Ratings Afrika

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15 May 2010

The Secretary to Parliament
c/o Mr Bradley Viljoen
Committee Section
Parliament of the RSA
PO Box 15
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Via e-mail to bviljoen@parliament.gov.za

Mr Viljoen

WRITTEN COMMENTS ON THE BILL MENTIONED IN GG33156 ON 3 MAY 2010

Please refer our comments to the committee.

We comment on the proposed amendments to the South African Reserve Bank Act of 1989 in our capacities as:

Principal of the African governance ratings agency Ratings Afrika;

Citizen of the Republic of South Africa;

Businessperson on the continent of Afrika.

We have no vested interest in the disputes between the SA Reserve Bank and some of its shareholders, or the Congress of South African Trade Unions; nor do we choose to take sides in any such differences except to the extent specifically stated in this document.

Our comments are to be taken as views in principle.

The writer accepts responsibility for the content of this document and states himself willing to enter into further discussion at an appropriate level and in any appropriate forum on any of the matters raised.

FUNDAMENTAL COMMENTS

1. THE TIMING OF THE AMENDMENTS AND THE PERIOD ALLOWED FOR COMMENT

   Given the overall expressions of the importance attached to the proposed amendments by the management of the South Africa Reserve Bank ("SARB") as reported at different times in the South African press, we view the manner in which the amendments were made available to the South African citizens, and the fourteen calendar days allowed for comment, to be examples of unsound corporate governance. We are critical of both aspects and find the combination to

be discouraging insofar as this seems to be directly in opposition to sound corporate governance, which seeks to serve the interests of the wide range of stakeholders. In essence the National Treasury is in one voice espousing "good corporate governance" (read: sound corporate governance) and at the same time acting counter to that goal.

Sound Corporate Governance has since the writings of Adam Smith (The Theory of Moral Sentiments) been focused on considering the interests of all stakeholders. It is not simply about acting lawfully. It is also not simply about following codified sectional views issued from time to time by parties who have not followed appropriate due process. Lastly it is not legislated and is unlikely to be possible to be legislated.

When considering the mechanisms applied in making these amendments, we suggest that the following parties are at minimum vital stakeholders in the SARB and legislation that underpins it:

All South African citizens

All international counterparties affected by its decisions on interest rates, regulatory aspects of its mandate (that includes foreign exchange rulings and practice, banking regulation and allied aspects)

All businesses within South Africa and the SADC region that transact in and are affected by the ZAR currency

Central banks within the SADC and in the larger Afrika

Within this grouping one of the most important considerations is to preserve the concept of fairness in dealing. The way the Bill is being handled speaks of unseemly haste. The lack of a rounded review of the leadership and directoral aspects at the SARB supports this concern.

Although not stated, the concern within the SARB at the actions of current shareholders within the provisions of the Act is palpable throughout the Bill. The impression is left that the amendments would serve to improve the soundness of corporate governance. Upon analysis the overall effect is however to limit or remove the rights of shareholders (and by inference, almost all stakeholders other than the SARB staff and the RSA government) without negotiation and public debate. This must easily qualify as one of the most worrying interpretations of appropriate action that we as a firm have come across over the past 25 years. It would not be countenanced in any labour or similar contractual relationship.

We propose a following of due process and the inclusion of alternative views before any amendment to the Act is contemplated.

2. THE PRIVATE NATURE OF THE SOUTH AFRICAN RESERVE BANK

Although the SARB seeks to underscore its private nature, the core of the relationship exhibits a strong governmental nature.

In terms of sound corporate governance the structure and functioning purports one character but in operation proves another. This is underscored by the proposed amendments, lack of consultation, lack of negotiation and lack of due process.

We propose that if the SARB wishes to be seen to be a private entity, that it be

structured as one and acts as one without governmental impediment; but if not, that it acknowledges its governmental role fully in all respects.

3. OVERALL ASPECTS OF SOUND CORPORATE GOVERNANCE

There are many aspects of sound corporate governance that are not contained in the amendments, starting with the lack of board oversight over the functions of the governors and the lack of an independent chairperson of the board of directors.

We propose a thorough review of all corporate governance aspects as regards the SARB, followed by structural changes to ensure integrity of design and function.

4. SUGGESTIONS FOR THE WAY FORWARD

The SARB has been in existence for a long time and its Act as well as the actions of its functionaries are steeped in past practices. We propose that modern principles of accountability and corporate action be applied to the new SARB in a manner calculated to show its consideration for the interests of all stakeholders.

DETAILED COMMENTS

Ratings Afrika has many comments on the detail incorporated in the Bill, but finds it difficult to do justice to the interests of all stakeholders in the short time made available for comment. Some of our comments relate to simple matters such as technically inappropriate use of wording that, being imprecise, is likely to cause legal uncertainty and potential litigation. Others are more complex and refer to the interaction between sections, which may have unintended consequences.

We propose a significant extension to the time made available for comment. A minimum of 46 additional calendar days are suggested, to bring the total to 60 days.

Linked to this suggestion for extension of the comment period we find it inappropriate in the extreme to “fast-track” amendments simply because articles were in the past so drafted that shareholders are legally able to influence the selection of directors. It is a matter for conjecture whether this was a mistake or not, but the almost unseemly haste is embarrassing to behold.

Sincerely

CHARL KOCKS
Agency principal

ADDENDUM ADDED 28 MAY 2010:

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The following detailed comments are presented:

1. Missing principles
    a. The governor of the SARB has large responsibilities in terms of the function he/she performs. As the proposals stand the governor is not only the functionary but also the leader of the board. This is unsound practice; the more so because past experience has seen inappropriate behaviour by governor(s) and given the "private" standing of the SARB there is no person who clearly takes responsibility that such behaviour is avoided. An independent chair to the board is called for, in the manner proposed by sound corporate governance world-wide. Strong technical ability would be balanced by gravitas and wisdom.
    b. The rule for the selection of directors is flawed given the lack of sufficient focus on the banking regulation that is one of the primary tasks of the SARB. If any criterion is appropriate, banking experience both within and outside RSA would be that criterion. The same applies to economic and monetary experience, and possibly corporate governance experience.
    c. The SARB needs to be structured in a manner that clarifies lines of responsibility, if not also lines of reporting.
    d. SARB disclosure and reporting needs to be codified in the articles to the extent that real openness is achieved. Current experience shows great depth in many disclosures that do not directly refer to the bank itself. Modern "inte-

grated report" style of disclosure is necessary.

e. Effectively the SARB should be a shining example of transparency, accountability and the following of high principle not only in its dealings but also in its reporting about its dealings.

f. There is an arrogance to the SARB that from time to time gives the impression that it believes itself to be above criticism. This can be rectified in the articles, but may well have to be handled in a code of conduct. This feeling of "being elevated above the populace" extends to dealings with the public. Essentially the SARB needs to be mindful of a role that sees it serving rather than ruling; with the understanding that from time to time highly unpopular decisions have to be taken, but always with humility.

2. The amendment seeks to change the rights of shareholders in such a manner that there clearly is no consultation with all existing shareholders; and the impression left by the amendments is that ineffective wording that has existed for many years, has been "manipulated" by some shareholders. In fact, the original error probably lies with the legislator; but the amendment itself and the accompanying memorandum has no element of "*mea culpa*" or of rectification. This is reinforced by public comments that we regard at minimum to have been unfortunate. In any proposed amendment we propose that the element of rectifying wording that may have led to unintended interpretation, needs to feature strongly in order to gain the high ground.
3. Wording of the amendments is such as to be bad English in part. An example is paragraph 1 where the reference is frequently to "... person which" instead of the correct form "... person that". This would seem to be evidence of hasty drafting.
4. In subparagraph 1(a) in defining "associate" at (a)(ii), the question of whether "an agreement or arrangement" has been entered into, is most difficult to prove or even disprove, and is likely to lead to lack of clarity.
5. Subparagraph 1(a) in defining "associate" is vague in (b)(iv) in "accustomed to act".
6. Subparagraph 1(c) in defining "employee of Government" is vague insofar as "works for Government" is open to debate. It could for example be stated that <u>effectively</u> the governor of the SARB "works" for the Government even though that person is not a direct employee of the State. Vagueness makes for bad law and creates uncertainty that favours those with much money, much time and much power.

7. Paragraph 2 deals with the appointment of the governors. If the SARB is to be a private institution then no outside appointment can be made because this immediately makes a mockery of the private status of the SARB.
8. The panel is in the amendment effectively a gatekeeper for directors of the SARB and by its structure and function, the panel makes a mockery of sound corporate governance because its actions are not subject to shareholder agreement or even public criticism.
9. The panel is appointed by the governor, chaired by the governor and in case of equality of votes, led by casting vote. The panel, if retained, should be selected by the directors and shareholders should thus have a greater impact on panel composition. In addition, an independent chairperson should chair the panel or such panel chairperson should be elected by directors.
10. The quorum should not explicitly require the governor in its composition.
11. There seems to be no fundamental reason why the panel could not nominate more than three candidates for a vacancy if it believes it appropriate.
12. Subparagraph 2(d)(i) is tautologous in requiring "bona fide for the benefit and interest of the Bank" but in being so, implies something other than the stated intention.
13. Subparagraph 2(d)(iii) is unclear in the insertion after subsection (2)(a) of subsection (aA)(iii), in the use of the word "same'. It is also vastly unclear in specifying which knowledge and skill such a director is required to have.
14. Subparagraph 2(d)(iii) compounds this lack of clarity in (aA)(iv) by reference to the previous subsection.
15. Subparagraph 2(e) treads on dangerous territory by seeking to predetermine what knowledge and skill base is essential for a properly functioning SARB. There is no motivation, other than sectional or political, for this delineation. It is also unlikely that someone with "knowledge and skill in labour" has skills that necessarily are of use to the SARB. Labour is a wide term, so any person who has been working for (say) 15 years will have that "skill". Similarly a single diamond digger could be seen to have "skill in mining".
16. Subparagraph 2(f) rules out the directorship of foreigners. This is viewed as highly unfortunate since knowledge transfer and foreign perspectives are precisely what the SARB may require from time to time. We would argue that this amounts to a negative response to what are perceived as threats, and indeed smacks of xenophobia, even if a milder form thereof.

17. In subparagraph 2(f) the amendment of (4)(f) is unclear as to the question whether suspended sentences are included.
18. Subparagraph 2(h) is contradictory in (5)(b) insofar as the chairman is precluded from granting leave of absence from more than three consecutive meetings while the borderline is in fact three consecutive absences already.
19. Subparagraph 2(h) allows no leniency for bona fide error in (5)(c).
20. Paragraph 3 is incorrect in assuming that there are “principles of good corporate governance” that are commonly accepted. Codes of practice as set out by various organisations are not principles; “good” is understood to be something that functions, rather than something that is positive; and in general this is akin to dictating creditworthiness but not describing what it means and how much is required. In addition there remains considerable difference of opinion on what constitutes sound corporate governance. (At the moment in our judgment the current SARB is not necessarily capable of achieving 50% on our scale of sound corporate governance, for example.)
21. Paragraph 3 further expects operational aspects like the opening or closing of branches to be authorised by the board. The board needs to focus on strategy and oversight.
22. Paragraph 3 uses “barbed wire”-style language to retain other responsibilities for the governors, rather than to allow the board to arrive at and amend a charter as agreed with the shareholders from time to time. The board should have the freedom to act as a private board should, if it is decided that the SARB should be private.
23. Paragraph 7 refers to Section 22 and its wording should be reviewed in the light of our earlier comment on the rectification of wording in the act and the treatment of the definition of associates. In the subparagraph 7(b) disclosure is required in quite authoritarian manner, which should be avoided.

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