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P O Box 427 Pretoria 0001 South Africa
370 Helen Joseph Street Pretoria 0002
+27 12 313 3911 / 0861 12 7272
www.resbank.co.za



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

Guidance Note 3/2021 issued in terms of section 6(5) of the Banks Act 94 of 1990

Distribution of dividends on ordinary shares and payment of cash bonuses to executive officers and material risk takers in light of the negative economic impact of the coronavirus disease 2019 (COVID-19) pandemic and the temporary regulatory capital relief provided by the Prudential Authority.

Executive summary

Since the outbreak of COVID-19, South Africa and the rest of the world have experienced both a first and second wave of infections. The negative impact of the spread of COVID-19 on the global and local economy resulted in the Prudential Authority (PA) providing substantive temporary regulatory relief to banks, branches of foreign institutions and controlling companies (hereinafter collectively referred to as 'banks') in 2020.

Although the full impact of the pandemic on the economy is uncertain, the successful rollout of vaccines is expected to boost global economic growth. Banks play a critical role in continuing to provide the necessary required funding to the wider economy amid the COVID-19 pandemic. In light of the above, it is essential that banks conserve their capital resources, among other things, to continue to retain their capacity to support the real economy in this environment of heightened uncertainty, while continuously complying with the prescribed prudential requirements and ensuring their long-term safety and soundness. In addition to supporting the real economy, capital resources must also be available to absorb losses that may result from an economic downturn.

As such, banks are advised to be prudent and consider the adequacy of their current and forecasted capital and profitability levels, internal capital targets and risk appetite as well as current and potential future risks posed by the ongoing pandemic when making distributions of dividends on ordinary shares and the payment of cash bonuses to executive officers and material risk takers. This guidance note outlines the need for banks to act prudently when considering making distributions of dividends on ordinary shares and the payment of cash bonuses to executive officers and material risk takers in 2021. The benefits of the regulatory relief measures provided by the PA should not be utilised for the aforementioned distribution of dividends and payment of bonuses.

This guidance note replaces Guidance Note 4 of 2020.

1. Introduction

- 1.1 Owing to the outbreak of the COVID-19 pandemic in South Africa in 2020, the PA pursued a range of temporary regulatory and supervisory relief measures to promote the safety and soundness of regulated financial institutions and, together with the South African Reserve Bank (SARB), undertook measures to mitigate the risks to financial stability caused by COVID-19.
- 1.2 Although the virus may continue in new waves, the successful rollout of vaccines is expected to boost global economic growth and, as a result, the SARB has revised global growth for 2021 upwards.
- 1.3 As stated hereinbefore, banks play a critical and unique role in supporting the wider economy, particularly during a period of economic disruption, such as the disruption caused by COVID-19.
- 1.4 Regulation 39(1) of the Regulations relating to Banks (the Regulations) imposes a duty on the board of directors of a bank to ensure that an adequate and effective process of corporate governance, which is consistent with the nature, complexity and risk inherent in the bank's on- and off-balance sheet activities and which responds to changes in the bank's environment and conditions, is established and maintained.
- 1.5 Furthermore, regulation 39(16) of the Regulations imposes a duty on the board of directors of a bank to ensure that:
 - 1.5.1 the bank's compensation or remuneration policies, processes, practices and procedures are duly aligned with the board-approved tolerance for risk or risk appetite, and in particular the board of directors shall ensure that compensation in the bank is duly adjusted for all relevant and material types of risk; and
 - 1.5.2 the bank's policies, processes, practices and procedures protect and promote the long-term safety and soundness of the bank.
- 1.6 Regulation 38(4) of the Regulations states that when the PA is of the opinion that a bank's policies, processes and procedures relating to compensation or remuneration are inadequate, the PA, among other things, may require the said bank:
 - 1.6.1 to maintain additional capital, calculated in such a manner and subject to such conditions as may be specified in writing by the PA; or
 - 1.6.2 to duly align the bank's compensation or remuneration policies, processes or procedures with the bank's relevant exposure to risk.

2. Guidance

- 2.1 The PA considers it critical that banks continue to fulfil the fundamental role of providing the required funding, among other things, to households and businesses amid the COVID-19 pandemic. For this purpose, it is essential that banks continue to appropriately conserve capital to retain their capacity to support the real economy in an environment of heightened uncertainty that continues to be caused by COVID-19.

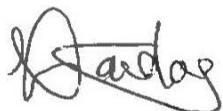
- 2.2 As such, the PA is of the view that capital resources must continue to be available to support the real economy and to absorb losses in the immediate and medium to long term and, as such, the PA expects banks to take into consideration the adequacy of their current and projected capital and profitability levels, internal capital targets and risk appetite as well as current and potential future risks of the global pandemic when making distributions of dividends on ordinary shares and payments of cash bonuses to executive officers and material risk takers in 2021.
- 2.3 The benefits of the regulatory relief measures provided by the PA in 2020 should not be utilised for making distributions of dividends on ordinary shares and making payments of cash bonuses to executive officers and material risk takers.
- 2.4 In those instances where boards of directors of banks do approve the distributions of dividends on ordinary shares and/or payments of cash bonuses to executive officers and material risk takers in 2021, payout ratios should be prudent and commensurate with the assessment of the current conditions and potential future uncertainty.
- 2.5 The responsibility for approving the distribution of dividends on ordinary shares and the payments of cash bonuses to executive officers and material risk takers ultimately rests with the board of directors of a bank. The PA remains confident that the respective boards of directors of banks will act prudently and will duly take into consideration, among other things, the current and anticipated capital levels of their banks, the current and future impact of COVID-19 and the slow pace of economic growth on the safety and soundness of their respective institutions.

3. Further action

- 3.1 Banks that are uncertain about the intended application of this guidance note should contact their respective frontline analysts for further guidance.
- 3.2 The PA will continue to engage with the banking industry and all other relevant stakeholders during this time, and will issue further guidance or implement additional measures as and when necessary.

4. Acknowledgement of receipt

- 4.1 Kindly ensure that a copy of this guidance note is made available to 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 the PA at the earliest convenience of the aforementioned signatories.



Kuben Naidoo
Deputy Governor and CEO: Prudential Authority

Date: 18 February 2021

Encl. 1

The previous guidance note issued was Guidance Note 2/2021, dated 11 February 2021.