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DEG – Deutsche Investitions – und Entwicklungsgesellschaft mbH
(the **Tier II Debtholder Committee**)
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Comments on the Banks Amendment Bill [B17-2014] to the Standing Committee on Finance

1. Introduction

Pursuant to the invitation issued by the Standing Committee on Finance requesting written submissions on the Banks Amendment Bill [B17-2014] (**Bill**) please see the comments of the Tier II Debtholder Committee on the Bill. The Tier II Debtholder Committee is an ad hoc committee of creditors which hold, either in their own right or on behalf of underlying clients, regulatory capital tier II notes issued by African Bank Limited (**ABL**). The Tier II Debtholder Committee has been established for the purposes of engaging with the curator in relation to the curatorship of ABL.

2. The proposed amendments to Section 69(2C) of the Banks Act

2.1 Differentiation between Creditors

- (a) If the Bill were to be enacted, Section 69(2C)(b) of the Banks Act, 1990 (**Banks Act**) would allow a curator to:
 - (i) dispose of any assets of the bank under curatorship;
 - (ii) transfer any of the liabilities of the bank under curatorship; or
 - (iii) dispose of any of the assets and transfer any of the liabilities of the bank under curatorship, other than in the ordinary course of business, provided the Minister of Finance (**Minister**) consents thereto.
- (b) The Minister may, in terms of the proposed Section 69(2C)(d), grant such approval if he considers the disposal, transfer, or disposal and transfer "*reasonably likely*" to promote a

stable banking sector in South Africa or to maintain public confidence in the South African banking sector.

- (c) The proposed amendments to Section 69(2C)(b) of the Banks Act accordingly authorise the curator and the Minister, unjustifiably in Tier II Debtholder Committee's view, to differentiate between creditors on an ad hoc and subjective basis by treating some creditors less favourably than others.
- (d) Our concerns here may be addressed by incorporating into the Bill a similar provision to the compromise provision in section 155 of the Companies Act, 2008 (**Companies Act**). Please see our proposed amendments to the Bill, which are reflected in the marked up Bill attached.

2.2 Deprivation of Existing Property Rights

- (a) The contractual rights held by creditors in relation to a bank under curatorship are regarded as "*property*" within the meaning of the Constitution.
- (b) In our submission, the proposed amendments to Section 69(2C) of the Banks Act authorise a deprivation of existing property rights on an ad hoc basis at the discretion of the curator and (indirectly) of the Minister. This deprivation of property is not rationally connected to the purpose of promoting confidence in, or the stability of, the banking sector in South Africa. Further it is our submission that the rights afforded to the curator and the Minister are disproportionate to the end sought to be achieved as the provisions are broadly framed and thus afford the curator and the Minister a virtually unfettered discretion to decide when and in what manner to deprive a creditor of its rights.
- (c) Our concerns here may be addressed by incorporating into the Bill a similar provision to the compromise provision in section 155 of the Companies Act. Please see our proposed amendments to the Bill which are reflected in the marked up Bill attached.

2.3 Increased cost of funding

Linked to the differentiation between creditors and the deprivation of existing property rights as discussed in paragraphs 2.1 and 2.2 above, is the fact that the uncertainty in relation to creditors' rights upon the curatorship of a bank as a consequence of the proposed amendments to section 69(2C) of the Banks Act will likely result in an increased cost of funding for South African banks going forward. This may have a detrimental impact on the object to ensure a stable banking sector in South Africa and could further erode public confidence in the South African banking sector. We submit that our proposed amendments will address this uncertainty such that, if our amendments are incorporated into the Bill, this should not have any material increase in the cost of funding for South African banks. Please see our proposed amendments to the Bill which are reflected in the marked up Bill attached.

2.4 Comparative Analysis with Basel III

- (a) The Basel III global regulatory standard proposed by the Basel Committee on Banking Supervision was implemented in South Africa on 1 January 2013 by amendment to the Regulation Relating to Banks (**Regulations**). Regulations 38(14)(b) (i) and (ii) of the Regulations provide that the proceeds of instruments issued prior to 1 January 2013 (and which thus do not meet with the Basel III regulatory capital requirements including the ability of the Registrar of Banks to write off or convert a regulatory capital instrument) still count as regulatory capital for the issuer subject to the regulatory capital phase out for such instruments contained in Regulation 38(14)(c) of the Regulations. As such, authorising the Minister effectively to write off debt, the proceeds of which counted toward the regulatory

capital of a bank under curatorship and which debt is owed to certain creditors under instruments predating 1 January 2013, would be contrary to the principles dealing with the phasing in of Basel III as contained in Regulation 38(14)(b) of the Regulations.

- (b) We submit that our proposed amendments will address this conflict with Basel III. Please see our proposed amendments to the Bill which are reflected in the marked up Bill attached.

2.5 Cherry Picking

The proposed amendments to section 69(2C) of the Banks Act would allow a curator, with the consent of the Minister, to dispose of any assets and/or transfer any liabilities of a bank under curatorship. These proposed powers would authorise the curator (and, indirectly, the Minister) to decide, on an ad hoc basis, which assets he or she wishes to dispose of and/or which liabilities he or she wishes to transfer. In our submission, the curator should not be allowed to “cherry pick” which liabilities can be transferred. Outside of a winding up of the bank, the curator should be required to transfer all liabilities which rank the same for payment, if any liabilities are to be transferred. Please see our proposed amendments to the Bill which are reflected in the marked up Bill attached.

2.6 Objects of Curatorship

One of the objects of curatorship is, as currently expressed in section 69 (2D) of the Banks Act, to enable the bank to pay its debts or meet its obligations and become a successful concern. The proposed amendments to section 69(2C) of the Banks Act would allow a curator, with the consent of the Minister, to dispose of assets and/or transfer liabilities to any entity (**Transferee**) without the requirement that such Transferee be a going concern.

Allowing a transfer to occur in such circumstances is contrary to the objects of curatorship. We submit that the ability of the curator to dispose of assets and/or transfer liabilities should be subject to the condition that the Minister is satisfied that the Transferee is a going concern or has a reasonable probability of becoming a going concern in order to satisfy all the obligations transferred to it. Please see our proposed amendments to the Bill which are reflected in the marked up Bill attached.

2.7 Comparator Principle

- (a) If enacted, the proposed amendments to section 69(2C) of the Banks Act would require the curator in his or her report to state whether or not there is a reasonable probability that a creditor will not incur greater losses on the date of the proposed disposal of assets and/or transfer liabilities than it would have been exposed to on a winding up. This amendment effectively imports a comparator principle into section 69 of the Banks Act, by requiring the curator to compare the position of a creditor of a bank under curatorship with the position of a creditor of a bank in a winding up.
- (b) Curatorship of a bank is not akin to the winding up of a bank, as section 69(2D) of the Banks Act makes clear, and the two situations are not appropriately compared with one another. It is our submission that incorporating the comparator principle into the proposed amendments to section 69(2C) of the Banks Act would be inimical to the purpose of curatorship.
- (c) To the extent that support for the proposed amendment is sought to be found in s 69(3)(b) of the Banks Act, we submit that that provision authorises a curator to make payments to any creditor or creditors of the bank in whatever order that he or she deems fit, and thus allows a curator to decide which creditor to pay in the ordinary course of the bank’s business from a commercial perspective. It does not incorporate the comparator principle into the Banks Act.

- (d) It is our submission that this amendment should be deleted. Please see our proposed amendments to the Bill which are reflected in the marked up Bill attached.

3. The proposed amendments to Section 69(3)(j) of the Banks Act

3.1 Retrospectivity

The proposed amendments to Section 69(3)(j) of the Banks Act, if enacted, would allow a curator to expose creditors to new consequences that they could not have foreseen at the time when they entered into their contractual relationship with the bank under curatorship, to the extent that such contractual arrangements contain a negative pledge on the bank encumbering its assets. This will have a detrimental impact on creditors of a bank under curatorship because such creditors would have accounted for these retrospective consequences in their pricing, had they been anticipated at the time the contract with the bank was entered into. We believe that our proposed amendments will address this issue. Please see our proposed amendments to the Bill which are reflected in the marked up Bill attached.

3.2 Deprivation of Existing Property Rights

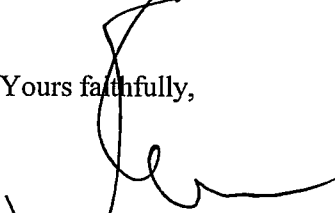
The proposed amendments to Section 69(3)(j) of the Banks Act would allow the curator to override the contractual rights of the bank's creditors. In our submission, this would give rise to an unconstitutional deprivation of existing property rights on the basis of the same arguments as discussed in paragraph 2.2 above. In our submission, these concerns may be addressed by incorporating into the Bill a similar provision to the compromise provision contained in section 155 of the Companies Act. Please see our proposed amendments to the Bill which are reflected in the marked up Bill attached.

3.3 Increased cost of funding

As the proposed amendments to Section 69(3)(j) of the Banks Act allow a curator to expose creditors to new consequences that they could not have foreseen at the time when they entered into their contractual relationship with the bank under curatorship, this will likely result in an increased cost of funding for South African banks going forward. This may have a detrimental impact on the object to ensure a stable banking sector in South Africa and could further erode public confidence in the South African banking sector. We submit that our proposed amendments will address this uncertainty, such that if our amendments are incorporated into the Bill this should not have any material increase in the cost of funding for South African banks. Please see our proposed amendments to the Bill which are reflected in the marked up Bill attached.

4. We request an opportunity to present our submissions before the Standing Committee on Finance on Wednesday 4 February 2015. In this regard we will be represented by senior counsel Mr Alfred Cockrell and by Mr Lionel Shawe of Allen & Overy (South Africa) LLP.

Yours faithfully,



Thea Hartman
on behalf of the Tier II Debtholder
Committee

Rough version – tracked change
Not a legal draft

69. Appointment of curator to bank

- (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.
- (b) The Registrar may appoint a person other than a person who is in the employ of the bank under curatorship, who in the opinion of the Registrar has wide experience of and is knowledgeable about the specific field of activities in which the bank under curatorship is predominantly engaged, to assist the curator in the management of the affairs of the bank under curatorship.
- (c) The person appointed in terms of paragraph (b) shall in respect of the services rendered by that person pursuant to his or her appointment be paid such remuneration out of the funds of the bank under curatorship as the Registrar may after consultation with the curator determine.
- (2) The Minister shall appoint a curator by letter of appointment which shall set out –
- (a) the name of the bank in respect of which the curator is appointed and the address of its head office;
- (b) directions in regard to the security which the curator has to furnish for the proper performance of his or her duties;
- (c) directions in regard to the remuneration of the curator; and
- (d) such other directions as to the management of the bank concerned or any matter incidental thereto, including directions in regard to the raising of money by that bank, as the Minister may deem necessary.
- (2A) On appointment of a curator-
- (a) the management of the bank concerned shall vest in the curator, subject to the supervision of the Registrar, and any other person vested with the management of the affairs of that bank shall be divested thereof; and
- (b) the curator shall recover and take possession of all the assets of the bank.
- (2B) The curator shall-
- (a) subject to the supervision of the Registrar, conduct the management contemplated in subsection 2(A)(a) in such a manner as the Registrar may deem to best promote the interests 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;
- (b) comply with any direction of the Registrar;
- (c) keep such accounting records and prepare such annual financial statements, interim reports and provisional annual financial statements as the bank or its directors would have been obliged to keep or prepare if the bank had not been placed under curatorship;
- (d) convene the annual general meeting and any other meeting of members of the bank provided for the Companies Act and, in that regard, comply with all the requirements with which the directors of the bank would in terms of the Companies Act have been obliged to comply if the bank had not been placed under curatorship; and

- (e) have the power to bring or defend in the name and on behalf of the bank any action or other legal proceedings of a civil nature and, subject to the provisions of any law relating to criminal proceedings, any criminal proceedings.

(2C) (a) Notwithstanding the provisions of subsection (3), the curator may –

- (i) dispose of any of the bank's assets;
- (ii) transfer ~~any of its~~ its liabilities; or
- (iii) dispose of any of its assets and transfer ~~any of its~~ its liabilities,

in the ordinary course of the bank's business.

(b) Except in the circumstances contemplated in paragraph (a) the curator may not, notwithstanding the provisions of section 112 of the Companies Act-

- (i) dispose of any of the bank's assets;
- (ii) transfer ~~any of its~~ liabilities; or
- (iii) dispose of any of its assets and transfer ~~any of its~~ liabilities, otherwise than in accordance with the provisions of section 54 of this Act and subsection (11) below.

~~(bA) (e) For the avoidance of doubt, any transfer of liabilities in terms of paragraphs (a) and/or (b) above shall be a transfer of all the liabilities of the bank which rank the same for payment outside of a winding up of the bank.~~

~~(c) In seeking consent for a respect of any disposal of assets, or transfer of liabilities, or disposal and transfer in terms of paragraph (b), the curator shall report to the Minister and Registrar, as the case may be, on the expected effect on the bank's creditors and, in particular, whether—~~

- ~~(i) the creditors are to be treated in an equitable manner; and~~
- ~~(ii) a reasonable probability exists that a creditor will not incur greater losses, as at the date of the proposed disposal, transfer or disposal and transfer, than would have been incurred if the bank had been wound up under section 68 of this Act on the date of the proposed disposal, transfer or disposal and transfer.~~

(d) The Minister must, in addition to the requirements of section 54, consider the curator's report as provided in paragraph (c) in making his or her decision in terms of section 54: Provided that notwithstanding the fact that the effect of the disposal, transfer or disposal and transfer will be that creditors are to be treated inequitably in paragraph (c)(i) and (ii) are is not satisfied, the Minister may, subject to section 54, consent to the disposal, transfer or disposal and transfer if it is ~~in his or her opinion,~~ reasonably likely to promote the maintenance of—

- (i) ___ a stable banking sector in the Republic; or
- (ii) ___ public confidence in the banking sector in the Republic;
- (iii) the person or entity to which the disposal of assets or transfer of liabilities or such disposal and transfer is to be made is a going concern and has a reasonable possibility of paying its debts and meeting all obligations in respect of any liabilities so transferred; and
- (iv) and such disposal, transfer, or disposal and transfer has been adopted and approved in accordance with subsection (11) below.

(2D) If at any time the curator is of the opinion that there is no reasonable probability that the continuation of the curatorship will enable the bank to pay its debts or meet its obligations and become a successful concern, the curator shall forthwith in writing inform the Registrar of such opinion.

(2E) Any money of the bank that becomes available to the curator shall be applied by him or her in paying the costs of the curatorship and in the conduct of the bank's business in accordance with the requirements of the curatorship

and, as far as the circumstances permit, in the payment of the claims of creditors which arose before the date of the curatorship.

(2F) (a) Every disposition of its property, which if made by an individual could for any reason be set aside in the event of such individual's insolvency, may, if made by a bank that is unable to pay its debts, be set aside by a court at the suit of the curator in the event of that bank being placed under curatorship, and the provisions of the law relating to insolvency, shall *mutatis mutandis* apply in respect of such disposition.

(b) For the purpose of this subsection the event which shall be deemed to correspond with a sequestration order under the Insolvency Act, 1936 (Act No. 24 of 1936), in the case of an insolvent, shall be the presentation to the Court of the letter of appointment of the curator.

(2G) The period during which any bank that is a mortgage debtor in respect of any mortgage bond is subject to curatorship in terms of this section shall be excluded in the calculation of any period of time for the purpose of determining whether such mortgage bond confers any preference in terms of section 88 of the Insolvency Act, 1936, as applied to the winding-up of banks in terms of this Act.

(3) The Minister may, in the letter of appointment or at any time subsequent thereto, empower the curator in his or her discretion, but subject to any condition which the Minister may impose--

(a) to suspend or reduce, as from the date of the curator's appointment as such or any subsequent date, the right of creditors of the bank concerned to claim or receive interest on any money owing to them by that bank;

(b) to make payments, whether in respect of capital or interest, to any creditor or creditors of the bank concerned at such time, in such order and in such manner as the curator may deem fit;

(c) to cancel any agreement between the bank concerned and any other party to advance moneys due after the date of the curator's appointment as such, or to cancel any agreement to extend any existing facility, if, in the opinion of the curator such advance or any loan under such facility would not be adequately secured or would not be repayable on terms satisfactory to the curator or if the bank lacks the necessary funds to meet its obligations under any such agreement or if it would not otherwise be in the interests of the bank;

(d) to convene from time to time, in such manner as the curator may deem fit, a meeting of creditors of the bank concerned for the purpose of establishing the nature and extent of the bank's indebtedness to such creditors and for consultation with such creditors in so far as their interests may be affected by decisions taken by the curator in the course of the management of the affairs of the bank concerned;

(e) to negotiate with any individual creditor of the bank concerned with a view to the final settlement of the affairs of such creditor with the bank;

(f) to make and carry out any decision in respect of the bank which in terms of the provisions of the Companies Act, the bank's memorandum of incorporation or the rules of any securities exchange, on which any securities of the bank or its controlling company are listed, would have required an ordinary resolution or a special resolution of shareholders of the bank or its controlling company;

(g) to cancel any lease of movable or immovable property entered into by the bank concerned prior to its being placed under curatorship: Provided that, notwithstanding the provisions of subsection (6), a claim for damages in respect of such cancellation may be instituted against the bank after the expiration of a period of one year as from the date of such cancellation;

(h) deleted

(i) to cancel any guarantee issued by the bank concerned prior to its being placed under curatorship, excluding such guarantee which the bank is required to make good within a period of 30 days as from the date of the appointment of the curator : Provided that, notwithstanding the provisions of subsection (6), a claim for damages in respect of any loss sustained by or damage caused to any person as a result of the cancellation of

a guarantee in terms of this paragraph, may be instituted against the bank after the expiration of a period of one year as from the date of such cancellation; and

(j) to raise funding on behalf of the bank and, notwithstanding any contractual obligations of the bank, to provide security over the assets of the bank in respect of such funding: Provided that such arrangement has been adopted and approved in accordance with subsection (11) below, notwithstanding the provisions of subsection (6), any claim for damages in respect of any loss sustained by, or damage caused to any person as a result of such security, may be instituted against the bank after the expiration of a period of one year as from the date of such provision of security.

(3A) The curator shall duly record the nature of and the reasons for each act performed by the curator under any power conferred upon the curator in terms of subsection (3), and such records shall be examined as part of the normal audit performed in respect of the affairs of the bank concerned.

(4) The Minister may, at any time and in any manner, amend the directions in the letter of appointment, and the powers granted by the Minister under subsection (3) to the curator.

(5) deleted.

(6) While such bank is under curatorship -

(a) all actions, legal proceedings, the execution of all writs, summonses and other legal process against that bank shall be stayed and not be instituted or proceeded with without the leave of the court; and

(b) deleted;

(6A) While a bank is under curatorship the curator shall on a monthly basis furnish the Registrar with a written report containing an exposition of the affairs of the bank concerned and in which it is stated whether or not, in the opinion of the curator, a reasonable probability exists that the bank will be able to pay its debts or to meet its obligations and to become a successful concern.

(6B) Notwithstanding any provision to the contrary contained in this Act, sections 35A, 35B and 46 of the Insolvency Act, 1936 (Act No. 24 of 1936), shall *mutatis mutandis* apply to the curator of any bank under curatorship and to such a bank as if the curator were a trustee of an insolvent estate and the bank were an insolvent or a sequestrated estate as contemplated in those sections;

(7) The Registrar shall as soon as is practicable announce the appointment of a curator and the powers granted to the curator on the appointment of the curator, and any amendment or withdrawal of such powers, by notice in the *Gazette*.

(8) Notwithstanding anything to the contrary contained in any law, the suspension, cancellation or termination of the registration of a bank while such bank is under curatorship in terms of this section shall not affect -

(a) any appointment made, direction issued, or any other thing done under this section in respect of such bank; or

(b) any power to be exercised or duty to be executed in respect of that bank under curatorship by the Minister, the Registrar or the curator, by virtue of the provisions of this section, and the Minister, the Registrar and the curator, respectively, shall until such time as the curatorship is terminated continue to exercise their respective powers and to execute their respective duties under this section in respect of the public company of which the registration as a bank has been so suspended, cancelled or terminated, as if such suspension, cancellation or termination had not taken place

(9) The Minister may-

(a) at any time withdraw the appointment of a curator;

(b) upon application by the Registrar withdraw the appointment of a curator.

(10) Curatorship of a bank shall lapse upon-

(a) the issue by the Minister of written notification to that effect to the curator; or

(b) the winding-up of the bank in terms of the provisions of section 68.

(11)(a) The curator may propose an arrangement or a compromise of the financial obligations of the bank to all of the creditors of the bank, or to all of the members of any class of its creditors, by delivering a copy of a proposal for the arrangement or compromise of the financial obligations of the bank-, and notice of a meeting to consider the proposal, to every creditor of the bank, or every member of the relevant class of creditors whose name or address is known to, or can reasonably be obtained by, the curator.

(b) A proposal contemplated in paragraph (a) must contain all information reasonably required to enable creditors to -decide -whether to accept or reject the proposal, and must be divided into three Parts, as follows:

(i) Part A—Background, which must include at least—

(aa) a complete list of all the material assets of the bank, as well as an indication as to which assets are held as security by creditors as of the date of the proposal;

(bb) a complete list of the creditors of the bank as of the date of the proposal, as well as an indication as to which creditors would qualify as secured, statutory preferent and concurrent in terms of the laws of insolvency, and an indication of which of the creditors have proved their claims;

(cc) the probable dividend that would be received by creditors, in their specific classes, if the bank were to be placed in liquidation;

(dd) a complete list of the holders of the bank's issued securities, and the effect that the proposal would have on them, if any; and

(ee) whether the proposal includes a proposal made informally by a creditor of the bank.

(ii) Part B—Proposals, which must include at least—

(aa) the nature and duration of any proposed debt moratorium;

(bb) the extent to which the bank is to be released from the payment of its debts, and the extent to which any debt is proposed to be converted to equity in the bank, or another bank or controlling company;

(cc) the treatment of contracts and ongoing role of the bank;

(dd) the property of the bank that is proposed to be available to pay creditors' claims;

(ee) the order of preference in which the proceeds of property of the bank will be applied to pay creditors if the proposal is adopted; and

(ff) the benefits of adopting the proposal as opposed to the benefits that would be received by creditors if the bank were to be placed in liquidation.

(iii) Part C—Assumptions and conditions, which must include at least—

(aa) a statement of the conditions that must be satisfied, if any, for the proposal to—

(A) come into operation; and

(B) be fully implemented;

(bb) the effect, if any, that the plan contemplates on the number of employees, and their terms and conditions of employment; and

(cc) a projected—

(A) balance sheet for the bank; and

(B) statement of income and expenses for the ensuing three years.,

each prepared on the assumption that the proposal is accepted.

(c) The projected balance sheet and statement required by paragraph (iii)(cc)—

(i) must include a notice of any significant assumptions on which the projections are based; and

(ii) may include alternative projections based on varying assumptions and contingencies.

(d) A proposal must conclude with a certificate by an authorised director or prescribed officer of the bank stating that any—

(i) factual information provided appears to be accurate, complete, and up to the date; and

- (ii) projections provided are estimates made in good faith on the basis of factual information and assumptions as set out in the statement.
- (e) In order to be adopted by the creditors of the bank, or the members of a relevant class of creditors, a proposal contemplated in this subsection must be supported by a majority in number, representing at least 75% in value of the creditors or class, as the case may be, present and voting in person or by proxy, at a meeting called for that purpose.
- (f) If a proposal is adopted as contemplated in paragraph (e)—
- (i) the curator, with the consent of the Minister, may apply to the court for an order approving the proposal; and
 - (ii) the court, on an application in terms of paragraph (i) may sanction the compromise or arrangement as set out in the adopted proposal, if it considers it just and equitable to do so, having regard to the number of creditors of any affected class of creditors, who were present or represented at the meeting, and who voted in favour of the proposal.
- (g) A copy of an order of the court sanctioning a compromise—
- (i) must be filed by the curator within five business days;
 - (ii) must be attached to each copy of the bank's Memorandum of Incorporation that is kept at the bank's registered office; and
 - (iii) is, subject to the consent of the Minister referred to in subsection 2(C)(d) above, final and binding on all of the bank's creditors or all of members of the relevant class of creditors, as the case may be, as of the date on which it is filed.
- (h) An arrangement or a compromise contemplated in this section does not affect the liability of any person who is a surety of the bank.
- (i) For the purposes of this subsection a "class of creditors" shall refer to all creditors who would be treated on a *pari passu* basis should the bank be placed in liquidation .