

Banks Amendment Bill

Response to Public Submissions

National Treasury | 17 March 2015



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

INTRODUCTION AND CONTEXT

National Treasury officials

- **National Treasury (NT)**
 - Mr Ismail Momoniat
 - Mr Roy Havemann
 - Ms Empie Van Schoor
 - Mr Vukile Davidson

- **South African Reserve Bank (SARB)**
 - Deputy Governor François Groepe
 - Bank Registrar Rene van Wyk
 - Acting Deputy Bank Registrar Mr Denzel Bostander

Purpose

- The National Treasury (“NT”) would like to thank the Standing Committee on Finance for the opportunity to provide its response to questions and comments arising from:
 - public hearings on the Bill (4 February 2015); and
 - additional 2 week consultation period.
- Submissions were received from the:
 - Association of Savings and Investments South Africa (“ASISA”),
 - Banking Association of South Africa (“BASA”),
 - The African Bank curator,
 - The South African Reserve Bank; and
 - Other affected parties.
- The NT are submitting additional new amendments in the form of a draft “A” Bill for the Committees consideration.

Documentation

Provided to committee today is the following documentation:

- Treasury's proposals in track-changes to originally tabled Bill
- Draft response document on major themes
- Detailed draft responses to each comment raised by stakeholders
- Constitutional opinion on proposals

Putting the Bill into perspective

- We are here today to deal with the Bill, and not the African Bank curatorship
- If Bill did not apply to any current curatorship, the Bill would not be controversial
- Any actual curatorship will always be subject to differences between different classes of creditors

BACKGROUND TO THE BILL

Background to public consultations on the Bill

- The Bill was approved by the Minister of Finance and Cabinet on 20 November 2014 & released for public comment in early December 2014.
- A total of 9 submissions were received during the public comment process. Each submission was thoroughly considered by the NT.
- During December 2014, the NT consulted extensively with senior counsel, all classes of creditors, financial sector regulatory bodies and with key industry stakeholders including the ASISA and BASA.
- On 5 February 2015, the Bill was tabled in Parliament. The tabled Bill, reflects changes made to take account of the comments received during the consultation process and the 9 submissions received.
- On 10 March 2015, NT presented at a joint sitting of the finance and trade and industry committee to provide details on African Bank.

Background to the Banks Amendment Bill, 2015

- There is still an urgent need to address gaps within financial sector legislation & mitigate existing risks in the financial system.
- The Bill, therefore, addresses several urgent short term and long term issues:
 - To facilitate the best option with respect to the curatorship of African Bank
 - To remedy some gaps identified by the IMF FSAP (Fin Sector Assessment Program) and adhere to international standards for financial sector regulation. (*A more comprehensive resolution framework will tabled before Parliament later in 2015*)
 - Aligning Banks Act provisions with appropriate sections of the Companies Act.

South Africa's current framework or dealing with failed banks

- 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
- 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

What's missing?

NT seeks to adopt international best practice through powers to facilitate a market based, least-cost resolution which does not subordinate public interest to private ones.

Namely:

- 1. The ability to segregate 'bad' assets from 'good' assets:** This would allow for continued market confidence and minimum disruption to the functioning of the financial sector.

- 1. The ability to allow the curator to facilitate a compromise between creditors to allow for a restructuring of a financial institution:** This is aimed at allowing a curator the mandate to restructure a financial group which requires the ability to restructure and or reduce liabilities by creditor consent

COMPARISON OF REGIMES

Does SA really need additional tools for resolution of banks?

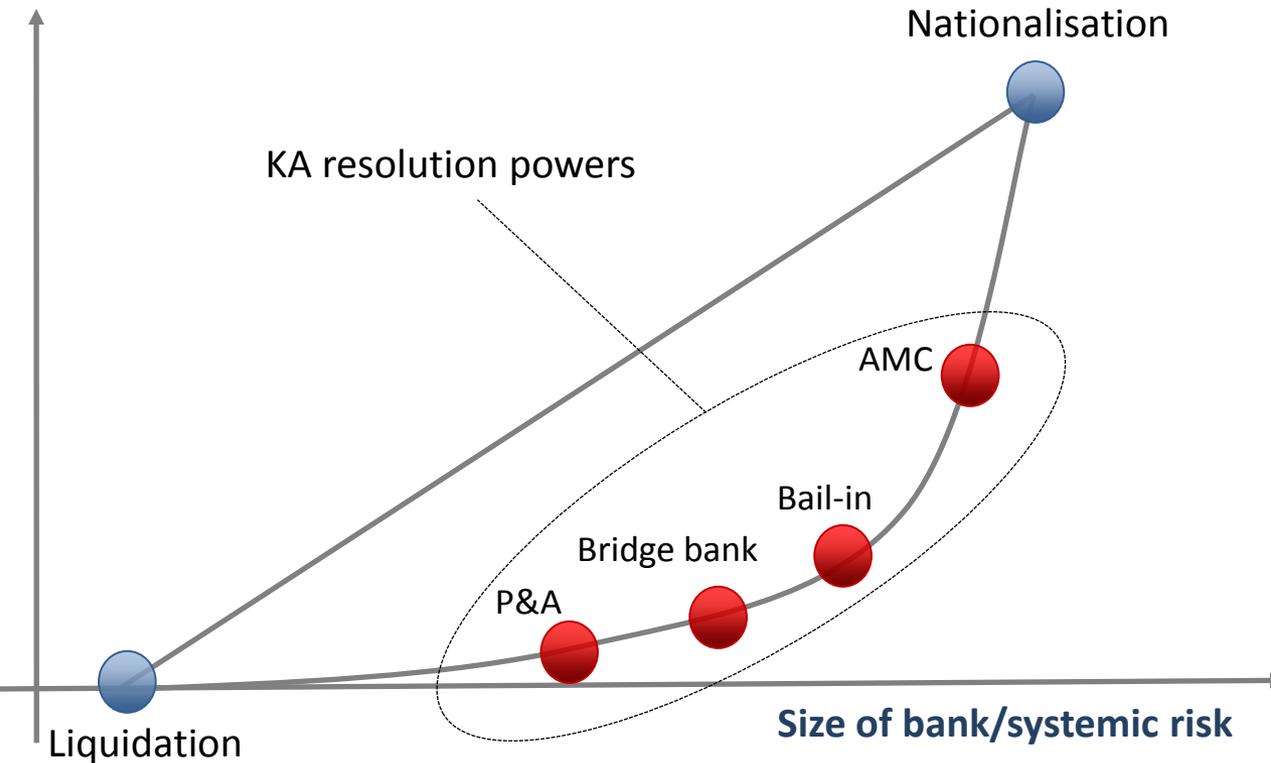
Review on Resolution Regimes – FSB Members

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

✓ Has power ✗ No power

South Africa clearly needs more resolution options

Fiscal cost/ moral hazard

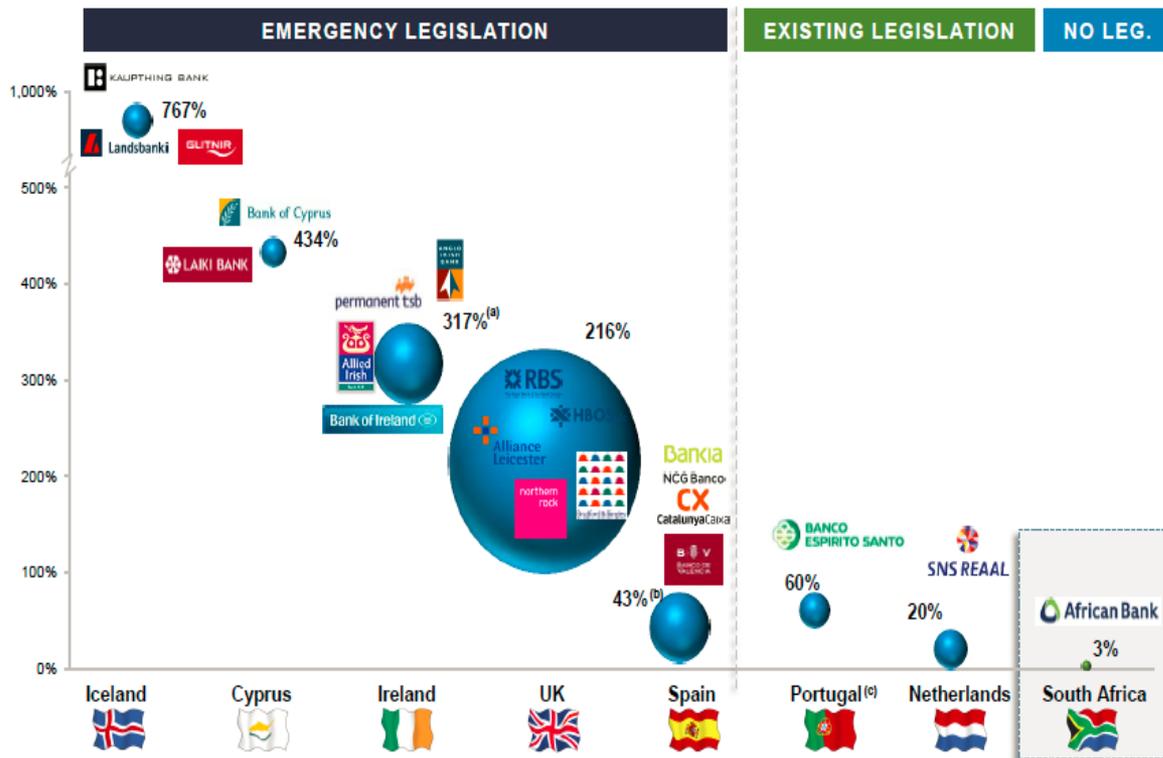


- How you respond to a bank in distress relies critically on how systemic it is
- In this case, we preferred to re-organise the bank with some losses to creditors
- Known as “bail-in” as opposed to “bail-out”
- Quite common in non-bank reorganisations

Why now?

Select Bank Restructuring Situations

BANK ASSETS AS A PERCENTAGE OF GDP



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

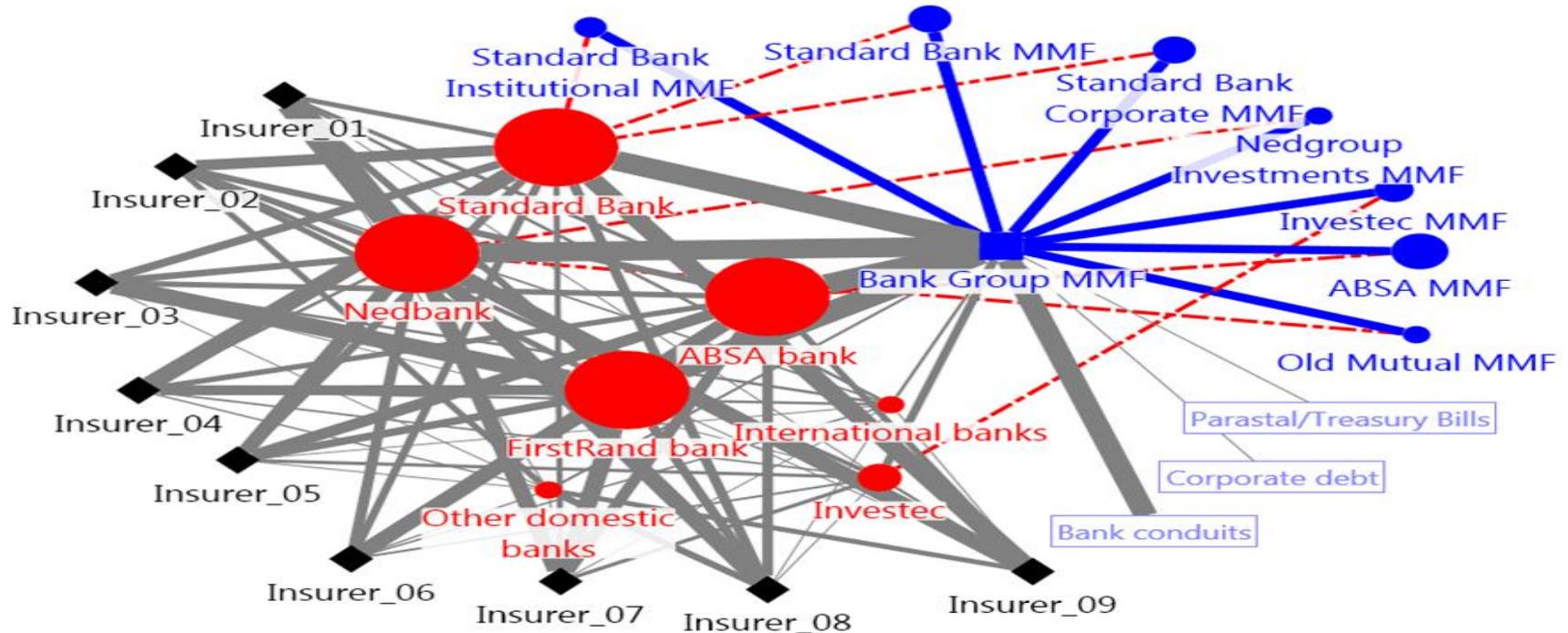
^b Only includes assets of Group 1 banks

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

- Banks cannot be resolved through normal insolvency laws
- Since the GFC, almost every country that has had a bank failure required revision to resolution or emergency legislation
- Although some argue that African Bank not systemic, SA's highly interconnected financial system makes it extremely risky.

Why urgent are reforms needed

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



KEY THEMES ARISING FROM PUBLIC SUBMISSIONS AND WORKSHOPS

Who are the main groups that commented

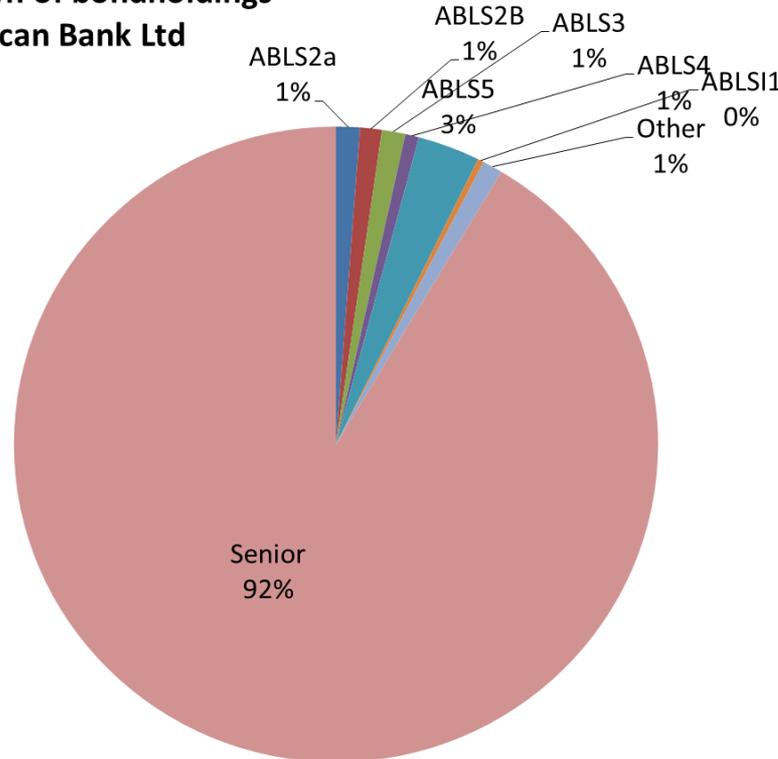
National Treasury received comments from 5 main groups:

Groups with substantive concerns:

- ***Senior / Tier 1 creditors***
 - Pension funds
 - Money market funds and other investment funds
- ***Junior / Sub-ordinated / Tier 2 creditors***

Relative sizes of various commentators in African Bank

Breakdown of bondholdings
African Bank Ltd

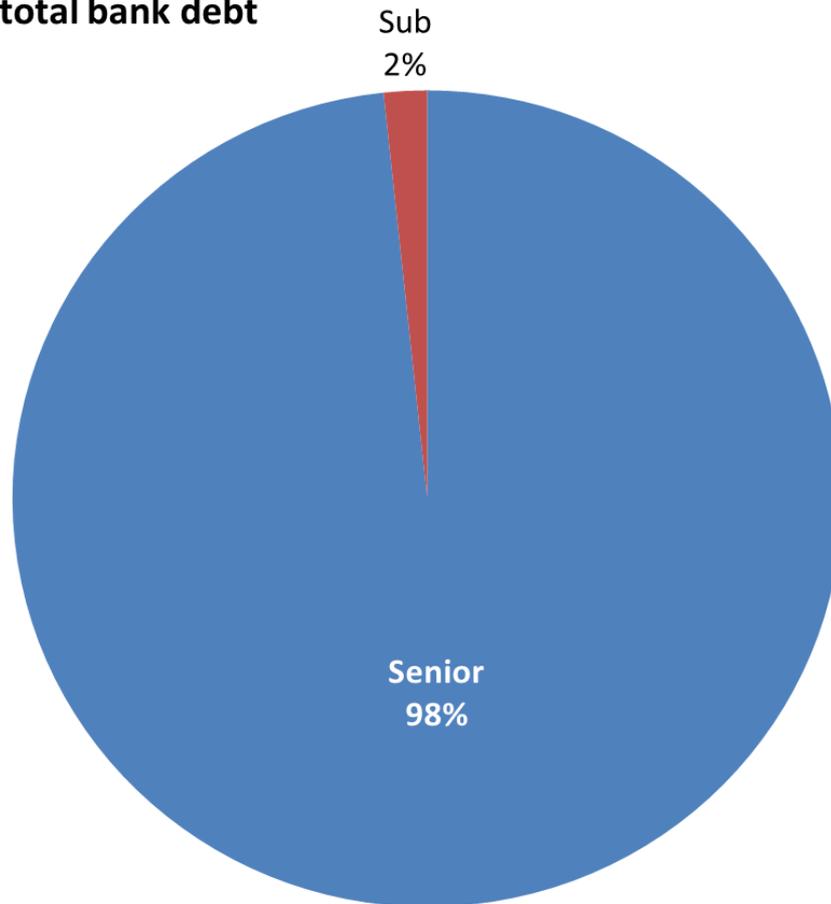


- Important to highlight that the late submission and accompanying legal opinion is with relation to a very specific series of bonds
- These collectively make up a small component of the overall
- There are also two sub-debt committees representing that group

Paragraph 20 of the Sub-debt Legal Opinion: We have also reviewed the Pricing Supplements for the ABLS2A Notes, the ABLS2B Notes, the ABLS3 Notes (both in their original form and as amended), the ABLS4 Notes (both in their original form and as amended) and the ABLS5 Notes (tranches 1, 2 and 3). We shall refer to these collectively as “the Pricing Supplements”.

Relative sizes of various commentators as source of banking sector funding

Breakdown of total bank debt



- Bank balance sheet is approximately R3.5 *trillion*
- Subordinated debt is approximately R60 to R80 *billion*

Key issue 1: Protection of creditor rights

Senior and Junior creditors concern

- The proposed amendments to the Bill will result in extensive discretion being granted to the curator and to the Minister.
- The ability of the curator to transfer the liabilities of the bank, impacts on creditors' rights.
- The contemplated amendments limit creditors' rights with limited participation by creditors in the process.

Proposal from stakeholders

- Creditors seek provisions which would ensure creditor approval as a requirement prior to any transfer of liabilities.

Key issue 1: Protection of creditor rights

Junior creditors concern

- The proposed amendments will result in the subordination of junior creditors in relation to senior creditors in curatorship.
- Curatorship is currently not liquidation and subordination of creditor classes occurs only in liquidation.
- The contemplated amendments limit creditors' rights with limited participation by creditors in the process.

Proposal from stakeholders

- Treat all creditor classes the same in curatorship or financially compensate creditors who normally, would be subordinated in liquidation.

Key issue 1: Protection of creditor rights

Treasury's view

- Property rights are protected in the Constitution and any unconstitutional resolution is subject to challenge. (see Senior Counsel opinion)
- The rights of creditors must be balanced against broader public policy objectives. In financial crisis (bank failures), speedy decisive action is required to prevent more generalised economic problems arising which have massive social costs.

Mitigating factors to address concerns:

- The Treasury believes that there are sufficient checks in other areas of law.
- The Minister or curator, in exercising public power is in any case always subject to PAJA, and a requirement to act fairly.
- In addition to that check, the Minister must behave in a way that will result in no creditor being worse off than they would be under liquidation.

Mitigating factors to address concerns:

- Propose to introduce section 155 of Companies Act

Key issue 1: Protection of creditor rights (cont.)

Treasury's view

- The Treasury believes that these creditors bought these instruments because the return on these instruments was higher than more senior (or higher ranking) claims commensurate with the higher risk they were assuming.
- It is not plausible to argue that higher returns, commensurate with greater risk should not, in curatorship, reflect this.
- Curatorship is a special resolution mechanism for banks because of their unique economic role, creditors will thus be treated in a way akin to liquidation
- The notion that rules relating to private property cannot be change if the in any way affect the value of that property is unreasonable. Environmental, tax, mineral etc, have meant changes to property law subject to the Constitution for public interest considerations.

Mitigating factors to address concerns:

- Treasury has followed international best practice (formulated by the G20) establishes that creditors be treated no worse than they would in liquidation.

Key issue 2: Valuation of transferred Assets

Senior and Junior concern

- At the heart of this proposal is the desire to ensure that assets and liabilities be transferred at fair market value.
- The proposed amendments will allow for the curator (subject to ministerial approval) discretion both in terms of which assets to transfer assets and at what value.
- This amendments allows the curator and/or Minister to much unfettered power in relation to creditor property rights.

Proposal from stakeholders

- The curator must transfer assets at fair market value.

Key issue 2: Valuation of transferred Assets

Treasury's view

- Determining what constitutes fair market value will require two things that are not possible in the context of financial stress or bank failure.
 - *Time*: this proposal will require the Minister, establishing through external engagement what fair-value is. This requirement is not reasonable given the purpose of this law.
 - Normal market conditions: In a crisis this not reasonably the case. The value of liabilities, contingent liabilities is near impossible to establish in a definitive manner.

Mitigating factors to address concerns:

- The Treasury believes that there are sufficient checks in other areas of law.
- The Minister or curator, in exercising public power is in any case always subject to PAJA, and a requirement to act fairly.
- In addition to that check, the Minister must behave in a way that will result in no creditor being worse off than they would be under liquidation. appropriate.

Key issue 3: Retrospectively (Constitutionality)

Junior creditor concern

- Sub-ordinated (Tier II) creditors believe that the proposed amendments are retrospective in nature.
- Sub-ordinated (Tier II) creditors believe that the amendments will apply to their rights in respect to events that occurred in August 2014 (African Bank curatorship).
- This class of creditors believe that they bought these instruments under specific regulatory conditions (Basell II) and although the amendments are in line with international best practice (Basel III), these new regulatory requirements can only be applied to new instruments.
- any retrospective application of the proposed amendments would be unconstitutional and would therefore invalidate the law.

Proposal from stakeholders

- Revoking all financial sector regulatory powers that would in any way affect current creditors rights

Key issue 3: Retrospectively (Constitutionality)

Treasury's view

- The Treasury has solicited legal opinions which have found that the Bill fully meets all constitutional requirements.
- In the opinion of Adv. Budlender, there is no limitation of retrospectively with respect to civil matters.

Mitigating factors to address concerns

- In addition, the SARB has been careful not to execute the intervention plan for African Bank before the amendments to the Banks Act have been accepted into law.
- In this regard the actions of the Curator will not be retrospective.

Conclusion

- Most stakeholders agree with the need for a Bill, even if they differ on the approach
- Substantial engagement with stakeholders
 - But it is to be expect that stakeholders attempt to elevate their own interests above those of other stakeholders
 - Treasury has tried to balance interests of all
- In response, Treasury proposes some additional wording
- Senior counsel opinion concludes that the new proposals are also Constitutional
- The Bill will enable further options in current curatorships

Thank You