Good Practice Guidance for Member Firms

Topic: **Corporate Governance**

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About AFEP
Founded in 2012, AFEP works on behalf of its members to be the representative body for Authorised Payment and Electronic Money Institutions. Our mission is to elevate the standards of the FX and e-money industry, and advocate on behalf of our members with regulators and government bodies.

Background

In August 2018 the FCA opened consultation on applying the FCA's Principles for Businesses to payment services and e-money sectors, as well as applying communication rules to advertising and communication (CP18/21). The outcome of this consultation was issued on 1st February 2019 by the FCA as the 'General standards and communication rules for the payment services and e-money sectors' (PS19/3).

In preparation for this in late 2018, the AFEP Executive Committee began writing industry guidance on several key topics to act as good practice for our industry. As this good practice guidance has significant impact on how FX, e-money and payment services firms are encouraged to operate and how AFEP works with the FCA, AFEP worked with members to write this good guidance through working groups and Round Table sessions.

Good Practice Guidance documents have been written and issued to members on the following topics:

1. Communications with customers (currency convertors & disclosure)
2. Safeguarding
3. Customer interests & Conflicts of interest
4. AML
5. Corporate Governance

AFEP recognises the importance of members not only adhering to FCA and other legislation but also these Good Practice Guidance documents. Member firms are required, as a condition of membership, to confirm they are using the Good Practice Guidance and applying it to their business to ensure quality and compliance with the regulations.

This is high level guidance as it is for each firm to determine how to comply with the requirements as relevant to their business model. This guidance is intended for Authorised Payment Institutions (API's) and Authorised Electronic Money Institutions (AEMI's) who are full members of AFEP. This guidance is designed to assist members, and the FCA approach documentation and legislative requirements should always take priority. Members are encouraged to take their own independent advice to ensure they are meeting requirements.

What is corporate governance?

A commonly cited definition of corporate governance is:

"Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship."[1]

The Financial Reporting Council's UK Corporate Governance Code ("the Code")

The Code is perhaps the best known statement of good corporate governance in the UK.[2] It applies to companies with a premium listing on the London Stock Exchange and contains a number of high level "Principles" alongside more specific "Provisions". Listed companies are obliged either to comply with the Code or explain why they have not done so.

Notwithstanding its limited formal application, the Code is a valuable resource for small and large firms alike. In this statement we summarise the Principles and Provisions and provide examples of good and poor practice with the aim of helping member firms, whatever their size and complexity, to implement good corporate governance in a way which is practical and proportionate.

The Code is divided into five chapters: "Board Leadership and Company Purpose", "Division of Responsibilities", "Composition, Succession and Evaluation", "Audit, Risk and Internal Control", and "Remuneration".

Board Leadership and Company Purpose

The Principles relevant to Board Leadership and Company Purpose state that a successful company is led by an effective and entrepreneurial board, whose role is promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society. They also stress that the board should establish the company's purpose, values and strategy; make sure adequate resources are made available for the company to meet its objectives; and establish a framework of prudent and effective systems and controls which enable risk to be managed.

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[1] Cadbury Committee on the Financial Aspects of Corporate Governance (1992). The Cadbury Committee was established in 1991 due to long-standing concerns regarding standards in financial reporting and accountability. The product of its work has grown into what is now the UK Corporate Governance Code, which applies to all companies with a premium listing on the London Stock Exchange.

[2] Although there are many other relevant materials which firms may also wish to consider. These include the FCA's Senior Managers and Certification Regime; the statements of directors' duties to be found in the Companies Act 2006; the UK Stewardship Code, which contains details of good practice for institutional investors when interacting with UK listed companies; the Companies (Miscellaneous Reporting) Regulations 2018; the Wates Corporate Governance Principles for Large Private Companies; the FRC Guidance on Board Effectiveness (July 2018); the FRC report on corporate culture and the role of board (July 2016); the FRC Guidance on Audit Committees (April 2016); the FRC Guidance on risk management and internal controls (September 2014); and the Quoted Companies' Alliance's Corporate Governance Code for Small and Mid-Size Quoted Companies, a set of voluntary corporate governance guidelines for AIM-listed companies; and FSA Finalised Guidance FG11/04 on governance in retail firms (March 2011). This is not an exhaustive list.

	Good practice	Poor practice
1	Create a company statement that drives the firm's culture to achieve its goals, communicating to all areas of the business regularly about direction of the firm, issues and opportunities.	Lack of understanding by staff of what the company is seeking to achieve, its attitude to risk and its relationships with stakeholders.
2	Regular assessment of quality MI by the Board to allow effective monitoring of performance.	Poor quality MI considered by Board at meetings which are not properly minuted, leading to badly informed decisions being taken for unclear reasons.
3	Provide a means for the workforce to raise concerns in confidence and, if they wish, anonymously.	Staff feeling unable to voice good faith concerns held about what they see and hear in the workplace.
4	Good quality board minutes recording any instances where directors have concerns about the operation of the board or the management of the company that cannot be resolved.	Lack of record keeping noting the rationale for decisions.

Division of Responsibilities

The Principles cited under the Code's Division of Responsibilities heading say that the board should contain an appropriate combination of executive and non-executive directors, with a chairperson responsible for leading the board, exercising objective judgment and promoting a culture of openness and debate. In larger firms, no one person or small group of individuals should wholly dominate the board's decision making.

	Good practice	Poor practice
1	Responsibilities of board members and committees should be clear, set out in writing and made available throughout the firm.	Confusion where individuals have oversight of a number of tasks, each carrying a degree of significance in the firm, i.e. Finance Manager oversees Compliance.

2	Delegate authority for different roles and demonstrate the division of responsibilities in an organisational chart.	Failure to document and disseminate divisions of responsibilities.

Composition, Succession and Evaluation

The relevant Principles here state that appointments to the board should be subject to a formal, rigorous and transparent procedure, with an effective succession plan being maintained for the board and senior management, and that the board and its committees should have a combination of skills, knowledge and experience.

	Good practice	Poor practice
1	Critical consideration of the skill sets needed to create a balanced board, and making sure the board is composed of people who are suitably qualified to assess the risks and opportunities to which the business is subject (e.g. emerging threats such as cyber attacks).	Lack of focus or transparency regarding criteria for board appointment.
2	Maintaining a policy on diversity and inclusion, its objectives and linkage to company strategy, and how it has been implemented.	Monopolisation of decision making or perspectives within boards of larger firms.

Audit, Risk and Internal Control

The Code notes under this heading that the board should establish formal and transparent policies and procedures to ensure the independence and effectiveness of internal and external audit functions, satisfying itself of the integrity of financial statements and establishing procedures to manage risk, oversee the internal control framework, and determine the nature and extent of the principal risks the company is willing to take in order to achieve its long-term strategic objectives.

	Good practice	**Poor practice**
1	Seek periodic audits, e.g. financial, safeguarding (PSD2), security (PSD2), AML.	Lack of systematic auditing across various business areas.
2	Explain the lines of defence, e.g. a small firm may not have an internal audit function.	Unable to explain systems and controls.
3	Have a clearly articulated risk appetite understood throughout the business.	Board has not set a risk appetite.
4	Evidence how outsourced functions are monitored and controlled.	Lack of proper oversight of third parties to whom functions outsourced.

Remuneration

Remuneration policies and practices should be designed to support the strategy and long term success of the firm, with executive remuneration aligned to company purpose and values and subject to a transparent and formal procedure.

	Good practice	Poor practice
1	Formal policies on workforce remuneration which ensure that incentives and rewards are aligned with culture.	Opaque criteria used to determine remuneration.
2	Remuneration schemes which promote long term shareholdings by executive directors which align with shareholder interests.	Improper discretionary considerations influencing remuneration.
3	Remuneration schemes should enable the use of discretion to override formulaic outcomes, and include provisions allowing the company to recover and / or withhold sums or share awards in certain specified circumstances.	