South African Reserve Bank

Prudential Authority

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G4/2019

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

Guidance Note 4/2019 issued in terms of section 6(5) of the Banks Act 94 of 1990

Meetings to be held during the 2019 calendar year with the boards of directors of banks and controlling companies

Executive summary

The purpose of this guidance note is to inform all banks with an asset size in excess of R50 billion, and the auditors of such banks, regarding the flavour-of-the-year topic for the discussions to be held with the respective boards of directors during 2019.

1. Background

1.1 In order to assist the Prudential Authority (the PA) to discharge its supervisory responsibilities, the scope of the meetings with boards of banks' directors (boards) to be held during the 2019 calendar year, must include a discussion on the flavour-of-the-year topic, '*The creation and institutionalisation of a culture of ethics and awareness*.'

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

The boards of all banks will be required to make a presentation and engage in discussions on the above-mentioned flavour-of-the-year topic. The duration for the presentation should be targeted at approximately 45 minutes. It is intended that the presentation should cover only the key elements of the topic. The PA also requires to be provided with a copy of the presentation at least two weeks prior to the board or executive committee meeting. The flavour-of-the-year topic is elaborated upon further below.

3. Considerations regarding matters pertaining to the institutionalisation and adoption of a culture of ethics

3.1 Background

The Banks Act No 94 of 1990

Section 60B of the Banks Act No 94 of 1990 requires that the process of corporate governance shall be established with the objective of achieving the bank's strategic and business objectives efficiently, effectively, *ethically* and equitably (within acceptable risk parameters), to ensure-

(a) compliance with the strategic framework and guidelines established for the bank or controlling company;

(b) commitment by the executive officers of the bank or controlling company to adhere to corporate behaviour that is universally recognised and accepted as correct and proper;

(c) a balance of interests of the shareholders and other interested persons who may be affected by the conduct of directors or executive officers of the bank or controlling company within a framework of effective accountability;

(d) that mechanisms and procedures are established and maintained to minimise or avoid potential conflicts of interests between the business interests of the bank or controlling company and the personal interests of directors or executive officers of the bank or controlling company;

(e) responsible conduct by the directors and executive officers of the bank or controlling company;

(f) achievement of the maximum level of efficiency and profitability of the bank within an acceptable risk profile for the bank or controlling company;

(g) timely, accurate and meaningful disclosure of matters that are material to the business of the bank or controlling company or the interests of the shareholders of or other persons having an interest in the bank or controlling company;

(h) that the board of directors retains control over the strategic and business direction of the bank or controlling company, whilst enabling its executives to manage the bank's or controlling company's operations and the achievement of the agreed strategic and business objectives; and

(i) compliance with all applicable laws and regulations.

The Companies Act no. 71 of 2008 and the Companies Amendment Act no. 3 of 2011

The Companies Act no. 71 of 2008 (Companies Act), as well as the Companies Amendment Act (no. 3 of 2011), came into effect on 1 May 2011, and regulation 43 to the Companies Act states that the following entities must have a social and ethics committee in place:

- all listed public companies;
- all companies who have a significant public interest; and
- any company with more than 500 employees or a turnover of more than R500 million.

King IV Report on Corporate Governance for South Africa 2016

The King IV Report on Corporate Governance for South Africa 2016 (King IV) mentions that 'corporate governance for the purposes of King IV is defined as '*the exercise of ethical and effective leadership'*.

Part 5.1 relating to leadership, ethics and corporate citizenship, under principle one requires that the '*governing body should lead ethically and effectively'*.

Under principle two of Part 5.1 it is stated that '*the governing body should govern the ethics of an organisation in a way that supports the establishment of an ethical culture'*.

Basel Committee for Banking Supervision principles

The Basel Committee for Banking Supervision (BCBS), in its 2015 paper entitled '*Corporate governance principles for banks*' (governance principles), specifically mentions the requirement and responsibility of the board to '*set the tone at the top.*'

Paragraph 14 of the governance principles specifically mentions that among their other responsibilities, board members and senior management are expected to define conduct risk based on the context of the bank's business.

It further elaborates on cases of misconduct that have been identified as stemming from:

- *the mis-selling of financial products to retail and business clients;*
- *the violation of national and international rules (tax rules, anti-money laundering rules, antiterrorism rules, economic sanctions, etc.); and*
- *the manipulation of financial markets – for instance, the manipulation of Libor rates and foreign exchange rates.*

The board should set the "tone at the top" and oversee management's role in fostering and maintaining a sound corporate and risk culture. Management should develop a written code of ethics or a code of conduct. Either code is intended to foster a culture of honesty and accountability to protect the interest of its customers and shareholders.

The notions of promoting a sound corporate culture in respect of ethics are also detailed within paragraphs 29, 31, 32 and 77 of the governance principles as follows:

a) Paragraph 29 reads as follows:

A fundamental component of good governance is a corporate culture of reinforcing appropriate norms for responsible and ethical behaviour. These norms are especially critical in terms of a bank's risk awareness, risk-taking behaviour and risk management (i.e. the bank's "risk culture").

In order to promote a sound corporate culture, the board should reinforce the 'tone at the top' by:

- setting and adhering to corporate values that create expectations that all business should be conducted in a legal and ethical manner, and overseeing the adherence to such values by senior management and other employees;
- promoting risk awareness within a strong risk culture, conveying the board's expectation that it does not support excessive risk-taking and that all employees are responsible for helping the bank operate within the established risk appetite and risk limits;
- confirming that appropriate steps have been or are being taken to communicate throughout the bank the corporate values, professional standards or codes of conduct it sets, together with supporting policies; and
- confirming that employees, including senior management, are aware that appropriate disciplinary or other actions will follow unacceptable behaviours and transgressions.

b) Paragraph 31 reads as follows:

A bank's code of conduct or code of ethics, or comparable policy, should define acceptable and unacceptable behaviours.

- It should explicitly disallow illegal activity, such as financial misreporting and misconduct, economic crime including fraud, breach of sanctions, money laundering, anti-competitive practices, bribery and corruption, or the violation of consumer rights.

- It should make clear that employees are expected to conduct themselves ethically and perform their job with skill and due care and diligence in addition to complying with laws, regulations and company policies.

c) Paragraph 32 reads as follows:

The bank's corporate values should recognise the critical importance of timely and frank discussion and escalation of problems to higher levels within the organisation.

- Employees should be encouraged and able to communicate, confidentially and without the risk of reprisal, legitimate concerns about illegal, unethical or questionable practices. This can be facilitated through a well communicated policy and adequate procedures and processes, consistent with national law, which allow employees to communicate material and bona fide concerns and observations of any violations in a confidential manner (e.g. whistle-blower policy). This includes communicating material concerns to the bank's supervisor.

- The board should have oversight of the whistleblowing policy mechanism and ensuring that senior management addresses legitimate issues that are raised.

- The board should take responsibility for ensuring that staff who raise concerns are protected from detrimental treatment or reprisals.

- The board should oversee and approve how and by whom legitimate material concerns shall be investigated and addressed by an objective independent internal or external body, senior management and/or the board itself.

d) Paragraph 77 reads as follows:

Other specialised committees that are recommended include:

- Ethics and compliance committee: ensures that the bank has the appropriate means for promoting proper decision-making, due consideration of the risks to the bank's reputation, and compliance with laws, regulations and internal rules.

United Nations Global Impact Principles and the ISO 26000 Guidance on Social Responsibility

The United Nations Global Impact Principles were effected to enforce the notion of corporate sustainability founded on the premise of a principled to conducting business. The 10th principle of the United Nations Global Impact Principles states that:

- Businesses should work against corruption in all its forms, including extortion and bribery.

The ISO 26000 Guidance on social responsibility standard acknowledges that corruption is recognised as a major hindrance to sustainable development, with a disproportionate impact on poor communities and recognises that it can also distort competition, distribution of wealth and economic growth.

3.2 Format of discussion

The PA requires the chairperson of the Social and Ethics Committee to present to the PA on how the ethics of your organisation is governed in a *way that supports the establishment of an ethical culture.* The presentation should also deal with the pertinent provisions of the Companies Act, the Banks Act, BCBS principles, and King IV; the UN Global Compact Principles may also be referred to.

Further to the aforementioned, the presentation should highlight detail regarding your ethics governance framework, which would include providing an overview of how monitoring and reporting occurs, how the institutionalisation of ethics is achieved, the ethics strategy your bank prescribes and whether there are any specific codes or policies addressing ethics in place.

4. Acknowledgement of receipt

4.1 Kindly ensure that a copy of this guidance note is made available to your institution's external 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 the Prudential Authority at the earliest convenience of the aforementioned signatories.

Kuben Naidoo
Deputy Governor and CEO: Prudential Authority

Date: 4 APRIL 2019

The previous guidance note issued was Guidance Note 3/2019, dated 1 April 2019.