



Bank of Papua New Guinea

**BANKING PRUDENTIAL STANDARD BPS320: CORPORATE
GOVERNANCE – COMPLIANCE FUNCTION REQUIREMENTS**

Issued under Section 27 of the *Banks and Financial Institutions Act 2000*

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OVERVIEW

Compliance risk is the risk of legal or regulatory sanctions, material financial loss or penalties or loss to reputation that an Authorized Institution (AI) may suffer as a result of its failure to comply with laws, regulations, standards, rules and codes of conduct or similar that apply to the AI's activities. Expectations for compliance go beyond what is legally binding and embrace broader standards of integrity and ethical conduct. As demonstrated in the recent financial markets turmoil, failure of financial institutions to consider the impact of its actions on its shareholders, customers, employees and the markets more generally can result in both financial and reputational damage, even if no law has been broken.

There is likely to be compliance expectations attached to every activity across an AI whether it arises from specific financial sector requirements or more general business laws. Therefore, while everyone across an AI has a compliance responsibility for their activities, the compliance function in an AI takes an institutional approach and provides assurance that all compliance obligations are being met and that new requirements are identified and addressed.

Part I: PRELIMINARY

1. Short Title

BPS320: Compliance Function Requirements

2. Authorisation

The Bank of Papua New Guinea (BPNG) is authorized to issue prudential standards under Section 27 of the *Banks and Financial Institutions Act (BFIA) 2000* in relation to prudential matters to be complied with by all Authorized Institutions.

3. Application

- a) This prudential standard applies to banks and other licensed financial institutions authorized under the BFIA 2000, collectively referred to as Authorised Institutions (AIs) for the purpose of this prudential standard.
- b) This prudential standard also applies to AIs that have a common Board for the parent and the subsidiary.
- c) This prudential standard forms part of the series dealing with Corporate Governance and must be read in conjunction with:
 - i) BPS300: Corporate Governance; and
 - ii) BPS310: Fit and Proper Requirements.

4. Definitions

For the purposes of this prudential standard, the words *Compliance Officer* are used to refer to the person responsible for compliance risk. Other titles may be used as long as the title meets the intent of this prudential standard.

Part II: STATEMENT OF POLICY

5. Purpose

- a) This prudential standard is based on the Basel Committee on Banking Supervision (BCBS)¹ papers on Sound Banking Practices with respect to compliance by banks. It requires that each AI establish an independent compliance function appropriate to the nature and scale of its operations and appoints a Compliance Officer.
- b) The key requirements include:
 - i) Establishing a permanent, effective and independent compliance function appropriate to the AIs size, activities and complexity with responsibilities that include advising senior management on compliance; monitoring compliance requirements; implementing compliance assurance; educating staff on compliance matters and assessing the AIs compliance risk;

¹ BCBS (Apr 2005), Compliance and the Compliance Function in banks, Bank for International Settlements (BIS)

— (Dec 2010), Sound Practices for the Management and Supervision of Operational Risk, BIS

— (Dec 2010), Operational Risk: Supervisory Guidelines for the Advance Measurement Approaches, BIS

— (Jul 2015), Guidelines for Corporate Governance Principles, BIS

- ii) Appointing a Compliance Officer with responsibilities for the implementation of compliance activities as well as contact for regulatory affairs; and
- iii) The undertaking of an annual review of the scope, breadth and continued adequacy of the compliance function by the internal audit function.

6. Scope

This standard applies to the board and the compliance function of an AI.

Part III: PRINCIPLES AND PRUDENTIAL REQUIREMENTS

7. Responsibility of Board and Senior Management

- a) The Board of Directors (the Board) is responsible for ensuring that the AI complies with all relevant laws, regulations, rules, prudential standards and codes to which it is subject under business laws, financial laws, licensing requirements and similar as well as the policies and procedures that the Board itself issues.
- b) The Board must ensure that there is a comprehensive compliance strategy including clear and documented policies and a permanent, effective and independent compliance function that is resourced appropriately to the activities, size and complexity of the AI. *Note: the compliance function and responsibilities should not be confused with Internal Audit and are expected to be separated from Internal Audit activities.*
- c) The Board is responsible for the establishment and implementation of compliance policies and procedures and communication and training to ensure that each staff member understands their responsibilities for compliance with external laws, regulations and standards as well as the AI's own policies and procedures. Group compliance policies and procedures can be adopted, provided that they meet the intent of this requirement.
- d) The Board must ensure that the AI implements robust reporting and management arrangements so that the probability of compliance breaches occurring is managed to an acceptable level, that all compliance breaches are identified promptly, reported, escalated and resolved effectively and in a timely manner, including remedial or disciplinary action as appropriate. Escalation of breaches must be appropriate to the seriousness of the breach including reporting to the Board or a Board Committee and BPNG or other regulators as appropriate (for example, Internal Revenue Commission (IRC), Port Moresby Stock Exchange with respect to listing rules and continuous disclosure requirements). The Board may delegate oversight of the AI's compliance risk management framework to an appropriate Board Committee, being either the Audit and Risk Committee or a separate Risk Committee depending on the size of the entity and number of directors.
- e) The Board must review and assess the effectiveness of compliance risk management at least annually.

8. Compliance Function Responsibilities

- a) While this prudential standard is not intended to impose a particular compliance organization or structure on the AI, BPNG expects that the Board of the AI will ensure that there is an integrated approach to compliance. Where the Compliance Officer is not responsible for the following activities, the AI must satisfy BPNG that the compliance activity is implemented effectively within that AI by:
- i) Developing, testing, refining and updating policies and procedures that are designed to ensure that the AI operates in full compliance with all relevant laws and other compliance requirements. This should include monitoring, escalation and reporting procedures;
 - ii) Advising the Board on compliance issues with laws, regulations and prudential requirements. *Note: Some compliance matters may be carved out and assigned to other experts, for example, compliance with listing rules may be the responsibility of the Corporate Secretary and compliance with taxation laws may be the responsibility of the Chief Finance Officer (CFO).*
 - iii) Educating staff on compliance issues and acting as a contact point for compliance queries from AI staff;
 - iv) Identifying, documenting and assessing the compliance risks associated with the AI's business activities, including the development of new products and business practices, acquisitions, information technology (IT) system changes, reorganisation and customer relationships;
 - v) Assessing the continued adequacy of the AI's compliance procedures and guidelines, and providing assurance to the Board as required, promptly following up any weaknesses or deficiencies including maintaining a register of breaches and the rectification action undertaken; and
 - vi) Reporting on a regular basis, at least annually, to the Board and senior management on compliance matters and associated risks. Reports should include changes to the AI's risk profile, summary of any identified breaches or deficiencies and the corrective measures recommended or taken to address them. Where the compliance function makes significant findings, these should be promptly reported to the Board and BPNG as appropriate.

9. Compliance Function Requirements

- a) The Board must ensure that the AI's compliance function must be permanent, effective and independent. To satisfy BPNG as to the commitment to compliance and strengthening the compliance culture, BPNG will look for the following characteristics:
- i) The compliance function has a formal status within the AI with clear and unfettered access to the Board or its committees to report on compliance issues;
 - ii) Depending on the size of the institution, there must be a group compliance officer or head of compliance with overall responsibility for coordinating the management of the AI's compliance risk;

- iii) The compliance officer (and staff) have clear and independent responsibilities for compliance and are not placed in a position where there is a conflict of interest with other responsibilities such as having direct business line responsibilities;
- iv) The compliance function is independent of Internal Audit. Note: In some institutions, Compliance is part of the Chief Risk Officer's reporting line, in others, it is a direct report to the Risk Management Committee.
- v) The compliance function has access to the information and personnel necessary to carry out responsibilities; and
- vi) The compliance function staff have the necessary knowledge and experience to identify and escalate issues to the Board, the relevant Board Committee and /or senior management.

10. Head of Compliance

The Board must ensure that an executive or senior staff member to take on the role and responsibilities of the compliance function, as the Chief Compliance Officer (or Head of Compliance or equivalent) with overall responsibility for coordinating the identification and management of the AI's compliance risk and for supervising the activities of other compliance function staff. The Chief Compliance Officer (or the person responsible for compliance) is expected to be the principal contact point for BPNG on regulation related and reporting matters.

11. Notification Requirements

- a) BPNG must be informed in writing by the Board when the Chief Compliance Officer (or the person responsible for compliance) takes up or leaves that position and, if leaving, the reasons for departure, within 7 working days.
- b) The Board must notify BPNG in writing within 7 working days of compliance breaches that are material or have otherwise been escalated to the Board or its management committee. While materiality tests may differ depending on the size and nature of the AI, compliance breaches that must be escalated to the Board or its Committee and BPNG include breaches of quantitative prudential requirements such as capital and liquidity; breaches that may pose a risk to financial stability such as inability to meet payments or settlement obligations; and compliance breaches that may affect public confidence in the AI such as breaches leading or likely to lead to reputation risks, breaches to anti-money laundering laws resulting in the provision of financial accommodation to terrorists etc.
- c) The Board must also notify BPNG in advance if it anticipates a material breach to the Act, any prudential standard requirements and the actions taken or proposed to be taken to address the problem.

12. Reporting

As part of its annual attestation to BPNG, the Chairman of the Board of the AI with the approval of all the directors must provide assurances regarding compliance with all laws,

regulations, prudential standards, code, rules and similar for each jurisdiction in which it operates.

Part IV: CORRECTIVE MEASURES

13. Remedial Measures and Sanctions

- a) If BPNG is not satisfied with the adequacy of an AI's systems and procedures for compliance risk management across the institutions, BPNG may vary the conditions of the AI's licence under section 14 of the BFIA 2000. Such conditions may include, but are not limited to:
 - i) Require immediate remediation of issues;
 - ii) Suspend or limit certain business activities relating to identified weaknesses;
 - iii) Prohibit certain transaction or a class of transactions;
 - iv) Require appointment of additional staff or third party support to address weaknesses identified; or
 - v) Reassessment of the fitness of certain responsible persons to continue to hold their position in the AI.

Part V: EFFECTIVE DATE

14. Commencement and Transitional Arrangements

- a) The effective date of this prudential standard shall be 1 January 2017 with full compliance required by 31 December 2018.
- b) Questions and enquiries relating to this prudential standard should be addressed to:

The Manager
Financial System Development Department
Financial System Supervision Group
Bank of Papua New Guinea
Post Office Box 121
PORT MORESBY
Tel: 322 7200
Fax: 321 4549