

BANKS AMENDMENT BILL (B17-2014)

Briefing Note to Standing Committee on Finance

Parliament of the Republic of South Africa

21 April 2015

Introduction

The Banking Association South Africa is thankful for the opportunity to brief the Standing Committee on Finance and expand upon our earlier letter supporting the Banks Amendment Bill during the Committee's public hearings on Bill.

We would like to assist the Committee in understanding why we are supportive of the Bill and to share our thoughts with you on the position that we have taken.

What is the Banking Association

We are an organisation that exists to contribute to the enablement of a conducive banking environment. Part of this responsibility is to ensure that we participate at the highest-level of decision making in the country. To this end, The Banking Association South Africa has structured and organised itself to ensure effective participation in cabinet and its executive through the caliber of people and leadership that interact with Government at various levels and through various structures.

The South African banking sector is highly regulated and ranked 3rd most stable sector in the World Economic 2013/2014 Global Competitive Report. Engagement with regulators is critical to maintaining such stability, as well as to continue refining the environment for sustainable business. The banking industry is the "oil that lubricates the economy" and it is thus critical for us to continually engage government.

Consistent and robust engagement with government enables The Banking Association South Africa to be on the front foot in considering legislative changes and influencing such changes. It also enables us to work with government to achieve a fine balance between sound and appropriate regulation and sustainable business operations. In this way, the industry performs its role of a good corporate citizen.

The regulatory institutions legislate and monitor how our members conduct their business in line with international standards and as such all engagement

strives to ensure that we are continually appraised on the latest changes in international policy.

The enablement of a conducive environment for banking must support initiatives to enable an inclusive economy, and The Banking Association South Africa is committed to working with stakeholders to enable banks' role in this.

To this end, The Banking Association South Africa has structured and organised itself to ensure effective participation in and continued contribution to providing input to the Parliament's National Assembly and National Council of Provinces, as a trusted business advisor and assist with better enabling legislation.

The Banking Association comprises of four divisions and the Office of the Managing Director:

- Inclusive Economy
- Prudential
- Market Conduct
- Corporate Citizenship

The Banking Association is not involved in any of the discussions pertaining to the curatorship of African Bank, and we would therefore respectfully request that any questions pertaining to African Bank be channelled to the appropriate representative; however, having observed much of the debate on this Bill, we can still see the merits of these proposed amendments and continue to provide our support for the Bill.

Context around recent Developments

It is important at this point to stress, that although we represent the banking sector, our members are complex financial entities that play a significant role in almost all of South Africa's financial markets. It is therefore not surprising, that on the one hand our members are subscribing to a consortium of investors, prepared to participate in a new entity and therefore would express support for the Bill, whilst on the other hand they are also responsible for managing the investments of the public and will vigorously oppose the Bill. This is not a new challenge for the Banking Association.

Therefore, we have approached the Banks Amendment Bill from the privileged position of having participated in many of the prudential debates around our regulatory framework, as we implement the best international practices that we subscribe to as a country. From this approach we are neither supportive nor dismissive of any of our member's views; we are merely expressing our support for the direction we are taking in the area of bank resolution.



International financial architecture – driving national implementation

In order to provide you with some insight on our view, we must remember that South Africa is a member of the G20 and has undertaken to adopt the best practices emanating from this institution. This means that the Financial Stability Board based in Switzerland, established by the G20 and tasked with strengthening the financial system, together with a number of standard setting bodies, including the Basel Committee on Banking Supervision at the Bank for International Settlements, also based in Switzerland, will not only guide the development of the financial sector legislation in South Africa, but also the pace at which it is implemented and the prioritisation of regulatory initiatives.

2008 G20 Declaration: Global Financial System Reform

As far back as 2008, when in the midst of the global financial crisis, the G20 met in Washington, USA and declared that they were determined to reform the global financial system, already at that stage, they identified as a task for all countries, to undertake a review of resolution regimes and bankruptcy laws to ensure that an orderly wind-down of large, complex, internationally active financial institutions, was possible.

Financial Stability Board: Policy framework for effective resolution

Chairman, that was in November 2008. By April 2009 they had established the Financial Stability Board, and in June 2010 at the G20 Summit in Toronto, Canada, called on the Financial Stability Board to develop a policy framework for effective resolution, of all types of financial institutions.

International Best Practice

Even before this framework was finalised, the International Monetary Fund and the World Bank in December of 2010, published a Country Report on South Africa, highlighting the need for the powers of the Registrar to be strengthened, particularly in regard to appointing a curator. In fact the recommendations were for the Minister of Finance to have less influence in the decision to appoint a curator, and for the then regulatory requirement of consent from the bank CEO and or chairperson as a precondition for curatorship, to be removed from the legislation.

This was in 2010, the year we hosted the FIFA Soccer World Cup and already the domestic agenda on resolution was being changed for South Africa. This brief history of how we got to where we are is necessary, as it is not by accident that we have made these decisions, in fact the curatorship of African Bank came at a time when South Africa was already crafting their resolution framework. A



white paper on the new resolution framework, I understand, has been completed by National Treasury, and will be released soon.

2011 G20 Summit and 2013 St Petersburg Summit

In 2011 at the G20 Summit in Cannes, France, the framework by the Financial Stability Board titled the *Key Attributes of Effective Resolution Regimes for Financial Institutions* was endorsed. In September 2013, at the St Petersburg Summit in Russia, South Africa, as a member of the G20, committed to make any necessary reforms to implement fully the Key Attributes.

South African International Best Practice

This is now the international best practice that South Africa and the rest of the World are adopting for the resolution of financial institutions. It will be this document that South Africa will be evaluated against when our framework for resolution is finalised.

12 Essential Features of The Key Attributes

The Key Attribute document sets out 12 essential features that should be part of the resolution regimes of all jurisdictions. As you can see, the 12 key attributes consider a diverse range of issues; however most of them would not be applicable to this Banks Amendment Bill.

The Key Attributes

Three aspects of the 12 key attributes, resolution powers, safeguards and funding firms in resolution, as we see them supporting this Banks Act Amendment and would urge the members of the Standing Committee on Finance, to study this document which in the Financial Stability Board October 2014 reissue of the Key Attributes included guidance on the resolution of non-bank financial institutions, so that you will be prepared for the changes that are imminent and inevitable for the South African financial sector.



The Key Attributes: Resolution Authorities and Powers

In the 2011 Key Attributes document, one of the key attributes is dedicated to resolution powers. A portion of this key attribute, under Section 3.3 on the transfer of assets and liabilities notes the following, and I quote:

“Resolution authorities should have the power to transfer selected assets and liabilities of the failed firm to a third party institution or to a newly established bridge institution. Any transfer of assets or liabilities should not:
(i) require the consent of any interested party or creditor to be valid; ”

Therefore in our view, the amendment to Section (2C) parts (a) and (b) makes specific provision for this principle, empowering the curator to establish a bridge institution, or for purposes of the SARB press announcement, a good bank.

Proposed Amendments

The deletion of the existing wording at small b Roman 2 [(b)(ii)] that the disposal of any assets should be for the purpose of returning the bank to a viable entity, is therefore restrictive and illogical and we agree with the motivation provided to remove the wording from the current Act.

In the case of African Bank we can see how this provision may have applied to the disposal of Ellerine Holdings Limited, but if this disposal did not return African Bank, automatically back to a viable entity in a reasonable period of time, then the curator would be forced to take the bank through a liquidation process.

The press announcement of the SARB on 10 August 2014, would indicate that even at that stage there was a need for ten billion rand to be injected into the good bank, by a consortium of investors to make it a viable entity. The bad bank with its impairments also received a R7 billion rand loan from the SARB.

Burden of a Failure of a Financial Institution

As we followed the debates around resolution, as early as June 2010 at the G20 Toronto Summit, a very clear direction was being crafted on who should carry the burden of a failure of a financial institution. I quote:

“We are following through on our commitment to reduce moral hazard in the financial system. We are committed to design and implement a system where we have the powers and tools to restructure or resolve all



types of financial institutions in crisis, without taxpayers ultimately bearing the burden. These powers should facilitate "going concern" capital and liquidity restructuring as well as "gone concern" restructuring and wind-down measures. We endorsed and have committed to implement our domestic resolution powers and tools in a manner that preserves financial stability...".

The Financial Stability Board in crafting the Key Attributes document responded to this instruction by introducing as one of its key attributes a section on the funding of firms in resolution. However, all through the document the theme of not using tax payer's money repeats itself. In the preamble it clearly sets out this objective in the following wording:

" The objective of an effective resolution regime is to make feasible the resolution of financial institutions without severe systemic disruption and without exposing taxpayers to loss, while protecting vital economic functions through mechanisms which make it possible for shareholders and unsecured and uninsured creditors to absorb losses in a manner that respects the hierarchy of claims in liquidation."

The specifics of how the Key Attributes document addresses this matter is detailed in the section mentioned earlier on funding firms in resolution:

- "6.1 Jurisdictions should have statutory or other policies in place so that authorities are not constrained to rely on public ownership or bail-out funds as a means of resolving firms.*
- 6.2 Where temporary sources of funding to maintain essential functions are needed to accomplish orderly resolution, the resolution authority or authority extending the temporary funding should make provision to recover any losses incurred (i) from shareholders and unsecured creditors subject to the "no creditor worse off than in liquidation" safeguard (see Key Attribute 5.2); or (ii) if necessary, from the financial system more widely."*

We are not aware of any intention by Government to underwrite the losses of African Bank and our understanding is that the seven billion rand loan provided by the SARB is secured by seventeen billion rand in assets pledged by the so called bad bank for this loan. Therefore when we considered the wording that is to be removed from the existing Act, it accords with our understanding that there is no obligation on Government to provide funding and with this wording intact, the options available to the curator are diminished, and the good bank as proposed could not be created.

It is also clear from these paragraphs in the Key Attributes that sharing in the loss of the bank, is to be amongst those that have invested in the bank, but



potentially, if that was not possible, from the broader financial system. We wait to see how this final requirement will be crafted into the proposed resolution bill for South Africa.

It did not seem reasonable from our vantage point to limit the curator's options in law, and therefore we did not object to the removal of the text.

However, the international standards are balanced with a duty of care. In as much as there is necessary flexibility provided for a rapid resolution, there are also safeguards introduced to protect innocent parties from being prejudiced by the curator's action. In this regard we are comfortable that Section 5 of the Key Attributes document has been considered and introduced simultaneously with the Banks Act Amendment Bill in the new section at the bottom of Page 2, small c and Roman 1 [(c)(i)] and running up to the top of page 3 where it continues with small Roman 2 [(ii)].

From Section 5 on Safeguards, from the Key Attributes document, you will be able to see how section c has been crafted into our framework to achieve the Respect of creditor hierarchy and "no creditors worse off" principle:

- "5.1 Resolution powers should be exercised in a way that respects the hierarchy of claims while providing flexibility to depart from the general principle of equal (pari passu) treatment of creditors of the same class, with transparency about the reasons for such departures, if necessary to contain the potential systemic impact of a firm's failure or to maximise the value for the benefit of all creditors as a whole. In particular, equity should absorb losses first, and no loss should be imposed on senior debt holders until subordinated debt (including all regulatory capital instruments) has been written-off entirely (whether or not that loss-absorption through write-down is accompanied by conversion to equity).*
- 5.2 Creditors should have a right to compensation where they do not receive at a minimum what they would have received in a liquidation of the firm under the applicable insolvency regime ("no creditor worse off than in liquidation" safeguard)."*

These safeguards are a necessary feature as they add a dimension of accountability by the curator and the resolution authority. This requirement should not be dismissed as an optional feature or that the wording used in the Banks Amendment Bill of "...a reasonable probability exists that a creditor will not incur greater losses..." does not set a high enough standard. We believe it does and would expect to see greater clarity in the Resolution Bill.

For our submission, and for the sake of time, we believe that these are the most important aspects of the Banks Amendment Bill, currently under



consideration. This does not mean that other parts of the Bill have lesser importance, but these amendments we have reflected on are necessary and must be introduced for South Africa to maintain its standards in line with the rest of the World.

We are not alone in dealing with these challenges; many jurisdictions including some of the premier financial centres are not able to meet the requirements of the Key Attributes yet.

November 2014: Financial Stability Board Progress Report

In November 2014, around the time of this proposed Banks Amendment Bill was released, the Financial Stability Board tabled a report on progress of members adopting the Key Attributes to the G20 meeting in Brisbane Australia, wherein they confirmed that only six jurisdictions (France, Germany, Japan, Mexico, Singapore and the UK) had during 2014 aligned with the Key Attributes. Seventeen others, including South Africa were still in the process of aligning. And yes, six plus seventeen does not equal twenty as in the G20, the European Union can impact on these numbers.

The position we have taken as BASA is based on the ongoing engagements between our industry and both the SARB and National Treasury that go back to the year 2013, on the establishment of a resolution authority and how many other matters, not yet brought before this committee, are to be considered and implemented within a resolution framework. Furthermore, our members do not only have to comply with South African legislation, we are also forced to comply with every jurisdictions legislation, in the country in which we operate and therefore we are aware of international developments and even comment on proposed frameworks. Internationally headquartered banks are also required to meet their home regulators requirements, whilst operating as a foreign branch in the South African banking sector. We therefore welcome any initiative that wishes to align regulatory requirements to a single vision, adopted uniformly across the globe such as the Key Attributes.

We are not alone in endorsing the Bill.



International Monetary Fund: South Africa – Financial System Stability Report

In December 2014, the International Monetary Fund published a country report on South Africa. Their observations around the regulatory framework for resolution in South Africa deserves a mention, and I shall quote from their report as follows:

"The South African Reserve Bank (SARB) is a proactive supervisor, with a high level of compliance with international standards on effective banking supervision. The SARB's decisive action in placing African Bank under curatorship limited contagion. Its proposed bail-in of senior unsecured creditors to share in the burden of resolution is also welcome and a step in the right direction of reducing the "too big to fail premium" for the large banks.

In addition, the crisis management and resolution framework should be upgraded. Early intervention powers of the SARB and other prudential regulators should be enhanced, and the intervention of African Bank underscores the need to introduce a resolution regime for banks and systemic nonbank financial institutions (NBFIs) that are in line with the Financial Stability Board's Key Attributes of Effective Resolution (KA).

As a member of the Financial Stability Board, the South African authorities are committed to reforming the resolution regime to make it compliant with the Key Attributes of Effective Resolution by end 2015."

The banking industry, as well as the broader financial sector is in the process of a dramatic change, driven by the international community to reposition the financial sector, in a way that has never been contemplated before.

South Africa through its participation in the G20, the Financial Stability Board and other forums such as the International Organisation of Securities Commissions (IOSCO) based in Madrid Spain, and the Basel Committee on Banking Supervision, has committed to adopting these global best practices in South Africa.

A number of these best practices may not suit our emerging market status and there is no doubt that you will find The Banking Association back in this House challenging the merits of the proposed legislation in future sittings. However for today, we believe that this proposed amendment is prudent and should be adopted.



Conclusion

The failure of African Bank was unexpected; however the decisive action taken by the Registrar of Banks together with the Governor of the Reserve Bank and the Minister of Finance and all their functionaries and advisors is to be commended. Their approach is in line with what would be expected of a banking sector that is rated as one of the safest banking sectors in the World. But that was on the 10th August 2014.

It may be of interest to the members of the House that the Financial Stability Board has announced the launch of its second peer review on resolution regimes last week on the 13 April, with feedback to the Financial Stability Board by the 8th May 2015, two weeks from now. It would be in South Africa's interests to have this Amendment Bill finalised before then.

Mr Chairman and honourable members of the house that concludes our presentation and we would welcome the opportunity to answer any questions you may have around our approach to the resolution framework.

