

Corporate Governance

■ General

Good Corporate Governance is the process and the control that align the interests of a wide range of different stakeholders such as shareholders, depositors, management, employees, creditors and the community. It contributes to sustainable growth by enhancing the performance and improves access to capital. DFCC Bank had been practicing high standards of Corporate Governance for several years based on the Organisation of Economic Cooperation & Development (OECD) principles of good governance.

An account of some of the key Corporate Governance practices of DFCC Bank is given in this report. It is followed by specific disclosures relating to the status of compliance with the mandatory requirements of Direction No. 12 of 2007 of the Central Bank of Sri Lanka (as amended) and Section 7.10 of the Listing Rules of the Colombo Stock Exchange.

■ Rights and Equitable Treatment of Shareholders

The basic right of the shareholders include ability to transfer shares freely while obtaining relevant information about the entity on a regular and timely basis and effectively participating in shareholder

meetings while sharing the profits of the entity. The shares of DFCC Bank can be freely transferred through the Colombo Stock Exchange subject to the aggregate limits imposed by law applicable to banking companies.

DFCC Bank holds its Annual General Meeting within three months of the end of the financial year and gives adequate notice of such meetings in terms of the Regulations. The information relating to the performance of the Bank is sent to all shareholders in order to enable effective shareholder participation in person or by proxy.

The Bank shares a reasonable portion of its profit with the shareholders while retaining the balance to support its growth and development. This year, the Bank intends paying out just under half of its distributable profit as dividends to its shareholders.

The Bank treats all its shareholders equally on the basis of one vote per ordinary share. The Bank has not issued any non-voting ordinary shares or preference shares.

The Head of Compliance advises closed periods for the trading in the Bank's shares by Employees and Directors when he is of

the view that they may be in possession of information that is not yet in the public domain and procedures are in place to monitor adherence.

■ Disclosure and Transparency

In good governance it is important to have a framework that ensures timely and accurate disclosure of material matters regarding the entity including financial position, performance, ownership and governance practices. DFCC Bank has a Board approved Corporate Communications Policy that pays a high degree of emphasis to providing accurate information quarterly to its shareholders with regard to the financial performance and the progress of the Bank. The Annual Report contains comprehensive reviews of performance as well as other information of relevance to the various stakeholders apart from reporting on the financial status of the Bank and Group. Price sensitive information is disclosed immediately to the Colombo Stock Exchange to be disseminated among the stockbrokers and shareholders. Such information is also given publicity through the media and in the Bank's website.

■ Attendance

The attendance of Directors at meetings of the Board and the Committees are given in the Table below. The Credit Committee conducts its meetings by circulation of the relevant papers and telephone conference when necessary.

Committee	Main Board		Audit Committee		Remuneration Committee		Nomination Committee		Integrated Risk Management Committee	
	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended
Mr J M S Brito	13*	13			4*	4	1	1	2*	2
Mrs S Cooray	13	12							2	2
Mr R Dalchow (resigned w.e.f. 31 March 2009)	13	9								
Mr A N Fonseka	13	13	6**	6**	4**	4	1**	1	2	2
Mr A M de S Jayaratne	13	12	6*	6						
Mr S N P Palihena	13	11	6	4					2	1
Mr C P R Perera	13	12			4	4	1*	1		
Mr D S Weerakkody	13	11	6	5	4	4	1	1		

* *Chairman*

** *By Invitation*

■ Disclosures on Corporate Governance Made in Terms of Provisions of Direction 12 of 2007 of The Central Bank of Sri Lanka

Set out below is the status on the Bank's Adherence with the Corporate Governance Rules as Required by Section 3 (8) of the Direction No. 12 of 2007 issued by the Central Bank of Sri Lanka.

■ Disclosure Requirements

i. The Board shall ensure that:

Annual audited financial statements and quarterly financial statements are prepared and published in accordance with the formats prescribed by the supervisory and regulatory authorities and applicable accounting standards;

and such statements are published in the newspaper in an abridged form, in Sinhala, Tamil and English
Status: Complied with.

ii. The Board shall ensure that the following minimum disclosures are made in the Annual Report:

A statement to the effect that the annual audited financial statements have been prepared in line with applicable

accounting standards and regulatory requirements, inclusive of specific disclosures.

Status: Complied with. Please refer 'Statement of Directors' Responsibility' on page 70 of this Annual Report.

A report by the Board on the Bank's internal control mechanism that confirms that the financial reporting system has been designed to provide reasonable assurance regarding the reliability of financial reporting, and that the preparation of financial statements for external purposes has been done in accordance with relevant accounting principles and regulatory requirements.

Status: Complied with. Please refer 'Statement of Directors' Responsibility' on page 70 of this Annual Report.

Total net accommodation as defined in 3 (7) (iii) of the Direction, granted to each category of related parties. The net accommodation granted to each category of related parties be disclosed as a percentage of the Bank's regulatory capital.

Status: Complied with. Please refer Note 58 to the financial statements on 'Related Party Disclosures' in this Annual Report.

The aggregate values of remuneration paid by the Bank to its key management personnel and the aggregate values of the transactions of the Bank with its key management personnel, set out by broad categories such as remuneration paid, accommodation granted and deposits or investments made in the Bank.

Status: Complied with. Please refer Note 58 to the financial statements on 'Related Party Disclosures' in this Annual Report.

A report setting out details of the compliance with prudential requirements, regulations, laws and internal control and measures taken to rectify any material non-compliance.

Status: There was no material non-compliance that has led to the breach of any prudential requirement with regard to a Direction issued by the Central Bank to reduce the shareholding in Commercial Bank of Ceylon PLC to 15% before 23 October 2008, the Bank has complied with the consequential provisions limiting the Bank's voting rights to 10% until the shareholding is reduced. This matter is sub-judice. Please refer to the Statement of Directors' Responsibility on page 70 of this Annual Report for details on compliance measures.

Annual Corporate Governance Report to be Published in the Annual Report as per Direction 3 (1) (xvi) of the Banking Act Directions No. 12 of 2007

Responsibilities of the Board

The Board has taken necessary steps to ensure the safety and soundness of the Bank, and its continuing capital adequacy.

Mr J M S Brito is the Chairman and Mr A N Fonseka is the Chief Executive Officer and their functions and responsibilities have been clearly defined by the Board.

The Board meets regularly, generally once a month. During the year there were 13 meetings with the active participation, in person or by alternate, by all members of the Board. During the year, all the Directors attended, either in person or through an alternate, over two-thirds of the number of meetings that were held. The schedule for regular meetings is set at the beginning of the year and any changes to the schedule are agreed well in advance.

Any Director may propose matters to be included in the Agenda under the relevant subjects or under any other business. The Board papers are dispatched in advance prior to the regular Board meetings and depending on the urgency, maximum possible notice is given for special

meetings. The Board has an agreed procedure in place for Directors to seek independent advice if they so require.

Mr T Wijemanna, Attorney-at- Law functions as the Secretary to the Board. The Secretary complies with the requirements imposed by the Direction, under the supervision and the guidance of the Board. The Secretary attends the Board meetings and prepares the minutes for the approval of the Board of Directors.

The minutes are kept under the custody of the Secretary. The minutes are recorded in sufficient detail, cross referring to the circular containing the data and information used by the Board in its deliberations, all related matters considered by the Board, key points of the discussions, recommendations and clarifications provided by the Chief Executive Officer and other relevant Officers and the decisions of the Board. Any interest disclosed by a Director and any dissenting view is always recorded in the minutes. The Directors do not participate in the decision-making process on matters, in which they have an interest and avoid conflicts of interests in their activities with the Bank. Any decision on an issue in which any one Director has an interest requires the unanimous consent of all the other Directors.

The Board has put in place systems and controls to facilitate the effective discharge of Board functions. The Board has also put in place effective systems to secure the integrity of information, internal controls and risk management.

The Directors also assessed the Board's overall performance at the end of the year and have concluded that the Board responsibilities are satisfactorily discharged.

Board's Composition

Chairman

Mr. J M S Brito - Non-Executive Director

Ex-Officio Director

Mr. A N Fonseka - General Manager/
Chief Executive

Independent Non-Executive Directors

Mr. A M de S Jayaratne - Senior Director

Mr. S N P Palihena

Mr. T Caglayan

Mr. C P R Perera

Government Director

Mrs. S Cooray

Non-Executive Director

Mr. D S Weerakkody

At present, there are eight Directors on the Board, whose bio data are given in this Annual Report. All the Directors have the necessary skills and experience to direct and lead the Bank.

The Chairman, J M S Brito is not an independent Director in terms of the Direction because he is the Chairman of the Subsidiary DFCC Vardhana Bank Limited. Mr. D S Weerakkody is not an independent director as he is a director of the associate company, Commercial Bank of Ceylon PLC. Mr A M de S Jayaratne, who is an independent Director has been designated Senior Director. The other independent Directors in terms of the Direction are Messrs C P R Perera, S N P Palihena and T Caglayan.

New appointments and re-election of Directors to the Board are considered and recommended by the Nominations Committee and based on such recommendations, final decisions are made by the Board. All Directors appointed to the Board, other than the Chief Executive Officer (Ex-officio Director) and Government Director are subject to re-election by shareholders at the first general meeting after their appointment. During the year 2008, the Board announced resignations of Directors and the reasons for such resignations.

Fitness and Propriety of Directors

The provisions of Section 42 of the Banking Act No. 30 of 1988 and the criteria set out in the Direction No. 12 of 2007, as amended, have been applied to determine the fitness and propriety of the Directors. The Board is of the view that each and every Director is a fit and proper person to serve as a Director of the Bank. No Director is over the age of 70 years. The only Director who is in office by virtue of the transitional provisions relating to Directors who have served more than nine years is Mr T Caglayan.

Delegation of Authority by the Board

The Board is empowered by the DFCC Bank Act and the Regulations thereunder to delegate to the Chief Executive Officer and Executive Committees any of the powers vested with the Board, subject to any condition the Board may impose. The Chief Executive Officer shall have powers, within the limitations applicable, to delegate such office/powers as he may think necessary, for the management and smooth operation of the Bank. The delegation of powers of the Board are subject to the general laws, regulations and Directions applicable to the Bank. To ensure that the delegation of authority would not in any way reduce the Board's ability to discharge its functions fully and effectively, such delegated powers are reviewed periodically by the Board and changes effected where appropriate.

Chairman and Chief Executive

Mr J M S Brito, is the Chairman of the Bank and Mr A N Fonseka is the Chief Executive Officer. There are no relationships, including financial, business, family any other material/relevant relationship between the Chairman and the Chief Executive Officer, other than being common Directors of DFCC Vardhana Bank. Similarly, no relationships prevail among the other members of the Board.

The Chairman provides leadership to the Board and facilitates the effective discharge of Board functions. He stimulates discussion on matters considered by the Board and invites views and comments from all Directors.

The Agenda for each Board Meeting is finalised by the Secretary under the direction of the Chief Executive and the Chairman.

The Secretary ensures that the Directors receive adequate information in a timely manner to prepare for Board meetings. On urgent matters, every effort is made to provide the information, as early as possible. The Board papers are prepared by employees to provide adequate information to the Board to deliberate on all key issues concerning the Bank.

All the Directors bring their independent judgment to bear on board deliberations. The Chairman takes action to ensure that the Board acts in the best interests of the Bank.

The Chairman presides at general meetings of shareholders. Shareholders are given the opportunity to seek clarification on matters under consideration.

The Chief Executive is responsible for the implementation of strategy and policy and also responsible for the day-to-day management of the Bank. The Chairman does not directly supervise any key management personnel. The Board monitors progress through reports submitted to it as well as periodic interaction with key management personnel.

Sub-committees

The following sub-committees have been appointed by the Board in terms of the requirements of Direction No. 12 requiring each such Committee to report to the Board:

- Board Audit Committee
- Board Human Resources and Remuneration Committee
- Board Nominations Committee
- Board Integrated Risk Management Committee

The Committee reports have been published in this Annual Report.

Related Party Transactions

Suitable mechanisms are in place to identify and capture related party transactions. The Directors and other Key Management

Personnel make declarations identifying related parties and take due steps to avoid any conflicts of interest referred to in the Direction. Related party transactions, when undertaken, are carried out on an arm's length basis without any special benefit to the party. Some Key Management Personnel (but not the Chief Executive Officer) have participated in approved loan schemes available to employees.

Disclosure on Bank's Adherence with the Corporate Governance Rules as Required by Section 7.10 of the Listing Rules of The Colombo Stock Exchange

■ Directors

Non-Executive Directors

- a. The Board of Directors of a listed company shall include at least, two Non-Executive Directors; or such number of Non-Executive Directors equivalent to one-third of the total number of Directors whichever is higher.
- b. The total number of Directors is to be calculated based on the number as at the conclusion of the immediately preceding Annual General Meeting.
- c. Any change occurring to this ratio shall be rectified within ninety (90) days from the date of the change.
Status: Complied with.

Independent Directors

- a. Where the constitution of the Board of Directors includes only two Non-Executive Directors as mentioned above, both such Non-Executive Directors shall be 'independent'.

In all other instances two or one-third of Non-Executive Directors appointed to the Board of Directors, whichever is higher shall be 'independent'.

Status: Complied with.

- b. The Board shall require each Non-Executive Director to submit a signed and dated declaration annually of his/her independence or non-independence against the criteria specified in the Code.
Status: Complied with.

■ Disclosures Relating to Directors

- a. The Board shall make a determination annually as to the independence or non-independence of each Non-Executive Director based on such declaration and other information available to the Board and shall set out in the Annual Report the names of Directors determined to be 'independent'.
Status: Complied with. Messrs J M S Brito, A M de S Jayaratne, S N P Palihena, C P R Perera and D Weerakkody meet all the specified criteria and have been determined by the Board to be independent.

- b. In the event a Director does not qualify as 'independent' against any of the criteria, but if the Board, taking account of all the circumstances, is of the opinion that the Director is nevertheless 'independent'; the Board shall specify the criteria not met and the basis for its determination in the Annual Report.

Status:

The following Non-Executive Directors do not meet all the specified criteria for Independent Directors. The criteria that are not met are set out below:

Mr T Caglayan - Has served over nine years as a Director having being appointed in August 1999.

Mrs S Coorey - Represents a specific stakeholder, the Government of Sri Lanka, on the Board.

However, taking into account the following factors, the Board has determined that they could nevertheless be considered independent.

- a. The Alternate Director who represented the Director has served more than nine years at the Board meetings until 31 March 2009 was only appointed as Alternate Director in September 2006.
- b. The Directors do not participate when considering transactions in which they have an interest and the DFCC Act requires unanimous approval of the other Directors on such transactions. On other matters, they act in accordance with their beliefs in the best interest of the Bank.
- c. No Director exercises undue influence over the deliberations of the Board or uses his/her seniority or position to prevent any other Director expressing his views on any matter.

- ii. Non-Executive Directors, a majority of whom shall be independent, whichever shall be higher.

Status: Complied with.

In a situation where both the parent company and the subsidiary are 'listed companies', the Remuneration Committee of the parent company may be permitted to function as the Remuneration Committee of the subsidiary.

However, if the parent company is not a listed company, then the Remuneration Committee of the parent company is not permitted to act as the Remuneration Committee of the subsidiary. The subsidiary should have a separate Remuneration Committee.
Status: Does not apply. DFCC Bank is not a subsidiary of any other company.

One Non-Executive Director shall be appointed as Chairman of the Committee by the Board of Directors.
Status: Complied with.

■ Functions

The Remuneration Committee shall recommend the remuneration payable to the Executive Directors and the Chief Executive Officer of the listed company and/or equivalent position thereof, to the Board of the listed company, which

will make the final determination upon consideration of such recommendations.
Status: Complied with.

■ Disclosures

The Annual Report should set out the names of Directors (or persons in the parent company's committee in the case of a Group company) comprising the Remuneration Committee, contain a statement of the remuneration policy and set out the aggregate remuneration paid to Executive and Non-Executive Directors.

The term 'remuneration' shall make reference to cash and all non-cash benefits whatsoever received in consideration of employment with the listed company (excluding statutory entitlements such as contribution to Employees' Provident Fund and Employees' Trust Fund).
Status: Complied with.

■ Audit Committee

A listed company shall have an Audit Committee in conformity with the following requirements.

■ Composition

The Audit Committee shall comprise a minimum of:

- i. Two Independent Non-Executive Directors (in instances where a company has only two Directors on its Board); or

- c. In addition to disclosures relating to the independence of a Director set out above, the Board shall publish in its Annual Report a brief resume of each Director on its Board which includes information on the nature of his/her expertise in relevant functional areas.
Status: Complied with.

- d. Upon appointment of a new Director to its Board, the Company shall forthwith provide to the Exchange a brief resume of such Director for dissemination to the public. Such resume shall include information on the matters itemised in paragraphs a, b and c above.
Status: Did not arise as no new Directors were appointed.

■ Remuneration Committee

A listed company shall have a Remuneration Committee in conformity with the following requirements:

■ Composition

The Remuneration Committee shall comprise a minimum of;

- i. Two Independent Non-Executive Directors (in instances where a company has only two Directors on its Board); or

- ii. Non-Executive Directors' a majority of whom shall be independent, whichever shall be higher.

Bank's Response: Complied with.

In a situation where both the Parent Company and the Subsidiary are 'listed companies', the Audit Committee of the Parent Company may function as the Audit Committee of the Subsidiary. However, if the Parent Company is not a listed company, then the Audit Committee of the Parent Company is not permitted to act as the Audit Committee of the Subsidiary. The Subsidiary should have a separate Audit Committee.

Status: Does not arise.

One Non-Executive Director shall be appointed as Chairman of the Committee by the Board of Directors.

Status: Complied with.

Unless otherwise determined by the Audit Committee, the Chief Executive Officer and the Chief Financial Officer of the Listed Company shall attend Audit Committee meetings.

Status: Complied with.

The Chairman or one Member of the Committee should be a Member of a recognised professional accounting body.

Status: Complied with.

■ Functions

Shall include -

- i. Oversight of the preparation, presentation and adequacy of disclosures in the financial statements of a listed company, in accordance with the Sri Lanka Accounting Standards.
Status: Complied with.
- ii. Oversight of the company's compliance with financial reporting requirements, information requirements of the Companies Act and other relevant financial reporting-related regulations and requirements.
Status: Complied with.
- iii. Oversight over the processes to ensure that the company's internal controls and risk management are adequate, to meet the requirements of the Sri Lanka Auditing Standards.
Status: Complied with.
- iv. Assessment of the independence and performance of the company's external auditors.
Status: Complied with.
- v. To make recommendations to the Board pertaining to appointment, re-appointment and removal of

external auditors and to approve the remuneration and terms of engagement of the external auditors.

Status: Complied with.

■ Disclosures

The names of the Directors (or persons in the parent company's committee in the case of a group company) comprising the Audit Committee should be disclosed in the Annual Report.

Status: Complied with.

The Committee shall make a determination of the independence of the Auditors and shall disclose the basis for such determination in the Annual Report.

Status: Complied with.

The Annual Report shall contain a report by the Audit Committee, setting out the manner of compliance by the company in relation to the above, during the period to which the Annual Report relates.

Status: Complied with.

Note: The specified criteria for independence of Directors in Direction No. 12 of 2007 of the Central Bank and Section 7.10 of the Listing Rules of the Colombo Stock Exchange are different.