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A Critical Analysis of Bank Failures in South Africa

by

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Summary

There are certain financial institutions that are considered to be systemically important financial institutions – which means that these institutions are of such a large scale that should they fail, it would disrupt the financial sector due to their complex nature and interconnectedness amongst other sectors of the economy and this could lead to bank runs and ultimately financial instability. As a result thereof, government authorities would need to step in and provide financial support to prevent the imminent threat associated with the possibility of bank failure. Thus, this dissertation aims to investigate and explore the common reasons and factors that contribute to banking institutions; inability to achieve or maintain financial stability in South Africa, subsequent to our democracy in 1994.

The dissertation will further explore the regulatory policy frameworks and the measures put in place to rescue banking institutions. The focus will be on the Banks Act. 94 of 1990, particularly section 68, which facilitates the procedure for winding up of a bank, and sections 69 and 69A, which facilitate the procedure for placing a bank under curatorship. This dissertation will also analyse the cases of African Bank and VBS Mutual Bank which recently fell into hardships, as well as the amendments implemented in terms of the Banks Amendment Act 3 of 2015.

Furthermore, the dissertation will highlight the importance of the South African Reserve Bank (SARB) and its evolution as a central bank. The changing roles of the SARB and the powers and responsibilities vested in it in terms of the South African Reserve Bank Act 90 of 1989, the Banks Act 94 of 1990, the Constitution of South Africa Act, 1996 and the Financial Sector Regulation Act 9 of 2017 will be explored in so far as the financial stability mandate is concerned. And finally, the new developments in the South African financial sector will be discussed: the shift to a Twin Peaks model, the Financial Sector Regulation Act and the powers of the Resolution Authorities.

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I would like to appreciate my supervisor, Professor Reghard Brits for his guidance and assistance towards the successful completion of this dissertation.

Abbreviations

ABIL	African Bank Investment Limited
BSD	Bank Supervision Department
CDO	Collateralized Debt Obligations
FSB	Financial Stability Board
FSCA	Financial Sector Conduct Authority
FSR Act	Financial Sector Regulation Act 9 of 2017
GFC	Global Financial Crisis that occurred between the periods 2007 - 2008.
NCA	National Credit Act 34 of 2005
PA	Prudential Authority
SARB	South African Reserve Bank
SIFIs	Systemically Important Financial Institutions
USA	United States of America
VBS	Venda Burial Society Mutual Bank

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Chapter 1:
General introduction

1.1 Introduction

The financial industry, in particular the banking sector, plays a significant role in developing the economy of South Africa. Banking institutions are at the centre of the financial realm: firstly, they operate as depositories for people and institutions that desire to save their funds and receive accrued interest on such deposits and secondly, they operate as a bridge between those with funds to invest and those who are in need of funds, as such deposits become available for purposes of lending and giving advancements, which plays a critical role in growing a financially sound economy, especially within a developing country.[1] In essence, the core business of a bank involves performing a variety of roles such as providing payment facilities, taking deposits and serving as a lending intermediary.[2] Although the day-to-day functions of a bank may seem simplistic, the risks that come with running this type of business makes it rather complicated.

The South African banking industry has various participants who are role players that contribute towards a sound financial system holistically; however, it is evident that the most successful and dominant role players within the banking industry are Standard Bank of South Africa, First Rand Bank, Amalgamated Bank of South Africa (ABSA), Nedbank Group and Investec.[3]

South Africa's financial sector regulation and supervision frameworks have developed over the years to adopt an efficient and financially sound financial system which ranks favourably amongst the regulatory frameworks of industrialized countries.[4] For this reason, the South African financial sector is highly ranked amongst the international financial sectors – becoming a point of attention as a high number of foreign banking institutions have established offices in the South Africa.

[1] The Banking Association of South Africa 'The Banking Association South Africa Submission on Transformation in the Financial Sector' March 2017 accessible on http://pmg-assets.s3-website-eu-west-1.amazonaws.com/170314BASA.pdf (accessed on 20 May 2018).
[2] AP Faure 'Banking: An introduction' (2013) 8-9.
[3] Businesstech 'South Africa's biggest banks still dominate despite competition' July 2019 accessible on https://businesstech.co.za/news/banking/325555/south-africas-biggest-banks-still-dominate-despite-competititon/ (accessed on 30 August 2019).
[4] The Banking Association of South Africa (n 1 above) 3.

While it is evident that the core banks are performing remarkably well, a number of small to medium banking institutions have proven to have difficulties in maintaining financial stability, which ultimately leads to them not being able to fulfil their obligations. One of the reasons for this may be that smaller banking institutions do not have safety nets, in the sense that government authorities and/or regulators are more prone to guarantee the continued existence of the core banking institutions as the downfall of a smaller banking institution is unlikely to cause systematic destabilization within the economy. According to Norcross,[5] banking institutions do not fail in isolation, but rather, in a crisis failure – where such a failure expands throughout other financial institutions even during a boom in the economy. He further explained that bank failures often occur as a result of poor management or fraudulent activities, and due to the interconnectedness in the financial sector, such bank failures could create adverse spill-over effects across the globe.[6]

1.2 The 2007 to 2008 Global Financial Crisis

Between the years 2007 and 2008, the Global Financial Crisis (GFC) emerged due to the significant plunge in value of properties in the United States of America (USA). There was a recession in the value of sub-prime mortgages and investors no longer believed in the efficiency of the system and as a result a liquidity crisis arose.[7] A credit crunch began in the US sub-prime mortgage market, when people who had low or moderate incomes were issued with mortgages. This essentially means that unlike the procedures and requirements followed to obtain a conventional prime mortgage, acquiring sub-prime mortgage did not require credit checks, down payments or adducing proof of income to illustrate your capabilities to repay the mortgage loan. This type of procedure tends to deteriorate the standards of lending. Owing to the risks associated with sub-prime mortgages, lenders (financial institutions) sought to protect themselves by converting the sub-prime mortgages into collateralized debt obligations (CDO) and in turn, sold them through the process of securitization to investors.[8]

[5] RW Norcross Jr 'The Bank Insolvency Game: FDIC Superpowers, the D'Oench Doctrine, and Federal Common Law'(1986) 103 Banking Law Journal 316 316-317.
[6] Norcross (n 5 above) 316 -320.
[7] J Davies 'Global Financial Crisis – What caused it and how the world responded' June 2018 accessible on https://www.canstar.com.au/home-loans/global-financial-crisis/ (accessed on 22 July 2018).
[8] R Baxter 'The global economic crisis and its impact on South Africa and the country's mining industry - Challenges for Monetary Policy-makers in Emerging Markets' (2009) 105 105-106.

It soon became evident that the borrowers were failing to meet their payment obligations to the banks and as such, a liquidity crisis began to ensue in the US economy which eventually spiralled rapidly across the global credit market. [9] Immovable properties (houses) were utilized as collateral in order to acquire a mortgage financing. Due to the increase of borrowers defaulting on their mortgage, the lenders (financial institutions) foreclosed the mortgage properties. This meant there was an increase in the number of properties that still needed to be bought in the market and not a sufficient number of people who were financially able to purchase, which created an excess supply. Therefore the values of the properties began to decline and the lenders sought to raise the interest rates in an attempt to be a position to meet their payment obligations to their investors. This unfortunately led to an increasing number of borrowers defaulting on their mortgage payments. Investors suffered tremendous losses, to a point where they were unwilling to acquire more CDOs as this was proven to be a high risk.[10] Due to the concerns and distrust they had in the financial system, investors along with depositors began to withdraw their funds simultaneously, leaving a number of financial institutions vulnerable and susceptible to severe liquidity problems.[11]

The adverse effects of the GFC were a testament to the high level of interconnectedness amongst the world's financial markets, as a number of investment banks in countries such as Australia and Europe suffered tremendous losses. The global credit markets became stagnant as lenders were unwilling to lend to one another, out of fear and uncertainty that their competitors' bad debts may be uncollectable.[12] These problems set off a domino effect as depositors and investors lost faith in the soundness and reliability of the financial industry, including the credit markets. According to Lastra,[13] the GFC evolved as a result of the combination of poorly structured monetary policy frameworks, macroeconomic imbalances, unforeseen financial innovations, and the increased number of lenders defaulting on their mortgage premiums in the USA illustrated just how fractured the regulation system in the financial sector was. The GFC was the most devastating financial crisis

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[9] The South African Reserve Bank: Annual Report 2007 Accessible on https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/3990/Chapter+1[1].pdf (accessed on 1 June 2018).
[10] Baxter (n 8 above) 105.
[11] Baxter (n 8 above) 105 - 106.
[12] Baxter (n 8 above) 105 - 106.
[13] RM Lastra 'Cross-Border Bank Insolvency' (2011) 2-3.

to have occurred in the USA since the previous Great Depression. However, it paved the way for improvements to be made in the USA financial regulation system and the world at large to develop their regulation systems that can foresee, monitor or prevent any further catastrophes that may arise.[14]

South Africa seemed to have survived the adverse effect arising from the GFC relatively well. The South African banking sector was not, from a broader view, adversely affected to a large extent by the turmoil in the international markets. The effects of the GFC were negligible due to the reality that the South African financial industry is not directly linked to the subprime mortgage market. Even though no serious issues arose for the South African banking sector, the commodity price shocks in the markets did affect the banking industry's revenue.[15] The International Monetary Fund (IMF) were of the view that as a result of the financial ties with other countries of the world, South Africa, Nigeria, Ghana, and Kenya would be adversely affected by the GFC and there would be a significant decline in the markets, capital movements, and strains on exchange rates. Furthermore, South Africa limited the borrowing of funds from other countries to finance financial institutions during the GFC.[16]

The GFC had revealed issues that impacted South Africa's economy such as a recession in the export market along with vehicle sales, while the manufacturing sector abruptly decreased in production and the mining sector was not performing well in response to the GFC.[17] As a result, economic growth was expected to decline and this threatened the lifeline of economic stability in South Africa. Notwithstanding the turmoil experienced, the South African financial system remained stable because there was a negligible level of external debts, strengthened and robust regulations, monetary and prudential policy frameworks, and residual exchange controls on citizens, which shielded the country from a full-scale banking crisis that took place in countries such as the United Kingdom and Europe. Nevertheless, some domestic banking institutions did experience monetary strains because there was a significant decline in obtaining advancements and credit extensions.[18]

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[14] RJ Shiller 'The Subprime Solution: How Today's Global Financial Crisis Happened, and What to Do about It' (2008) 22.
[15] The South African Reserve Bank - Annual Report 2007 (n 9 above).
[16] International Monetary Fund 'Impact of the Global Financial Crisis on Sub-Saharan Africa' (2009) 3-4.
[17] Baxter (n 8 above) 112.
[18] V Padayachee 'Global economic recession: effects and implications for South Africa at a time of political challenges, Claves de la Economia Mundial University of KwaZulu-Natal,Durban' (2012) accessible on

In South Africa, the procedure to obtain credit is regulated due to credit providers' failure to maintain the principle of responsible lending, which often left consumers indebted to them.[19] One of the important statutes that played a part in shielding the financial system of South Africa in the midst of the GFC crisis is the National Credit Act 34 of 2005 (NCA). The NCA's objectives are, *inter alia*, to promote responsibility in the credit market by encouraging credit providers to borrow responsibly and discouraging reckless credit approvals to consumers who will not be in a position to repay such credit.[20] There are also certain regulations that need to be complied with prior to a credit provider concluding a credit agreement with a potential customer for the approval of a credit extension. Firstly the prospective consumer would have to undergo a credit assessment based on the information he or she will provide to the credit provider to ascertain his or her ability to repay the credit extension.[21] Secondly, the prospective consumer must understand and appreciate the risk and costs associated with applying for a credit extension.[22] And thirdly, factors such as the prospective consumer's previous debt re-payment records, financial means and obligations must be taken into account.[23]

Baxter argues that despite South Africa having survived the GFC relatively well, a number of sectors and companies sought to protect themselves and moved into 'survival mode' in fear of the adverse effects stemming from the GFC.[24] He adds that if these financial institutions are assisted financially by the government to continue their existence, then a large number of South African citizens will gain employment in the labour sector.[25] Thus, the main notion is to cultivate the private sector with the intent to create and preserve employment and ultimately grow the South African economy.

http://www2.lse.ac.uk/internationalDevelopment/20thAnniversaryConference/ImpactoftheGlobalFC.pdf (accessed on 26 June 2018).

[19] M Kelly-Louw 'Introduction to the National Credit Act' (2007) 15(4) Juta Business Law 147 147-148.

[20] S 3(c) of the NCA.

[21] S 81(1) of the NCA.

[22] S 81(2)(a)(i) of the NCA.

[23] S 81(2)(a)(ii) & (iii) of the NCA.

[24] Baxter (n 8 above) 114-115.

[25] Baxter (n 8 above) 114-115.

1.3 Bank failures in South Africa post 1994

The demise of a financial institution has the potential to adversely implicate the financial, economic and political sectors.[26] South Africa has had its share of distressed banks over the years since 1994. The table below provides a schedule of failed banks, the causes and outcomes thereof post South Africa becoming a democracy in 1994.[27]

Table 1

Bank Institution	Principal causes	Outcome
1994		
Alpha Bank Limited	1. Severe financial problems. 2. Poor management 3. Cash-flow problems. *Note: The SARB intervened by providing a cash injection of approximately R150 000 000 in the attempt to protect Alpha Bank's depositors, however, the bank was unable to repay the said amount*	Placed under curatorship on 21 September 1990. Subsequently, a Court order for final liquidation was issued on 30 March 1994.
Prima Bank Limited	1. Liquidity problems due to a large number of non-performing loans. .[28]	A Court order for final liquidation was issued on 29 July 1994.
1995		
The African Bank Limited	1. Liquidity problems 2. Poor management 3. Inadequate capital	Placed under curatorship on 8 September 1995
1996		
Community Bank	1.Liquidity problems	Placed under curatorship on 13 May 1996
1997 - 1998		
Islamic Bank Limited	1. High level of unsecured lending that ultimately lead to liquidity problems 2. Poor management	Court order for Provisional liquidation was issued on 21 November 1997 Court order for final liquidation was issued on 13 January 1998

[26] C Okeahalam 'The political economy of Bank failure and supervision in the Republic of South Africa' (1998) 3(2) African Journal of Political Science 29 48. Accessible on http://pdfproc.lib.msu.edu/?file=/DMC/African%20Journals/pdfs/political%20science/volume3n2/ajps003002004.pdf (accessed on 8 February 2020).

[27] This information was obtained from the Annual Reports (Appendices) for the period 1994 to 2018 from the South African Reserve bank website.

[28] Okeahalam (n 26 above) 36 -38.

<table>
<tr><td colspan="3">Deregistered Banks for the period 1997 - 1998</td></tr>
<tr><td colspan="3">1. NBS Bank Limited - 1 October 1997
2. Syfrets Bank Limited - 1 October 1997;
3. Unibank Savings and Loans Limited - 14 August 1998
4. Barclays Bank of South Africa Limited - 26 March 1998;
5. BOE Investment Bank Limited - 1 October 1998;
6. BOE Private Bank & Trust Company Limited - 1 October 1998;
7. Investec Bank Limited - 31 March 1997;</td></tr>
<tr><th>Bank Institution</th><th>Principal causes</th><th>Outcome</th></tr>
<tr><td colspan="3">1999</td></tr>
<tr><td>FBC Fidelity Bank Limited</td><td>1. Liquidity problems.
2. Poor management</td><td>Placed under curatorship on 25 October 1999.

Note: Majority of the bank was transferred to Peoples Bank Limited.</td></tr>
<tr><td colspan="3">Deregistered Banks in 2000</td></tr>
<tr><td colspan="3">1. Bank of Taiwan (South Africa) Limited - 30 June 2000
2. McCarthy Bank Limited - 21 July 2000
3. Ons Eerste Volksbank - 15 June 2000.</td></tr>
<tr><th>Bank Institution</th><th>Principal causes</th><th>Outcome</th></tr>
<tr><td colspan="3">2001</td></tr>
<tr><td>Regal Treasury Private Bank Limited</td><td>1. Poor management</td><td>Placed under curatorship on 26 June 2001. Subsequently, A Court order for final liquidation was issued on 10 February 2004 for Regal Treasury Private Bank Limited.</td></tr>
<tr><td colspan="3">Deregistered Banks between the period 2001 - 2013</td></tr>
<tr><td colspan="2">1. LBW on Long Limited - 28 December 2001;
2. Morgan Guaranty Trust Company of New York - 10 November 2001;
3. Southern Bank of Africa Limited - 4 April 2001;
4. TNBS Mutual Bank - 5 February 2001;
5. Brait Merchant Bank Limited - 30 September 2002;
6. Cadiz Investment Bank Limited - 15 April 2002;
7. Corpcapital Bank Limited - 28 November 2002;</td><td>16. Cape of Good Hope Bank Limited - 21 February 2003;
17. ING Bank N.V. South Africa Branch - 7 July 2003;
18. Nedcor Investment Bank Limited - 21 February 2003;
19. PSG Investment Bank Limited - 30 May 2003;
20. RMB Asset Finance Bank Limited - 28 July 2003;
21. Securities Investment Bank Limited - 18 February 2003;
22. Unibank Limited - 31 March 2003;
23. Gensec Bank Limited – 21 June 2004;</td></tr>
</table>

<table>
<tr><td colspan="2">8. FirstCorp Merchant Bank Limited - 17 April 2002;
9. International Bank of Southern Africa Limited - 30 April 2002;
10. Merrill Lynch Capital Markets Bank Limited - 5 April 2002;
11. PSG Investment Bank Limited - 31 October 2002;
12. Old Mutual Bank Limited - 17 December 2002;
13. TA Bank of South Africa Limited - 5 April 2002;
14. African Merchant Bank Limited - 30 September 2003;
15. BOE Bank Limited - 21 February 2003;</td><td>24. MLS Bank Limited – 1 April 2004;
25. New Republic Bank Limited – 30 January 2004;
26. Saambou Bank Limited – 30 April 2004;
27. Peoples Bank Limited – February 2005;
28. Barclays Bank plc (South Africa Branch) - 30 June 2006;
29. Commerzbank Aktiengesellschaft - 31 July 2009;
30. Meeg Bank Limited - 16 September 2009;
31. Imperial Bank Limited – 1 October 2010;
32. The Royal Bank of Scotland NV - 31 January 2011;
33. Credit Agricole Corporate and Investment Bank (South Africa Branch) – 19 October 2012;
34. The Hongkong and Shanghai Banking Corporation Limited - 31 March 2013.</td></tr>
<tr><th>Bank Institution</th><th>Principal causes</th><th>Outcome</th></tr>
<tr><td colspan="3">2014</td></tr>
<tr><td>African Bank Limited</td><td>1. Liquidity problems.
2. Poor management</td><td>Placed under curatorship on 10 August 2014</td></tr>
<tr><td colspan="3">Deregistered Banks in 2016</td></tr>
<tr><td colspan="3">1. African Bank Limited (1975/002526/07) - 4 April 2016</td></tr>
<tr><th>Bank Institution</th><th>Principal causes</th><th>Outcome</th></tr>
<tr><td colspan="3">2018</td></tr>
<tr><td>VBS Mutual Bank</td><td>1. Severe liquidity problems.
2. Poor management (Corrupt management)</td><td>Placed under curatorship on 11 March 2018.

Court order for final liquidation was issued on 13 November 2018</td></tr>
</table>

The above table indicates that since 1994, the factors that contributed most to bank failures in South Africa arose from credit risk, liquidity risk, bank regulation, inefficient management, capital requirements and external economic factors. It has also become evident from the table that when banking institutions fell into hard times, the central bank, the SARB, would intervene in an attempt to salvage that particular banking institution from complete shutdown. The financial sector significantly contributes to the

development of the economy and maintaining public confidence.[29] For this reason it is important that banking regulations be strengthened in order to deter any possible banking failures in future.

1.4 The purpose of this dissertation

The dissertation intends to uncover the reasons why banking institutions have failed since South Africa became a democracy in 1994, and to that end, specifically to analyse the African Bank and VBS Mutual Bank case to establish how they arrived to their financial woes. The study will further look into the available mechanisms to mitigate bank failures in South Africa, more particularly in terms of section 68 of the Banks Act 94 of 1990, which facilitates the procedure for the winding-up of a bank (which will be dealt with briefly), and sections 69 and 69A, which facilitate the procedure for placing a bank under curatorship, as well as to review regulations put in place to supervise banks in order to establish to what extent these measures been helpful. The changing roles of the SARB and the powers and responsibilities vested to it in terms of the South African Reserve Bank Act 90 of 1989, the Banks Act, the Constitution of South Africa, 1996 and the Financial Sector Regulation Act 9 of 2017 will be explored, particularly with reference to the financial stability mandate.

In this dissertation it will be noted that bank failures are inevitable and government authorities or financial regulators cannot be held liable for such failures. However, they can take pro-active steps to identify, monitor and supervise the risks that arise from such failures. Therefore, the new developments in the South African financial sector will be discussed, including the move towards a Twin Peaks model, the promulgation of the Financial Sector Regulation Act and the powers vested in the Resolution Authority to ensure the effectiveness and efficiency of the bank resolution.

[29] A Maredza & S Ikhide 'The Impact of the Global Financial Crisis on Efficiency and Productivity of the Banking System in South Africa' Economic Research Southern Africa working paper 328 (January 2013) 2.

Chapter 2:

The South African financial legal framework – mechanisms available to financially distressed banking institutions

2.1 Introduction

Banking institutions are of a *sui generis* nature and due to the significant role they play in the enhancement of an economy; extensive regulatory frameworks are imposed on them to ensure the continuation of their critical functions and shared services in the interest of a stable and sound financial system.[30] Despite the regulatory frameworks put in place, the GFC was one of the hurdles that illustrated how high the level of interconnectedness in the financial realm was. Furthermore, the GFC revealed that a vast majority of countries lacked sufficient and responsive regulatory frameworks to deal with distressed banking institutions. Moreover, there was not an effective system that could identify and monitor the probability of systemic risks and as a result, the consequences of failing banking institutions could not be contained in an expeditious fashion. After the GFC, it became evident that bank failures are inevitable and there was a need to establish a more efficient global financial regulatory framework that would be capable of meeting the shortfalls and would be able to identify, monitor and manage any threats that may arise to disrupt the stability of the financial systems worldwide.

The financial regulation framework that was previously in operation was the single-regulator approach, wherein a particular regulator was tasked with the responsibility to monitor and supervise, and was solely responsible for the conduct of both the prudential regulation and the business affairs for all financial institutions that provide services to consumers.[31] Therefore, the banking institutions, insurance institutions, other financial institutions and capital markets were regulated by their own separate regulators,[32] but due to a lack of synchronization this approach was quite

[30] Okeahalam (n 26 above) 29-48.
[31] Department of National Treasury 'A safer financial sector to serve South Africa better' February 2011 accessible on http://www.treasury.gov.za/twinpeaks/20131211%20-%20Item%202%20A%20safer%20financial%20sector%20to%20serve%20South%20Africa%20better.pdf (accessed on 19 May 2019).
[32] Department of National Treasury, The South African Reserve Bank & The Financial Sector Conduct Authority 'Strengthening South Africa's Resolution Framework For Financial Institutions' August 2015 accessible on

problematic. There were issues in relation to the possibility of a conflict of interest because a particular regulator was solely in charge of both the financial regulation and market behaviour. Furthermore, these sectors often do not seek the same objectives: on the one hand, market conduct regulation is more concerned with the needs of the customer and maintaining public confidence, while the prudential regulation focuses more on the interests of the business and ensuring that proper financial practices are adopted. The Financial Regulatory Reform Steering Committee[33] was of the opinion that the government did not want to become complacent and proposed that the financial regulation framework in South Africa should shift towards the Twin Peaks model.[34]

2.2 The operation of the Twin Peaks model in South Africa

The concept of the Twin Peaks model as a regulatory framework was initially proposed by Michael Taylor in 1995, with the intent to advance the supervision aspect of the financial regulation system in the United Kingdom, as a number of developed economies, including that of the United Kingdom, were failing to persevere through the fast changing financial system over time.[35] The Twin Peaks model is composed of two separate regulatory bodies: The prudential regulation – which is responsible for monitoring and encouraging good financial practices to financial institutions that offer services to consumers; and the market behaviour regulation – which is in charge of the efficiency of the financial system along with the protection of financial consumers, through regulating the manner in which these institutions conduct their business. Taylor was of the view that when regulating the financial sector, two objectives should always be borne in mind: firstly, to maintain and preserve the stability of the financial system and secondly, protecting consumers and/or investors against incompetence, fraudulent activities and abuse of market power by the financial institutions.[36]

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http://www.treasury.gov.za/twinpeaks/Strengthening%20South%20Africa%E2%80%99s%20Resolution%20Framework%20for%20Financial%20Institutions.pdf (accessed on 15 August 2019)

[33] The committee comprised of senior official from three important financial regulatory institutions: The South African Reserve Bank, the Financial Sector Conduct Authority (previously known as the Financial Services Board) and the National Treasury.

[34] Department of National Treasury 'Implementing a twin peaks model of financial regulation in South Africa' February 2013 accessible on http://www.treasury.gov.za/twinpeaks/20131211%20-%20Item%203%20Roadmap.pdf (accessed on 19 May 2019).

[35] M Taylor 'Twin Peaks: A Regulatory Structure for the New Century' (1995) 1-18.

[36] Taylor (n 36 above) 1-18.

The introduction of the Twin Peaks model as a possible regulatory framework came to public knowledge when the Minister of Finance made his budget speech in 2011.[37] Subsequent thereto, the Financial Sector Regulation Bill was introduced with the objective to improve the financial segment to encourage good financial practices.[38] Because South Africa forms part of the G-20,[39] it strived to implement the international financial standards proposed after the GFC by incorporating a framework that will be in a position to assess its domestic financial systems to ensure its efficiency and soundness.[40]

The Twin Peaks model in South Africa is quite unique compared to the original model as it comprises of three peaks:

1. The market conduct regulator – the Financial Sector Conduct Authority (FSCA) who is tasked with the responsibility to supervise the behaviour of financial institutions, maintain market integrity, protect clients of such institutions and maintain trust in the financial system. The FSCA regulates as well as supervises financial institutions that are registered financial services providers, such as insurers, financial advisors and financial intermediaries.[41] Furthermore, the National Credit Regulator (NCR) will be in charge of regulating market behaviour in respect of credit extensions.[42]

2. The prudential regulator – the Prudential Authority (PA), a separate juristic entity that is situated within the SARB. The PA is tasked with the responsibility to improve and develop the prudential safety and soundness of regulated financial intuitions, such as banks and insurers.[43]

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[37] Department of National Treasury 'Implementing twin peaks model regulation in South Africa' July 2016 accessible on http://www.treasury.gov.za/comm_media/press/2016/20160721%20-%20Media%20Statement%20on%20Twin%20peaks.pdf (accessed on 28 April 2019).
[38] Department of National Treasury 'Financial Sector Regulation (Twin Peaks) Bill' August 2015 accessible on http://pmg-assets.s3-website-eu-west-1.amazonaws.com/150811Twin_Peaks.pdf (accessed on 12 September 2018).
[39] E Denters 'Regulation and supervision of the global financial system. A proposal for institutional reform' (2009) 1(3) Amsterdam Law Forum 63-65.
[40] Department of National Treasury 'Implementing a twin peaks model of financial regulation in South Africa' February 2013 accessible on http://www.treasury.gov.za/twinpeaks/20131211%20-%20Item%203%20Roadmap.pdf (accessed on 19 September 2019).
[41] J De Jager 'The South African Reserve Bank: Blowing winds of change (Part 2)' 2013 25 South African Mercantile Law Journal 492 508.
[42] Department of National Treasury (n 40 above) 18.
[43] G Van Niekerk & C Van Heerden 'Twin Peaks: the role of the South African central bank in promoting and maintaining financial stability' 2017 80 Tydskrif vir Hedendaagse Romeins-Hollandse Reg 636 642.

3. The SARB will be accountable for the overall express and comprehensive financial stability mandate within the financial sector.[44]

2.3 The roles of the SARB as a central bank

The SARB is an independent non-commercial and non-profit maximizing legal juristic person that is governed by the SARB Act.[45] Unlike ordinary companies, the SARB is non-competitive, meaning it does not utilize its advantageous monopolistic position to its benefit and to the detriment of other banks.[46] The SARB, in accordance with the provisions set out in the Constitution of the Republic of South Africa, 1996 (the Constitution)[47] and the SARB Act, serves as the central bank of the Republic and its powers are provided in the SARB Act. Therefore, its authority is limited to the scope of the SARB Act. The SARB's main purpose is to safeguard the rand currency for the benefit and development of the country. This objective is emphasized in both the Constitution and in the SARB Act.[48]

Furthermore, it is firmly established within the Constitution that, while working towards its main goal, the SARB must carry out its duties autonomously and without intimidation, bias or injustice and is required to consult the Minister of Finance regularly.[49] The SARB has a unitary board structure that comprises of government officials, the Board of management and directors appointed by its shareholders.[50] Since the government is involved, the SARB has its independence entrenched in the Constitution in order shield it from any political influence. On the other hand, its independence is entrenched to prevent the SARB from diverging from its public interest goals.

[44] Van Niekerk & Van Heerden (n 43 above) 642.
[45] The South African Reserve Bank Act No. 90 of 1989. This Act was established into law on 1 August 1989 and was aimed at consolidating the laws regulating the SARB; the financial system of South Africa and any matters in connection thereof.
[46] J De Jager 'The South African Reserve Bank: an evaluation of the origin, evolution and status of a central bank (Part 1)' (2006) 18 South African Mercantile Law Journal 159 161.
[47] S 223 of the Constitution provides that the SARB is the central bank of South Africa.
[48] S 224(1) of the Constitution, along with S 3 of the SARB Act.
[49] S 224(2) of the Constitution.
[50] De Jager (n 47 above) 170.

It is commonly established worldwide that the formation of a central bank would be to maintain financial stability and in doing so, preserve the worth of its currency.[51] Insofar as the idea to develop the financial stability is concerned, the SARB Act does not explicitly make provision for the SARB to regulate the financial stability of the country. It was thus important that amendments be made and the SARB be given explicit powers and responsibilities to enhance, foresee and monitor the well-being of the financial institutions.[52]

The Financial Sector Regulation Act[53] (FSRA) came into effect in August 2017 and this piece of legislation brought about major changes in South Africa's financial services regulatory and risk management frameworks, including moving to a Twin Peaks model. The FSRA brought about big changes by conferring powers and responsibilities on the SARB to actively promote financial stability throughout the financial industry and the markets.[54] The FSRA defines the concept of "financial stability" as follows:

> "(a) institutions offering financial products and services without disruption;
> (b) institutions in a position to regularly offer financial products and services without disruption regardless of external economic changes; and
> (c) assurance in the capability of the institutions to carry on offering financial products and services without disruption regardless of external economic changes;."[55]

2.3.1 The financial stability mandate

Central banks are generally accepted to be the most suitable institutions that will possess the necessary skills and capabilities to ensure systemic stability within an economy. Therefore, it was no surprise that the SARB was appointed as the appropriate authority to oversee the financial stability mandate[56] in South Africa, along

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[51] B Bekink & C Botha 'The role of a Modern Central Bank in Managing Consumer Bankruptcies and Corporate Failures: A South African Public-Law Angle of Incidence' (2009) 21 South African Mercantile Law Journal 74 84.

[52] C Stals 'Mr. Stals looks at the role of central banks in today's economies and discusses the experience of South Africa' April 1997 accessible on https://www.bis.org/review/r970514a.pdf (accessed on 19 January 2019).

[53] Financial Sector Regulation Act 9 of 2017.

[54] Chapter 2 of the FSRA imposes a mandate on the SARB to preserve and maintain stability in the financial system. In the event that a systemic event is likely to compromise and disrupt the financial stability of South Africa, the SARB must resuscitate the soundness of the financial stability. In addition to this, the SARB must also supervise the state of the financial system and possible risks that may pose a threat to financial stability.

[55] S 4(1) of the FSRA 9 of 2017.

[56] De Jager (n 41 above) 499.

with its other responsibilities in respect of the micro and macro prudential supervision, and maintaining price stability within the Republic.[57] With its additional mandate to preserve the state of the financial system, the SARB needs to promote good banking practices amongst the banking institutions.

2.3.2 The overseer and supervisor of financial services and institutions

The SARB had a Bank Supervision Department (BSD) that was in charge of regulating the banking industry for the benefit of depositors and the financial system.[58] This was achieved through monitoring and supervising the financial risks that banking institutions undertake. This process is achieved by making use of the international regulatory and supervisory standards (mainly prudential) and the necessary skills and qualifications possessed by the board of management, risk assessments, execution and continuous improvement on the supervisory plan customized to suit the risk profile of the banking institution.[59] Therefore, this process prepared the SARB to be sound and strong enough to survive during economic downswings. Subsequent to the reforms in the regulation framework and the promulgation of the FSRA, the BSD was dissolved and the Prudential Authority was established to assume the mandate of regulating the prudential affairs of financial institutions and the market.[60] It is also important to note that both the PA and FSCA are required to provide support and work in collaboration with the SARB in maintaining overall the macro-prudential and micro-prudential regulations of the financial system of South Africa.[61]

2.3.3 Lender of last resort

Central banks have always been entrusted with the role of providing financial assistance to financial institutions in distress, after all other avenues have been exhausted.[62] The SARB is no stranger to this responsibility as one of its roles entails

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57 Department of National Treasury 'Implementing a twin peaks model of financial regulation in South Africa' February 2013 accessible on http://www.treasury.gov.za/twinpeaks/20131211%20-%20Item%203%20Roadmap.pdf (accessed on19 May 2019).

58 De Jager (n 41 above) 506-507.

59 WG Schulze 'The Sources of South African Banking Law – A Twenty-first Century Perspective (Part I)' (2002) 14 South African Mercantile Law Journal 438 441.

60 Van Niekerk & Van Heerden (n 43 above) 642.

61 Van Niekerk & Van Heerden (n 43 above) 642.

62 JJ De Jager 'Central Bank, lender of last resort assistance: An elusive concept?' (2010) 43(2) De Jure 228 232.

being a lender-of-last-resort to financial institutions that are experiencing hardships.[63] This essentially means that when a banking institution is experiencing financial difficulties, and exceptional circumstances exist for financial assistance, the SARB is required to step in and diffuse the adverse effects that the distressed banking institution may have on its investors, depositors and possibly the financial system by extending credit (which is essentially taxpayers' money) in the event of inadequate financial liquidity.[64] It must be noted that financial assistance from the central bank is provided to financial institutions with the sole purpose to safeguard the financial system from systemic risks. Many central banks, especially the ones in advanced economies, exercised this role during the 2008 GFC as a vast number of large financial institutions who were recognised as systemically important financial institutions (SIFIs) were on the verge of collapsing.[65]

Domanski, Moessner and Nelson note that "lender of last resort" funding is also known as emergency liquidity assistance (ELA).[66] Therefore, financial assistance from the central bank is not guaranteed to all financial institutions facing difficulties, however, it is granted to financial institutions that don't have adequate liquidity levels and is likely to pose a threat to the stability of the financial system should it fail. Gavin and Hausmann were of the view that a financial institution is vulnerable when relatively small blows to profits, asset quality, or liquidity levels place the institution in a position where it is unable to fulfil its monthly obligations to its debtors, thereby conducting an act of insolvency.".[67] However, it should be noted that there has been some criticism[68] of the government authorities' intervention to provide financial assistance to failed banks, in the sense that: why should taxpayers have to take the fall for the greedy and irresponsible actions or decisions taken by the banks' managers to operate banks in

[63] De Jager (n 62 above) 236.
[64] De Jager (n 62 above) 236-237.
[65] V Rooplall 'Financial stability and macroprudential policy' (2016) MCOM dissertation University of South Africa 18. V Roopal notes that in 2008 the USA government spent around $187 billion to bail out Fannie Mae and Freddie Mac, America's two largest mortgage lenders. These institutions held $5 trillion worth of home loans and the USA treasury had to buy about $100 billion worth of preferred stocks and MBSs to redeem these two large institutions from financial distress.
[66]D Domanski, R Moessner & W Nelson 'Central banks as lender of last resort: experiences during the 2007-2010 crisis and lessons for the future' May 2014 Finance and Economics discussion series working paper accessible on https://www.federalreserve.gov/econresdata/feds/2014/files/2014110pap.pdf (accessed on 19 January 2019).
[67] R Hausmann & M Gavin, 'The Roots of Banking Crises: The Macroeconomic Context in: Banking Crises in Latin America' (1996) Tydskrif vir die Suid Afrikaanse Reg 48 48-49.
[68] See De Jager (n 62 above) 241-243. Also see De Jager (n 41 above) 492 - 493.

an effective and efficient manner? De Jager argued that the intervention of central banks by using taxpayers' money to stimulate recoveries, more often than not, created larger financial markets and larger financial crises that posed a threat to the whole financial systems and societies.[69]

The financial industry, in particular the banking sector, plays an essential part in developing the growth of the economy and maintaining public assurance of a well-functioning financial system. A bank failure, especially one that qualifies as a SIFI, has the ability to bring about economic catastrophe that could disseminate throughout the global financial realm and ultimately cause bank runs. Therefore, it is crucial that a financial regulatory system has preventative measures to reduce the risks associated with failure of a banking institution without putting the public interest as well as the financial system in jeopardy.

2.4 The Banks Act 94 of 1990

The Banks Act is mainly aimed at regulating and supervising the business affairs of banking institutions who acquire deposits from the public.[70] It is also focused on prudential regulation – ensuring the financial soundness of banks, as they are important players in the market and largely contribute to the development of the economy. The Banks Act provides that should a banking institution experience financial distress, it can either be wound-up or be placed under curatorship, depending on the circumstances. In what follows, I will briefly discuss the winding-up of a bank then deal extensively with the curatorship process.

2.4.1 Winding-up of a banking institution

The Banks Act makes provisions for the winding-up of a banking institution in financial distress. Section 68 of the Banks Act provides that regardless of the provisions set out in section 69 of the Banks Act and any other contradictory provisions set out in the Companies Act 71 of 2008 ('Companies Act'), the Registrar may make an application to a proficient court to have the banking institution wound up in accordance with the provisions set out in the Companies Act. Furthermore, the Registrar is entitled to contest any application for the winding up of a banking institution made by another

[69] De Jager (n 41 above) 492.
[70] See the preamble on the Banks Act 94 of 1990.

individual.[71] The Banks Act further provides that the Registrar is required to recommend a person, who will then be assigned by the Master of the High Court as provisional liquidator or liquidator of such banking institution.[72] Moreover, the Bank Act provides that the Master must assign the person recommended by the Registrar, whom the Registrar is of the opinion that such person has adequate skills, knowledge and experience in the current developments in the banking industry, and provide support to the provisional liquidator or liquidator in the day-to-day duties of such provisional liquidator or liquidator with regard to the banking institution.[73]

Over the years, when banking institutions have experienced financial difficulties, the winding-up procedure was rarely invoked.[74] It has been argued[75] that the winding-up of a bank, like any other business in accordance with the provisions set out in the Companies Act, is an injustice as banking institutions require a different approach due to the complex nature of their business. Lastra[76] reiterates that the solution to a dynamic and effective bank crisis management resolution would require the government authorities and private sector to have a more hands-on approach to the matter, rather than to resort to the insolvency proceedings that are typically designed to aid corporate bankruptcy.

2.4.2 Placing a banking institution under curatorship

The institution of placing a bank under curatorship originally stems from the provisions in terms of section 40 of the Banks Act of 1965.[77] The previous Act was repealed and the provisions of section 40 were re-enacted into section 69 of the Banks Act.[78] Thus, the current framework of curatorship is set out in terms of section 69 read with section 69A of the Banks Act. These provisions facilitate the procedure to be implemented in

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[71] S 68(1)(a) of the Banks Act 94 of 1990.
[72] S 68(1)(b) of the Banks Act 94 of 1990.
[73] S 68(1)(c) of the Banks Act 94 of 1990.
[74] See the Table that reflects bank failures in South Africa subsequent to its democracy in Chapter 1.
[75] EG Corrigan 'Are banks special? A revisitation in The Region' March 2000 Federal Reserve Bank of Minneapolis accessible on https://www.minneapolisfed.org/publications/the-region/are-banks-special (accessed on 7 April 2019).
[76] Lastra (n 13 above) 1-2.
[77] Banks Act 23 of 1965. S 40 of the Act provided that the Minister must be of the opinion that the curatorship was desirable in the public interest, and he had to consult with the banking institution concerned. Thereafter, the banking institution would have to give its written consent for the appointment of the curator.
[78] WG Schulze 'The Institution of Curatorship of a Bank in Terms of Section 69 of the Banks Act 94 of 1990 - A Rare Decision' (1999) 11 South African Mercantile Law Journal 428 429.

the appointment of a curator and the powers such an individual may exercise in the attempt to salvage what remains of the failing bank.

The placing of banking institutions under curatorship arose from the realization that the bank's critical functions[79] are of a *sui generis* nature and in order for these functions to be performed effectively, there must be a notable degree of trust and confidence in the banking institution by its depositors.[80]

Curatorship can be described as a mechanism utilized when there is reason to believe that a banking institution will not be in a position to meet its monthly financial obligations, as and when required to its debtors.[81] Whether a banking institution needs to be placed under curatorship, is determined by the Registrar of Banks ('Registrar').[82] The Registrar role in placing a banking institution under curatorship is very important. As the Registrar is responsible for the regulation and supervision of banking institutions that are registered within South Africa, this means that he is in a position to look into the financial affairs of such institutions and his recommendation on the financial status of the banking institution would be required in order to ascertain whether a banking institution must be placed under curatorship.

The Minister of Finance[83] may, upon receiving a recommendation from the Registrar and also taking into account the interests of the public, appoint a curator[84] to a banking institution. In terms of the previous Act, the banking institution in question had to give written consent before the curator could be appointed.[85] This more often than not delayed and obstructed the Minister of Finance and Registrar's ability to act promptly when a banking institution encountered financial difficulties.[86] It was evident that the intention of the provisions set out in section 40 of the previous Act meant to give the Minister of Finance all the powers and duties of a court, except for the power

[79] Critical functions are those functions that banks are licensed to perform that contribute to the economy and whose failure will disrupt the stability of the financial system of the country. These critical functions are, *inter alia*, taking deposits, granting credit loans, payment systems and settlement systems.
[80] National Treasury 'Statement by the Minister of Finance on the placement of SAAMBOU Bank Limited under curatorship in terms of Section 69 of the Banks Act to Parliament on Thursday 14 February 2002'. Accessible on http://www.treasury.gov.za/comm_media/speeches/2002/2002021401.pdf (accessed on 30 April 2019).
[81] S 69(1)(a) of the Banks Act 94 of 1990.
[82] S 69(1)(a) of the Banks Act 94 of 1990.
[83] S 69(1)(a) of the Banks Act 94 of 1990.
[84] A curator may be defined as an individual who is appointed to take care of anything on behalf of another person.
[85] Schulze (n 78 above) 428.
[86] Schulze (n 78 above) 430

to direct that legal proceedings or execution be stayed in respect of a bank under curatorship, as this could only be done by a competent court.[87] However, in terms of the new Banks Act, the Minister of Finance is required to inform the chief executive officer or the chairperson of the banking institution of his intention to appoint a curator by way of a written letter.[88] Placing a banking institution under curatorship is a discretionary process. There must be reasonable belief that in the event that the particular banking institution in question should fall to its demise, it will not be in the best interest of the public and that there is a likelihood that it will threaten the financial stability of the country.[89]

The Registrar may choose to appoint someone who is not employed in the banking institution that is placed under curatorship.[90] Such a person must, in the Registrar's view have adequate experience of and must be knowledgeable about the business affairs and the responsibilities of managing a bank under curatorship, in order to assist the curator effectively in his role.[91] This person will be remunerated for the services he has rendered from the funds of the banking institution under curatorship as the Registrar may, after consultation with the curator, determine.[92]

Section 69(2)(a) to (d) of the Banks Act requires that the Minister set out the following information in his letter of appointment of a curator to a banking institution that is to be placed under curatorship:

> "(a) the name of the bank in respect of which the curator is appointed and the address of its head office;
> (b) directions in regard to the security which the curator has to furnish for the proper performance of his or her duties;
> (c) directions in regard to the remuneration of the curator; and
> (d) such other directions as to the management of the bank concerned or any matter incidental thereto, including directions in regard to the raising of money by that bank, as the Minister may deem necessary."

[87] *Ex Parte Registrar of Banks* 1968 (3) SA 300 (C) 301H.
[88] S 69(1)(a) of the Banks Act 94 of 1990.
[89] S 69(1)(a) of the Banks Act 94 of 1990.
[90] S 69(1)(b) of the Banks Act 94 of 1990.
[91] S 69(1)(b) of the Banks Act 94 of 1990.
[92] S 69(1)(c) of the Banks Act 94 of 1990.

The Registrar is required to publicise the assignment of the curator, the authorities vested to him and any amendments to or withdrawal of such powers. Such publication must be made in the Government Gazette.[93]

The legal effect of placing a banking institution under curatorship is that once a curator is appointed, the existing chief executive officer or the board of management will be relieved from their duties and the affairs of the bank concerned will be managed by curator, who must administer the bank taking cognizance of how this will affect the people or companies that it is indebted to, the employees and the financial industry holistically[94]. However, the curator's power to make decisions regarding the banking institution will be under the management of the Registrar. Furthermore, the curator will be vested with the powers to possess and take control of all the assets of the banking institution.[95] Even though the curator is required to work under the supervision of the Register, he ultimately reports to the Minister.

In terms of section 69(2B) of the Banks Act, the curator's authority includes:

> "The curator shall—
> (a) under the management of the Registrar, carry out the managerial duties in terms of subsection (2A)(a) as directed by the Registrar taking into account the interest of people and companies that the banking institution is indebted to, its employees and the banking industry at large;
> (b) oblige to any recommendation made by the Registrar;
> (c) obtain accounting records and compile annual financial statements, provisional reports and annual financial statements just as the board of management would have been required to do, had the banking institution not been placed under curatorship;
> (d) conduct annual general meetings and any other meetings invested parties of the banking institution in accordance with the Companies Act as well as comply with any other requirements that the board of management would have complied with, had the banking institution not be place under curatorship;
> (e) have the authority to summons or defend on behalf of the banking institution any civil and criminal lawsuit that may arise."

A very important duty of the curator would be to hold general meetings yearly and any other meetings with the banking institution's creditors, who are usually its depositors thereby complying with all the requirements set out in the Companies Act that the

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[93] S 69(7) of the Banks Act 94 of 1990.
[94] S 69(2A)(a) of the Banks Act 94 of 1990.
[95] S 69(2A) (b) of the Banks Act 94 of 1990.

board of management would have under normal circumstances, complied with, had the banking institution not be placed under curatorship.[96]

Section 69(2C)(a) of the Banks Act provides that the curator's powers which consist of disposing of any of the banking institution's viable assets and transferring its liabilities during the working times. Section 69(2C)(b) of the Banks Act further provides that the curator may not, regardless of the provisions set out in section 112 of the Companies Act,[97] discard either of the banking institution's assets or liabilities, unless such conduct is in accordance with section 54 of the Banks Act.[98] Following the implementation of the new Companies Act of 2008, the parliament amended the provisions of section 69(2C)(b)[99] to allow the implementation of the provisions set out in the new Companies Act to apply to banking institutions placed under curatorship.

The institution of placing a bank under curatorship was previously limiting and deficient when it came to dealing with banking institutions that were experiencing financial woes in their operations but were in the midst of being rescued. Section 69 enabled the curator to discard assets of the bank but failed to make provision to discard its liabilities during business times. This deficiency became evident when African Bank was placed under curatorship. There was, *inter alia*, a need to amplify the curator's power in respect of the disposal of part or whole of the banking institution's business with the intent to coordinate a successful resolution of a bank under curatorship. Parliament expediently amended the Banks Act through the establishment of the Banks Amendment Act.[100] In addition to the curator's powers to move around assets and liabilities of the bank's business, the curator was tasked with the responsibility to indicate whether the bank's creditor(s) are treated fairly and determining the likelihood of the creditor(s) suffering more losses should parts of the bank be discarded or transferred as opposed to the position they would be in had it just been wound-up in terms of the Banks Act.[101]

Curatorship can be terminated upon the Minister issuing a written notice in this regard to the curator or by endorsing an application to wind up the bank in accordance

[96] S 69(2B)(d) of the Banks Act 94 of 1990.
[97] Companies Act 71 of 2008.
[98] S 54 of the Banks Act 94 of 1990 which sets out the provisions for amalgamations, mergers and arrangements where a bank is involved.
[99] The provisions of S 69(2C)(b) of the Banks Act 94 of 1990 have been modified in terms of the Banks Amendment Act 13 of 2013.
[100] Banks Amendment Act 3 of 2015.
[101] S 69 (2C)(c)(i) –(ii) of the Banks Act 94 of 1990.

with section 68 of the Act.[102] In the case of the *Registrar of Banks v New Republic Bank Ltd*,[103] the court held that:

> "It was clear from the wording of s 69 that the institution of curatorship was only to be terminated at the instance of a curator after giving all creditors and members due notice of his intention to apply to the Minister for that purpose".[104]

It is safe to say that section 69 of the Banks Act, together with the amendments incorporated into the Act, gives curators sufficient powers and more options to enable him or her to salvage what remains of the distressed bank and ensure the continuation of its critical functions and shared services. However, section 69 does not operate in solitude. Section 69A makes provision for an inquiry into the causes of the bank failure, with the aim of correcting the corporate errors made, and holding the people who might have caused or are implicated, personally liable for the downfall of the bank.

2.4.3 Section 69A: Investigation of affairs of a bank under curatorship

The Registrar is entitled, at his discretion, to assign an individual to be a commissioner in order to investigate the overall business affairs of the banking institution as well as any person(s) associated with that banking institution currently under curatorship.[105] The investigating process of a banking institution under curatorship can be a tedious and mammoth undertaking, thus, the Registrar may at his own discretion, appoint one or two individuals to provide support to the commissioner in conducting the investigation of the banking institution in question.[106] Furthermore, the commissioner's is required to take guidance from the Registrar.[107] In the recent VBS Bank matter, Advocate Terry Motau SC was appointed as the commissioner and he was assisted by Werksmans Attorneys. Prior to the appointment of a commissioner or the appointment of the individual(s) who will assist the commissioner with the investigations, there is a duty placed on the Registrar to ensure that such individual(s) appointed are able to make objective and impartial submissions on the affairs of the banking institution concerned. .[108]

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[102] S 69(10)(a) and (b) of the Banks Act 94 of 1990.
[103] *Registrar of Banks v New Republic Bank Ltd* [1999] 2 All SA 459 (D) 462.
[104] *Registrar of Banks v New Republic Bank Ltd* (n 103 above) 467 f-h.
[105] S 69A(1) of the Banks Act 94 of 1990.
[106] S 69A(2) of the Banks Act 94 of 1990.
[107] S 69A(2) of the Banks Act 94 of 1990.
[108] S 69A(3) of the Banks Act 94 of 1990.

In terms of section 69A(4) of the Banks Act, the commissioner and any other individual(s) employed will be vested with the same authorities provided for in sections 4[109] and 5[110] of the Inspection of Financial Institutions Act,[111] that a registrar or an inspector would have to efficiently perform their functions.[112] The aforementioned powers include administering an oath, affirmation or examination of the board of management, the staff and shareholders of the institution, obtaining warrants to gain access to enter the premises, restricted rooms and seizing of any documentation that relates to the affairs of the institution that is necessary for the investigation process.[113] The Registrar is liable for all the costs incurred in relation to the investigation, however, the Registrar may at his discretion, allocate a portion or the whole costs to be paid out from the assets of the banking institution concerned.[114]

The commissioner is required to conclude the investigation process within five months from his assignment date.[115] The commissioner is further required to prepare a report within thirty days after having finalized the investigation. Such report must set out the conclusions of the commissioner, and determine whether it would be beneficial to the depositors and creditors of the banking institution concerned to continue with the curatorship process or be liquidated.[116] In the case of African Bank, the commissioner was appointed on 30 August 2014 and finalized his report in March 2015. However, the report was only made available to the public on 12 May 2016.[117] In the recent VBS case, the commissioner was appointed in April 2018 and finalized his report in September 2018.[118] The report compiled by the commissioner must

[109] S 4 of the Inspection of Financial Institutions Act gives authority to inspectors investigating institutions. Also see S 69A(5) of the Banks Act 94 of 1990.
[110] S 5 of the Inspection of Financial Institutions Act gives authority to inspectors investigating individuals. Also see s 69A(5A) of the Banks Act.
[111] The Inspection of Financial Institutions Act 80 of 1998.
[112] The preamble of this Act indicates that the provisions of this Act are meant give authority to investigate into the affairs of financial institutions; investigate into the affairs of unregistered companies carrying out business of financial institutions; and anything in relation thereto.
[113] See S 4(1)(a) to (f) and S 5 (a) to (b)of the Inspection of Financial Institutions Act 80 of 1998.
[114] S 69A(10) of the Banks Act 94 of 1990.
[115] S 69A(11) of the Banks Ac 94 of 1990.
[116] S 69A(11) of the Banks Ac 94 of 1990.
[117] Advocate JF Myburgh Report 'Investigation in terms of Section 69A of the Banks Act 94 of 1994' accessible on https://www.resbank.co.za/Publications/Detail-Item-View/Pages/Publications.aspx?sarbweb=3b6aa07d-92ab-441f-b7bf-bb7dfb1bedb4&sarblist=21b5222e-7125-4e55-bb65-56fd3333371e&sarbitem=7288 (accessed on 29 May 2019).
[118] Advocate T Motau Report "the Great Bank Heist – Investigator's Report to the Prudential Authority" accessible on https://www.resbank.co.za/publications/detail-item-view/pages/publications.aspx?sarbweb=3b6aa07d-92ab-441f-b7bf-

delivered to the Registrar, the Minister and, in the circumstances that the findings indicate that there was an element of reckless, negligent or fraudulent conduct when the board of management carried out the affairs of the banking institution, the commissioner is required to disclose the names of the perpetrators by submitting a duplicate of the report to the attorney-general.[119] The reports compiled by the commissioner are often confidential, but the Register may, after seeking advice from the Minister, publicise whole or part of the report.[120] This provision is important as it places an element of accountability on the board of management of the banking institution by identifying the persons who managed the affairs of the bank with negligence, recklessness or fraudulent conduct and such persons will be reported to the law enforcers for criminal charges.

2.5 Case analyses of bank curatorship

2.5.1 African Bank case

The African Bank recently experienced hardships and this had an adverse effect on the local markets which brought about significant systemic risk in the country's financial system.[121] African Bank Limited was a completely owned subsidiary of the company African Bank Investments Limited ("ABIL"), which was listed on the Johannesburg Stock Exchange. The hierarchy of the entities was outlined as follows:

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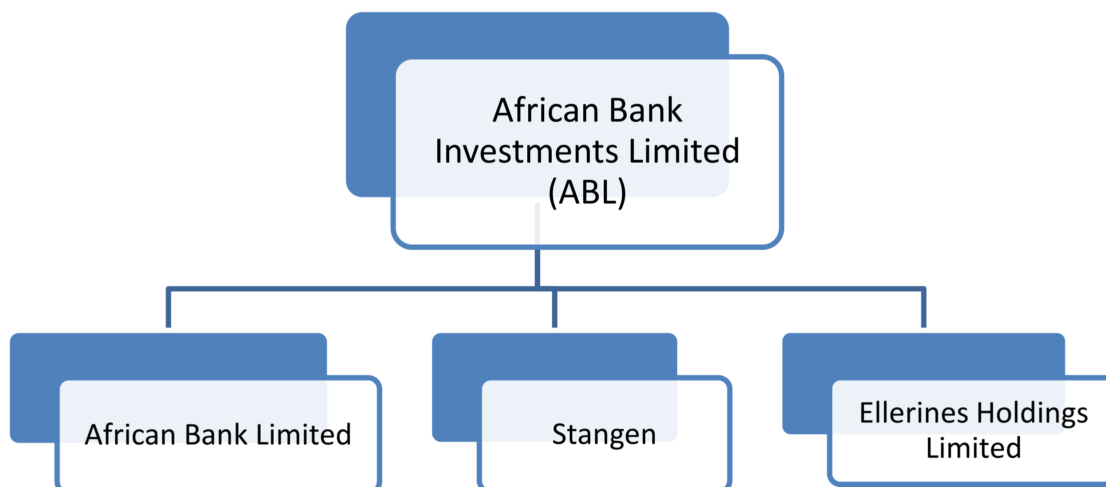
[119] S 69A(12) of the Banks Act 94 of 1990.

[120] S 69A(13) of the Banks Act 94 of 1990.

[121] LB Sanders, E Mare & DCJ De Jongh 'Banking regulations: An examination of the failure of African Bank using Merton's structural model' 2017 113 (7/8) South African Journal of Science 1 1.



[122]

African Bank was a mono-line bank. This means that unlike the conventional banks, African Bank was best known for providing unsecured loans such as personal loans and credit cards to lower income consumers in South Africa.[123] Because of the bank's inability to manage its own affairs, it was placed under curatorship on 10 August 2014. Mr Tom Winterboer was assigned as the curator and was vested with the powers and control as stipulated in the Act. Although African Bank was not considered to be amongst the largest banking institutions, there was a reason to believe that its failure could pose a systemic threat to the financial system because it had over 3 million customers, who were mostly historically disadvantaged people, along with the role it played in financial inclusion and the adverse impact its failure would have on the socio-political environment.[124] According to the SARB Governor, the causes that ultimately lead to African Bank's downfall were, *inter alia*, a liquidity crisis; the bank's impaired policy framework; the increased credit risk; and the lack of an innovative and effective business model.[125]

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[122] National Treasury 'Update on the curatorship of African Bank Ltd' March 2014 accessible on http://pmg-assets.s3-website-eu-west-1.amazonaws.com/150310africanbank.pdf (accessed on 25 July 2019).

[123] National Treasury 'Update on the curatorship of African Bank Ltd' March 2014 (n 122 above) 15.

[124] Myburgh Report (n117 above) 28.

[125] The SARB 'Remarks by the Governor of the South African Reserve Bank, Gill Marcus at the press conference on the 10th of August 2014: African Bank Limited' accessible on https://www.resbank.co.za/Lists/Speeches/Attachments/414/Governor%27s%20Address%20-%20ABIL.pdf (accessed on 25 May 2019).

African Bank made profit through corporate and capital market borrowings as well as issuing different kinds of debt instruments to the wholesale market.[126] Despite the adverse environment and the increasing competition in the unsecured lending market, African Bank responded by extending large amounts of unsecured credit, but when the economy experienced a recession, and the lower income customers began to default on their payments, African Bank began operating at a loss. By conducting its business in this manner, African Bank failed to comply with the Basel Core Principles for Effective Banking Supervision,[127] particularly in respect maintaining adequate of capital levels, as the bank lacked sufficient funds to absorb the shock arising from underperforming assets and high risk loans.[128] Furthermore, ABIL's acquisition of the furniture retailer, Ellerines Holdings ('Ellerines'), turned into a liability rather than an investment as it required a monthly payment of R70 million.[129] However, during the curatorship process, ABIL had to dispose of Ellerines. Shortly thereafter, Ellerines was placed under business rescue on 7 August 2014. This step was imperative for the recovery process, as this took a big load off ABIL's and African Bank's financial obligations.[130]

The commissioner that was appointed to investigate the affairs of African Bank, Advocate Myburgh, compiled a comprehensive report on its downfall and it was found that the board of management of both the bank and ABIL managed the affairs of the bank negligently and recklessly.[131] The commissioner's report also revealed that African Bank did not implement adequate corporate governance as a number of its directors lacked the necessary skills and due diligence in approving loans from the bank to Ellerines. Furthermore, African Bank was not compliant with the prudential requirements and it did not exercise sound banking practices as prescribed by the Basel Core Principles for Effective Banking Supervision.[132] The BSD (established within the SARB) was formerly responsible for supervising the activities of banking

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[126] Myburgh Report (n 117 above) 27.
[127] Basel Committee on Banking Supervision 'Core Principles for Effective Banking Supervision' September 2012 accessible on https://www.bis.org/publ/bcbs213.pdf (accessed on 30 July 2019. See core principle 16: capital adequacy.
[128] National Treasury 'Update on the curatorship of African Bank Ltd' March 2014 (n 122 above) 6-8.
[129] Remarks by the Governor Gill Marcus (n 125 above) 3.
[130] Remarks by the Governor Gill Marcus (n 125 above) 3
[131] Myburgh Report (n117 above) 475-476.
[132] Myburgh Report (n117 above) 476-477.

institutions and it took proactive measures to ensure confidence in the South African financial sector, when African Bank fell into difficulties.[133]

Havemann explains that the plan to salvage African Bank comprised of two components: to divide the bank into a "good bank" and a "bad bank". This meant that loans that performed reasonably well would be transferred to the good bank to ensure the continuation of its critical functions and critical shared services, while the non-performing loans would remain in the bad bank, which no longer formed part of African Bank and would eventually be wound down.[134]

African Bank was the first banking institution whose curatorship plan included the bail-in of creditors as opposed to resorting to bail-outs from the government authorities. In other words, the fund-raising aspect of restructuring African Bank was partly at the loss of its creditors and shareholders as opposed to the previous custom where government authorities would bare the complete loss and use public funds to recapitalise the failed banking institution. The SARB formed a consortium with six other banking institutions[135] and the Public Investment Corporation (PIC), who undersigned to raise capital in the amount of R10 billion. The funds raised were aimed at ensuring that a new bank be registered with the intent to hold and maintain performing loans and assets. This initiative provided transparency and confidence in the banking industry, which lowered the chance of bank runs. The new registered banking institution would be known as the "good bank", but would still trade under the name of African Bank. The criteria to place claims of senior unsecured debt holders into the "good" or "bad" bank was determined as follows: A claim in the "good bank" at 90% of the face value of their instruments and the remaining 10% would stay in the "bad bank".[136] These criteria put subordinate creditors at a loss as their claims were considered to be of no value. Thereafter, negotiations between the SARB, the senior and subordinate creditors ensued and it was agreed that 37.5% of the subordinate creditors' claims would be moved into the good bank.[137] The SARB bought a

[133] Myburgh Report (n117 above) 28-29.
[134] RC Havemann 'Lessons from South African bank failures 2002 to 2014' (LLD Thesis University of Stellenbosch 2019) 94.
[135] The banking institutions that participated in the alliance were Absa Bank Limited, Capitec Bank, FirstRand Bank Limited, Investec Bank Limited, Nedbank Limited and Standard Bank Limited.
[136] Havemann (n 134 above) 94.
[137] Havemann (n 134 above) 94.

substantial part of African Bank's liabilities for an amount of R7 billion, which included the non and under-performing assets as well as the high risk loans.[138]

The restructuring plan for African Bank has proven to be successful. The bank had stabilised and the liquidity situation had improved. African Bank's Chief Executive Officer ('CEO'), Brian Riley, announced that the bank made a profit of R335 million for the period April 2016 to September 2016, with the assistance from both the bank and its insurance entity. The considerable loss of goodwill in the amount of R1 947 million meant that the bank recorded an attributable loss to owners of some R1 678 million.[139] The CEO further advised that because of the SARB's participation in African Bank's road to recovery, it became one of the most regulated banking institutions in South Africa. African Bank has modified its business model by taking more deposits and credit assessments to ensure secure lending will be implemented.[140] African Bank has successfully transitioned from a mono-line lender to an omni-channel business offering more products which will assist the bank from solely depending on wholesale funding.

2.5.2 The VBS Mutual Bank case

The VBS Mutual Bank ('VBS'), previously known as the Venda Building Society, was initially formed in 1982 and subsequently converted into a mutual bank in 1992.[141]

Mutual banks are supervised by the SARB and regulated through the provisions set out in the Mutual Banks Act.[142] Mutual banks can be defined as banking institutions that are designed to serve low-income consumers and are used to encourage saving within the communities they are established.[143] Mutual Banks are different from commercial banks – they tend to be smaller in size than commercial banks. The main objective of a mutual bank is often aimed at encouraging and

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[138] The bad book at that time had a book value net of specific impairments of R 17-billion. It must be noted that collection against the bad books continued and remained consistent: no exceptions for holiday payments were granted to individuals and companies that were indebted to the bank.
[139] The Citizen 'African Bank Reborn' accessible on https://www.africanbank.co.za/media/51569/brian-the-citizen-3.pdf (accessed on 20 June 2019).
[140] The Citizen 'African Bank Reborn' (n 139 above) 2-3.
[141] City Press 'What is VBS Mutual Bank? Everything you need to know' September 2016 accessible on https://city-press.news24.com/News/what-is-vbs-mutual-bank-everything-you-need-to-know-20160922 (accessed on 14 April 2019).
[142] Mutual Bank Act 124 of 1993.
[143] Market Business News 'what is a savings mutual bank? Definition and meaning' accessible on https://marketbusinessnews.com/financial-glossary/mutual-savings-bank/ (accessed on 5 October 2019). Also see S 1 of the Mutual Banks Act 124 of 1993 at (xx)(a)-(b).

promoting saving.[144] One of the incentives of saving in a mutual bank rather than a commercial bank is that its depositors are able to acquire ownership interests in the bank.[145] Such depositors are, *inter alia*, entitled to vote at shareholder meetings and are entitled to receive dividends on shares.[146]

The SARB placed VBS under curatorship on 11 March 2018[147] in an attempt to salvage what remained of the mutual bank and preserve the depositors' confidence in the bank. The demise of VBS was aggravated by a combination of factors – high dependence on municipal deposits, inadequate management, high operational costs, lack of corporate governance and poor regulatory frameworks which ultimately led to a liquidity crisis.[148] VBS was not necessarily regarded as a financial institution that could be systemic, but due to the fact that the majority of its deposits came from municipalities (public funds), this prompted the decision to have the bank placed under curatorship.[149] The manner in which VBS conducted its business was questionable and this involved reckless business practices, failure and/or omitting to disclose material information and irregular conduct by the shareholders, board of management and other stakeholders. Such conduct encouraged an investigation into the affairs of VBS.[150] On 13 April 2018,[151] the Prudential Authority, who is tasked with the responsibility to supervise and maintain soundness of regulated financial institutions, appointed Advocate Terry Motau SC ("the commissioner") to investigate the business affairs of VBS in respect of section 134 of the FSRA.[152]

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[144] Lawful Living 'What we all need to know. What not to do.' (July 2017) accessible on https://lawfulliving.co.za/book/text/financial-services--mutual-banks.html (accessed on 14 April 2019).
[145] Lawful Living (n 144 above).
[146] Lawful Living (n 144 above).
[147] Advocate T Motau SC Report 'VBS Mutual Bank: The Great Bank Heist - Investigator's Report to the Prudential Authority' accessible on https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/8830/VBS%20Mutual%20Bank%20-%20The%20Great%20Bank%20Heist.pdf (accessed on 15 May 2019).
[148] The SARB 'Financial Stability Review' 2nd edition 2018 accessible on https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/8904/Second%20edition%202018%20FSR.pdf (accessed on 18 August 2019).
[149] The SARB 'Financial Stability Review' (n 129 above) 32. Placing VBS under curatorship also affected domestic financial institutions such as Nzalo Insurance Ltd, Bophelo Life Insurance Ltd, the Bophelo Beneficiary Fund and Bophelo Benefits Services.
[150] *The Prudential Authority v VBS Mutual Bank & 3 others* 79005/18 (unreported) para 35.
[151] The Great Bank Heist Report (n 147 above) 2.
[152] S 134 of the FSR Act provides that the regulator may assign an individual to investigate as well as assign another individual to provide support the individual investigating the affairs of the bank in question. Such appointment must be reduced to writing.

Subsequently, the SARB received an investigation report from the commissioner on 5 October 2018.[153] The report was addressed to the Prudential Authority and illustrated that the substantiated information gathered under the investigation revealed the main aspect of unlawfulness that eventually led to the downfall of VBS. This involved the approaches used by the individuals who were entrusted with the responsibility to look after depositors' funds, who basically disregarded their responsibilities and embarked on an industrial-scale looting exercise that essentially benefited themselves and well-connected politicians. The commissioner further indicated that there were additional aspects at play:

1. Large amounts of money were paid to various individuals as incentives for the roles they played in the looting scheme and a number of VBS's board of management and other involved parties were bribed in exchange to conceal and to turn a blind eye while the looting proceeded.[154]

2. VBS colluded with a number of municipalities as these municipalities made generous deposits into VBS – despite the fact that such conduct was *ultra vires*[155] and frowned upon.[156] VBS also attracted substantial deposits from government institutions including the Passenger Rail Agency of South Africa (PRASA), in the form of "commissions".[157] Thus, VBS's board of management went out of their way to bribe several government officers who were in a position of power to approve the payment of such deposits.

3. VBS's board of management exploited its banking systems by making large deposits into Vele Investments (Pty) Ltd, a company owned by the chairperson and chief operations manager of VBS, and by approving massively overdrawn banking facilities to the benefit of Vele Investments and its associates.[158] There

[153] The Great Bank Heist Report (n 147 above) 9.
[154] The Great Bank Heist Report (n 147 above) 9.
[155] The Local Government Municipal Finance Management Act No.56 of 2003 defines "investment", in respect of funds to a municipality, as depositing the funds, or keeping assets of a municipality with a financial institution with the intention hold the funds for safe keeping.
[156] The reason behind restricting municipalities and their entities from depositing funds into mutual banks is in line with the objective of ensuring that the funds are meant for service delivery and must be managed as responsibly as possible.
[157] The Great Bank Heist Report (n 147 above) 9.
[158] The Great Bank Heist Report (n 147 above) 9.

was clearly a conflict of interest between the board of management responsible of managing depositors' funds and Vele Investments. VBS board of management's judgment was clouded by greed and they were hell bent on benefiting at the cost of its depositors.

Furthermore, VBS intentionally omitted and misrepresented its annual financial statements. The VBS board of management went out of their way to ensure that, by fraudulent means, the looting remained concealed from the eyes of the public and they continued to benefit financially.[159]

The report further revealed that VBS's misrepresentation and fraudulent acts deceived the Registrar in such a way that at face value, it appeared to be financially sound, when in fact its liabilities grossly surpassed its assets by R180 million and it was insolvent by 31 March 2017.[160] Therefore, at the point in time when VBS was placed under curatorship, the extent of the damage was irrevocable. Upon concluding his report, the commissioner recommended that it would be in the best interest of all affected parties that VBS be wound-up because there were no prospects of salvation. The VBS was poorly managed, and the board of management failed and neglected to implement the necessary corporate government principles[161] for the benefit and growth of the banking institution, as well as adequately perform their fiduciary duties towards the banking institution.

The Prudential Authority issued an application for the winding up of VBS on 13 November 2018.[162] The application was not opposed by the respondents. VBS was factually insolvent, since its liabilities greatly exceeded its assets. Furthermore, it was commercially insolvent and was not in a position to meet its financial obligations. The Prudential Authority was of the view that a final wind up of VBS was necessary and this action will enable the liquidator to use the mechanisms provided for in insolvency legislation and the Companies Act to effect recoveries and, furthermore, to follow through on the recommendations set out in the report compiled by Advocate Motau.[163]

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[159] The Great Bank Heist Report (n 147 above) 10.
[160] The Great Bank Heist Report (n 147 above) 10.
[161] Institutions that incorporate the core principles of good corporate governance; fairness, accountability and transparency, more often than most, outperform other institutions and are prone to obtain more investors, whose support can help with the financial growth of the institution.
[162] *The Prudential Authority v VBS Mutual Bank & 3 others* 79005/18 (unreported).
[163] The South African Reserve Bank 'South African Reserve Bank on VBS liquidation- media statement' October 2018 accessible on https://www.gov.za/speeches/south-african-reserve-bank-vbs-liquidation-30-oct-2018-0000 (accessed on July 2019).

On these bases, the court granted the application to have VBS wound-up under a final as opposed to provisional liquidation order.

Chapter 3:
Bank resolution: a new way of dealing with failed banking institutions

3.1 Introduction

Bank resolution can defined be as the process whereby a resolution authority makes use of certain resolution tools to raise funds and/or restructure the failing or failed banking institution.[164] The objectives of bank resolution are to preserve the interests of the public, to ensure the continued existence of the banking institution's critical functions and shared services, to avoid an adverse impact on the firmness of the financial system and to minimise the reliance on public funds..[165] The critical functions are the services that a banking institution provides that contribute to economic growth and the demise thereof can adversely affect the state of the financial system. An example of a critical function performed by a banking institution would be payment systems.

Subsequent to the 2007-2008 GFC, it became evident that there was a need for an innovative and efficient regulatory framework that would be able to identify, monitor and supervise the risks associated with significantly important financial institutions (SIFIs)[166] and other financial institutions that may be experiencing financial difficulties that could possibly impact the financial system or the development of the economy negatively. In an attempt to maintain financial stability globally, international standard setting bodies devised a number of reforms to tackle the shortfalls in the financial regulation systems.

It was with this vision that the Financial Stability Board[167] issued a policy known as '*The Key Attributes of Effective Resolution Regimes for financial institutions*' which provides mechanisms that member jurisdictions can implement in their own policy

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[164] Single Resolution Board 'What is Bank Resolution?' accessible on https://srb.europa.eu/en/content/what-bank-resolution (accessed on 15 August 2019).
[165] Single Resolution Board 'What is Bank Resolution?' (n 164 above).
[166] Systemically Important Financial Institutions are defined as institutions that are so large and systemically interconnected in nature that should it experience financial distress, it will disrupt the financial system and economic activity holistically.
[167] The Financial Stability Board was inaugurated in April 2009. The governments of the countries that are members of the G-20 endorsed the FSB's initial carter on 25 September 2009.

frameworks to enable them to efficiently assist failing financial institutions.[168] As South Africa is amongst the countries that form part of the Group of Twenty (G-20),[169] it intends to incorporate some of these attributes into its financial regulatory framework.

3.2 The imperative features of an effective resolution regime for banking institutions

In August 2015, the National Treasury in collaboration with the SARB and the FSCA published a policy framework known as *Strengthening South Africa's Resolution Framework for Financial institutions* ('The Red Book'),[170] as a guideline that can be implemented in the resolution of failing financial institutions. The Red book sets out a number of stabilisation tools that may be applied to manage and mitigate the adverse impact that failing financial institutions could pose on the financial soundness and stability of the economy as well as minimize the cost implications for central banks.

3.2.1 Bail-in

Previously, regulation authorities used the bail-out feature to recapitalize a financial institution that was in financial woes. This meant that in order to avoid a dominos effect, as a result of its magnitude and interconnectedness with other financial institutions, the government would intervene and inject public funds into the institution in an attempt to bring it back to a viable state.[171] This tool was only applicable to financial institutions that government deemed to be so large that should it fail, it could disrupt the financial system in its entirety.[172] However, the use of the bail-out tool proved to be more crippling than helpful for the following reasons:[173]

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[168] Financial Stability Board 'The Key Attributes of Effective Resolution Regimes for Financial Institutions' (October 2011) accessible on https://www.fsb.org/wp-content/uploads/r_111104cc.pdf (accessed on 15 August 2019). Amendments were made to this policy document in October 2014 in order to incorporate guidelines to be applied for the resolution of non-bank financial institutions and the markets.

[169] The G-20 is a platform utilized by 20 countries to discuss and amend policies relating to international financial stability.

[170] Department of National Treasury, The South African Reserve Bank & The Financial Sector Conduct Authority 'Strengthening South Africa's Resolution Framework For Financial Institutions' (August 2015) accessible on http://www.treasury.gov.za/twinpeaks/Strengthening%20South%20Africa%E2%80%99s%20Resolution%20Framework%20for%20Financial%20Institutions.pdf (accessed on 15 August 2019).

[171] E Avgouleas & C Goodhart 'Critical Reflections on Bank Bail-ins' (2015) 1 Journal of Financial Regulation 3 3.

[172] Avgouleas & Goodhart (n 171 above) 3-4.

[173] Avgouleas & Goodhart (n 171 above) 3-4.

1. The burden of loss and responsibility to rescue financial institutions shifted to the taxpayers, as public funds were used to recapitalise the institution; and
2. the use of public funds to bail-out banking institutions has the potential to cause a major moral hazard risk and undermine market discipline. Institutions would be reluctant to comply with rules and regulations of conducting an orderly bank institution, knowing that in the event that they are to fail, there is a safety net available to rescue it and this may pose a threat to the financial system in the long run.

Subsequent to the 2007-2008 GFC, the bail-in tool was adopted as one of the stabilisation tools to resolve the banking institution effectively. The bail-in feature allows authorities to raise funds for the failing or failed banking institution from its shareholders and creditors without solely having to rely on the SARB to inject public funds to maintain the continuity of its critical and shared functions.[174] This feature shifts the burden of bearing losses to the banking institution's shareholders and creditors. The bail-in feature gives the resolution authority the power to write down the banking institution's shares, equity as well as its unsecured and uninsured creditors' claims in order to accrue sufficient funds and cover the losses and facilitate the early stages of the resolution process.[175] This means that the banking institution's losses are assigned to its shareholders through the cancellation of their shares and to its creditors by converting their claims to equity. A valuation is administered in order to determine the extent of the bail-in amount required from the shareholders and creditors to recapitalise and restructure the institution.[176] Therefore, the losses are written down in the insolvency hierarchy. Furthermore, any capital notes or contractual bail-in instruments whose conditions were not affected before the entry of the resolution proceedings must also be written down and converted.[177] This resolution feature shifts the focus from the protection of the banking institution's shareholders and creditors to the overall maintenance of financial stability.

[174] Strengthening South Africa's Resolution Framework for Financial Institutions (n 170 above) 20.
[175] Avgouleas & Goodhart (n 171 above) 4 - 5.
[176] The Key Attributes of Effective Resolution Regimes for Financial Institutions' (n 168 above) 9.
[177] The Key Attributes of Effective Resolution Regimes for Financial Institutions (n 168 above) 9.

3.2.2 Stabilisation powers

A resolution framework should provide the designated resolution authority with the necessary powers to administer the resolution process of the failing or failed financial institution in an orderly manner.[178] The stabilisation powers include the ability to transfer assets and liabilities, fully or partially for purposes of restricting a failing bank.[179] Thus, the stabilisation tools provide a more flexible approach for the resolution authorities to transfer assets and liabilities as it deems necessary and create bridging intuitions to separate the 'good' part of the banking institution that will contain the healthy and viable assets and senior liabilities and abandon the 'bad' part of the banking institution leaving behind the unviable assets and subordinate liabilities.[180] The stabilisation tool was initially implemented in the case of African Bank during its hardships and proved to be successful in its restructuring process.

3.2.3 Deposit Insurance Scheme

The *Key Attributes* propose that member jurisdictions ought to consider establishing privately funded depositor insurance to ensure that the interests of the depositors are protected or alternatively, make payment arrangements with the private sector to retrieve any public funds that the government temporarily provided in an attempt to assist in the resolution process.[181] Financial safety nets are a vital aspect of a credible resolution framework. Deposit insurance schemes provide assurance that covered depositors will receive a portion of their funds should the banking institution not be able to fulfil its financial obligations. This in turn strengthens public trust in the financial system as well as maintains its stability as this mitigates the costs involved in resolving and restructuring the failing banking institution and provides protection to the affected depositors from loss. This also prevents the likelihood of a spillage to other banking institutions and bank runs.[182]

A deposit insurance scheme can be defined as a set of legal, operational and financial regulations that are set in place, with the objective to administer the compensation of covered depositors in an efficient and transparent manner and also

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[178] The Key Attributes of Effective Resolution Regimes for Financial Institutions (n 168 above) 7.
[179] Strengthening South Africa's Resolution Framework for Financial Institutions (n 170 above) 19.
[180] Strengthening South Africa's Resolution Framework for Financial Institutions (n 170 above) 19.
[181] The Key Attributes of Effective Resolution Regimes for Financial Institutions (n 168 above) 12.
[182] Strengthening South Africa's Resolution Framework for Financial Institutions (n 170 above) 13.

taking cognisance of how the depositors will be affected should the bank failure.[183] There are two types of deposit insurance: implicit and explicit deposit insurance.

3.2.3.1 Implicit deposit insurance

The implicit deposit insurance is when the government commits to compensate all depositors, creditors and shareholders in the event that the banking institution is unable to fulfil its financial obligations.[184] This type of deposit insurance does not impose any risk-based contributions from the banking institution. However, the burden of loss shifts to the government, who facilitates the compensation of depositors by injecting public funds into the banking institution. Furthermore, the eligibility for this deposit insurance is at the discretion of the government authorities and it does not set a limit as to the extent of protection made available to the depositors, which can likely cause a strain on public resources.[185]

3.2.3.2 Explicit deposit insurance

The explicit deposit insurance is when the government has established a scheme through a legally binding document that mandates banking institutions and any other financial institutions that take deposits, to create a basic deposit insurance system that sets out clear and certain terms as to how the system will function as well as its limitation thereof.[186]

Despite the fact that South Africa is a member of the G-20[187] without an established deposit insurance scheme, there was an implied deposit insurance system where the government would aid failing banking institutions, at its own discretion, by injecting large amounts of public funds into the resolution process.[188] This system

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[183] The South African Reserve Bank 'Designing a deposit insurance scheme for South Africa – a discussion paper' May 2017 accessible on Designing%20a%20deposit%20insurance%20scheme%20for%20South%20Africa.pdf (accessed on 15 September 2019).

[184] The Herald 'types of deposit insurance systems' August 2013 accessible on https://www.herald.co.zw/types-of-deposit-insurance-systems/ (accessed on 10 September 2019).

[185] The Herald 'types of deposit insurance systems' (n 184 above) 1.

[186] The Herald 'types of deposit insurance systems' (n 184 above) 1-2.

[187] Strengthening South Africa's Resolution Framework for Financial Institutions (n 170 above) 32. China and Saudi Arabia are amongst the remaining G-20 countries that have not established an explicit deposit insurance scheme, however, these countries are in the process of adopting an explicit deposit scheme into their resolution frameworks.

[188] The South African Reserve Bank 'Designing a deposit insurance scheme for South Africa – a discussion paper' May 2017 accessible on Designing%20a%20deposit%20insurance%20scheme%20for%20South%20Africa.pdf 2 (accessed on 15 September 2019).

proved to be inefficient, lacked transparency and was not in line with the financial stability objective as there was no guarantee that depositors would be compensated, and the private sector would not get involved and assist with the raising of funds.[189] The taxpayers cover the costs of recapitalising a bank failure. Therefore, implicit deposit insurance is not viable in the long run as it creates uncertainty with regard to the standing of depositors and the use of public funds, which in the end causes strain on the distribution of public funds and resources.

Even though the adoption of an exclusively private fund by the financial industry may be a long term objective, the regulation authorities were adamant that a deposit guarantee scheme be featured as a tool in the existing resolution framework.[190] The primary functions of the deposit guarantee scheme would be to ensure that funds are available and accessible thereby mitigating the costs of the resolution procedure for a failing banking institution and protect depositors that are covered in the scheme from incurring any loss.[191] The depositor guarantee scheme will be implemented and administered by the SARB.[192] All banking institutions registered in terms of the Banks Act,[193] Mutual Banks Act[194] and Cooperative Banks Act[195] will be required join the scheme on a compulsory basis.[196] The responsibility to raise funds for the deposit insurance scheme should be that of the financial or banking industry.[197] In 2017, the SARB published a policy document titled *Designing a deposit insurance scheme for South Africa*[198] to emphasise the importance of establishing an explicit deposit insurance fund for South Africa that is exclusively funded by the banking sector.[199] This policy document sets out the possible advantages of the incorporation of the explicit deposit insurance guarantee scheme, including providing the regulation authorities with a variety of options for recapitalizing in a resolution process without having to solely rely on the injection of public funds.[200] For instance, the contributed funds could be utilised as a bail-in tool to recapitalise the failing bank or cover the

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[189] Designing a deposit insurance scheme for South Africa – a discussion paper (n 188 above) 2.
[190] Strengthening South Africa's Resolution Framework for Financial Institutions (n 168 above) 13.
[191] Strengthening South Africa's Resolution Framework for Financial Institutions (n 168 above) 13.
[192] Strengthening South Africa's Resolution Framework for Financial Institutions (n 168 above) 14.
[193] The Banks Act 94 of 1990.
[194] The Mutual Banks Act 124 of 1993.
[195] The Cooperative Banks Act 40 of 2007.
[196] Designing a deposit insurance scheme for South Africa – a discussion paper (n 188 above) 26.
[197] Strengthening South Africa's Resolution Framework for Financial Institutions (n 168 above) 37.
[198] Designing a deposit insurance scheme for South Africa – a discussion paper (n 188 above) 2.
[199] Designing a deposit insurance scheme for South Africa – a discussion paper (n 188 above) 1.
[200] Designing a deposit insurance scheme for South Africa – a discussion paper (n 188 above) 10.

costs to transfer deposits to another banking institution. Furthermore, it could level out the arena between new entrants and the well-known, reputable banking institutions thereby giving smaller banking institutions a competitive advantage.[201] It may promote financial inclusion by making finances more accessible to the smaller banking sector and could boost confidence in the financial system. There have been some concerns, in relation to providing an explicit deposit guarantee scheme and protecting depositors from bearing the burden of loss, as this could potentially encourage the depositors to take unusual business risks, thereby possibly contributing to moral hazard and the reduction in market discipline.[202] It must be born in mind that an explicit deposit insurance scheme is intended to complement the existing regulatory and resolution frameworks. Furthermore, it is important the coverage level of the scheme is continuously reviewed to ensure that there is an adequate balance between the need to protect the depositors and ensuring that market discipline is maintained.[203] The ultimate objective of the deposit guarantee scheme is to enhance and maintain a stable financial system in the country through maintaining public confidence by shielding covered depositors from incurring any loss in the event of a bank failure.[204]

3.2.4 Loss absorbing capacity

Loss absorbing capacity is a crucial element in any resolution framework. Financial institutions, especially banks, are required to have a certain amount of financial resources available in order to withstand possible shocks and losses that may arise during the course of its business as well as have funds available when it is in distress.[205] This requirement is centred on the financial institution's going concern loss absorbing capacity. The resolution authority needs to recapitalise the failing financial institution during the resolution process, so it is imperative that the financial institutions has adequate levels of gone-concern loss absorbing capacity.[206] This means that a failed or failing financial institution needs to have sufficient levels of bail-in able subordinate debt available for distribution.[207]

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[201] Designing a deposit insurance scheme for South Africa – a discussion paper (n 188 above) 11.
[202] Designing a deposit insurance scheme for South Africa – a discussion paper (n 188 above) 16.
[203] Financial Stability Board 'Thematic Review on Deposit Insurance Systems' February 2012 accessible on https://www.fsb.org/wp-content/uploads/r_120208.pdf?page_moved=1 (accessed on 16 September 2019).
[204] Designing a deposit insurance scheme for South Africa – a discussion paper (n 188 above) 8.
[205] Strengthening South Africa's Resolution Framework for Financial Institutions (n 170 above) 53-54.
[206] Strengthening South Africa's Resolution Framework for Financial Institutions (n 170 above) 54.
[207] Strengthening South Africa's Resolution Framework for Financial Institutions (n 170 above) 54.

3.2.5 The importance of the creditor hierarchy

Resolution authorities need to exercise their powers in such a manner that it does not infringe the hierarchy of creditor claims.[208] The table below illustrates the current hierarchy in which creditors make their claims in respect of corporate insolvency framework and the proposed hierarchy in terms of the resolution framework:[209]

Table 2

Current Hierarchy	Proposed Hierarchy
Secured	Secured
	Preferred
Preferred	Qualifying depositors
Unsecured	Unsecured
	Subordinate loss absorbing capacity
Shares	Preference shares
	Ordinary share

Due to the fact that the resolution framework is structured with the objective to maintain financial stability and preserve public funds rather than to protect creditors, it is imperative that the inclusion of safeguards be incorporated into the framework to ensure that creditors do not suffer unequal and unnecessary losses.[210] The main safeguard protecting creditors is the 'no-creditor-worse-off than in liquidation' principle. This principle provides that resolution authorities should not assign greater losses to creditors in a resolution process than the losses that creditors would have suffered had the financial institution been placed under liquidation.[211] Therefore, creditors are allowed to recover at least the minimum of what they would have received under the insolvency regime. Furthermore, the board of management of the financial institution under the resolution process ought to be protected in law against any legal actions that may arise as a result of complying with the decisions of the resolution authority.[212] Resolution authorities are also required to take cognisance of the insolvency creditor hierarchy when utilising the bail-in tool.

[208] The Key Attributes of Effective Resolution Regimes for Financial Institutions' (n 168 above) 11.
[209] J Botes, LLM lecture on bank resolution at the University of Pretoria, 9 May 2017.
[210] Strengthening South Africa's Resolution Framework for Financial Institutions (n 170 above) 47.
[211] Strengthening South Africa's Resolution Framework for Financial Institutions (n 170 above) 47.
[212] The Key Attributes of Effective Resolution Regimes for Financial Institutions' (n 168 above) 11.

With regard to legal remedies and judicial action, resolution authorities ought to execute their resolution powers in a swift and flexible manner, taking cognisance of constitutionally protected legal remedies and due process.[213]

[213] The Key Attributes of Effective Resolution Regimes for Financial Institutions' (n 168 above) 11.

Chapter 4:
Conclusion

The objective of this dissertation was to establish the reasons for why banks struggle to achieve or maintain financial stability and to analyse the statutes put in place in an attempt to mitigate the reoccurrence of bank failures. Furthermore, this dissertation analysed the new reforms incorporated into the financial regulation framework of financial institutions aimed at strengthening and maintaining a healthy financial system in the country.

As illustrated in the table in chapter 1, bank failures are a global epidemic and have the effect of possibly leading to economic instability. Banking institutions fail as a result of credit risks, liquidity risks, internal factors such as inadequate management, corruption, inadequate business models and external economic factors as well as interest rates, exchange rates, inflation and taxes.

In chapter 2, the analysis of the cases of African Bank and VBS Mutual Bank who recently fell into hardships shed some light on pressing issues pertaining to the banking sector. The lessons learnt are as follows:

1. Bank failures are inevitable. In the event that the banking institution fails, investors and depositors will suffer adversely as there is not a structured plan to compensate for the losses incurred.
2. Government bail-outs have negative consequences as public funds have to be spontaneously allocated to failing banking institutions and this caused significant strains on state resources. Furthermore, it contributed to the likelihood of moral hazard and market conduct disruptions. Therefore, the bail-out tool should preferably be discarded.
3. The institution of curatorship is not a mechanism guaranteed to all financial institutions experiencing financial difficulties. The Registrar needs to be satisfied that the financial institution in question will not able to fulfil its financial obligations as and when required to perform. There are a number of other deciding factors, including, *inter alia*, the interests of the depositors of the financial institution, rendering social services, community development and the prospects of recovering to a viable institution.

4. Corporate insolvency frameworks are not adequate enough to resolve the issues of insolvent financial intuitions, particularly banking institutions and there is a need to formulate a resolution framework specially designed to carter for the complex nature of such financial institutions that would be able to shield the financial system from any possible volatility.

Havemann argues that subsequent to the bank crisis in 2002, South African banking regulators came to the realisation that credit growth was rapidly increasing and therefore they decided to increase the capital adequacy ratios.[214] Havemann further indicates that when the banking regulators restricted credit extensions, this decision actually shielded South Africa by minimising the adverse effects of the GFC when it spread across the world.[215] Every crisis opens our eyes to the possibilities of change. It provides us with the opportunities to restructure regulation frameworks that govern the affairs of financial institutions to be regulated in a manner that will promote the soundness and stability of the financial system, which essentially will contribute towards economic growth and be beneficial to the wider society.

Subsequent to the GFC, the objective to maintain financial stability became a central goal of financial regulations throughout the world. South Africa has a relatively well developed financial system and as such, the adverse effects of the GFC in South Africa were mild as compared to the other regions of the world. The SARB was of the opinion that the financial sector remained vigilant during the challenging period and as a result thereof, the financial system maintained adequate liquidity and capital.[216] Furthermore, factors such as low leverage ratios, sound profitability and limited exposure to foreign assets and foreign funding lessened the impact of the GFC on the South African financial system.[217] Despite the relatively diminutive impact that the GFC had on South Africa, the government was committed to making changes to the financial regulatory frameworks in order to comply with international standards as well as to preserve and strengthen the financial system.

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[214] Havemann (n 134 above) 8.
[215] Havemann (n 134 above) 8-9.
[216] The South African Reserve Bank ‘Annual Report 2009 Bank Supervision Department’ January 2009 accessible on https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/25/Chapter%201.pdf (accessed on 25 September 2019).
[217] The South African Reserve Bank Annual Report 2009 (note 216 above).

The government was of the view that the appropriate regulatory structure for the country would be the Twin Peaks model, which is a purpose driven financial regulation model. In South African, the Twin Peaks model is entrenched in terms of the FSRA and comprises of three divisions: the FSCA responsible for enhancing and maintaining integrity in the financial markets and the protection of consumers; the PA responsible to regulate financial institutions and the markets and lastly the SARB that has the mandate to maintain the financial stability of South Africa. Furthermore, the FSCA and PA are also required to provide support and collaborate with the SARB in maintaining financial stability in South Africa. The FSRA sets out the mandates, objective and functions of these three divisions and essentially provides legal certainty as to how South Africa intends to achieve the rationale of maintaining financial stability.

It is acknowledged that there are some useful mechanisms available for banking institutions that are facing financial hardships. The curatorship process as provided for in terms of section 69 of the Banks Act was created with the intent to resuscitate a failing banking institution in an effective and speedy manner and to prevent the likelihood of bank runs. This process in itself has its own shortcomings in terms of the curator's ability to manage the affairs of the failing institution. Therefore, in 2015, the necessary amendments were promptly enacted with the purpose to give the curator powers with regard to the transfer of the banking institution's assets and liabilities, and to manage the affairs of the financial institution in its best interest.

The manner in which the curatorship process for African Bank was conducted was quite unorthodox as some of the proposals made by the FSB for effective resolutions in respect of financial institutions were incorporated into the process. The key attribute utilised was the creation of a new institution (the good bank) that would hold all the viable assets and liabilities of the financial institution with the intent to ensure its continued existence and shared critical functions and services, while abandoning the non-viable liabilities in the old institution (bad bank). Furthermore, the bail-in approach was implemented as opposed to the previously used bail-out approach.

Unfortunately, VBS was a classic case of corporate governance failure and the curatorship process could therefore not be implemented as it was corrupt to the core with no prospects of becoming viable. Thereafter, an application to place VBS under final liquidation was granted.

Although the current resolution tools have been relatively successful in the past, there is a high chance that when an actual systemic financial institution fails, these current resolution tools would not be adequate enough to prevent a spillage to the financial system.

It is evident that there is a need for a resolution regime specifically structured to efficiently contain and manage the risks associated with a failing financial institutions that are capable of disrupting a financially sound financial system.

The Key Attributes serve as guidelines for member jurisdictions to incorporate or establish a resolution regime structured in such a way that it is capable of resolving the issues of financial institutions or market infrastructures without adversely affecting the soundness of the financial system and solely relying on public funds to cover the costs incurred.

In South Africa, there are proposals to reform the regulation framework of financial institution insolvency and resolution. The regulators intend to establish a resolution regime that provides adequate strategies to curb the systemic risks of a failing financial institutions in an orderly and cost-effective manner. It is recommended that public funds bailout should be discarded and the shareholders should bear the burden of costs for the resolution plan of the failed financial institution. Furthermore, an explicit deposit guarantee scheme that is funded by the financial sector should be established in order to prevent and protect covered depositors from incurring any losses.

It is further recommended that regulators should take cognisance of creditor hierarchy when developing a resolution regime to efficiently deal with the failed financial institutions and ensure that creditors will not be prejudiced during the resolution process.

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