

**REPORT OF THE GOVERNOR'S PANEL OF EXPERTS  
TO INVESTIGATE THE S A RESERVE BANK'S ROLE  
WITH REGARD TO THE FINANCIAL ASSISTANCE  
PACKAGE TO BANKORP LIMITED**

**TABLE OF CONTENTS**

	<b>EXECUTIVE SUMMARY</b>	4
1	<b>CHAPTER 1: INTRODUCTION</b>	12
1.1	Terms of reference	13
1.2	Work programme	13
1.3	Structure of the Report	15
1.4	Words of thanks	16
2	<b>CHAPTER 2: BACKGROUND INFORMATION</b>	17
2.1	Synopsis of the political, institutional and economic environment at the time of the S A Reserve Bank's assistance to Bankorp	17
3	<b>CHAPTER 3: CHRONOLOGY OF EVENTS</b>	29
3.1	Synopsis of the growth of and assistance to Bankorp	29
4	<b>CHAPTER 4 (FIRST TERM OF REFERENCE): LEGALITY OF THE ASSISTANCE TO BANKORP</b>	39
4.1	Enquiry into the lawfulness of the S A Reserve Bank/Bankorp/ABSA assistance agreement	39
5	<b>CHAPTER 5 (SECOND TERM OF REFERENCE): REVIEW AGAINST FINANCIAL POLICIES AND PROCEDURES OF THE S A RESERVE BANK</b>	47
5.1	Introduction	47

5.2	Local comparison of assistance at the time	47
5.3	Comparison with principles stated by Dr Stals	51
5.4	Conclusion	54
6	<b>CHAPTER 6 (THIRD TERM OF REFERENCE): ANALYSIS OF INTERNATIONALLY ACCEPTED PRINCIPLES OF BEST PRACTICE IN ASSISTING BANKS IN DISTRESS AT THE TIME OF BANKORP'S ASSISTANCE</b>	56
6.1	Introduction	56
6.2	International policies towards distressed banks from 1973 to 1993	57
6.3	Evaluation of the S A Reserve Bank's assistance packages for Bankorp/ABSA in relation to central bank principles	66
6.4	Questions of motivation	73
6.5	Conclusions	75
7	<b>CHAPTER 7 (FIFTH TERM OF REFERENCE): CONSIDERATION OF RESTITUTION</b>	78
7.1	Possible action by the S A Reserve Bank	78
7.2	Quantification of benefits	79
8	<b>CHAPTER 8 (FOURTH TERM OF REFERENCE): BEST PRACTICE FOR FUTURE CONDUCT</b>	85
8.1	Lender-of-last-resort facilities – current best practice	85
8.2	Current South African practice	90
8.3	Consistency of South African current practice with international <i>best practice</i>	96
8.4	The context of central bank assistance: the regulatory and financial policy architecture	97
8.5	Transparency	107
8.6	Central bank assistance, financial architecture and South African transformation	110
8.7	Conclusions	111

9	<b>CHAPTER 9: CONCLUSIONS</b>	113
10	<b>ANNEXURES</b>	
10.1	Chronology of events	123
10.2	Definitions	132
10.3	Legal opinion on restitution	138
10.4	Documents considered by the Panel	142
10.5	References	152

**REPORT OF THE GOVERNOR'S PANEL OF EXPERTS  
TO INVESTIGATE THE S A RESERVE BANK'S ROLE  
WITH REGARD TO THE FINANCIAL ASSISTANCE  
PACKAGE TO BANKORP LIMITED**

**EXECUTIVE SUMMARY**

From 1985 to 1992 the South African Reserve Bank provided assistance to Bankorp and, for the period 1992 to 1995, to its new owner, ABSA. After the existence of that assistance belatedly became public knowledge, its nature and validity became the subject of controversy which was not resolved.

Consequently, on 15 June 2000 the Governor of the S A Reserve Bank appointed a *Panel of experts to investigate the S A Reserve Bank's role with regard to the financial assistance package to Bankorp* ("the Panel") and instructed it to determine:

- 1 whether the S A Reserve Bank, in providing financial assistance to Bankorp, has contravened the provisions of the S A Reserve Bank Act, No 90 of 1989, or any other Act;
- 2 whether the financial policies and procedures of the S A Reserve Bank with regard to financial assistance have been adhered to in the case of the Bank's assistance to Bankorp;
- 3 whether the S A Reserve Bank's conduct in the provision of financial assistance to Bankorp was in accordance with internationally accepted principles of best practice; and
- 4 guidelines and best practice with regard to possible future conduct of the S A Reserve Bank with regard to banks in distress.

On 16 February 2001 the Panel's terms of reference were expanded to include:

- 5 in the event of a finding by the Panel that the assistance to Bankorp by the S A Reserve Bank was *ultra vires* the power of the Bank, the consideration of whether restitution can be claimed, and if so, the manner thereof.

The Panel interpreted these terms of reference to include the agreement between the S A Reserve Bank and ABSA, concluded in 1994 as a result of the acquisition of Bankorp by ABSA in 1992.

## **Background**

Although the assistance granted to Bankorp/ABSA has been the topic of media speculation over many years and had been investigated previously, the Panel found no definitive findings emanating from these previous enquiries. Accordingly, a major objective of the Panel was to produce a comprehensive Report that would bring about closure of this issue.

The Reserve Bank's assistance to Bankorp under review by the Panel commenced in 1985 during a period of political and economic difficulties in South Africa. The assistance was increased in 1986, reviewed and increased in 1990 and again increased in 1991. The assistance was transferred to ABSA when it acquired Bankorp in 1992, and continued until 1995.

In 1985, South Africa's banking system had been suffering the shock of adjusting to international anti-apartheid sanctions, and Reserve Bank policy was conditioned by the political climate of the period. Whatever the motivation, it is noteworthy that, unlike three quarters of International Monetary Fund member countries (including several highly developed countries) in the past thirty years, South Africa actually experienced no major, system-threatening banking failures during this period.

Although the Panel concluded that the decision to provide financial assistance to Bankorp was justified in the interest of protecting the stability of the domestic banking system, its form and structure was seriously flawed when considered as a whole. It does not match present day standards for central bank assistance, but more important, it did not match the standards set by the contemporary practice of other comparable countries' central banks. Most of the individual undesirable features of the assistance given to Bankorp were also found in the Reserve Bank's assistance to other banks, but their combined application to the extent seen in Bankorp is exceptional.

## Principal findings

Bankorp in 1985 was a bank that had grown fast, partly by absorbing a number of weak banks. Its request for assistance in 1985 was a symptom of potential solvency problems and those underlying problems worsened during the course of the assistance. The Reserve Bank, however, initially gave assistance of a type that could, at best, address a pure liquidity problem and, even then, did not meet the standards of best practice. Subsequent assistance was of a type relevant for a bank facing a remediable solvency crisis, but for that purpose it did not match international good practice. Overall, the assistance was flawed in the following features of form and structure:

- 1 The length of time for which assistance, in the form of successive packages, was given.
- 2 The willingness of the Reserve Bank to accept successive related requests for additional assistance.
- 3 The continuing secrecy with which the assistance was covered even after the danger of systemic risk had passed, owing to the limiting provisions of section 33 of the S A Reserve Bank Act. However, the secrecy provisions of the S A Reserve Bank Act have been amended in 1997 to allow for some form of disclosure.
- 4 The use of a simulated transaction to disguise as a loan the Reserve Bank's assistance which was, in substance, solvency support in the form of a grant or donation.
- 5 The absence of measures to protect the interests of the Reserve Bank and, thereby, the taxpayers, by the Reserve Bank securing a share of the equity of Bankorp in exchange for its capital contribution.
- 6 The failure to give assistance with conditions that would protect the banking system's depositors while penalising the shareholders and management of Bankorp. In fact, the shareholders of Bankorp benefited from the assistance.

- 7 The Reserve Bank's assistance had the effect of conferring benefits on Sanlam's policy holders and pension funds and on the minority shareholders of Bankorp rather than solely on its depositors.
- 8 The failure, for half the duration of the assistance or longer, to monitor effectively the business of the beneficiary, Bankorp.
- 9 The failure to implement methods used successfully in other countries for alleviating banks' bad debt problems, such as creating a special institution to administer delinquent assets.
- 10 Under the S A Reserve Bank Act of 1989 the Reserve Bank was obliged to consult the Minister of Finance on certain matters, e.g. assistance to banks in distress. A meeting to seek the approval of the then Minister for the review of assistance to Bankorp was, in fact, held in 1990. That occasioned a further flaw in the design of the assistance packages since the then Minister, Mr B J du Plessis, was the brother of Mr A S du Plessis, a director of Sankorp, a subsidiary of the majority shareholder (Sanlam) of Bankorp, and indeed of Bankorp itself. Owing to a possible conflict of interests, the Minister should have recused himself from any such participation.

Viewed in their totality, these flaws in the Reserve Bank's methods of assistance to Bankorp/ABSA were of a serious nature. In the Panel's opinion the provision of a grant, using a simulated transaction, implies that the Reserve Bank acted outside its statutory powers, for, judged by international standards as required by section 10(1)(s) of the S A Reserve Bank Act of 1989, that action meant that the function being carried out was not such *as central banks customarily may perform*.

The Reserve Bank's assistance conferred benefits on Sanlam's policy holders and pension fund beneficiaries and on the minority shareholders of Bankorp. That is contrary to public perception published in the media, and contrary to the conclusions of the Heath Special Investigative Unit. Those perceptions and conclusions have incorrectly asserted that major benefits were received by the shareholders of ABSA.

The conclusion that the Reserve Bank acted *ultra vires* leads to a consideration of restitution. It is the view of the Panel that, in principle, restitution from the beneficiaries may be sought, but that it may well be difficult and extremely costly to

achieve through litigation, because of the difficulty of determining the exact class of beneficiaries, apportioning the enrichment and the fact that duly appointed officials of the Reserve Bank made the key decisions.

The flaws in the Bankorp/ABSA assistance also informs consideration of the Reserve Bank's current principles and practice. Today, the Reserve Bank's principles and practice relating to distressed banks and to reform in related areas of the financial architecture are comparable to the highest current international standards.

### **Specific findings**

The Panel's conclusions are discussed in chapters 4 to 8 of the Report, but can be summarised as follows:

**First term of reference:** to determine whether the Reserve Bank, in providing financial assistance to Bankorp, has contravened the provisions of the S A Reserve Bank Act, or any other Act

The first set of agreements concluded between the Reserve Bank and Bankorp in 1985 and 1986 was structured on the basis of a low interest loan. As the S A Reserve Bank Act does not appear to preclude the Bank from charging interest at a rate lower than the market rate the Panel cannot conclude that the S A Reserve Bank acted outside the scope of its powers in concluding these agreements.

However, the agreements of 1990 and 1991 constituted simulated transactions which, in law, amounted to donations of money. There is no legal basis by which the S A Reserve Bank could have entered into such agreements, save if the Bank's actions can be justified under section 10(1)(s) of its Act. This is not the case, as the S A Reserve Bank's assistance did not accord with good international practice and the Bank's assistance was, therefore, *ultra vires*.

The consequence of an unlawful agreement is that it was rendered void *ab initio*. Where one of the parties to the agreement, in the first place, was not authorised to be such a party, the agreement could never have acquired a legal existence.

That being so, the beneficiaries of the assistance packages obtained benefits from the actions of the S A Reserve Bank to which, in law, they may never have been entitled.

**Second term of reference:** to determine whether internal policies and procedures of the Reserve Bank with regard to financial assistance have been adhered to in the case of the Reserve Bank's assistance to Bankorp

The Panel has examined other instances of Reserve Bank assistance to distressed banks that occurred before or during the period in which assistance was given to Bankorp/ABSA. In several cases the structure and form of the Reserve Bank's assistance had features similar to those of the assistance afforded to Bankorp. However, taken as a whole, the assistance to Bankorp was different in that it had features which together were not present in any other single case.

**Third term of reference:** to determine whether the S A Reserve Bank's conduct in the provision of financial assistance to Bankorp was in accordance with internationally accepted principles of best practice

The Panel reviewed internationally accepted principles of best practice for dealing with distressed banks and concluded that the methods used to assist Bankorp were flawed, whether providing liquidity support to Bankorp, as in the early stages of its intervention, or providing solvency support in the early 1990s.

Specifically, the Reserve Bank took no equity claim on the future profits of Bankorp, nor did it attempt to protect depositors by removing Bankorp's bad debts to a special institution charged with managing them separately. Nor did it attempt to organise a merger with a sound banking institution.

The assistance was provided over a period that was unusually long by international standards, as the Reserve Bank acceded to successive Bankorp requests for more assistance. Despite those successive requests, the Reserve Bank only assessed adequately the risks pertaining to Bankorp when further assistance was requested in 1990.

The objective of all the international examples of bank assistance practice and principles reviewed by the Panel was to protect the banking system and its

depositors, and a clear recognition of the undesirability of protecting shareholders. In the Bankorp/ABSA case no such distinction is apparent. In fact the outcome of the assistance was to benefit shareholders, for the net asset value of Bankorp and the price they received when taken over by ABSA was raised by the amount of the assistance.

**Fifth term of reference:** to consider, in the event of a finding by the Panel that the financial assistance to Bankorp by the S A Reserve Bank was *ultra vires* the power of the Bank, whether restitution can be claimed, and if so, the manner thereof

Given the finding that the contracts were illegal, it would not be possible for the S A Reserve Bank to recover any loss under the law of contract. However, another legal avenue is open in such cases, namely on the basis of unjustified enrichment enjoyed by Bankorp/ABSA.

Notwithstanding allegations in the public domain about conspiracies, the Panel did not find any evidence which would have justified such a conclusion. Accordingly, the S A Reserve Bank would not come to court in a position where its previous office bearers were shown to have acted with knowledge of the Bank's lack of legal capacity to enter into such a transaction. Even if this was the case, there would be a compelling argument that public interest favoured restitution to a public institution which had been impoverished and which impoverishment would be for the account of the public.

However, any possible action would be based upon enrichment as opposed to contract where estoppel may be relevant. Thus proof of the existence of a beneficiary would be the critical issue.

The Panel is of the view that ABSA paid for the continued assistance of Bankorp by the Reserve Bank and could not be regarded as beneficiaries of Reserve Bank assistance package. ABSA paid fair value for Bankorp. Due to the complex nature of the impact that the various packages might have had on the value of capital invested in Bankorp, it is difficult for the Panel to assess with accuracy the extent of the benefits derived by Bankorp shareholders. Evidence supports the conclusion that Sanlam, the major Bankorp shareholder was aware that it would have received no value, or less value, for its shareholding absent Reserve Bank assistance.

**Fourth term of reference:** to determine guidelines and best practice with regard to possible future conduct of the S A Reserve Bank with regard to banks in distress

The Panel has concluded that the Reserve Bank's practices for dealing with banks in distress are much improved since the time of the Bankorp assistance packages and are now in line with best practice elsewhere and, if followed consistently, should avoid the dangers encountered by many other countries with less robust approaches. The Panel sees no need, therefore for a new set of guidelines to govern practice in this area.

Nonetheless, the Panel does consider that improvements continue to be needed to the overall architecture. Several countries have claimed that inefficiencies can result from subjecting one financial group of companies or conglomerate to supervision by more than one agency. Some have suggested that this could prove to be the case in South Africa. However, while institutional arrangements need to reflect organisational changes, such as the growth of financial conglomerates within the financial sector, the present arrangements work well and considerable care will need to be taken before disturbing them.

However, one reform which should be immediately considered, is the development of an effective and well designed deposit insurance facility. The Panel recommends that this should be proceeded with now.

It will be important that there be greater transparency of assistance operations once the operational need for secrecy is past. In the Panel's view, the recent amendment to the Reserve Bank Act allows for this, and measures to ensure intervention is fully recorded will make transparency possible.

Finally the Panel recommends the Reserve Bank actively reviews the means by which central bank principles of bank supervision and assistance to distressed banks relate to South Africa's socio-economic priority of transformation. To conclude, the Panel considers that on all the evidence available to it, this Report has brought to light all the material discoverable facts concerning Reserve Bank assistance to Bankorp/ABSA, and that public knowledge of them should end the uncertainty and misinterpretation that has been fuelled by the absence of a rigorous investigation previously.