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SOUTH AFRICAN RESERVE BANK
Prudential Authority

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

Guidance Note 3/2022 issued in terms of section 6(5) of the Banks Act 94 of 1990

Meetings to be held during the 2022 calendar year with the boards of directors of banks, controlling companies, and branches of foreign institutions.

Executive summary

This guidance note serves to inform all banks, controlling companies, and branches of foreign institutions (hereinafter collectively referred to as 'banks') of the flavour-of-the-year topic for the discussions to be held with the respective boards of directors (boards) of banks during 2022.

A. Meetings

1. Introduction

1.1 To assist the Prudential Authority (PA) to discharge its supervisory responsibilities, the scope of the meetings with the banks' boards during the 2022 calendar year will include a discussion on the following flavour-of-the-year topic:

2. Succession planning

2.1 Background

2.1.1 Ongoing changes in the business and operating environment, transformation, market disruption, innovative technologies, new business models and other forms of competitive pressures, require a suitable level of continuity in corporate governance and organisational structures of financial institutions. This in turn necessitate that financial institutions continually identify suitably skilled and experienced individuals who are capable of strategically steering it through the challenges brought about by aforementioned changing conditions. Governing bodies, such as the board, board committees, executive committees, management forums and other key individuals/persons should also be agile and attuned to these changes and ensure that proactive succession planning is done to respond to expected and unexpected changes in the composition of boards, board committees, senior management, and other key individuals/persons in financial institutions. Being unprepared for aforementioned changes could result in uncertainty, instability and pose a potential risk to financial institutions. While executive and senior management turnover is inevitable, unexpected occurrences can create uncertainty and disorder in any management team, particularly in the absence of an adequate and comprehensive succession plan/program/strategy.

2.1.2 Succession planning essentially entails strategically identifying and developing new and potential leaders and key talent who can move into leadership and/or key roles when they become vacant, and is therefore critical for boards, executives, key individuals/persons responsible for risk management, compliance, and internal audit functions (assurance providers), and other business-critical roles. It entails having a long-term vision for the financial institution and may entail lateral moves, assignments to special projects, leadership within teams, and internal or external development opportunities.

2.1.3 Succession planning has implications for the strategy of a bank, its reputation, its sustainability, corporate governance, and corporate social responsibility. Poor succession planning inevitably could create a leadership vacuum at both a board, executive and senior management levels, and could negatively impact the financial institution's ability to successfully achieve its longer-term strategic focus and objectives and could undermine confidence in the bank and its governance structures. It is critical that a bank's succession plan/program/strategy is a living document that is active, current, includes a deliberate development and cross-training focus, and ideally has multiple potential candidates and developmental programs. It should be a multilayered process involving a detailed assessment of the bank's needs relative to its resource and skill gaps, with an intentional focus on developing potential successors for key roles, while promoting accountability through ongoing evaluation. It is the foundation to successfully address both planned and unexpected critical staff changes and should be a continuous and well thought-through process.

2.1.4 The PA's governance review methodology is informed *inter alia* by the Banks Act 94 of 1990 (the Banks Act), Banks Act Directive 4/2018, the King Code (King IV) on Corporate Governance, and other corporate governance best practices (see Banks Act Directive 4/2018 for other references). King IV highlights the importance of a succession plan for both executive and non-executive governing body members as critical to the effectiveness of the governing body. Practice 13 of Principle 7 states that "the governing body should establish a succession plan for its membership which should include the identification, mentorship and development of future candidates". King IV further recommends that governing bodies should ensure succession plans exist for their own members, as well as for the chief executive officer (CEO) and the executive management team.

2.1.5 Section 64B of the Banks Act states that the board of a bank and controlling company shall establish a directors' affairs committee (DAC), consisting only of non-executive directors of the bank or controlling company. The functions of the DAC shall be to assist the board to establish and maintain a board directorship continuity programme entailing a review of the performance of and planning for successors to the executive directors, ensure measures are in place to ensure continuity of non-executive directors; and a regular review of the composition of skills, experience and other qualities required for the effectiveness of the board. The DAC shall assist the board in the nomination of successors to key positions in the bank or controlling company in order to ensure that a management succession plan is in place.

2.1.6 With reference to the PA's pre-emptive, outcomes focused and risk-based supervisory approach, it is important for the PA to assess and determine that banks have robust, adequate, and efficient succession plans, practices, and policies in place, that are commensurate with its size, nature and complexity of a bank and will result in successors that are fit and proper and are eligible in terms of relevant legislation. This assessment forms an important component to enhance the PA's ability to effectively achieve its ongoing supervisory objectives and mandate. Interactions between banks and the PA on succession planning should be timely, open and frank.

2.2 Format of discussion

2.2.1 The chairperson of the DAC (or equivalent) is required to make a presentation to the PA on succession planning. The duration of the presentation should be approximately 75 minutes.

2.2.2 The PA requires a copy of the presentation to be provided at least three weeks prior to the date of the board meeting.

2.2.3 As a minimum, the following aspects, as it relates to the involvement of the board / senior executives / representatives, should be covered during the presentation:

a. General overview of the institution's approach to talent management and succession planning.
b. Indication of which governance forums/decision-making forums have the mandate to discuss and recommend succession planning for the CEO and non-executives of the board and the frequency of it, including whether any deviations are permissible to internal processes and mandates.
c. Indication of which governance forums have the mandate to discuss succession planning for senior executives, assurance providers and other business-critical roles, and the frequency thereof, including whether any deviations are permissible to internal processes and mandates.
d. Demonstrating that the board has a clear and robust succession strategy to identify, assess and select board candidates, including reviewing whether board candidates possess the relevant knowledge, skills, and experience to ensure that current and future competencies are aligned to the bank's strategy.
e. Overview of the current approved succession plan for the board, board committees, the chair of the board, executives and key senior management, assurance providers and other business-critical roles and plans to fill existing vacancies. This should include key roles most at risk and succession plans in place to mitigate the risk.
f. The Board's assessment of the adequacy of existing succession planning, including the adequacy of coverage of emergency/interim (unplanned vacancy) successors, ready now successors, ready in 1-2 years successors, and ready in 3-5 years successors, and gaps identified and how provision is being made for potential multiple shifts within an organisation.
g. Board Directorship continuity programme and succession planning: Overview of processes in place for the board, executives and key senior management, and the frequency of review of the aforementioned.
h. Skills and experience required of board members and senior executives to effectively implement the bank's strategy.

i. Processes in place to identify future board members (e.g., whether head-hunters or external consultants are used, and so forth.), mentorship and development of existing board members.
j. Development plans for successors, including training programs and assessment of performance against development plans.
k. Internal and external communication plan (including consideration of regulatory requirements such as listing requirements where relevant) to deal with any changes in the board, senior executives and so forth.
l. Challenges faced in attracting suitable candidates and scarce skills.
m. Overview of nominations/board appointment policy, including frequency of review thereof.
n. Transformation considerations undertaken in succession planning and targets.
o. Board evaluation process and how succession planning is assessed as part of the evaluation.
p. Retirement age of executives and board members, including the policy that governs age and tenure.
q. Issues relating to succession planning raised by internal and/or external audit in the past 2 years.
r. Metrics in place to assess the effectiveness of succession planning (including but not limited to evidence in the form of turnover rates, ability of the organisation to retain talent, % of open positions filled from succession candidates, time taken to fill open positions, duration of key positions performed on an interim basis, recruiting costs etc.)
s. Method/s applied to identify successors, and extent of granularity in reviewing and identifying talent in terms of junior, middle, and senior management.

2.2.4 As a minimum, the following documents should be submitted:

a. Agenda and unredacted minutes of the governance forums/decision-making forums where succession was discussed (last 4 meetings).
b. Terms of reference of the committee/s mentioned in point 2.2.4 a above.
c. Copies of the formal succession plans in place for the board, senior executives, assurance providers and other business-critical roles. (Should include emergency/interim (unplanned vacancy), ready now, ready in 1-2 years, ready in 3-5 years coverage and names of identified individuals with details regarding their age, qualifications, experience, tenure, and current positions). The PA may request copies of the CV's of successors.
d. Board Directorship continuity programme.
e. Development plans for successors, including training programs and assessment of performance against development plans.
f. Nominations/board appointment policy.
g. Policy that governs retirement age and tenure.

2.2.5 The PA will continue to closely monitor succession planning as part of its ongoing supervision and will engage banks on the matter through other prudential meetings such as the meetings with the Chairperson of the Board and CEO of the bank and key business lines/segments, where necessary. Due to the sensitive nature of succession planning discussions, the PA may request closed sessions with the DAC and/or the CEO to discuss more pertinent details of a bank's formal succession plan, as and when needed. This will form part of the agenda of the meeting and banks will be advised of this in good time prior to the meeting.

2.2.6 In preparation for the meeting with the board/executives as well as other engagements, your institution may be requested to furnish the PA with certain additional documentation and/or information on succession planning (this will be communicated prior to engagements). Such documentation and/or information must be forwarded electronically to the PA prior to any meeting or engagement.

2.2.7 Further, in preparation for the meeting, the Board is required to ensure that only persons that are familiar with the succession plan/s are present for the discussion so as to not breach internal confidentiality.

2.2.8 The PA may consider communicating the thematic outcome of these engagements to the industry at an aggregated industry level.

B. Acknowledgement of receipt

1. Kindly ensure that a copy of this guidance note is made available to your institution's Board and auditors. The attached acknowledgement of receipt, duly completed and signed by both the CEO of the institution and the said auditors, should be returned to the PA at your earliest convenience of the aforementioned signatories.

Kuben Naidoo
Deputy Governor and CEO: Prudential Authority

Date: 11 March 2022

Encl. 1

The previous guidance note issued was Banks Act Guidance Note 2/2022, dated 9 March 2022.