Precedents in Bank Resolution Legislation

We understand that the National Treasury presented their position on the Banks Amendment Bill to the Standing Committee on Finance on February 3rd, 2015

- **In their submissions, it was claimed that multiple other jurisdictions have "introduced legislation while resolving banks"**
  - Examples included the UK, Portugal, Iceland, Germany, Dubai, Spain, the USA, Ireland, Belgium, Lithuania and Cyprus
- **While we do not argue the validity of resolution regimes, and while we do not want to engage on a case-by-case rebuttal of these points, we disagree with the National Treasury position given that:**

1. The urgency in changing the legislation is to address the African Bank case specifically rather than to undertake a broader review of the South African banking resolution regime. Moreover, the fact that discussions around a new Bank Resolution regime for South Africa have been ongoing since December 2013 with no urgency further supports our view that the amendment to the Banks Act is an African Bank specific modification of the law
2. With regulators in other countries moving to resolution regimes, banks in those jurisdictions have been encouraged to issue Basel III capital and/or subjected to requirements that capital issued be subject to write-down at the point of non-viability. Conversely, the lack of urgency shown by South Africa to move to a resolution regime indicated to local banks that the regulator was comfortable with the status quo of Basel II capital
3. Where existing resolution regimes did not exist, the law has been changed retrospectively only to resolve banks in regimes where there was immediate systemic risk, and the examples demonstrate idiosyncratic differences with the case of African Bank

- **Our view is that the amendments to the Banks Act serve the sole purpose of giving the curator the ability to implement a deal without the consent of some of African Banks' creditors, who will have their property rights removed retrospectively**
- **While we do believe that a long-term banking resolution framework is required, and do foresee a phased implementation of the Basel III regulatory standard as beneficial to the broader financial system in South Africa, we disagree that a specific amendment to address the case of African Bank should be implemented retrospectively in order to push through the recapitalisation at the expense of one group of creditors**

1 Urgency and Timing of Legislative Change

Banks have been facing pressure globally ever since the onset of the financial crisis in 2008

- **Immediately post the onset of the financial crisis, various countries started implementing regimes in order to be better positioned to address future challenges**
- **South Africa is a member of the Financial Stability Board (the "FSB"), whose mandate is to "monitor and make recommendations about the global financial system"**
  - The FSB has been actively promoting since 2011 changes to local banking regulations in order to develop strong regulatory, supervisory and other financial sector policies in relation to effective resolution regimes
    - As a result, in 2011, European countries undertook the decision of enforcing the Basel III features (ability to be bailed-in) to liabilities in resolution, which will start from 2016 (a forward looking and not retrospective change)
- **Despite this, South Africa showed no urgency in taking action to amend its regime and to shift its banking framework to incorporate Basel III or FSB resolution mechanics**
  - As highlighted on page 5, in contrast to other countries, South Africa does not have any banking resolution measure currently in place
  - South Africa had 4 years to consider implementing a new legislation and to decide on any modifications to its banking sector regulations
  - There does not seem to have been any urgency in implementing any legislative changes until the African Bank case came to light
- **Therefore, it is reasonable to believe that creditors would assume that the governing bodies in South Africa were comfortable with the curatorship structure as currently drafted**
  - South Africa has up until now seen no urgency to make any amendments, and looked comfortable with banks holding regulatory capital under the Basel II framework, which does not envisage write-down at any stage

➢ **We believe that the fact that the SARB and National Treasury are acting now to push through this legislation is solely to be able to implement the deal at African Bank, rather than to find a longer-term solution to bank resolutions in South Africa**

2 Basel II vs. Basel III Frameworks

Following the financial crisis, the members of the Basel Committee on Banking Supervision (BCBS) agreed in 2010-2011 a new regulatory standard on bank capital adequacy ("Basel III")

- **Under Basel III, changes were made to the terms and rights of the regulatory capital held by banks compared to Basel II securities**
  - New Basel III terms will reduce rights of tier 2 noteholders significantly relative to Basel II as per BCBS 189
- **In particular, under Basel III, regulatory tier II capital can be "bailed-in" and therefore written-off in the event of a "trigger event" defined by the BCBS[a] as the earlier of:**
  - "A decision that a write-off, without which the firm would become non-viable is necessary, as determined by the relevant authority" and
  - "The decision to make a public sector injection of capital, or equivalent support, without which the firm would have become non-viable, as determined by the relevant authority"
- **In 2014, global banks issued $174bn Basel III capital instruments[b]**
  - The rise in debt issuance shows that institutions globally are aware of the different treatment to both types of notes and demonstrates a clear recognition that Basel III notes are different to Basel II notes
- **The African Bank Tier II Notes are issued under the Basel II framework and never contemplated "bail-in" in their terms and conditions**

- **The Banks Amendment Bill seeks to provide the curator with the power, retrospectively, to treat African Banks' Tier II regulatory capital as capital held under Basel III rather than Basel II framework, despite the clear recognition that both types of notes are different forms of capital**
- **The SARB and the National Treasury did not have any sense of urgency in challenging the difference between Tier II capital under the Basel II and Basel III frameworks until it was <u>convenient</u> in order to address a <u>specific</u> situation**

a BCBS Press release, 13 January 2011, "Annex: Minimum requirements to ensure loss absorbency at the point of non-viability"
b Source: Financial Times

3 The Cases Provided are Different from African Bank

In their submissions to the Standing Committee on Finance on the 3rd of February, the National Treasury and the SARB listed a number of examples of previous cases in which national legislation was passed in order to implement a banking resolution

- **We would argue that the examples provided, however, differ from the case of African Bank and demonstrate multiple "idiosyncratic" features that are not applicable in this case, for example:**
  - Northern Rock (UK): the assets transferred to UKAR ("bad" bank) hold substantial value, with Tier II notes having been tendered for and redeemed at c.50% of face value. In addition, the subordinated liabilities have been tendered for and redeemed ahead of the government in recovery
  - Banco Espirito Santo (Portugal): A framework for banking resolution was already in place since 2012, and legislation was passed only in order to establish a bridge bank. Creditors had therefore already been forewarned that they could be bailed-in (vs. South Africa, where regulators seemed comfortable with the Basel II framework in place)
- **The majority of other countries in which creditors were "bailed-in" had pre-existing regimes in place for resolving banks**
  - When banks failed, the regulators applied the framework already in place
  - Creditors were aware of this potential risk prior to the resolution being put in place
    - This is not the case for African Bank, where the regulators have not acted on the 2011 FSB directives and creditors could reasonably assume they were comfortable with the legal regime already in place
- **Furthermore, cases in which governments retrospectively changed the legislation were those in which there was a systemic risk to the financial system and governments were incapable of remedy due to the size of the exposure**
  - This does not appear to be the case for African Bank and South Africa, as highlighted on page 6

- **The examples provided had unique features and differ from the case of African Bank**
- **Legislation has been retrospectively applied in situations where there was systemic risk**

Review on Resolution Regimes – FSB Members

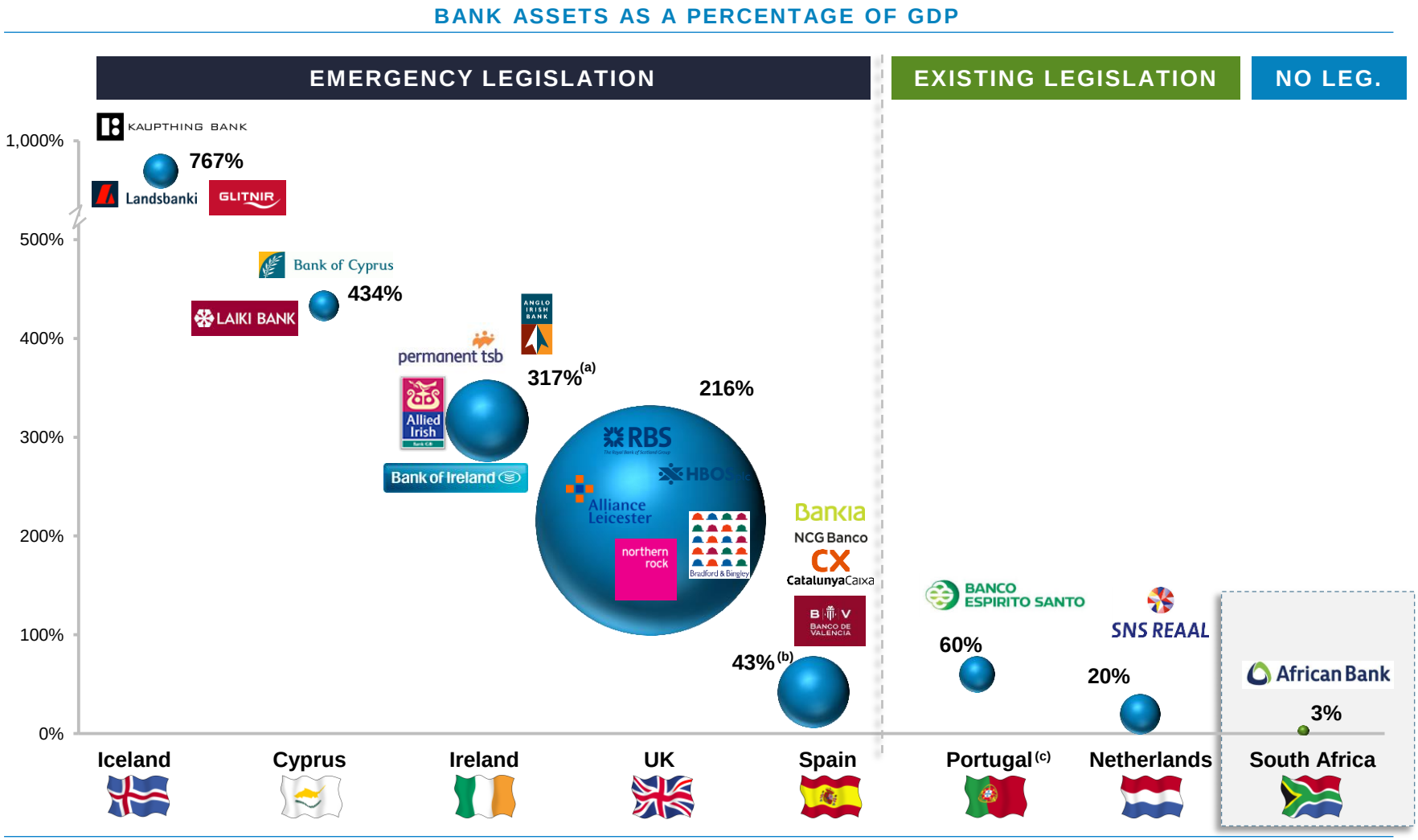
COUNTRY	TRANSFER OF ASSETS / LIABILITIES	BAIL-IN WITHIN RESOLUTION[a]	DEPARTURE FROM EQUAL TREATMENTS OF CREDITORS OF SAME CLASS	ESTABLISH BRIDGE BANK
	✓	✗	✓ *(exercise of transfer powers)*	✓
	✓	✗	✗	✓
	✓	✗	✓	✓
	✗	✗	✗	✗
	✓	✗	✓ *(possible, subject to compensation)*	✓
	✓	✗	✗	✗
	✓	✗	✗	✓
	✗	✗	✗	✗
	✓	✓ *(limited to subordinated loans and liabilities)*	✗	✓
	✓	✗	✓ *(where necessary for purposes of resolution objectives)*	✓

✓ **Has power** ✗ **No power**

Source: "Thematic review on Resolution Regimes", 11 April 2013, Financial Stability Board

a From 2016, all EU member countries will allow bail-in within their resolution regimes

Select Bank Restructuring Situations



Source: IMF World Economic Outlook, Company Information

Note Bubble sizes correspond to total troubled bank assets

a Irish Emergency Act in 2010 did not result in bail-in of Tier II noteholders and therefore, not analogous to African Bank

b Only includes assets of Group 1 banks

c Resolution framework created in February 2012; subsequently amended to allow establishment of a bridge bank following BES collapse