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LETTER SENT TO ALL: MICROCREDIT INSTITUTIONS
OTHER STAKEHOLDERS

Dear Sir or Madam,

Minimum Expectations for Corporate Governance Framework in Microcredit Institutions ("MCIs")

The Microcredit Act ("the Act"), which was passed into law in January 2021, accorded Bank of Jamaica ("the Bank") with supervisory responsibility for microcredit institutions ("MCIs") operating in Jamaica. In particular, the Bank is responsible for the ongoing supervision of MCIs with the primary objective of minimizing the likelihood of the sector being used as a conduit for money laundering ("ML") and terrorism financing ("TF"), as well as of ensuring that MCIs maintain adequate standards for market conduct.

At this stage of the licensing and supervisory process, the Bank considers it imperative to apprise MCIs of the expectations and standards of a good corporate governance framework. Corporate governance refers to the combination of rules, processes or laws by which MCIs are operated, regulated and controlled. Good corporate governance ensures that mechanisms are instituted and operationalized to strike a balance between the management and control of the organization and the needs of stakeholders. It is the Bank's minimum expectation that corporate governance frameworks adopted by MCIs will reflect the principles of fairness, responsibility, transparency, accountability, corporate integrity, and compliance with regulations ***(see Appendix I)***.

A good corporate governance framework also places great emphasis on the importance of the Board of Directors as a governing body[1] ***(see Appendix II for the responsibility of the Board of Directors)***. Directors should possess the necessary skills and experience to contribute to the work of the Board of Directors. Furthermore, international best practice distinguishes between different categories of directors according to the degree to which such directors are involved in, or related to the affairs of the institution, and divides the directors into three categories of

[1] The Board of Directors is the body responsible for representing, administering, managing and supervising the institution and assumes the broadest powers in all of those areas of the institution.

executive, non-executive and independent directors ***(see Appendix III)***. In light of the aforesaid, it is the Bank's expectation that the composition of the Board of Directors ("the Board") adopted by MCIs will ensure a balance of skills and experience as may be deemed appropriate and desirable in congruence with the size, complexity and risk profile of the MCI. Section 29(a) of the Microcredit Act outlines that the Board of Directors is responsible for corporate governance and the business performance of the MCI. Therefore, it is the Bank's minimum expectation that the number of directors on the Board must not be less than three (3) for micro and small sized MCIs. However, for MCIs which are managing large books of business, as defined by gross loans, it is the Bank's expectation that the minimum number of members of the Board must not be less than five (5). In both instances, the number of independent directors of the Board must be at least one-third (1/3) of the total number of directors ***(see Appendix IV)***.

It is important that there be a full separation between administration and management duties and responsibilities so that each body carries out its duties with the highest efficiency. Therefore, members of the Board of Directors are responsible for the general strategy, control and oversight and must not interfere in the general management activities to which the Board of Directors must delegate the institution's management. Moreover, it is the Bank's expectation that the separation among administrative, management and governance duties must never result in important decisions or measures being taken by the institution's management bodies without the Board of Directors' knowledge and non-objection. Furthermore, international best practice requires that the roles of the chairperson and the Chief Executive Officer ("CEO") be separated. In so doing, the separation of the roles of chairperson and CEO increases the Board's independence from management and leads to better monitoring and oversight. When the CEO is also the chair, a conflict of interest arises as the CEO manages the institution and the chair leads the board in overseeing (including hiring, compensating, and replacing as necessary) the CEO. Thus, it is the Bank's expectation that there be a clear division of responsibilities between the chairperson and the Chief Executive Officer (***see Appendix V for the separation of responsibilities***).

Importantly, it is the Bank's expectation that MCIs will establish a compliance function whose purpose is to ensure that the operation of the MCI is compliant with all regulatory and legal requirements, as well as the approved policies of the business operations. In that regard, compliance risk is defined as the risk of legal or regulatory sanctions, material financial loss, or loss to reputation that an institution may suffer as a result of its failure to comply with laws, regulations, rules, related approved policies and standards on the business operations, and codes of conduct applicable to personnel related to the business. Further, the individual with responsibility for the compliance function – sometimes referred to as the Nominated Officer – must establish and operationalize the policies, procedures and reporting arrangements which are in congruence with the needs and size of the institution, and are aligned with the MCI's risk management strategy and structure. The main purpose of the compliance function is to support the MCI's efforts to comply with all regulatory and legal requirements and uphold high standards of honesty and integrity.

By the same token, it is the Bank's expectation that MCIs will implement an Internal Audit function[2] by developing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and corporate governance processes. As such, internal audit evaluates the control environment, assesses risks and components of risk management, communicates these findings to the Board, through the audit committee, and makes suggestions for improvement. An internal audit does not only cover the MCI's finances, but also its operations, systems, and procedures. Thus, internal audit helps MCIs accomplish their objectives by introducing a systematic, disciplined and independent approach to the evaluation and improvement of the effectiveness of risk management, control, and corporate governance processes of the MCI.

The Act enshrines the conduct of regulation and supervision of the MCI sector using a risk-based approach which embraces, among other things, the fact that satisfactory governance arrangements will differ across MCIs in the sector based on the size, complexity and the inherent risk profile of each MCI. In this regard, while international best practice suggests that the separation of audit and compliance oversight ensures that each function has the sufficient resources to carry out its respective responsibilities when reporting into the independent members of the board, in the instance of micro and small sized MCIs, the functions of the Nominated Officer and internal audit could be undertaken by the same officer.

Should you have any queries or concerns in relation to the foregoing, please contact Miss Janice Smith at Janice.Smith@boj.org.jm or at (876) 922-0750 (ext. 2908). Electronic correspondence should be copied to microcredit@boj.org.jm.

Please be guided accordingly.

Yours sincerely,

Jide Lewis

Jide Lewis (Mr.) Ph.D., CFA, FRM
Chief Prudential Officer
Financial Institutions Supervisory Division

Attachment: Appendices (I – V)

c. Miss Maurene A. Simms, Deputy Governor
Miss Wainet Fearon, Division Chief
Major Keron Burrell, Deputy Division Chief
Miss Janice Smith, Head, Microcredit Regulatory Oversight

[2] Internal audit is an independent, objective assurance and consulting activity designed to add value and improve an institution's operations.

APPENDIX I – PRINCIPLES OF GOOD CORPORATE GOVERNANCE

It is the Bank's minimum expectation that MCIs' corporate governance framework ("CGF") will build on the following principles:

1. **Fairness** – the corporate governance framework must protect shareholders' rights and ensure the equitable treatment of all shareholders, including minority shareholders. All shareholders should have the opportunity to obtain effective redress for violations of their rights. In that regard, the CGF must guarantee the fair treatment of all shareholders, including minority shareholders' rights.
2. **Responsibility** – the CGF for administrators and senior executives must aim at creating long-term, sustainable value for shareholders and other stakeholders.
3. **Transparency** – the CGF must ensure that timely and accurate disclosure is made of all material matters regarding the institution's affairs, which includes performance, ownership, financial status, and governance structure. In addition, the CGF must promote confidentiality, integrity, fluidity, and transparency in the microcredit sector.
4. **Accountability** – the CGF must ensure that proper channels are in place in relation to the strategic guidance of the MCI, the effective monitoring of management by the Board, and the Board is accountable to the MCI and its shareholders.
5. **Honest and integrity** – the CGF must ensure that its members and representatives act in good faith in the general interests of the institution, honestly and rigorously. It should also promote honorable and impeccable behavior based on the belief that without integrity, customer, stakeholder and the institution's trust is impossible.
6. **Compliance** – the CGF must ensure that its members and the operation of the institution complies with all legal and regulatory requirements, as well as its approved policies and standards.

APPENDIX II - THE ROLES AND RESPONSIBILITIES OF THE BOARD OF DIRECTORS

It is the Bank's expectation that the responsibilities of the Board of MCIs will include, but will not be limited to the following in effectively discharging its responsibilities:

1. Assuming overall responsibility and accountability of the affairs of the MCI. In that vein, the Board must establish the strategic direction, governance framework and corporate culture; and must ensure compliance with regulatory requirements.
2. Approving and overseeing the implementation of the MCI's overall business strategy with measurable goals.
3. Approving and implementing the MCI's governance framework that is commensurate with the size, complexity, business strategy, risk profile of the MCI, and regulatory requirements.
4. Assessing the effectiveness of its governance framework periodically.
5. Appointing the Chairperson and the CEO and defining the roles and responsibilities of such members.
6. Ensuring that there is a sound corporate culture within the MCI, which reinforces ethical, prudential and professional behavior.
7. Leading in the establishment of the MCI's corporate culture and values, including developing codes of conduct, policies and procedures for the management of conflicts of interest.
8. Establishing and reviewing the institution's Risk Appetite Statement in congruence with its business strategy and governance framework.
9. Ensuring the implementation of systems and controls to identify, mitigate, and manage risks prudently.
10. Establishing policies in relation to Board commitment and competency.
11. Establishing policies and procedures in relation to the oversight of senior management.
12. Adopting appropriate policies and procedures that are in adherence to the legal and regulatory frameworks.

APPENDIX III – CATEGORIES OF DIRECTORS

Executive Directors

1. Executive Directors of an MCI must only comprise of directors who also hold executive positions in the MCI. This typically includes:
    a. The CEO;
    b. The CFO; and
    c. Other executive manager of the MCI.
2. Members of the Board who also have management responsibilities are considered as executive directors.
3. It is the Bank's expectation that only an employee of an MCI must be nominated, elected and/or appointed as an executive director of the MCI, and the executive directors must have functional reporting lines in the organizational structure of the MCI.

Non-Executive Directors

4. Non-executive directors of an MCI refer to Board members who do not hold executive positions in the MCI. These directors are valued for their subject matter expertise and industry experience in effectively overseeing the management of the MCI. It is the Bank's expectation that effective non-executive directors must portray the following attributes:
    a. integrity and high ethical standards;
    b. sound judgment;
    c. the ability and willingness to challenge and probe; and
    d. strong interpersonal skills.
5. It is the Bank's expectation that these directors must possess credible track records, and have necessary skills, competency and experience to bring independent judgment on the issues of strategy, performance, resources and standards of best business practice and conduct. Furthermore, it is the Bank's expectation that a non-executive director must not be appointed or function as an executive director of the MCI.

Independent Directors

6. Independent directors of an MCI refer to Board members who have no direct or indirect connection or relationship with the MCI other than their board membership. In that vein, these directors must;
    a. Not be employed by the MCI or its affiliates or be a director of any of its affiliates;
    b. Not have 20 per cent or more of the shareholder's voting rights;
    c. Not be a shareholder of the MCI owning 20 per cent or more of the MCI's shares or that of another MCI;
    d. Not have an immediate relative[3], who is a director or senior manager of the MCI or who holds shares amounting to 20 per cent or more of the voting rights of the MCI.
    e. Not have been paid or received a substantial amount or been a major shareholder of a company that has been paid or received from the company a substantial amount of monetary benefits.

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[3] "immediate relative" in relation to any person, means the person's spouse, children (including step children) and their spouses, parents, brothers or sisters;

7. It is the Bank's expectation that these members can make substantial contributions to important decisions regarding the operations of the MCIs, especially in reviewing and making determinations based on reports arising from the Nominated Officer concerning money laundering and terrorism financing risks and reporting emanating from internal audit, evaluating executive performance, setting appropriate remuneration for executives and board members, reviewing financial statements, and resolving corporate conflicts.

APPENDIX IV – COMPOSITE AND SIZE OF THE BOARD OF DIRECTORS

1. It is the Bank's expectation that the number of directors should be guided by the specific needs of the MCI, such as: risk profile, complexity, required skills and its shareholders. In that regard, the MCI must choose a Board of directors' size that will enable it to:
    a. Hold productive and constructive discussion;
    b. Make prompt and rational decisions; and
    c. Efficiently organize the work of its committees.
2. MCIs are being reminded that having either too few or too many directors can be a problem for effective decision-making. In that regard, a small board of directors may not allow the MCI to benefit from an appropriate mix-of-skills and breadth of experience. On the other hand, a larger board of directors is typically more difficult to manage and can make consensus building a time-consuming and difficult task. The challenge in selecting the correct board of directors' size is striking an appropriate balance between the needs, complexity, risk profile and size of the MCI.
3. When deciding on the size and composite of the Board for MCIs, licensees must be categorized into either of the two tiers.
    a. Tier 1 MCIs are required to have gross loans of less than JMD75 000 000.00 or such other value that the Bank may consider appropriate. In this regard, it is the Bank's expectation that the minimum number of members of the Board must not be less than three (3) and the number of independent directors must be at least one-third of the Board.
    b. Tier 2 MCIs are required to have gross loans of JMD75 000 000.00 or greater or such other value that the Bank may consider appropriate. In this regard, it is the Bank's expectation that the minimum number of members of the Board must not be less than five (5) and the number of independent directors must be at least one-third of the Board.

    MCIs are being reminded that the composite and size of the Board in both Tiers are minimum expectations and where the size, complexity and the risk profile of the institution require a greater number of Board members and/or independent directors, the licensee must adopt such composition and size as may be deemed appropriate to the size, complexity and the risk profile of the institution.

APPENDIX V - SEPARATION OF RESPONSIBILITIES FOR THE CEO AND CHAIRPERSON

1. It is the Bank's expectation that the responsibilities of the Chairperson of the Board of MCIs will at least include the following:
   a. Provide leadership to the Board;
   b. Maintain and ensure a balance of powers between executive and non-executive directors;
   c. Secure effective participation of both executive and non-executive directors;
   d. Ensure the Board works effectively and discharges its responsibilities;
   e. Implement decisions or directions of the Bank or any other competent authority;
   f. Ensure key issues are discussed by the Board in a timely manner;
   g. Not engage in activities involving direct supervision of senior management or any other day-to-day operational activities;
   h. Ensure appropriate steps are taken to maintain effective communication with shareholders and communicate the views of shareholders;
2. It is the Bank's expectation that the CEO will function as an executive who is in charge of the day-to-day management of the operations and business of the MCI. In that regard, the responsibilities of the CEO must at least include:
   a. Implementing business and risk strategies in order to achieve the MCI's strategic objectives;
   b. Establishing a management structure that promotes accountability and transparency throughout the MCI's operations and preserves the effectiveness and independence of control functions;
   c. Promoting, in concert with the Board, a sound corporate culture within the MCI, which reinforces ethical, prudent, and professional behavior;
   d. Ensuring implementation of proper compliance culture and being accountable for accurate submission of information to the Bank;
   e. Strengthening the regulatory and supervisory compliance framework;
   f. Addressing the supervisory concerns and non-compliance with regulatory requirements or internal policies in a timely and appropriate manner;