - iii) Annual evaluation process for assessing the performance of the Board, the Chairman and each individual director; and
 - iv) Process to monitor and record the ongoing compliance with all Fit and Proper requirements.
- d) A foreign subsidiary can adopt its parent's group framework for annual Board appraisal provided the AI is able to prove to BPNG that these arrangements as a minimum satisfy the intent of these requirements.
- e) The Board must dedicate sufficient time and allocate sufficient funds for director development in the annual budget and provide other resources to ensure that all directors acquire, maintain and deepen their knowledge and develop the skills required to fulfil their obligations prudently and professionally.
- f) The Board of each AI must have in place a formal policy on Board renewal. This policy must provide details of how the Board intends to address renewal in order to ensure it remains open to new ideas and independent thinking, while retaining adequate expertise. The policy must also address terms of appointments and set the maximum periods that a person may serve as the chairman, director or on committees subject to the following restrictions:
 - i) No person must be appointed as a director of an AI for more than 3 consecutive terms or 9 consecutive years, whichever is shorter; and
 - ii) No director can serve as Chairman for more than 6 consecutive years.

12. Culture and Conduct

- a) The Board must set the tone from the top to establish and promote corporate values and the highest levels of professional standards and integrity. To this end, BPNG expects each AI to implement comprehensive corporate governance strategies across the AI and its subsidiaries and throughout the group to which it may belong. While any strategy must be tailored to meet the nature and complexity of the AI, at a minimum, the approach must include:
 - i) Code of Conduct (Code) that articulates acceptable behaviour for both directors and staff, including avoiding and managing conflicts of interest, which aligns with the Board's expectations for compliance with statutory and

- policy obligations as well as the risk appetite and risk management frameworks;
- ii) Sign off by directors and employees that they understand the Code and sanctions for breaching the policy;
 - iii) Appropriate and unambiguous sanctions where the Code has been breached;
 - iv) A whistle-blowing policy that provides for procedures, channels and protection for employees to communicate illegal, unethical or questionable practices to higher levels including, the Chair, or the Chair of the Audit Committee or Audit and Risk Committee. If there are serious prudential concerns the Chair must report promptly to the BPNG and where the illegal, unethical or questionable practices relate to the Chair or senior staff, the policy must provide that the employee may communicate the concerns directly to BPNG; and
 - v) Integrated communication and performance management activities to ensure that all directors and staff are aware of values, professional standards and the Code and associated expectations; that directors and staff receive regular refresher training, and that the board evaluation process and the staff performance management process measures these behavioural expectations.
- b) A foreign subsidiary can adopt its group corporate governance strategies provided the AI is able to prove to BPNG that these arrangements satisfy the intent of this requirement.
- c) Each AI must implement a Conflict of Interest Policy for the Board. At a minimum the policy must include:
- i) A requirement that conflicts of interest must be avoided, and that only where the conflict cannot be avoided, that it must be appropriately managed;
 - ii) Maintaining an up-to-date Register of Interests which is updated at every regular board meeting;
 - iii) A duty on directors to disclose any matter that may result, or has already resulted, in a conflict of interest;
 - iv) Maintaining a record in the minutes of disclosures of alerted conflict of interest with each director also signing off at least annually a conflict of interest declaration;
 - v) Restrictions on dealing in securities that meet the requirements set out in clauses 13(b) - 13(h) and 14;
 - vi) A review or approval process for directors prior to engagement in activities that may be construed as creating a conflict of interest (such as serving on another board or as a potential supplier of goods and services to the company) to ensure that any conflict of interest may be avoided or alternatively, managed properly;
 - vii) Procedures for dealing with conflicts of interest where they exist, including the affected director abstaining from participating in any decision including receiving Board information, participating in discussions and voting on any motion;
 - viii) Adequate procedures to ensure that transactions with related parties are made on an arms-length basis; and
 - ix) Procedures for dealing with non-compliance with the conflict of interest policy.
- d) A foreign subsidiary whose parent is subject to similar prudential regulation can adopt its group Conflict of Interest Policy provided that the AI is able to prove to BPNG that these arrangements satisfy the intent of this requirement.

13. Dealing in Securities

- a) Each AI that is listed on the Port Moresby Stock Exchange (POMSoX), or is part of a group that is listed or includes entities listed on POMSoX, must establish restrictions on dealing by responsible persons and others in securities of the AI or related listed entity. The minimum restrictions below are in addition to other relevant legal or regulatory requirements such as those imposed under listing rules or Companies Act 1997.
- b) Restrictions in dealing in securities must apply to ensure integrity and transparency and avoid actual or suspected insider trading or market manipulation by anyone who may have access to sensitive information or otherwise benefit from movements in the share price.
- c) The AI may take either of two alternative approaches, to establish prohibited trading periods, either:
 - i) Define open periods when trading may take place; for example, identify 2-4 trading windows throughout the year of 1 or 2 weeks duration. Such windows must not be during periods leading up to important announcements or year-end; or
 - ii) Define closed periods that create blackout periods when dealing in securities is prohibited.
- d) In either approach, trading must be prohibited as follows:
 - i) In the period 60 days immediately preceding a preliminary announcement of the annual report;
 - ii) In the period 30 days prior to the end of its financial year and half year;
 - iii) In the period 30 days prior to 31 December or balance date of the AI; or
 - iv) Any other period when there exists any matter that constitutes inside information in relation to the AI (or related entities).
- e) In addition to the blackout periods, other than a responsible person, no one is to have access to sensitive information or otherwise benefit and movements in the share price must not deal in any securities of the AI or related entities without obtaining clearance to deal in advance of placing the order as follows:
 - i) A director (other than the chairman or CEO) or Company Secretary must not deal in any securities without first notifying the Chairman (or a director designated by the board for this purpose) and receiving a written clearance to deal;
 - ii) The Chairman must not deal in any securities of the company without first notifying the Chair of the Audit Committee or the Chair of the Audit and Risk Committee and receiving written clearance to deal;
 - iii) The CEO must not deal in any securities of the company without first notifying the Chairman and receiving written clearance to deal (or senior independent director if the chairman is not available); and
 - iv) Other responsible persons and those discharging managerial responsibilities (who are not directors) must not deal in any securities without first notifying the Company Secretary or a designated director and receiving written clearance to deal.
- f) A response to a request for clearance to deal must be given within 5 business days of the request being made.
- g) The company must maintain a record of the response to any dealing request made by a responsible person and of any clearance given. A copy of the response and clearance (if any) must be given to the person concerned.

- h) Clearances have a shelf life of five days only. That is, a person who is given clearance to deal in accordance with paragraphs 13(c) - 13(e) must deal as soon as possible and in any event within 5 business days of clearance being received.

14. Circumstances for Refusal

A clearance to deal in securities must not be given during a closed or prohibited period.

15. Acting as a Trustee or Other Decision-maker

- a) Where a responsible person is also a trustee, director of an investment manager or similar, the investment vehicle may deal in the AI's securities (or related entities securities) during prohibited periods provided the responsible person is not a beneficiary or investor; the decision to deal is taken by the other trustees or by investment managers on behalf of the trustees independently of the responsible person, that is without consultation to, involvement or advice from the responsible person.
- b) The AI must keep a register of the interests of responsible persons who are also trustees, directors of an investment manager or similar, who may deal in the AI's securities (or related entities securities).

16. Remuneration Governance

16.1 Board Remuneration Committee

- a) Each AI must, unless otherwise approved in writing by BPNG, establish a Board Remuneration Committee. BPNG will consider approval if satisfied that the AI can demonstrate that the functions and responsibilities will be undertaken appropriately by the whole Board. However, separate Board committee charters are required.
- b) A foreign subsidiary can adopt its group Remuneration Framework provided that the AI is able to prove to BPNG that these arrangements satisfy the intent of this requirement.
- c) The Board Remuneration Committee must have a written charter that outlines the Committee's roles, responsibilities and terms of operation, including as a minimum, responsibility for:
 - i) Monitoring compliance with the AI's remuneration policy periodically and making recommendations to the Board on the policy and the remuneration of all Officers;
 - ii) Ensuring that the performance-based components of remuneration encourage behaviour that supports both the entities long-term financial soundness and its risk management framework; and
 - iii) Conducting regular reviews of, and making recommendations to the Board on the Remuneration Policy.
- d) The Board Remuneration Committee must:
 - i) Be chaired by an independent director; and
 - ii) Be comprised of a minimum of 3 suitably qualified and experienced directors.
- e) An executive director, CEO or manager must not be a member of the Remuneration Committee.
- f) Members of the Board Remuneration Committee must be available to meet with BPNG on request.

16.2 Remuneration Policy

- g) Each AI must establish and maintain a documented Remuneration Policy. The Remuneration Policy must outline the remuneration objectives and the structure of the remuneration arrangements.
- h) The Remuneration Policy must be approved by the Board.
- i) The performance-based components of remuneration must be designed to be long-term and align remuneration with prudent risk-taking and must incorporate adjustments to reflect:
 - i. The outcomes of business activities;
 - ii) The risks related to the business activities taking into account, where relevant, of the cost of the associated capital; and
 - iii) The time necessary for the outcomes of those business activities to be reliably measured.
- j) The Remuneration Policy must set out who is covered by the Policy and at a minimum:
 - i) Detail the remuneration objectives and the structure of the remuneration arrangements, including but not limited to any performance-based remuneration components;
 - ii) Align remuneration with the objectives of the AI;
 - iii) Encourage behaviour that takes into consideration:
 - a) the AI's long-term financial soundness; and
 - b) the risk management framework including compliance.
 - iv) Set out who is covered by the policy. At a minimum the policy must cover all officers of the AI;
 - v) Provide that employees of the AI require specific written approval from the Board for any outside employment, this must be clearly required as a condition of employment; and
 - vi) A copy of the Board approved Remuneration Policy must be submitted to the Bank including approved revised versions. Where any changes or revisions are made to the policy, a revised version must be submitted in track changes mode.
- k) The Remuneration Committee shall review annually the fees paid to all directors and committee members.
- l) BPNG may determine that an individual or class of individuals must be covered by the AI's Remuneration Policy. BPNG will notify the AI of such a determination in writing.
- m) Nothing in this prudential standard prevents an AI from adopting and applying a group Remuneration Policy that is also used by a related body corporate provided that the policy has been approved by the Board of the AI and that the Board is able to prove to BPNG that these arrangements satisfy the intent of this requirement.
- n) The Remuneration Policy must form part of the AI's risk management framework.

17. Audit Arrangements

17.1 Board Audit and Risk Committee

- a) The Board Audit and Risk Committee must be provided with the powers necessary to enable it to obtain all information necessary for the performance of its functions. Further, it must have unfettered access to senior management, the internal and external auditors and heads of risk management functions, and vice versa.

- b) The Board Audit and Risk Committee must comprise at least 3 members. All members of Committee must be non-executive directors with a majority of independent directors.
- c) No person, other than the Audit & Risk Committee members shall be entitled to attend Audit and Risk Committee meetings. The Chairman and other non-executive directors may be invited to attend and may also request approval to meet with the Committee.
- d) The Chairperson of the Committee must be an independent director.
- e) The responsibilities of the Board Audit Committee must include oversight of:
 - i) Framing policy on internal audit and financial reporting;
 - ii) Overseeing the financial reporting process;
 - iii) Providing oversight of and interacting with the AI's internal and external auditors;
 - iv) Approving or recommending to the board or shareholders for their approval, the appointment, remuneration and dismissal of external auditors;
 - v) Reviewing and approving the audit scope and frequency;
 - vi) Receiving key audit reports and ensuring that senior management is taking necessary corrective actions in a timely manner to address control weaknesses, non-compliance with policies, laws and regulations and other problems identified by auditors and other control functions;
 - vii) Overseeing the establishment of accounting policies and practices by the AI; and
 - viii) Reviewing third-party opinions on the design and effectiveness of the overall risk governance framework and internal control systems.
- f) Where the Board Audit and Risk Committee is responsible for oversight of the Risk Management Frameworks, the charter must address those responsibilities identified in the applicable prudential standard.
- g) The Board Audit and Risk Committee must ensure the adequacy and independence of both the internal and external audit functions. The Board Audit and Risk Committee must review the engagement of the auditor at least annually, including making an assessment of whether the auditor meets the Audit Independence requirements under law, professional standards and as set out in this prudential standard.
- h) The Board Audit and Risk Committee must regularly review the internal and external audit plans, ensuring that they cover all compliance with legislations, prudential standards and regulations and financial reporting requirements of the AI. It must also regularly review the findings of audits, and ensure that issues are being managed and rectified in an appropriate and timely manner.
- i) The Board Audit and Risk Committee may require the attendance of the internal and/or the external auditors to meetings of the Committee, as necessary.
- j) The Board Audit and Risk Committee must implement policies and procedures for directors and employees of the AI to submit on a confidential basis, concerns and information about accounting, internal controls, compliance, audit and other matters. Such an internal whistle blower policy must be supported by awareness programs as well as protection for those directors and employees who escalate issues under the whistle blowing policy.
- k) Members of the Board Audit and Risk Committee must be available to meet with BPNG on request.

17.2 Internal Audit

- l) Each AI must have an independent and adequately resourced internal audit function. An AI may apply to BPNG for an exemption, setting out the reasons for exemption and propose alternative internal audit arrangements. BPNG may approve alternative arrangements in writing, where it is satisfied that all of the internal audit objectives will be met.
- m) The internal audit function must have a reporting line and unfettered access to the Board Chair and Board Audit and Risk Committee.
- n) The internal auditor must have unfettered access to all of the AI's business lines and support functions.
- o) The objectives of the internal audit function must include compliance with the Board approved policies and procedures, the effectiveness and operation of internal controls and an evaluation of the adequacy and effectiveness of the financial reporting and Risk Management Framework of the AI.

17.3 Auditor Independence

- p) Auditor Independence is subject to Companies Act 1997 as well as professional accounting standards. The requirements in this prudential standard are intended to support the independence of the auditor.
- q) The Board must be satisfied that the appointed external auditor is independent and that there is no conflict of interest that could compromise, or be seen to compromise, the independence of the auditor.
- r) As part of the process of ascertaining the independence of the auditor, the AI must obtain a declaration from the auditor that:
 - i) The auditor is independent, both in appearance and in fact;
 - ii) The auditor has no conflict of interest situation; and
 - iii) There is nothing to the auditor's knowledge (either in relation to the individual auditor or any audit firm or audit company of which the auditor is a member or director) that could or could be seen to compromise that independence.
- s) For the purposes of this prudential standard, a conflict of interest situation is determined to exist in relation to an AI if:
 - i) The auditor is not capable of exercising objective and impartial judgement in relation to the conduct of the work that is undertaken for the AI in relation to the BFIA 2000, prudential standards or Applicable Accounting and Reporting Standards; or
 - ii) A reasonable person, with full knowledge of all relevant facts and circumstances, would conclude that the auditor is not capable of exercising objective and impartial judgement in relation to undertaking the work for the AI for the purposes of the BFIA 2000, prudential standards or applicable accounting and reporting standards.
- t) A person cannot be appointed as a director or senior manager of an AI if in the prior 3 years the person served as a lead auditor of the AI, or was a reviewing auditor of the associated audit work or was a director, partner or equivalent of the firm appointed as external auditors, whether or not involved directly with the audit.
- u) There must be adequate rotation of audit personnel conducting the AI's external audit. No individual must play a significant role in the audit of an AI for more than five successive years or more than 5 years out of seven successive years. BPNG may grant an exemption from this restriction where the individual provides specialist technical services that are otherwise not readily available, for example, review of

treasury functions or IT security. The AI must apply for an exemption on behalf of the external auditors. Note: This restriction applies to individuals regardless of the audit firm appointed as external auditor. An individual may return to the audit team following a break of at least 3 years.

18. Provision of Information to BPNG

- a) No prospective, current, or former officer, employee or contractor (including professional service provider) of an AI may be constrained or impeded, whether by confidentiality clauses or other means, from:
 - i) Disclosing information to BPNG, from discussing issues with BPNG that relate to management and prudential supervision of the AI, or from providing documents under their control to BPNG; or
 - ii) Providing information to auditors and others, such as administrators or statutory managers who have statutory responsibilities in relation to the AI.
- b) Each AI must ensure that its internal policies and contractual arrangements do not explicitly or implicitly restrict or discourage auditors or other parties from communicating with BPNG.

19. Notification Requirements

- a) Each AI must notify BPNG of material governance breakdowns being those matters escalated to the Board Audit and Risk Committee (and Risk Committee as appropriate), at the end of every quarter.
- b) Each AI must notify BPNG in writing with 7 working days of the departure of directors, senior management, responsible persons or head of any oversight function including the reasons for leaving.

20. Reporting

As part of its annual attestation to BPNG, the Board of the AI must provide assurances regarding governance, effectiveness of internal controls, Board assessment and effectiveness, auditor independence and continued compliance with all laws, regulations, prudential standards, code, rules and similar for each jurisdiction in which it operates.

Part IV: CORRECTIVE MEASURES

21. Remedial Measures and Sanctions

- a) If BPNG is not satisfied with the adequacy of an AI's corporate governance framework and its implementation, BPNG may vary the conditions of the AI's licence under Section 14 of the BFIA 2000. Such conditions may include, but are not limited to:
 - i) Requiring immediate re-mediation of problem issues;
 - ii) Suspension or limitation on certain business activities relating to identified weaknesses;
 - iii) Prohibiting a certain transaction or a class of transactions;
 - iv) Requiring appointment of additional staff or third-party support to address weaknesses identified;
 - v) Suspension or the removal of any directors, managers or chief executive; or
 - vi) Appointment of alternative auditors or other professionals to conduct audits or reviews.

Part V: EFFECTIVE DATE

22. Commencement and Transitional Arrangements

- a) The effective date of this prudential standard shall be 1 January 2017 with full compliance required by 31 December 2018.
- b) Paragraph 13 regarding Dealing in Securities – the effective date shall be 1 January 2017 with full compliance by 31 December 2018.
- c) For the purpose of transition to the term limits to be applied under paragraph 11(f) as 1 January 2017, a person has been a director of an AI for 5 or more consecutive years, that person may complete their existing term and be considered for appointment for one more term of up to 3 years. This limit applies whether or not that director is also the Chairman.
- d) Questions and enquiries relating to this prudential standard should be addressed to:

The Manager
Financial System Development Department
Financial System Supervision Group
Bank of Papua New Guinea
Post Office Box 121
PORT MORESBY
Tel: 322 7200
Fax: 321 4549

Part VI: APPENDIX

Appendix A: Independent Director

A director is not independent if:

- a) The director is a Shareholder Controller of the AI, or an officer of or otherwise associated, directly or indirectly, with a Shareholder Controller in an AI;
- b) The director holds or has any significant links with other Directors through involvement in other companies or bodies, with cross-directorships or links that would materially interfere with the director's objective or independent judgement or ability to act in the best interests of the AI;
- c) The director has within the last three (3) years been a principal of a material professional advisor or a material consultant to the AI or an employee materially associated with the service provider;
- d) The director has within the last 3 years been a material supplier of the AI or an officer, shareholder controller of, or otherwise associated directly or indirectly with a material supplier;
- e) The director is employed, or has previously been employed in an executive capacity by the AI or group member, and there has not been a period of at least 3 years between ceasing such employment and serving on the Board;
- f) The director has any other material interest, relationship or association with any person or entity which affects, or could be perceived to affect the independence of the Director;
- g) The director has a material contractual relationship with the AI or its subsidiary or group member to which an AI is part of (other than as a director of the AI); and
- h) The Board, unless the Bank has any objection, determines that the director is not independent in character and judgement.

Appendix B: Risk Management Framework (RMF)

1. The RMF should contain a risk appetite statement and risk tolerance limits, as well as a description of the roles and responsibilities of those overseeing the implementation of the RMF. The RMF is not an end of itself and is expected to form an integral part of the Board's decision making process.

Risk Appetite Statement

2. The risk appetite statement reflects the level of risk that the AI is willing to assume and manage in the pursuit of its business objectives. It reflects the AI's business and risk strategies (that is, the risk-return trade-off) and include qualitative elements or principles, as well as quantitative measures. While each AI must determine and document its own statement, matters typically addressed include:
 - a) Enterprise-wide measures that can be allocated for the main business activities and risks (for example, earnings at risk, capital at risk)

- b) Classes of business – by product or geography – or specific risks in which a AI does or does not want to be exposed (for example, types of lending, country exposures, commodity exposures);
- c) Liquidity preferences (for example, sources of funding, mix of liquid assets, duration);
- d) Hedging strategies (for example, currencies or commodities, floating to fixed interest); and
- e) Operational controls (for example, security, internal system requirements, tolerance for outsourcing risks).

Risk Tolerance Limits

3. The risk tolerance limits complement the AI's risk appetite statement, and reflect the level of risk that the AI is willing to bear for each type of risk. Risk tolerance limits are often quantitative and are expected to be specific, measurable, frequency-based and reportable. Such limits also allow for monitoring on an individual and aggregate basis as well as over time. The level of granularity of the limits will depend on the AI's size and activities and could include:
 - a) Acceptable credit limits (which may be based in part on credit ratings);
 - b) Acceptable leverage ratio or target economic capital levels.
 - c) Value at risk models;
 - d) Liquidity, basis and duration risk; and
 - e) Concentration levels (for example, by country/region, by asset class) and amounts in risk positions (credit risk, market risk, equity risk).

Implementation of the RMF

4. The board is responsible to implement the RMF throughout the AI and to subsidiaries as a core element of overall enterprise-wide risk management.
5. The RMF is not an end in itself and each AI is expected to be able to demonstrate alignment with the AI's corporate strategy, Internal Capital Adequacy Process (ICAAP), financial plans, strategies for individual business units and operations as well as risk management policies and procedures.
6. While the RMF sets aggregate limits, those limits should be disaggregated and allocated to business units as appropriate. It may be appropriate for these units to develop more specific risk appetite and tolerance measures consistent with the nature of the unit's operations and within limits established by the Board for those activities.
7. The RMF must be supported by clear implementation strategies that provides for effective controls, monitoring and reporting and other procedures to ensure on-going operational compliance with the RMF. These are expected to include:
 - a) Risk management systems for the major risk categories (for example, credit, market, operational, liquidity) with both qualitative and quantitative measures;
 - b) Regular reporting to the Board, committees and senior management on the effectiveness of processes and compliance with the RMF as well as action plans to address weaknesses; and

- c) Regular Internal Audit reviews to assess compliance with the RMF on an enterprise wide basis.

Appendix C: Annual Attestation

ANNUAL ATTESTATION

Name of Reporting Institution:.....

Reporting Date:.... ..,20.....

We, the undersigned, being the Chairman of the (i) Board of Directors, and (ii) the Senior Auditor of the institution named above, do hereby certify jointly and severally to the following:

- a) The Group comprising the AI and its subsidiaries, has complied with all laws, regulations, prudential standards, code, rules and similar for each jurisdiction in which it operates.
- b) The Group comprising the AI and its subsidiaries, has:
 - i. employed best practices with respect to Governance;
 - ii) continued to comply with fit and proper requirements for all responsible persons;
 - iii) identified the key financial and operating risks of the AI;
 - iv) established systems to control and monitor those risks including, where appropriate, adherence to prudent policies and procedures, to reasonable operating limits and to adequate and timely reporting processes; and
 - v) satisfied itself that those risk management systems are operating effectively and are adequate in regard to the risks they are designed to control.
- c) there is no actual or potential conflicts of interest exist with respect to the AIs engagement of the external auditor which may compromise the independence of the auditor's performance.

Signed this day of, 20.....

.....

Chairman of Board of Directors

.....

Print Name

.....

Senior Auditor

.....

Print Name