Jessica Chew Cheng Lian: Opening remarks - Launch of the Directors Remuneration Report 2024

Opening remarks by Ms Jessica Chew Cheng Lian, Deputy Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the Launch of the Directors Remuneration Report 2024, Kuala Lumpur, 11 November 2024.

* * *

It is my great pleasure to be here today at the launch of the second update of the Directors Remuneration Report. I believe its last update was in 2017. While that might not seem so long ago, in the period since then, our world has been upended in ways we could not have imagined in 2017. Two words come to mind – COVID and Artificial Intelligence.

This Report is therefore either timely, or some might say, late. Either way, I have no doubt it will provide useful and actionable data and insights that will help boards objectively approach what can be an awkward subject with a higher degree of confidence, particularly with shareholders, but also with the public more generally as public scrutiny of financial institutions continues to increase.

I am grateful for the opportunity to speak to you today and unsurprisingly, I would like to take this opportunity to talk about governance. Good governance remains the bedrock of sound financial institutions.

Few can deny the immense progress in good governance practices that has been achieved in our financial system over the past two decades. To some extent this has been in response to strengthened regulations and the strong supervisory focus of Bank Negara Malaysia on governance. But the real improvements that we have seen in the quality of governance has been driven by firms that have seriously invested in building strong boards - not just in form but in substance; and not because they are acting on the advice of the company secretary who is working off a compliance checklist, but because these firms get that strong boards protect and enhance franchise value.

Corporate governance today and its multiverse challenges

This has never been more true in this 21st century that is racing into a future that is unknown and still uncertain in many respects. The question, "Where was the board?" is almost a guaranteed response to any incident, regardless of the nature of the incident. Even if the board cannot be held specifically accountable for the incident, questions invariably arise on whether the board had properly discharged its general corporate fiduciary responsibilities.

Board responsibilities are also ever evolving and growing, with technological disruption, cybersecurity threats, geopolitical tensions, and environmental pressures among the many challenges that could threaten existing business models and ultimately, financial sustainability. These challenges continue to place increasingly higher demands on boards, especially boards of financial institutions.

Understandably, boards have questioned if we are asking too much of them. It's a question that we do not take lightly and continue to reflect carefully on. We do not believe the responsibilities placed on the board are too broad or heavy. The board's responsibilities should be broad, consistent with the duty of care, skill and diligence, and the duty to act in the best interest of the company under a strict duty of loyalty. Such duties can only be properly exercised within the broader frame and context of the environment that financial institutions operate in today. That means directors must bear direct responsibility for helping the firms that they serve navigate a highly complex operating environment and all the elements that go into what that environment entails.

However, the board's responsibility is one of oversight, as distinct from management. So when boards complain over the expectations placed on them in our prudential and conduct standards, it is often a reflection of how those expectations are being met, rather than what those expectations are. As an example, if boards are not controlling the board agenda, setting clear standards on what, when and how information should be provided to them to enable them to discharge their oversight role, or doing enough to drive a strong culture of accountability for prudent risk taking and fair treatment of consumers, then they are more likely to feel overwhelmed. More fundamentally, some boards remain under-resourced in terms of the collective knowledge and expertise, as well as investments in ongoing board education, required to provide strategic direction and constructive challenge to management.

These are practical issues for the board to address. As supervisors, we assess if boards are functioning effectively to consistently promote and reinforce safe, sound and responsible practices. And we continue to evolve our regulatory and supervisory responses in light of our engagements with financial institutions, our supervisory observations and the risks that we see.

Responsibility Mapping as a tool for greater management accountability

For example, the issuance of the Responsibility Mapping policy document in 2023 aims to provide clarity on the responsibilities assigned to individual members of senior management. This in turn will help boards drive management action to resolve outstanding issues and strengthen performance and risk management. The preparation of the responsibility map provides an opportunity for directors to carefully consider whether the current organisation structure, management strength and allocation of responsibilities remains fit-for-purpose in the context of today's business environment, and the institution's business model and risk profile.

We see Responsibility Mapping as being a critical lever to help boards effectively discharge their oversight role as senior managers will have to demonstrate that they have taken appropriate and necessary actions to ensure the effective management of areas under their purview. This includes an expectation that senior managers should have an in-depth understanding of how the activities within their area of responsibility contribute to the safety and soundness of the financial institution and take reasonable steps to ensure that the activities are well-supported with the right talent and the necessary infrastructure, as well as appropriate governance and risk management controls to monitor risk-taking behaviours.

It is therefore in the boards' best interest to ensure that the Responsibility Mapping framework is implemented effectively.

Enhancing governance standards in line with evolving financial landscape

Bank Negara Malaysia will also be embarking on the review of the policy document on Corporate Governance in 2025. While the current requirements are still largely relevant, the review will consider adopting a more principle-based approach in areas where governance practices have attained a higher level of maturity.

Among other things, we plan to review the common directorship restrictions within a financial group. When this policy was introduced in 2016, mirror boards which had been prevalent raised real concerns over the ability of the board to act in the best interests of separate entities in situations where interests may diverge. With significant improvements in the quality of governance observed and clearer expectations of boards, we are looking at whether a principle-based approach can deliver a better balance for some financial institutions - between filling board vacancies with strong individuals and ensuring that the interests of individual entities are preserved.

Along a similar vein, we will also be seeking your feedback on the requirement for individual entities within a financial group to establish their own board committees. In addition, we intend to address expectations surrounding issues of culture and conduct more explicitly.

We are still at an early stage of this review. As part of this process, we plan to conduct a series of smaller focus groups with directors starting next year to get your feedback and perspectives before we finalise any policy proposals for formal consultation. This will also provide an opportunity for us to have an open conversation on broader governance observations and supervisory expectations.

Bank Negara Malaysia's supervisory and enforcement approaches

Bank Negara Malaysia will continue to use a range of regulatory, supervisory and enforcement tools to promote strong governance in financial institutions. It is firstly, the role of a financial institution's leadership, including its board, to govern and manage the entity in line with safe and sound practices. When supervisory concerns are raised, it is therefore for the board to examine and address deeper, underlying issues of incentives, culture and accountability for risks that the supervisory concerns may be pointing to.

Too often however, boards have not gone beyond fixing the symptoms, while leaving root causes largely unaddressed. In firms where boards have done so, we have seen transformative, lasting changes - putting firms on stronger paths that have not only reduced vulnerabilities, but improved competitiveness. Conversely, we don't have to look very far back to the banking turmoil of 2023 to find evidence of unattended, persisting governance weaknesses that eventually became a flashpoint for events that precipitated the demise of one of the world's largest financial institutions.

Before taking supervisory actions, Bank Negara Malaysia therefore takes into consideration the effectiveness of the corrective actions taken by boards and management to rectify weaknesses in governance and controls. Supervisory actions may also include formal directives to take specific actions, or undertakings provided by the board.

In more serious cases of criminal misconduct, recurring and unresolved risk management and control deficiencies, we will escalate our actions to enforcement actions such as administrative penalties, compounds and public reprimands. These decisions are deliberated by a committee of the Bank that considers all relevant factors including the deterrent effect of enforcement actions in reducing risks in the financial system and promoting public trust in financial institutions.

Concluding remarks

Ladies and gentlemen,

The significant improvements in the governance of financial institutions today may have had their roots in crises, but as memories fade, boards run a risk of falling into a state of relative complacency.

The Remuneration Report will shed light on the extent to which boards are thinking about issues such as diversity on boards and we may well find that change has been relatively limited. To what extent are boards today being intentional about, and paying close attention to, the balance in compensation systems between short- and long-term performance? How boards engage on matters that concern broader stakeholder interests – such as social and environmental issues - is also an important question for boards today. And in more than a few institutions, the data revolution appears to be sweeping through every part of the organisation except the boardroom, when one should expect technology advancements and data availability to also have a more profound impact on the way boards function.

Today, we still observe a large gulf between the governance practices of large versus smaller financial institutions, even after accounting for proportional applications. If there is one thing we can all agree on, it is that efforts to strengthen our individual and collective capacity to respond to operational disruptions and crisis events through effective recovery planning needs continuous rigour and improvement.

And I have already touched on culture where room for greater progress remains.

I leave you to reflect on how your board is considering these issues today, and the nature and quality of your interactions with management on them. As you do, it may be worth keeping in mind the words of former Intel CEO, Andy Grove, who said that "Success breeds complacency. Complacency breeds failure. Only the paranoid survive". We do not want dysfunctional boards, but a healthy dose of professional scepticism with strong strategic leadership from the top will clearly be essential ingredients for successful boards of the future.

On that note, let me close by once again thank you and FIDE Forum for the opportunity to be here and I look forward to more details from the latest findings of the Remuneration Report.

Thank you.