



## Prudential Communication 3 of 2021

### Co-operative Banks Act

### Flavour-of-the-year topic communication to Co-operative Financial Institutions and Co-operative Banks

#### ***Objective of this Prudential Communication***

*This communication provides information on the Prudential Authority's flavour-of-the-year topic for CFIs and Co-operative Banks for the 2021 calendar year.*

#### **1. Application**

- 1.1 This Prudential Communication is applicable to all licensed Co-operative Financial Institutions and Co-operative Banks .

#### **2. Purpose**

The purpose of this Prudential Communication is to provide information on the flavour-of-the-year topic for Co-operative Financial Institutions and Co-operative Banks for the 2021 calendar year.

#### **3. Introduction**

- 3.1. Annually, the Prudential Authority (PA) considers whether any current developments affecting regulated institutions at a sector level are of such significance that additional focus from a supervisory perspective would be required. The topic(s), selected through the PA's governance processes, are communicated to regulated institutions at the beginning of the year and are referred to as 'flavour-of-the-year' topics.
- 3.2. The PA has determined that for the 2021 calendar year, the flavour-of-the year-topic will be *Governance Structures and arrangements within* Co-operative Financial Institutions and Co-operative Banks.

#### **4. Co-operative Governance in Member Based Institutions**

##### **4.1. Background**

Governance continues to be an important issue affecting today's marketplace, with many theories, best practices and scorecards having been developed with the goal of creating efficient and effective governance principles. CFIs and Co-operative Banks have a mission to bring fair and affordable financial services to members, who are often of ordinary means, and to do so through a co-operative banking business that is owned and democratically controlled by the members it serves. Wherever CFIs and Co-operative Banks operate and regardless of

size, an indispensable key to achieving their mission has always been and continues to be strong, effective governance.

At their core, CFIs and Co-operative Banks are fundamentally different from other for-profit financial institutions, such as commercial banks. For-profit financial institutions have one primary goal: to maximize the return to the shareholder. As a result, traditional corporate governance principles serve to ensure that profitability is achieved for the shareholders, not the actual users of the bank's financial services. Like for-profit corporations, CFIs and Co-operative Banks seek to generate profits in order to directly benefit the owners. However, unlike private commercial banks and other for-profit institutions, the members serve as both the owners of the CFIs and Co-operative Banks and recipients of the services of the institutions.

Thus when CFIs and Co-operative Banks maximize their profits, it manifests in the form of lower interest rates on loans, lower service fees and higher dividends for the members. In addition to this unique aspect, CFIs and Co-operative Banks are democratic institutions, where a single member receives a single vote, regardless of financial stake in the organization.

#### 4.2. Understanding Governance in CFIs and Co-operative Banks

Co-operative Governance refers to the framework from which CFI and Co-op Bank directors can be inspired to work collectively to build an effective and sustainable CFIs or Co-operative Banks. From a compliance and stewardship perspective it is concerned with the practices and procedures that the board of directors (the board) develops in order to achieve its specific goals. A democratic view of governance would be that the board represents the interests of the members of the CFI/Co-operative Bank and other stakeholders connected with the organisation.

To assist with relationship management and co-operative structure, the World Council of Credit Unions (WOCCU)<sup>1</sup> recognises a three-part system of governance. First, *external governance* addresses the issues that CFIs and Co-operative Banks face as participants in the financial marketplace. All financial institutions, regardless of structure, are expected to operate in a transparent manner, comply with regulatory and prudential standards and be held accountable to the public. Second, *internal governance* defines the responsibilities and accountability of the general membership, the board of directors, management and the staff. These responsibilities include achieving an appropriate governing structure of the CFI or Co-operative Banks, preserving the continuity of CFI or Co-operative Banks, creating balance within the organization and remaining accountable for their actions. The third principle, *individual governance*, ensures that the CFI or Co-operative Bank obtains directors and management who are able to fulfil the two previous obligations of external and internal governance through integrity, competence and commitment. By adhering to the principles of this three-part model of external, internal and individual governance, CFIs and Co-operative Banks can better achieve their ultimate goal of bringing affordable, quality financial services to their members.

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<sup>1</sup> WOCCU White Paper on Credit Union Governance

#### 4.3. Format of the discussions with the Board on the 'flavour of the year topic'

The care, diligence, skill and prudence exhibited by the board and management of CFIs and co-operative bank have a critical influence on the financial institution's viability, safety and soundness as well as its ability to meet its business objectives.

Using the format outlined below, the board of directors of all CFIs and Co-operative Banks will be required to make a presentation (as represented by the board's Chair) and the entire board must engage with the PA on the above mentioned flavour of the year topic. The duration of the topic should be targeted at a maximum of 45 minutes.

The PA may consider to communicate the outcome of these engagements to the sector at an aggregated sector level. The PA also requires to be provided with a copy of the presentation, at least two weeks prior to the scheduled board meeting. The flavour of the topic is elaborated below :

#### 4.4. Considerations regarding Governance in CFIs and Co-operative Banks

At a minimum, the following aspects should be considered by the board of directors:

- a. Role of the board and oversight of the CFI and Co-operative Bank. This must include an overview of the board, its composition, terms and skills.
- b. How the board ensures it has the required knowledge, awareness and understanding to provide oversight in line with the co-operative principles and prudential standards.
- c. How the board ensures continuity of board members, including how the board objectively identifies and retain volunteers with the relevant expertise.
- d. How the board balances strategy versus operations.
- e. How the board ensures continued education/development on governance.
- f. The board's understanding of the role and function of the Audit/Supervisory Committee.
- g. The board's understanding of the prudential requirements and the co-operative model.
- h. Identification and assessment of the risks (financial and non-financial) and the impact (quantitative and qualitative) of these on the ability of the board to discharge on its mandate.
- i. The board's approach, responsibility and accountability to providing governance oversight with respect to changing technological requirements, increased supervisory oversight and the need to provide relevant and up-to-date products and services to members.

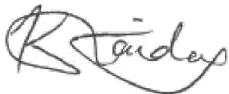
#### 4.5. Other arrangements

Kindly ensure that a copy of this letter is made available to your institution's independent auditors. Kindly acknowledge receipt of this letter.

**5. Acknowledgement of receipt**

A written acknowledgement of receipt of this communication, signed by both the Managing Director and the board's Chairperson of the CFIs and Co-operative Bank, should be submitted at the earliest convenience to the PA Frontline team responsible for the supervision of the CFIs and Co-operative Banks. Should you have any queries in this regard, please contact the relevant PA Frontline team.

Yours sincerely

A handwritten signature in black ink, appearing to read 'K. Naidoo', written in a cursive style.

**Kuben Naidoo**  
**Deputy Governor and CEO: Prudential Authority**

**Date:** 2021-03-24