



Paper on the Oversight Mechanism

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Introduction

1. This paper proposes and details the Oversight Mechanism (OM) the Board of Directors (Board) will establish for the purpose of overseeing the management and operation of the Bank, as required by Article 26(iv)¹ of the Asian Infrastructure Investment Bank (AIIB or the Bank) Articles of Agreement (AoA).
2. The Chief Negotiators, in the Explanatory Notes from the Report on the AoA, foresaw the important areas which the OM could cover as additional elements to the regular Board supervision of Management through reporting to the Board by the President. They were, among others: audit, evaluation, fraud and corruption, project complaints and staff grievances. The OM is designed to provide an additional level of assurance and engagement for the Board of Directors in these areas. It is intended to ensure maximum accountability and address potential issues of reputational risk as they arise.
3. Within the Board Decision on the Accountability Framework (AF), it agreed to approve an OM. As AIIB is now nearly three years into operation, most of the components of the OM are already in place and it is appropriate for the Board to now set up an interconnected OM which firmly and formally embeds these components in the governance framework of AIIB.
4. This paper explains in detail the tools the Board has at its disposal to conduct its oversight and supervise the President, and elaborates on how these tools should be organized, including as part of the OM. For the purpose of conceptual clarity in this paper, the word supervision is used to refer to activities the Board undertakes on a regular basis and which are already in place, where oversight will be used only in reference to the oversight under the OM, which is expected to be more issue-specific in nature.

AIIB's Existing Supervision

5. Regular supervision is necessary to ensure that the President manages the Bank in accordance with Board-approved policies and strategies, develops and maintains a

¹ Article 26, "Board of Directors: Powers" states, "The Board of Directors shall [...] (iv) supervise the management and operation of the Bank on a regular basis, and establish an oversight mechanism for that purpose, in line with principles of transparency, openness, independence and accountability; [...]".

high-quality investment portfolio and effectively deploys resources and protects shareholder capital. The Board has effectively supervised Management since AIIB's founding by rigorous review of Management reporting to the Board on all areas of the Bank's business.

6. Furthermore, AIIB has instituted a series of measures to enhance and strengthen the Board's supervision of Management and its ability to hold Management accountable with the approval of the AF. The AF clearly demarcates the division of responsibilities of the Board and the President and has further strengthened accountability and enhanced efficiency and effectiveness of the Bank.
7. Review and approval of **the Bank's annual Business Plan and Budget** is the Board's most important supervision tool. Its supervision of the implementation of the business plan and budget, which has been expanded to include quarterly reporting from Management, gives the Board visibility over and ownership of the key developments across the Bank.
8. The Board sets the priorities for AIIB and the boundaries in which it must operate by approving **policies and key sector strategies**. The Board's role in setting the strategic direction of the Bank was strengthened considerably with the adoption of the AF, which in turn improves its ability to conduct efficient and effective supervision. The Board now approves all strategies (e.g., AIIB no longer uses approach papers) and it can reconsider and reshape these strategies as it sees fit to adapt to changed circumstances. The Board can hold Management accountable by tracking progress against specific indicators in each strategy's results framework. In due course, the Board will approve a Bankwide Results Framework and hold the President and Management accountable for its implementation. This will be done, in part, through the annual review of the performance of the President.
9. Monitoring of **the investment program** is another key area for Board supervision. Through adopting the AF, the Board's supervision of AIIB's operations has broadened. On a quarterly basis, Management reports to the Board on the investment portfolio, while the Board has access to individual project implementation monitoring reports through the Board portal.
10. The Board supervises **the use of financial resources** through receiving quarterly updates on financial activities and provides Management with authorities to borrow, execute asset and liability management operations, as well as manage Bank funds. The Board must also reaffirm annually the risk allocation in the Risk Appetite Statement (RAS) to which Management is held accountable in the pursuance of AIIB's mandate. The supervision here is done to ensure AIIB conducts business in a way that safeguards the high reputation it has already gained within the international community and in the financial world.
11. The Board also supervises **the Human Resources** function of AIIB through Management's quarterly reporting to the Board. Such reporting has evolved over time

to become more sophisticated and comprehensive, and now broadly covers areas like corporate culture development and training.

12. To assist in its supervision, three **committees of the Board** were established, namely the Policy and Strategy Committee (PSC), Budget and Human Resources Committee (BHRC) and Audit and Risk Committee (ARC) (previously known as the Audit Committee, see below explanations for the change). External experts were also competitively appointed to the ARC to advise the Board on best practices and provide impartial views. At the same time, the President established an internal audit function to enhance internal control. The BHRC incorporates the Ethics Committee, as required by the Code of Conduct for Board Officials approved by the Board of Governors.
13. While developing the AF, the Board and the President updated the Bank's organizational structure to strengthen the three lines of defense (LOD), ensuring the Board's delegation of authority of project approvals to the President will result in best practice standards of governance. As part of this, the Audit Committee was revised to become the ARC. It was agreed that the Chief Risk Officer would participate in meetings of the ARC, with a line of access to and raise issues directly to the ARC as and when necessary. Separately, the Chief Internal Audit Officer was given the authority to access and communicate and interact directly with the ARC, including meetings without Management present, as may be required to fulfil its function.

Summary of Existing Supervision and its Relation to the Oversight Mechanism

14. The challenge in defining the scope of the OM is that several of the functions under the OM have corresponding functions within Management. However, this also reflects an appropriate separation of powers to ensure proper checks and balances. The division of labor between the Board and Management is healthy and efficient, as long as the Board is content that sufficient processes are in place for concerns to be elevated to the Board as needed.
15. In general, the components of the OM map against the three LOD Management has established. Management has followed best practice according to the standard definition of the three LOD by the Institute of Internal Auditors. This states that the first LOD is operational management, the second LOD is performed by the risk management and compliance functions and the third LOD is internal audit.
16. In many instances, issues that could ultimately be reviewed under the OM should first be addressed by Management. On financial results, for example, Management has established three LOD, with internal audit being the third LOD. Under the AF, a mechanism was put in place to allow the Chief Internal Audit Officer to raise issues directly with the Board ARC as and when necessary. With this arrangement already in place, the audit function that the Chief Negotiators saw as being part of the OM should be confined to External Audit (see below), which is fully independent of Management.

17. Compliance is another such area. AIIB has organized its compliance function along the following lines:
 - 17.1. Compliance with AIIB's operational policies including its Operational Procurement and Environmental and Social Policy (ESP) for projects is ensured by Investment Operations Department as the first LOD and the Vice President for Policy and Strategy (VP PS) as a second LOD. For the ESP, an additional compliance review performed by CEIU is triggered if Project-affected people register complaints alleging noncompliance and seek a compliance review. That latter process is part of the OM.
 - 17.2. Compliance with AIIB's Financial and Risk Policies and functions recommended by the Bank of International Settlements including Know Your Client (KYC), Anti-Money Laundering (AML), Combating the Financing of Terrorism (CTF) and other laws, rules and standards are ensured by Investment Operations Department and Office of the Treasurer as the first LOD and the Risk Management Department as the second LOD.
18. Management of fraud and corruption risks is a management function performed by Investment Operations (first LOD), Risk Management Department (second LOD) and Internal Audit (third LOD). There is a role for CEIU in investigation of fraud or corruption cases stemming from AIIB's financing of Projects and driving awareness of the Bank's Policy on Prohibited Practices, which is part of the OM integrity function.
19. Management is responsible for delivering results as set out in the corporate results framework or results frameworks for projects or strategies. Management is also responsible for monitoring and reporting on achievements and changes against these results frameworks, including gathering of relevant data and information. CEIU responsibility includes periodic independent evaluation of AIIB investment operations. This may be done as early learning assessments in collaboration with IO or as independent post-evaluations.
20. Both Management and the Board have a role in dealing with staff grievances. The Board authorized in November 2016 the Bank's Staff Regulations. Article 14(2) of the Staff Regulations requires that "[t]he Staff Rules shall establish appropriate procedures to address challenges regarding decisions taken by the Bank which adversely affect them directly and personally." This requirement has been implemented by Staff Rule 8.01, Administrative Review Procedure, adopted by the President in June 2018. Staff Rule 8.01 is an internal administrative review procedure. In the first instance, it provides an opportunity for a Staff member to mediate their grievance with the Director General, Human Resources. If the Staff Member is dissatisfied with the outcome, he or she may seek a final Administrative Review Decision by the President.
21. In such a situation, the President is required to appoint an Independent Reviewer from outside the Bank. Cooperation with the Independent Reviewer is compulsory and failure to cooperate by any staff is misconduct. The Independent Reviewer follows a process

that conforms to due process and generally recognized principles of international administrative law. The recommendation of the Independent Reviewer is copied to the Staff Member concerned at the same time that it is sent to the President. In lieu of reversing or varying the challenged administrative decision, the Independent Reviewer may recommend awarding financial compensation. The President is required to consider the report of the Independent Reviewer and recommendation. To the extent that the President deviates from the recommendation of the Independent Reviewer, he must state reasons for doing so. These procedures for dealing with staff grievances incorporate an independent review to inform the final decision by the President.

22. Under Staff Rule 8.01/10.2, “[a]n anonymized factual and legal summary of the Administrative Review Decision shall be promptly prepared by the General Counsel and made available to the staff of the Bank.” Dissemination of this summary on the Bank’s intranet shall also ensure its availability to the Board.
23. Entirely distinct from this process, Article 13(4) of the Staff Regulations states that “[a] process for appeals [of the President’s Administrative Review Decision] to an independent administrative tribunal shall be established.” As the Bank gains experience with the staff grievance procedure outlined above, an Independent Administrative Tribunal will be established in due time.

Components of the Oversight Mechanism

24. Recognizing the division of labor between the Board and Management, and acknowledging that each area for which the Board should be concerned has a component that is the responsibility of Management, the OM shall focus on the **External Auditor, the external component of Staff Grievances, and three functions of CEIU.**

External Auditor

25. External auditors reside outside any organization’s structure, but perform an important role in the Bank’s overall governance and control structure. The role of the external auditor is to independently assess financial reporting controls and audit financial statements. This, by nature, implies an assessment on part of the first, second and/or third LOD, and thus plays an important role in providing assurances to the Board on the Bank’s internal governance arrangements.
26. The External Auditor is appointed by the Board, upon recommendation by the President through a competitive selection process. The work of the external auditor will be handled through the ARC of the Board, on which it will report annually to the Board. If suitable, these reports could be included in the Annual Report of the ARC, which is already prepared by the committee each year. Given the role in assessing financial reporting controls, and potential engagement in other issues, the President will issue a Directive on the Independence of External Auditor.

Staff Grievances Mechanism

27. AIIB has a transparent process for addressing staff grievances, as the President has adopted Staff Rule 8.01, Administrative Review Procedure (see paragraphs 20-23). Staff Rule 8.01 will be reviewed three years from the implementation of the Oversight Mechanism. This review is important input to implementation of Article 13(4) of the Staff Regulations, since the selection of an appropriate administrative tribunal should be made with a view to coherence with AIIB's internal procedures, settled after a period of testing. Implementation of Article 13(4) of the Staff Regulations will be dealt with in a separate document discussed with, and authorized by, the Board, in due course.
28. While there is no function for the Board in respect of specific cases which go to the Administrative Review Procedure, it is proposed that the BHRC would receive the summary of the Administrative Review Decision, as explained in paragraph 22. It could report annually to the Board on this part of the OM as part of its regular reports.

Three Functions of CEIU

29. CEIU currently benefits from three years' operational experience and is operating smoothly. The goal of agreeing the OM is to formalize these structures and make changes to strengthen the effectiveness of CEIU.
30. The President has established CEIU that reports directly to the Board. CEIU combines three functions (**evaluation, anti-fraud and corruption and complaints handling**) traditionally carried out by different units at other MDBs. CEIU consolidates them under one roof. This allows for greater synergy between these functions (especially in deriving and sharing lessons learned) and supports the Board in its supervisory role. A key consideration in designing CEIU was to ensure it could exercise relevant functions independent of Management while ensuring that CEIU remains engaged with and contributes to the rest of AIIB.
31. To date, CEIU has struck a healthy balance between independence and engagement. MD-CEIU participation in the Executive Committee and other meetings of Management as an observer, at the invitation of the President, is mutually beneficial. This helps CEIU to understand the background and issues related to decisions made by Management and to play a constructive role in expeditiously raising concerns with Management for resolution. It also improves immensely CEIU's overall effectiveness in feeding back findings and becomes a forum for CEIU to participate in the formulation and review of policies and strategies.
32. As an AIIB unit, the staffing and budget components of CEIU should be treated the same way as the regular departments of the Bank. In particular, CEIU and its staff are subject to the same discipline as other departments, including coverage by the Internal Audit Office, and requirements under the Code of Conduct for Bank Personnel and Staff Regulations and Rules. Such equal treatment is consistent with AIIB's Cultural Attributes, which will reinforce the spirit of Bankwide collaboration and openness.

33. However, two areas where independence must be maintained are in the investigation into complaints alleging noncompliance with the ESP in AIIB-financed projects, and evaluation of projects. An adequate budget for these two functions is to be guaranteed (elaborated in the ToR for CEIU). With respect to ESP-related complaints, a process for handling such complaints through the Project-affected People's Mechanism (PPM) was agreed by the Board in 2018. Handling of corruption-related complaints is already provided for in the Prohibited Practices Policy (as updated in 2017) and a sufficient budget is also ensured to carry out these investigations.
34. Conducting evaluations of operations must also be independent. Independent evaluation is necessary to assure that quality standards are not compromised. Evaluation must operate in the absence of Management-imposed restrictions that could limit transparent discussion and the disclosure of evaluation findings. It must also be free of Management-imposed constraints on its budget or human resources when undertaking evaluation of projects. On the other hand, it is appropriate for Management to be engaged in order to enhance the unit's effectiveness when Management applies lessons learned from the early learning assessments and post-evaluation of projects.
35. Management's current focus is developing AIIB's business, under the guidance of the Board. In the coming five years, only a limited number of projects will have been completed and be available for meaningful evaluation. Down the road, following the evaluations of a number of projects, AIIB will be able to assess the effectiveness of operational policies and strategies implemented and the scope of CEIU's functions may be further expanded to include such assessments and thematic reviews. This will be considered as part of the review of the OM in three years. Meanwhile, CEIU can collect information from its operations evaluation and provide that as independent input to the review of policies and strategies in due course. When Management initiates such a review, CEIU will be invited to join the task force as an active member, contributing its independent input to the review.
36. Measures must also be put in place to avoid conflict of interest in the evaluation, complaint-resolution and integrity functions. There must be provisions to ensure that past, current or immediate future employment and financial considerations, or prior professional or personal relationships and considerations, do not interfere with the objectivity, or perceived objectivity, of evaluators and investigators.
37. As AIIB grows, the importance of CEIU's functions will increase. The Board should be fully informed of the work of CEIU on a regular basis. Therefore, it is appropriate to consider a framework for CEIU to hold itself accountable to the Board. There are three layers to the Board's monitoring and supervision of CEIU: First, CEIU provides regular updates to the Board in a format consistent with regular Management updates. Second, CEIU provides detailed reporting on specific areas of work to Board committees. In particular, requests received by the PPM and project evaluation-related issues will be reported to the PSC while investigation of Prohibited Practices and related issues will be reported to the ARC. Third, the MD-CEIU will have a forum to meet with members

of the Board without Management present in an informal setting. The following section describes procedural improvements that will facilitate these meetings.

Dean of the Board and Directors' Forum

38. The Board is AIIB's decision-making body for a wide range of matters specified in the AoA. The Board is composed of the Directors elected by the Board of Governors, while the President chairs the Board. Any decisions that are sought must be taken by the Board through a meeting held in accordance with the AoA and Rules of Procedure of the Board. For example, the Board has the power to decide upon policies, strategies, the commissioning of external reports, and so forth.
39. However, it is also valuable to ensure that there are opportunities for Directors to share information and exchange views among themselves and with the MD-CEIU. Such meetings do not constitute a formal meeting of the Board, but nonetheless procedures need to be established to ensure these are properly structured and to ensure all Directors are afforded the opportunity to participate. The term used to describe these sessions will be "Directors' Forum." The Directors' Forum is for the purpose of sharing information and exchanging views only. To facilitate these sessions, it is proposed that a new position of Dean of the Board be established. The Dean shall chair the Directors' Forum, which includes meetings in the following configurations, and may consult with other members of the Board on any matters relating to proposed Directors' Forum.
 - 39.1. Meetings between members of the Board and a consultant who facilitates the performance review of the President.
 - 39.2. Meetings between members of the Board with the MD-CEIU.
 - 39.3. Meetings between members of the Board.
40. The Dean shall also have a formal role of chairing Board meetings when it considers an Ethics Investigation Report and related issues regarding alleged misconduct of the President. The Rules of Procedure of the Board will be amended to reflect this role.
41. The Dean of Board shall be the longest-serving Director of a different nationality to that of the President, and who is willing to take on the role. The Dean may not concurrently serve as a chair for one of the Board committees. The term for the Dean will be two years and no Director may serve as Dean for more than two consecutive terms.
42. The Corporate Secretary will provide support to the Dean for arranging meetings, including sending notices, convening venues and taking notes, as appropriate. The General Counsel will provide legal advice to the Dean, as appropriate.
43. A Directors' Forum is called by the Dean. The Dean may choose to call a Directors' Forum at the request of a Director, at the request of the MD-CEIU, or on his or her own.