

Regulatory Expectations of Bank Boards – A Webinar for Non-Executive Directors and Professional Advisors

Monday 10 May 2021

Regulatory Expectations of Bank Boards - A conference for Non-Executive Directors and professional advisors

Ruth Grioli

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Anton Mahkats

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The Role of the Non Executive Director in business planning and stress testing

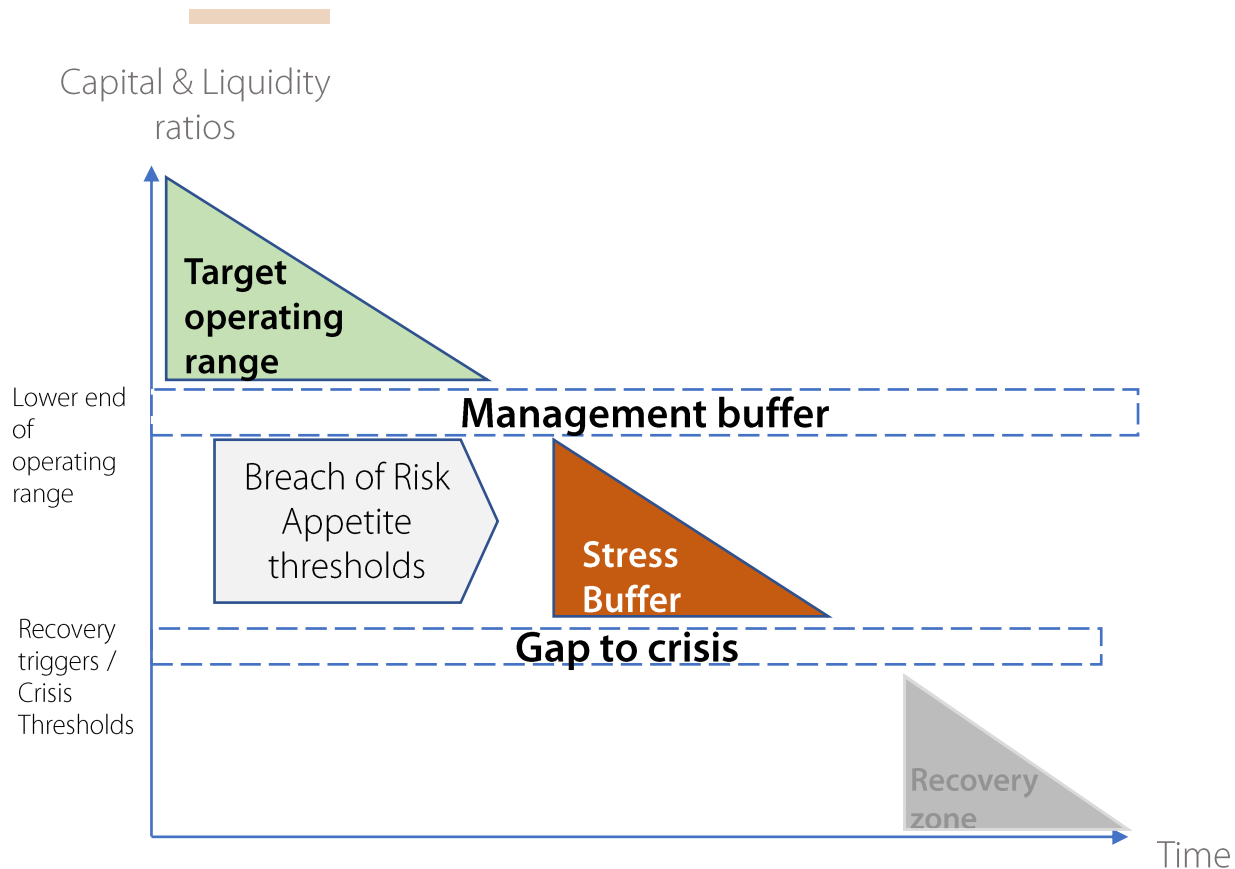
Nikolaos Grapsas

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Banking Supervision



Business Plan and Stress Test as integral components of Strategic Planning



MFSA identifies Strategic Planning as high priority supervisory area where credit institutions are expected to:

- Develop a robust governance framework
- Align Business and Risk Strategy
- Drive business sustainability under normal conditions
- Ensure business viability under stressed conditions
- Use outputs of Stress Test in the decision making process
- Allocate sufficient resources and maintain strong IT infrastructure

The role of Non Executive Directors in the Business Plan (1/2)

Successful supervisory role of management body is demonstrated when NEDs are able to provide feedback on:

Governance

- Describe the governance process for agreeing the business plan and tell us about some of the areas that provoked debate or might be controversial?
- What in your view are the key dependencies or areas where you think meeting the targets will be challenging?

Balance sheet

- What do you think will be the main drivers of balance sheet growth and how do they align to the bank's risk appetite?

Revenues

- What is your view of the key features impacting interest margin?
- What are the key drivers of fee income?

The role of Non Executive Directors in the Business Plan (1/2)

Pricing

oTalk us through how the board ensures that the bank is pricing for risk appropriately?

Cost

oTell us about how the board satisfied itself that the cost assumptions used are reasonable?
oWhat are the key drivers of cost changes over the planning cycle?

Profitability

oCan you explain what the appropriate level of profitability is for the bank to sustain its growth and generate returns?
oHow do you ensure that internal capital generation is aligned with risks assumed?

Non Executive Directors, Stress Test and ICAAP/ILAAP (1/2)

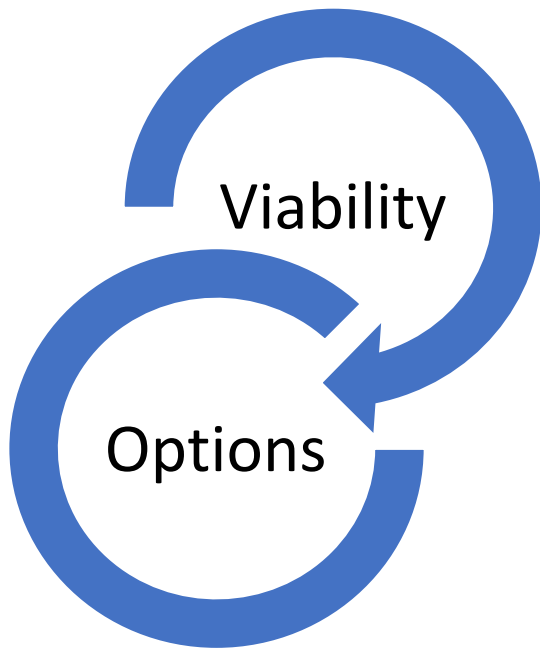
Successful supervisory role of management body is demonstrated when NEDs are able to provide feedback on:

Stress Test evaluates viability of balance sheet in an idiosyncratic or market wide stress;

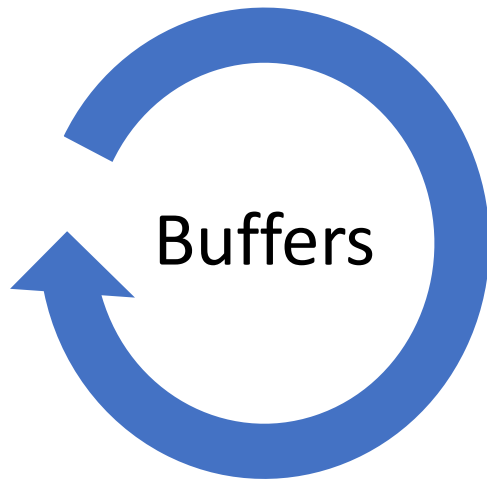
- How did you ensure the scenario was severe but plausible and applied appropriately to the balance sheet?
- How did you demonstrate understanding of how the balance sheet reacts in a stress?

Recovery Plan sets out what options are available to the Board when a stress hits to mitigate the impact of a stress;

- How did you evaluate whether the recovery actions are plausible and effective in a stress scenario?
- How did you assess the net impact of the stress and recovery actions on the balance sheet?



Non Executive Directors, Stress Test and ICAAP/ILAAP (1/2)



Management Buffer / (P2G) –to be held over minimum capital requirements to ensure the bank can meet its minimum capital through an economic cycle;

- What is the risk appetite of the Board for its balance sheet in a stress?
- How did you evaluate and set out management actions required in a stress?
- How did you determine what P2G is required? Or any other management buffers you have applied?

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The Role of the NED in the oversight of a 3 Lines of Defence model

Ruth Grioli

Nikolaos Grapsas

Banking Supervision



What is the MFSA looking for in an interview with NEDs?

NEDs might be asked:

- to explain how they have ensured that the quality and quantity of resources are adequate in the second and third line
- to explain how they use the reports from the risk, compliance and audit functions to gain an insight on the risk profile
- to provide examples of how the internal governance is effective in supporting Board decision making



What makes for good quality Board reporting?



- Risk Reporting – we are expecting NEDs to be able to demonstrate how they ensure that quality risk reports are digestible and used in Board meetings.
- Compliance Reporting – Directors should indicate in which ways the Compliance Report is providing Directors with the necessary assurance of an effective Compliance function in place.
- Internal Audit – the Board will only be able to claim to the regulator it has an effective 3 Lines of Defence model if it can evidence that the IA function is operating effectively.
- Culture – very good quality reporting allows the NEDs an insight into the culture of the bank e.g. through staff feedback, IA actions outstanding, amount of training offered, customer satisfaction data.

What other evidence supports efficiency of NEDs ?



- Evidence provided by Senior Executives where they have been challenged at Board over proposals;
- Quality regulatory documents – e.g. ICAAP, ILAAP, Recovery Plan, Board Succession Plan;
- Evidence in the minutes of meetings that appropriate time and attention is given to regulatory matters;
- Results of self-assessment of the 3LoD model performance;
- Promotion of regular training sessions for the Control Functions and the NEDs

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The MFSA's Minimum Engagement Level for banks and interviews with Non Executive Directors

Anton Mahkats, Deputy Head
Caroline Porter, Senior Manager



Minimum Engagement Level (MEL)



Purpose

- MFSA evaluation of business performance and controls risks
- Follow up to SREP actions
- Opportunity for discussion on policy issues, regulation or to horizon scan

Schedule

- Board Chair – annual catch up with Head of Supervision
- Chair of the Audit Committee
- Chair of the Risk Committee
- Chief Executive Officer
- Chief Risk Officer
- Chief Financial Officer
- Internal Auditor
- MLRO Interview

Top 5 Agenda Points for Board MEL Meetings

Chair	Risk	Audit
Maintaining appropriate skillsets on the Board to oversee business performance and risks	Risk appetite and links to business plan	Performance against business plan including profitability
Evaluating management performance including the CEO	Oversight of the ICAAP, ILAAP, Recovery Plan and Stress Testing	Cost Management (staff, IT, operations)
Board's view of ICAAP and ILAAP	Topical Regulatory Risks (e.g. credit risk, climate change)	Provisions
Outlook for business performance	Adequacy of the second line risk function / risk reporting	Adequacy of the third line Internal Audit function / IA annual report
AML/CFT Controls	AML/CFT Controls	Annual Results / External Audit

Areas of Governance that Boards could focus on given observations from our 2020 Governance Thematic Review

- Ensure debates at Board level provide NEDs with a good understanding of the bank's strategy and risk profile;
- Consider what induction training and ongoing development is provided for NEDs;
- Conducting bi-annual suitability assessments to evaluate board performance / NED bilaterals with Chair;
- Ensure the number of board members is sufficient to cover the risk profile of the bank;
- Document areas of challenge and debate in the board meetings in minutes;
- Require information to support inform your view on the adequacy of resources in the second and third line;
- Consider what risk reporting you need from management and tell the regulator how it informs your judgement;
- Actively review the audit plan and ask for an annual Internal Audit report on the bank's risk profile.

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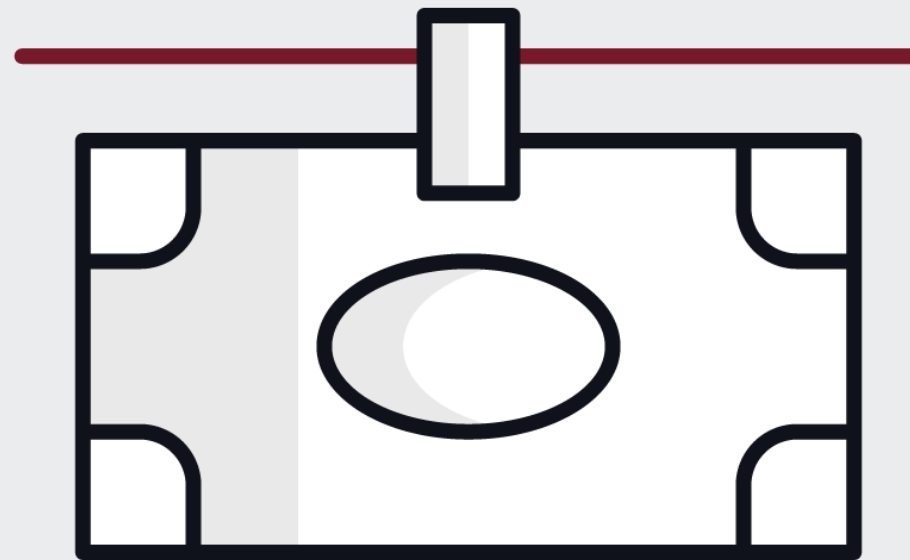
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AML Challenges Facing Banks and Expected Standards

Kurt Spiteri Lucas, Senior Analyst

Eric Micallef, Analyst

Financial Crime Compliance



Scope



- Instilling a heightened Financial Crime Compliance Culture.
- NEDs are not excluded from being aware of financial crime matters.

NEDs should ensure the Adequacy of Their AML/MLRO Function

Supervisors often query the following questions to establish how a bank is satisfying itself by ensuring that its Financial Crime-related functions are adequate:

- What is the bank doing to attract and develop qualified staff?
- How do you satisfy yourself that the bank's MLRO function has sufficient seniority and what evidence have you got that their work has an impact on business decision?
- What actions is the Board taking to appropriate staff training?



How are NEDs Remaining Aware of How Banks are Not Exposed Financial Crime Risks?

NEDs should seek evidence from:

- Reports on the adequacy of your CRAs and application of your policy framework; including policies regarding Anti-Bribery and Corruption;
- Feedback on the BRA;
- Whether backlogs in reviews are being dealt with or internal audit actions followed up;
- Independent reviews of the transaction monitoring and suspicious transaction reporting systems;
- Feedback on the bank has appropriate customer data repositories;
- Feedback on the IT systems, ensuring they are not old and limited in their interface capabilities.



NEDs Should See Evidence Demonstrating Their Bank is Compliant with International Sanctions

- Sanctions are an integral part of the fight against financial crime.
- NEDs should be aware of a bank's sanctions procedures.
- OFAC Sanctions.



Supervisors will ask what evidence you are using to satisfy yourselves that the bank is compliant?

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Summary of the day and an international perspective

Nick Dexter
10 May 2021



Some thoughts on today

- **Role of the NED**
- **Regulatory relationship**
- **AML challenges**
-

UK Senior Managers and Certification Regime (SM&CR)

- **Senior Managers Regime (SMR):** the most senior decision-makers at the firm must be assessed as fit and proper, have clearly defined responsibilities and be subject to enhanced conduct requirements;
- **Certification Regime:** for key risk-taking employees below the top tier, firms need to determine on appointment and then certify annually that they are fit and proper to undertake their roles;
- **Regulatory references:** as part of the hiring process for senior decision-makers and key risk-taking employees, firms must exchange mandatory employment references, containing information on prior conduct; and
- **Conduct Rules:** all financial services staff are subject to minimum conduct standards requiring, among other things, that they act with integrity and due skill, care and diligence

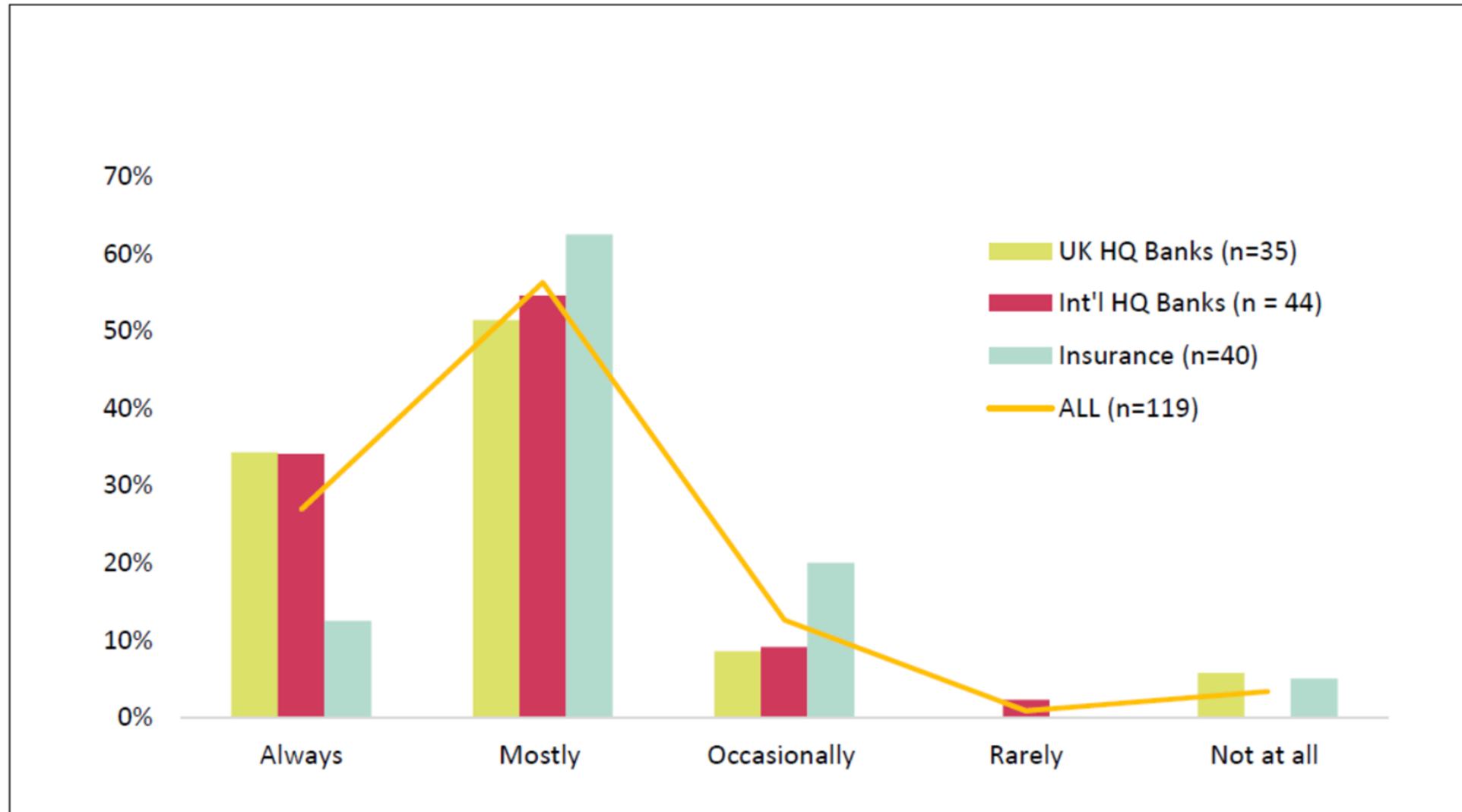
PRA's expectations of boards

The PRA expects the boards and management of regulated firms to run the business prudently, consistent with the firm's own safety and soundness and the continuing stability of the financial system.

The desired outcome from a regulatory standpoint is an effective board, which is one that:

- establishes a sustainable business model and a clear strategy consistent with that model;
- articulates and oversees a clear and measurable statement of risk appetite against which major business options are actively assessed; and
- meets its regulatory obligations, is open with the regulators and sets a culture that supports prudent management.

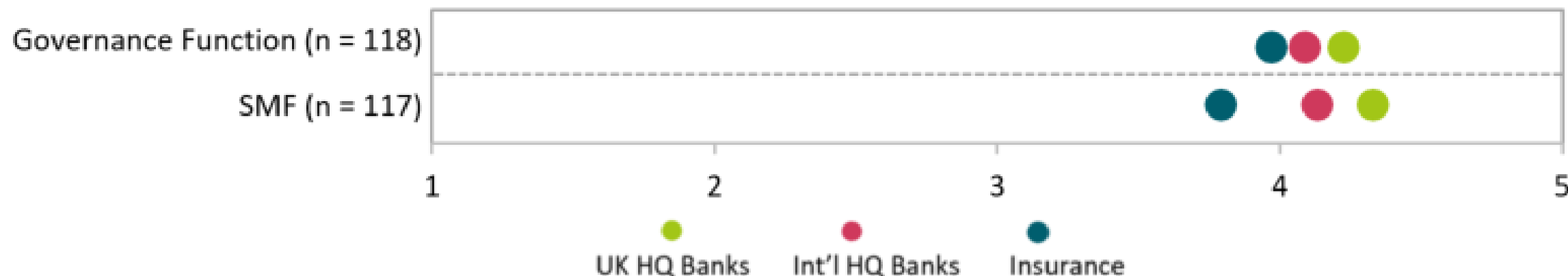
Has the SM&CR been integrated into firms' business-as-usual practices in ways that go beyond simple regulatory compliance?



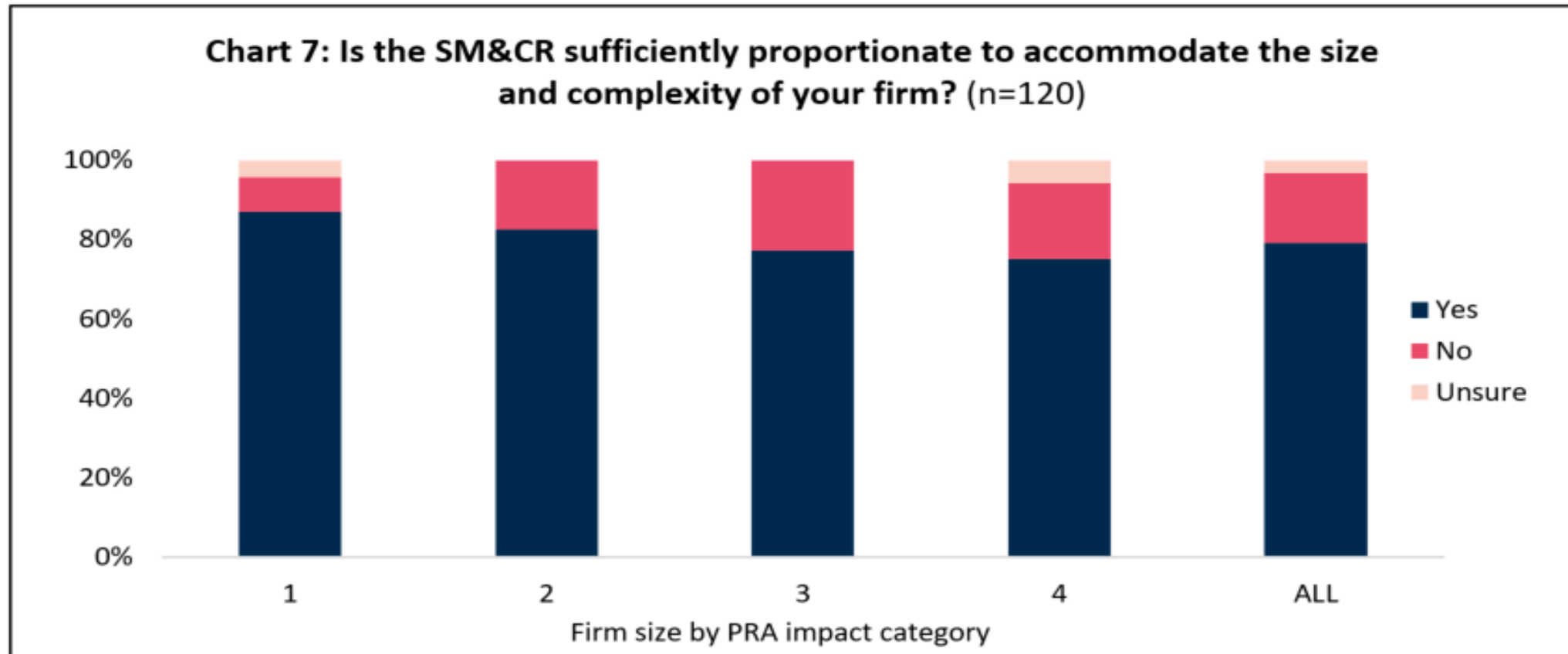
Accountability of individual directors

Do the specific accountabilities of individual directors established by the Senior Managers Regime work in a way that complements the collective responsibility of the board of directors?

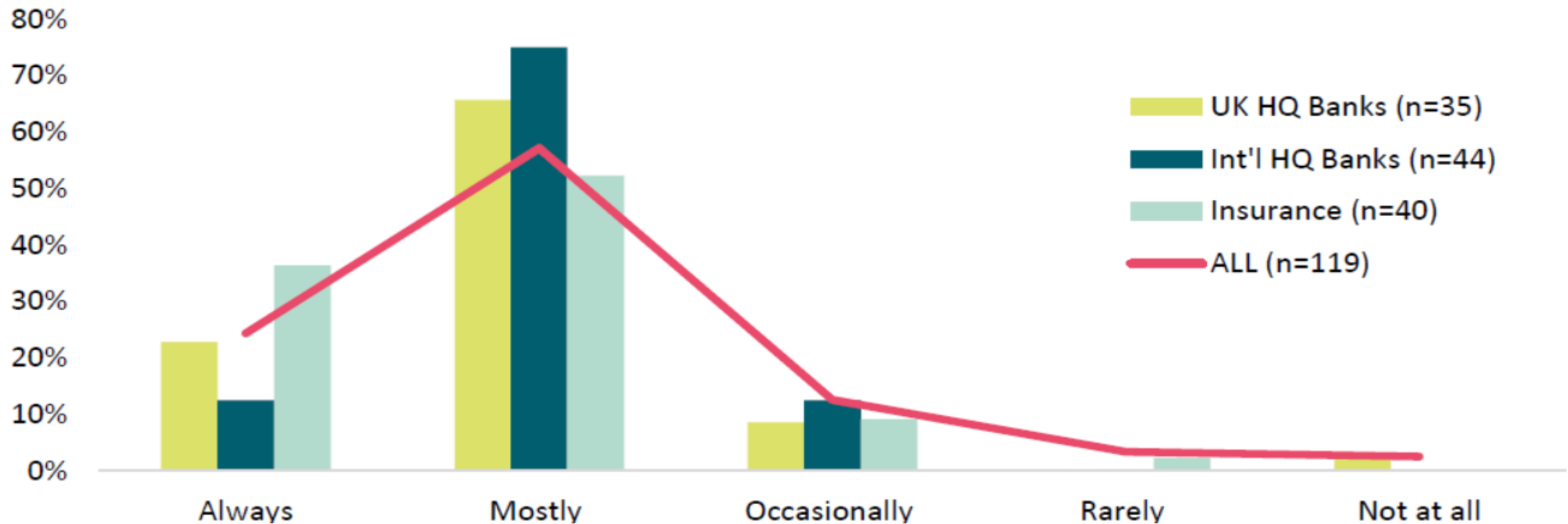
(1 = strongly disagree, 5 = strongly agree)



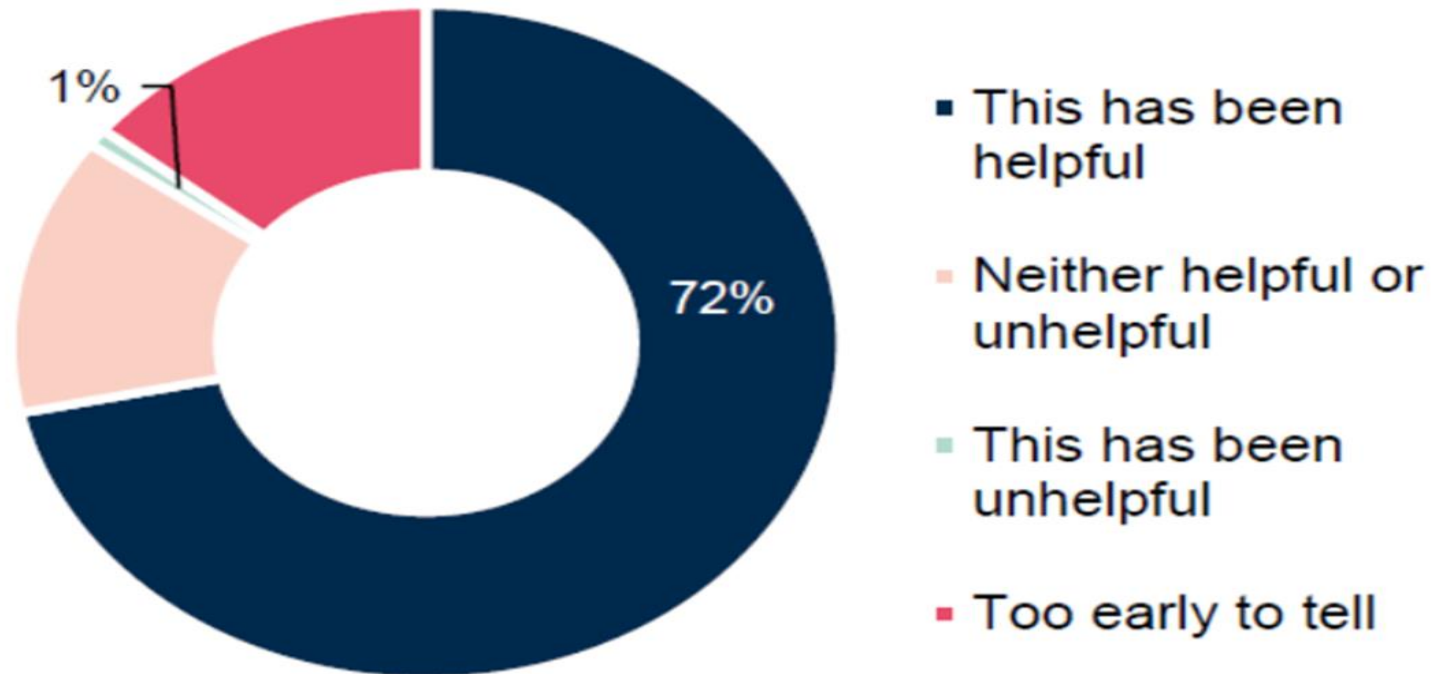
Ensuring the SM&CR is flexible enough for different business models



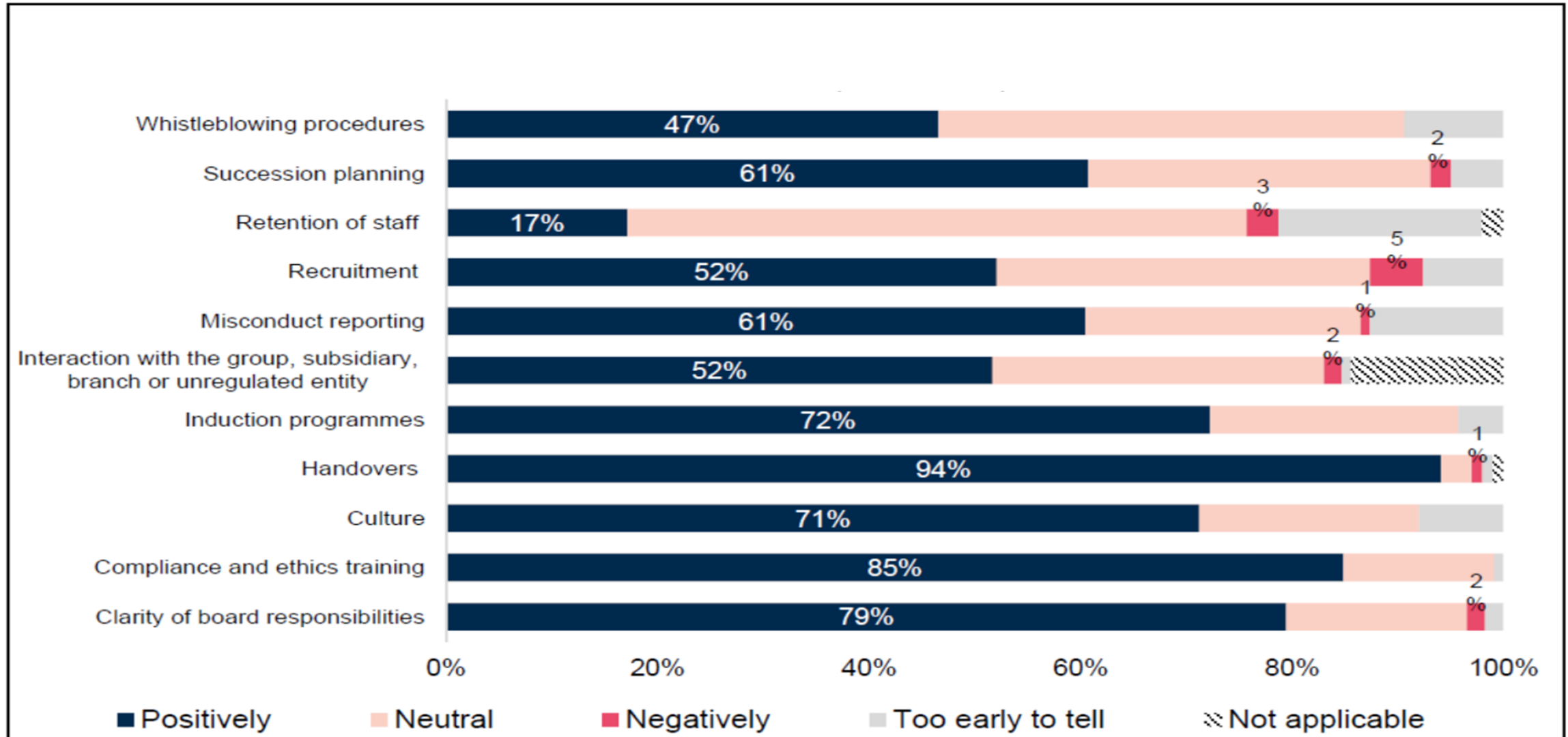
Has the SM&CR made it easier for your firm to hold individuals to account?



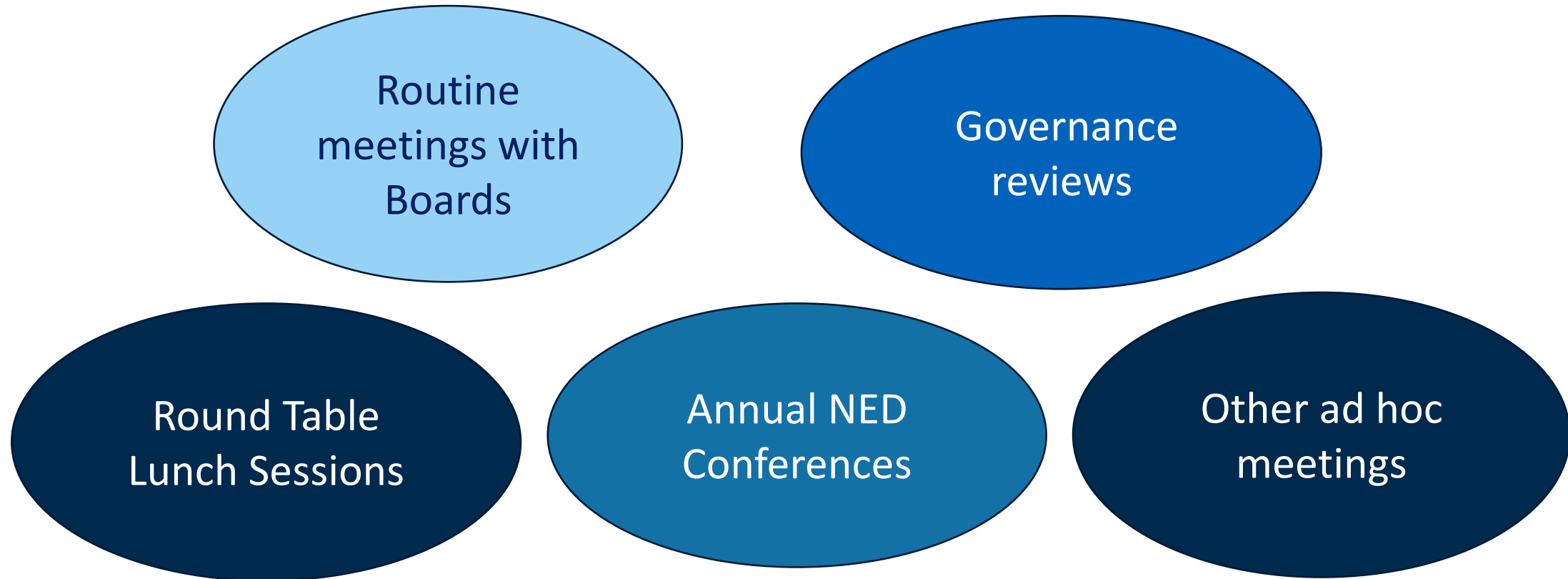
How helpful have these requirements and guidance been in clarifying responsibilities in your firm?



How have different areas of your firm been affected by the SM&CR?



Regulators' Interaction with the Board



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