

Banks Amendment Bill

Standing Committee on Finance

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national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Why are we here?

- Urgent amendments to the Banks Act
- To increase options for curator appointed to resolve a bank which is unable to meet its obligations
- It is urgent because we would like to extend this option to the curatorship of African Bank
- Whilst Twin Peaks system will introduce more modern legislation to resolve a failing bank, this will be too late for current challenges
- Option provided for is the splitting up of a failing bank under curatorship into a Good Bank and a Bad Bank
- If this additional option is not available, the option of liquidation can be utilised, leaving everyone worse off (creditors, employees, customers)
 - Intention is that this option leaves no creditor worse off
- This Bill will meet resistance from those (mostly creditors) who hope to get more.....

Bank Failures: Why does it really matter?

Lessons internationally show crisis management packages for bank failures in countries as diverse as the US, Japan, Korea, Mexico, and Turkey and most recently Portugal- all cost the taxpayer significantly ranging from 13% of GDP in Finland to 32% in Turkey.

The key lesson from other countries dealing with risks to financial stability-

1. **It is very PAINFUL with lots of losers:**

- Any intervention plan involves a transfer of wealth from creditors to debtors.

2. **Speed saves and reduces costs:**

- A key driver of this variation in ultimate fiscal costs is the speed with which governments act to resolve the crisis.
- While the upfront cost of interventions is high, if done right, the government will not be left empty handed.

What to expect when Bill may affect current stakeholders

- Key stakeholders are depositors, senior and subordinated creditors, shareholders
- Depositors are protected, but investors are not
- Fund managers have lost money and have to act in the interest of their respective funds
- Many companies have conflicting positions
 - Large financial groups are exposed to curatorship in various ways – through:
 - Bank
 - Asset management subsidiary
 - Different fund managers from same asset management co
 - Submissions are sometimes contradictory
 - One group has signed four separate submissions from four different perspectives

Who are the real victims of a bank's failure?

- There are affected stakeholders:
 - Retail and corporate depositors
 - Taxpayers
 - Employees of the bank
 - Borrowers
 - The banking system as a whole
 - Creditors of the bank
 - Pension funds

BACKGROUND: BANK FAILURES

Many countries have introduced legislation while resolving banks

- **UK** - The Banking (Special Provisions) Act 2008, emergency legislation used to take Northern Rock plc into temporary public ownership and to resolve Bradford & Bingley Plc and a number of Icelandic banks (eventually replaced by Banking Act 2009). The Bill took just four days from its first reading in Parliament to receive Royal Assent.
- **Portugal** - Law no. 62-A/2008, of 11 November was passed to nationalize the entire share capital of Banco Português de Negócios, S. A (a Portuguese bank facing a serious distress situation). The first reading in parliament took place on 3 November 2008 and the law was published on 11 November 2008 in the Portuguese Official Gazette
- **Iceland** - Emergency Act 125/2008, emergency legislation enabling the supervisory authority to take over Kaupthing, Glitnir and Landsbanki in order to preserve financial stability
- **Germany** - The German Financial Market Stability Act 2008, was an emergency act in the light of the upcoming financial crisis in 2008. The Act was formally proposed on 14 October 2008 and enacted four days later (*i.e.* on 18 October 2008), as certain mandatory consultation periods were waived by the relevant legislative bodies.
- **Dubai** - Decree No. 57 in 2009, bespoke insolvency protection regulations to govern any future formal reorganisation and restructuring of Dubai World. It took c.3 weeks from the start of the Dubai World restructuring for the Ruler of Dubai to pass Decree No. 57
- **Spain** - Series of Royal Decree Laws in 2009, 2011 and 2012 to deal with Spanish banking crisis and introduce resolution tools. Royal Decrees are used by Government in cases of extraordinary and urgent need and come into force immediately (and will then be debated and voted on by congress within 30 days).



Post-financial crisis bank resolution / restructuring / insolvency legislation continued...

- **USA** – Dodd-Frank Act 2010, implementing changes that, among other things, affected the oversight and supervision of, and provided a new resolution procedure for, financial Institutions
- **Ireland** - Credit Institutions (Stabilisation) Act 2010, passed to deal with retail banking crisis (subsequently replaced in 2011)
- **Belgium** - The Law of 2 June 2010 on the expansion of rescue measures for undertakings in the banking and finance sector, post-Dexia crisis, allowed for emergency appropriation of shares in systemically important banks (replaced in 2014) and c.4 months passed between the date of proposal and the date of adoption.
- **UK** - The Investment Bank Special Administration Regulations 2011, provided a new special administration regime for investment banks
- **Germany** - The German Restructuring Act 2011 was an act simultaneously implementing and amending different existing statutes. The legislative procedure was initiated on 3 September 2010 and the Act was enacted on 1 January 2011
- **Lithuania** - 2011 amendments to various banking laws to deal with Snoras nationalisation and insolvency. A number of amendments were made to existing legislation on an urgent basis
- **Portugal** – Decree-Law no 31-A/2012, of 10 February introduced several amendments to Portuguese banking regulations, in particular the creation of a Resolution Fund and the introduction of intervention and resolution measures (anticipating the implementation of European Directives to that effect)



Post-financial crisis bank resolution / restructuring / insolvency legislation continued...

- **Cyprus** - Resolution of Credit and Other Institutions Law of 2013, passed to deal with the banking crisis in Cyprus
- **Portugal** – Decree-Law no. 114-A/2014, of 1 August implemented Directive 2014/59/EU of the European Parliament and of the Council, of 15 May, amending the framework for recovery and resolution of credit institutions and investment firms already provided for in the Portuguese Banking Act. The Decree-Law draft proposal was prepared a couple of days before its approval by the Council of Ministers on 31 July 2014, having been published on 1 August 2014 in the Portuguese Official Gazette.
- **Portugal** – Decree-Law no. 114-B/2014, of 4 August amended the scope of the resolution measures and the terms and conditions for the sale of the shares or assets of the bridge bank provided for in the Portuguese Banking Act. The Decree-Law draft proposal was prepared and discussed during the weekend of its approval by the Council of Ministers which took place on 3 August 2014, having been published on 4 August 2014 in the Portuguese Official Gazette.



Why are Banks treated differently from other companies when facing insolvency

- Any bank in trouble (or even perceived to be in trouble) will be subject to a bank run
- A bank is built on maintaining PUBLIC TRUST AND CONFIDENCE, and when trust and confidence disappears, it will be exposed to severe liquidity risk and a run on deposits
- A failing bank affects all other banks, as banks are interconnected, so banks pose a SYSTEMIC risk to the entire banking and financial sector
- Hence concept of **systemically important financial institution** (SIFI)
- Recent banking crisis since 2008 include
 - Bear Sterns in the USA in 2007
 - Northern Rock in the UK in 2007
 - Lehmans in the USA in 2008
 - Banco Espirito Santo in 2014

Previous bank failures in South Africa

- South Africa has a few bank failures, all before 2008
 - Most significant was SAAMBOU
- Banks Act has a well-established system of curatorship that has successfully saved some banks
- Other banks that failed and were wound down
 - Islamic, MEEG, Regal Bank, BOE, Unifer
- Banks Act has provided an alternative approach to the (old and new) Companies Act in SA

POST-2008 GLOBAL FINANCIAL CRISIS INTERNATIONAL DEVELOPMENTS

Recovery and Resolution: What's the big idea?

Since the 2008 Global Financial Crisis, legislative and regulatory authorities have been developing **systems and controls to reduce the need for bank bailouts**.

New regulatory standards are being put in place to make all financial institutions, especially banks, more robust and reduce the risk of failure in the future.

To ensure a high international standard and best practice the G20's Financial Stability Board (FSB) introduced : **Key Attributes of Effective Resolution Regimes (2011 and 2014)**.

The Key Attributes: Public interest trump private interest

The FSB Key Attributes consider both public interest and private interest **but** elevate the public good above all else.

The FSB outline the following features as key for effective resolutions regimes:

- **not rely on public solvency support** and not create an expectation that such support will be available;
- **allocate losses to firm owners (shareholders) and unsecured and uninsured creditors** in their order of seniority;
- **be credible** and thereby provide incentives for market-based solutions.
- **ensure continuity of systemically important financial services**, and payment, clearing and settlement functions;
- **avoid unnecessary destruction of value**, and therefore minimise the overall costs of resolution in home and host jurisdictions and, where consistent with the other objectives, losses for creditors;
- **provide for speed and transparency** and as much predictability as possible through legal and procedural clarity and advanced planning for orderly resolution;
- provide a mandate in law for cooperation, information exchange and co-ordination domestically and with relevant foreign resolution authorities before and during a resolution;
- **ensure that non-viable financial institutions can exit the market** in an orderly way

South Africa's response to Global Finance Crisis

- Strengthening of regulatory system through shift towards Twin Peaks
- SARB given responsibility to oversee FINANCIAL STABILITY
- Creation of two separate regulators
 - Prudential Authority established in the Reserve Bank to ensure financial soundness and well-being of financial institutions
 - Market Conduct Authority established as a separate, dedicated regulator outside the Reserve Bank to ensure customers are treated fairly
- Publication of second revised Financial Sector Regulation Bill in Dec 2014, together with a discussion document
- Publication of Draft Market Conduct Policy Framework
- Further key legislation to follow
 - New Resolution Bill in 2015
 - Conduct of Financial Institutions Bill in 2015

2014 FSAP on SA recommends further improvements

In 2013 and 2014 SA underwent comprehensive reviews of the robustness of its financial sector regulation, including crisis management measures.

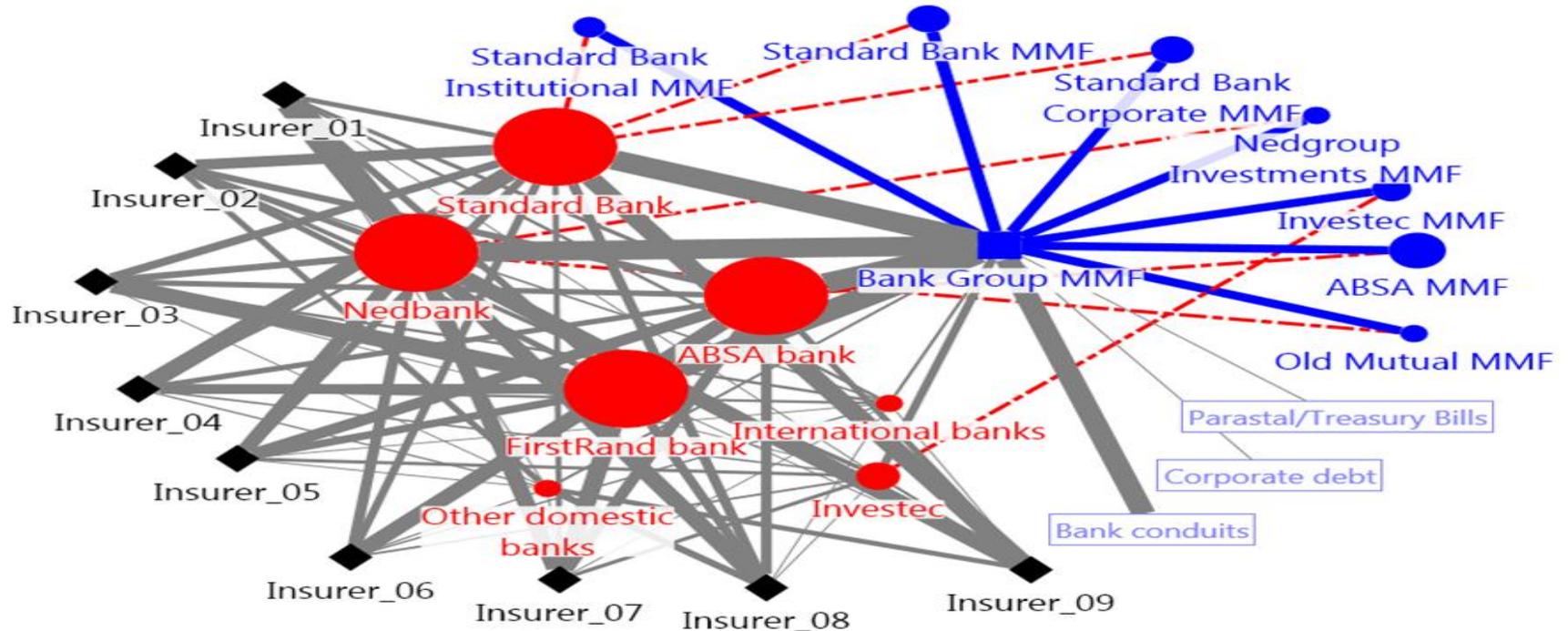
Conducted by the IMF, the 2014 FSAP assessment found:

- SA's **resolution regime must be updated** to meet best international practice.
- The **current curatorship powers lack critical features** to deal with a systemic failure and minimise taxpayer risk
- **Resolution powers should be available at an earlier juncture**, facilitate a wider range of resolution tools (including bail-in and bridge banks) and not be at risk of being suspended or reversed

National Treasury – Reserve Bank team is preparing a Bill to address this

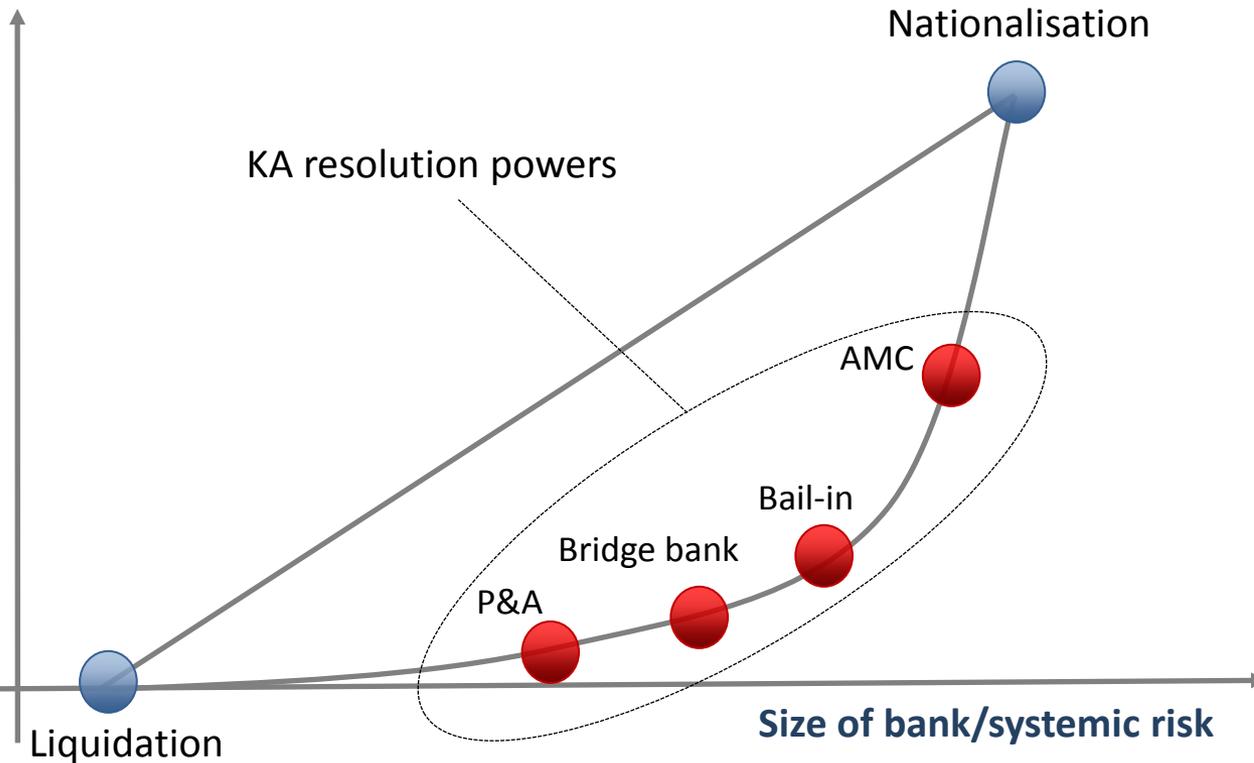
Why are reforms needed?

Interconnectedness and complexity mean that curatorship requires flexibility; and **even small banks can have systemic implications**



Why are reforms needed?

Fiscal cost/ moral hazard



- How you respond to a bank in distress relies critically on how systemic it is
- In this case, we preferred to re-organise the bank with some losses to creditors
- Known as “bail-in” as opposed to “bail-out”
- Quite common in non-bank reorganisations

PROPOSED AMENDMENTS IN BANKS ACT

How does “curatorship” overlap with “recovery” and “resolution”

Curatorship

Regulator applies to Minister for curatorship

- **S 69 (1) (a)** If, in the opinion of the Registrar, any bank will be **unable to repay, when legally obliged to do so, deposits made with it or will probably be unable to meet any other of its obligations**, the Minister may, if he or she deems it desirable in the public interest, by notifying the chief executive officer or the chairperson of the board of directors of that bank in writing, appoint a curator to the bank.
- Typically to:
 - Protect depositors or policy holders
 - Protect the financial system from disruption

Gaps in the law

- Currently the Banks Act is vague on certain points:

- s 69(2B)

*conduct the management [of the bank]... in such a manner as the Registrar may deem to **best promote the interest of the creditors** of the bank concerned and of the banking sector as a whole and the rights of employees in accordance with relevant labour legislation”*

One of the proposals is to better measure ‘interest of the creditors’ following Key Attributes

- s 69(2C)

Allows curator to “**dispose of any of the bank’s assets**” – however the law is silent on the liabilities of the bank

Proposals

- We propose that the curator **may transfer liabilities** provided:
 - that **creditors are treated in an equitable manner**
 - Reasonable probability that creditor will be **no worse off than in liquidation**
 - **A due process** is followed, which allows creditors the “right to be heard”, or *audi alterem partem*
 - Legally, the right to be heard is a double right
 - First, the curator must follow due process in preparing his report
 - Second, the Minister or the curator (as the case may be) must follow due process to ‘*consider the report*’ and coming to a conclusion
- Of course, creditors retain the right to take legal action against either the curator or the Minister

Proposals

- Propose that section is introduced “ordinary resolution” in addition to the wording of the “special resolution”
 - Holding company versus bank
- Section 69(3)(j)
 - “Raise funding on behalf of the bank”
 - To allow the bank in curatorship to obtain funding from the Reserve Bank, and for the Reserve Bank to recover this money

Process of consultation

- Following Cabinet approval, Bill published in December 2014
- Consultations:
 - December 2014:
 - Curator
 - Reserve Bank
 - Senior counsel and State Law Advisers
 - All Major creditors groups and categories (through ASISA)
 - January 2015:
 - All Major creditors groups and categories
 - Counsel (Tregrove, Budlender, Kuper, Unterhalter)
 - Industry's Recovery and Resolution Task Group (Banking Association and ASISA)
 - Banking Association
 - Banking consortium

Who are the stakeholders during a curatorship?

- **Retail depositors**
 - Ordinary South Africans who put their savings in a Bank.
 - Try for 100% covered.
- **Senior / Tier 1 creditors**
 - Pension funds
 - Money market funds and other investment funds
- **Junior / Sub-ordinated / Tier 2 creditors.**
 - Higher risk investment funds that invested in higher-yielding, high-risk 'subordinated' debt
 - Pensioners should avoid this type of instrument
- **Shareholders**
 - Highest risk

What are the main concerns?

Three main issues will likely be raised.

1. Creditor Protection

Curator must balance rights between groups:

- **Depositors:** ordinary depositors must be protected as far as possible
- **Broader society:** risk of a wider crisis
- **Creditors:** Those who invested and expect a return.
- Treasury believes that there are sufficient checks in other areas of law
- Curator / Minister cannot act alone, and according to PAJA must consult with affected groups

What are the main concerns

2. Valuation of transferred liabilities

The National Treasury view:

Determining what constitutes fair market value will require two things:

- **Time:** Generally in a crisis establishing a fair-market price is not reasonable.
- **Normal market conditions:** to establish fair market value is a normally functioning market.

What are the main concerns

3. Equal treatment of *pari-passu* claims:

Sub-ordinated (Tier II) creditors maintain that they should be treated the same (*pari-passu*) as senior (Tier 1) creditors

National Treasury view:

- Creditors bought these instruments because the return on these instruments was higher than more senior (or higher ranking) claims.

Treasury Response to other objections

- Many red herrings in some of the comments received
- Some comments received from some creditors suggest the Bill may be unconstitutional
 - Treasury believes the Bill is not unconstitutional
 - Refer to legal opinion by Unterhalter and Budlender
 - Some of the objection is not consistent, as it implies that the current system of curatorship (without the amendments) is unconstitutional
- Some comments go against international trends
 - Objections to curatorship over Companies Act is out of line with global practices
 - Comments on adverse impact on future investment is misplaced as this is what the USA, UK, EU countries also do
- Distinction between Basel 2 and Basel 3 is not relevant to resolution

Conclusion

- Treasury is open to comments and amendments, and keen to minimise losses to creditors and other stakeholders, without resorting to taxpayer bail-out
- However, investors who invested must accept responsibility for losses
- Current option provides a further option which may, or may not, be used on existing (or future) curatorships
- Many legal teams will be involved in this process, each team batting for a specific party or fund
- Care must be taken in deliberations not to get into operational detail on current curatorships
- Key question to ask is:
 - Do these amendments leave any creditor or stakeholder worse off than in a normal liquidation?
 - Do these amendments leave any creditor or stakeholder worse off than the current Banks Act?

End