

Update on the curatorship of African Bank Ltd

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national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Outline

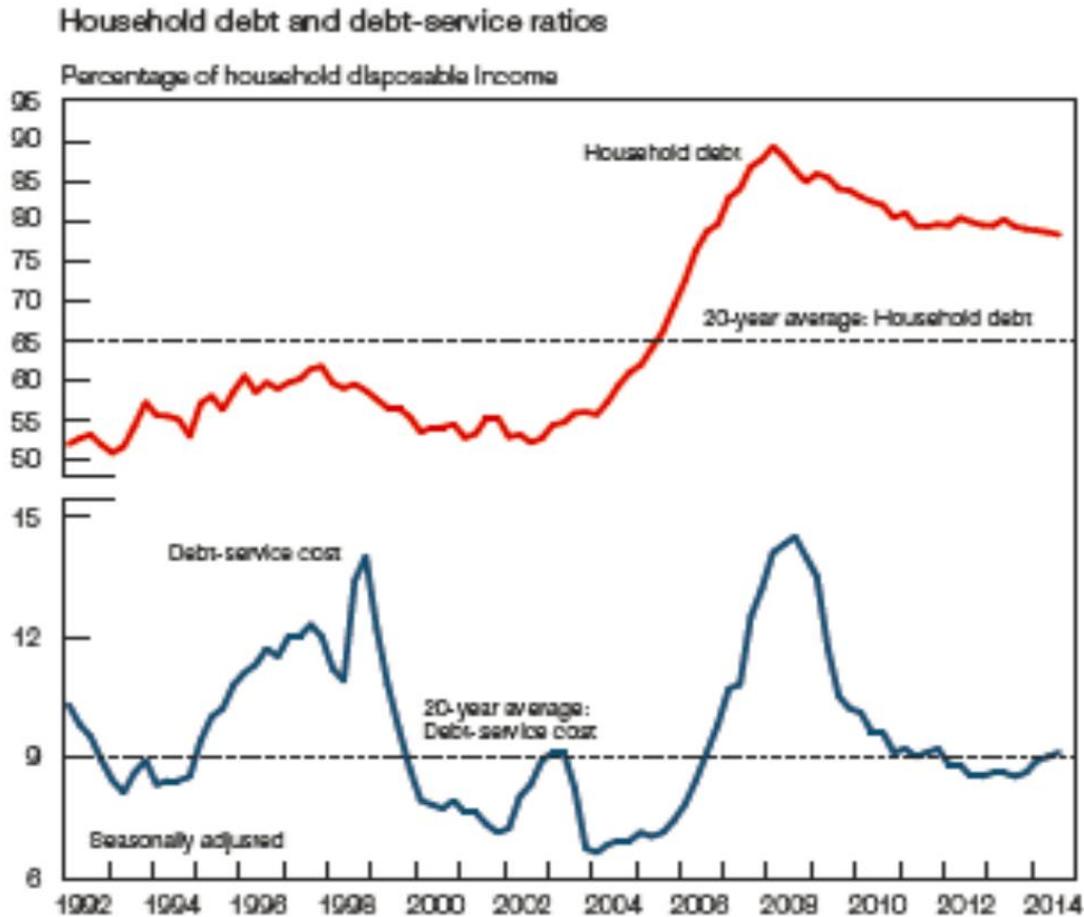
- Timeline of events that led to curatorship of ABL
- Reserve Bank announcement
- Progress to date
- Regulatory lessons

Focus of the presentation

- Focus today is on:
 - Key events
 - Initial Lessons learnt
 - Proposed way forward
- Attached documentation:
 - Financial Stability Assessment Program: Review of our legislation for bank and other failures
 - Financial Stability Board: Key attributes of effective resolution regimes

What is context of African Bank's failure?

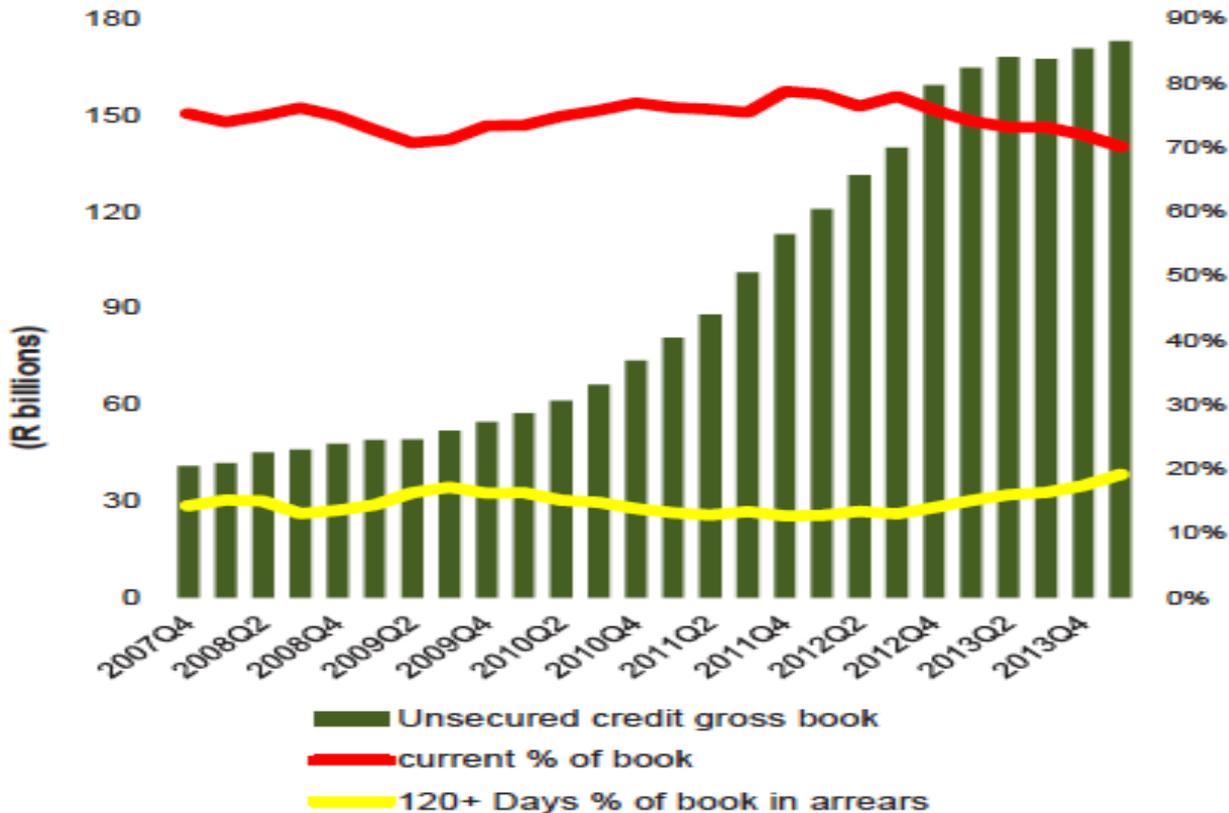
From 2008, household debt, particularly unsecured lending, began to rise rapidly



- Household debt rose significantly from 2008
- Debt-services costs rose
- Households still challenged (\pm 45 per cent of households have impaired records)
- Cabinet concerned (particularly about EAOs) and announced measures in Dec 2013
- Budget Speech outlined progress

Rapid increase in lending, slowed in 2013

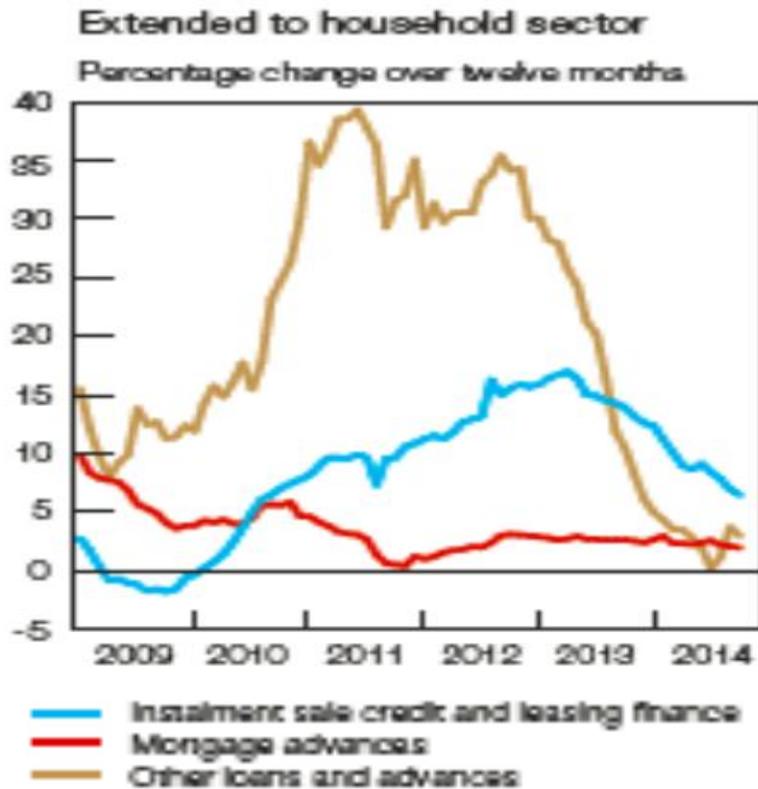
Trends in unsecured lending 2007 - 2014



- Substantial rise in unsecured lending between 2007 and 2012
- Growth rate slowed from 2013 onward, and credit quality deteriorated

African Bank faced a challenging environment

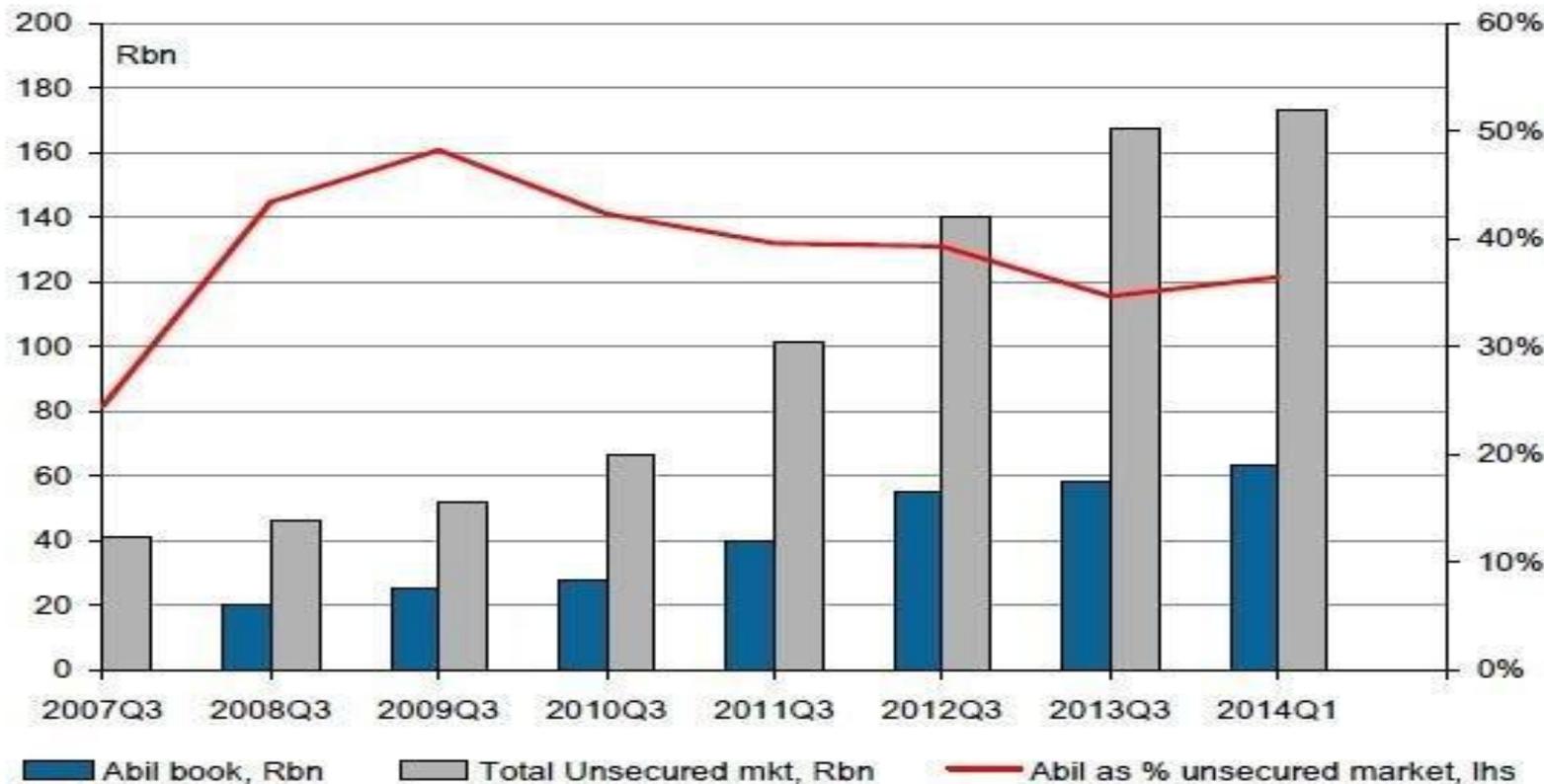
Credit in SA 2009 - 2014



- Following the GFC, the advanced economies provided large amounts of liquidity globally (“quantitative easing”)
- This liquidity and low global interest rates made it easier for African Bank to raise funding
- However, conditions became more complex from 2013

Despite the adverse environment, African Bank continued to extend large amounts of credit

ABIL loans a big part of the total unsecured market



Source: ABIL, NCR, RMB Morgan Stanley Research

What is curatorship?

SA's framework on dealing with failed banks

- Internationally, there is a distinction between **recovery** and **resolution**
- South African framework for resolution:
 - Section 69 of the Banks Act (1990) provides certain powers to resolve a bank in distress
 - Minister appoints a curator on the advice of the Registrar of Banks
 - Curator reports regularly to the Minister and Registrar
 - Initially reported weekly
 - Currently reports monthly
 - Liquidation of a bank is in section 68 of the Bank Act
- So the law provides for a bank to be put into curatorship, where management of a bank is taken over by a curator, backed by guarantees to depositors to stop a run on a bank

Recovery and Resolution: Ensuring the private sector internalise the full cost of failure

The distinction between “recovery” and “resolution” is an important one:

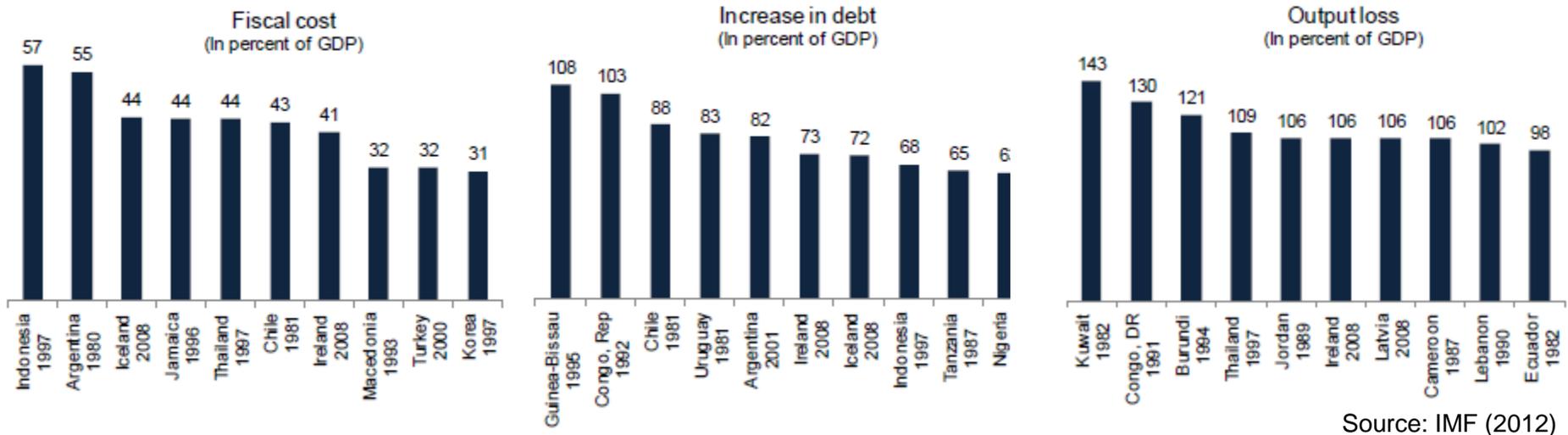
- **Recovery plans** detail the actions a firm would take to avoid failure by staying well-capitalised and well-funded in the case of an adverse event (market-wide or institution specific).

The goal is to identify preventative actions to ensure an institution never reaches the point of non-viability (“PoNV”) (“going concern”). Recovery plans are triggered upon the breach of pre-specified quantitative triggers and are supplemented by stress-testing and a qualitative overlay.

- **Resolution plans**, are designed to facilitate actions by the relevant authorities to minimise any impact to the wider financial system after the PoNV.

In a resolution scenario, the relevant resolution authority and/or regulators– not management - make the decisions based on prespecified plans created by the companies (so called “Living Wills”).

Bank failures can be very significant for society, the fiscus, and the economy



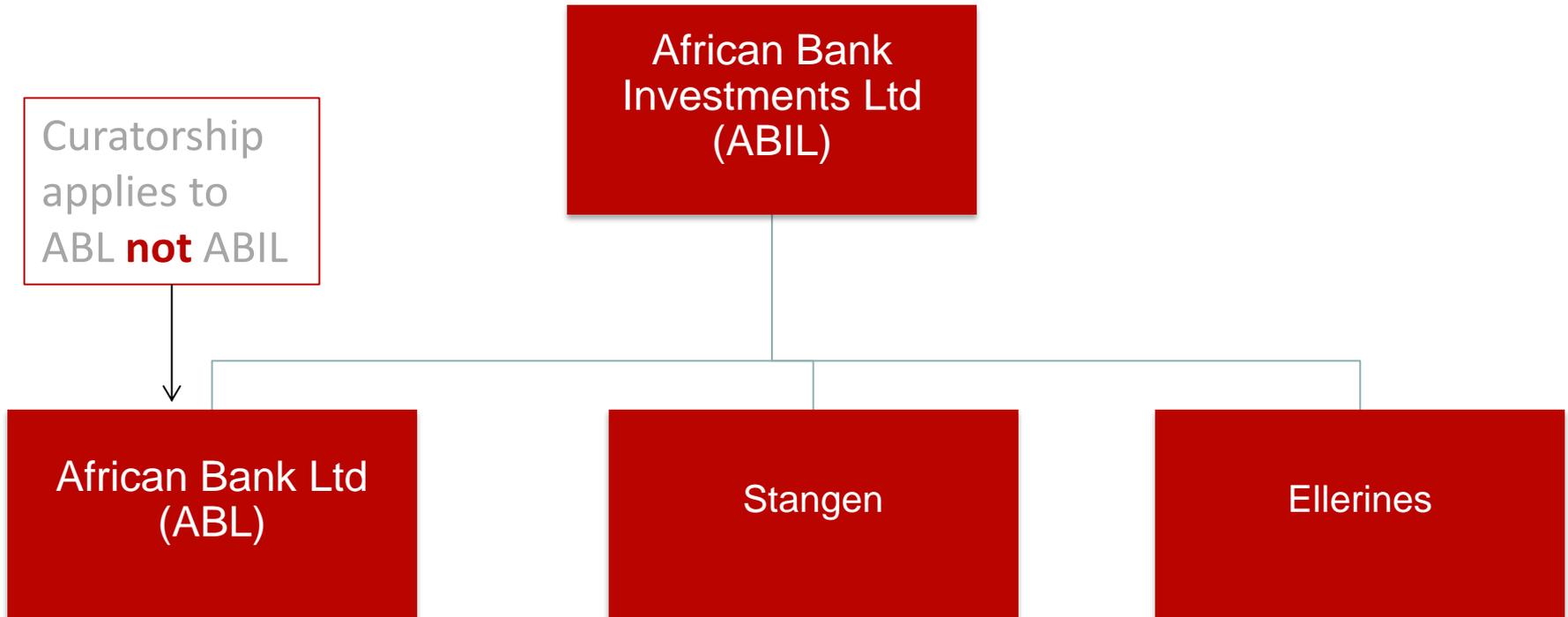
The key lesson from other countries dealing with risks to financial stability-

1. **It is very PAINFUL with lots of losers** Any intervention plan involves a transfer of wealth from creditors to debtors, from those that behaved prudently to those that took excessive risks.

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.

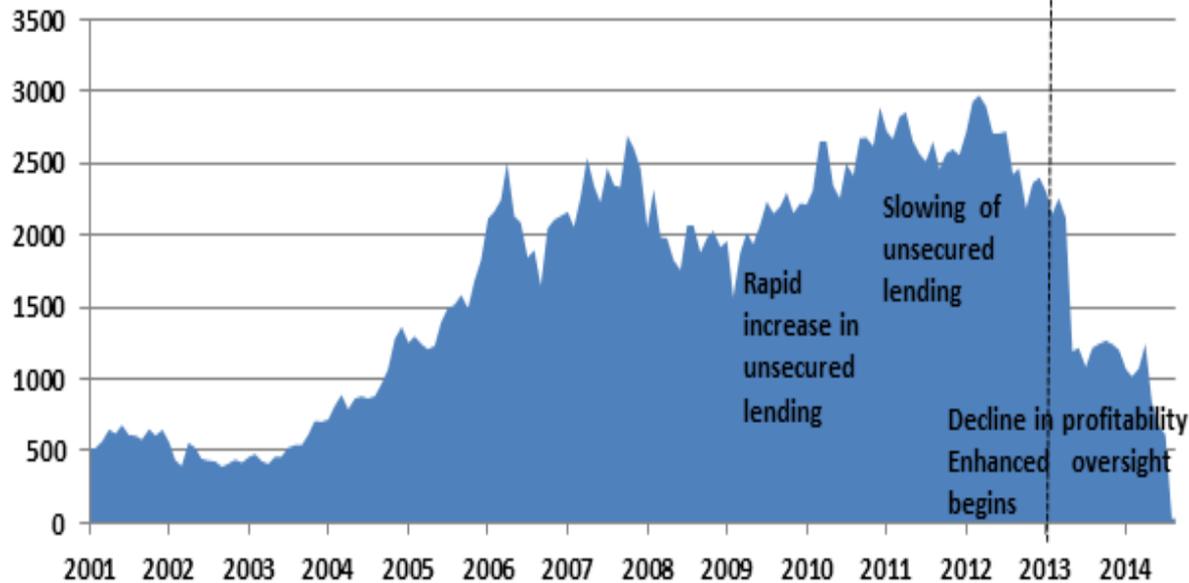
What led to the African Bank curatorship?

Outline of the entity



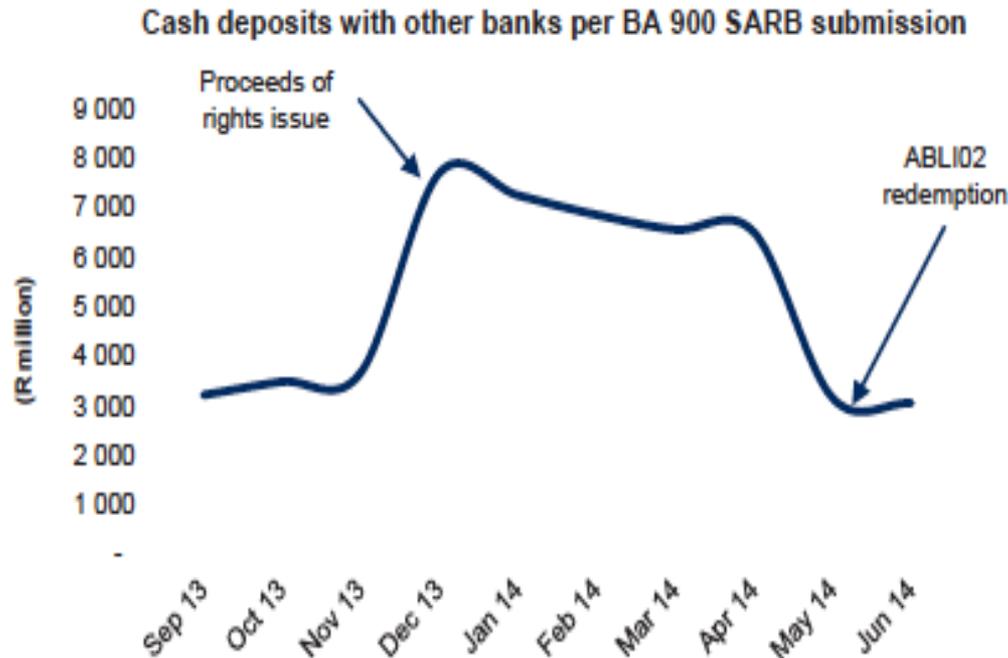
Signs of Trouble in 2013-14

ABIL share price 2001 - 2015



- African Bank relied on wholesale funding (senior unsecured and subordinated debt)
- The business model was similar to that of Northern Rock
- NPLs continued to surprise market
- In the first instance, regulator tries to nurse the bank back to health, so this happened for 12? months before curatorship

Liquidity position also had begun to deteriorate

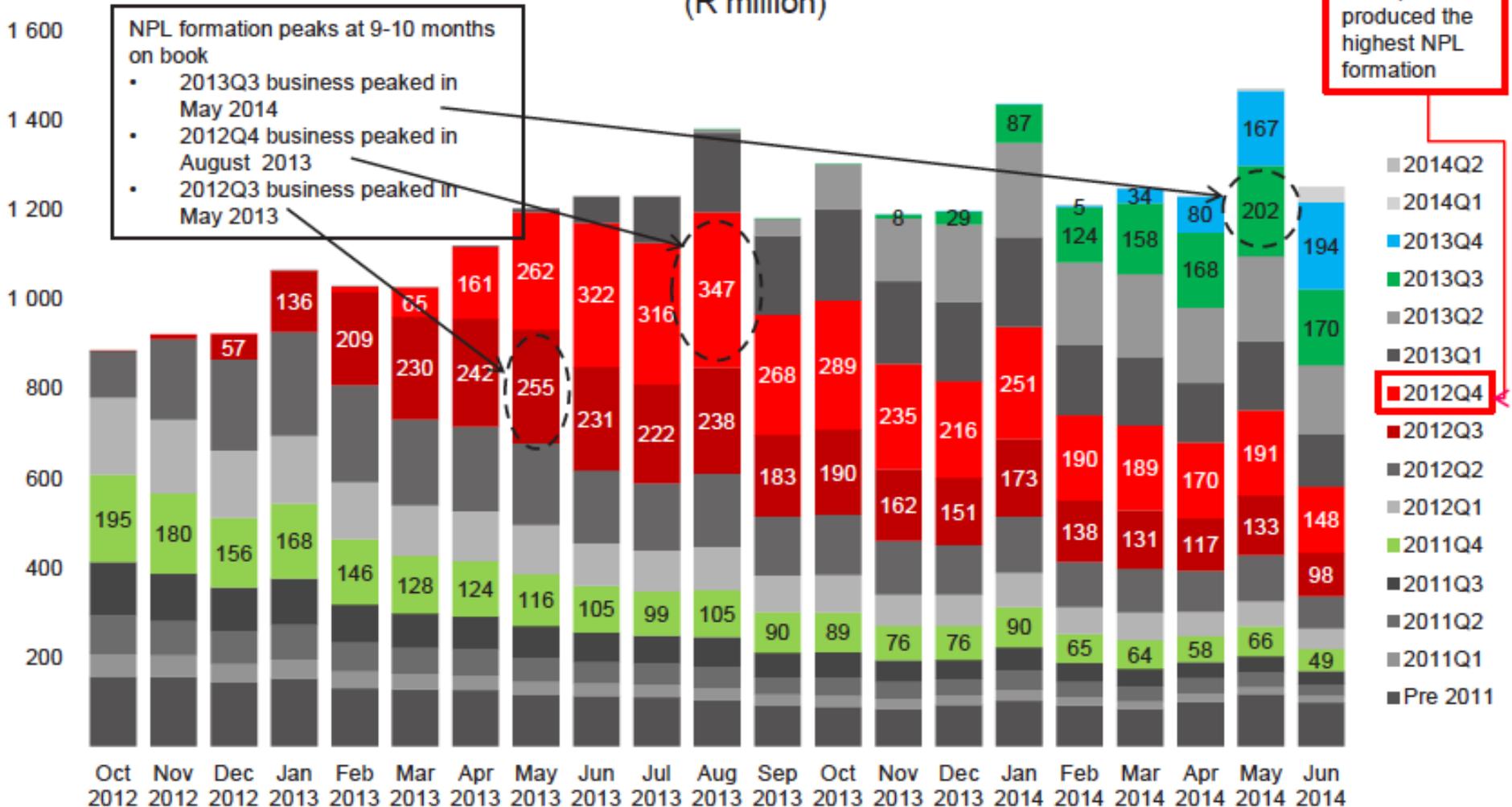


- Sharp decline in liquidity from April 2014 to June 2014
- 2014Q3 update highlighted that ABL “roll rates” had declined
- A key part of the curatorship has been to increase liquidity, and curator has been successful in this regard

Source: ABIL 2014Q3 update to investors

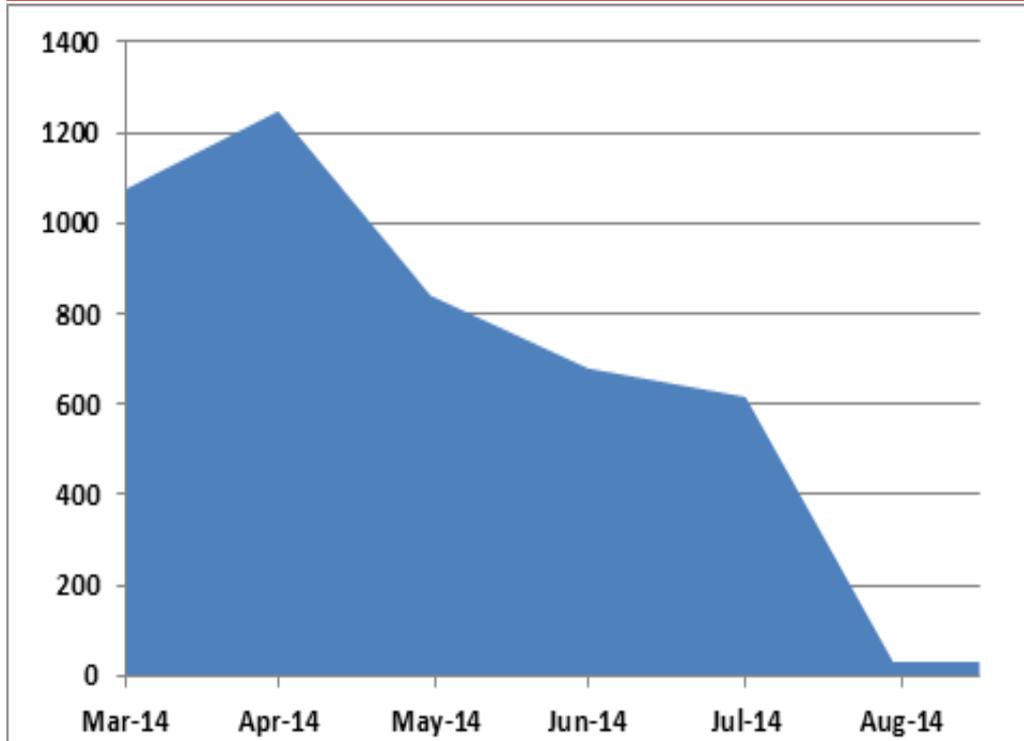
Highest NPLs formed in 2012Q4

Gross NPL formation split by quarterly tranche of business
(R million)



Rapid deterioration led to curatorship

ABIL share price 6 March – 6 September 2014



- Additional impairment provision of R3 billion
- Negative capital impact of R1,5 – R2,5 billion as part of eliminating future exposure of ABIL to EHL
- ABIL's capital ratios below levels achieved following 2013 rights offer
- Total impact: A capital raise of at least R8,5 billion to restore the capital ratios
- CEO resigns

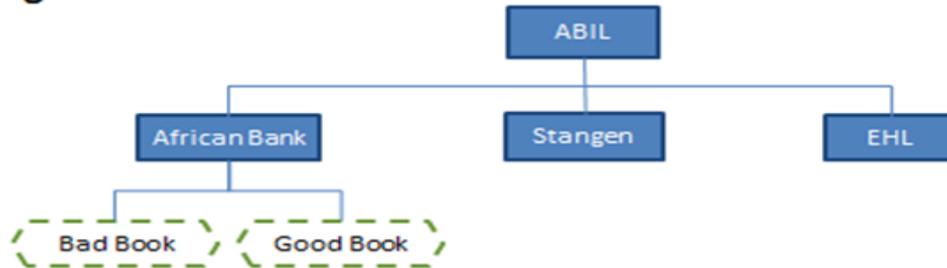
Curatorship

These adverse developments led to the Reserve Bank announcing a package of measures on 10 August 2014

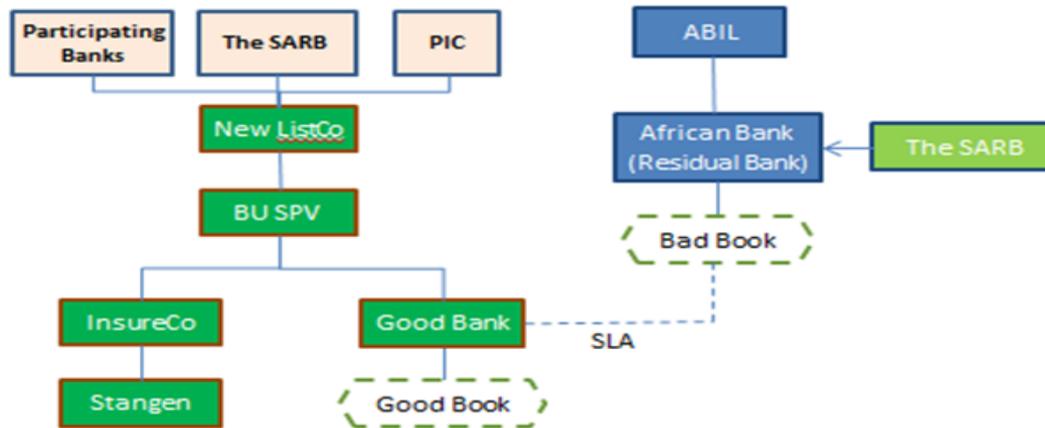
- African Bank placed into curatorship by Minister on Registrar's recommendation
- Good Bank will be created through a capital raising of R10 billion
- Capital raising is underwritten by six South African banks and PIC
- The Good Bank will be a new registered bank and a wholly owned subsidiary of a newly established holding company which is intended to be listed on the Johannesburg Stock Exchange ("JSE") in due course.
- Loans of book value R26 billion transferred from ABL to Good Bank
- Stangen will be a subsidiary of Good Bank Holding company
- Retail depositors transferred without loss, and continue to receive interest
- All senior unsecured debt holders* offered amended terms and will be transferred to the Good Bank, subject to a 10% haircut of their face value

Proposal at the time was to take existing structure and to reorganise

Existing structure



Proposed structure



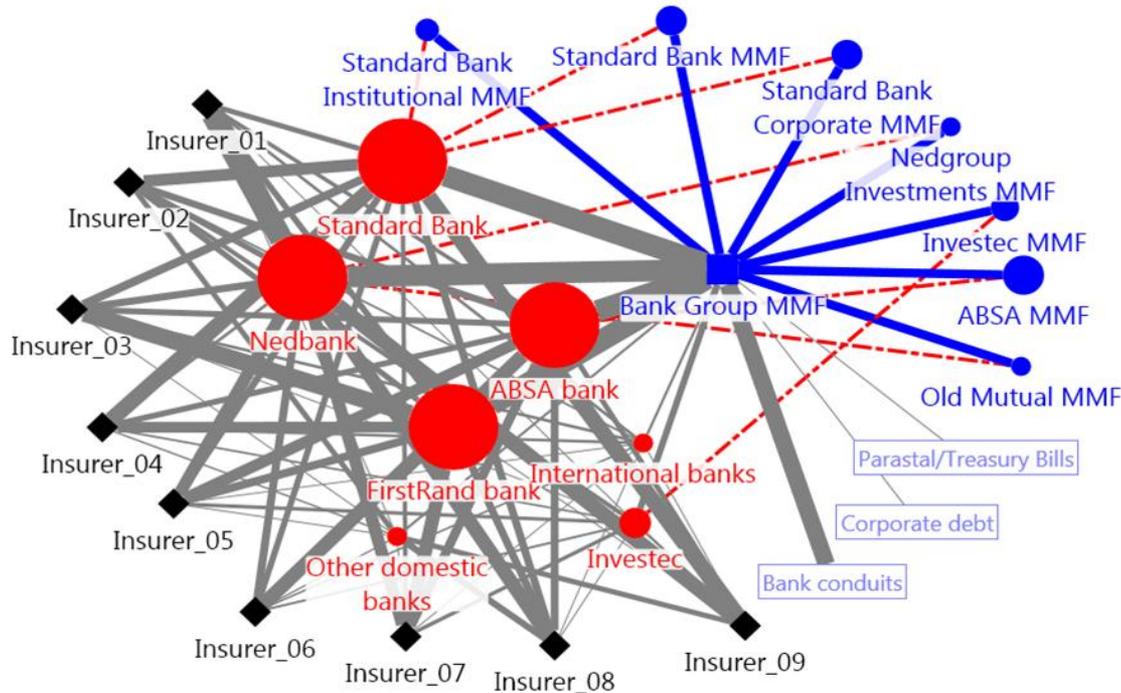
- At the time, it was estimated injection of R7 billion from Reserve Bank would be required
- Current estimates are that this will be much smaller
- Supported by R7bn backstop from Treasury
- At this stage zero costs to taxpayers expected

Most recent update on curatorship

- The Bank has stabilised and the liquidity situation has improved
- Total monthly collections have varied between R2,075 million and R2,475 million between August 2014 and January 2015.
- Total monthly disbursements (new loans) have varied between R550 million and R750 million between August 2014 and January 2015, in line with the lower risk appetite and expectations.
- Curator has indicated that disbursements of R1 billion will be targeted
- Change in business model (higher quality credit risk, secured lending)

Why was decision taken?

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



- African Banks bonds were purchased by yield-hungry MMFs.
- These links between banks and MMFs complicated the environment

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 next steps?

- Implementing the proposal requires the Banks Amendment Bill to be passed
- In parallel:
 - May 2015: the Curator will provide an Information Memorandum (“IM”) to be made available to all interested parties, detailing the intended restructuring approach to African Bank.
 - The IM is intended to inform affected parties of the proposed restructuring of African Bank, including details of anticipated offers to affected creditors and other parties, the financial information supporting the anticipated approach and details of the alternative approaches assessed and rationale for following the anticipated approach in the circumstances.
 - Curator will take public comment on the proposal from all interested parties and based on that will propose an optimal way forward

What are the initial lessons?

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. They represent a globally agreed framework for dealing with bank failures

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

2014 FSAP on SA recommends further improvements

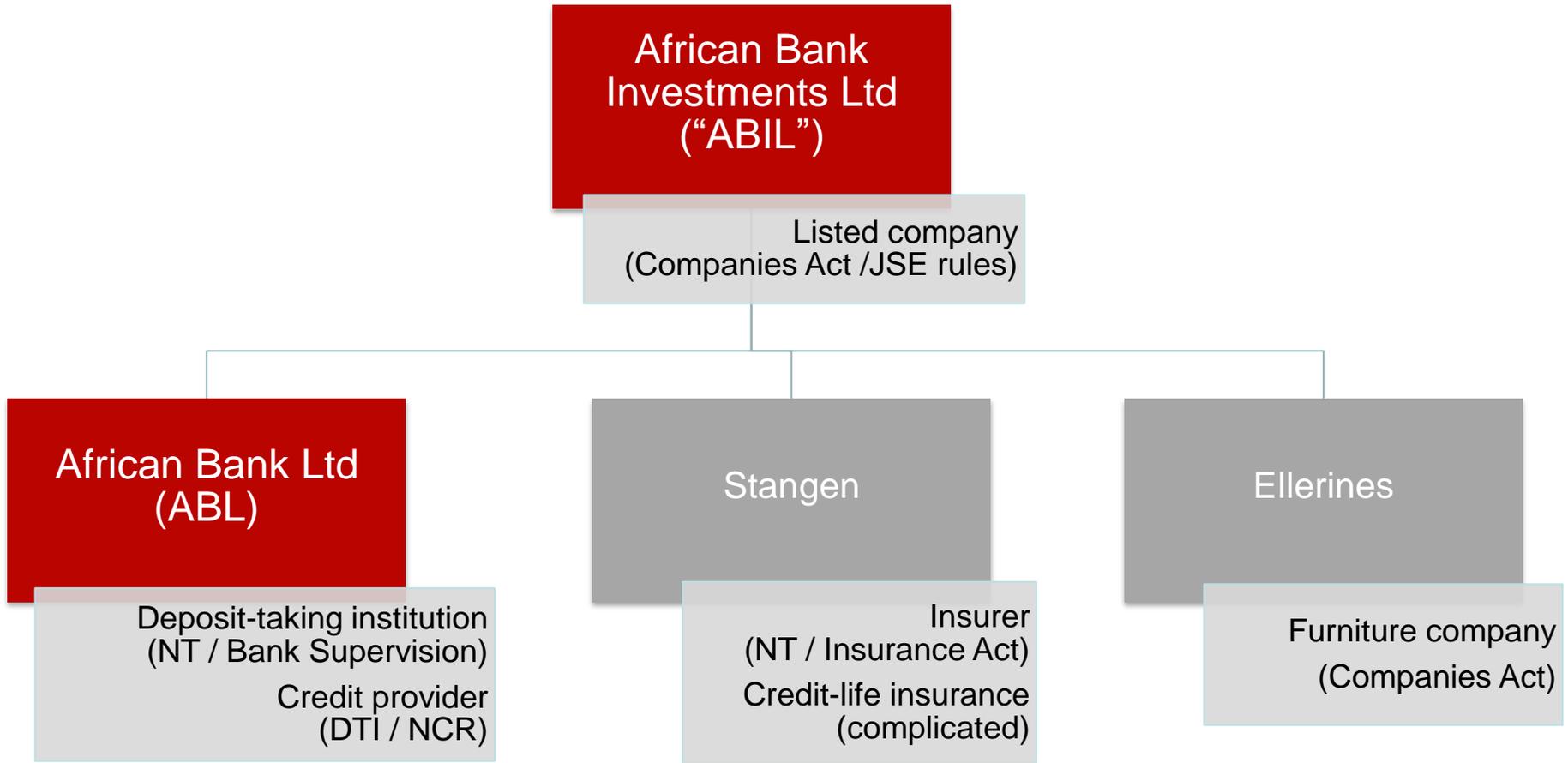
In 2013 and 2014 SA underwent comprehensive reviews of the robustness of its financial sector regulation, including crisis management measures.

Conducted by the IMF, the 2014 FSAP assessment found:

- Regulatory system is **fragmented** and **regulators are uncoordinated**
- 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 these findings
G-20/FSB Peer review also highlighted regulator co-ordination

A key challenge is the multitude of regulators involved (SARB, NCR, FSB, Companies Act)

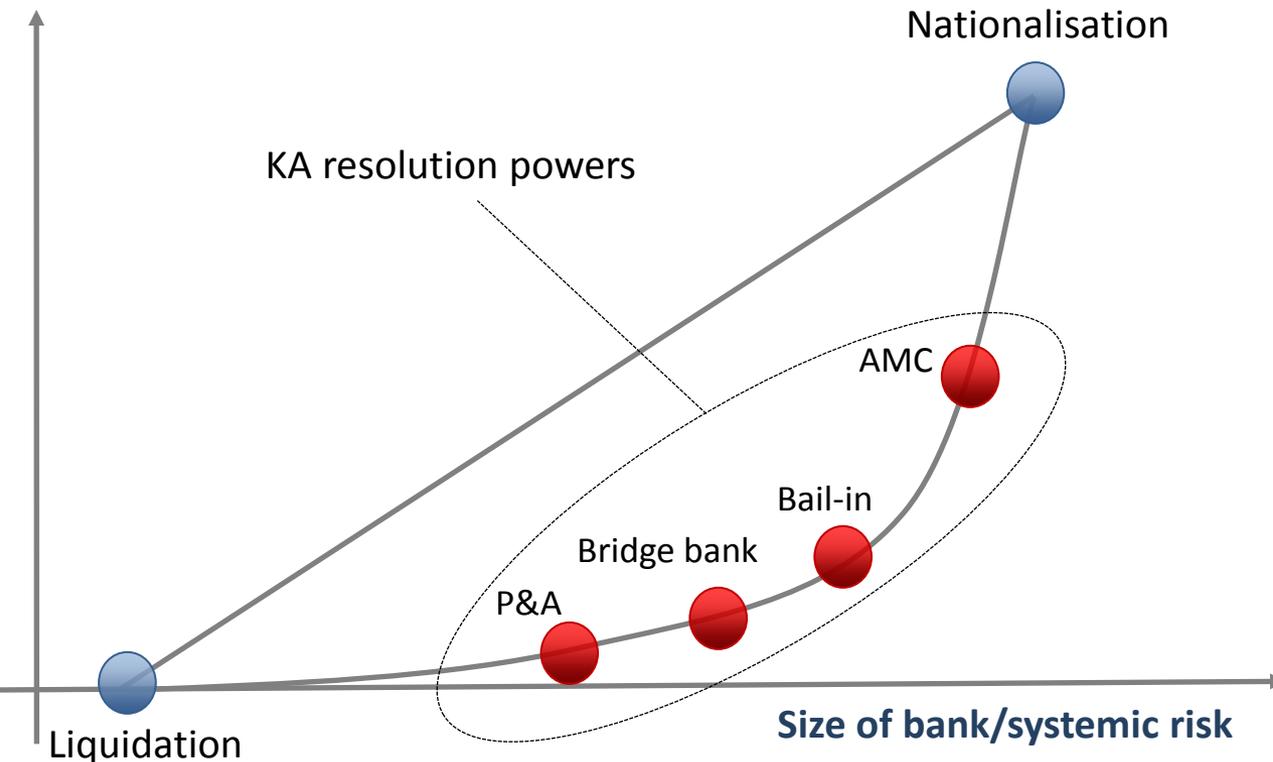


NCR is responsible for asset-side of balance sheet (the loans made by the bank)

BSD is responsible for liability side (the depositors in the bank)

Also, more options than merely curatorship are required

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

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Need to accelerate our domestic reforms to strengthen the regulatory system

- Strengthening of regulatory system through shift towards Twin Peaks
- SARB given responsibility to oversee FINANCIAL STABILITY
- Creation of two separate regulators
 - Prudential Regulator established in the SARB to ensure financial soundness and well-being of financial institutions
 - Market Conduct Regulator established as a separate, dedicated regulator outside the SARB 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

Thank you