

PNB Compliance and Ethics Program

Over the past ten (10) years, the Philippine Banking System had to reassess its compliance, ethics, governance and risk management practices. The recent cases of cyber-attacks to both government and private institutions all over the world, exposure to hefty fines and penalties of non-compliance to existing and evolving regulations to govern the changing, aggressive business environment and latest cases of fraud by bank employees exposed by media. Levity aside, the worldwide financial system became the focus of public concern during the recent cyber-attack on banks' systems. The crisis exposed the need to strengthen the nation's anti-money laundering law, easing the bank deposit secrecy law, and increasing monetary penalties for AML violations. However it is more imperative for banks to bolster its compliance framework, ethics and corporate governance. Banks should actively promote a degree of safe and sound banking practices in their operations through a compliance system that fully adheres to banking laws, rules and regulations and to maintain an environment that is governed by the highest form of ethical standards and best practices of good corporate governance. This is achieved primarily through the formulation of policies and procedures, an organizational structure and an effective compliance program that will support the financial institution's compliance requirement.

There is no doubt that strengthening of processes are called for to mitigate compliance and business risks which are critical for the preservation of the franchise licenses of a bank. What is evidently required is an effective compliance system, where there is a clear understanding and delegation of responsibilities across all levels that include the board of directors, senior management, the officers and staff who are responsible for day-to-day management. Over the years, PNB instituted and lived with the eight (8) elements of an effective compliance framework.

1. Executive Level Oversight
2. Compliance Structure
3. Policies and Procedures
4. Monitoring and Assessment
5. MIS, Controls & Reporting
6. Training
7. Compliance Review and Testing
8. Working with Regulatory Bodies and Enforcement Agencies

Eight Elements of PNB's Effective Compliance Framework

1. Executive Level Oversight

Oversight of the Compliance Program by the Board of Directors and Senior Management is essential to its implementation across every organization. The PNB Board ensures that a Compliance Program is defined for the bank and the compliance issues are resolved expeditiously.

Senior Management is responsible for establishing a compliance policy, ensuring that it is observed, and reporting to the Board of Directors on its on-going implementation as well as assessing its effectiveness and appropriateness.

The role & responsibility as the lead senior officer of the Compliance Program is the primary task of the Chief Compliance Officer of the Bank. To ensure independence, the Chief Compliance Officer has direct reporting line to the Board of Directors through the Board Audit and Compliance Committee (BACC) on all matters related to compliance. The primary role of the Chief Compliance Officer is to provide advisory and guidance to Senior Management and the Board and to all business units, branches and business vehicle entities on new, existing and changes in the laws, rules and regulations as well as make recommendations on compliance related matters.

2. Compliance Structure

The structure of the compliance function varies based on the size and complexity of the financial institution. The compliance organization of every bank, because of the required independence from the business' day-to-day activities, must report directly to the Board of Directors or any Board-level or approved committee. Every bank's compliance organization must function independently from the business activities of the institution and should have access to all operational areas as well as any records or files necessary to enable it to carry out its duties and responsibilities. This is best achieved in banking organizations where there is full support from the Board and Senior Management for corporate governance and where the compliance function in turn is proactive in addressing issues before exceptions occur. This helps protect the reputation of banks, as well as builds credibility internally and externally.

The compliance culture can be embedded in the bank's operations and compliance risk management across all levels and function thru a structured hierarchy of control. The foundation of a stable compliance structure lies on competent compliance officer and compliance designates. Each level of control would have specific role and responsibilities with corresponding tools.

PNB compliance organization, because of the required independence from the business day-to-day activities, reports directly to the Board Audit and Compliance Committee (BACC) and for administrative matters, has a matrix reporting line to the President. The Global Compliance Group function independently from the business activities of the institution and have access to all operational areas as well as any records or files necessary to enable it to carry out its duties and responsibilities.

The organizational structure is designed to focus on the key business and regulatory risk areas, to develop and implement standardized self-assessment compliance programs, monitor outstanding issues, provide guidance in formulating corrective actions, influence closure of audit issues and periodically conduct training and institutionalize compliance reviews and testing among the different bank units, branches and business vehicles.

The Bank fully adheres to Foreign Account Tax Compliance Act (FATCA) and has effectively implemented policies and procedures to carry out FATCA regulations. Consequently, the Bank has appointed a FATCA Compliance Officer integrates the implementation of the FATCA regulatory requirements enterprise wide.

Branch Operation Division (BOD) AML Support Team includes the following:

- **Area Operations Officer (44)**

The AOO is responsible in identifying assessing and conducting periodic review of High Risk AML processes within his assigned Branch Area. He shall report directly to BOD AML Compliance Committee and recommend action plan to immediately close all identified gaps on AML compliance/issues related to branch operations.

- **Sales and Service Head (630)**

The SSH is the designated Branch AML Compliance Officer with matrix reporting to the Domestic AML Regulations and MIS Department under the Global AML Compliance Division of the Global Compliance Group. He shall ensure all AMLC requests and BSP-AMLSG examination requirements as transmitted to AOO within 48 hours from receipt of email notices; the effects for accounts subject of Freeze Order, Provisional Asset Preservation Order, Asset Preservation Order or AMLC Resolution are implemented immediately.

Therefore, the Branch AML Compliance Framework is composed of **674** BOD and branch officers directly involved in the effective implementation of the MLPP. The establishment of the BOD AML Compliance Framework was to identify key officers that will provide closer supervision on AML Compliance. The BOD is upgrading the job description of the existing officers and re-defining the reporting line through the BOD organizational structure to incorporate the changes.

The Global Compliance Group compliance structure staffing requirements on a group wide basis will vary from country-to-country. There may be instance that it is necessary to appoint a regional compliance officer or the designation of a competent compliance officer that will be able to perform con-current regional oversight responsibilities based on the business needs and an assessment of the business risks. Similarly, compliance oversight of a small branch business operations and a related entity of similar product and services operating in the same country may have the same compliance officer with oversight on both businesses covered by a service level agreement approved by the board and with appropriate regulatory clearances.

- Appointment of AML Cybercrime Officer reports directly to Domestic AML Regulations and MIS Dept Head. He is the GCG designated central-point of contact for all identified cyber-crime related transactions coursed thru the Bank front-end and core banking system applications.
- In line with the Three-year Compliance Strategic Plan of GCG from sustaining and upgrading to strengthening the Bank's Compliance Framework, the 2017 reorganization of Compliance Group was approved by BACC and Board in February 2017.

The reorganization takes into consideration succession planning, change in the core banking system, continuous/sustaining the transaction monitoring activities attuned to the latest trends, in-sourcing by other offices of transaction monitoring and enhanced due diligence of alerts of GCG, upgrading the compliance testing review programs to incorporate new regulatory requirements and enhancing the compliance training programs to align with the Bank's 2017 Business Plan/Strategic Plan. The reorganization shall increase the plantilla positions from 59 to 71, all officers.

The six major divisions are:

- 1) Global Anti-Money Laundering Compliance Division
- 2) Compliance System Support Division
- 3) Regulatory Compliance Division
- 4) Business Vehicle Management Compliance Division
- 5) Compliance Testing Review Division
- 6) Corporate Governance and Sustainability Division

Two (2) Deputy Chief Compliance Officer (DCCO) positions were created to assist the Chief Compliance Officer in providing oversight to the Divisions under supervision and fast track implementation of succession planning to identify personnel who will take on higher level positions/responsibilities and intensify on-the-job training.

Upgrading of Compliance System Support Department into a Division to ensure existing and future compliance system requirements are implemented/supported under the new core banking system and existing and new software applications.

For the Global Compliance Group to effectively accomplish its goals, the Chief Compliance Officer that heads the group is supported by two (2) Deputy Chief Compliance Officers, six (6) Compliance Division Heads, supported by 630 Branch AML Compliance Officers, 45 Area Compliance Officer Designates, 60 Head Office Compliance Officer Designates, 9 Compliance Officers for overseas branches and offices, 5 Compliance Officers for Domestic Subsidiaries and 7 overseas subsidiaries Compliance Officers.

3. Policies and Procedures

Banks must have updated policies and procedures embracing the compliance framework, the corporate governance guidelines, new, existing and changes in the laws, rules and regulations issued by regulators. Banks should ensure that these are strictly followed to achieve effective compliance in the organization. The written policies and procedures must establish the minimum corporate standards on how to fully adhere to new and existing laws and regulations that are aligned with the business priorities and initiatives.

PNB developed at least five compliance programs for inherent high risk products and services to ensure the controls are strictly observed, multiple thresholds defined and there are responsible officers that implement dual control requirements. More so, the compliance programs clearly articulate mitigating controls that need to be implemented. It should be noted that these compliance programs were designed in accordance with the compliance framework and risk rating systems introduced by regulators. Board approved Compliance Bulletins averaging 4 per month are issued to timely inform the bank employees of new regulations, enhanced compliance and control procedures that are eventually incorporated in the Compliance and Operations Manuals annually.

4. Monitoring and Assessment

A continuous monitoring and assessment of the compliance program is critical and will provide compliance and business management of a bank a reasonable assurance that the compliance program continues to function effectively and efficiently. The compliance program must include

both on-going and point-in-time monitoring responsibilities and must incorporate self-assessment and independent assessment techniques.

PNB adapts a three-year strategic compliance plan with the objective to sustain and upgrade existing policies and procedures and practices, take proactive actions by strengthening succession planning, risk rating systems compliance test scripts and investigation processes with the ultimate goal to preserve franchise licenses achieved through standardization of manuals, compliance testing programs and compliance package across all businesses.

RCSA, CCSA, CICA & Quarterly Certifications

Since 2007, the Bank has adopted the Risk and Control Self-Assessment (RCSA) Program as integral to the bank's ICAAP Program. In 2010, the Global Compliance Group (GCG) has developed a template for regulatory compliance that forms part of the RCSA program for all business units. Compliance reviews aim to validate the adequacy of internal controls and compliance with applicable laws, regulations and corporate standards affecting the business unit.

Based on the results of the RCSA and GCG's compliance testings, GCG is tasked to provide guidance to the business unit to update the RCSA template with new regulations, if any, and recommend corrective actions for areas with noted deficiencies and/or lapses.

Under the bank's Internal Capital Adequacy Assessment Process (ICAAP) Program, GCG is the lead owner of the compliance risk. With the above processes, GCG is able to quantify compliance risk on a bank-wide basis including the impact of the subsidiaries and affiliates for potential penalties and related expenses arising from non-compliance, deficiencies and possible violations.

To provide focus on select units that require closer supervision to address critical regulatory concerns, the Compliance and Control Self Assessment (CCSA) supplements the RCSA Program.

We have introduced the Compliance and Control Self-Assessment (CCSA) for business and support units that cater to more complex products and services. The CCSA was developed to provide a comprehensive list of inherent risk areas, mitigating controls and testing of implementation for the line to have a deeper understanding of sustaining a residual risk assessment of "LOW RISK". The document focuses on high risk areas and closure of gaps covered by supporting documents as proof of those corrective actions were sustained.

On an annual basis, GCG prepares the comprehensive enterprise-wide Compliance and Control Self-Assessment to look into the overall compliance and control environment of the Bank including its subsidiaries and affiliates both overseas and domestic.

On an annual basis, GCG perform a comprehensive enterprise-wide Compliance and Internal Control Assessment (CICA) that looks into the overall compliance and control environment of the bank including its subsidiaries and affiliates, both overseas and domestic. CICA considers issues such as potential exposure to regulatory penalties, past internal and external examination findings, past compliance audit or compliance review findings, new regulatory issuances or amendments to regulations, validation of regulatory examinations/IAG responses, personnel movements/change in organizational structure, operational or system enhancements, new products and services, and

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recent market developments which shall be expanded to include Political/Economic Environment/Banking Industry Concerns. CICA ensures proper compliance monitoring, which consequently plays a major role in determining the condition of various business units and basis of compliance testing activities for the year.

On a quarterly basis, GCG Team evaluates the quarterly regulatory and AML certifications issued by Compliance Officers and Designates.

5. MIS and Reporting/Controls

New regulations and prudential reporting requirements are being introduced by regulators each year to improve transparency and accuracy. To comply with these, Banks must designed a number of reports to ensure tracking of critical issues and corrective actions are complete, timely and there is accurate flow of information among the different units, branches and legal entities. Banking organizations should also ensure that they have adequate management information systems that provide management with timely reports on compliance like training, effective compliance system and certifications.

On a monthly basis, the results of the Compliance Package are presented to the appropriate Board Committees and respective Boards which give importance on the independent reports issued by internal and external auditors and the various regulatory examination reports issued by host country regulators.

PNB, in the last two years, we have implemented the Annual AML Risk Assessment across business legal vehicles in compliance with host country regulatory requirements.

The Annual Risk Assessment serves as the basis of review of the effectiveness of the AML transaction monitoring profile alerts used by the businesses in isolating unusual transactions that will require EDDs, filing of STRs/SARs to appropriate regulatory bodies or enforcement agencies.

6. Training

A successful framework involves the training of staff at all levels and across departments to maintain a sound compliance program. It is the responsibility of senior management to keep front and back office employees trained to keep abreast with the changes in regulations and best practices in internal controls. The culture of compliance has to be built systematically across the organization from grass roots through a series of familiarisation programmes.

The bank should make all personnel aware of the banking laws and regulations that affect their areas of responsibilities and should provide training regarding bank's policies and procedures for those areas. Training could be primarily in the form of formal lectures or classroom training, in the form of a briefing, modular sessions or survey questionnaires.

The appointment of Compliance Officers/Designates is reviewed annually to determine the training needs of each Compliance Officer/Compliance Designates as approved by the Board Audit and Compliance Committee. The role and responsibilities of a Compliance Officer/Compliance Designate is covered by signed Job Descriptions. Compliance Officers/Compliance Designates undergo regular training on new and existing laws, rules and regulations and corporate standards

to ensure they are empowered to effectively carry out compliance duties and responsibilities. Based on skills gap evaluation, the Compliance Officers/Compliance Designates are required to enrol or attend seminars relevant to their respective areas i.e. Trust, IT, AML, Treasury, Cyber Security and Fraud Management.

Continuous education of bank personnel is an important element in the compliance function to maintain a sound compliance program. Trainings are provided to make all personnel aware of the existing banking laws and regulations and policies and procedures relevant to their areas of responsibilities. Training could be in the form of a formal lecture, briefing, modular sessions or survey questionnaires conducted by the Global Compliance Group, Human Resources Group or external subject matter experts.

Global Compliance Group will establish and developed other training courses and materials covering subjects, as and when warranted. The Global Compliance Group will also designate which courses as "compulsory" for certain employees and "frequency for refresher". It is mandated that all employee must pass based on a rated written examination all the "compulsory" training courses that are available.

Global Compliance Group, in coordination with the Human Resources Group, conducts basic compliance awareness training for all existing employees and new hires. All new hires must undergo compliance and AML awareness training prior assumption of duties while existing employees are required to participate in refresher courses within a period of 18 to 24 months.

Training for different sectors for specific compliance policies ("in depth" training) will be tailored fit to the needs of a particular group. The groupings may be divided into: Branch Clusters, New Tellers, New Hires, Sales and Service Heads, New Internal Auditors, New Officers, Business and Support Units and Legal Vehicle Management Units.

7. Compliance Review and Testing

Independent testing should be conducted to verify that compliance-risk mitigation activities are in place and functioning as intended throughout the organization. In conducting a compliance review and testing, consideration should be given to issues such as potential exposure to regulatory penalties, past internal and external audit examination reports, past compliance testing and review results, and new amendments to regulations. Other areas that maybe focused in will include personnel turnover, operational processes, system enhancements, new product offerings, and recent market developments.

PNB have conducted train-the-trainer seminars to expedite transfer of knowledge and best practices to the internal auditors, Branch Area Operations Officers and the Compliance Officer Designates to upgrade the quality of self-assessment practices, selection of random samples and review of sustained corrective actions. For 2015, there were about 130 compliance testing reports issued on selected areas using the risk-based approach. For 2016 & YTD 2017, 183 & 115 compliance testings and reviews were conducted, respectively. In accordance with BSP Circulars on the role of Compliance Office, Internal Audit Group and the Risk Management Group, Compliance takes the pro-active role of providing advisory and assisting line in strengthening the implementation of mitigating controls, Risk Management Group issues policies to cover financial

risk while Internal Audit Group reviews on an ex-post basis whether prescribed guidelines of the Bank were followed.

Compliance Testing and Review Undertaken by the business

All business units have to carry out their own self-assessment compliance testing on the vital elements of the regulatory and AML compliance and control procedures. Domestic subsidiaries, overseas branches and subsidiaries submits on a monthly basis report on the result of monthly meetings which includes discussions of outstanding regulatory and IAG findings, new regulatory issuances, new products/services to be launched, and updating of policies and procedures. As a result, Global Compliance Group (GCG) is able to assess the prevailing risk on each domestic subsidiaries, overseas branches and subsidiaries.

The self-assessment process is the key “control” engine that will enable the business to mitigate any compliance and control risk. The internal Quarterly Regulatory compliance Certification and/or the semi-annual RCSA were designed to capture relevant laws, rules, regulations and related bank policies that are applicable to the business unit/entity. Any deficiencies noted in their assessment will require implementation of corrective actions for the bank to achieve a satisfactory level of compliance group-wide by yearend. The Branch/Business Unit Compliance Officer/Designate or designated independent staff may coordinate the performance of the self-assessment, Compliance Testing and the documentation of results to Global Compliance Group. Deficiencies or lapses detected during the testing must be documented, and if the issue is considered as significant, it will be escalated to higher level authority. The compliance certification test results, corrective action plans, and the corrective action for legal/regulatory compliance matters are reviewed by the Business/Support Group Head and concurred by the Global Compliance Group.

The bank employee performing the compliance review or testing should be independent of the area and/or transactions being reviewed. Testing procedures and results are to be documented including the methodology or the corrective actions required for closure of an exception or finding. Exceptions which are isolated or clerical in nature need to be communicated to the Branch Head or Unit Head. Exceptions that are systemic/repeat in nature or that could have significant impact to the bank should be escalated to the Group Head, GCG Head, and Senior Management. All findings that remain unresolved or open beyond the target resolution date must have a monitoring tracking process to ensure that required or changes to the corrective actions are escalated to the responsible senior for immediate implementation.

8. Working with regulatory bodies and enforcement agencies

Beyond compliance, through timely submission of regulatory reports, active participation in technical working groups among regulatory bodies and banking organizations and full cooperation with enforcement regulatory bodies and government agencies on-going investigations, the bank initiates new policies and procedures to align with international best practices. Anticipating new regulatory requirements based on draft documents include bank looking into new systems, policy changes, updating procedures and enhancing MIS management reports.

The events of the past months have determined the need to sustain the trust and market confidence that the banking community serves - the stakeholders. An effective compliance framework means more profits to banks because resources are focused on revenue generating

activities, for the stockholders - good corporate image of strong compliance leads to increase in share value, good compliance attracts quality customers and protects attrition of loyal customers. For the employee, it is the pride of belonging to a reputable bank and to the bank regulators; a model bank founded on good corporate governance that promotes best practices.

Therefore, an evolving effective compliance framework goes a long way in strengthening ties and enhancing market perception among customers of financial institutions, interbank counterparties and the regulators.

The framework is indeed working effectively. The eight (8) elements of PNB Compliance Framework have been beneficial to the Institution. With the strong support and active engagement of the PNB Board of Directors and Senior Management with the guidance of the regulators, PNB was able to achieve the following in 2016 to 1st half of 2017.

<i>Key Elements</i>	<i>2016-2017 Major Enhancements</i>
Executive Level Oversight	<ul style="list-style-type: none"> Created Management Committees for complex business & support groups
Compliance Structure	<ul style="list-style-type: none"> Appointment of AML Cybercrime Officer Reorganization of Compliance Group to 6 divisions, created 2 Deputy Chief Compliance Officers; and increase of plantilla positions from 59 to 71 all officers
Policies and Procedures	<ul style="list-style-type: none"> Developed at least 5 modified compliance programs for inherent high risk products and services
Monitoring and Assessment	<ul style="list-style-type: none"> Conducted CCSA (RCSA Program), Annual comprehensive enterprise-wide CICA and quarterly certifications
MIS and Controls	<ul style="list-style-type: none"> Prepared monthly comprehensive compliance package for Board and Senior Management Implemented Annual Risk Assessment across business legal vehicles
Training	<ul style="list-style-type: none"> Trained Compliance Officers/Compliance Designates to be empowered to effectively carry out compliance duties and responsibilities
Compliance Reviews and Testing	<ul style="list-style-type: none"> Relied on competent and independent reviewers comprised of auditors, branch Area Operations Officers, compliance officers/compliance designates and risk overseers.
Working with Regulatory Bodies and Enforcement Agencies	<ul style="list-style-type: none"> Ensured timely submission of reports and actively participated in technical working groups among regulatory bodies and banking organizations

Ethical Standards Committee (ESC)

Philippine National Bank has an Ethical Standards Committee (ESC) with the Head of the Legal Group as Chairperson and Head of the Human Resource Group as Vice Chair with members from various Business and Support Units. The ESC, who meets weekly, is a management committee carrying out the following responsibilities:

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1. Maintain high level of ethical standards among the Bank's employees as well as manage reputational risk by implementing the Bank's Code of Conduct.
2. Conduct investigation and render decisions if and when warranted or make its recommendation on various disciplinary cases involving officers and rank and file employees of PNB including its overseas branches/ offices and foreign subsidiaries as referred by the Fact Finding Committee of concerned office in accordance with the provisions of the Code of Conduct.
 - Authorize the implementation of disciplinary action against erring employees including termination of employment of employees with the rank below Vice President
 - Submit/ endorse to the Board of Directors through the Office of the President and Corporate Governance Committee for approval/ disposition all cases of termination of employment of employees with the rank of Vice President and above.
3. Conduct further investigation and render a decision on sexual harassment cases involving officers and rank and file employees as endorsed/ filed by the Committee on Decorum and Investigation (CDI).
4. Conduct appropriate investigation on reports of suspected or actual commission of fraud, misconduct and/ or violation of any law, rule, regulation, policies, etc. as endorsed by the Head of the Corporate Security Group (CSG) as provided for under the Bank's Whistleblower Policy.
5. Ensure that existing legal and regulatory requirements are complied with when implementing disciplinary process/ action.
6. Continuously renew, update and implement changes on the Bank's ethical code policies and regulations, as deemed necessary.
7. Periodically report status/ resolution of disciplinary cases to the Corporate Governance Committee.

PNB is committed to its compliance, ethics and governance programs. For violations on policies, procedures and Ethics, this is handled by the Ethical Standards Committee, with corresponding sanctions/penalties, if necessary after due process. Rewards and recognitions are also given to employees and groups who have imbibed and promoted compliance with the rules and regulations, ethics and corporate governance as part of the quarterly assessment and performance appraisals of officers and employees of the Bank. More so, recognized individuals/groups were cited as part of the quarterly Pulong ng Bayan where awards and recognitions, monetary and non-monetary are given by the Bank.

The Bank, as a financial institution, its Board and Senior Management are committed to a compliance enterprise framework guided by the principle that:

“Compliance and good corporate governance is embedded in the corporate culture as deeply as the desired corporate goals of achieving the revenue targets and expense management and in the process preserve the franchise value of the bank”.