REGULATORY MEASURES TO ADDRESS BANK FAILURES IN ZIMBABWE

by

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I have come full circle. I began my academic journey as a young lady from Zimbabwe who wanted to study law with inspiration from the human rights violations, gender-based violence and the struggling economy of Zimbabwe. Studying law brought joy and meaning to my young life, and I was motivated to take up postgraduate studies soon after my LLB. The decision to take up doctoral studies has been the most rewarding yet challenging decision of my academic life. I have learnt a great deal, but I remain curious in my research and in my quest to contribute to the law. It has been a challenging task that requires patience and endurance. During the lonely and confusing times, I drew strength from Ephesians 3:20 “Now to Him who is able to do exceedingly abundantly above all that we ask or think, according to the power that works in us.” It is for this reason that I am grateful to God for his love and his grace in my life thus far.

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ABSTRACT

The main rationale of prudential bank regulation and supervision of banks has traditionally been to ensure the safety and soundness of banks and protection of depositors. However, best practice standards in bank supervision acknowledge that it is impossible to completely prevent bank failures. Therefore, it is crucial to have regulatory measures in place to deal with banks that fail. Banks are core players in the financial system as the intermediaries between savers and users of capital. In addition, banks provide critical services to consumers, small and medium-sized businesses, large corporate entities and governments who rely on them to conduct their daily business, both at domestic and international level.

Banks also fulfil a sui generis role that sets them apart from other financial institutions that are role players in the financial system because, *inter alia*, they hold “highly” liquid liabilities in the form of deposits that are repayable on demand; they extend long-term loans that may be difficult to sell or borrow against on short notice; they are the back-up source of liquidity to all other institutions (financial and non-financial); and, are also the transmission belt for monetary policy. Unlike other players in the financial system, banks are vulnerable to loss of public confidence and to liquidity risk. Liquidity risk being the risk that a bank will not have sufficient cash to meet short term obligations and the fact that a "run on the bank" by depositors can result in devastating liquidity drainage. Because banks play a special role in the economy and their failure may have a significant impact on financial stability, they need a special approach when they become insolvent or are likely to become insolvent.

The 2008 Global Financial Crisis (“GFC”) demonstrated the importance of special resolution regimes for banks; and the need to balance the interests of shareholders, creditors and depositors, while promoting financial stability objectives. Given the critical role of banks in the economy the need is clear for a special resolution regime for banks that provides a legal framework for regulators that avails to them a suite of resolution tools which they can apply to resolve the bank in an orderly manner; to rescue those parts of the bank that may still be viable and to liquidate those parts that are not whilst avoiding a drain on public funds.

In order to deal with bank failures in Zimbabwe, the Banking Act [Chapter 24:20] has provided for the mechanism of curatorship since 2000, as a rescue measure aimed at restoring failing banks to economic viability. Curatorship has over the years been applied with mixed success; consequently, Zimbabwe has undertaken a number of reforms which include the enactment of the Troubled Financial Institutions (Resolution) Act in 2005; and the introduction of the problem bank regime via the Banking Amendment Act of 2015. Throughout these reforms, Zimbabwe has elected to retain

curatorship, which was once a standalone process in banking legislation to enable bank rescue; and assimilated it into a broader bank resolution framework.

This study seeks to determine whether Zimbabwe's resolution regime requires to be strengthened and if so, to recommend reforms that will align the resolution regime in Zimbabwe with international best practice. For such purpose it will draw upon the Financial Stability Board's Key Attributes of Effective Resolution Regime as international best practice benchmark. It will further also consider guidance yielded by a comparative study of the resolution regimes in the United Kingdom and South Africa.

Key words: Banks; Bank failures; Banking regulation; Curatorship; Special Resolution Regime; Zimbabwe.

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DECLARATION OF ORIGINALITY

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LIST OF ABBREVIATIONS

BCBS	Basel Committee on Banking Supervision
BASC	British South Africa Company
BCCI	Bank of Credit and Commerce International
BIS	Bank of International Settlements
BoE	Bank of England
BRRD	European Bank Recovery and Resolution Directive
CABS	Central Africa Building Society
CBZ	Commercial Bank of Zimbabwe
CCP	Central Counterparties
CMG	Crisis Management Group
DPC	Depositor Protection Corporation
DRIS	Designated Resolution Institutions
ESAP	Economic Structural Adjustment Program
EU	European Union
FCA	Financial Conduct Authority
FMI	Financial Market Infrastructures
FSB	Financial Stability Board
FSCS	Financial Services Compensation Scheme
FSA	Financial Services Authority
FSAP	Financial Sector Assessment Program
FSF	Financial Stability Forum
G-20	Group of Twenty

G-SIFI	Global Systemically Important Financial Institution
GFC	Global Financial Crisis
IMF	International Monetary Fund
IPEC	Insurance and Pensions Commission
JMB	Johnson Matthey Bank
KAs	Key Attributes
LOLR	Lender of last resort
MBCA	Merchant Bank of Central Africa
MIS	Management Information Systems
PRA	Prudential Regulation Authority
RBZ	Reserve Bank of Zimbabwe
RRP	Recovery and Resolution Plan
SARB	South African Reserve Bank
SEC	Securities Exchange Commission
SIFI	Systemically Important Financial Institution
SMEDCO	Small and Medium Enterprises Development Corporation
SRR	Special Resolution Regime
TBTF	Too Big To Fail
UK	United Kingdom
UNICITRAL	United Nations Commission on International Trade Law
USA	United States of America
World Bank	International Bank for Reconstruction and Development

ZABG	Zimbabwe Allied Banking Group
ZEPARU	Zimbabwe Economic Policy and Research Unit

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Chapter One: Background to the study

1.1 Introduction

A strong and resilient banking system is the foundation for sustainable economic growth, given that banks are at the centre of the credit intermediation process between savers and investors. In addition, banks provide critical services to consumers, small and medium-sized businesses, large corporate entities and governments who rely on them to conduct their daily business, both at a domestic and international level.[1] Banks engage in so-called "fractional reserve banking"[2] (which requires them to keep a certain portion of their deposits in reserves) and can "create money out of nothing" through credit extension.[3] As observed by Haentjens, banks are very often the most dominant players in a financial system.[4]

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[1] Basel Committee on Banking Supervision, *Basel III A global regulatory framework for resilient banks and banking systems*, December 2010 Revised 2011 available at https://www.bis.org/publ/bcbs189.pdf accessed 7 June 2020 para 3. See also Franke, Krahnen and von Lupke "Effective resolution of banks: Problems and solutions" Sustainable Architecture for Finance in Europe ("SAFE") Working Paper Series No 19 available at https://connect.up.ac.za/https/www.econstor.eu/bitstream/10419/102027/1/796624771.pdf accessed 15 August 2020 at 1 where they remark that "[T]he banking system is an indispensable part of the economy. Through its payment system it provides the lifeblood for the exchange of goods and services, and through its banking services, in particular deposit taking and lending to firms, households and states, it supports the buildup of production facilities and the smoothing of consumption over time."

[2] As explained by Alifanov "On the dangers inherent in a fractional reserve banking system" 2015 29 *Student Economic Review* 117. Monetary Thought: "Under a fractional reserve banking system, the central bank imposes a legal requirement on all banks operating under its mandate to maintain a specified proportion of their deposits in reserves. Reserves against these deposits can take the form either of currency on hand (vault cash) or balances at the central bank itself. Originally reserve requirements were designed as a safeguard against 'runs' on the banks that were quite widespread over the world until roughly the 1930s-40s. The rationale behind this system was that by requiring financial institutions to hold some liquid assets on hand, central banks wished to reassure the depositors that their money was available on demand." The fractional reserve model is also referred to as the money multiplier model – see Werner "Can banks individually create money out of nothing? - the theories and the empirical evidence" 2014 *International Review of Financial Analysis* 1.

[3] See Werner "Can banks individually create money out of nothing? - the theories and the empirical evidence" 2014 *International Review of Financial Analysis* 1-19. This paper is of great significance in the context of the role of banks in the financial system as it presents the first empirical evidence regarding the question whether banks "can create money out of nothing". In particular it shows that the financial intermediation theory of banking that posits that banks are merely financial intermediaries like other non-bank financial institutions cannot be upheld. In addition the fractional reserve theory of banking argues that although individual banks are mere individual intermediaries that cannot create banking but collectively banks are able to create money through systemic interaction. However a third theory (the credit creation theory of banking) argues that banks are individually able to "create money out of nothing" when it extends credit.

[4] Haentjens "Bank recovery and resolution: an overview of international initiatives" 2014 *International Insolvency Review* 255.

Banks are however not only core players in the financial system - they are also special. Corrigan pointed out in a famous paper in 1982 that banks perform three essential functions that make them special in relation to other financial institutions, namely:[5] they issue transactions accounts (which entails that they hold liabilities that are payable on demand at par and that are readily transferrable to third parties); they are the back-up source of liquidity to all other institutions (financial and non-financial) and they are also the transmission belt for monetary policy. These essential functions performed by banks are highly interdependent and the ability of banks to perform such functions dictates the need for a high degree of public confidence in the overall financial condition of banks - and in particular in the quality of bank assets. Corrigan further observes that over the years this has translated into banks being uniquely enabled to have access to deposit insurance schemes[6] and lender of last resort[7] assistance by central banks in a bid to maintain financial system stability.[8] Hüpkes elaborates on the special nature of banks by pointing out, like Corrigan, that banks typically hold "highly liquid" liabilities in the form of deposits that are repayable at par on demand whilst on the asset side, banks generally hold long-term loans that may be difficult to sell or borrow against on short notice. As explained by Hüpkes:[9] "Under normal circumstances, this mismatch of maturity does not pose a major problem: whereas withdrawals are subject to the law of large numbers, loans will be held until maturity and repaid at face value. A bank's required capitalization covers the risk of loan loss and a cushion of liquid assets ensures its ability to cover withdrawals in normal times. If, however, something happens to disturb confidence in the bank's ability to meet its payment obligations,

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[5] Corrigan "Are banks special?" In Federal Reserve Bank of Minneapolis Annual Report 1982 available at https://econpapers.repec.org/article/fipfedmar/y_3a1982.htm accessed 15 August 2020 at 507.

[6] In terms of the International Association of Deposit Insurers *IADI Core Principles For Effective Deposit Insurance Systems* available at https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf accessed on 12 May 2019 "deposit insurance" is defined as "a system established to protect depositors against the loss of their insured deposits in the event that a bank is unable to meet its obligations to the depositors."

[7] The lender of last resort function of the central bank entails the discretionary provision of financial support by the central bank to other banks in order to avoid spillover effects that may compromise financial system stability. See IMF Working Paper, Dobler, Gray, Murphy, Radzewicz-Bak, *The Lender of Last Resort Function after the Global Financial Crisis* IMF Working Paper No 16/10 2016 available at https://www.imf.org/external/pubs/ft/wp/2016/wp1610.pdf accessed 15 August 2020.

[8] Corrigan "Are banks special?" In Federal Reserve Bank of Minneapolis Annual Report 1982 available at https://econpapers.repec.org/article/fipfedmar/y_3a1982.htm accessed 15 August 2020 at 507. See also Kelley EW Jnr "Are banks still special?" In: Enoch C, John H. Green JH (eds) *Banking Soundness and Monetary Policy* International Monetary Fund (1997) International Monetary Fund 263.

[9] Hüpkes "Insolvency – why a special regime for banks?" 2005 3 *Current Developments in Monetary and Financial Law* 3. Saal, Lindgren, Garcia *Bank Soundness and Macroeconomic Policy* (1996) International Monetary Fund 6.

massive withdrawals of deposits risk causing liquidity problems and may threaten the bank's solvency."

It is consequently evident that, as banks generally make up a large, if not *the* largest, segment of a country's financial system and are key financial intermediaries and key participants in the payments system, taking deposits from the public at large, this puts them in a position where their operations, and consequently also their failure, can have a particularly significant impact on financial stability. The business models of banks also differ significantly from those of other players in the financial system. In particular, Haentjens points to fractional reserve banking as being one of the aspects that, in the early days of banking history, led to bank insolvency together with the fact that banks lent on longer terms than deposits could be retrieved. Banks' business models were thus inherently risky from the very beginning.[10] Unlike some other players in the financial system banks are especially susceptible to liquidity risk,[11] being the risk that a bank will not have sufficient cash to meet short term obligations. This risk, as highlighted by Hüpkes, stems from the fact that banks "borrow short and lend long"[12] – meaning that generally they take deposits that are repayable on demand, most of which they then lend out on much longer terms at profitable rates thus giving rise to the "maturity mismatch" described above. The liquidity risk inherent in this business model may, in those instances where banks are not able to meet deposits on demand (whether as a result of temporary liquidity problems or factual insolvency) precipitate a "run on the bank"[13] by its depositors, resulting in devastating liquidity drainage. Depending on the size and interconnectedness of the bank concerned, its failure can have spill-over effects that can contaminate other financial institutions through a

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[10] Haentjens "Bank recovery and resolution: an overview of international initiatives" 2014 *International Insolvency Review* 255.

[11] See Matis and Matis, "Liquidity risk management in post-crisis conditions" 2015 *Procedia Economics and Finance* 1188 point out that liquidity risk is "the most important financial market risk" and refers to a situation where a bank does not have adequate liquidity to meet its financial obligations. See also Ghenimi, Chaibi, Omri "The effects of liquidity risk and credit risk on bank stability: evidence from the MENA region" 2017 *Borsa Istanbul Review* 238.

[12] De Grauwe "The banking crisis: causes, consequences and remedies" Centre for European Policy Studies ("CEPS") Policy Brief No 178 2008 available at accessed http://aei.pitt.edu/11706/1/1758.pdf accessed 1 August 2020 para 1.

[13] As observed by Diamond, Dybvig "Bank runs, deposit insurance, and liquidity" 1983 *Journal of Political Economy* 401, during a bank run depositors withdraw their deposits from the bank concerned because they expect such bank to fail. Diamond and Dybvig however point out that, in fact, these sudden withdrawals can force a bank to liquidate many of its assets at a loss (so-called "fire sales") and actually cause the bank to fail. See further Anginer, Demirguc-Kunt *Bank Runs and Moral Hazard: A Review of Deposit Insurance* World Bank Policy Research Working Paper 8589, 2018 available at https://elibrary.worldbank.org/doi/abs/10.1596/1813-9450-8589 accessed 23 April 2019.

process of contagion[14] and consequently a "bank run" may eventually even trigger the collapse of a domestic or global financial system.[15]

Bank failure is of course not always precipitated by bank runs and can arise from various other sources such as bad business decisions, poor governance and sometimes, outright corruption by senior management and shareholders.[16] The gist is however that, although the function of prudential regulation and supervision is fundamentally to ensure the "safety and soundness" of banks, best practice standards in banking supervision acknowledge that it is impossible to completely prevent bank

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[14] See Claessens, Forbes "International financial contagion: the theory, evidence, and policy implications" *IMF's Roles in Emerging Market Economies Conference*, Amsterdam, The Netherlands, 18 –19 November 2004 where they explain the evolution of the concept of "contagion" in financial literature which, in simple terms, refer to the spread of financial market turmoil. See further Bricco, Xu, *Interconnectedness and Contagion Analysis: A Practical Framework* IMF Working Paper WP/19/220 2019 available at https://www.sipotra.it/wp-content/uploads/2019/10/Interconnectedness-and-Contagion-Analysis-A-Practical-Framework.pdf accessed 16 August 2020.

[15] Kaufman notes that what makes the perception of bank failures more important, particularly for public policy, is the fear that "the failure may spill over to other banks and possibly beyond the banking system to the financial system as a whole, domestic macroeconomy, and other countries. Similar fears are generally not perceived for the failure of other firms. The failure of a steel mill, software manufacturer or grocery store is not widely perceived to spill over to other firms in the same industry". Lang and Stulz note that "the surviving firms frequently benefit from losing a competitor and being able to expand their market shares." Kaufman further notes that, "because banks are closely intertwined financially with each other through lending to and borrowing from each other, holding deposit balances with each other, and the payments clearing system, a failure of any one bank is believed to be more likely to spill over to other banks and to do so more quickly." See Kaufman "Bank Failures and Regulation" 1996 *Cato Journal* 19. See also Lang, Stulz "Contagion and competitive intra-industry effects of bankruptcy announcements: an empirical analysis" 1992 *Journal of financial economics* 45. See further Jackson, "Danger lurking in the shadows: why regulators lack the authority to effectively fight contagion in the shadow banking system" 2013 *Havard LR* 732.

[16] Regarding the causes of bank failures see Brownbridge "The Causes of Financial Distress in Local Banks in Africa and Implications for Prudential Policy" United Nations Conference on Trade and Development ("UNCTAD") UNCTAD/OSG/DP/132 March 1998 available at http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.598.6626&rep=rep1&type=pdf accessed 1 August 2020; Basel Committee on Banking Supervision, *Bank Failures in Mature Economies* Working Paper No 13, April 2004 available at https://www.bis.org/publ/bcbs_wp13.pdf accessed on 1 August 2020; Calomiris "Bank failures in theory and history: the great depression and other "contagious" events" 2007 National Bureau of Economic Research Working Paper 13597, available at https://www.nber.org/papers/w13597.pdf accessed 1 August 2020; Berger, Imbierowicz, Rauch "The role of corporate governance in bank failures during the recent financial crisis" 2016 *Journal of Money, Credit and Banking* 729.

failures.[17] It is an inevitable fact of life that banks sometimes fail - even in jurisdictions with "state of the art" prudential frameworks.[18]

Although effective and efficient prudential regulation and supervision can contribute significantly towards minimizing bank failure through the application of various measures that enhance the resilience of banks[19] such as improved capital and liquidity requirements, enhanced corporate governance and an improved supervisory enforcement toolkit as well as "early intervention"[20] and "prompt corrective action"[21]

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[17] The Basel Committee on Banking Supervision, *Core Principles for Effective Banking Supervision* ("BCP") available at https://www.bis.org/publ/bcbs230.pdf accessed on 12 May 2018, originally issued by the Basel Committee on Banking Supervisions ("BCBS") in 1997 and subsequently updated in 2006 and 2012, sets out the *de facto* minimum standard for sound prudential regulation and supervision of banks. In particular the BCP indicate at 5 that "[I]t should not be an objective of banking supervision to prevent bank failures. However, supervision should aim to reduce the probability and impact of a bank failure, including by working with resolution authorities, so that when failure occurs, it is in an orderly manner."

[18] Haentjens "Bank recovery and resolution: an overview of international initiatives" 2014 *International Insolvency Review* 255 observes that "Banks fail from time to time. That is a fact of life…We should have known that banks may fall insolvent, as banks have done so since they have come into existence. The word 'bankrupt'…even derives from the failure of a bank." In the latter regard Haentjens referred to the ritual art in Roman times of breaking a banker's table or Banca, behind which he conducted his business, which act signified the banker's insolvency.

[19] See Basel Committee on Banking Supervision, *Strengthening the resilience of the banking sector*, December 2009 available at https://www.bis.org/publ/bcbs164.pdf accessed 11 June 2018. See also Selmier "Design rules for more resilient banking systems" 2016 *Policy and Society* 253; Ojo "Strengthening the resilience of the banking sector: Proposals to strengthen global capital and liquidity regulations" Center for European Law and Politics , University of Bremen, Oxford Brookes University 2010 available at https://www.researchgate.net/publication/46446999_Strengthening_the_resilience_of_the_banking_sector_Proposals_to_strengthen_global_capital_and_liquidity_regulations accessed 11 June 2018; Gray "Toward a more resilient financial system?" 2013 *Seattle University Law Review* 799.

[20] As explained by Svoronos *Early intervention regimes for weak banks* Financial Stability Institute FSI Insights on policy implementation No 6 at 1 available at https://www.bis.org/fsi/publ/insights6.pdf accessed on 2 August 2020 prudential authorities conduct "early interventions with the aim of prompting banks to address their weaknesses in a timely way. Early intervention measures are normally authorized under regular supervisory powers and generally allows for a significant amount of supervisory discretion and judgment. Some jurisdictions have also set up more formal early intervention measures to enable supervisors to directly address banks' weaknesses and trigger effective action when specific conditions are met. These interventions would for example follow when a banks minimum capital requirements are breached and formal early intervention would include powers to remove the management and/or board of the bank or to appoint an administrator for the bank." See further Restoy "Early Intervention regimes: the balance between rules vs discretion" *Speech presented at the FSI-IADI Meeting on early supervisory intervention, resolution and deposit insurance*, Basel, Switzerland, 12 September 2017 available at https://www.bis.org/speeches/sp170912.pdf accessed on 2 August 2020 who observes that "early intervention, from a supervisor's perspective "might be about the ability to change management behaviour, through moral suasion and more formal supervisory actions, while a bank's financial condition remains sound. This is broadly consistent with the goals of 'risk-based' supervision….that is, the ability to identify and address weaknesses in risk management and governance before these shortcomings permeate a bank's balance sheet and adversely affect earnings and regulatory capital."

[21] See Restoy "Early intervention regimes: the balance between rules vs discretion" *Speech presented at the FSI-IADI Meeting on early supervisory intervention, resolution and deposit insurance*, Basel, Switzerland, 12 September 2017 available at https://www.bis.org/speeches/sp170912.pdf accessed on 2 August 2020: Prompt corrective action was first introduced in the United States in the Federal

measures aimed at restoring the safety and soundness of banks and preventing their insolvency, it is also crucial to have regulatory measures in place to deal with banks that fail. This underlines the need for an appropriate framework that covers the whole continuum: regulatory measures that enable ordinary supervision when the business of the bank is going smoothly and is "plain sailing"; more stringent measures allowing the regulator to intervene and steer a bank that has veered into "unsafe and unsound" water back on track; and also measures where the regulator is allowed to step in and take over a bank's management in order to deal with failing banks that find themselves close to, or on, the rocks. The degree of distress experienced by a bank that finds itself on the brink of insolvency and unable to pay its debt may of course also differ: sometimes it may be possible for the regulator to "rescue" or "save" a bank which it regards as systemically important[22] because of the effect its failure can have on financial stability whilst in other instances the magnitude of the bank's problems and the loss of value of its shares and assets puts it beyond rescue, thus making liquidation the only option.

1.2 A new paradigm for dealing with failing banks in the 21st century

The optimal approach for dealing with failing banks in the 21st century has to a large extent been informed by changes that occurred over the course of the 20th century. In particular the 20th century saw some fundamental changes in the size of banks and the nature of banking business. Banks have increased tenfold or more in size, complexity

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Deposit Corporation Improvement Act of 1991 after the saving and loan and commercial bank crisis in the late 1980s. Restoy explains that prompt corrective action (which in some jurisdictions are also referred to as early intervention measures) prescribes "a series of both discretionary and mandatory corrective actions to be taken promptly when capital ratios decline to certain levels, with actions ranging from restricting growth, when a bank is considered to be undercapitalized to closing a bank if its tangible capital falls below 2% for a certain period of time." See also Dahl, Spivey "Prompt corrective action and bank efforts to recover from undercapitalization" 1995 *Journal of Banking and Finance* 225.

[22] See Basel Committee on Banking Supervision, *A framework for dealing with domestic systemically important banks*, October 2012 available at https://www.bis.org/publ/bcbs233.pdf accessed 12 June 2018; Basel Committee on Banking Supervision, *Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement*, July 2013 available at https://www.bis.org/publ/bcbs255.pdf accessed 12 June 2018; Yao, Zhu, Wei, Li "A systemic importance score for identifying systemically important banks" 2015 55 *Procedia Computer Science* 72 where it is indicated that a systemically important bank is a large, highly interconnected financial institution whose failure or impairment would potentially pose an unavoidable risk to the whole financial system and consequently harm the real economy.

and interconnectedness.[23] With the advent of universal banking[24] and conglomeration boundaries have become blurred and many banks have become intertwined in the global economy as part of large, often "Too Big To Fail" (TBTF)[25] financial conglomerates[26] that engage in an array of diverse and increasingly sophisticated

[23] As pointed out by Haentjens "Bank recovery and resolution: an overview of international initiatives" 2014 *International Insolvency Review* 255 the business and structure and cross-border operations of banks have evolved significantly with banks moving from the traditional "business of a bank" which entailed taking deposits and making loans to the blurred realm of "universal banking" where they "engaged in a wide variety of activities spanning deposit-taking and lending, dabbling in securities and investments all while their products and services became increasingly sophisticated and complex". In particular, banks moved past the notion of the "stand-alone" bank to a financial environment where they became part of large banking groups and often a bank became but one of the subsidiaries in large diversified financial conglomerates. Especially in these large financial conglomerates risk to the stability of the bank would arise from the risky ventures of other subsidiaries in the conglomerate and the bank's funds would be moved around to address financial deficiencies or funds risky investments undertaking by other subsidiaries. See also Miskova, Orszaghova "MREL: gone concern loss absorbing capacity" 2015 3:2015 *National Bank of Slovakia Banking Journal* 18 who remark that bank's business models have evolved beyond the traditional retail domain and they became increasingly engaged in trading and capital market activities. The financial sector also became more integrated across borders.

[24] Universal banks are financial institutions that offer the entire range of financial services and may sell insurance, and carry out securities transactions on behalf of others. See Lugulu "Addressing the moral hazard through Explicit Deposit Insurance: a comparative appraisal of the Kenya Deposit Insurance Act, 2012" (2019), *LLD Thesis, University of Pretoria* 9; Garten "Universal banking and financial stability" 1993 *Brooklyn Journal of International Law* 159; Benstone "Universal banking" 1994 *Journal of Economic Perspectives* 121 and Macey "The inevitability of universal banking" 1993 *Brooklyn Journal of International Law* 203. See also Wilmarth, "The dark side of universal banking: financial conglomerates and the origins of the subprime financial crisis" 2009 *Connecticut Law Review* 963; Dwivedi "Transformation of Financial Institutions into Universal Banks" 2015 available at https://www.lawctopus.com/academike/transformation-financial-institutions-universal-banks/ accessed 21 November 2019.

[25] To define "Too Big to Fail" (TBTF) Stern and Feldman start with the observation that "banks fail. Some banks fail without notice while other failing banks capture the attention of policymakers, often because of the bank's large size and significant role in the financial system. The failure of a large banking organization is seen as posing significant risks to other institutions, to the financial system as a whole and possibly to the economic and social order. Because of such fears, policymakers in many countries – developed and less developed, democratic and autocratic – respond by protecting uninsured creditors of banks from all or some of the losses they otherwise would face. These banks have assumed the title of TBTF, a term describing the receipt of discretionary government support by a bank's uninsured creditors who are not automatically entitled to government support. To the extent that creditors of TBTF banks expect government protection, they reduce their vigilance in monitoring and responding to these banks' activities. When creditors exert less of this type of market discipline, the banks may take excessive risks. TBTF banks will make loans and other bets that seem quite foolish in retrospect. These costs sound abstract but are, in fact, measured in hundreds of billions of dollars of lost income and output for countries, some of which have faced significant economic downturns because of the instability that TBTF helped to create. This undesirable behavior is frequently referred to as the "moral hazard" of TBTF protection. Such behavior wastes resources." See Stern, Feldman *Too Big to Fail: The Hazards of Bank Bailouts* (2004). See also Zhou, "Are banks too big to fail? measuring systemic importance of financial institutions" 2009 available at SSRN: https://dx.doi.org/10.2139/ssrn.1546384 accessed 21 November 2019; Mishkin "How big a problem is Too Big to Fail? a review of Gary Stern and Ron Feldman's Too Big to Fail: the hazards of bank bailouts" 2006 *Journal of Economic Literature* 988; Munger, Salsman "The implications of bailouts is "Too Big to Fail" too big" 2013 *Georgetown Journal of Law and Public Policy* 433.

[26] Financial conglomerates are defined as financial service firms that conduct at least two of the three major areas of financial services. While some operations may be exercised through a subsidiary, the criterion is that the parent company must consolidate non-traditional banking activities in its annual

products and services such as securitization and derivative trading. These new business models by banks transcend the traditional, and simpler, banking business of taking deposits and extending loans. Given the special nature of banks, particularly their role in taking deposits from the public, extending credit and their critical instrumentality in the payments system - which all mean that their failure may have a significantly devastating impact on financial stability - as well as the fact that their business and structures have diversified extensively and have become more risky, it has become clear that normal commercial insolvency procedures with their protracted procedural layers are not best suited to dealing with failing banks. Because banks are special role players in the economy and their failure can often have significant financial stability implications, they need a special approach when they become insolvent or are likely to become insolvent. Thus, bank failure merits a *lex specialis*.

This important point is emphasized by Hüpkes who states, in answer to the question why banks should be accorded special treatment in insolvency, that "the common answer is that banks play a special role in a country's economy in that, collectively, their functions are so important as to constitute a type of public service."[27] She points out that, in addition to the factors that make banks special as alluded to above,[28] what *actually* makes banks most special is their vulnerability to the loss of public confidence and bank runs which requires swift action to prevent contagion and loss of value when a bank encounters financial difficulty.[29] Hüpkes refers to the view held by some that "bank supervisors should only deal with 'living' banks while 'fatally ill' or 'dead' banks should be turned over to the 'mortician', the bankruptcy court." The argument in this regard is that since an insolvent bank can no longer conduct the business of a bank it

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statement. Conglomeration is thus associated with the potential conduct of a range of financial services comprising traditional banking (deposit-taking and lending), security-related services (for example trading of financial instruments and their derivatives, underwriting of new debt and equity issues, brokerage, investment management) and insurance. Universal banks on the other hand are defined as diversified banking institutions that also hold equity stakes in non-financial companies. See Vander-Vennet "Cost and profit efficiency of financial conglomerates and universal banks in Europe" 2002 *Journal of Money, Credit and Banking* 260. See also Wilmarth, "The dark side of universal banking: financial conglomerates and the origins of the subprime financial crisis" 2009 *Connecticut Law Review* 963 and Lugulu "Addressing the moral hazard through Explicit Deposit Insurance: a comparative appraisal of the Kenya Deposit Insurance Act, 2012" (2019), *LLD Thesis, University of Pretoria* 11.

[27] Hüpkes "Insolvency – why a special regime for banks?" 2005 3 *Current Developments in Monetary and Financial Law* 3.

[28] See para 1.

[29] Hüpkes "Insolvency – why a special regime for banks?" 2005 3 *Current Developments in Monetary and Financial Law* 4. Campbell and Cartwright "Deposit insurance, consumer protection, bank safety and moral hazard" 1999 *European Business Law Review* 96 argue that knowledge that deposits are partially protected may not be enough to prevent a bank run.

is no longer a bank and should therefore be treated like any other bankrupt corporation.[30] Yet Hüpkes indicates that this argument holds only in part, as banks "are already subject to special regulation which determines the condition of their operation, it is, therefore, only the bank supervisor - and not a bankruptcy judge or a meeting of creditors - who is in a position to determine whether a bank is viable. Thus, the bank supervisor must have a voice in the insolvency procedure."[31] She further points out that financial assets, as opposed to material assets such as merchandise, can be dissipated secretly and very quickly. For this reason alone, she argues that the bank supervisor needs to be able to intervene rapidly to prevent losses to depositors. Hüpkes also remarks that the unitary decision-making process under [bank] regulatory law appears faster and more efficient than the negotiated process under ordinary insolvency laws. This is because, given the special challenges involved in dealing with the failure of a bank as special institution in the financial system and economy, the bank supervisor needs to be able to swiftly take action in an emergency without being hamstrung by pre-compliance with various procedural requirements as would apply in terms of ordinary insolvency rules.[32]

In line with the aforementioned Franke, Krahnen and von Lupke remark that dealing with bank insolvency does not only differ from normal insolvency procedure by pace but also by objectives, because while ordinary insolvency procedure has the exclusive aim of maximizing proceeds, a special regime for dealing with bank insolvency will also aim to preserve financial stability.[33] As observed by Hüpkes: "the primary objective of the banking law is to ensure the stability of the financial sector as a whole and to prevent systemic problems." She further explains that whereas the receiver of a bankrupt company seeks to maximize assets in the interest of the creditors, the main objective of the receiver of a failed bank is to minimize the impact of the failure on the

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[30] Hüpkes "Insolvency – why a special regime for banks?" 2005 3 *Current Developments in Monetary and Financial Law* 8. Ashmead "Bankruptcy: In re Colonial Reality Co.: The second circuit harmonizes bankruptcy and bank insolvency law (rejecting established bankruptcy case law in the process)" 1994 60 *Brooklyn Law Review* 517, 519 comparing the relevant rules under the Bankruptcy Code to the procedure under the Federal Deposit Insurance Act governing bank insolvencies.

[31] Hüpkes E "Insolvency – why a special regime for banks?" 2005 3 *Current Developments in Monetary and Financial Law* 8.

[32] Hüpkes "Insolvency – why a special regime for banks?" 2005 3 *Current Developments in Monetary and Financial Law* 12.

[33] Franke, Krahnen and von Lupke "Effective resolution of banks: problems and solutions" Sustainable Architecture for Finance in Europe ("SAFE") Working Paper Series No. 19 available at https://connect.up.ac.za/https/www.econstor.eu/bitstream/10419/102027/1/796624771.pdf accessed 23 May 2018 2.

entire banking system. Therefore, in addition to creditor and debtor interests, bank insolvency must consider the public interest. In certain circumstances this consideration may also warrant a departure from the "*pari passu*"[34] principle (the equal treatment of all creditors) which holds in general insolvency law. For example, depositors and small creditors may be paid out in full while larger creditors are forced into a renegotiation of their claims. Similarly, it may be necessary to sell assets into an unfavourable market, or sell a business in a manner that does not take full advantage its value, in order to avoid market disruptions.[35] This sentiment that normal corporate insolvency procedures are insufficient to deal with bank failure is echoed by Randell who observes that the task of resolving even quite a small bank swiftly, and without allowing contagion to spread to other parts of the financial system, can be impossible if the authorities only have corporate insolvency procedures at their disposal.[36]

Apart from the fact that bank failure requires an expanded special framework dedicated to handling the peculiar exigencies of such failure in the public interest in financial stability, it is further to be noted that, given the interconnected structures that modern banks form part of, dealing with bank failure has become an increasingly complex, challenging and often costly exercise requiring radical and innovative measures to be applied. Straightforward "whole bank rescue" where a curator or administrator is appointed to take control of a bank that is failing and manage it out of its distress, thereby "rescuing" the entire failing bank so that it becomes a prosperous entity again, if maybe once viable in simpler times of more traditional and much smaller banking operations, has become increasingly difficult if not impossible, to apply in the 21st

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[34] *Pari passu* is a latin phrase meaning "with equal step", from *pari* ablative of *par*, "equal" and *passu*, ablative of *passus*, "step". That is to say, *pari passu* refers to things that are in the same situation, things that rank equally. See Olivares-Caminal "The pari passu clause in sovereign debt instruments: developments in recent litigation" BIS Papers No. 72 available at https://www.bis.org/publ/bppdf/bispap72u.pdf accessed 20 August 2020. Pari passu is also defined as "equal in right of payment". The *pari passu* principles means that "all unsecured creditors in insolvency processes, such as administration, liquidation, and bankruptcy must share equally any available assets of the company or individual, or any proceeds from the sale of any of those assets, in proportion to the debts due to each creditor. It is one of the most fundamental principles of insolvency law, although it can be varied by agreement." See Thompson Reuters "Pari passu" available at https://uk.practicallaw.thomsonreuters.com/1-384-6152?transitionType=Default&contextData=(sc.Default)&firstPage=true accessed 20 August 2020. See also Buchheit, Pam "The *pari passu* clause in sovereign debt instruments" 2004 *Emory Law Journal* 869.

[35] Hüpkes "Insolvency – why a special regime for banks?" 2005 3 *Current Developments in Monetary and Financial Law* 12.

[36] Randell "Legal aspects of bank resolution: designing the powers and solutions" *Paper presented at conference on "Operational Aspects of Bank Resolution and Restructuring" at the European Bank for Reconstruction and Development*, London, 19 March 2012 at 1.

century landscape where banks are entangled in complex, opaque networks of banking groups and conglomerate structures. In fact, in this era of financial leviathans "whole bank rescue" is a mirage, as practice has revealed that saving a bank and its operations in their entirety is not a general occurrence these days.[37] Rather, what has been happening on a *de facto* practical level in recent decades is that, where possible, viable parts of banks were being saved whilst their unviable parts were allowed to exit the financial system.

The drawback, especially during the recent 2008 Global Financial Crisis ("GFC"), was that due to the lack of an appropriate bank resolution framework in many countries, the process of dealing with bank failures was often facilitated by disorderly, messy "bail-outs" by treasuries and central banks who dipped their hands deep into taxpayers' money. However the 2008 GFC[38] that had its origin in the subprime mortgage crisis in the United States[39] was an seismic watershed event that spectacularly changed the

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[37] See the various bank failures discussed in Chapters 3, 4 and 5 of this thesis.

[38] Helleiner describes the 2008 global financial crisis as "the most severe since the Great Depression of the 1930s." See Helleiner E "Understanding the 2007 – 2008 global financial crisis: Lessons for scholars of international political economy" 2011 14 *Annual review of political science* 67. See also Mishkin "Over the cliff: from the subprime to the global financial crisis" 2011 *Journal of Economic Perspectives* 49; Stiglitz "Lessons from the Global Financial Crisis of 2008" 2010 *Seoul Journal of Economics* 321.

[39] See Demyanyk, Van Hemert "Understanding the subprime mortgage crisis" 2011 *The Review of Financial Studies* 1848 the term "subprime" can be used to describe "certain characteristics of the borrower (e.g., a FICO credit score less than 660); lender (e.g., specialization in high-cost loans); security of which the loan can become a part (e.g., high projected default rate for the pool of underlying loans); or mortgage contract type (e.g., no money down and no documentation provided, or a 2/28 hybrid). The common element across definitions of a subprime loan is a high default risk." See also the Cambridge dictionary, which describes "subprime" as an adjective used to describe the practice of lending money, especially to buy a house, to people who may not be able to pay it back. See also Calem, Gillen, Wachter "The neighbourhood distribution of subprime mortgage lending" 2004 *Journal of Real Estate Finance and Economics* 393 who observed that subprime lending in the residential mortgage market is characterized by relatively high credit risk and interest rates or fees. See further Mishkin "Over the cliff: from the subprime to the global financial crisis" 2011 *Journal of Economic Perspectives* 49 who explains the subprime mortgage crisis as follows: "The first disruption of credit markets in the recent financial crisis is often dated to August 7, 2007, when the French bank BNP Paribas suspended redemption of shares held in some of its money market funds. A boom in U.S. housing prices had peaked around 2005. As housing prices started to decline, mortgage-backed financial securities—in many cases, securities based on subprime residential mortgages but then divided into more senior claims that were supposedly safe and junior claims that were recognized to be risky—began to experience huge losses. By early 2008, losses on these securities were estimated to be on the order of $500 billion dollars. What developed in late 2007 and into 2008 was a series of bank runs on financial institutions. But instead of a classic bank run, it was described as a run on the shadow banking system. A bank has deposits that are short-term liabilities and assets that are long-term loans. Thus, in a classic bank run, when bank depositors run to withdraw deposits, the bank cannot readily convert its long-term assets into cash. In the shadow banking system, institutions have short-term liabilities in the form of short-term borrowing, like repurchase agreements (or repos), which use longer-term assets like mortgage-backed securities as collateral. A key element of this borrowing is the use of a "haircut", that is, a requirement that borrowers post collateral that is valued at more than the loan. For example, if a borrower took out a $100 million loan in a repo agreement, it might have to

trajectory of financial regulation, causing a significant shift in the global financial regulatory paradigm and elevating the pursuit of financial stability as core regulatory objective post GFC.[40] Regulators consequently became more intent on limiting moral hazard[41] and reigning in the risky ventures of systemically important banks and other financial institutions through increased and improved prudential and market conduct regulation.[42] The wake of the crisis also spelled the end of TBTF and evidenced a decisive move from the culture of "bail-out"[43] that was prevalent in the pre-GFC

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post $105 million of mortgage-backed securities as collateral, and the haircut would then be 5 percent. As the value of mortgage-backed securities fell and uncertainty about their future value increased, haircuts rose to levels as high as 50 percent. The result was that the same amount of collateral would now support less borrowing, leading to deleveraging in which financial institutions had to sell off assets. The resulting "fire sale" dynamic led to an adverse feedback loop in which the decline in asset values lowered the collateral's value while further raising uncertainty, causing haircuts to rise further, forcing financial institutions to deleverage and sell more assets, and so on. The collapse of Bear Stearns in March 2008 was the most visible of these runs on the shadow financing system. Short-term financing for Bear Stearns dried up. Its long-term assets could not quickly be turned into ready cash at a fair price, and without access to short-term funding, it could not continue. The Federal Reserve brokered a deal for JP Morgan Chase to purchase Bear, which was not unprecedented, but as part of the deal the Fed also took onto its books $30 billions of Bear Stearns's toxic assets, which was unprecedented. However, this deal and the opening of new Federal Reserve lending facilities to investment banks helped restore some calm to the market."

[40] National Treasury Policy Document, *A Safer Financial Sector to Serve South Africa Better*, 2011 available at http://www.treasury.gov.za/twinpeaks/20131211%20-%20Item%202%20A%20safer%20financial%20sector%20to%20serve%20South%20Africa%20better.pdf accessed 25 November 2019.

[41] See Marshall "Moral hazard" 1976 *The American Economic Review* 880. Moral hazard is commonly defined as "excessive expenditure due to eligibility for insurance benefits. In effect, the beneficiary is subsidized in his purchases and, as a consequence, continues to spend after marginal benefit falls below marginal cost. In this common view the social cost of moral hazard is the deadweight loss associated with the insurance subsidy." See Marshall "Moral hazard" 1976 *The American Economic Review* 880. See also McCoy "The moral hazard implications of deposit insurance: theory and evidence" *Seminar on current developments in monetary and financial law*, Washington D.C., 23-27 October 2006 who explains moral hazard as follows: On the one hand, explicit deposit insurance can significantly reduce the incidence of bank runs or even stop runs altogether in countries with strong institutions and proper safeguards. On the other hand, when not done carefully, explicit deposit insurance can fuel bank crises by giving banks perverse incentives to take unnecessary risks. See also Gropp, Vesala "Deposit insurance, moral hazard and market monitoring" 2004 European Central Bank Working Paper No. 302 available at https://connect.up.ac.za/https/www.econstor.eu/bitstream/10419/152736/1/ecbwp0302.pdf accessed 20 August 2020.

[42] National Treasury Policy Document, *Strengthening South Africa's Resolution Framework for Financial Institutions*, 2015 available at http://www.treasury.gov.za/twinpeaks/Strengthening%20South%20Africa%E2%80%99s%20Resolution%20Framework%20for%20Financial%20Institutions.pdf accessed 25 November 2019.

[43] A bail out (also termed solvency support) is the rescue of a failing institution by means of the provision of public funds. Bail-outs are not only costly, but are associated with moral hazard, whereby – in anticipation of a bail-out in the event of distress – banks are incentivised to take excessive risks or engage in strategies to become TBTF or collectively overinvest into specific classes of assets (such that in the event of systemic distress affecting those asset classes, the banks are too many to fail). Empirical research shows that bank resolution reforms that transfer risk from taxpayers to bank shareholders and creditors reduce the costs associated with bank failure, including the *ex-ante* costs (the costs related to the risk that a solvent bank might fail in a given period). This does not capture the full impact on public finances – effective bank resolution can reduce the risk of indirect effects in the

landscape and during the GFC, to a more controlled culture of "bail-in"[44] post GFC. Whereas bail-outs during the GFC were extended in a haphazard *ad hoc* fashion using taxpayers' money, the "bail-in" concept entailed a more controlled pre-planned approach premised upon the view that those who profited most from the business of a bank, namely its shareholders, investors and other creditors, needed to be called to task to recapitalise the bank when it encountered failure. Using public funds (taxpayers' money) to bail out the distressed institution no longer became the go-to measure for addressing systemic bank failure.

From the perspective of this thesis, the words of Winston Churchill to "never let a good crisis go to waste"[45] thus appear very apt. Indeed, one of the positive regulatory spin-offs of the 2008 GFC was that it put "bank resolution" as a comprehensive approach to dealing with failing banks on the map, so to speak. In addressing bank failure and dealing with failing banks, the post–GFC regulatory reforms assumed a pre-emptive as well as a remedial stance: it entailed elaborate ex ante interventions by international standard setting bodies such as the Basel committee on Banking Supervision that issued *Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems.*[46] Basel III is a pro-active intervention framework aimed at preventing bank distress and failure by strengthening prudential regulation and the ability of banks to be more resilient in the face of adverse economic circumstances and other events. Basel III seeks to achieve this objective through imposing more stringent capital reserve requirements, enhanced risk coverage, reducing pro-cyclicality[47] and

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real economy, as financial crises are associated with higher borrowing costs, a slowdown in GDP growth, and higher asset prices. See Brodie, *Bank Resolution: Key Issues and Local Perspectives*, (2019).

[44] The bail-in approach constitutes a "radical re-thinking of who bears the ultimate costs of the operation of the financial system and especially of fractional reserve banking. It replaces the public subsidy with a private penalty or with private insurance forcing banks to internalize the costs of the risks they assume. This penalty is meant to force creditors to intensify bank monitoring thereby helping to restore market discipline and become more alert about the levels of leverage a bank carries." See Avgouleas and Goodhart "An anatomy of bank bail-ins: why the eurozone needs a fiscal backstop for the banking sector" 2016 *European Economy – Banks Regulation and the Real Sector* 75. See further Chapter 2 para 2.4 regarding bail-in within resolution.

[45] British Prime Minister Sir Wiston Churchill's famous observation – made during the bleakest days of World War II. See Larson *The Splendid and the Vile: A Saga of Churchill, Family and Defiance During the Blitz* (2020).

[46] Basel Committee on Banking Supervision, *Basel III A global regulatory framework for more resilient banks and banking systems*, December 2010 Revised 2011 available at https://www.bis.org/publ/bcbs189.pdf accessed 11 December 2019. The Basel III Accord was issued in December 2010 and revised in June 2011.

[47] Landau "Procyclicality – what it means and what could be done" *The Bank of Spain's conference on Procyclicality and the Role of Financial Regulation;* Madrid, 4 May 2009 available at

promoting countercyclical buffers[48] - all aimed at increasing a bank's ability to absorb losses and remain resilient.[49] Across the globe prudential frameworks were upgraded to include early intervention measures and prompt corrective action provisions. There was also renewed emphasis on the need for effective deposit insurance systems[50] designed to mitigate moral hazard and promote market discipline through the imposition of risk-based premiums on member banks.

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https://www.bis.org/review/r090805d.pdf accessed 11 December 2019. According to Landau, Procyclicality refers to "the tendency of financial variables to fluctuate around a trend during the economic cycle. This points to the policy challenges regulators face. They have to try and identify when pure cyclical fluctuations morph into something different: either a change in the trend itself or the start of a cumulative process. Landau points out that a good operational approach to procyclicality would look at all amplification mechanisms which provoke (or allow) the financial system to deviate durably or permanently from its predetermined path) so that the trend itself may be affected in the short or medium run." See also Feldstein and Mauboussin "Procyclicality and its extremes" 2018 available at https://www.bluemountaincapital.com/wp-content/uploads/2015/03/Procyclicality-and-Its-Extremes.pdf accessed 11 December 2019. Feldstein and Mauboussin explain that "in economics, procyclical variables move in the same direction as the economy: consumers and businesses and investors are bold when economic conditions appear strong and timid in the wake of weakness. Procyclical behaviour need not be reckless or irrational. Some procyclical behaviour is warranted because there is more opportunity when the economy is strong than when it is weak." See also Caruana "Basel III: towards a safer financial system" *3rd Santander International Banking Conference*, Madrid, 15 September 2010 available at https://www.bis.org/speeches/sp100921.pdf accessed 11 December 2019. Caruna describes procyclicality as the financial system's tendency to amplify the ups and downs of the economy. Caruana points out that on the procyclicality aspect, Basel III will promote the build-up of buffers in good times that can be drawn down in periods of stress.

[48] Basel Committee on Banking Supervision, *Basel III A global regulatory framework for more resilient banks and banking systems*, December 2010 Revised 2011 available at https://www.bis.org/publ/bcbs189.pdf accessed 11 December 2019. Basel III notes that "losses incurred in the banking sector can be extremely large when a downturn is preceded by a period of excess credit growth. These losses can destabilise the banking sector and spark a vicious circle, whereby problems in the financial system can contribute to a downturn in the real economy that then feeds back on to the banking sector. These interactions highlight the particular importance of the banking sector building up additional capital defences in periods where the risks of system-wide stress are growing markedly. The countercyclical buffer aims to ensure that banking sector capital requirements take account of the macro-financial environment in which banks operate. It will be deployed by national jurisdictions when excess aggregate credit growth is judged to be associated with a build-up of system-wide risk to ensure the banking system has a buffer of capital to protect it against future potential losses. This focus on excess aggregate credit growth means that jurisdictions are likely to only need to deploy the buffer on an infrequent basis. The buffer for internationally-active banks will be a weighted average of the buffers deployed across all the jurisdictions to which it has credit exposures. This means that they will likely find themselves subject to a small buffer on a more frequent basis, since credit cycles are not always highly correlated across jurisdictions."

[49] The G20 *Seoul Summit Leaders' Declaration* 2010 available at http://www.g20.utoronto.ca/2010/g20seoul.html accessed 12 August 2016.

[50] International Association of Deposit Insurers, *IADI Core Principles for Effective Deposit Insurance Systems* November 2014 available at https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf accessed 17 July 2020. See also Micajkova "Deposit Insurance in times of financial crisis" 2013 *South-Eastern Europe Journal of Economics* 165 and Kerlin "Development of deposit insurance systems in the world" 2015 *Journal of Management and Financial Sciences* 33.

With regard to failing banks the haphazard ad hoc bail-outs during the GFC[51] thus directed the regulatory sentiment decidedly against TBTF and the moral hazard and drain on public funds occasioned by the bail-outs that were extended to these institutions. Accordingly, the post GFC regulatory paradigm is intent on the "orderly resolution" of financial institutions. Although a concept with various permutations that are often country-specific, Randell describes orderly bank resolution as "special arrangements for the winding-up or restructuring of a failing bank by virtue of powers that go beyond the general powers conferred by the normal insolvency law applying to companies. These powers may exist within insolvency legislation or by adaptation of insolvency processes, but often they take the form of special administrative powers that can be exercised by the authorities without, or alongside, normal insolvency proceedings."[52]

Notably bank resolution is not a new concept[53] that emerged post GFC but the focus on orderly bank resolution has become increasingly pertinent in the context of reforms undertaken after the Crisis. In fact, the evolution of orderly bank resolution as a key regulatory pursuit gained momentum in 1998, in the aftermath of the Barings insolvency in the UK,[54] when a report was published by the G30 together with INSOL International which specifically addressed the problems that may arise in a cross-border insolvency in the financial sector. In particular this report observed that no framework existed to address such a situation.[55]

At the time of the GFC most countries had frameworks for dealing with failing banks but these frameworks were generally pegged on non-integrated resolution options that

[51] For examples of such haphazard bail-outs see Quaglia, Hodson "European perspectives on the Global Financial Crisis: introduction" 2009 *Journal of Common Market Studies* 939. See further Wray LR "Global Financial Crisis: causes, bail-out, future draft" 2012 80:4 *UMKC Law Review* 1101 and Ait-Sahalia, Andritzky, Jobst, Nowak, Tamirisa "Market response to policy initiatives during the global financial crisis" 2012 87 *Journal of International Economics* 162.

[52] Randell "Legal aspects of bank resolution: designing the powers and solutions" *Paper presented at conference on "Operational Aspects of Bank Resolution and Restructuring" at the European Bank for Reconstruction and Development*, London, 19 March 2012 at 4. See further the discussion of the FSB Key Attributes of Effective Resolution Regime as discussed in Chapter 2 hereinafter.

[53] See Basel Committee on Banking Supervision, *Resolution Policies and frameworks – progress so far*, July 2011 available at https://www.bis.org/publ/bcbs200.pdf accessed on 24 April 2020.

[54] See UK chapter para 2.

[55] United Nations, Commission on International Trade Law, Working Group V (Insolvency Law), *Insolvency of Large and Complex Financial Institutions*, *Note by the Secretariat*, 24 September 2012 available at https://undocs.org/en/A/CN.9/WG.V/WP.109 accessed 17 August 2020 at 3. Haentjens "Bank recovery and resolution: an overview of international initiatives" 2014 *International Insolvency Review* 255.

were limited in scope and scale and comprised of narrow bank rescue procedures and of a liquidation process for banks that could not be saved. Following the GFC, but really given impetus by the insolvency of Lehman Brothers in September 2008,[56] the G20 and other international leaders acknowledged that an effective resolution framework for financial institutions was essential to secure financial stability and limit moral hazard. It was also recognised that such a framework should be accompanied by robust cross-border coordination mechanisms as the financial services sector became increasingly interconnected and global over time. The G20 consequently called for a review of resolution regimes and insolvency laws.[57]

In April 2009, the Financial Stability Forum (the Financial Stability Board's predecessor) published "Principles for cross-border cooperation on crisis management", requiring that national authorities develop cooperation strategies and measures for information sharing between themselves. In this document they also strongly encouraged financial institutions to maintain contingency plans.[58] The BCBS also worked on a report and recommendations for the resolution of cross-border financial institutions following the recognition that prudential measures such as capital requirements alone cannot limit moral hazard without instituting a viable resolution process for cross-border financial institutions. Haentjens observes that the realization had dawned that "in order to prevent financial institutions from relying on public lenders of last resort, a credible resolution framework should be put in place."[59] The BCBS concluded that national authorities should have the tools to effectuate the orderly resolution of all types of financial institutions, and thus contribute to the minimization

[56] For more detail on the failure of Lehman Brothers see Mishkin "Over the cliff: from the subprime to the global financial crisis" 2011 *Journal of Economic Perspectives* 49 and also Swedberg "The structure of confidence and the collapse of Lehman Brothers" 2010 *Markets on Trial: The Economic Sociology of the U.S Financial Crisis: Part A* 71.

[57] IMF, *Resolution of cross-border banks – A proposed framework for enhanced coordination,* June 2010 available at https://www.imf.org/external/np/pp/eng/2010/061110.pdf accessed 17 August 2020 at 5. Haentjens "Bank recovery and resolution: an overview of international initiatives" 2014 *International Insolvency Review* 255.

[58] Financial Stability Forum, *FSF Principles for cross-border cooperation on crisis management* April 2009 available at https://www.fsb.org/wp-content/uploads/r_0904c.pdf accessed 17 August 2020. Haentjens "Bank recovery and resolution: an overview of international initiatives" 2014 *International Insolvency Review* 255.

[59] Basel Committee on Banking Supervision, *Report and Recommendations of the Cross-border Bank Resolution Group*, 2010 available at http://www.bis.org/publ/bcbs162.pdf?noframes=1 accessed 18 May 2020 at 3. Haentjens "Bank Recovery and Resolution: An Overview of International Initiatives" 2014 *International Insolvency Review* 255.

of risk, consumer protection, limitation of moral hazard and promotion of market efficiency.[60]

In 2009 the IMF and World Bank also published a study titled "An Overview of the Legal, Institutional and Regulatory Frameworks for Bank Insolvency" which focused on deposit taking institutions at the domestic level (i.e. not on cross-border institutions).[61] Subsequently in June 2010 the IMF published a further report titled "Resolution of Cross-Border Banks – A Proposed Framework for Enhanced Coordination"[62] indicating that under an enhanced coordination framework cooperating authorities could share the burden of funding failed banks and agree on taking of resolution actions with cross-border effects. Note should also be taken that the United Nations Commission on International Trade Law (UNCITRAL) also played a role in the context of the development of resolution regimes. In 2004 UNCITRAL published Parts 1 and 2 of its "Legislative Guide to Insolvency Law" in respect of domestic commercial insolvency regimes.[63] In the wake of the GFC Part 3 of the UNCITRAL Guide was published in 2010 and addressed the treatment of enterprise groups in insolvency, nationally and internationally.[64]

The international best practice benchmark for orderly resolution frameworks was conceptualised by the Financial Stability Board (FSB) that issued its *Key Attributes of*

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[60] Basel Committee on Banking Supervision, *Report and Recommendations of the Cross-border Bank Resolution Group*, 2010 available at http://www.bis.org/publ/bcbs162.pdf?noframes=1 accessed 18 May 2020 at 5 and 16 et seq. Haentjens "Bank recovery and resolution: an overview of international initiatives" 2014 *International Insolvency Review* 255.

[61] International Monetary Fund and the World Bank *An Overview of the Legal, Institutional, and Regulatory Framework for Bank Insolvency*, April 2009 available at https://www.imf.org/external/np/pp/eng/2009/041709.pdf accessed 17 August 2020.

[62] IMF, *Resolution of cross-border banks – A proposed framework for enhanced coordination,* June 2010 available at https://www.imf.org/external/np/pp/eng/2010/061110.pdf accessed 17 August 2020. Haentjens "Bank recovery and resolution: an overview of international initiatives" 2014 *International Insolvency Review* 255.

[63] United Nations, Commission on International Trade Law, *Legislative Guide on Insolvency Law* (part 1 and 2) United Nations, New York 2004 available at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf accessed 17 August 2020. Haentjens "Bank Recovery and Resolution: An Overview of International Initiatives" 2014 *International Insolvency Review* 255.

[64] Wessels *International Insolvency Law 3rd edition* (2012) para. 10425. Haentjens "Bank recovery and resolution: an overview of international initiatives" 2014 *International Insolvency Review* 255. Given the overlap between the issues addressed in Part 3 of the UNCITRAL Guide and the issues addressed by the BCBS in its work on cross-border banking groups, the BCBS recommended that the UNCITRAL Guide should also be used for banking group insolvencies. Consequently the UNCITRAL Working Group V (Insolvency Law) referred the development of rules regarding the recognition of foreign resolution actions and cross-border cooperation in the context of large and complex financial institutions insolvencies to the FSB.

Effective Resolution Regimes for Financial Institutions ("the KAs") in 2011 (updated in 2014) as a blueprint for reform to facilitate the orderly recovery and resolution of distressed financial institutions such as banks.[65] These principles were crafted with a view to setting standards for resolving and "rescuing" banks or parts thereof that are able to be saved in an orderly manner and facilitating the orderly exit from the financial system of those banks or parts of banks for which liquidation is the more appropriate option, as discussed in detail in Chapter Two hereinafter.[66]

1.3 Dealing with bank failures in Zimbabwe

Zimbabwe is a developing country with a fragile economy that, like most other countries, has to deal with many challenges, *inter alia* that of failing banks. In order to deal with bank failures the Banking Act [Chapter 24:20] provided for the mechanism of curatorship since 2000 as a rescue measure aimed at restoring failing banks to economic viability.[67] As such section 53 of the Banking Act provides that the central bank, the Reserve Bank of Zimbabwe ("RBZ"), can place a bank under curatorship where the RBZ considers that the bank is in an unsound financial condition and is not operating by sound administrative and accounting practices and procedures or has failed to comply with the minimum financial requirements prescribed in terms of the Banking Act. In simple terms curatorship is an administrative process that provides the curator with a toolkit to take over the management and assets of the failing bank with the aim of restoring it to economic viability. Curatorship has over the years been applied with mixed success as discussed hereinafter in Chapter Three. It was however clearly not the sole panacea for all banks who encountered failure.

The problem of failing banks occasioned various reforms aimed at making banks more resilient and strengthening their corporate governance frameworks, but the problem of bank failures, although mitigated, nevertheless remain given that sound prudential regulation is not an absolute safeguard against bank failure. Zimbabwe has consequently in recent years undertaken a number of reforms to improve its framework

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[65] Financial Stability Board, *Key Attributes of Effective Resolution Regimes for Financial Institutions*, October 2014 available at https://www.fsb.org/wp-content/uploads/r_141015.pdf accessed 7 June 2020.

[66] *Ibid*.

[67] The Banking Act [Chapter 24:20] commenced on 1 August 2000. The previous Banking Act is [Chapter 24:01] of 1965.

for dealing with failing banks. The reforms included the enactment of the Troubled Financial Institutions (Resolution) Act in 2005 and the introduction of a problem bank regime via the Banking Amendment Act of 2015, as discussed in detail in Chapter Three. Throughout these reforms Zimbabwe has chosen to retain curatorship which was initially a separate standalone process in its banking legislation for purposes of enabling bank rescue but which in recent times have been assimilated into a broader bank resolution framework.

The IMF has however indicated that the framework for bank resolution in Zimbabwe requires to be augmented and strengthened.[68] Clearly a comprehensive resolution regime that complies with international best practice in all material respects whilst still tailored to suit the specific country needs and legal landscape of Zimbabwe would serve the country well when it comes to dealing with bank failure.

1.4 Research statement

Curatorship of banks, if appropriately designed and effectively implemented, can serve to provide a process through which distressed banks can be managed back to viability thus enabling the maintenance of financial system stability. However, in the post-GFC landscape the optimal approach to dealing with failing banks, including the "rescue" of a failing bank or parts of a failing bank that may still be viable, has been broadened to encompass a comprehensive and integrated resolution regime which avails a wider range of tools and powers to the resolution authority than under curatorship. Post GFC best practice therefore recommends that countries should adopt holistic resolution regimes from which the regulators can then cherry pick appropriate solutions to deal with failing banks. As such a well-designed resolution regime should yield tools and powers that can be applied for purposes of bank rescue as well as for liquidating and facilitating the orderly exit from the financial system of banks, or those parts of banks, that are no longer viable and are unable to be salvaged.

Accordingly, using the FSB Key Attributes of Effective Resolution Regimes as discussed in Chapter 2 hereinafter as benchmark, this study will consider curatorship

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[68] IMF Country Reports, *Zimbabwe: Staff Monitored Program – Press Release and Staff Report, No. 19/144* May 2019 available at https://www.imf.org/en/Publications/CR/Issues/2019/05/31/Zimbabwe-Staff-Monitored-Program-Press-Release-and-Staff-Report-46952 accessed 17 August 2020.

as applied in sections 53 to 56 of the Zimbabwean Banking Act as well as measures subsequently adopted to deal with failing banks in Zimbabwe. The purpose of the study is to determine whether Zimbabwe currently adopts an optimal resolution approach to dealing with bank failure that would effectively facilitate bank rescue where appropriate or whether any reforms to the current resolution framework are required, in which instance suitable recommendations will be made.

1.5 Research objectives

The research objectives of this study will be to:

(a) Interrogate international best practice in relation to the design features of an effective orderly bank resolution framework to deal with bank failure, with a particular focus on measures to rescue a failing bank or parts thereof;

(b) to interrogate the process of curatorship in Zimbabwe as well as subsequent reforms to banking legislation aimed at dealing with failing banks in order to determine any gaps that may exist in the resolution approach applied to dealing with failing banks, including rescuing parts of failing banks where viable;

(c) to interrogate the approaches towards dealing with failing banks, including those measures geared at rescuing failing banks in the selected comparative jurisdictions, namely the United Kingdom and South Africa, to ascertain whether they could yield any guidance for Zimbabwe;

(d) to make proposals for the reform of Zimbabwe’s resolution framework for dealing with bank failures, including measures aimed at rescuing failing banks or parts thereof.

1.6 Selection of comparative jurisdictions

For purposes of this study two comparative jurisdictions are selected, namely the United Kingdom and South Africa.

The UK is selected as a comparative jurisdiction for the following reasons: Zimbabwe (then Southern Rhodesia) was colonised in 1890 by Cecil John Rhodes’ British South

Africa Company's (BASC) search for gold.[69] Southern Rhodesia was automatically admitted into the imperial sterling currency arrangements from 1890.[70] Like other British colonies, Southern Rhodesia became generally "linked through systematic primary product export to the wider international economy," but particularly to serve the early colonial settler economy and its trade with Britain.[71] Commercial banking was initially foreign-owned as elsewhere in Africa.[72] As a result British Banking law influenced the development of the banking laws in Zimbabwe hence Zimbabwe had a relatively sophisticated range of financial markets and institutions, which began to develop before the 1960s (the decade of African Independence), many years before Zimbabwe's full independence in 1980.[73] In addition, London is recognised as one of the World's biggest financial centres as it dominates international financial market activity and is also home and host to some of the biggest financial institutions in the

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[69] Nyamunda "Money, banking and Rhodesia's Unilateral Declaration of Independence" 2017 *The Journal of Imperial and Commonwealth History* 751. As the BSAC initially speculated on mining but latterly diversified into land, the ultimate beneficiary of Southern Rhodesia's colonisation was London.

[70] As pointed out by Nyamunda, colonial monetization was essential because "the interests of leading Western nations lay in ensuring that the currencies of countries engaged in international trade were soundly based, readily convertible, and otherwise compatible with the working of the gold standard so that world commerce could be conducted and expanded with smooth efficiency". See Nyamunda "British sterling imperialism, settler colonialism and the political economy of money and finance in Southern Rhodesia 1945 – 1962" 2017 *African Economic History* 81.

[71] *Ibid*. Nyamunda explains that the Second World War, however, "triggered secondary industrial development through import substitution industrialisation (ISI), leading also to urban expansion. Colonial monetary arrangements had largely displaced indigenous exchange traditions, subjecting Africans to the interests of settler and imperial capital. In Southern Rhodesia, Britain wanted a guaranteed sterling market for tobacco, for example, to avoid buying from the United States and therefore save dollars in the imperial foreign exchange reserves. Consequently, although Southern Rhodesia reaped a guaranteed and enlarged market for its tobacco by default, it still demanded discretionary financial authority from the British Empire through the creation of a Central bank and exit from the sterling area in the late 1940s and 1950s, culminating in seeking an outright political solution."

[72] See Harvey "The limited impact of financial sector reforms in Zimbabwe" 1996 Working Paper No. 36, Institute of Development Studies, University of Sussex available at https://opendocs.ids.ac.uk/opendocs/bitstream/handle/20.500.12413/3340/Wp36.pdf?sequence=1 accessed 17 August 2020 3.

[73] *Ibid*. Nyamunda alludes to the following: Currency Board was established in 1938, a stock exchange opened as early as 1946; and by 1963 there were thirteen brokers, and 98 quoted shares. Treasury bills were first issued in 1952, enabling banks to acquire local liquid assets and providing the government with budget finance from funds which had previously been in foreign bank balances. A central bank was established in 1956 for the Federation of Rhodesia and Nyasaland, of which Zimbabwe (then Southern Rhodesia) was a dominant member. The motivation was not, as with the later establishment of central banks in other African countries, a belief that a central bank would in some way redress the lack of credit for Africans, but a "desire for greater monetary autonomy and a recognition of the waste involved in a 100 per cent foreign exchange coverage against local currency". Two accepting houses (merchant banks) were established in 1956 soon after the foundation of the central bank, and two discount houses were established in 1959. When the Federation broke up in 1963, the central bank simply changed from being the Bank of Rhodesia and Nyasaland to become the Reserve Bank of Rhodesia in 1965, and the Reserve Bank of Zimbabwe in 1980.

world.[74] Furthermore, the UK is one of the countries hardest hit by the GFC but it rapidly improved its crisis management framework including a new Special Resolution Regime to resolve and restructure failing institutions.[75]

Like Zimbabwe, South Africa is also a third world country and arguably the leading emerging market on the African content. South Africa has been a member of the G-20 since its inception and has over the years gained recognition as a country with a robust approach to banking regulation and it has historically had relatively few bank failures. South Africa has for many decades made use of curatorship as a measure to deal with failing banks in an attempt to effect bank rescue. However, in recent times South Africa has embarked on transitioning from a narrow approach to dealing with bank failures which comprised of curatorship and liquidation as the two options available to deal with such failures to a more comprehensive resolution regime with an expanded toolkit to deal with failing banks.

1.7 Methodology

The proposed research will comprise a critical doctrinal study of policy documents, legislation as well as books, journal articles, cases and internet sources and media statements.

1.8 Delimitation

The main focus of this study is whether the resolution framework employed in Zimbabwe is optimal from the perspective of rescuing failing banks or parts thereof. Accordingly, the focus of the thesis will be on aspects such as the scope of the resolution regime, triggers for resolution and resolution objectives, the resolution authority, resolution funding; safeguards to protect property rights; the general resolution powers of the resolution authority; and the main resolution measures (tools)

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[74] IMF Working Papers, Chan-Lau, Mitra, Ong**,** *Contagion risk in the international banking system and implications for London as a global financial center* IMF Working Paper WP/07/74 2007 available at https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Contagion-Risk-in-the-International-Banking-System-and-Implications-for-London-As-a-Global-20577 accessed 7 June 2020.

[75] IMF Country Report**,** *United Kingdom: Financial Sector Assessment Program, Financial System Stability Assessment*, IMF Country Report No. 16/167, 2016 available at https://www.imf.org/external/pubs/ft/scr/2016/cr16167.pdf accessed 7 June 2020. See also Hodson and Mabbett, "UK economic policy and the Global Financial Crisis: paradigm lost" 2009 *Journal of Common Market Studies* 1041.

as well as whether curatorship or a tool akin to curatorship could be incorporated as part of a country's broader resolution regime. For the sake of completeness Chapter 2 will provide an overview of all twelve FSB Key Attributes, including Key Attributes 7,8,9 and 12 which deals with the legal framework for cross-border cooperation, crisis management, cooperation agreements and information sharing. However, these lastmentioned aspects lend themselves to a detailed and separate study and will not be addressed in any detail in this thesis. Albeit that liquidation of a failing banks forms part of the broader concept of bank resolution, the liquidation of failing banks is not part of the focus of the study and consequently bank liquidation will only be referred to peripherally where relevant. Further, it is acknowledged that bank resolution is not applied *in vacuo* but slots in as part of the financial safety net that includes prudential regulation and deposit insurance. Accordingly, bank failure has to be treated first by applying prudential measures that would curb such failure. These measures would for example include provisions pertaining to adequate licensing criteria, regulatory capital and liquidity requirements, limits on significant shareholding and large exposures, strengthened corporate governance measures, and an appropriate sanctioning regime with best practice provisions for early intervention and prompt corrective actions by the bank supervisor. An in-depth discussion of these measures is however beyond the focus of this thesis and occasionally some peripheral mention will be made of them. Likewise, peripheral reference only will be made to deposit insurance and its relevance in the context of bank resolution. A detailed examination of deposit insurance as a mechanism to mitigate the cost of dealing with bank failure is however beyond the scope of this thesis.

1.9 Chapter Lay-out

Chapter One serves as the roadmap for this thesis. It considers the special nature of banks which is also the reason why banks should be treated differently from other corporate financial institutions when they fail. It highlights the focus of the study which is to consider and evaluate measures taken in Zimbabwe to deal with failing banks and whether the current resolution framework for failing banks in Zimbabwe is in need of reform and if so, how it can be reformed to align it with best international practice. Chapter One further sets out the research statement and the research objectives of the study, the research methodology to be applied, the rationale for the selection of the

comparative jurisdictions and the delimitations of the study as well as a broad lay-out of the structure of the thesis.

Chapter Two will interrogate the international best practice standards for dealing with failed banks post GFC. In particular it will consider the *FSB Key Attributes of Effective Resolution Regimes* as international standards by which countries can benchmark the effectiveness of their approach to dealing with bank failures.

Chapter Three will comprise of a critical investigation into the legislative framework for dealing with bank failures in Zimbabwe in order to identify aspects that require reform to align it with international best practice.

Chapter Four will entail a critical investigation into the legal framework for dealing with bank failure in the UK with specific focus on rescuing of failing banks or parts thereof and best practice guidance to be taken in this regard.

Likewise Chapter Five will comprise of a critical analysis of measures available in South Africa to address bank failure, again with the aim of focusing on the rescue of failing banks and taking best practice guidance in this context.

Chapter Six will contain the conclusions and recommendations of the study.

Chapter Two: International best practice for dealing with failing banks

2.1 Introduction

The FSB Key Attributes of Effective Resolution Regimes for Financial Institutions were adopted at the 2011 plenary meeting of the FSB as the core elements considered necessary for the design of a comprehensive and effective resolution regime.[76] The G-20 Heads of States and Government subsequently endorsed the Key Attributes at the Cannes Summit in November 2011 as "new international standards for resolution

[76] Financial Stability Board: Key Attributes of Effective Resolution Regimes for Financial Institutions 15 October 2014 1. See also "Key Attributes of Effective Resolution Regimes for Financial Institutions" available at https://www.fsb.org/wp-content/uploads/r_141015.pdf accessed 7 September 2019.

regimes".[77] Albeit that the policy document containing the Key Attributes is not a binding legislative instrument it is widely accepted as capturing international best practice for resolution regimes and its relevance as benchmark for resolution regimes is also entrenched in the Basel Core Principles of Effective Bank Supervision.[78] In particular the Basel Committee on Banking Supervision recommended that national authorities "should have appropriate tools to deal with all types of financial institutions in difficulties so that an orderly resolution can be achieved that helps maintain financial stability, minimise systemic risk, protect consumers, limit moral hazard and promote market efficiency."[79]

On 15 October 2015, the FSB adopted additional guidance that elaborates on specific Key Attributes relating to information sharing for resolution purposes and sector-specific guidance that sets out how the Key Attributes should be applied for insurers, financial market infrastructures and the protection of client assets in resolution.[80] The newly adopted guidance documents have been incorporated as annexes into the 2014 version of the Key Attributes document. Notably, no changes were made to the text of the twelve Key Attributes of October 2011 and they remain the umbrella standard for resolution regimes covering financial institutions of all types that could be systemic

[77] *Ibid*. See also section 13, Communiqué G20 Leaders Summit – Cannes 3-4 November 2011 available at https://www.oecd.org/g20/summits/cannes/Cannes%20Leaders%20Communiqué%204%20%20November%202011.pdf accessed 17 September 2020. The Key Attributes are used by the World Bank and IMF in providing Financial Sector Assessment Programs and Technical Assessments.

[78] See the Basel Core Principles for Effective Banking Supervision para 51 where it is stated that: "Effective crisis management frameworks and resolution regimes help to minimize potential disruptions to financial stability arising from banks and financial institutions that are in distress or failing. A sound institutional framework for crisis management and resolution requires a clear mandate and an effective legal underpinning for each relevant authority (such as banking supervisors, national resolution authorities, finance ministries and central banks). The relevant authorities should have a broad range of powers and appropriate tools provided in law to resolve a financial institution that is no longer viable and where there is no reasonable prospect of it becoming viable. There should also be agreement among the relevant authorities on their individual and joint responsibilities for crisis management and resolution, and how they will discharge these responsibilities in a coordinated manner. This should include the ability to share confidential information among one another to facilitate planning in advance to handle recovery and resolution situations and to manage such events when they do occur." See also Basel Committee on Banking Supervision *Resolution policies and frameworks – progress so far*, July 2011 available at https://www.bis.org/publ/bcbs200.pdf accessed on 24 April 2020 for an assessment of *inter alia* legislative and other changes to national resolution regimes and policies needed to accomplish effective bank resolution.

[79] Basel Committee on Banking Supervision *Resolution policies and frameworks – progress so far*, July 2011 available at https://www.bis.org/publ/bcbs200.pdf accessed on 24 April 2020 para 39.

[80] *Ibid.*

when they fail.[81] Given that the Key Attributes do not limit its design features for resolution regimes to the resolution of banks only but also cater for non-bank financial institutions the term “firm” is used by the FSB in the discussion of the framework for an effective resolution regime. For purposes of this thesis, the Key Attributes will however be discussed in relation to dealing with bank failure specifically hence in addition to some peripheral references to “firms”, in the discussion below reference will generally be made to the concept “bank”.

The FSB is of the view that the implementation of the Key Attributes ought to allow authorities to resolve financial institutions in an orderly manner without taxpayer exposure to loss from solvency support while maintaining continuity of their vital economic functions.[82] Accordingly, the objective of an “effective resolution regime,” as contemplated in the Key Attributes, is to “make possible the resolution of financial institutions without severe systemic disruption and without exposing taxpayers to loss while protecting vital economic functions through mechanisms which make it possible for shareholders and unsecured creditors to absorb losses in a manner that respects the hierarchy of claims in liquidation”.[83]

The Key Attributes set out twelve essential features that the FSB argues, should be part of the resolution regimes of all jurisdictions in order to ensure their effectiveness.[84] These “building blocks” of an effective resolution regime cover the following: the scope of the resolution regime; the designated resolution authority; resolution powers; set-off; netting; collateralisation and segregation of client assets; safeguards during resolution; funding of firms in resolution; legal framework conditions for cross-border cooperation; crisis management groups (“CMGs”); institution-specific cross-border cooperation agreements; resolvability assessments; recovery and resolution planning; and, access to information and information sharing, as discussed in more detail below.

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[81] *Ibid* 2. The annexes to the Key Attributes provide guidance on implementing and interpreting the Key Attributes. They do not form part of the Key Attributes standard and accordingly will not form part of the discussion in this chapter.

[82] Financial Stability Board: Key Attributes of Effective Resolution Regimes for Financial Institutions 15 October 2014 1.

[83] Financial Stability Board: Key Attributes of Effective Resolution Regimes for Financial Institutions 15 October 2014 3. See also National Treasury, *Strengthening South Africa’s Resolution Framework for Financial Institutions*, 2015 available at http://www.treasury.gov.za/twinpeaks/Strengthening%20South%20Africa%E2%80%99s%20Resolution%20Framework%20for%20Financial%20Institutions.pdf accessed 7 June 2020 8.

[84] *Ibid*.

In terms of the Key Attributes, an effective resolution regime should, *inter alia*: "ensure continuity of systemically important financial services, and payment, clearing and settlement functions; protect, where applicable and in coordination with the relevant insurance schemes and arrangements such depositors, insurance policyholders and investors as are covered by such schemes and arrangements and ensure rapid return of segregated client assets; allocate losses to firm owners (shareholders) and unsecured and uninsured creditors in a manner that respects the hierarchy of claims; not rely on public solvency support and not create an expectation that such support will be available; avoid unnecessary destruction of value and seek to minimise costs of resolution in home and host jurisdictions and losses to creditors and ensure that non-viable firms can exit the market in an orderly way."[85]

From a bank resolution perspective, the Key Attributes consequently require jurisdictions to have a resolution regime that provides the designated resolution authority, responsible for administering the regime, with a broad range of powers and options to resolve a bank that is "no longer viable and has no reasonable prospect of becoming so".[86] Such a resolution regime should include two main types of mechanisms, namely stabilization options as well as liquidation options. Stabilization options are aimed at achieving continuity of systemically important functions of a failing bank. It seeks to do so by way of sale or transfer of shares in the bank or by selling or transferring all or part of the bank's business to a third party (either directly or through a bridge institution as discussed below) and/or an officially mandated creditor-financed recapitalisation ("bail-in" as discussed below) of the entity that continues providing critical functions. Liquidation options are resolution mechanisms that provide for the orderly closure and winding-down of all or part of the failing bank's business in a manner that aims to protect insured depositors, insurance policyholders and retail customers.[87]

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[85] Financial Stability Board: Key Attributes of Effective Resolution Regimes for Financial Institutions 15 October 2014 3. As observed by Dewatripont and Freixas "Bank resolution: a framework for the assessment of regulatory intervention" 2011 *Oxford Review of Economic Policy* 415 "Broadly speaking, the objective of any bank intervention should be to minimize the social cost of bank distress by choosing the best procedures to cope with it, in particular with respect to the need for transferring funds to some of the bank claimholders."

[86] *Ibid*.

[87] Financial Stability Board: Key Attributes of Effective Resolution Regimes for Financial Institutions 15 October 2014 3. See also Cihak, Nier *The need for Special Resolution Regimes for Financial Institutions – The case of the European Union* IMF Working Paper WP/09/200 2009 available at

As pointed out by Lugulu, the Key Attributes significantly enhance the resolution of financial institutions by increasing the options available to governments as opposed to the options, pre-GFC and during the GFC, of either implementing costly corporate insolvency procedures or using taxpayers' funds to bail out failing financial institutions.[88] In similar vein Randell observes that "a well-designed bank resolution regime can provide a government with options that help to avoid the issue of a blanket guarantee of the liabilities of a bank or banks and, thereby, the socialization of all bank debt. Under a resolution regime, the government can ensure that the burden of bank failure is shared with shareholders and creditors of the failed bank or banks."[89]

Randell emphasizes that ensuring the continuity of customers' payments and other banking services, including access to their deposits, is important in protecting and enhancing financial stability because when "depositors see that the customers of one bank have lost or are unable to access their money for an extended period, they may well be likely to try to extract money from other banks, triggering a chain of bank runs across the entire system."[90] Randell further points out that bank resolution proceedings can also enhance and protect financial stability in a number of other ways. He poignantly observes that by facilitating the swift restructuring of the bank's activities between those which will be continued by a purchaser or a "good bank" and those which will enter insolvency proceedings or be dissolved in a "bad bank", bank resolution can ensure that the loss of credit provision and other financial capacity to the real economy is reduced. He further observes that, by contrast, insolvency proceedings are likely to last for a longer period and the timetable for the insolvency proceedings may be determined partly by the actions of creditors who are interested in maximizing their own recoveries rather than minimizing damage to the real economy as a whole. In addition, insolvency proceedings may lead to some "fire sales" which have the potential to transmit contagion to other banks, whereas the use of a "bridge institution" through bank resolution proceedings may enable assets to be held and sold over a longer period. Moreover, the "deadweight costs" of insolvency, comprising not

https://www.imf.org/external/pubs/ft/wp/2009/wp09200.pdf accessed 17 September 2020 at 10 where they discuss the "special tools" required during bank resolution.

[88] Lugulu H "Addressing the moral hazard through Explicit Deposit Insurance: a comparative appraisal of the Kenya Deposit Insurance Act, 2012" (2019), *LLD Thesis, University of Pretoria* 68.

[89] Randell "Legal Aspects of Bank Resolution: Designing the Powers and Solutions" *Paper presented at conference on "Operational Aspects of Bank Resolution and Restructuring" at the European Bank for Reconstruction and Development*, London, 19 March 2012 3.

[90] *Ibid* 6.

only professional costs but also the costs of the "sudden stop" termination of contracts and positions, can be very considerable; resolution proceedings may enable many of these costs to be reduced.[91]

2.2 FSB Key Attributes: Design features of an effective bank resolution regime

As pointed out in Chapter One, the thesis focuses on aspects such as the scope of the resolution regime, triggers for resolution and resolution objectives, the resolution authority, resolution funding; safeguards to protect property rights; the general resolution powers of the resolution authority; and the main resolution measures (tools) as well as whether curatorship or a tool akin to curatorship could be incorporated as part of a country's broader resolution regime. For the sake of completeness, the discussion below will also set out the main contents of Key Attributes 7, 8, 9 and 12 that deal with cross-border cooperation, crisis-management, cooperation agreements and information sharing in the context of resolution but the design features in these four Key Attributes lend themselves to a separate study and will not be addressed in any detail when interrogating the resolution frameworks in Zimbabwe, the UK and South Africa.[92]

2.2.1 Key Attribute 1: Scope

It is trite that clarity on the scope of a legal framework for bank resolution is critical to provide legal certainty and strengthen enforcement of such a resolution regime. Accordingly, it is of fundamental importance that there should be sufficient certainty regarding the scope of application of a bank resolution regime and the types of banks to which, and the circumstances in which, it will apply.

In recognition of this important principle the first Key Attribute relates to the scope of the resolution regime. As such it seeks to lay down principles that may be used to determine which banks in a country's financial system should be subjected to a formal resolution regime in the event of failure. In terms of Key Attribute 1 any financial institution that could be "systemically significant or critical" if it fails, should be subject

[91] Randell "Legal Aspects of Bank Resolution: Designing the Powers and Solutions" *Paper presented at conference on "Operational Aspects of Bank Resolution and Restructuring" at the European Bank for Reconstruction and Development*, London, 19 March 2012 6.
[92] Chapter One para 1.8.

to an effective resolution regime that has the design components set out in the Key Attributes. It further requires that the resolution regime be clear and transparent as to the financial institutions within its scope and indicates that the resolution regime should extend to holding companies of a firm; non-regulated operational entities within a financial group or conglomerate that are significant to the business of the group or conglomerate; as well as branches of foreign firms.[93]

2.2.2 Key Attribute 2: Resolution Authority

Hüpkes observes that since it is the role of the bank supervisor to assess the bank's capital and evaluate the quality of its assets, it is also the bank supervisor who determines at what point a bank is no longer viable and must be closed thus: "a bank is insolvent when the supervisor says it's insolvent".[94] She emphasizes that insolvency is therefore not the first relevant trigger for intervention into the operations of a bank but that the bank supervisor intervenes with increased urgency the deeper a bank veers off required levels of safety and soundness, given that it is the purpose of prudential regulation and supervision to ensure that a bank's financial condition is closely monitored. Growing financial losses, management failures and shortcomings of internal systems and controls should therefore prompt the bank supervisor to intervene before such weaknesses develop into a situation where the bank becomes over-indebted and creditors incur losses. As underlined by Hupkes, this is "the raison d'etre of prudential regulation and supervision". Given this involvement of the bank supervisor in evaluating bank assets and determining bank solvency, she points out that in many jurisdictions it is the bank supervisor who has the authority, to the exclusion of individual creditors, to initiate insolvency proceedings.[95] Accordingly the bank supervisor (which is often the central bank but may also be another institution) should be actively involved in the bank resolution process.

Key Attribute 2 consequently focuses on the resolution authority that must direct the entry of a bank into resolution and apply the measures provided by the resolution

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[93] Key Attributes par 1.1.

[94] Hüpkes "Insolvency – why a special regime for banks?" 2005 3 *Current Developments in Monetary and Financial Law* 10. Ryback Lender-of-Last- Resort Issues – Past, Present and Future In: *Current Developments in Monetary and Financial Law*, (1999) International Monetary Fund, Washington, D.C 226.

[95] Hüpkes "Insolvency – why a special regime for banks?" 2005 3 *Current Developments in Monetary and Financial Law* 10.

regime. This Key Attribute requires each jurisdiction to have a designated administrative authority or authorities responsible for exercising specific resolution powers over banks that fall within the scope of the resolution regime. Where there are multiple resolution authorities within a jurisdiction (for example if both the central bank and deposit insurer have resolution functions) as their respective mandates, Key Attribute 2 requires that their roles and responsibilities should be clearly defined and coordinated.[96]

In terms of the Key Attributes an effective resolution regime requires the resolution authority to pursue clear objectives central to orderly resolution. These objectives must however be pursued with the necessary respect for the rights of persons who stand to be affected by the application of the resolution tools afforded by the relevant resolution regime and any cross-border effects that such resolution may have. In particular the resolution authority is required, as part of its statutory objectives and functions, to:[97]

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

The aforesaid considerations provide the parameters within which the resolution authority must strive to attain its objectives and exercise its functions and powers. In terms of Key Attribute 2, where there is a presence of foreign bank branches in a particular jurisdiction, the resolution authority should further have the authority to enter

[96] Key Attribute 2.1. Key Attribute 2.2 provides that "where different resolution authorities are in charge of resolving entities of the same group within a single jurisdiction, the resolution regime of that jurisdiction should identify a lead authority that coordinates the resolution of the legal entities within that jurisdiction."

[97] Key Attribute 2.3.

into agreements with the resolution authorities of such other jurisdiction.[98] To fulfill its resolution functions adequately and without fear of interference (especially political interference) Key Attribute 2 further requires the resolution authority to have operational independence consistent with its statutory responsibilities, as well as transparent processes, sound governance and adequate resources. Given the invasiveness of the resolution powers to be applied it is also important that, from an accountability perspective, the resolution authority is subject to rigorous evaluation and accountability mechanisms to assess the effectiveness of any resolution measures it undertakes. The resolution authority is further required to have the expertise, resources and the operational capacity to implement resolution measures with regard to large and complex financial institutions.[99]

In order to enable the resolution authority to take a robust approach to bank resolution in pursuit of the ultimate objective of financial stability it is necessary to ensure that the resolution authority is not hamstrung by the fear of legal persecution in respect of any resolution actions it undertakes. Accordingly Key Attribute 2 further requires of an effective resolution framework to provide for protection of the resolution authority and its staff against liability for actions taken and omissions made while discharging their duties in the exercise of resolution powers in good faith.[100] The legislative framework capturing the resolution regime is also required to give the resolution authority unimpeded access to institutions where such access is material for purposes of resolution planning and preparation and implementation of resolution measures.[101] Thus, a bank that is in resolution or any of the other entities of which it is part (if for example it is part of a banking group or financial conglomerate) should not be able to obstruct attempts by the resolution authority to obtain information and to apply resolution measures.

2.2.3 Key Attribute 3: Resolution powers

Appropriate and effective resolution powers are critical to an effective resolution regime. Key Attribute 3 addresses resolution powers and how they should be exercised

[98] Key Attribute 2.4.
[99] Key Attribute 2.5.
[100] Key Attribute 2.6. This includes actions in support of foreign resolution proceedings.
[101] Key Attribute 2.7.

with regard to a number of aspects, namely: powers applicable in the context of entry into resolution, general resolution powers and specific resolution powers or tools such as transfer of assets and liabilities, use of bridge institutions and "bail-in within resolution". For purposes of the discussion of resolution tools and powers it should be pointed out that in a specific distinction between resolution tools and powers is not evident from the Key Attributes and it appears that they are sometimes used interchangeably. However, it is submitted that resolution "tools" would in principle refer to the main tools such as transfer of assets and liabilities, bridge banks and bail-in, whereas resolution "powers" would refer to the specific and general powers necessary to facilitate and support the application of the resolution tools.

2.2.3.1 Entry into resolution

In terms of Key Attribute 3.1 resolution should be initiated when a bank "is no longer viable or likely to be no longer viable and has no reasonable prospect of becoming so." Important to note is that it requires that an effective resolution regime should provide for "timely and early" entry into resolution *before* the bank concerned is balance-sheet insolvent and *before* all its equity has been fully wiped out. This means that the resolution framework should contain clear standards or suitable indicators of non-viability to help guide decisions on whether the bank concerned meets the conditions for entry into resolution. Such clear indicators will serve to ensure that failing banks are placed into resolution timeously and that loss of value through regulatory forbearance[102] or inertia is avoided.

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[102] Gallemore "Does bank opacity enable regulatory forbearance?" (2013), *PHD Dissertation, Kenan-Flagler School of Business* at 1 and 9. wherein explains that "bank regulators are responsible for monitoring the financial sector, which includes closing troubled banks. However, regulators do not always choose to close an unsound bank, and instead practice forbearance by allowing the bank to continue operating." The desire to practice forbearance can stem from political pressure, potential loss of reputation, or concerns about the health of the financial sector. Forbearance allows the troubled bank to potentially escalate risk-taking or continue its existing risky behavior, which can increase the ultimate cost of resolving the bank. However, forbearance can be a prudent regulatory choice if the bank recovers without costly intervention or if closing the troubled bank would spread problems to or undermine confidence in healthy institutions. See also Huizinga, Laeven "Bank valuation and regulatory forbearance during a financial crisis" *European Banking Center Discussion Paper No. 2009-17* available at https://d1wqtxts1xzle7.cloudfront.net/51766848/Bank_Valuation_and_Regulatory_Forbearanc20170212-9617-1ohvq86.pdf?1486948931=&response-content-disposition=inline%3B+filename%3DBank_Valuation_and_Regulatory_Forbearanc.pdf&Expires=1600450600&Signature=H-XC1LgKu1GyxMtuC1cmPG6pDunWzj9oaVofAwjKjTkXsRx1QHKWtlTGWLUulBhZ~m41kodWLj1jMuM75oN7-D15Ag9nrjoEfbj5bbTKnnklLV8eCh-zSEjmVcNCbyoNknx3W7ATnAgFxFxkXmFxd5c7OLltRNBOi6jftGUiZ1CweEE4xThvH57BlVIVhwa

2.2.3.2 General resolution powers

Various key aspects require consideration in order to ensure that bank resolution can be approached in an optimal manner. A pertinent consideration is how to deal with the shareholders of the failing bank and how to hold them accountable for the risks taken by the bank and what measures need to be put in place to ensure that they are not able to block or derail the resolution process. As observed by Babis, the main justification for interfering with shareholder rights during resolution concerns public interest, which requires financial stability and the continuation of essential banking services. Babis points out that “financial stability is a public good, which benefits the economy and society as a whole, as opposed to the interests of shareholders, which are private.” Consequently, an efficient framework for recovery and resolution, which aims to protect broader societal rights, should take priority over shareholder’s legal rights and economic interests.[103]

In the context of the shift from a culture of “bail-out” of systemically important banks to a more calculated approach that favours “bail-in within resolution” Babis comments that the view which prevailed was that “imposing the costs of bank failure on taxpayers is unfair, politically unpopular, and that it draws upon funds which could have been used in another socially beneficial function. On the contrary, shareholders voluntarily undertake an investment risk, knowingly undertaking the position of residual claimants in insolvency. Consequently, shareholders should be the first to absorb bank losses, in order to protect public finances.”[104] Babis points out that in the case of a bank failure,

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XEZca6io6IXRBV4UsR2-EJNRavIitQDOrPoNxjUPUIi~i~pkDPAinNeRwFLs4e60Xi1qsj5AG68xxfECrTW2EXahJ1xf3~piRX7cFHSnlN9v8xm9j7QktPmh54R9EVypKJ1vjem~HLiOrVCNHRUvNKQ__&Key-Pair-Id=APKAJLOHF5GGSLRBV4ZA accessed 17 September 2020. They state that “distressed asset markets provide financial firms with incentives to use managerial discretion over financial reporting to increase earnings and preserve book value, for example, by using advantageous valuation techniques and making favorable assessments of asset impairment. Bank regulators can in principle impose regulatory discipline on banks, and force them to adjust asset valuations and capital downward. However, at times of financial crisis when bank distress is widespread, regulatory forbearance is often applied to minimize disruptions to the real economy and the overall financial system caused by bank failures. As a consequence, discretion over financial reporting rules by bank managers combined with regulatory forbearance causes banks to understate underlying balance sheet stresses and to overstate regulatory capital.”

[103] Babis, “Bank Recovery and Resolution: What About Shareholder Rights?” 2012 University of Cambridge Legal Studies Research Paper Series, Paper No. 23/2012 available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2144753&download=yes accessed 17 September 2020 6-7.

[104] Babis, “Bank Recovery and Resolution: What About Shareholder Rights?” 2012 University of Cambridge Legal Studies Research Paper Series, Paper No. 23/2012 available at

at least in the case of large systemic banks, the social costs (which includes costs on public finances, the financial system and the wider economy) are significantly more than the private costs on shareholders. This means that the perverse incentives that spur shareholders on to encourage excessive risk-taking by the bank in which they hold shares can have severe and wide-ranging implications, which extend further than the private costs of the bank failure itself. As Babis observes: "Also, shareholders of large banks are prone to moral hazard, because of the expectation that big banks will not be allowed to fail. Consequently, bank shareholders have incentives to increase risk-taking and keep banks too big to fail. However, imposing losses on shareholders can contribute to reducing shareholders' excessive risk-taking incentives, and can incentivize shareholders to exercise discipline on bank directors."[105]

Babis further points out that shareholder rights may constitute barriers to effective resolution as they may be used to block resolution tools. In particular, she indicates that when shareholders make decisions their private interests are paramount and the danger exists that they may therefore not approve onerous resolution measures (such as cancellation or dilution of their shares or transfer of the ownership of the bank, capital increase etc.) *even* if such measures are the optimal solution from a financial stability perspective. In addition, Babis observes that the exercise of shareholder rights can delay recovery and resolution. In this regard she mentions governance rights, including shareholder approvals and procedural rights, and also convocation periods, that can create significant delays to the detriment of the resolution process.[106] She points out that the effectiveness of resolution may further be inhibited by notification or disclosure requirements. In particular Babis mentions the example where the announcement that a bank approaches the threshold for resolution may create stress

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2144753&download=yes accessed 17 September 2020 7. See also Financial Stability Board, Consultative Document: Effective Resolution of Systemically Important Financial Institutions - Recommendations and Timelines, 19 July 2011 available at https://www.fsb.org/wp-content/uploads/r_110719.pdf accessed 17 September 2020 9.

[105] *Ibid* 8.

[106] *Ibid* 8-9. The most prevalent example from the GFC was the Fortis case, where court proceedings initiated by Belgian shareholders and the court decision that shareholder approval was necessary to proceed delayed significantly the transfer of the Belgian part of the cross-border group to a private sector purchaser.

in the market, which may have the effect of increasing such bank's funding costs, and thus it may consequently add to the deterioration of the troubled bank's situation.[107]

In order to enable the application of resolution measures and tools Hupkes indicates that typically, a full or partial suspension of payments and a stay of enforcement action (moratorium) will be required to protect depositors' interests and to avoid the dissipation or the attachment of assets by certain creditors to the detriment of others. A moratorium is therefore a critical instrument during bank resolution as it allows some time to consider valuable resolution options while fending off pressure from creditors who would otherwise seek to enforce their claims.[108]

To cater for sufficient powers to adequately address all the challenges that may be experienced during bank resolution and in order to facilitate optimal bank resolution, Key Attribute 3.2 thus requires that resolution authorities should have at their disposal "a broad range" of resolution powers. These resolution powers do not constitute a *numerus clausus* but it is indicated that they should include the following:

(a) the power to remove and replace the senior management and directors of the failing bank and recover monies from responsible persons, including "claw–back" of variable remuneration;[109]

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[107] Babis, "Bank Recovery and Resolution: What About Shareholder Rights?" 2012 University of Cambridge Legal Studies Research Paper Series, Paper No. 23/2012 available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2144753&download=yes accessed 17 September 2020 9. See also Avgouleas, Goodhart "Critical reflections on bank bail-ins" 2015 *Journal of Financial Regulation* 13 who point out that a resolution framework involves a significant degree of intervention in the troubled bank and is likely to restrict or abolish shareholder rights and interest , with the purpose to enable timely and unhindered intervention on banks and to ensure that shareholders are the ones who primarily absorb bank losses.

[108] Hüpkes "Insolvency – why a special regime for banks?" 2005 3 *Current Developments in Monetary and Financial Law* 17-18.

[109] See Weaver and Tompkins "Variable pay agreements: ensuring proper protection for employers" available at http://employmentblog.practicallaw.com/variable-pay-agreements-ensuring-proper-protection-for-employers/ accessed 17 September 2020 where it is explained that a clawback provision amounts to "a contractual agreement between the employer and the employee, which requires the employee on the occurrence of a specified event (or events) to return an amount of their variable pay. This can be because either the performance of the business is later found to be not as good as initially reported, or because the participant has committed some kind of misconduct which is uncovered after vesting." See also Ferrarini *Bankers' Compensation and Prudential Supervision: The International Principles* In: Hill JG, Thomas RS (eds.) *Research Handbook on Executive Pay*, (2012), Edward Elgar Pub. Ferrarini states that "the financial crisis of 2008 has put the banking industry's compensation policies and incentive models under severe scrutiny from investors, regulators, politicians and the wider public, on both sides of the Atlantic. Two main problems have been discussed in the political arena. One is the level of remuneration at large banks, which appeared to be excessive in the United States, but also in Europe. The other is the remuneration structure, which, according to widespread opinion, may induce excessive risk taking

(b) the power to appoint an "administrator" to take control and manage the failing bank with the objective of restoring such bank, or parts of its business, to ongoing and sustainable viability;

(c) the power to operate and resolve the failing bank, which should include powers to terminate contracts, continue or assign contracts, purchase or sell assets, write down debt and the power to take any other action necessary to restructure or wind down the failing bank's operations;

(d) the power to ensure continuity of essential or critical services and functions rendered by the failing bank by requiring other companies in the same group to continue to provide essential services to the bank in resolution, any successor or an acquiring entity; ensuring that the "residual bank in resolution" can temporarily provide services to a successor or an acquiring entity; or procuring necessary services from unaffiliated third parties;

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and encourage short-termism. Social resentment focused on the former. Lavish compensation packages paid by banks, which governments subsequently had to rescue, amplified the social debate, often provoking a populist response by politicians. Regulatory concerns concentrated on the latter, regarding remuneration design as main contributor to excessive risk taking by rewarding bankers for superior performance, whilst not penalizing failure. The FSB adopted principles following coordinated action by the G-20 governments, which rapidly responded to heavy political pressure deriving, both domestically and internationally, from the financial crisis and repeated bank failures." See Financial Stability Forum, *FSF Principles for Sound Compensation Practices* available at https://www.fsb.org/wp-content/uploads/r_0904b.pdf accessed 17 September 2020 and Financial Stability Board, *FSB Principles for Sound Compensation Practices Implementation Standards*, 25 September 2009 available at https://www.fsb.org/wp-content/uploads/r_090925c.pdf accessed 17 September 2020. One of the areas dealt with is the emphasis on effective alignment of compensation with prudent risk-taking and compensation practices that reduce employees' incentive to take excessive risk. The Principles state that "compensation must be adjusted for all types of risks, including those difficult-to-measure, such as liquidity risk, reputation risk, and capital cost. The Standards require "significant financial institutions" to ensure that total variable compensation does not limit their ability to strengthen their capital base. Compensation outcomes should be symmetric with risk outcomes. In particular, compensation systems should link the size of the bonus pool to the overall performance of the firm; employees' incentive payments should be tied to the contribution of the individual and business to such performance; and bonuses should diminish or disappear in the event of poor firm, divisional or business unit performance. Furthermore subdued or negative financial performance of the firm should generally lead to a considerable contraction of the firm's total variable compensation, taking into account both current compensation and reductions in payouts of amounts previously earned, including through malus or clawback arrangements. Malus and clawback clauses are rather new in compensation contracts, although adjustments of incentives according to performance criteria were also made pre-crisis. These clauses are applicable to both cash incentives and share-based payments. They enable boards to reduce or reclaim bonuses paid based on results that are unrepresentative of the company's performance over the long-term or later prove to have been misstated. Where cash incentives are deferred, unvested portions should be clawed back in the event of negative business performance."

(e) the power to override rights of shareholders of the bank in resolution, including requirements for shareholder approval of particular transactions, in order to permit a merger, acquisition, sale of substantial business operations, recapitalization or other measures to restructure and dispose of the failing bank's business or its liabilities and assets;

(f) the power to transfer or sell assets and liabilities of the failing bank, as well as legal rights and obligations, including deposit liabilities and ownership in shares, to a solvent third party, regardless of any requirements for consent or novation that would otherwise apply;[110]

(g) the power to establish a temporary bridge institution,[111] to take over and continue operating certain critical functions and viable options of the failed bank; [112]

(h) the power to establish a separate asset management vehicle[113] to which non-performing loans or difficult-to-value assets can be transferred;

(i) the power to undertake "bail-in within resolution",[114] as a means to achieve or help achieve continuity of essential or critical functions either (i) by recapitalising[115] the failing bank, or, alternatively, (ii) by capitalizing

[110] Key Attribute 3.3.
[111] See para 2.2.3.4 below.
[112] Key Attribute 3.4
[113] For example, as a subsidiary of a distressed bank, an entity with a separate charter, or as a trust or asset management company.
[114] See para 2.2.3.5 below.
[115] Chennells and Winfield explain that in common with other resolution tools bail-in allows a failing bank to be stabilised prior to a restructuring. There are two distinct steps to the stabilisation phase: the first step is to estimate the outstanding losses of the bank, which is achieved through an initial valuation of its asset and liabilities. This valuation is necessary prior to any resolution, in order to establish whether the bank is indeed failing, or likely to fail. Chennells and Winfield further explained that losses which have not already been fully recognised are absorbed by writing down the value of the failing bank's assets. The authors observe that the losses may or may not wipe out the existing equity in the bank, but they are likely to push the failing bank's capital level below that which is required by the prudential supervisor and "if the losses exceed the existing equity, each layer of unsecured creditors in the creditor hierarchy will be written down, in the order of their ranking in insolvency, until the amount necessary to recognise the outstanding losses is covered. The second step is to restore the capital the firm needs to support its activities, to ensure that the market has confidence in the firm, and to meet the requirements of the prudential supervisor through the subsequent restructuring phase. The bulk of the recapitalisation is likely to be achieved by converting the claims of creditors into equity." See Chennells, Wingfield "Bank failure and bail-in: an introduction" 2015 3 *Quarterly Bulletin* 228. See also Goodhart, Avgouleas *A critical evaluation of bail-in as a bank recapitalisation mechanism* In: Allen F, Carletti E, Gray J (eds.) *Bearing the losses from bank and sovereign default in the eurozone*, (2014) FIC Press, Philadelphia 65.

a newly established entity or bridge institution to which these critical functions have been transferred following closure of the non-viable bank (whose residual business would then be wound up and the bank liquidated);[116]

(j) the power to temporarily stay the exercise of early termination rights that may be triggered once a failing bank enters into resolution or that may otherwise be triggered by the use of resolution powers;[117]

(k) the power to impose a moratorium with a suspension of payments to unsecured creditors (except for payments and property transfers to central counterparties (CCPs)[118] and those entered into the payment, clearing and settlements systems) coupled with a stay on enforcement actions by creditors attempting to attach assets or otherwise collect money or property from the bank in resolution, while protecting the enforcement of eligible netting and collateral agreements;[119] and

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[116] Key Attribute 3.5.

[117] Key Attribute 4.3 and Annex IV.

[118] Rehlon, Nixon "Central counterparties: what are they, why do they matter and how does the Bank supervise them?" 2013 *Bank of England Quarterly Bulletin* 147. Central counterparties also known as clearing houses, place themselves between the buyer and seller of an original trade, leading to a less complex web of exposures. CCPs effectively guarantee the obligations under the contract agreed between the two counterparties, both of which would be participants of the CCP. If one counterparty fails, the other is protected via the default management procedures and resources of the CCP. See also Duffie "Resolution of failing central counterparties" 2014 Stanford University Graduate School of Business Research Paper No. 15-12 available at https://pdfs.semanticscholar.org/4c6d/202c5e1f1a6099fab09f061365d287ff5024.pdf accessed 17 September 2020 wherein a central counterparty is defined as "a financial market utility that lowers counterparty default risk on specified financial contracts by acting as buyer to every seller, and as seller to every buyer. Thus if either of the original counterparties fails to perform, the CCP effectively guarantees payment to the other."

[119] Bank for International Settlements, *OTC Derivatives: Settlement Procedures and Counterparty Risk Management* Report by the Committee on Payment and Settlement Systems and the Euro-currency Standing Committee of the central banks of the Group of Ten countries, 1998 available at https://www.bis.org/cpmi/publ/d27.pdf accessed 17 September 2020. Netting refers to "offsetting of positions or obligations by counterparties. Close-out netting is an arrangement to settle all contracted but not yet due obligations to and claims on a counterparty by one single payment, immediately upon the occurrence of one of the defined events of default. Collateral is an asset that is delivered by the collateral provider to secure an obligation to the collateral taker. Collateral arrangements may take different legal forms; collateral may be obtained using the method of title transfer or pledge. Typically, government securities and cash are used as collateral in the context of OTC derivatives transactions." See also Bliss, Kaufman "Derivatives and Systemic Risk: Netting, Collateral and Closeout" Federal Reserve Bank of Chicago WP 2005-03 available at https://fraser.stlouisfed.org/files/docs/historical/frbchi/workingpapers/frbchi_workingpaper_2005-03.pdf accessed 17 September 2020.

(l) the power to effect the closure and orderly wind-down (liquidation) of the whole or part of a failing bank with timely payout or transfer of insured deposits and prompt[120] access to transaction accounts and to segregated client funds.[121]

The resolution toolkit thus comprises various powers that can be applied, in a variety of combinations, to deal with the resolution of a failing bank in an optimal and orderly manner. It is also clear from the above that the resolution authority will be required to consider whether there are indeed parts of the failing bank that can be "saved" and if so, an "administrator" can be appointed by the resolution authority to attempt to manage those parts back to viability. Consequently resolution as contemplated in the Key Attributes is not only aimed at facilitating the orderly exit of the bank from the financial system with as little disruption as possible to financial stability but, insofar as salvaging the still healthy or at least "rescuable" parts of a failing bank is concerned, certain resolution powers can also be applied as a "rescue tool".

The interaction between the various resolution powers and tools is clearly critical to the effectiveness of a resolution regime. As observed by the Basel Committee on Banking Supervision, the effectiveness of one resolution tool may depend critically on the availability of certain other tools. The Committee indicates that, for example, the power to transfer contracts will only be effective if, simultaneously the resolution authority has the power to temporarily override contractual early termination rights, and the effectiveness of bridge bank powers will be dependent on the availability of appropriate funding arrangements to support the operations of the bridge bank. Accordingly, the overall effectiveness of the resolution regime will depend on the "interplay of all

[120] For example providing for reimbursement of depositors within 7 days after they had filed their claims.

[121] Werner "How do banks create money, and why can other firms not do the same? An explanation for the coexistence of lending and deposit-taking" 2014 *International Review of Financial Analysis* 71. Werner explains that "in the UK the Client Money Rules in Financial Conduct Authority Client Asset Regulations ("CASS") require all firms that hold client money to segregate such money in accounts that keep them separate from the assets or liabilities of the firm itself. A firm, on receiving any client money, must promptly place this money into one or more accounts opened with any of the following: a central bank; a CRD credit institution; a bank authorised in a third country; a qualifying money market fund". For firms that do not have a banking authorisation, client deposits must be held in segregated accounts with banks or money market funds. See also "Money kept in segregated accounts" available at https://en.samt.ag/segregated-client-accounts accessed 17 September 2020.

available tools, their speedy and effective implementation, and cannot be gauged merely on the basis of a checklist of individual resolution tools."[122]

2.2.3.3 Transfer of assets and liabilities

Dewatripont and Freixas indicate that during bank resolution a joint "asset and liability"-restructuring would be a beneficial option. They remark that a combination of a transfer of assets and liabilities may yield the best benefits where the failing bank is split into two parts, dividing the bank's balance sheet so as to create a "good bank" that is capable of continuing a profitable activity and a "bad bank" that functions as a shell for the residual assets and claims. As explained by Dewatripont and Freixas, in principle the division of the bank can occur on the asset side of the balance sheet, by separating "troubled assets" from the rest –the so-called "asset separation"-tool. It can also occur on the liability side, by grouping the existing assets (or a subset thereof) with a subset of the most senior liabilities, and by placing the remaining junior liabilities in a "bad bank".[123]

The Key Attributes accordingly recommend that resolution authorities should have the power to transfer selected assets and liabilities of the failed institution to a third party institution or to a newly established "bridge institution". In order to ensure that this transfer process occurs as smoothly and speedily as possible and to avoid loss of value any such transfer of assets and liabilities should not require the consent of any interested party or creditor to be valid. It should also not constitute a default or termination event in relation to any obligation relating to such assets or liabilities or under any contract to which the failed bank is a party.[124] This ensures that the resolution authority is not hamstrung in its efforts to swiftly deal with the resolution of a

[122] Basel Committee on Banking Supervision, *Resolution policies and frameworks – progress so far*, July 2011 available at https://www.bis.org/publ/bcbs200.pdf accessed on 24 April 2020 para 67.

[123] Dewatripont, Freixas "Bank resolution: a framework for the assessment of regulatory intervention" 2011 *Oxford Review of Economic Policy* 418. They observe that "[P]erhaps a better classification would be 'good banks' and 'uncertain banks' where the latter concentrate all the valuation uncertainty either of a specific bank or of all distressed banks in the economy."

[124] Key Attribute 3.3. Regarding termination events see Key Attribute 4.2. Randell "Legal Aspects of Bank Resolution: Designing the Powers and Solutions" *Paper presented at conference on "Operational Aspects of Bank Resolution and Restructuring" at the European Bank for Reconstruction and Development*, London, 19 March 2012 12 indicates that the transfer of assets and liabilities under a "purchase-and –assumption"-transaction basically entails "an accelerated auction of the deposit–taking business of a failing bank where the most attractive offer is selected.

failed bank given that time is critical in ensuring that the failing bank's dire position is not aggravated at the cost of financial stability.

2.2.3.4 Bridge Institution

As explained by Randell, the "bridge institution" (bridge bank) may be used as a means of transferring the operational part of the business of a failing bank in order to stabilize such operational business with a view to subsequently dispose of it in, for example, a "purchase and assumption"-transaction. Alternatively a bridge bank may be used to take assets of the failing bank out of the insolvent entity so that the failing bank may be wound down in a more stable manner over a longer time period.[125] McGuire indicates that in transactions involving a bridge bank the resolution authority acts as the "acquirer" by creating a new, temporary, full-service bank that is designed to bridge the "gap" between the failure of a bank and the time when the resolution authority is in a position to implement a satisfactory acquisition by a third party. She further points out that bridge banks are a temporary resolution tool that generally are only in operation for a limited time period of a year to two years.[126]

The Key Attributes thus require resolution authorities as part of their resolution toolkit to have the power to establish one or more bridge banks to take over and continue operating certain critical functions and viable operations of a failed bank. This should include:[127]

(a) the power to enter into legally enforceable agreements in terms whereof the resolution authority transfers, and the bridge bank receives, selected assets and liabilities of the bank in resolution;

(b) the power to establish the terms and conditions under which the bridge bank has the capacity to operate as a "going concern".[128] Such terms

[125] Randell "Legal Aspects of Bank Resolution: Designing the Powers and Solutions" *Paper presented at conference on "Operational Aspects of Bank Resolution and Restructuring" at the European Bank for Reconstruction and Development*, London, 19 March 2012 13.

[126] McGuire, *Simple Tools to Assist in the Resolution of Troubled Banks* available at https://openknowledge.worldbank.org/bitstream/handle/10986/12342/680200WP0Box360k0Resolution0Toolkit.pdf?sequence=1 accessed 17 September 2020 9. McGuire indicates that because the bridge bank is designed to operate as an open deposit-taking institution, it is usually subject to all prudential requirements. She further points out that a bridge bank is designed to operate in a "conservative manner" with the goal of preserving the franchise value of the failing bank.

[127] Key Attribute 3.4.

[128] Basel Committee on Banking Supervision, *Resolution policies and frameworks – progress so far*, July 2011 available at https://www.bis.org/publ/bcbs200.pdf accessed on 24 April 2020. Going

and conditions should cover the following: the manner in which the bridge bank will obtain capital or operational financing and other liquidity support; which prudential and other regulatory requirements will apply to the bridge bank's operations; the selection of the bridge bank's management and how its corporate governance will be conducted; and also how the bridge bank will perform such other temporary functions as the resolution authority may prescribe from time to time;

(c) the power to reverse, where necessary, transfers of assets and liabilities to a bridge bank subject to appropriate safeguards, such as time restrictions; and

(d) the power to arrange the sale or liquidation of the bridge bank, or the sale of some or all of its assets and liabilities to best effect the objectives of the resolution authority.

2.2.3.5 "Bail-in within resolution"

As indicated the 2008 GFC triggered the shift from a culture of "bail-out" to a culture of "bail-in" post GFC.[129] Notably the bail-in tool has been hailed as "the most significant regulatory achievement in post crisis efforts to end "Too Big to Fail".[130] Bail-in has *inter alia* been described as a measure aimed at facilitating a swift reorganization of a failing bank's balance sheet.[131] Avgouleas and Goodhart remark that essentially bank bail-ins "constitutes a radical rethinking of who bears the ultimate costs of the operation of fractional reserve banking".[132] They explain that the bail-in tool involves replacing the implicit public guarantee, on which fractional reserve banking has operated, with a

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concern concept means that a firm has the resources needed to continue operating indefinitely until it provides evidence to the contrary. This term also refers to a company's ability to make enough money to stay afloat or to avoid bankruptcy. See also "Going concern" available at http://www.businessdictionary.com/definition/going-concern.html accessed 17 September 2020.

[129] See Chapter One para 2.

[130] Ringe, "Bail-in between liquidity and solvency" 2016 Oxford Legal Studies Research Paper No 33/2016 available at https://www.valuewalk.com/2016/07/bail-in-liquidity-and-solvency/ accessed 17 September 2020 3; Janssen "Bail-in from an insolvency law perspective" 2017 *Norton Journal of Bankruptcy Law and Practice* 5. Chennells, Wingfield "Bank failure and bail-in: an introduction" 2015 3 *Quarterly Bulletin* 228 remark that "Bail –in is not a silver bullet. By itself it cannot guarantee that the resolution of a failed firm will be orderly. However it is an essential component of a wider framework that, taken together, will allow authorities to intervene to manage the failure of large complex firms in an orderly way."

[131] Janssen "Bail-in from an insolvency law perspective" 2017 *Norton Journal of Bankruptcy Law and Practice* 6. See also Sommer "Why Bail-in ? And How!" 2014 *FRBNY Economic Policy Review* 217.

[132] Avgouleas, Goodhart "Critical reflections on bank bail-ins" 2015 *Journal of Financial Regulation* 3-4.

system of private penalties, entailing that the cost of bank failures "are shifted to where they best belong", namely with bank shareholders and creditors. The result is that, in a system where bail-in applies, banks will tend to internalize the cost of risks which they assume thereby also exhibiting better market discipline.[133] Thus Avgouleas and Goodhart state that essentially, a bail-in mechanism means that, to a certain extent, "a pre-planned contract replaces the bankruptcy process, giving greater certainty as to the sufficiency of funds to cover bank losses and facilitating early recapitalization. In addition, the bail-in mechanism can be used to keep the bank as a going concern and to avoid 'disruptive liquidation or dis-membering' of the failing bank."[134]

As further explained by Jansen, the bail-in tool allows authorities to reduce the nominal value of share capital and to write down liabilities and convert liabilities into share capital of a bank.[135] She observes that the application of the bail-in mechanism replicates a debt restructuring procedure governed by general company and insolvency law in which the nominal value of the share capital and claims against the company (bank) is reduced and creditors' claims are converted into equity interests in the company's (bank's) capital. It entails that creditors may receive shares in the company (bank) or warrants or other options to subscribe for shares in the company's (bank's) capital in exchange for a cancellation of their claims. The aim of the bail-in mechanism may be the recapitalization of either the existing company (bank) or of a new entity that receives assets and liabilities of the (failing) existing company (bank).[136] Jansen further observes that the bail-in tool entails a kind of "pre-packaged procedure" in the sense that the debt restructuring is based on the resolution strategy *agreed* by the relevant resolution authorities *beforehand* by means of resolution plans.[137] The resolution authority is consequently permitted to implement a bail-in (literally a "cram

[133] *Ibid* 4-5.
[134] *Ibid* 5. As observed by Dewatripont and Freixas "Bank resolution: a framework for the assessment of regulatory intervention" 2011 *Oxford Review of Economic Policy* at 417: "[T]he simplest and most transparent form of revaluation of liabilities is a bail-in consisting in the transformation of some or all unsecured liabilities into equity. The burden of recapitalization is then borne by those who made unsecured loans to the banks in question."
[135] Janssen "Bail-in from an insolvency law perspective" 2017 *Norton Journal of Bankruptcy Law and Practice* 4.
[136] *Ibid* 6-7. See also Hüpkes "Revolution in resolution: loss-absorption, recapitalization and restructuring of distressed banks" 2015 *Butterworths Journal of International Banking and Financial Law* 35.
[137] Author's emphasis.

down") despite the shareholders and creditors of the failing bank not being in agreement with the bail-in measures taken.[138]

Boccuzzi and De Lisa also indicate that the main objective of the application of the bail-in tool is the recapitalization of the failing bank. They point out that bail-in can *inter alia* also be used to convert to equity, or reduce the amount of liabilities, that are transferred to a bridge bank. Thus in essence "bail-in mirrors the effects of insolvency but in reverse order". It allows resolution authorities not only to write down subordinated debt and convert it into capital, but bail-in also permits resolution authorities to write down and convert into capital the remaining eligible liabilities in order to achieve the broadest loss absorbing capacity. Notably bail-in is also applied in a specific sequence which entails that it is applied to shareholders first; then to the holders of other capital instruments and subordinated debt and other unsecured creditors and lastly to the deposit guarantee scheme which intervenes in lieu of depositors.[139]

Chennells and Wingfield explain more palatably that during a bail-in the claims of shareholders and unsecured creditors are written down and/or converted into equity, in a manner that respects the hierarchy of claims prescribed in insolvency law, in order to absorb the losses of the failing bank and to recapitalize the bank or its successor. The bail-in has the result that the failing bank is allowed to continue to operate and to meet supervisory requirements so that its critical functions can be maintained immediately after it enters into resolution. They explain further that "[U]nlike a debt-for-equity swap, where the terms of any exchange for shares are negotiated by the relevant private parties, a bail-in would be imposed upon the firm and its creditors by the resolution authority. There would be no requirement to get the consent of shareholders, creditors or the existing management of the firm. And there is no requirement for court to approve the bail-in."[140]

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[138] Janssen "Bail-in from an insolvency law perspective" 2017 *Norton Journal of Bankruptcy Law and Practice* 7. As pointed out by Jansen such "cram down" by administrative decision can be justified on the basis of the belief that a failing bank's shareholders and creditors would withhold their consent to any proposed composition or reorganization plan if they expect a bail-out rescue to be undertaken by the government which would yield greater benefits than liquidation.

[139] Boccuzzi, De Lisa "Does bail-in definitely rule out bailout?" 2017 *Journal of Financial Management Markets and Institutions* 93.

[140] Chennells, Wingfield "Bank failure and bail-in: an introduction" 2015 3 *Quarterly Bulletin* 232. See also Figures 1 and 2 on 232-233 for a practical explanation of the application of bail-in.

As a prime design feature of an effective resolution regime Key Attribute 3.5 consequently states that powers to carry out "bail-in within resolution" should enable resolution authorities to:

"(a) write down,[141] *in a manner that respects the hierarchy of claims in liquidation*,[142] equity or other instruments of ownership of the bank that has been placed in resolution, unsecured and uninsured creditor claims to the extent necessary to absorb the losses; and to

(b) convert into equity or other instruments of ownership[143] of such bank (or any successor in resolution or the parent company within the same jurisdiction), all or parts of the unsecured and uninsured creditor claims *in a manner that respects the hierarchy of claims in liquidation*;[144]

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[141] Basel Committee on Banking Supervision, *Resolution policies and frameworks – progress so far*, July 2011 available at https://www.bis.org/publ/bcbs200.pdf accessed on 24 April 2020 para 67. The "debt write-down tool" would enable resolution authorities to write down the claims some or all of the unsecured creditors of a failing institution and, possibly, to convert debt claims to equity. See also Conlon, Cotter "Anatomy of a bail-in" 2014 *Journal of Financial Stability* 257.

[142] Author's emphasis. Regarding the hierarchy of claims in liquidation see Key attribute 5.1.

[143] Chennells, Wingfield "Bank failure and bail-in: an introduction" 2015 3 *Quarterly Bulletin* 232. Chennells and Wingfield explain that "in a bail-in, the claims of shareholders and unsecured creditors are written down and/or converted into equity to absorb the losses of the failed firm and recapitalise the firm or its successor. This is done in a manner that respects the hierarchy of claims prescribed in insolvency law. A bail-in allows the firm to continue to operate and to meet supervisory requirements so that the critical functions the firm provides can be maintained immediately after entry into resolution. Unlike a debt-for-equity swap, where the terms of any exchange of debt for shares are negotiated by the relevant private parties, a bail-in would be imposed upon the firm and its creditors by the resolution authority. There would be no requirement to get the consent of shareholders, creditors or the existing management of the firm. And there is no requirement for court approval of the bail-in." See also Melaschenko, Reynolds "A template for recapitalising too big to fail banks" 2013 *BIS Quarterly Review* 32.

[144] Author's emphasis.

(c) upon entry of the bank into resolution, convert or write-down any contingent convertible[145] or contractual bail-in instruments[146] whose term had not been triggered prior to entry into resolution and treating the resulting instruments in line with (a) or (b) above."

The Key Attributes further recommend that the resolution regime should enable the application of "bail-in within resolution" in conjunction with other resolution powers to ensure the viability of the bank that is being resolved or of the newly established entity following the implementation of bail-in. As such it is suggested that "bail-in within resolution" should be combined with, for example, removing problem assets, replacing senior management and adopting a new business plan.[147]

2.2.3.6 Exercise of resolution powers and tools

The well-considered and appropriate application of resolution powers and tools is critical to an effective resolution regime. The Key Attributes indicate that the resolution authority should have the legal and operational capacity to apply one, or a combination

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[145] Abdul, Jaffe end Tchistyi explain that "contingent convertible bonds (CCBs) are instruments offering potential value as a component of corporate capital structures for all types of firms, as well as being considered for the reform of prudential bank regulation following the recent financial crisis. CCBs are debt instruments that automatically convert to equity if and when the issuing firm or bank reaches a specified level of financial distress. CCBs are receiving attention as a new instrument for prudential banking regulation because they have the potential to avoid the bank bailouts that occurred during the subprime mortgage crisis when banks could not raise sufficient new capital and bank regulators feared the consequences if systemically important banks failed. CCBs initially enter a bank's capital structure as debt instruments, thus providing the debt-instrument benefits of a tax shield and a control on principal-agent conflicts between bank management and shareholders. If and when the bank reaches the specified degree of financial distress, however, the debt is automatically converted to equity. The conversion recapitalizes the bank without requiring any ex-post action by banks to raise new equity or the government to bail them out. The automatic recapitalization feature of CCBs thus offers a relatively low-cost mechanism to avoid the costs that otherwise arise with the threatened bankruptcy of systemically important banking firms." See Albul, Jaffee, Tchistyi "Contingent Convertible Bonds and Capital Structure Decisions" Coleman Fung Risk Management Research Center Working Paper No. 2010-01 2010 available at https://escholarship.org/content/qt95821712/qt95821712.pdf accessed 18 September 2020. See also Sunjoo "Bail-in to End the 'Too Big to Fail' Dilemma" KDI Focus No. 80, *Korea Development Institute* 2017 available at https://connect.up.ac.za/https/www.econstor.eu/bitstream/10419/200881/1/kdi-focus-80.pdf accessed 18 September 2020.

[146] As pointed out by Green and Jennings-Mares, "contractual bail-in instruments are those which contain a contractual term providing that where a resolution authority decides to apply the bail-in tool the instrument shall be written down/converted before other eligible liabilities are written down or converted; and are subject to a binding subordination agreement, undertaking or other provision under which, in the event of normal insolvency proceedings, it ranks below other eligible liabilities and cannot be repaid until other outstanding eligible liabilities have been settled." See Green, Jennings-Mares "EU Bail-in powers and transaction structuring" 2014 available at https://connect.up.ac.za/https/media2.mofo.com/documents/141016eubailinpowersandtransactionstructuring.pdf accessed 18 September 2020.

[147] Key Attribute 3.6.

of, resolution powers, with resolution actions being either combined or applied sequentially. It should further be able to apply different types of resolution powers to different parts of the failing bank's business. Finally, the resolution authority should be able to initiate a wind-down (liquidation) for those non-critical operations of the failing bank that, in the view of the authorities involved in the resolution of the failing bank, are not critical to the financial system or the economy.[148]

Insofar as banks that form part of financial groups (i.e. banking groups or financial conglomerates) are concerned, the Key Attributes take a holistic approach and require that when applying resolution powers to individual components of a financial group located in its jurisdiction, the resolution authority should have regard to the impact of such resolution power on the group as a whole and also on financial stability in other affected jurisdictions. It is further required that the resolution authority should undertake best efforts to avoid taking resolution actions that could reasonably be expected to trigger instability elsewhere in the group concerned or in the financial system.[149]

2.2.4 Key Attribute 4: Set-off, netting, collateralization, segregation of client assets

In terms of the Key Attributes the legal framework governing set-off rights, contractual netting and collateralisation agreements and the segregation of client assets should be clear, transparent and enforceable during a crisis or resolution, and should not hamper the effective implementation of resolution measures.[150] Subject to adequate safeguards, the Key Attributes require that entry into resolution and the exercise of any resolution powers should not trigger statutory or contractual set-off rights as the triggering and exercise of these rights may derail resolution efforts. Entry into resolution and the exercise of resolution powers should also not constitute an "early termination"-event that entitles any counterparty of the failing bank to exercise contractual acceleration or early termination rights *provided* the substantive obligations under the contract continue to be performed.[151] Should contractual acceleration or

[148] Key Attribute 3.8. See also Key Attribute 3.2 xii.
[149] Key Attribute 3.9.
[150] Key Attribute 4.1.
[151] Key Attribute 4.2.

early termination rights nevertheless be exercisable, the Key Attributes require the resolution authority to have the power to temporarily stay such rights where they arise only by reason of the failed bank's entry into resolution or in connection with the exercise of resolution powers. In terms of the Key Attributes the stay on contractual acceleration or early termination rights should further meet a number of requirements:[152] it should be strictly limited in time (for example, a period not exceeding 2 business days is suggested in the Key Attributes); it should be subject to adequate safeguards that protect the integrity of financial contracts and provide certainty to counterparties;[153] and it should not affect the exercise of early termination rights of a counterparty against the failing bank in the case of any default that is not related to the bank's entry into resolution or the exercise of the relevant resolution power occurring before, during or after the period of the stay (for example, payment default or failure to deliver or return collateral on a specific due date).[154]

2.2.5 Key Attribute 5: Safeguards

In order to maintain the tenets of orderly resolution the Key Attributes recommend a number of safeguards to be incorporated into an effective resolution regime. These crucial safeguards to be built into a resolution regime entail respect for the creditor hierarchy in insolvency in relation to payment of claims and observing the "no creditor worse off" principle. This means resolution powers must be exercised in a way that respects the hierarchy of claims in insolvency while providing flexibility to depart from the general principle of equal (*pari passu*) treatment of creditors of the same class. The Key Attributes underline that there needs to be transparency about the reasons for such departures from the *pari passu t*reatment of creditors of the same class, if it is necessary to contain the potential systemic impact of a bank's failure or to maximize the value for the benefit of all creditors as a collective. In particular, the Key Attributes require that equity should absorb losses first, and that no loss should be imposed on

[152] Key Attribute 4.3.
[153] I-Annex 5 on Conditions for a temporary stay.
[154] Key Attribute 4.3. In terms of Key Attribute 4.4 Resolution authorities ought to apply the temporary stay on early termination rights in accordance with the guidance set out in I-Annex 5 to the Key Attributes to make certain that it does not compromise the safe and orderly operations of regulated exchanges and FMIs. The Key Attributes indicate that the stay may be imposed by the resolution authority on a discretionary basis alternatively it may be automatic in its operation. In either case, jurisdictions are required to ensure that there is clarity as to the beginning and end of the stay.

senior debt holders[155] until subordinated debt[156] (including all regulatory capital instruments)[157] has been written-off entirely (regardless of whether such loss-absorption through write-down is accompanied by conversion to equity).[158]

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[155] Senior debt refers to debt whose terms, in the event of bankruptcy, require it to be repaid before subordinated debt receives payment. See Everett "Subordinated debt-nature and enforcement" 1965 *The Business Lawyer* 953 where it is explained that subordinated debt may be described as "indebtedness for borrowed money which, in the event of the insolvency, liquidation or reorganization of the borrower, is subordinate and junior in right of payment to other indebtedness of the borrower for borrowed money. Such other indebtedness is sometimes referred to as superior debt or, perhaps more often, as senior debt." See also Galligar "Subordination agreements" 1961 70:3 *The Yale Law Journal* 376 who explains subordination agreements as "the subordination of the right to receive payment of certain indebtedness (the subordinated debt) to the prior payment of certain other indebtedness (the senior debt) of the same debtor. Put another way-in the circumstances specified in the subordination agreement, the senior debt must be paid in full before payment may be made on the subordinated debt and retained by the subordinating creditor."

[156] Subordinated debt is a form of debt where the holders of are the first creditors to bear any losses resulting from risky investments by banks. In contrast to shareholders, however, these subordinated debt holders do not participate in the upward gains from such risky activities. This gives subordinated debt holders a strong preference for low-risk investments by the banks and an incentive to monitor the behavior of banks because the banks' risk has a direct influence on subordinated debt holders' payoffs. See Blum "Subordinated debt, market discipline and banks' risk taking" 2002 *Journal of Banking and Finance* 1427. See also Everett "Subordinated debt -nature and enforcement" 1965 *The Business Lawyer* 953.

[157] Schoenmaker "Regulatory capital: why is it different" 2015 *Accounting and Business Research* 468 points out that the basic purpose of regulatory capital is to absorb losses in order to protect other claimholders, especially deposit holders. He further explains that regulatory capital comes in different forms that serve different purposes "There are two types of capital, namely, going concern capital: this allows an institution to continue its activities and helps to prevent insolvency. Tier 1 capital is considered to be the going concern capital. The purest form is Common Equity Tier 1 (CET1) capital. The second is gone concern capital: this helps ensuring that depositors and senior creditors can be repaid if the institution fails. This category of capital includes hybrid capital and subordinated debt. Gone concern capital is named Tier 2 capital. Tier 1 capital is seen as the best form of capital, with Common Equity Tier 1 (CET1) instruments, mainly common shares and retained earnings, being the predominant form of Tier 1 capital. Tier 2 capital is known as supplementary capital. The latter consists of undisclosed reserves, revaluation reserves, general provisions, hybrid instruments (which combine certain characteristics of equity and certain characteristics of debt) and subordinated debt. At the same time, there are certain deductions from regulatory capital, such as goodwill and investments in bank and other financial subsidiaries. Equity capital consists of issued and fully paid ordinary shares/common stock and non-cumulative perpetual preferred stock (but excluding cumulative preferred stock), and disclosed reserves (including retained earnings). This key element of regulatory capital is the only element common to all countries' banking systems and wholly visible in the published accounts. Basel I introduces subordinated term debt (as well as the hybrid instruments) in addition to core equity capital. The Basel Committee recognises that subordinated term debt instruments have significant deficiencies as constituents of regulatory capital in view of their fixed maturity and inability to absorb losses except in a liquidation. The Committee puts therefore restrictions on the amount of such debt capital. Only subordinated term debt instruments with a minimum original term to maturity of over five years may be included within the supplementary elements of capital, up to a maximum of 50 per cent of the core equity capital. More generally, Basel I sets the target standard ratio of capital to risk-weighted assets at 8 per cent, of which the core equity capital was at least 4 per cent. Basel II introduces a third tier of capital (Tier 3) in the form of short-term subordinated debt to meet a proportion of the capital requirements for market risks. While subordinated term debt has an original maturity of at least five years, this new short-term subordinated debt needs only an original maturity of at least two years. It is subject to a lock-in clause, which stipulates that neither interest nor principal may be paid (even at maturity) if such payment means that the bank falls below or remains below its minimum capital requirement. The global financial crisis did painfully show that large parts of the regulatory capital could not absorb

As also indicated by the Key Attributes creditors should, in alignment with the "[N]o creditor worse off than in liquidation"-safeguard, further have a right to compensation where they do not receive, at a minimum, what they would have received if the failed bank was liquidated under the applicable insolvency regime.[159]

Yet another safeguard required by the Key Attributes to be incorporated into the framework of an effective resolution regime is that directors and officers of the bank that is being resolved should be protected in law (for example, from litigation by shareholders or creditors) in respect of resolution actions they take in compliance with decisions of the resolution authority.[160] An additional safeguard pertains to legal remedies and judicial action. In this regard it is required that the resolution authority should have the capacity to exercise its resolution powers with the necessary speed and flexibility, subject to constitutionally protected legal remedies and due process.[161]

A particularly important feature of an effective resolution regime is that the resolution authority should not be interrupted in its application of resolution powers by subjecting its decision to place a bank in resolution to review or appeal by a court or other body and thus derailing or delaying the resolution process. Accordingly, the Key Attributes indicate that the resolution framework should *not* provide for judicial actions that could constrain the implementation of, or result in a reversal of, measures taken by resolution

losses on a going concern basis. Moreover, the widespread use of internal models led to very low levels of regulatory capital. These models were used to reduce the risk weights in the risk-weighted capital requirements. While risk-weighted capital requirements stayed flat, the actual level of capital – appropriately measured by the (unweighted) leverage ratio – declined sharply from 1994 up to 2007. The main purpose of Basel III is to improve both the quality and the level of capital. On the quality side, the key role of CET1 is reinforced. Rating agencies are also looking at CET1 ratios to assess the soundness of banks. Basel III (just like Basel I and II) requires that goodwill and all other intangibles must be deducted in the calculation of CET1. In other words, Basel III uses the stringent definition of tangible equity. In addition, Basel III will require – as a new element – that deferred tax assets that rely on future profitability of the bank to be realised are to be deducted in the calculation of CET1. Moreover, a bank's holding of its own common shares are deducted from CET1 (unless already derecognised under the relevant accounting standards). In addition to the quality, Basel III also substantially increases the level of capital. Previously, banks had to hold total capital of at least 8% of RWAs. But the minimum requirement for CET1 capital was only 2%. CET1 has been increased from 2% to 4.5%, while total Tier 1 capital should be 6%. This produces additional Tier 1 capital of 1.5%, which may include capital instruments like Cocos. Cocos are contingent convertible bonds that convert to equity if the regulatory capital ratio drops below a certain predetermined threshold. Tier 2 capital should be at least 2%."

[158] Key Attribute 5.1.

[159] Key Attribute 5.2.

[160] Key Attribute 5.3.

[161] Key Attribute 5.4. In particular the Key Attributes require that in those jurisdictions where a court order is still required to apply resolution measures, resolution authorities should take this into consideration in the resolution planning process so as to make certain that the time required for court proceedings will not compromise the effective implementation of resolution measures.

authorities acting within their legal powers and in good faith. Instead, it is recommended that the resolution regime should provide for redress by allowing injured person or entities to approach the court for compensation to be awarded, if justified.[162] The Key Attributes further provide that, in order to preserve market confidence, jurisdictions should in their resolution frameworks provide for flexibility to allow temporary exemptions from disclosure requirements. Alternatively it should allow for a postponement of disclosures required by the bank in resolution, for example, under market reporting, takeover provisions and listing rules, where the disclosure by the failing bank could affect the successful implementation of resolution measures.[163]

2.2.6 Key Attribute 6: Funding of firms in resolution

The GFC spectacularly demonstrated how costly it can be to resolve financial institutions in the absence of a well-designed resolution regime that contemplates how a specific institution can be resolved should it encounter failure. It has also illuminated the fact that it is best to plan in advance for resolution and for how such resolution will be funded rather than to wait for an institution to fail and only at that point to then haphazardly scurry around looking for funds to enable appropriate resolution. The GFC has further had the result that the end of "Too Big to Fail" also spells the end of ad hoc arbitrary bail-outs of financial institutions with taxpayers' money or at least that bail-outs should not be the norm but the absolute exception.[164] In line with this shift in approach the Key Attributes stress that jurisdictions should have statutory or other policies in place so that resolution authorities are not constrained to rely on public ownership or bail-out funds as a means of resolving firms. Where temporary resources of funding to maintain essential functions are needed to accomplish orderly resolution, the resolution authority or authority extending the temporary funding is consequently required to make provision to cover any losses incurred from funding obtained from shareholders and unsecured creditors subject to the "no creditor worse off than in liquidation" safeguard; or if necessary, from the financial system more widely.[165]

[162] Key Attribute 5.5.
[163] Key Attribute 5.6.
[164] Key Attribute 6.1
[165] Key Attributes 6.1 and 6.2.

In respect of funding of resolution operations the Key Attributes consequently require that jurisdictions should have in place privately financed deposit insurance or resolution funds. Alternatively there should be a funding mechanism for *ex post* recovery from the industry of the costs of providing temporary financing to facilitate the resolution of the failing bank.[166] It is further indicated that where any temporary funding is provided by the authorities it should be subject to strict conditions that minimize the risk of moral hazard,[167] and should include the following:[168]

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

As a last resort and for the overarching purpose of financial stability, the Key Attributes indicate that some countries may decide to incorporate a power in their resolution toolkit to place a failed bank under temporary public ownership[169] and control in order

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[166] Key Attribute 6.3.

[167] McCoy "The Moral Hazard Implications of Deposit Insurance: Theory and Evidence" *Seminar on current developments in monetary and financial law*, Washington D.C., 23-27 October 2006. McCoy observes that "explicit deposit insurance can significantly reduce the incidence of bank runs or even stop runs altogether in countries with strong institutions and proper safeguards. On the other hand, when not done carefully, explicit deposit insurance can fuel bank crises by giving banks perverse incentives to take unnecessary risks." In the deposit insurance context, she points out that "moral hazard manifests itself in two ways. First, explicit deposit insurance gives insured banks incentives to pursue added risks because they can capture any profits but shift any losses to the government. Second, explicit deposit insurance reduces incentives by depositors and shareholders to monitor their banks." See also Marshall "Moral hazard" 1976 *The American Economic Review* 880. Moral hazard is commonly defined as "excessive expenditure due to eligibility for insurance benefits. In effect, the beneficiary is subsidized in his purchases and, as a consequence, continues to spend after marginal benefit falls below marginal cost. In this common view the social cost of moral hazard is the deadweight loss associated with the insurance subsidy." See also Shavell "On moral hazard and insurance" 1979 *The Quarterly Journal of Economics* 541.

[168] Key Attribute 6.4.

[169] Temporary public ownership is the compulsory acquisition of the share capital of the financial institution (or in certain circumstance, its parent) by the State. See Avgouleas "Banking supervision and the special resolution regime of the Banking Act 2009: the unfinished reform" 2009 *Capital Markets Law Journal* 201. See also Chapter Four para 8.7 (e).

to continue its critical operations, while seeking to arrange a permanent solution such as a sale or merger with a commercial private sector purchaser. In such instance the Key Attributes require that provision be made to recover any losses incurred by the state from unsecured creditors or, if necessary, from the financial system more widely.[170]

2.2.7 Key Attribute 7: Legal framework for Cross-border cooperation

In some instances a bank's failure may have effects that transcend the borders of the country where it is incorporated and also affect foreign economies hence the Key Attributes require that the statutory mandate of a resolution authority should empower and strongly encourage the authority, wherever possible, to act to achieve a "cooperative solution" with foreign resolution authorities. As such it advises that legislation and regulations in a specific jurisdiction should not contain provisions that trigger automatic action in that jurisdiction as a result of official intervention or the initiation of resolution or insolvency proceedings in another jurisdiction. It should however reserve the right of discretionary national action necessary to achieve domestic stability in the absence of effective international cooperation and information sharing. Where a resolution authority takes discretionary national action the Key Attributes consequently oblige it to also give particular consideration to the impact of such action on financial stability in other jurisdictions.[171]

The Key Attributes further require the resolution authority to have resolution powers over local branches of foreign firms operating within its jurisdiction. In addition, the resolution authority should have the capacity to use its powers either to support a resolution carried out by a foreign home authority (for example, the resolution authority could order a transfer of property located within its jurisdiction to a bridge institution established by the foreign home authority). Alternatively, in exceptional instances, the Key attributes indicate that the resolution authority ought to be able to take measures on its own initiative where the home (domestic) jurisdiction is not taking action or where

[170] Key Attribute 6.5.
[171] Key Attribute 7.1 and 7.2.

the home jurisdiction acts in a manner that does not sufficiently heed the need to preserve financial stability in the local jurisdiction.[172]

The Key Attributes further recommend that national laws and regulations should not discriminate against creditors on the basis of their nationality, the location of their claim or the jurisdiction where claims are payable. It is suggested that the treatment of creditors and ranking in insolvency should be transparent and properly disclosed to depositors, insurance policy holders and other creditors.[173] The Key Attributes specifically require jurisdictions to provide for transparent and expedited processes to give effect to foreign resolution measures. It is suggested that this can be done either by way of a mutual recognition process or by taking measures under the domestic resolution regime that support and are consistent with the resolution measures taken by the foreign home resolution authority. Recognition or support of foreign measures should be provisional on the equitable treatment of creditors in the foreign resolution proceeding.[174]

The Key Attributes also require the resolution authority to have the legal capacity, subject to adequate confidentiality requirements and protections for sensitive data, to share information. Such information sharing would include recovery and resolution plans (RRPs), pertaining to a banking group as a whole or to individual subsidiaries or branches, with relevant foreign authorities where such information-sharing is necessary for recovery and resolution planning or for implementing a coordinated resolution.[175] Jurisdictions are further required to make provision in their resolution frameworks for confidentiality arrangements and statutory safeguards for the protection of information received from foreign authorities.[176]

2.2.8 Key Attribute 8: Crisis Management Groups (CMGs)

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[172] Key Attribute 7.3. "Where a resolution authority acting as host authority takes discretionary national action, it should give prior notification and consult the foreign home authority."

[173] Key Attribute 7.4.

[174] Key Attribute 7.5. Such recognition or support measures would enable a foreign home resolution authority to gain rapid control over the firm (branches or shares in a subsidiary) or its assets that are located in the host jurisdiction, as appropriate, in cases where the firm is being resolved under the law of the foreign home jurisdiction.

[175] Key Attribute 7.6.

[176] Key Attribute 7.7.

The old adage "[I]f you fail to plan, you plan to fail" also rings true in the context of dealing with bank failures in an orderly manner and even more so where the bank concerned is a very large, systemically important institution that is part of a giant financial conglomerate. Crisis times when a bank is already failing are therefore not the appropriate times for planning how to manage a crisis such as a systemic bank failure. It is thus prudent that planning pertaining to how such a crisis will be dealt with occurs, at a fundamental level, quite some time prior to the onset of a financial crisis occasioned by the bank's collapse. The Key Attributes consequently emphasize that it is of the utmost importance to at least have proper structures in place for crisis management during the failure of a global systemically important financial institution (G-SIFI)[177] that has an international presence.

[177] As observed by the Basel Committee on Banking Supervision, "during the GFC, the failure or impairment of a number of large, globally active financial institutions sent shocks through the financial system, which in turn, harmed the real economy. Supervisors and other relevant authorities had limited options to prevent problems affecting individual firms from spreading and thereby undermining financial stability. As a consequence, public sector intervention to restore financial stability during the crisis was conducted on a massive scale. Both the financial and economic costs of these interventions and the associated increase in moral hazard mean that additional measures need to be put in place to reduce the likelihood and severity of problems that emanate from the failure of global systemically important financial institutions (G-SIFIs). In response to the crisis, the Basel Committee on Banking Supervision has adopted a series of reforms to improve the resilience of banks and banking systems. They include increasing the required quality and quantity of capital in the banking system, improving risk coverage, introducing a leverage ratio to serve as a backstop to the risk-based regime, and introducing capital conservation and countercyclical buffers as well as a global standard for liquidity risk. The capital adequacy measures are applied to all internationally active banks to ensure that each bank maintains an appropriate level of capital relative to its own exposures. A number of the policy measures will have a particular impact on G-SIBs, given that their business models have generally placed greater emphasis on trading and capital markets-related activities, which are most affected by the enhanced risk coverage of the capital framework. These policy measures are significant, but they are not sufficient to address the negative externalities posed by G-SIBs or to protect the system from the wider spillover risks of G-SIBs. The rationale for adopting additional policy measures for G-SIBs is based on the cross-border negative externalities created by systemically important banks, which current regulatory policies do not fully address." These include, "the moral hazard costs associated with implicit guarantees derived from the perceived expectation of government support may amplify risk-taking, reduce market discipline and create competitive distortions, and further increase the probability of distress in the future. As a result, the costs associated with moral hazard add to any direct costs of support that may be borne by taxpayers. In addition, given the potential cross-border repercussions of a problem in any of the G-SIBs on the financial institutions in many countries and on the global economy at large, this is not uniquely a problem for national authorities, and therefore requires a global minimum agreement." Because "there is no single solution to the externalities posed by G-SIBs, the official community is addressing the issues through a multipronged approach. The broad aim of the policies is to reduce the probability of failure of G-SIBs by increasing their going-concern loss absorbency; and reduce the extent or impact of failure of G-SIBs, by improving global recovery and resolution frameworks." The FSB, in consultation with the Basel Committee on Banking Supervision and national authorities, has identified G-SIBs since 2011. The list of G-SIBs is divided into "buckets" corresponding to required level of additional loss absorbency. The list of G-SIBs is updated annually each November, together with information on the application of policy measures to G-SIBs under the integrated set of policy measures to address the systemic and moral hazard risks associated with systemically important financial institutions published by the FSB in 2011. See Global

In terms of the Key Attributes home and key host authorities of all G-SIFIs should maintain crisis management groups (CMGs) with the objective of enhancing preparedness for, and facilitating the management and resolution of, a cross-border financial crisis affecting a specific institution. Such CMGs are required to include the supervisory authorities, central banks, resolution authorities, finance ministries and the public authorities responsible for guarantee schemes of jurisdictions that are home or host to entities of the group to which a failing globally systemic bank belongs and that are material to its resolution. These authorities are further required to cooperate closely with authorities in other jurisdictions where the failing bank has a systemic presence.[178]

2.2.9 Key Attribute 9: Institution-specific cross-border cooperation agreements

Globally systemically important financial institutions spread their operations over various jurisdictions and as such their failure can have a significant collective impact that could destabilize financial systems in all the countries in which they operate. In view thereof the Key Attributes recommend that for all G-SIFIs there should be, at a minimum, institution-specific cooperation agreements[179] in place between the home and relevant host authorities that need to be involved in the planning and crisis resolution stages. These agreements should, *inter alia*:[180] establish the objectives and processes for cooperation through CMGs; define the roles and responsibilities of the authorities pre-crisis during the recovery and resolution planning phases as well as during a crisis; set out information-sharing processes that will apply before and during a crisis, including information-sharing with any host authorities that are not represented in the CMG (with clear reference to the legal bases for information sharing in the respective national laws and to the arrangements that protect the confidentiality of the shared information); set out the coordination-processes pertaining to the development of the RRPs for the bank concerned (including parent or holding company and

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Systemically Important Financial Institutions (G-SIFIs) available at https://www.fsb.org/work-of-the-fsb/policy-development/addressing-sifis/global-systemically-important-financial-institutions-g-sifis/ accessed 17 September 2020. See further Basel Committee on Banking Supervision, *Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement*, July 2013 available at https://www.bis.org/publ/bcbs255.pdf accessed 12 June 2018.

[178] Key Attribute 8.1. In terms of Key Attribute 8.2 CMGs are further required to keep under active review, and report as appropriate to the FSB and the FSB Peer Review Council on: progress in coordination and information sharing within the CMGs and with host authorities that are not represented in the CMGs; the recovery and resolution planning process for G-SIFIs under institution-specific cooperation agreements; and the resolvability of G-SIFIs.

[179] These agreement should contain the features specified in I-Annex 2 to the Key Attributes.

[180] Key Attribute 9.1.

significant subsidiaries, branches and affiliates that are within the scope of the agreement, and for engagement with the bank as part of this process); set out the coordination-processes applicable to home and host authorities in the conduct of resolvability assessments; include agreed procedures for the home authority to inform and consult host authorities in a timely manner when there are material adverse developments affecting the failing bank and before taking any significant action or crisis measures; include agreed procedures for the host authority to inform and consult the home authority in a timely manner when there are material adverse developments affecting the failing bank and before taking any discretionary action or crisis measure; provide an appropriate level of detail with regard to the cross-border implementation of specific resolution measures, including with respect to the use of powers pertaining to bridge institutions and bail-in within resolution; provide for meetings between top officials of the relevant authorities to be held at least annually to review the robustness of the overall resolution strategy for G-SIFIs; and provide for regular (at a minimum, annual) reviews by appropriate senior officials of the operational plans implementing the resolution strategies.

The Key Attributes further require the existence of such agreements to be made public and permits the home authorities to publish the broad structure of these agreements, if agreed to by the all the authorities that are party to the said agreements.[181]

2.2.10 Key Attribute 10: Resolvability assessments

The hallmark of the Key Attributes is that it encourages a pro-active approach to bank resolution. As part of this pro-active approach it requires that resolution authorities should regularly undertake, at least for G-SIFIs, resolvability assessments. Such resolvability assessments seek to evaluate the feasibility of resolution strategies and their credibility in the light of the likely impact of a bank's failure on the financial system and the overall economy.[182] In undertaking resolvability assessments, the Key Attributes recommend that resolution authorities should, in coordination with other relevant authorities, assess a number of critical aspects, namely: the extent to which critical financial services, and payment, clearing and settlement functions can continue

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[181] Key Attribute 9.2.
[182] Key Attribute 10.1. Such resolvability assessments should be conducted in accordance with the guidance set out in I-Annex 3 to the Key Attributes.

to be performed; the nature and extent of intra-group exposures and their impact on resolution if they need to be unwound; the capacity of the failing bank concerned to deliver sufficiently detailed accurate and timely information to support resolution efforts; and the robustness of cross-border cooperation and information sharing arrangements.[183]

To improve a failing bank's resolvability, the Key Attributes recommend that supervisory authorities or resolution authorities should further have powers to require, where necessary, that appropriate measures be adopted by the bank concerned to reduce the complexity and costliness of resolution should it fail at a future point, duly taking into account the effect of these measures on the soundness and stability of ongoing business. Such measures could for example include changes to the failing bank's business practices, structure or organization. To enable the continued operation of systemically important functions, the Key Attributes recommend that authorities should evaluate whether to require that these functions be segregated in legally and operationally independent entities that are shielded from group problems.[184]

2.2.11 Key Attribute 11: Recovery and resolution planning

During the 2008 GFC the experience was that systemically significant financial institutions failed, leaving regulators to mop up the mess and figure out how to resolve the institution with the result often being *ad hoc* disorderly bailouts. Given that such an approach does not aid orderly resolution the Key Attributes require jurisdictions to put in place an ongoing process for recovery and resolution planning. Such planning process should at a minimum cover domestic systemically important banks.[185] The idea is thus that recovery plans, and also resolution plans (also referred to as "living wills")[186] should be made in times that banks are still healthy. Recovery plans should serve as a precautionary measure to enable a bank that veers into unsafe and unsound

[183] Key Attribute 10.2. Group resolvability assessments should, in terms of Key Attribute 10.3, be conducted by the home authority of the G-SIFI and coordinated with the firm's CMG taking into account national assessments by host authorities. Host resolution authorities that conduct resolvability assessments of subsidiaries located in their jurisdiction should, in terms of Key Attribute 10.4, coordinate as much as possible with the home authority that conducts resolvability assessment for the group as a whole.
[184] Key Attribute 10.5.
[185] Key Attribute 11.1.
[186] Goodhart, Segoviano, *Optimal Bank Recovery* IMF Working Paper WP/15/217 2015 available at https://www.imf.org/external/pubs/ft/wp/2015/wp15217.pdf accessed 17 September 2020 5.

territory to recover to a sound position whilst resolution plans should be aimed at having a structured approach to resolving a bank whose recovery plans could not serve to avert its failure.

The Key Attributes accordingly require jurisdictions to ensure recovery and resolution plans that are both robust and credible, containing certain essential elements,[187] are in place for all G-SIFIs and for any other financial institution that, in the opinion of its home authority, could have an impact on financial stability in the event of its failure.[188]

The recovery and resolution plans should be informed by resolvability assessments as mentioned in Key Attribute 10.[189] As specified in the Key Attributes, these plans should take account of the specific circumstances of the bank concerned and should reflect its nature, complexity, interconnectedness, level of substitutability and size. The resolution framework should further require that the bank's senior management provide the necessary input to the resolution authorities to enable the resolution authorities to assess the bank's recovery plans; and they should also provide the necessary input to assist the resolution authority with the preparation of resolution plans. The requirements that recovery and resolution plans respectively have to meet in compliance with the Key Attributes are discussed in more detail below:

2.2.11.1 Recovery plan

As indicated by Goodhart and Segoviano the recovery phase precedes the onset of any need for resolution.[190] Haentjens similarly observes that recovery plans pertain to "the stage in which a turnaround could be accomplished so as to stave off insolvency".[191]

A recovery plan is devised by the bank itself as part of its compliance duties required by the bank supervisor so that the recovery plan is in place and can be used by the

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[187] The essential elements of recovery and resolution plans are set out in I-Annex 4 of the Key Attributes.
[188] Key Attribute 11.2.
[189] Key Attribute 10.
[190] Goodhart, Segoviano, *Optimal Bank Recovery* IMF Working Paper WP/15/217 2015 available at https://www.imf.org/external/pubs/ft/wp/2015/wp15217.pdf accessed 17 September 2020 5. They point out that "[C]learly entry into the recovery phase is a serious business, and quite traumatic for management, if only because there is always a danger that the news may leak, leading to reputational damage. Left to themselves managers would be inclined to defer leaving entry into this phase far too late. On the other hand, because it is a serious step, it should not be initiated until there is a serious chance, without a major change of direction, of subsequent failure."
[191] Haentjens "Bank recovery and resolution: an overview of international initiatives" 2014 *International Insolvency Review* 255.

bank concerned to facilitate its recovery from a period of financial distress.[192] Supervisory and resolution authorities are required by the Key Attributes to ensure that banks maintain a recovery plan that identifies options to restore financial strength and viability when they come under severe stress. Consequently recovery plans should include:[193] credible options to cope with a range of scenarios including both idiosyncratic and market wide stress; scenarios that address capital shortfalls and liquidity pressures; and processes to ensure timely implementation of recovery options in a range of stress situations.

2.2.11.2 Resolution plan

Avgouleas, Goodhart and Schoenmaker indicate that resolution plans may prove to be a regulatory instrument of critical importance that may allow banks to be unwound in an orderly manner without imposing disproportionate costs on the taxpayer. They point out that the objective of resolution plans is to establish, *ex ante*, conditions that would "allow a wider range of options other than having the whole bank rescued". As such resolution plans are drawn up in advance for purposes of being used by the resolution authority to effect an orderly resolution if a bank encounters failure at a future stage. As such Avgouleas, Goodhart and Schoenmaker observe that a resolution plan aims to make contingency plans for times of stress. These plans should therefore be used to develop scenarios under which certain parts of the failing bank that are less important from a financial stability perspective can be sold or put into liquidation. The systemically important parts may then be rescued albeit Avgouleas, Goodhart and Schoenmaker point out that the choice of exactly which resolution tools to apply may

[192] Yauri, Musa, Kaoje "Bank recapitalisation in Nigeria; resuscitating liquidity and forestalling distress?" 2012 *International Journal of Business and Science* 298 indicate that the term "bank failure" and "bank distress" have been closely interchanged in literature. They indicate that "bank failure or bank distress could be loosely defined as the inability of a bank to meet up with its financial obligation to customers. In technical terms, banks are defined as financially distressed when they are technically insolvent and/or illiquid. In financial terms, to be insolvent means that a business is both unable to meet its current obligations to settle its outstanding debts. It is also stated that insolvency and financial distress/failure are two different things. This is mainly because distress or failure occurs when insolvency is officially recognised and the organisation is closed or measures are taken towards consolidation or merger." See also Whitaker "The early stages of financial distress" 1999 *Journal of Economics and Finance* 124. Whitaker notes that "a commonly used proxy for financial distress is default, or the inability to meet contractual debt obligations as they become due. He further states that the effects of financial distress are not limited to those firms which default but arise as the likelihood of default increases. Potentially, a substantial portion of the effects of financial distress are incurred well prior to default since much of the loss in firm value occurs during the years preceding default or bankruptcy rather than after."

[193] Key Attribute 11.5.

be an *ex post* decision. They indicate that this is only possible with a "straightforward legal structure" in which the different parts of the failing bank are easily identified and separated. Consequently the development of resolution plans may result in the bank supervisor imposing a simplification of the legal structure of the bank concerned which will then make resolution less complicated in future.[194]

In line with the aforementioned, the Key Attributes state that resolution plans are made when a bank is still healthy but that they serve as a precautionary measure to have a structured approach to resolution should the bank fail at some future point. Thus resolution plans are intended to facilitate the effective use of resolution powers to protect systemically important functions of the failing bank, with the aim of enabling feasible resolution of the bank without severe disruption of the financial system and without exposing taxpayers to loss. Resolution plans are consequently required to include a substantive resolution strategy agreed by top officials of the failing bank and an operational plan for its implementation. It must identify, in particular:[195] financial and economic functions rendered by the failing bank for which continuity is critical; suitable resolution options to preserve those functions or wind them down in an orderly manner; data requirements pertaining to the bank's business operations, structures and systemically important functions; potential barriers to effective resolution and specific actions to mitigate those barriers; actions to protect insured depositors and insurance policy holders and ensure the rapid return of segregated client assets; and clear options or principles for the bank's exit from the resolution process.

In accordance with the Key Attributes banks should further be required to ensure that key service level agreements can be maintained in crisis situations and in resolution. It is also required that contracts entered into by banks should include provisions that prevent recovery or resolution events from being regarded as triggers for termination of those contracts. Likewise such contracts should also contain provisions to facilitate

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[194] Avgouleas, Goodhart, Schoenmaker "Bank Resolution Plans as a catalyst for global financial reform" 2013 9 *Journal of Financial Stability* 211. They indicate that simplification of corporate structures would assist supervisors in getting a better overview of, and a more effective handle on large banking groups.

[195] Key Attribute 11.6.

transfer of the contract concerned to a bridge institution or third party acquirer if the bank concerned is put into resolution.[196]

The Key Attributes further require that supervisory and resolution authorities should ensure that recovery and resolution plans are regularly updated and reviewed. This means that they need to be updated at least annually or when there are material changes to the bank's business or structure, and that these plans should be subject to regular reviews with the bank's CMG.[197] Resolution authorities should also have the power, if they are not satisfied with a bank's recovery plan,[198] to require appropriate measures to address those aspects that they are not satisfied with.[199]

2.2.12 Key Attribute 12: Access to information and information sharing

During bank resolution effective access to information is of critical importance. It is evident that such information-sharing should pertain to relevant information that should be shared as swiftly as possible to facilitate the necessary resolution action. In this regard the Key Attributes stipulate that jurisdictions should ensure that no legal, regulatory or policy impediments exist that would hinder the appropriate exchange of information between supervisory authorities, central banks, resolution authorities, finance ministries and the public authorities responsible for guarantee schemes. In

[196] Key Attribute 11.7. At least for G-SIFIs, Key Attribute 11.8 requires that the home resolution authority should lead the development of the group resolution plan in coordination with all members of the firm's CMG. Host authorities that are involved in the CMG or are the authorities of jurisdictions where the firm has a systemic presence should be given access to RRPs and the information and measures that would have an impact on their jurisdiction. Host resolution authorities may, in terms of Key Attribute 11.9, maintain their own resolution plans for the institution's operations in their jurisdictions cooperating with the home authority to ensure that the plan is as consistent as possible with the group plan.

[197] Key Attributes 11.10 and 11.11. "The substantive resolution strategy for each G-SIFI should be subject, at least annually, to a review by top officials of home and relevant host authorities and, where appropriate, the review should involve the firm's CEO. The operational plans for implementing each resolution strategy should be, at least annually, reviewed by appropriate senior officials of the home and relevant host authorities."

[198] Duchaine, Dzhaha, Supeene "Cross-border resolution of financial firms" 2015 CIGI Graduate Fellow Series No. 6 available at https://www.cigionline.org/sites/default/files/graduate_fellows_pb_no.6.pdf accessed 17 September 2020. As both a prudential supervisor and a crisis manager, resolution authorities undertake regular resolvability assessments for G-SIFIs within their jurisdictions, constructing firm-specific recovery and resolution plans (RRPs) with the input of senior management at the firm. RRPs contain contingency plans for different scenarios wherein the firm experiences financial stress, including strategies in the event that the firm faces a critical liquidity shortfall. If the resolution authority is not satisfied that a firm could feasibly be wound down in a crisis, it can ask the firm to address remaining issues, which could extend to mandatory restructuring or the dissolution of subsidiaries.

[199] Key Attribute 11.12. Relevant home and host authorities should provide for prior consultation on the actions contemplated.

particular the Key Attributes recommend that:[200] the sharing of all information relevant for recovery and resolution planning and for resolution should be possible in normal times and during a crisis at both the domestic and cross-border level; the procedures for the sharing of information relating to G-SIFIs should be set out in institution-specific cooperation agreements;[201] and where appropriate and necessary to respect the sensitive nature of information, information sharing may be restricted, but it should still be possible to exchange such information among the top officials of the relevant home and host authorities.

The Key Attributes further recommend that jurisdictions should require institutions to maintain management information systems (MIS)[202] that are able to produce information on a timely basis, both during normal times for recovery and resolution planning and also during resolution. Information should be available at the group level and the legal entity level (taking into account information needs under different resolution scenarios, including the separation of individual entities from the group). Institutions should be required, in particular, to:[203] maintain a detailed inventory, including description and the location of the MIS used in their material legal entities, mapped to their core services and critical functions; identify and address exogenous legal constraints on the exchange of management information among the constituent entities of a financial group (for example, as regards the information flow from individual entities of the group to the parent entity); demonstrate, as part of the recovery and resolution planning process, that they are able to produce the essential information needed to implement such plans within a short period of time (for example 24 hours);

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[200] Key Attribute 12.1.

[201] I-Annex 1 of the Key Attributes.

[202] Nolte, Hoelscher, "Using the FSB Key Attributes to Design Bank Resolution Frameworks for Non-FSB members: Proportionality and Implementation Challenges" 2020 available at https://openknowledge.worldbank.org/bitstream/handle/10986/34040/Using-the-FSB-Key-Attributes-to-Design-Bank-Resolution-Frameworks-for-Non-FSB-Members-Proportionality-and-Implementation-Challenges.pdf?sequence=4 accessed 17 September 2020. According to this report, Key Attribute 12 ensures that the resolution authority has access to critical information from the firms it needs for resolution purposes and that firms can produce the information needed within a short time frame. Firms will have to be able to produce the information needed for resolution purposes in a timely manner when requested by the resolution authority to do so. For complex institutions, firms may be required to set up management information systems, which can track, produce, and update the information on request. The resolution authority should have unimpeded (physical) access to the firms for which it is responsible for the purpose of resolution planning. Furthermore, the financial safety net partners should also be allowed to share firm-specific information between among themselves to allow for system-wide planning and coordination processes. A further requirement is that such exchange of information should be subject to strong confidentiality rules because sensitive firm-specific information will be exchanged.

[203] Key Attribute 12.2.

and maintain specific information at a legal entity level, including, for example, "information on intra-group guarantees and intra-group trades booked on a back-to-back basis."

2.3 Conclusion

From the above discussion it is clear that a resolution regime that complies with the FSB Key Attributes provides a comprehensive and holistic framework that seeks to facilitate the orderly resolution of failing banks that are systemically important. Although clearly aimed at preventing ad hoc and arbitrary bail-outs of those types of financial institutions that were previously regarded as "too big to fail" the Key Attributes also recognise that systemic importance is not only linked to size. It is possible for a bank that is not one of the largest banks in a country to nevertheless be systemically important if, for example, it fulfils a specific niche role in the market and its critical services require continuation in order to prevent serious disruption in the financial system. The Key Attributes also underline the importance of legal certainty as to the scope of a resolution regime in order to avoid confusion and regulatory arbitrage in the event that a bank fails. The importance of clear triggers for entry into resolution that are implemented sufficiently early to avoid loss of value that would make resolution unsuitable is pivotal to an effective resolution regime. Furthermore the Key Attributes underline the important point that where a bank is part of a larger banking group or financial conglomerate as is usually the case these days, the application of the resolution regime should be capable of being extended to the whole banking group or conglomerate if necessary.

The necessity of having an independent and dedicated resolution authority is highlighted by Key Attribute 2. Such a resolution authority is generally the central bank or both the central bank and the deposit insurer where the latter has a loss minimiser mandate.[204] It is of course also possible to have a resolution authority that is an independent authority but, given the central bank's mandate for financial stability, its role as lender of last resort and the fact that in many countries the central bank is also the bank supervisor who not only has sound knowledge of the business of banks but

[204] Kletouri "Deposit protection system's design and effectiveness" 2015 *Journal of Banking Regulation* 52. Kletouri states that "a loss minimizer mandate is where the insurer actively engages in the selection from a full suite of appropriate least-cost resolution strategies."

is also in a prime position to detect when a bank is in unsafe and unsound territory, it would generally be the preferred resolution authority. Within an effective resolution regime the objectives of the resolution authority, which guide the application of the resolution tools, are clear: the resolution authority must pursue financial stability and ensure continuity of systemically important financial services as well as payment clearing and settlement functions and seek to protect bank depositors whilst avoiding unnecessary destruction of value and containing the cost of resolution. In order to ensure that the resolution authority keeps to its resolution mandate in line with the Key Attributes it is further necessary for measures ensuring its accountability to be set out within the legislative framework that captures the resolution regime. Albeit aimed at minimising cost, resolution nevertheless is costly hence it is also evident that the effectiveness of a resolution regime will hinge largely on the availability of resolution funding. Legal protection for the resolution authority should also be secured in the resolution regime so that it has the freedom to select and apply the optimal resolution action for a particular bank without having to be concerned about legal action being pursued against it or its officials.

Given that resolution entails planning for the event of failure long before such event occurs and given the need to act swiftly when a bank enters into resolution to avoid any further loss of value and public confidence, the Key Attributes underscore the importance of putting the resolution authority in a position where it can access, without obstruction, all information relevant to the effective resolution of a bank – both in anticipation of, and during, resolution.

From the above overview it is also evident that the mainstay of an effective resolution regime is the availability of appropriate resolution powers to facilitate swift, optimal and orderly resolution of a bank that has fallen on hard times. As observed above, the timing of when to trigger resolution is of utmost importance as timely resolution has a significant impact on the availability of the resolution measures for a specific bank. If a regulator waits too long before putting a bank in resolution it may compromise the range of resolution tools that can be applied to such bank and may even make orderly resolution impossible. Consequently it is critical that resolution be triggered at a time when a bank is not yet balance-sheet insolvent and there is still some equity to work with during resolution and while it is still possible to preserve the said bank's critical functions.

As regards resolution powers the Key Attributes require that they should *inter alia* comprise powers aimed at addressing the management and control of the failing bank; termination of contracts, disposal of assets and writing down of debt, and ensuring that critical services can be continued. So as not to allow resolution efforts to be derailed by uncooperative shareholders or by creditors seeking to enforce their claims at the expense of the larger group of the failing bank's creditors, it is also critical that an effective resolution regime provide for overriding of shareholder rights. Likewise it is critical to also provide for a moratorium on legal proceedings against the failing bank subject to also providing for creditor and shareholder safeguards to prevent deprivation of property without compensation. Of particular importance is the power of the resolution authority to appoint an administrator to implement the resolution plan pre-designed by the resolution authority with the assistance of the bank concerned, which administrator is *inter alia* tasked with taking control of the failing bank and managing it with the aim of restoring the bank, or at least parts thereof, to viability.

Insofar as the resolution tool comprising the transfer of assets and liabilities is concerned the Key Attributes allow the resolution authority to cherry pick assets and liabilities to be dealt with in a manner that would best serve the orderly resolution of the bank concerned. The bridge institution tool is a rather innovative resolution tool that started making its appearance in resolution regimes but it is evident that "bail in within resolution" is the flagship tool of an effective resolution regime. This innovative tool aims to address the TBTF-problem and, whilst seeking to ensure that those who benefit most from the profit made by the bank are held accountable to recapitalize the bank when it enters financial distress, it also has the added advantage of curbing moral hazard by limiting the bank's appetite for unwarranted risk-taking and it instils market discipline.

By the time a bank moves into the realm of resolution the resolution authority should thus have the required insight into the failing bank's business (facilitated by the resolution plans that have been put in place for the said bank as part of the bank supervisor's obligations) to determine which parts of the bank to "save" and which parts to liquidate. In a sense the resolution authority is enabled by an effective resolution regime to approach the resolution of a specific bank like a surgeon with a map of which limbs and functions to preserve and which ones to amputate. In this context the Key Attributes recognise that it is also critical to ensure that the application of resolution

actions and tools are insulated from being regarded as triggers for contractual acceleration or early termination rights.

The FSB Key Attributes thus require a holistic approach to dealing with a failing bank in a timeous (and pre-planned) manner where the resolution authority can apply the resolution tools in a combination and/or sequence that would be optimal for dealing with the bank concerned whilst preserving financial stability or at least minimising disruption to financial stability.

Chapter Three: Regulatory measures to address bank failures in Zimbabwe

3.1 Introduction

This chapter will focus on regulatory measures to deal with bank failures in Zimbabwe since its independence in 1980 until present times, focusing on particular measures aimed at the rescue of failing banks. Accordingly the chapter will interrogate the process of curatorship as set out in section 53 to 56 of the Zimbabwean Banking Act [Chap 24:20] as a rescue measure to deal with bank failure. Subsequent legislative attempts to introduce further measures to address bank failure and their interaction with curatorship will also be considered, in particular the regime introduced for "troubled" financial institutions in 2005 and the subsequent "problem" bank regime introduced by the 2015 Banking Amendment Act. The purpose of the Chapter will be to enable the eventual consideration in the concluding chapter of this thesis regarding an optimal resolution framework for Zimbabwe that will *inter alia* enable the rescue of failing banks or parts thereof with an augmented toolkit that is aligned with international standards for effective resolution regimes as captured in the FSB Key Attributes.

As indicated in Chapter One the features of a resolution framework pertaining to cross –border cooperation, crisis management, cooperation agreements and information sharing captured in FSB Key Attributes 7, 8, 9 and 12 fall beyond the scope of this thesis.[205]

3.2 Background

In Zimbabwe, various statutes regulate the banking industry.[206] The most significant of these statutes is the Reserve Bank of Zimbabwe Act, [Chapter 22:15] ("the RBZ

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[205] Chapter 1 para 1.8.

[206] Manase, Madhuku *A handbook on banking law in Zimbabwe* (1999) 1. See also Nhavira, Mudzonga, Mugocha "Financial Regulation and Supervision in Zimbabwe: An Evaluation of Adequacy and Options" 2013 *Zimbabwe Economic Policy Analysis and Research Unit Working Paper* available at http://www.zeparu.co.zw/sites/default/files/2018-03/FINANCIAL%20REGULATION%20AND%20SUPERVISION%20IN%20ZIMBABWE%20AN%20EVALUATION%20OF%20ADEQUACY%20AND%20OPTIONS2.pdf accessed 4 July 2019 v.

Act");[207] the Banking Act, [Chapter 24:20] and the Banking Amendment Act, 2015 ("the Banking Amendment Act");[208] Bank Use Promotion and Suppression of Money Laundering Act, [Chapter 24:24]; the Exchange Control Act [Chapter 22:05] and the National Payment Systems Act [Chapter 24:23].[209] There are five principal agencies charged with the responsibility of financial regulation and supervision.[210] These are the Ministry of Finance, the RBZ as central bank,[211] the Deposit Protection Corporation ("DPC"), the Securities Exchange Commission ("SEC")[212] and the Insurance and Pensions Commission ("IPEC").[213] The main players in the regulation and management of failing banks are the RBZ and the DPC.[214]

Before proceeding to the regulatory measures in place to address bank failure in Zimbabwe, note should be taken of the definition of a "banking institution" in terms of the main banking statutes as well the types of banks and other financial institutions operating in Zimbabwe. The Banking Act [Chapter 24:20] defines a "banking institution" as a company that is registered or required to be registered in terms of the Act to conduct any class of banking business in Zimbabwe.[215] The Banking Act further defines "banking business" as the business of "accepting deposits of money withdrawable or repayable on demand or after a fixed period or after notice and the employment of those deposits in the whole or in part by lending or any other means for the account and at the risk of the person accepting such deposits."[216]

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[207] The Reserve Bank Act [Chapter 22:15] empowers the Reserve Bank to supervise banking institutions and foster stability and proper functioning of the financial system.

[208] The Banking Act was established in 2000. The Banking Act [Chapter 24:20] and Banking Regulations Statutory Instrument 205 of 2000 provide for registration, regulation, continuous monitoring and supervision of persons conducting banking business in Zimbabwe. The Banking Amendment Act No 12 of 2015, which is designed to enhance troubled bank resolution was promulgated into law in May 2016.

[209] Bank Supervision Legal Framework available at https://www.rbz.co.zw/index.php/regulation-supervision/regulation-supervision/legal-framework accessed 25 April 2019.

[210] *Ibid*.

[211] *Ibid*. The Ministry of Finance is the ultimate supervisor of the financial system. All the regulators and supervisors of the financial system fall under the authority of the Ministry of Finance.

[212] *Ibid*. The SEC was formed with the objectives *inter alias*: investor protection, reduce systemic risk and promote market integrity.

[213] *Ibid*. The IPEC was formed with the objectives, *inter alias*, of regulating and monitoring the insurance and pension industries in Zimbabwe.

[214] Magondo "An assessment of the effectiveness of the regulatory tools in managing bank failures in Zimbabwe" (2015), *MBA Dissertation, University of Zimbabwe* v.

[215] Section 2(1) of the Banking Act [Chapter 24:20].

[216] *Ibid*. This definition developed from common law specifically from the English case of *United Dominion Trust v Kirkwood* [1966] 2 QB 431 which identified the main characteristics of bankers to include "accepting money deposits from their customers and collect cheques from their customers and place them to their credit; honouring cheques or orders drawn on them by their customers when

The Zimbabwean financial sector currently comprises of twenty-one operating banking institutions which include thirteen commercial banks, four building societies,[217] one savings bank,[218] one merchant bank, one infrastructure development bank[219] and one development finance institution.[220] Section 5 of the Banking Act provides that no person other than a registered banking institution is permitted to conduct banking business in Zimbabwe. Also, no registered banking institution is allowed to conduct any class of banking business unless it is registered in that class nor may it engage in banking activities that are not specified in its registration certificate.[221] In terms of section 6 of the Banking Act, the classes of banking business in which a banking institution may be registered are as follows:[222]

(a) Commercial Banks: The Banking Act [Chapter 24:20] defines a commercial bank as "a banking institution that conducts banking business in Zimbabwe and whose business mainly consists of acceptance of deposits withdrawable by cheque or otherwise."[223] Commercial banks are also engaged in lending money to businesses and individuals.[224] In Zimbabwe, the major commercial

presented for payment and debit customer accounts accordingly; and operating current accounts in general, pay cheques drawn on them and collect cheques for customers." See also Manase, Madhuku. *A handbook on banking law in Zimbabwe* (1999) 2.

[217] Building Societies are regulated by the Building Societies Act [Chapter 24:02]. Building societies do not offer current accounts but instead operate the fixed deposits accounts and savings accounts. They receive deposits from their customers which deposits are generally used to provide mortgage finance to prospective homeowners or people intending to undertake building programs. Building societies in Zimbabwe include CABS, FBC Building Society, National Building Society, and ZB Building Society.

[218] The People's Own Savings Bank which is governed by the People's Own Savings Bank of Zimbabwe Act [Chapter 24:22]. The People's Own Savings Bank accepts deposits from its customers. It does not operate through the current account system but instead operates either fixed deposit account or the ordinary savings account.

[219] The Infrastructure Development Bank of Zimbabwe ("IDBZ") is governed by the Infrastructure Development Bank of Zimbabwe Act [Chapter 24:14]. "The bank was primarily set up as a vehicle for the promotion of economic development and growth, and improvement of the living standards of Zimbabweans through the development of infrastructure, which includes but not limited to roads, dams, water reticulation, housing, sewerage, technology, amenities, and utilities." See the list of Operating Banking Institutions available at https://www.rbz.co.zw/index.php/regulation-supervision/regulation-supervision/banking-institutions/141-infrastructure-development-bank-of-zimbabwe-idbz accessed 1 February 2020.

[220] See the list of Operating Banking Institutions available at https://www.rbz.co.zw/index.php/regulation-supervision/regulation-supervision/banking-institutions accessed 25 April 2019.

[221] Section 5(2) of the Banking Act [Chapter 24:20].

[222] It also excludes the Infrastructure Development Bank of Zimbabwe ("IDBZ") which is governed by the Infrastructure Development Bank of Zimbabwe Act [Chapter 24:14]. According to the RBZ, there are 21 operating banking institutions in Zimbabwe. See the list of Operating Banking Institutions available at https://www.rbz.co.zw/index.php/regulation-supervision/regulation-supervision/banking-institutions accessed 25 April 2019.

[223] Section 2(1) of the Banking Act [Chapter 24:20].

[224] Manase, Madhuku *A handbook on banking law in Zimbabwe* (1999) 3.

banks are First Capital Bank Limited (formerly Barclays Bank of Zimbabwe Limited), Commercial Bank of Zimbabwe Limited ("CBZ"), Standard Chartered Bank Limited, BancABC Bank Limited, and Stanbic Bank Zimbabwe Ltd.[225]

(b) Discount houses: Discount houses are specialized banking institutions that accept deposits from the banking business sectors and use the deposited money to make short term loans to governments, parastatals, municipal authorities, and private business.[226] In return, discount houses acquire security in the form of treasury bills, government and local authority bonds, commercial bills, certificates of deposits and in particular the now popular negotiable certificates of deposit.[227] This lending and borrowing take place in a specialized money market commonly referred to as a discount market.[228] Due to the financial environment in Zimbabwe discount houses have closed.[229]

(c) Merchant Banks (or Accepting houses): The Banking Act does not use the term "merchant bank" but rather "accepting house". Merchant banks specialize in the financing of trade, by providing credit in various forms.[230] Merchant bankers also advise the business community on investments on the Stock Exchange, mergers and takeovers or when they want to engage in long term borrowing on the domestic and international money markets.[231] The only merchant bank currently registered in Zimbabwe is Tetrad Investment Bank Limited.[232]

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[225] See the list of Operating Banking Institutions available at https://www.rbz.co.zw/index.php/regulation-supervision/regulation-supervision/banking-institutions accessed 25 April 2019.
[226] Manase, Madhuku *A handbook on banking law in Zimbabwe* (1999) 3.
[227] *Ibid*.
[228] Manase, Madhuku *A handbook on banking law in Zimbabwe* (1999) 3.
[229] For example, Century Discount House closed on 2 January 2004, Rapid Discount House closed on 26 March 2004 and Sagit Finance House closed on 2 March 2006. Depositors of these institutions were reimbursed by the DPC in Zimbabwean Dollar and payments have been closed. Update on closed banks available at https://www.dpcorp.co.zw/update-on-closed-banks.html accessed 5 December 2019.
[230] *Ibid*. See section 2(1) of the Banking Act [Chapter 24:20].
[231] *Ibid*.
[232] See the list of Operating Banking Institutions available at https://www.rbz.co.zw/index.php/regulation-supervision/regulation-supervision/banking-institutions accessed 25 April 2019.

(d) Finance House: The Banking Act defines a "finance house" as "a banking institution that conducts banking business in Zimbabwe and whose business consists mainly in hire-purchase financing, financial leasing or factoring."[233] An example of such an institution is the Small and Medium Enterprises Development Corporation ("SMEDCO").[234]

(e) Microfinance Bank: The Banking Act defines a microfinance bank as a banking institution that limits any credit facility to any single borrower to a maximum of 5% of its capital base and whose business mainly consists of the provision of credit to either small and medium enterprises as defined in the Income Tax Act [Chapter 23:06] or to individuals whose monthly income is below the poverty datum line or whose monthly income does not exceed 5x times the poverty datum line.[235] Such banking institutions include ABC Moneylenders (Pty) Ltd and Credfin (Pty) Ltd.[236]

3.3 The Reserve Bank of Zimbabwe

The RBZ has its origins in the Bank of Rhodesia and Nyasaland which was created in March 1956 as a central bank for the Federation of Rhodesia and Nyasaland.[237] After the break-up of the Federation of Rhodesia and Nyasaland in 1963 and consequently the termination of the currency union between Northern and Southern Rhodesia and Nyasaland (now Zambia, Zimbabwe and Malawi), the Parliament of Southern

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[233] Section 2(1) of the Banking Act [Chapter 24:20].

[234] "The Small and Medium Enterprises Development Corporation (SMEDCO) was formed in 1983 and is a parastatal which falls under the Ministry of Small and Medium Enterprises and Co-operative Development. The organization began operations in April 1984. The institution changed its name from Small Enterprises Development Corporation (SEDCO) to Small and Medium Enterprises Development Corporation (SMEDCO) following amendments to the SME Act in February 2014. SMEDCO is a development finance institution which primarily exists to promote the development of micro, small and medium enterprises, and cooperatives in the country, through lending and capacity building." See the list of Operating Banking Institutions available at https://www.rbz.co.zw/index.php/regulation-supervision/regulation-supervision/banking-institutions accessed 25 April 2019.

[235] Section 2(1) of the Banking Act [Chapter 24:20].

[236] Registered Microfinance Institutions available at https://www.rbz.co.zw/index.php/regulation-supervision/regulation-supervision/micro-finance-institutions accessed 25 April 2019.

[237] History of the Reserve Bank of Zimbabwe available at https://www.rbz.co.zw/index.php/about-us/about-us/history accessed 27 April 2019. The Federation of Rhodesia and Nyasaland (also known as the Central African Federation) was a federal semi-Dominion that consisted of three southern African territories, namely, the self-governing British colony of Southern Rhodesia and the British protectorates of Northern Rhodesia and Nyasaland between 1953 and 1963.

Rhodesia enacted the Reserve Bank of Rhodesia Act on 16 November 1964, creating a new central bank, the Reserve Bank of Rhodesia, and replacing the Central African pound with the Rhodesian pound.[238] Upon achievement of *de jure* independence recognised by the international community, including the United Kingdom and the attainment of majority rule on 18 April 1980, the Reserve Bank of Rhodesia subsequently became the Reserve Bank of Zimbabwe ("RBZ"), with its headquarters in the capital city, Harare.[239] The RBZ operates under the RBZ Act, [Chapter 22:15] of 1964.[240] The RBZ Act *inter alia* provides for a Board of Directors[241] as governing body of the RBZ and for the appointment of the Governor of RBZ who is responsible for heading the day-to-day administration and operations of the Bank.[242] Njanike notes that the Reserve Bank of Zimbabwe Act states the objectives of the RBZ as central bank, meaning that if independence exists, then it is only in as far as instrument independence is concerned, because goal independence is taken away by the mere existence of a statute which stipulates the operations and objectives of the RBZ.[243]

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[238] Noko "Dollarization: the case of Zimbabwe", 2011 *Cato Journal* 340.

[239] *Ibid*. Noko indicates that, originally, the RBZ was situated in Vincent (now Mapondera) Building in Harare from where the High Court of Zimbabwe currently operates, and later moved to Bank Chambers at 76 Samora Machel Avenue, in June 1957 as its new headquarters. Following a rapid growth in its operations and staff, the RBZ found it necessary to construct its current headquarters complex at 80 Samora Machel Avenue. The building, billed as the most technologically advanced in Zimbabwe was officially opened on May 31 1996. See also History of the Reserve Bank of Zimbabwe available at https://www.rbz.co.zw/index.php/about-us/about-us/history accessed 27 April 2019.

[240] *Ibid*.

[241] Section 21 of the Reserve Bank Act [Chapter 22:15]. The board of directors is responsible for formulating the policy of the RBZ and supervising the RBZ's administration and operations. The Board shall consist of the Governor or both Deputy Governors and a person employed in the Ministry of Finance appointed by the Minister and not fewer than five or more than nine directors.

[242] Section 14 of the Reserve Bank Act [Chapter 22:15] states that the Governor and not more than two Deputy Governors shall be appointed by the President after consultation with the Minister for renewable five-year-terms. The current Governor of the Reserve Bank of Zimbabwe is Dr John Mangudya. The Governor and Deputy Governors are appointed based on their competence and experience in matters relating to banking, finance and economics. See also section 46 of the Reserve Bank Act which states that in June and December of each year, "the Governor shall submit to the Minister a policy statement containing a description of the monetary policy to be followed by the Bank during the next succeeding six months and a statement of the reasons for those policies; and a statement of the principles that the Bank proposes to follow in the implementation of the monetary policy; and an evaluation of the monetary policy and its implementation for the last preceding six months." See also History of the Reserve Bank of Zimbabwe available at https://www.rbz.co.zw/index.php/about-us/about-us/history accessed 27 April 2019.

[243] Njanike "Central bank independency on the development of the financial sector. A case of the Reserve Bank of Zimbabwe (1998 – 2008)" 2010 *Annals of the University of Petrosani, Economics* 254.

The RBZ's mission is to safeguard the stability and safety of the Zimbabwean financial system and to promote inclusive growth.[244] As central bank the RBZ is responsible for the formulation and implementation of monetary policy, directed at ensuring low and stable inflation levels.[245] A further core function of the RBZ is to maintain a stable banking system through its supervisory[246] and lender of last resort functions.[247] Other secondary roles of the RBZ include the management of the country's gold and foreign exchange assets.[248] The RBZ is also the sole issuer of currency (notes and coins) and acts as banker and advisor to the Government of Zimbabwe.[249] Moreover, the RBZ is responsible for ensuring that Zimbabwe's financial system remains up-to-date with international standards that are set by the Bank of International Settlements despite not being a member of BIS.[250]

Like many other central banks the RBZ is also tasked with bank supervision. In particular section 6 of the RBZ Act empowers the RBZ to supervise the operations of all banking institutions in the country and foster stability and proper functioning of the

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[244] Section 6(b) and (c) of the Reserve Bank Act [Chapter 22:15]. See also Vision and Mission of the Reserve Bank of Zimbabwe available at https://www.rbz.co.zw/index.php/about-us/about-us/mandate accessed 27 April 2018.

[245] Section 6(f) of the Reserve Bank Act [Chapter 22:15]. See also Functions of the Reserve Bank of Zimbabwe available at https://www.rbz.co.zw/index.php/about-us/about-us/functions accessed on 27 April 2019.

[246] Section 6(e) of the Reserve Bank Act [Chapter 22:15]. See Nhavira, Mudzonga, Mugocha "Financial Regulation and Supervision in Zimbabwe: An Evaluation of Adequacy and Options" 2013 *Zimbabwe Economic Policy Analysis and Research Unit Working Paper* available at http://www.zeparu.co.zw/sites/default/files/2018-03/FINANCIAL%20REGULATION%20AND%20SUPERVISION%20IN%20ZIMBABWE%20AN%20EVALUATION%20OF%20ADEQUACY%20AND%20OPTIONS2.pdf accessed 4 July 2019 v.

[247] The RBZ's function as a lender of last resort is provided for in section 11(5) of the Reserve Bank Act [Chapter 22:15]. In terms of section 11(5), the RBZ "may on such terms and conditions as it may determine, act as lender of last resort for banking institutions, by granting to them or for their benefit, for periods, not more than 3 months, loans other than those specified by section 59 of the Banking Act and contingent commitments."

[248] Section 47(3) of the Reserve Bank Act [Chapter 22:15].

[249] Section 40 of the Reserve Bank Act [Chapter 22:15] states that the RBZ shall have the sole right to make or cause to be made and to issue bank notes in Zimbabwe. Section 43 of the Reserve Bank Act [Chapter 22:15] states that the RBZ shall have the sole right to make or cause to be made and to issue coins in Zimbabwe.

[250] Nhavira, Mudzonga, Mugocha "Financial Regulation and Supervision in Zimbabwe: An Evaluation of Adequacy and Options" 2013 *Zimbabwe Economic Policy Analysis and Research Unit Working Paper* available at http://www.zeparu.co.zw/sites/default/files/2018-03/FINANCIAL%20REGULATION%20AND%20SUPERVISION%20IN%20ZIMBABWE%20AN%20EVALUATION%20OF%20ADEQUACY%20AND%20OPTIONS2.pdf accessed 4 July 2019 9. See also Kondongwe, "The root causes of bank failures in Zimbabwe since the year 2008 to 2015 (Report)" 2015 available at https://connect.up.ac.za/https/ssrn.com/abstract=3120898 accessed 7 June 2020 13.

financial system.[251] The RBZ thus functions as the systemic as well as the prudential regulator in the Zimbabwean financial system. Initially the previous Banking Act [Chapter 24:01] did not set out the RBZ's responsibilities in relation to bank supervision but this Act was repealed in 2000 by the current Banking Act [Chapter 24:20], which provides the present framework for bank supervision. The Banking Act *inter alia* sets out the requirements for licensing[252] of banking institutions and their permitted activities; [253] minimum capital and minimum reserve requirements[254] and restrictions on certain transactions.[255] The supervision and investigation of banking institutions as part of the RBZ supervisory duties are dealt with in section 45 to 52 of the Banking Act. These duties *inter alia* entail that the RBZ Supervision Division has to continuously monitor and supervise banking institutions and their associates for compliance with the Banking Act and has to conduct investigations into banking institutions where the RBZ deems it necessary for the purpose of preventing, investigating or detecting a contravention of the Banking Act or any other law.[256] The Supervision Division also "scrutinizes periodic returns under its risk-based supervision (off-site examination) and undertakes regular examinations of the books and records of the bank through on-site examinations to ensure conformity with statutory regulations as well as with RBZ Prudential Guidelines."[257]

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[251] Section 6(1)(c) and (e) of the Reserve Bank of Zimbabwe Act [Chapter 22:15]. See also Bank Supervision available at https://www.rbz.co.zw/index.php/about-us/departments/bank-supervision accessed 27 April 2019.

[252] Section 8 to 15 of the Banking Act [Chapter 24:20]. As pointed out by Nhavira, Mudzonga, Mugocha "Financial Regulation and Supervision in Zimbabwe: An Evaluation of Adequacy and Options" 2013 *Zimbabwe Economic Policy Analysis and Research Unit Working Paper* available at http://www.zeparu.co.zw/sites/default/files/2018-03/FINANCIAL%20REGULATION%20AND%20SUPERVISION%20IN%20ZIMBABWE%20AN%20EVALUATION%20OF%20ADEQUACY%20AND%20OPTIONS2.pdf accessed 4 July 2019 9 prior to 2000 the registration of banks was the responsibility of the Ministry of Finance whilst supervision was the purview of the RBZ. However the Banking Act of 2000 [Chapter 24:20] and Statutory Instrument 205 of 2000 transferred all responsibility to the RBZ.

[253] Section 7 of the Banking Act [Chapter 24:20].

[254] Sections 29 and 30 of the Banking Act [Chapter 24:20] respectively.

[255] Section 32 to 35 of the Banking Act [Chapter 24: 20].

[256] Section 45(1)(a) and (b) of the Banking Act [Chapter 24:20].

[257] *Ibid*. See also Guidelines available at https://www.rbz.co.zw/index.php/regulation-supervision/regulation-supervision/guidelines-circulars-and-public-notices accessed 8 December 2019. Examples of some of the guidelines published by the RBZ include: Bank Supervision Division Prudential Standards No 02-2016/BSD: Deposit-Taking Microfinance Institutions November 2016 and Bank Supervision Division Guideline No 02-2015/BSD: External Audit Framework for Banking and Non-Bank Financial Institutions January 2015.

Albeit that a discussion thereof is beyond the scope of this thesis, note should be taken that Zimbabwe also operates an explicit deposit protection scheme since 1 July 2003.[258]

3.4 History of bank failures in Zimbabwe

Zimbabwe's financial sector was relatively stable for a number of years after independence in 1980 but the sector experienced instability from the mid-1990s following a period of deregulation and liberalization.[259] In 1990, the Government of Zimbabwe launched a fully-fledged International Monetary Fund ("IMF") and World Bank monitored-program, the *Economic Structural Adjustment Program* ("*ESAP*"). The *ESAP* aimed to deregulate the economy (prices, employment and wages), reduce the

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[258] The Deposit Protection Corporation ("DPC") is a statutory body previously known as the Deposit Protection Board established on 1 July 2003 in terms of the Banking Act [Chapter 24:20] as read with Banking (Deposit Protection) Regulations, Statutory Instrument 29 of 2003. The Deposit Protection Board was required to exercise its functions to achieve the following objectives— "(a) protecting depositors, particularly small depositors; and (b) contributing towards the stability of Zimbabwe's financial system; and (c) enhancing competition between different sectors and institutions in Zimbabwe's financial system; and (d) promoting sound business practices for contributory institutions." The Corporation assumed the new name in terms of the Deposit Protection Act [Chapter 24:29], No. 7/2011 which came into effect on 16 March 2012 which also resulted in the Corporation's mandate being expanded to include responsibilities such as the resolution of failing or failed banks, judicial management and liquidation of closed banks. The enhanced mandate has enabled DPC to effectively carry out its objectives in line with international best practice. The Corporation's primary objective is "to provide deposit protection to depositors in deposit taking institutions licensed by the Reserve Bank of Zimbabwe under the Banking Act (Chapter 24:20), Building Societies Act (Chapter 24:02), People's Own Savings Bank ("POSB") Act (Chapter 24:22), Infrastructure Development Bank of Zimbabwe ("IDBZ") Act (Chapter 24:14) and Micro-finance Act (Chapter 24:29) such as commercial banks, merchant banks, building societies, discount houses, finance houses, deposit-taking micro-finance institutions, People's Own Savings Bank ("POSB") and Infrastructure Development Bank of Zimbabwe ("IDBZ")." In the event of a bank failure, DPC will compensate depositors part or all of their funds that were in the closed bank up to the maximum cover limit prevailing at the time of bank closure. The cover limit is set at ZWL10,000 (Ten Thousand Zimbabwean Dollars) per depositor per bank and $500 (Five Hundred Zimbabwean Dollars) for deposit-taking micro-finance institutions effective 1 January 2020. The Deposit Protection Fund is established under Section 13 of the Deposit Protection Corporation Act [Chapter 24:29]. The primary objective of the Fund is to compensate depositors in full or in part, for losses incurred in the event of insolvency of a contributory institution. The Fund is vested in and administered by the DPC. The creation of the Fund is a Government policy in response to a growing need to moderate instability in the banking sector and to protect the public against the worst consequences of bank failure. Statutory Instrument 156 of 2013 outlining the rules and regulations governing the operation of the Deposit Protection Fund is in place. See further Deposit Protection Corporation available at https://www.dpcorp.co.zw/about-dpc.html accessed 4 August 2020.

[259] Nhavira, Mudzonga, Mugocha "Financial Regulation and Supervision in Zimbabwe: An Evaluation of Adequacy and Options" 2013 *Zimbabwe Economic Policy Analysis and Research Unit Working Paper* available at http://www.zeparu.co.zw/sites/default/files/2018-03/FINANCIAL%20REGULATION%20AND%20SUPERVISION%20IN%20ZIMBABWE%20AN%20EVALUATION%20OF%20ADEQUACY%20AND%20OPTIONS2.pdf accessed 4 July 2019 4.

public deficit, and continue relaxing restrictions on trade.[260] As observed by Marquette the *ESAP* signaled a formal shift away from state interventionism and regulation toward non-interventionism, privatization and deregulation.[261] Part of the *ESAP* entailed the implementation of financial reforms through liberalization and deregulation of the banking sector.[262] The main reason for these reforms was the view that the oligopolistic[263] nature of the Zimbabwean banking sector at the time prevented competition among the various players and deprived the sector of choice and quality in service, innovation, and efficiency.[264] The Government of Zimbabwe, through the Ministry of Finance and the RBZ, began issuing out new banking licences to financial players to the extent that between 1991 and 2003, there was a significant increase of banking institutions.[265] Before the *ESAP*, the banking sector was dominated by foreign-owned banks and the Government of Zimbabwe controlled the interest rates, deposit rates and credit ceilings amongst other controls.[266] The sector had a few participants who included the RBZ, five commercial banks, two discount houses, four merchant

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[260] *Ibid*. See also Munangagwa "The economic decline of Zimbabwe" 2009 *The Gettysburg Economic Review* 112 who notes that "the main goals of ESAP were to: achieve GDP growth of 5 percent during 1991 – 1995; raise savings to 25 percent of GDP; reduce budget deficit from over 10 percent GDP to 5 percent by 1995; and reduce inflation from 17.7 percent to 10 percent by 1995. ESAP was implemented to achieve economic recovery and sustained growth through balancing the budget, strengthening the private sector and removing controls on trade."

[261] Marquette "Current Poverty, Structural Adjustment, and Drought in Zimbabwe" 1997 *World Development* 1143.

[262] Magondo "An assessment of the effectiveness of the regulatory tools in managing bank failures in Zimbabwe" (2015), *MBA Dissertation, University of Zimbabwe* 1. See also Nhavira, Mudzonga, Mugocha "Financial Regulation and Supervision in Zimbabwe: An Evaluation of Adequacy and Options" 2013 *Zimbabwe Economic Policy Analysis and Research Unit Working Paper* available at http://www.zeparu.co.zw/sites/default/files/2018-03/FINANCIAL%20REGULATION%20AND%20SUPERVISION%20IN%20ZIMBABWE%20AN%20EVALUATION%20OF%20ADEQUACY%20AND%20OPTIONS2.pdf accessed 4 July 2019 4.

[263] Whish, Bailey *Competition law* (2018) 570–571 observe that "Oligopoly exists where a few firms between them supply all or most of the goods or services on a market without any of them having a clear ascendancy over the others. Oligopoly can lead to a well-known problem for competition law and policy: oligopolists are able, by virtue of the characteristics of the market, to behave in a parallel manner and to derive benefits from their collective market power without necessarily, entering into an agreement or concerted practice of the kind generally prohibited by competition law. This is called tacit collusion and it is the result of each firm's individual and rational response to market conditions."

[264] Magondo "An assessment of the effectiveness of the regulatory tools in managing bank failures in Zimbabwe" (2015), *MBA Dissertation, University of Zimbabwe* 1. See also Nhavira, Mudzonga, Mugocha "Financial Regulation and Supervision in Zimbabwe: An Evaluation of Adequacy and Options" 2013 *Zimbabwe Economic Policy Analysis and Research Unit Working Paper* available at http://www.zeparu.co.zw/sites/default/files/2018-03/FINANCIAL%20REGULATION%20AND%20SUPERVISION%20IN%20ZIMBABWE%20AN%20EVALUATION%20OF%20ADEQUACY%20AND%20OPTIONS2.pdf accessed 4 July 2019 4.

[265] *Ibid*. According to Nhavira and others, in 1990 before the financial reforms, there were only 21 banking institutions. They increased to 23 in 1993 and by 2003, before the banking institutions collapse, they had increased to 41.

[266] *Ibid*.

banks, three building societies, six finance houses and the Post Office Savings Bank.[267] Strategic institutions such as the Credit Guarantee Company, the Small Enterprises Development Company, Agricultural Finance Corporation, the Industrial Development Corporation and the Zimbabwean Development Bank also formed part of the sector.[268] These institutions had special functions to direct funds to specific sectors such as agriculture and industry.[269]

The deregulation of the financial services under the *ESAP* however also attracted other investors into the banking sector.[270] According to Magondo, this sector was still seen as a beacon of entrepreneurship for the indigenous people notwithstanding the harsh economic climate which was prevailing at the time.[271] The liberalization of the banking sector consequently saw the licensing of fourteen indigenous banks between 1991 and 2002.[272] As a result, notable changes to the financial sector architecture included the increase of discount houses from six to eight, building societies from three to five and commercial banks from five to sixteen between 1991 and 2002.[273]

The licensing of indigenous banks was the Government of Zimbabwe's strategy to break the dominance by foreign banks[274] and create an avenue to accumulate wealth at a domestic level.[275] Most indigenous banks, however, had significant ownership concentration and families had majority shareholding in these institutions.[276] These families represented top management and sat on the board of directors but did not

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[267] *Ibid*.
[268] *Ibid* 2.
[269] *Ibid*.
[270] Magondo "An assessment of the effectiveness of the regulatory tools in managing bank failures in Zimbabwe" (2015), *MBA Dissertation, University of Zimbabwe* 2.
[271] *Ibid*.
[272] *Ibid*. Banks licensed after the Liberalization of the Banking Sector include Commercial Bank of Zimbabwe (1991), First National Building Society (1993), Leasing Company of Zimbabwe (1999), Century Bank (1999), Zimbabwe Building Society (1993), Barbican Banking Corporation (1999), National Merchant Bank – NMB (1993), Universal Merchant Bank (1995), Genesis Investment Bank (1995), Trust Merchant Bank (1996), First Banking Corporation (1997), Kingdom Bank Limited (1997), Agricultural Development Bank (1999) and Time Bank of Zimbabwe (2002).
[273] *Ibid* 3.
[274] Since liberalization, entry into the market by foreign banks has been limited due to restrictions such as minimum 30% local shareholding as well as stringent foreign currency controls in addition to caution amongst the licensing authorities to issue licenses to foreign banks thus most of the entrants were local.
[275] *Ibid*.
[276] *Ibid*. For example Nicholas Vingirai's Intermarket Banking Corporation which was placed under curatorship in 2004 and Roger Boka's United Merchant Bank which collapsed in 1998. See Zororo "Financial distress and corporate governance in Zimbabwean banks" 2006 *Corporate Governance* 648.

necessarily have the skill and expertise to prudently manage these banks.[277] Consequently, Magondo points out that most indigenous banks were burdened with weak corporate governance structures which made them susceptible to failure.[278]

By 1996, it was clear that the Government of Zimbabwe was not prepared to implement the rest of the *ESAP* reforms that was expected and as a result, a division developed with the IMF and the World Bank and further support of loans and economic reform strategies by these entities was discontinued.[279] This was followed by the Democratic Republic of Congo war,[280] and the unbudgeted pay-out of pensions to the country's war veterans that contributed to the decline of the Zimbabwean dollar.[281] The aforesaid events were soon followed by the land invasions of 2000 which, according to the Zimbabwe Economic Policy and Research Unit ("ZEPARU"), undermined the economy further as Zimbabwe is highly dependent on agricultural output.[282] Thereafter, the

[277] *Ibid*.

[278] *Ibid*.

[279] Nhavira, Mudzonga, Mugocha "Financial Regulation and Supervision in Zimbabwe: An Evaluation of Adequacy and Options" 2013 *Zimbabwe Economic Policy Analysis and Research Unit Working Paper* available at http://www.zeparu.co.zw/sites/default/files/2018-03/FINANCIAL%20REGULATION%20AND%20SUPERVISION%20IN%20ZIMBABWE%20AN%20EVALUATION%20OF%20ADEQUACY%20AND%20OPTIONS2.pdf accessed 4 July 2019 40.

[280] Munangagwa "The economic decline of Zimbabwe" 2009 *The Gettysburg Economic Review* 114 observes that "In a move widely criticized, Zimbabwe entered the war in the Democratic Republic of Congo in 1998. Assessing the involvement of Zimbabwe's troops in the war in the Democratic Republic of Congo, it is evident that this was one of the pivotal starting points of Zimbabwe's economic decline. Zimbabwe aligned itself to the government of Laurent Kabila and fought against the Tutsi rebels of the Rwandan and Burundi forces. The government had not budgeted for the war, it turned out to be more expensive than originally anticipated, and the government could not raise taxes to pay for it. The costs to Zimbabwe were estimated to have been almost 3 million USD per day, and analysts state that the government spent ZWD $6 billion in unbudgeted expenditure on the war." See also Kararach and Otieno *Economic Management in a Hyperinflationary Environment: The Political Economy of Zimbabwe 1980 – 2008*, (2016) 254.

[281] Munangagwa "The economic decline of Zimbabwe" 2009 *The Gettysburg Economic Review* 114 indicate that "During the first half of 1997, the war veterans (of Zimbabwe's war for independence) organized themselves and demonstrations that were initially ignored by the government. As the intensity of the strikes grew the government was forced to pay the war veterans a once-off gratuity of ZWD $50,000 by December 31, 1997 and a monthly pension of $2,000 USD beginning January 1998. To raise money for this unbudgeted expense, the government tried to introduce a "war veterans" levy but they faced much opposition from the labour force and had to effectively borrow money to meet these obligations. This dramatic increase in budget expenditure had serious negative consequences for the country's budget position. The total cost is estimated to be ZWD $4 billion and the resultant government deficit led to the withdrawal of the IMF support." See also Brett, Winter "Origins of the Zimbabwe Crisis" 2003 available at https://hsf.org.za/publications/focus/issue-30-second-quarter-2003/origins-of-the-zimbabwe-crisis accessed 27 November 2019.

[282] See Munangagwa "The economic decline of Zimbabwe" 2009 *The Gettysburg Economic Review* 115. See also Nhavira, Mudzonga, Mugocha "Financial Regulation and Supervision in Zimbabwe: An Evaluation of Adequacy and Options" 2013 *Zimbabwe Economic Policy Analysis and Research Unit Working Paper* available at http://www.zeparu.co.zw/sites/default/files/2018-03/FINANCIAL%20REGULATION%20AND%20SUPERVISION%20IN%20ZIMBABWE%20AN%20EVALUATION%20OF%20ADEQUACY%20AND%20OPTIONS2.pdf accessed 4 July 2019 40.

economy spiralled into a deep decline marked by unprecedented hyperinflation that stretched to 2008.[283]

The subsequent introduction of multiple currencies in 2009 brought some brief relief and saw significant economic growth averaging 9.5% between 2009 to 2011 and inflation below 5%.[284] However, the economic decline took hold again and according to ZEPARU, since 2011, challenges that burden the financial sector include macroeconomic illiquidity,[285] low savings, unstable deposits and short-term loans coupled with the absence of an active interbank market[286] and limited access to affordable external credit lines.[287]

Insofar as bank failures in particular were concerned Nyamutowa indicates that the banking sector went through a number of marked phases of bank collapses. At the time of independence in 1980 the following banks were in operation in Zimbabwe: Rhodesian Banking Corporation (later renamed ZB Bank), Barclays Bank, Standard Bank, Merchant Bank of Central Africa ("MBCA"), Bank of Credit and Commerce Zimbabwe, Grindlay Bank (now Stanbic), Beverley Building Society, Central Africa Building Society ("CABS") and the Post Office Savings Bank (now the People's Own

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283 *Ibid*. The country's Gross Domestic Product ("GDP") growth rate was -7.4% in 2000 but dropped to -10.4% in 2003. It is estimated that GDP fell by 40% between 2000 and 2008. The inflation rate was 7% in 1980, 622% in January 2004, 1281.1% in December 2006 and 231 million % by July 2008.

284 Nhavira, Mudzonga, Mugocha "Financial Regulation and Supervision in Zimbabwe: An Evaluation of Adequacy and Options" 2013 *Zimbabwe Economic Policy Analysis and Research Unit Working Paper* available at http://www.zeparu.co.zw/sites/default/files/2018-03/FINANCIAL%20REGULATION%20AND%20SUPERVISION%20IN%20ZIMBABWE%20AN%20EVALUATION%20OF%20ADEQUACY%20AND%20OPTIONS2.pdf accessed 4 July 2019 40. See also Nkomazana, Niyimbanira "An overview of the economic causes and effects of dollarization: case of Zimbabwe" 2014 *Mediterranean Journal of Social Sciences* 69. See also Ellyne "Lessons from Zimbabwe's Hyperinflation and Dollarization" 2013 available at https://www.researchgate.net/profile/Mark_Ellyne/publication/281150323_Lessons_From_Zimbabwe's_Hyperinflation_and_Dollarization/links/55d8d38308aeb38e8a87b760.pdf accessed 8 December 2019 21. Ellyne points out that "proponents of dollarization argue that it reduces inflation to that of host currency, it boosts exports, and the resulting improvement to confidence and fiscal credibility results in lower interest rates, increased foreign investment and improved growth." See also Sikwila "Dollarization and the Zimbabwe's Economy" 2013 *Journal of Economics and Behavioural Studies* 401.

285 Examples of macroeconomic factors include economic outputs, unemployment rates, and inflation.

286 The interbank market in Zimbabwe is limited. The Interbank market was rendered dis-functional after the collapse of confidence in the financial industry. Banks themselves have no confidence in each other, and this has resulted in limited liquidity smoothening in the banking industry. See Nhavira, Mudzonga, Mugocha "Financial Regulation and Supervision in Zimbabwe: An Evaluation of Adequacy and Options" 2013 *Zimbabwe Economic Policy Analysis and Research Unit Working Paper* available at http://www.zeparu.co.zw/sites/default/files/2018-03/FINANCIAL%20REGULATION%20AND%20SUPERVISION%20IN%20ZIMBABWE%20AN%20EVALUATION%20OF%20ADEQUACY%20AND%20OPTIONS2.pdf accessed 4 July 2019 65.

287 *Ibid*.

Savings Bank). The signs of a financial crisis emerged in 1998 with the collapse of United Merchant Bank *inter alia* as a result of bad loans and mismanagement.[288] During the 1990s and early 2000s six banks collapsed, namely: CBZ (1991), United Merchant Bank (1998), Zimbank, Zimbabwe Building Society (2002), First National Building Society (2003), and Universal Merchant Bank (2002).[289] The Government of Zimbabwe responded by bailing out three of the affected banks, CBZ, Zimbank, and Zimbabwe Building Society.[290] Some legislative reforms were subsequently made to address specific challenges in the banking sector.[291] As pointed out above, the Banking Act [Chapter 24:01] which was in operation at the time was repealed and the current Banking Act [Chapter 24:20] was enacted together with Banking Regulations that came into effect on 1 August 2000 and the RBZ supervisory responsibilities were eventually captured in this legislation.[292] In 2002, the RBZ proposed further amendments to the Banking Act and Banking Regulations of 2000[293] with the objective of strengthening the RBZ's supervisory capacity in order to improve effectiveness; expanding the legal framework in compliance with the Basel Committee's *Core Principles for Effective Banking Supervision*[294] and addressing areas of ambiguity in the legislation.[295]

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288 Nyamutowa, Masunda "An Analysis of Credit Risk Management Practices in Commercial Banking Institutions in Zimbabwe" 2013 *International Journal of Economic Research* 31.

289 Nhavira, Mudzonga, Mugocha "Financial Regulation and Supervision in Zimbabwe: An Evaluation of Adequacy and Options" 2013 *Zimbabwe Economic Policy Analysis and Research Unit Working Paper* available at http://www.zeparu.co.zw/sites/default/files/2018-03/FINANCIAL%20REGULATION%20AND%20SUPERVISION%20IN%20ZIMBABWE%20AN%20EVALUATION%20OF%20ADEQUACY%20AND%20OPTIONS2.pdf accessed 4 July 2019 42.

290 *Ibid*.

291 *Ibid*.

292 See section 45 of the Banking Act (Chapter 24:20). As indicated above the Banking Act [Chapter 24:01] of 1965 did not specifically provide for banking supervision activities by the RBZ. The Banking Act went through amendments, the major focus of the proposed changes were to give the RBZ a proper legal basis for all its responsibilities, including banking supervision. In the interim, the RBZ put in place a mechanism to carry out both off-site surveillance and on-site examination of banking institutions, and it received full cooperation from these institutions. See The Payment System in Zimbabwe available at https://www.bis.org/cpmi/paysys/zimbabwe.pdf accessed 8 December 2019.

293 Banking Act Chapter 24:20 as amended by Act 12 of 2002. Banking Regulations, 2000 published in Statutory Instrument 205 of 2000.

294 Core Principles for Effective Banking Supervision (Basel Core Principles) September 1997 available at https://www.bis.org/publ/bcbsc102.pdf accessed 8 December 2019.

295 Nhavira, Mudzonga, Mugocha "Financial Regulation and Supervision in Zimbabwe: An Evaluation of Adequacy and Options" 2013 *Zimbabwe Economic Policy Analysis and Research Unit Working Paper* available at http://www.zeparu.co.zw/sites/default/files/2018-03/FINANCIAL%20REGULATION%20AND%20SUPERVISION%20IN%20ZIMBABWE%20AN%20EVALUATION%20OF%20ADEQUACY%20AND%20OPTIONS2.pdf accessed 4 July 2019 42.

Despite these efforts, the Zimbabwean financial sector experienced the worst financial crisis, the so-called "bank wide liquidity crisis" between 2003 and 2006. This second wave of bank failures in Zimbabwe occurred after the RBZ's Monetary Policy Statement in 2003. Sithole and Mtetwa indicate that the period leading to the "bank wide liquidity crisis" that occurred in this second wave of bank failures was characterized by periods of high inflation levels that rose to an unprecedented 619.5% in November 2003. As a result banks began to experience negative real interest rates in respect of their investments in the money market, causing them to turn to the stock market and consequently initiating an upswing on the Zimbabwe Stock Exchange.[296] The rising euphoria in the stock, real estate and illegal forex market was further sustained by a lax monetary policy as the RBZ would offer "cheap money" due to extreme lowering of interest rates far below inflation levels in the economy. This lax monetary policy led to overtrading and caused a "market bubble".[297] This market bubble burst with the announcement of the December 2003 Monetary Policy statement which resulted in banks finding themselves in illiquid positions and unable to quickly off-set these positions.[298] The "bank wide liquidity crisis" that followed saw the collapse of 14 banking institutions which included commercial banks, building societies, discount houses and merchant banks.[299]

The first banking institution that failed during the "bank wide liquidity crisis" was ENG Asset Management that declared bankruptcy on 19 December 2003, a few hours after the announcement of the monetary policy statement. Subsequent collapses were: Century Discount House (January 2004), Century Bank Limited (February 2004), First National Building Society (February 2004), Intermarket Discount House (March 2004), Intermarket Building Society (March 2004), Barbican Bank (February 2004), Metropolitan Bank (March 2004), National Discount House (May 2004), Time Bank (July 2004), Trust Bank (July 2004), NMB Bank (August 2004), Royal Bank (August 2004), Rapid Discount House (September 2004), and CFX Bank (October 2004). Of

[296] Sithole, Mtetwa "Bank Failures in Zimbabwe: Lessons from the 2003-2004 Bank Wide Liquidity Crisis" 2009 *UNISWA Research Journal* 44. See also Abel, Le Roux "An evaluation of the efficiency of the banking sector in Zimbabwe" 2017 *African Review of Economics and Finance* 285.

[297] *Ibid*. See also Mtwetwa "The stock market as an indicator of economic growth: Zimbabwe's case (1990-2004)" (2007), *MSc Dissertation, National University of Science and Technology.*

[298] Sithole, Mtetwa "Bank Failures in Zimbabwe: Lessons from the 2003-2004 Bank Wide Liquidity Crisis" 2009 *UNISWA Research Journal* 46. See also Faber "Destruction of old and creation of new bubbles" Monthly Market Commentary available on http://gloomboomdoom.com/maniacs/panics/crashes/html accessed on 23 April 2018.

[299] *Ibid*.

these failing banking institutions seven were placed under curatorship in terms of the Banking Act, two received liquidity support (bail outs) from the RBZ and five were put in compulsory liquidation.[300] Sakarombe points out that at this time the Zimbabwean Government attempted to set up a Troubled Bank Relief Fund ("TBF"), as discussed in more detail in paragraph 3.6 below, in order to save failing banks but this endeavor was fruitless. In this time the RBZ also created the Allied Financial Services Initiative where certain troubled banking institutions were consolidated into a single institution named the Zimbabwe Allied Banking Group ("ZAGB").[301]

The ZAGB was formed through the merger of three commercial banks which were placed under curatorship, namely Barbican Bank, Royal Bank and Trust Bank.[302] In sum, the institutions that were placed under curatorship during this time were the following: Intermarket Building society (curatorship and subsequently allowed to reopen), Century Bank (curatorship and subsequently incorporated into CFX Bank Ltd – the latter bank also being put into curatorship), Time bank (curatorship and subsequently incorporated into Zimbabwe Allied Banking Group ("ZAGB")), CFX Bank (curatorship and allowed to reopen), Royal Bank (curatorship and subsequently incorporated into ZAGB), Trust Bank (curatorship and subsequently incorporated into ZAGB) and Barbican Bank (curatorship and subsequently incorporated into ZAGB).[303]

The subsequent Monetary Policy Statement of 21 April 2004 identified the following as the causes of the 2003/2004 crisis: extensive diversification, high prevalence of insider loans, weak corporate governance, imprudent credit risk management; evasion from core banking activities and speculation; underhand foreign currency dealings to fund off-shore dealings; inadequate board oversight, and weak risk management

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[300] Sithole, Mtetwa "Bank Failures in Zimbabwe: Lessons from the 2003-2004 Bank Wide Liquidity Crisis" 2009 *UNISWA Research Journal* 46.

[301] Sakarombe "Financial Inclusion and Bank Stability in Zimbabwe" 2018 *International Journal of Academic Research in Economics & Management Sciences* 125.

[302] Reserve Bank of Zimbabwe, *Annual Report* 2004 available at https://www.rbz.co.zw/documents/ar/2004AnnualReport.pdf accessed 4 August 2020. See also Vuvete, Vuvete "A Condolence Message to a Dead Bank, A Get Well Soon Message to an Ailing Bank and a Congratulatory Message to a Strong Bank: Common Views from a Neglected Shareholder" 2016 *IOSR Journal of Business and Management* 78-85.

[303] Sithole, Mtetwa "Bank Failures in Zimbabwe: Lessons from the 2003-2004 Bank Wide Liquidity Crisis" 2009 *UNISWA Research Journal* 46. See Table 1 for the list of bank failures during 2003 and 2004. Reserve Bank of Zimbabwe, Report on failed banking institutions, June 2005. See also Chapter 4 Reserve Bank of Zimbabwe, *Bank Licensing, Supervision & Surveillance Annual Report* 2005 available at https://www.rbz.co.zw/documents/BLSS/Annual%20Reports/2005/RBZ%202005_Annual_Report.pdf accessed 30 July 2019.

frameworks.[304] The *RBZ Failed Banking Institutions Report*[305] that was subsequently released in 2005 also confirms that factors that contributed to these bank failures included managerial problems, poor asset management, fraud, insider loans, and large exposures to specific individuals or sectors.[306] Sithole and Mtetwa poignantly observe that the general macroeconomic instability that prevailed in the economy did not help salvage the situation either.[307] To ensure that banks adopted good corporate governance principles and practices the RBZ issued *Guidelines on Corporate Governance* in 2004[308] and also issued a *Guideline on Minimum Internal Audit Standards.*[309]

Subsequently in 2007 to 2009 another wave of bank failures occurred in Zimbabwe. Vuvete and Vuvete remark that during this period there was failure and collapse of the whole banking system caused by inflationary pressures, and bank customers salary based savings accounts were frozen thus leading to a decline in consumer confidence in banks. The period 2012 to 2015 saw a further period of instability in the banking sector with liquidity problems and subsequent bank failures.[310] During this phase Interfin Merchant Bank was placed under curatorship, Royal Bank was closed and

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[304] Nyamutowa, Masunda "An Analysis of Credit Risk Management Practices in Commercial Banking Institutions in Zimbabwe" 2013 *International Journal of Economic Research* 34.

[305] Reserve Bank of Zimbabwe, Report on failed banking institutions, June 2005.

[306] Sithole, Mtetwa "Bank Failures in Zimbabwe: Lessons from the 2003-2004 Bank Wide Liquidity Crisis" 2009 *UNISWA Research Journal* 47.

[307] Sithole, Mtetwa "Bank Failures in Zimbabwe: Lessons from the 2003-2004 Bank Wide Liquidity Crisis" 2009 *UNISWA Research Journal* 47 – 49 for a discussion of the macroeconomic and political conditions that prevailed at the time. They remark that since the government wholly owns the RBZ, political interference is ubiquitous in its affairs and the RBZ has been accused in many quarters of offering liquidity support only to politically connected banks. In this regard see also Muranda "Financial distress and Corporate governance in Zimbabwean banks" 2006 *Corporate Governance* 643.

[308] Reserve Bank of Zimbabwe, *Bank Licensing, Supervision and Surveillance Guideline No.01-2004/BSD Corporate Governance* available at https://www.rbz.co.zw/documents/BLSS/guide_circ_not/minimum-internal-audit-guidelines.pdf accessed 4 August 2020. See also Dzomira "Analysis of bank failures during financial tumult in Africa – Zimbabwe: a historical review" 2014 *Journal of Governance and Legislation* 78.

[309] Reserve Bank of Zimbabwe, *Bank Licensing, Supervision and Surveillance Guideline No.02-2004/BSD Minimum Internal Audit Standards* available at https://www.rbz.co.zw/documents/BLSS/guide_circ_not/minimum-internal-audit-guidelines.pdf accessed 4 August 2020. See also Dzomira "Analysis of bank failures during financial tumult in Africa – Zimbabwe: a historical review" 2014 *Journal of Governance and Legislation* 78.

[310] Vuvete, Vuvete "A Condolence Message to a Dead Bank, A Get Well Soon Message to an Ailing Bank and a Congratulatory Message to a Strong Bank: Common Views from a Neglected Shareholder" 2016 *IOSR Journal of Business and Management* 78.

Genesis Bank surrendered its licence after being unable to raise adequate capital and, as pointed out by Dzomira, a number of banks remained undercapitalized.[311]

It thus appears that Zimbabwe has had a significant number of bank failures since independence. In dealing with these failing banks the RBZ for a considerable number of years oscillated between curatorship and liquidation, depending on the nature and extent of the particular distressed bank's problems. In particular, as indicated above, the curatorship process has been applied on a number of occasions leading to the rescue of some banks. Notably as a result of the bank wide crisis in the early 2000s Zimbabwe also sought to address bank failures by adopting specific legislation aimed at dealing with troubled banks albeit that this turned out not to be a successful endeavour due to problems with the relief fund established to facilitate the troubled bank program, thus leading to further legislative intervention to deal with failing banks.

The discussion below will consequently focus on the process of curatorship as the mechanism initially applied by Zimbabwe to deal with failing banks and particularly as a measure to attempt to facilitate the rescue of failing banks. Consideration will thereafter be given to subsequent measures introduced in Zimbabwe in 2005 to deal with "troubled banks" and measures thereafter introduced in 2015 to deal with "problem banks".

3.5 Curatorship as per section 53 of the Banking Act [Chapter 24:20]

3.5.1 Introduction

Sections 53 to 56 in Part X of the Banking Act set out the process for the curatorship of banks. A "curator" was defined as a person under whom the management of a banking institution (hereinafter referred to as a "bank") has been placed by a direction issued in terms of section 53 of the Banking Act.[312] According to section 53 of the Banking Act, the RBZ, after consulting the Minister[313] *and* the DPC,[314] could issue a

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[311] Dzomira "Analysis of bank failures during financial tumult in Africa – Zimbabwe: a historical review" 2014 *Journal of Governance and Legislation* 78.
[312] Section 2 of the Banking Act [Chapter 24:20].
[313] The Minister of Finance or any other Minister to whom the President may, from time to time, assign the administration of the Banking Act [Chapter 24:20].
[314] See footnote 52 above.

written direction to a bank placing it under the management of a curator in the following circumstances:[315]

(a) where the RBZ considered that the bank was in an unsound financial condition and was not operating in accordance with sound administrative and accounting practices and procedures, and not adhering to proper risk-management policies; or

(b) the bank had failed to comply with the minimum financial requirements prescribed in terms of the Banking Act[316] and the RBZ considered that it was unlikely to comply with them unless it was placed under curatorship.

In terms of section 53 the bank would be under curatorship for such a period, whether "definite or indefinite", as in the RBZ's opinion would permit the institution's financial condition to be "remedied or resolved".[317] Notably the concepts "remedied" and "resolved" were not defined in the Banking Act but on a practical level they referred to restoring the bank's viability as a going concern (remedy) or facilitating its exit from the financial system (resolve). Before issuing a direction to place a bank under curatorship, the RBZ was generally required to inform the bank concerned of its intention to do so and its reasons for forming that intention and had to afford the bank a reasonable opportunity to make representations in the matter. The RBZ could however deviate from this requirement if in the RBZ's opinion allowing time for representations would lead to a disposal of the bank's assets or other action that could prejudice its creditors

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[315] Section 53(1) of the Banking Act [Chapter 24:20]. See also the Banking Amendment Act, 2015 and The Reserve Bank of Zimbabwe Troubled and Insolvent Banks Policy: A Framework for Timely and Effective Responses to Banking Problems 2011 50 available at https://www.rbz.co.zw/documents/BLSS/guide_circ_not/troubled-and-insolvent-bank-policy-revised.-06.06.2011doc.pdf accessed 20 July 2019.

[316] See Financial Requirements in Part V of the Banking Act [Chapter 24:20]. Examples include section 29 of the Banking Act [Chapter 24:20] which states that "every banking institution whose head office is situated in Zimbabwe shall have and maintain in Zimbabwe such minimum capital as may be prescribed." Section 30 of the Banking Act [Chapter 24:20] states that "every banking institution shall maintain against its liabilities to the public in Zimbabwe, as shown in the last preceding statement furnished to the Reserve Bank, a minimum reserve balance with the Reserve Bank at such rate as the Reserve Bank may, from time to time, determine in respect of the various classes of liabilities to the public" of the banking institution concerned.

[317] Section 53(1) of the Banking Act [Chapter 24:20]. See also Magondo "An assessment of the effectiveness of the regulatory tools in managing bank failures in Zimbabwe" (2015), *MBA Dissertation, University of Zimbabwe* 35.

or depositors or if the appointment of a curator was recommended by an investigator in a report to the Reserve Bank in terms of section 50.[318]

The direction issued to place a bank under curatorship had to state the reasons for the appointment of the curator, the name of the curator, the security to be furnished by the curator for the proper performance of his or her duties,[319] the powers (as set out in section 55 of the Banking Act, discussed below) that could be exercised by the curator, the period during which the failing bank concerned would be managed by the curator and, where appropriate, it had to deal with the freezing of funds in terms of section 56 of the Banking Act, as discussed hereinafter.[320] The RBZ could at any time amend the direction and was required to consult the Minister and inform the bank concerned of its intention to do so.[321] In such event it also had to afford the failing bank a reasonable opportunity to make representations in the matter except where a deviation was permitted in terms of section 53(2) as alluded to above.[322]

As soon as possible after issuing the direction to put the failing bank under curatorship, the RBZ had to publish such curatorship in the Gazette and in one or more issues of a newspaper circulating in the area in which the bank concerned conducted business.[323]

3.5.2 Purpose and Effect of Curatorship

According to the RBZ, curatorship aimed to protect the interests of depositors and creditors, while the curator determined the full extent of the problems faced by the failing bank before recommending the way forward.[324] Curatorship had the effect that, upon the issue of a direction to appoint a curator, the powers of every director, officer

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318 Section 53(2) of the Banking Act [Chapter 24:20]. Section 50 of the Banking Act [Chapter 24:20] provides for the procedure on completion of investigation in terms of section 49 and states that "on completion of the investigation, an inspector shall forward his report to the Reserve Bank. On receipt of the report, the Reserve Bank shall send a summary of the conclusions and recommendations in the report to the banking institution which was the subject of the investigation and invite them to make representations. A banking institution to which a summary of conclusions and recommendations has been sent, may within 30 days submit to the Reserve Bank representations on any of the conclusions and recommendations."

319 See section 53(3)(b1) of the Banking Act [Chapter 24:20]. See also Banking Amendment Act, 2015.

320 Section 53(3) of the Banking Act [Chapter 24:20].

321 Such amendment must also be published –see section 53(5) of the Banking Act [Chapter 24:20].

322 Section 53(5) of the Banking Act [Chapter 24:20].

323 Section 53(4) of the Banking Act [Chapter 24:20]. The same rule applies to any amendment of the direction by the RBZ. See section 53(5) of the Banking Act [Chapter 24:20].

324 Gono, Governor of the Reserve Bank of Zimbabwe Report, 2006 14. See also Magondo "An assessment of the effectiveness of the regulatory tools in managing bank failures in Zimbabwe" (2015), *MBA Dissertation, University of Zimbabwe* 5.

and shareholder of the banking institution concerned were suspended, except to the extent that the curator may permit them to exercise their powers.[325]

To prevent the curatorship process being derailed by enforcement steps taken by the failing bank's creditors, the Banking Act provided for a moratorium on legal proceedings against the distressed bank. In this regard section 54(2) of the Banking Act stipulated that all legal proceedings and the execution of all writs, summonses and other legal processes against the banking institution concerned were stayed and that they could be instituted or proceeded with unless the High Court has granted such leave.[326] Put simply, this meant that no party would then be able to commence any litigation against the bank under curatorship or continue with litigation that had already started without the granting of the necessary leave by the High Court. Without such leave by the High Court, any purported proceedings would be a legal nullity.[327] Curatorship further had the effect that the operation of the doctrine of set-off by any creditor against the bank placed under curatorship was peremptorily suspended.[328]

3.5.3 Powers and duties of curator

The curator had a number of powers and duties to deal with the distressed bank's financial situation. As a first measure the curator had to take over and assume the management of the bank concerned.[329] The curator was required to manage the bank in such a manner as the *curator* considered prudent and most likely to promote the interests of the bank and that of its creditors.[330] The curator also had to ensure proper compliance by the bank with the provisions of the Banking Act.[331] He was further obliged to ensure that proper accounting records were kept and proper annual financial statements were prepared concerning the operations of the bank under curatorship.[332]

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[325] Section 54(1) of the Banking Act [Chapter 24:20]. See, in this regard, *Patterson Fungai Timba and Renaissance Financial Holdings Ltd v Professor C.J. Chetsanga and Collin Kuhuni and Monica Maitirwa Mukonoweshuro* HH 350-17 at 3; *Jeffery Mzwimbi and others v Reserve Bank of Zimbabwe* SC 35/05.

[326] See also Magondo "An assessment of the effectiveness of the regulatory tools in managing bank failures in Zimbabwe" (2015), *MBA Dissertation, University of Zimbabwe* 35.

[327] *Patterson Fungai Timba and Renaissance Financial Holdings Ltd v Professor C.J. Chetsanga and Collin Kuhuni and Monica Maitirwa Mukonoweshuro* HH 350-17 at 3.

[328] *Ibid*.

[329] Section 55 (1) (a) of the Banking Act [Chapter 24:20].

[330] Section 55 (1) (b) of the Banking Act [Chapter 24:20]. Author's emphasis.

[331] Section 55 (1) (c) of the Banking Act [Chapter 24:20].

[332] Section 55 (1) (d) of the Banking Act [Chapter 24:20].

The curator was also required to prepare reports for the RBZ showing the assets and liabilities of the bank under curatorship as well as its debts and obligations, verified by the bank's auditor, and in addition all information that was necessary to enable the RBZ to become fully acquainted with the bank's financial position.[333]

The curator was further tasked to establish the reasons for the bank's failure. He was obliged in terms of section 55(1)(f) of the Banking Act to examine the affairs and transactions of the failing bank before it was placed under curatorship. The purpose of such investigation was to ascertain whether any past or present director, officer or employee of the failing bank had contravened any provisions of the Banking Act, or committed any offence, or was personally liable to pay any damages to the failing bank or was personally liable for any of the failing bank's liabilities.[334] Within three months after the bank was placed under curatorship, the curator then had to submit to the RBZ a report containing the full particulars of any such contravention, offence or liability.[335]

In addition to the abovementioned statutory powers conferred on the curator by section 55(1) of the Banking Act, the curator had the powers (to the extent that he was authorized to exercise them in terms of the direction under which he was appointed) to:[336]

(a) suspend or reduce the right of the failing bank's creditors to claim or receive interest on any money owing to them by such bank;[337]

(b) make payments, at any time , order and manner that he deemed fit in respect of capital or interest, to any creditor of the failing bank;

[333] Section 5(1) (e) of the Banking Act [Chapter 24:20]: "Any person alleging to be a creditor of a banking institution under curatorship may, upon furnishing satisfactory written proof to the curator that he is able to prove a claim against the banking institution, and upon payment of the prescribed fee (if any), request that any specific report or every report made by the curator in terms of section 55 (1) (e), (f) or (g) of the Banking Act, be made available to him after the curator avails it to the RBZ, and the curator is obliged comply with such request." Section 55(3)(a) of the Banking Act [Chapter 24:20]. See also section 31 of the Banking Amendment Act, 2015. Furthermore, any person who is aggrieved by the curator's decision or action may appeal against it to the RBZ. Section 55(4) of the Banking Act [Chapter 24:20]. See also *Jeffery Mzwimbi and others v Reserve Bank of Zimbabwe* SC 35/05 and *Trust Holdings Limited v Reserve Bank of Zimbabwe and others* SC 36/05.

[334] Section 55(1)(f) of the Banking Act [Chapter 24:20].

[335] *Ibid*.

[336] These powers are set out in section 55(2) of the Banking Act [Chapter 24:20].

[337] In terms of section 55(2)(a) of the Banking Act [Chapter 24:20] such suspension may be imposed on the date that the banking institution was placed under curatorship or on any subsequent date.

(c) cancel any agreement between the failing bank and any other party to advance money to such party due after the date on which the bank was placed under curatorship. The curator could also cancel any agreement to extend any existing credit facility after that date;[338]

(d) convene a meeting of creditors of the failing bank. The aim of such meeting was for purposes of establishing the nature and extent of the failing bank's indebtedness to its creditors and consulting them on decisions taken by the curator in the course of managing the bank's affairs, to the extent that the creditors' interests may have been affected by those decisions;

(e) enter into negotiations with any individual creditor of the failing bank with a view to a final settlement of such creditor's "affairs" with the bank;

(f) make and carry out any decision which in terms of the Zimbabwean Companies Act [Chapter 24:03] would have been required to be made by way of a special resolution contemplated in section 135 of the Companies Act;[339]

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[338] This power can be exercised if, in the opinion of the curator, "such advance or any loan under such facility would not be adequately secured or would not be repayable on terms satisfactory to the curator; or the institution lacks the necessary funds to meet its obligations under any such agreement, or it would not otherwise be in the interests of the institution to abide by the agreement."

[339] Section 135 of the Companies Act [Chapter 24:03] provides for resolutions requiring special notice. Section 135(1) states that "where, in this Act or of the articles of association of a company, special notice is required of a resolution, the resolution shall not be effective unless notice of the intention to move it has been given to the company not less than twenty-eight days before the meeting at which it is moved, and the company shall give its members notice of any such resolution at the same time and in the same manner as it gives notice of the meeting or, if that is not practicable, shall give them notice thereof, either by advertisement in a newspaper having an appropriate circulation or in any other mode allowed by the articles, not less than twenty-one days before the meeting: Provided that if, after notice of the intention to move such a resolution has been given to the company, a meeting is called for a date twenty-eight days or less after the notice has been given, the notice though not given within the time required by this subsection shall be deemed to have been properly given for the purposes thereof". Section 135(2) provides that "if the status of any person in relation to a company will be affected by the terms of a resolution of which special notice has been given the company shall send to, or serve upon, such person a copy of such resolution and of the notice of the meeting at which it will be moved at the time when similar notice is given to the members of the company, and such person shall be entitled to speak on the resolution at the meeting before any vote is taken upon it". Furthermore, section 135(3) provides that "if default is made by a company in giving notice to its members or to any person whose status is affected as aforesaid the company and every officer of the company who is in default shall be guilty of an offence and liable to a fine not exceeding level three."

(g) cancel any lease of movable or immovable property entered into by the bank concerned *before* it was placed under curatorship;[340]

(h) dispose, of any asset of the failing bank either by means of by public auction, tender or individual negotiation;[341]

(i) cancel any guarantee issued by the bank before the date on which it was placed under curatorship. (This however did not apply to, a guarantee that the failing bank was required to perform on within a period of 30 days after entering curatorship);[342]

(j) generally, take any action necessary for the administration or operation of the bank under curatorship. This included the sale or closure of any branch, agency, or other offices of the bank concerned and, subject to any other law, the dismissal of any of its officers or employees.

Insofar as the power of the curator to dispose of the failing bank's assets are concerned, note should be taken of the case of *Jeffrey Mzwimbi and Ors v Reserve Bank of Zimbabwe and Ors*[343] (also referred to as the *Royal Bank*-case) where it was argued that since the curator had the power to dispose of the failing banks assets, he could sell all the assets of such bank. In this case the court however held:[344] "That submission cannot be accepted because the principal objective in placing a banking institution under the management of a curator is not to liquidate the institution but to enable it to become a successful concern. Accordingly, the curator's power to sell any asset or branch of the banking institution concerned could only be exercised in order to achieve that objective."

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[340] A claim for damages in respect of such cancellation may, however, be instituted against the institution under curatorship after the expiration of a period of one year as from the date of such cancellation or after such shorter period as the High Court may permit.

[341] Such assets include any advance or any loan facility contemplated in para 55(2)(c) of the Banking Act; and an asset for the disposal of which an approval contemplated in section 228 of the Companies Act [Chapter 24:03] would have been a prerequisite.

[342] Section 55(3) of the Banking Act [Chapter 24:20]. It should however be noted that in terms of the proviso to section 55(3) a claim for damages in respect of any loss sustained by or damage caused to any person as a result of such cancellation of a guarantee may be instituted against the institution after the expiration of a period of one year as from the date of cancellation of the guarantee or after such shorter period as the High Court may permit.

[343] *Jeffrey Mzwimbi and Ors v Reserve Bank of Zimbabwe and Ors SC 35-05* (also referred to as the Royal Bank-case)

[344] Para 7 of the Royal Bank-case.

The accountability of the curator was ensured by the requirement in section 55(3) of the Banking Act that he must record the nature of, and the reasons for, each action performed by him in the course of his curatorship.[345] Notably the Banking Act provided that any person who was aggrieved by any decision or action taken by a curator may appeal against it to the RBZ.[346]

The "oversight" role of the RBZ in the context of curatorship was further reinforced by the curator's continuous reporting obligations: one year after the failing bank was placed under curatorship and thereafter at 6-monthly intervals, the curator was required to report to the RBZ, in writing, as to whether or not, in his opinion, it was in the interests of the institution's creditors and depositors that the institution should remain under curatorship.[347] If however, at any time, he was of the view that continued curatorship would not enable the bank "to become a successful concern", he had to advise the RBZ accordingly.[348] This latter provision thus made it evident that curatorship was directed at restoring the economic viability of the failing bank.

3.5.4 Freezing of deposits and investments

Notably, in terms of section 56 of the Banking Act, if the RBZ considered it necessary when it placed a bank under curatorship to preserve the financial standing of such bank or to prevent an uncontrolled withdrawal or removal of funds or assets from such bank, the RBZ could direct that all or any of the amounts deposited with or invested in the bank be "frozen" for up to a period of one year.[349] The curator was also authorised in terms of section 56(2) to impose such a freezing of amounts during the course of the curatorship pursuant to prior consultation with the RBZ.[350] As possible after freezing any amount, the curator had to publish notice thereof in the Gazette and newspapers that he believed would bring such freezing to the notice of depositors and investors concerned.[351] Where any amounts had been frozen in terms of section 56 and as long as those amounts remained frozen, no person was entitled to withdraw or remove any

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[345] Such records shall be examined as part of the normal audit of the records of the banking institution concerned.
[346] Section 55(4) and (5) of the Banking Act [Chapter 24:20].
[347] Section 55(1)(g) of the Banking Act [Chapter 24:20].
[348] *Ibid*.
[349] Sections 56(1) of the Banking Act [Chapter 24:20].
[350] Section 56(3) of the Banking Act [Chapter 24:20].
[351] Section 56(4) of the Banking Act [Chapter 24:20].

such amount from the bank under curatorship; or to set off any such amount against any amount owed to the bank; or to pledge or hypothecate any such amount *except to the extent permitted by the curator*.[352] The RBZ could further recover from the bank under curatorship all the expenses necessarily incurred in connection with the curator's administration of such bank.[353]

Curatorship was however not suitable for each instance where a bank encountered failure and even in those instances where curatorship was initially applied in an attempt to rescue a failing bank such curatorship was not always successful. Where a bank was found to be insolvent, or no longer able to remain viable, the RBZ would then cancel the bank's license and apply to the High Court to place such bank under liquidation, a discussion of which is beyond the scope of this thesis.[354]

Although curatorship was applied to a number of failing banks over the years Mandizvidza pointed out that, whilst curatorship was meant to preserve depositor funds, it had the unintended consequences of denying depositors access to their funds for long periods of time. He observed that "many depositors were questioning the wisdom of curatorship" and that they lost confidence in the financial sector.[355]

3.6 The Troubled Financial Institutions (Resolution) Act [Chapter 24:28]

3.6.1 General

The wave of bank failures during the "systemwide bank failure"-period in 2003 to 2004 prompted further reform in Zimbabwe aimed at dealing with failing banks that were beyond the point of self-recovery. These reforms *inter alia* included the formation of

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[352] Section 56(5) of the Banking Act [Chapter 24:20]. Author's emphasis.

[353] Section 56A of the Banking Act [Chapter 24:20]. See also section 32 of the Banking Amendment Act, 2015. In any proceedings in a court for the recovery of such expenses, a certificate signed by the Governor or Deputy Governor of the RBZ and setting out the amount of the expenses thereof are prima facie proof of the amount sought to be recovered.

[354] For further detail on bank liquidation see section 57 of the Banking Act [Chapter 24:20]. See also Gono, Governor of the Reserve Bank of Zimbabwe Report, 2006 14.

[355] Mandizvidza "Recent Bank Resolution Experience-Zimbabwe" presented at session 19 of the *International Association of Deposit Insurers :Resolution of Problem Banks: Purchase and Assumption Option*, Abuja, Nigeria, 9-13 May 2011 available at http://www.ndic.gov.ng/files/Bank%20Resolution%20-%20ZIMBABWE%20Experience.pptx accessed 17 July 2020.

the Deposit Protection Board in July 2003 that operated a "paybox" mandate[356] in terms whereof it was responsible for depositor payouts when banks failed.[357] The Governor of the RBZ at the time, Dr Gideon Gono, informed the Parliamentary Portfolio Committee on Budget, Finance and Development at a hearing on 20 September 2004 that a comprehensive plan for troubled banks had been drawn up and would be implemented following consultation with stakeholders.[358] These plans entailed the establishment of a Troubled Banks Fund, as alluded to in the introductory part of this Chapter, for purposes of resolving solvency and liquidity deficiencies in banks and also creating a new legislative framework for dealing with troubled banks.[359] With effect from 14 January 2005, Zimbabwe introduced a comprehensive legislative framework in the form of the *Troubled Financial Institutions (Resolution) Act [Chapter 24:28]* (hereinafter "TFIR Act")[360] to effectively deal with distressed banks and other financial institutions and restore the stability of the financial sector.[361] The preamble to the Act indicated that it sought "[T]o provide for the administration of troubled financial institutions; to provide for formulation and implementation of schemes of resolution in respect of such institutions; and to provide for matters connected with or incidental to the foregoing." For purposes of this Act the concept "financial institution" included banks, building societies, the People's Own Savings Bank, asset managers, collective

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[356] See International Association of Deposit Insurers, *IADI Core Principles for Effective Deposit Insurance Systems* November 2014 available at https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf accessed 9 December 2020 where it is explained that the mandate of the deposit insurer refers to the set of official instructions describing its roles and responsibilities. According to the IADI Core Principles there is no single mandate or set of mandates suitable for all deposit insurers. When assigning a mandate to a deposit insurer, jurisdiction-specific circumstances must be taken into account. Mandates can range from narrow "pay box" systems to those with extensive responsibilities such as preventive action and loss or risk minimisation/management, with a variety of combination in between. A "pay box" mandate is the most simple mandate where the deposit insurer is only responsible for the reimbursement of insured deposits.

[357] *Ibid* 5.

[358] As report in The Herald (21 September 2004) available at https://www. allafrica.com.stories/200409210341.html accessed on 17 June 2020.

[359] Mandizvidza "Recent Bank Resolution Experience-Zimbabwe" presented at session 19 of the *International Association of Deposit Insurers :Resolution of Problem Banks: Purchase and Assumption Option*, Abuja, Nigeria, 9-13 May 2011 available at http://www.ndic.gov.ng/files/Bank%20Resolution%20-%20ZIMBABWE%20Experience.pptx accessed 17 July 2020.

[360] Troubled Financial Institutions (Resolution) Act [Chapter 24:28] published by General Notice 10 of 2005 on 14 January 2005 (hereinafter TFIR Act).

[361] Nhavira, Mudzonga, Mugocha "Financial Regulation and Supervision in Zimbabwe: An Evaluation of Adequacy and Options" 2013 *Zimbabwe Economic Policy Analysis and Research Unit Working Paper* available at http://www.zeparu.co.zw/sites/default/files/2018-03/FINANCIAL%20REGULATION%20AND%20SUPERVISION%20IN%20ZIMBABWE%20AN%20EVALUATION%20OF%20ADEQUACY%20AND%20OPTIONS2.pdf accessed 4 July 2019 43.

investment schemes and "any person who carries on a business of acceptance of deposits and other repayable funds from the public".[362] As is clear from the collective provisions of the TFIR, although not stated expressly in any provision in such specific words, the RBZ, as central bank tasked with bank supervision, functioned as the resolution authority under the TFIR Act.

The objective of the TFIR Act was to provide for the "administration of troubled institutions, to provide for formulation and implementation of schemes of *resolution* in respect of such institutions,[363] and to provide for matters connected therewith."[364] Albeit that "resolution" as a concept was not defined in the TFIR Act, it was clear that the purpose of this Act (as also evidenced by its title) was to set up a dedicated resolution framework, *separate from the Banking Act*, for dealing with troubled banks as well as other non-bank financial institutions. It is to be noted however that this framework introduced by the TFIR Act did not replace the curatorship process in the Banking Act albeit that the interaction between the curatorship process and the TFIR Act, if any, was not clear. It would appear that if a troubled bank was put into resolution as contemplated in the TFIR the administrator that would be appointed by the RBZ to implement the scheme of resolution would be fulfilling a function similar to, but broader than curatorship, as discussed below. In line with the focus of this thesis the discussion of the TFIR Act below is limited to troubled banks.

3.6.2 Declaration as troubled financial institution

Part II of the TFIR Act bore the heading "Declaration of Troubled Financial Institutions". Under this part section 4 was titled "Investigation of certain financial institutions" and

[362] See the definition of "troubled financial institution" in section 3 of the TFIR Act.

[363] The Troubled Financial Institutions (Resolution) Act [Chapter 24:28] provided for administration which aimed to restore a troubled financial institution to a sound financial condition and if it cannot be restored, other modes of resolution which included "reconstructing the troubled financial institution with a view to securing the registration of a successor financial institution that will succeed to the banking or other business undertaken by the troubled financial institution; amalgamating the troubled financial institution or any part of its banking or other business with one or more other troubled financial institutions; transferring all or any part of the banking or other business of the troubled financial institution to any other financial institution together with all or part of the assets and liabilities of the troubled financial institution which remain after the administration and winding up of the troubled financial institution in accordance with section 57 of the Banking Act [Chapter 24:20]."

[364] Preamble of TFIR Act. Author's emphasis. See also Gono, Governor of the Reserve Bank of Zimbabwe Report, 2006 15.

provided that if the RBZ had reasonable grounds for believing that a financial institution-

(a) which was indebted to the RBZ (whether by virtue of having received assistance from the Troubled Bank Fund[365] or otherwise) was unable to repay its indebtedness to the RBZ; or

(b) would need public funds (i.e. a bail-out) in order to prevent systemic risk[366]; or

(c) had failed to comply or was unlikely to be able to comply with any requirement relating to capital, reserves, assets, liabilities, credits or deposits or other requirement prescribed for purposes of section 29[367], 30[368] or 31[369] of the Banking Act; or

(d) was not conducting its business in accordance with sound administrative, accounting, corporate governance or risk management practices and procedures;

then the RBZ could direct an inspector to conduct an investigation into such bank or any aspect of its management or activities.[370]

Such investigation would be governed by section 49 to 52[371] of the Banking Act subject to the proviso that the RBZ could require the bank concerned to make representations

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[365] See para 3.6.1 above.

[366] "Systemic risk" was stated in section 4 of the TFIR Act to be a "risk that a failure on the part of such troubled financial institution to meet its obligations may result in other such financial institutions being unable to meet their respective obligations."

[367] Section 29 of the Banking Act [Chapter 24:20] provides for minimum capital requirements that banks have to comply with.

[368] Section 30 of the banking Act [Chapter 24:20] provides for minimum reserves that banks have to comply with.

[369] Section 31 of the Banking Act [Chapter 24:20] provides for the Minister of Finance to prescribe further financial requirements that banks have to comply with.

[370] Notably the TFIR Act *inter alia* made provision in section 5 for certain actions to be taken where it was established that a financial institution was "not troubled but in default of the Banking Act etc." A discussion of these corrective actions are however beyond the scope of this thesis.

[371] Section 49 of the Banking Act [Chapter 24:20] provides for an investigation into a bank that has failed to furnish the RBZ with required statements, documents or information or that has furnish incorrect or incomplete information; or that has failed to comply with the provisions of the banking act, or that has been reported by its auditor to have engaged in irregularities or that the RBZ believes to have committed an offence; or prejudiced the rights of depositors; etc. Section 50 deals with the investigator's report and the procedure to be followed on completion of the investigation; section 51 deals with actions by the RBZ following an investigation and section 52 deals with the expenses of an investigation.

in terms of section 50(3)[372] of the Banking Act if the RBZ considered that urgent action on the inspector's report might be necessary to prevent irreparable harm to the financial institution or its depositors, creditors or members.[373]

In particular section 6 of the TFIR Act provided for the RBZ to declare a bank as a "troubled financial institution" pursuant to an investigator's report in terms of section 4 of the TFIR Act or the report of a supervisor following upon an investigation under section 47[374] of the Banking Act. To make such declaration the RBZ had to be satisfied that the bank: had failed to repay or was unlikely to repay, in full and on the due date, any moneys that had been advanced to it from the Troubled Bank Fund or other moneys it owed to the RBZ; or would need to receive public funds in order to prevent systemic risk; or had failed to comply or was unlikely to comply with any requirement relating to capital reserves, assets, liabilities, credits, deposits or other requirement prescribed for the purposes of section 29, 30 or 31 of the Banking Act, as mentioned above.

Such declaration would thus generally follow after the RBZ afforded the bank concerned an adequate opportunity to make representations in the matter. Once the bank was declared as a troubled financial institution the RBZ could then place the troubled bank under administration which entailed the implementation of a scheme of resolution by an administrator named in the "troubled financial institution"-declaration as discussed in more detail below in paragraph 3.6.3.1. Like with curatorship, a proviso however applied in this regard, namely that where the RBZ considered that immediate action was necessary to prevent the disposal of any of the bank's assets or any other actual or potential prejudice to the bank's members, creditors, depositors or employees, the RBZ could take such action without affording the troubled bank an

[372] Section 50(3) of the Banking Act [Chapter 24:20] provides that a banking institution to which a summary of conclusions and recommendations pursuant to an investigation in terms of section 49 had been sent may, within 30 days thereafter, submit representations to the RBZ on any of the conclusions or recommendations.

[373] Section 4(2) TFIR Act. Such representations would then have to be submitted within one week after the RBZ received the summary of the inspector's conclusions and recommendations.

[374] Section 47 of the Banking Act [Chapter 24:20] provides that for purposes of monitoring and supervising banks, a supervisor may *inter alia* "enter the premises of the bank or any other premises in which it believes on reasonable grounds that securities, books records, accounts or documents pertaining to the bank's business are being kept; require any officer, employee or agent of the bank to produce any of the bank's securities, books, records, accounts or documents; search the premises; open any strong room, safe or container; examine and make extracts from any copies of any of the bank's securities, books, records or documents and remove them for examination."

opportunity to make presentations and only later allow it to make such representations.[375]

The declaration of a bank as “troubled financial institution” had to mention the name of the troubled bank; the reasons for declaring it to be troubled; the name of the administrator and his assistants (where applicable) and contain directions that the troubled bank would be under the control and management of the administrator and that any other person vested with the management of the bank’s affairs would, from the commencement of administration, be divested of such management. It further had to include such other directions as to the control and management of the troubled bank as the RBZ decided fit.[376] Notably the “troubled financial institution”-declaration was also then deemed to have been issued in relation to every associate of the troubled bank unless the associate institution was able to satisfy the administrator that its accounts were audited separately from that of the bank, or that the circumstances mentioned in section 6(1)(c),(d) or (e) of the TFIR Act as mentioned above did not apply to it, and that it was conducting its business in accordance with sound administrative, accounting, corporate governance or risk management practices and procedures.[377]

The declaration that a bank was a “troubled financial institution” had to be published in the Gazette and one or more issues of a newspaper circulating in the area where such troubled financial institution principally conducted its business.[378] The declaration could be amended or revoked by the RBZ at any time.[379] The declaration further had to be confirmed by the High Court on application by the RBZ within 30 days after it took effect. The court could then either confirm the declaration unconditionally or subject to

[375] Section 6(1) TFIR Act. Where the RBZ took action without affording the troubled bank the opportunity to make representations it had to do so as soon as possible afterwards by affording the chairperson of the troubled bank’s board and the institution’s chief executive officer a reasonable opportunity to make representations. For such purpose the administrator also had to allow them access to the troubled bank’s books and records.

[376] Section 6(2) TFIR Act.

[377] Section 6(3)(a) to (c) TFIR Act.

[378] Section 6(6) TFIR Act. In terms of section 6(7) the effect of such a declaration kicked in a soon as it was delivered to the troubled bank’s CEO or to a member of its board alternatively on the date on which it was published in the Gazette, whichever was the earlier.

[379] Section 6(8) TFIR Act.

amendment or variation or it could set the declaration aside together with directions necessary to reverse any effects of the declaration.[380]

3.6.3 Effect of declaration as troubled financial institution

3.6.3.1 Placing a troubled bank in administration

As indicated above, the declaration of a failing bank as a "troubled financial institution" had the effect of placing the troubled bank under the control and management of an "administrator".[381] Such declaration of a bank as a "troubled financial institution" suspended the powers of every director, officer and member of the troubled bank (except to the extent that the administrator permitted them to exercise their powers). It also, unless the administrator ordered otherwise, had the effect of nullifying every disposition of the troubled bank's property (including rights of action) and nullifying every transfer of shares or alteration in the status of the bank's shareholders made after the administration process by the administrator had already commenced. Further effects were that the declaration suspended the operation of set-off by the troubled bank in respect of any amount owed to it by one of its creditors; suspended all rights of action against the troubled bank and every action or proceeding commenced against it (except with leave of the administrator and on such terms as the administrator may have imposed) and vacated any attachment or execution of the troubled bank's assets that occurred after the commencement of the administration. The declaration of a bank as a troubled financial institution further had the effect of suspending any lien held by any financial institution or by any other person over the property of the troubled bank except a lien held by the RBZ or by a payment system recognized by the RBZ in terms of section 3(1) of the National Payment Systems Act [Chapter 24:22].[382]

The administrator was obliged to transmit the declaration of the bank as "troubled financial institution" within seven days of the commencement of the administration to the Registrar of the High Court, the Master of the High Court, relevant Sheriff and Registrar of Deeds and to the CEO of any institution where the troubled bank held any

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[380] Section 6(9) TFIR Act.

[381] In terms of section 3 of the TFIR Act an "administrator was defined to mean "an administrator appointed under section 6(1), and includes any assistant administrator appointed under that provision."

[382] Section 7 TFIR Act.

accounts. Upon receipt of the declaration the Registrar of Deeds was obliged to enter a caveat against the transfer of any immovable property or the cancellation or cession of any bond registered in the name of or belonging to the troubled bank. Upon receipt of a copy of the declaration the CEO of an institution where the troubled bank held an account also had to immediately freeze such account.[383]

3.6.3.2 Object of administration

Part IV of the TFIR Act was titled "Objects of administration and functions of administrator." In accordance with section 10 of the Act the purpose of the administration procedure was to safeguard the interests of the depositors, creditors and shareholders (members) of a bank that was declared to be a "troubled financial institution". It would do so by either restoring the troubled bank to a sound financial condition or, if it could not be so restored, to safeguard the interests of the depositors, creditors and member in accordance with one or more of a number of "modes of resolution". These modes of resolution were the following:[384]

(a) "reconstructing"[385] the troubled financial institution with a view to securing the registration of a "successor financial institution"[386] that would succeed to the banking and other business undertaken by the troubled bank and to such of its other assets and liabilities as remained after the administration; or

(b) amalgamating the troubled bank or any part of its banking or other business with one or more other troubled financial institutions and securing the registration of a "successor financial institution"[387] that

[383] Section 7(1) to (4) TFIR Act.
[384] Section 10(a) to (d) TFIR Act.
[385] This concept was not defined in the TFIR Act and should thus bear its ordinary grammatical meaning which is "to build (something damaged or destroyed) again" as per the Merriam-Webster Dictionary available at https://www.merriam-webster.com accessed on 4 April 2020. It is submitted that the intention was most likely that the troubled bank would be "restructured" and that its assets and viable parts of its business would be transferred to a successor financial institution that would then render the essential functions previously rendered by the troubled bank.
[386] A "successor financial institution" was defined in the TFIR Act to mean "a successor to a troubled financial institution that is reconstructed, amalgamated or transferred in terms of section 19(a), (b), (c)."
[387] Successor financial institution means a successor to a troubled financial institution that is reconstructed, amalgamated or transferred in terms of section 10 (a), (b) or (c) of the TFIR Act. See section 3 of the TFIR Act.

would succeed to the assets, liabilities and banking or other business undertaken by the amalgamated financial institutions;[388] or

(c) transferring all or any part of the banking or other business of the troubled bank to any other financial institution together with all or part of the assets and liabilities of the troubled bank which remained after the administration; or

(d) winding up the troubled financial institution in accordance with section 57[389] of the Banking Act, if any of the aforementioned options were not deemed feasible by the administrator.

3.6.3.3 General powers of the administrator

As part of his "general powers" the administrator had all the powers of a curator under section 55 of the Banking Act as set out in paragraph 3.5.3 above. In addition the TFIR Act gave the administrator the following further powers which he could exercise *without* the authority of the directors or shareholders of the troubled financial institution, but *subject* to any directions by the RBZ:

(a) to carry on or discontinue any part of the business of the troubled bank;

(b) to freeze all or any class of deposits placed with the troubled bank indefinitely or for a fixed period;

(c) to stop or limit the payment of any obligation, including interest;

(d) to set aside any disposition of the property of the troubled bank or of any specified person in terms of section 13 of the TFIR Act;[390]

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[388] Notably section 43 of the TFIR Act stipulated that the Competition Act [Chapter 14:28] would not apply to any amalgamation, merger or transfer of any financial institution carried out in accordance with the TFIR Act.

[389] Section 57 of the Banking Act [Chapter 24:20] contains special provisions relating to winding up or judicial management of banking institutions. A discussion thereof is beyond the scope of this thesis.

[390] Section 13 of the TFIR Act provides for voidable disposition of property by troubled financial institutions and specified persons. Section 13(1) states that "if an administrator has reasonable grounds for believing that a troubled financial institution or specified person has made any disposition of the property of such institution or of his or her own property, as the case may be, in collusion with another person for the purpose of securing that property against sequestration in the course of insolvency or administration proceedings, the administrator may, on not less than fourteen days' written notice to the person in whose favour the disposition was made, apply to a magistrate or judge in chambers (depending on which court has jurisdiction in the matter) for an order setting aside such

(e) to operate every account with another financial institution operated by the troubled bank immediately before the commencement of its administration;

(f) to draw, accept, make and endorse any cheque, bill of exchange or promissory note in the name and on behalf of the troubled bank. Also, for the purpose of carrying on the business of the troubled bank, to impose any additional liability upon the troubled bank;

(g) to raise money in any way;

(h) to bring or defend any action or other legal proceeding of a civil nature and, subject to any law relating to criminal procedure, any criminal proceeding in the name and on behalf of the troubled bank;

(i) to agree to any offer of composition made to the troubled bank by any debtor or contributory and to accept any reasonable part of any debt in discharge of the whole debt or to provide a reasonably timed extension for payment ;

(j) to compromise or admit any claim or demand against the troubled bank, including an unliquidated claim;

(k) to execute in the name of, and on behalf of, the troubled bank all deeds, receipts and other documents;

(l) to prove a claim in the estate of any contributory or debtor of the troubled bank and to receive payment either in full or as dividend;

(m) to submit any dispute concerning the troubled bank or any claim or demand by or upon the troubled bank to arbitrators for determination;[391]

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disposition and causing such property to be delivered to the administrator." Section 13(2) provides that "a disposition shall not be set aside in terms of subsection (1) if the person in whose favour the disposition was made proves that the disposition was not collusive but made in the ordinary course of business without the intention of securing that property against sequestration in the course of insolvency or administration proceedings." Furthermore, 13(3) states that "for the avoidance of doubt it is declared that no criminal conviction for an offence under section 41 is required in order for the administrator to take action under this section."

[391] See in this regard also section 32 of the TFIR Act that provided for arbitration where the valuation of the troubled bank's shares by the administrator or RBZ was disputed.

(n) to elect to adopt or to abandon any contract for the acquisition of immovable property by the troubled bank, that was entered into by the bank before its administration commenced, in the instance where transfer of such property had not yet been effected in favour of the troubled bank;[392]

(o) to terminate any lease entered into by the troubled bank as lessee;[393] and

(p) to sell, deliver or transfer, the movable and immovable property of the troubled bank, whether by public auction or otherwise.

In addition to the aforementioned the administrator was also given the powers as specified in sections 224, 228, 229, 230, 231, 232, 233, 234, 235, 237, 239 and 240 of the Companies Act [Chapter 24:03] to deal with the operations of the troubled bank.[394]

3.6.3.4 Identification of persons responsible for causing the troubled bank's problems

[392] The exercise of this power was however subject to the proviso that if the administrator did not make an election within 6 weeks after being required in writing to do so, the person entitled under the contract could apply to the court for cancellation of the contract and delivery of possession of the immovable property. It was also provided that nothing in this paragraph would affect the concurrent claim against the troubled bank for damages for non-fulfilment of the contract.

[393] Such termination had to be done by notice in writing to the lessor but was however subject to the condition that nothing contained in this paragraph would affect any claim by the lessor against the troubled bank for damages he may have sustained due to the non-performance in terms of the lease. Also, if the administrator did not, within three months from commencement of the administration, notify the lessor that he was prepared to continue the lease on behalf of the troubled bank, he would be deemed to have terminated the lease at the end of that three months. The rent due under any lease terminated as such from the commencement of the administration to the termination of the lease by the administrator would be included in the costs of administration. The fact that a lease had been terminated by the administrator would not deprive the administrator of any right to compensation for improvements made during the period of the lease.

[394] Section 11(2) TFIR Act. See further section 12 of the TFIR Act regarding the application of section 220, 236, 269, 270 and 290 of the Companies Act to the administration of a troubled bank in terms of Part IV of the TFIR Act. Section 224 deals with opening a bank account for a company in liquidation; section 228 deals with settlement of list of contributories after making a winding up order by the court; section 229 is about requiring delivery of property by any contributory; section 230 deals with ordering payment of debt by contributory; section 231 deals with making calls and ordering payment; section 232 deals with ordering payment into bank; section 233 deals with order on contributory conclusive evidence; section 234 states the court's duty to adjust rights of contributories; section 235 deals with inspection of books by creditors and contributories; section 237 deals with summoning persons suspected of having property of company; section 239 deals with arrest of absconding contributory and section 240 deals with powers of the court to be cumulative of already existing powers of instituting proceedings against any contributory or debtor of a company.

Section 18 of the TFIR Act provided that, if in the course of compiling a statement under section 14 of the Act regarding the troubled bank's affairs, the administrator was of the opinion that any past or present director, officer or member of the troubled bank or other person who appeared to the administrator to have knowingly been a part to the carrying on of the business of the bank in a certain manner specified in the Act the administrator could subject such person to an examination. Conduct (or rather misconduct) in respect of which an examination could be undertaken included conduct where the relevant person carried on the bank's business in a reckless manner; or with gross negligence or with the intent to defraud any person or for any fraudulent purpose; or if fraud had been committed in the promotion or formation of the said bank. Such person could be summonsed to attend before the administrator and could be questioned regarding the promotion and formation of the troubled bank or the way in which the business of the bank was conducted or regarding such person's conduct or dealings where he was a director or officer of the troubled bank.[395] The administrator had the power, in addition to summoning a person for an examination and conducting such examination, to administer oaths, require the production or delivery of documents, punish defaulting or recalcitrant witnesses and to allow costs and expenses to witnesses.[396] Persons who were summoned for an examination but who failed to attend or remain in attendance at the examination could be apprehended in terms of a warrant and brought before the administrator. Failing a reasonable explanation for their failure to appear or remain in attendance at the examination, such persons could even be committed to prison by the administrator.[397]

3.6.3.5 Schemes of Resolution and Interim Management of Successor Financial Institutions

Part V of the TFIR Act was titled "Schemes of Resolution and Interim Management of Successor Financial Institutions". In this context section 26 of the TFIR Act provided for powers of the administrator with respect to a "scheme of resolution".[398] It stipulated that, subject to section 27 (titled "special provisions for the repayment of depositors of

[395] Section 18(1) TFIR Act.
[396] Section 18(2) TFIR Act.
[397] Section 18(3) to (5) TFIR Act. See also section 24 of the TFIR Act regarding offences by specified persons in relation to the functions of the administrator.
[398] In terms of section 3 of the TFIR Act a "scheme of resolution" is described as "a scheme referred to in section 26".

troubled financial institutions"), the administrator had powers to formulate and implement a "scheme of resolution" in relation to the troubled bank. These powers of the administrator were also subject to directions by the RBZ and entailed that the administrator could do one or more of the following:[399]

(a) issue to the RBZ (in right of the State) shares or other securities in a successor financial institution in satisfaction of the indebtedness of the troubled bank to the RBZ;

(b) consolidate or re-divide shares of the same or different classes held by a member in a troubled bank into any number of shares[400] of any denomination equivalent to the true or fair value of the shares previously held by such member;

(c) cancel any shares held by a member in a troubled bank and issue to such member any number of shares of any denomination in a successor financial institution equivalent to the true or fair value of the shares previously held by that member;

(d) convert any right, interest or claim held by a creditor in relation to a troubled bank into shares equal in value to the true or fair value of the right, claim or interest previously held by the creditor and issue the shares to the creditor as fully paid up shares;

(e) issue to any creditor of the troubled bank any debentures or other securities (not being shares in a successor financial institution) in satisfaction of any claim, right or interest held by the creditor in relation to the troubled bank;

(f) amend the troubled bank's memorandum and articles of association;

(g) amalgamate two or more troubled banks that were administered by the same administrator;

[399] Section 26(1) TFIR Act.
[400] Whether of the same or different classes.

(h) on directions by the RBZ, amalgamate the troubled bank with any other troubled financial institution administered by another administrator;

(i) dissolve the troubled bank or any of its associates and secure the formation of one or more financial institutions, in which instance these latter institution or institutions would then be the successor/s to the troubled bank or any of its associates;

(k) redistribute the assets and liabilities of the troubled bank and any of its associates between them or between its successor financial institution/s;

(l) dissolve the troubled bank's board of directors and substitute the board with any assistant administrator;

(m) confirm in office any director of the troubled bank;

(n) appoint and vest the management of any successor financial institution in an interim board of directors of any successor financial institution -such interim board would then hold office until the next annual general meeting of the troubled bank following its administration.

In terms of section 26(2) an administrator could register a successor financial institution in any class of business referred to in section 6 of the Banking Act or as any type of institution provided for under any other Act, notwithstanding that such class of business differed from the business that was originally carried on by the troubled bank. Where the RBZ had appointed administrators in respect of two or more troubled financial institutions and gave them a direction to amalgamate those troubled financial institutions in accordance with section 26(1)(i), the RBZ itself could, through those administrators, exercise all of the powers in section 26(1) and (2) as if it were the sole administrator of the institutions to be amalgamated.[401]

Section 28 of the TFIR Act dealt with the approval of a scheme of resolution. It required the administrator, no later than two months after the commencement of the troubled bank's administration, to produce a provisional scheme of resolution and present it to a joint meeting of creditors and shareholders. The provisional scheme of resolution

[401] Section 26(3) TFIR Act.

had to provide for any of the matters specified in section 26 of the TFIR Act.[402] The administrator could then make changes to the provisional scheme in accordance with the "opinions and wishes" of the creditors and shareholders expressed at the joint meeting. As soon as possible after the aforesaid meeting the administrator had to submit the provisional resolution scheme, with any variations thereto, to the RBZ, together with a report summarizing the "opinions and wishes" of the creditors or shareholders in relation to the scheme. The RBZ could, after considering the provisional resolution scheme and the report, approve the scheme or could approve it subject to such variations as the RBZ directed and then it would become the final scheme of resolution.[403] Once the scheme was approved by the RBZ the administrator had to present it to a joint meeting of creditors and shareholders. Any person who was aggrieved by a final resolution scheme could seek a review thereof by the RBZ.[404]

Where resolution was not possible because, pursuant to presentations by the administrator, the RBZ was of the view that no feasible scheme for resolution of a particular troubled bank could be formulated except by advancing additional public funds to it, *and such funds were unavailable*, section 29 required the RBZ to cancel the declaration of the bank concerned as a troubled bank. In such instance the failing bank would then be put into liquidation in terms of section 57 of the Banking Act.

As regards the implementation of the scheme of resolution and matters incidental thereto, section 30 provided that the administrator was obliged, and had the power to undertake, all things necessary to carry out the scheme of resolution that was approved for the troubled bank. The Minister of Finance was tasked to nominate the persons who, on behalf of the State, would hold the shares in any successor financial institution. Any dividends or monies received by such a person in right of or on the disposal of any share or right acquired by the state by virtue of the TFIR Act was required to be paid into the Troubled Bank Fund.[405]

[402] Section 28(1) TFIR Act.
[403] Although the TFIR Act did not expressly state that the RBZ could also reject the plan it is submitted that the fact that the RBZ had a discretion to approve the plan meant that it could thus also exercise such discretion by *not* approving the plan. If no subsequent plan was approved by the RBZ the troubled bank would then have to be liquidated.
[404] Section 28(2) to (6) TFIR Act. A person who was aggrieved by a final scheme of resolution could, within 14 days after it was presented to a joint meeting of creditors and members, seek review thereof by the RBZ by notice filed in the prescribed manner and period.
[405] Section 30(1) to (3) TFIR Act.

Section 31 of the TFIR Act provided for an interim board that would, subject to the memorandum and articles of the successor financial institution, take over from the administrator and assume the management of the troubled bank. This board was required to manage the troubled bank in such a manner as it considered "most economic and most likely to promote the interests of the members and creditors" of the said bank. In addition it had to lodge a copy of the scheme of resolution for the troubled bank with the Registrar of the High Court and had to comply with any of the requirements of section 123 of the Companies Act[406] with which the troubled bank would have been obliged to comply had it not been placed under administration. It also had to keep such accounting records and prepare such annual financial statements as the troubled bank or its directors would have been obliged to keep or prepare had it not been placed under administration; and had to convene the annual general meetings and other meetings of shareholders of the troubled bank provided for by the Companies Act.[407] The interim board further had to convene meetings of creditors and had to submit reports to these meetings which showed the assets and liabilities of the troubled bank and its debts and obligations as verified by its auditor, as well as all information necessary to enable the troubled bank's creditors to become fully

[406] Section 123 of the Companies Act [Chapter 24:03] provides for annual return to be made by company, when the annual return must be filed with the registrar of companies, what should be annexed to the annual summary etc. Section 123(1) provides that "subject to subsection (2), every company shall make and file with the registrar an annual return consisting of a summary, in the form contained in the Sixth Schedule or as near thereto as circumstances admit, specifying the following particulars — (a) all such particulars with respect to the persons who at the date of the return are the directors of the company and any person who at that date is secretary of the company as are by this Act required to be contained with respect to directors and the secretary, respectively, in the register of directors and secretaries of a company and the name and address of every person appointed as an auditor of the company; (b) the situation of the registered office of the company; (c) the place where the register of members is kept if, under the provisions of this Act, it is not kept at the registered office of the company; (d) the amount of the share capital of the company, and the number of the shares into which it is divided; (e) the number of shares taken from the date of incorporation of the company up to the date of the return; (f) the number of shares issued for cash; (g) the number of shares issued as fully or partly paid up otherwise than in cash and the nature of the consideration given for such shares; (h) the amount called up on each share; (i) the total amount of calls unpaid; (j) the total amount of the sums, if any, paid by way of commission in respect of any shares or debentures, or allowed by way of discount in respect of any debentures, since the date of the last return; (k) the total number of shares forfeited; (l) the discount allowed on the issue of any shares issued at a discount or so much of that discount as has not been written off at the date on which the return is made."

[407] Section 31 (c) to (f). With regard to these meetings the successor institution also had to comply with all the requirements with which the directors of the company would in terms of the Companies Act have been obliged to comply had the institution not been placed under administration.

acquainted with the bank's position as at its financial year end or the period covered by any such interim report.[408]

3.6.3.6 Miscellaneous matters

Part VI of the TFIR Act provided for a number of general matters. These included the provision made by section 32 for arbitration where the valuation of the troubled bank's shares by the administrator or RBZ was disputed. The Act also provided that to the extent possible to do so without prejudicing the viability of the troubled bank or successor financial institution, the administrator and interim board had to endeavor to retain employees of the troubled bank on terms that were not less favourable than those that prevailed prior to the troubled bank's administration.[409]

Section 34 dealt with the application of assets during a troubled bank's administration. It stipulated that the administrator or interim board was not permitted, without leave by the RBZ, to sell or otherwise dispose of the assets of a troubled bank or successor financial institution except in the ordinary course of the bank's business. Money that became available had to be applied by the administrator or interim board towards paying the costs of the administration; conducting the troubled bank's business in accordance with the declaration or scheme of resolution; and, as far as permitted by the circumstances, paying the claims of creditors that arose prior to the commencement of the administration. In particular section 34(3) required that the creditor hierarchy in the Insolvency Act [Chapter 6:04][410] be observed by stipulating that "[T]he costs of the administration and the claims of creditors of the troubled

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[408] Section 31(g) to (i) TFIR Act. The board also had to lodge with the Master of the High Court copies of documents submitted at all the aforesaid meetings.

[409] Section 33 TFIR Act.

[410] When a company enters Insolvency and has to be liquidated, the order in which creditors are paid is defined by the Insolvency Act [Chapter 6:04]. The hierarchy is divided into classes of creditor, and each class or group must be paid in full before the liquidator moves on to the next. The categories include secured, preferential creditors and non-preferent claims. See section 110 – 113 (secured claims) 99 – 108 (preferent claims) section 109 (non-preferent claims) of the Insolvency Act [Chapter 6:04]. See also Fitzpatrick, Chigumira, Dube and Tausha "Enhancing Zimbabwe's regime for resolving corporate financial distress: current challenges and possible solutions" 2014 *Zimbabwe Economic Policy Analysis and Research Unit Working Paper* available at https://elibrary.acbfpact.org/acbf/collect/acbf/index/assoc/HASHadde/4db72883/80675f9a/7a.dir/enhancing%20zimbabwe.pdf accessed 4 August 2020 at 22 wherein the authors state that "in applying the provisions of the Insolvency Act in the context of a company wind-up, it should be noted that preferential and general creditors are only entitled to the "free residue" of the estate. Free residue is that 'portion of the estate which is not subject to any right of preference by reason of any special mortgage, landlord's legal hypothec, pledge or right of retention.' Proceeds from the sale of encumbered property of the debtor will thus be distributed to the appropriate secured creditor in accordance with its claim."

institution shall be paid in accordance with the law relating to insolvency as if those costs were costs of the sequestration of an estate and those claims were claims against an insolvent estate." This part also dealt with the position of the troubled bank's auditor during administration and administration expenses .[411]

Section 35 further dealt with the remuneration of the administrator and any assistant administrator and section 36 provided for liabilities incurred by the administrator and interim board to have preference over pre-administration liabilities whilst section 37 provided that the period that a troubled bank was under administration would be excluded in determining whether a mortgage bond conferred any preference under section 111(3) of the Insolvency Act.

3.6.3.7 Cancellation of declaration

If, at any time during the administration of a troubled bank the administrator notified the RBZ in writing that the purpose of the declaration of a failing bank as a troubled financial institution had been fulfilled or that for any reason it was undesirable that such declaration remain in force, section 40(1) permitted the RBZ to cancel the declaration by notice published in the Gazette. Once this was done the administrator was divested of his functions. In cancelling a declaration the RBZ could (insofar as these matters had not been provided for under a scheme of resolution relating to the troubled bank) give directions necessary for the resumption of the management and control of the bank concerned, including directions regarding convening a general meeting to elect directors to the board of the bank.[412] Upon cancellation of a declaration of a failing bank as a troubled financial institution, any action or proceeding commenced against the bank concerned at the time when the declaration was issued, or right of action held against the said bank at that time, was revived or could be recommenced.[413]

3.7 Developments subsequent to the enactment of the Troubled Financial Institutions (Resolution) Act

During the time that the TFIR Act was in existence 16 banks failed. Seven of these banks were placed under curatorship, one was liquidated and four were bailed out with

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[411] Section 38 and 39 of the TFIR Act respectively.
[412] Section 40(2) TFIR Act.
[413] Section 40(3) TFIR Act. See further section 41 regarding offences consequent to administration.

the Troubled Bank Fund. Trust Bank, Royal Bank and Barbican Bank, as alluded to in above, were amalgamated in 2005 in terms of the TFIR Act into the Zimbabwe Allied Banking Group ("ZABG").[414] In the mid-term monetary statement issued by the RBZ on 31 July 2012[415] the Governor of the RBZ remarked that the establishment of the ZABG "was an important step in addressing financial stability and safeguarding depositors' funds. It marked the beginning of a new era in the history of the Zimbabwean financial sector." He indicated that the ZABG was created as a special purpose vehicle which facilitated the conversion of the assets of troubled banks into equity. Troubled banks that qualified were amalgamated into the ZABG as a single entity, which was meant to avoid the reputational risk faced by the banks that failed.[416]

The comprehensive resolution framework set up by TFIR Act was however doomed because, as pointed out by Mandizvidza, some of the banks that accessed the Troubled Bank Fund failed to repay the loans they received from the Fund and also failed to recapitalise.[417] The Fund was thus bled dry and was discontinued causing the TFIR Act to become a white elephant.

3.8 The Banking Amendment Act, 2015

3.8.1 Introduction

Although the resolution regime introduced by the TFIR Act contained what would, at face value, appear to be a workable and comprehensive approach to dealing with troubled banks it however did not prove to be a panacea to dealing with the ills of failing Zimbabwean banks the Troubled Bank Fund that would enable the application of the

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[414] Para 3.4 above. See *Trust Holdings Ltd v Reserve Bank of Zimbabwe and Others* [2005] ZWSC 36 (4 September 2005) where it is pointed by the court out that on 28 October 2004 the RBZ stated in its monetary policy review that all troubled banks would be amalgamated into the ZAGB.

[415] Reserve Bank of Zimbabwe, *Mid-term Monetary Policy Statement* July 2012 available at https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&ved=2ahUKEwjpsODIzf7qAhUIUhUIHZ6iBgAQFjAJegQICRAB&url=https%3A%2F%2Fwww.zimra.co.zw%2Fcomponent%2Fphocadownload%2Fcategory%2F18-government-gazettes%3Fdownload%3D199%3Amid-term-monetary-policy-statement-july-2012&usg=AOvVaw1htMGh-TsLLdTvsc0NFeMM accessed 18 July 2020 para 2.9.

[416] *Ibid*.

[417] Reserve Bank of Zimbabwe, *Bank Licensing, Supervision & Surveillance Annual Report* 2005 available at https://www.rbz.co.zw/documents/BLSS/Annual%20Reports/2005/RBZ%202005_Annual_Report.pdf accessed 30 July 2019. See also Makoni "Overview of Zimbabwean banking sector (part one)" 2010 available at https://ezinearticles.com/?Overview-of-Zimbabwean-Banking-Sector-(Part-One)&id=4185197 accessed 2 August 2020.

resolution regime envisaged by the Act was misused by failing banks. In a further bid to deal with the issue of failing banks the Banking Amendment Act, 2015 ("the Banking Amendment Act") was promulgated on 13 May 2016 and the TFIR was repealed.[418] According to the RBZ, previous delays in the resolution of troubled banks left many depositors in Zimbabwe severely prejudiced due to loss in value of their deposits and contributed to loss of public confidence in the banking sector.[419] The RBZ was however optimistic about the changes introduced by the 2015 Banking Amendment Act, stating that it covers a "comprehensive troubled bank resolution framework" which empowers the RBZ to swiftly resolve problem banking institutions in the public interest and also places responsibilities on the RBZ to protect assets of depositors during resolution.[420] The preamble of the Banking Amendment Act indicated that it sought to amend the Banking Act and the RBZ's organic law, namely the Reserve Bank of Zimbabwe Act as well as the Deposit Protection Corporation Act as well as the Schedule to the Reserve Bank of Zimbabwe Amendment Act No 1 of 2010; to repeal the TFIR Act and "to provide for maters connected to or incidental to the foregoing." Although the discussion that follows focuses on the resolution regime introduced for problem banks, it should be noted that the Banking Amendment Act, 2015 introduced or amended various provisions of the Banking Act aimed at improving the safety and soundness of banks which included *inter alia*, provisions to limit large exposures in banks[421] (thus limiting concentration risk);[422] restrictions on the rights of persons to control banking

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[418] As stated in its preamble, the Banking Amendment Act, 2015 repeals the Troubled Financial Institutions (Resolution Act) [Chapter 24:28] and the provisions of the Banking Amendment Act, 2015 are incorporated into the Banking Act [Chapter 24:20]. See also The Reserve Bank of Zimbabwe Bank Supervision Annual Report 2015 available at https://www.rbz.co.zw/documents/BLSS/Annual%20Reports/2015/BSD%20ANNUAL%20REPORT%202015.pdf accessed 10 September 2019.

[419] *Ibid*.

[420] *Ibid*.

[421] Section 15A of the Banking Act [Chapter 24:20] introduced by section 8 of the Banking Amendment Act, 2015.

[422] Concentration risk can be defined as "any single (direct or indirect) exposure or group of exposures with the potential to produce losses large enough to threaten an institution's health or its ability to maintain its core business." See Principles for the management of concentration risk available at https://web.actuaries.ie/sites/default/files/ermresources/11._annex_2g_principles_for_the_mgmt_of_concentration_risk.pdf accessed 4 August 2020. See also Financial risk available at https://www.resbank.co.za/Markets/ForeignReserves/RiskManagement/Pages/Financial-risk.aspx accessed 4 August 2020 where concentration risk is defined as "the risk posed to the Bank by any single or group of exposures which have the potential to incur large losses. The Bank mitigates this risk through diversification, and by limiting the extent of exposure to any one institution relative to the market value of the portfolio. This excludes government owned entities and guaranteed securities of highly rated countries."

institutions;[423] "fit and proper" and other requirements for pre-approval by the RBZ of the board of directors of banks;[424] provisions pertaining to responsibilities and conduct of directors of banks and their controlling companies[425] and provisions on corporate governance.[426] In particular the Banking Amendment Act, 2015 also sought to strengthen the powers of the RBZ as bank supervisor where a bank was found to have contravened the Banking Act or its conditions of registration by providing for the RBZ to take immediate action which may *inter alia* include:[427] requiring the bank concerned to develop and implement a capital restoration plan; restricting the activities or investments of such bank; and taking control of any assets of the bank and prohibiting or restricting the disposal or use of those assets.

It was clear that the Banking Amendment Act, 2015 was an attempt to address bank resolution from a clean slate – this time within the framework of the Banking Act. The Banking Amendment Act introduced the term "problem banking institution" which refers to a bank whose capital adequacy, asset quality or liquidity or solvency is, or will be (in the opinion of the Registrar of Banks in the Bank Supervision Department of the RBZ),[428] "significantly impaired unless there is a major improvement in its financial resources, risk profile, strategic business direction, risk management capabilities or quality of management."[429]

Although not defining the concept "resolution" the Banking Amendment Act, 2015 introduced a bank resolution framework into the Banking Act by inserting section 52A, titled "Problem Banking Institutions", into Part IX (supervision and investigation of banking institutions) of the Banking Act.[430] Section 52A applies where the RBZ determines that, in relation to a particular problem bank, it is in the public interest or in

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[423] Section 51F of the Banking Act introduced by section 8 of the Banking Amendment Act, 2015.

[424] Section 18 of the Banking Act as amended by section 10 of the Banking Amendment Act, 2015.

[425] Section 20A inserted by section 13 of the Banking Amendment Act, 2015. Notably this included the duty to act bona fide for the benefit of the bank and its depositors and shareholders.

[426] Section 28A inserted by section 17 of the Banking Amendment Act, 2015. In this context section 17 of the Banking Amendment Act, 2015 also inserted provisions on the compliance function (section 28B) and risk committee (section 28C).

[427] Section 48 as amended by section 28 of the Banking Amendment Act, 2015.

[428] Section 4 of the Banking Amendment Act, 2015 introduced a new section 4A into the Banking Act which provided that the functions of the Registrar of banks entail responsibility for registration and cancellation of banks and performing any other functions conferred onto it by the Banking Act or another Act. A new section 4B was also introduced to indicate the manner in which the Registrar is tasked to exercise its functions.

[429] Section 2 of the Banking Amendment Act, 2015 which incorporated this definition into section 2 of the Banking Act [Chapter 24:20].

[430] Inserted by section 29 of the Banking Amendment Act, 2015.

the interests of depositors or creditors of a banking institution *to avoid cancelling its registration*[431] in order to achieve any or more of the following objectives: to protect and enhance the stability of the financial system, to protect and enhance public confidence in the banking system, to protect depositors and, where applicable, to protect public funds.[432] As part of the resolution framework the Amendment Act also introduced section 52B (confirmation of problem bank notice) and 52C (implementation of bank resolution plan) into the Banking Act.[433] The Amendment Act did not introduce a provision specifically stating that the RBZ was the designated resolution authority, neither was the Reserve Bank of Zimbabwe Act amended at any stage to provide as such, but it is clear from the provisions introduced as section 52A, 52B and 52C of the Banking Act that the RBZ was indeed the resolution authority.

For purposes of initiating bank resolution section 52A provides that where the RBZ, following an investigation into a bank in terms of section 49 of the Banking Act, or based on financial intelligence which in its opinion is sound and efficient, has identified a bank as a problem bank it may formulate and implement a "resolution plan" for such bank. Identifying a bank as a problem bank is competent where:[434]

(a) The bank can no longer maintain the prescribed amounts of capital and reserves or is otherwise in an unsound financial condition; or

(b) the bank can no longer maintain net assets of an amount or nature sufficient to safeguard its creditors; or

(c) the bank can no longer provide adequate security for the assets entrusted to it; or

(d) the bank is facing liquidity problems or its prudential liquidity ratios are below the prescribed regulatory minimum; or

(e) the bank has failed to put in place and implement a sound corporate governance framework and a risk management framework or it is in

[431] Author's emphasis.
[432] Section 52A(1) of the Banking Amendment Act, 2015.
[433] Section 29 of the Banking Amendment Act, 2015.
[434] Section 52A(2)(a) – (h) of the Banking Amendment Act, 2015.

breach of good corporate governance requirements or its operations exhibit poor risk management; or

(f) the bank is carrying out activities it is not permitted to conduct or employing undesirable methods in carrying on its business; or

(g) the bank has not complied with any instruction, requirement or condition imposed by the Registrar of Banks in terms of the Banking Act; or

(h) the bank is not being operated or it is not conducting its activities in the best interests of its depositors.

3.8.2 Resolution measures

The bank resolution plan to be formulated and implemented by the RBZ as resolution authority may involve any of the following measures:[435] merging the problem bank with another bank; the acquisition of the problem bank by another banking institution; the acquisition by or transfer to a third party of any asset or liability of the problem bank, (including any asset held in trust); the establishment of a "bridging banking institution" to acquire part or all of the assets and liabilities of the problem banking institution; appointing a curator with powers to "establish and institute a timely plan of resolution" to take control of the problem bank; the winding up of the problem bank; or the taking of "any action necessary to give effect to the plan of resolution", including the sale or closure of any branch, agency or other office of the problem bank and, subject to any other law, the dismissal of any of its officers or employees.

3.8.3 Resolution Plan

Where the RBZ makes a determination in terms of section 52A(1) that a bank is a problem bank it must give the bank an opportunity to make representations in the matter.[436] Thereafter, it must serve on the bank's principal officer, at its registered office, a "problem bank notice" announcing that the bank has been declared a problem bank and indicating the bank resolution plan that the RBZ will be implementing or cause to be implemented in respect of such bank.[437] The RBZ must also publish the

[435] Section 52A(2)(i) – (o) of the Banking Amendment Act, 2015.
[436] Section 52A(3) of the Banking Amendment Act, 2015.
[437] Section 52A(3)(a)(i) and (ii) of the Banking Amendment Act, 2015.

problem bank notice in the Gazette.[438] Where the RBZ however considers that immediate action is necessary to prevent irreparable harm to the banking institution or its depositors or creditors, the RBZ may take such action without affording the failing bank an opportunity to make representations.[439]

In formulating a bank resolution plan, the RBZ is required to "have regard to public interest and to ensure that any measures taken under the plan are proportionate to the harm they are intended to remedy."[440] The RBZ also has to ensure that where any property or interest or right in property is to be acquired under the bank resolution plan (other than shares and assets of the problem bank) reasonable notice is given to everyone whose interest or right will be affected by the acquisition and fair and adequate compensation is paid within a reasonable time after the acquisition. If the acquisition is contested, the RBZ must ensure that an application is made to court for an order confirming the acquisition and the property or interest or right is "returned" if the court does not confirm the acquisition.[441] Moreover, the RBZ is obliged to ensure that all bidders or offerors seeking to acquire assets of the problem banking institution are treated equally and fairly. The RBZ must further ensure, as far as practicable, that any person who acquires assets of the problem bank also acquires an equivalent value of its liabilities.[442]

Pending the formulation and implementation of a bank resolution plan, the RBZ may take such measures concerning the problem bank as, in its opinion, is necessary to preserve the capital, assets and liquidity of such bank and to protect the interests of its depositors and other creditors.[443] These "emergency" measures may include limiting the activities of the bank; removing or replacing all or any of its directors of and

[438] Section 52A(3)(b) of the Banking Amendment Act, 2015.

[439] *Ibid*.

[440] Section 52A(4)(a) and (b) of the Banking Amendment Act, 2015. The RBZ may "disclose confidential information concerning a problem banking institution, subject to a confidentiality agreement, to a bidder or offeror who proposes to acquire the institution or its assets or liabilities under a bank resolution plan." See section 52A (5) of the Banking Amendment Act, 2015.

[441] Section 52A(4)(c)(i) – (iv) of the Banking Amendment Act, 2015.

[442] Section 52A(4)(d) and (e) of the Banking Amendment Act, 2015.

[443] Section 52A(6)(a) and (b) of the Banking Amendment Act, 2015. These measures may be taken either before or after the confirmation of the Problem bank notice in terms of section 52B of the Banking Act (as introduced by section 29 of the Banking Amendment Act, 2015).

prohibiting or restricting the disposal of any of the bank's assets as well as any action referred to in section 48(3) of the Banking Act as set out in paragraph 3.8.1 above.[444]

3.8.4 Confirmation of problem bank notice

At any time *prior* to the implementation of a bank resolution plan, the problem bank notice must be confirmed on application made in chambers by the RBZ to a judge of the High Court. Such application must occur on not less than fourteen days' prior written notice to the directors, shareholders, principal officers and creditors of the problem bank.[445] A decision by a judge not to issue a confirming order or to issue it subject to amendment does however not bar the RBZ from making a fresh application based on new evidence it obtained since the original application or to correct any mistake in the original application.[446]

Pending the determination of such confirmation application the RBZ may take any of the measures referred to in section 52A(6)[447] and, in the interest of its creditors or depositors or in the public interest, the RBZ may also take any other formal supervisory or enforcement action against the problem bank.[448] Where the court confirms a problem bank notice and the bank resolution plan for the problem bank concerned proposes that such bank be placed in liquidation section 52B(7) stipulates that it will not be necessary to issue a separate notice of liquidation as required by section 57 of

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[444] Section 52A(7) (a) – (c) of the Banking Amendment Act, 2015.

[445] Section 52B(1) of the Banking Amendment Act, 2015. The application must be accompanied by a copy of the problem bank notice relating to the bank that is the subject of the application; a statement of the reasons why the RBZ was of the view that anyone of the circumstances used to identify a problem banking institution as per section 52A(2)(a)-(h) were present in relation to the bank concerned; a statement of affairs of the said bank indicating the extent of its assets and liabilities and proof that a principal officer of the bank had been served with a problem bank notice. See section 52B(2)(a) – (d) of the Banking Amendment Act, 2015.

[446] Section 52B (3) of the Banking Amendment Act, 2015. See also section 52B(4) of the Banking Amendment Act, 2015 which states that where an appeal is noted against a decision of the High Court in the application referred to above, "the Supreme Court shall ensure that it delivers a judgment within thirty days after the appeal was filed in accordance with the rules of court." Section 52B(5) of the Banking Amendment Act, 2015 states that if an appeal is noted against a decision of the High Court in the application to confirm a problem bank notice, no court shall set aside the decision of the RBZ made pursuant to a bank resolution plan without the consent of the RBZ, "unless the court is satisfied that the decision was made corruptly or in bad faith. Provided that this subsection shall not prevent a court from awarding a fair and adequate compensation to any person who has suffered loss as a result of the decision."

[447] As set out in para 3.8.3 above.

[448] Section 52B(6) of the Banking Act [Chapter 24:20].

the Banking Act, which as pointed out above,[449] sets out the process for bank liquidation.

3.8.5 Implementation of bank resolution plan

The implementation of a bank resolution plan is dealt with in section 52C as introduced by the 2015 Banking Amendment Act. In terms of section 52C the implementation of a bank resolution plan is done by a curator appointed for such purpose. For purposes of section 52C a "curator" means "an agent of the Reserve Bank acting as an independent contractor *or* the Reserve Bank itself operating through one of its employees, *and includes* any special asset management company established in terms of Part IX A of the Reserve Bank Act.[450]

Where a curator has taken control of a problem bank under a bank resolution plan, section 52C(2) provides that the shareholders of the institution shall have no rights with respect to their shares, except to the extent permitted under the plan.[451] Within ninety days after a curator has taken control of a problem bank under a bank resolution plan, the RBZ, after consulting with the DPC, must decide what to do about the problem bank. As such the RBZ must determine whether to restructure, reorganise or wind up the bank; or it may come up with an alternative bank resolution plan based upon any combination of restructuring, reorganization or winding up of the bank. Alternatively it may decide, subject to section 52C, on any other option which provides for expeditious resolution of the problem bank's problems.[452] There is however a proviso that if the new bank resolution plan is materially different from the one that was submitted in the confirmation application in terms of section 52B, the RBZ must obtain leave from the court that previously confirmed such application to depart from the original bank resolution plan. The court may then make any directions on the matter that it thinks fit.

Section 52C(4) further introduces a moratorium to facilitate the implementation of the bank resolution plan. As such it provides that for a time period of 90 days after a curator has taken control of a problem bank under a bank resolution plan, a moratorium applies

[449] See para 3.6.3.2 above. As indicated, a discussion of bank liquidation is beyond the scope of this thesis.
[450] Section 52C of the Banking Act [Chapter 24:20].
[451] Section 52C(2) of the Banking Amendment Act, 2015.
[452] Section 52C(3)(a) and (b) of the Banking Amendment Act, 2015.

during which no proceedings may be commenced against the problem bank by its creditors. Protection is also provided in relation to transfers made in terms of a bank resolution plan. In this regard section 52C(5) provides that notwithstanding any other law, where under a bank resolution plan, any asset of a problem bank has been transferred to any person; or control of a problem bank has been transferred to any person; or the whole or part of the problem bank's business has been transferred to any person, no court may set aside such transfer without the consent of the RBZ. The only exception to the aforementioned rule is where the court is satisfied that the transfer was made fraudulently, corruptly or in bad faith.[453] It is however explicitly provided that section 52C(5) shall not prevent a court from awarding fair and adequate compensation to any person who has suffered loss as a result of the transfer.[454]

3.8.6 Amendment of section 53, 55 and 56 of the Banking Act

The 2015 Banking Amendment Act also introduces a number of specific changes to section 53(1), (2) and (3) of the Banking Act that deals with the placing of an institution under curatorship as discussed in paragraph 3.5 above.[455] These changes to section 53 merely serve to introduce a requirement that the Minister be consulted and that security be provided by the curator for the proper performance of his duties. The Banking Amendment Act further amends section 55 which deals with the powers and duties of the curator by the insertion of a section 55(3a) that provides as follows:[456]

"Any person alleging to be a creditor of a banking institution under curatorship may, upon furnishing such written proof to the curator as will satisfy the curator that the person is able to prove a claim against the banking institution, and upon payment of the prescribed fee (if any), request that any specific report or every report made by the curator under subsection (1)(e), (f) and (g) be availed to him or her as soon as is practicable after the curator avails it to the Reserve Bank, and the curator shall comply with such request."

A new section 56A titled "[E]xpenses of curatorship" has also been inserted into the Banking Act to provide that the RBZ may recover from a bank that has been placed in

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[453] Section 52C(5)(a) – (c) of the Banking Amendment Act, 2015.
[454] *Ibid*.
[455] See section 30 of the Banking Amendment Act, 2015.
[456] Section 31 of the Banking Amendment Act, 2015.

curatorship "all the expenses it has necessarily incurred in connection with the curator's administration of the institution".[457]

3.9 Conclusion

The overview provided in this Chapter pointed out that since its independence in 1980 Zimbabwe has had in place a framework for prudential supervision of banks, captured in the Banking Act [Chap 24:20], as amended over the years to enhance the safety and soundness of financial institutions. This prudential framework was supplemented in 2003 by a framework for deposit insurance as captured in the Deposit Protection Corporation Act [Chapter 24:29] that enhanced the financial safety net arrangements in the country.[458]

Bank failures have however been pervasive in Zimbabwe: since its independence, and due to many different reasons, numerous bank failures occurred and the process of curatorship provided for in section 53 to 56 in the Banking Act was used on a number of occasions to attempt to save some of these banks whilst other banks were liquidated without first being subjected to curatorship. The curatorship procedure originally availed by the Banking Act was relatively straightforward: the process provided for clear triggers, namely that a bank could be placed under curatorship where the RBZ as central bank considered the bank to be in an unsound financial condition and not operating in accordance with sound administrative or accounting practices and procedures or not adhering to proper risk-management policies; or where the bank failed to comply with the minimum financial requirements set by the Banking Act and the RBZ was of the view that the bank was unlikely to comply with those requirements unless it was placed under curatorship.

The stated aim of curatorship was the protection of the failing bank's depositors and creditors whilst the curator determined the bank's complete position before making recommendations on future actions to be taken. The curator was tasked to take over the management of the bank and the Banking Act appropriately provided for a

[457] See section 32 of the Banking Amendment Act, 2015. Section 56A(2) further provides that in any court proceedings for the recovery of any expenses referred to in section 56A(1), a certificate purporting to be signed by the Governor or a Deputy Governor of the RBZ and setting out the amount of the expenses concerned will be prima facie proof of the amount of such expenses.

[458] See para 3.3 above.

moratorium on enforcement actions by the failing bank's creditors so that the curator could take steps necessary to manage the bank out of its financial misery in a manner that the curator considered prudent and in the interest of the bank's creditors. The public interest in a stable financial sector was thus not originally stated as the yardstick for applying curatorship which process appeared rather to be driven by optimizing yield for creditors and protecting depositors as a species of creditors. During curatorship the curator had various duties to ensure compliance by the bank with the Banking Act - which compliance was crucial if the bank was to be rescued. Notably it was also the curator (and not any other person specifically appointed) who had to conduct the enquiry into the reasons for the bank's failure and decide who should be prosecuted or sued in this regard. Not outsourcing the investigation into the reasons for the bank's financial woes appears sensible as it served to contain the costs of curatorship.

The curator's toolkit was relatively well-stocked and included suspending or reducing claims; making payments to creditors; cancellation of agreements; convening meetings with creditors to establish the nature and extent of claims against the failing bank; negotiating individual settlements; making and carrying out decisions that shareholders would otherwise take as well as disposing of the assets of the failing bank. The curatorship process also provided for a type of "catch all"-power enabling the curator to "take any action necessary for the administration or operation" of the bank under curatorship which includes closure of branches and dismissal of employees. It is however unclear whether this "catch all"-provision would have accommodated the power to transfer liabilities or a combination of the transfer of liabilities and assets. Most likely such a broad interpretation would not be feasible given that disposal of assets is specifically and expressly dealt with by section 55(2) of the Banking Act. One would thus expect the legislature to have inserted a similar specific provision regarding transfer of liabilities if the intention was also to allow for same. A measure that could be applied during curatorship that, if applied appropriately, would operate well in tandem with the moratorium on enforcement, was the provision made for freezing of funds during curatorship. The curator did not have a carte blanche to conduct the curatorship as he pleases and was held accountable by the requirement to record the nature of, and reasons for, each action that he took in the course of the curatorship and also by the oversight role played by the RBZ during curatorship.

The Zimbabwean curatorship process was however not without its shortcomings. Some aspects of the curatorship process that could compromise the ability of the curatorship as mechanism to enable the rescue of a failing bank were, *inter alia*: the limited suite of rescue options to the avail of the curator which basically comprised of managing the institution, dealing with claims and effecting disposal of assets; the lack of a clear indication of the period of curatorship which meant that there was no legislative incentive for wrapping up the curatorship as swiftly as possible which delay could lead to loss of value; the process of allowing the failing bank to make submissions regarding the appropriateness of curatorship which added further protraction to the process that could potentially derail rescue efforts and the fact that the process could be appealed against which could create further uncertainty and delay and could arguably occasion further loss of value of the bank concerned.

Curatorship constituted a limited resolution measure that had a narrow and specific aim, namely, to facilitate the rescue of a failing bank. If such rescue was not viable the bank concerned would be put into liquidation. Consequently curatorship as limited measure to deal with failing banks was not sufficient to comprehensively address the challenge of dealing with Zimbabwean banks that encountered failure hence Zimbabwe sought to find a more comprehensive mechanism that provided an augmented suite of resolution tools and powers to effectively deal with the exigencies of bank failure. The 2003-2004 wave of bank failures was the catalyst for the introduction of the Troubled Financial Institutions (Resolution) Act [Chapter 24:28] ("TFIR Act") and the establishment of the Troubled Banks Fund. This Act was a mammoth attempt at establishing a framework that would deal with troubled banks that found themselves in unsafe and unsound territory. As such it appears to have been the first attempt at creating a more comprehensive resolution framework for troubled financial institutions – well before the 2008 GFC illuminated the need for orderly resolution frameworks for banks and other financial institutions. As pointed out, the TFIR Act did however not replace the curatorship process in the Banking Act and the exact nature of the interaction between the TFIR Act and the curatorship process, if any, is unclear.

In particular the TFIR Act envisaged a process in terms whereof a bank would be declared as a "troubled financial institution" pursuant to an investigation by the RBZ. Such bank would then be placed under control and management of an "administrator".

It appears that administration in terms of the TFIR Act was meant to fulfil a similar type of role as curatorship in its original format under the Banking Act but that it was broader than curatorship in the sense that the administrator was tasked with implementing a resolution plan for the failing bank. The administrator was thus not tied down to the objective of rescuing the bank but could apply a variety of measures to resolve the bank, one of which could have been to see if the bank, or at least some part of the bank, could be rescued. Notable about the reach of administration under the TFIR Act was that it extended to "every associate of the troubled bank" thus meaning that in this respect it had a wider reach than curatorship that applied to the individual troubled bank only.

The effect of the administration mechanism was similar to curatorship in the sense that it vested the administrator with the control and management of the troubled bank and gave the administrator all the powers that a curator would have under section 55 of the Banking Act. However administration as contemplated in the TFIR Act was more invasive than curatorship as the administrator was given a number of extra powers which included carrying on or discontinuing any part of the troubled bank's business; raising money in any way; and agreeing to offers of composition. Administration was also more invasive than curatorship in that it automatically nullified every disposition of the failing bank's property and nullified every transfer of shares or alteration in the status of the failing bank's members made after the commencement of the administration process. It further suspended the operation of set-off by the bank's creditors. Like curatorship it placed a moratorium on enforcement of claims by the bank's creditors but went even further to specifically vacate attachment or execution of the bank's assets that occurred after administration commenced. Further measures contemplated during administration that were not provided for under the curatorship process entailed suspension of liens over the property of the troubled bank and entering of a caveat that would prevent transfer of immovable property belonging to the bank or cancellation or cession of any bond - thus a type of a more extensive "freezing" than the freezing of deposits and investments contemplated by the curatorship process.

The objective of administration as envisaged under the TFIR Act was also more extensive than the objective of curatorship that was focused on the protection of depositors and creditors whilst the curator figured out what to do next about the failing

bank. Specifically the administration procedure under the TFIR Act was intended to safeguard the interests of depositors, creditors and in the latter regard specifically also *shareholders* of the failing bank - which was to be done either by restoring the bank's financial health or, if not possible, to provide for "modes of resolution" that would also aim to safeguard the interest of depositors, creditors and shareholders of the bank concerned. Thus administration contemplated saving the troubled bank as a first goal whilst also more broadly contemplating effective resolution of the troubled bank where its rescue was not possible.

The TFIR Act accordingly provided a further framework for dealing with a troubled bank if the bank's health could not be restored which entailed implementing the following further measures (apparently on their own or in combination): reconstruction of the troubled bank for purposes of securing the registration of a successor institution; amalgamating (merging) the troubled bank or any part of its banking business with other troubled financial institutions and securing registration of a "successor financial institution"; transferring all or parts of the banking or other business of the troubled bank to any other financial institution together with all or part of the assets or liabilities of the troubled bank that remained after the administration process and finally, if none of the aforesaid options were feasible, then liquidating the troubled institution. It thus appears that the TFIR Act envisaged an approach whereby attempts would first be made to "resuscitate" the failing bank and restore its economic viability and, failing such likelihood, to preserve those parts that could still be vital and viable and assimilate them into the financial system in a different entity; and finally allowing the "unrescuable" parts of the bank to exit the financial system through liquidation.

In particular the TFIR Act afforded the administrator numerous intrusive powers in the context of formulating and implementing a scheme of resolution for a troubled banks that *inter alia* entailed issuing of shares and conversion of shares in the troubled bank; registering a successor financial institution; amending the bank's memorandum of incorporation; redistributing its assets and liabilities; replacing its board of directors and merging two or more troubled banks. A drawback was however the many time-consuming procedural layers introduced into the process as the proposal for the scheme of resolution of the troubled bank had to go through an extensive approval process, first by the bank's creditors and thereupon by the RBZ. A further drawback that could create delay in the process of dealing effectively with a troubled bank was

that the final scheme of arrangement could be taken on review by creditors of the troubled bank. It can also be argued that some of the powers to be applied during resolution such as removal of the troubled bank's board of directors should have occurred at a much earlier stage as an early intervention method that could have prevented the bank from encountering failure. A significant drawback is that there is a dearth of authority on the application of the TFIR Act and the extent to which it was implemented in Zimbabwe. The "demise" of the TFIR Act however appears to have been caused by misuse of the Troubled Banks Fund and not as a result of specific features of the quite elaborate resolution framework introduced by the Act itself, which presented an augmented toolkit to deal with bank failure compared to the curatorship process.

The Banking Amendment Act, 2015 was subsequently introduced to repeal the ill-fated TFIR Act and to overhaul the framework for regulation and supervision of banks including the introduction of a new resolution framework as captured in section 52A, 52B and 52C and the amendments to section 53 to 56 of the Banking Act. The Amendment Act sought to bring about improvement through widescale reforms which not only included the adoption of prudential standards on bank supervision but also included a holistic approach (albeit not as comprehensive and varied as the approach introduced by the TFIR Act) to deal with the problem of failing Zimbabwean banks. Various new prudential measures were introduced in an attempt to enhance the safety and soundness of banks at the front-end and by so doing, to minimize the incidence of bank failures. The Banking Amendment Act introduced the concept of a "problem banking institution", being a bank "whose capital adequacy, asset quality or liquidity or solvency is, or will be (in the opinion of the Registrar), significantly impaired unless there is a major improvement in its financial resources, risk profile, strategic business directive, risk management capabilities or quality of management." This definition thus underscored the fact that there are various factors that may compromise a bank's safety and soundness which need to be addressed in order to prevent bank failure.

The measures to address the challenge of "problem banking institutions" were addressed by the insertion of section 52A into Part IX of the Banking Act. Notably this provision sought to firstly avoid cancelling the registration (thus avoiding licence revocation) of a failing bank for the broader purpose of protecting and enhancing financial system stability and public confidence in the banking system and also to

protect depositors and public funds. Thus, in line with developments post-GFC, the public interest in the stability of the Zimbabwean financial system became the overriding factor that determined whether a bank would be put into resolution. Arguably this financial stability objective would also influence the point at which such resolution is triggered by the RBZ, as preserving the value of the failing bank through timeous resolution intervention would be a paramount consideration. In the resolution regime introduced by the Amendment Act the RBZ as resolution authority is entrusted with the power to formulate and implement a resolution plan. Unlike the protracted process envisaged by the TFIR Act the implementation of such resolution plan is not subject to passing various procedural hurdles for approval although the RBZ has to approach a court for confirmation of the problem bank notice which application may be opposed by shareholders and creditors. The resolution plan to be applied by the RBZ may encompass a suite of typical resolution powers (apparently alone or in combination), namely: merging of the problem bank with another bank; acquisition of the problem bank by another bank; transfer of assets and liabilities to a third party; using a bridge bank to acquire all or part of the assets and liabilities of the problem bank; and finally, if all else fails - liquidation of the problem bank. These resolution powers introduced by the Banking Amendment Act are topped up with a type of general "catch all"-provision permitting "the taking of any action necessary to give effect to the plan of resolution, including the sale or closure of any branch, agency, or other office of the problem banking institution and, subject to any other law, the dismissal of any of its officers and employees."

The opportunity for a problem bank to make "representations" once the RBZ decides to declare it as a problem bank (subject to subsequent court confirmation) is however perpetuated in the resolution regime introduced by the Banking Amendment Act. Albeit that the exact nature of such representations are not specified it can be surmised that these representations would most likely relate to reasons why the bank should not be placed in resolution. The amendments introduced by the Banking Amendment Act, 2015 further requires the RBZ to observe property rights through notification requirements and payment of compensation. However, acquisitions as part of a resolution plan could be contested in court which may arguably add a further procedural layer of delay to the resolution process in respect of a failing bank. Interestingly the RBZ is also required to ensure that "so far as practicable, any person

who acquires assets of the problem banking institution acquires an equivalent value of its liabilities" which may conceivably deter prospective purchasers from acquiring assets of problem banks and may impede the effectiveness and speed with which resolution is administered.

The Banking Amendment Act, 2015 has now clearly incorporated curatorship as *one of the measures* that can be applied within the broader framework of bank resolution introduced by the Act. In particular, a curator can be appointed by the RBZ for the broader purpose of attending to the implementation of a bank resolution plan. It has also extended the meaning of "curator" to cover independent contractors who are employed to act as curators or the RBZ itself acting through an employee or an asset management company established in terms of the Reserve Bank Act. The rights of shareholders are curtailed to the extent set out in the resolution plan and where curatorship is selected as resolution measure the curatorship process is fast-tracked by providing for the curator to take a decision within 90 days on the restructuring, reorganization or winding up of the failing bank or determining an alternative resolution plan. An absolute moratorium on court action by the failing bank's creditors apply for a period of 90 days after the bank has been put into resolution.

From the aforesaid it thus appears that the curatorship process in section 53 of the Banking Act is not only amended to the limited extent as indicated in section 30, 31 and 32 of the Banking Amendment Act, 2015 but also by the provisions introduced by the new section 52C as pointed out above. Thus, whereas curatorship functioned as a singular "rescue" mechanism with a narrow focus and limited toolkit prior to the amendments introduced by the Banking Amendment Act it has now been assimilated as one of the resolution measures available in the broader resolution regime for failing banks in Zimbabwe. The curator is now tasked more broadly with implementing a resolution plan which may include measures other than measures narrowly focused on saving the problem bank but rather aimed at facilitating its orderly resolution, which may or may not, include rescue measures to preserve certain parts or critical functions of the failing bank.

Chapter Four: The United Kingdom's approach to dealing with bank failure and bank rescue

4.1 Chapter Overview

This chapter will provide an overview of the evolution in the UK's approach to dealing with bank failure and the rescue of failing banks or parts of their business. To contextualize the discussions in this chapter, background will first be provided regarding the UK's approach to aspects of bank regulation that are relevant to bank failure and regulatory developments that impacted the approach by UK regulators when dealing with failing banks. Thereupon the administration process under the Insolvency Act 1986, as a generic approach to dealing with failure of companies (and not banks specifically) that was initially applied in the absence of a framework dedicated to dealing with bank failure, will be discussed. This will be followed by a discussion of the Northern Rock Crisis as the catalyst for change in the UK's approach to dealing with failing banks. Subsequent to dealing with the impact of the Northern Rock failure on the UK's approach to dealing with failing banks, the provisions of the Banking (Special Provisions) Act 2008, the Banking Act 2009, the European Bank Recovery and Resolution Directive ("BRRD 2014") that had to be transposed by the UK as (then) EU Member State and the subsequent amendments to the special resolution regime in the 2009 Banking Act will be interrogated to inform the conclusions on the UK position dealt with in this chapter.

As indicated in Chapter One the features of a resolution framework pertaining to cross –border cooperation, crisis management; cooperation agreements and information sharing captured in FSB Key Attributes 7, 8, 9 and 12 fall beyond the scope of this thesis.[459]

4.2 Introduction

The United Kingdom ("UK") has over the years featured very prominently in the international history of banking and the UK's central bank, the Bank of England ("BoE"), which was established in 1649, is arguably the most famous central bank in the world.[460] The Bank of England's mission is to promote the good of the people of the United Kingdom by maintaining monetary and financial stability.[461] The BoE was nationalized in 1946 and, although it is owned by the UK government, it has operational independence.[462]

Interestingly though, despite its prominence over the centuries as an international banking and financial hub, the UK's approach to bank regulation and supervision was never formally captured in any legislation but was, until quite late in the twentieth century, administered informally by the BoE. It seemed to be an arrangement that worked relatively well as England had very few bank failures since inception of the BoE as central bank.[463] The Banking Act 1979 was the first UK Act to put banking regulation

[459] Chapter 1 para 1.8.

[460] Schooner and Taylor "Convergence and Competition: The Case of Bank Regulation in Britain and the United States"(1999) *Michigan Journal of International Law* 606: In 1694 the BOE was established as a commercial bank enjoying an extensive range of governmentally conferred privileges. In particular it was alone among banks in being permitted to raise capital from a large body of investors. All other banks in England and Wales were forced to adopt the partnership form and were limited. At 609 Schooner and Taylor point out that the "Nineteenth Century also saw the transformation of the BoE from the dominant commercial bank to an institution that, while remaining privately owned, began to discharge some of the recognizable functions of a central bank. The BoE became the custodian of the banking system's reserves of coin and bullion against its note and deposit liabilities. The existence of this large reserve meant that the BoE was able to act as the liquidity supplier of cash to the financial system in times of liquidity shortage. The BoE gradually began to take on the role of lender of last resort without making an explicit commitment to accept this responsibility. While the BoE's willingness to provide support to institutions was not unqualified, by 1873, the BoE's role as lender of last resort during liquidity crises was entrenched." See also Davies, Richardson, Katinaite, Manning "Evolution of the UK Banking System" 2010 *Bank of England Quarterly Bulletin* 321.

[461] The Bank of England available at https://www.bankofengland.co.uk/ (accessed 16 August 2018).

[462] For a discussion of the operational independence of the BoE see Evemy "The Bank of England, operational independence and the financial crisis" 2018 *British Politics* 347.

[463] Logan "The United Kingdom's small bank crisis of the early 1990s: what were the leading indicators of failure?" (2001) Bank of England Working Paper No.139 available at https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2001/the-uks-small-banks-crisis-

on a statutory footing. Before 1979 there was no formal regulation of the banking sector.[464] The Secondary Banking Crisis of 1973-74[465] however spurred the development of statute-based bank regulation in England. This Crisis also resulted in some immediate and significant changes in the BoE's methods of supervision.[466] Schooner and Taylor remark that the BoE inherited statute–based regulation as captured in the 1979 Banking Act was a natural extension of the BoE's traditional role. Notably however, the 1979 Banking Act made no attempt to lay down detailed and rigid capital and liquidity requirements, thus enabling the BoE to apply the flexible, case-by-case approach it had followed since the days of supervision by the Discount Office.[467]

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of-the-early 1990s.pdf?la=en&hash=0EBB6BF99F442D91E41662494702F8F4281BF3C5 accessed 22 June 2020 9 remarks that "bank failure has fortunately been a rare event in the United Kingdom." He points out that "even more infrequent has been the simultaneous failure of a number of banks that potentially threatens the stability of the financial system." See also Schooner "Bank Insolvency Regimes in the United States and the United Kingdom" 2005 *Transnational Lawyer* 391.

[464] McConnachie "A History of Banking Regulation in the UK" 2009 *Prosperity* available at http://prosperityuk.com/2009/07/a-history-of-banking-regulation-in-the-uk/ accessed 22 June 2020; Rawlings, Georgosouli and Russo "Regulation of financial services: aims and methods" 2014 available at https://www.qmul.ac.uk/ccls/media/ccls/docs/research/020-Report.pdf accessed 22 June 2020.

[465] The Secondary Banking Crisis of 1973-74 involved the dramatic failure of a number of smaller, secondary banks in the UK fooling a property boom that went bust. For more detail see BoE, *The secondary banking crisis and the Bank of England's support operations* 1978 available at https://www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/1978/the-second-banking-crisis-and-the-boes-support-operations.pdf?la=en&hash=E0C5BA38A93C3EB25B1598E27EC2B85E8917499F accessed 22 June 2020. Schenk "Summer in the City: Banking Failures of 1974 and the Development of International Banking Supervision" 2014 *The English Historical Review* 1129.

[466] Schooner and Taylor "Convergence and Competition: The Case of Bank Regulation in Britain and the United States"(1999) *Michigan Journal of International Law* 625. Schooner and Taylor at 629 indicate that the BOE's informal system of banking supervision, which had matured during the 1930s and continued with only modest change during the immediate post-war period, could not survive the Secondary Banking Crisis. The fall-out from the Secondary Banking Crisis made legislation inevitable despite the BOE's preference for the *status quo*. Schooner and Taylor point out that the Secondary Banking Crisis highlighted four major deficiencies in the informal system of regulation conducted by the BOE *inter alia* that considerable public confusion existed regarding the status of bank recognitions; many depository institutions were completely unsupervised; no formal arrangements depositor protection arrangements in the vent of bank failure existed. Finally, even where the BOE did play a supervisory role, its efforts were not wholly effective.

[467] Schooner and Taylor "Convergence and Competition: The Case of Bank Regulation in Britain and the United States" (1999) *Michigan Journal of International Law* 631. See also Hennessy, *A domestic history of the Bank of England, 1930 – 1960*, (1992) 232. It is stated that the role of the Discount Office was to maintain the day-to day contact between the Bank and the money market and with the City's financial community as a whole, and to keep the Governors and the Chief Cashier informed of events, personalities and developments of interest to the Bank. It was also the most important of the various channels by which guidance was given to the commercial banks about the detailed implementation of credit restrictions. The Office acted as "lender of last resort" when the discount houses found themselves short of cash and the Bank was unwilling to relieve the shortage by means of the purchase of Treasury, commercial or local authority Bills. A further function was seeking of bankers' references on behalf of customers of the Bank; it also provided references in answer to enquiries about banks with accounts in the Drawing Office. See also Sayers, *The Bank of England 1891-1944: Volume 1*, (1976) 272. Sayers points out that "Traditionally it was through the Discount

The principal criteria for licensing in terms of the 1979 Banking Act was that a bank had to have "for a reasonable period of time enjoyed, a high reputation and standing in the financial community".[468]

The Banking Act of 1987 subsequently tightened the BoE's regulatory control. The impetus for the 1987 Banking Act was the crisis in Johnson Matthey Bank ("JMB") in 1984 which exposed deficiencies in the 1979 Banking Act.[469] McConnachie points out that while the BoE took over the running of JMB under the authorization of the (then) Chancellor of the Exchequer,[470] the BoE did so with the intention of "running it down carefully" and not in an attempt to keep it going as a viable business.[471]

Office that the Bank expected to sense the need for action, and through the Discount Office that most of its decisions impinged on the outside world."

[468] Banking Act 1979, sch.2, Pt I, para 1(1). See Rawlings, Georgosouli and Russo "Regulation of financial services: aims and methods" 2014 available at https://www.qmul.ac.uk/ccls/media/ccls/docs/research/020-Report.pdf accessed 22 June 2020 12.

[469] Schooner and Taylor "Convergence and Competition: The Case of Bank Regulation in Britain and the United States" (1999) *Michigan Journal of International Law* 632-633 remark that the first major challenge to the BoE's traditional style of supervision was the rescue of Johnson Matthey Bankers (JMB), a subsidiary of Johnson Matthey gold refiners, which was one of the five London gold-dealing banks at the time. It was a recognized bank under the 1979 Act. As an institution of "high reputation and standing" it was subject to little supervision. JMB's problems arose when it grafted a rapidly growing lending business onto its gold-dealing activities. In the four years prior to September 1984, JMB's loan portfolio grew from 34 million pounds to 450 million pounds, with one third of the increase occurring in the last six months of the period. JMB's lending was also highly concentrated, with two customers borrowing sums amounting to 65% and 34% of the bank's capital respectively. On 25 September 1984 JMB's accountants recommended additional loan loss provisions that would have virtually wiped out JMB's capital. The BOE did not detect JMB's imprudent lending practices until too late. There were various reasons for this but most importantly the BoEs trust in recognized banks. Although JMB was not a significant bank and might have been allowed to fail, the BoE did not wish to risk serious instability in the gold market given JMB's dealings with other gold banks. Thus the BoE purchased JMB for 1 pound after its parent company, Johnson Matthey, agreed to inject 50 million pounds of capital. The BoE installed new management under the chairmanship of one of its own directors, and the new managers immediately increased the loan loss provisions by 254 million pounds. See also Rawlings, Georgosouli and Russo 12-13.

[470] The Chancellor of the Exchequer is the UK government's chief financial minister and one of the most senior members of cabinet. He is responsible for raising revenue through taxation or borrowing and for controlling public spending. He has overall responsibility for the work of the HM Treasury. His responsibilities cover fiscal policy including presenting of the annual budget, monetary policy, setting inflation targets and ministerial arrangements in his role as Second Lord of Treasury. The current role holder is Rishi Sunak who was appointed Chancellor of the Exchequer on 13 February 2020. See Chancellor of the Exchequer available at https://www.gov.uk/government/ministers/chancellor-of-the-exchequer accessed 22 February 2020. See also Chancellor of the exchequer available at https://dictionary.cambridge.org/dictionary/english/chancellor-of-the-exchequer accessed 22 February 2020.

[471] McConnachie "A History of Banking Regulation in the UK" 2009 *Prosperity* available at http://prosperityuk.com/2009/07/a-history-of-banking-regulation-in-the-uk/ accessed 22 June 2020 11.

Subsequent to the JMB-incident the Leigh-Pemberton Committee[472] was established whose recommendations were subsequently incorporated in the Banking Act of 1987. The Committee's most important recommendation was to abolish the then prevailing two tier banking system and to replace it with a single category of "authorized institution" subject to certain statutory criteria subsequently incorporated in Schedule 3 to the Banking Act. These criteria included *inter alia* that directors should be fit and proper, that the board of directors of a bank should consist of an appropriate number of non-executives, and that a bank's business must be governed with "integrity and skill" and in a "prudent manner."[473] The 1987 Banking Act increased the BoE's supervisory role significantly, including the power to vet shareholders of UK banks. There was an absolute prohibition on the acceptance of deposits by a person in the course of carrying on a deposit-taking business, unless that person was an "authorized institution" as per section 67(2) of the Act. Authorization could be restricted or revoked, and the BoE had the power to undertake investigations into the affairs of authorized institutions. The 1987 Act also established a Deposit Protection Scheme (subsequently replaced by the Financial Services Compensation Scheme ("FSCS")[474] in 2001).[475]

[472] Schooner and Taylor "Convergence and Competition: The Case of Bank Regulation in Britain and the United States" (1999) *Michigan Journal of International Law* 634. See also Talani, *Globalization, Hegemony and the Future of the City of London* (2012), 58. The Leigh-Pemberton Committee was announced to parliament by Chancellor Lawson on 17 December 1984. The purpose of the committee was to look into the UK system of bank supervision and make recommendations. This committee, however, was to be chaired by the governor of the Bank of England, Leigh-Pemberton, and composed of various members, including leading representatives from the City, such as the distinguished commercial banker Deryk Vander Weyer, former deputy chairman of Barclays Bank and one of the outstanding commercial bankers of his generation.

[473] *Ibid*.

[474] The FSCS is the statutory compensation fund of last resort for customers of authorized financial services firms (i.e. those regulated by the FCA and the PRA). The FSCS is independent of the UK government and the financial services sector, and was established under the Financial Services and Markets Act 2000, becoming operational on 1 December 2001 (although claims from before this date are also eligible to be considered for compensation). The rules governing the purpose and operation of the FSCS are set out in the Financial Services Handbook but broadly, the FSCS will pay if a firm is unable or likely to be unable, to pay claims against it. The FSCS aims to pay compensation within seven days of a bank, building society or credit union failing. In any event the rules require that a claim relating to a protected deposit payment be normally made within 20 working days. Deposits made by private individuals and small businesses to any authorized firms (referred to as retail deposits) are protected by the FSCS. The rules make it clear that the FSCS will only pay claims if unable to meet claims against it because of its financial circumstances. If a firm is still trading and has sufficient financial resources to satisfy a claim, the FSCS is unlikely to consider the claim as being eligible for compensation.

[475] McConnachie "A History of Banking Regulation in the UK" 2009 *Prosperity* available at http://prosperityuk.com/2009/07/a-history-of-banking-regulation-in-the-uk/ accessed 22 June 2020 11.

Between the Banking Act of 1987 and the subsequent adoption of the Bank of England Act of 1998 two major banking scandals however occurred: In 1991 the Bank of Credit and Commerce International ("BCCI") collapsed due to fraud perpetrated by senior staff.[476] This led to the Bingham Commission of Inquiry[477] in October 1992 that made recommendations in three broad areas: addressing opaque financial structures; detection and prevention of fraud and improvement of information flows to supervisors. The Bingham Report stated with regards to the BCCI failure that: "the most important single lesson of this debacle is that banking group structures which deny supervisors a clear view of how business is conducted should be outlawed." Accordingly the Commission recommended that the BoE should be given express power to refuse or revoke authorization of banks in instances where the opaque structure of the group to which a bank belonged had the practical effect that proper supervision would be impossible.[478]

The second scandal occurred with the near collapse of Barings Bank in 1995: In this instance the BoE allowed a company, Barings Securities, to be conducted as a regulated subsidiary of Barings Bank UK. On a practical level this led to an unrestricted flow of money from Barings Bank to Barings Securities, which money was used to fund the trading of derivatives by Nick Leeson, a trader for Barings Singapore. Leeson's

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[476] Logan "The United Kingdom's small bank crisis of the early 1990s: what were the leading indicators of failure?" (2001) Bank of England Working Paper No.139 available at https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2001/the-uks-small-banks-crisis-of-the-early 1990s.pdf?la=en&hash=0EBB6BF99F442D91E41662494702F8F4281BF3C5 accessed 22 June 2020 10 indicates that the announcement of BCCI's closure on 5 July 1991 rapidly accelerated the withdrawal of wholesale funds from small and medium-sized UK banks. Within three years, 25% of the banks in this section of the banking sector had, in a sense, failed. See also Rawlings, Georgosouli and Russo "Regulation of financial services: aims and methods" 2014 available at https://www.qmul.ac.uk/ccls/media/ccls/docs/research/020-Report.pdf accessed 22 June 2020 15.

[477] The closure of BCCI by supervisory action on 5 July 1991 provoked widespread public concern. The financial community and the press criticised the United Kingdom authorities (above all the Bank of England) for not taking this action long before. Others, particularly depositors, employees and shareholders, criticised the closure as precipitate and unjustified. It was against this background of public concern that the establishment of the Inquiry into the Supervision of the Bank of Credit and Commerce International was announced on 19 July 1991. The terms of references of the inquiry are "To enquire into supervision of BCCI under the Banking Acts, to consider whether the action taken by all the UK authorities was appropriate and timely; and to make recommendations" See Bingham Inquiry, Right Honourable Lord Justice Bingham, Return to an Address of the Honourable the House of Commons 22 October 1992, Inquiry Into The Supervision of the Bank of Credit and Commerce International (1992) available at https://archive.org/details/InquiryIntoTheSupervisionOfTheBankOfCreditAndCommerceInternational accessed 22 June 2020 (iii).

[478] *Ibid* 181. See also McConnachie "A History of Banking Regulation in the UK" 2009 *Prosperity* available at http://prosperityuk.com/2009/07/a-history-of-banking-regulation-in-the-uk/ accessed 22 June 2020 12.

irresponsible trading on the futures market resulted in debts of approximately 287 million British Pounds. McConacchie however points out that, despite these losses, action by regulators and other banks meant that Barings' derivative positions on the exchanges in Singapore and Japan were closed with no apparent losses to other parties. Depositors' interests were protected through the sale of most of the assets and liabilities of the Barings Group. Barings Bank survived this crisis and depositors were able to retrieve their deposits. On 27 February 1995 the Chancellor of the Exchequer announced that the Board of Banking Supervision of the BoE would conduct an investigation into the events leading to the collapse of Barings.[479] The formal terms of reference of the inquiry were later agreed to be: "To establish in detail the events that led to the collapse of Barings; to identify the lessons to be drawn, for institutions, for the Bank's own regulatory and supervisory arrangements, and for the UK system of regulation more generally; and to report to the Chancellor of the Exchequer".[480] The main conclusions of the report were that the losses suffered during the Barings-scandal were a result of unauthorized and concealed trading activities within Barings Singapore; that there was serious failure of control and managerial confusion within Barings Bank; and Leeson's trading activities and the lack of control and management by Barings Bank had not been detected timeously by the bank's external auditors or the BoE.[481]

Subsequent to these two banking scandals the Bank of England Act of 1998 was adopted. This Act granted the power to the BoE to determine monetary policy and had two objectives, namely: to give the BoE operational responsibility for setting interest rates to meet the Government's inflation targets;[482] and to transfer responsibility for the supervision of deposit-taking institutions from the BoE to the Financial Services

[479] Return to an order of the Honourable the House of Commons dated 18 July 1995 for the *Report of the Board of Banking Supervision Inquiry into the circumstances of the collapse of Barings*, London: HMSO, 1995 available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/235622/0673.pdf accessed 22 June 2020.
[480] *Ibid* para 1.2.
[481] *Ibid* para 13.4. McConnachie "A History of Banking Regulation in the UK" 2009 *Prosperity* available at http://prosperityuk.com/2009/07/a-history-of-banking-regulation-in-the-uk/ accessed 22 June 2020 13. Rawlings, Georgosouli and Russo "Regulation of financial services: aims and methods" 2014 available at https://www.qmul.ac.uk/ccls/media/ccls/docs/research/020-Report.pdf accessed 22 June 2020 16.
[482] Section 13 of the Bank of England Act of 1998.

Authority ("FSA").[483] Shortly thereafter, the Financial Services Authority ("FSA") was established under the Financial Services and Markets Act 2000, as single mega-regulator that was responsible for both prudential and market conduct regulation and supervision of the British financial system. Prudential regulation and supervision of banks was thus removed from the remit of the BoE under this regulatory model. HM Treasury (the Treasury), the BoE and the FSA consequently constituted the "tripartite authorities" that was responsible for regulation of the financial system in Britain prior to the GFC.[484] McConnachie points out that aspects of bank supervision such as "regulating the acceptance of deposits in the course of a deposit taking business, the Deposit Protection Scheme, banking names and descriptions, overseas institutions with representative offices, and the gathering and disclosure of information" continued to be governed by the Banking Act 1987.

The peculiar approach to banking regulation and supervision in the UK, coupled with the fact that bank failures were not rife and were generally dealt with ad hoc by the BoE led thereto that there was never any dedicated legislative framework for dealing specifically with failing banks in the UK. In particular there was no dedicated procedure for dealing with the rescue of a failing bank or parts of a failing bank and if a bank encountered trouble it either was placed under the normal administration procedure provided for in the Insolvency Act 1986, or if it was beyond being revived to viability, the bank was liquidated. The UK thus did not have a specific procedure in its banking legislation to deal with failing banks per se and that provided a mechanism for bank rescue such as the process for curatorship that was a part of the banking legislation in Zimbabwe and South Africa, as discussed in Chapter Three and Five of this thesis respectively. However the spectacular collapse of Northern Rock in 2007 was a watershed event that caused the UK to seriously consider their rather informal approach to dealing with failing banks. On top of the Northern Rock incident came the

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[483] Section 21 of the Bank of England Act of 1998. McConnachie "A History of Banking Regulation in the UK" 2009 *Prosperity* available at http://prosperityuk.com/2009/07/a-history-of-banking-regulation-in-the-uk/ accessed 22 June 2020 13.

[484] For more detail on the regulatory dispensation introduced by the Financial Services and Markets Act 2000 see Norton "Global financial sector reform: the single financial regulator model based on the United Kingdom FSA experience – a critical evaluation" 2005 *The International Lawyer* 15; Taylor "The road from twin peaks – and the way back" 2009 *Connecticut Insurance Law Journal* 61; Ferran "The break-up of the Financial Services Authority" 2011 *Oxford Journal of Legal Studies* 455; Briault "Revisiting the rationale for a single national financial services regulator" 2002 *FSA Occasional Papers* 1.

2008 Global Financial Crisis which, as indicated in the Turner Review,[485] affected the UK's financial system severely due to its global interconnections[486] and which thus also acted as a catalyst for change in the approach to dealing with bank failures in the UK.

In order to appreciate the considerable extent of the changes that were introduced in the recent past in the context of the regulatory approach to bank failures in the UK it is consequently necessary to briefly consider the process of "general or normal" administration that were initially applied to banks under the Insolvency Act. The purpose of such discussion will not be to serve as a treatise for dissecting this process in great depths from an insolvency law perspective but rather to illuminate the objectives of the process and the toolkit that was at the time available to the administrator to apply for purposes of saving a failing bank.

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[485] The Chairperson of the FSA, Adair Turner was instructed to compile a review on the impact of the GFC on the UK which was subsequently released as The Financial Services Authority, *The Turner Review: A regulatory response to the global banking crisis*, March 2009 available at http://www.actuaries.org/CTTEES_TFRISKCRISIS/Documents/turner_review.pdf accessed 7 June 2020. Turner indicated (at 29) that, as a leading centre for trading activity by UK and foreign owned banks, which underpinned the securitized credit model, and as the home jurisdiction of several leading global banks, it was inevitable that the UK would be affected by the developments that led to the 2008 GFC. US mutual funds and structured investment vehicles (SIVs) were very significant buyers of UK securitized credit with the result that when they stopped buying a large source of funding for UK credit extension disappeared. In addition several of the UK's largest banks were major players in the "acquire and arbitrage"-model of credit intermediation in the UK, US and other international operations. As pointed out by Turner "UK bank leverages increased significantly as trading books expanded: in those trading books, UK banks, like US commercial and investment banks, were on average placing increased reliance on 'liquidity through marketability' and they were deeply involved in the growing and intricate web of intra-financial system assets and liabilities. They were therefore as exposed as US banks and investment banks to loss of confidence, disappearance of liquidity, and fall of asset prices which gathered pace from summer 2007 but which became catastrophic after the collapse of Lehman Brothers in September 2008." In addition Turner also emphasized that "the UK experienced a credit and property cycle similar to that seen in the US during the lead-up to the GFC, but with some specific features which played a crucial role in determining the particular form that the Crisis took in the UK. Turner observes that in the UK, as in the US, the decade running up to 2007 was a period for rapid credit growth in the household sector. Total mortgage debt to GDP increased from 50% to over 80% and an increasing supply of mortgages was available at very high initial loan-to-value ratios as borrowers and lenders assumed that debt burdens were likely to fall with continuous property price appreciation which delivered large increases in the value of household assets." Turner remarks that, though not to the same extent as the US subprime market, mortgage credit in the UK was extended to social categories which would not previously have enjoyed access to mortgage funding and consequently "the buy-to-let sector grew from trivial to significant proportions."

[486] In September and October 2008 several UK banks such as Bradford and Bingley, Royal Bank of Scotland and HBOS, the largest UK mortgage lender, almost collapsed. See also Chambers "Banking on reform in 2010: is regulatory change ever enough and will the general election hold the answers for the financial services industry" 2010 *The Law Teacher* 220 and MacNeil "The trajectory of regulatory reform in the UK in the wake of the financial crisis" 2010 *European Business Organization Law Review* 483.

4.3 Administration under the Insolvency Act 1986

4.3.1 The administration procedure as originally enacted in the Insolvency Act1986

Part II of the Insolvency Act 1986 introduced the mechanism of administration orders into UK insolvency law.[487] It described an administration order as an order directing that, during the period that the administration order is in force, the affairs, business and property of a company that is subject to such order shall be managed by an administrator appointed for such purpose by the court.[488] In terms of section 8 of the Insolvency Act a court, if satisfied that a company was, or was likely to become, unable to pay its debts,[489] had a discretion to make an administration order in respect of that

[487] Insolvency Act 1986, Chapter 45, Part II. The 1986 Act was largely based on recommendations of the Review Committee on Insolvency Law chaired by Sir Kenneth Cork. The Cork Report was published in 1982. See Fletcher "UK Corporate Rescue: Recent Developments – Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements – the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002" (2004) *European Business Organization Law Review* 119. See also Conway "Insolvency: company administration" Briefing Paper Number 4915, 11 December 2019, *House of Commons Library* available at https://commonslibrary.parliament.uk/research-briefings/sn04915/ accessed 17 June 2020 remarks (at 3) that "at its heart, administration is a company rescue procedure". She states (on 5) that "[A]dministration is an insolvency process; a company rescue procedure. For a viable company in financial difficulty , administration can create a breathing space in which to restructure and rescue the company so that it can continue trading as a going concern." The administration procedure is designed to hold a business together pending the formulation of plans to put in place a financial restructuring for purposes of rescuing the company. Rhim A "Reorganization Schemes Under U.K. Insolvency Act of 1986: Chapter 11 as a Springboard for Discussion" 1994 *Loy. L.A. Int'l & Comp. L.J.* at 991 remarks that the administration procedure "allows a company to maintain its liquid assets, thereby protecting shareholder and employee interests." See further Prentice, Oditah, Segal "Administration: the Insolvency Act 1986, Part 11" 1994 *L.M.C.L.Q* 487; McCormack "Control and Corporate Rescue – An Anglo-American Evaluation" 2007 *International and Comparative Law Quarterly* 515; Yang, Li "The History of Corporate Rescue in the UK" 2012 *Asian Social Science* 21.

[488] Section 8(2) of the Insolvency Act 1986.

[489] In terms of section 123 of the Insolvency Act 1986 a company is unable to meets it debts if: "(a) if a creditor (by assignment or otherwise) to whom the company is indebted in a sum exceeding £ 750 then due has served on the company, by leaving it at the company's registered office, a written demand (in the prescribed form) requiring the company to pay the sum so due and the company has for 3 weeks thereafter neglected to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor; or (b) if, in England and Wales, execution or other process issued on a judgment, decree or order of any court in favour of any creditor of the company is returned unsatisfied in whole or in part; or (c) if in Scotland, the induciae of a charge for payment of an extract decree, or an extract registered bond, or an extract registered protest, have expired without payment being made, or (d) if, in Northern Ireland, a certificate of enforceability has been granted in respect of a judgment against the company, or (e) if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due."

company if the court considered that the administration order was likely to achieve the following purpose:[490]

(a) the survival of the company, and the whole or any part of its undertaking, as a going concern;

(b) the approval of a voluntary arrangement under Part I of the Act;[491]

(c) the sanctioning under section 425 of the UK Companies Act[492] of a compromise or arrangement between the company and any persons mentioned in section 425 of the Companies Act;

(d) a more advantageous realization of the company's assets than would be effected if the company was wound up.

The person who wished to be appointed as an administrator had to be qualified as an insolvency practitioner. He was also an officer of the court and as such had a duty to act in good faith, and to be impartial and independent in managing the business of the

[490] Section 8(3) of the Insolvency Act 1986. See also Rhim "Reorganization Schemes Under U.K. Insolvency Act of 1986: Chapter 11 as a Springboard for Discussion" 1994 *Loy. L.A. Int'l & Comp. L.J.* 1001 to 1002.

[491] Part 1 of the Insolvency Act provides for company voluntary arrangements which entail that the directors of the company concerned (other than one for which an administration order is in force or that is being liquidated) may make a proposal to the company and its creditors for a composition in satisfaction of the company's debts or a scheme of arrangement of its affairs. See section 1 to 7 of the Insolvency Act 1986.

[492] Section 425 of the Companies Act 1985 deals with the powers of a company to compromise with creditors and members. Section 425(1) states that "where a compromise or arrangement is proposed between a company and its creditors, or any class of them, or between the company and its members, or any class of them, the court may on the application of the company or any creditor or member of it or, in the case of a company being wound up or an administration order being in force in relation to a company, of the liquidator or administrator, order a meeting of the creditors or class of creditors, or of the members of the company or class of members (as the case may be), to be summoned in such manner as the court directs." Section 425(2) states that, if a majority in number representing three-fourths in value of the creditors or class of creditors or members or class of members (as the case may be), present and voting either in person or by proxy at the meeting, agree to any compromise or arrangement, the compromise or arrangement, if sanctioned by the court, is binding on all creditors or the class of creditors or on the members or class of members (as the case may be), and also on the company or, in the case of a company in the course of being wound up, on the liquidator and contributories of the company. Section 425(3) provides that the court's order under subsection (2) has no effect until an office copy of it has been delivered to the registrar of companies for registration; and a copy of every such order shall be annexed to every copy of the company's memorandum issued after the order has been made or, in the case of a company not having a memorandum, of every copy so issued of the instrument constituting the company or defining its constitution. Section 425(4) states that if a company makes default in complying with subsection (3), the company and every officer of it who is in default is liable to a fine. In this section a "company" means any company liable to be wound up under the Companies Act 1985, and "arrangement" includes a reorganisation of the company's share capital by the consolidation of shares of different classes or by the division of shares into shares of different classes, or by both of those methods.

company and dealing with its property.[493] Notably the court could remove the administrator from office if he ceased to be qualified as an insolvency practitioner or upon discharge of the administration order.[494] As discussed below, section 27 of the Insolvency Act also provided for instances when shareholders or creditors of the company under administration could approach the court to deal with an administrator who failed to attend to their interests. The costs incurred during administration were generally paid from the company's assets.[495]

4.3.1.1 Effect of administration order

During the period commencing with the presentation of a petition for an administration order and ending with the granting of such order or the dismissal thereof, there was a moratorium[496] on resolutions or orders; as well as on enforcement against security held over assets of the company and legal proceedings and execution.[497] This moratorium applied also once an administration order was granted but subject to exceptions: during the period that an administration order was in force no resolution for winding up the company could be passed, and no winding up order could be made; no administrative receiver[498] could be appointed for the company; no other steps could be taken to enforce any security that was held over that company's property; no steps could be taken to repossess goods under a hire purchase agreement (except with the administrator's consent or leave by the court subject to such terms as the court may

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[493] Paragraph 5, Schedule B1, Insolvency Act 1986. See also Conway "Insolvency: company administration" Briefing Paper Number 4915, 11 December 2019, *House of Commons Library* available at https://commonslibrary.parliament.uk/research-briefings/sn04915/ accessed 17 June 2020 8.

[494] Section 19 of the Insolvency Act 1986.

[495] See also Conway "Insolvency: company administration" Briefing Paper Number 4915, 11 December 2019, *House of Commons Library* available at https://commonslibrary.parliament.uk/research-briefings/sn04915/ accessed 17 June 2020 8 – 9.

[496] Also referred to as a "protective cloak" by Conway "Insolvency: company administration" Briefing Paper Number 4915, 11 December 2019, *House of Commons Library* available at https://commonslibrary.parliament.uk/research-briefings/sn04915/ accessed 17 June 2020 1. Conway at 8 states that the moratorium is " intended to provide the company and the administrator with a 'breathing space, freeing them from creditor pressure, giving them time to formulate proposals, lay them before the creditors and implement those which are approved." See further Rhim A "Reorganization Schemes Under U.K. Insolvency Act of 1986: Chapter 11 as a Springboard for Discussion" 1994 *Loy. L.A. Int'l & Comp. L.J.* 985 who refers to this moratorium as "a breathing spell".

[497] Section 10(2) of the Insolvency Act 1986.

[498] Section 29(2) of the Insolvency Act 1986 states that "administrative receiver" "means a receiver or manager of the whole (or substantially the whole) of a company's property appointed by or on behalf of the holders of any debentures of the company secured by a charge which, as created, was a floating charge, or by such a charge and one or more other securities; or a person who would be such a receiver or manager but for the appointment of some other person as the receiver of part of the company's property."

impose); no other proceedings or execution or legal process could be instituted or continued; and no distress[499] could be levied against the company under administration or its property (unless with the administrator's consent of leave by the court, subject to such terms as the court may impose).[500]

4.3.1.2 Powers of the administrator

As observed by Fletcher, the administration order procedure implemented by Part II of the Insolvency Act 1986, involved the assumption of managerial control of the business and assets of the company by the administrator "but with a remit defined by the court in its order of appointment, thus imparting a wider collective purpose to the procedure."[501]

The administrator's general powers were set out in section 14 of the Insolvency Act which provided that the administrator may "do all such things as may be necessary for the management of the affairs, business and property of the company" and that he had the powers specified in Schedule 1 to the Insolvency Act.[502] According to Schedule 1 the administrator had the following powers:

(a) To take possession of and collect the property of the company and to take such proceedings for the aforesaid purpose as he deemed expedient;

(b) to sell or otherwise dispose of the companies' property by public auction or private contract;

(c) to raise or borrow money against security over the company's property;

(d) to appoint a solicitor or other professionally qualified person to assist the administrator in the execution of his functions;

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[499] Distress means seizure and detention of the goods of another as pledge or obtain satisfaction of a claim by the sale of the goods seized. See Definition of distress available at https://www.merriam-webster.com/dictionary/distress accessed 22 June 2020.

[500] Section 11(3) of the Insolvency Act 1986.

[501] Fletcher "UK Corporate Rescue: Recent Developments – Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements – the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002" (2004) *European Business Organization Law Review* 124.

[502] Section 14(1) of the Insolvency Act 1986.

(e) to bring or defend any action or other legal proceedings in the name and on behalf of the company;

(f) to use the company's seal;

(g) to do all acts and to execute any deed, receipt or document in the company's name and on behalf of the company;

(h) to draw, accept, make and endorse any bill or promissory note in the name of the company's or on the company's behalf;

(i) to appoint any agent to conduct any business that the administrator was unable to do himself or which could more conveniently be done by an agent;

(j) to employ and dismiss employees;

(k) to do anything necessary for the realization of the company's property;

(l) to make any payment necessary for, or incidental to, the performance of the administrator's functions;

(m) to carry on the functions of the business of the company;

(n) to transfer the whole or parts of the company's business to subsidiaries of the company;

(o) to grant or accept a surrender of a lease or tenancy of any of the company's property, and to enter into a lease or tenancy of any property that was required or convenient for the company's business;

(p) to enter into any arrangement or compromise on behalf of the company;

(q) to call up any uncalled capital of the company;

(r) to rank and claim in the bankruptcy, insolvency, sequestration or liquidation of any of the company's debtors and to accede to trust deeds for the creditors of any such debtor;

(s) to present or defend a petition for the winding up of the company;

(t) to effect a change of the company's registered address; and

(u) to "do all other things incidental to the exercise" of the aforementioned powers.

The administrator also had the power to:[503] remove any director of the company; fill any vacancy; and call meetings of shareholders or creditors. He could further apply to the court in terms of section 14(3) of the Insolvency Act for directions in relation to any particular matter that pertained to the execution of his functions. Notably any power conferred on the company or its officers in terms of the Insolvency Act, Companies Act or the companies' constituent documents, and which could be exercised in a manner that could interfere with the exercise of the administrator's powers would not be exercisable unless the administrator consented thereto.[504]

Section 15 dealt specifically with the administrator's powers in respect of charged property (that is, property over which security rights exist). It provided that the administrator may dispose of, or otherwise exercise his powers in relation to any of the company's property which was subject to a security right "as if the property were not subject to the security." Where, on application by the administrator, the court was satisfied that the disposal (with or without other assets) of the company's property that was subject to a security right to which section 15 applied, or any goods in relation to a hire purchase agreement that were in the company's possession, would be likely to promote one or more of the purposes of the administration order, the court could authorize the administrator to dispose of such property free from such encumbrance.[505]

4.3.1.3 Discharge or variation of administration order

The administrator could, in accordance with section 18(1) of the Insolvency Act, at any time apply to court for the discharge of the administration order or for variation thereof so as to specify an additional purpose. The Act required the administrator to make such

[503]Section 14(2)(a) and (b) of the Insolvency Act 1986.

[504]Section 14(4) Insolvency Act 1986. Section 14(5) stipulates that in exercising his powers the administrator is deemed the company's agent.

[505] As stated by section 15, Insolvency Act 1986: "as if it were not subject to the security or to dispose of the goods as if all rights of the owners under the hire purchase agreement were vested in the company." Where property is disposed under section 15 the security holder has the same priority in respect of any property of the company that directly or indirectly represents the property disposed of as he would have had in respect of the property that was subject to the security. It is further a condition of an order made in terms of section 15(2) that the security holder should be compensated from the proceeds of a disposal of the property – see section 15.

an application if it appeared to him that the purpose or each of the purposes of the administration order as specified in section 8(3) of the Insolvency Act had been achieved or was incapable of being achieved. Alternatively he had to bring such application on request by a meeting of the company's creditors.[506] At the hearing of such application the court could then discharge or vary the administration order and make such consequential provision as the court deemed fit or it could adjourn the hearing of the application conditionally or unconditionally or make an interim order or any other order that it deemed fit.

4.3.1.4 Duties of the administrator

Once an administration order was granted the administrator had to send notice thereof to the company; had to publish the order; and had to notify the company's creditors, the registrar of companies and certain other prescribed persons of the order.[507] The administrator also had to require a statement from the company that was placed under administration which *inter alia* had to include: particulars of the company's assets, debts and liabilities; the names and addresses of its creditors and the securities that they held as well as detail regarding those securities.[508]

The general duties of the administrator were set out in section 17 of the Insolvency Act which provided that the administrator, on his appointment, had to take into his custody or under his control all property to which the company was, or appeared to be, entitled. The administrator subsequently had to, in accordance with directions by the court, manage the affairs, business and property of the company at any time prior to the approval of his proposals under section 24 of the Insolvency Act. Once his proposals, as discussed below, were approved he had to manage the company's affairs, business and property in accordance with those proposals (as revised from time to time). He was further obliged to summons a meeting of creditors when requested to do so by one tenth in value of the company's creditors or on direction by the court.[509]

As regards the administrator's proposals, the position was that within three months from the date on which the administration order was granted (or such longer period as

[506] See section 26, Insolvency Act 1986 regarding the establishment of the creditors' committee.
[507] Section 21(1) and (2) Insolvency Act 1986.
[508] Section 22(1) and (2) Insolvency Act 1986. See section 22(3) for the list of persons that such statement may be required from.
[509] Section 17(3) Insolvency Act 1986.

allowed by the court) the administrator had to send a statement to all the company's creditors of his proposals for achieving the purpose or purposes specified in the administration order. He also thereafter had to present a copy of such statement of proposals to a meeting of the company's creditors. In addition, he was required to send a copy of the proposal to all shareholders of the company or arrange for its publication so that it could come to their notice.[510] The creditors were then required, at a creditors meeting convened for such purpose, to decide whether or not to approve the administrator's proposals. After the meeting, the administrator had to report back to the court. If the meeting of creditors declined to approve the administrator's proposals (with or without modifications) the court could discharge the administration order and make any consequential order that it deemed fit. Alternatively the court could adjourn the hearing unconditionally or conditionally or grant an interim order that it deemed fit.[511]

Where the administrator's proposals had been approved (with or without modifications) and he wanted to make revision of substantial proposals, he was required to notify the creditors thereof and convene another creditors meeting and table the revisions for approval.[512]

4.3.1.5 Protection of interests of shareholders and creditors

Section 27 of the Insolvency Act provided for the protection of the interests of the failing company's shareholders and creditors. At any time when an administration order was in force a shareholder or creditor of the company that was under administration could apply to court for an order that the company's affairs, business and property were being or had been managed by the administrator in a manner that was unfairly prejudicial to their general interests or to the interest of some of them; or that any actual or proposed act or omission by the administrator would prejudice them. The court could then grant such relief as it deemed fit. In particular the court could grant an order that: regulated the future management by the administrator of the company's affairs, business and property; required that the administrator refrain from doing or continuing with an act

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[510] Section 23(1) and (2) Insolvency Act 1986.
[511] Section 21(1) to (4) Insolvency Act 1986.
[512] Section 25(1) and (2) Insolvency Act 1986. In terms of section 25(4) the meeting of creditors "may approve the proposed revisions with modifications but shall not do so unless the administrator consents to each modification."

complained of or an act that he was alleged to have omitted; required the convening of a meeting of the company's shareholders or creditors in order to consider such matters as the court may direct; or discharged the administration order and made such consequential provision as the court deemed fit.[513]

4.3.2 The administration procedure as amended by the Enterprise Act 2002

Fletcher wryly remarks, *inter alia* about the administration procedure as introduced by Part II of the Insolvency Act 1986, that the "ink was scarcely dry on the legislative reform before many of the shortcomings related in the previous legislation began to manifest themselves." The Insolvency Act 2000[514] subsequently introduced a number of reforms to the company voluntary procedure provided for in Part 1 of the Insolvency Act. Seven months after the Insolvency Act of 2000 received Royal Assent a White paper titled *Productivity and Enterprise: Insolvency – A Second Chance*[515] was published. One of the proposals in the White Paper was that, in order to enable the administration procedure to function "as a fast-acting, effective and accessible vehicle for corporate rescue, it would be streamlined and made more accessible through the reduction of the formalities prescribed at the point of commencement."[516] Part 10 of the Enterprise Act 2002[517] which entered into operation on 15 September 2003 brought significant reform. Section 248 of the Enterprise Act replaced the original Part II of the Insolvency Act 1986 with a new Part II, of which substantive provisions pertaining to administration were all contained in a new and comprehensive schedule B1 to the Insolvency Act of 1986.

Schedule B1 significantly reshuffled, expanded and amended the provisions of the administration procedure over the course of 116 paragraphs many of which contain

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[513] Section 27(1) to (4) Insolvency Act 1986.

[514] Insolvency Act 2000 (Chapter 39). This Act was enacted on 30 November 2000 to amend the law about insolvency, to amend the Company Directors Disqualification Act 1986, and for connected purposes.

[515] Department of Trade and Industry: Productivity and Enterprise: Insolvency – A Second Chance available at https://webarchive.nationalarchives.gov.uk/+/http:/www.insolvency.gov.uk/cwp/cm5234.pdf accessed 22 June 2020.

[516] *Ibid* para 2.5 and 2.6. Fletcher "UK Corporate Rescue: Recent Developments – Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements – the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002" (2004) *European Business Organization Law Review* 129.

[517] Enterprise Act 2002 (Chapter 40).

extensive subparagraphs. Only substantial changes to the new "streamlined"[518] administration procedure relevant to this thesis, will be relayed here.[519]

Three routes (as opposed to the court being the only route previously) for obtaining an administrator's appointment were introduced, namely: by means of a court order in terms of paragraph 10; by the holder of a floating charge under paragraph 14 or by the company or its directors under paragraph 22 of Schedule B1.[520] The purpose of administration was recast in paragraph 3(1) of Schedule B1 which stated that the administrator must perform his functions with the objective of:[521]

"(a) rescuing the company as a going concern, or

(b) achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being put into administration), or

(c) realizing property to make a distribution to one or more secured or preferential creditors."

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518 Fletcher "UK Corporate Rescue: Recent Developments – Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements – the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002" (2004) *European Business Organization Law Review* 135.

519 Notably in paragraph 1 of Schedule B1 the following clarifications were introduced: "(a) a company is 'in administration' while the appointment of an administrator of the company has effect, (b) a company 'enters administration' when the appointment of an administrator takes effect, (c) a company ceases to be in administration when the appointment of an administrator of the company ceases to have effect in accordance with this Schedule, and (d) a company does not cease to be in administration merely because an administrator vacates office (by reason of resignation, death or otherwise) or is removed from office."

520 As observed by Fletcher "UK Corporate Rescue: Recent Developments – Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements – the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002" (2004) *European Business Organization Law Review* 136 "[O]f the new procedure itself, one may remark that it has a hybrid quality, in that it combines some features of the original, court-based process initiated by the making of an administration order, with a facility for certain parties to exercise a right of appointment directly. In effect, the latter route into administration draws its inspiration from the 'out of court" appointment of an administrative receiver, albeit with significant gradations as between different types of appointor."

521 See Fletcher "UK Corporate Rescue: Recent Developments – Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements – the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002" (2004) *European Business Organization Law Review* 135 to 136. He comments that the drafting of this provision necessarily reflects the fact that it must function in relation to those cases where the court is not involved in the process as well as cases where the procedure is begun by the court making an administration order. I his view the structure of this provision is complex and implies a hierarchy of purposes in terms whereof the primary objective is to rescue the company as a going concern.

The administrator was required, subject to sub-paragraph (4), to perform his functions in the interests of the company's creditors as a whole.[522] He had to perform his functions pertaining to the rescuing of the company as a going concern unless he was of the view that it was either not reasonably practical to achieve such rescue or that winding up of the company would achieve a better result for the creditors as a whole.[523] He was permitted to perform his functions pertaining to the third objective (realization of assets) only if he was of the view that it was not reasonably practicable to achieve either of the objectives specified in paragraph 1(1)(a) and (b) (rescue or winding up) and if by doing so he did not unnecessarily harm the interests of the creditors of the company as a whole.[524]

The moratoriums that accompanied administration were captured in paragraph 42 (moratorium on insolvency), paragraph 43 (moratorium on legal process) and paragraph 44 (interim moratorium) of Schedule B1.[525] As regards the process of administration paragraph 46 of Schedule B1 also required notification of the administrator's appointment to the company, its creditors and certain other persons and paragraph 47 contained expanded provisions regarding the statement of the company's affairs that had to be obtained by the administrator. The expanded provisions regarding the administrator's proposals and consideration thereof were dealt with in paragraph 49 to 55. In terms of paragraph 59, which dealt with the general powers of an administrator, the administrator could "do anything necessary or expedient for the management of the affairs, business and property of the company".[526] In terms of paragraph 60 the administrator had the powers under Schedule 1 to the

[522] Para 3(2) Schedule B1, Insolvency Act 1986. According to Fletcher "UK Corporate Rescue: Recent Developments – Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements – the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002" (2004) *European Business Organization Law Review* 137 the policy approach underlying this provision appeared to have been "the desire of English insolvency law to elevate the interests of creditors above the other possible benefits of a corporate rescue, including the preservation of shareholder value and continuation of employment that might be achieved."

[523] Para 3(3) Schedule B1, Insolvency Act 1986.

[524] Para 3(4) Schedule B1, Insolvency Act 1986.

[525] Fletcher "UK Corporate Rescue: Recent Developments – Changes to Administrative Receivership, Administration, and Company Voluntary Arrangements – the Insolvency Act 2000, the White Paper 2001, and the Enterprise Act 2002" (2004) *European Business Organization Law Review* 144 indicates that the moratorium provisions in Schedule B1 gives rise to an automatic stay that progresses through two distinct phases. Phase I comprises of an interim moratorium extending from when the first formal step is taken to put the company in administration until when administration formally commences. Phase II commences when the company formally "enters administration" and prevails while the company is "in administration."

[526] Para 59(3) Schedule B1, Insolvency Act states that a person who deals with an administrator in good faith and for value need not inquire whether such administrator is acting within his powers.

Act but the power to sell, lease or otherwise dispose of property was subject to regulations made under paragraph 60A of Schedule B1. Notably the administrator had all the powers under Schedule 1 as listed above in the discussion of the initial provisions of the Insolvency Act relating to administration except that the following new powers were added: the power to refer any question affecting the company to arbitration; the power to effect and maintain insurances in respect of the company's business and property and the power to establish subsidiaries of the company.[527]

Paragraph 67 of Schedule B1 required the administrator, on his appointment, to take custody or control of all the property "to which he thinks the company is entitled." In terms of paragraph 65 the administrator could make a distribution to a creditor of the company under administration. The administrator was further required to manage the affairs, business and property of the company in accordance with his proposals as approved or revised or as directed by the court.[528] Paragraph 70 made provision for the administrator to dispose of charged property subject to a floating charge[529] as if it were not subject to such floating charge whereas paragraph 71 contained provisions relating to how the administrator must deal with secured property subject to non-floating charges.[530] The administrator's obligations in relation to hire purchase property was captured in paragraph 72 and protections for secured or preferential creditors were dealt with extensively in paragraph 73. Schedule B1 also pertinently provided for the ending of administration in paragraphs 76 to 78 (automatic end of administration);

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[527] Numbers 5,6 and 15, Schedule 1, Insolvency Act 1986.

[528] Para 68 Schedule B1 Insolvency Act 1986.

[529] Secured claims are those secured by various pledges such as mortgage, lien and registered pledge, fixed charge and floating charge. If the debtor fails to pay in time, the creditors are entitled to sell the pledged assets or have it be sold to cover the debt amount due. The floating charge differs from other securities in that the object of the floating charge is more uncertain than the object of other securities. The floating charge is fluctuating in nature and covers almost all movable property of the debtor, with only a few, minor exceptions. In the case of any other charge, the unsecured creditors are aware of the assets that are secured, while the case of the floating charge involves the unsecured creditors being unaware of the extent. The unawareness on the part of the unsecured creditors causes injustice and discourages the unsecured creditors from participation in the insolvency proceedings. See Kasak "Special treatment of the floating charge in insolvency proceedings" 2015 *Juridica International* 70. See also Akintola "What is left of the floating charge? an empirical outlook" 2015 *Butterworths Journal of International Banking and Financial law* 404.

[530] Fergusson "A practical guide to insolvency" 2009 *Legal Information Management* 201 wherein it is explained that creditors are not all equal. Their status determines their pecking order. Some creditors such as banks and other lenders have security. Security is classed as either fixed or floating, depending on the nature of the assets charged. Assets such as land, or assets which are affixed to land, or used permanently in a business can be caught as a fixed charge. The fixed charge creditor is entitled to proceeds. Other assets, such as stock, can be caught by a floating charge. The floating charge creditor has priority, but only after preferential creditors and, in some cases, ordinary creditors who are entitled to a top slice. Such creditors are in a better position than unsecured creditors.

paragraph 79 (court ending administration on application of administrator);[531] paragraph 80 (termination of administration where objective achieved); paragraph 81 (court ending administration on application of creditor); paragraph 82 (public interest winding up); paragraph 83 (moving from administration to creditors voluntary liquidation); and paragraph 84 (moving from administration to dissolution).

4.4 Northern Rock and the shift in the UK's approach to dealing with bank failure

The failure of Northern Rock was a seismic gamechanger that put the UK on a new regulatory trajectory that eventually culminated in the adoption of a comprehensive bespoke framework to deal with bank failure.

In August 2007 the UK experienced its first bank run ("the run on the Rock") in over 140 years.[532] Although Northern Rock was not a particularly large bank (it was at the time ranked 7th largest in the UK in terms of assets) it was nevertheless a significant retail bank and a substantial mortgage lender.[533] In three days deposits of

[531]This will occur where the administrator thinks that the administration cannot be achieved in relation to the company or is of the view that the company should not have entered into administration- see para 79(2) Schedule B1, Insolvency Act 1986.

[532] Prior to the Northern Rock bank run the last bank run in the UK occurred in 1866 in respect of Overend Guerney & Co. Avgouleas "Banking supervision and the special resolution regime of the Banking Act 2009: the unfinished reform" 2009 *Capital Markets Law Journal* 206. See also Tomasi, "Corporate rescue, governance and risk taking in Northern Rock: Part 1" 2008 *Company Lawyer* 297. Overend, Gurney & Co. was not a retail bank. It was a discount house whose deposits mainly came from other banks. In the early 1860s, the company expanded from its core business in well-secured Bills of exchange into riskier investments, such as shipyards and shipping lines, with inadequate collateral. Walter Bagehot, a British economist and journalist famous for his 1873 publication *Lombard Street* that dealt with the principles underlying the Lender of Last Resort (LOLR) function of the BoE), observed that the company made losses "in a manner so reckless and so foolish, that one would think a child who had lent money in the City of London would have lent it better". Towards the end of 1865 and in early 1866, there was a severe tightening of monetary policy and several businesses to which the company had borrowed collapsed. An attempt by the company to avoid bankruptcy by converting from a private partnership to a limited liability company failed to attract sufficient new capital. The share price fell rapidly, encouraging depositors to withdraw funds. On 9 May 1866, after an inspection of the company's books suggesting that it was close to bankruptcy, the Bank of England declined to give support. The following day, Overend, Gurney & Co. suspended cash payments, sparking "terror and anxiety" so that "a run commenced upon all the banks, the magnitude of which can hardly be conceived". About midday on 10 May, "the tumult became a rout. The doors of the most respectable Banking Houses were besieged ... and throngs heaving and tumbling about Lombard Street made the narrow thoroughfare impassable." The Bank of England lent £4 million on that day, and secured the support of William Gladstone, the Chancellor of the Exchequer, for suspension of the Bank Charter Act to enable it to lend more in the days that followed. The run ended, but, during the three weeks following Overend's downfall, as many as ten banks suspended cash payments, and Walter Bagehot criticised the Bank of England for lending "hesitatingly, reluctantly and with misgiving".

[533] House of Commons, Treasury Committee, *The Run on the Rock*, Fifth Report of Session 2007-08, 24 January 2008 available at

approximately 3 billion British Pounds were withdrawn. The run by Northern Rock's depositors began immediately after the announcement that the bank had sought liquidity assistance from the BoE and that the regulatory authorities had declared that the bank was insolvent.[534] Llewellyn points out that attempts were *inter alia* made to find a private sector solution of the Northern Rock failure but this proved not to be possible and the bank was subsequently taken into temporary public ownership in what was "one of the biggest nationalizations ever undertaken in the UK".[535]

Avgouleas observes that the Northern Rock failure was followed by political blames, severe criticism of the FSA's style of supervision and the BoE's handling of the crisis.[536] The Parliamentary enquiry into the Northern Rock crisis,[537] which considered in detail the conduct of the FSA and of the BoE, severely criticized the actions of both institutions, but reserved the harshest criticism for the FSA, blaming it for having "systematically failed" in its duty to supervise Northern Rock.[538] As highlighted by Llewellyn, the run on Northern Rock exposed certain fundamental weaknesses in the

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https://publications.parliament.uk/pa/cm200708/cmselect/cmtreasy/56/56i.pdf accessed 7 June 2020. Financial Services Authority**,** *Internal Audit Division, The Supervision of Northern Rock: A Lessons Learned Review Report*, March 2008, available at https://webarchive.nationalarchives.gov.uk/20081113032304/http://www.fsa.gov.uk/pubs/other/nr_report.pdf accessed 1 April 2020. See Llewellyn The Northern Rock Crisis: A Multi-Dimensional Problem in Congdon et al *The Failure of Northern Rock-A Multidimensional Case Study*, (2009) SUERF-The European Money and Finance Forum, Vienna, 14 where he provides the following background: Northern Rock (previously a mutual building society) converted to bank status in 1997. On conversion and stripped of the previous constraints on its business powers under the Building Societies Act, Northern Rock acquired legal powers to conduct the full range of banking business. However, the bank opted to remain focused predominantly on the residential mortgage market. From the outset it adopted a "securitization and funding strategy" which was increasingly based on secured wholesale money (through the issue of mortgaged-backed securities) and other capital market funding. At its greatest, Northern Rock had assets of over 100 billion British Pound and a growth rate of around 20 percent for over a decade. Although it was only the seventh largest mortgage lender in the UK, in the first half of 2007 its new mortgage lending accounted for around 25% of the total mortgage lending in the UK. Northern Rock's pace of mortgage lending soon substantially exceeded the growth of retail deposits with the "funding gap" met through securitization and other wholesale market funding. See also Tomasi, "Corporate rescue, governance and risk taking in Northern Rock: Part 2" 2008 *Company Lawyer* 330; Haentjens and Wessels *Research Handbook on crisis management in the banking sector* (2015) 526.

[534] Congdon et al *The Failure of Northern Rock-A Multidimensional Case Study*, (2009) SUERF-The European Money and Finance Forum, Vienna, preface; Llewellyn The Northern Rock Crisis: A Multi-Dimensional Problem in Congdon et al *The Failure of Northern Rock-A Multidimensional Case Study*, (2009) SUERF-The European Money and Finance Forum, Vienna, 13.

[535] *Ibid* 15. In Llewellyn's view this whole arrangement actually amounted to an ad hoc bridge bank mechanism. See the discussion on bridge banks in par 8.7 (b) below.

[536] Avgouleas "Banking supervision and the special resolution regime of the Banking Act 2009: the unfinished reform" 2009 *Capital Markets Law Journal* 202.

[537] The Run on the Rock.

[538] Avgouleas "Banking supervision and the special resolution regime of the Banking Act 2009: the unfinished reform" 2009 *Capital Markets Law Journal* 202.

UK's financial regulatory regime, *inter alia*:[539] a fundamental flaw in the deposit protection scheme; *the lack of an established bankruptcy regime for banks and the lack of a well-established or predictable resolution regime for handling troubled banks.* It was also problematic that the UK had an institutional structure of supervision that separated responsibility for systemic stability and lender of last resort[540] (located in the BoE) from prudential supervision of individual banks (located at that stage within the FSA). Llewellyn remarks that "[T]his was always likely to be potentially hazardous in crisis conditions" and that in particular, there were fundamental "fault lines" in the UK's institutional arrangements for handling distressed banks.[541]

The Northern Rock episode thus revealed that substantial reform was needed in five main areas of banking regulation and supervision: insolvency arrangements for banks, resolution arrangements in the case of failed banks, deposit protection arrangements,

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[539] Llewellyn The Northern Rock Crisis: A Multi-Dimensional Problem in Congdon et al *The Failure of Northern Rock-A Multidimensional Case Study*, (2009) SUERF-The European Money and Finance Forum, Vienna, 14. Author's emphasis. See also The Financial Services Authority, *The Turner Review: A regulatory response to the global banking crisis*, March 2009, 75 available at http://www.actuaries.org/CTTEES_TFRISKCRISIS/Documents/turner_review.pdf accessed 7 June 2020.

[540] Freixas et al, "Lender of last resort: a review of the literature" 1999 *Financial Stability Review* 152 wherein LOLR is defined "as the discretionary provision of liquidity to a financial institution (or the market as a whole) by the central bank in reaction to an adverse shock which causes an abnormal increase in demand for liquidity which cannot be met from an alternative source. The central bank provides liquidity (reserve money) in exchange for, or against the security of, financial assets. Although this increases the liquidity of a bank's balance sheet it does not change the overall value of its assets. A lender of last resort is also defined as an institution willing to extent credit when no one else will. In the United Kingdom, the BOE takes on this role and lends to deposit-taking institutions in emergency circumstances. See also Rochet and Vives "Coordination failures and the lender of last resort: was Bagehot right after all?" 2004 *Journal of the European Economic Association* 1116. The essential point of the classical doctrine elaborated by Bagehot asserts that the LOLR role is to lend to "solvent but illiquid" banks under certain conditions. The LOLR facility and deposit insurance were instituted precisely to provide stability to the banking system and avoid unfavourable consequences for the real sector. Traditional banking panics were eliminated with the LOLR facility and deposit insurance by the end of the nineteenth century in Europe, after the crisis of the 1930s in the United States and, by now, also mostly in emerging economies, which have suffered numerous crises until today. The LOLR's function of providing emergency liquidity assistance has been criticized for provoking moral hazard on the banks' side.

[541] Llewellyn The Northern Rock Crisis: A Multi-Dimensional Problem in Congdon et al *The Failure of Northern Rock-A Multidimensional Case Study*, (2009) SUERF-The European Money and Finance Forum, Vienna, 14.

a "prompt corrective action"[542] regime and crisis management arrangements.[543] Llewellyn observes that because of the lack of a clearly defined bank insolvency model, the arrangements for deposit protection could not guarantee that payments would be made promptly thus exposing bank deposits to liquidity risk. In particular he points out that the legal position was that a bank could be put into administration under the Insolvency Act 1986 without freezing deposits.[544] These problems were recognized by the UK Government that issued a comprehensive consultation process in January 2008 together with the BOE and FSA culminating in two discussion documents titled *HM Treasury Financial Stability and depositor protection: strengthening the framework*[545] and *HM Treasury Financial Stability and Depositor Protection: Special Resolution Regime*.[546] The latter document specifically addressed two of the "fault lines" in the supervisory architecture pertaining to the UK financial system, namely the

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542 Llewellyn The Northern Rock Crisis: A Multi-Dimensional Problem in Congdon et al *The Failure of Northern Rock-A Multidimensional Case Study*, (2009) SUERF-The European Money and Finance Forum, Vienna, 57. A prompt corrective action approach formalises specific ratio tripwires which when breached serve as the basis for mandatory intervention by the supervisory authorities. Such prompt corrective actions include increased monitoring, raising additional capital, withholding interest and dividend payments to subordinated debt holders and equity holders respectively, requiring acceptance of an offer to be acquired, and closure of the institution. According to Llewellyn, the typical reluctance by regulatory authorities to move towards some form of PCA is because they wish to maintain regulatory discretion. However, in contrast, a more structured approach to intervention can improve the credibility of the supervisory authorities in that all market participants have a high level of certainty that action will be taken and at what stage. At the same time, by removing any prospect that a bank facing difficulties might be treated leniently, bank managers have every incentive to manage their banks prudently so as to reduce the probability of distress. Complementing this structured resolution approach with a clear uniform order for distributing the assets of failed credit institutions ensures that, ex ante, all bank investors are fully aware of their risk position, that action will be taken and at what stage and, therefore, reduce opportunities for bargaining of residual economic rents. A popular misunderstanding with prompt corrective action mechanisms is that it exists to prevent bank failures and therefore creates moral hazard behaviour. A suitably structured prompt corrective action tool aims to make certain that the functions of a failing bank are maintained, by identifying as early as possible that a bank is failing. The regulatory authorities can, therefore, begin to set up mechanisms to deal with insured depositors in case the bank does eventually become classified as failed. Equally, prompt corrective action enforces actions on a failing bank that will not leave uninsured investors and bank management immune from financial losses, thereby further reducing the possibility of moral hazard behaviour.

543 Llewellyn The Northern Rock Crisis: A Multi-Dimensional Problem in Congdon et al *The Failure of Northern Rock-A Multidimensional Case Study*, (2009) SUERF-The European Money and Finance Forum, Vienna, 17.

544 *Ibid* 27.

545 HM Treasury Financial Stability and depositor protection: strengthening the framework available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/243413/7308.pdf accessed 22 June 2020.

546 HM Treasury Financial Stability and Depositor Protection: Special Resolution Regime available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/238704/7459.pdf accessed 22 June 2020. See also House of Commons, Treasury Committee, *The Run on the Rock*, Fifth Report of Session 2007-08, 24 January 2008 available at https://publications.parliament.uk/pa/cm200708/cmselect/cmtreasy/56/56i.pdf accessed 7 June 2020.

issue of whether the UK needed a special insolvency regime for banks; and the planned resolution regime to replace the ad hoc arrangements that applied pursuant to the Northern Rock failure which were captured in the Banking (Special Provisions) Act of 2008, as discussed below.

Mayes and Wood remark that the special resolution regime contemplated for the UK in particular had to be able to handle two eventualities:[547] an orderly closure of a failing bank before losses mounted if no market solution could be found; and a rapid transfer of the bank as a whole or its key operations into the control of the relevant authorities "without a break in business". On 17 February 2008, the Chancellor of the Exchequer, announced the nationalization of Northern Rock, bringing forward legislation "to take Northern Rock into a period of temporary public ownership."[548] The Banking (Special Provisions) Bill was summarily introduced to the House of Commons on 19 February 2008 and received the Royal Assent on 21 February 2008 as a temporary legislative framework that would be in place for a year pending the move towards a dedicated special resolution regime for dealing with bank failure in the UK. These developments subsequently culminated in the Banking Act 2009 which received Royal assent on 12 February 2009 and came into force on 21 February 2009.[549]

4.5 The Banking (Special Provisions Act) 2008

As indicated above, the UK Banking (Special Provisions) Act of 2008 was quite a brief Act (comprising only 17 sections) that was hastily enacted as an interim framework to provide a basis for dealing with the Northern Rock Failure *ad hoc* whilst the transition to a more comprehensive regime for dealing with failing banks was being contemplated.[550] The preamble of the 2008 Act stated that it was "[A]n Act to make

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[547]Mayes and Wood The Northern Rock Crisis in the UK in Condon Congdon et al *The Failure of Northern Rock-A Multidimensional Case Study*, (2009) SUERF-The European Money and Finance Forum, Vienna, 42. Eisenbeis and Kaufman Lessons from the demise of the UK's Northern Rock and the US' Countrywide and IndyMac in Congdon et al *The Failure of Northern Rock-A Multidimensional Case Study*, (2009) SUERF-The European Money and Finance Forum, Vienna, 81 also point out that the adoption of a special bank resolution regime in the UK would permit legal closing of an insolvent institution and placing it in receivership quickly and resolving it on the basis of an administrative rather than a judicial process.

[548] Lastra Northern Rock and Banking Law Reform in the UK in Congdon et al *The Failure of Northern Rock-A Multidimensional Case Study*, (2009) SUERF-The European Money and Finance Forum, Vienna, 131.

[549] *Ibid*.

[550]See also Ellinger et al *Ellinger's Modern Banking Law* (2011) 28; Tomasi, "Creating a template for banking insolvency law reform after the collapse of Northern Rock: Part 1" 2009 *Insolvency*

provision to enable the Treasury in certain circumstances to make an order relating to the transfer of securities issued by, or of property, rights or liabilities belonging to, an authorized deposit-taker; to make further provision in relation to building societies; and for connected purposes."

The Banking (Special Provisions) Act of 2008 dealt with "authorized UK deposit-takers" which referred to UK banks that were licensed to accept deposits in terms of Chapter 4 of the Financial Services and Markets Act 2000. Section 2 of the 2008 Act dealt with "Cases where [the] Treasury's powers are exercisable". Section 2(1) indicated that, subject to subsection 7 of the Act,[551] the power of the Treasury to make an order under section 3 of the Act (transfer of securities issued by an authorized UK deposit-taker), or section 6 of the Act (transfer of property, rights and liabilities of an authorized UK deposit-taker) was exercisable in relation to an authorized UK deposit-taker if (and only if) it appeared to the Treasury to be desirable to make the order for either or both of the following purposes:[552]

(a) maintaining the UK financial system's stability in circumstances where the Treasury considered that there would be a serious threat to such stability if the order were not made;

(b) protecting the public interest in circumstances where financial assistance had been provided by the Treasury to the bank concerned for the purpose of maintaining the stability of the UK financial system.[553]

Intelligence 2; Kayondo, Legal aspects of distressed bank rescue: Lessons for Uganda from the South African and English experience, LLM Dissertation, University of Pretoria, 2016, 89.

[551] Section 2(7) of the 2008 Act states that where an order has been made under section 3 (transfer of securities issued by an authorised deposit-taker) or section 6 (transfer of property, rights and liabilities of an authorised UK deposit-taker) in relation to any authorised UK deposit-taker, subsection (1) does not apply in relation to any subsequent exercise of the power to make an order under either of those sections in relation to that deposit-taker.

[552] Section 2(2) of the 2008 Act.

[553] Section 2(3) provided that the reference in section 2(2)(b) to "the provision of financial assistance by the Treasury to the deposit–taker" included any case where the BoE had provided financial assistance to the deposit-taker and the Treasury have assumed a liability in respect of the assistance; the liability is of a kind of which the Treasury was expected to give relevant notice, and the Treasury had given relevant notice of the liability. It also included any case where the Chancellor of the Exchequer had announced that the Treasury (whether acting alone or with the BoE) would, if necessary, put in place relevant guarantee arrangements in relation to the deposit-taker (as well as any case where any such arrangements had been put in place, whether or not following such an announcement).

The Banking (Special Provisions) Act 2008 *inter alia* provided for transfer of securities issued by a UK bank to the BoE, or a nominee of the Treasury, or a company wholly owned by the BoE or another body corporate.[554] Where the Treasury made an order for the transfer of such rights in securities, provision was further made in section 4 of the 2008 Act that the Treasury could make an order regarding the extinguishment of subscription rights in order to facilitate the transfer. In terms of section 5 of the 2008 Act the Treasury was obliged to provide for compensation to persons who held the relevant securities immediately before they were transferred.

Transfer of property rights and liabilities were dealt with in section 6 of the 2008 Act which provided that the Treasury could "by order make provision for or in connection with, or in consequence of, the transfer of property rights and liabilities of an authorized UK deposit-taker to either (or each) of the following-

(a) a company wholly owned by the Bank of England or the Treasury;

(b) a body corporate not within paragraph (a)."

Compensation for such a transfer was dealt with in section 7 that required the Treasury to make an order determining the amount of "any compensation payable by the Treasury to the authorized UK deposit-taker concerned" and determining the amount of "any compensation payable by the transferee to the authorized UK deposit-taker concerned."[555] The Banking (Special Provisions) Act 2008 also provided for further transfers following a transfer of securities or property, rights and liabilities of the failing bank to the public sector.[556] Broad powers regarding "[C]onsequential and supplementary provision" were also bestowed on the Treasury by section 11 of the Banking (Special Provisions) Act 2008 in order to deal with a failing bank, *inter alia* by disapplying any specified statutory provision or rule of law; providing for any specified statutory provisions to apply with specified modifications or providing for matters such

[554] Section 3 of the Banking (Special Provisions) Act 2008.

[555] Section 7(3) stated that in determining the amount of any compensation payable by the Treasury by virtue of any provision in an order under section 7, it had to be assumed that all financial assistance granted by the BoE or Treasury to the failing bank had been withdrawn and that it would not in future provide any assistance to such bank. As per section 7(4) the references to the provision of financial assistance by the Treasury (on its own or together with the BoE) would, if necessary, put in place guarantee arrangements in relation to the failing bank.

[556] Section 8 of the Banking (Special Provisions) Act 2008. See also section 9 which dealt with "Supplementary provision about compensation schemes etc." as well as section 10 that dealt with "Tax consequences".

as: imposing a moratorium on commencement or continuation of legal proceedings; dissolution of the failing bank or a subsidiary of the failing bank; exempting directors of the failing bank from liability for certain acts or omission and regarding compensation payable by the Treasury to affected persons.[557] Section 16 provided for the money in relation to compensation by the Treasury as contemplated by the 2008 Act to be made available by the UK government.

4.6 The Banking Act 2009 and subsequent developments

According to the International Bar Association ("IBA") Financial Crisis Report, the Banking Act 2009 was the "most important legislative response" by the UK on issues pertaining to the GFC.[558] Acknowledging that the UK authorities were ill-equipped to deal with bank failures, Lastra remarks that the 2009 Act established for the first time in the UK's banking history a permanent statutory regime for dealing with bank failure. As observed by Lastra, from the point of insolvency law, the move towards a *lex specialis* for banks in the UK was a significant development.[559]

Part 1 of the UK Banking Act 2009 introduced the UK's Special Resolution Regime (also known as the SRR) for banks that are failing or had failed. Section 1(1) of the 2009 Act provided that the purpose of the special resolution regime for banks was to address the situation where *all or part* of the business of a bank has encountered, or is likely to encounter, financial difficulties.[560] The 2009 Act initially provided for five objectives of the special resolution regime that the resolution authorities were obliged to have regard to, namely:[561] to protect and enhance the stability[562] of the financial systems of the UK (Objective 1); to protect and enhance public confidence in the

[557] Section 12(2), (3) and (4) of the Banking (Special Provisions) Act 2008. The rest of the sections in the Act dealt with "Orders and regulations; general" (section 13); "Orders and regulations: retrospective provisions" (section 14); "Interpretation" (section 15) and "Short title, commencement and extent."

[558] IBA Taskforce on the Global Financial Crisis Report (October 2010) available at http://www.davispolk.com/files/uploads/FIG//Financial_Crisis_Report_IBA.pdf accessed 6 August 2018.

[559] Lastra Northern Rock and Banking Law Reform in the UK in Congdon et al *The Failure of Northern Rock-A Multidimensional Case Study*, (2009) SUERF-The European Money and Finance Forum, Vienna, 139.

[560] Author's emphasis.

[561] Section 4(4) to 4(8)of the Banking Act of 2009. Notably section 4(10) states that the order in which the objectives are listed in section 4 is not significant and that they are to be balanced as appropriate in each case.

[562] As per section 4(9) the reference to the stability of the financial systems of the United Kingdom referred to in section 4(4) includes , in particular, a reference to the continuity of banking services.

stability of the banking systems of the UK (Objective 2); to protect depositors (Objective 3); to protect public funds (Objective 4); and to avoid interfering with property rights in contravention of a Convention right within the meaning of the Human Rights Act 1998 (Objective 5).

The UK's special resolution regime as initially introduced in 2009 consisted of:[563]

(a) three stabilization options contained in Part 1 of the Act, which at the time were: transfer to a private sector purchaser (dealt with in section 11); transfer to a bridge bank (dealt with in section 12), and transfer to temporary public ownership (dealt with in section 13);

(b) the bank insolvency procedure (Part 2); and

(c) the bank administration procedure (Part 3).

The BoE, Treasury and the FSA would each play a role in the UK's new special resolution regime for banks.[564] The Banking Act of 2009 further provided for the Treasury to issue a "Code of Practice" to deal with the practical use of the stabilization powers, the bank insolvency procedures, and the administration procedure introduced by the Act. The Code *inter alia* provided guidance on how the special resolution objectives are to be understood and achieved and the choice between different resolution options.[565]

It is necessary at this point to allude to another significant change in the UK's landscape of financial regulation post GFC which entailed switching to a new model of financial regulation. The regulatory model that prevailed at the time of the GFC, comprising of the tripartite authorities namely the Treasury, BoE and the FSA (the later operating as integrated mega regulator) fell out of favour as it was not very effective[566]

[563] As per section 1(2) and (3) of the Banking Act of 2009.
[564] Section 1(5) of the Banking Act of 2009.
[565] Section 5(1) and 5(2) of the Banking Act of 2009.
[566] The UK Joint Committee on the draft Financial Services Bill which preceded the introduction of the UK Twin Peaks model highlighted weaknesses with the then existing tripartite regulatory structure (comprising of the Treasury, the BoE and the FSA) and *inter alia* remarked in 2010 that: "The evidence of the recent financial crisis suggests that mixing functions can contribute to a lack of focus on rising macro-prudential risk and difficulties in moving to a 'war footing' when that risk becomes substantial. In addition, the incentives are different." – see House of Commons, Treasury Committee, *Financial Regulation: a preliminary consideration of the Government's proposals* Seventh Report of Session 2010 – 11, Volume 1, 3 February 2011 available at

and the UK subsequently transitioned to a Twin Peaks model in 2012. The UK Twin Peaks model was introduced by the Financial Services Act 2012 that also made significant amendments to the Financial Services and Markets Act 2000. In this Twin Peaks model the FSA was replaced by two new regulators, the Prudential Regulation Authority ("PRA") that is tasked with prudential regulation (and that was initially established a subsidiary of the BoE but is now part of the BoE) and the Financial Conduct Authority ("FCA") that is tasked with market conduct regulation.[567] The PRA and FCA consequently replaced the FSA as part of the authorities involved in bank resolution.

It was also in the aftermath of the GFC that the European Union, suffering heavily from the effects of the Crisis,[568] undertook reforms to plug the gaps in its approach to dealing with bank failures. Notably the UK Banking Act 2009 and the innovative special resolution regime it introduced also in some respects served as a model for the very comprehensive Bank Recovery and Resolution Directive ("BRRD")[569] that was subsequently adopted by the European Union ("EU") in 2014.[570] As the UK was still an EU member at that time it had to make significant amendments to the special resolution regime introduced by the Banking Act 2009 in order to transpose the Directive into UK domestic law and facilitate alignment with the BRRD.[571] The BRRD was published in

https://publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/430/430i.pdf accessed 22 June 2020 para 83.

[567] For more detail on the UK Twin Peaks model see Godwin, Howse and Ramsay "A Jurisdictional Comparison of the Twin Peaks model of Financial Regulation" 2017 *Journal of Banking Regulation* 103; Lui "Single or Twin? the UK financial regulatory landscape after the financial crisis of 2007-2009" 2012 *Journal of Banking Regulation* 24; Taylor "Regulatory Reform in the U.K." 2013 *North Carolina Banking Institute* 227.

[568] Terazi and Senel "The effects of the global financial crisis on the central and eastern European Union countries" 2011 *International Journal of Business and Social Science* 186. See also Dabrowski "The global financial crisis: lessons for European integration" 2010 *Economic Systems* 38.

[569] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC. 2005/56/EC, 2007/36/EC,2011/35/EU,2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council [2014] OJ L173/190 (hereinafter BRRD).

[570] A directive is an EU legal act that needs to be incorporated into national law by EU Member States before a given deadline, with notification to the Commission. It sets out goals that all Member States must achieve, while giving them discretion as to how to reach them. It is not directly applicable.

[571] Transposition of EU law is the procedure by which EU member states incorporate EU directives into their national law in order to make their objectives, requirements and deadlines directly applicable. Member States transposing directives into national law can choose the form and methods for doing so, but are bound by the terms of the directive as to the result to be achieved and the deadline by which transposition should take place. With regard to EU legislation and legislative procedures, Member States are compelled to transpose directives into their legislation within the prescribed deadline and to apply EU law correctly and effectively. They are also required to report to the

the Official Journal of the European Union on 12 June 2014 and was subsequently transposed into UK law by means of six statutory instruments[572] and an amendment to the Banking Act effected through the Financial Services (Banking Reform) Act 2013. The majority of these amendments came into force in January 2015. [573]

In order to avoid the extensive and unnecessary duplication and deflection that will follow from a tortuously long-winded and detailed discussion of all the provisions regarding the UK's special resolution regime introduced by the very comprehensive Banking Act when it was first adopted in 2009, followed by a discussion of the provisions in the very comprehensive BRRD, and then again a discussion of the provisions of the very comprehensive Banking Act 2009 as significantly and extensively amended after transposition of the BRRD, it has been deemed prudent and appropriate instead to make concise reference to the regime introduced by the BRRD and thereafter deal in more detail with the UK special resolution regime in its current format as contained in the amended Banking Act 2009, including the new dedicated framework for bank administration.

4.7 The EU Bank Recovery and Resolution Directive (BRRD)

4.7.1 Introduction

Commission on the transposition of directives into their national legislation, and on the performance of the legislation. Member States are also responsible for the enforcement of EU law (whether transposed or directly applicable) in their national legal systems. See European Parliament: Transposition, Implementation and enforcement of Union law available at http://www.epgencms.europarl.europa.eu/cmsdata/upload/09adb8a6-5006-4bfe-9b1e-d9a7afde2be2/EPRS_ATAG_627141_Transposition_implementation_and_enforcement_of_EU_law-FINAL.pdf accessed 22 June 2020. See also Steunenberg and Rhinard "The transposition of European law in EU member states: between process and politics" 2010 *European Political Science Review* 495. Steunenberg and Rhinard explain that when the member states of the EU agree on a new directive, this policy instrument still has a long way to go before it is finally implemented. For a directive to become 'law in action', member states must transpose it into national law before national or subnational administrations and agencies can apply the new rule. Transposition is thus a critical prerequisite for the effective implementation of European policy. Without proper transposition, a directive will not be fully incorporated into the national legal order, and the *acquis communautaire* risks becoming fragmented and unevenly applied.

[572] The Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009, as amended; The Bank Recovery and Resolution (No.2) Order 2014 (S2014/3348); The Bank Recovery and Resolution Order 2014 (S1 2014/3329); The Banks and Building Societies (Depositor Preference and Priorities) Order 2014 (S1 2014 /3486); The Banking Act 2009 (Mandatory Compensation Arrangements Following Bail-in) Regulations 2014 (S1 2014/3330); and The Banking Act 2009 (Restriction on Special Bail-in Provision etc.) Order 2014 (S1 2014/3350).

[573] Usher "UK Bank resolution" 2015 available at https://www.fieldfisher.com/en/insights/uk-bank-resolution#sthash.OfORFuiH.dpbs accessed 12 December 2020.

On 15 April 2014 the European Parliament approved the Bank Recovery and Resolution Directive ("BRRD"), which is in all material respects aligned with the FSB Key Attributes, after several months of negotiations between the Commission, the European Council and the Parliament.[574] The BRRD came into operation on 2 July 2014.[575] Member countries were required to adopt and publish the necessary laws and regulations to transpose the Directive into their domestic legislation by 31 December 2014, and to apply them from 1 January 2015.[576] A key element of the new powers introduced by the BRRD was the bail-in tool, requiring banks to recapitalize and absorb losses from within, which was made mandatory as of 1 January 2016.[577]

As pointed out in the BRRD, the GFC revealed that there was a significant lack at Union level to deal effectively with unsound or failing banks as a result whereof EU Member States were forced to "save" institutions by using taxpayers money.[578] Thus the BRRD states that a regime is required that provides authorities with a credible set of early intervention tools to intervene sufficiently early and swiftly in respect of an unsound or failing institution for purposes of ensuring continuity of the institution's critical functions,[579] while minimising the impact of its failure on the economic and financial system. It is stated that such a regime should ensure that shareholders bear losses first and that creditors bear losses after shareholders subject to the principle that no (shareholder[580] or) creditor should be worse off[581] during resolution than if the

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[574] De Lis *et al* "BVVA Research Compendium on bank resolution regimes : from the FSB to the EU and US Frameworks" 2014 available at https://www.bbvaresearch.com/en/publicaciones/compendium-on-bank-resolution-regimes/ accessed on 29 April 2020 1 (hereinafter Compendium) 13.

[575] European Union: Addressing troubled financial institutions' problems available at https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=LEGISSUM:240406_10 accessed 22 June 2020. See also ISDA: European Bank Recovery and Resolution Directive available at https://www.isda.org/a/4GiDE/brrd-implementation-monitor-v3.pdf accessed 22 June 2020.

[576] HM Treasury, Transposition of the Bank Recovery and Resolution Directive 2014 available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/335755/PU1678_final__1_.pdf accessed 22 June 2020 4.

[577] European Union, Addressing troubled financial institutions' problems available at https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=LEGISSUM:240406_10 accessed 22 June 2020.

[578] Recital 1, BRRD.

[579] Article 2(35) of the BRRD defines "critical functions" to mean "activities, services or operations the discontinuance of which is likely in one or more Member States, to lead to the disruption of services that are essential to the real economy or to disrupt financial stability due to the size, market share, external and internal interconnectedness, complexity or cross-border activities of an institution or group, with particular regard to the substitutability of those activities, services or operations."

[580] Naturally a bank's shareholders are also its creditors.

[581] See Chapter 2 para 2.2.5. The "no creditor worse off"-principle requires that no shareholder or creditor must be left worse off from the use of resolution powers than they would have been had the entity entered insolvency instead of resolution. See *The Bank of England's approach to resolution* October 2017 available at https://www.bankofengland.co.uk/-/media/BOE/files/news/2017/october/the-bank-of-england-approach-to-

failing institution was liquidated. New powers were thus necessary to enable authorities to maintain uninterrupted access to deposits and payment transactions, sell viable portions of the failing institution and apportion losses in a fair and predictable manner. It was envisaged that these objectives would assist in avoiding destabilization of financial markets and would reduce costs for taxpayers.[582]

The goal of the very comprehensive Directive is to achieve a common harmonised framework of rules and powers that guide all interventions by EU countries in banking crises. In terms of Article 1 the BRRD applies to all credit institutions and investment firms established in the European Union, including EU financial institutions if they are subsidiaries of a credit institution; EU financial holding companies; parent financial holding companies in a Member State and branches of institutions that are established outside the EU.[583] In particular, for purposes of appropriate and proportionate application of the resolution tools provided by the Directive, resolution authorities and competent authorities, as indicated below, are required in terms of Recital 14 to take the following aspects into account in relation to each institution: the nature of its business, its shareholding structure, its legal form, its risk profile, size, legal status, its interconnectedness to other institutions or to the financial system in general, the scope and the complexity of its activities and its membership of an institutional protection scheme, whether it is involved in investment services or activities and whether its failure and subsequent winding up under normal insolvency proceedings would likely have a significant negative impact on the financial system and economy.

In terms of the BRRD Member' States may designate the public authorities (usually central banks and finance ministries) that will act as resolution authorities**.** Generally resolution powers are granted to existing competent authorities, central banks or ministries. In order to avoid conflicts of interest between the supervisory and resolution functions of the authorities involved in bank resolution, the BRRD requires clear and operational independence between the resolution and supervisory or other activities of the relevant authority.[584] Financing of resolution is dealt with in Article 100 to 107 of the BRRD which *inter alia* requires levying *ex ante* contributions on banks to a

resolution.pdf?la=en&hash=FC806900972DDE7246AD8CD1DF8B8C324BE7652F accessed 14 August 2018 44.

[582] Recital 5, BRRD.

[583] See also the definition of "institution under resolution" in Article 2(83) BRRD.

[584] Compendium 14.

resolution fund and Article 109 that deals with the use of deposit guarantee schemes in the context of resolution.[585] The BRRD indicates that in light of the consequences that a failure of an institution may have on the financial system and economy of Member States as well as the possible need to use public funds (bail-out) to resolve a crisis, the Ministry of Finance or other relevant ministers should be closely involved in the crisis management and resolution process.[586] As stated in Recital 45, "[I]n order to avoid moral hazard, any failing institution should be able to exit the market, irrespective of its size and interconnectedness, without causing systemic disruption."

The BRRD is based on three main pillars, namely:[587]

(a) Preparation and prevention:[588] This entails that banks are required to draft recovery plans to indicate how they will recover from a period of distress while resolution authorities must prepare resolution plans to ensure the continuity of critical functions of the failing bank.

(b) Early intervention:[589] This entails that the supervisor may activate early intervention measures, as discussed in more detail below, if a bank does not meet regulatory capital requirements or is likely to breach such regulatory requirements. The bank is then required to restore its financial situation (recovery), for example, by implementing recovery measures, and/or adopting key reforms or restructuring its debts. Up until this stage the bank is generally still under private management.[590]

(c) Resolution powers and tools:[591] The resolution phase entails that the authorities take control of the failing bank in order to resolve it in an orderly manner. Resolution is activated only if the two previous stages

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585 The European system of funding arrangements consists of national financing arrangements; borrowing between national financing arrangements and the mutualisation of national financing arrangements – see also Compendium 27. Regarding the ranking of deposits in the insolvency hierarchy see Article 108 BRRD.

586 Recital 16, BRRD.

587 Compendium 13.

588 Recital 19 and 21, BRRD; Articles 4 to 10 (recovery) and Articles 11 to 14 Resolution plans) as well as Article 15 to 18 (resolvability) BRRD. See also Compendium 14 to 17.

589 Recital 40 BRRD; Article 27(early intervention measures); Article 28(removal of senior management and management body); Article 29 (Temporary administrator) and Article 30 (coordination of early intervention measures and appointment of temporary administrator in relation to groups).

590 Recital 39 BRRD. This will be the situation unless a temporary administrator is appointed in terms of Article 29, as discussed below in para 7.2.2.

591 Recital 40 BRRD; Article 31 to 87 BRRD.

fail. The following resolution tools can then be applied:[592] i) sale of business; ii) bridge institution; iii) asset separation; and iv) debt conversion or write down (the “bail-in” tool), as discussed in more detail below.

4.7.2 The Pillars of the BRRD

4.7.2.1 Pillar 1: Recovery and resolution plans

The first pillar of the BRRD which involves preparation and prevention to minimise the risks of potential problems, requires banks and resolution authorities to develop recovery and resolution plans respectively as *ex ante* measures in dealing with troubled banks.[593] As pointed out in Chapter Two,[594] the purpose of a recovery plan[595] is to serve as a plan to assist the bank, when it encounters problems that endangers its safety and soundness, to recover from these problems whilst still remaining under its own private control (thus before its position has deteriorated to such an extent that the supervisor takes public control of the bank by putting it into resolution). The BRRD accordingly envisages that recovery plans[596] will complement the bank’s existing policies and risk management framework with respect to capital and liquidity by including and analysing a variety of management actions under recovery situations. Article 5 of the BRRD sets out the requirements for recovery plans and *inter alia* requires banks to prepare and regularly update their recovery plans which requirement should be applied proportionately, reflecting the systemic importance of the bank. These recovery plans must be detailed and based on realistic assumptions (credible) applicable in a range of robust and severe scenarios and must be submitted to the bank supervisors for a complete assessment in accordance with Article 6 BRRD. It should take into account the bank’s funding sources and the degree to which support would be credibly available. During such assessment the supervisor must *inter alia* determine whether the plans are comprehensive and whether they could feasibly restore the bank's viability, in a timely manner, even in periods of severe financial

[592] Recital 59, BRRD.
[593] Recital 22, BRRD.
[594] See Chapter two para 2.2.11.
[595] Article 2(32) of the BRRD defines a recovery plan as “a recovery plan drawn up and maintained by an institution in accordance with Article 5.”
[596] See Recital 21, 22, 24, 31, 32, 33, 35 and 37 BRRD.

stress.[597] Notably, recovery plans are required to be developed both at group level and for the individual institutions within the group (thus on a consolidated and individual level)[598] and the BRRD stipulates that these plans should be assessed and approved on an annual basis in order to ensure that they remain relevant.[599]

The BRRD also requires the formulation of proportionate resolution plans that are prepared *ex ante* by the resolution authority with assistance from the bank supervisor and bank concerned.[600] In terms of Recital 25 of the BRRD authorities should have all the information necessary to identify and ensure the continuance of the critical functions of the failing bank. Due to a bank's knowledge of its own functioning and peculiar problems, resolution plans should be drafted by the resolution authorities on the basis of, *inter alia*, information provided by the bank.[601] The resolution authorities may thus request the bank to assist it in the drafting and annual updating of the resolution plan for that specific bank.[602] The authorities will use the resolution plan to assess the resolvability of the bank or group concerned. In terms of Article 10(7) of the BRRD a resolution plan must contain a summary of the key elements of the plan, a summary of the material changes to the bank that occurred after the last resolution information was filed; a demonstration of how critical functions and core business lines could be legally and economically separated to the extent necessary from other functions, so as to ensure continuity in the event of failure of the bank. It must also provide an estimation of the timeframe necessary for executing each material aspect of the plan and a detailed description of the resolvability assessment carried out on the bank; measures to address impediments on resolvability; the processes for determining the value and marketability of critical functions; arrangements for information exchange and an explanation of how resolution could be conducted without resorting to extraordinary financial support or emergency liquidity assistance by the central bank or other central bank liquidity assistance. Also included in the plan should be a description of the different resolution strategies that could be applied; a description of critical interdependencies; and options for preserving access to payments and

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[597] Article 6(2) BRRD. Compendium 15 to 17.
[598] Recital 33, BRRD.
[599] Recital 21 and 24 BRRD; Article 5(2) BRRD.
[600] Article 2(41) defines a "resolution plan" to mean "a resolution plan for an institution as drawn up in accordance with Article 10." Recital 25, BRRD indicates that "resolution planning is an essential component of effective resolution."
[601] Recital 26, BRRD.
[602] Article 10(5) BRRD.

clearing services and other infrastructures and an assessment of the portability of client positions; an analysis of how the plan will impact employees of the bank; a plan for communicating with the media and public; the minimum requirement for own funds and eligible liabilities[603] and a deadline to reach that level; where applicable the minimum requirements for own funds and contractual bail-in instruments and a deadline to reach that specific level; a description of essential operations and systems for maintaining the continuous functioning of the bank's operations and any opinion expressed by the bank regarding the resolution plan.[604] According to Recital 29 resolution authorities should have the power, based on resolvability assessments conducted in respect of banks, to require changes to the structure and organization of the bank, to take measures that are necessary and proportionate to reduce or remove material impediments to the application of resolution tools and that would ensure the resolvability of the bank. Recital 31 captures the general sentiment post-GFC that bail-outs should be avoided by stating that recovery and resolution plans "should not assume access to extraordinary financial support or expose taxpayers to the risk of loss."

4.7.2.2 Pillar 2: Early intervention and temporary administration

As can be seen from the explanation of the pillars of the BRRD above, the regime it introduces is indeed very comprehensive and also covers early intervention (which is generally part of ordinary bank supervision) to attempt to steer a bank out of its troubles and avoid the stage where the bank's position has deteriorated so much that it is put into resolution.[605] The BRRD expands the powers of the competent authorities to intervene at an early stage in cases where a bank is in breach of prudential

[603] Article 2(1) para (71) BRRD, "eligible liabilities" means "the liabilities and capital instruments that do not qualify as Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments of an institution or entity referred to in point (b), (c) or (d) of Article 1(1) that are not excluded from the scope of the bail-in tool by virtue of Article 44(2)." Article 1(1) (b), (c) and (d) refer to "financial institutions that are established in the Union when the financial institution is a subsidiary of a credit institution or investment firm, or of a company referred to in point (c) or (d), and is covered by the supervision of the parent undertaking on a consolidated basis in accordance with Articles 6 to 17 of Regulation (EU) No 575/2013; financial holding companies, mixed financial holding companies and mixed-activity holding companies that are established in the Union; and parent financial holding companies in a Member State, Union parent financial holding companies, parent mixed financial holding companies in a Member State, Union parent mixed financial holding companies."

[604] Article 10(a) to (r), BRRD.

[605] Recital 40 BRRD states that: "In order to preserve financial stability, it is important that competent authorities are able to remedy the deterioration of an institution's financial and economic situation before that institution reaches a point at which authorities have no other alternative than to resolve it."

requirements or, due *inter alia* to a rapidly deteriorating financial condition, including deteriorating liquidity, increasing levels of leverage, non-performing loans or concentration of exposures.[606] The following early intervention measures are then at the disposal of the authorities:[607] requiring the board of directors of the bank to implement certain measures set out in the recovery plan; requiring the board to come up with an action plan to overcome problems in the bank; requiring the board to convene a meeting with shareholders for purposes of taking decisions as required by the authorities; requiring unfit members of the board and senior management to be removed or replaced; requiring the board to draw up a plan for negotiation on debt restructuring with creditors; requiring a change of the bank's business strategy; requiring changes to the legal or operational structure of the bank; and acquiring information necessary to update the resolution plan and prepare for possible resolution.

If the early intervention measures are insufficient to address a bank's deteriorating financial position, the resolution authority may then in terms of the BRRD appoint a "temporary administrator" that can either replace the bank's management temporarily or work together with the bank's management to assist the bank to recover to a safe and sound position.[608] The temporary administrator is appointed for a maximum period of one year (which period may, in terms of article 29(7) of the BRRD, be "exceptionally renewed if the conditions for appointing the temporary administrator continue to be met"). The main purpose of the appointment of a temporary administrator is to facilitate the restoration of the institution's financial stability and prudent management within the shortest time possible –thus the temporary administrator is appointed as part of recovery efforts to prevent a bank from failing and having to be put into resolution. For such purposes the temporary administrator may, *inter alia*, even increase the failing

[606] Article 27 BRRD.

[607] Article 27(1)(a) to (h), BRRD.

[608] Recital 40 BRRD. See Maarand "The concept of recovery of credit institutions in the bank recovery and resolution directive" 2019 *Juridica International* 110. Maarand explains that where replacement of the senior management or management body is insufficient, Member States shall ensure that competent authorities may appoint one or more temporary administrators to the institution, either to replace the management body temporarily or to work temporarily with the management body, with the powers, role and functions, and term of the temporary administrator being determined by the competent authority. See also Sipos and Kovacs "Crisis resolution in the field of the financial prudential supervision – some legal and economic aspects" 2014 *European Scientific Journal* 20.

bank's capital or reorganise the ownership structure.[609] The competent authority must specify the powers of the temporary administrator at the time of his appointment based on what is proportionate in the circumstances. Such powers may include some or all of the powers of the bank's board, including the power to exercise some or all of the administrative functions of the board. The role and function of the temporary administrator may include ascertaining the financial position of the failing bank, managing the business of the bank with a view to preserving or restoring its financial position and taking measures to restore the sound and prudent management of the bank's business. The competent authority must specify any limits on the role and function of the temporary administrator at the time of appointment. In order to achieve these goals, the temporary administrator must have the qualifications, ability and knowledge required to carry out the requisite functions and must not have any conflicts of interest. An important safeguard is that the competent authority may also require that certain acts of a temporary administrator be subject to prior consent of the competent authority. The temporary administrator may further exercise the power to convene a general meeting of the shareholders of the failing bank and to set the agenda of such a meeting only with the prior consent of the competent authority. He must report to the competent authority on the financial position of the bank that is under his administration and on the acts performed in the course of his appointment at intervals set by the competent authority and at the end of his mandate. The BRRD further indicates that the appointment of a temporary administrator should, *inter alia*, not prejudice the rights of shareholders.[610]

It is further important to note that, as indicated in Recital 39 of the BRRD, during the recovery and early intervention phases provided for under the BRRD, shareholders retain full responsibility and control of the bank *except when a temporary administrator has been appointed by the competent authority.*[611] The moment that the bank enters into the resolution phase the shareholders however lose such responsibility and control of the bank. Notably, where the financial position of a bank has severely deteriorated

[609] Compendium 18. Recital 40, BRRD, indicates that the task of the temporary administrator should be to exercise any powers conferred on it in order to promote solutions aimed at redressing the financial situation of the failing institution.
[610] Article 29(2) to (8) BRRD.
[611] Author's emphasis.

the bank may be put in resolution without the authorities first being obliged to apply early intervention measures,[612] but such a situation should be rare.

4.7.2.3 Pillar 3: Resolution powers and tools

The BRRD introduces a broad all-encompassing resolution regime[613] in the EU as alternative to merely liquidating a bank due to its view that "liquidation under normal insolvency proceedings might jeopardize financial stability, interrupt the provision of critical functions, and affect the protection of depositors…". The objectives of resolution should therefore be "to ensure the continuity of critical functions to avoid adverse effects on financial stability, to protect public funds by minimising reliance on extraordinary financial support to failing institutions and to protect covered depositors, investors, client funds and client assets."[614] Recital 41 of the BRRD emphasizes that the resolution framework "should provide for timely entry into resolution before a financial institution is balance-sheet insolvent and before all equity has been fully wiped out. Resolution should be initiated when a competent authority, after consulting a resolution authority, determines that an institution is failing or likely to fail and alternative measures as specified in this Directive would prevent such a failure within a reasonable timeframe." It further indicates that a bank should be considered to be failing or likely to fail "when it infringes or is likely in the near future to be unable to pay its debts as they fall due, or when the institution requires extraordinary public support except in the particular instances laid down in this Directive".

The BRRD sets five objectives and some general principles to protect the failing bank's stability with a special order for the allocation of losses. The resolution objectives are: "to ensure the continuity of critical functions; to avoid a significant adverse effect on the financial system, in particular by preventing contagion, including to market infrastructures, and by maintaining market discipline; to protect public funds by

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612 Recital 53 BRRD.

613 Article 2(1) defines "resolution" to mean "the application of a resolution tool or a tool referred to in Article 37(9) in order to achieve one or more of the resolution objectives referred to in Article 31(2)."

614 Recital 45, BRRD. See also Recital 49 which states that "[T]he resolution tools should therefore be applied only to those institutions that are failing or likely to fail, and only when it is necessary to pursue the objective of financial stability in the general interest. In particular, resolution tools should be applied where the institution cannot be wound up under normal insolvency proceedings without destabilizing the financial system and the measures are necessary in order to ensure the rapid transfer and continuation of systemically important functions and where there is no reasonable prospect for any alternative private solution, including any increase of capital by the existing shareholders or by any third party sufficient to restore the full viability of the institution."

minimising extraordinary public support; to protect depositors; and to protect client funds and assets." It also sets out trigger conditions to activate the resolution process. The conditions that the BRRD establishes for triggering the application of resolution tools thus enables the authorities to take action when a bank is either insolvent or very close to insolvency.[615] As pointed out in Chapter Two, the idea is that the resolution authorities should step in to address the situation before the failing bank is only an empty shell totally depleted of assets and liquidity. The "point of non-viability" of a bank for purposes of triggering the resolution phase in the BRRD is the point at which the relevant authority determines that the bank meets the conditions for resolution. In this regard the BRRD provides that resolution actions should be taken when all the following conditions are met:[616]

(a) The competent authority (supervisor), after consulting with the resolution authority, has made a determination that the bank "is failing or likely to fail".

(b) Having regard to timing and other relevant circumstances, there is no reasonable prospect that any alternative private sector measures or supervisory action or write down or conversion of capital instruments would prevent the failure of the bank concerned within a reasonable timeframe.

(c) The public interest necessitates that resolution action be taken.

Article 35 of the BRRD provides for the resolution authority to appoint a "special manager" to replace the failing bank's board of directors and take over the management of the bank and implement resolution measures as directed by the resolution authority. The special manager has all the powers of the shareholders and the board but may only exercise such powers under the control of the resolution authority.[617] In terms of article 35(3) the special manager "shall have the statutory duty to take all the measures necessary to promote the resolution objectives referred to in

[615] Compendium 20.
[616] Article 32 BRRD. See further Article 32(4) regarding the instance when a bank will be deemed to be failing or likely to fail.
[617] Article 35(2) BRRD.

Article 31 and implement resolution actions according to the decision of the resolution authority."

Notably Recital 46 of the BRRD states that "[T]he winding up of a failing institution through normal insolvency proceedings should always be considered before resolution tools are applied. *A failing institution should be maintained through the use of resolution tools as a going concern with the use, to the extent possible, of private funds.* That may be achieved either through sale to or a merger with a private sector purchaser, or after having written down the liabilities of the institution, or after having converted its debt to equity, in order to effect a recapitalisation."[618] As succinctly captured in Recital 84 of the BRRD "resolution authorities should have all the necessary powers that, in different combinations, may be exercised when applying the resolution tools. They should include the power to transfer shares in, or assets, rights or liabilities of, a failing institution to another entity such as another institution or a bridge institution, the power to write down or cancel shares, or write down or convert liabilities of a failing institution, the power to replace the management and the power to impose a temporary moratorium on the payment of claims. Supplementary powers are needed, including the power to require continuity of essential services from other parts of a group."

The BRRD accordingly affords resolution authorities the following resolution tools, accompanied by wide powers,[619] to resolve a failing bank, when the trigger conditions for resolution are satisfied:

(a) The sale of business tool:[620] The sale of business tool empowers the resolution authorities to sell the bank under resolution, without having to first obtain the consent of the shareholders or complying with other procedural requirements. In accordance with this tool the resolution authorities may, on commercial terms, sell any of the failing bank's shares or other instruments representing ownership, and all or any of its

[618] Author's emphasis.
[619] See Article 72 of the BRRD that deals with the exercise of resolution powers.
[620] Article 2(58) BRRD defines the "sale of business tool" to mean "the mechanism for effecting a transfer by a resolution authority of shares or other instruments of ownership issued by an institution under resolution, or assets, rights or liabilities, of an institution under resolution to a purchaser that is not a bridge institution, in accordance with article 38." See further Binder "The Relevance of the Resolution Tools within the SRM" European Banking Institute Working Paper Series 2018 No 29 at 11; Bognár "Overview of the New System for Bank Recovery and Resolution in the EU" 2013 *European Journal of Current Legal Issues*.

assets, rights and liabilities.[621] The BRRD specifically requires that, unless it compromises the resolution objectives, the sale must be conducted on "commercial terms" hence the authorities are required to market the instruments to be transferred in accordance with market value principles.[622] The sale of business tool can be applied more than once in the course of the resolution of a failing bank and the resolution authorities may even, with the prior consent of the purchaser, transfer the property back to the failing bank.[623] Notably the BRRD indicates that "[W]here the resolution tools have been used to transfer the systemically important services or viable business of an institution to a sound entity such as a private sector purchaser or bridge institution, the residual part of an institution should be liquidated within an appropriate time frame having regard to any need for the failing institution to provide services or support to enable the purchaser or bridge institution to carry out the activities or services required by virtue of that transfer."[624]

(b) The bridge institution tool:[625] The use of the bridge institution tool serves as a temporary measure to house the assets and continue the critical operations of the failing bank pending the sale of parts of the failing bank to private sector purchasers.[626] The bridge institution tool empowers the resolution authority to transfer, without the consent of the shareholders or third parties, the shares or other instruments of ownership, assets, rights and liabilities of the failing bank to a bridge institution[627] (it can be

[621] Article 38(1)(a) and (b) BRRD.

[622] Recital 61, BRRD requires that marketing of the failing bank's business or part of the business for sale to a private sector purchaser should occur "in an open, transparent and non-discriminatory process, while aiming to maximise, as far as possible, the sale price." See also Article 38(2) BRRD.

[623] Article 38(5) and (6) BRRD. See further Article 39 BRRD regarding the procedural requirements for the application of the sale of business tool.

[624] Recital 60, BRRD.

[625] Article 2(60) BRRD defines a "bridge institution tool" to mean "the mechanism for transferring shares or other instruments of ownership issued by an institution under resolution or assets, rights or liabilities of an institution under resolution to a bridge institution, in accordance with Article 40."

[626] Recital 65 BRRD indicates that "[A]s an institution which is wholly or partially owned by one or more public authorities or controlled by the resolution authority, a bridge institution would have as its main purpose ensuring that essential financial services continue to be provided to the clients of the failing institution and that essential financial activities continue to be performed. The bridge institution should be operated as a viable going concern and be put back on the market when conditions are appropriate and within the period laid down in this Directive or wound up if not viable."

[627] Article 40(1)(a) and (b) BRRD. Article 40(3) stipulates that when the resolution authority applies the bail in tool it must ensure that "the total value of liabilities transferred to the bridge institution does

done more than once in the course of the resolution process).[628] If certain conditions are met, this tool also empowers the resolution authority to transfer these instruments from the bridge institution back to the bank under resolution; or alternatively transfer them from the bridge institution to a third party.[629] In order to use the bridge institution tool the following requirements must be met:[630] the bridge institution must be a legal entity wholly or partially owned or controlled by one or more public authorities. It must be created for the purpose of receiving some or all of the shares or other instruments of ownership, assets, rights and liabilities of a failing bank for purposes of maintaining the failing bank's critical functions. As such the bridge institution is to be considered "a continuation of the institution under resolution".[631] The resolution authorities are empowered to make decisions regarding the bridge institution's incorporation documents, the appointment of its management and related matters and its risk profile. The objective of the bridge institution tool is to sell the assets, rights and liabilities of the failing bank that has been put into in resolution to private parties. Such sale must occur swiftly by means of open and transparent marketing and on commercial terms. Being a temporary measure a bridge institution may as a general rule only operate for two years.[632] After the expiry of this period, the operation of the bridge institution is terminated *inter alia* by liquidation of the bridge institution, by selling all its assets rights or liabilities to a third party, or by merging it with another institution.[633]

(c) The asset separation tool:[634] Resolution authorities can use this tool to unilaterally transfer assets, rights or liabilities of a bank that is in

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not exceed the total value of the rights and assets transferred from the institution under resolution or provided by other sources." See further Article 41 regarding the operation of a bridge institution.

[628] Article 40(5) BRRD.

[629] Article 40(6) BRRD.

[630] Article 40(2) BRRD.

[631] Article 40(9) BRRD.

[632] Article 41 (5) BRRD. However this period may, in terms of Article 41(6) and (7) be extended for one or more additional one year periods based on a detailed assessment of the situation, including an assessment of the market conditions and outlook, that justifies such extension.

[633] Article 41(3).

[634] Article 2(55) BRRD defines an "asset separation tool" to mean "the mechanism for effecting a transfer by a resolution authority of assets, rights or liabilities of an institution under resolution to an asset management vehicle in accordance with Article 42." See also Binder "The Relevance of the

resolution or a bridge institution to one or more asset management vehicles which must then "manage the assets transferred to it with a view to maximising their value through eventual sale or orderly wind down."[635] In terms of the BRRD the asset separation tool should be used when the resolution authority determines that:[636] liquidation of the failing bank's "bad assets" under insolvency proceeding could have an adverse effect on financial markets; it is necessary for the proper functioning of the bank under resolution or a bridge institution; or such a transfer is necessary to maximise liquidation proceeds. The objective of the asset separation tool is to separate the distressed, problematic assets of the failing bank from its other assets (the so-called "good bank/bad bank"[637]–split),[638] and to manage them a way that would maximise their value. Notably the asset separation tool may not be applied as a standalone measure (due to

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Resolution Tools within the SRM" European Banking Institute Working Paper Series 2018 No 29 at 13.

[635] Article 42(1) and (3) BRRD. Such transfer may take place without obtaining prior consent from the shareholders of the bank in resolution or any third party other than the bridge institution and without complying with any procedural requirements in terms of company or securities laws.

[636] Article 42(5)(a) to (c).

[637] Pinedo "Removing toxic assets from balance sheets: structures based on the good bank – bad bank model" 2009 *Journal of Securities Law, Regulation and Compliance* 290. Pinedo explains that in a good bank-bad bank structure, a financial institution establishes a separate entity for its "bad" assets. The resulting "good" bank, free of troubled assets, can expect restored investor and market confidence, allowing it to raise capital with no trouble and at more affordable rates, and resume normalised lending. In structuring a bad bank, consideration must be given to the ultimate goal of the bad bank, that is, whether its purpose is solely to liquidate bad assets or whether it will also contain business operations. That decision influences other decisions, including ownership of the bad bank, the legal and regulatory structure, capital and liquidity requirements, management, composition of the asset pool to be transferred and valuation of those assets. If the bad bank is left to focus completely on loan recovery and self-liquidation, then funds recovered from the troubled assets in the bad bank are paid to shareholders of the bad bank in the form of a dividend or interest payment after any repayment of debt raised by the bad bank to fund the purchase of the troubled assets. The goal of the good bank-bad bank structure is to "clean up" the balance sheet of the good bank by transferring to the bad bank assets that are illiquid, non-performing or otherwise resulting in write-downs and draining capital. See also Brierley "The UK Special Resolution Regime for failing banks in an international context" 2009 *The Bank of England Financial Stability Paper* 10.

[638] For more detail on this process of segregating the good parts of a failing bank from its bad parts during bank resolution see Fitzpatrick "The Return of 'Good Bank-Bad Bank'" 2008 *The Wall Street Journal;* Singh and LaBrosse "Developing a framework for Effective Financial Crisis Management" 2011 *OECD Journal Financial Market Trends* 1; Schafer and Zimmerman "Bad Bank(s) and Recapitalization of the Banking Sector" 2009 44:4 *Intereconomics* 215; Donnelly "Liberal economic nationalism, financial stability, and Commission leniency in Banking Union" 2018 *Journal of Economic Policy Reform* 159.

moral hazard[639] created by the competitive advantage it affords)[640] but may only be used in conjunction with another resolution tool. The resolution authorities therefore have the right to transfer the assets, rights or liabilities of a failing bank to an asset management vehicle at market value or, under certain conditions, transfer them back to the failing institution. The asset management vehicle will be a legal entity owned by public authorities. As with the bridge institution tool, the resolution authority will appoint asset managers who must either maximise the value of the instruments through sale thereof alternatively they must wind down the business in an orderly manner.

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[639] Weber "Moral hazard, market discipline and self-regulation – what have we learnt?" Ceremony for the 50th Anniversary of Bank Negara Malaysia: "50 Years of Central Banking – Stability and Sustainability", Kuala Lumpur, 10 February 2009. Weber explains that in "order to illustrate the concept of moral hazard, one should look at the process of credit risk transfer in the form of securitisation, which played a key role in the events leading to the current financial crisis. Principally, credit risk transfer is a very beneficial means of allocating risk in the financial market as it disconnects the originator of a risky asset from the ultimate risk-taker. The downside of this separation is, however, that once the credit risk is forwarded there is no incentive for the originator to monitor the debtor. This is what we call moral hazard and what has ultimately resulted in an erosion of credit standards not only in US subprime but also in other credit market segments. In general, the ultimate risk-taker does not have the necessary information to monitor the debtor and the transfer process unnecessarily complicates the default risk assessment of the securitised assets." See also Allen *et al* "Moral hazard and Government Guarantees in the Banking Industry" 2015 *Journal of Financial Regulation* 30. Allen and others explain the concept of moral hazard as follows: The use of public funds in the financial sector in the years 2008 – 2013 was vast. The interventions took various forms ranging from recapitalization, to loans and implicit as well as explicit guarantees. With the exception of Lehman Brothers, all large financial institutions which faced difficulties (both banks and non-banks) were bailed out. This led to a large disbursement for many governments and threatened the solvency of various European countries such as Ireland and Spain. The public interventions were effective in restoring confidence and maintaining financial stability, but generated considerable negative consequences in terms of sovereigns' fiscal positions, banks' and firms' health, and cost of funding. In response to the crisis, various regulatory measures were introduced both in the USA and Europe. In Europe, new regulations were imposed both on sovereigns and banks. This included the new Fiscal Compact, the creation of a banking union in the Eurozone, and new directives on capital regulation and resolution mechanisms. The main objectives of the new regulatory framework are to reduce the use of taxpayers' money in the future and limit unwarranted risk taking, or in other words, moral hazard, resulting from widespread support to the financial system. To achieve these goals, the new rules attempt to introduce more discipline both for sovereigns and banks, decrease the public support to banks, and strengthen the resiliency of financial institutions. The moral hazard problem associated with public intervention is seen in the public and academic debate as its major downside. It can undermine the effectiveness of intervention in reducing financial instability, and thus magnify the costs for the government in providing it. This has been a key argument to support the view that large public intervention in the financial sector can be detrimental and should be limited or devised in a way that makes certain that banks bear the costs of the intervention together with the taxpayers.

[640] Recital 67, BRRD.

(d) The bail-in tool:[641] The innovative bail-in tool is regarded as the "cornerstone" of the BRRD.[642] This tool may be applied for any of the following purposes:[643] to recapitalise a failing bank that meets the conditions for resolution "to the extent sufficient to restore its ability to comply with the conditions for authorization …and to continue to carry out the activities for which it is authorised…and to sustain market confidence in the institution or entity"; and "to convert to equity or reduce the principal amount of claims or debt instruments that are transferred to a bridge institution with a view to providing capital for that institution; or under the sale of business tool or asset separation tool." It is usually also accompanied by replacement of the failing bank's management.[644] By writing down such claims or converting them into equity the bail-in tool shoulders much of the burden to help recapitalize a failing bank instead of imposing this burden on taxpayers through the use of public funds. In particular Recital 67 of the BRRD provides that: "An effective resolution regime should minimise the costs of the resolution of a failing institution borne by the taxpayers. It should ensure that systemic institutions can be resolved without jeopardising financial stability. The bail-in tool achieves that objective by ensuring that shareholders and creditors of institutions have stronger incentive to monitor the health of an institution during normal circumstances and meets the Financial Stability Board Recommendation that statutory debt-write down and conversion powers be included in a framework for resolution, as an additional option in conjunction with other resolution tools." In addition Recital 68 state that

[641] Article 2(57) BRRD defines the "bail-in" tool to mean "the mechanism for effecting the exercise by a resolution authority of the write down and conversion powers in relation to liabilities of an institution under resolution in accordance with Article 43." See further Avgouleas and Goodhart "Critical Reflections on Bank Bail-ins" 2015 *Journal of Financial Regulation* 3; Cariboni *et al* "Reducing and sharing the burden of bank failures" 2015 *OECD Journal Financial Market Trends* 29.

[642] Compendium 22. See Recital 69 to 73 BRRD. See also Recital 77 regarding *pari passu* treatment of creditors during application of the bail-in tool.

[643] Article 43(2)(a) and (b) BRRD.

[644] Recital 69 BRRD indicates that where the bail-in tool is applied with the objective of restoring the failing institution's capital for purposes of enabling it to operate as a going concern, the resolution through bail-in should be accompanied by a replacement of management. Such replacement should occur except where it is appropriate and necessary to retain the failing bank's management for the "achievement of resolution objectives, and a subsequent restructuring of the institution and its activities in a way that addresses the reasons for its failure."

for purposes of ensuring that resolution authorities have the necessary flexibility to allocate losses to creditors in a range of circumstances, those authorities should be able to apply the bail-in tool "both where the objective is to resolve the failing institution as a going concern if there is a realistic prospect that the institution's viability may be restored, and where systemically important services are transferred to a bridge institution and the residual part of the institution ceases to operate and is wound up." Recital 77 of the BRRD indicates that unless otherwise specified in the BRRD, "resolution authorities should apply the bail-in tool in a way that respects the *pari passu* treatment of creditors and the statutory ranking of claims under the applicable insolvency law. Losses should first be absorbed by regulatory capital instruments and should be allocated to shareholders either through the cancellation or transfer of shares or through severe dilution. Where those instruments are not sufficient, subordinated debt should be converted or written down. Senior liabilities should be converted or written down if the subordinate classes have been converted or written down entirely."

In terms of Article 43(3) of the BRRD resolution authorities may apply the bail-in tool only if there is a reasonable prospect that the bail-in tool together with other relevant measures implemented in accordance with a business reorganisation plan "will, in addition to achieving relevant resolution objectives, restore the institution….to financial soundness and long-term viability." As regards the characteristics of the bail-in tool in terms of the BRRD the following should be noted:[645] certain liabilities are always excluded from the application of the bail-in tool,[646] namely covered deposits;[647] secured liabilities including covered bonds and another instruments that according to national law are secured in a way similar to covered bonds; liabilities with a maturity of less than seven days

[645] See Article 44 BRRD regarding the scope of the bail-in tool.
[646] Recital 70 BRRD states that "[I]t is not appropriate to apply the bail-in tool to claims in so far as they are secured, collateralized or otherwise guaranteed. However, in order to ensure that the bail-in tool is effective and achieves its objectives, it is desirable that it can be applied to as wide a range of unsecured liabilities of a failing institution as possible."
[647] See Recital 71 BRRD which indicates that due to the fact that the protection of covered depositors is one of the most important objectives of resolution, it means that the bail-in tool should not be used in relation to covered deposits.

arising from participation in payment systems and inter-bank liabilities with a maturity of less than seven days. Other liabilities that can also not be bailed in include liabilities arising from employ remuneration, trade creditors arising from the provision of the failed bank, tax and social security authorities and Deposit Guarantee Schemes. Resolution authorities can further exclude or partially exclude, any liabilities from bail-in according to the following criteria: i) if they cannot be bailed in timeously; ii) to ensure continuity of critical functions; iii) to avoid contagion that could cause a serious disturbance to the economy of a Member State or of the EU; or iv) to avoid value destruction that would increase losses of other creditors. Notably losses that are not absorbed by excluded liabilities must be borne by other creditors (under the "no creditor worse off than in liquidation"-principle), or by the resolution fund. The BRRD has established deposit preference in order to ensure protection for the depositors of a failing bank that is placed into resolution. As regards implementation of the bail-in tool, Article 46 of the BRRD sets out how the assessment of the bail-in amount is to be conducted whilst Article 47 deals with the "[T]reatment of shareholders in bail-in or write down or conversion of capital instruments" and Article 48 deals with the "[S]equence of write down and conversion."[648] In terms of Article 49 the resolution authority may exercise write down and conversion powers in relation to a liability arising from a derivative only upon or after closing out the derivatives. Accordingly the hierarchy of claims when applying the bail-in tool follows the following order:[649] i) Common Equity Tier 1 instruments ("CET 1");[650] ii) if writing down CET1

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648 See also Article 50 BRRD which deals with the rate of conversion of debt into equity as well as Article 51 (recovery and reorganization measures to accompany bail-in) and Article 52 (business reorganization plan); Article 53 (effect of bail-in); Article 54 (removal of procedural impediments to bail-in); Article 55 (contractual recognition of bail-in).

649 Compendium 23.

650 "Common Equity Tier 1 instruments" means capital instruments that meet the conditions laid down in Article 28(1) to (4), Article 29(1) to (5) or Article 31(1) of Regulation (EU) No 575/2013. Article 28(1) to (4) of Regulation (EU) No 575/2013 states that "capital instruments shall qualify as Common Equity Tier 1 instruments only if all the following conditions are met: (a) the instruments are issued directly by the institution with the prior approval of the owners of the institution or, where permitted under applicable national law, the management body of the institution; (b) the instruments are paid up and their purchase is not funded directly or indirectly by the institution; (c) the instruments meet all the following conditions as regards their classification: (i) they qualify as capital within the meaning of Article 22 of Directive 86/635/EEC, (ii) they are classified as equity within the meaning of the

is not sufficient then authorities should reduce to zero the principal of Additional Tier 1 instruments[651] and Tier 2 instruments,[652] iii) only then followed by subordinated debt not classified as Additional Tier 1 or Tier 2, iv) senior debt and uncovered corporate deposits, v) uncovered SME and retail deposits, vi) and, finally, deposits covered by the by Deposit Guarantee Scheme.

4.7.3 Bail-out as a last resort option

Additionally, in the very extraordinary situation of a systemic crisis, the BRRD provides that the resolution authority may seek funding from alternative financing sources, through the use of government stabilisation tools that involve public funds ("bail-out").[653] Thus the BRRD permits bail-outs only under very extraordinary circumstances

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applicable accounting framework; (iii) they are classified as equity capital for the purposes of determining balance sheet insolvency, where applicable under national insolvency law; (d) the instruments are clearly and separately disclosed on the balance sheet in the financial statements of the institution; (e) the instruments are perpetual…." Article 29(1) to (5) of Regulation (EU) No 575/2013 states that "capital instruments issued by mutuals, cooperative societies, savings institutions and similar institutions shall qualify as Common Equity Tier 1 instruments only if the conditions laid down in Article 28 with modifications resulting from the application of Article 29 are met…." Article 31(1) of Regulation (EU) No 575/2013 states that "in emergency situations, competent authorities may permit institutions to include in Common Equity Tier 1 capital instruments that comply at least with the conditions laid down in points (b) to (e) of Article 28(1) where all of the following conditions are met: (a) the capital instruments are issued after 1 January 2014; (b) the capital instruments are considered State aid by the Commission; (c) the capital instruments are issued within the context of recapitalisation measures pursuant to State aid – rules existing at the time…."

[651] Additional Tier 1 instruments "means capital instruments that meet the conditions laid down in Article 52(1) of Regulation (EU) No 575/2013." Article 52(1) of Regulation (EU) No 575/2013 states that "capital instruments shall qualify as Additional Tier 1 instruments only if the following conditions are met: (a) the instruments are issued and paid up; (b) the instruments are not purchased by any of the following: (i) institution and its subsidiaries; (ii) an undertaking in which the institution has a participation in the form of ownership, direct or by way of control, of 20% or more of the voting rights or capital of that undertaking; (c) the purchase of instruments is not funded directly or indirectly by the institution; (d) the instruments rank below Tier 2 instruments in the event of the insolvency of the institution…."

[652] Tier 2 instruments "means capital instruments or subordinated loans that meet the conditions laid down in Article 63 of Regulation (EU) No 575/2013." Article 63 of Regulation (EU) No 575/2013 states that "capital instruments and subordinated loans shall qualify as Tier 2 instruments provided the following conditions are met: (a) the instruments are issued or the subordinated loans are raised, as applicable, and fully paid-up; (b) the instruments are not purchased or the subordinated loans are not granted, as applicable, by any of the following: (i) the institution or its subsidiaries; (ii) an undertaking in which the institution has participation in the form of ownership, direct or by way of control, of 20 % or more of the voting rights or capital of that undertaking; (c) the purchase of the instruments or the granting of the subordinated loans, as applicable, is not funded directly or indirectly by the institution…."

[653] Note however that Recital 55 states that "[S]ave as expressly specified in this Directive, the resolution tools should be applied before any public sector injection of capital or equivalent extraordinary public financial support to an institution. This however should not impede the use of funds from the deposit guarantee schemes or resolution funds in order to absorb losses that would otherwise have been suffered by covered depositors or discretionarily excluded creditors. In that respect, the use of

as a last resort measure. The BRRD provides that in the very extraordinary situation of a systemic crisis;[654] the resolution authority may seek funding from alternative financing sources through the use of government stabilisation tools when the following conditions are met:[655]

"(a) Application of government support: "A contribution to loss absorption and recapitalisation equal to an amount not less than 8% of total liabilities including own funds of the failing bank has been made by shareholders and the holders of other instruments of ownership,[656] the holders of relevant capital instruments and other eligible liabilities through write-down, conversion or otherwise." The contribution of the resolution fund is capped at 5% of a bank's total liabilities.

(b) State Aid: This shall be conditional on prior and final approval under the State Aid rules.

(c) Last resort option: The government stabilisation tools must be used as a last resort measure. As such it must only be used after the resolution authorities have assessed and applied the other resolution tools to the maximum extent practicable. This option must be used to avoid significant adverse effects on financial stability or protect the public interest."

The government stabilisation tools[657] include a temporary public ownership tool[658] and a public equity support tool (public injections of capital).[659] The "temporary public ownership" tool (nationalization) entails the full takeover of equity securities by EU

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extraordinary public financial support, resolution funds or deposit guarantee schemes to assist in the resolution of failing institutions should comply with the relevant State aid provisions." Regarding state aid see also Article 107 and 108 of Treaty Provisions on State Aid: Core provisions of the Treaty on the Functioning of the European Union ("TFEU") https://ec.europa.eu/competition/state_aid/legislation/compilation/a_01_03_11_en.pdf accessed 22 June 2020.

[654] Systemic crisis" is defined in Article 2(30) of the BRRD as "a disruption in the financial system with the potential to have serious negative consequences for the internal market and the real economy. All types of financial intermediaries, markets and infrastructure may be potentially important to some degree."

[655] Compendium 26.

[656] See Recital 75 BRRD.

[657] Article 56 BRRD.

[658] Article 58 BRRD.

[659] Article 57 BRRD.

Member States. The failing bank is required to be managed in a commercial and professional manner and re-privatisation must be ensured as soon as business and financial conditions permit. Notably, when using the temporary public ownership tool it must be confirmed that no other resolution tool (that is, bridge bank, asset separation, bail-in etc.) can adequately protect the public interest. As regards the "public equity support" the BRRD provides that EU Member States complying with national law may participate in the recapitalisation of the institution, providing capital in exchange for common equity Tier 1[660] (core equity), additional Tier 1 instruments[661] or Tier 2 instruments.[662] Failing banks that receive aid are required, in terms of the BRRD, to be managed in a commercial and professional manner and Member States are required to sell their shares obtained in the process of recapitalisation as soon as business and financial conditions permit.

4.7.4 General Resolution powers

Article 63 of the BRRD sets out various general resolution powers that the resolution authority may exercise, namely:[663] the power to request relevant updated information; the power to take control of an institution under resolution and exercise all the rights or other capital instruments; the power to amend or alter the maturity of debt instruments and powers of the shareholders, other owners and board of directors of the failing bank; the power to transfer the failing bank's shares and other instruments of ownership as well as assets, rights and liabilities of the failing bank; the power to reduce or write off the principal amount or balance of certain debts; the power to convert certain debts into ordinary shares or other instruments of ownership; the power to cancel debt instruments other than secured liabilities; the power to reduce or cancel the nominal amount of shares or other instruments of ownership; the power to require the failing bank or its holding company to issue new shares or other instruments of ownership; the power to close out and terminate financial contracts or derivative contracts; the

[660] See Footnote 166 above.
[661] See Footnote 167 above.
[662] See Footnote 168 above.
[663] See also Article 64 BRRD for ancillary powers and Article 65 BRRD that deals with the power to require the provision of services and facilities as well as Article 66 BRRD that deals with powers to enforce crisis management or crisis prevention measures; Article 68 regarding exclusion of certain contractual terms in early intervention and resolution; Article 69 regarding the power to suspend certain obligations; Article 70 regarding powers to restrict the enforcement of security rights and Article 71 regarding powers to temporarily suspend termination rights.

power to remove or replace the board of directors and senior management of the failing bank and the power to require the competent authority to assess a private sector buyer.

4.7.5 BRRD safeguards

During resolution the BRRD requires that various safeguards be observed. It requires that resolution authorities take all appropriate measures to ensure that resolution action is taken in accordance with the principles that shareholders and creditors bear a fitting share of the failing bank's losses, that the failing bank's management should generally be replaced, that resolution costs should be reduced and that creditors of the same class are treated equally (*pari passu*).[664] However, if necessary in the public interest, it is possible to treat creditors of the same class differently.[665] The BRRD also observes consultation with employees of the bank that is in resolution.[666] Recital 50 states that interference with property rights should not be disproportionate hence affected shareholders and creditors should not incur greater losses[667] during resolution than if the bank had been liquidated at the time that it was decided to put it into resolution. It also states that in the case of a partial transfer of assets of a bank under resolution to a private purchaser or a bridge bank, the residual part of the bank under resolution should be wound up under normal insolvency proceedings. In order to protect shareholders and creditors who are left in the winding up proceedings of the residual bank, compensation should be paid "not less than what it is estimated they would have recovered if the whole institution had been wound up under normal insolvency proceedings." The BRRD further requires that for purposes of protecting shareholder and creditor rights, there should *inter alia* be clear obligations in the resolution regime concerning the valuation of assets and liabilities of the bank that is being resolved.[668] Provision is also made for safeguards for counterparties in partial

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[664] See Recital 77 BBRD; Article 73 BRRD.
[665] Recital 47, BRRD. See also Recital 77 BRRD.
[666] Recital 48, BRRD. Note also Recital 87 which states that "resolution authorities should have ancillary powers to ensure the effectiveness of the transfer of shares or debt instruments and assets, rights and liabilities. Subject to the safeguards specified in this Directive, those powers should include the power to remove third parties' rights from the transferred instruments or assets and the power to enforce contracts and to provide for the continuity of arrangements vis-à-vis the recipient of the transferred assets and shares. However, the rights of employees to terminate a contract of employment should not be affected."
[667] See Article 75 BRRD.
[668] Recital 51, BRRD; Article 74 BRRD.

transfers;[669] protection for financial collateral, set off and netting arrangements;[670] protection for structured finance arrangements and covered bonds;[671] and protection of trading, clearing and settlement systems during partial transfers.[672]

4.8 The UK special resolution regime as contained in the Banking Act 2009 (as amended)

4.8.1 Introduction

The UK Banking Act of 2009, as revised and amended in alignment with the BRRD, contains the augmented Special Resolution Regime ("SRR") for banks in the UK that are failing or had failed. As mandated by section 5 of the Banking Act 2009 the UK Treasury has published a statutory code of practice that has to be read with the provisions of the Banking Act in respect of the application of the SRR.[673] Further detailed guidance is contained the BoE's publication titled *The Bank of England's Approach to Resolution*, which is known as the "Purple Book" (October 2017)[674] and which, as pointed out by Malek, Potts and Dzwig, is widely regarded in the industry as "setting the benchmark internationally".[675] The BoE has made a commitment to the UK Parliament to achieve a fully operational resolution framework in respect of major UK banks by 2022.[676]

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669 Article 77 BRRD.
670 Article 78 BRRD.
671 Article 79 BRRD.
672 Article 80 BRRD.
673 HM Treasury, *Banking Act 2009: special resolution regime code of practice*, March 2017 available at https://www.assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/602948/Special-Resolution-Regime-Code-of-Practice.pdf accessed 22 June 2020. A revised code of practice was published in December 2020 – available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945165/SRR_CoP_December_2020.pdf accessed 9 January 2021.
674 *The Bank of England's approach to resolution*, October 2017 available at https://www.bankofengland.co.uk/-/media/boe/files/news/2017/october/the-bank-of-england-approach-to-resolution.pdf?la=en&hash=FC806900972DDE7246AD8CD1DF8B8C324BE7652F accessed 22 June 2020. See also *The Bank of England's approach to resolution*, October 2014 available at http://www.rdmf.es/wp-content/uploads/2014/11/documento-del-Banco-de-Inglaterra.pdf accessed 22 June 2020.
675 Malek, Potts, Dzwig *United Kingdom in: Brodie S (Ed)*, *Bank Resolution: Key Issues and Local Perspectives*, (2019) London: INSOL International, 171.
676 Bank of England, *The Bank of England's Response to the Treasury Committee's Enquiry into Capital,* 2017 available at http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasurycommittee/capital-andresolution/written/69208.html accessed 22 June 2020. The last major step in

Malek, Potts and Dzwig point out that the BRRD was fully implemented in UK law, but that it has not been transposed verbatim. Consequently there are a number of differences between the general EU approach as per the BRRD and the UK's approach as captured in the amended 2009 Banking Act which Act will also be modified further in the post-Brexit phase. Currently these *inter alia* include differences in the resolution objectives (the UK has seven resolution objectives whereas the BRRD has five) and differences in terminology (the UK, for example, refers to the "private sector purchaser" tool rather than the "sale of business" tool, and the "bridge bank" tool rather than the "bridge institution" tool). There are also substantive differences between the BRRD and the UK's mechanisms for ensuring that no shareholder or creditor is worse off in a bank resolution than they would otherwise be in ordinary insolvency proceedings. Given that the UK has chosen to give up its EU membership as a result of Brexit these differences between the UK and EU regimes will not be explored any further in this thesis, except for some peripheral mention where relevant. This thesis will make some mention of, but will not explore, the amendments already effected to the UK's special resolution regime in anticipation of Brexit and post-Brexit as these changes have no impact on the main features of the UK's resolution regime as discussed below but are mainly directed at facilitating the domestic application of the UK regime now that BRRD compliance by the UK is no longer required. [677]

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completing that project was the implementation of the Resolvability Assessment Framework package, which was published on 30 July 2019.

[677] The BoE issued two consultation papers specifically dealing with the challenges of Brexit in October 2018 (UK Withdrawal from the EU: The Bank of England's Approach to Resolution Statements of Policy and Onshored Binding Technical Standards available at https://www.bankofengland.co.uk/-/media/boe/files/paper/2018/uk-withdrawal-from-eu-boe-approach-to-resolution-sops-and-onshored-bts-complete.pdf?la=en&hash=450BE158DDF0D972247AC794438B0E8ED8179431 accessed 22 June 2020), part of the consultation package, (The Bank of England's Approach to Amending Financial Services Legislation under the European Union (Withdrawal) Act 2018 (PRA CP25/18)) available at https://www.bankofengland.co.uk/-/media/boe/files/paper/2018/cp2518.pdf?la=en&hash=B43B7D866F8BCC23423B276C5A0669C61396727D accessed 22 June 2020 and December 2018 (UK Withdrawal from the EU: Further Changes to PRA Rulebook and Binding Technical Standards – Resolution Binding Technical Standards (PRA CP32/18)). Key features of the proposed changes, as explained in the consultation papers, were that the BRRD will not have any legal effect in the UK after Brexit. The applicable legislation for bank recovery and resolution will be domestic legislation as amended by the Bank Recovery and Resolution and Miscellaneous Provisions (Amendment) (EU Exit) Regulations 2018. On 18 April 2019, the BoE and PRA published a Policy Statement The Bank of England's amendments to financial services legislation under the European Union (Withdrawal) Act 2018 (PRA Policy Statement 5/19) available at https://www.bankofengland.co.uk/-/media/boe/files/paper/2019/the-boes-amendments-to-financial-services-legislation-under-the-eu-withdrawal-act-2018-june-2019.pdf accessed 22 June 2020 setting out their final policy, including

4.8.2 Purpose and scope of the special resolution regime

The revised Banking Act 2009, after its amendment to facilitate transposition of the BRRD into the UK's domestic banking law, retained the provision capturing the purpose of the special resolution regime for banks as being "to address the situation where all or part of the business of a bank has encountered, or is likely to encounter, financial difficulties."

Pursuant to amendment the revised special resolution regime now comprises the following parts:[678]

(a) five stabilization options (Part 1): (i) transfer to a private sector purchaser (section 11), transfer to a bridge bank (section 12), transfer to an asset management vehicle (section 12ZA), bail-in (section 12A) and transfer to temporary public ownership (section 13);

(b) the bank insolvency procedure (liquidation) (Part 2); and

(c) the bank administration procedure (Part 3).

The regime has thus been expanded post BRRD-implementation by including the transfer to an asset management vehicle and bail-in as additional stabilization options.

Supervisory Statements and a Policy Statement, with effect from the "exit day" on which the UK would leave the EU. In relation to the BRRD, the Bank and PRA have each issued an EU exit instrument –see The EU Exit Instrument: The Technical Standards (Bank Recovery and Resolution Directive) (Amendment Etc.) (EU Exit) (No 1) Instrument 2019 available at https://www.bankofengland.co.uk/-/media/boe/files/paper/2019/ps519-section-b-app7-brrd-april-2019.pdf?la=en&hash=660C24F4EE070FF1B478CF24DEB26D59E89C5435 accessed 22 June 2020 issued by the Bank, and the EU Exit Instrument: The Technical Standards (Bank Recovery and Resolution Directive) (EU Exit) (No 2) Instrument 2019 issued by the PRA available at https://www.bankofengland.co.uk/-/media/boe/files/paper/2019/ps519-section-b-app3-brrd.pdf?la=en&hash=BA6D3E617EB48514630B6E18449F762395BD9674 accessed 22 June 2020. See also UK Withdrawal from the EU: Changes Following Extension of Article 50 (CP18/19) available at https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2019/cp1819-complete.pdf?la=en&hash=573F7920C9CFF71114674FE54707645F9CF4C247 accessed 22 June 2020; Policy Statement: Interpretation of EU Guidelines and Recommendations: Bank of England and PRA Approach after the UK's Withdrawal from the EU (2019), para 2.2 available at https://www.bankofengland.co.uk/-/media/boe/files/paper/2019/interpretation-of-eu-guidelines-and-recommendations-boe-and-pra-approach-sop.pdf?la=en&hash=5875625EA07D84777DC534D1A48B9AB34C063A5D accessed 22 June 2020. A non-exhaustive list of the guidelines that continue to apply is set out in Appendix 2 to the Policy Statement.

[678] Section 1(2) and (3) of the Banking Act 2009, as revised.

Each of the aforementioned stabilization options is achieved by the exercise of one or more "stabilization powers" which include: the resolution instrument powers (sections 12A(2) and 48 U to 48 W); the share transfer powers (sections 15, 16, 26 to 31 and 85), the property transfer powers (sections 33, 41A and 42 to 46) as well as the third country instrument powers (section 89H to 89J – a discussion of which is beyond the scope of this thesis.)[679]

4.8.3 Resolution authority

The BoE is the resolution authority and the Treasury, Prudential Authority and FCA also each has a role in the special resolution regime (collectively referred to as the "authorities").[680] Thus, although the BoE is the formal resolution authority in the UK, it is not solely responsible for bank resolution as the other institutions form part of the authorities actively involved in bank resolution.

Malek, Potts and Dzwig point out that under the BRRD, the resolution function of the relevant resolution authority must be kept operationally separate from its supervisory and other functions. However, unlike some jurisdictions which have chosen to entrust those functions to separate institutions, the UK has kept both bank supervision and resolution within the BoE, as the PRA (which is now part of the BoE),[681] is the bank supervisor and the UK's Resolution Directorate, which is part of the BOE's Deputy Governorship for Financial Stability, is responsible for the resolution function.[682]

Notably the 2009 Banking Act provides extensively in section 83 for the BoE to appoint persons to conduct investigations into banks as instructed by the BoE. Such an investigation would thus reveal whether a bank is operating in unsafe or unsound circumstances.

4.8.4 Pre-resolution powers

Chapter 2 of the revised Banking Act 2009 introduces "pre-resolution powers" for the BoE which include the removal of impediments to the exercise of pre-resolution

[679] Section 1(4) of the Banking Act 2009, as revised.
[680] Section 1(5) of the Banking Act 2009, as revised.
[681] See the discussion of the UK Twin Peaks model in para 6 above.
[682] Malek, Potts, Dzwig *United Kingdom in: Brodie S (Ed)*, *Bank Resolution: Key Issues and Local Perspectives*, (2019) London: INSOL International, 172.

powers. Such pre-resolution powers *inter alia* allow the BoE to give directions to persons to take measures required to address the effective exercise of the stabilization powers or the winding up of an institution.[683] The pre-resolution power may in terms of section 3A(3) of the Banking Act as revised, include directions: to amend a group financial support agreement;[684] where no such agreement exists, to review the need to enter into such agreement; to enter into an agreement regarding the provision of services pertaining to rendering of critical functions; to limit exposures by the failing bank; to provide information to the BoE relevant to the exercise of its stabilization powers; to dispose of certain assets of the failing bank; to cease carrying out certain activities that were previously carried out by the failing bank; to cease the development of new or existing business operations; to change the legal or operational structure of the failing bank or that of a subsidiary; and to establish a financial holding company that is not a subsidiary of an institution, another financial holding company or a mixed financial holding company.[685] The BoE may further direct that a minimum requirement for own funds and eligible liabilities (for bail-in purposes) be maintained by a bank.[686]

4.8.5 Recovery and resolution planning and the resolvability assessment framework

Banks are required to develop their own recovery plans to enable them to recover from an unsound position.[687] The PRA as bank supervisor monitors such recovery planning

[683] Section 3A of the Banking Act 2009, as revised. See also section 3B regarding safeguards relating to directives by the BoE under section 3A.

[684] Section 3A(8) of the Banking Act 2009, as revised states that "group financial support agreement" has the meaning given by section 192JB(4) of the Financial Services and Markets Act 2000. Section 192JB(4) states that "group financial support agreement" means an agreement for the provision of financial support from one member of a group to another which satisfies the conditions set out in Article 19 of Directive 2014/59/EU of the European Parliament and of the Council of 15th May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms.

[685] Section 3A(8) of the Banking Act 2009, as revised states that "mixed financial holding company" has the meaning given by Article 4.1(21) of the capital requirements regulation. Article 4.1(21) of the capital requirements regulation states that a mixed financial holding company means mixed financial holding company as defined in point (15) of Article 2 of Directive 2002/87/EC. Article(15) of Directive 2002/87/EC states that "mixed financial holding company" shall mean a parent undertaking, other than a regulated entity, which together with its subsidiaries, at least one of which is a regulated entity which has its head office in the Community, and other entities, constitutes a financial conglomerate.

[686] Section 3A(4) of the Banking Act 2009, as revised.

[687] See The Bank Recovery and Resolution Order 2016 available at https://www.legislation.gov.uk/ukdsi/2016/9780111151099/contents accessed 9 January 2021. See also BoE PRA Supervisory Statement SS9/17: Recovery Planning (December 2020) (BoE PRA SS) available at https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2020/ss917update-december-

and expects banks to undertake recovery planning "so that they are ready for financial stress, can stabilize their financial position and can recover from financial losses."[688] Minimum requirements for recovery planning as well as various recovery options are set out in the BoE and PRA's Supervision Statement.[689]

The BoE as resolution authority develops a resolution plan for each UK bank and group. Such resolution plan is based on a preferred resolution strategy which generally follows one of three broad resolution strategies: bail-in, partial transfer or insolvency (liquidation).[690] Banks are required to undertake contingency planning for resolution. In order to ensure that resolution plans can be effectively implemented, the BoE undertakes an annual resolvability assessment (in consultation with the PRA or FCA) for each bank to identify any barriers to such bank's resolvability, such as loss-absorbing capacity[691] and cross-border cooperation issues.[692]

2020.pdf?la=en&hash=7EE218D863A63481884C23BD12C17AA72C147F81 accessed 9 January 2021 and PRA Rulebook: Recovery Planning.

688 BoE PRA SS par 1.6.

689 BoE PRA SS par 2.

690 Purple Book 27 para 3.2.

691 Brierley "Ending too-big-to-fail: progress since the crisis, the importance of loss-absorbing capacity and the UK approach to resolution" 2017 *European Business Organization Law Review* 457. Brierley explains the concept as follows: the global financial crisis and its aftermath demonstrated that the largest banks— the global systemically-important banks (G-SIBs)—were too big to fail (TBTF). They had to be bailed out. These bail-outs were followed in some cases by fiscal tightening that led to slowdowns or even recessions in real economies, with wide-ranging costs that are still apparent today. Public fury at this outcome focused on the implications for bank owners and investors—they get the upside when times are good and banks profitable but suffer no downside when times are bad and banks failing. The general taxpayer, by contrast, gets no upside, only the downside. This led to the observation that bank profits are privatised whereas bank losses are socialised. Major steps have been taken since then to end "too big to fail". This involved the development of resolution regimes, the negotiation and agreement of cooperative resolution strategies for global systemically-important banks (G-SIBs); the identification of barriers to resolvability; and paving the way to removing those barriers. A vital aspect of this is requiring all banks to have sufficient loss-absorbing capacity to ensure their orderly resolution. In November 2015, the G20 Leaders endorsed the Financial Stability Board's (FSB) standard for total loss-absorbing capacity (TLAC). A similar concept—known as the Minimum Requirement for Own Funds and Eligible Liabilities (MREL)—is also a key aspect of the EU Bank Recovery and Resolution Directive (BRRD), which has now been implemented in virtually all EU countries. The TLAC "requires G-SIBs to issue sufficient equity and debt that can absorb losses and recapitalise banks—or successor firms to which their critical economic functions have been transferred—in the event of a bank's failure. The famous TLAC 'term sheet' sets out in detail the required quantum and quality of TLAC instruments that G-SIBs need to issue." The "standard's provisions cover two concepts: external TLAC and internal TLAC: External TLAC: comprises the resources that need to be maintained by resolution entities — those entities within G-SIBs to which resolution powers will be applied under the preferred resolution strategy. Internal TLAC: the instruments that need to be issued by 'material' subsidiaries or sub-groups to resolution entities — so losses at failing key operating subsidiaries can be pushed up to the resolution entities without the subsidiaries needing to enter resolution."

692 Purple Book 27 para 3.7.

4.8.6 Special resolution action

Chapter 3 of the revised Banking Act 2009 is titled "Special Resolution Action". It sets out the seven special resolution objectives which the authorities are obliged to observe when resolving a failing bank, namely:[693] to make certain the continuity of banking services in the UK and of critical functions[694] (Objective 1); to protect and enhance the stability of the UK financial system in particular by preventing contagion and maintaining market discipline (Objective 2); to protect and enhance public confidence in the stability of the UK financial system (Objective 3); to protect public funds, including through the minimization of reliance on extraordinary public financial support (Objective 4); to protect covered investors and covered depositors (Objective 5); to protect client assets (Objective 6); and to avoid interfering with property rights in contravention of a convention right within the meaning of the Human Rights Act 1998 (Objective 7). As indicated by section 4(10), the order in which the objectives are listed is not significant and they are required to be balanced as appropriate in each case.

In accordance with section 7 which sets out general conditions for the exercise of stabilization powers, a stabilization power may be exercised in respect of a bank only if the PRA is satisfied that Condition 1, as set out below, is met; *and* if the BoE is satisfied that Conditions 2, 3 and 4 as set out below are met. Condition 1 is that the bank is failing or is likely to fail. Condition 2 is that, having regard to timing and other relevant circumstances, it is not reasonably likely that (ignoring the stabilization powers) action will be taken in respect of the failing bank that will result in Condition 1 ceasing to be met. Condition 3 is that the exercise of the power is necessary in the public interest in the advancement of one or more of the special resolution objectives. Condition 4 is that one or more of the special resolution objectives would not be met to the same extent by the winding up of the failing bank.[695] For purposes of Condition 1 a bank is failing or likely to fail if:

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[693] Section 4(3A) to (9) of the Banking Act 2009, as revised.

[694] Section 3 of the Banking Act 2009, as revised, "critical functions" means "activities, services or operations the discontinuance of which is likely in one or more EEA states— (a) to lead to the disruption of services that are essential to the economy, or (b) to disrupt financial stability, due to the size, market share, external and internal connectedness, complexity or cross-border activities of a bank or a group which includes a bank (with particular regard to the substitutability of those activities, services or operations)."

[695] Section 7(1) to 5 of the Banking Act 2009, as revised. In terms of section 7(5A) read with section 7(5F) the PRA must, after consulting the BoE, treat Condition 1 as met if satisfied that such condition

"(a) it is failing, or is likely to fail, to satisfy the threshold conditions[696] in circumstances where that failure would justify the variation or cancellation by the PRA under section 55J of the Financial Services and Markets Act 2000 of the bank's permission under Part 4A of that Act to carry on one or more regulated activities;

(b) the value of the assets of the bank determined in accordance with the valuation carried out for the purposes of section 6E (pre-resolution valuation) is less than the amount of its liabilities so determined;

(c) the bank is unable to pay its debts or other liabilities as they fall due;

(d) one or more of the paragraphs (a) to (c) will, in the near future, apply to the bank, or

(e) extraordinary public financial support is required in respect of the bank and subsection (5E)[697] does not apply in that respect."

Section 8 is titled "Specific Conditions: private sector purchaser, bridge bank or asset management vehicle". It stipulates that in a "financial assistance"-case[698] the BoE may exercise a stabilization power pertaining to a private sector purchaser, bridge bank or asset management vehicle *only* if approved by the Treasury.

Malek, Potts and Dzwig explain the practical application of the general conditions for a stabilisation option to be used, and the decision-making responsibilities in relation to

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would be met but for financial assistance provided by the Treasury or BoE, disregarding the ordinary market assistance offered by the BoE on its usual terms. The BoE is required by section 7(5B) to treat Condition 2 as met if satisfied that it would be met but for financial assistance as described in section 7(5A). Notably section 7(6) stipulates that the special resolution objectives are not relevant to Conditions 1 and 2.

[696] In terms of section 7(5D) the "threshold conditions refer to threshold conditions for licensing of the bank by the PRA as defined in section 55B(1) of the Financial Services and Markets Act 2000.

[697] Section 7(5E) applies where, in order to remedy a serious disturbance in the UK economy and to preserve financial stability, the extraordinary public support takes any of the following forms:
" (a) a State guarantee to back liquidity facilities provided by central banks;
(b) a State guarantee of newly issued liabilities;
(c) an injection of own funds, or purchase of capital instruments, at prices and on terms that do not confer an advantage upon the bank, where none of the circumstances referred to in subsection (5C)(a),(b) or (c) are present at the time the public support is granted and none of the Cases 1 to 4 in section 6A apply."

[698] In terms of section 8(2) "financial assistance case" means a case where the Treasury notifies the BoE that the Treasury provided financial assistance in respect of a bank for purposes of resolving or reducing a serious threat to the stability of the UK's financial system.

each, as follows:[699] First, the PRA must decide that the bank concerned is *failing or likely to fail*. In making such a decision, the PRA must consult with the BoE.[700] This criterion would be satisfied in the following circumstances:[701] there has been a failure to meet asset or management requirements that would justify the PRA cancelling the failing bank's permission to carry out regulated activities; the failing bank's assets are less than its liabilities; the failing bank is unable to pay its liabilities; or extraordinary public financial support is required but other than to remedy a serious disturbance in the economy of the UK. Second, the BoE must decide that it is not reasonably likely that action other than resolution action will prevent the failure of the bank concerned. In making this decision, the BoE must consult with the PRA, the FCA and the Treasury.[702] Possible alternative actions include supervisory measures such as suspending dividends or management bonuses, financial restructuring or partial sale.[703] The Purple Book indicates that this second condition is deemed met if, *but for* financial assistance from the Treasury or the BoE, it would be met. Insolvency is not required.[704] Any mandatory write-down of capital instruments will be taken into account.[705] Third, the BoE must decide that using a stabilisation option is in the public interest in the advancement of a special resolution objective.[706] For purposes of such decision, the BoE is required to consult with the PRA, the FCA and the Treasury. Fourth, the BoE must decide that the special resolution objectives will not be met to the same extent by a winding-up of the failing bank. Again the BoE is required to consult with the PRA, the FCA and the Treasury in making such decision.[707]

4.8.7 The stabilization options

[699] Malek, Potts, Dzwig *United Kingdom in: Brodie S (Ed)*, *Bank Resolution: Key Issues and Local Perspectives*, (2019) London: INSOL International, 174. See also Purple Book, 15, fig 3.
[700] Section 7(5F) of the Banking Act 2009, as revised.
[701] Section 7(5C) of the Banking Act 2009, as revised.
[702] Section 7(5G) of the Banking Act 2009,as revised.
[703] Purple Book, 14, para 1.22.
[704] Purple Book, 14, para 1.23.
[705] Purple Book, 14, para 1.21.
[706] Section 7(4) of the Banking Act 2009, as revised.
[707] Notably sections 76 and 77 of the Banking Act 2009, as revised, provide that if the Treasury notifies the BOE that the use of a resolution tool would contravene an international-law obligation of the UK, then the BoE cannot exercise that tool.

(a) Private sector purchaser (section 11):[708] This option entails selling all or part of the business of a failing bank to a commercial purchaser. For such purpose the BoE may make one or more share transfer instruments or property transfer instruments.[709] Notably a share transfer instrument or a property transfer may enable the BoE to remove a director or senior manager of the failing bank or to vary or terminate their service contracts or to appoint new directors and senior managers.[710] As pointed out by Malek, Potts and Dzwig, the transfer process will usually follow an auction.[711] The marketing process must be transparent, without conflicts of interest, must take account of the need to act quickly and must maximise the sale price as far as possible.[712] As stated in the Purple Book, banks for which the partial transfer option is appropriate tend to have a single critical function, relating to accounts customers use for everyday payments and cash withdrawals.[713] The tool will be used for banks with between 40,000 and 80,000 transactional accounts,[714] which is below the threshold for bail-in as discussed below. As a minimum, the Purple Book indicates that this tool should mean high-ranking deposits (including FSCS-protected deposits) are transferred with high-quality assets to a private-sector purchaser or bridge bank. The rest of the firm is likely to be put into insolvency.[715]

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[708] See also section 50 regarding compensation arrangements in respect of the sale to a private sector purchaser.
[709] See further section 14 to 32 regarding transfer of securities including shares and section 33 to 48 regarding property transfers.
[710] Section 20 and 36A respectively of the Banking Act 2009, as revised. In terms of section 20(5) and section 36A(4) a "senior manager" means a person who exercises executive functions in the failing bank or banking group company and who is directly responsible and accountable to the directors for the day to day management of such bank or banking group company. Section 81D of the Banking Act 2009, states that "banking group company" means an undertaking which is (or but for the exercise of a stabilization power, would be) in the same group as a bank EU institution or third-country institution (within the meaning of section 81B(9)) and in respect of which any conditions specified in an order made by the Treasury are met.
[711] Malek, Potts, Dzwig *United Kingdom in: Brodie S (Ed)*, *Bank Resolution: Key Issues and Local Perspectives*, (2019) London: INSOL International, 174. See also Purple Book 25 para 2.9.
[712] Section 11A(2) of the Banking Act 2009, as revised.
[713] Purple Book, 16, box 1.
[714] As per the Purple Book at 16, Box 1, a transactional account is one used at least nine times in the three months prior to an annual monitoring date.
[715] *Ibid*.

(b) Bridge bank (section 12): This option entails transferring, by means of share transfer instruments and property transfer instruments, all or parts of the business a failing bank to a bridge bank that is wholly owned and controlled by the BoE. The bridge bank must be created for the purpose of receiving a transfer in accordance with section 12 with a view to maintaining access to critical functions previously rendered by the failing bank and for purposes of selling the failing bank or its business in due course. Where all or substantially all of the bridge bank's assets, rights and liabilities have been transferred to a third party, or following a transfer to the bridge bank under section 12, and no further transfer to the bridge bank is made during the relevant post transfer period, the Act requires the BoE to take steps for the winding up of the bridge bank.[716] Bridge banks are allowed to operate for two years after the share or property transfer from the failing bank (which period may be extended by one year in certain circumstances).[717] Notably however, the BoE will not consider resolution complete, where a bridge bank has been used, until there is a more permanent arrangement.[718]

(c) Asset management vehicle (section 12ZA): This stabilization option entails transferring all or part of the business of the failing bank or (as subsequently transferred to a) bridge bank to one or more asset management vehicles by means of property transfer instruments made by the BoE.[719] For purposes of section 12ZA an asset management vehicle is an undertaking that is wholly or partially owned (directly or indirectly) by the BoE or the Treasury, controlled by the BoE and created for purposes of receiving some or all of the assets, rights and liabilities of one or more failing banks or one or more bridge banks or both.[720] In terms of section 12ZA(4) the asset management vehicle is required to manage

[716] Section 12(1) to (3A) of the Banking Act 2009, as revised. This does however not apply where the bridge bank has merged with another entity, or no longer meets the requirements of its function as bridge bank or has been wound up already – see section 12(3B).
[717] Section 3C and D of the Banking Act 2009, as revised. See also section 12(4) and (5) regarding an "onward bridge bank".
[718] Malek, Potts, Dzwig *United Kingdom in: Brodie S (Ed)*, *Bank Resolution: Key Issues and Local Perspectives*, (2019) London: INSOL International, 169. Purple Book, 26, para 2.35.
[719] Section 12ZA(3) and (5) of the Banking Act 2009, as revised.
[720] Section 12ZA (2) of the Banking Act 2009, as revised.

the assets transferred to it with a view to maximizing their value through eventual sale or orderly winding down. As alluded to above, the asset management tool can only be used together with another resolution tool.[721] It can also only be used if a normal liquidation of the assets would adversely affect financial markets, the transfer of assets is necessary to ensure the proper functioning of the transferring bank or bridge bank; or it would maximise recoveries.[722]

(d) Bail-in option (section 12A): This new tool that has been added to the BoE's resolution toolkit is extensively dealt with in the revised Banking Act 2009. As pointed out by Malek, Potts and Dzwig, and indicated in the Purple Book, the BoE considers the bail-in tool appropriate for the largest banks, with balance sheets of not less than 15 billion to 25 billion British Pound, which are too large to split up or sell to a private purchaser.[723] The bail-in tool in the 2009 Banking Act as revised, entails that the BoE exercises its power to make one or more resolution instruments containing provisions or proposals for any of the following:[724] special bail-in provisions; provision for securities issued by a failing bank to be transferred to a resolution administrator (as discussed below) or another person; proposals regarding the future ownership of a failing bank or its business and any other proposals or provisions deemed appropriate by the BoE. Section 12AA sets out the sequence for write down and conversion of capital instruments and liabilities (debts). The special bail-in provisions are contained in section 48B[725] and entails any of the following (or any combination of the following): a provision cancelling a debt owed by the bank; a provision modifying or changing the form of a debt owed by the bank or a provision that a contract under which the bank is indebted should have effect as if a specified right has been exercised under it. This would, in terms of section 48B(5), entail converting an instrument under which the failing bank owes a debt from

[721] Section 8ZA(2) of the Banking Act 2009, as revised.
[722] Section 8ZA(3) of the Banking Act, as revised; Purple Book, 25 to 26, para 2.25.
[723] Purple Book, 16, box 1.
[724] Section 12A(3) to (6) of the Banking Act 2009, as revised.
[725] See further section 48 D of the Banking Act 2009, as revised regarding the general interpretation of section 48B.

one class to another; replacing it with an instrument of another class; creating a new security or converting debts into securities issued by a bridge bank. Notably the following liabilities of a failing bank are excluded from the bail-in provisions:[726] protected deposits, secured debts; any liability that the bank has by virtue of holding client assets; debts with original maturity of less than 7 days owed to a credit institution or investment firm; liabilities arising from participation in a settlement system; debts owed to an employee or pension scheme; debts owing to creditors arising from the provision of goods or services and debts (levies or contributions) owed to the FSCF as deposit guarantee scheme.

In terms of section 48 of the 2009 Banking Act, as revised, the special bail-in provisions also include any associated provision that the BoE deems appropriate to make in consequence of any provision that is made in the same resolution instrument or another resolution instrument made in respect of the failing bank.[727] Examples of special bail-in provisions include provisions that transactions or events have, or do not have, specified consequences or are required to be treated in a specific manner for specific purposes and provisions discharging persons from further performance of obligations under a contract and dealing with the consequences of such discharge. In terms of section 48B(10) the BoE may exclude any eligible liability or class of liabilities from the application of the bail-in provisions if, and only if, the BoE *inter alia* deems such exclusion justified on one or more of the grounds set out in section 48B(12).[728]

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[726] Section 48B(8) of the Banking Act 2009, as revised.

[727] Section 48B(1) and (2). In terms of section 48B(4) a power to make a special bail-in provision may be exercised only for the purpose of, or in connection with, reducing , deferring or cancelling a debt by a bank but may not be exercised so as to affect any excluded debt.

[728] In terms of section 48B(12) the grounds for exclusion of the application of the bail-in provisions to certain eligible liabilities or class of liabilities are"

"(a) that it is not reasonably possible to give effect to a special bail-in provision in relation to the liability or class within a reasonable time;

(b) that the exclusion is necessary and proportionate to achieve the continuity of the critical functions and core business lines in a manner that maintains the ability of the bank to continue key operations, services and transactions;

(c) that the exclusion is necessary and proportionate to avoid giving rise to widespread contagion, in particular as regards protected deposits held by natural persons or micro-enterprises, small enterprises or medium-sized enterprises, which would severely disrupt the functioning of

(e) public ownership (section 13):[729] This option entails that the Treasury will make share transfer instruments in terms whereof the shares of the failing bank are transferred to a nominee of the Treasury or a company that is wholly owned by the Treasury.[730] It thus contemplates temporary nationalization of the failing bank. In addition to the usual conditions for resolution, the Treasury may only take a bank into temporary public ownership if satisfied that it is necessary to resolve or reduce a serious threat to the UK financial system, or to protect the public interest in those instances where the Treasury has provided financial assistance.[731] Prior to deciding to take a bank into temporary public ownership the Treasury must consult the PRA, the FCA and the BoE.

4.8.8 Resolution instruments and safeguards

When applying the stabilization powers the BoE is required by section 48B of the 2009 Banking Act as revised, to duly consider the following safeguards: the principle that all the liabilities of the bank should be treated in accordance with the priority they would enjoy during liquidation; the principle that creditors who would have equal priority in a liquidation should be treated equally and bear losses on an equal footing; the level of loss absorbing capacity[732] that would remain in the bank pursuant to an exclusion of certain liabilities; and the need to maintain adequate resources to deal with the implications for public funds as a result of anything that is done in future in connection with the exercise of one or more stabilization powers.[733] The BoE is further required by section 48E to report to the Chancellor of the Exchequer regarding its application of the special bail-in provisions and any deviation from the "insolvency treatment

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financial markets, including financial market infrastructures, in a manner that could cause a serious disturbance to the economy of an EEA state;

(d) that the making of special bail-in provision in relation to the liability would cause a reduction in value such that the losses borne by other creditors would be higher than if the liability were excluded." See further section 48C regarding the meaning of "protected deposits."

[729] See also section 50 regarding compensation arrangements in respect of temporary public ownership.

[730] Section 13 of the Banking Act 2009, as revised. The company wholly owned by the Treasury must be distinguished from a company wholly owned by the BoE which is used for application of the bridge bank stabilization option in section 12.

[731] Section 9(1) to ((4) Banking Act 2009, as revised.

[732] See Footnote 16 above.

[733] Section 48B(13) Banking Act 2009, as revised.

principles"[734] that creditors of the same class should generally suffer no greater loss than would be suffered if the failing bank had been liquidated instead and that creditors of the same class should be treated equally in relation to the losses they suffer (thus observing the "no shareholder or creditor worse off" principle and the *pari passu*-principle). In particular section 60B deals with the "no shareholder or creditor worse off"- principle under the heading "[P]rinciple of no less favourable treatment".[735]

In terms of section 48H a resolution instrument may require a resolution administrator or one or more directors of the failing bank to draw up a "business reorganization plan" with respect to that bank, which plan must then be submitted to the BoE for approval. A business reorganization means a plan that includes an assessment of the factors that caused the bank to be failing; a description of the measures that have to be adopted with a view to restoring the viability of the failing bank; and a timetable for the implementation of such measures.[736] Provision is further made in section 48N regarding the power of the BoE to remove directors and senior managers, to vary or terminate other service contracts or to appoint new directors or senior managers. A resolution instrument made in the context of bail-in may further require the directors of the failing bank to comply with directions set out in such instrument.[737] Section 48P deals with orders to safeguard certain protected financial arrangements which include security interest, title transfer collateral agreements, set-off arrangements and netting arrangements.[738] This protection entails the restriction of the exercise of powers that

[734] Section 48E(4) Banking Act 2009, as revised provides that the insolvency treatment principles are that where an instrument includes special bail-in provision-

(a) the provision made by the instrument must be consistent with treating all the liabilities of the bank in accordance with the priority that they would enjoy on a liquidation, and

(b) any creditors who would have equal priority on a liquidation are to bear losses on an equal footing with each other." See also section 48G (priority between creditors).

[735] See also section 48L(1) of the Banking Act 2009, as revised which provides for the cancellation and modification of securities and conversion of securities from one form or class to another and section 60A regarding compensation arrangements during bail-in.

[736] Section 48H(2) of the Banking Act 2009, as revised.

[737] Section 48O of the Banking Act 2009, as revised.

[738] Section 48P(2) provides the following descriptions of these protected financial arrangements: "netting arrangements" means "arrangements under which a number of claims or obligations can be converted into a net claim or obligation", and includes, in particular, "close-out" netting arrangements, under which "actual or theoretical debts are calculated during the course of a contract for the purpose of enabling them to be set off against each other or to be converted into a net debt"; "security interests" means arrangements under which "one person acquires, by way of security, an actual or contingent interest in the property of another"; "set-off arrangements" means "arrangements under which two or more debts, claims or obligations can be set off against each other"; "title transfer collateral arrangements" means "arrangements under which Person 1 transfers assets to Person 2 on terms providing for Person 2 to transfer assets if specified obligations are discharged."

might affect protected arrangements; imposing conditions on the exercise of such powers; requiring an instrument that makes special bail-in provision to also provide for protected arrangements; providing for a resolution instrument to be void or voidable if the instrument contravenes an order made for purposes of protecting the protected financial arrangements; and specifying principles with which the BoE is required to comply in respect of exercising powers that involve protected arrangements or that may affect protected arrangements.[739]

4.8.9 Resolution Funding

In terms of section 3A(2) of the Banking Act 2009, as revised, the BoE as resolution authority may direct a "relevant person" to "take measures to address impediments to resolvability, specifically in relation to their capabilities and arrangements to support funding in resolution." Such relevant person includes the failing bank itself, its holding company or a subsidiary of the bank. Banks are also required to monitor and mobilise liquidity sources for resolution purposes.[740]

Section 58 of the Banking Act 2009, as revised provides for a resolution fund order to *inter alia* determine: who will be entitled to share in the proceeds where property that has been transferred has been sold; how such proceeds will be calculated and the manner of calculation of the share in the proceeds. The section also sets out the parameters within which resolution funding can be applied.

4.8.10 Resolution administrator

In terms of section 62B of the Banking Act 2009, as revised, the BoE may appoint an individual or a body corporate as a "resolution administrator".[741] The resolution administrator is appointed to hold any securities that may be transferred or issued to it in its capacity as resolution administrator and must perform any other functions conferred on it by Part 1 of the Banking Act 2009, as revised. The resolution

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[739] Section 48P(3) of the Banking Act 2009, as revised.

[740] See further BoE *Appendix 2: The Bank of England's Statement of Policy on Funding in Resolution* (July 2019) available at https://www.bankofengland.co.uk/-/media/boe/files/paper/2019/bank-of-england-funding-in-resolution-sop.pdf accessed 9 January 2021.

[741] More than one resolution administrators may be appointed – see section 62B(5) of the Banking Act 2009, as revised. As per section 62D a "resolution administrator" is "not a servant or agent of the Crown (and in particular, is not a civil servant).

administrator is obliged to take all measures necessary to promote the special resolution objectives and must in the execution of its functions also observe any other objectives specified in an instrument issued under Part 1 or in the instrument in terms whereof he was appointed.[742] Further functions of a resolution administrator as specified in section 62C include: managing the failing bank's business or exercising any other power in relation to management of such bank's business; exercising any other powers of the failing bank; exercising any powers that the BoE may consider appropriate. In terms of section 62D(1) the resolution administrator may "do anything necessary or desirable for the purposes of or in connection with the performance of the functions" of his office as resolution administrator.

Notably a resolution administrator is appointed to manage a bank in resolution and assist the BoE in the implementation of a resolution plan and is not to be confused with a "bank administrator" appointed under Part 3 of the Banking Act, as discussed in more detail below.

4.9. Bank Administration under Part 3 of the Banking Act 2009, as revised

4.9.1 Introduction

In the Explanatory Notes on the Banking Act 2009, as revised it is stated, regarding Part 3, that: "This Part establishes a new bank administration procedure for use where there has been a partial transfer of business from a failing bank. A bank administrator may be appointed by the court to administer the affairs of an insolvent *residual* bank created where part of a bank has been transferred to a private sector purchaser or to a bridge bank under the SRR."[743]

Section 114(1) of the Banking Act 2009, as revised provides that a bank liquidator who thinks that administration would "achieve a better result for the bank's creditors as a whole than bank insolvency" may apply to the court for an administration order. Such application is then made under paragraph 38 of Schedule B1 to the Insolvency Act 1986. In terms of section 114(2) an application for an administration order may be made only if the following three conditions are satisfied: Condition 1 is that the

[742] Section 62B(8) of the Banking Act 2009, as revised.
[743] HM Treasury *Banking Act 2009 Explanatory Notes* para 10 available at https://www.legislation.gov.uk/ukpga/2009/1/notes/contents accessed 26 January 2021.

liquidation committee has passed a full payment resolution; Condition 2 is that the liquidation committee has resolved that "moving to administration might enable the rescue of the bank as a going concern"; and Condition 3 is that "the bank liquidator is satisfied, as a result of arrangements made with the FSCS, that any depositors still eligible for compensation under the scheme will receive their payments or have their accounts transferred during administration."

Section 120 inter alia provides that an application for an administration order in respect of a failing bank may not be determined and an administrator of such bank may not be appointed unless the following conditions are satisfied: Condition 1 is that PRA and the BoE has been notified by the applicant for an administration order, that the application has been made. Condition 2 is that a copy of the notice complying with Condition 1 has been filed with the court and that the court subsequently made it available for public inspection. Condition 3 is that the period of two weeks, beginning with the day on which the notice is received, has ended, and the BoE has informed such person that it does not intend to apply for a bank insolvency order or exercise a stabilization power under Part 1. In addition both the BoE and the PRA must have informed the person who gave the notice that it does not intend to apply for a bank insolvency order. Condition 4 is that no application for a bank insolvency proceeding is pending.[744]

Part 3 of the Banking Act 2009 contains various provisions setting out the framework for the bank administration process which is now, unlike the general administration procedure under the Insolvency Act that was previously used to also deal with failing banks more broadly as a species of corporate entities, a special tailormade administration process created specifically for banks. These provisions must be read together with the administration provisions in the Insolvency Act, 1986 (in relation to the parts of administration provisions in the Banking Act 2009 that refer to "normal administration") and the Bank Administration (England and Wales Rules) 2009.[745] In terms of section 136(2) of the Banking Act 2009 as revised, the main features of bank administration are that:

[744] Section 120(1) read with section 120(4),(5),(6),(7) and (8).

[745] The Bank Administration (England and Wales) Rules 2009, Statutory Instrument No 357 of 2009 (hereinafter the Bank Administration Rules) available at http://www.legislation.gov.uk/uksi/2009/357/contents/made accessed 22 June 2020. The purpose of these rules is to prescribe a procedure for the appointment of a bank administrator and the operation of bank administration – see Rule 6.

(a) it is used where part[746] of the business of a bank is sold to a private sector purchaser in terms of section 11 or is transferred to a bridge bank in terms of section 12 (and it can also be used in certain cases of multiple transfers under Part 1);

(b) the court appoints a bank administrator[747] on application by the BoE;

(c) the bank administrator is able and must ensure that the remaining part of the failing bank that was not sold or transferred ("the residual bank") provides services or facilities required to enable the private sector purchaser or the bridge bank to operate effectively; and

(d) in other respects the process is the same as for normal administration under the Insolvency Act 1986, subject to specified modifications.[748]

Bank administration orders are provided for in section 141 which describes a bank administration order as "an order appointing a person as the bank administrator of a bank".[749] An application for a bank administration order may, in terms of section 142(1) of the 2009 Banking Act, as revised, be made to the court by the BoE and must nominate a person to be appointed as the bank administrator.[750] Eligibility for appointment as a bank administrator is reserved for persons qualified to act as insolvency practitioners.

The BoE may apply for a bank administration order in respect of a failing bank if the following conditions are met: Condition 1 is that the BoE has made or intends to make a property transfer instrument in respect of the failing bank in accordance with section 11(2) (private sector purchaser) or 12(2) (bridge bank). Condition 2 is that the BoE is satisfied that the residual bank is unable to pay its debts, or is likely to become unable

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746 Part means senses relating to a portion or division of a whole. See Oxford English Dictionary available at https://www.oed.com/view/Entry/138188?rskey=433zP2&result=1#eid accessed 22 June 2020.

747 In terms of section 146 a bank administrator is an officer of court.

748 See the discussion of normal administration under the Insolvency Act 1986 in para 3 above.

749 See Bank Administration Rule 9 regarding the content of a bank administration order and Rule 11 regarding the statement by the proposed bank administrator that must accompany the application for an administration order as well as Rule 12 that sets out the content of the witness statement by the BoE that must be filed when a bank administration order is applied for.

750 Section 142(1) read with section 142(2) of the Banking Act 2009. In terms of section 142(3) the bank that is to be placed under administration must be given notice of an application for an administration order , in accordance with rules under section 411 of the Insolvency Act 1986 (as applied by section 160 of the Banking Act 2009).

to pay its debts as a result of the property transfer instrument which the Bank intends to make.[751] The court may then grant a bank administration order if satisfied that the conditions in section 143 were met. Alternatively it may adjourn or dismiss the application for an administration order. As per section 141(4) a bank administration order takes effect in accordance with its terms; and the process of a bank administration order having effect may be described as "bank administration" in relation to the bank, and while the order has effect the bank may be described as being "in bank administration".

4.9.2 Objectives of bank administration

As set out in section 137, the objectives of bank administration are two-fold, namely: Objective 1 is support for the private sector purchaser or bridge bank,[752] and Objective 2 entails "normal" administration. Objective 1 takes priority over Objective 2 but a bank administrator is obliged to begin working towards both objectives immediately once he is appointed.[753] The first objective of bank administration under the Banking Act 2009, that of supporting a private sector purchaser or bridge bank, is dealt with in more detail in section 138. As elaborated in section 138(1), Objective 1 is to ensure the supply to the private sector purchaser or bridge bank of such services and facilities as are required to enable it, in the opinion of the BoE, to operate effectively.[754] In the case of bank administration following a private sector purchase, the bank administrator is obliged to co-operate with any request of the BoE to enter into an agreement for the residual bank to provide services or facilities to the private sector purchaser. Further, in pursuing Objective 1, the bank administrator must have regard to the terms of that or any other agreement entered into between the residual bank and the private sector purchaser. In particular, the bank administrator is obliged to avoid any action that is

[751] Section143(1) and (2) of the Banking Act 2009, as revised.

[752] Where there has been a multiple transfer (for example, a transfer to a private sector purchaser as well as a transfer to a bridge bank) as occurred in the case of Dunfermline Building Society then Objective 1 must be pursued in relation to each transferee that, in the BoE's opinion, requires such services and facilities.

[753] Section 137(1) and (2) of the Banking Act 2009, as revised.

[754] Section 139(2) of the Banking Act 2009, as revised, stipulates that for the purposes of Objective 1 the reference to services and facilities includes a reference to acting as transferor or transferee under a supplemental or reverse property transfer instrument, and the reference to "supply" includes a reference to supply by persons other than the residual bank.

likely to prejudice performance by the residual bank of its obligations in accordance with those agreed terms.[755]

In the case of bank administration pursuant to transfer to a bridge bank, the bank administrator is obliged to co-operate with any request of the BoE to enter into an agreement for the residual bank to provide services or facilities to the bridge bank. Like with the position in relation to a private sector purchaser, the bank administrator is also in relation to administration following transfer to a bridge bank, obliged in terms of section 138 of the 2009 Banking Act, as revised, to avoid any action that is likely to prejudice performance by the residual bank of its obligations in accordance with an agreement to provide services or facilities. The administrator must further ensure that, as far as is reasonably practicable, an agreement entered into includes provision for consideration at market rate.[756] Where a bank administrator requires the BoE's consent or approval with regard to any action in accordance with Part 3, section 138(3) provides that the BoE may withhold such consent or approval *only* on the grounds that the action might prejudice the achievement of Objective 1.

Section 139 deals with the duration of Objective 1. It provides that Objective 1 (support to private sector purchaser or bridge bank) ceases if the BoE notifies the bank administrator via an "Objective 1 Achievement Notice" that the residual bank is no longer required in connection with the private sector purchaser or bridge bank.[757] Section 140 deals with "Objective 2: 'normal' administration". Section 140 indicates that normal administration is aimed at rescuing the residual bank as a going concern ("Objective 2(a)"), or alternatively achieving a better result for the residual bank's creditors as a whole than would be likely if the residual bank were wound up without

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[755] See section 138(3)(a) to (d) of the Banking Act 2009, as revised. If the bank administrator is in doubt regarding the effect of those terms, he may apply to the court for directions under paragraph 63 of Schedule B1 to the Insolvency Act, 1986 (applied by section 145 of the Banking Act 2009). The private sector purchaser may also refer a dispute about any agreement with the residual bank, to the court by applying for directions under paragraph 63 of Schedule B1 to the Insolvency Act.

[756] Section 138(4)(a) and (b) of the Banking Act 2009, as revised. Section 138(4)(c) stipulates that section 138(4) paragraph (b) does not prevent the bank administrator from entering into an agreement on any terms that the bank administrator thinks necessary in pursuit of Objective 1. In terms of section 138(4)(d) paragraph (c) does not apply after Objective 1 ceases.

[757] Section 139(2) of the Banking Act 2009. A bank administrator who is of the opinion that Objective 1 is no longer required may apply to the court for directions under paragraph 63 of Schedule B1 to the Insolvency Act, 1986 (applied by section 145 of the Banking Act 2009); in which instance the court may direct the BoE to consider whether to give notice under section 139 (1). Note also section 139(3) which states that if immediately upon the granting of a bank administration order, the BoE is of the view that the residual bank is not required in connection with the private sector purchaser or bridge bank, the BoE may give An "Objective 1 Achievement Notice" notice under section 139(1).

first being put under bank administration ("Objective 2(b)"). In pursuing Objective 2 a bank administrator is consequently required to aim to achieve the rescue of the residual bank as going concern (Objective 2(a)) *unless* he is of the opinion either that it is not reasonably practicable to achieve such rescue of the residual bank as a going concern, or that Objective 2(b) would achieve a better result for the residual bank's creditors as a whole.[758] In pursuing Objective 2(b) in bank administration following transfer to a bridge bank, the bank administrator may however not sell any asset unless such asset is on a list of realizable assets agreed between the bank administrator and the BoE, or unless the BoE has given an Objective 1 Achievement Notice (thus indicating that the residual bank is no longer required in connection with the private sector purchaser or bridge bank).[759]

4.9.3 General powers and duties of bank administrator

The general powers and duties of the bank administrator are dealt with in section 145. In terms of section 145(1) a bank administrator may do "anything necessary or expedient" for the pursuit of the objectives mentioned in section 137. The Bank administrator's duties are the same as those contained in Schedule B1 of the Insolvency Act 1986, as revised but are subject to certain modifications as set out in section 145(4) read with "Table 1 of Applied Provisions" in the Banking Act 2009, as revised. The modifications relate mainly to terminology such as, for example, the use of the word "bank administrator" instead of administrator" and the use of the word "bank administration " instead of "administration" and requirements that certain actions may only be taken after the BoE has given an "Objective 1 Achievement Notice" or requiring that the objectives of bank resolution as set out in the Banking Act be observed at various stages of the bank administration procedure.[760]

Section 147 deals with the bank administrator's proposals and applies before the giving of an Objective 1 Achievement Notice by the BoE.[761] In accordance with section 147(2) the bank administrator must, as soon as is reasonably practicable after his appointment, make a statement setting out proposals for achieving the objectives in

[758] Section 140(1) and (2) of the Banking Act 2009, as revised.
[759] Section 120(3) of the Banking Act 2009, as revised.
[760] See para 9.2 above.
[761] At which point paragraph 49 of Schedule B1 to the Insolvency Act 1986 applies in accordance with section 145 – see section147(1).

section 137. The statement must: indicate whether the bank administrator proposes to pursue Objective 2(a) or 2(b) in section 140; and it must have been agreed with the BoE.[762] The bank administrator must send the statement to the PRA and may also revise the statement.[763] Bank Administration Rule 28 elaborates on the process to be followed in relation to the bank administrator's proposals during the Objective 1 stage and indicates further information, in addition to the information required by section 147 that the statement of proposals must include.[764] Provision for the bank administrator's statement of proposals which he is required to make under paragraph 49 of Schedule B1 to the Insolvency Act as it applies during the Objective 2 stage of bank administration are fleshed out in Bank Administration Rule 29.[765] Notably Table 1 of

[762] Section 147(3) and (4). In terms of section 137(5) a bank administrator who is unable to agree a statement with the BoE may apply to the court for directions under paragraph 63 of Schedule B1 to the Insolvency Act 1986 (as applied by section 145 of the Banking Act 2009). The court may then make any order, including dispensing with the need for the BoE's agreement.

[763] In terms of section 147(8) the bank administrator's statement containing his proposal for achieving the section 137-objectives must be treated in the same way (subject to this section 149) as a statement under para 49 of Schedule B1 to the Insolvency Act 1986.

[764] This additional information required in terms of Bank administration Rule 28 are: details of the court and court reference number; details of the bank; details of the bank administrator's appointment; in the case of joint bank administrators details of how they will apportion their functions; the names of the directors and secretary of the bank and details of any shareholding they have in the bank; an account of the circumstances that led to the application for the appointment of the bank administrator; if a statement of the bank's affairs was submitted, a copy of a summary thereof with comments by the administrator; information relating to an order limiting disclosure (if any) of the statement of the bank's affairs; if a full statement of affairs is not provided detail regarding the bank's creditors; proposals regarding the administrator's remuneration; how the bank administrator proposes to pursue Objective 1 and whether he proposes to pursue Objective 2(a) or Objective 2(b); if he proposes to pursue Objective 2(a) an explanation of how bank administration will be achieved in that stage; If he proposes to pursue Objective 2(b) an explanation of how bank administration will be achieved in the Objective 2(b) stage; the manner in which the affairs and business of the bank had been managed since the date of the administrator's appointment (including the reasons for and the terms of any asset disposals); and the manner in which the bank's affairs and business will be managed and financed if the administrator's proposals are approved.

[765] See also Table 1 in section 145(6) of the Banking Act 2009, as revised. Bank Administration Rule 29 provides that the Objective 2 statement of proposals must include: "details of the court and court reference number; details of the bank; details of the administrator's appointment; in the case of joint bank administrators details of how they will apportion their functions; the names of the directors and secretary of the bank and details of any shareholding they have in the bank; an account of the circumstances that led to the application for the appointment of the bank administrator; if a statement of the bank's affairs was submitted, a copy of a summary thereof with comments by the administrator; information relating to an order limiting disclosure (if any) of the statement of the bank's affairs; if a full statement of affairs is not provided detail regarding the bank's creditors; proposals regarding the administrator's remuneration; details of whether (and why) the bank administrator proposes to apply to the court under section 176A (5) of the Insolvency Act (omission of distribution to unsecured creditors: as applied by Table 2 in section 145(6) of the Banking Act 2009)[unless the administrator intends to propose a company voluntary arrangement]; an estimate of the value of the prescribed part for purposes of section 176A (unless the bank administrator intends to propose a company voluntary arrangement); an estimate of the value of the bank's net property (unless the bank administrator intends to propose a company voluntary arrangement); whether the administrator will pursue Objective 2(a) or Objective 2(b); if he proposes to pursue Objective 2(a) how he envisages that the purpose of bank administration will be achieved; alternatively if he proposes to pursue

the Applied Provisions as set out in the Banking Act requires the bank administrator, prior to making proposals in the case of a bank administration following transfer to a bridge bank, to consult the BoE about the chances of a payment to the residual bank from a scheme established by the resolution fund order under section 49(3) of the Banking Act 2009, as revised.

Section 148, titled "Information Sharing" applies to bank administration following transfer to a bridge bank. Within 5 days beginning with the day on which the bank administrator is appointed, the BoE is required to give the bank administrator information about the financial positions of both the residual bank and the bridge bank. While the residual bank is in bank administration the bridge bank must give the bank administrator, on request, such information about the financial position of the bridge bank that the bank administrator requires for the purposes of pursuing Objective 1 in section 137, namely providing support to the bridge bank. Until the BoE has given an Objective 1 Achievement Notice, the bank administrator must give the BoE information on request; allow the BoE access to records on request; give the bridge bank information on request; allow the bridge bank access to records on request; keep the BoE informed about, and allow the BoE to participate in, any discussions between the bank administrator and another person which relate to, or are likely to affect, pursuit of Objective 1 in section 137; and keep the bridge bank informed about, and allow the bridge bank to participate in, any discussions between the bank administrator and another person which relate to, or are likely to affect, the pursuit of Objective 1 in section 137.

During the bank administration procedure the administrator must, in terms of Bank Administration Rule 35, submit a progress report to the creditors every six months[766] which must include: details of the court where the proceedings are instituted and the court reference number, details of the bank concerned; full details of the bank administrator; in the case of joint bank administrators, details of the apportionment of

Objective 2(b) he must indicate how he envisages that the purpose of the bank administration will be achieved, and how he proposes that the bank administration shall end (that is, winding up or voluntary arrangement, in accordance with section 152 of the Banking Act, 2009); the reasons in the event that the administrator has decided not to call a meeting of creditors; the manner in which the affairs and business of the bank had been managed and financed since it was put under administration; the manner in which the administrator will manage the bank and its affairs if his proposals are approved and any other information the administrator deems necessary to enable creditors to decide whether or not to vote for the approval of the proposals."

[766] Bank Administration Rule 36.

their functions; details of any extensions of the initial period of the administrator's appointment; details of progress during the period of the report, including a receipts and payments account;[767] details of any assets that remain to be realised; details of any amounts received from a scheme under a resolution fund order, and any other information likely to be relevant to the creditors. During the Objective 1 Stage, Bank Administration Rule 35(3) requires the progress report to include details of: the extent of the business of the bank that has been transferred; any property, rights or liabilities that have been transferred, or which the bank administrator expects to be transferred, under a power in Part 1 of the Banking Act 2009; any requirements imposed on the residual bank, for the purpose of the pursuit of Objective 1, under a power in Part, and the arrangements for managing and financing the bank during the Objective 1 Stage.

Section 153, titled "Successful rescue", applies if the BoE has given an "Objective 1 Achievement Notice" and the bank administrator has pursued Objective 2(a) (in section 140) and believes that it has been achieved. The bank administrator may then give a notice bringing his appointment to an end on the achievement of such objectives.[768] Where the BoE has given an Objective 1 Achievement Notice, and the bank administrator pursues Objective 2(b) (achieving a better result for the creditors as a whole) the bank administrator may give a notice under paragraph 84 of Schedule B1 to the Insolvency Act 1986 (indicating that there are no more assets for distribution), or may make a proposal in accordance with section 1 of the Insolvency Act for a company voluntary arrangement.[769]

4.10 Conclusion

From the overview provided in this Chapter the UK, despite being one of the most prominent financial centres in the world, took a rather informal and flexible approach to bank supervision which, to some extent, also explains why it only actively moved towards the adoption of a special bank resolution regime after the Northern Rock-crisis.

[767] In terms of Rule 35(2) a receipts and payments account must state what assets of the bank have been realised, the value they fetched, and the payments have been made to creditors or others.

[768] Section 153(2) Banking Act 2009, as revised. Such notice is brought under paragraph 80 of Schedule B1 to the Insolvency Act 1986. A bank administrator who gives a notice in accordance with section 153 (2) must send a copy to the FSA. In terms of section 153(4) failure without reasonable excuse to comply with section 153(3) is an offence. See further Bank Administration Rule 48 (End of administration: successful rescue) and Bank Administration Rule 49 (End of Administration; dissolution).

[769] Section 154(1) and (2) Banking Act 2009, as revised.

This “relaxed” approach is evident from the fact that the UK only formalized its banking regulation regime when the Banking Act 1979 was adopted after the 1973-74 Secondary Banking Crisis. Pursuant to the Johnson Matthey Bank-crisis more stringent regulation followed with the adoption of the 1987 Banking Act and the introduction of a deposit protection scheme. The failure of BCCI and Barings Bank triggered further reforms that *inter alia* entailed the BoE relinquishing its powers of bank supervision to the FSA that, at the time, was a mega-regulator tasked with both prudential and market conduct supervision of financial institutions in the UK. During all these years no dedicated legislative framework for dealing with failing banks existed and the notion was that bank failure could be handled either under the administration procedure in the Insolvency Act as a rescue mechanism failing which the bank would be liquidated. The collapse of Northern Rock shortly before the GFC however put the way in which the UK dealt with bank failures on a very different and more pro-active regulatory trajectory. As pointed out much of the blame for how the Northern Rock-incident was blamed was laid at the feet of the then existing tripartite authorities, namely the BoE, Treasury and the FSA. The 2008 GFC also proved to be a cathartic experience for the globally interconnected UK financial system and the trigger for more significant reforms in its approach to dealing with bank failure.

The “general” or normal” administration process that was generally applied to companies under the UK Insolvency Act bears some resemblance to the process of curatorship used as a rescue mechanism in Zimbabwe and also, as will be discussed in Chapter Five, in South Africa. The trigger for its application was inability by a failing bank to pay its debts upon which event the judicial realm was then entered by applying to court to make an order placing such failing bank under administration. The administration process was implemented by an administrator who took over the management of the failing bank in an attempt to facilitate its rescue. A moratorium kicked in from the moment the petition for an administration order was made thus preventing litigious creditors from laying their hands on the bank’s assets and ruining its chances of recovery. The administrator had relatively wide powers *inter alia* enabling him to sell assets and raise or borrow money against security and to operate the failing bank’s business and appoint or dismiss employees topped up by a catch all power to “do all things incidental” to the exercise of his powers of administration. The

Insolvency Act also imposed various duties on the administrator to ensure the effective execution of the administration procedure.

The drawback was however that this administration procedure was never written specifically with a bank in mind but more broadly for companies. As such it was a rather convoluted procedure with many procedural layers and, instead of being an administrative process that occurred outside the judicial sphere, it was a court-driven process in which the ultimate discretion as to how to deal with the failing bank lay with the court instead of the regulator tasked with bank supervision. The administration process also hinged heavily on obtaining creditor approval for proposals by the administrator aimed at dealing with the distressed bank. If creditors and shareholders were of the opinion that their interest were not being properly served by the administrator, they could derail the administration process by applying for the administrator's discharge. Also, the administration process was a reactionary process, implemented only when a bank reached a certain level of financial distress and no framework was in place to "responsibilize" the bank to plan ahead for how it would recover if it fell on hard times. The new "streamlined" administration procedure introduced by the Insolvency Act of 2000 brought about some changes to the administration process and had a clearer rescue focus but it was evident that the interests of creditors still drove this process which was not tailormade specifically for failing banks with their failure having more direct implications for financial stability in the UK.

The run on Northern Rock, combined with the onset of the 2008 GFC, provided the wake-up call for the UK in relation to the importance of a dedicated framework for dealing with and resolving failing banks. The gaps in the way that the UK approached bank failure were exposed and led the UK towards adopting a special resolution regime for banks aimed at facilitating the orderly closure of a failing bank before it was bled dry of equity and transfer of the bank and continuation of its critical operations where viable. This new regime, albeit limited in scope, was introduced by the Banking (Special Provisions Act) 2008 that put a very different spin on the UK's approach to dealing with bank failure and the resolution of failing banks. Now it was not merely creditors interests that drove the process but a broader goal, namely the maintenance of financial stability and the protection of the public interest in a stable financial system whilst acknowledging the pressure that a financial bail-out puts on the taxpayer. The

2008 Act provided for special purpose vehicles to which property rights and liabilities of a failing bank could be transferred in an attempt to deal, in particular, with the Northern Rock-failure. It was thus not a long term resolution framework that was introduced but rather an ad hoc measure focused on a singular bank failure - but it nevertheless paved the way for a more innovative and comprehensive approach to bank failure to be introduced by the Banking Act 2009.

The Banking Act 2009, as the first *lex specialis* for facilitating orderly bank resolution in the lead-up to the UK's transition to a Twin Peaks model of financial regulation, changed the regulatory approach to dealing with bank failure most significantly. The bespoke special resolution regime for banks introduced by the 2009 Act set out clear objectives for bank resolution which acknowledged the need to preserve financial system stability. It emphasized the need for stabilizing the situation of the distressed bank through three specific stabilization options, namely transfer to a private sector purchaser; transfer to a bridge bank and transfer to temporary public ownership. This bespoke legislation introduced in the UK provided guidance when the EU subsequently drafted the BRRD which then had to be transposed by the UK (as EU member state at the time) into its domestic legislation.

The EU's BRRD embodied a decided move away from bail-out as the go-to-option for dealing with a bank that was failing. The comprehensive and pro-active regime captured in the BRRD consists of various measures that build onto each other and that are implemented at different stages during bank supervision in order to firstly try and prevent bank failure through recovery planning and subsequently implementing early intervention measures and, if these measures do not suffice, then to resolve the failing bank in a holistic and orderly manner. Resolution is then applied in accordance with a resolution plan that was conceptualized well in advance at a time when sound regulatory planning was not yet tainted by haphazard plans made during the adrenaline fuzz spiked by a crisis. Smoothing the resolution process into a well-planned execution of various measures that would enable continuation of critical functions became the overriding theme of the BRRD. Notably the BRRD introduced the innovative "bail-in" tool onto the EU bank resolution scene thus spectacularly extending the suite of powers that could be applied during bank resolution.

Attempts to *prevent* banks from failing (thus to make sure that they do not fail and have to be put in resolution) under the BRRD were facilitated by the mechanism put in place for the appointment of a temporary administrator to restore the bank's stability and prudent management within a period of one year or less. The temporary administrator was appointed as part of recovery efforts to ensure that a bank remains safe and sound and does not fail hence the temporary administrator is given intrusive powers permitting him to make changes to the bank's capital and ownership structure to avert its failure. The BRRD also introduces an element of proportionality into the rescue procedure carried out by a temporary administrator by allowing the resolution authority to decide what powers would be most suitable to give such administrator in relation to a specific failed bank. The BRRD further specifically requires the temporary administrator to be suitable for the job and ensures a sufficient degree of supervision of such administrator by requiring prior consent from the resolution authority for certain acts to be executed by the administrator. Although shareholders lose their control over the failing bank once a temporary manager is appointed to try and manage the bank to viability, the rights of shareholders are nevertheless protected by the provision that the appointment of a temporary administrator should not prejudice the rights of shareholders.

The emphasis that the BRRD places on timely triggering of the resolution regime is also pertinent as the timing of resolution is crucial to how effective and orderly such resolution will eventually turn out to be. Consequently the requirement that entry into resolution should occur before equity is wiped out and the bank reaches an insolvent state would contribute to avoiding regulatory inertia and forbearance that may compromise the effective and orderly resolution of the failing bank and impact negatively on financial system stability. Clarity on when to implement the resolution regime in relation to a failing bank is consequently provided by the resolution conditions set out in the BRRD for triggering such resolution. During the resolution phase the resolution authority may appoint a "special manager" to take over the management of the bank concerned and implement the resolution authority's decisions pertaining to resolution.

It is further clear that the BRRD encourages a sensible and proportional approach to resolution that would ensure that a failing bank with no prospect of being restored to viability will not be kept alive artificially for such a long period that creditors and

shareholders are hung out to dry and financial system stability is compromised. The range of resolution tools availed by the BRRD are well-conceptualized and cover the whole spectrum of options that could be applied to ensure that the resolution of a failing bank is undertaken in an optimal and orderly manner, namely: the sale of business tool; the bridge institution tool; the asset separation tool ("bad bank"/ "good bank"-split) and the bail-in tool as "state-of-the-art" cornerstone tool that seeks to reduce the use of public funds in resolving failing banks. Notably the bail-in tool also seeks to make shareholders and creditors more pro-active and responsible for guarding the health of the bank concerned. The bail-in tool in the BRRD further ensures fairness during resolution through the *pari passu* treatment of creditors and observance of creditor ranking in insolvency.

The UK's subsequent transposition of the provisions of the BRRD into the 2009 Banking Act thus resulted in the UK taking its nascent but already impressive bank resolution regime as originally captured in the 2009 Banking Act (that was to some extent a model for the subsequent introduction of the BRRD) to a level where it now constitutes a comprehensive resolution framework that ranks among the best in the world.[770] The application of the statutory resolution regime contained in the 2009 Banking Act, as revised, by the BoE as resolution authority in conjunction with the Treasury, PRA, FCA and FSCS, is supplemented by a code of practice and the detailed guidance provided in the Purple Book. Banks are required to plan for resolution funding. Seven special resolution objectives *inter alia* aimed at preserving financial system stability; protection of public confidence in the financial system; protection of public funds; covered investors and depositors guide the application of the resolution regime. Compliance with the conditions for resolution set out in the 2009 Act further ensure that the application of the resolution regime is triggered timeously and appropriately. The comprehensive special resolution regime for banks contained in the 2009 Banking Act comprises five stabilization options; a bank insolvency procedure and a bank administration procedure. The stabilization options are aligned to those contained in the BRRD, namely transfer to a private sector purchaser (sale of asset tool); the bridge bank tool; transfer to an asset management vehicle (asset separation tool); the bail-in tool and the temporary public ownership tool. The application of each

[770] Malek, Potts, Dzwig *United Kingdom in: Brodie S (Ed)*, *Bank Resolution: Key Issues and Local Perspectives*, (2019) London: INSOL International, 171.

of these tools is also subject to certain conditions that ensure that they are appropriately applied.

The stage for the application of resolution powers is prepared by providing the BoE with pre-resolution powers that enables the BoE to give directions for actions to be taken to enable the effective exercise of stabilization powers or winding up of an institution. The UK regime is also supported by provision for resolution planning and annual resolvability assessments. The regime further observes the safeguards of *pari passu* treatment of creditors; respect for the creditor ranking in insolvency and the "no creditor worse off"-principle. In addition the BoE has general resolution powers permitting it to make changes to the board of the bank and the senior manager structure. The practical implementation of the resolution regime is further facilitated by the appointment of a resolution administrator to assist with the implementation of the resolution plan and manage the business of the failing bank and exercise various powers in relation to such bank's business.

As part of the broader bank resolution regime the 2009 Banking Act, as revised, also contains a bank-specific administration procedure that can be applied, albeit as a second objective, to "rescue" a failing bank as opposed to the general administration procedure under the Insolvency Act that provided the previous mechanism for bank rescue. To avoid unnecessary duplication this special administration regime for banks incorporates some of the provisions of the administration procedure under the Insolvency Act. Notably this procedure is not a classic rescue procedure like curatorship in Zimbabwe in its original format or normal administration as initially applied in the UK under the Insolvency Act, 1986 but is used where a part of the business of the failing bank has already been sold to a private sector purchaser or transferred to a bridge bank. Thus it is applied not to the failing bank in its original format but to the "residual bank" that remains after other resolution tools such as sale to a private purchaser or transfer to a bridge bank had already been applied at an earlier resolution stage. The residual part of the bank that was not sold or transferred is then managed by the administrator to ensure that the private sector purchaser or bridge bank can operate effectively. Consequently the objectives of bank administration are dual in nature: its first priority is support for the private sector purchaser or bridge bank.

The bank administrator under the designated administration regime contained in the 2009 Banking Act has wide powers, enabling him to do “anything necessary or expedient” in pursuit of the objectives of bank administration. He has to set out proposals for achieving the objectives of the bank administration process and where a transfer to a bridge bank was involved, he is obliged to consult the BoE regarding the availability of resolution funding and certain information-sharing measures is also put in place to make certain that the BoE and the bridge bank that must receive service and facilities support from the residual bank is apprised of how the administration process is progressing. Creditors are kept informed of how the administration of the residual bank is rolling out via the progress report that the administrator must submit every six months. A “successful rescue” eventually occurs when an Objective 1 Achievement Notice” is issued by the BoE coupled with the belief and subsequent notice by the administrator that Objective 2(a) has been achieved and pursued.

The Chapter thus illuminated the UK’s journey from a rather laissez-faire approach to banking regulation through particular crises that triggered various regulatory responses eventually resulted in a robust formal framework for banking regulation as well as the introduction of an explicit deposit insurance framework which, importantly, also now includes a comprehensive and bespoke bank resolution regime as part of the UK’s financial safety net arrangement.

Chapter Five: South Africa's approach to dealing with bank failure

5.1 Chapter Overview

This Chapter will interrogate the evolution of South Africa's approach to dealing with failing banks, focusing in particular on measures initially aimed at rescuing parts of failing banks and developments that led to a broadening of the legal framework for dealing with failing banks. The Chapter will provide brief background on the South African approach to the regulation of banks in order to contextualize the discussion. The evolution of the process of curatorship as rescue mechanism provided for by section 69 of the Banks Act, accompanied by the provisions in section 69A for inquiring into the causes of the failure of a bank that is placed under curatorship, will subsequently be discussed. Thereupon consideration will be given to the rescue of African Bank which proved to be a rubicon event from the perspective of dealing with bank failure in South Africa. This is because the 2015 Banks Amendment Act that was hastily enacted to broaden the powers of the curator to effectively deal with the failure of this relatively small niche bank, actually moved South Africa closer to the aegis of the more comprehensive approach to dealing with bank failure that is characteristic of effective post-GFC bank resolution regimes contemplated in the FSB Key Attributes. The Chapter will further consider South Africa's recent decision to transition to a comprehensive resolution regime, the policy journey that paved the way for such shift in its approach to dealing with bank failure and the features of the proposed new resolution regime as currently captured in the Financial Sector Laws Amendment Bill of 2018.

As indicated in Chapter One the features of a resolution framework pertaining to cross –border cooperation, crisis management, cooperation agreements and information sharing captured in FSB Key Attributes 7, 8, 9 and 12 fall beyond the scope of this thesis.[771]

5.2 Background

The South African banking sector has always been a very concentrated oligopoly and has remained so, with six systemically important banks having been designated as

[771] Chapter 1 para 1.8.

SIFI banks in 2019, namely:[772] Nedbank Ltd, Standard Bank, Absa Bank, FirstRand Bank, Investec and Capitec Bank, currently dominating the scene and accounting for a share of more than 90% of the banking sector. South Africa introduced formal bank regulation on a national level in 1921 under the Currency and Banking Act, 31 of 1920 that established the South African Reserve Bank ("SARB") as the country's central bank.[773] In 1942, the Banking Act 38 of 1942 was enacted as a framework for bank regulation in South Africa with the SARB as bank supervisor.[774] This Act was subsequently amended[775] and later consolidated with the Building Societies Act 82 of 1986. In 1990 the Banks Act was repealed by the Deposit Taking Institutions Act 94 of 1990 that was later renamed the Banks Act 94 of 1990.[776]

Over the years the SARB, which is publicly owned and operationally independent,[777] gained prominence as a robust bank regulator, joined the Bank of International Settlements ("BIS")[778] as a member in June 1971 and in 2009 South Africa became the first African country to join the G-20.[779] The main powers and functioning of the

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[772] South African Reserve Bank, *Financial Stability Review*, 2020 available at https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/9956/FSRMay2020.pdf accessed on 12 June 2020 39.

[773] South African Reserve Bank, *Commemorative publication,* 2011 available at https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/4987/SARB%20Commemorative%20publication.pdf accessed 7 June 2020 3-4.The Currency and Banking Act 31 of 1920 was replaced by the South African Reserve Bank Act 29 of 1944, which Act was subsequently replaced by the South African Reserve Bank Act 90 of 1989. See also De Jager "The South African Reserve Bank: blowing winds of change" 2013 *SA Merc LJ* 342 and Mollentze, The South African Reserve Bank In Van Wyk K, Botha Z, Goodspeed I (Eds), *Understanding South African financial markets*, (2016) 37.

[774] Banking Act 38 of 1942. See also Moorcroft, Vessio *Moorcroft Banking Law and Practice* (2009 *et seq*) chapter 14 (hereinafter *Moorcroft* (2009 *et seq*)) para 1-3.

[775] Banking Amendment Act 25 of 1947, Banking Amendment Act 41 of 1951 and Banks Act 23 of 1965.

[776] Moorcroft (2009 *et seq*) 2-1.

[777] De Jager "The South African Reserve Bank: an evaluation of the origin, evolution and status of a Central Bank (Part 2)" 2006 *SA Merc LJ* 274.

[778] Baker, *The Bank for International Settlements: Evolution and Evaluation*, (2002) 2: Based In Basel Switzerland, the BIS ("the bank for central banks") was formed in 1930 by the so-called Young Plan (also called the "Dawes Plan") under the Hague Agreement to facilitate and coordinate the reparations payments or settlements by the German Government after World War II, which was its major function at the time. A second objective involved the service of the BIS as coordinator of the operations of central banks across the globe. Since then the BIS developed various other roles in the field of international banking including research on major banking issues and promulgation of international standards pertaining to banking regulation and supervision. BIS Committees comprise the Basel Committee on Banking Supervision, the Committee on Payments and Market Infrastructures, the Committee on the Global Financial System and the Markets Committee. There are also several independent associations headquartered at the BIS, namely, the Financial Stability Board, the International Association of Deposit Insurers, the International Association of Insurance Supervisors. For more information on the BIS visit its website at https://www.bis.org.

[779] Boulle "The Republic of South Africa and the G-20: Its political, national interests and priorities as member of the process" available at

SARB as banking supervisor were set out in section 10 of the South African Reserve Bank Act[780] read with the provisions of the Banks Act[781] and the Regulations relating to banks made in terms of section 90 of the Banks Act.[782] Through its Bank Supervision Department which housed the Office for Banks headed by the Registrar of Banks,[783] the SARB undertook intrusive supervision of South African banks in order to ensure, as far as possible, their safety and soundness. In particular the Banks Act, as amended over the years, provided for the SARB to license banks after having subjected a proposed new bank to a two stage authorization process to *inter alia* make certain that the bank had adequate capital, that its management would be fit and proper persons and that the bank would be managed in a prudent manner in the public interest.[784] It further contained provisions limiting concentration risk brought about by large exposures;[785] prudential requirements to ensure a bank's loss-absorbing capacity;[786] and measures for appropriate corporate governance and risk management.[787] The SARB as prudential regulator of banks were afforded wide investigative powers by the Banks Act that enabled it to conduct on-site and off-site supervision and keep a watchful eye over prudential compliance by banks.[788] The SARB also had a range of

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https://www.kas.de/c/document_library/get_file?uuid=9278c444-6163-2651-22ce-d8dec97cd104&groupId=252038 accessed 26 January 2021.

[780] The South African Reserve Bank Act 90 of 1989. See section 10(v) which indicated that the function of the SARB was *inter alia* to perform the (supervisory) functions assigned by the Banks Act.

[781] The Banks Act, Act 94 of 1990.

[782] Regulations relating to Banks issued in terms of section 90 of the Banks Act, 1990, published in Government Gazette no. 34838 of 15 December 2011 accessible at: https://www.gov.za/sites/default/files/gcis_document/201409/34838rg9644gon1033.pdf accessed 15 June 2016.

[783] Section 3 of the Banks Act; see further De Jager "The South African Reserve Bank: blowing winds of change (part 2)" 2013 *SA Merc LJ* 506; International Monetary Fund Country Report No. 14/340 *South Africa Financial System Stability Assessment* (3 December 2014) https://www.imf.org/external/pubs/ft/scr/2014/cr14340.pdf accessed 15 June 2016, hereinafter IMF 14/340, at 55; Van Niekerk G "The role of the central bank in the promotion and maintenance of financial stability-a comparative appraisal" (2018), *LLD thesis, University of Pretoria.* See also De Jager "The South African Reserve Bank: an evaluation of the origin, evolution and status of a central bank (part 1)" 2006 *SA Merc LJ* 159 and De Jager "The South African Reserve Bank: an evaluation of the origin, evolution and status of a central bank (part 2)" 2006 *SA Merc LJ* 274; Bekink, Botha "The role of a modern central bank in managing consumer bankruptcies and corporate failures: a South African public-law angle of incidence" 2009 *SA Merc LJ* 74.

[784] Sections 11 to 35 of the Banks Act 94 of 1990 regarding authorization to establish banks including their registration and cancellation of registration and annual licensing obligations.

[785] Section 73 of the Banks Act 94 of 1990.

[786] Section 70 to 75 of the Banks Act 94 of 1990.

[787] Section 60B and section 64B of the Banks Act 94 of 1990, respectively.

[788] Section 11 and 12 of the Reserve Bank Act 89 of 1990.

enforcement powers that it could apply where banks failed to meet the conditions for their continued licensing.[789]

As a member of the Bank for International Settlements ("BIS"), South Africa has also over the years aligned itself with various international standards issued in the banking regulatory context, and implemented the Basel II (minimum regulatory capital, capital management and market discipline) reforms on 1 January 2008 until December 2011, and subsequently phased in Basel 2.5 (improved risk coverage and increased capital requirements with a particular focus on trading instruments exposed to credit risk) from January 2011 to December 2012 followed by Basel III reforms since January 2013 (raising the quality of capital, enhancing the risk coverage of the regulatory framework, introducing capital buffers, introducing a leverage ratio to prevent build-up of excessive risk; monitoring of minimum liquidity standards and introducing additional capital buffers for SIFIs).[790] As recently observed by the SARB: "[B]anks are expected to have in place appropriate risk management systems, capital and liquidity buffers, risk management systems and governance arrangements to ensure that they operate as viable businesses in normal times and can withstand stress in difficult times".[791]

As a result of this robust regulatory framework, South Africa did not suffer continuous widespread bank failures.[792] Banks failed occasionally but not too often and these were generally smaller banks that were not systemic. That being said, South Africa nevertheless experienced a series of bank failures in the 1990s as well as a small bank crisis in 2003 and 2004, which led to various amendments to augment the curatorship process as discussed in more detail in paragraph 3.1 below. Notably South Africa

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[789] Section 23 to 29 of the Banks Act 94 of 1990 provides for cancellation of a bank's registration and withdrawal of its licence; section 26 allows for restriction of certain activities of banks; and section 90 provides for offences and penalties.

[790] The South African Reserve Bank, *South Africa's implementation of Basel II and Basel III* available at https://www.resbank.co.za/PrudentialAuthority/Deposit-takers/Banks/Supervision/Pages/South-Africa%27s-implementation-of-Basel-II-and-Basel-III.aspx accessed 12 March 2019. See also the South African Reserve Bank, *Financial Stability Review*, 2020 available at https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/9956/FSRMay2020.pdf accessed on 12 June 2020 32-39 for a review of progress with Basel III implementation in South Africa. For detail regarding the various Basel concordats see the Basel website at https://www.bis.org/publ/bcbsc312.pdf accessed 12 August 2018.

[791] South African Reserve Bank, *Ending too big to fail: South Africa's intended approach to bank resolution, South African Reserve Bank consultation paper*, 2019 available at https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/9398/South%20Africa's%20intended%20approach%20to%20bank%20resolution.pdf accessed 7 June 2020 (hereinafter *SARB resolution approach discussion pape*r) 10.

[792] As observed in the *SARB resolution approach discussion paper* at 10: bank failures in South Africa are a "a rare event."

never operated an explicit deposit insurance framework[793] which meant that in the event of bank failure the likelihood existed, but was not guaranteed, that the Treasury and central bank would step in and mop up the mess by extending a bail-out with public funds in order to ensure the protection of depositors. However, the lack of a deposit insurance framework in South Africa as a G20-country was to a certain extent intentional: the large banks that comprised more than 90% of the banking sector were perceived to be less risky and the absence of deposit insurance would arguably instill more market discipline and cause banks to take on less risk that could threaten their stability than if they had been insulated from failure and thus prone to moral hazard that engendered excessive risk-taking. There consequently was no guarantee that if a bank failed the Treasury and central bank would extend a helping hand and bank failures were dealt with in the context of implicit deposit insurance. Such implicit deposit insurance functioned on the principle of "constructive ambiguity" meaning that banks generally had no certainty that they would be rescued in the event of failure and that it was within the central bank's discretion, taking into account the systemic importance of a failing bank, whether it would intervene to save the bank.[794]

Pre-GFC a South African bank that encountered problems leaving it unable to pay its debts that were beyond the scope of self-recovery or ordinary regulatory corrective action imposed through application of measures in the Bank's Act aimed at restoring the safety and soundness of the institution, generally had only two options provided by the legislative framework: if deemed eligible by the central bank, the failing bank could be placed under curatorship in terms of section 69 of the Banks Act. Alternatively it would be wound up in terms of the bank liquidation process provided for in section 68 of the Banks Act (a discussion of which is beyond the scope of this thesis).

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[793] South Africa lacked a deposit insurance framework for several years and is only now in the process of transitioning to a formal deposit insurance framework as proposed in the Financial Sector Laws Amendment Bill 2018. See para 7 below.

[794] Van Heerden "Deposit Protection in South Africa: Recent Developments" 2020 *Journal of International Banking Law and Regulation* 45. Regarding implicit deposit insurance and the concept of constructive ambiguity see further Anginer, Demirguc-Kunt "Bank runs and moral hazard: a review of deposit insurance" World bank Policy Research Working Paper 8589 available at http://documents1.worldbank.org/curated/en/548031537377082747/pdf/WPS8589.pdf accessed 29 October 2019 (hereinafter Anginer & Demirguc-Kunt); Demirguc-Kunt, Kane, Laeven "Deposit Insurance Database" IMF Working Paper WP/14/118 available at https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Deposit-Insurance-Database-41710 accessed 29 October 2019.

5.3 Curatorship as per section 69 of the Banks Act

5.3.1 Curatorship as originally enacted

5.3.1.1 Introduction

Section 69 of the Deposit Taking Institutions Act of 1990[795] (subsequently renamed the Banks Act)[796] introduced the process for curatorship of banks in South Africa. Curatorship served to replace the previously existing court-ordered process of judicial management[797] for failing banks. As stated in the *New Republic Bank* case the rationale for the introduction of the curatorship process was to "remove curatorship from the judicial to the administrative aegis" and to create a procedure that is not unnecessarily shackled by requiring appointment of curators by court and other costly judicial intervention.[798] One of the primary objectives of curatorship was to create a counter to a "run on the bank".[799] Not all failing banks were eligible to be placed under curatorship and generally this process was discretionarily applied only to banks that had some systemic importance in the sense that their failure could destabilise, or cause significant disruption in, the financial system and whose unsafe and unsound position was not such that liquidation was the only option.

The provisions in the Banks Act that set out the curatorship process as captured in section 69 did not initially specify the objective of the curatorship although *de facto* it was clear that curatorship was aimed at restoring a failing bank's viability as a going

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[795] Deposit-Taking Institutions Act 94 of 1990. The previous process for dealing with the rescue of failing banks was contained in section 40 of the Banks Act 23 of 1965, as amended by section 1 of the Financial Institutions Amendment Act 94 of 1977. See further Willis *Banking in South African Law* (1981) 94-96; Schulze "The institution of curatorship of a bank in terms of Section 69 of the Banks Act 94 of 1990 – a rare decision", 1999 *SA Merc LJ* 428; *Moorcroft* (2009 *et seq*) Chapter 14.

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

[797] The court-based process of judicial management as a unique measure to "rescue" failing companies was introduced by the South African Companies Act 46 of 1926 and when the aforesaid Act was repealed the judicial management procedure was continued in section 427 of the Companies Act 61 of 1973. It was however abolished with the repeal of the 1973 Companies Act when a new "business rescue"-procedure was introduced by the Companies Act 71 of 2008. See further Rajak and Henning "Business Rescue for South Africa" 1999 *S. African L.J.* 265; Loubser "Judicial Management as a Business Rescue Procedure in South African Corporate Law" 2004 *SA Merc LJ* 137.

[798] In *Ex Parte Registrar of Banks* 1968 (3) SA 300 (C) at 301H; *Registrar of Banks v New Republic Bank Ltd [*1999] 2 All SA 459(D) 467. Moorcroft (2009 *et seq*) par 14.1. See Schulze "The institution of curatorship of a bank in terms of Section 69 of the Banks Act 94 of 1990 – a rare decision", 1999 *SA Merc LJ* 428 for a discussion of the *New Republic Bank*-case.

[799] Moorcroft (2009 *et seq*) para 14.2. See also *Ex Parte Registrar of Banks* 1968 (3) SA 300(C); *Registrar of Banks v New Republic Bank Ltd* [1999] 2 All SA 459(D).

concern. In its original format section 69 provided for a curator to be appointed to a failing bank by the Minister of Finance acting on the advice of the SARB as central bank and bank supervisor at the time. Where the Registrar of Banks held the view that a bank was "in financial difficulties"[800] section 69 gave the Minister of Finance the discretion, *if he deemed it desirable in the public interest*, to appoint a curator to such bank.[801] Initially the Act required the Minister to first consult with the failing bank and obtain its consent to apply the curatorship mechanism to the bank. The Minister then appointed the curator in a letter of appointment that provided information regarding the bank to which the curator was appointed and set out directions pertaining to security to be furnished by the curator for the proper performance of his duties. Notably the letter of appointment also provided directions regarding the management of the bank concerned or any matter incidental thereto, including such directions pertaining to the raising of money by that bank, as the Minister deemed necessary.[802] The appointment of the curator and his powers as curator were announced by the Registrar through publication in the Government Gazette and any subsequent amendment or withdrawal of such powers also had to be similarly published.[803]

5.3.1.2 Effect of curatorship

Once the curator was appointed the management of the failing bank vested in him, subject to the supervision of the Registrar. The bank's board of directors was thus divested of the management of the bank.[804] As an initial step the curator was tasked to recover and take possession of all the assets of the failing bank.[805] Section 69(6) further provided for a moratorium on legal proceedings as well as a bar on the application of set-off against the failing bank which applied during the course of the curatorship in order to prevent lawsuits and debt execution endeavours from derailing the curatorship efforts.[806]

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[800] The concept "financial difficulties" was not defined in the Banks Act.

[801] Section 69(1) Deposit-Taking Institutions Act 94 of 1990. Author's emphasis.

[802] Section 69(2)(a) to (d) Deposit-Taking Institutions Act 94 of 1990.

[803] Section 69(7) Deposit-Taking Institutions Act 94 of 1990.

[804]Section 69(5)(a) Deposit-Taking Institutions Act 94 of 1990. See *Alpha Bank Bpk & Andere v Registrateur van Banke & Andere* 1996(1) SA 330 (A) at 351-352; *Unibank Savings and Loans Ltd (formerly Community Bank) v ABSA Bank Ltd* 2000 (4) SA 191 (W) para 19.

[805] Section 69(5)(b) Deposit-Taking Institutions 94 of 1990.

[806] Section 69(6)(a) and (b) Deposit-Taking Institutions Act 94 of 1990. Section 69(6)(a) stipulated that "all actions, legal proceedings, the execution of all writs, summonses and other legal process against that bank shall be stayed and not be instituted or proceeded with without the leave of the court". As

5.3.1.3 Powers of curator

When section 69 was initially introduced the curator did not have a very comprehensive toolkit to apply during the curatorship process. Section 69(3) provided that the Minister could, in the curator's letter of appointment or at any time subsequent thereto, in his discretion and subject to any conditions he wished to impose, grant the curator the following powers:[807]

(a) to suspend or reduce the right of the bank's creditors to claim or receive interest on any money that the failing bank owed them;

(b) to make payments (capital or interest) to the failing bank's creditors in such order and manner as the curator deemed fit; or

(c) to cancel any agreement between the failing bank and any other party to advance money due after the date of the curator's appointment, or to cancel any agreement to extend any existing facility. This could be done if the curator was of the view that such advance or any loan under such facility would not be adequately secured or would not be repayable on terms that were satisfactory to the bank or if the bank lacked the necessary funds to meet its obligation under any such agreement or if it would otherwise not be in the interest of the failing bank.

5.3.2 Amendments to the curatorship process since its inception until prior to the failure of African Bank

5.3.2.1 Bank failures

Subsequent to its initial introduction the curatorship process in section 69 underwent a number of changes in order to refine the process and augment the curator's toolkit. These changes were introduced incrementally pursuant to a number of bank failures that occurred between 1990 and 2004. Okeahalam lists the following bank failures that occurred, mainly as a result of inadequate capital and poor governance, since the

explained by *Moorcroft* (2009 *et seq*) para 14.2 at 14-3 this *inter alia* had the implication that while curatorship was in place a pending winding-up application of the distressed bank was stayed. See *Registrar of Banks v New Republic Bank Ltd* [1999] 2 All SA 459(D).

[807] Section 69(3)(a) to (c) Deposit-Taking Institutions Act 94 of 1990.

enactment of the current Banking Act in 1990:[808] Alpha Bank (1990), Cape Investment Bank (1991), Pretoria Bank, Sechold Bank (1993), Prima Bank (1994), African Bank (1995),[809] Community Bank, and the Islamic Bank of South Africa (November 1997). Further bank failures included: FBC Fidelity Bank Ltd (1999), Cashbank (2000), and Regal Treasury Bank (2002). A notorious "lifeboat" was also extended to ABSA Bank to acquire Bankorp in 1995.[810]

Havemann further documents the South African small bank crisis of 2002/2003 that was triggered by the run on Saambou Bank in February 2002, followed by the failure of another seven banks within a month, including the fifth largest bank and another five within a year.[811] The first wave of bank failures commenced when Saambou Bank was placed under curatorship on 9 February 2002.[812] This triggered concerns about other small banks and following the announcement of Saambou Bank's curatorship seven other banks immediately experienced runs: BOE Bank, Merrill Lynch, TA Bank, FirstCorp, PSG Investment Bank and International Bank.[813] The BOE run was the most serious and the SARB provided emergency liquidity assistance to BOE to stabilize the system and extended a bail out to it on 14 March 2002. As pointed out by Havemann, BOE was able to continue operating, albeit in substantial distress, while a purchase and assumption agreement was negotiated with Nedbank, one of the five largest South African banks at the time. BOE was eventually absorbed into Nedbank and deregistered a year later. The other small banks that experienced runs were left to fail and were subsequently deregistered.[814] The second wave of bank failures started in September 2002 and involved the failure of Brait Merchant Bank (September 2002), Corpcapital (November 2002), Old Mutual Bank (December 2002), SECIB Bank

[808] Okeahalam "The political economy of bank failure and supervision in the Republic of South Africa" 1998 *African Journal of Political Science* 29 at 35-38.
[809] When it failed in 1995 African Bank was put under curatorship of the Curator Mr J Louw of KPMG.
[810] *ABSA Bank Ltd and Others v Public Protector and Others* [2018] ZAGPPHC 2.
[811] Havemann RC "Lessons from South African bank failures 2002 to 2014" (2019), *PhD (Economics) Thesis, University of Stellenbosch* 11 to 12 (hereinafter Havemann(2019)). The run on Saambou was triggered by the announcement on 15 January 2001 by South Africa's then largest bank, ABSA, of significant losses suffered by its microlending subsidiary, Unifer. As pointed out by Havemann, Saambou had a very similar client-basis as Unifer thus causing concern amongst depositors regarding common exposures.
[812] Statement by the Minister of Finance on the placement of Saambou Bank Ltd under curatorship, in terms of section 69 of the Banks Act, to Parliament on Thursday 14 February 2002 available at http://www.treasury.gov.za/comm_media/speeches/2002/2002021401.pdf accessed 7 May 2020.
[813] Havemann (2019) 13. As pointed out by Havemann these banks collectively made up 6.6 per cent of total deposits in South Africa as at February 2002 of which BOE Bank alone made up 6.5%.
[814] Havemann (2019) 13 to 16.

(February 2003) and Unibank (March 2003). This was followed by a third wave of bank failures that involved Nedcor Investment and Cape of Good Hope (February 2003), ING and Rand Merchant Bank (July 2003) and African Merchant Bank (September 2003).[815]

5.3.2.2 Amendments to curatorship process

The various changes to the curatorship process that were consequently made in order to streamline the process, entail the following: In 1992 the curatorship provisions in section 69 were amended by the introduction of a section 69(1)(b)[816] to provide that the Registrar could appoint a person, other than a person employed by the failing bank to assist the curator in managing the affairs of the bank under curatorship. Such person had to have wide experience and was required to be knowledgeable about the field of activities in which the bank under curatorship was mainly engaged. A few additional powers were added to the powers listed in section 69(3), namely that the curator could:

(a) convene meetings of creditors of the bank under curatorship for the purpose of establishing the nature and extent of the bank's indebtedness to them and in order to consult with them insofar as their interests stood to be affected by decisions taken by the curator in the course of the curatorship of the bank;

(b) negotiate with any individual creditor of the bank with a view to a final settlement of the "affairs" of such creditor with the bank;

(c) make and carry out, in the course of managing the bank under curatorship, "any decision which in terms of the provisions of the Companies Act would have been required to be made by way of a special resolution";[817]

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[815] See Havemann (2019) 16 Table 2.2 Timeline of cancellations and curatorships.

[816] Deposit –Taking Institutions Amendment Act, 42 of 1992 as published per GN 1070 in GG 13919 of 15 April 1992, clause 8. The existing section 69(1) was renumbered to section 69(1)(a).

[817] Special resolutions were governed by section 199 of the Companies Act 61 of 1973 which provided the requirements for special resolutions: "a resolution by a company shall be a special resolution if at a general meeting of which not less than twenty-one clear days' notice has been given specifying the intention to propose the resolution as a special resolution, the terms and effect of the resolution and the reasons for it and at which - (a) members holding in the aggregate not less than one-fourth of the total votes of all the members entitled to vote thereat, are present in person or by proxy; or (b) in the case of a company limited by guarantee, not less than one-fourth of the members entitled to vote thereat are present in person or by proxy, the resolution has been passed, on a show of hands, by not

(d) cancel any lease of movable or immovable property entered into by the bank prior to its curatorship;[818]

(e) dispose of any of the failing bank's assets (by public auction, tender or individual negotiation). This included any advance or loan under a facility and any asset in relation to which approval as contemplated in section 228[819] of the Companies Act would have been a prerequisite; or

(f) cancel any guarantee issued by the bank prior to its curatorship except a guarantee which the bank was required to make good within a period of 30 days from the curator's appointment.[820]

A section 69(3A) was also added to the effect that the curator was obliged to record the nature of, and the reasons for, each act that he performed under the powers conferred on him by section 69(3).[821]

From the aforementioned it is clear that the 1992 Amendment Act thus significantly augmented the powers of the curator, acknowledging that curatorship would potentially impact the rights of shareholders and creditors and giving the curator an expanded toolkit to use during curatorship of a failing bank which also enabled him to dispose of the failing bank's assets. The latter was a very important power that could potentially be used to obtain money to pay off the failing bank's debts or even recapitalise it, thus turning its fortunes around and enabling it to carry on with its business.

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less than three-fourths of the number of members of the company entitled to vote on a show of hands at the meeting who are present in person or by proxy or, where a poll has been demanded, by not less than three-fourths of the total votes to which the members present in person or by proxy are entitled."

[818] It was however provided that a damages action could be instituted in respect of such cancellation after expiry of one year as from the date of such cancellation. The rationale for this one-year period was probably the view that by such time the curatorship would have ended (and with it the moratorium against legal proceedings) or the bank would be in the process of being liquidated (if the curatorship was unsuccessful).

[819] Section 228 of the Companies Act 61 of 1973 dealt with the disposal of undertaking or greater part of the assets of company. This section provided that "notwithstanding anything contained in its memorandum or articles, the directors of a company shall not have the power, save by a special resolution of its members, to dispose of - (a) the whole or the greater part of the undertaking of the company; or (b) the whole or the greater part of the assets of the company."

[820] Again provision was made that a damages claim based on cancellation of a guarantee could be instituted within one year as from the date of cancellation of the guarantee.

[821] It was further provided that such records would be examined as part of the normal audit of the affairs of the bank under curatorship.

In 1993 a further amendment followed[822] which introduced a reporting requirement via the insertion of section 69(6A). It required that while a bank was under curatorship the curator would be obliged, on the expiry of a period of one year from the date of his appointment and thereafter bi-annually after the expiry of every period of six months, to provide the Registrar with a written report indicating whether or not, it is in the interest of the bank's depositors that the bank remains under curatorship. Yet another amendment of section 69(1) came in 1994 to provide that the Minister first had to obtain the written consent of the chief executive officer or the chairman of the board of directors of the failing bank in order to place the bank under curatorship. The Registrar was given a discretion to appoint an assistant for the curator (and was not obliged to do so as per the 1992 amendment).[823] A section 69(8) was further added which read as follows:

"(8) Notwithstanding anything to the contrary contained in any law, the suspension, cancellation or termination of the registration of a bank while such a bank is under curatorship in terms of this section shall not affect-

(a) any appointment made, direction issued, or any other thing done under this section in respect of such bank; or

(b) any power to be exercised or duty to be executed in respect of the bank under curatorship by the Minister, the Registrar or the curator, by virtue of the provisions of this section,

and the Minister, the Registrar and the curator, respectively, shall until such time as the curatorship is terminated continue to exercise their respective powers and to execute their respective duties under this section in respect of the public company of which the registration as a bank has been so suspended, cancelled or terminated, as if such suspension, cancellation or termination had not taken place."

At this stage section 69A was also inserted into the Act to make provision for the investigation of the affairs of a bank under curatorship. In terms of section 69A(1) the Registrar could, while a bank was under curatorship, appoint a person as

[822] Deposit –Taking Institutions Amendment Act 9 of 1993 as published per GN 369 in GG 14626 of 10 March 1993, clause 17.
[823] Banks Amendment Act 26 of 1994 as published per GN in GG No 16122 of 2 December 1994.

Commissioner to investigate the "business, trade, dealings, affairs or assets and liabilities" of the bank and its associates. Assistants could further be appointed to assist the Commissioner with the investigation.[824] The Commissioner was given wide powers of investigation and could *inter alia* summons[825] and examine persons under oath, including any person who previously was a director, auditor, attorney, valuator, agent, servant, employee, member, debtor, creditor or a shareholder of the failing bank or any of its associates. These powers of the Commissioner also applied to any other person that the Commissioner deemed capable of providing information regarding the business, trade, dealings, affairs or assets and liabilities of the bank or its associates.[826] Persons who were summonsed could be apprehended and brought before the Commissioner if they failed to attend at an inquiry without providing a lawful excuse.[827] In terms of section 69A(11) the Registrar had to bear the costs of a section 69A-investigation unless the Registrar directed that all or part of such costs and expenses were to be paid out of the assets of the bank under curatorship.

The Commissioner's investigation was subject to specific time limits and had to be completed within a period of five months. Within 30 days after completion of the investigation he had to submit a written report stating, *inter alia*, whether or not, in his opinion: it would be in the interest of the depositors or other creditors of the bank under curatorship that such bank remains under curatorship or that the Registrar applies to court for the winding up of the bank or an order placing the bank under judicial management. He also had to indicate whether it appeared that any business of the bank under curatorship had been carried on recklessly or negligently or with the intent

[824] Section 69A(2) Banks Act 94 of 1990. The assistants were subject to the curator's control and directions. Before appointing the commissioner and his assistants the Registrar was required, in terms of section 69A(3) to take all reasonable steps to ensure that they would be able to report objectively and impartially on the affairs of the bank under curatorship and its associated.

[825] Section 69A(7) Banks Act 94 of 1990.

[826] Section 69A(5)(a) and (b) Banks Act 94 of 1990. In terms of section 69(6)(a) a person examined by a commissioner under section 69A was not entitled at such examination, to refuse to answer any question on the basis that the answer would tend to incriminate him. Neither was he entitled to refuse to answer on the basis that he was to be tried on a criminal charge and that the answer would prejudice him at such criminal trial. The Commissioner was however obliged to direct, in terms of section 69A(6)(b) that no information regarding such questions and answers were to be published. Such evidence was also barred from being admissible in criminal proceedings except where a person was charged with an offence relating to the inquiry in terms of section 69A(14). See further section 69A(14) regarding offences in relation to the section 69A inquiry.

[827] Section 69A(8) Banks Act 94 of 1990.

to defraud depositors or other creditors of the bank or any other person, or for any fraudulent purpose.

Where he found that there was recklessness, negligence or fraud involved, persons who were party to carrying on the business of the bank in such manner had to be identified. Once completed the report had to be forwarded to the Registrar, the Minister and in the event of a finding that a person engaged in fraudulent behaviour in carrying on the bank's business, to the Attorney-General.[828] In accordance with section 69A(13) the Commissioner's report was private and confidential unless the Registrar, pursuant to consultation with the Minister, directed otherwise in respect of the whole report or a part thereof.

The investigation by a Commissioner in terms of section 69A thus fulfilled the important function of determining the reasons that led to the failure of the bank and caused it to be placed under curatorship. It particularly served to identify the persons responsible for such situation and to eventually hold them accountable whether by way of criminal proceedings and/or civil damages claims. It would also expose any regulatory failure that contributed to the bank's demise.

In 1996 section 69 was again amended by the deletion of section 69(6)(b) and the insertion of a section 69(6B) that read as follows:[829]

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[828] Section 69(11) and (12) of the Banks Act 94 of 1990.

[829] Banks Amendment Act 55 of 1996 as published by GN 1755 in GG 17531 of 1 November 1996, clause 6. Section 35A of the Insolvency Act 24 of 1936 deals with transactions on an exchange and the termination thereof upon sequestration (and pursuant to section 69(6b), curatorship) whilst section 35B provides for automatic termination, upon date of liquidation (and, pursuant to section 69(6B), curatorship) of all unperformed obligations arising out of "master agreements." Once unperformed obligations terminate, values must be calculated at "market value" as at the date of liquidation (curatorship), these values must be netted and net amount is payable – see "The Rescue of African Bank: a view from the trenches" presentation by Webber Wentzel Attorneys (the legal team who assisted African Bank curator, Tom Winterboer), University of Johannesburg Annual Banking Law Update (ABLU), 19 October 2016, published in the ABLU Conference Bundle Book 2. Section 46 provides for set-off where the estate of one of the parties to a transaction that resulted in set-off, wholly or in part, is sequestrated within a period of six months after the taking place of the set-off or where a person to whom a claim against a debtor has been ceded has in turn ceded such claim to a third person against whom the aforementioned debtor had a claim, thus resulting in set-off, and the estate of the said debtor is sequestrated within a year after the cession. In such instance the curator may abide by the set-off or, he may, if the set-off was not effected in the ordinary course of business, with the approval of the Master of the High Court (who is responsible for administration of insolvent estates) disregard it. In the latter instance the curator can then call upon the person concerned to pay the estate the debt he would owe it but for the set-off. Making these provisions of the Insolvency Act applicable serves to reign in much of the chaos that would otherwise be caused on a distressed bank's derivative portfolio. See further Van Heerden "The rescue of African Bank: a step forward in Banking Regulation

“(6B) Notwithstanding any provision to the contrary contained in this Act, sections 35A, 35B and 46 of the Insolvency Act, 1936 (Act No. 24 of 1936) shall mutatis mutandis apply to the curator of any bank under curatorship and to such a bank as if the curator were a trustee of an insolvent estate and the bank were an insolvent or sequestrated estate as contemplated in those sections.”

These provisions introduced by section 69(6B) is of significance especially in the context of derivative transactions:[830] Section 35A of the Insolvency Act[831] deals with transactions on an exchange and the termination thereof upon sequestration (and by analogy curatorship). Section 35B further provides for automatic termination, upon date of liquidation (and, by analogy curatorship) of all unperformed obligations arising out of "master agreements.” When unperformed obligations terminate values of transactions must be calculated at "market value" as at the date of liquidation (curatorship), these values must be netted and the net amount is then payable.[832] Section 46 of the Insolvency Act deals with set-off where the estate of one of the parties to a transaction that resulted in set-off, is sequestrated within a period of six months after the set-off alternatively where a person who obtained cession of a claim against a debtor has in turn ceded that claim to a third person against whom the aforementioned debtor had a claim, thus resulting in set-off. Where the estate of the said debtor is sequestrated within a year after such cession the Insolvency Act stipulates that the curator may abide by the set-off or, where the set-off was not effected in the ordinary course of business, the curator may with the approval of the Master of the High Court disregard such set-off. Where this occurs the curator can then call upon the person concerned to pay the estate the debt he would owe it but for the set-off. Van Heerden accordingly observes that making these provisions of the Insolvency Act applicable serves to reign in much of the chaos that would otherwise be caused on a distressed bank’s derivative portfolio.[833] It also provides for set-off not to operate in a manner that would prefer some of the bank’s creditors above others.

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in South Africa” 2017 *Journal of International Banking Law and Regulation* 350 (hereinafter Van Heerden 2017).

[830] Van Heerden 2017 353.

[831] Act 24 of 1936.

[832] “The Rescue of African Bank: a view from the trenches” presentation by Webber Wentzel Attorneys (the legal team who assisted African Bank curator, Tom Winterboer), University of Johannesburg Annual Banking Law Update (ABLU), 19 October 2016, published in the ABLU Conference Bundle Book 2.

[833] *Ibid*.

In 2000 yet another amendment to the curatorship process followed in terms of the Banks Amendment Act 36 of 2000.[834] This time section 69(1) was amended to provide that the Minister could, where he deemed it desirable in the public interest, appoint a curator to the bank if, in the opinion of the Registrar, the bank "will be unable to repay, when legally obliged to do so, deposits made with it or will probably be unable to meet any other of its obligations." At this stage however it still remained a requirement that the written consent of the chief executive officer or the chairman of the board of directors had to be obtained before the curator could be appointed. A new section 69(2A) was inserted to provide that on the curator's appointment the management of the bank vested in him, subject to the supervision of the Registrar, and that any other person vested with the management of the affairs of the bank would be divested thereof. This was followed by a new section 69(2B) which provided that the curator was required, subject to the supervision of the Registrar, to conduct the management of the bank "in such a manner as the Registrar may deem to best promote the interests of the creditors of the bank concerned and of the banking sector as a whole." This made it clear that curatorship was aligned with the prevailing creditor-oriented sentiment in South Africa insolvency law[835] but that it also took into account the destabilising impact of bank failure on the financial system. The curator further had to comply with any direction by the Registrar and to carry out the following duties: to keep accounting records and prepare annual financial statements, interim reports and provisional annual financial statements of the bank; and to convene the annual general meeting and any other meetings required by the Companies Act. In addition it gave the curator the power to bring or defend legal proceedings (civil and criminal), in the name of and on behalf of, the bank under curatorship.

Further important amendments effected by the Amendment Act of 2000 were the limitation on the disposal of assets which provided that the curator could, notwithstanding section 69(3), dispose of any of the bank's asset's *in the ordinary course of the bank's business.*[836] For a disposal of assets that was *not* in the ordinary course of the bank's business the curator had to obtain certain permissions stated in

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[834] Banks Amendment Act 36 of 2000 as published by GN 1024 in GG 21663 of 18 October 2000, clause 10.

[835] Boraine, Evans, Roestoff, Steyn "The Pro-Creditor Approach in South African Insolvency Law and the Possible Impact of the Constitution" 2015 3 *Nottingham Insolvency and Business Law e-Journal* 59.

[836] Author's emphasis.

section 54 of the Banks Act.[837] He was also not permitted to make such a disposal for which permission in terms of section 54 was required "unless a reasonable probability exists that such disposal will enable the bank to pay its debts or meet its obligations *and become a successful concern.*"[838] This reinforced the aim of curatorship to restore the failing bank to economic viability and also guided the curator's decision when considering to dispose of the failing bank's assets.

A new section 69(2D) was further introduced which provided that, if at any time the curator was of the opinion that there was "no reasonable probability that the continuation of the curatorship would enable the bank to pay its debts or meet its obligations and become a successful concern", he was obliged to inform the Registrar thereof forthwith and in writing. This amendment thus ensured that a curatorship would not drag on indefinitely to the point where only a shell of the bank concerned would be left with nothing to yield even in liquidation. Given that no specific time frame is imposed by section 69 within which to conduct and wrap up a bank curatorship this amendment was significantly prudent. The new section 69(2E) that was also introduced at this time stated that any money of the bank that became available to the curator had to be applied by him in paying the cost of the curatorship and in the conduct of the bank's business in accordance with the curatorship and, as far as circumstances permitted, in the payments of claims of creditors that arose before the date of the curatorship. Two other new sections were also inserted: Section 69(2F) permitted the curator to set aside certain dubious transactions that were entered into by the failing bank by stipulating that "every disposition of property, which, if made by an individual could for any reason be set aside in the event of such individual's insolvency, may, if made by a bank that is unable to pay its debts be set aside by a court at the suit of the curator in the event of that bank being placed under curatorship, and the provisions of the law relating to insolvency shall *mutatis mutandis* apply in respect of such

[837] Section 54 of the Banks Act 94 of 1990 provides for amalgamations, mergers and arrangements and states that "the Minister must consent, in writing and conveyed through the Authority, to - (a) an amalgamation, merger or arrangement referred to in Chapter 5 of the Companies Act and which involves a bank as one of the principal parties to the relevant transaction; and (Section 54(1)(a) substituted by section 24(b) of Banks Amendment Act 22 of 2013 (b) an arrangement for the transfer of more than 25 per cent of the assets, liabilities or assets and liabilities of a bank to another person; Provided that the 25 per cent referred to in paragraph (b) shall be calculated by aggregating the amount of the transferred assets, liabilities or assets and liabilities together with any previous transfer of assets, liabilities or assets and liabilities within the same financial year of the bank concerned: Provided further that the Minister's consent is granted beforehand."

[838] Author's emphasis.

disposition."[839] This allowed the curator to recover money and assets that were alienated in circumstances that would for instance have preferred some of the bank's creditors over others thus aligning with the objective that the curatorship should be to the benefit of the creditors as a whole. In addition a new section 69(2G) was introduced which further provided that "[T]he period during which any bank is a mortgage debtor in terms of this section shall be excluded in the calculation of any period of time for the purpose of determining whether such mortgage bond confers any preference in terms of section 88 of the Insolvency Act, 1936,[840] as applied to the winding-up of banks in terms of this Act."

The Amendment Act of 2000 further deleted section 69(3)(h)[841] and substituted section 69(4) with a provision that the Minister could, at any time and any manner, amend (but not withdraw) the directions in the curator's letter of appointment and the powers granted to the curator in terms of section 69(3). Section 69(5)[842] was deleted and section 69(6A) was substituted to provide that the curator had to provide a report to the Registrar on a *monthly* basis. Such report had to contain an exposition of the affairs of the bank concerned and had to state whether or not, in the curator's opinion "*a reasonable probability exists that the bank will be able to pay its debts or to meet its obligations and to become a successful concern*." This meant that the Registrar of banks would be able to monitor on a monthly basis whether the curatorship was yielding the required result of "reviving" the failed bank or whether it would be necessary to put an end to the curatorship and allow the bank to be liquidated. This was reinforced by a new subsection (9) that was added to provide that the Minister could at any time withdraw the curator's appointment or withdraw such appointment

[839] Section 69(2F)(a). The new section 69(2F)(b) provided that the event that would correspond to a sequestration order under the Insolvency Act 24 of 1936 would be the presentation to the court of the curator's letter of appointment.

[840] Section 88 of the Insolvency Act 24 of 1936 provides that certain mortgages are invalid and states that "a mortgage bond, other than a kustingbrief, whether special or general passed for the purpose of securing the payment of a debt not previously secured, which was incurred more than two months prior to the lodging of the bond with the registrar of deeds concerned for registration or for the purpose of securing the payment of a debt incurred in novation of or substitution for any such first-mentioned debt, shall not confer any preference if the estate of the mortgage debtor is sequestrated within a period of six months after such lodging: Provided that a mortgage bond shall be deemed not to have been lodged as aforesaid, if it was withdrawn from registration."

[841] As indicated above this section gave the curator the power to dispose, by public auction, tender or individual negotiation, of the failing bank's assets, including any advance or loan under a facility or any asset for which disposal approval in terms of section 228 of the Companies Act was required.

[842] As indicated in par 3.1.2 above, section 69(5) previously merely provided that the management of the failing bank would vest in the curator on his appointment and that he had to recover and take possession of the said bank's assets.

upon application by the Registrar. Of course, this power of the Minister could also be used to get rid of a curator that was not doing his job properly. A new section 69(10) was further inserted to provide that the curatorship of a bank would lapse upon the Minister issuing a written notification to that effect to the curator; or the winding up of the bank in terms of section 68 of the Banks Act.[843] Insofar as the Commission of investigation into the affairs of the bank under curatorship was concerned it is to be noted that the Amendment Act of 2000 also amended section 69A by the deletion of section 69A(11)(b)(ii) that contained a reference to the procedure of judicial management.[844]

In 2003 the Banks Act underwent a further series of amendments which included amendments to the curatorship process. Section 69 was slightly amended merely to reflect the fact that the Chairperson of the board of the directors and the curator could also be women.[845] Section 69A that deals with the investigation of the affairs of a bank under also underwent similar type of amendments as well as amendments to reflect that the inquiry by the Commissioner was to be conducted in camera and was not accessible to the public.[846] In 2013[847] a further amendment of section 69 occurred that did away with the requirement that the CEO and chairperson of the failing bank's board of directors to consent to a bank being placed under curatorship. This requirement was substituted with a requirement that they merely be "notified" of the Minister's decision to place the bank under curatorship. Section 69(2B) was also substituted to provide that the curator was obliged not only to conduct the management of the bank under curatorship in such a manner as the Registrar deemed fit to promote the interests of the said bank and the stability of the banking sector as a whole but also to manage it

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843 Section 68 of the Banks Act 94 of 1990 provides special provisions relating to winding-up of bank and states that "notwithstanding the provisions of section 69 of this Act and anything to the contrary contained in the Companies Act- (a) the Authority shall have the right to apply to a competent court for the winding-up of any bank in terms of the Companies Act, and the Authority shall have the right to oppose any such application made by any other person; (b) no person other than a person recommended by the Authority shall be appointed by a Master of the High Court as provisional liquidator or liquidator of a bank; and (c) the Master shall appoint a person designated by the Authority, who shall be a person who in the opinion of the Authority has wide experience of, and is knowledgeable about the latest developments in, the banking industry, to assist a provisional liquidator or liquidator referred to in paragraph (b) in the performance of the functions of such provisional liquidator or liquidator in respect of the bank in question".

844 Banks Amendment Act 36 of 2000, clause 11. Regarding judicial management see par 3.1.1 above.

845 Banks Amendment Act 19 of 2002 published by GN 1115 in GG 25294 of 5 August 2003. The title of this Amendment Act is stated as "No.19 of 2002: Banks Amendment Act, 2003".

846 *Ibid*, clause 11.

847 Bank's Amendment Act 22 of 2013 published by GN 992 in GG 37144 of 10 December 2013.

in a way that would best promote the rights of employees in accordance with relevant labour legislation. The reference in section 69(2C)(b) to section 228 of the Companies Act in relation to disposal of the bank's asset was replaced with a reference to section 112 of the new Companies Act 71 of 2008 and section 69(3)(f) was substituted for the following: "(f) to make and carry out, in the course of the curator's management of the bank concerned, any decision which in terms of the provisions of the Companies Act or the bank's memorandum of incorporation would have been required to be made by way of a special resolution contemplated in section 65 of the said Act and in terms of the bank's memorandum of incorporation."

The result of all these amendments to the curatorship process in section 69 of the Banks Act was accordingly that the objective of curatorship was eventually more clearly spelled out as it became evident that curatorship sought to enable a failing bank to become a going concern, if viable - failing which the bank had to be liquidated. As a result of these amendments the process was streamlined as the impediment was removed of first having to first obtain "permission" to place a bank in curatorship from the failing bank's executive members (who are often actually instrumental in the downfall of the bank and who might also often not be in favour of being divested of their management of the bank and definitely averse to the idea of lawsuits that could follow should they have been reckless or negligent or fraudulent in the way they conducted the bank's business.) Notably the curator's powers were extensively amended to cater for a much broader range of interventions than was the case when the curatorship process was initially introduced. In particular the ability of the curator to dispose of the bank's assets in an attempt to restore its viability as a going concern appeared to be a power that would give the curator considerable leeway in his attempts to rescue the failing bank. It was also realised that the curator could be hamstrung in his efforts to save the failing bank if his rescue efforts were vetoed by the bank's shareholders hence the provision for the curator to make and carry out a decision which would otherwise have had to be passed by special resolution by the bank's shareholders. From these amendments it is also clear that the role of the Registrar of Banks during curatorship was, quite aptly, intensified - as captured by the requirement that the curator had to furnish monthly reports to the Registrar. These reports put the Registrar in a position not only to monitor the actions taken by the curator but also to put an end to the curatorship process if it became evident that it was not yielding the

desired results or to get rid of a curator who was not doing his job properly. In addition, the curatorship process was complimented by the process introduced by section 69A to ensure that those persons responsible for the demise of the failing bank could be held accountable and that some of the losses that were suffered due to their reckless or fraudulent conduct could be recovered thus alleviating the burden on public funds that might have to be applied to reimburse depositors in the event that the bank was allowed to fail.

The curatorship process in section 69, as a *lex specialis* for dealing with failing banks, was applied a number of times during the course of the 1990s and early 2000s after which a stable period of approximately 10 years was experienced in the South African banking sector. The ultimate gamechanger for the application of the curatorship process in the post-GFC landscape which evidenced a more broad-minded and diversified approach to dealing with failing banks, however presented itself in 2014 with the failure of African bank.

5.4 The rescue of African Bank

5.4.1 Introduction

Van Heerden points out that, although not a systemic bank in terms of size, African Bank fulfilled a niche role in the South African banking sector due to its unique business model in terms whereof its core business comprised of unsecured lending to approximately 3 million low income consumers who would otherwise usually be foreclosed from access to credit.[848] The bank was a wholly owned subsidiary of the holding company, African Bank Investment Ltd ("ABIL")[849] and pursued a high risk business model with virtually no business diversification, not generally taking deposits[850] and raising capital through debt and equity issuances. Its problems began

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[848] Van Heerden 2017 353.

[849] Paragraph 25 of Myburgh "Exparte: African Bank Limited In re: Investigation in terms of s69A of the Banks Act, 94 of 1990" Report in terms of section 69A(11) of the Banks Act, 2016 available at 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 11 April 2017 (hereafter Myburgh Report) where the holding portfolio of ABIL is set out in detail. Abil also owned an insurance company, Standard General Insurance Ltd (Stangen) as well as two other insurance companies, Relyant Insurance Company and Relyant Life Assurance Company.

[850] Deposits comprised approximately 1% of the portfolio of African Bank.

when, shortly before the 2008 GFC, African Bank acquired a large furniture retailer, Ellerines Furnishers (Pty) Ltd, that served the segment of customers that fit the customer profile of African Bank, for an amount of R9,2 billion.[851] As observed by Van Heerden,[852] the acquisition of Ellerines however turned out to be a bad business decision which led to an increasing and unsustainable monthly liquidity drain on African Bank. When African Bank's troubles started to mount, its CEO resigned and the bank estimated an expected loss of at least R6.4 billion in 2014, shortly after attempting to recover from its misfortunes through recapitalizing the bank by raising R5.5 billion in a rights offer in December 2013.[853]

African Bank's distinct role as major unsecured lender in the South African banking sector and the probability that contagion risk[854] could erode financial system stability motivated the SARB to put African Bank in curatorship on 10 August 2014.[855]

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[851] Bonorchis and Spillane "In Africa a bright idea in banking leaves a trail of ruin" available at http://www.bloomberg.com/news/articles/2014-08-27/how-brightest-brain-kirkinis-failed-with-his-african-bank accessed on 2 April 2017. Ellerines sold furniture on credit, thus displaying a similar business model as African Bank, but after Ellerines was acquired by ABIL it began to record unsustainably large losses inter alia with declining product sales.

[852] Van Heerden 2017 353.

[853] Jones "African Bank in Curatorship: sharing the pain" http://www.financialmail.co.za/coverstory/2014/08/14/african-bank-in-curatorship-sharing-the-pain accessed on 6 April 2017. Interestingly the rights offer was underwritten by Goldman Sachs International. See further the Myburg Report available at 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 11 April 2017. Notably the South African Reserve Bank kept a close eye on African Bank from late 2012 already in view of concerns regarding the bank's liquidity, its impairment and provisioning policy and its rapid credit growth. Accordingly various meetings between the Bank Supervision Department in the Reserve Bank and the African Bank took place. The measures taken by African Bank as a result of this engagement included: a higher level of provisioning for non-performing loans; a review of its provisioning policy; the rights issue of R5.5 billion referred to above and a request to dispose of the bank's furniture arm, Ellerines Holdings Ltd (as per paragraph 33 of the Myburgh Report).

[854] Apparently also quite some concern about information contagion that could eventually pose some systemic risk. See Georg "Bail-out of African Bank risks future problems" available at http://www.bdlive.co.za/opinion/2014/08/14/bail-out-of-african-bank-risks-future-problems accessed on 11 April 2017.

[855] Whether African Bank was systemic or not was not a clear cut case but the SARB prepared a report in March 2014 (as alluded to in paragraph 31 of the Myburgh Report) wherein it was stated that the bank was regarded as systemic to the South African Banking system, mainly on the basis of its extensive client base of more than 3 million customers, its role in financial inclusion, the negative impact on the socio-political environment should it fail, and the effect on foreign investor confidence, in the light hereof that part of its wholesale funding was sourced offshore. See also Barry "Is African Bank too big to fail?" available at http://www.moneyweb.co.za/uncategorized/is-african-bank-too-big-to-fail/ accessed on 6 April 2017; Loubser "African Bank too inclusive too fail" available at http://www.Sanlam.co.za/mediacentre/media-category/economic-commentary/African%20Bank%20Too%20Inclusive%20To%20Fail accessed on 6 April 2017. The then Governor of the Reserve Bank, Gill Marcus, however significantly stated: "Notwithstanding the challenges facing African Bank, government's policy of financial inclusion is appropriate and

Managing African Bank out of its distress involved a lot of creative thinking and, as observed by Van Heerden, early into the curatorship process it was realized that some interventions, beyond the scope of the tools availed by the curatorship process at the time, "were necessary to *inter alia* rid African Bank of bad debt and other impediments that was driving its failure, in order to facilitate, metaphorically speaking, the birth of a new 'good bank'."[856] As summarized by Van Heerden, the main actions taken and proposed by the curator were the following:[857] In an attempt to stabilize the situation and preserve equity in the failing institution the curator immediately suspended interest payments on all funding and froze the repayment of maturing funding.[858] It was proposed that the bank be restructured through a "'bad bank/good bank'-split which entailed the separation of its assets and liabilities into a 'bad/residual bank' comprising of bad loans; high–risk loans and other liquidity draining assets and regrouping the good business (with a book value of approximately R26 billion) into a 'good bank' that would ultimately be listed on the Johannesburg Stock Exchange."[859] The "bad/residual bank" comprised of impairments to the value of R17 billion, comprising a significant portion of the non- and underperforming assets that would be moved to a special purpose vehicle that would separate it from the "good bank".[860] It was further proposed that the SARB would purchase the bad/residual bank for R7 billion and that a consortium comprising of a number of other banks[861] together with the Public Investment Corporation would recapitalise the new good bank with a R10 billion capital injection. Senior bonds[862] would be transferred to the new bank, following a 10%

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important." and "While we do not see systemic risk in this, we would be conscious that any bank that fails has risk to it."

856 Van Heerden 2017 354.

857 Van Heerden 2017 355-6.

858 Mageba "African Bank Curatorship update" available at http://www.stanlibperformance.com/BusinessUpdate/2015/Q1/01-i1/index.htm accessed on 7 May 2017.

859 Jones "African Bank in curatorship: sharing the pain" available at http://www.financialmail.co.za/coverstory/2014/08/14/african-bank-in-curatorship-sharing-the-pain accessed on 7 May 2017.

860 Lendico "What happened with African Bank?" available at http://www.Lendico.co.za/blog/African-bank-bailout-136.html; Sanchez D "Why it failed: African Bank gave credit to the poor" available at https://moguldom.com/70304/failed-s-african-bank-gave-credit-to-the-poor/ accessed 12 April 2017; Bonorchis and Spillane "How Kirkinis failed with African Bank" available at http://www.moneyweb.co.za/uncategorized/how-kirkinis-failed-with-african-bank accessed on 11 May 2017. Winterboer "African Bank Ltd (in curatorship) Annual Financial Statements" 2015 available at https://www.sharenet.co.za/jsepdf/SENS_20151208_S365970.pdf accessed 11 May 2017 5.

861 The banks that formed the consortium were Absa, Capitec, Firstrand, Standard Bank and Investec.

862 "Senior debt" available at https://www.investopedia.com/terms/s/seniordebt.asp accessed 13 July 2020 were it is explained that "senior debt is borrowed money that a company must repay first if it goes out of business. Each type of financing has a different priority level in being repaid if the company goes

"haircut",[863] and equity and subordinated bondholders[864] would be offered the opportunity to participate in the recapitalization of the good bank. Senior bondholders would receive a new senior bond to the value of 80 cents in the Rand, issued by the "good bank" as well as a cash payment of 10 cents in the Rand. A new instrument for the remaining 10 cents would be issued out of the old African Bank and would represent a residual claim. Subordinated bondholders would receive compensation to the value of 37.5 cent in the Rand. Ninety percent of this compensation would be in a

out of business. If a company goes bankrupt, the issuers of senior debt, which are often bondholders or banks that have issued revolving credit lines, are most likely to be repaid, followed by junior debt holders, preferred stock holders and common stock holders, possibly by selling collateral held for debt repayment. Therefore, senior debt is debt and obligations which are prioritized for repayment in the case of bankruptcy; senior debt has the highest priority and therefore the lowest risk. Thus, this type of debt typically carries or offers lower interest rates. It is most often secured by collateral, also making it relatively less risky." See also "What is senior debt?" available at https://www.bondcapital.ca/learn/what-is-senior-debt/ accessed 13 July 2020 were senior debt is described as the "first level of a corporation's liabilities which means it is paid out first, ahead of all other creditors. Senior debt, as opposed to junior debt, is first in seniority and is often secured by collateral in the form of a lien. Senior debt is among the safest form of financing for the party providing the funds. Due to its inherent low risk, it also provides the least amount of return. However, in exchange for this low return, significant protection is provided even in the event of bankruptcy. Should a corporation go bankrupt, any remaining funds, dissolved assets or other available sources of value must first repay senior debt before other creditors are able to collect."

[863] SARB announced its decision to "bail in" senior unsecured creditors by writing down their claims by 10 per cent.

[864] Subordinated debt is described as "a hybrid financing instrument that sits between senior debt and equity in the capital structure. It can be used to provide a higher quantum of capital while minimising the dilution of shareholder returns." See "Subordinated debt and minority equity" available at https://www.investec.com/en_gb/corporate-finance/corporate-lending/subordinated-debt-and-minority-equity.html accessed 13 July 2020. Equity vs Sub-debt financing available at https://www.entrepreneur.com/article/72734 accessed 13 July 2020. "Subordinated debt is debt that ranks behind the main debt, known as senior debt, in priority of payment. Senior debt principal and interest-usually in the form of a bank loan-is paid off first while the subordinated debt principal and interest is paid off second. Equity financing is the method of raising capital by selling company stock to investors. In return for the investment, the shareholders receive ownership interests in the company. The catch with equity financing is that it can dilute the ownership of the company for the shareholders, potentially resulting in a loss of control". See also "Senior vs subordinated debt" available at https://www.investopedia.com/terms/s/seniordebt.asp accessed 13 July 2020 explains that "the difference between subordinated debt and senior debt is the priority in which the debt claims are paid by a firm in bankruptcy or liquidation. If a company has both subordinated debt and senior debt and has to file for bankruptcy or face liquidation, the senior debt is paid back before the subordinated debt. Once the senior debt is completely paid back, the company then repays the subordinated debt. Thus, if a company files for bankruptcy, senior debt claims are paid first. All other debt is subordinated (junior). Collateral from asset-backed debts may be sold to pay off senior secured debt. Senior unsecured debt is then paid using other company assets. If any assets remain, subordinated debt is paid. For this reason, subordinated creditors may lose some or all of the principal and interest payments that they are owed."

Tier II instrument[865] in the new "good bank" with the remaining 10% in the form of a cash pay-out.[866]

In order to implement this innovative proposal for addressing the African bank failure it was necessary to augment the curatorship procedure by means of an amendment to section 69 of the Banks Act which imported various new features into the curatorship procedure.

5.4.2 The 2015 Banks Amendment Act

The 2015 Banks Amendment Act[867] was hastily signed into law on 25 June 2015 in order to facilitate the execution of the rescue plan for African Bank.[868] The 2015 Amendment Act amended section 69 of the Banks Act as follows: section 69(2)(C) that regulated the disposal of assets during curatorship, was substituted to provide that the curator may not only dispose of the bank's assets but also transfer its liabilities or dispose of any of its assets *and* transfer any of its liabilities in the ordinary course of the bank's business.[869] In seeking a consent for a disposal of assets or a transfer of

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[865] Tier 2 capital is an important element that bank regulators use to determine a bank's total capital base. It is seen as less reliable than Tier 1 capital – another element used to determine a bank's capital base. The objective of Tier 2 is to provide loss absorption on a gone-concern basis. For an instrument to be included in Tier 2 capital it must be issued and paid in; subordinated to depositors and general creditors of the bank; is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis depositors and general bank creditors; maturity: minimum original maturity of at least five years, recognition in regulatory capital in the remaining five years before maturity will be amortised on a straight line basis and there are no step-ups or other incentives to redeem; the investor must have no rights to accelerate the repayment of future scheduled payments (coupon or principal), except in bankruptcy and liquidation. See full criteria Basel Committee on Banking Supervision, *Basel III A global regulatory framework for resilient banks and banking systems*, December 2010 Revised 2011 available at https://www.bis.org/publ/bcbs189.pdf accessed 7 June 2020 at 18. See also "Tier 1 Capital vs. Tier 2 Capital: What's the Difference?" available at https://www.investopedia.com/ask/answers/043015/what-difference-between-tier-1-capital-and-tier-2-capital.asp accessed 13 July 2020 were it is explained that tier 2 capital is a bank's supplementary capital. Undisclosed reserves, subordinated term debts, hybrid financial products, and other items make up these funds.

[866] "Debt-holders support African Bank restructuring proposal" available at http://citizen.co.za/392066/debt-holders-support-african-bank-restructuring-proposal/ accessed on 17 May 2017; Barry "Who gets what in African Bank Restructure" available at http://www.moneyweb.co.za/news/companies-and-deals/gets-african-bank-restructure/ accessed 17 May 2017; African Bank *Investor Relations and Restructuring Updates* http://www.africanbank.co.za/about-us/investors accessed on 17 May 2017.

[867] Act No 3 of 2015 published in Government Gazette No 38942 of 29 June 2015. See also Smith "Legal boost for African Bank Restructuring" available at http://www.fin24.com/Companies/Financial-Services/Legal-boost-for-African-bank-restructuring-20150630 accessed on 19 May 2017.

[868] The South Africa Reserve Bank authorised the creation of the "good bank" on 27 August 2015. The Financial Services Board subsequently licensed the "good bank" as a financial services provider.

[869] Section 2(a) of the 2015 Amendment Act.

liabilities or both, other than in the ordinary course of the bank's business, the curator was required to report to the Minister of Finance or the Registrar of Banks, on the expected effect of that such a disposal or transfer would have on the bank's creditors. In particular the curator had to indicate whether the creditors would be treated in an "equitable manner" and whether a reasonable probability existed that a creditor would not incur greater losses, as at the date of the proposed transaction, than would have been incurred if the bank had on that date been wound up under the Banks Act (thus importing the NCWOL-principle[870] as set out in the Key Attributes, into the curatorship process). It was however possible for the Minister or the Registrar to consent to the aforesaid disposal, transfer or disposal *and* transfer *notwithstanding* that it could prejudice the bank's creditors if such disposal or transfer or disposal *and* transfer was "reasonably likely to promote the maintenance of a stable banking sector in the Republic or public confidence in the banking sector in the Republic."

In addition section 69(3)(f) was substituted to empower the curator to make and carry out, any decision in respect of the failing bank which, in terms of the provisions of the Banks Act, or the Companies Act, or the bank's memorandum of incorporation or the rules of any securities exchange on which any securities of the bank or its controlling company are listed, would have required an "ordinary resolution or a special resolution" of shareholders in the bank or its controlling company.[871] A subsection 3(j) was added to permit the curator to raise funding from the SARB, or any entity controlled by the SARB, on behalf of the bank under curatorship. It permitted the curator, notwithstanding any contractual obligations of the bank under curatorship, but without prejudice to real security rights, to provide security over the bank's assets in respect of such funding.[872] The curator could further propose and enter into an arrangement or compromise between the bank and all its creditors, or all the members of any class of creditors, as contemplated in the Companies Act.[873]

5.4.3 The new African Bank

[870] See Chapter 2 para 2.2.5.
[871] Section 2(c) of the 2015 Amendment Act.
[872] There is however a proviso that, notwithstanding the provisions of section 69(6), any claim for damages caused to any person as a result of such security, may be instituted against the bank after expiration of one year as from the date of such provision of security.
[873] Section 2(d) of the 2015 Amendment Act.

In addition to the “good bank/bad bank”-split, Van Heerden points out that the curatorship of African Bank involved the implementation of other corrective measures including re-designing the bank’s business model, reorganizing the board of directors, reviewing the bank’s risk governance framework, provisioning methodologies,[874] credit policies and tools and the implementation of various cost reduction measures. It also entailed focusing strategically on further diversification of the “good bank” business, including its product offering, target markets and source funding.[875] Ellerines, which triggered the bank’s financial downfall, was placed into business rescue and later liquidated.[876]

Approximately eighteen months after the curatorship of African Bank was announced, the new (good) bank called *African Bank Limited*, was launched on 4 April 2016. The

[874] “In making loans, banks face the risk that borrowers will default and the full amount of the loan will not be recovered. When a loan loss becomes likely, a bank will make a charge to the profit and loss statement (“provision”) to create a loan loss reserve that is shown on the balance sheet. When the full amount of principal and interest on the loan becomes uncollectible, the loan balance is reduced through a charge to the loan loss reserve. Loan loss provisioning levels and the adequacy of the reserve are only as good as the methodology used to estimate losses in the loan portfolio. A loan grading scheme assigns each loan a grade that reflects its probability of default. Loans in one of the lower credit quality grades are often referred to as “non-performing loans” (NPLs), although the precise definition of what constitutes an NPL differs across countries and time. An inadequate loan grading scheme undermines the provisioning process and leads to distortions in a bank’s balance sheet and an overstatement of capital and capital ratios.” See Angklomkliew, George, Packer “Issues and developments in loan loss provisioning: the case of Asia” 2009 *BIS Quarterly Review* 70. See also Zamil “Expected loss provisioning under a global pandemic” 2020 Financial Stability Institute available at https://www.bis.org/fsi/fsibriefs3.pdf accessed 13 July 2020. The 2007–09 GFC exposed major shortcomings in the accounting principles that underpinned banks’ loan loss provisioning practices. At the time, the accounting standard for loan loss provisioning “was based on a so-called incurred loss (IL) model, limiting the ability of banks to recognise loan loss provisions in advance of a loss event. It was also criticised as being procyclical, because a large amount of provisions were recognised only after losses became evident. In response, accounting standard setters introduced a loan valuation framework based on expected credit losses (ECL).” In 2014, the International Accounting Standards Board (IASB) introduced International Financial Reporting Standards (IFRS) 9, which became effective on 1 January 2018 and are used in many jurisdictions including South Africa. IFRS 9 requires the determination of expected credit losses that takes into account all reasonable and supportable forward-looking macroeconomic information. See South African Reserve Bank, *Regulatory treatment of accounting provisions – interim approach and transitional arrangements including disclosure and auditing aspects* D5/2017 available at https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/8100/D5%20of%202017.pdf accessed 13 July 2020.

[875] Van Heerden 2017 356. See also Cameron “African Bank Rescue Plan” available at http://www.news24.com/MyNews24/African-Bank-Rescue-Plan-20140831 accessed on 19 August 2018.

[876] Van Heerden 2017 356. See also Admin “SARB to introduce support measures for ABIL” available at http://www.cnbafrica.com/news/southern-africa/2014/08/10/sarb-abil-support-measures.pdf accessed on 19 August 2019.

former African Bank Limited under Curatorship, was renamed "Residual Debt Services" and continued under curatorship.[877]

Some time after the launching of the new African bank, the, report by Commissioner who was appointed to undertake an investigation into the affairs of African Bank to determine the reasons that led to its curatorship, was publicly released on 12 May 2016.[878] The Commissioner found that there was no evidence that the bank's business was conducted with fraudulent intention but it was nevertheless found that its business was conducted negligently and in some respects recklessly, especially pertaining to the acquisition of Ellerines which put a large drain on the bank's liquidity. The Commissioner found that the Boards of ABIL and African Bank were parties to the aforementioned negligent and reckless conduct but the Commissioner did not make a finding that each board member individually was responsible for such conduct.[879]

5.5 The failure of VBS

Notably after the African Bank incident yet another bank failure occurred in 2016, namely that of the mutual bank[880] Venda Building Society, otherwise known as VBS,

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[877] Van Heerden 2017 356. See also African Bank SENS announcement "Commencement of Business Operations and Change of Name to "African Bank Limited" available at http://www.thevault.exchange/?get_group_doc=4926/145957586-ABKSENS4April2016.pdf accessed on 19 August 2018. See also Residual Debt Services Ltd available at https://www.africanbank.co.za/en/home/restructure-archive-residual-debt-services/ accessed 17 July 2020 wherein it is stated that Residual Bank Limited ("RDS") is the same legal entity as the old (predecessor) African Bank Limited. RDS operates under the curatorship of Craig Du Plessis, subject to the supervision of the Registrar of Banks.

[878] This comprehensive 477 page report is available at https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/7288/Report%20-%20Investigation%20in%20terms%20of%20s69A%20of%20the%20Banks%20Act,%2094%20of%201990.pdf accessed 19 August 2018. Adv V Maleka SC and Mr B Abrahams was appointed to assist the Commissioner with the investigation together with a team of attorneys and personnel from the SARB.

[879] Paras 691 to 695 of the Myburgh Report. As summarized by Van Heerden 2017 356: The negligent conduct identified in the report included the financial assistance provided to Ellerines, lack of appropriate provisioning and poor risk management as well as aggressive growing of the bank's loan book. The bank also lacked appropriate corporate governance and the board was found to have allowed themselves to be dominated by the CEO especially in relation to the disastrous acquisition of Ellerines. It was also found that the business of the bank was conducted recklessly in making unsecured loans to Ellerines in aggregate of R1.4 billion despite any reasonable prospect of the loans being repaid. It was further concluded that Abil and African Bank had acted negligently in underestimating the financial implications of issues such as bad debts, impairments, the cost of funding Ellerines; the risk of the market losing confidence in Abil and the bank and the funders failing to continue to support Abil and the Bank.

[880] Section 1 of the Mutual Banks Act 124 of 1993 states that mutual bank means "a juristic person the members of which qualify as such by virtue of their being shareholders in that juristic person and are entitled to participate in the exercise of control in a general meeting of that juristic person and that is registered as a mutual bank in terms of the Mutual Banks Act 124 of 1993."

which served as community bank in the rural Venda area in South Africa. Although initially placed under curatorship it soon became clear that the downfall of VBS was at the hands of its own corrupt management who had been robbing the bank blind of more than R2 billion, as revealed in the Report by the Commissioner who was appointed in terms of section 69A of the Banks Act. Having been robbed by its own board and managers to the point of insolvency this bank could however not be rescued or at least salvaged to some extent. In the absence of an explicit deposit insurance system the SARB compensated VBS depositors and arranged for depositor payouts to be facilitated by Nedbank. The VBS curatorship was terminated and VBS was swiftly put into liquidation, thus not yielding any poignant lesson in the context of curatorship other than it was not an all-encompassing panacea for addressing bank failure and that some banks had to be allowed to fail.[881]

5.6 Towards a bank resolution regime in South Africa

5.6.1 Introduction

From the abovementioned discussion of the African Bank rescue it is clear that, as a result of the amendments introduced by the 2015 Banks Amendment Act, the curatorship process was substantially expanded to provide the curator with an augmented toolkit and powers and by incorporating safeguards that are reminiscent of more comprehensive bank resolution regimes as advocated by the FSB Key Attributes and inter alia adopted by various countries, including the UK as discussed in Chapter Four, in recent years. The amendments effected by the 2015 Amendment Act, albeit that it was in some respects aligned to certain key features of a resolution regime as reflected in the FSB Key attributes, were however not comprehensive enough to completely transform the South African curatorship process into a resolution regime *proper.* At most it resembled a quasi-resolution regime or put differently, a curatorship

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[881] The curator that was appointed for VBS was Mr Anoosh Rooplal of SizweNtsalubaGobodo Advisory Services (Proprietary) Limited. For more detail regarding the scandalous VBS failure see the VBS Press Statement by the SARB on 19 July 2018 available at http://antcast.antfarm.co.za/sarb/mpc2018/presentation.asp?id=4338 accessed 3 March 2019. See also Motau T "The Great Bank Heist: Investigator's Report to the Prudential Authority" available at https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/8830/VBS%20Mutual%20Bank%20-%20The%20Great%20Bank%20Heist.pdf accessed 3 March 2019.

regime with some features of broader bank resolution akin to those captured in the FSB Key Attributes.

Although the failure of African Bank and the measures subsequently applied to rescue its viable business can nevertheless be hailed as a watershed moment in catapulting South Africa on its journey towards a resolution regime for banks, it should be noted that the decision to adopt a resolution framework was actually on the cards some time before the African Bank failure and that such decision clearly influenced the 2015 amendments to the curatorship process. In fact, the changes effected in the 2015 Banks Amendment Act to accommodate the rescue of African Bank essentially endorsed the fact that South Africa, after committing itself at the 2010 Seoul G-20 Conference[882] to alignment with international efforts to improve financial regulation post-GFC, especially the drive to address the "Too Big To Fail-problem",[883] was on a slow but steady trajectory towards adopting a comprehensive bank resolution framework. Such a framework would include a full suite of resolution tools and powers in order to better deal with bank failures, salvage viable parts and critical functions of failing banks and facilitate the orderly exit of banks or parts of banks that are non-viable - with as little systemic disruption as possible.

This initiative to transition to a comprehensive resolution regime gained momentum pursuant to a review of South Africa's resolution framework by the World Bank in terms of its initiative programme in 2009/2010.[884] A subsequent thematic peer review by the Financial Services Board in 2012[885] revealed gaps in a number of areas where South

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[882] The G20 Seoul Summit Leaders' Declaration available at http://www.g20.utoronto.ca/2010/g20seoul.html accessed 4 April 2020. See also the G20 Seoul Summit Action Plan and Table containing policy commitments by G20 members at 38 available at https://www.mofa.go.jp/policy/economy/g20_summit/2010-2/commitments.pdf accessed 3 April 2020.

[883] National Treasury, *Strengthening South Africa's Resolution Framework for Financial Institutions* 2015 4 available at https://www.treasury.gov.za?twinpeaks/Sterngthening%30South%20Africa's%20Resolution%20Framework%20for%20Financal%20Institutions.pdf accessed on 7 February 2019.

[884] The World Bank Group Financial Safety Nets and Bank Resolution Frameworks in Southern Africa: Key Issues and Challenges available at https://www.openknowledge.worldbank.org/bitstream/handle/10986/31511/Key-Issues-and-Challenges.pdf accessed 12 April 2020. National Treasury, *Strengthening South Africa's Resolution Framework for Financial Institutions* 2015 4 available at http://www.treasury.gov.za/twinpeaks/Strengthening%20South%20Africa's%20Resolution%20Framework%20for%20Financial%20Institutions.pdf accessed on 7 February 2019.

[885] Financial Stability Board, *Thematic Peer Review on Deposit Insurance Systems, Peer Review Report,* 8 February 2012 available at https://www.fsb.org/wp-content/uploads/r_120208.pdf accessed 12 April 2020. See also National Treasury, *Strengthening South Africa's Resolution*

Africa's approach to dealing with bank failures did not comply with the FSB Key Attributes for effective resolution regimes (the 2011 version). These gaps were confirmed by the IMF in its subsequent 2015 Financial Sector Assessment Program (FSAP)[886] of South Africa's financial system. Some of the gaps identified were inter alia that:[887] curatorship had narrow application in the sense that it only applied to the failing bank and not to other institutions within, for example, a banking group or financial conglomerate of which the bank formed part. There was also no dedicated resolution authority for *all* financial institutions (thus not banks only) and given the silo sectoral model of financial regulation that prevailed at the time, different financial institutions fell under the jurisdiction of a number of sector-specific financial regulators who was tasked to deal with their financial distress. Curatorship was found wanting as it applied only once the failing bank had already encountered significant problems hence the IMF was of the view that there was limited room for timely intervention to prevent a "severe and avoidable loss of value." The IMF observed that powers that could be applied to deal with failing financial institutions were fragmented over various acts, stabilization powers were limited and these powers required shareholder or Board approval, delaying the regulatory efforts to appropriately deal with the failing bank and compromising financial stability. There were also limited provision for set-off, netting, collateralization and segregation of client assets. Insofar as safeguards were concerned, the IMF pointed out that in accordance with the Insolvency Act 24 of 1936 all unsecured creditors ranked *pari passu* while some creditor preference could be justified on financial stability grounds.[888] The IMF further pointed out that South Africa lacked a privately funded explicit deposit protection system and a resolution fund and that failing banks were bailed out in accordance with implicit guarantee arrangements that involved the application of taxpayer's money. There were also gaps identified by

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Framework for Financial Institutions 2015 4 available at http://www.treasury.gov.za/twinpeaks/Strengthening%20South%20Africa's%20Resolution%20Framework%20for%20Financial%20Institutions.pdf accessed on 7 February 2019.

[886] IMF Country Reports, *South Africa: Financial Sector Assessment Program – Financial Safety Net, Bank Resolution, and Crisis Management Framework – Technical Note,* Report No 15/53 March 2015 available at https://www.imf.org/en/Publications/CR/Issues/2016/12/31/South-Africa-Financial-Sector-Assessment-Program-Financial-Safety-Net-Bank-Resolution-and-42755 12 April 2020 (hereinafter IMF 15/53) 19-23 and 27-31. See also IMF South Africa, *Financial system Stability Assessment Country Report No 14/340*,8-9,27-29 2014 available at https://www.imf.org/external/pubs/ft/scr/2014/cr14340.pdf accessed 12 April 2020.

[887] IMF 15/53 at 27-31.

[888] See the 2015 Banks Amendment Act discussed in para 4.2 above in this regard.

the IMF in cross-border cooperation and information-sharing and it was pointed out that South Africa did not partake in any cross-border crisis management groups.[889]

The IMF further observed that although South Africa had initiated recovery plans for banks the requirements for recovery plans had, at the time, only been published in a Banks Act Circular and was not captured in legislation. In addition the IMF indicated that comprehensive resolution plans still had to be developed for South African banks. There were also no formal requirements or procedures for resolvability assessments which were at the time being conducted "ad hoc, as required, and not based on cross-industry agreed methodologies."[890]

The FSAP Report also highlighted that whilst the process of curatorship had been used to deal with recent bank failures, "it revealed certain constraints of the model, as the solutions found in these cases rested substantially on cooperation with creditors as well as the taxpayer guaranteed transfer of retail deposits, both of which have only a reasonable chance of success with relatively small banks."[891] In light of these experiences, and as the curatorship framework had not yet been tested by the failure of a systemically important bank, the FSAP concluded that the crisis management resolution framework should be substantially enhanced. The IMF consequently recommended that the authorities introduce a resolution regime compliant with the FSB Key Attributes of Effective Resolution Regimes and that the SARB be made the resolution authority of all banks and systemically important financial institutions. The FSAP also recommended removing constraints to the SARB's early intervention powers and improving legal protection for resolution officials.[892]

As pointed out in Chapter 2, the FSB Key Attributes were formally adopted as an international standard in 2015 and all G20 member countries committed to their implementation.[893] Thus, in August 2015 National Treasury and the SARB jointly introduced the move towards a comprehensive resolution regime for financial

[889] *Ibid.*
[890] IMF 15/53 at 13; National Treasury, *Strengthening South Africa's Resolution Framework for Financial Institutions* 2015 available at http://www.treasury.gov.za/twinpeaks/Strengthening%20South%20Africa's%20Resolution%20Framework%20for%20Financial%20Institutions.pdf accessed on 7 February 2019 Table 1: South Africa's resolution framework assessed against KAs at 5-7.
[891] *Ibid.*
[892] *Ibid.*
[893] See Chapter Two para 2.1.

institutions in South Africa with a discussion paper titled "Strengthening South Africa's Resolution Framework For Financial Institutions" (hereinafter *SA Resolution Framework*).[894] In this discussion paper, which was intended to form the basis from which a special resolution bill would eventually be drafted, the concept "designated resolution institutions" ("DRIS") was used. DRIS, for purposes of the envisaged resolution regime, was a wide concept signifying the intention that the envisaged resolution regime would be an all-encompassing regime that would apply to registered banks; non-bank financial institutions designated as systemically important financial institutions; financial market infrastructures and the groups within which they operate (thus from the ultimate holding company downwards, including foreign branches and subsidiaries). Although the intention was to eventually adopt such an all-encompassing resolution framework for financial institutions in South Africa, the policy paper indicated that, as a starting point, it would focus only on how resolution would apply to banks.[895]

The discussion paper set out the important functions of banks in the economy, pointing out the inadequacy of normal insolvency processes to sufficiently deal with failure of a systemically important bank.[896] It further indicated that the objective of the resolution regime to be captured in the envisaged special resolution bill, would be to contribute to the protection and enhancement of the stability of South Africa's financial system "by improving the resolvability and, in the event of failure, facilitating the orderly resolution of financial institutions that are DRIS."[897] Certain "sub-considerations" were listed, namely that when undertaking any action or exercising any resolution power the resolution authority should seek to maintain financial system stability, "including by maintaining the continuity of systemically important financial services, and payment, clearing and settlement functions; minimizing the risk of contagion and maintaining confidence in the financial system." It was also envisaged that the resolution authority would have to aim to protect depositors in accordance with the (yet to be introduced) explicit deposit insurance arrangements and to seek to minimize or avoid taxpayer

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[894] National Treasury, *Strengthening South Africa's Resolution Framework for Financial Institutions* 2015 available at http://www.treasury.gov.za/twinpeaks/Strengthening%20South%20Africa's%20Resolution%20Framework%20for%20Financial%20Institutions.pdf accessed on 7 February 2019 (hereinafter *SA Resolution Framework*).
[895] *SA Resolution Framework* 1.
[896] *SA Resolution Framework* 2.
[897] *SA Resolution Framework* 6.

costs; moral hazard; adverse impacts on the economy and unnecessary loss of value.[898]

The *SA Resolution Framework* discussion paper further indicated, in line with the IMF recommendations above, that the SARB would be the resolution authority and that all resolution powers available in the envisaged special resolution bill would be vested in the SARB. It was contemplated that the SARB would be able to delegate its resolution powers to another regulator in relation to the resolution of specific institutions that would fall within the scope of the Special Resolution Bill. The discussion paper mentioned that various aspects of the SARB's role as resolution authority would need to be addressed, *inter alia* decision-making processes, coordination requirements, accountability requirements, temporary exemption from specific legal requirements that may hinder quick and effective decision-making and resolution as well as protection of SARB staff and consultants against claims.[899] Chapter 3 of the discussion paper addressed the introduction of pre-resolution processes and powers comprising matters such as recovery plans, resolution plans and strategies, administering an explicit deposit guarantee scheme, cross-border cooperation and pre-resolution powers to be exercised by the SARB.[900]

5.6.2 The adoption of a Twin Peaks model of Financial Regulation in South Africa

Notably before crafting the legislative framework for the envisaged resolution regime South Africa, as a fundamental step in aligning itself with the international reform agenda, set out to adopt a new, more optimal approach to financial regulation. Whereas the financial systems of many countries across the globe suffered severely during and consequent to the 2008 GFC, South Africa was fortunate to have largely weathered the GFC. Apart from the fact that its involvement in the foreign markets where the GFC caused most destruction were limited, South Africa's "escape" from the worst effects of the GFC was mainly attributed to its well regulated financial sector, appropriate and conservative risk management practices at domestic banks, limited

[898] *SA Resolution Framework* 8. The resolution authority would also be required to seek to minimize or avoid adverse impacts on the financial systems of other jurisdictions.
[899] *SA Resolution Framework* 9-11.
[900] *SA Resolution Framework* 12-15. See further Table 2: Pre-resolution powers at 16 and 17 which list the following powers: information-gathering powers, power to investigate, powers relating to recovery plans, powers relating to resolution plans, powers relating to the deposit guarantee scheme and cross border cooperation.

exposure to foreign assets and its subsidiary structure and listing requirements for registered banks as well as a robust monetary policy framework, countercyclical[901] monetary policy, a proactive approach to dealing with bank credit risks and a focus on reducing household vulnerability.[902] To give effect to its commitment at the Seoul Conference mentioned above, South Africa embarked on its journey towards the model that it selected as optimal for the South African financial sector: a country specific adaptation of Michael Taylor's Twin Peaks model as initially pioneered in Australia in 1998.[903] This change in the approach to financial regulation would not only ensure systemic protection of the stability of the South African financial system and ensure that financial institutions are safe and sound but it would also seek to protect financial consumers and combat financial crime.[904]

In February 2011 the National Treasury put South Africa on the road towards a Twin Peaks model of financial regulation by objective with the release of a comprehensive policy document titled "A Safer Financial Sector to serve South Africa better" (the "Redbook").[905] Subsequently an additional policy document titled "Implementing a Twin Peaks System of Financial Regulation in South Africa" (the "Roadmap")[906] was published and after extensive consultation resulting in a number of drafts, the Financial Sector Regulation Act 9 of 2017 was signed into law in August 2017.[907] As pointed out

[901] A countercyclical monetary policy is aimed at reducing spending during a boom period and increasing spending during a recession- see IMF, *Monetary Policy: Stabilizing Prices and Output*, February 2020 available at https://www.imf.org/external/pubs/ft/fandd/basic.monpol.html accessed 27 June 2020.

[902] National Treasury, *A Safer Financial Sector to Serve South Africa Better*, 2011 available at http://www.treasury.gov.za/twinpeaks/20131211%20-%20Item%202%20A%20safer%20financial%20sector%20to%20serve%20South%20Africa%20better.pdf accessed 7 June 2020.

[903] Taylor *"Twin peaks": A regulatory structure for the new century* (1995) Centre for the Study of Financial Innovation – Financial Service Industry - Issue 20 of DSFI series at 2 and 3. See also Taylor M "Financial Regulation in the United Kingdom: a structure for the 21st century" 1996 *Futures and Derivatives Law Review* 7; Taylor "Redrawing the Regulatory map: why the Financial Services Act must not be reformed in isolation" 1996 *Butterworths Journal of International Banking and Financial Law* 463; Taylor M *Twin Peaks Revisited: a second chance for regulatory reform* (2009) Centre for the Study of Financial Innovation, Paper 89 available at http://static1.squarespace.com/static/54d620fce4b049bf4cd5be9b/t/55241044e4b03769e017208a/1428426820095/Twin+Peaks+Revisited.pdf accessed on 11 October 2019.

[904] *Ibid*.

[905] National Treasury, *A Safer Financial Sector to Serve South Africa Better*, 2011 available at http://www.treasury.gov.za/twinpeaks/20131211%20-%20Item%202%20A%20safer%20financial%20sector%20to%20serve%20South%20Africa%20better.pdf accessed 7 June 2020.

[906] *Ibid*.

[907] Financial Sector Regulation Act 9 of 2017 published by GN853 in GG 41060 of 22 August 2017 (hereinafter FSRA).

by Van Heerden and Van Niekerk, this Act serves as framework law implementing the first phase of the South African Twin Peaks model which would be followed up with incremental changes to financial sector laws over time.[908]

The main features of the Twin Peaks model as introduced by the Financial Sector Regulation Act are the following: The SARB, as central bank, was given a pronounced and comprehensive financial stability mandate with a systemwide macroprudential focus that is now for the first time captured expressly in legislation. A new prudential regulator, the Prudential Authority was established as a separate juristic entity located within the SARB, and is responsible for systemwide prudential supervision of financial institutions (including banks). A new market conduct regulator, the Financial Sector Conduct Authority, was also established as a separate juristic entity to oversee market conduct of financial institutions on a systemwide basis.[909]

As observed by Van Heerden and Van Niekerk, the South African Twin Peaks model thus comprises three peaks:[910] the SARB, Prudential Authority and Financial Sector Conduct Authority, whilst other financial regulators such as the National Credit Regulator[911] and the Financial Intelligence Centre[912] operate *within* the twin peaks model but *outside* of the peaks established by the model. Important for purposes of this thesis is to note that, because bank supervision was removed from the remit of the SARB and entrusted to the Prudential Authority, changes were also effected to the curatorship process in section 69 to replace all references to the Registrar of Banks with references to the Prudential Authority.[913] Thus the position at the time of writing this thesis, whilst the envisaged new South African bank resolution regime is currently still contained in draft legislation, is that the curatorship process in section 69 is

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[908] Section 8 of the FSRA. Further amendments to sector specific laws from time to time will ensure that the Twin Peaks model is reflected in all necessary legislation. See also Van Heerden and Van Niekerk "Twin Peaks in South Africa: a new role for the central bank" 2017 *Law and Financial Markets Review* 154 (hereinafter Van Heerden and Van Niekerk 2017).

[909] Van Heerden and Van Niekerk 2017 2. See also Godwin and Schmulow "The Financial Sector Regulation Bill in South Africa, Second Draft: Lessons from Australia" 2015 *South African Law Journal* 756; Schmulow "Financial Regulatory Governance in South Africa: The move towards Twin Peaks" 2017 *African Journal of International and Comparative Law* 393.

[910] Van Heerden & Van Niekerk 2017 3.

[911] Established in terms of section 12 of the National Credit Act 34 of 2005 to oversee the regulation of the South African credit market.

[912] Established in terms of section 2 of the Financial Intelligence Centre Act 38 of 2001 (FICA) to combat money laundering activities and the financing of terrorist and related activities.

[913] See Schedule 2 to the FSRA that sets out the various amendments to provisions of the Banks Act 94 of 1990 in order to reflect the replacement of the Registrar of Banks with the Prudential Authority.

overseen by the Prudential Authority while the Minister of Finance, acting upon recommendation of the Prudential Authority, is still responsible for the appointment of the curator. Once the resolution regime introduced by the Financial Sector Laws Amendment Bill as discussed below, comes into operation, the curatorship process as contained in section 69 of the Banks Act as well as the specific section 69A investigation by the Commissioner will no longer exist. The new resolution regime will however be applied within a financial system that is optimally regulated in terms of the Twin Peaks model which gives priority to financial system stability.[914]

5.6.3 The envisaged resolution regime introduced by the Financial Sector Laws Amendment Bill

When it eventually came to the drafting of the legislative framework for South Africa's proposed resolution[915] regime it was opted not to include the resolution regime in a separate resolution bill as initially envisaged but rather to incorporate it into the Financial Sector Regulation Act 9 of 2017 in the form of a new Chapter 12A that will be inserted into the said Act. The resolution regime sought to be so introduced was published in September 2018 in the Financial Sector Laws Amendment Bill ("FSLA Bill").[916] It is envisaged to be a broad regime that is contemplated to eventually serve

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[914] Currently the objective of the FSRA is "to achieve a stable financial system that works in the interests of financial consumers and that supports balanced and sustainable economic growth in the Republic, by establishing, in conjunction with the specific financial sector laws, a regulatory and supervisory framework that promotes-
(a) financial stability;
(b) the safety and soundness of financial institutions;
(c) the fair treatment and protection of financial customers;
(d) the efficiency and integrity of the financial system;
(e) the prevention of financial crime;
(f) financial inclusion;
(g) transformation of the financial sector; and
(h) confidence in the financial system."

[915] Cl 38 of the FSLA Bill inserts a definition of "resolution" into section 1 of the FSRA to mean "the management of the affairs of the designated institution as provided for in Chapter 12A."

[916] Financial Sector Laws Amendment Bill B-2018 as introduced in the National Assembly available at http://www.treasury.gov.za/twinpeaks/Financial%20Sector%20Laws%20Amendment%20Bill.pdf accessed 17 July 2020 (hereinafter FSLA Bill). Note also that cl 40 of the FSLA Bill proposes the substitution of section 9 of the FSRA that deals with inconsistencies between the FSRA and other financial sector laws to provide that in the event of any inconsistency between a provision of the FSRA, other than a Regulation or a regulatory instrument made under this FSRA, and a provision of another Act that is a financial sector law; or deals with the failure or insolvency of a company or the appointment of a statutory manager, curator or similar person to a designated institution, the provision of the FSRA prevails (see section 9(1)). It also stipulates that in the "event of any inconsistency between a provision of a Regulation or a regulatory instrument made in terms of this Act and a provision of a regulation or a regulatory instrument made in terms of a specific financial

as resolution regime for banks *and* all systemically important non-bank financial institutions operating in the South African financial system. This explains the decision not to introduce the resolution regime into the Banks Act but rather to incorporate it into the Financial Sector Regulation Act as generic framework Act that sets out the South African Twin Peaks model and which applies to all financial institutions in South Africa.

The FSLA Bill accordingly seeks to amend the Financial Sector Regulation Act to *inter alia* "provide for the establishment of a framework for the resolution of banks and systemically important non-bank financial institutions to ensure that the impacts and potential impacts of a failure of a bank or systemically important financial institution on financial stability are managed appropriately" and to designate the SARB as the resolution authority.[917] The FSLA Bill introduces various new definitions[918] into the Financial Sector Regulation Act to accommodate the interpretation of the provisions relating to bank resolution that will apply to "designated institutions" which, in terms of an amendment contemplated to be effected to section 29A, *inter alia*, are banks and systemically important financial institutions.[919] The Bill also seeks to amend the

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sector law;" or in terms of another law that deals with the failure or insolvency of a company or the appointment of a statutory manager, curator or similar person to a designated institution, the provision of the Regulation or regulatory instrument made in terms of the FSRA prevails (see section 9(2)).

[917] Preamble of FSLA Bill 2018. The FSLA Bill (cl 37) also seeks to amend the long title of the Financial Sector Regulation Act accordingly.

[918] See cl 38 of the FSLA Bill that introduces the amendments to the definition section contained in section 1 of the Financial Sector Regulation Act. These definitions will be alluded to where relevant in the discussion of the resolution regime proposed to be inserted in Chapter 12A of the FSRA.

[919] See cl 45 of the FSLA Bill which introduces section 29A to provide that for purposes of the Financial Sector Regulation Act the concept "designated institution" means each of the following:
"(a) a bank;
(b) a systemically important financial institution;
(c) the payment system operator and participants of a systemically important payment system;
(d) a company that is a holding company of a bank, a systemically important financial institution, or a payments system operator of a systemically important payments system; and
(e) subject to any determination in terms of subsection (2), if a bank or a systemically important financial institution is a member of a financial conglomerate in terms of section 160, each of the other members of the financial conglomerate." Notably cl 46 of the FSLA Bill also seeks to amend section 30 of the FSRA to enable the issuing of prudential standards and regulator's directives in respect of designated institutions to mitigate the risk of systemic events that may erode the stability of the South African financial system. Such standards and directives will pertain to solvency measures and capital requirements, including counter-cyclical capital buffers; leverage ratios; liquidity; organizational structures; risk management arrangements; sectoral and geographical exposures, required statistical returns; and recovery and resolution planning. The *SARB resolution approach discussion paper* explains at 9 that the practical implication of the definition of "designated institutions" is that all banks, mutual banks and cooperative banks will fall under the resolution regime and other relevant provisions of the FSLA Bill from the day of its enactment. Non-bank financial institutions will only fall under this regime if they had been formally designated as SIFIs.

objective of the Financial Sector Regulation Act as set out in section 7 of the Act by means of the addition of a subparagraph (i) that provides for the following objective to be included in the said section: "(i) the orderly resolution of designated institutions in resolution and, in connection with that, protection of depositors in banks through a deposit insurance scheme and containing the cost to the Republic of the steps taken."[920] The reference to containing the cost of resolution reflects alignment with the post-GFC sentiment against extending bail-outs to failing banks that may be perceived as "Too Big To Fail". Notably a definition of "orderly resolution of a designated institution" is introduced into section 1 of the Financial Sector Regulation Act by clause 38 of the FSLA Bill to mean "the management of the affairs of the designated institution as provided in Chapter 12A in a way that-

(a) maintains financial stability; and

(b) in the case of a bank, protects the interests of depositors,

including by ensuring that the critical functions performed by the designated institution continue to be performed."

To facilitate a better understanding of the proposed resolution regime, the Financial Stability Department of the SARB, like the BoE in the UK, also deemed it fit to release a discussion paper in July 2019 titled "Ending too big to fail: South Africa's intended approach to bank resolution" (hereinafter *SARB resolution approach discussion paper*).[921] The purpose of this discussion paper is to provide an overview of how the SARB intends to perform its functions as the resolution authority as well as some of the requirements that may be imposed on designated institutions[922] after the promulgation of the FSLA Bill.[923] Accordingly the discussion below will comprise an

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[920] Cl 39 FSLA Bill.

[921] *SARB resolution approach discussion paper* available at https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/9398/South%20Africa%27s%20intended%20approach%20to%20bank%20resolution.pdf accessed on 12 April 2020. The discussion paper indicates at 4 that in line with South Africa's commitment to implement the FSB Key Attributes and end the "Too big to fail"- phenomenon, the existing "resolution" framework was reviewed and steps were taken to strengthen it where deficiencies were identified and to introduce missing elements of the Key Attributes.

[922] Clause 39 of the FSLA Bill inserts a definition of "designated institution in resolution" into section 1 of the FSRA to mean "a designated institution in respect of which a determination in terms of section 166J(2) is in force."

[923] *SARB resolution approach* discussion paper 5. These requirements *inter alia* entail heightened prudential regulation as per the new section 29A as introduced by cl 45 of the FSLA Bill.

overview of the resolution regime as captured in the envisaged new Chapter 12A read together with explanations provided by the *SARB resolution approach discussion paper*.

In line with the focus of this thesis the discussion of the resolution regime introduced by the FSLA Bill will focus on bank resolution only, hence, instead of using the generic term "designated institution", the term "bank" will be used when discussing the resolution regime. As indicated above, the FSLA Bill once enacted, will repeal the provisions in section 68 (bank liquidation), as well as 69 and 69A of the Banks Act that deals with liquidation, curatorship and the Commission of Inquiry into the reasons for bank failure, respectively.[924] This means that the whole curatorship process in terms of section 69 as recently augmented by the 2015 Banks Amendment Bill will no longer exist as a standalone bank-specific procedure contained in the Banks Act. Although a discussion of deposit insurance is beyond the scope of this thesis, it needs to be pointed out that the FSLA Bill also introduces a framework for explicit deposit insurance into the Financial Sector Regulation Act. The result will be that South Africa will henceforth, once the Bill is enacted, also have an explicit deposit insurance framework that will operate in tandem with the new resolution regime and will extend necessary and swift protection to bank depositors within the broader context of the South African Twin Peaks model of financial regulation.[925]

5.6.4 Recovery and resolution planning as ex ante measures

Prior to delving into the features of the new resolution regime as conceptualized in the FSLA Bill that is envisaged for South Africa it is necessary to consider developments relating to recovery and resolution plans for South African banks given that such plans will either (through recovery plans) serve to prevent bank failure that may trigger resolution alternatively they will (through resolution plans) provide a pre-conceptualized blueprint for optimal resolution of a failing bank.

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[924] Cl 12 FSLA Bill.

[925] See cl 54 of the FSLA Bill, in particular Part 6 to 8 of the new Chapter 12A that is sought to be introduced into the FSRA as well as sections 166Z, 166AA and 166AB as contained in Part 5 of the envisaged Chapter 12A (read together with the applicable definitions introduced into section 1 of the FSRA by cl 38 of the FSLA Bill) for the provisions regarding deposit insurance. See also Van Heerden "Deposit Protection in South Africa: Recent Developments" 2020 *Journal of International Bank Law and Regulation* 45.

As indicated in Chapter 2,[926] the FSB Key Attributes require financial institutions to have dedicated *ex ante* recovery and resolution plans that can assist in the self-applied recovery of the bank from a crisis event (recovery plans drafted by the bank itself and approved by its Board of directors) and the application of a resolution plan by the regulator (drafted by the regulator with the assistance of the bank concerned).[927] The requirements regarding recovery plans were introduced as part of the prudential regulation of banks in terms of the Banks Act and were phased in through Directive 1/2015 that was issued by the Bank Supervision Department of the SARB, specifying the minimum requirements that a bank recovery plan should meet.[928] The Directive further sets out governance requirements and key information to be provided in the recovery plan regarding the group structure and key legal entities within the banking group. Guidance is provided on the triggers for recovery planning purposes and considerations relating to stress scenarios are also covered in the directive as well as guidance on the recovery options.[929]

The position currently is that the Prudential Authority requires all banks to develop recovery plans to ensure that they would be able to deal with events or periods of severe stress and take sufficient pre-emptive steps to avoid failure and resolution. The Prudential Authority sets minimum standards for recovery plans, to ensure that these plans include credible options, tailored for each bank, to cope with a wide range of stress events and scenarios. When a bank enters a period of stress, it is the responsibility of the bank's management to trigger and implement the appropriate aspects of its recovery plan. In particular the SARB states that recovery plans cannot assume the availability of any recovery actions that are not under the particular bank's

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[926] Chapter Two para 2.2.11.

[927] *SARB resolution approach discussion paper* 11 which indicates that although they are different, recovery and resolution are interrelated insofar as both rely on a bank's capabilities to measure and model capital and liquidity needs in stress situations, and on the actions that might be taken take in response to stress to restructure business lines or to dispose of assets.

[928] Directive 1/2015; *Strengthening South Africa's Resolution Framework for Financial Institutions*, 2015 12 available at http://www.treasury.gov.za/twinpeaks/Strengthening%20South%20Africa%E2%80%99s%20Resolution%20Framework%20for%20Financial%20Institutions.pdf accessed 12 April 2018.The Directive makes the requirement of a recovery plan applicable to all registered banks and controlling companies in South Africa, including locally registered branches of foreign banks.

[929] *Ibid*.

control such as where statutory resolution powers are needed or where banks require financial support by the authorities.[930]

In tandem with recovery plans bank regulators are also required to design individual resolution plans for banks under their supervision, which plans are aimed at figuring out in advance how to best resolve the bank concerned in the event of its failure. The SARB has indicated that without effective resolution planning, resolvability assessments and the removal of barriers to resolvability, it will not achieve the resolution objectives in the FSLA Bill, as discussed below. The resolution planning process is thus necessary to enable the SARB to gain in-depth resolution related information about each bank, so that it can develop feasible resolution strategies tailored to each institution, and put in place the capacity to execute the resolution plans, conduct resolvability assessments and remove barriers to resolvability.[931] Thus, resolution planning is an integral component of the envisaged South African resolution regime being a plan that is drafted in preparation for orderly resolution and its application is triggered once a bank enters into resolution.

The FSLA Bill accordingly introduces a provision on "resolution planning"[932] in section 166E of the new Chapter 12A of the Financial Sector Regulation Act, which provides that the SARB must, on the basis of risk analyses conducted in consultation with the financial sector regulators, take adequate and appropriate steps to plan for the potential need for the orderly resolution of designated institutions. Notably, although resolution plans are to be drafted prior to resolution of a failing bank, the obligation to draft them is captured within the proposed new Chapter 12A of the Financial Sector Regulation Act that contains the resolution regime.

[930] *SARB resolution approach* discussion paper 10.

[931] As observed in the *SARB resolution approach* discussion paper 13 -14: "Resolution planning should not be seen as planning for specific scenarios of failure or as a path of action to which the resolution authority commits itself. Rather it aims to make an institution resolvable by pre-emptively putting in place recapitalization capacity, the availability of resolution-related information and arrangements to ensure the continuity of critical functions and continued access to financial market infrastructures when a bank enters resolution, as well as funding arrangements and agreements with host authorities on the key elements of cooperation in cross border resolution arrangements, among other things. Resolution plans should be neutral to the cause of failure and should not be seen as an indication of a firm's probability of failure. Rather effective resolution planning should be seen as an integral part of financial regulation on a going-concern basis."

[932] As pointed out in para 6.4 above, the concept of recovery planning has already been introduced via Directive 1/2015.

As explained in the *SARB resolution approach discussion paper* the SARB will, in cooperation with a bank, identify the critical functions that are performed by such bank and that would need to be continued should the bank enter resolution. A "Critical function" in relation to a bank in resolution means a function that is:[933]

> "(a) essential to, or that contributes substantially to, financial stability and is performed by the designated institution; and
>
> (b) provided to, and essential to the continued operation of the designated institution."

The resolution plan should address all measures necessary to ensure that these services can continue uninterrupted should the bank go into resolution. The idea is *inter alia* to facilitate "operational continuity in resolution" ("OCIR") which refers to the capability of a bank in resolution to continue with its critical functions and the operations that support these functions. An important element of resolution planning is therefore also to put mechanisms in place to ensure that services continue to be provided to a bank in resolution, for example through contractual arrangements between the designated institution and service providers. As remarked by the SARB "[R]esolution planning will be a process that is performed on an ongoing basis, alongside regulation and supervision. Planning for failure will no longer be an activity that only takes place when a bank faces difficulties or approaches a point of non-viability. Resolution plans have to be developed irrespective of a bank's probability of failure. Some of the lessons of the global financial crisis that led to the requirement for resolution planning were that (i) big banks can also fail, and (ii) even healthy banks can fail if the external environment deteriorates sufficiently and rapidly."[934]

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[933] As per the definition of "critical function" inserted into section 1 of the FSRA by cl 38 of the FSLA Bill.

[934] Importantly the *SARB resolution approach discussion paper* at 50 further points out that "[R]esolution planning does more than prepare for resolution because the planning process in itself often leads to more resilient institutions by looking at the structure and operations of a bank through a different lens. Banks that are structured for an orderly failure understand their own businesses better, have more insight into their own vulnerabilities and take efforts to strengthen these." The SARB further emphasizes that resolution planning also improves market discipline. It states that the reason for this is that if investors are convinced that resolution plans are feasible, market pricing starts to reflect the true underlying risks of individual banks, and investors start to reward well-managed banks relative to badly managed banks. According to the SARB, as long as investors believe that big banks will be bailed out by government, all banks have equal risks for investors and, as a result, risk is not accurately priced. The SARB thus highlights that resolution planning "is not an event, but an iterative process in which resolvability assessments continually lead to further improvements."

The *SARB resolution approach discussion paper* also addresses the concepts of "open bank resolution" and "closed bank resolution". It points out that an open bank resolution strategy[935] requires the bank to continue with its operations meaning that the bank will need to have sufficient funding available in resolution. As underlined by the SARB an important element of a credible resolution plan is therefore to assess the likely funding needs and identify potential sources of funding in resolution. Banks will consequently be required to determine their funding needs as part of resolution planning, and to ensure that their management information systems enable them to monitor and report on their possible funding needs during a resolution.[936]

5.6.5 Chapter 12A of the Financial Sector Regulation Act: The resolution regime

The envisaged resolution regime will be contained in the new Chapter 12A, titled "Resolution of designated institutions", comprising of section 166A to Z that is proposed to be inserted into the Financial Sector Regulation Act by clause 54 of the FSLA Bill. Chapter 12A is divided into eight parts of which Parts 1 to 4 capture the proposed resolution regime: Part 1 contains general provisions with respect to designated institutions and *inter alia* provides for the exercise of the SARB's powers as resolution authority; its resolution objectives and resolution functions as well as resolution planning, bridge companies and liquidation. Part 2 is titled "Placing designated institutions in resolution" and inter alia contains provisions relating to the placing of a bank in resolution; when such bank will cease to be in resolution and the management and control of the affairs of the bank in resolution by the SARB as well as the role of resolution practitioners[937] and transfer of shares in the bank in resolution. Part 3 contains "[R]esolution measures" and *inter alia* deals with valuation of assets and liabilities, the SARB's resolution powers and resolution action[938] (including restructuring and bail-in) as well as the outcome of resolution actions; creditor hierarchy and *pari passu* and the "no creditor worse off"-rule ("NCWOL"). Part 4 is titled

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[935] See the discussion of open bank and closed bank resolution strategies in Chapter Two para 2.2.3.

[936] SARB resolution approach discussion paper 9.

[937] Cl 38 of the FSLA Bill inserts a definition of "resolution practitioner" into section 1 of the FSRA to mean "a person appointed in terms of section 166O".

[938] Cl 38 of the FSLA Bill inserts a definition of "resolution action" into section 1 of the FSRA which means "a function or a power-
(a) conferred on the Reserve Bank for the purpose of; or
(b) performed by the Reserve Bank in connection with,
the resolution of a designated institution (including a function or power conferred or performed for the purpose of reducing the risk that a designated institution may need to be placed in resolution)."

"protections" and contains provisions that provide protection relating to the administrative process for actions taken by the SARB in the course of bank resolution. Note should also be taken of Part 5 that is titled "[B]anks in resolution – covered deposits" and addresses the obligation of the yet-to-be-established Deposit Corporation to ensure that bank depositors have access to their covered deposits and the limit of cover that applies to such deposits. The deposit insurance framework is captured in Parts 5 to 8 of the envisaged Chapter 12A.

The discussion below will not follow the chronological course of the provisions pertaining to bank resolution in the envisaged Chapter 12A, but will rather group relevant provisions together to present a clearer picture of what this proposed resolution regime entails. It should further be noted that instead of merely citing clause 54 of the Financial Sector Laws Amendment Bill, which is the comprehensive clause that imports the new resolution regime into the Financial Sector Regulation Act, as authority for each new provision the particular sections in the Financial Sector Regulation Act that will be introduced or affected will be cited as it will provide greater clarity.

5.6.5.1 Placing designated institutions in resolution

As indicated by the *SARB resolution approach discussion paper*, when it becomes likely that a bank will become non-viable, a process of close cooperation between the SARB, the Prudential Authority and National Treasury will be required to determine the appropriate course of action.[939] In terms of section 166J provision is made for a determination by the Minister of Finance to place a designated institution in resolution. Section 166J stipulates that, if in the opinion of the SARB (as resolution authority), a failing bank (i) is, or will likely be, unable to meet its obligations (whether or not the failing bank is insolvent); and (ii) it is necessary to ensure the orderly resolution of the bank concerned to maintain financial stability; or (iii) to protect the depositors of such bank, the SARB may recommend to the Minister of Finance that the designated institution be placed in resolution.[940] The Minister may, after considering the SARB's recommendation, *and* if he considers that the aforesaid requirements are met, make a

[939] *SARB resolution approach discussion paper* 9.

[940] See proposed section 166J(1) FSRA. Note that all references in footnotes hereinafter to section 166 are to the proposed section 166 FSRA as introduced by the FSLA Bill.

written recommendation, addressed to the Governor of the SARB, placing the failing bank in resolution.[941] The SARB must then notify the Managing Director or Chairperson of the board of directors of the failing bank of such determination and must also publish the determination.[942] In order to ensure that creditors of such a bank do not derail resolution efforts by the SARB by enforcing their claims against the bank, section 166L provides that placing a failing bank in resolution does not constitute a termination or acceleration event.[943]

In practical terms the Prudential Authority should report to the SARB if there is an event or action taken by bank that causes it to breach early warning indicators that it is veering into troubled waters or that triggers the implementation of its recovery plan. The Prudential Authority also has to inform the SARB if it is of the view that a bank will become non-viable or if it may have to implement recovery action to prevent becoming non-viable. The SARB will then consult the Prudential Authority to assess whether the bank may become unable to meet its obligations and whether it should be put into resolution. If it is of the opinion that the bank should go into resolution the Governor will engage with the Minister of Finance regarding possible resolution actions that the SARB may need to take and will recommend to the Minister to place the bank in resolution.[944]

The SARB will then execute the resolution of the bank in accordance with the envisaged new section 166A which provides that the SARB is the resolution authority and has the resolution functions conferred on it by the Financial Sector Regulation Act, which resolution functions are to be performed by the Governor of the SARB.[945]

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[941] Section 166J(2) FSRA. Section 166J(3) provides that (3) In subsections (1) and (2), 'obligation' includes an obligation in terms of a prudential standard.

[942] Section 166J(4) and (5) FSRA. Failure to comply with section 166J(4) or (5) does however not invalidate a recommendation or a determination made in terms of this section- see section 166J(6).

[943] In terms of the proposed section 166L(1) FSRA a provision of an agreement is of no effect "to the extent that the provision would, on the basis that a designated institution has been or is proposed to be placed in resolution, or on the basis of a resolution action or proposed resolution action in relation to a designated institution,-
(a) confer a right, or impose an obligation, on a person; or
(b) accelerate or otherwise vary an obligation of a person,
whether or not the person is a party to the agreement."
Section 166K(1) does however not apply in relation to an obligation to give notice to a person - see section 166L(2).

[944] *SARB resolution approach discussion paper 52 to 53*: The recommendation will include a high-level description of the proposed resolution strategy and resolution actions contemplated by the SARB and an overview of how these actions should result in orderly resolution of the bank concerned.

[945] Section 166A(1) and (2) FSRA.

5.6.5.2 Objective of resolution and main features of the resolution process

As per the proposed section 166B the objective of the SARB in performing its resolution functions is "to assist in maintaining financial stability and protecting the interests of depositors of banks through the orderly resolution of designated institutions that are in resolution." The *SARB resolution approach discussion paper* emphasizes that the aim is to achieve this resolution objective with minimal cost to taxpayers and indicates that this objective will also guide the use of the powers and tools set out in the FSLA Bill.[946] As alluded to by the *SARB resolution approach discussion paper* past experience has shown that the "nature of a bank's business, and the degree to which it relies on the confidence of its depositors and creditors, could turn a stress scenario into a possible failure in a very short time, often affecting liquidity long before solvency comes under threat." In view thereof the intended resolution regime enables resolution to be triggered *before* all recovery actions have been depleted if the SARB regards the recovery options at the bank's disposal as insufficient to deal with the stress event, or if a bank can only be resolved with the use of the statutory resolution powers.[947]

The *SARB resolution approach discussion* paper poignantly stresses the fact that "no framework can completely remove the possibility that public funds may be required to stabilize a failing institution, especially if it is a SIFI." However, insofar as the application of resolution powers are concerned it points out that the provisions in the FSLA Bill require the SARB to impose losses on the failing institution's own creditors and shareholders before relying on public funds (thus to apply "bail in" as a first option before applying "bail out"), and to enable the recapitalization of a firm in resolution from its own balance sheet.

As explained in the *discussion paper*, the resolution strategy to be applied by the SARB will be either a "closed bank"-resolution strategy or an "open bank"-resolution strategy depending *inter alia* on the size and systemic importance of the bank concerned. Where a "closed bank"-resolution strategy is applied the bank concerned will cease to exist in its pre-resolution form under its own license, while with "open bank"-resolution the bank will continue to function in its pre-resolution form under its own licence.[948] The

[946] *SARB resolution approach discussion paper* 6.
[947] *SARB resolution approach discussion paper* 11.
[948] *SARB resolution approach discussion paper* 20.

discussion paper further explains that "closed bank"-resolution strategies focus mainly on ways to limit losses to creditors and depositors as well as to limit contagion effects on the rest of the financial system. They include selling the bank or parts thereof to private sector buyers, winding-down activities, transferring parts of the bank to another bank or bridge bank and funding such transfers from the deposit insurance fund (which is envisaged to have a "paybox plus" mandate[949] that gives it a greater role in resolution than mere depositor payouts); or liquidating the bank and effecting a depositor payout from the deposit insurance fund.[950] The *discussion paper* however indicates that liquidation should not be the "default outcome" for smaller banks that fail. It states that factors that will influence the choice between a "closed bank" or an "open bank"-resolution strategy would include: the reasons for the bank's failure, whether the bank has a viable business model, the probability that it can be restored to a viable entity, sources of financial support other than from government and the possibility of a private sector solution.

According to the *discussion paper* an open bank resolution strategy would be appropriate for banks that are too big and systemically important for any "closed bank"-resolution strategy to be practically feasible and where such a strategy would have severe negative consequences for financial stability and the real economy.[951] Open bank resolution is significantly more complex and, as indicated in the *discussion paper*, such process will have three phases, namely stabilisation, restructuring and exit from resolution.[952] The "stabilisation phase" of the resolution will start once the public announcement is made that the bank concerned has been placed in resolution. Stabilisation will entail the application of immediate measures that the SARB has to take for purposes of maintaining financial stability when a bank enters resolution. In the discussion paper it is explained that this phase focuses on all the actions necessary at the point of resolution to ensure that the bank's critical functions continue without interruption, that it does not default on its contractual obligations, and that contagion and the impact of the bank having entered resolution on the financial system is

[949] In terms of the IADI Core Principles for Effective Deposit Insurance Systems available at https://www.iadi.org/en/assets/Fi7 le/Core%20Principles/cprevised2014nov.pdf accessed 17 July 2020, a "paybox plus mandate", where the deposit insurer has additional responsibilities, such as certain resolution functions (e.g. financial support). See also Van Heerden "Deposit Protection in South Africa: Recent Developments" 2020 *Journal of International Banking Law and Regulation* 45.

[950] *SARB resolution approach discussion paper* 20-21.

[951] *SARB resolution approach discussion paper* 21.

[952] *SARB resolution approach discussion paper* 51.

contained. Key actions in this phase *inter alia* entail recapitalisation of the failing bank and ensuring that the bank has adequate funding and liquidity available to continue operating and performing critical functions. As observed by the SARB: "[E]ntry into resolution will not itself address the cause of failure, and the stabilisation phase only provides the SARB with time for an orderly restructuring to address any problems in the balance sheet and to restore viability."[953]

However, the SARB indicates that the second and longer phase, called the "restructuring phase" during which the actual resolution of the failing bank is undertaken, is likely to take several months, or even longer, to complete. This phase will consist of interventions over time to restore the bank's viability and to allow it to exit resolution as a going concern. The SARB thus explains that when following an "open bank"-resolution strategy "the ultimate aim is *not necessarily to preserve the entire legal entity* in its existing form over the long term, but to preserve those parts of the institution that are necessary for the continuation of its critical functions and critical shared services, and for it to be a viable business. However the entity exiting resolution may well be smaller and simpler than when it entered resolution."[954]

The third and final phase is when the bank "exits" resolution. The *discussion paper* indicates that, if the SARB is satisfied that the bank concerned will be able to implement its restructuring plan, subject to appropriate governance processes, and that it will be able to meet its regulatory requirements, the SARB will recommend that the bank can "exit" resolution. The SARB must then announce the bank's exit from resolution, which will provide an opportunity to reaffirm the bank's future viability and ability to function as a going concern.[955]

The main new resolution powers introduced by the Bill, which are discussed in more detail below, are "statutory bail-in"[956] and the power to establish a bridge company to

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[953] *SARB Resolution approach discussion paper* 22.
[954] *SARB resolution approach discussion paper* 23. Author's emphasis.
[955] *SARB resolution approach discussion paper* 56.
[956] Note should be taken of the distinction between regulatory bail-in and statutory bail-in in relation to South African banks. As pointed out in the *SARB resolution approach* discussion paper Box 1 (at 16), the regulatory framework for banks provides the Prudential Authority with the power to trigger the contractual write-down or conversion clauses embedded in additional tier 1 (AT1) and tier 2 (T2) regulatory capital instruments at either the point where the Prudential Authority determines it necessary to prevent the firm from becoming non-viable, or when public sector support is required to prevent the bank concerned from failing. As observed in the *SARB resolution approach* discussion paper the co-existence of these regulatory bail-in powers and the statutory bail-in powers introduced

which all or part of a failing bank's assets and liabilities are transferred during resolution. As indicated in the discussion paper, bail-in will enable the SARB to recapitalize a failing bank at the point of entry into resolution. For purposes of effecting such bail-in banks are required to maintain a specified level of eligible liabilities that are designated for bail-in in resolution and a new tranche of loss absorbing instruments, and consequently so-called "Flac"-instruments have also been introduced by the FSLA Bill. In addition the FSLA Bill provides for a number of general powers to support an orderly resolution which *inter alia* comprise a "bar" against termination events and the imposition of moratoriums by the SARB.[957]

5.6.5.3 Resolution practitioners / controllers

As pointed out in the discussion of the policy documents preceding the introduction of a South African resolution regime, it will in some instances be possible for the SARB to delegate its resolution functions.[958] Accordingly section 166I provides that the SARB may, in writing delegate any of its resolution functions; and may at any time amend such a delegation.[959] Subject to section 166I(4),[960] a delegation of the SARB's resolution functions may be made to: a Deputy Governor of the SARB; a staff member of the SARB; a resolution practitioner (referred to in the SARB resolution approach

by the FSLA Bill requires coordination between the two authorities. To formalize such coordination, the FSLA Bill amended section 31 of the FSRA (see clause 47 FSLA Bill) to require the Prudential Authority to obtain the concurrence of the SARB before taking any action to write down or convert the liabilities of a designated institution. The *SARB resolution approach* discussion paper further explains that "regulatory bail-in can occur before and outside of resolution as a recovery option and can be applied to AT 1 and T2 debt instruments, without any realized losses (apart from dilution) imposed on common equity tier 1 (CET 1). Notably regulatory bail-in does not follow the statutory creditor hierarchy but imposes losses on creditors who have contractually agreed to it. Statutory bail-in can however only be applied in resolution and must strictly observe the statutory creditor hierarchy and safeguards introduced by the FSLA Bill. As a general rule each tranche of either equity or debt must be depleted before losses can be imposed on a more senior tranche." The discussion paper indicates that the implication of the difference between the regulatory and statutory bail-in frameworks is that "the creditor hierarchy and loss given default for investors can differ, depending on whether the regulatory, statutory or both bail-in powers are applied, and the sequence in which they are applied."

[957] *SARB resolution approach* discussion paper 14.

[958] See para 6.1 above.

[959] Section 166I(1)(a) and (b) FSRA. Section 166I(5) FSRA stipulates that a delegation of the SARB's resolution functions is subject to the limitations and conditions specified in the delegation; does not divest the SARB of responsibility in respect of the delegated power or duty; and may be revoked in writing at any time. Section 166I(3) does however not permit the SARB to delegate a power in terms of section 166J; or its power to delegate as contained in section 166I.

[960] Section 166(4) FSRA provides that a delegation in terms of section 166I(2)(c) is to be limited to resolution functions.

discussion document as a "resolution controller"); a financial sector regulator; or the (Deposit) Corporation.[961]

Section 166O provides for the appointment of resolution practitioners. It stipulates that the SARB must, subject to section 166O(2),[962] as soon as practicable after a failing bank is placed in resolution, appoint a person to be the resolution practitioner for such bank while it is in resolution. Specified powers and functions are then delegated to the resolution practitioner in terms of section 166I.[963] A resolution practitioner need however not be appointed if the SARB considers that, in the circumstances, it is not necessary to do so to achieve the ordinary resolution of the bank concerned. The appointment of a resolution practitioner is thus discretionary upon whether the exigencies of resolution of the failing bank require such appointment. The resolution practitioner is obliged to comply with any instruction from the SARB in relation to the designated institution; he must give the SARB, at least monthly, a report on his activities in relation to the bank in resolution; and must further comply with the other terms of his appointment.[964] The SARB may, at any time, in writing, terminate the appointment of the resolution practitioner.[965]

The SARB has indicated in the *SARB resolution approach discussion paper* that it will immediately appoint a resolution controller (resolution practitioner) to assist it with executing the resolution strategy for a bank that is placed in resolution. By the time the SARB announces the entry of a failing bank into resolution, the resolution controller should already be informed about this responsibility as well as the resolution path for the bank concerned and the actions that should be taken on behalf of the SARB.[966] Notably the *SARB resolution approach discussion* paper points out that the role of a resolution controller will be "different from that of a curator" and other similar functionaries provided for in the current frameworks dealing with the failure of financial institutions. The *discussion paper* further points out that in terms of the current provisions in section 69 of the Banks Act, a number of legal powers are assigned by

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[961] Section 166I(2) FSRA. In terms of section 166I(6) anything done by a delegate in terms of the delegation must be regarded as having been done by the SARB.

[962] Section 166O(2) stipulates that a "person need not be appointed in terms of subsection (1) if the Reserve Bank considers that, in the circumstances, it is not necessary to do so to achieve the orderly resolution of the designated institution."

[963] The appointment must be in writing.

[964] Section 166M(4) FSRA.

[965] Section 166M(3) FSRA.

[966] *SARB resolution approach discussion paper* 23.

the Prudential Authority to the curator. However, in terms of the FSLA Bill, all legal powers will continue to vest with the SARB, and the SARB will remain the authority responsible for exercising these powers and for taking the necessary resolution actions. The role of the resolution controller will be to assist the SARB in the execution of the resolution strategy by performing the following functions: executing the day-to-day management of the bank in resolution on behalf of the SARB; conducting meetings with creditors and other stakeholders; ensuring that the actions of the bank in resolution are in line with the resolution strategy set by the SARB; and providing information for assessments and valuations.[967]

5.6.5.4 Resolution Functions

Section 166C sets out parameters for the exercise of the SARB's resolution functions. It stipulates that to achieve its objective set out in section 166B, the SARB must perform its resolution functions in relation to a bank in resolution, and make certain that the affairs of such bank are managed "so as to maintain, as far as practicable, financial stability". To the extent practicable to do so consistently with section 166B(1), the SARB is required, in performing its resolution functions in relation to a bank in resolution, including managing the affairs of such bank, "to have regard to, and seek to minimize any adverse impact on, the interests of shareholders and creditors of other members in the group of companies of which the bank in resolution forms part; and to comply with, and ensure that the bank in resolution complies with applicable labour laws".[968]

As emphasized throughout this thesis, time is particularly important in the context of bank resolution to avoid that the process becomes too protracted with too great a loss of value in the institution being resolved. For purposes of enabling the optimal orderly resolution of a failing bank to be executed as swiftly as possible, the new resolution regime puts a number of provisions in place to prevent attempts by creditors of the failing bank to enforce their claims or to prevent shareholders from blocking resolution actions that the SARB intends to take or to prevent delays caused by parties raising non-compliance with specific laws. Accordingly section 166G provides that an action

[967] SARB resolution approach discussion paper 23.
[968] Section 166B(2)(a) and (b) FSRA. In terms of section 166B(3)FSRA the SARB may, in relation to the resolution of a failing bank consider the possible impact that its action may have on the financial stability of a foreign jurisdiction where the bank is registered.

taken by the SARB, or by a bank in resolution in terms of the Financial Sector Regulation Act, will not be an act of insolvency and will not be admissible as evidence of insolvency of such bank or member of a group of companies of which a such bank is part.[969] Section 166G further provides that an action taken by the SARB in the exercise or performance of its resolution functions, and an action that the SARB causes a bank in resolution to take, will not be invalid merely because of the operation of the Companies Act or any other Act specified in regulations made for purposes of this section. It will also not constitute a breach of a duty that the SARB may owe to the bank in resolution, or that the SARB or the bank in resolution may owe to the shareholders or creditors of the said bank, including an obligation in terms of an agreement.[970]

5.6.5.5 General powers

Section 166M provides that while a bank is in resolution, the SARB as the resolution authority, has the power and authority to manage and control the affairs of such bank, and to exercise any of the powers of the governing body and the shareholders or a specific class of shareholders of that bank. This includes powers to the exclusion of the bank's board and officers, and the shareholders, of the bank in resolution.[971] Accordingly the general powers that the SARB can exercise include the power:[972]

(a) to convene meetings of creditors of the bank in resolution for purposes of consulting with them in relation to how the SARB will exercise its management powers and its resolution powers;

(b) to negotiate with a creditor of the bank in resolution regarding final settlement of such creditor's claims; and

(c) to propose and enter into arrangements or compromises between the bank in resolution and all its creditors, or all the creditors of a specific class, in terms of section 155 of the Companies Act.[973]

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[969] Section 166G(1) FSRA.
[970] Section 166G(2)(a) and (b) FSRA.
[971] Section 166M FSRA.
[972] Section 166M(2) FSRA. Section 166N FSRA however makes it clear that by assuming these powers over a bank in resolution the SARB does not become its holding company.
[973] Section 155 of the Companies Act 71 of 2008 provides for compromise between company and creditors. This section applies to a company, irrespective of whether or not it is financially distressed

The *SARB resolution approach discussion paper* thus indicates that after the Minister of Finance makes a determination to place a failing bank in resolution, the control and management of that bank will vest in the SARB as one of its general resolution powers. The SARB will consequently be responsible for the day-to-day management of the bank in resolution, which it may direct the resolution controller (resolution practitioner) to execute on its behalf.[974]

As indicated above, the proposed section 166L stipulates that, placing a bank in resolution may not be considered a default event. The rationale for this provision is to ensure that counterparties cannot consider resolution as an early default event that may give rise to early termination rights and consequent enforcement of their claims against the bank that is being resolved. The *SARB resolution approach discussion paper* states that these provisions will also ensure that cross-default clauses in agreements may not apply when a bank is placed in resolution.[975]

As pointed out in the *SARB resolution approach discussion paper* the SARB may also issue moratoriums, including, as provided for by section 166R,[976] for the suspension of the failing bank's obligations in terms of the agreements it entered into before it was

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unless it is engaged in business rescue proceedings in terms of chapter 6 of the Companies Act. The board of a company, or the liquidator of such a company if it is being wound up, may propose an arrangement or a compromise of its financial obligations to all of its creditors, or to all of the members of any class of its creditors, by delivering a copy of the proposal, and notice of meeting to consider the proposal, to every creditor of the company, or every member of the relevant class of creditors whose name or address is known to, or can reasonably be obtained by, the company; and the Commission. The abovementioned proposal must contain all information reasonably required to facilitate creditors in deciding whether or not to accept or reject the proposal and must be divided into three parts namely: Part A – Background which must include a complete list of all the material assets of the company, as well as an indication as to which assets are held as security by creditors as of the date of the proposal; a complete list of the creditors of the company as of the date of the proposal, as well as an indication as to which creditors would qualify as secured, statutory preferent and concurrent in terms of the laws of insolvency, and an indication of which of the creditors have proved their claims etc.; Part B – Proposal which must include the nature and duration of any proposed debt moratorium; the extent to which the company is to be released from the payment of its debts, and the extent to which any debt is proposed to be converted to equity in the company, or another company etc.; Part C – Assumptions and conditions which must include a statement of the conditions that must be satisfied, if any, for the proposal to come into operation and be fully implemented; the effect if any, that the plan contemplates on the number of employees, and their terms and conditions of employment. The proposal must conclude with a certificate by an authorised director or prescribed officer of the company stating that any information provided is accurate and up to date and projections provided are estimates made in good faith. The proposal will have been adopted by the creditors of the company if it is supported by a majority in number representing at least 75 per cent in value of the creditors or class, as the case may be, present and voting in person or by proxy, at a meeting called for that purpose.

[974] *SARB resolution approach discussion paper* 19.

[975] SARB resolution approach discussion paper 18.

[976] See para 5.5.6 below.

placed in resolution. Moratoriums will be for a limited period, which will be prescribed in a prudential standard, and will only be used in exceptional circumstances to mitigate the impact on financial stability occasioned by putting the bank in resolution.[977]

Under the heading "powers", section 166R accordingly provides that if the SARB determines that is necessary to do so for the orderly resolution of a bank that has been placed in resolution, the SARB may do any of the following:

(a) cancel an agreement that the failing bank entered into before it was placed in resolution;[978]

(b) suspend legal proceedings or arbitration proceedings to which the bank in resolution is a party;[979]

(c) suspend the institution of damages claims against the bank in resolution;[980]

(d) suspend an obligation of a party to an agreement to which the bank in resolution is a party;[981] or

(e) prohibit the commencement of legal or arbitration proceedings against the bank in resolution.[982]

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977 SARB resolution approach discussion paper 18.

978 Section 166R(1)(a) provides that the SARB may "(a) subject to subsection (3), by notice to the other parties to an agreement to which the designated institution is a party, being an agreement that came into effect before the designated institution was put in resolution, cancel the agreement with effect from the date stated in the notice, which date must be after the date of the notice".

979 Section 166R(1)(b) provides that the SARB may "subject to subsection (4), by written notice to the parties and lodging notice to that effect with the court or arbitrator, suspend specified legal proceedings or arbitration proceedings to which the designated institution is a party".

980 Section 166R(1)(c) provides that the SARB may "despite subsection (3), and subject to subsection (4), by written notice to the parties, suspend the institution of any claim for damages in respect of loss sustained by a person resulting from a cancellation of an agreement in terms of paragraph (a)".

981 In terms of section 166R(1)(d) the SARB may "subject to subsection (4), by written notice to the parties to an agreement to which a designated institution is a party, suspend an obligation of a party to the agreement".

982 In terms of section 166R(1)(e) the SARB may "subject to subsection (5), by notice published in the Register, prohibit the commencement of specified legal proceedings or arbitration proceedings against the designated institution." In terms of section 166R(4) a notice in terms of subsection (1)(b),(c) or (d) must specify the period of the suspension, which must be a reasonable period. Section 166 R(5) further provides that a notice in terms of subsection (1)(e) must specify the period of the prohibition, which must be a reasonable period. In accordance with section 166R(6) a notice in terms of subsection (1)(b), (c), (d) or (e) further suspends the operation of any time barring terms, whether in an agreement or a law and includes the suspension of the running of prescription in terms of the prescription Act 1969, (Act No.68 of 1969), for the specified period.

Section 166R(2) stipulates that the SARB may exercise the power to cancel an agreement in terms of section 166R(1)(a) only if the agreement prefers one creditor of the bank in resolution over another creditor of the same class; or if the agreement is unreasonably onerous on the bank in resolution; or if the agreement is a lease of movable or immovable property entered into before the failing bank was placed in resolution; or to the extent that the agreement is a guarantee issued by the failing bank before it was placed in resolution, excluding a guarantee that the bank is required to make good within 30 days after it was placed in resolution.[983]

5.6.5.6 Resolution measures and tools

The first resolution action that the SARB will take during a failing bank's resolution is to (attempt to) ensure that the bank's capital is restored to the level where it can continue meeting its regulatory requirements. This will be achieved through statutory bail-in, which the SARB acknowledges is a "complex process" that it unpacks to a certain extent in the *resolution approach discussion paper* and which will be set out in more detail in further discussion paper that the SARB will issue at a later stage.[984]

The *SARB resolution approach discussion paper* explains in more palatable terms that statutory bail-in, in relation to a bank in resolution, in broad terms, includes the power:

(a) to write-down of the failing bank's shares;

(b) to issue new shares in the bank in resolution;

(c) to write-down, subject to exclusions, the liabilities of the bank in resolution; and/or

(d) to convert debt instruments into equity.

As pointed out by the SARB, statutory bail-in can only be applied during the resolution of a failing bank. It must strictly observe the statutory creditor hierarchy and safeguards introduced by the FSLA Bill. The *SARB resolution approach discussion paper* further

[983] Section 166R(2). Section 166R(3) further provides that cancellation of an agreement in terms of section 166R(1)(a) does not affect the rights of the parties to the agreement, which rights were accrued before the date the cancellation takes effect.

[984] In the SARB resolution approach discussion paper the SARB has indicated that it is working on the detailed elements of bail-in execution and restructuring and will issue further guidance when this work, including industry consultation, has been completed.

points out that the general rule in this regard is that each tranche of either equity or debt must be depleted before losses can be imposed on a more senior tranche.[985]

The bail-in tool will thus enable the SARB to recapitalize a failing bank at the point that it enters the resolution process. According to the *discussion paper* the requirement that is placed on banks to maintain a specified level of (eligible) liabilities that are designated for bail-in within resolution, where creditors are aware of and compensated for the inherent risks pertaining to these liabilities, will enable the SARB, through bail-in, to first assign losses to shareholders and creditors with sufficient capacity to also restore the capital of a bank in resolution.[986] As pointed out above, the FSLA Bill introduced a new tranche of loss-absorbing instruments, called "Flac' instruments,[987] which will be subordinated to other unsecured liabilities and will be clearly earmarked for bail-in in resolution.[988]

The *SARB resolution approach discussion paper* also indicates that the SARB is of the view that statutory bail-in will be appropriate for banks with an "open bank"- resolution

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[985] SARB resolution approach discussion paper 16.

[986] SARB resolution approach discussion paper 14.

[987] As inserted into the definitions in section 1 of the FSRA by cl 38 of the FSLA Bill a "Flac instrument" means "a financial instrument issued by a designated institution, being an instrument that-

(a) complies with the requirements prescribed by a prudential standard for a flac instrument; and

(b) is of a kind that is not counted for the purpose of determining whether the designated institution satisfies the applicable requirements of-

(i) Chapter VI of the Banks Act;

(ii) Chapter V of the Mutual Banks Act, 1993 (Act No. 124 of 1993);

(iii) Chapter III of the Co-operative Banks Act, 2007 (Act No. 40 of 2007); or

(iv) Chapter 6 of the Insurance Act, 2017 (Act No. 18 of 2017),

or prudential standards made for the purposes of any of those provisions."

See also the amendments to the Insolvency Act introduced by the FSLA Bill as discussed in para 10 below.

[988] SARB resolution approach discussion paper 14-15. In the discussion paper the SARB remarks that the FSLA Bill allows for all liabilities, except those stipulated in section 166R, to be subject to bail-in in order to absorb losses. Although legally possible, the SARB points out that there are practical impediments to bailing in many of these liabilities. For example, "the unexpected bail in of, deposits that are not covered by the Deposit Insurance Scheme may well exacerbate the financial stability risks of such a decision. Furthermore, there may be time-consuming operational challenges associated with identifying and locating liability holders as well as with the valuation of certain liabilities subject to the bail-in." To overcome these complexities and possible adverse consequences that may arise during bail-in, the SARB may require the issuance of these Flac instruments, which will form "a pre-identified, transparent tranche of funding instruments available for bail-in at the point of resolution." The discussion paper indicates that holders of flac instruments should be informed investors who are aware of the risks associated with their investments, able to assess these risks and be accordingly compensated through the returns they receive. In terms of the creditor hierarchy (read with the provisions of the FSLA Bill), Flac instruments "will be subordinated to unsecured liabilities but will rank senior to regulatory capital instruments." See further the SARB resolution approach discussion paper 30: Box 3 regarding the characteristics of Flac instruments.

plan[989] where recapitalization through statutory bail-in is the key element of the resolution strategy. These banks are most likely to be SIFI banks[990] and as indicated above, they will be required to hold a specified level of flac instruments for resolution.[991]

The *discussion paper* further points out that the FSLA Bill requires the SARB's decision on the write-down or write-off of any instruments to be informed by an independent valuation. The SARB will appoint an independent firm to conduct such valuations before it takes resolution actions. To ensure that the SARB can recapitalise the designated institution within a reasonable period, the SARB indicates that it may be necessary to transfer the shares that would be subject to bail-in to a bridge vehicle (bridge company) until the valuation is finalised. This will allow for the conversion of the Flac instruments to new shares while the valuation is conducted.[992]

As can be expected, the bail-in process will involve extensive consultation with stakeholders, including affected shareholders and creditors. It is indicated that the SARB will therefore have to follow the administrative process requirements[993] set out in the FSLA Bill which will give affected creditors and shareholders the opportunity to review the intended action by the SARB and to make submissions in respect thereof. After completion of the valuation and subsequent review by the affected parties, the instruments in the bridge vehicle will be bailed-in.[994]

The provisions to be incorporated into Chapter 12A to address the aspect of valuation of assets and liabilities, bridge companies and bail-in are accordingly as follows:

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[989] See para 6.5.2 above.

[990] Section 29 of the FSRA provides for the designation of systemically important banks by the Governor of SARB. Once a bank is designated as a SIFI the SARB may direct the Prudential Authority to apply heightened prudential regulation to such bank in order to increase its loss-absorbing capacity. These heightened prudential measures may include: solvency measures and capital requirements (which may include requirements in relation to countercyclical capital buffers); leverage ratios; liquidity; organisational structures; risk management arrangements (including guarantee arrangements); sectoral and geographical exposures; required statistical returns; recovery and resolution planning and any other matter in respect of which a prudential standard may be made.

[991] *SARB resolution approach discussion paper* 15. The SARB points out that banks which are not subject to open-bank resolution planning will not be required to hold a specified amount of Flac instruments but that for these banks regulatory bail-in can still play a useful role in recovery. See also section 166T which is titled "outcome of resolution actions" and provides that the SARB may exercise and perform its resolution powers in terms of Part 3, and its associated powers, in relation to a liability of a bank in resolution in a way that results in the liability being substituted with a shareholding in the bank in resolution or in a bridge company.

[992] *SARB resolution approach discussion paper* 15.

[993] Cl 91 of the FSLA provides for fair administrative action subject to the Promotion of Administrative Justice Act 3 of 2000.

[994] *SARB resolution approach discussion paper* 16.

5.6.5.6.1 Valuation

Part 3 of Chapter 12A bears the heading "Resolution Measures". Before the resolution tools can be applied the proposed section 166Q(1) *inter alia* requires, as a first step, the valuation of the assets and liabilities of a failing bank that is put into resolution. This has to be done before the SARB takes a resolution action in relation to such bank. The purpose of the valuation is to inform the SARB in relation to the resolution action it seeks to take. The valuation must state the amount that, in the valuator's opinion, would be realized from the asset, or the amount that, in the valuator's opinion, would be the amount payable on the liability, in a winding-up of the bank in resolution.[995] As soon as practicable after a failing bank ceases to be in resolution, the SARB is required to obtain a further valuation of the assets and liabilities that were dealt with in the resolution action.[996]

As explained in the SARB resolution approach discussion paper the requirement to obtain a valuation is a complex component of resolution that has to be performed at a sufficient standard to ensure that resolution actions are properly executed. In addition, valuation also has to be performed under time constraints to avoid further erosion of value of the failing bank's assets and liabilities and to provide the best probability of an orderly resolution.[997]

5.6.5.6.2 Bridge bank

Section 166F provides that the SARB may, for the purposes of exercising and performing its resolution functions, incorporate a bridge company[998] that will be wholly owned by the SARB.[999] As part of the measures applied during resolution the SARB may transfer some or all of the shares that it holds in such a bridge company to any person.[1000]

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[995] Section 166P(1)(a),(c) and (b) FSRA respectively.

[996] Notably section 166Q(3) FSRA obliges the SARB, in engaging a valuation for the purpose of section 166Q, to specify the assumptions the valuator is to make in conducting the valuation.

[997] SARB resolution approach discussion paper 46.

[998] In terms of the amendment to section 1 of the FSRA by clause 38 of the FSLA Bill a "Bridge company" means "a company incorporated in terms of section 166F."

[999] Section 166F(1)(a) and (b).

[1000] Section 166F(2). If a bridge company is being used in connection with the resolution of a failing bank, section 166F(3) stipulates that the SARB must, in consultation with the responsible authorities for the financial sector laws, formulate a plan for the bridge company to meet all the requirements in terms of applicable financial sector laws. In terms of section 166F(4) a bridge company of which the

5.6.5.6.3 Resolution action (including restructuring and bail-in)

As explained in the *SARB resolution approach discussion paper* the proposed sections 166R (as dealt with above in paragraph 6.5.5) and 166S will enable the SARB to take certain actions, collectively referred to as "statutory bail-in", alluded to above, in relation to a bank in resolution.

The *SARB resolution approach discussion paper* explains that the SARB will have the ability to restructure a bank in resolution by using the powers in the proposed section 166S, as set out below, namely by a transfer of any or all of the assets and/or liabilities of the failing bank; and/or by conducting a sale, merger or similar arrangement. According to the *discussion paper* these powers can also be used in combination with the bridge company tool, in which case it will enable the SARB to, for example, transfer the critical functions and critical shared services of the failing bank the new entity by transferring the underlying assets and liabilities. It will also be possible for the SARB to do a partial transfer by separating the failed or failing parts of the bank in resolution from those that are needed for the continuation of the critical functions and critical shared services (thus a "good bank/bad bank"-split via asset separation). Where either bail-in or transfers result in losses to shareholders or creditors, they will have to meet the safeguards specified in the FSLA Bill.[1001]

Section 166S bears the heading "Resolution action (including restructuring and bail-in)" and lies at the heart of the new resolution regime. It provides that if the SARB determines that it is necessary for the orderly resolution of a bank that such bank enters into a particular transaction during the resolution process, such bank may enter into that transaction, and may do so "despite any law or agreement that would otherwise restrict or prevent it from doing so, including a law or agreement that requires consent or approval by a specified person."[1002] For purposes of section 166S, "transaction" includes each of the following: transferring, creating an interest in or dealing in any other way with assets and liabilities of the designated institution; and an amalgamation,

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SARB is the sole shareholder, and an officer or employee of such a bridge company, are exempt from requirements in terms of a financial sector law until the bridge company applies for a licence in terms of the financial sector law.

[1001] *SARB resolution approach discussion paper* 18.

[1002] Section 166S(1) FSRA.

merger or arrangement of a kind referred to in Chapter 5 of the Companies Act that involves a bank in resolution as a party thereto.[1003]

The SARB is required to consult the Prudential Authority in making a determination that the failing bank should enter into a transaction in terms of section 166S(1).[1004] When the transaction comes into effect section 166S(4) provides that:[1005]

> "(a) the assets and liabilities of the parties that are transferred in terms of the transaction vest in, and become binding upon, the parties in accordance with the terms of the transaction;
>
> (b) a party to the transaction in whom an asset vests, or whom a liability binds under the transaction, has the same rights and is subject to the same obligations as those that the transferor may have had or to which it or by which it may have been bound immediately before the transfer; and
>
> (c) in the case of an amalgamation-
>
> > (i) all agreements, appointments, transactions and documents entered into, made, drawn up or executed with, by or in favour of any of the amalgamating or merging parties and in force immediately before the transaction came into effect remain of full force and effect and must be construed for all purposes as if they had been entered into, made, drawn up or executed with, by or in favour of the amalgamated entity; and
> >
> > (ii) any bond, pledge, guarantee or instrument to secure future advances, facilities or services by any of the amalgamating parties remain of full force and effect and must be construed for all purposes as a bond, pledge, guarantee or instrument given to or

[1003] Section 166S(2)(a) and (b) FSRA.
[1004] Section 166(3) FSRA.
[1005] Section 166S(4)(c)(i) FSRA does not apply to agreements, appointments, transactions and documents that by virtue of the terms and conditions of the transaction, are not to be retained in force after the amalgamation - see section 166S(5).

in favour of the amalgamated entity as security for future advances, facilities or services by that entity."

Despite any law or agreement (including the bank in resolution's memorandum of incorporation), a bank in resolution may, if the SARB determines that it is necessary for the orderly resolution of such bank, cancel a share of the bank that is valued, in terms of section 166Q(1) at zero value (in liquidation); or it may issue new shares of the designated institution, on terms approved by the SARB.[1006] In relation to an agreement to which the bank in resolution is a party the SARB may, for purposes of orderly resolution of such bank, by written order and with notice to the affected party or parties:[1007] reduce the amount that is or may become payable to a party to the agreement, subject to sections 166Q (which deals with valuation –in this context for compensating the party concerned) and V (which imports the NCWOL principle); or it may cancel the agreement.[1008] Unsettled exchange traded transactions, derivatives, deposits held by the contemplated Corporation for Public Deposits and unsecured transactions between settlement system participants are however excluded from the application of bail-in.[1009]

5.6.6 Safeguards

The *SARB resolution approach discussion paper* remarks that resolution empowers the SARB to act to protect financial stability but points out that however "in doing so it needs to deliver an outcome that is broadly consistent with how losses would have been distributed in an insolvency and that leaves no creditor worse off than they would have been in liquidation (the NCWOL rule). When conducting a resolution, the SARB cannot act in disregard of the private interest of creditors and shareholders". This

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[1006] Section 166S(6) FSRA.

[1007] Section 166S(7)(a) and (b) FSRA.

[1008] Subject to section 166S(7)(a), cancellation of an agreement in terms of section 166S(7)(b) does not affect the rights of the parties to the agreement, which rights were accrued before the date the cancellation takes effect – see section 166S(8). Section 166S(10) further stipulates that an action in terms of section 166S does not by itself give rise to any right by a party to, or a person who holds an interest in, an agreement referred to in section 166S(7).

[1009] In more detail section 166S(9) stipulates that section 166S(7) does not apply to: "an unsettled exchange traded transaction, including a transaction on a licensed exchange; a derivative instrument as defined in section 1 of the Financial Markets Act 19 of 2012; a deposit where the deposit holder is the Corporation for Public Deposits established by section 2 of the Corporation for Public Deposits Act, 1984 (Act 46 of 1984); an unsecured transaction between two or more settlement system participants as defined in section 1 of the National Payment System Act 78 of 1998, made for purposes of that Act."

means that the SARB's actions must not only be subject to the resolution objectives stated in the FSLA Bill, but also to the following safeguards:

(a) The SARB's resolution actions are subject to the rule that no creditor or shareholder should be worse off as a result of resolution actions than would be the case in liquidation (NCWOL rule) as captured in the proposed section 166V.[1010]

(b) When assigning losses in resolution, the SARB is obliged in terms of section 166J[1011] to respect the creditor hierarchy[1012] in the Insolvency Act 24 of 1936. Notably the FSLA Bill includes various amendments to the Insolvency Act, including changes to the creditor hierarchy, as explained in paragraph 5.9 below. The SARB must also ensure the *pari passu* treatment of creditors in the same class, unless a deviation is required to ensure that the SARB conducts an orderly resolution and for financial stability to be maintained. As stated in the *SARB resolution approach discussion paper*, deviation from *pari passu* treatment of creditors of the same class "will be exceptional and only applied when there is a clear

[1010] Section 166V(1) provides that the SARB must not take resolution action that would result in a creditor or shareholder of the bank in resolution receiving less than such creditor or shareholder would have received if the bank had been liquidated.[1010] Failure to comply with section 166V(1) "does however not invalidate an acquisition of property by a bona fide purchaser for value who is not aware of the failure to comply" (but may give rise to a right to compensation in the creditor or shareholder) - see section 166V(3). Section 166V(4) stipulates that as soon as practicable after the SARB receives a valuation in terms of section 166Q(2) in respect of a bank in resolution, the SARB must consider, having regard to the valuation, whether a creditor or shareholder of the bank received, in respect of resolution action, *less* than it would have received if that bank had been liquidated. If so, section 166V(4) requires the SARB to determine the amount of the shortfall which the creditor or shareholder is then entitled to recover from the bank in resolution - see section 166V(5) and (6).

[1011] Section 166J is titled "creditor hierarchy and *pari passu*". It stipulates that the SARB must not take a resolution action and must make certain that a bank in resolution does not take a resolution action, if it appears to the SARB that the result of the action would be that the value of a claim of a creditor of the designated institution would be reduced. Section 166 J(1) does not apply to the claims of shareholders; or if the claims of creditors and shareholders of the designated institution that rank lower in the creditor hierarchy have been reduced to zero. Section 166(4) obliges the SARB to ensure that, when a bank in resolution takes resolution action, claims of creditors and shareholders of such bank that would have the same ranking in insolvency are treated *in pari passu.* In terms of section 166J(5) the aforesaid requirements however do not apply if the SARB determines that it is necessary to treat the claims differently to effect the orderly resolution of the said bank.

[1012] Cl 38 of the FSLA Bill amends section 38 of the FSRA by inserting a definition of "Creditor hierarchy" that means "the order in which a liquidator must, in terms of the Insolvency Act, apply property to satisfy claims of creditors". See para 10 below regarding how the creditor hierarchy in terms of the Insolvency Act is amended.

and convincing rationale for doing so. The baseline approach is to strictly follow the creditor hierarchy”.[1013]

5.6.7 End of resolution

Section 166K deals with the position when a failing bank that has been put into resolution ceases to be in resolution. It indicates that if a bank is in resolution; and the SARB considers that it is no longer necessary that the bank remains in resolution to maintain financial stability; or to protect depositors of the bank, the SARB must recommend to the Minister to revoke the determination in terms of section 166J(2) by which the bank was placed in resolution. The Minister may then, after considering a SARB’s recommendation, revoke such determination.[1014] Section 166K(4) further provides that a designated institution also ceases to be in resolution when a liquidator (and not a provisional liquidator) is appointed for such institution, unless the court orders otherwise. This provision appears to create the impression that liquidation is not one of resolution powers to be applied by SARB but as indicated below, liquidation of banks is indeed included as part of the new resolution regime to be incorporated into Chapter 12A of the Financial Sector Regulation Act.

5.6.8 Liquidation

The comprehensive resolution regime set out in Chapter 12A also incorporates liquidation as a manner of dealing with a failing bank that has been put into resolution. Accordingly section 166H incorporates provisions relating to liquidation of a failing bank which are currently dealt with by section 68 of the Banks Act that, as pointed out, will be repealed once the FSLA Bill is enacted. A discussion of the provisions pertaining to liquidation of a failed bank is beyond the scope of this thesis, but it should be noted that the SARB may in terms of section 166H(1) apply to a competent court for the winding–up of a failing bank on the grounds that the bank has been placed in resolution and there are no reasonable prospects that the bank will cease to be in resolution.[1015]

[1013] *SARB resolution approach discussion paper* 19.

[1014] Section 166K(2). In terms of section 166K(3) each revocation of resolution of a designated institution must be published by the SARB. Failure to do so does however not invalidate the revocation.

[1015] See further *SARB resolution approach discussion paper* 19.

5.6.9 Costs of resolution

Costs of resolution are dealt with in section 166X which provides that SARB may recover from a bank in resolution, or from such a bank after it ceases to be in resolution, amounts that the SARB "reasonably and properly" incurred in exercising and performing its resolution functions in relation to that bank while in resolution.

5.6.10 Protections

Section 166Y deals with administrative process for actions taken by the SARB in terms of Chapter 12A and applies in relation to the following functions taken by the SARB: an action in terms of section 166J(1);[1016] and an action in relation to a bank in resolution, that adversely affects the rights of any person[1017] and that has a direct, external legal effect.[1018] Section 166Y(2) stipulates that the SARB must, subject to section 166Y(3),[1019] before taking an action to which section 166Y applies publish notice of the action with a statement indicating the reasons for the proposed action and including information relevant to the matter. The notice must invite any person whose rights have been affected by resolution action taken by the SARB to make representations to the SARB on the matter within a reasonable period specified in the notice.[1020] If however the SARB determines that compliance with sections 166Y(1) and (2) in respect of a proposed action is likely to affect financial stability negatively, or defeat the object of the proposed action, the SARB may take the action without complying with those subsections.[1021]

[1016] Section 166J(1) states that "if in the opinion of the Reserve Bank a designated institution is or will likely be unable to meet its obligations (whether or not the designated institution is insolvent) and it is necessary to ensure the orderly resolution of the designated institution to (i) maintain financial stability or (ii) in the case of a bank or a member of a group of companies of which a bank is a member, to protect depositors of the bank, the Reserve Bank may recommend to the Minister that the designated institution be placed in resolution."

[1017] Referred to as a "person concerned".

[1018] Section 166Y(1) FSRA.

[1019] Section 166(3) provides that in deciding whether to take the action, the SARB must take into account all submissions received by the end of the period specified in terms of section 166Y(2)(b).

[1020] Such period need not exceed 14 days.

[1021] If the SARB takes an action to which section 166Y applies without complying with section 166Y(1) or (2), it must publish a statement of the reasons why these subsections were not complied with. Any person whose rights have been affected may make submissions to the SARB within one month after publication of the statement. The SARB must consider the submissions and, as soon as practicable, publish a further notice stating what action, if any, it proposes to take on the matter, including whether it proposes to rescind or revoke the action or to provide persons whose rights have been affected with restitution-see section 166Y(5)(a) to (c). Notably section 166Y(7) stipulates that in respect of an

5.7 Deposit protection during bank resolution

Although a discussion of the deposit protection framework introduced by the FSLA Bill is beyond the scope of this thesis, it has to be appreciated that the deposit insurance framework will work in tandem with the resolution regime as part of the financial safety net. In particular the FSLA Bill provides for the establishment of a Deposit Corporation (Corporation)[1022] that will be located as subsidiary within the SARB to ensure adequate deposit protection in the context of resolution. As pointed out above, the Corporation will have a "paybox plus" –mandate which means the mandate will not be limited to administering the yet to be established Deposit Protection Fund and effecting depositor pay-outs only but that it will also include some resolution functions.[1023] The location of the Deposit Corporation within the SARB will clearly facilitate swift information sharing and cooperation in the context of bank resolution.

The Bill introduces the deposit insurance framework into the Financial Sector Regulation Act as Parts 5 to 8 of Chapter 12A. Part 5 is titled "Banks in Resolution - covered deposits".[1024] In this Part of Chapter 12A section 166Z deals with the obligation of the Corporation to make certain that bank depositors have access to their covered deposits. It provides that where a bank is in resolution, the Corporation must apply the (yet to be established) Deposit Insurance Fund in one or more of the following ways to ensure that depositors of the bank concerned have access to their covered deposits: to reimburse the bank in resolution for payments such bank has made (while in resolution) to depositors in respect of covered deposits; to reimburse depositors of the bank in resolution in respect of their covered deposits; or to make payments in terms

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action to which section 166Y applies, the procedure specified in Section 166Y applies instead of the procedure prescribed by sections 3 and 4 of the Promotion of Administrative Justice Act. The SARB is however not allowed to rescind or revoke an action taken in terms of section 166J or K.

[1022] Clause 38 of the FSLA Bill amends section 1 of the Financial Act by inserting a definition of "Corporation" which means" the Corporation for Deposit Insurance established by section 166AD".

[1023] See para 6.5.2 above.

[1024] The limit of coverage for covered deposits is dealt with in section 166AA FSRA. As such the maximum amount that may be applied from the Deposit Insurance Fund in respect of a depositor of a bank in resolution is the lesser of-

(a) the sum of

(i) the total of the amounts standing to the credit of the accounts with the bank held by the depositor alone; and

(ii) for each account with the bank held by the depositor together with one or more persons, an amount calculated as the amount standing to the credit of the account divided by the number of account holders of the account; and

(b) the amount prescribed by the Minister in Regulations made for purposes of section 166AA.

of an agreement related to a transaction referred to in section 166S(1), being an agreement in relation to the covered deposits of the bank in resolution.[1025]

5.8 Immunities

Notably Clause 60 of the FSLA Bill also amends section 285 of the Financial Sector Regulation Act to provide for immunities for the SARB and financial sector regulators and also for the Corporation, a Board member, a staff member of the Corporation, a resolution practitioner and a person appointed or delegated by a financial sector regulator, the SARB or Corporation to exercise a power or perform a function or duty in terms of a financial sector law. The effect of the immunity is that the regulator or person concerned will not be liable for, or in respect of, any loss or damage suffered or incurred by any person arising from a decision taken or action performed in good faith in the exercise of a function, power or duty in terms of a financial sector law thus also providing protection in the context of resolution actions.

5.9 Amendments to the Insolvency Act pertaining to resolution

Section 32 of the Insolvency Act 24 of 1936 which deals with the procedure for setting aside improper dispositions made in the context of insolvent circumstances, will be amended by the FSLA Bill which substitutes section 32(4) with a new subsection that *inter alia* stipulates that sections 27,[1026] 28,[1027] 29,[1028] 30,[1029] 31[1030] and 32 of the Insolvency Act do not apply to any disposition made by the SARB in exercising its resolution functions in terms of the Financial Sector Regulation Act.[1031] The effect is thus that the trustee in an insolvent estate will not be able to have any such actions set

[1025] Section 166Z(1)(a) to (c). An agreement referred to in subsection (1)(c) may include any of the following: a secured loan to the bank in resolution; a loss sharing agreement between the Corporation and the bank in resolution or a person assuming liability for covered deposits of the bank in resolution; or a guarantee in favour of the bank in resolution, the SARB or another person in respect of the bank's obligations in relation to the covered deposits of the bank in resolution.
[1026] Section 27 of the Insolvency Act deals with dispositions in an antenuptial contract.
[1027] The reference to section 28 is erroneous as this section has been repealed long ago in terms of section 78 of Act 27 of 1943.
[1028] Section 29 of the Insolvency Act deals with voidable preferences.
[1029] Section 30 of the Insolvency Act deals with undue preference.
[1030] Section 31 of the Insolvency Act deals with collusive dealings before sequestration.
[1031] Clause 1 FSLA Bill. Accordingly the trustee in an insolvent estate will not have any right to set aside such dispositions.

aside neither will the liquidator if a bank that has been placed in resolution is subsequently liquidated.

Clause 7 of the FSLA Bill will also insert a new section 98AA into the Insolvency Act to the effect that after the resolution of a bank that has been placed in resolution, any balance of the free residue[1032] must be applied in defraying costs reasonably and properly incurred by the SARB in performing the resolution functions in relation to that bank. Depositor preference is created by means of a new section 102A in the Insolvency Act that provides that after paying the SARB's resolution costs as per section 98AA, any balance of the free residue must be applied to pay any claims proved against the estate in question which were covered as a covered deposit together with interest thereon as provided in section 103(2) of the Insolvency Act.[1033] Section 103 of the Insolvency Act will be amended to state that "[A]ny balance of the free residue after making provision for the expenditure mentioned in section 96 to 103, inclusive, shall be applied".[1034] Flac instruments will be provided for in the new section 103A to be inserted in the Insolvency Act which provides that "Thereafter any balance of the free residue shall be applied in the payment of any claims proved against the estate in question arising in connection with Flac instruments as defined in the Financial Sector Regulation Act 9 of 2017".[1035]

A section 103B is will be inserted into the Insolvency Act which provides as follows in relation to regulatory capital: "103B(1) Thereafter any balance of the free residue shall be applied in the payment of any claims proved against the estate in question arising in connection with the amounts designated as regulatory capital in terms of a financial sector law." The proposed new section 103B(2) provides that, as between themselves, the claims referred to in section 103B(1) "shall rank as prescribed in a financial sector law, or if there is no such financial sector law, they shall rank *pari passu* and abate in equal proportion, if necessary." Clause 7[1036] of the FSLA Bill will amend the

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[1032] The Insolvency Act defines free residue, in relation to an insolvent estate, as "that portion of the estate which is not subject to any right of preference by reason of any special mortgage, legal hypothec, pledge or right of retention."

[1033] Section 102A(1) as inserted by clause 3 of the FSLA Bill. For purposes of section 102A "covered deposit" has the meaning ascribed to it in the (proposed amendment of) section 1 of the FSRA.

[1034] Clause 4 FSLA Bill.

[1035] Clause 5 FSLA Bill.

[1036] Clause 7 FSLA Bill stipulates as follows: "The arrangement of sections in the Insolvency Act, 1936, is hereby amended by the insertion after the item relating to-

arrangement of certain sections in the Insolvency Act with the result that the amended creditor hierarchy will be as set out in the figure below:[1037]

***SARB resolution approach discussion paper* Figure 2: Creditor hierarchy in insolvency**

Current	**Amended**
Secured creditors (up to value of security)	Secured creditors (up to value of security)
Preferred creditors	Preferred creditors

(a) section 98A of the following item:

"98AA Cost of resolution of designated institutions"

(b) section 102 of the following item:

"102A. Preference in terms of covered deposits"; and

(c) section 103 of the following items:

"103A.Flac instruments

"103B. Regulatory capital".

[1037] *SARB resolution approach discussion paper* at 20.

<table>
<tr><td></td><td>Covered deposits</td></tr>
<tr><td rowspan="3">Unsecured creditors</td><td>Unsecured creditors (including uncovered deposits and non-qualifying debt instruments)</td></tr>
<tr><td>Flac instruments</td></tr>
<tr><td>Regulatory debt instruments (in the order as determined by the regulatory framework)</td></tr>
</table>

5.10 Investigation into reasons for bank failure

Notably the repeal of section 69A of the Banks Act will be compensated for by clause 52 of the FSLA Bill that will amend section 134 of the Financial Sector Regulation Act that deals with the appointment of investigators by inserting a subsection (1A) which provides that the SARB may appoint a person as investigator to conduct an investigation into the prior business, trade, dealings, affairs or assets and liabilities of a bank in resolution. It also provides for assistants to be appointed to aid in the investigation.

A new section 135A will be inserted into the Financial Sector Regulation Act by clause 53 of the FSLA Bill which provides for "investigations into designated institutions in resolution". Such investigator is tasked to carry out an investigation into the bank into resolution and to report to the SARB whether, in the investigator's opinion, the bank should be wound up, remain in resolution for a specified period or until a specified event occurs; or cease to be in resolution. He must also report on whether any business of the bank, before it was placed in resolution, was carried on negligently, recklessly or fraudulently; and whether civil and/or criminal proceedings should be instituted against any person in connection with the conduct of the business of the bank before it was placed in resolution.

5.11 FSB findings in relation to proposed South African resolution regime

In March 2020 the FSB published its peer review on the proposed framework for bank resolution and deposit insurance in South Africa.[1038] The FSB commended South Africa on the good progress it made with its resolution regime (which the FSB indicated is broadly complaint with the FSB Key Attributes for Effective Resolution Regimes) as well as its envisaged deposit insurance framework (which in the FSB's view demonstrates a commitment to implement the IADI Core Principles for Effective Deposit Insurance systems). The Review however concluded that there was still additional work to be done to ensure that the new resolution regime and deposit insurance system can be implemented effectively.[1039]

Particularly in respect of the bank resolution framework the FSB required that a clear implementation roadmap be set, including the identification and sequencing of key policies, timelines for delivery and resource requirements. The FSB also found that it was necessary to enhance the operating model for the SARB as resolution authority and to review emergency liquidity arrangements in light of the new resolution framework and further to introduce a mechanism for ex post recovery from the industry of funds applied for resolution.[1040]

5.12 The Financial Sector Laws Amendment Bill 2020

In August 2020 the Financial Sector Law Amendment Bill B15 of 2020 was tabled in Parliament.[1041] Insofar as the resolution provision proposed in the 2020 version of the Bill is concerned these provisions, except as pointed out below and save for some limited grammatical editing and replacing the words "parri passu" in the proposed section 166U with "equal", are a verbatim replica of those that were set out in the 2018 Bill as discussed above. The only other changes are the following:

The proposed section 166D has been changed to include, in the list of actions relating to winding-up and similar steps for which concurrence of the SARB is required, a section 166D(1)(e): "any step corresponding to, or having the same or a similar effect

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[1038] FSB *Peer Review of South Africa, Review Report* available at https://www.fsb.org/wp-content/uploads/P160320.pdf accessed 19 April 2020.
[1039] *Ibid* 1.
[1040] *Ibid* 19 – 21.
[1041] See also the *Notice of intention to introduce Financial Sector Laws Amendment Bill, 2020 in National Assembly and Publication of Explanatory Summary of Bill* GN 672 published in GG No43441 of 17 June 2020.

to a step mentioned in paragraph (f) or (g).” A catch-all provision is also included as proposed section 166(1)(k) into the aforementioned list, namely: “any action by a financial sector regulator to reduce the value of an outstanding claim against the designated institution or to convert an instrument issued by the designated institution to another instrument, whether such action is taken in terms of a financial sector law or agreement.”

Section 166 H that deals with liquidation, has been changed by the addition of a new section 166H (6) which reads: “Notwithstanding anything to the contrary contained in any law, a liquidator or a trustee in liquidation may not cancel or set aside a disposition made, or a transaction or an action taken, by the Reserve Bank in exercising its resolution functions in terms of this Act.”

A new section 166W was inserted after the provisions dealing with equal treatment of creditors and the NCWOL- principle, in order to provide for the ranking of claims in the following terms:

“(1) Subject to the provisions of this Act, claims against a designated institution in resolution will rank in the order provided in the Insolvency Act, regardless of whether the claim arose before or during the resolution.

(2) Notwithstanding the provisions of any law, if a designated institution is placed in liquidation, the trustee or liquidator must—

(a) after payment of any preferred creditors provided for in the Insolvency Act, and before the payment of any unsecured creditors, apply the balance of the free residue in liquidation in the payment of any claims proved against the estate in question which were covered as a covered deposit in terms of this Act with interest thereon calculated as provided for in section 103(2) of the Insolvency Act;

(b) after payment of any unsecured creditors, apply the balance of the free residue in liquidation in the payment of any claims proved against the estate in question arising in connection with flac instruments as defined in this Act; and

(c) after the payment of flac instruments or, if no claims in connection with flac instruments have been made, then after the payment of unsecured creditors, apply the balance of the free residue in liquidation in the payment of any claims proved

against the estate in question arising in connection with the amounts in terms of debt instruments designated as regulatory capital in terms of a financial sector law in the order prescribed in the financial sector law.

(3) Any payments made by the trustee or liquidator in terms of subsection (2)(c) must be paid in the order prescribed in the financial sector law or, if the financial sector law does not prescribe the order, they must rank equally and abate in equal proportion, if necessary.

(4) Notwithstanding the provisions of any law, the Reserve Bank must apply any money of the designated institution in resolution that becomes available to the resolution authority in paying the cost of the resolution and, subject to the provisions of this Act, in the payment of the claims of creditors which arose before the date of resolution."

5.13 Conclusion

Like Zimbabwe South Africa is also a developing country but with a stronger economy. Its history of banking regulation is somewhat different to that of Zimbabwe given that South Africa has taken a robust approach to banking regulation and has gained some prominence internationally as a member of the BIS and the only African country that is a member of the G20. Similar to Zimbabwe South Africa has also experienced a number of bank failures although fewer than Zimbabwe.

Formal banking regulation on a national level in South Africa entered the scene with the enactment of the Currency and Banking Act 31 of 1920 and the SARB, that was established as central bank under this Act, proved to be a robust bank regulator over the course of many years. As time went by the framework for banking regulation underwent various improvements and South Africa implemented various reforms in alignment with the international reform agenda driven by international standards setting bodies. Consequently South African banks have generally remained well capitalized and none of the big South African banks encountered failure. The relatively low incidence of bank failure was one of the reasons why South Africa, despite its compliance with international standards, never adopted an explicit deposit insurance framework and has only recently commenced the journey towards explicit deposit insurance. It also explains the availability of only two mechanisms in the banks Act to

deal with bank failure: curatorship as a rescue mechanism and liquidation for those banks that were either not eligible for curatorship or could, despite curatorship, not be saved.

Curatorship under section 69 of the Banks Act evolved significantly over the years and many of these changes were informed by lessons learned during curatorship of banks that were encountering failure and had to be saved. Notable about curatorship in terms of section 69 was that it was an administrative procedure which meant that it removed bank rescue from the costs and delay occasioned by its predecessor, judicial management. Thus, free from the constraints of procedure that generally characterizes court–based insolvency proceedings curatorship enabled a swifter approach to dealing with a failing bank which was good from a loss-of-value-avoidance perspective and as pointed out, it also counteracted bank runs. The constructive ambiguity with which the SARB applied the curatorship tool also served its purpose from a market discipline perspective. The public interest was the drive behind curatorship and although not expressly stated such public interest obviously related to the interest in a stable banking sector and more broadly, a stable financial system in South Africa. The curatorship procedure further evolved from a procedure where the failing bank was consulted on the prospect of curatorship to the point where the SARB and the Minister of Finance took the reigns when a bank was experiencing problems.

Curatorship in terms of section 69 of the Banks Act had several features that enabled the SARB, through the Registrar of Banks, to facilitate the rescue of failing banks. These included the power of the curator to take over the management of the failing bank and its assets whilst the moratorium against enforcement triggered by curatorship ensured preservation of assets of the failing institution and enhancing its chances of being rescued. The curator's toolkit also evolved over the years to include powers to call meetings with the failing bank's creditors; suspend or reduce claims by creditors and make payments to them or enter into settlements; cancel agreements; take certain decisions that shareholders would otherwise have to take by means of a special resolution, cancel leases of property; cancel guarantees and importantly, dispose of the failing bank's property where required to improve the bank's situation. The accountability of the curator for the proper execution of his mandate was further ensured by reporting obligations that placed the Registrar of Banks, and by implication also the Minister of Finance, in a position to assess whether the curatorship was

working or whether they would otherwise need to pull the plug on the attempted rescue of the bank concerned. The process provided by the introduction of section 69A for investigation into the affairs of a failing bank was also added to supplement the curatorship procedure and enable identification of the reasons for failure and the persons behind it who could then be brought to reckoning and possible recovery of damages. The investigation procedure in terms of section 69A of course also served the added function of maintaining confidence in the banking system as the public could see that the SARB as central bank did not let those responsible for the bank's failure off the hook.

Despite the significant augmentation of the curatorship procedure it nevertheless transpired that in the post-GFC regulatory milieu a more comprehensive and innovative approach to optimally deal with bank failure was required. The failure of African Bank proved to be the opportunity for South Africa to consider a radical redesign of its approach to bank failure and the curatorship mechanism. While apparently making changes to the curatorship procedure South Africa actually narrowed the gap between the limited framework for bank resolution in the banks Act and international best practice in resolution frameworks as captured in the FSB Key Attributes of Effective Resolution Regimes. Having regard to what transpired in the context of curatorship as a result of the amendments introduced by the 2015 Banks Amendment Act it can be seen that the amendments introduced a more holistic perspective on the question as to how to deal with bank failure. Whereas the objective of curatorship previously was focused solely on getting the failing bank to become a successful concern again the 2015 amendments took a broader approach by acknowledging that sometimes bank rescue may turn out not to be viable but that in such instance outright liquidation might also not be necessary. Instead of rescuing the whole failing bank it may in some instance be possible to achieve an optimal outcome by means of applying asset separation through a "good bank"/"bad bank"-split that would enable continuation of the critical functions of the failing banks whilst those liabilities that were ruining its chances of being economically viable could be moved out of the way. Whereas curatorship was previously aimed at maximizing yield for creditors it was now realized that, albeit that respect for creditor rights remained of great importance, the maintenance of a stable banking sector or public confidence in the South African banking sector was paramount. The curator was consequently also given more

extensive powers to take decisions that could otherwise only be taken by shareholders to ensure that regulatory efforts at dealing with a failing bank could not be derailed by shareholders who had agendas other than to promote the maintenance of a stable banking sector. The curator's ability to raise funding to execute the curatorship and deal with the failing bank's woes were also augmented hence the previous go-to-solution where the central bank and Treasury would step in and mop up the mess with a bail-out with public funds was also addressed. The fact that these new amendments facilitated the rescue of the "good" African Bank consequently illustrates the effectiveness of the asset separation tool as a measure to enable a bank resolution where one part of a bank (the good bank) can be rescued while another part is severed from the bank (the bad bank). Just as the rescue of African bank showed that in some instances banks or parts thereof can be rescued as part of a broader resolution approach that actually transcends the limitations of curatorship in the narrow sense, so did the non-rescue of VBS yield the lesson that there are also instances when a bank's problems transcend resolution measures aimed at keeping the bank alive.

South Africa as a developing country is at a new regulatory frontier as is evident from its recent transition in 2017 to a Twin Peaks model of financial regulation by objective which *inter alia* saw banking supervision being removed from the remit of the SARB and transferred to the Prudential Authority as dedicated prudential regulator. Prominent against all the changes occurring within the context of financial regulation is also the progress made with the introduction of a comprehensive resolution regime and an explicit deposit insurance framework as captured in the Financial Sector Laws Amendment Bill of December 2018 and subsequently in the Financial Sector Laws Amendment Bill of 2020 and clarified by the *SARB resolution approach discussion paper.* Instead of being imported into the regulatory framework via the Special Bank Resolution Bill it has been deemed fit to provide the envisaged resolution regime with a broader scope of application by incorporating it into the Financial Sector Regulation Act as framework act for the South African Twin Peaks model. This means that the resolution framework would eventually be able to be applied to banks as well as non-banks. As pointed out once the new Chapter 12A that will be inserted into the Financial Sector Regulation Act, the provisions of the Banks Act that deal with curatorship of banks and the commission of inquiry into the reason for the bank's failure will be repealed (as would the provisions in the Bank's Act on bank liquidation).

The application of the envisaged resolution framework to a failing bank will engage the SARB, National Treasury and the newly established Prudential Authority. The objective of resolution is aimed at orderly resolution of a failing bank for purposes of broader financial system stability and depositor protection. The decision to nominate SARB, as central bank and lender of last resort, as resolution authority is sensible given that it is no longer directly involved in bank supervision and not as exposed to the conflict that may sometimes arise between financial stability and prudential regulation as it would have been if it still had both those roles. The actual placing of the bank into resolution is done by the Minister of Finance as ultimate authority responsible for overseeing the health of the South African financial system.

Important to note is that the envisaged new resolution framework is not a reactionary framework like the curatorship framework (and also the previous liquidation framework). Bank resolution in South Africa will hinge on pro-active *ex ante* measures such as recovery and resolution plans to *inter alia* preserve a failing bank's critical functions as well as a comprehensive suite of resolution tools and powers. This means that banks and regulators will be able to avert haphazard decision making at the time that a bank fails as they will be obliged to identify the bank's critical functions and conceptualize well in advance how to optimally approach the resolution of such bank. Consequently the way in which bank failure will be dealt with will be much less of a crisis-response than in the previous dispensation.

The envisaged bank resolution regime, that is aligned with the international best practice view that a failing bank should be "bailed-in" by its creditors and shareholders, will be triggered sufficiently early to prevent loss of value in the failing institution and will provide the resolution authority with the power to appoint resolution practitioners to implement the bank resolution regime when a bank fails. Resolution practitioners will be different from curators under section 69 as the resolution practitioner will be implementing a plan designed in advance by the SARB as resolution authority and the powers and tolls to be implemented during such resolution will be broader than those that could be exercised by a curator. From the SARB's discussion paper it also becomes clear that the resolution regime will be adapted to deal with failure of systemically important banks as well as failure of smaller banks. In particular where an open bank resolution-strategy is followed the aim will be to rescue parts of the bank by preserving those parts necessary for viably continuing its critical functions. Such bank

will move through three phases, namely stabilization, restructuring and then finally, if successfully rescued, exiting resolution and continuing those critical operations that were preserved. In addition to tools such as sale of the distressed bank to a private sector purchaser other resolution tools that are used internationally in evolved resolution frameworks, such as the bridge bank tool, restructuring (by asset separation through a "good bank"/ "bad bank" split) and the bail-in tool (through which the bank will be recapitalized) will be used, most likely in combination, to achieve an optimal resolution of a failing bank. Safeguards that will apply during bank resolution include respect for the creditor hierarchy in insolvency during the assignment of losses and observance of the "no creditor worse off"-principle as well as safeguards pertaining to the treatment of employees. The SARB will take control of the management of the failing institution against the backdrop of a moratorium on enforcement action and the management powers to be exercised during resolution resemble the powers given to a curator under the previous regime such as the power to convene meetings with creditors; enter into settlement negotiations with creditors; proposing and entering into compromises with creditors; cancelling agreements and so forth. Liquidation of a failing bank also forms part of the envisaged resolution regime and will be applied to a bank or those parts of the bank that cannot be rescued.

Although some changes to the envisaged resolution regime will occur prior to its final enactment the discussion in this Chapter showed that South Africa will soon have an augmented financial safety net comprising of a robust framework for bank regulation coupled with a comprehensive bank resolution framework and a framework for explicit deposit insurance.

Chapter six: Conclusions and recommendations

6.1 Introduction

Over the years various financial crises have demonstrated exactly how special banks are. They are special not only because they serve a critical intermediary role in the financial system but also because their distress can wreak havoc on the financial systems of countries and even continents. As such bank failure may impact negatively on the public interest in a stable financial system that is able to continuously provide critical functions, such as vital payment and settlement services, credit intermediation and providing a safe, secure environment where depositors can place their savings. Being a critical cog in the highly interconnected wheels of the economy, the failure of one bank may set in motion a process of contagion that can cause the wheels of the economy to come to a grinding halt. It is thus clear that the health of banks is essential to the stability of a country's financial system and that it ought to be closely guarded by means of an appropriate prudential framework that allows banks supervisors not only to implement measures aimed at instilling market discipline and curbing excessive risk-taking but to actively intervene where banks find themselves in "unsafe and unsound" territory. As pointed out in this thesis, the rationale underlying bank regulation and supervision is not to avoid bank failure at all costs.[1042] Thus, although the general premise is that banks should be operated prudently within the confines of regulatory measures aimed at promoting their safety and soundness and maintaining their viability, it is nevertheless recognized that some banks will unfortunately fail. The reasons for bank failures are diverse and may range from dabbling in risky ventures that turn out to have hazardous financial consequences, to corporate governance failures, or outright corruption, or even a totally unanticipated systemic event like the current Covid 19-pandemic.

The question then arises as to how to deal with banks that are failing past those measures where ordinary or more intrusive regulatory intervention by the bank supervisor and recovery tactics by the bank itself can restore a bank's viability? Here again, this thesis has pointed out that not only are banks special, their failure and

[1042] Chapter One para 2.

eventual insolvency are also special.[1043] It has been argued by scholars such as Hupkes, Haentjens and Lastra, and rightly so, that normal insolvency regimes are unfit to deal with bank failure and insolvency in an appropriate manner that, especially in the event that the failing bank concerned is systemically important, will not compromise financial stability.[1044] It has also been highlighted that bank failures are not suitable to ad hoc crisis treatment but that it actually requires advanced planning and a well-structured, orderly and methodological approach and an extensive resolution toolkit to optimally deal with bank failure, be it for purposes of attempting to save parts of a failing bank and/or merely to facilitate its orderly exit from the financial system - if not viable through orderly rescue, then at least through orderly liquidation.

As poignantly observed by the erstwhile Governor of the BoE, Mervyn King: "Banks are international in life but national in death."[1045] Albeit that this observation was made in relation to a jurisdiction with a large number of internationally active banks the crucial lesson of this statement rings true for all jurisdictions: bank failures in the first place fall upon the domestic authorities to be dealt with. How to best deal with bank failures in order not to compromise financial stability should thus be a priority on the regulatory agenda of every country across the globe.

In the context of dealing with failing banks it has also been pointed out that traditionally two options dominated the scene: if viable, the authorities would attempt to "rescue" the failing bank by making use of mechanisms such as curatorship (or administration in the UK) that provided a limited number of options for rescuing a failing bank. If rescue attempts were not viable, the failing bank would be liquidated.[1046] In many instances bank rescue through the curatorship mechanism was not an option due to the dire situation of the bank concerned, compounded by fraud and corruption that may have bled such bank dry of liquidity - sometimes even causing it to be rotten at the core[1047]

[1043] Chapter One para 2.
[1044] Chapter One para 2. See also Hüpkes "Insolvency – why a special regime for banks?" 2005 3 *Current Developments in Monetary and Financial Law* 8 and Haentjens "Bank recovery and resolution: an overview of international initiatives" 2014 *International Insolvency Review* 255. See also Chapter Four para 4.6.
[1045] The Financial Services Authority, *The Turner Review: A regulatory response to the global banking crisis*, March 2009 available at http://www.actuaries.org/CTTEES_TFRISKCRISIS/Documents/turner_review.pdf accessed 7 June 2020 36.
[1046] Chapter One para 2.
[1047] See the failure of VBS in Chapter Five para 5.5.

- in which event liquidation was then the only option from the start and no rescue attempts would be feasible. Curatorship and liquidation were thus applied, sometimes on their own, sometimes with liquidation following upon curatorship, being the two tools of the trade in dealing with bank failures for many years.

In the past few decades however, a more holistic approach began to emerge and some jurisdictions started to deal with failing banks in a more comprehensive, pre-conceptualised and structured manner resulting in the concept of "orderly bank resolution" gaining ground in the run-up to the 2008 GFC. Orderly bank resolution became a paramount regulatory pursuit on the international reform agenda as a result of the 2008 GFC and the havoc wreaked on economies by the disorderly failure of large financial conglomerates and the extension of bail-outs with public funds. As discussed in Chapter Two, the international best practice benchmark for effective resolution frameworks was subsequently set by the FSB when it issued the *Key Attributes of Effective Resolution Regimes* in 2011 and updated it in 2014.

Using the FSB Key Attributes as yardstick, this thesis specifically set out to consider whether the current framework in Zimbabwe for dealing with failing banks is optimal or whether it needs to be reformed to provide a more integrated and all-encompassing approach to dealing with bank failures in the form of a comprehensive bank resolution framework that is more aligned with the Key Attributes. In particular this entailed considering the mechanism of curatorship that has been applied as a lonestanding bank rescue mechanism in Zimbabwe for many years and tracing the evolution of Zimbabwe's resolution regime that now includes curatorship as part of the broader resolution toolkit.[1048]

The aforesaid research question was sought to be answered first by considering international best practice in bank resolution as captured in the FSB Key Attributes of Effective Resolution Regimes and consequently by considering how the approaches to dealing with bank failure applied by the UK and South Africa as comparative jurisdictions, have evolved over the years and whether they could provide any guidance for Zimbabwe. As indicated the thesis focused on aspects such as the scope of the resolution regime, triggers for resolution and resolution objectives, the resolution authority, resolution funding; safeguards to protect property rights; the general

[1048] Chapter One para 4.

resolution powers of the resolution authority; and the main resolution measures (tools) as well as whether curatorship or a tool akin to curatorship could be incorporated as part of a country's broader resolution regime.

6.2 Bank resolution as optimal approach to deal with failing banks

The 2008 GFC was, as pointed out in this thesis, a seismic event in the financial history of the world that caused severe disruption to many financial systems across the globe and compromised the interconnected global financial system more severely than any other previous crisis.[1049] It set the international regulatory agenda on a new trajectory focused on the promotion and maintenance of financial stability as core objective and in the process it yielded a more prudent approach to regulating banks, being the bedrock of the financial system, both in their life and in their death or near-death. The 2008 GFC, in particular, has pushed regulators globally towards a new regulatory frontier where dealing with bank failures in the most optimal way possible in order not to compromise financial system stability has become a regulatory imperative. Although some jurisdictions already applied more sophisticated techniques than others for resolving financial institutions pre-GFC, as observed above, it was the 2008 Crisis that led to the conceptualization of a coherent best practice framework for orderly bank resolution captured in the FSB Key Attributes of Effective Resolution Regimes as discussed in detail in Chapter Two of this thesis.

What makes the approach to bank resolution as set out in the FSB Key Attributes optimal is the comprehensive pre-planned and structured approach it takes to bank resolution, the well-developed resolution toolkit it provides and the safeguards it observes. These features all serve to enable the resolution authority to effect the most orderly bank resolution possible in a given instance and within clear statutory parameters that seek to minimize reliance on taxpayers' money and prevents creditors and shareholders from derailing resolution efforts whilst observing the creditor hierarchy in insolvency and ensuring that no creditor is "worse off than in liquidation" (NCWOL).

In particular, an effective bank resolution framework is not a mechanism that is kept on the shelf until a bank eventually fails. It is a vital part of the financial safety net that

[1049] Chapter One para 2.

features on the regulatory agenda already at the moment that a bank enters the regulatory realm upon being licensed. This is so because the approach to orderly bank resolution set out in the Key Attributes requires the bank supervisor, from the early stages of bank supervision, to engage the assistance of banks in attempting to preserve their safety and soundness and to recover from situations that may compromise such safety and soundness, by means of pre-conceptualized and approved recovery plans that are regularly updated. The regulator is also required to be pro-active by compiling resolution plans for banks well in advance and while those banks are still safe and sound in order to ensure that, where a bank nevertheless encounters failure, haphazard attempts to dealing with such failure is averted and the bank can be resolved in the most optimal and orderly manner possible. As such the failure does then not become the regulator's headache. This is because the resolution plan is tailormade for the specific bank and has been drafted with the assistance of the bank at a time when crisis situations did not cloud regulatory judgment and information could be extracted from bank officials under normal circumstances where their cooperation was not compromised by concerns about their positions and future.

Moving away from the limited rescue options previously yielded by the curatorship mechanism, it was pointed out in Chapter Two that the Key Attributes provide a holistic and creative approach to bank resolution which gives the resolution authority various resolution tools and powers that can be applied creatively on their own or in combination to deal with a failing bank.

6.3 Curatorship

In seeking to address the research question, this thesis has detailed how bank failures have over the years been dealt with in Zimbabwe and also in South Africa and the UK. In particular it showed that, whereas the process of curatorship (or administration in the UK as initially catered for in the Insolvency Act) may have initially provided a solution to the rescue of a failing bank or featured as a prelude to its subsequent exit from the financial system, the environment wherein bank failures take place in current times have outgrown the small outfit of traditional curatorship. Simply put, the curatorship process does not provide a comprehensive enough framework and toolkit to deal with the complexities posed by bank failures in the 21st century. Modern banks operate within complex, opaque conglomerate structures and their portfolios are

significantly diversified, their processes laden with innovation and technicality, to such an extent that the relatively straightforward rescue mechanism offered by curatorship on its own is no longer an optimal measure to try and save failing banks.

The reasons for concluding that curatorship as a standalone measure does not provide an optimal mechanism for dealing with failing banks are based on the following material gaps that have been identified in the curatorship process as considered in Chapters Three to Five of this thesis:

(a) Firstly, the curatorship process is triggered too late and often occurs when the bank concerned has already been drained of liquidity and equity leaving the curator precious little room within which to manoeuvre with his limited toolkit to achieve an optimal rescue of a failing bank.

(b) Second, due to the lack of proper advance planning for how to deal with bank failure (that is, lack of a resolution or failure plan) the regulatory authorities and curator are thrown in at the deep end when the bank fails. They then have to come up with crisis plans to deal with such failure, usually under immense pressure and within a very short time, often broadly conceptualized within the space of a "curatorship weekend".[1050] The curatorship process is thus not optimal in terms of achieving an orderly pre-conceptualized response to bank failure.

(c) Curatorship generally applies only to the failing bank itself and does not provide any powers to the curator or regulatory authorities to contemplate broader restructuring within a financial conglomerate or banking group of which such failing bank may be a part.

(d) The tools that can be applied during curatorship are limited and do not provide for innovative tools such as "statutory bail-in" which is a modern tool by means of which to attempt to rescue a failing bank through a recapitalization by creditors and shareholders without resorting to public

[1050] Curatorship/resolution weekend is when policy makers allow an institution to fail on a Friday and find itself rescued by the time markets open again on Monday. See Davies "Bank Resolutions: Long weekend" available at https://www.globalcapital.com/article/b1f44br8jyjv82/bank-resolutions-long-weekend accessed 17 December 2020.

funds. In the absence of a well-conceptualised comprehensive framework for dealing with banks that are failing or have failed, regulators have to scramble to obtain funds to deal with the costs of bank failure whereas planning ahead for funding of bank resolution within the context of an appropriate and integrated resolution regime would address this problem.

It is to be noted though, that it is not the intention of this thesis to discredit curatorship or a measure akin to curatorship as a mechanism for dealing with failing banks but rather to show that it should function as part of a broader resolution regime.

6.4 Observations on the Zimbabwean framework for dealing with bank failure

In Chapter Three of this thesis it was pointed out that Zimbabwe currently has a relatively comprehensive framework for prudential regulation and supervision of banks as set out in the Banking Act [Chapter 24:20], with measures to enhance the safety and soundness of Zimbabwean banks. The country, unlike many other developing countries, also has a framework for depositor protection captured in the Deposit Protection Corporation Act [Chapter 24:29] that was introduced in 2003. Thus, insofar as the financial safety net is concerned Zimbabwe appears to be in a relatively strong position in relation to the components of prudential supervision and depositor protection. The financial safety net in Zimbabwe however requires to be strengthened in respect of the framework for dealing with failing banks to ensure that such banks are resolved in an optimal and orderly manner.

As discussed in this thesis, Zimbabwe experienced several bank failures since independence in the 1980s, some of which occurred in similar time periods or “waves”. The reason for these bank failures were varied and, as it falls onto prudential regulation and supervision in the first place to provide measures to try and keep banks safe and sound, it was indicated that some reforms in this regard occurred (albeit that a detailed interrogation of the suite of measures introduced over the years to prevent bank failure was not undertaken as it is beyond the scope of this thesis). It was further indicated

that curatorship as a rescue measure was applied to a number of these failing banks with mixed success.[1051]

Compared to countries like the UK and South Africa the curatorship mechanism in Zimbabwe appeared to be well-aligned with regard to the powers and duties of the curator (or administrator) in the aforementioned two countries and the range of measures that could be applied in an attempt to nurse a failing bank back to health in the days before more comprehensive resolution regimes entered the regulatory agenda. The decision to apply curatorship to a failing bank was largely left to the RBZ as central bank and bank supervisor, albeit in consultation with the Minister of Finance and the DPC. The curator took over responsibility for the management of a failing bank and was able to enlist assistance from such bank's management and employee corps. The curator's powers *inter alia* covered the authority to dispose of the failing bank's assets, negotiate with creditors and make payments to them, and cancel agreements to eventually restore viability to a failing bank. The curator further had to interrogate the reasons behind the failure of a bank and identify those responsible for the bank's demise so that they could be held accountable.[1052]

As further indicated in Chapter Three, Zimbabwe introduced a more comprehensive framework for resolving failing banks, separate from the Banks Act, as long ago as 2005 - well before the 2008-GFC emphasized the importance of an appropriate bank resolution framework and a couple of years before the FSB Key Attributes of Effective Resolution Regimes were issued. This framework that was captured in the Troubled Financial Institutions (Resolution) Act [Chapter 24:28] ("TFIR Act") gave the RBZ some sweeping powers to apply in order to resolve a failing bank and extended those powers also to associates of the troubled bank, thus widening the reach of the resolution regime. The TFIR Act provided for the appointment of an "administrator" to implement a resolution plan conceptualized by the RBZ, not long in advance, but at the time that the bank was sought to be declared a "troubled financial institution". For purposes of implementing the resolution plan the administrator could exercise various "resolution-supporting" powers which *inter alia* included nullifying any disposition of the bank's property and transfer of shares that occurred after the administration process had

[1051] Chapter Three para 3.4.
[1052] Chapter Three para 3.5.3.

already begun. The administration procedure in terms of the TFIR Act, which was akin to but broader than curatorship as it entailed implementing broader resolution measures, pursued two objectives; either rescuing the bank by restoring its financial soundness or, failing the aforementioned, resolving the bank whilst safeguarding the interests of depositors, creditors and members. These modes of resolution had features that were in various respects similar to the features of effective resolution regimes that were later captured in the FSB Key Attributes as international benchmark. However, as pointed out the TFIR Act was repealed in 2015 and albeit that there is a dearth of authority on the reasons for such repeal it appears that it was misuse of the Troubled Banks Fund[1053] that led to the Act's demise.[1054]

The current bank resolution framework in Zimbabwe comprises of the curatorship procedure in sections 53 to 56 and the new provisions pertaining to "problem banks" that have been imported into the Banking Act via section 52A, 52B and 52C against the backdrop of other amendments to improve bank supervision and early intervention powers to minimize bank failure. It also includes the provisions for bank liquidation in section 57 of the Act although a discussion of bank liquidation is beyond the scope of this thesis.[1055] The effect of the insertion of section 52A, 52B and 52C in the Banking Act is that what was stated by RBZ to be a more "comprehensive resolution framework", has been introduced in Zimbabwe. This new resolution regime incorporates curatorship as one of the options available during resolution. From the discussion of the current Zimbabwean resolution framework in Chapter Three of this thesis it appears that although there are various respects in which the current framework is aligned with the FSB Key Attributes as international benchmark for effective resolution regimes there are also some gaps that require to be addressed. As indicated in Chapter One such alignment assessment will not address alignment with FSB Key Attributes 7, 8, 9 and 12 on cross-border collaboration, crisis management and information sharing and cross-border cooperation agreements. In particular, when comparing the current framework for bank resolution in Zimbabwe, as captured in the

[1053] Troubled Bank Fund means the Troubled Bank Fund established by the Reserve Bank for the purpose of providing financial assistance to financial institutions.
[1054] Chapter 3 para 3.8.1.
[1055] See the delimitation in Chapter One para 1.8.

Banking Act pursuant to the 2015 Banking Amendment Act, to the FSB Key Attributes for alignment the following is apparent:

(a) Alignment with Key Attribute 1: Scope of the resolution regime

The current framework for bank resolution in Zimbabwe is aligned with FSB Key Attribute 1 as it is clear that the resolution regime applies to "problem banks" which are, in brief, described as banks with significantly impaired capital adequacy, asset quality or liquidity or solvency.[1056] It is also clear that the resolution regime will, in principle and obviously also proportionally, apply to all problem banks as the regime is not limited to only apply to systemically important banks. However mention is not made of the applicability of the resolution regime to subsidiaries or branches of foreign banks operating in Zimbabwe.[1057]

(b) Alignment with Key Attribute 2: Resolution Authority

The bank resolution regime in Zimbabwe is substantially aligned with Key Attribute 2 in that the RBZ, as central bank is the designated resolution authority that pursues financial stability and continuity of systemically important functions and the operation of the payments system. A depositor protection framework administered by the Deposit Protection Corporation supports the resolution functions of the RBZ. The RBZ is guided by the objectives of resolution stated in section 52A(1) of the Banking Act, namely the protection and enhancement of financial system stability; the protection and enhancement of public confidence in the banking system; depositor protection and protection of public funds. It is further clear from the power given to the RBZ (pending the formulation and implementation of a resolution plan) to take measures concerning the problem bank that are necessary to preserve its capital, assets and liquidity, that the RBZ will seek to avoid unnecessary destruction of value and losses to creditors.[1058] Albeit that there is some debate about the RBZ's independence, as pointed out by Njanjike, it appears that the RBZ has some operational independence and having regard to the RBZ's previous experience with bank resolution it is also clear that the

[1056] Section 2 of the Banking Act as amended.
[1057] For example Stanbic Bank Zimbabwe and First Capital Bank of Zimbabwe (formerly Barclays Bank of Zimbabwe Ltd). See the Operating Banking Institutions listed on the RBZ website available at https://www.rbz.co.zw/index.php/regulation-supervision/regulation-supervision/banking-institutions accessed 4 November 2020.
[1058] Section 52A(6)(a) and (b) of the Banking Act.

RBZ has the expertise to implement resolution measures. However the resolution framework introduced into the Banking Act by the 2015 Banking Amendment Act does not list the continuation of critical functions of the failing bank as a resolution objective and it also does not specifically provide for the RBZ and its staff to be protected against liability for actions and omissions whilst executing their resolution powers in good faith.

(c) Alignment with Key Attribute 3: Resolution Powers

The bank resolution regime in Zimbabwe is aligned with Key Attribute 3 insofar as resolution is triggered when a bank is no longer viable or likely to be no longer viable. To determine whether a bank should enter resolution various criteria are set out in section 52A(2)(a) to enable the identification of problem banks such as, for example, that the bank can no longer meet the prescribed capital requirements or is otherwise in an unsound financial condition. Each of the instances listed in the aforementioned section could trigger resolution and it is thus not necessary that all the criteria have to be met cumulatively before a bank is determined to be a "problem bank". Provided the RBZ is vigilant it appears that entry into resolution can be triggered timely at an early stage before the failing bank is balance sheet insolvent and while there still is some equity to work with during resolution.

The Zimbabwean resolution regime is also substantially aligned with Key Attribute 3 in respect of the resolution powers it provides. As such the resolution framework for problem banks gives the RBZ powers for the removal and replacement of directors and senior managers[1059] and also provides for a curator (administrator) that can be appointed to rescue the bank or parts thereof by managing it in accordance with a resolution plan conceptualized by the RBZ.[1060] Given that the curatorship process is part of the resolution regime it means that the curators' powers as set out in section 53 applies which entail various powers necessary to operate and resolve the failing bank, including powers to terminate contracts, purchase or sell assets, write down debt and take any other action necessary to restructure or wind down the bank's operations.

Continuity of essential services and functions performed by problem banks in the Zimbabwean resolution regime, although not specifically listed in section 52A as a

[1059] Section 52A(2)(o) of the Banking Act. See also section 52A(7)(a) – (c) that allows the RBZ to remove or replace directors pending the formulation and approval of a bank resolution plan.
[1060] Section 52C(2) of the Banking Act.

resolution objective, is ensured by the establishment of a "bridging banking institution" to take over and continue to operate critical functions and viable operations of the failing bank.[1061] Although the Key Attributes suggest a time limit of no longer than two years for Bridge banks, the Zimbabwean regime does not incorporate such time limit.[1062]

Adequate provision is further made to override shareholder rights, specifically rights to force compliance with approval requirements in order to obtain permission for mergers, sale of substantial business operations, recapitalization and other measures to restructure and dispose of the problem bank's business or its assets and liabilities. In fact section 52C(2) provides that shareholders have no rights with respect to their shares except to the extent permitted under the resolution plan. As pointed out in paragraph (e) below property rights are respected through compensation awards. The regime further imposes a moratorium during which enforcement by creditors of other claims against the failing bank are stayed.[1063]

In line with Key Attribute 3 a framework is in place for the closure and orderly wind-down of a failing bank or parts thereof and a deposit protection framework is in place to enable timely payout of insured deposits. It is further possible for the RBZ as resolution authority to apply one or a combination of resolution powers. The resolution tools comprise the option of a merger or the acquisition of the problem bank by a third party purchaser as well as the use of the bridge bank-tool, the appointment of a curator to implement a resolution plan and liquidation in relation to those parts of the bank that cannot be rescued. The bank resolution regime in Zimbabwe's Banking Act does however not contain a properly developed bail-in tool that could enable continuity of the failing bank's critical functions through recapitalization of such bank.

(d) Alignment with Key Attribute 4: Set-off, netting, collateralization

The resolution regime in Zimbabwe is not aligned with Key Attribute 4 in that the legal framework does not address set-off rights, contractual netting and collateralization

[1061] Section 52A(2) of the Banking Act.
[1062] Chapter 2 para 2.2.3.4.
[1063] Section 52C(4) of the Banking Act.

agreements and segregation of client assets. The regime however provides for an automatic limited stay (moratorium) on legal proceedings against the failing bank.

(e) Alignment with Key Attribute 5: Safeguards

In line with Key Attribute 5 the resolution regime captured in the Banking Act pursuant to the 2015 amendments provides for protection of property rights.[1064] It does so by stipulating that reasonable notice be given to persons whose property rights will be affected and that they should receive fair and adequate compensation within a reasonable time after their rights have been acquired. The framework does however not contain specific provisions stipulating that resolution powers are to be exercised in a way that respects the hierarchy of claims in insolvency and the *pari passu* treatment of creditors of a similar class. Given the lack of such specific reference a provision to allow departure from the equal treatment of creditors if such departure is necessary in the interest of financial stability or to maximize value for the benefit of the creditors as a group, is also absent from the Zimbabwean resolution framework. Although the regime provides for fair compensation of those whose property rights are affected by the resolution measures that are applied there is no specific mention that such compensation will observe the "no creditor worse off"-principle requiring such compensation, at a minimum, to be what they would have received if the bank concerned had been liquidated.

(f) Alignment with Key Attribute 6: Resolution Funding

Zimbabwe's resolution regime lacks sufficient alignment with Key Attribute 6 although it does comply with the deposit insurance requirement set by this Key Attribute. Particularly, it is unclear exactly how the funding of resolution actions by the RBZ in respect of a failing bank will be done. Notably the Zimbabwean resolution framework provides for recovery by the RBZ of funding extended to maintain critical functions of a bank that has been put into resolution by allowing the RBZ, in terms of section 56A of the Banking Act, to recover such funds expended by the curator during the implementation of the resolution plan. It however contains no provisions addressing the conditions under which temporary funding during resolution should be extended in

[1064] Section 52A(4)(c)(i) of the Banking Act.

order to reduce the risk of moral hazard. The exact interaction, if any, between the RBZ and the Deposit Corporation is not addressed in the resolution framework.

(g) Alignment with Key Attribute 10: Resolvability assessments

No provision is made in the Zimbabwean resolution framework as captured in the Banking Act for resolvability assessments to be conducted in order to evaluate the feasibility of resolution strategies and the credibility of such strategies in light of the likely impact that the failure of a bank that has been put in resolution may have on the financial system and the economy. Given the lack of such requirement there is also no provisions that deal with the powers of the RBZ in relation to resolvability assessments.

(h) Alignment with Key Attribute 11: Recovery and resolution planning

In its current format the Zimbabwean Banking Act does not provide for recovery plans to be compiled and regularly updated by banks. It also does not provide for *advance* resolution planning by the RBZ as part of its ordinary supervisory functions in anticipation of bank failure. It only requires the RBZ to formulate a resolution plan *after* investigating a bank and determining that it is a problem bank. The Act does however saliently provide that in formulating such *ex post* resolution plan the RBZ must give consideration to the public interest and ensure that proportionate resolution measures are applied.[1065] The lack of provisions in the Banking Act pertaining to resolvability assessments can be linked to the Zimbabwean resolution framework's non-alignment with Key Attribute 11 that requires an effective resolution regime to provide for robust and credible recovery and resolution plans, conceptualized well in advance of any failure that may materialise, and regularly updated, to be put in place by banks and the resolution authority respectively. Consequently Zimbabwean banks are not privy to the positive spin-off that such plans would otherwise have, namely instilling of market discipline and being equipped with a recovery plan, conceptualized well in advance, to self-restore their health should they encounter problems and failing that, a resolution plan, also conceptualized well in advance.

6.5 Insights for Zimbabwe from comparisons made with the approach to dealing with failing banks in the United Kingdom and South Africa

[1065] Section 52A(4)(a) of the Banking Act.

As a first step Zimbabwe should take comfort in the fact that both the UK and South Africa, having applied standalone measures such as administration and curatorship to rescue failing banks over the course of many years, have in recent times also aligned themselves with the international best practice approach to comprehensive bank resolution as set out in the FSB Key Attributes for Effective Resolution Regimes. Consequently the transition by the UK and the contemplated transition by South Africa to comprehensive resolution regimes that are aligned with the FSB Key Attributes should reassure Zimbabwe that augmenting its existing resolution framework to align it in even more respects with the features of effective resolution regimes set out in the Key Attributes would be a step in the right direction and would considerably strengthen the financial safety net arrangements in Zimbabwe.

6.5.1 Guidance from the United Kingdom

6.5.1.1 Alignment with the FSB Key Attributes

Although the UK has had a rather informal system of banking regulation until the enactment of the Banking Act in 1979 and has lacked a *lex specialis* for dealing with failing banks until the introduction of the 2009 Banking Act, the UK's current bank resolution framework is comprehensive. Insofar as alignment of this framework with the Key Attributes is concerned, the following is apparent:

(a) Alignment with Key Attribute 1: Scope of the resolution regime

As indicated in Chapter Four, the UK has a bespoke special bank resolution regime which also served as a model for the drafting of the EU's BRRD. The current framework for bank resolution in the UK is aligned with FSB Key Attribute 1 as the regime applies to banks that have encountered or that are likely to encounter, financial difficulties.[1066] It is further clear that the resolution regime will in principle apply to all failing banks as the regime is not limited to only apply to systemically important banks.

(b) Alignment with Key Attribute 2: Resolution Authority

The bank resolution regime in the UK is compliant with Key Attribute 2 in that the BoE, as central bank is the formal resolution authority that pursues financial stability and

[1066] Section 1(1) of the Banking Act 2009, as revised. See Chapter Four para 4.8.2.

continuity of systemically important functions and the operation of the payments system.[1067] The Treasury, Prudential Authority (as part of the BoE) and the Financial Conduct Authority also have specific roles during bank resolution. A depositor protection framework in the form of the Financial Services Compensation Scheme (FSCS) supports the resolution functions of the BoE. The BoE further seeks to avoid unnecessary destruction of value and losses to creditors, it is operationally independent[1068] and has the expertise to implement resolution measures. Provision is made for the BoE and its staff to be protected against liability for actions and omissions whilst executing their resolution powers in good faith.

(c) Alignment with Key Attribute 3: Resolution Powers

The bank resolution regime in the UK is aligned with Key Attribute 3 insofar as resolution is triggered when a bank is no longer viable or likely to be no longer viable. Certain conditions are stipulated in section 7 of the Banking Act, 2009 to enable the BoE to determine whether a bank is encountering or likely to encounter financial difficulties thus enabling it to trigger entry into resolution timely at an early stage before the failing bank is balance sheet insolvent and while there still is some equity to facilitate resolution.

The UK's resolution regime is also aligned with Key Attribute 3 in respect of the suite of resolution powers it provides. The resolution authority in the UK is provided with the whole range of resolution powers listed in the FSB Key Attributes which comprises transfer to a private sector purchaser; transfer to a bridge bank; transfer to an asset management vehicle and also a well-conceptualized bail-in tool and a public ownership tool.[1069] The regime further provides for a "resolution administrator" that can be appointed to implement a resolution plan and to attempt to rescue the bank or parts thereof by managing it back to ongoing and sustainable viability.[1070] In addition the Special Bank Resolution Regime in the 2009 Banking Act specifically also provides for an "administrator" (other than a resolution administrator) to apply a bank-specific administratorship process to a failing bank as a measure to facilitate its rescue.

[1067] Section 216 of the Banking Act 2009, as revised. See Chapter Four para 4.8.3.
[1068] Section 30C of the Bank of England Act 1998.
[1069] Section 11, 12, 12ZA and 12 A (read with section 48B) and section 13 respectively of the Banking Act 2009, as revised. See Chapter Four para 4.8.7.
[1070] Part 3 of the Banking Act 2009, as revised. See further Chapter Four para 4.9.

Provision is also made for various powers necessary to operate and resolve the failing bank, including powers to terminate contracts or to continue or assign contracts, purchase or sell assets, write down debt and take any other action necessary to restructure or wind down the bank's operations.[1071]

Adequate provision is further made to override shareholder rights, specifically rights to force compliance with approval requirements in order to obtain permission for mergers, sale of substantial business operations, recapitalization and other measures to restructure and dispose of the problem bank's business or its assets and liabilities. The regime also provides for a stay on the exercise of early termination rights and imposes a moratorium during which enforcement by creditors of other claims against the failing bank are stayed.[1072]

A framework is further in place for the closure and orderly winding-down of a failing bank or parts thereof[1073] and, as pointed out, a deposit protection framework in the form of the FSCS is in place to enable timely payout of insured deposits. It is further possible for the BoE as resolution authority to apply one or a combination of resolution powers.[1074]

(d) Alignment with Key Attribute 4: Set-off, netting, collateralization

The UK's bank resolution regime is aligned with Key Attribute 4 in that the legal framework pertaining to set-off rights, contractual netting and collateralization agreements and segregation of client assets is clear, transparent and enforceable during resolution and does not impede the effective implementation of resolution measures.[1075] Entry into resolution does not trigger any contractual or statutory set-off rights and does not constitute an early termination event that can entitle a creditor to exercise contractual acceleration or early termination rights.

(e) Alignment with Key Attribute 5: Safeguards

The resolution regime in the Banking Act, 2009 as revised, is aligned with Key Attribute 5 and resolution powers are exercised in a way that respects the hierarchy of claims

[1071] Section 12AA of the Banking Act ,2009. See also Chapter Four para 4.8.7(d).
[1072] Chapter Four para 4.8.
[1073] See Part 2 of the Banking Act, 2009 which sets out the bank insolvency procedure.
[1074] See Chapter Four para 4.8.7.
[1075] Section 48P(2) of the Banking Act, 2009.

in insolvency and the *pari passu* treatment of creditors of a similar class.[1076] It however adds flexibility in allowing departure from the equal treatment of creditors but requires the BoE to report to the Chancellor of the Exchequer in the event of deviation.[1077] The UK bank resolution framework also observe shareholders and creditors' rights to compensation in accordance with the "no shareholder or creditor worse off"-principle captured in section 60B of the Banking Act.

(f) Alignment with Key Attribute 6: Resolution Funding

Section 58 of the Banking Act ensures compliance by the UK's bank resolution regime with Key Attribute 6 as it provides extensively for the establishment of a resolution fund.[1078] The section also sets out clear parameters for the application of resolution funding.

(g) Alignment with Key Attribute 10: Resolvability assessments

In alignment with Key Attribute 10 the resolution framework in the Banking Act 2009, as revised requires the BoE to undertake annual resolvability assessments for each bank in order to identify any aspects that may compromise a bank's resolvability.[1079]

(h) Alignment with Key Attribute 11: Recovery and resolution planning

The Banking Act 2009, as revised is aligned with Key Attribute 11 as it requires banks to have recovery plans in place and requires the BoE as resolution authority to develop resolution plans for banks which follows one of three broad strategies, namely, bail-in, partial transfer or insolvency (liquidation).[1080]

6.5.1.2 Observations regarding guidance

From the above overview it is clear that the special bank resolution regime in the UK is materially compliant with the FSB Key Attributes for Effective Resolution Regimes. As pointed out, provision is also made for a special bank administration procedure comprising a mixture of bank-specific provisions as well as provisions contained in the

[1076] Section 48B(13) of the Banking Act, 2009 as revised. See Chapter Four para 4.8.8.
[1077] Section 48E(4) of the Banking Act 2009, as revised.
[1078] See Chapter Four para 4.8.9.
[1079] Purple Book 27 par 3.7. See Chapter Four para 4.8.5.
[1080] Purple Book 27 par 3.2. See Chapter Four para 4.8.5.

"normal" administration procedure under the Insolvency Act to provide a procedure for the rescue of a failing bank where there is a likelihood that such bank can be rescued.

In particular it is submitted that Zimbabwe can take guidance from the UK's special resolution regime with regard to the objectives of resolution which pertinently include the preservation of critical functions of the failing bank. The UK regime is also clear on the triggers for resolution and the take-away for Zimbabwe in this regard is that resolution should be triggered timely in order to prevent regulatory forbearance that may result in unnecessary loss of value of the failing bank concerned. The UK also provides a good example insofar as it pertains to the range of resolution powers it affords and a valuable lesson in this context the UK sets out clear conditions that are required to be met before the stabilization options can be exercised by the resolution authority, which ensures that the various resolution tools are not applied arbitrarily.

Zimbabwe may also benefit from having regard to specifically how the bail in-tool in the UK is conceptualized and legislatively entrenched. Zimbabwe could further benefit from interrogating the UK's approach to taking problem banks under temporary public ownership where the other resolution options are not suitable to dealing with a failing bank, and to heed the parameters for the application of this specific resolution tool. The parameters outlined in the 2009 Banking Act pertaining to the application of resolution funding may also yield useful guidance.

Heed can further be taken of the UK's approach to recovery and resolution planning to guide the drafting of provisions in the Zimbabwean Banking Act and banking regulations pertaining to recovery and resolution planning and the introduction of resolvability assessments. It would further be useful for Zimbabwe to consider the provisions in the UK Banking Act that deals with the equal treatment of creditors and the "no creditor worse off principle" to inform the drafting of these provisions in the Zimbabwean Banking Act. Consideration could also be given to the provisions in the UK Banking Act dealing with set off, netting and collaterization as it may be prudent for future purposes to have the latter provisions in the Zimbabwean resolution framework even though they may have limited application in the current Zimbabwean context where there is no large scale trading in derivatives.[1081]

[1081] On the need for a derivative market in Zimbabwe see Njanjike "Derivative Market: An Integral Part of the Zimbabwe Stock Exchange"(2010) *Annals of the University of Petrosani, Economics* 217.

Like the UK with its Purple Book, Zimbabwe may also benefit from a code that sets out the practical explanation of the Zimbabwean bank resolution regime.

6.5.2 Guidance from South Africa

6.5.2.1 Alignment with the FSB Key Attributes

As discussed in Chapter Five, South Africa is a developing country with a robust bank regulation framework, and is currently in the process of transitioning to a comprehensive resolution regime that will be inserted into the Financial Sector Regulation Act 9 of 2017 as Chapter 12A via the Financial Sector Laws Amendment Bill of 2018 as recently updated by means of the Financial Sector Laws Amendment Bill 2020. This Bill simultaneously seeks to introduce an explicit deposit protection framework into the South African financial safety net.[1082] Although there may be some further amendments to the resolution framework contemplated for South Africa it appears that the main features of this framework has been fleshed out in the updated version of the Financial Sector Laws Amendment Bill in alignment with the FSB Key Attributes for Effective Resolution Regimes which guided the conceptualization of the contemplated South African resolution regime and has undergone a mainly favourable FSB Peer Review. Consequently it can be expected that the resolution regime that will be enacted eventually will be substantially similar to the one captured in the FSLA Bill of 2018 as further updated in the 2020 version of the Bill, as discussed in Chapter 5 of this thesis.

(a) Alignment with Key Attribute 1: Scope of the resolution regime

The contemplated framework for bank resolution in South Africa is aligned with FSB Key Attribute 1 as it will apply to banks that are, or are likely to become unable to meet their obligations.[1083] The resolution regime is further not limited to only apply to systemically important banks.

(b) Alignment with Key Attribute 2: Resolution Authority

The contemplated bank resolution regime in South Africa is substantially aligned with Key Attribute 2 in that the SARB, as central bank is the designated resolution

[1082] Chapter Five para 5.6.3.
[1083] Proposed section s166J(1) of the Financial Sector Regulation Act. See Chapter Five para 5.6.5.1.

authority[1084] that pursues financial stability[1085] and continuity of systemically important functions[1086] and the operation of the payments system. The contemplated new deposit insurance framework administered by the Corporation for Deposit Insurance will provide support for the resolution functions of the SARB.[1087] It is clear from the objective of maintaining financial stability that the SARB will seek to avoid unnecessary destruction of value and losses to creditors during the application of the envisaged resolution regime to a particular bank. As required by Key Attribute 2 the SARB is operationally independent and being actively involved in banking regulation for a century already as well as participating actively in international standard setting bodies and keeping abreast of the international regulatory agenda, that it has the expertise to implement resolution measures.[1088] The proposed South African resolution regime also provides for legal protection (immunities) for the resolution authority, its employees and other financial sector regulators and Corporation for resolution actions taken in good faith.[1089]

(c) Alignment with Key Attribute 3: Resolution Powers

The bank resolution regime in South Africa is aligned with Key Attribute 3 insofar as resolution is triggered when a bank is no longer viable or likely to be no longer viable. This will happen if the bank is unable, or is likely to become unable to meets its obligations. The contemplated framework for bank resolution in South Africa thus ensures that entry into resolution is triggered timely at an early stage before the failing bank is balance sheet insolvent and while there still is some equity to work with during resolution.

The contemplated South African regime is further aligned with Key Attribute 3 in respect of the resolution powers it provides. The SARB as resolution authority will have a full suite of resolution powers that also includes the novel bail-in tool. The contemplated resolution regime further provides for a resolution practitioner,[1090] who

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[1084] Proposed section 166A of the Financial Sector Regulation Act.
[1085] Proposed section 166 B of the Financial Sector Regulation Act. See Chapter Five para 5.6.5.2.
[1086] See the definition of "critical function" that will be inserted into section 1 of the Financial Sector Regulation Act via clause 38 of the Financial Sector Laws Amendment Bill. See Chapter Five para 5.6.4.
[1087] See Chapter Five para 5.7.
[1088] See Chapter Five para 1.2
[1089] Chapter 5 para 5.8.
[1090] Proposed section 1660 of the Financial Sector Regulation Act.

is not exactly similar to a curator as contemplated in (the to-be-repealed) section 69, but who can be appointed to assist the SARB in implementing a resolution plan for a failing bank and can be tasked to carry out any of the SARB's resolution functions such as the rescue of the bank or parts thereof by managing it back to ongoing and sustainable viability. Provision is also made for various powers necessary to operate and resolve the failing bank, including powers to terminate contracts or to continue or assign contracts, purchase or sell assets, write down debt and take any other action necessary to restructure or wind down the bank's operations.[1091]

Adequate provision is further made to override shareholder rights, specifically rights to force compliance with approval requirements in order to obtain permission for mergers, sale of substantial business operations, recapitalization and other measures to restructure and dispose of the problem bank's business or its assets and liabilities. The regime also provides for a stay on the exercise of early termination rights[1092] and imposes a moratorium during which enforcement by creditors of other claims against the failing bank are stayed.[1093]

The contemplated South African resolution regime will provide for the establishment of bridge banks,[1094] restructuring (which include mergers and asset separation) and bail-in[1095] as resolution tools. The SARB as resolution authority can apply one or a combination of resolution powers.

A framework is further in place for the closure and orderly wind-down of a failing bank or parts thereof[1096] and, as indicated above, a deposit protection framework is in place to enable timely payout of insured deposits.

(d) Alignment with Key Attribute 4: Set-off, netting, collateralization

The South African resolution regime is aligned with Key Attribute 4 in that the legal framework pertaining to set-off rights, contractual netting and collateralization agreements and segregation of client assets is clear, transparent and enforceable

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[1091] Chapter Five para 5.6.4.4 and 5.6.5.5.
[1092] Proposed section 166L of the Financial Sector Regulation Act.
[1093] Proposed section 166C and section 166R of the Financial Sector Regulation Act. See Chapter Five para 5.6.4.5. and para 5.6.5.5.
[1094] Proposed section 166F of the Financial Sector Regulation Act. See Chapter Five para 5.6.5.6.2.
[1095] Proposed section 166R and 166S of the Financial Sector Regulation Act. See Chapter Five para 5.6.5.6.3.
[1096] Proposed section 166H of the Financial Sector Regulation Act.

during resolution and does not impede the effective implementation of resolution measures. Entry into resolution does not trigger any contractual or statutory set-off rights and does not constitute an early termination event that can entitle a creditor to exercise contractual acceleration or early termination rights. In any event the regime provides for an automatic limited stay on legal proceedings against the failing bank.

(e) Alignment with Key Attribute 5: Safeguards

The proposed South African resolution framework is aligned with Key Attribute 5 that requires resolution powers to be exercised in a way that respects the hierarchy of claims in insolvency and the *pari passu* treatment of creditors of a similar class.[1097] The regime also observe creditors' rights to receive compensation that would at a minimum be what they would have received in liquidation and thus incorporates the "no creditor worse off"-principle required by Key Attribute 5.[1098]

(f) Alignment with Key Attribute 6: Resolution Funding

The proposed South African resolution framework is aligned with Key Attribute 6 by providing in the proposed section 166X of the Financial Sector Regulation Act for recovery by the SARB of temporary funding extended to maintain critical functions of a bank that has been put into resolution.[1099]

(g) Alignment with Key Attribute 10: Resolvability assessments

In alignment with Key Attribute 10 the SARB will conduct resolvability assessments for South African Banks.[1100]

(h) Alignment with Key Attribute 11: Recovery and resolution planning

The proposed South African resolution regime is compliant with Key Attribute 11. As indicated in Chapter 3 South African banks are already since 2015 required to formulate recovery plans in accordance with Directive 1/2015 issued by the SARB.

[1097] Proposed section 166J of the Financial Sector Regulation Act.
[1098] Proposed section 166V of the Financial Sector Regulation Act.
[1099] Chapter Five para 5.6.9.
[1100] SARB Resolution Approach Discussion Paper 13-14.

Under the proposed resolution regime the SARB will also draft resolution plans for banks that will be updated regularly.[1101]

6.5.2.2 Observations regarding guidance

From the above benchmarking exercise it thus appears that the proposed South African resolution regime, once enacted, will be largely compliant with the FSB Key Attributes. It is submitted that Zimbabwe could in particular take guidance from South Africa in relation to how the support by the Deposit Corporation can be garnered in assisting with the resolution process. It may be worthwhile for Zimbabwe to change its Deposit Protection Corporation mandate from a mere "paybox" to a "paybox plus" so that it can be more involved in the bank resolution process.[1102] From a resolution funding perspective Zimbabwe could also consider how the deposit insurance fund can be structured to provide greater funding opportunity during bank resolution. Guidance may also be taken from the proposed South African framework on the provision of legal protection for the RBZ as resolution authority; its employees and the Deposit Corporation in relation to resolution actions they take in good faith.

It may further be useful for Zimbabwe to consult the South African framework, in particular Directive 1/2015, to take guidance on the requirements for recovery plans by banks. The provision made in the South African regime for valuation of assets of a failing bank prior to resolution action to inform any resolution action subsequently decided upon is prudent as is the safeguard of post resolution valuation.[1103]

Like the UK's Purple Book, the SARB resolution approach discussion paper provides some valuable insights into the practical application of the envisaged new resolution regime and Zimbabwe could consider compiling such a type of document to provide guidance on the application of its bank resolution regime.

6.6. Recommendations for the reform of the bank resolution regime in Zimbabwe

Zimbabwe's bank resolution framework can be augmented – in the Banking Act as well as by means of regulations (to flesh out certain of the aspects, such as for example

[1101] Chapter Five para 5.6.4.
[1102] Chapter Three para 3.6.1 and Chapter Five 5.6.5.2.
[1103] Chapter Five para 5.6.5.6.1.

what resolution plans should contain). To address the gaps in Zimbabwe's bank resolution framework as currently captured in the Banking Act, the following recommendations are made that will serve to strengthen Zimbabwe's resolution framework and align it with international best practice:

6.6.1 Recommendation 1

The objective of bank resolution in Zimbabwe should be augmented to also include the continuation of the critical functions as a specific objective.

6.6.2 Recommendation 2

In alignment with Key Attribute 7 the scope of application of the resolution regime in the Banking Act should be extended to also apply to subsidiaries or branches of foreign banks that operate in Zimbabwe.

6.6.3 Recommendation 3

Provision should be made in the Banking Act for banks to compile credible recovery plans within three months after they are licensed, setting out how they will recover if they encounter problems that compromise their safety and soundness. It should also be required that such recovery plans be updated at least annually. Compliance with this requirement should be a condition for ongoing licensing. Failure by banks to comply with this requirement should be viewed in a serious light as it may compromise financial system stability. Consequently the RBZ should be able to direct a non-compliant bank to file a recovery plan, failing which sanctions may be imposed on that bank such as licence revocation and /or an administrative fine. Given the impact on financial stability that failure to compile a recovery plan may have, directors and officials of the bank concerned could also be held accountable by the insertion of a provision in the Banking Act to the effect that any such person who, in any manner, hinders compliance with the requirement to have a recovery plan in place for the bank concerned, is guilty of an offence and subject to imprisonment and a fine.

6.6.4 Recommendation 4

Provision should be made in the Banking Act for the RBZ as resolution authority to compile a resolution plan for a bank within three months after such bank is licensed. The Act should further require banks to provide all information to the RBZ that it needs to enable the compilation of the resolution plan and to provide the RBZ with any assistance it may require for purposes of resolution planning and compiling and updating a resolution plan. Compliance with these requirements should be a condition for ongoing licensing failing which sanctions may be imposed on a bank that does not co-operate with the RBZ in relation to resolution plans. Such sanctions could include licence revocation and/or an administrative fine. Given the impact on financial stability that failure to compile a resolution plan may have, directors and officials of the bank concerned could also be held accountable by the insertion of a provision in the Banking Act to the effect that any such person who, in any manner, hinders compliance with the requirement to have a resolution plan in place for the bank concerned, is guilty of an offence and subject to imprisonment and a fine.

6.6.5 Recommendation 5

The grounds for identifying a bank as a problem bank on which the decision by the RBZ to place that bank in resolution is based, as captured in section 52A(2)(a)-(h) of the Banking Act, can be expanded by adding a "catch all" provision to enable the RBZ to identify a bank as problem bank if it is engaged in any activity that may compromise financial system stability.

6.6.6 Recommendation 6

The resolution regime captured in the Banking Act contains various procedural layers that entail court involvement. Judicial constraints on the resolution process should be eliminated as it may cause delay and costs which are counterproductive to bank resolution. The resolution process should be an administrative process that would enable swift application of resolution measures. Consequently it should not be necessary for the RBZ as resolution authority to approach the court for confirmation of a problem bank determination that serves a trigger for resolution action. In line with best international practice shareholders and other creditors or officials and employees of a bank that is aggrieved by the RBZ's determination that such bank is a problem bank and that it should be put into resolution should not be able to approach a court

for a stay of the resolution process or a setting aside of the determination that it is a problem bank and must be resolved. Provision should be made only for an interested party to approach a court for compensation for any damages it may have suffered as a result of resolution actions taken by the RBZ that were not bona fide and in line with the objective of safeguarding financial stability in Zimbabwe.

It is thus recommended that all the provisions in the Banking Act regarding confirmation of the problem bank notice and steps that may be taken pending the outcome of such confirmation application should be removed.

6.6.7 Recommendation 7

In line with Recommendation 4 the opportunity for the problem bank to make representations to the RBZ in relation to the problem bank determination as envisaged by section 52A(3) should be removed completely (thus also implicating removal of the exception in this regard) given that it may cause delay in the resolution process and can lead to loss of value in the bank concerned.

6.6.8 Recommendation 8

Provision should be made in the Banking Act for the valuation of a problem bank's assets prior to resolution action specifically for purposes of informing the most appropriate resolution action to be taken. Post–resolution evaluation of the problem bank's assets that were transferred should also occur to ensure the payment of fair compensation to shareholders.

6.6.9 Recommendation 9

The requirement in section 52A(4)(e) of the Banking Act that the RBZ must ensure, as far as practicable, that when a person acquires assets of a problem bank then it should also acquire an equivalent value of the problem bank's liabilities, should be removed. This provision is not supported by international best practice and may impede the ability of the RBZ to sell assets of the failing bank to private sector purchasers who may, for good reason, not be interested in acquiring the problem banks liabilities especially if those liabilities led to the problem bank's failure.

6.6.10 Recommendation 10

Whilst it is commendable that the RBZ respects property rights during bank resolution and provides for compensation, the provision in section 52A(4)(c) permitting a person to make application to court in the event that there is a dispute regarding the acquisition of such rights may cause delay and costs and could even derail resolution of the problem bank. Accordingly it is recommended that this provision should be removed.

6.6.11 Recommendation 11

The 90 day time limit for the application of the moratorium in section 54C(4) should be extended to allow for the moratorium against legal proceedings to apply for the duration of the resolution process as the lifting of the moratorium after only 90 days since the curator took control of a problem bank may compromise resolution efforts.

6.6.12 Recommendation 12

The Banking Act should be amended to introduce the bail-in tool to the RBZ's suite of resolution powers. Guidance in this regard can be taken from the UK's 2009 Banking Act and also from the relevant provisions in this regard as proposed in South Africa's Financial Sector Laws Amendment Bill.

6.6.13 Recommendation 13

Provision should be made in the Banking Act to address set-off rights, contractual netting and collateralization agreements and segregation of client assets in terms that are clear, transparent and enforceable during resolution and does not impede the effective implementation of resolution measures. It should further be explicitly stated that entry into resolution does not trigger any contractual or statutory set-off rights and does not constitute an early termination event that can entitle a creditor to exercise contractual acceleration or early termination rights.

6.6.14 Recommendation 14

A provision should be introduced into the Banking Act to stipulate that resolution powers must be exercised in a way that respects the hierarchy of claims in insolvency

and the *pari passu* treatment of creditors of a similar class. Allowance should further be made for departure from the equal treatment of creditors if such departure is necessary in the interest of financial stability or to maximize value for the benefit of the creditors as a group. In addition it should be stipulated that where creditors are to be compensated such compensation will generally observe the “no creditor worse off”-principle and will at a minimum be what they would have received if the bank concerned had been liquidated.

6.6.15 Recommendation 15

Provision should be made in the Banking Act for the establishment of a resolution fund that can be established through annual levies imposed on banks. To boost the fund a specified percentage of all administrative fines imposed on banks for non-compliance with the provisions of the Banking Act could also be apportioned to the resolution fund. Where funds are advanced by the RBZ to facilitate the resolution of a failing bank provision should be made for recovery of such funds post-resolution.

6.6.16 Recommendation 16

In order to facilitate the orderly execution of resolution measures where a failing bank is put into resolution the Banking Act should provide for resolvability assessments of banks to be conducted by the RBZ on an annual or bi-annual basis in order to evaluate the feasibility of each bank’s resolution strategies and the credibility of those strategies.

6.6.17 Recommendation 17

The Banking Act needs to be amended to provide for the necessary protections and immunities for the RBZ personnel in relation to actions and omissions that occur in the course of the bona fide execution of their resolution functions.

6.7 Final remarks

Zimbabwe has been pro-active in acknowledging the need for a more comprehensive resolution framework to deal with failing banks and has made two substantive attempts to put such a framework in place, first by means of the TFIR Act that was later repealed and thereafter by means of the resolution provisions introduced into the Banking Act

by the 2015 Banking Amendment Act. By aligning the resolution framework in the Banking Act with the FSB Key Attributes of Effective Resolution Regimes in those respects where it is currently not aligned, Zimbabwe will be fortifying its resolution framework in line with best international practice. That being said, it is important to ensure that the resolution framework should be fit for purpose bearing in mind the unique country-context of Zimbabwe hence it is important to ensure that any amendments to the current resolution framework are credible and workable in Zimbabwe.

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