South African Reserve Bank
From the Office of
the Registrar of Banks

G3/2012

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To: All banks, controlling companies, branches of foreign institutions, eligible institutions and auditors of banks or controlling companies

Guidance note 3/2012 issued in terms of section 6(5) of the Banks Act, 1990

Meetings to be held during the 2012 calendar year with the boards of directors of banks and controlling companies

Executive summary

This guidance note serves to inform all banks and controlling companies of the flavour-of-the-year topics for the discussions to be held with the respective boards of directors during 2012.

A. Meetings with boards of directors

1. Introduction

In order to assist the Office of the Registrar of Banks (this Office) to discharge its supervisory responsibilities, the scope of the meetings with banks' boards of directors (Boards) and Chief Executive Officers (CEOs) to be held during the 2012 calendar year will consist of a discussion of the following three flavour-of-the-year topics:

1.1 unsecured lending,
1.2 banks' African strategy, and
1.3 recovery and resolution planning.

2. Format of the meetings to be held with banks' boards of directors

All banks' boards of directors will be required to make a presentation and/or engage in discussion on the above-mentioned flavour-of-the-year topics. Whilst no time limit is prescribed per topic presentation it is intended that each presentation should cover only the key elements of the specific topic. This Office also requires to be furnished with a copy of each presentation at least two weeks prior to the Board meeting. The three flavour-of-the-year topics are discussed in greater detail below.

3. Unsecured lending

3.1 Background

The banking sector has in recent times seen a pronounced growth in banks' exposure to unsecured lending. The result hereof has been a rapid increase, albeit generally from a low base, in on-balance sheet exposure pertaining to personal and term loan categories. This Office wishes to ensure it has a proper understanding of banks' strategies pertaining to unsecured lending and to ensure that banks have in place sufficiently robust risk management policies, processes and procedures to prevent such lending resulting in high levels of bad debts. Consequently, it is against this backdrop that this Office has decided to include unsecured lending as one of the flavour-of-the-year topics.

3.2 Format of presentation

Utilising the format outlined below, the chairperson of the capital and risk management subcommittee will be required to give a presentation on the following aspects:

3.2.1 The bank's definition of unsecured lending.

3.2.2 Overview of governance structures relating to credit risk specifically in respect of unsecured lending.

3.2.3 Business strategy for unsecured lending:

- 3.2.3.1 risk appetite and tolerance levels,
- 3.2.3.2 the extent to which risk appetite and tolerance levels have been breached during the past year, and
- 3.2.3.3 risk assessment (risk-monitoring tools).

3.2.4 Overview of unsecured portfolio highlighting size, tenor and overall risk distribution of the following product types:

- 3.2.4.1 personal loans,
- 3.2.4.2 micro finance, and
- 3.2.4.3 credit cards.

3.2.5 Pricing of products.

3.2.6 Overview of the application process:

- 3.2.6.1 target market,
- 3.2.6.2 affordability test, and
- 3.2.6.3 credit scoring mechanisms.

3.2.7 Risk profiling of clients.

3.2.8 Portfolio performance:

- 3.2.8.1 impaired advances to total loans per product.

3.2.9 Capital:

3.2.9.1 regulatory, and
3.2.9.2 economic capital.

3.2.10 Collections:

3.2.10.1 collection strategies in place,
3.2.10.2 changes, if any, to resource allocation, and
3.2.10.3 details of information technology infrastructure to facilitate effective monitoring and collections.

3.2.11 Write-off policy.

4. Banks' African strategy

4.1 Background

Africa presents banks with various opportunities for sustained growth. Africa's growing trade links with other emerging markets have raised its strategic importance in banking. However, similar to many other countries, African countries face persistent, long-term development challenges. It is against this backdrop that this Office has decided that banks' African strategy should be one of the flavour-of-the-year topics.

4.2 Format of discussion

Utilising the format outlined below, the chairperson of the capital and risk management subcommittee will be required to give a presentation on the following aspects:

4.2.1 Overall African strategy of the bank (per business line or product type).

4.2.2 Challenges vs opportunities.

4.2.3 Consideration of the countries/markets that the bank intends to invest in, with specific focus on the following:

4.2.3.1 country risk (from an economic and business perspective),
4.2.3.2 level of maturity,
4.2.3.3 regulatory landscape of African counterparts, and
4.2.3.4 focus on specific/niche sectors.

4.2.4 Key growth opportunities:

4.2.4.1 retail banking,
4.2.4.2 corporate banking,
4.2.4.3 bancassurance, and
4.2.4.4 other.

4.2.5 Factors influencing the bank's African strategy:

4.2.5.1 shareholders,
4.2.5.2 economic conditions,
4.2.5.3 political stability/interference, and
4.2.5.4 financial outlook.

4.2.6 Consideration relating to the regional and product management model:

4.2.6.1 product offerings,
4.2.6.2 customer segmentation, and
4.2.6.3 competition from local and international competitors.

4.2.7 Factors determining the appropriate structure for the successful execution of the African strategy:

4.2.7.1 management,
4.2.7.2 governance,
4.2.7.3 integration concerns,
4.2.7.4 internal controls, and
4.2.7.5 impact of the global economic crisis on the international banking landscape, and its impact on the Board's strategy to expand into Africa.

4.2.8 Regulatory environment in Africa:

4.2.8.1 regulatory approvals required,
4.2.8.2 ownership,
4.2.8.3 bureaucracy,
4.2.8.4 corruption, and
4.2.8.5 anti-money laundering.

4.2.9 Greenfields vs acquisition considerations:

4.2.9.1 due diligence,
4.2.9.2 start-up costs,
4.2.9.3 branding costs, and
4.2.9.4 distribution points.

4.2.10 Technology platforms:

4.2.10.1 reporting considerations.

4.2.11 Implementation plan:

4.2.11.1 timing considerations.

5. Recovery and resolution planning

5.1 Background

South Africa is currently in the process of strengthening its resolution regime in order to be in line with international best practices. This is being done by drawing on some of the lessons learnt from the interventions of authorities in advanced economies during the global financial crisis. In this regard, the Financial Stability Board (FSB) released the final version of its *Key Attributes of Effective Resolution Regimes for Financial Institutions* (Key Attributes) on 4 November 2011. These Key Attributes constitute the international standard for resolution planning with which South Africa, as a member of both the FSB and the G-20, has to comply.

The main objectives of an effective resolution regime are to (1) reduce moral hazards in the financial system, (2) protect the stability of the financial system, and (3) minimise the cost of crisis resolution to the taxpayer. In order to attain these objectives, processes and arrangements should ideally be in place to enable the orderly unwinding of financial institutions (including systemically significant institutions), preferably without intervention, financial support or guarantees from the government or the central bank. An important element to help achieve this is the requirement that banks should have in place recovery and resolution plans (RRPs) to promote irresolvability as part of the overall supervisory process. Jurisdictions are therefore required to put in place an ongoing process for recovery and resolution planning and to conduct regular resolvability assessments.

A recovery plan component of the RRP should serve as a guide to the recovery of a distressed bank, whereas the resolution component should help to make feasible the resolution of any bank without severe systemic disruption and without exposing taxpayers to loss. The essential elements of the FSB's Key Attributes of RRPs can be viewed on the website: http://www.financialstabilityboard.org/publications, (Annexure III of the document). It is against this backdrop that this Office has decided that banks' recovery and resolution planning should be one of the flavour-of-the-year topics.

5.2 Format of discussion

Banks will not be expected to present a final resolution plan or recovery process to this Office. However, this Office would like to raise awareness and assist Boards in starting the planning process in this regard. Utilising the format outlined below, the chairperson of the capital and risk management subcommittee will be required to make a presentation covering the following aspects:

5.2.1 Key elements:

- 5.2.1.1 the Board's conclusion on the current state of the bank's ability to recover from severe stress and, in the event it was unable to recover, its ability to be resolved over a weekend, if required,
- 5.2.1.2 summary of issues and correcting actions the bank has indentified to improve its recovery actions (or capacity to recover), and
- 5.2.1.3 summary of issues and correcting actions the bank has identified to improve its resolvability.

5.2.2 Key elements of the recovery plan:

5.2.2.1 detailed exposition of how the implementation of the recovery plan fits within the existing risk management framework,
5.2.2.2 explanation of the triggers that would indicate when the plan should be invoked, including the specification of roles and responsibilities and indicating who has the necessary authority to invoke the plan,
5.2.2.3 a comparative summary of the bank/banking group's list of recovery options,
5.2.2.4 description of each recovery option using a consistent framework,
5.2.2.5 list of key executives/managers who will be involved in each recovery action, and
5.2.2.6 communication plan (internal and external) to accompany the recovery options that outlines the issues to be considered when implementing the options, including a description of the roles to be played by individuals identified.

5.2.3 If the bank was to fall under extreme stress, a description of the business continuity and financial continuity procedures in place.

5.2.4 A description of how the bank would provide the regulators, in a timely manner, with the information they would require in order to make the most appropriate decision regarding the actions required to resolve the bank should action be required.

5.2.5 A description of the scenarios that address capital shortfalls and liquidity pressures.

5.2.6 A description of the processes in place to ensure the timely implementation of recovery options in a range of stress scenarios.

5.2.7 Sale of one or more business units – likelihood of shareholder and regulatory approval.

5.2.8 Names and contact details of members of the team responsible for implementing the plan and the location of team members.

5.2.9 Banks should have in its possession a substantive resolution strategy agreed to by the senior management of the bank and an operational plan for its implementation. In particular, the plan should identify:

5.2.9.1 financial and economic functions for which continuity is critical,
5.2.9.2 suitable resolution options to either preserve those functions or wind them down in an orderly manner,
5.2.9.3 data requirements on the bank's business operations, structures, and systemically important functions,
5.2.9.4 potential barriers to effective resolution and actions to mitigate those barriers, and
5.2.9.5 clear options or principles for the exit from the resolution process.

B. Acknowledgement of receipt

1. Two additional copies of this guidance note are enclosed for use by your institution's independent auditors. The attached acknowledgement of receipt, duly completed and signed by both the chief executive officer of the institution and the said auditors, should be returned to this Office at the earliest convenience of the aforementioned signatories.

René Van Wyk
Registrar of Banks

The previous guidance note issued was Guidance Note 2/2012, dated 8 February 2012.