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Received: 1 June 2023 | Revised: 2 December 2023

DOI: 10.1002/iir.1524

RESEARCH ARTICLE

INSOL International WILEY

Bank resolution in South Africa: Recent developments

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Abstract

In this contribution, the authors explore recent developments in South Africa's approach to bank resolution, assessing compliance of its new regime with the Financial Stability Board's Key Attributes of Effective Resolution Regimes for Financial Institutions (KAs). Emphasizing the imperative for orderly resolutions to avert financial crises, the authors scrutinize the post-2008 Global Financial Crisis regulatory landscape. Until June 2023, South Africa's approach to bank failure was limited to curatorship and liquidation under the Banks Act 94 of 1990. Addressing gaps identified by international bodies such as the Financial Stability Board, International Monetary Fund, and the World Bank, and taking lessons from the failure of African Bank in 2014, South Africa has transitioned to a Twin Peaks regulatory model and also introduced a comprehensive resolution framework effective June 1, 2023, captured in the Financial Sector Regulation Act 9 of 2017. This framework currently applies to banks only. The South African Reserve Bank now holds an explicit financial stability mandate and is designated as the resolution authority. The article discusses the design

This contribution is based on the comparative South African chapter in the author's thesis titled 'Regulatory Measures to Address Bank Failures in Zimbabwe', supervised by Corlia Van Heerden.

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features for an effective resolution regime as recommended in the KAs to benchmark the new South African resolution regime, noting overall compliance. However, it acknowledges the need for further development in certain respects to enhance alignment.

1 | INTRODUCTION

A strong and resilient banking system is the foundation for sustainable economic growth, given that banks are at the centre of the credit intermediation process between savers and investors. As observed by Haentjens, banks are very often the most dominant players in a financial system.[1]

Corrigan points out that banks perform three essential functions that make them 'special' in comparison with other financial institutions, namely: they issue transaction accounts (which entails that they hold liabilities that are payable on demand at par and that are readily transferable to third parties); they are the back-up source of liquidity to all other institutions; and they are also the 'transmission belt' for monetary policy.[2] These functions are highly interdependent, and the ability of banks to perform such functions dictates the need for a high degree of public confidence in the overall financial condition of banks.

It is consequently evident that, as banks generally make up a large, if not the largest, segment of a country's financial system, this puts them in a position where their operations, and consequently also their failure, can significantly impact financial stability. The business models of banks also differ from those of other financial institutions. In particular, Haentjens points to fractional reserve banking[3] as being one of the aspects that, in the early days of banking history, led to bank insolvency together with the fact that banks lent on longer terms than deposits could be retrieved. Over the years, information that banks may be encountering financial distress led to 'bank runs'[4] by depositors, even sometimes on 'healthy' banks, resulting in devastating liquidity drainage. Depending on the size and interconnectedness of the bank concerned,

[1]Matthias Haentjens, 'Bank Recovery and Resolution: An Overview of International Initiatives' (2014) International Insolvency Law Review 255.

[2]Gerald Corrigan, 'Are Banks Special?' (Federal Reserve Bank of Minneapolis Annual Report, 1982) 507 <https://fraser.stlouisfed.org/title/annual-report-federal-reserve-bank-minneapolis-473/annual-report-1982-18309>.

[3]See Sergey Alifanov, 'On the Dangers Inherent in a Fractional Reserve Banking System' (2015) 29 Student Economic Review Monetary Thought 117: 'Under a fractional reserve banking system, the central bank imposes a legal requirement on all banks operating under its mandate to maintain a specified proportion of their deposits in reserves. Reserves against these deposits can take the form either of currency on hand (vault cash) or balances at the central bank itself. Originally reserve requirements were designed as a safeguard against "runs" on the banks that were quite widespread over the world until roughly the 1930s–1940s. The rationale behind this system was that by requiring financial institutions to hold some liquid assets on hand, central banks wished to reassure the depositors that their money was available on demand'.

[4]See Douglas Diamond and Philip Dybvig, 'Bank Runs, Deposit Insurance, and Liquidity' (1983) 19 Journal of Political Economy 401; Deniz Anginer and Asli Demirguc-Kunt, 'Bank Runs and Moral Hazard: A Review of Deposit Insurance' (World Bank Policy Research Working Paper 8589, 2018) <https://elibrary.worldbank.org/doi/abs/10.1596/1813-9450-8589>.

its failure could contaminate other financial institutions and such contagion[5] could cause large-scale financial system collapse.

Although the function of prudential regulation and supervision is fundamentally to ensure the 'safety and soundness' of banks, best practice standards in banking supervision however acknowledge that it is impossible to completely prevent bank failures.[6] In addition to having a robust framework to regulate and supervise banks that provides for adequate regular supervisory powers as well as an appropriate early intervention regime, it is consequently essential, from the perspective of preserving financial system stability, critical functions and depositor and broader financial consumer protection, to consider how to optimally deal with banks that fail. This would require the financial safety net to also include a framework for ensuring orderly resolution of a failing bank operating in tandem with a well-designed explicit deposit insurance framework.

The discussion below will focus on best practice design features of an effective bank resolution regime and will benchmark South Africa's new bank resolution regime for alignment with such best practice features.

2 | A NEW PARADIGM FOR DEALING WITH FAILING BANKS

During the past few decades, especially during the 2008 Global Financial Crisis ('GFC'),[7] it became increasingly clear that, not only are banks 'special' as pointed out by Corrigan, their insolvency is also 'special'. Banks' business operations and structures have diversified extensively over the years and their exposures have become more risky, thus making it evident that normal commercial insolvency procedures with their protracted and costly procedural layers and extensive judicial involvement, which may even lead to reversals of decisions and actions pertaining to dealing with insolvent banks, are not best suited to optimally deal with failing banks.[8]

A *sui generis* approach is therefore required when banks become insolvent or are likely to become insolvent. Such approach must enable swift action, preferably by the bank supervisor who is *au fait* with the special character and operations of banks and who can take appropriate, calculated and timely actions to prevent loss of value and maintain financial stability while also protecting depositors. Hüpkes poignantly states, in answer to the question why banks should be accorded special treatment in insolvency, that:

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[5]Jana Bricco and TengTeng Xu, 'Interconnectedness and Contagion Analysis: A Practical Framework' (IMF Working Paper WP/19/220, 2019) <www.sipotra.it/wp-content/uploads/2019/10/Interconnectedness-and-Contagion-Analysis-A-Practical-Framework.pdf>.

[6]The Basel Committee on Banking Supervision, 'Core Principles for Effective Banking Supervision' (2012) 5 <www.bis.org/publ/bcbs230.pdf>, indicate that '[I]t should not be an objective of banking supervision to prevent bank failures. However, supervision should aim to reduce the probability and impact of a bank failure, including by working with resolution authorities, so that when failure occurs, it is in an orderly manner'.

[7]Joseph Stiglitz, 'Lessons from the Global Financial Crisis of 2008' (2010) 23 Seoul Journal of Economics 321; Frederic Mishkin, 'Over the Cliff: From the Subprime to the Global Financial Crisis' (2011) 25 Journal of Economic Perspectives 49.

[8]Charles Randell, 'Legal Aspects of Bank Resolution: Designing the Powers and Solutions' (Operational Aspects of Bank Resolution and Restructuring Conference, European Bank for Reconstruction and Development, London, March 2012) 4 <www.ebrd.com/downloads/news/ran2.pdf>.

> the common answer is that banks play a special role in a country's economy in that, collectively, their functions are so important as to constitute a type of public service.[9]

Thus, bank failure merits a *lex specialis*.

It was particularly the haphazard, ad hoc taxpayer-funded bail-outs[10] of financial institutions during the GFC that directed the regulatory sentiment decidedly against 'Too Big To Fail' (TBTF) financial institutions, including supersized banks, and the drain on public funds and increase in moral hazard occasioned by these bail-outs. Consequently, the post-GFC regulatory paradigm, focused on financial stability as a core pursuit,[11] is intent on the 'orderly resolution' of financial institutions within the context of a financial safety net arrangement that includes not only robust prudential regulation and supervision and appropriate early intervention, but also a well-conceptualized explicit deposit insurance framework.[12] Although a concept with various country-specific permutations, Randell describes orderly bank resolution as:

> special arrangements for the winding-up or restructuring of a failing bank by virtue of powers that go beyond the general powers conferred by the normal insolvency law applying to companies.[13]

The current international best practice standard for orderly resolution frameworks is the Financial Stability Board's Key Attributes of Effective Resolution Regimes for Financial Institutions (FSB 'KAs', issued in 2011 and updated in 2014).[14] A brief overview of selected aspects of the KAs will be provided below to benchmark selected aspects of the new South African bank resolution regime for compliance.

3 | THE FSB KEY ATTRIBUTES OF EFFECTIVE RESOLUTION REGIMES

The Key Attributes (KAs) comprise of 12 attributes that constitute the design features of an effective bank resolution framework, and cover the following aspects: scope; resolution

[9]Eva Hüpkes, 'Insolvency – Why a Special Regime for Banks?' (2005) 3 Current Developments in Monetary and Financial Law 1, 3.

[10]For examples of such bail-outs, see Dermot Hodson and Lucia Quaglia, 'European Perspectives on the Global Financial Crisis: Introduction' (2009) 47 Journal of Common Market Studies 939; Randall Wray, 'Global Financial Crisis: Causes, Bail-Out, Future Draft' (2012) 80 UMKC Law Review 1101.

[11]Committee on the Global Financial System, 'Structural Changes in Banking After the Crisis' (CGFS Papers No 60, 2018) 8 <www.bis.org/publ/cgfs60.pdf>; Alessandra Cicci, 'G20 Performance on Financial Stability' (*G20 Insights*, 9 April 2020) <www.g20-insights.org/wp-content/uploads/2020/04/g20-performance-on-financial-stability-1586431961.pdf>.

[12]International Association of Deposit Insurers, 'IADI Core Principles for Effective Deposit Insurance Systems' (2014) <www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf>.

[13]Randell (n 8).

[14]Financial Stability Board, 'Key Attributes of Effective Resolution Regimes for Financial Institutions' (2014) <www.fsb.org/wp-content/uploads/r_141015.pdf>. In 2016, the Financial Stability Board published the 'Key Attributes Assessment Methodology for the Banking Sector' which sets out essential criteria to guide the assessment of the compliance of a jurisdiction's bank resolution frameworks with the FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions. It is designed to promote consistent assessments of bank resolution regimes across jurisdictions. See 'Financial Stability Board, 'Key Attributes Assessment Methodology for the Banking Sector' (2016) <https://www.fsb.org/wp-content/uploads/Key-Attributes-Assessment-Methodology-for-the-Banking-Sector.pdf>.

authority; resolution powers; set-off, netting, collateralisation, segregation of client assets; safeguards; resolution funding; legal framework conditions for cross-border cooperation; crisis management groups; institution-specific cross-border cooperation agreements; resolvability assessments; recovery and resolution planning; and access to information and information sharing. The discussion hereinafter will however be limited to the scope; resolution authority; resolution objectives; resolution triggers; resolution powers and tools; set-off, netting, collateralisation, segregation of client assets; safeguards; resolution funding; ex ante recovery and resolution planning and resolvability assessments.

In terms of KA 1, the scope of a country's resolution framework should cover any financial institution that could be systemically significant or critical if it fails.[15] KA 2 recommends that an operationally independent administrative 'resolution authority' should be designated to implement the resolution regime.[16] The statutory objectives and functions of the resolution authority should:

> pursue financial stability and ensure continuity of systemically important financial services, and payment, clearing and settlement functions; protect, where applicable and in coordination with the relevant insurance schemes and arrangements, such depositors, insurance policy holders and investors as are covered by such schemes and arrangements; avoid unnecessary destruction of value and seek to minimise the overall costs of resolution in home and host jurisdictions and losses to creditors, where that is consistent with the other statutory objectives; and duly consider the potential impact of its resolution actions on financial stability in other jurisdictions.[17]

The KAs recommend a forward-looking approach to resolution by means of credible and regularly updated recovery and resolution plans, covering at a minimum domestically systemically important banks.[18] Recovery plans, updated regularly, are drafted by the banks themselves and should identify options to restore financial strength and viability and avert failure when the bank encounters severe stress.[19] Resolution plans ('Living Wills') are drafted by the resolution authority, assisted by the bank concerned, should also be regularly updated, and are intended to be applied when the bank nevertheless encounters such failure that it has to be placed in resolution. Credible resolution plans must facilitate the effective use of resolution powers to protect systemically important functions, to make the resolution of any bank viable without severe disruption, and without exposing taxpayers to loss.[20]

KA 3 requires resolution to be initiated (triggered) when a bank is:

> no longer viable or likely to be no longer viable and has no reasonable prospects of becoming so.[21]

[15]FSB 2014 (n 14) 5; World Bank Group, 'Financial Safety Nets and Bank Resolution Frameworks in Southern Africa: Key Issues and Challenges' (Working Paper, 2019) 8 <https://openknowledge.worldbank.org/bitstream/handle/10986/31511/Key-Issues-and-Challenges.pdf?sequence=1&isAllowed=y>.

[16]Idem. Where there are multiple resolution authorities within a jurisdiction, their respective mandates, roles and responsibilities should be clearly defined and coordinated.

[17]FSB 2014 (n 14) 6.

[18]KA 11.1.

[19]KA 11.5.

[20]KA 11.6.

[21]KA 3.1.

The resolution regime must provide for timely and early entry into resolution before a bank is balance sheet insolvent and before all equity has been fully wiped out. Clear standards or suitable indicators of non-viability are therefore required in the resolution framework to guide decisions on whether the conditions for entry into resolution have been met.[22]

KA 3.2 recommends that resolution authorities should have a broad range of resolution powers, including the power to[23]:

- Take control of the failing bank, remove and replace directors and senior management and recover monies from those responsible for the bank's failure;
- appoint an administrator to manage the failing bank with the aim of restoring the bank or at least parts of its business to ongoing and sustainable viability;
- operate and resolve a failing bank, including powers to terminate, continue or assign contracts, purchase and sell assets, write down debt, or taking any other action necessary for restructuring or winding down the bank's operations;
- ensure continuity of essential services and functions by, for example, requiring other companies in the same group to continue providing essential services to the bank in resolution, any successor or acquiring entity; and ensuring that the residual bank in resolution can temporarily provide such services to a successor or an acquiring entity; or procuring necessary services from third parties;
- override shareholder rights, such as a requirement that shareholder approval is needed for particular transactions, or to permit a merger, acquisition, sale of substantial business operations, recapitalisation or other measures to restructure and dispose of the bank's business or its assets and liabilities;
- transfer or sell the failing bank's assets and liabilities, legal rights and obligations, including deposit liabilities and ownership in shares, to a solvent third party[24];
- establish a temporary bridge bank for taking over and continuing to operate certain of the failing bank's critical functions and viable operations[25];
- establish a separate asset management vehicle to which non-performing loans or difficult-to-value assets can be transferred for management and run-down;
- carry out ‘bail-in within resolution’, as a means to achieve continuity of essential functions either (a) through recapitalisation of the failing bank or (b) through capitalisation of a newly established bridge bank to which such essential functions have been transferred after closure of the failed bank (the residual business of which would then be wound up and the bank liquidated)[26];

[22]Idem.

[23]KA 3.2 (i)–(xii).

[24]KA 3.3.

[25]KA 3.4. A bridge bank is a new bank, publicly owned and established by the resolution authority or another relevant agency, that acquires the critical business functions and services of a failing bank. It is capitalized through the transfer of assets (in an amount exceeding any liabilities transferred), to the bridge bank and by the bail-in of liabilities. Capitalization can also be achieved by the injection of funds through a resolution fund or the government. The non-critical functions and impaired assets of the failed bank are then wound up through liquidation processes.

[26]KA 3.5. This power enables the resolution authorities to write down and/or convert into equity the unsecured creditor claims of the bank to the extent necessary to absorb losses and in an order that respects the creditor hierarchy in insolvency. The objective of the bail-in tool is to ensure that the costs of resolving a failing bank fall upon its shareholders and creditors, and to avoid disruption and loss of value associated with ordinary insolvency proceedings while minimising risk to public funds.

- temporarily stay the exercise of early termination rights that may otherwise be triggered when a bank enters into resolution or in connection with the use of resolution powers[27];
- impose a (limited) moratorium with a suspension of payments to unsecured creditors and customers and a stay on creditor actions against the failing bank, while protecting the enforcement of eligible netting and collateral agreements[28]; and
- effect a closure and orderly liquidation of the whole or part of a failing bank with a timely pay-out or transfer of insured deposits and prompt access to transaction accounts and segregated client funds.[29]

Resolution powers can be applied alone or in combination, with resolution actions being either combined or applied sequentially and different types of resolution powers can be applied to different parts of the failing bank's business.[30] Clearly, the augmented suite of resolution powers and tools set out above considerably strengthen the resolution authority's ability and flexibility to optimally resolve failing banks in an orderly manner.

KA 4.1 and 4.2 further require that, subject to adequate safeguards, a bank's entry into resolution and the exercise of any resolution powers should not trigger statutory or contractual set-off rights or present an early termination trigger that could compromise resolution efforts.[31] However, should contractual acceleration or early termination rights be exercisable, the resolution authority should be empowered to effect a temporary stay of such rights where they arise purely as a result of the bank's entry into resolution or in connection with the exercise of any resolution powers.[32]

As an important safeguard to protect property rights of shareholders and creditors, the KAs require that resolution powers be exercised in a way that respects the creditor hierarchy in insolvency. There should however also be flexibility to depart from the general principle of equal (pari passu) treatment of creditors of the same class if such deviation is necessary to contain the potential systemic impact of a bank's failure or to maximise value for the benefit of the whole group of creditors.[33] Creditors should further be compensated if they do not receive in bank resolution, at a minimum, what they would have received had the bank rather been liquidated instead—the 'no creditor worse off than in liquidation'—principle ('NCWOL') that is premised on a counterfactual liquidation valuation to inform the extent of compensation, if any.[34]

Further safeguards require directors and officers of the bank in resolution to be legally protected from lawsuits by shareholders or creditors for bona fide actions taken when

[27]KA 4.3.

[28]Bank for International Settlements, 'OTC Derivatives: Settlement Procedures and Counterparty Risk Management' (1998) <www.bis.org/cpmi/publ/d27.pdf>. See also Robert Bliss and George Kaufman, 'Derivatives and Systemic Risk: Netting, Collateral and Closeout' (Federal Reserve Bank of Chicago WP 2005–03) <https://fraser.stlouisfed.org/files/docs/historical/frbchi/workingpapers/frbchi_workingpaper_2005-03.pdf>.

[29]Closure and wind-down involves withdrawing the operating license of a non-viable bank and pay out of insured depositors by the deposit insurance agency. See World Bank Group, 'Financial Safety Nets and Bank Resolution Frameworks in Southern Africa: Key Issues and Challenges' (Working Paper, 6, 2019) <https://openknowledge.worldbank.org/bitstream/handle/10986/31511/Key-Issues-and-Challenges.pdf?sequence=1&isAllowed=y> accessed 21 February 2023.

[30]KA 3.8.

[31]KA 4.1 and 4.2.

[32]KA 4.3.

[33]KA 5.1. Such departure should be transparently motivated.

[34]KA 5.2.

complying with decisions of the resolution authority.[35] The KAs also recommend that the resolution framework should not provide for judicial actions (such as appeals or reviews) that could constrain the swift implementation of, or result in a reversal of, good faith resolution measures taken by resolution authorities, acting within their legal powers.[36] Provision should rather be made for redress by awarding compensation, where justified.[37]

In respect of resolution funding, the KAs recommend that jurisdictions should have in place privately financed deposit insurance or resolution funds. Alternatively, there should be a funding mechanism for ex post recovery from the industry of the costs of providing temporary financing to facilitate the resolution of the failing bank.[38] It is further indicated that where any temporary funding is provided by the authorities it should be subject to strict conditions that minimise the risk of moral hazard,[39] and should include the following[40]:

i. a determination that the provision of temporary funding is necessary to foster financial stability; and that such funding will permit the implementation of an optimal resolution option that is best able to achieve the objectives of an orderly resolution; and that private sources of funding have been exhausted or cannot achieve these objectives; and
ii. the allocation of losses to equity holders and of residual costs, as appropriate, to unsecured and uninsured creditors and the industry through ex post assessments, insurance premiums or other mechanisms.

As a last resort and for the overarching purpose of financial stability, the KAs indicate that some countries may decide to incorporate a power in their resolution toolkit to place a failed bank under temporary public ownership[41] and control, in order to continue its critical operations, while seeking to arrange a permanent solution such as a sale or merger with a commercial private sector purchaser. In such instance, the KAs require that provision be made to recover any losses incurred by the state from unsecured creditors or, if necessary, from the financial system more widely.[42]

To augment resolution planning, resolution authorities should conduct regular resolvability assessments to evaluate the viability and credibility of resolution plans.[43] This would include assessing: the extent to which critical financial services and payment, clearing and settlement functions can continue to be performed; the nature and extent of intra-group exposures and their impact on resolution if they need to be unwound; and robustness of cross-border cooperation and information sharing arrangements.[44]

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[35]KA 5.3.

[36]KA 5.5.

[37]Idem. See also World Bank Group (n 15) 5.

[38]KA 6.3.

[39]Patricia McCoy, 'The Moral Hazard Implications of Deposit Insurance: Theory and Evidence' (Seminar on Current Developments in Monetary and Financial Law, Washington D.C., 23–27 October 2006).

[40]KA 6.4.

[41]Temporary public ownership is the compulsory acquisition of the share capital of the financial institution (or in certain circumstance, its parent) by the State: Emilios Avgouleas, 'Banking Supervision and The Special Resolution Regime of the Banking Act 2009: The Unfinished Reform' (2009) 4 Capital Markets Law Journal 201.

[42]KA 6.5.

[43]KA 10.1.

[44]KA 10.2.

4 | BANK RESOLUTION IN SOUTH AFRICA

4.1 | Background

The South African banking sector has always been a very concentrated oligopoly and has remained so, with six large banks, accounting for a share of more than 90% of the banking sector, having been designated as domestically systemically important banks in 2019.[45] South Africa introduced formal bank regulation on a national level in 1921 under the Currency and Banking Act 31 of 1920 that established the South African Reserve Bank ('SARB') as central bank.[46] Subsequently, the Banks Act 38 of 1942 was enacted as a framework for bank regulation with the SARB as bank supervisor.[47] This Act was thereafter amended[48] and consolidated with the Building Societies Act 82 of 1986. The Banks Act was repealed by the Deposit Taking Institutions Act 94 of 1990 (that was later renamed the Banks Act 94 of 1990) and which provides the current bank regulatory framework.[49]

In the decades since its establishment, the SARB, which is publicly owned and operationally independent,[50] gained prominence as a robust bank supervisor, having joined the Bank of International Settlements ('BIS') as a member in June 1971, and in 1999 South Africa became the first African country to join the G-20.[51] The main powers and functions of the SARB are set out in section 10 of the South African Reserve Bank Act[52] read with the provisions of the Banks Act[53] and the Regulations relating to Banks.[54] Through its Bank Supervision Department, which housed the Office for Banks headed by the Registrar of Banks,[55] the SARB executed

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[45]Nedbank Ltd, Standard Bank, Absa Bank and FirstRand Bank, Investec and Capitec Bank. South African Reserve Bank, 'Financial Stability Review First Edition 2020' (2020) 39 <https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2020/9956/FSRMay2020.pdf>.

[46]The Currency and Banking Act 31 of 1920 was replaced by the South African Reserve Bank Act 29 of 1944, itself subsequently replaced by the South African Reserve Bank Act 90 of 1989; South African Reserve Bank, 'South African Reserve Bank Commemorative Publication 2011' (2012) 3–4 <www.resbank.co.za/en/home/publications/publication-detail-pages/other-publications/other-publications/2012/4987>; See also Johann De Jager, 'The South African Reserve Bank: Blowing Winds of Change (Part 1)' (2013) 25 SA Merc LJ 342.

[47]Banks Act 38 of 1942. See also Johan Moorcroft and Monica Vessio, *Moorcroft Banking Law and Practice* (LexisNexis SA, Issue 13), para 1–3.

[48]Banking Amendment Act 25 of 1947; Banking Amendment Act 41 of 1951; Banks Act 23 of 1965.

[49]Moorcroft and Vessio (n 47), para 2–1.

[50]Johann De Jager, 'The South African Reserve Bank: An Evaluation of the Origin, Evolution and Status of a Central Bank (Part 2)' (2006) 18 SA Merc LJ 274.

[51]Laurance Boulle, 'The Republic of South Africa and the G-20: Its Political, National Interests and Priorities as Member of the Process', in Wilhelm Hofmeister (ed), *G2: Perceptions and Perspectives for Global Governance* (Konrad-Adenauer-Stiftung, 2011).

[52]Section 10(v), South African Reserve Bank Act 90 of 1989, indicated that the function of the SARB was inter alia to perform the (supervisory) functions assigned by the Banks Act 94 of 1990.

[53]The Banks Act 94 of 1990.

[54]Regulations relating to Banks issued in terms of section 90, Banks Act 94 of 1990, published in Government Gazette no. 34838 of 15 December 2011 <www.gov.za/sites/default/files/gcis_document/201409/34838rg9644gon1033.pdf>.

[55]Section 3, Banks Act 94 of 1990; Johann De Jager, 'The South African Reserve Bank: An Evaluation of the Origin, Evolution and Status of a Central Bank (Part 1)' (2006) 18 SA Merc LJ 159; De Jager (n 50); Johann De Jager, 'The South African Reserve Bank: Blowing Winds of Change (Part 2)' (2013) 25 SA Merc LJ 492, 506; International Monetary Fund, 'South Africa Financial System Stability Assessment' (IMF Country Report No. 14/340, 2014) 55 <www.imf.org/external/pubs/ft/scr/2014/cr14340.pdf>; Gerda van Niekerk, 'The Role of the Central Bank in the Promotion and Maintenance of Financial Stability-A Comparative Appraisal' (LLD thesis, University of Pretoria, 2018).

comprehensive and robust supervision of South African banks until the country recently transitioned to a Twin Peaks model of financial regulation.

As a BIS member and a G20 member, South Africa has over the years aligned itself with various international standards pertaining to bank regulation. Due to its robust bank regulatory framework, the country did not suffer continuous widespread bank failures.[56] Banks failed occasionally but not too often, and failures were generally those of smaller non-systemic banks and not SIFI-banks. There were nevertheless a series of bank failures in the 1990s as well as a small bank crisis in 2003 and 2004.[57] Notably, the country operated on the basis of implicit deposit insurance, which meant that in the event of bank failure the likelihood existed, but was not guaranteed, that the failing bank would be bailed out with public funds.[58]

In terms of the Banks Act, there were until very recently, only two options to deal with bank failure: if deemed eligible, the failing bank could be placed under curatorship in terms of section 69 of the Banks Act; alternatively, it could be liquidated in terms of section 68 of the Banks Act.

Notably, section 69 of the Deposit Taking Institutions Act 94 of 1990 (subsequently renamed the Banks Act)[59] introduced the *sui generis* process for curatorship of banks in South Africa, replacing the previous court-ordered process of judicial management[60] for failing banks.[61] Curatorship provided an administrative procedure that was not unnecessarily shackled by costly, time-consuming judicial processes.[62] Its primary objective was to restore the failing bank's viability as a going concern.[63] However, not all failing banks were eligible to be placed under curatorship and generally it was applied only to banks with some systemic significance.

The Minister of Finance, acting on recommendation of the SARB, placed a bank under curatorship, and the curator took over the management of the failing bank and its assets,[64] subject to supervision by the Registrar of Banks, in such a manner as the Registrar deemed would best promote the interests of the bank's creditors and the banking sector as a whole.[65] Provision was also made for a moratorium on legal proceedings against the failing bank to afford the curator some opportunity to address the bank's problems.[66]

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[56]As observed in SARB, 'Ending Too Big to Fail: South Africa's Intended Approach to Bank Resolution' (2019) 10 <www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/resolution-planning/South%20Africa%27s%20intended%20approach%20to%20bank%20resolution%20-%202019.pdf>, bank failures in South Africa are a 'a rare event'.

[57]Charles Okeahalam, 'The Political Economy of Bank Failure and Supervision in the Republic of South Africa' (1998) 3(2) African Journal of Political Science 29, 35–38; Roy Havemann, 'Lessons From South African Bank Failures 2002 to 2014' (PhD thesis, University of Stellenbosch, 2019) 11.

[58]Corlia van Heerden, 'Deposit Protection in South Africa: Recent Developments' (2020) 35 Journal of International Banking Law and Regulation 45.

[59]Per the Deposit-Taking Institutions Amendment Act 9 of 1993, published by GN 369 GG 14626 of 10 March 1993.

[60]The previous process, judicial management, for dealing with the rescue of failing banks was contained in section 40, Banks Act 23 of 1965, as amended by section 1, Financial Institutions Amendment Act 94 of 1977. The court-based process of judicial management was a unique measure to 'rescue' failing companies introduced by the South African Companies Act 46 of 1926 and was abolished with the repeal of the Companies Act 61 of 1973, when a new 'business rescue'-procedure was introduced by Chapter 6, Companies Act 71 of 2008. See Moorcroft and Vessio (n 47), para 1–3.

[61]Okeahalam (n 57), 35–38.

[62]In *Ex Parte Registrar of Banks* 1968 (3) SA 300 (C), 301H; *Registrar of Banks v New Republic Bank Ltd* 1999 (2) All SA 459 (D), 467. Moorcroft and Vessio (n 47), para 14.1.

[63]Moorcroft and Vessio (n 47), para 14.2.

[64]Section 69(2A)(a) and (b), Banks Act 94 of 1990.

[65]ibid, section 69(2B)(a).

[66]ibid, section 69(6).

The curator had various powers, inter alia to bring or defend, civil and criminal proceedings[67], and dispose of any of the bank's assets in the ordinary course of the bank's business.[68] Apart from disposing of assets in the ordinary course of business, he could however not dispose of any of the bank's assets otherwise than in accordance with the provisions of section 54 of the Banks Act[69] or effect such a disposal unless a reasonable probability existed that the disposal would enable the bank to pay its debt or meet its obligations and become a successful concern again.[70] He could also apply to court to set aside certain dispositions made by the failing bank.[71] In addition, the Minister could grant the curator powers to: suspend or reduce the rights of creditors to claim or receive interest on money owing to them; make payments to creditors; cancel agreements to advance money or to extend any existing facility; convene creditors' meetings; negotiate settlement of claims with creditors; make and carry out any decision that would have been required to be made by way of a special resolution by shareholders; cancel any lease of movable or immovable property entered into by the bank; and cancel guarantees issued by the bank prior to its curatorship. The curatorship process was further complemented by section 69A[72] of the Banks Act that provided for a Commissioner to investigate the 'business, trade, dealings, affairs or assets and liabilities' of the bank and its associates in order to determine the causes of its failure and the parties responsible for such failure.

5 | AFRICAN BANK AND THE NEW BANK RESOLUTION TRAJECTORY

The ultimate game changer for the application of the South African curatorship process in the post-GFC landscape, which evidenced a more broad-minded and diversified approach that brought improved alignment with international standards for bank resolution, presented itself in 2014 with the failure of African Bank.[73] Although not a systemic bank in terms of size, African Bank fulfilled a niche role in the South African banking sector due to its unique business model that comprised mainly unsecured lending to approximately 3 million low-income consumers who would otherwise be foreclosed from access to credit.[74] The bank's woes began when it acquired a large furniture retailer that turned out to be a bad business decision, which put an unsustainable monthly liquidity drainage on the bank and eventually contributed to its failure and entry into curatorship.[75]

To facilitate the innovative rescue of African Bank, the Banks Amendment Act 2015[76] was hastily passed, and the curatorship process was amended by inter alia giving the curator the

[67]ibid, section 69(2B)(c) to (e).
[68]ibid, section 69(2C)(a).
[69]ibid, section 54, providing for amalgamations, mergers and arrangements, requiring the Minister of Finance's prior consent.
[70]ibid, section 69(2C)(b)(i) and (ii).
[71]ibid, section 69(2F)(a).
[72]ibid, section 69A 'Investigation of affairs of bank under curatorship'.
[73]For a detailed discussion, see Corlia van Heerden, 'The Rescue of African Bank: A Step forward in Banking Regulation in South Africa' (2017) 32 Journal of International Banking Law and Regulation 350.
[74]ibid 354.
[75]Renee Bonorchis and Chris Spillane, 'In Africa a Bright Idea in Banking Leaves a Trail of Ruin' (*Bloomberg*, 27 August 2014) <www.bloomberg.com/news/articles/2014-08-27/how-brightest-brain-kirkinis-failed-with-his-african-bank>.
[76]Banks Amendment Act No 3 of 2015, published in Government Gazette No 38942 of 29 June 2015, <https://gazettes.africa/akn/za/officialGazette/government-gazette/2015-06-29/38942/eng@2015-06-29>.

power not only to dispose of the bank's assets but also transfer its liabilities *or* dispose of any of its assets *and* transfer any of its liabilities in the ordinary course of business.[77] In seeking consent for such a transaction, other than in the ordinary course of business, the curator had to report to the Minister of Finance or the Registrar of Banks, regarding the expected effect of the transaction on the bank's creditors; whether they would be treated in an 'equitable manner'; and whether a reasonable probability existed that creditors would not suffer greater losses than would have been suffered if the bank had been wound up (thus importing the KA's NCWOL-principle). The Minister or the Registrar could however consent to the aforesaid transaction *notwithstanding* that it could prejudice the bank's creditors if such transaction was:

> reasonably likely to promote the maintenance of a stable banking sector in the Republic or public confidence in the banking sector in the Republic.[78]

Thus, the broader interest in financial stability could trump the interests of individual creditors of the failing bank.

The 2015 amendments permitted the curator to further make and carry out any decision in respect of the failing bank which would otherwise have required an ordinary resolution or a special resolution of the bank's shareholders or its controlling company—thus permitting the overriding of shareholder's rights and avoiding them blocking actions taken to facilitate effective curatorship.[79] He could also raise funding from the SARB, or any entity controlled by the SARB, on behalf of the bank under curatorship. The curator could, notwithstanding any contractual obligations of the said bank, but without prejudice to real security rights, provide security over the bank's assets in respect of such funding. He could also propose and enter into an arrangement or compromise between the bank and its creditors.[80]

Albeit that these amendments were made to section 69 of the Banks Act to augment the curatorship process, it is clear that they actually introduced features of a broader approach to bank resolution into the Banks Act that aligned it in certain respects with the FSB KAs.

6 | THE TRANSITION TO A TWIN PEAKS MODEL

After operating a silo sectoral model of financial regulation for many years, South Africa transitioned to a Twin Peaks model in 2017, captured in the Financial Sector Regulation Act 9 of 2017. Under the Twin Peaks model, a new system-wide prudential regulator, the Prudential Authority, and a new system-wide financial conduct regulator, the Financial Sector Conduct Authority, were established. The SARB is entrusted with an explicit and comprehensive financial stability mandate, captured in legislation for the first time; bank supervision has been removed from the SARB's remit and is now undertaken by the Prudential Authority.[81]

[77]ibid, section 2(a).
[78]Idem.
[79]ibid, section 2(b).
[80]ibid, section 2(d).
[81]Sections 11, 32 and 56, Financial Sector Regulation Act 9 of 2017. For more detail on the South African Twin Peaks model, see Corlia van Heerden and Gerda van Niekerk, 'The Financial Stability Mandate of the South African Central Bank in the Post-Crisis Landscape' (2018) 33 Journal of International Banking Law and Regulation 414.

7 | A COMPREHENSIVE BANK RESOLUTION FRAMEWORK FOR SOUTH AFRICA

Notably, the initiative to transition to a comprehensive resolution regime aligned with international best practice actually gained momentum at an earlier stage than the 2015 amendments to the Banks Act, pursuant to a World Bank Review in 2009–2010 of South Africa's existing framework for dealing with failing banks.[82] A subsequent thematic peer review by the FSB in 2012[83] revealed gaps in a number of areas where the South African framework did not comply with the FSB KAs. These gaps were confirmed by the IMF in its 2015 Financial Sector Assessment Program ('FSAP')[84] of South Africa.

In August 2015, the National Treasury and the SARB jointly introduced the move towards a comprehensive resolution regime with a Discussion Paper titled *Strengthening South Africa's Resolution Framework For Financial Institutions* ('SA Resolution Framework'),[85] indicating that, as a starting point, it would focus only on how resolution would apply to banks and that such regime would in due course be captured in a Special Resolution Bill.

8 | THE RESOLUTION FRAMEWORK INTRODUCED BY THE FINANCIAL SECTOR LAWS AMENDMENT ACT

8.1 | Background

When the legislative framework for South Africa's proposed resolution regime was eventually drafted, it was opted not to include it in a separate Special Resolution Bill as initially envisaged, but rather to incorporate it, together with an explicit deposit insurance scheme framework, as a new Chapter 12A, titled 'Resolution of Designated Institutions',[86] into the Financial Sector Regulation Act 9 of 2017 (being the legislation that introduced the South African Twin Peaks model) ('FSRA'). The proposed resolution framework was first published in September 2018 as part of the Financial Sector Laws Amendment Bill.[87] To facilitate a better understanding of the proposed resolution regime, the SARB's Financial Stability Department released a Discussion Paper in July 2019, titled *Ending too big to fail: South Africa's intended approach to bank resolution* ('Discussion Paper 2019').[88] A second

[82]World Bank Group (n 15).

[83]Financial Stability Board, 'Thematic Peer Review on Deposit Insurance Systems' (Peer Review Report, 2012) <www.fsb.org/wp-content/uploads/r_120208.pdf>.

[84]International Monetary Fund, 'South Africa: Financial Sector Assessment Program – Financial Safety Net, Bank Resolution, and Crisis Management Framework – Technical Note' (IMF Country Report No 2015/053, 2015), 19–-23 and 27–-31, available at: <www.imf.org/en/Publications/CR/Issues/2016/12/31/South-Africa-Financial-Sector-Assessment-Program-Financial-Safety-Net-Bank-Resolution-and-42755>; International Monetary Fund (above note 55), 8–-9, 27–-29.

[85]National Treasury Republic of South Africa, 'Strengthening South Africa's Resolution Framework for Financial Institutions' (2015) <www.treasury.gov.za/twinpeaks/Strengthening%20South%20Africa's%20Resolution%20Framework%20for%20Financial%20Institutions.pdf>.

[86]Section 51, Financial Sector Laws Amendment Act 23 of 2021 ('FSLAA').

[87]Financial Sector Laws Amendment Bill B-2018, as introduced in the National Assembly <http://www.treasury.gov.za/twinpeaks/Financial%20Sector%20Laws%20Amendment%20Bill.pdf> accessed 17 July 2021('FSLA Bill').

[88]SARB resolution approach discussion paper <https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/resolution-planning/South%20Africa%27s%20intended%20approach%20to%20bank%20resolution%20-%202019.pdf>.

draft of the Bill was published for public comment in 2020[89] and eventually enacted as the Financial Sector Laws Amendment Act 23 of 2021('FSLAA'). South Africa's first deposit insurance body, the Corporation for Deposit Insurance ('CODI') and certain provisions pertaining to the explicit deposit insurance scheme framework, will become operational in April 2024 and the resolution provisions came into effect on 1 June 2023 and are in the process of being operationalised.[90]

To wipe the slate clean, the FSLAA repealed section 68 (winding-up of banks), section 69 (curatorship of banks) and section 69A (Commission of inquiry) of the Banks Act,[91] which repeal became effective from 1 June 2023.[92] Notably, section 134 of the FSRA has been amended to provide for a standardised Commission of inquiry procedure.[93]

A high-level discussion of the main features of the proposed new resolution regime, which is intended to eventually cover all financial institutions and not only banks, is provided below, focusing on bank resolution. Notably, resolution funding and the interaction between resolution and deposit insurance will not be addressed and will be discussed in a follow-up contribution.

8.2 | Key features of the new South African Bank resolution regime

8.2.1 | Resolution authority and resolution objectives

The FSLAA amended the FSRA to inter alia.

> provide for the establishment of a framework for the resolution of designated institutions to ensure that the impact or potential impact of a failure of a designated institution on financial stability is managed appropriately.[94]

It also introduced various new definitions[95] pertinent to 'orderly resolution', which is defined as follows:

> the management of the affairs of the designated institution as provided in Chapter 12A in a way that:
> a. assists in maintaining financial stability;
> b. ensures that the critical functions performed by the designated institution continue to be performed; and
> c. in the case of a bank, protects the interests of depositors.

[89]Financial Sector Laws Amendment Bill B15-2020 <https://static.pmg.org.za/B15-2020_Financial_Sector_Laws.pdf>.
[90]Financial Sector Laws Amendment Act, 2021: Commencement of Certain Provisions, published in Government Gazette no. 48294 of 24 March 2023 ('FSLAA Commencement') <https://www.gov.za/sites/default/files/gcis_document/202303/48294gon3202.pdf>.
[91]Banks Act 94 of 1990.
[92]Section 9, FSLAA. See also FSLAA Commencement (n 90).
[93]ibid, section 49.
[94]ibid, Preamble.
[95]ibid, section 35.

The objective of the FSRA, as stated in section 7, has been expanded to include:

> the orderly resolution of designated institutions in resolution and, in connection with that, protection of depositors in banks through a deposit insurance scheme and containing the cost to the Republic of the steps taken.[96]

The SARB is the designated resolution authority. Its resolution objectives are to assist in maintaining financial stability and protecting the interests of depositors by means of orderly resolution of failing banks.[97] Although the aforesaid resolution objectives do not specifically include a reference to containing the cost of resolution, it is submitted that, given the expanded wording of section 7 of the FSRA as mentioned above, the minimisation of costs-objective can also by implication be read into section 166B of the FSRA, which sets out the resolution objectives.

8.2.2 | Resolution triggers

The Discussion Paper 2019 indicates that when it becomes likely that a South African bank will become non-viable, the SARB, Prudential Authority and National Treasury will closely cooperate to determine the appropriate course of action.[98] For SIFI-banks, the SARB will follow an open bank resolution strategy to at least initially enable the bank to continue existing under its own licence with the probability of being restructured over time. It is further intended to apply resolution of a banking group at the holding company level.[99] The resolution triggers are stated in section 166J of the FSRA, which stipulates that, if in the opinion of the SARB, a failing bank:

a. is, or will likely be, unable to meet its obligations (whether or not the said bank is insolvent); and
b. it is necessary to ensure the orderly resolution of the bank concerned to maintain financial stability; or to protect the depositors of such bank,

the SARB may recommend to the Minister of Finance to place the bank in resolution. If the Minister agrees, he will make such a written determination, directed to the Governor of the SARB.[100] The determination is then communicated to the Managing Director or Chairperson of the failing bank's board of directors and the SARB must publish each such determination albeit that the mode of publication is not specified.[101] In order to ensure that bank's creditors do not derail resolution efforts by enforcing their claims against the failing bank, in line with the KAs, placing a failing bank in resolution does not constitute a termination or acceleration event.[102]

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[96] ibid, section 36 (Author's emphasis).
[97] Sections 166A and 166B, Financial Sector Regulation Act 9 of 2017 ('FSRA'), as amended by the FSLAA. All further references will be to sections of the FSRA (as amended by the FSLAA) unless indicated otherwise.
[98] Discussion Paper 2019, 51.
[99] Discussion Paper 2019, 21.
[100] Section 166J, FSRA.
[101] ibid, section 166J(4) and (5); Non-compliance with the aforesaid subsections does however not invalidate a recommendation or determination to place a failing bank into resolution.
[102] ibid, section 166L.

Winding-up (liquidation) and any similar steps, such as, for example, suspending, varying, amending or revoking a bank's licence, require the SARB's prior concurrence; failing which, any such steps will be void.[103]

8.2.3 | SARB's resolution functions: Aspects that have to be observed

To achieve its resolution objectives, the SARB must perform its resolution functions in respect of a bank that has been placed in resolution and ensure that such bank's affairs are managed with the aim of maintaining financial stability 'as far as practicable'. To such extent, the SARB must have regard to, and seek to minimise, any adverse impact on the shareholders, creditors or other members of the group of companies of which the bank in resolution forms part. It must also comply with applicable labour laws and ensure similar compliance by the bank in resolution. The SARB 'may' further consider the possible impact that its resolution actions may have on a foreign jurisdiction where the bank in resolution is registered, but it is submitted that this should actually be cast as an obligation.[104]

Notably, the SARB intends to take a three-stage approach to resolution: Step one will entail stabilisation of the bank; the second step will entail restoring the bank's viability so that it can at least partly continue doing business as a going concern, and the third step will then entail exit from resolution.[105]

8.2.4 | Recovery and resolution planning as ex ante measures

Notably, certain requirements regarding recovery plans for banks were introduced through Directive 1/2015 that was issued by the (then) Bank Supervision Department of the SARB, specifying the minimum requirements that a bank recovery plan should meet.[106] Compliance with this requirement is currently overseen by the Prudential Authority.[107]

A provision on ex ante resolution planning has been introduced into the FSRA,[108] which stipulates that the SARB must, on the basis of risk analyses conducted in consultation with the financial sector regulators, take adequate and appropriate steps to plan for the potential need for orderly bank resolution.

8.2.5 | Valuation

As an initial step, to inform the resolution action to be taken by the SARB, the SARB will do an internal valuation of the failing Bank's assets and liabilities. However a formal valuation of the assets and liabilities of a failing bank must be done by an independent valuator *before* the SARB takes any resolution action in relation to such bank.[109] The valuation must state the amount

[103]ibid, section 166D.

[104]ibid, section 166C(1), (2) and (3).

[105]Discussion Paper 2019, 51 to 56.

[106]Directive 1/2015; National Treasury (n 85) 12; The Directive makes the requirement of a recovery plan applicable to all registered banks and controlling companies in South Africa, including locally registered branches of foreign banks.

[107]Discussion Paper 2019, 10.

[108]Section 166E, FSRA.

[109]ibid, section 166Q, FSRA, introducing Part 3 'Resolution Measures'.

that, in the valuator's opinion, would be realised from the asset, or the amount that, in his opinion, would be the amount payable on the liability, in a liquidation of the bank. As soon as practicable after a bank ceases to be in resolution, the SARB must obtain a further valuation of the assets and liabilities that were dealt with during resolution to inform whether any shareholder or creditor was actually treated worse than they would have been treated had the bank been liquidated instead of being placed into resolution. The SARB must also specify the assumptions that the valuator must make when conducting the valuation and the valuator is required to meet the requirements to be specified in a prudential standard that will be issued to ensure his independence. These valuations must be made available to the shareholders and creditors of the bank, but the time or instance at which it must be made available is not specified.[110]

8.2.6 | Resolution tools

The SARB is given various tools and other powers that it can apply during bank resolution. These include innovative tools captured in the FSB KAs, such as the bail-in tool and the use of bridge banks, as discussed in more detail below.

Transfer of assets and liabilities; amalgamation and merger; scheme of arrangement

Section 166S is titled 'Resolution action, including restructuring and bail-in'. Section 166S (1) provides that if the SARB, in consultation with the Prudential Authority, determines that it is necessary for a bank in resolution to enter into a particular transaction, then the bank may enter into that transaction, despite any law or agreement that would otherwise restrict or prevent it from doing so.[111] In this context, 'transaction' includes: transferring, creating an interest in, or dealing in any other way with the bank in resolution's assets and liabilities; and an amalgamation or merger, or a scheme of arrangement as described in the Companies Act 71 of 2008, that involves the bank in resolution.[112]

Bridge bank

Section 166F provides that the SARB may, for the purposes of exercising and performing its resolution functions, incorporate a bridge company (bridge bank)[113] that will be wholly owned by the SARB and not by the Government. As part of the measures applied during resolution, the SARB may transfer some or all of the shares that it holds in such a bridge bank to any person. The SARB is required to formulate a plan for the bridge bank to meet all requirements in terms of financial sector laws, but exemption from this requirement is provided until 'the bridge company (bank) applies for a licence in terms of the (applicable) financial law.'[114]

Notably, section 166T, titled 'Outcome of resolution actions', provides that the SARB may exercise and perform its resolution powers and associated powers in respect of a liability of the bank in resolution in a manner that results in the liability being substituted with a shareholding in the bank in resolution or in a bridge bank.

[110]ibid, section 166Q(2) to (5).

[111]This includes laws or agreements that require consent or approval by a specified person.

[112]Section 166S(2)(a) and (b), FSRA.

[113]ibid, section 1, defining 'bridge company' as 'a company incorporated in terms of section 166F'.

[114]ibid, section 166F (Words in brackets inserted by authors).

Bail-in

Provision is made for FLAC instrument to be identified in a prudential standard, which will comprise selected debt instruments that banks will be required to hold to be readily available to be bailed in for purposes of recapitalizing the bank in resolution.[115]

It should further be noted that section 166S(6) provides that despite any law or agreement, including the memorandum of association of the bank in resolution, such bank may: cancel a share of the bank that is valued, in terms of section 166Q(1), at zero value, in liquidation; and issue new shares of the bank in resolution, on terms approved by the SARB. In terms of section 166S(7), the SARB may further, by written order and upon notice to a party to an agreement with the bank in resolution, reduce the amount that is or may become payable in terms of such agreement[116]; or it may by written notice to all the other parties to such an agreement, cancel that agreement.[117] Section 166S(7) does however not apply to: an unsettled exchange traded transaction; a derivative instrument as defined in section 1 of the Financial Markets Act 19 of 2012; a deposit where the deposit holder is the Corporation for Public Deposits[118]; or a transaction in the settlement system between two or more settlement system participants as provided for in the National Payment System Act 78 of 1998.[119] Although the new resolution framework does not contain a prohibition against judicial review, it is stated that an action in terms of section 166S 'does not, by itself, give rise to any right by a party, or a person who holds an interest in, an agreement referred to in subsection (7)'.

8.2.7 | Resolution powers

Taking control

When a bank is placed in resolution, the SARB has the power to manage and control such bank's affairs, meaning the SARB can exclusively exercise any powers of the board of directors and the shareholders or a specific class of shareholders of the bank. This inter alia includes the power to convene creditors meetings for purposes of consulting with them regarding the exercise of the powers taken over by the SARB; negotiating with creditors regarding settlement of their claims against the bank in resolution; and proposing and entering into arrangements or compromises between the bank in resolution and all or certain of its creditors.[120]

The SARB will thus be responsible for the day-to-day management of a bank in resolution and may appoint a resolution practitioner to execute such function on its behalf.[121] The resolution practitioner must comply with instructions from the SARB, report to the SARB at least on

[115]ibid, sections 35, 43 and 166W.

[116]ibid, section 166S(7)(a).

[117]ibid, section 166S(7)(b). However, section 166S(8), FSRA indicates that, subject to section (7)(a), cancellation of an agreement in terms of section 166S(7)(b) does not affect rights of parties to the agreement that accrued before the date on which the cancellation becomes effective.

[118]The Corporation for Public Deposits was established by section 2, Public Deposits Act 46 of 1984.

[119]Section 166S(9), FSRA.

[120]ibid, section 166M(1) and (2).

[121]ibid, section 166O(1). The resolution practitioner exercises specified delegated powers and functions in terms of section 166I, FSRA, which provides for delegation of the SARB's resolution functions; Notably, in terms of section 166I (3), delegation of the SARB's determination to place a bank in resolution as provided for in section 166J cannot be delegated and neither can the SARB's power to delegate its resolution functions as provided for in section 166I delegated. See also Discussion Paper 2019, 19.

a monthly basis regarding his activities in relation to the bank in resolution and comply with the other terms of his appointment.[122]

Trading in shares

Section 166P(1) and (3) of the FSRA further prohibits trading shares of a bank in resolution without the (prior) approval of the SARB, failing which such share transfer will be of no effect.[123]

Moratoria

To avoid litigation by creditors that may compromise the resolution process, the SARB may issue moratoria, for a reasonable period, to suspend the failing bank's obligations in terms of the agreements it entered into before it was placed in resolution; to suspend damages claims for loss sustained; and suspend legal and arbitration proceedings.[124] As explained in the Discussion Paper 2019, moratoria will be for a limited period, which will be prescribed in a prudential standard, and will only be used in exceptional circumstances to mitigate the impact on financial stability occasioned by placing the bank in resolution.[125]

Cancellation of agreements

The SARB may also cancel an agreement that the bank entered into before it was placed in resolution but only if the agreement prefers one creditor of the bank in resolution over another creditor of the same class; if the agreement is unreasonably onerous on the bank in resolution; if it is a lease of movable or immovable property entered into before the bank was placed into resolution; or if the agreement is a guarantee issued by the bank before it was placed in resolution (excluding a guarantee that has to be honoured within 30 days after the bank was placed in resolution).[126]

Prohibition of commencement of litigation or arbitration

The SARB may further prohibit the commencement of legal or arbitration proceedings against a bank in resolution for a 'reasonable period.'[127] Such power does however not extend to enforcement of judgements.

8.2.8 | Safeguards

Pari passu treatment of creditors and shareholders

When executing a bank resolution, the private interest of creditors and shareholders cannot be disregarded. This means that the SARB's actions must also observe certain safeguards as provided for in s166U, titled 'Creditor hierarchy and equality of claims'. In terms of section 166U (1), the SARB must not take a resolution action and must ensure that a bank in resolution does not take a resolution action if it appears that the result of such action would be that the value of a claim of a creditor of the bank would be reduced. Section 166U(1) does however not apply to

[122]ibid, section 166O(4).

[123]ibid, section 166P(2) for exceptions to such prohibition.

[124]ibid, section 166R(1)(b) to (d), read with section 166(4). See also Discussion Paper 2019, 18.

[125]Discussion Paper 2019, 18.

[126]Section 166R(1)(a), FSRA, read with section 166R(2). As per section 166R(3), cancellation of an agreement does not affect the right of the parties that accrued prior to the effective date of cancellation.

[127]ibid, section 166R(1)(e), read with section 166R(5).

the claims of shareholders or if the claims of creditors and shareholders of the bank in resolution that rank lower in the creditor hierarchy have been reduced to zero.[128] In taking a resolution action, the SARB and the bank in resolution must treat claims of creditors and shareholders of the bank in resolution that would have the same ranking in insolvency, equally (pari passu). Deviation from the pari passu treatment of creditors and shareholders is permitted if the SARB determines that it is necessary to treat their claims differently to effect the orderly resolution of the bank concerned.[129]

No creditor worse off rule ('NCWOL')

Section 166V(1) provides that the SARB must not take resolution actions that would result in a creditor or shareholder of the bank in resolution receiving less than they would have received if the bank had been liquidated instead. As soon as practicable after the SARB receives a valuation in terms of section 166Q(2) as discussed above,[130] it must consider, having regard to such valuation, whether a creditor or shareholder of the bank in resolution received, in respect of resolution action taken, less than he would have received had the bank been liquidated instead. If the answer is in the affirmative, then the SARB must determine the amount of such shortfall[131] which the creditor or shareholder is entitled to recover from the bank in resolution.[132]

Creditor hierarchy

Section 166W is titled 'Ranking of claims' and stipulates that, subject to the provisions of the FSRA, claims against a bank in resolution will rank in the order provided for in the Insolvency Act 24 of 1936, irrespective of whether such claims arose before or during resolution.[133] Section 166W(2) further states that notwithstanding the provisions of any law, if a bank is placed in liquidation, the trustee or liquidator must:

a. *after payment of any preferred creditors provided for in the Insolvency Act, and before the payment of any unsecured creditors*, apply the balance of the free residue in liquidation in the payment of any claims proved against the estate in question which were covered as a covered deposit in terms of this Act with interest thereon calculated as provided for in section 103(2) of the Insolvency Act;
b. after payment of any unsecured creditors, apply the balance of the free residue in liquidation in the payment of any claims proved against the estate in question arising in connection with FLAC instruments[134] as defined in this Act; and
c. after the payment of the FLAC instruments, or if no claims in connection with FLAC instruments have been made, then after the payment of unsecured creditors, apply the balance of the free residue in liquidation in the payment of any claims proved against the estate in question arising in connection with the amounts in terms of debt instruments designated as regulatory capital in terms of a financial sector law in the order prescribed in the financial sector law.

[128]ibid, section 166U(2). In terms of section 166U(3), failure to comply with section 166U(1) does however not invalidate the action taken.
[129]ibid, section 166U(4)(a) to (c).
[130]See above section 8.2.5.
[131]Section 166V(4)(a) and (b), FSRA.
[132]ibid, section 166V(5). Section 166V(6) provides that section 166V(5) 'does not limit any claim that the creditor or shareholder may have for any additional amount'.
[133]ibid, section 166W(1).
[134]In terms of section 1, FSRA, requirements for FLAC instruments will be prescribed in a prudential standard.

Any payments effected by the trustee or liquidator in accordance with section 166W(2)(c) has to be paid in the order prescribed in the financial sector law or, if such law does not prescribe any order, they must rank equally and abate in equal proportion, if necessary.[135] Notably, section 166W(4) provides that, notwithstanding the provisions of any law, the SARB must apply any money of the bank in resolution that becomes available to the SARB to pay the cost of resolution and, subject to the provisions of the FSRA, to pay the claims of creditors that arose prior to the date on which the bank was placed in resolution.

End of resolution

In terms of section 166K, a bank ceases to be in resolution when the SARB considers that it is no longer necessary that the bank remains in resolution to maintain financial stability, or to protect its depositors. The SARB must then recommend to the Minister of Finance to revoke the determination by which the bank was placed in resolution.[136] The other instance that a bank will cease to be in resolution is when a liquidator is appointed for such bank, unless the court orders otherwise.

Liquidation

When a bank is failing, it will either be placed in liquidation or placed in resolution to preserve viable parts and critical functions. Thus, liquidation may be an option to be implemented instead of resolution, alternatively it may be an option once the bank has been placed into resolution and, for example, the residual non-viable part of the bank has to be wound up.

Section 166H incorporates provisions relating to the liquidation of a failing bank, which were previously dealt with by section 68 of the Banks Act that, as pointed out above, was repealed by the FSLAA on 1 June 2023. The SARB may thus inter alia apply to a competent court for the winding-up of a failing bank on the grounds that the bank has been placed in resolution and there are no reasonable prospects that the bank will cease to be in resolution.[137]

Costs of resolution and protections

Section 166Y provides that the SARB may recover from a bank in resolution, or from such a bank after it ceases to be in resolution, amounts that the SARB incurred in exercising and performing its resolution functions in relation to that bank while in resolution. Protection for resolution actions taken by the SARB is further provided for in section 166Z. The FSLAA also amended section 285 of the FSRA to provide several persons involved in resolution with immunities against claims for loss or damage pertaining to the exercise a power or performance of a function or duty in terms of a financial sector law.[138]

9 | CONCLUSION

Despite the significant augmentation of the curatorship procedure over the years preceding the 2008 GFC, it nevertheless transpired that in the post-GFC regulatory milieu a more

[135]ibid, section 166W(3).

[136]ibid, section 166K(2). Section 166K(3) requires each revocation of resolution of a designated institution to be published by the SARB. Failure to do so does however not invalidate the revocation.

[137]ibid, section 166H(1). See also Discussion Paper 2019, 19.

[138]ibid, section 57.

comprehensive and innovative approach to optimally deal with bank failure in South Africa was required. The work by international bodies such as the FSB, IMF and World Bank and the near-failure of African Bank proved to be the opportunity for South Africa to consider a radical redesign of its approach to dealing with bank failure. The curatorship of African Bank presented an opportune moment to introduce and test features of evolved bank resolution approach that were lacking in the South African framework. While apparently making innovative changes to the curatorship procedure, South Africa actually narrowed the gap between the limited framework for bank resolution in the Banks Act and international best practice as captured in the FSB KAs.

South Africa, as a developing country, is now at a new regulatory frontier as is evident from its recent transition to a Twin Peaks model of financial regulation. Prominent among all the changes occurring within the context of financial regulation is also the introduction of a comprehensive resolution regime and an explicit deposit insurance framework as captured in the FSRA. As appears from the overview of the new South African resolution regime, it is largely compliant with the features of the KAs discussed in this contribution albeit that certain aspects would need to be fleshed out in secondary legislative instruments to ensure greater alignment. The application of the resolution framework to a failing bank will primarily engage the SARB, National Treasury and the Prudential Authority. The objective of resolution is appropriately aimed at orderly resolution of a failing bank for purposes of broader financial system stability and depositor protection and by implication also containing the costs of resolution. The decision to nominate SARB, as central bank and lender of last resort, as resolution authority is sensible given that it is no longer directly involved in bank supervision and not as exposed to the conflict that may sometimes arise between financial stability and prudential regulation.

Important to note is that the envisaged new resolution framework is not a reactionary framework like the curatorship framework (and also the previous liquidation framework). The new resolution framework contains pro-active ex ante measures such as recovery plans as a self-correcting measure to be applied by a distressed bank, and forward-looking resolution planning to avoid haphazard decision-making during crisis times and present a structured regularly updated approach, conceptualised well in advance, to preserve a failing bank's critical functions, prevent unnecessary loss of equity and facilitate orderly resolution. Resolvability assessments will test the credibility of resolution plans and indicate in which respects they need to be augmented. The resolution authority is equipped with an internationally aligned and comprehensive suite of resolution tools and powers, including innovative measures such as bail-in and bridge banks, that will enable orderly resolution as an optimal means to deal with bank failures in South Africa albeit that consideration could be given to further augmentation of the resolution toolkit.

Resolution practitioners can be appointed by SARB to implement resolution measures. The approach that will be followed will be different from that previously followed by curators under section 69 as the resolution practitioner will be implementing a plan conceptualised in advance by the SARB (thus he will not have the carte blanche to draft a resolution plan all by himself and manage the institution that was previously attributed to a curator under section 69) and the bank concerned. Notably, the powers and tools to be implemented during such resolution will be broader than those that could be exercised by a curator.

From the SARB's Discussion Paper 2019, it is clear that the resolution regime will not be limited to dealing with systemically important banks only but will be toned down proportionately where a smaller bank enters the realm of resolution.

Although provision is made for overriding shareholder rights, safeguards that will apply during bank resolution include respect for the creditor hierarchy in insolvency during the assignment of losses and observance of the NCWOL-principle as well as safeguards pertaining to the treatment of employees, and protection for persons carrying out bona fide resolution actions. Attention should however be given to incorporate a judicial review provision that provides for compensation only. In line with the KAs, the SARB will take control of the management of the failing bank against the backdrop of a moratorium on enforcement action and some of the management powers to be exercised during resolution resemble the powers given to a curator under the previous regime such as the power to convene meetings with creditors; enter into settlement negotiations with creditors; proposing and entering into compromises with creditors; cancelling agreements and so forth. Liquidation of a failing bank will be applied either initially as alternative to resolution or to those parts of a bank in resolution that cannot be resolved. Clearly the operationalising of the resolution regime will entail further tweaks to align the regime in more respects with the KAs and, although not discussed in this contribution, it is evident that pro-active contingency planning and crisis management with a clear structure for fast, effective and efficient collaboration between role players, domestically and in host countries where South African banks have subsidiaries, will be crucial to the success of this new regime.

The introduction of the new resolution regime is a great step forward for South Africa as it will be joining the ranks of other G20-jurisdictions to ensure that the country has an augmented financial safety net that optimally deals with bank failure.

How to cite this article: Nyaude, A. B., & Van Heerden, C. (2024). Bank resolution in South Africa: Recent developments. *International Insolvency Review*, 1–23. https://doi.org/10.1002/iir.1524