

STAKEHOLDER CONSULTATION ON  
REVISITING THE CORPORATE GOVERNANCE  
FRAMEWORK FOR ENTITIES AUTHORISED BY  
THE MFSA AND LISTED COMPANIES

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## Table of Abbreviations

AML	Anti-Money Laundering
CEO	Chief Executive Officer
CFT	Combatting the Financing of Terrorism
CPD	Continuous Professional Development
CRD	Capital Requirements Directive
EU	European Union
IoD	Institute of Directors
MFSA	Malta Financial Services Authority
MiFID	Markets in Financial Instruments Directive
ML	Money Laundering
MLRO	Money Laundering Reporting Officer
MoU	Memorandum of Understanding
OECD	Organisation for Economic Cooperation and Development
TF	Financing of Terrorism

## Foreword by the CEO



Joseph Cuschieri

Chief Executive Officer

Good Corporate Governance is crucial. It ensures that companies operate transparently, efficiently and effectively, and fosters mutual trust with stakeholders and the general public. In this light, as part of our Strategic Plan 2019-2021, we are seeking to promulgate a comprehensive and enforceable cross-sectoral Corporate Governance framework for all entities authorised by the Malta Financial Services Authority, as well as listed companies.

During the past months we have taken stock of the currently applicable requirements and expectations vis-à-vis Corporate Governance, namely the existing European and Maltese regulatory frameworks. Through this publication we are seeking to put forward the Authority's proposals, seeking feedback, in line with our strategy of enhancing engagement with stakeholders.

This document first outlines how Corporate Governance is addressed at supranational level, and the Corporate Governance framework, which is currently applicable in Malta. Following this overview, we set out our proposal to revisit the existing Corporate Governance framework, with the intention of raising the bar and creating a culture where Corporate Governance is considered as a top priority. The main proposals being made in this regard are: [i] a comprehensive principles-based Corporate Governance Code which is applicable to all entities authorised by the MFSA and Listed Companies, which would then be supplemented by sector-specific rules and complementing guidance notes, in order to ensure that the proportionality principle is applied; [ii] that entities will be expected to 'apply and explain' the high-level principles based code, and to 'comply or explain' how they are following the applicable rules and guidelines; and [iii] proposals for principles to be included within the code, *inter alia* on the Board of Directors, the responsibilities of functionaries and officials, engagement with stakeholders, committees, corporate culture, ethics framework, risk management, as well as other matters, including Anti-Money Laundering and Combatting the Financing of Terrorism, Continuous Professional Development and Corporate Social Responsibility.

We believe that the proposals set out in this document will significantly raise the bar with respect to Corporate Governance in Malta and will ultimately have a positive effect on the financial services industry, encouraging growth and modernisation.

I invite all interested parties to provide feedback, so that together we can put forward a robust framework which enhances Corporate Governance in Malta, in line with our statutory objectives of protecting consumers of financial services and safeguarding market integrity and financial stability.

## 1 Introduction

One of the most comprehensive definitions of corporate governance was provided by the 1992 Cadbury Report whereby it was stated that “Corporate governance is the system by which companies are directed and controlled.”<sup>1</sup> The Basel Committee on Banking Supervision provides a more detailed definition stating that Corporate Governance is “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 are allocated and how corporate decisions are made.”<sup>2</sup> Good corporate governance therefore ensures that companies operate transparently, efficiently and effectively. This enhances their reputation, generates trust amongst stakeholders and, in turn, leads to value generation thus making companies more attractive for capital investment.

As stated in the [MFSA Strategic Plan 2019-2021](#), the Malta Financial Services Authority (‘MFSA’) has signed a Memorandum of Understanding (‘MoU’) with the Institute of Directors (‘IoD’) based in the UK and their local Chapter, the IoD Malta Branch. Whilst the main purpose of the MoU is to improve director education and standards, the Authority and the IoD are also collaborating with a view of drafting a Corporate Governance Code for entities falling within the MFSA’s remit. In this light, the Authority is today issuing this Discussion Paper in order to seek stakeholders’ views prior to drafting the new Code.

The Authority is seeking to create a comprehensive and enforceable framework for all entities authorised by it and listed companies, laying out the expectations for good Corporate Governance applicable cross-sectorally.

Further to this Introductory Chapter, this Discussion Paper has three additional sections as follows:

- Chapter 2 provides an overview of the current requirements and expectations in relation to corporate governance. This Chapter will briefly examine the G20/OECD Principles of Corporate Governance,<sup>3</sup> as well as the existing European and Maltese regulatory frameworks.
- Chapter 3 sets out the Authority’s proposal for a comprehensive regulatory framework for Corporate Governance in Malta with sections on the: [i] scope and application of the Code; [ii] type of Code and its enforceability; [iii] Board of Directors; [iv] responsibilities of the functionaries and officials; [v] stakeholder engagement; [vi] committees; [vii] corporate culture; [viii] ethics; [ix] risk management and [x] other matters.
- Chapter 4 seeks feedback from stakeholders as a conclusion to the discussion paper and outlines the next steps which the MFSA will be undertaking.

It is emphasised that the proposals put forward in this discussion paper are not binding and are subject to changes and revisions following representations received from licence holders and other stakeholders. It is important that persons involved in the consultation bear these considerations in mind.

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<sup>1</sup> The Financial Aspects of Corporate Governance (The Cadbury Report), December 1992, available online at: <https://ecgi.global/sites/default/files//codes/documents/cadbury.pdf>

<sup>2</sup> Basel Committee on Banking Supervision, Guidelines: Corporate Governance Principles for Banks, available online at: <https://www.bis.org/bcbs/publ/d328.pdf>

<sup>3</sup> G20/OECD Principles of Corporate Governance, available online at: <https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf>

## 2 Current Requirements and Expectations

Notwithstanding that the high-level principles underpinning good corporate governance remain constant, trends in both the Financial and Corporate sectors will have an effect on their application. Over the past years, developments such as, for example, the added emphasis on sustainability, the ever-increasing integration of capital markets, the increase in cross-border trade, as well as corporate failures, have strengthened the demand for higher standards of Corporate Governance.

The overview that follows, of how the topic is addressed at a supranational level, and the corporate governance framework, which is currently applicable in Malta, will provide the background for the proposals being made by the Authority through this document.

### 2.1 Corporate Governance at a Supranational Level

#### 2.1.1 G20/OECD Principles of Corporate Governance

The G20/OECD Principles of Corporate Governance may be considered as the benchmark for the evaluation and improvement of Corporate Governance frameworks world-wide. First published in 1999, and reviewed as recently as 2015, the G20/OECD set out the following six non-binding principles, which are designed to support regulators and policymakers in creating an effective framework for Corporate Governance:

“Principle 1 - Ensuring the basis for an effective corporate governance framework - The corporate governance framework should promote transparent and fair markets and the efficient allocation of resources. It should be consistent with the rule of law and support effective supervision and enforcement.

Principle 2 – The rights and equitable treatment of shareholders and key ownership functions – The corporate governance framework should protect and facilitate the exercise of shareholders’ rights and ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

Principle 3 – Institutional investors, stock markets, and other intermediaries – The corporate governance framework should provide sound incentives throughout the investment chain and provide for stock markets to function in a way that contributes to good corporate governance.

Principle 4 – The role of stakeholders in corporate governance – The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs and the sustainability of financially sound enterprises.

Principle 5 – Disclosure and Transparency – The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

Principle 6 - The responsibilities of the Board – The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board’s accountability of the company and the shareholders.<sup>4</sup>

The G20/OECD’s principles provide the guidance necessary to obtain a structured framework which balances the protection of investors and stakeholders with economic efficiency, sustainable growth and financial stability. It also provides flexibility by retaining the possibility of adaptation to different national economic scenarios. This is primarily achieved by providing shareholders, board members and executives as well as financial intermediaries and service providers with the right incentives to perform their roles within a framework of checks and balances. The quality of a corporate governance framework can be assessed against these principles and reference can also be made thereto in the development of more detailed provisions, both mandatory and voluntary, which may take into account country-specific economic, legal, and cultural differences.

## 2.1.2 European Union Legislation

Over the past years, the European Union has issued several legislative instruments regulating the financial services sector. Whilst the various instruments do *inter alia* set out corporate governance requirements at a sectoral level, there is no comprehensive cross-sectoral framework specifically addressing the issue at EU level. In this respect, one may refer to various provisions<sup>5</sup> within, for example, the Markets in Financial Instruments Directive (MiFID)<sup>6</sup>, the Capital Requirements Directive (CRD)<sup>7</sup>, Solvency II Directive,<sup>8</sup> and the Shareholders’ Rights Directive.<sup>9</sup> Furthermore, specifically with respect to disclosure, also of note is Directive 2014/95/EU amending Directive 2013/34/EU regarding “Disclosure of non-financial and diversity information by certain large undertakings and groups”<sup>10</sup> which however applies only to large undertakings as defined by the Directive 2013/34/EU<sup>11</sup> and public interest companies.

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<sup>4</sup> G20/OECD Principles of Corporate Governance, available online at: <https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf>

<sup>5</sup> One will find requirements applicable to the management body of firms, governance arrangements such as organisational structure, policies and procedures which are required to be in place, remuneration, committees, disclosures, fitness and propriety, time commitment etc.

<sup>6</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast) – MiFID II – This framework is applicable to investment services providers.

<sup>7</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC – CRD IV – This framework is applicable to investment firms and credit institutions.

<sup>8</sup> Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) - This framework is applicable to insurance and reinsurance firms.

<sup>9</sup> Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement.

<sup>10</sup> Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.

<sup>11</sup> Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC.

## 2.2 The Maltese Corporate Governance Framework

The main legislative source for Corporate Governance under Maltese Law is the Companies Act.<sup>12</sup> It sets out the types of commercial partnerships available and the applicable requirements for such entities. Specifically, with respect to companies, it *inter alia* establishes the accountabilities of the Board of Directors, the rights of shareholders as well as transparency obligations.

The Companies Act is then complemented by three additional documents: [i] [the Corporate Governance Guidelines for Public Interest Companies](#); [ii] [the Corporate Governance Manual for Directors of Investment Companies and Collective Investment Schemes](#); and [iii] [Appendix 5.1 to the Listing Rules - the Code of Principles of Good Corporate Governance](#).

### 2.2.1 The Corporate Governance Guidelines for Public Interest Companies

The Corporate Governance Guidelines for public interest companies is a set of nine guidelines, applicable to public interest companies.<sup>13</sup> Based on the G20/OECD Principles, these guidelines set out best practices as follows:

“Guideline 1 – The Board – A company should be headed by an effective board, which should lead and control the company

Guideline 2 – The Chairman of the Board – There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company’s business.

Guideline 3 – Directors – The board should be composed of persons who, as a group, have the required diversity of knowledge, judgment and experience to properly complete their tasks. This may require the inclusion of a number of non-executive directors (including independent non-executive directors).

Guideline 4 – The Responsibilities of the Board – The board has the first level responsibility of executing the four basic roles of corporate governance namely: accountability, monitoring, strategy formulation and policy development.

Guideline 5 – Board Meetings – The board should meet sufficiently regularly to discharge its duties effectively. Ample opportunity must be given to all board members during meetings to convey their opinions and discuss issues set on the board agenda so that they honour their responsibilities at all times.

Guideline 6 – Information and Professional Development – The board should [i] actively participate in the appointment of senior management; [ii] ensure that there is adequate training in the company for management and employees; and [iii] establish a succession plan for senior management.

Guideline 7 – Relations with Shareholders – The board shall serve the legitimate interests of the company and account to shareholders fully. Companies should use the general meeting to communicate with shareholders.

<sup>12</sup> Laws of Malta, Chapter 386, Companies Act – available online at:

<http://www.justiceservices.gov.mt/DownloadDocument.aspx?app=lom&itemid=8853>

<sup>13</sup> A ‘public interest company’ is defined in the guidelines as “one of the following three types of companies: (a) a regulated company; or (b) a company that has issued debt securities to the public and whose securities are not admitted to listing on a recognised investment exchange; or a government-owned entity established as a limited liability company.

Guideline 8 – Conflicts of Interest – Directors’ primary responsibility is always to act in the interest of the company and its shareholders irrespective of who appointed them to the board.

Guidelines 9 – Corporate Social Responsibility – Directors should seek to adhere to accepted principles of corporate social responsibility in their day-to-day management practices of the company.”<sup>14</sup>

Being best practices, the above guidelines are not enforceable and allow for flexibility in their application.

### 2.2.2 The Corporate Governance Manual for Directors of Investment Companies and Collective Investment Schemes

Issued in 2014, the “Corporate Governance Manual for Directors of Investment Companies and Collective Investment Schemes”,<sup>15</sup> is a non-binding manual which seeks to raise awareness of directors of investment companies on the importance of good Corporate Governance practices. The Manual sets out best practices on: [i] the role of the director of a fund; [ii] the appointment and resignation of directors; [iii] board size, composition and structure; [iv] board proceedings; [v] the information pack; [vi] the investment management report; [vii] the administrator report; [viii] the custodian report; [ix] the audit report; [x] conflicts of interest and confidentiality; [xi] codes of conduct; [xii] communication with investors; [xiii] AML and CFT; [xiv] indemnity and insurance; [xv] advisors to the board; [xvi] crisis management; [xvii] termination of a fund; and [xviii] issues common to all directors.

### 2.2.3 Appendix 5.1 to the Listing Rules - the Code of Principles of Good Corporate Governance

The Board of Governors of the MFSA also acts as the Listing Authority. In this respect, the MFSA and the Listing Authority should be considered as separate bodies. As per Article 11 of the Financial Markets Act, it is the function of the Listing Authority:

- “(a) to authorise the admissibility of such financial instruments as it considers appropriate to any recognised list;
- (b) to make Listing Rules for the better implementation and purposes of this Part of this Act;
- (c) to ensure compliance with any requirements or conditions set out in Listing Rules for listed financial instruments to remain listed and to monitor the timely disclosure of information by issuers or any other person subject to the Listing Rules with the objective of ensuring effective and equal access to the public in Malta and in all Member States or EEA States where the transferable securities are traded;
- (d) to act as the central competent administrative authority responsible for carrying out the obligations provided for in the Transparency Directive and for ensuring that the provisions adopted pursuant to this Directive are applied and to issue rules in furtherance of its responsibility under any provisions of the

<sup>14</sup> The Corporate Government Guidelines for Public Interest Companies, available online at: <https://www.mfsa.mt/wp-content/uploads/2018/12/MFSA-CG-Guidelines-for-Public-Interest.pdf>

<sup>15</sup> Corporate Governance Manual for Directors of Investment Companies and Collective Investment Schemes, available online at: <https://www.mfsa.mt/wp-content/uploads/2019/02/MFSA-Corporate-Governance-Manual-Sept-2014.pdf>

said Directive which rules shall be binding on issuers, shareholders and any other person as may be indicated in the said rules;

(e) to act as the authority competent to supervise bids for the purpose of the Listing Rules made or introduced pursuant to the Takeover Bids Directive;

(f) to cooperate with ESMA for the purposes of the Prospectus Directive, in accordance with Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010.”<sup>16</sup>

Corporate Governance requirements are also included within the Listing Rules, specifically Appendix 5.1 thereto<sup>17</sup> which provides a Code of Principles of Good Corporate Governance. This Code is an integral part of the Listing Rules and all listed companies, bar Collective Investment Schemes, are expected to “endeavour to adopt the Code of Principles of Good Corporate Governance contained in Appendix 5.1...and shall prepare a report explaining how it has complied with the provisions of the said Appendix.”<sup>18</sup> The Listing Rules therefore take a ‘Comply or Explain’ approach to the Corporate Governance Code as equity-listed companies are required to report how they are complying with or to explain/justify any deviations from the Code.

The Code provides a number of principles, supporting principles and provisions with respect to: [i] the board; [ii] the Chairman and Chief Executive; [iii] composition of the board; [iv] responsibilities of the board; [v] board meetings; [vi] information and professional development; [vii] evaluation of board’s performance; [viii] committees; [ix] relations with shareholders and the market; [x] institutional shareholders; [xi] conflicts of interest; and [xii] corporate social responsibility.

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<sup>16</sup> Financial Markets Act, Chapter 345 of the Laws of Malta, Article 11

<sup>17</sup> Listing Rules, Appendix 5.1, ‘The Code of Principles of Good Corporate Governance’, available online at: [https://www.mfsa.mt/wp-content/uploads/2019/07/20190530\\_FullListingRulesAmendments.pdf](https://www.mfsa.mt/wp-content/uploads/2019/07/20190530_FullListingRulesAmendments.pdf)

<sup>18</sup> Listing Rule 5.94

### 3 A proposal for a holistic regulatory framework for Corporate Governance in Malta

#### 3.1 Introduction

Good corporate governance enhances public confidence and fosters trust between companies, stakeholders and the general public. It also allows directors and executives to focus on growth, value creation and long-term sustainability. The financial crisis has shown how the consequences of poor Corporate Governance can have a domino effect, posing a systemic risk to the financial stability of the entire global economy. In this respect, the review of the Corporate Governance framework in Malta can be considered as complementary to the MFSA's mission of protecting investors as well as other stakeholders and ensuring the stability and integrity of the financial markets.

Through this discussion paper, the MFSA is seeking stakeholders' views on its proposal to revisit the existing corporate governance framework, with the intention of raising the bar by creating a culture where good corporate governance is considered as a top priority by any given entity. The MFSA is seeking to: [i] enhance the effectiveness of existing provisions, given that these are still relevant today; [ii] introduce new provisions, where necessary, in order to address recent developments; [iii] introduce the enforceability of certain aspects of the framework.

The Authority believes that the proposals which are set out in this document will have a positive effect on the manner in which MFSA authorised entities and Malta-listed Companies are perceived, both domestically and within the international scenario and will subsequently facilitate business growth, access to finance, investment and other services/resources which will support modernisation and expansion. In this respect, having higher corporate governance standards will also make Malta a more attractive place to invest in.

#### 3.2 Scope and Application

Prior to discussing the substantive principles which will be proposed for inclusion within the new Code, it is submitted that a discussion on its scope and application is merited.

It is being proposed that one comprehensive Corporate Governance Code which is drafted in simple and clear language, using layman's terms to every extent possible, is issued. It will be applicable to all entities authorised by the MFSA and Listed Companies. The Authority is cognisant that entities' approach to corporate governance will depend on the nature, size and complexity of its business, operating environment and stakeholders. In this respect, whilst the Code will be principles-based, further detail and guidance will be provided in the form of guidance notes, or within rules and this will ensure that a 'one size fits all' approach is not adopted and that the proportionality principle<sup>19</sup> is applied. In this respect, whilst the Code itself will be applicable cross-sectorally, the possibility of having sector specific guidance/rules would be retained.

Further to the above, as explained in Section 2.1.2, European legislation contains several provisions which seek to ensure corporate governance, which are directly applicable or respectively transposed in sectoral legislation or rulebooks. In this respect, the proposals which are being put forward in this document are intended to complement the already existent framework and should any conflict arise

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<sup>19</sup> In this respect the proportionality principle may *inter alia* be implemented in terms of [i] size and complexity of the business of the entity in question; [ii] type and nature of the business of the entity; and [iii] the risk posed by the entity to consumers and the stability and integrity of the financial markets.

between existent legislation and the Code (and any Rules or Guidance Issued thereunder), the former will take precedence over the latter.

Taking Listed Companies as an example, the Corporate Governance Code would be applicable; however, the Code will not in any way impinge on the governance provisions found within the applicable sectoral framework, such as the Listing Rules – these would still apply. Furthermore, should any conflict arise it would be the sectoral framework which applies; if the sectoral framework is silent on a particular matter, the provisions of the Code or guidelines thereto would apply.

**Q1** What are your views on the proposed approach?

### 3.3 Type of Code

Corporate governance codes may take one of three approaches, as follows:

- a) 'Comply or Else' – This is a traditional top-down approach where mandatory principles are set out by a central Authority and companies must comply with them or face enforcement action;
- b) 'Comply or Explain' – The adoption of this approach leaves room for companies to choose whether they should comply with the rules set out or whether they should explain to stakeholders the reasons for non-compliance; and
- c) 'Apply and Explain' – Under this approach, compliance with a set of principles is assumed and entities are expected to explain how they are complying with the said principles, to the various stakeholders.

In view of the above, corporate governance codes may be: [i] rulesbased – this is a mandatory or prescriptive approach to governance practices and tends to focus upon compliance requirements; [ii] principles-based – this approach provides the high-level principles and provides more flexibility than the more prescriptive rules-based approach; or [iii] a hybrid approach involving a combination of both the rules-based and principles-based approaches.

The Authority is of the view that a balance between regulation and soft law must be sought in order to strengthen the Maltese corporate governance framework and is, in this respect, proposing the adoption of a hybrid approach.

The Authority is cognisant that entities operating in different sectors merit different requirements, and it is therefore being proposed that a principles-based Code which provides the high-level standards for good corporate governance is promulgated. Should this approach be adopted, the Authority will subsequently also issue sector-specific rules and complementing guidance notes on how entities are to adhere and 'explain' their adherence to the Code. Whilst entities will be expected, through a reporting framework, to 'apply and explain' the high-level principles-based code, they will be expected to 'comply or explain' how they are following the applicable rules and guidelines.

Any explanations provided should be concise, yet sufficiently detailed, to provide a clear picture. Similarly to the approach taken by the European Commission's recommendations of the 9 April 2014,<sup>20</sup>

<sup>20</sup> Commission Recommendation of 9 April 2014 on the quality of corporate governance reporting ('comply or explain'), available online at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014H0208&from=EN>

rules to eliminate ‘boiler plating’ - i.e. the tendency of corporations to re-use explanations already provided in previous years or by other firms – will also be introduced.

**Q2** What are your views on the Authority’s proposal to introduce a cross-sectoral Corporate Governance Code based on a hybrid approach?

**Q3** Do you agree with the Authority’s proposals vis-à-vis the explanations required?

### 3.4 The Board of Directors

Directors perform a crucial role within a company, and it is important that they have a good understanding and appreciation of the importance of good corporate governance. The existent Maltese Corporate Governance framework already provides guidance on various aspects related to the board; however, it is felt that these should be strengthened to reinforce the fundamental role of the Board of Directors. In this light, whilst certain provisions of the existent framework will be retained within the new Code, new principles will be introduced. The Authority is therefore proposing that principles relating to the: [i] structure and composition of the board; [ii] diversity; [iii] appointment, resignation, dismissal and removal of directors; [iv] directors’ responsibilities; [v] remuneration; [vi] evaluation of board performance; [vii] board meetings; [viii] conflicts of interest and confidentiality; and [ix] advisors to the board; are included within the framework. In this regard, the Authority is furthermore proposing a new obligation for the board to draw up a board charter which sets out its policies and procedures.

**Q4** Are there any additional aspects, relating to the board of directors, which should be included within the framework?

#### 3.4.1 Structure and Composition of the Board

The Authority is of the view that the structure and composition of the board should be included within the framework. It is proposed that the following requirements are set out: [i] the structure and composition of the board should ensure that no person or group of persons can dominate decision making; [ii] where there are any conflicts of interest, that these are adequately disclosed to stakeholders; [iii] a mix of executive and non-executive directors sit on the board, with applicability of this requirement and the exact board composition depending on the nature, size and complexity of the business of the specific company;<sup>21</sup> [iv] a clear distinction should be made between the role of the Chairman of the board and that of the Chief Executive Officer, provided that where the size of the company does not merit having a Chairman and a CEO, then the reasons why should be adequately explained to all stakeholders; and [v] the board should collectively have sufficient knowledge, experience and expertise to be capable of undertaking their role.

For entities which appoint, or which may be required to appoint, more than one non-executive director, the Authority is considering introducing a requirement for such entities to appoint a Lead Independent Director from amongst its non-executive directors. Such person would act as a conduit for non-executive

<sup>21</sup> For purposes of this discussion paper, the term non-executive director shall mean a member of the board who does not have management responsibilities and therefore performs an oversight and monitoring role. On the other hand, the term executive director shall mean a director who is responsible for the day-to-day management of the entity.

directors to deal with sensitive board issues and would encourage meetings to take place between the independent non-executive directors<sup>22</sup> in accordance with international corporate governance best practice.

Specifically, with respect to entities' organisational structure, the Authority is also considering the introduction of a requirement to publish an up-to-date organisation structure on their website and to clearly articulate all governance roles, responsibilities or accountabilities.

**Q5** What are your views on **the Authority's proposals?**

**3.4.2** Diversity on the Board

Further to Section 3.4.1 above, the MFSA is also of the view that boards should have the right balance *inter alia* of knowledge, experience and gender. The Authority is considering including a provision within the Code for companies to ensure diversity. In this manner Companies would be required to explain their initiatives to ensure diversity on the board.

**Q6** What are your thoughts on the introduction of a requirement for companies to have initiatives to achieve diversity on the Board?

**3.4.3** Appointment, Resignation, Dismissal and Removal of Directors

The appointment of directors should be the outcome of a formal and transparent process, based on objective criteria. It is being proposed that the Code includes a provision which would require companies to explain the appointment process and the selection criteria availed of. In this respect, companies should *inter alia* consider the individual's fitness and properness for the role. Reference may be made to [Guidance on the fitness and properness assessments applied by the Authority](#), issued on the 2 July 2019. In summary, fitness and properness is assessed against the following four criteria:

- |   |  |
|---|--|
| i. Competence                                       | It should be demonstrated to the Authority that a person has an appropriate level of knowledge, professional expertise and experience, both practical and professional, to perform his/her duties. The level of knowledge required would vary in accordance with the level of responsibility and the type of activity to be carried out. |
| ii. Reputation                                      | It should be demonstrated to the Authority that a person is of good repute and that they intend to act in an honest, ethical and trustworthy manner. The assessment of reputation is twofold, an evaluation of: [i] integrity (historical reputation) and; [ii] solvency (financial soundness).  |
| iii. Conflicts of Interest and Independence of mind | A person should be able to make sound, objective and independent decisions and judgements. Conflicts of interest may affect independence – persons will not be considered suitable if  |

<sup>22</sup> For purposes of this discussion paper, being 'independent' shall mean that the person does not have any present or recent past relationships or links of any nature with the entity or its management that could influence the person's objective and balanced judgement and reduce the ability to take decisions independently.

a conflict of interest which poses a material risk which is not possible to prevent, adequately mitigate or manage.

iv. Time Commitment

A person must be able to commit sufficient time to perform the function he/she is proposed for, efficiently and effectively. Time commitment is assessed both quantitatively (an assessment of the number of commitments held by a person) and qualitatively (an assessment of the factors which determine the amount of time a person can dedicate to his function)

In this respect the Authority is considering: [i] raising the requirements vis-à-vis competence by requiring directors to have adequate qualification/certification; [ii] requiring companies to provide an induction programme to any newly-appointed director; and [iii] issuing a policy on multiple involvements.

Furthermore, specifically with respect to resignations, the Authority is proposing the inclusion of a provision within the Code, requiring companies to explain the resignation process for directors and the succession planning undertaken as well as measures to mitigate key-man risk. Moreover, it is also being proposed that provisions on the procedure to remove/dismiss a director are included.

**Q7** What are your views **on the Authority's proposals?**

### 3.4.4 Directors' Responsibilities

In order to clearly set out the expectations which the Authority places on board members, it is being proposed that the new Code contains provisions on directors' responsibilities *inter alia* including [i] their joint and several liability; [ii] the duty to act honestly, fairly and professionally in the interest of the company and stakeholders; as well as [iii] the consequences of breaches of their duties as directors or breaches being committed by the company of which they are director/s. For ease of reference, it is being proposed that the provisions of Article 136A of the Companies Act<sup>23</sup> are reiterated within the Code. Furthermore, a provision stating that, as part of their oversight role, directors should also monitor the financial health of the company including capital, solvency and liquidity levels, and its status as a going concern.

**Q8** Do you agree that the Code should include provisions on **Directors'** Responsibilities?

### 3.4.5 Board Members' Remuneration

The remuneration afforded to directors should ultimately be aimed at long term sustainability and therefore be in the best interest of the company and its investors. Whilst compensation packages should be competitive and conducive to attracting the best talent, this should not come at the expense of the company or stakeholders. In this respect the Authority is proposing the inclusion of the following provisions within the Code: [i] the requirement to have a formal and transparent procedure for the determination of directors' pay; [ii] the requirement for adequate disclosures to be made with respect to both the procedure for the determination of directors' remuneration and the remuneration being afforded to directors; and [iii] the requirement to grant shareholders the right to influence how much

<sup>23</sup> Article 136A sets out the general duties of directors.

the directors are paid, including a right to vote *ex ante* on the remuneration policy and *ex post* on the amount of remuneration granted to Directors in the past financial year.

**Q9** What are your views on **the Authority's** proposals with respect to the remuneration of the board?

**Q10** Kindly suggest ways to enhance the transparency of Remuneration Policies.

### 3.4.6 Evaluation of Board Performance

It is being proposed that the Code contains a provision requiring the board to make an evaluation of its own performance and that of its committees – this provision will also state the extent to which the results thereof and subsequent action plans are published. A similar provision already exists within the Code of Principles of Good Corporate Governance for Listed Entities.<sup>24</sup> Furthermore, it is also being proposed that the individual performance of every member of the board should be assessed.

**Q11** What are your views on these proposals?

### 3.4.7 Board Meetings

Supervisory experience has shown that there is no common approach with respect to the frequency of board meetings, their procedure and the manner with which they are minuted. The Authority is proposing including *inter alia* the following requirements within the new framework: [i] that board meetings are convened regularly – in this respect the Authority is considering including a requirement that such meetings are held at least quarterly; [ii] that the board ensures that matters, such as the procedures for board meetings, e.g. quora, meeting frequency, voting rights etc. are included in the memorandum and articles of the company; [iii] a 'board pack' is compiled and circulated within a reasonable timeframe prior to the meeting; and [iv] that board meetings are minuted in a manner which is sufficiently detailed for the user to understand: (a) the rationale underlying any decision taken and the underlying discussions, including any specific concerns raised by individual directors; and (b) that the board has considered the impact of their decisions on the company's various stakeholders.

**Q12** **Kindly provide your views on the Authority's proposals.**

### 3.4.8 Conflicts of Interest and Confidentiality

The existing provisions on conflicts of interest and confidentiality of the current framework will be tweaked for the purposes of implementing a hybrid approach. Whilst the existing provisions provide a duty for directors to avoid and to disclose any actual or potential conflicts of interest, a new obligation requiring the company secretary to maintain a register of interests will be proposed. This obligation will also provide for a periodical review of the register.

<sup>24</sup> Vide Principle 7

Furthermore, provisions on related party transactions will also be introduced. It is widely accepted that business transactions between a company and its insiders (directors, officers, major shareholders, or their relatives and related parties) may not necessarily be in the best interest of the company. In this respect, companies will be required to mitigate risks of such transactions and would therefore be expected to explain how such risks are mitigated.

**Q13** **Kindly provide your views on the Authority’s proposals in relation to conflict of interest provisions being proposed for inclusion in the Code.**

**Q14** Specifically, with respect to related party transactions, do you agree that the framework should include provisions in order to mitigate the inherent risk of such transactions?

**Q15** Further to Q14 above, do **you believe a ‘materiality’ threshold should be introduced with respect to related party transactions?**

### 3.4.9 Advisors to the Board

Supervisory experience has shown that boards frequently engage advisors, such as legal professionals and business strategists, to assist them when exercising their role and undertaking their duties. It should be ensured that such advisors are simply undertaking an advisory role and not taking decisions for the directors. In this respect, the Authority is proposing the inclusion of a provision to this effect.

**Q16** Do you agree that a provision requiring the board to ensure that its advisors are simply performing an advisory role and not taking decisions on behalf of directors should be included in the framework?

## 3.5 Responsibilities of Functionaries and Officials

### 3.5.1 Chairman of the Board and Chief Executive Officer

Apart from clearly setting out the role and responsibility of the Chairman and Chief Executive Officer, it is being proposed that the Code contains a provision which obliges entities to ensure that a clear line of demarcation subsists between the running of the board and the executive responsibility of running the company.

Supervisory experience has shown that certain entities have, in the past, appointed persons who are not directors, as the Chairman of their respective board. Given the possible implications that such persons may be considered shadow directors, the Authority is of the view that a provision requiring entities to select a Chairman of the board from amongst their directors should be included.

### 3.5.2 Company Secretary

Apart from reiterating the responsibilities listed in point 72 of the First Schedule to the Companies Act,<sup>25</sup> it is proposed that the Code clearly sets out the Company Secretary's role as a point of liaison between the board, its committees, the directors themselves etc. A similar provision already exists in the Code of Principles of Good Corporate Governance – Appendix 5.1 to the Listing Rules.<sup>26</sup>

### 3.5.3 Compliance Officer

It is also being proposed that the role and responsibilities of the Compliance Officer are clearly defined. It is being proposed that the Code contains a provision stating that the Compliance Officer is to be independent and shall be responsible for: [i] monitoring and assessing the adequacy and effectiveness of the measures and procedures which the company has in place to identify and mitigate risk/s of failure, and its compliance with legal and regulatory obligations; and [ii] advising and assisting the relevant persons responsible for carrying out investment services and activities to comply with its legal and regulatory obligations.

### 3.5.4 Money Laundering Reporting Officer

It is being proposed that the Code contains a provision stating that entities covered by the Code are to appoint and have an MLRO, in place, at all times. Given that the role of the MLRO is an onerous one, the company should ensure that it is only accepted by individuals who fully understand the extent of the responsibilities attached to the role. When appointing an MLRO, the company must ensure compliance with the applicable provisions of Part I of the Implementing Procedures as well as any sector-specific Implementing Procedures issued by the FIAU in terms of the provisions of the Prevention of Money Laundering and Funding of Terrorism Regulations.

**Q17**

What are your views on the proposals for the Code to clearly set out the responsibilities of the above-mentioned functionaries?

## 3.6 Engagement with Stakeholders

The Authority is cognisant that the Corporate Governance framework should give due consideration to stakeholders' interests and views. Stakeholders may *inter alia* include local communities, suppliers, creditors, customers and employees. Constant dialogue and engagement therewith should be encouraged given that it may be conducive to the long-term success of the company. In this respect, the Authority is proposing the inclusion of a provision in the Code stating that the board should constantly be aware of the opinion of its stakeholders. The proposed provision should require companies to explain how stakeholders' view have been taken into consideration within the decision-making process. Additionally, the Authority is also considering the introduction of provisions on how entities should disclose the manner it has engaged stakeholders.

**Q18**

**What are your views on the Authority's proposal to introduce** provisions seeking to enhance stakeholder engagement, within the framework?

<sup>25</sup> Point 72 of the First Schedule to the Companies Act sets out the role and responsibilities of the Company Secretary.

<sup>26</sup> Appendix 5.1 to the Listing Rules, Principle 6

### 3.6.1 Engagement with Shareholders

The Corporate Governance framework should promote shareholder participation in the main corporate decisions. The European Commission encourages<sup>27</sup> a purposeful dialogue between the board and shareholders on relevant matters. In this respect, further to the rights attributed to shareholders at law, procedures should be in place to ensure effectiveness of their exercise.

The Authority is of the view that effective protection of shareholders' rights, including minority shareholders, enhances the allocation of resources and increases the company's value, in a scenario of transparency and trust. Specifically, the protection of minority shareholders is crucial to avoid mismanagement by any majority shareholders. For this purpose, the Authority is proposing to reinforce the already existent provisions within the Maltese corporate governance framework, by setting out provisions for the board to: [i] regularly seek shareholders' feedback and constantly be aware of their views; [ii] develop a constructive dialogue with shareholders; [iii] ensure that all the necessary facilities and information are available for shareholders to be able to exercise their rights; and [iv] treat all shareholders equally, irrespective of their holding.

**Q19** Kindly provide your views in relation to the above.

### 3.6.2 Engagement with Institutional Investors

The increased presence of institutional investors, such as *inter alia* funds and insurance companies, has reshaped the financial markets. Such investors may actively contribute to a company's success given that they have a real interest in obtaining positive returns for their investment. In this light, the Authority is proposing provisions within the new framework to promote best practices and encourage a proactive approach. This notwithstanding, the board is to treat all investors equally and not favour a set of investors over other minor investors.

In line with the OECD Principles,<sup>28</sup> the Authority is considering the introduction of a requirement to have policies with respect to the engagement therewith in place, in order to increase institutional investors' engagement. Such policies are to be made available to all shareholders and any conflicts of interest disclosed.

**Q20** Do you agree with the Authority's **proposal of increasing the** engagement of Institutional Shareholders?

### 3.6.3 Engagement with Employees

In order to address any existing expectation gaps, the Authority is proposing the introduction of a requirement to have formal policies in place to facilitate the flagging of concerns by the workforce with respect to any unethical or illegal situations which may exist, or which may have come to their knowledge and to ensure proportionate and independent investigation of such matters.

<sup>27</sup> See, for example, European Commission Green Paper on The EU Corporate Governance Framework, COM2011 (164) final, available online at: <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0164:FIN:EN:PDF>

<sup>28</sup> OECD Principles, Principle 3

**Q21**

In your view, are there any other areas vis-à-vis stakeholder engagement which the Authority could include within the framework?

### 3.7 Committees

The MFSA is also considering introducing provisions in relation to the appointment of: [i] an Audit Committee; [ii] a Risk Committee; [iii] a Remuneration Committee; [iv] a Nomination Committee; and [v] a Good Governance Committee. The provisions on these committees, which would be appointed by the Board of Directors based on the principle of proportionality, would *inter alia* include details on composition, structure, the procedure to be followed by the respective committees as well as the contents of a charter for such committees. Where appointed, committees should be listed on the company website and their work summarised in the annual report.

#### 3.7.1 Audit Committee

The Audit Committee would be responsible for assisting the Board of Directors in its oversight activities, particularly with respect to internal governance and controls, financial statements, risk management and for the monitoring of internal and external audit. Where, due to the application of the proportionality principle, an Audit Committee is not present, a member of the Board of Directors should assume responsibility over such review.

#### 3.7.2 Risk Committee

The Risk Committee would be responsible for the establishment of an entity-wide risk management framework and its oversight. As a result, the Risk Committee would be assisting the board in setting the company's risk appetite and in fulfilling its oversight responsibilities. It is proposed that at least one director is a member of the Risk Committee.

#### 3.7.3 Remuneration Committee

The Remuneration Committee would be responsible for setting out remuneration policies and establishing the remuneration packages for directors and senior executives. It should ensure that remuneration is sufficiently competitive to attract, retain and motivate directors and senior executives. It should be composed of directors who have no personal financial interest, other than as shareholders in the company. Where remuneration is not performance-related<sup>29</sup>, the role of the Remuneration Committee may be carried out by the board itself. The inclusion of a provision requiring a Remuneration Committee follows what was stated in Section 3.4.5 above vis-à-vis board members' remuneration.

#### 3.7.4 Nomination Committee

<sup>29</sup> Performance-related remuneration would include share options and pension benefits, profit-sharing arrangements and any other emoluments payable to the directors related to the performance of the company in question.

The establishment of a Nomination Committee ties with Section 3.4.3 of this discussion paper, in the sense that a Nomination Committee could be one of the ways by which a formal and transparent procedure for the appointment of new directors to the board could be established.

The Committee, which should be composed entirely of directors of the company, should: [i] propose candidates, to the board, who, in its view, are fit and proper to act as directors of the company; [ii] periodically assess the structure size, composition and performance of the board and make recommendations to the board with respect to any changes; [iii] consider succession planning; and [iv] review policies for board selection and appointment of senior management; and [iv] encourage diversity with respect to appointments.

### 3.7.5 Good Governance Committee

Further to the obligations of the Board of Directors, the Good Governance Committee would have an oversight role on governance matters. It would flag any issues to the board and suggest how these may be remedied. It is proposed that at least one director is a member of this committee.

**Q22** Kindly provide us with your views in respect of the above.

### 3.8 Corporate Culture

An enterprise can only achieve its full potential through the commitment of its management body to a set of values, including *inter alia* honesty, integrity, ethical behaviour, innovation, transparency and excellence. The advantages associated with a positive corporate culture taking a top-down approach ranges from improved corporate reputation and image to better risk management. It also helps build stronger relationships and trust with stakeholders. Furthermore, companies should also adhere to accepted principles of corporate social responsibility in their day-to-day activities. The Authority is therefore proposing to introduce provisions setting out the responsibility of the Board of Directors to establish a culture which is aligned with the strategy of the entity, enhancing trust, integrity and ethics, preserving the long-term value of the enterprise, thereby creating a top-down approach to positive corporate culture.

**Q23** Do you agree with the Authority's **proposals with respect to** Corporate Culture?

### 3.9 Ethics Frameworks

Companies which take an effective corporate governance approach place accountability, transparency and ethical standards at the heart of their activities and throughout their structures. The Authority is therefore proposing the inclusion of a provision within the new Code which stipulates that entities should have an ethics framework, including a Code of Ethics, to be followed by an entity's decision makers, to safeguard credibility and reputation.

**Q24** What are your views in this respect?

### 3.10 Risk Management

Further to Section 3.7.2 above, as part of the initiative to raise the bar for Corporate Governance, the Authority is proposing the inclusion of provisions to strengthen the risk management and controls. In this respect it is being proposed that the framework: [i] makes it clear that the Board of Directors retains responsibility for risk management activities and risks arising from business models, particularly setting the risk appetite and assessing and monitoring the company's main risks; [ii] recommends that the board performs a regular assessment of the company's main risks;<sup>30</sup> and [iii] recommends an annual review of the procedures and policies vis-à-vis risk governance.

**Q25** Kindly provide your thoughts on the above matter.

### 3.11 Other matters

#### 3.11.1 Anti-Money Laundering and Combatting the Financing of Terrorism

The MFSA maintains continuous oversight of the conduct and financial stability of firms it regulates to safeguard the integrity and stability of Malta's diverse and growing financial services sector. In this respect, the Authority considers adequate arrangements to mitigate the risk of firms being used to commit financial crime, particularly money laundering ('ML') and/or funding of terrorism ('TF'), to be crucial. The Authority is considering including a provision within the Code stating that firms must have robust governance, effective processes and adequate internal control mechanisms to manage their ML and TF risk.

**Q26** What are your views on the Code making explicit reference to AML/CFT?

#### 3.11.2 Continuous Professional Development

Further to the enhanced competence requirements being proposed above, the MFSA is considering the introduction of a Continuous Professional Development requirement for directors. This would include a requirement for a number of mandatory CPD hours to ensure regular updating of knowledge and skills.

**Q27** What are your views with respect to the above?

#### 3.11.3 Professional Indemnity Insurance

<sup>30</sup> As per the [FRC Guidance on Risk Management, Internal Control and Related Financial and Business Reporting \(2014\)](#), these include *inter alia* situations that can impact the company's business model; solvency; future performance or reputation.

Given the potential liability which may be attributable to directors and key functionalities, the Authority is proposing including a provision stating that directors shall take out professional indemnity cover.

**Q28** What are your views with respect to the above?

#### 3.11.4 Business Continuity and Disaster Recovery

The Authority considers business continuity management as being integral to good corporate governance. The Authority is proposing the inclusion of provisions, within the framework, requiring companies to have strategic management processes which identify potential threats, and which fully consider disaster recovery and business continuity. This should include advance planning and preparations that are necessary to minimise loss and ensure continuity of the critical business functions of a company in the event of disruption. Apart from safeguarding their interests, Companies should also consider those of stakeholders, particularly those of its customers.

**Q29** What are your thoughts on provisions on the inclusion of provisions on Business Continuity Management within the framework?

#### 3.11.5 Disclosures

Transparency is a core pillar of a strong corporate governance framework. To this effect, it is being proposed to place further emphasis thereon, by inserting this principle within the new Code, highlighting the importance of Companies adopting a transparent approach with all stakeholders vis-à-vis both financial and non-financial information. This may *inter alia* include disclosures in relation to sustainable finance<sup>31</sup> and corporate social responsibility.

**Q30** Are you in agreement that there should be a principle specifically on disclosure?

#### 3.11.6 Compliance Statements

The Authority is considering introducing a requirement for boards to draw up and publish a statement vis-à-vis compliance with the corporate governance framework. Such a statement should be signed by the board, forwarded to the Authority, published in the annual report and on the company's website. It should identify areas of material non-compliance with the code and give reasons, where applicable, for any alternative practice(s) adopted. The statement should clearly state whether: [i] the entity has complied with the code; or [ii] the entity has partially complied with the code; or [iii] the entity has not complied with the code. The Authority is also considering requiring a similar statement to be made by the company's auditors.

**Q31** What are your views in this respect?

<sup>31</sup> In this respect one may *inter alia* refer to the European Commission's [Guidelines on reporting climate-related information](#)

### 3.11.7 Corporate Social Responsibility

Corporate Social Responsibility is crucial in the modern corporate environment. Guideline 9.2 of the Corporate Governance Guidelines for Public Interest Companies defines corporate social responsibility as:

“the continuing commitment by business entities to behave ethically and contribute to economic development while improving the quality of life of the work force and their families as well as of the local community and society at large. Being socially responsible means not only fulfilling legal expectations, but also going beyond compliance and investing ‘more’ into human capital, the environment and the relations with stakeholders.”<sup>32</sup>

It is being proposed that further to what is already found within the current Corporate Governance Guidelines i.e. that directors should seek to adhere to accepted principles of corporate social responsibility in their day-to-day management practices of the company; a provision is introduced to ensure that “organisations disclose policies and performance relating to business ethics, the environment and, where material to the company, social issues, human rights and other public policy commitments.”<sup>33</sup>

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**Q32** What are your views on the above?

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<sup>32</sup> Guideline 9.2 Corporate Governance Guidelines for Public Interest Companies

<sup>33</sup> OECD Principles, Principle 5.A.2

## 4 Conclusion

The MFSA is seeking feedback from stakeholders prior to proceeding with detailed proposals on the implementation of the initiatives presented in this document.

The consultation is open to the public until Wednesday 26 February 2020. Industry Participants and interested parties are invited to send their responses via email to [CorporateGovernance@mfsa.mt](mailto:CorporateGovernance@mfsa.mt).

Following this consultation process, the Authority will review feedback received from stakeholders and subsequently proceed to issue a feedback statement and update the corporate governance framework accordingly.

In line with the Authority's Vision to enhance stakeholder engagement, draft versions of any proposed amendments to existing frameworks or new rules, will be issued for public consultation.