SOUTH AFRICAN RESERVE BANK
Prudential Authority

# Prudential Standard MB01 - Governance and risk management requirements for mutual banks

***Objectives and key requirements of Prudential Standard MB01***

*This Standard is made under sections 105 and 107 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) read with sections 1A and 91 of the Mutual Banks Act, 1993 (Act No. 124 of 1993).*

*It is the responsibility of the board to ensure that the mutual bank meets the principles and requirements for governance and risk management on a continuous basis.*

*This Standard prescribes the Prudential Authority's requirements and principles on governance and risk management for mutual banks with regard to culture, governance, risk management, the role of the board, board committees, conduct of directors and executive officers, fitness and propriety of directors and executive officers, internal controls, control functions, outsourcing, remuneration, conflict of interest, related party transactions and disclosures.*

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## 1. Commencement

1.1 This Standard commences on XX XXXX 2021.

| Version number | Commencement date |
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| 1 | XX XXXX 2021 |
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## 2. Legislative authority

2.1. This Standard is made under sections 105 and 107 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) read with sections 1A and 91 of the Act.

## 3. Application

3.1. This Standard applies to all mutual banks licensed under the Act.

## 4. Definitions and interpretation

4.1. In this Standard, 'the Act' means the Mutual Banks Act, 1993 (Act No. 124 of 1993) and any word or expression to which a meaning has been assigned in the Act or the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) bears the meaning so assigned to it, unless the context indicates otherwise.

4.2 For the purpose of this Standard:

(a) **'control function'** means each of the following:
   (i) the risk management function;
   (ii) the compliance function; and
   (iii) the internal audit function;

(b) **'executive officer'** means any employee of the mutual bank who is in charge of a risk management function of the mutual bank, the head of a control function of the mutual bank, and any manager of the mutual bank who is responsible, or reports, directly to the chief executive officer of the mutual bank;

(c) **'material business activity or function'** means a business activity or function that has the potential to have a significant impact on the mutual bank's business operations or its ability to manage risks effectively should it be disrupted;

(d) **'non-executive director'** means a director that is not an employee of the mutual bank or an employee of a related party or associate of the mutual bank;

(e) **'senior management'** means an executive officer and the chief executive officer of a mutual bank; and

(f) **'related party'** in relation to a person (the "first person"), means a person connected to the first person in a manner described in section 2(1)(a), (b) or (c) of the Companies Act, 2008 (Act No. 71 of 2008).

4.3 The 'Objectives and key requirements of Prudential Standard MB01' that are italicised in the preamble of this Standard must not be used in the

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interpretation of any paragraph of this Standard.

## 5. Roles and responsibilities

5.1 The care, diligence, skill and prudence exhibited by the board and senior management of a mutual bank have a critical influence on the mutual bank's viability, safety and soundness as well as its ability to meet its business objectives.

5.2 Although governance processes may differ from one mutual bank to another, the foundations of good governance are created by the board and senior management who are entrusted by the members to understand and diligently discharge their responsibilities with prudence.

5.3 The board of the mutual bank is ultimately responsible for ensuring that the mutual bank complies with all the requirements and principles of good governance and risk management outlined in this Standard.

5.4 The board, auditors of the mutual bank, the employee in charge of a risk management function and the heads of other control functions must without undue delay inform the Prudential Authority in writing of any matter they become aware of in the performance of their functions that will negatively affect the maintenance of sound governance and risk management principles.

## 6. Role of the board

6.1 An effective corporate governance framework plays a fundamental role in ensuring that a mutual bank responsibly delivers on its obligations to its stakeholders while ensuring the ongoing viability of the business.

6.2 The overall accountability for the mutual bank rests with the board. In driving the culture of the mutual bank, the board must consider the following principles:

(a) create, protect and return member value;
(b) lay solid foundations for management and oversight;
(c) structuring the board to add member value;
(d) act ethically and responsibly;
(e) safeguard integrity in reporting;
(f) make timely and balanced disclosures;
(g) respect the rights of members and other stakeholders;
(h) recognise and manage risk; and
(i) remunerate fairly and responsibly.

6.3 The board of a mutual bank in discharging its governance responsibilities must ensure that the following key areas of governance are effectively managed and addressed:



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(a) **A culture of ethics**: Approving and monitoring organisational ethics, adherence to values of mutuality, operational and compliance standards and policies. Acknowledging that acting ethically and responsibly goes beyond mere compliance with legal obligations. Reinforcing the principle of acting with honesty and integrity to create, protect and return value to members and financial customers, including acting ethically towards the broader community.

(b) **Strategic planning**: Considering, approving, and monitoring strategic business plans for the mutual bank. Finalising a clear set of strategic objectives designed to ensure the sustainable creation, protection and return of value for members and financial customers. Obtaining collaboration and support for these strategic objectives from the members. Monitoring and reviewing implementation of the strategic objectives and reporting regularly to members as to the implementation, monitoring and review of the strategic objectives.

(c) **Oversight**: Approving and overseeing management's implementation of the mutual bank's strategic objectives, governance and risk management frameworks as well as the corporate culture. This should also include mechanisms to determine how the performance of the board and senior management is monitored and evaluated.

(d) **Structure of the board**: A mutual bank must have a board that meets the organisation's minimum requirements, is of an appropriate size, diversity and composition, and has the skills, independence and commitment to discharge its duties and responsibilities effectively.

(e) **Competent senior management**: The appointment of a chief executive officer and executive officers that have the necessary experience, knowledge and qualifications to operate the mutual bank and is a fit and proper person as contemplated in paragraph 8 .

(f) **Risk identification**: Recognising, identifying and evaluating the risks involved in the mutual bank's business operations.

(g) **Systems integrity**: Ensuring that business operations and systems are managed within a formal IT framework.

(h) **Succession planning**: Developing a plan of succession to replace directors, the chief executive officer and executive officers should the need arise.

(i) **Communication and disclosure**: Approving and monitoring a system of effective communication that addresses communication between the different structures, levels and stakeholders of the mutual bank. A mutual bank must make timely, transparent and balanced disclosure of all matters concerning the mutual bank that a reasonable person would expect to have a material effect on the value received from ongoing membership and the interests of members and other stakeholders.

(j) **Accountability**: The board is primarily accountable for the governance and performance of the mutual bank. The board is also accountable for ensuring that the mutual bank follows the applicable laws, behaves in an ethical manner, and manages the member's and financial customer's funds with due care.

(k) **Relationship with stakeholders**: The mutual bank must consider and implement processes and procedures to define clear roles and ensure effective relationships with stakeholders.

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6.4 In addition to the responsibilities outlined in paragraph 6.3, the board must ensure that:

(a) an effective board-approved governance framework is developed, documented and implemented by the mutual bank;
(b) the governance framework:
    (i) is proportionate to the nature, scale and complexity of the business and risks of the mutual bank;
    (ii) includes effective systems of corporate governance, risk management and internal controls; and
    (iii) is reviewed at least annually;
(c) the board's roles and responsibilities are clearly specified in the governance framework and includes but is not limited to:
    (i) establishing and overseeing the risk management function;
    (ii) overseeing the control functions and material risk decisions;
    (iv) ensuring the independence and adequate resourcing of the control functions; and
    (iv) establishing and overseeing the effective implementation of a remuneration and incentive model that demonstrably supports prudent decision making, is consistent with the mutual bank's risk appetite, and does not induce excessive or inappropriate risk taking.
(d) there is adequate disclosure of the respective roles and responsibilities of the board and senior management;
(e) there are appropriate processes in place that support strong communication between different levels of management, the board and board committees;
(f) the mutual bank has comprehensive internal processes to assist the board and senior management to monitor and assess the adequacy and effectiveness of the mutual bank's risk-management policies, procedures, systems, and controls;
(g) the internal processes referred to in sub-paragraph (f) above must be structured wherever feasible in accordance with the three lines of defence risk management model, comprising the first-line of defence-management and internal controls, second-line of defence – risk management and compliance and third-line of defence - internal audit;
(h) where the members of the mutual bank are significant owners, that robust risk management and disclosure processes are implemented to ensure that the significant owner does not introduce additional risk or disproportionately influences decision-making, governance and risk management processes; and
(i) there are robust processes to address conflict of interest and encourage whistle-blowing.

## 7. Conduct of directors and executive officers

7.1 In addition to the provisions of regulation 37 of the Regulations relating to Mutual Banks and section 37(2) of the Act, a director and executive officer in the performance of his or her functions must:

(a) act in accordance with the highest standards of honesty and ethical conduct;

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(b) protect and safeguard the assets and resources of the mutual bank against loss, theft, misuse and misapplication;
(c) ensure effective communication with and provision of accurate information relating to financial and operational matters to the members of the mutual bank;
(d) ensure full, accurate, sensible, timely and meaningful disclosures in reports or returns submitted to the Prudential Authority and other regulatory authorities;
(e) treat information obtained in the performance of his or her functions with the necessary confidentiality;
(f) disclose conflict of interest; and
(g) ensure compliance with all applicable legislation and report any non-compliance or unlawful behaviour to the relevant financial sector regulator or regulatory authorities.

## 8. Fitness and propriety of directors and executive officers

8.1 All directors and executive officers must be fit and proper to hold such positions. In addition to the provisions of regulation 39 of the Regulations relating to Mutual Banks, the Prudential Authority may object to the proposed appointment by means of a written notice stating the grounds for the objection within 20 days of receipt of the notice referred to in regulation 39 of the Regulations relating to Mutual Banks.

8.2 The mutual bank must have processes in place to assess the fitness and propriety of new directors and executive officers as well as to review the fitness and propriety of existing directors and executive officers at least on an annual basis.

8.3 In addition to the provisions of section 38 of the Act, the mutual bank must, when assessing and reviewing the fitness and propriety of directors and executive officers, have regard to:

(a) the competence and soundness of judgment of the person for the fulfilment of the responsibilities of the particular office;
(b) the diligence with which the person concerned is likely to fulfil those responsibilities;
(c) previous conduct and activities of the person in business or financial matters; and
(d) any evidence that the person –
  (i) has been convicted (and that conviction has not been expunged) of a financial crime as defined in section 1 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) or any offence involving dishonesty;
  (ii) has been convicted of an offence committed after the Constitution of the Republic of South Africa, 1993 (Act No. 200 of 1993), took effect, and sentenced to imprisonment without the option of a fine;
  (iii) has contravened the provisions of any law designed for protecting members of the public against financial loss due to the dishonesty or incompetence of, or malpractices by, persons engaged in the provision of banking, insurance, investment or other financial

services; or the management of juristic persons, or against financial loss due to activities relating to insolvency;

(iv) is a former director or manager of a bank or other deposit taking institution and that the person's action contributed to the inability of the institution to pay its debt;

(v) had taken part in any business practices that, in the opinion of the mutual bank were deceitful, prejudicial or otherwise improper (whether unlawful or not) or which otherwise brought discredit on that person's methods of conducting business; or

(vi) had taken part in or been associated with any such other business practices as would, or had otherwise conducted himself or herself in such a way as to, cast doubt on his or her competence and soundness of judgement.

8.4 The fitness and propriety of new directors must be tested by the mutual bank before taking up their roles or being nominated as a candidate for election as a director.

8.5 The mutual bank must in the election of directors provide members with documentation that clearly sets out:

(a) material information in its possession relevant to a decision to nominate a director or re-elect a director;
(b) the terms of an appointment, as well as the rights, duties and responsibilities of both the appointee and the mutual bank;
(c) an explanation of the board's code of conduct and policy in relation to managing conflict of interest; and
(d) an explanation of the legislative and mutual bank's requirements for the conduct of directors as well as the maximum terms for directorship in accordance with the articles.

**9. Directors' affairs committee**

9.1 Mutual banks must have formal, rigorous and transparent processes for the nomination, election and appointment of all directors.

9.2 To retain mutual knowledge, board succession must be a staged process, with induction and exit processes for incoming and outgoing directors.

9.3 The board of the mutual bank must establish a directors' affairs committee consisting only of non-executive directors of the mutual bank.

9.4 The mandate of the directors' affairs committee is to assist the board-

(a) in its determination and evaluation of the adequacy, efficiency and appropriateness of the corporate governance structure and practices of the mutual bank;
(b) to establish and maintain a board directorship continuity programme entailing-
    (i) a review of the performance of and planning for successors to the executive directors;

(ii) measures to ensure continuity of non-executive directors;
(iii) a regular review of the composition of skills, experience and other qualities required for the effectiveness of the board; and
(iv) an annual self-assessment of the board as a whole and of the contribution of each individual director;

(c) in the nomination of successors to the key positions in the mutual bank to ensure that a management succession plan is in place;
(d) in determining whether the services of any director should be terminated; and
(e) in developing a board skills matrix setting out the mix of skills and diversity that the board currently possesses or is seeking to achieve in its composition. The matrix must be informed by the purpose and strategic objectives of the mutual bank.

**10. Risk committee**

10.1 The board of the mutual bank must establish a risk committee comprising at least three members of whom at least two are non-executive directors.

10.2 The chairperson of the risk committee must be a non-executive director.

10.3 The mandate of the risk committee shall be to assist the board of directors-

(a) in its evaluation of the adequacy and efficiency of the risk policies, procedures, practices and controls applied within the mutual bank in the day-to-day management of its business;
(b) in the identification of the build-up of and concentration of the various risks to which the mutual bank is exposed;
(c) in developing a risk mitigation strategy to ensure that the mutual bank manages the risks in an optimal manner;
(d) in ensuring that a formal risk assessment is undertaken at least annually;
(e) in identifying and regularly monitoring all key risks and key performance indicators to ensure that its decision-making capability and accuracy of its reporting is maintained at a high level;
(f) to facilitate and promote communication, through reporting structures, regarding the matters referred to in sub-paragraph (a) above or any other related matter, between the board and the executive officers of the mutual bank;
(g) to establish an independent risk management function, the head of which shall act as the reference point for all aspects relating to risk management within the mutual bank, including the responsibility to arrange training of members of the board in the different risk areas to which that mutual bank is exposed;
(h) to introduce such measures as may serve to enhance the adequacy and efficiency of the risk management policies, procedures, practices and controls applied within that bank or controlling company;
(i) to co-ordinate the monitoring of risk management for the mutual bank;
(j) to establish and implement a process of internal controls and reviews to ensure the integrity of the overall risk and capital management process;
(k) to establish and implement policies and procedures designed to ensure that the mutual bank measures and reports all material risks;

(l) to establish and implement a process that relates to the available capital to the level of risk; and

(m) to establish and implement a process that states capital plans with respect to risk, taking account of the bank's strategic focus and business plan.

## 11. Risk management strategy and framework

11.1 A mutual bank must develop and implement a sound, board approved risk management strategy that sets out the types of risks that the mutual bank is willing to accept in implementing its business plan, and the way in which it will manage those risks.

11.2 The risk management strategy must be proportionate to the nature, scale and complexity of the mutual bank and holistically focus on all sources of risk emanating from the financial portfolio and business activities of the mutual bank.

11.3 The risk management strategy must also include a clear plan on how to prudently manage material risk.

11.4 At a minimum, a mutual bank's documented risk management strategy, must:

(a) identify the objectives of the strategy;

(b) define the board-approved risk appetite and ensure its alignment with the mutual bank's strategic intent, capital and financial position and compensation practices;

(c) clearly convey the risk appetite statement in a manner that must:

- (i) include both quantitative and qualitative considerations;
- (ii) establish the individual and aggregate level and types of risk that the mutual bank is willing to assume in advance of and in order to achieve its business activities within its risk capacity;
- (iii) define the boundaries and business considerations in accordance with which the institution is expected to operate when pursuing the business strategy; and
- (v) communicate the board's risk appetite effectively throughout the mutual bank, linking it to daily operational decision-making and establishing the means to raise risk issues and strategic concerns across the mutual bank;

(d) describe each material risk (including emerging risks) and the mutual bank's approach to managing those risks;

(e) list the policies and procedures for dealing with risk management;

(f) summarise the roles and risk management responsibilities of the board, board committees and executive officers;

(g) include a documented process for board approval for any deviations from the risk management strategy or risk appetite;

(h) provide for the monitoring of actual performance against risk appetite limits;

(i) outline the actions to be taken when stated risk limits are breached, including disciplinary actions for excessive risk-taking, escalation procedures and board of director notification; and

(j) outline the mutual bank's approach to ensuring relevant stakeholders of the mutual bank are aware of the risk management system and for instilling an appropriate risk culture across the mutual bank.

11.5 The board must ensure that the risk management strategy is regularly monitored for soundness as well as effectiveness and is reviewed at least annually.

11.6 A risk management report, including a summary of the review of the strategy, where applicable, must be provided to the members through annual reporting.

11.7 Material changes to the risk management policies must be approved by the board of directors, properly justified and documented. The documentation must be available for review by internal audit, the audit committee, external audit, and the Prudential Authority.

11.8 At a minimum, the risk management strategy, including policies, must cover the following risks:
(a) solvency risk;
(b) liquidity risk;
(c) currency risk;
(d) concentration risk;
(e) credit risk;
(f) market risk (position risk);
(g) interest-rate risk;
(h) counterparty risk;
(i) information technology risk including cyber risk;
(j) operational risk;
(k) legal and compliance risk; and
(l) remuneration risk.

11.9 A mutual bank may combine one or more of the policies for addressing risks specified in paragraph 11.8, provided the mutual bank is satisfied that the specified risks do not justify a separate policy given the nature, scale and complexity of its business and risks.

11.10 The mutual bank must ensure that it develops a robust and effective risk management framework comprising of systems, processes and procedures that give effect to the mutual bank's risk management strategy.

11.11 The risk management framework must be reviewed, at least, on an annual basis.

## 12. Management responsibility for internal controls

12.1 A mutual bank must ensure that there is a clear distinction between management and the board's responsibilities, and a clear division of responsibilities aligned to the three lines of defence.

12.2 Decision-making (or authorising decisions), protection of assets and accounting control need to be assigned to different control areas.

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12.3 Senior management should ensure that internal controls and related procedures are appropriately designed and executed and that these procedures include a sufficient level of senior management oversight.

12.4 Internal controls and related procedures should be subject to regular review and testing.

12.5 The mutual bank's operational risk management framework should include formal change management and project management processes to mitigate operational risk arising from modifications to operations, policies, procedures, and controls.

## 13. Control functions

1.1 The mutual bank must have, as part of its overall corporate governance framework, effective functions for risk management, compliance and internal audit.

1.2 The board must ensure that employees in in control functions are suitable and remain suitable to fulfil their respective roles.

1.3 The adequacy of and adherence to control mechanisms should be assessed regularly through independent compliance programs and independent reviews.

1.4 Heads of control functions must be fit and proper and must be assessed in terms of paragraph 8.

1.5 There should be processes to ensure that the performance of employees in control functions are individually reviewed and assessed through appropriate oversight structures.

1.6 Governance arrangements must ensure that the control functions have sufficient authority, independence and resources.

1.7 Control functions must have access and reporting lines to the board and its sub-committees.

## 14. Policies and procedures

14.1 A mutual bank must develop and implement appropriate board-approved policies and procedures commensurate with the nature, size and complexity of the business.

14.2 The policies must be reviewed at least annually to ensure that they remain appropriate and effective.

14.3 Policies and procedures must be well communicated across the mutual bank.

14.4 The following policies, as a minimum, must be developed by a mutual bank and can exist as a stand-alone policy or can be merged under suitable common areas:

(a) Savings policy;
(b) Credit risk management policy;
(c) Investment policy;
(d) Human resources policy;
(e) Outsourcing policy;
(f) Procurement policy;
(g) Risk management policies as required in paragraph 11 above;
(h) Business continuity policy;
(i) Conflict of interest policy;
(j) Whistleblowing policy; and
(k) Information disclosure policy.

## 15. Remuneration

15.1 The board is responsible for the mutual bank's remuneration policy and practices and must ensure that such policy and practices:

(a) are aligned with the mutual bank's culture, strategies, risk appetite and long-term interests;
(b) are aligned with the interests of its members and financial customers;
(c) appropriately balances the interests mentioned in sub-paragraphs (a) and (b) above and mitigates the risks of any conflict between such interests;
(d) do not induce excessive or inappropriate risk taking; and
(e) support sound governance principles.

15.2 The board in discharging its responsibility must:

(a) consult closely with the risk committee of the mutual bank to evaluate the incentives created by the remuneration system;
(b) must actively oversee, monitor and review the remuneration system's design and operation to ensure that the system operates efficiently and effectively;
(c) ensure disclosure and transparency of the mutual bank's remuneration policy, process and practices;
(d) ensure that the remuneration of employees in control functions must be determined independently from the business areas overseen and to ensure independence, their performance measures should be based principally on the achievement of the objective of their functions;
(e) exercise competent and independent judgement on compensation policies, processes and practices and the incentives created for managing risk, capital and liquidity;
(f) evaluate practices by which compensation is paid for potential future revenues in respect of which the timing and likelihood of realisation remain uncertain;
(g) ensure that all relevant decisions are consistent with an assessment of the mutual bank's financial condition and future prospects;

(h) ensure that the mutual bank's remuneration policy, processes and procedures are in compliance with the relevant requirements specified in this standard and such further requirements as may be specified in writing by the Prudential Authority;

(i) ensure that performance measures are based principally on the achievement of board approved objectives of the mutual bank and its relevant functions; and

(j) consult with members on remuneration as well as remuneration policies, processes and practices.

## 16. Outsourcing

16.1 Where a mutual bank outsources a material activity or function, it must retain the same degree of oversight of, and accountability for, the outsourced activity or function as applies to non-outsourced activities or functions.

16.2 The mutual bank must have appropriate governance and control frameworks in place to achieve oversight and accountability and to manage any risks associated with outsourcing.

16.3 Outsourcing must not materially increase risk to the mutual bank and adversely affect the mutual bank's ability to manage its risks and meet its legal and regulatory obligations.

16.4 The management of any risks arising from outsourcing arrangements should be addressed through the institution's risk management framework, internal control processes and outsourcing policy.

16.5 The board must adopt and regularly review an outsourcing policy.

16.6 Outsourcing of a material activity or function arrangements (including but not limited to outsourcing of control functions) must be submitted to the Prudential Authority for prior approval.

16.7 Outsourcing arrangements must be governed by written contracts that meet prescribed minimum standards aimed at ensuring the mutual bank can exercise adequate ongoing oversight over the performance of the outsource party concerned and that the arrangement can be terminated without undue disruption to the mutual bank's business continuity.

16.8 Outsourcing relationships should only be entered into after the mutual bank has conducted an appropriate due diligence exercise to satisfy itself that the outsource party has the necessary expertise, competence and capabilities.

16.9 Outsourcing arrangements must not be subject to conflict of interest.

## 17. Conflict of interest policy

17.1 The mutual bank must develop and implement a conflict of interest policy and an objective compliance process for implementing the policy.

17.2 The corporate governance and risk management frameworks as well as the internal controls of the mutual bank must provide for the monitoring, mitigation and management of actual and potential conflicts of interest between the mutual bank's board, senior management, employees, members and other stakeholders; and must appropriately balance such interests and mitigate the risks of any conflict between such interests.

17.3 The board must ensure that appropriate disclosure is made on conflict of interest and potential conflict of interest. The disclosure must include information on the mutual bank's approach to managing material conflict of interest that is not consistent with the conflict of interest policy.

## 18. Related party transactions

18.1 The board must ensure that transactions with a related party are reviewed to assess the risk to the safety and soundness of the mutual bank and are subject to appropriate restrictions.

18.2 Related party transactions must be sufficiently disclosed in the annual report of the mutual bank.

18.3 The Prudential Authority may request information on transactions between the mutual bank and a related party.

## 19. Disclosures and reporting

19.1 A mutual bank should make timely, transparent and balanced disclosure of all matters concerning the mutual bank that a reasonable person would expect to have a material effect on the value received from ongoing membership and the interests of members and other stakeholders.

19.2 A mutual bank must have a board approved clear policy that addresses the management of information relevant to disclosures.

19.3 The policy on disclosures must include a process for the vetting and authorisation of any external communication that may affect the making of an investment decision by a current or potential member.

19.4 Disclosures must be accurate, clear and presented in an understandable manner.

19.5 Timely public disclosure must be made on a mutual bank's website, in its annual and periodic financial reports or in other appropriate forms.

19.6 The PA may determine additional reporting requirements for this Prudential Standard.

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