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SOUTH AFRICAN RESERVE BANK
Prudential Authority

Ref.: 15/8/2

G2/2022

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

Guidance Note 2/2022 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.

Executive summary

Since the outbreak of COVID-19, South Africa and the rest of the world have experienced numerous waves of infections. The negative impact of the spread of COVID-19 on global and local economies resulted in the Prudential Authority (PA) providing temporary regulatory relief to banks, branches of foreign institutions and controlling companies (hereinafter collectively referred to as 'banks') in 2020. The PA subsequently withdrew or amended these relief measures through Directives 5, 7 and 8 of 2021 for reasons enumerated therein.

Although the full impact of the pandemic on the economy remains uncertain, economic activity has largely been restored to normality and the successful rollout of vaccines is expected to boost global and domestic economic growth. Banks continue to play a critical role in providing funding to the wider economy amid the COVID-19 pandemic. As a result, it is essential that banks continue to conserve their capital resources in order 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 distributions of dividends on ordinary shares and the payment of cash bonuses to executive officers and material risk takers for the duration of the COVID-19 related uncertainty.

This guidance note replaces Guidance Note 3 of 2021.

1. Introduction

- 1.1 In response to the outbreak of COVID-19 in South Africa during 2020, the PA implemented a range of temporary regulatory and supervisory relief measures to support the safety and soundness of regulated financial institutions and, together with the South African Reserve Bank, undertook measures to mitigate risks to financial stability caused by COVID-19.
- 1.2 Although the virus may continue to mutate, resulting in further waves of infections, the rollout of vaccines is expected to contain the adverse macroeconomic consequences and support economic recovery going forward, both domestically and globally.
- 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.
- 1.7 Finally, regulation 38(8)(e)(iv)(D) of the Regulations states that banks must maintain a capital conservation buffer intended to ensure that banks build up capital buffers outside periods of stress identified in writing by the Registrar, which capital buffers may be drawn down as losses are incurred during the subsequent periods of stress.

2. Guidance

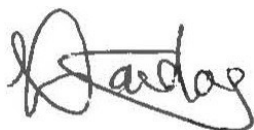
- 21 The PA considers it critical that banks continue to fulfil the fundamental role of providing the required funding, among other things, to households and businesses amid the COVID-19 pandemic. For this purpose, it is essential that banks continue to appropriately conserve capital resources to retain their capacity to support the real economy during the pandemic.
- 22 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, medium and 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. Therefore, all relevant decisions regarding payment of dividends and bonuses must continue to be carefully assessed and balanced against the need to support the real economy notwithstanding the PA's decision to withdraw or amend the temporary regulatory relief measures for reasons enumerated in the respective withdrawal notices.
- 23 In those instances where shareholders and/or 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 respectively in 2022 and beyond, payout ratios should be prudent and commensurate with the banks' respective assessments of the current conditions and potential future uncertainty.
- 24 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 and/or shareholders of a bank. The PA remains confident that banks will act prudently when discharging their respective responsibilities.

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 and will issue further guidance and/or implement additional measures should circumstances so warrant.

4. Acknowledgement of receipt

- 4.1 Kindly ensure that a copy of this guidance note is made available to your institution's auditors. The attached acknowledgement of receipt duly completed and signed by both the chief executive officer of the institution and the said auditors, must be returned to the Prudential Authority at the earliest convenience of the aforementioned signatories.

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

Kuben Naidoo
Deputy Governor and CEO: Prudential Authority

Date: 9 March 2022

Encl. 1

The previous guidance note issued was Banks Act Guidance note 1/2022, dated 25 February 2022.