Chapter 3: Developments relating to banking legislation

3.1 Introduction

A key responsibility of the Department is to ensure that the legal framework for the regulation and supervision of banks and banking groups in South Africa remains relevant and current. Consequently, the legal framework pertaining to banking regulation has to reflect local and international market developments, and to comply with the applicable international regulatory and supervisory standards and best practice. The Department is therefore required to review the banking legislation, that is, the Banks Act, 1990, the Mutual Banks Act, 1993 (Act No. 124 of 1993), the Regulations relating to Banks issued in respect thereof and other pieces of related banking legislation on an ongoing basis and to make recommendations to the Minister of Finance to effect the necessary amendments. Accordingly, this chapter provides an overview of the key initiatives monitored, and developments considered, by the Department in this regard.

In addition, details of proposed amendments to the Banks Act, 1990 and the Regulations relating to Banks are provided, as well as information relating to illegal deposit-taking, the New Companies Act, 2008 (Act No. 71 of 2008), co-operative banks, Postbank and the King report on corporate governance for South Africa. Finally, an overview is provided of the decision of the Board of Review in the review of the Registrar's decision in respect of an application for authorisation to establish a bank.

3.2 The Banks Act, 1990 and the Regulations relating to Banks

The Banks Act, 1990 and Regulations relating to Banks were last amended on 1 January 2008, in the main, to align the South African banking legislative framework with the principles of Basel II. Since then, the Department has been monitoring, among others things, the developments relating to the G-20 discussions and publications and directives issued by the Basel Committee and the FSB on the one hand, and developments relating to the New Companies Act, King III and court decisions, on the other, in order to identify possible areas that would necessitate amendments to the Banks Act, 1990 or the Regulations relating to Banks.

sufficient certainty has been obtained in various areas to crystallise certain proposed amendments

Although finality has not been reached on all the initiatives monitored by the Department, sufficient certainty has been obtained in various areas to crystallise certain proposed amendments to the Banks Act, 1990 and the Regulations relating to Banks.

3.3 Initiatives monitored and developments considered by the Department

3.3.1 International developments related to the global financial crisis

Following the sub-prime and international financial market crisis, and the resultant effects globally, the FSB issued a paper on the causes, effects and regulatory response to the crisis during April 2008. Although South Africa was fortunate in not being directly affected by the primary crisis, it has obviously been affected by the so-called 'second-round' or secondary effects.

The Department has participated in working groups that were established by National Treasury in order to comment on, and implement proposals, made by the G-20 working groups that were established to deal with the causes and effects of the global financial crisis. Thus far, the Department has not identified any issue that would necessitate material amendments to the Banks Act, 1990, although various amendments to the Regulations relating to Banks will be required.

Based mainly on the comprehensive initiatives and strategies of, and the various new, amended or proposed requirements or standards issued by, various international standard-setting bodies, such as the G-20, the FSB and the Basel Committee, the Department identified the internationally agreed strategic focus areas that will, or are likely to, require amendments to the regulatory framework.

Furthermore, since the introduction on 1 January 2008 of the amended Regulations relating to Banks that incorporated, among other things, the requirements of the internationally agreed Basel II framework, the Department had to take various internal policy decisions in respect of certain matters that have to be incorporated into the Regulations relating to Banks, and identified areas in the Regulations relating to Banks that require correction or further clarification.

The Department is in the process of amending its regulatory and supervisory framework to remain aligned with the aforesaid internationally agreed standards, practices or requirements, and to incorporate the aforesaid policy decisions, corrections and clarifications into the regulatory framework.

The Department plans to issue draft documents in 2010 of the proposed amended Banks Act, 1990, and Regulations relating to Banks for review and comment by key role players.

the Department to issue draft documents of the proposed amended Banks Act and Regulations during 2010

3.3.2 Companies Act, 2008 (Act No. 71 of 2008)

The New Companies Act was promulgated in April 2009, but is set to become effective only during the second half of 2010. The Department commissioned external legal consultants to conduct a thorough comparison of the New Companies Act with the Banks Act, 1990 and to advise the Department on the various changes and possible impact on the Banks Act, 1990. The consultants' report will serve as a guide to identify possible amendments to the Banks Act, 1990 in consultation with the banking industry.

3.3.3 Current Directives, Circulars and Guidance Notes

The Department is currently considering the inclusion of previously issued Directives, Circulars and Guidance Notes into either the Banks Act, 1990 or the Regulations relating to Banks.

3.3.4 Board of Review findings

An application for authorisation to establish a bank was refused by the Department. The Registrar's decision was taken on review in terms of section 9 of the Banks Act, 1990 to the Board of Review who, in turn, dismissed the application and upheld the Registrar's decision.

an application for authorisation to establish a bank was refused by the Department

The applicant then applied to the High Court (Pretoria) to have the decision of the Board of Review set aside. The application was, however, dismissed with costs on 24 October 2009. This matter is discussed in greater detail in section 3.11.2 of this report.

3.4 Proposed amendments to the Banks Act, 1990

Please note that **[words in bold and in square brackets]** represent proposed deletions from, and <u>underlined words</u> represent proposed inclusions in, existing provisions of the Banks Act, 1990.

<u>Definitions (Section 1(1))</u>

[“co-operative”]	– replacing the reference to the ‘Co-operatives Act, 1981 (Act No. 91 of 1981)” with the “Co-operatives Act, 2005 (Act No. 14 of 2005)”.
[“Companies Act”]	– changing to reference to the “New Companies Act”.
[“director”]	– amending definition to prohibit banks from using the name “director” in respect of persons that are not duly appointed company directors.
[“holding company”]	– changing in line with New Companies Act.
[“liquid assets”]	– replacing the reference to the Co-operatives Act, 1981 (Act No. 91 of 1981) with the Co-operatives Act, 2005 (Act No. 14 of 2005). – deleting the reference to the Marketing Act, 1968 (Act No. 59 of 1968) which has been repealed. – considering proposals to change the elements within the definition.
[“Registrar of Companies”]	– changing in line with the New Companies Act.
[“Regulations relating to branches”]	– replacing the reference to the *Government Gazette* No. 30627 of 1 January 2008.

<u>Exclusions from the application of the Act (section 2)</u>

The reference to “Public Investment Commissioners” should be changed to “Public Investment Corporation” and the reference to the “Public Investment Commissioners Act, 1984” should be changed to the “Public Investment Corporations Act, 2004 (Act No. 23 of 2004)”.

<u>Review of decisions taken by the Registrar (section 9)</u>

The findings made by the Board of Review and the court’s judgment will be studied to identify possible amendments to section 9 of the Banks Act, 1990.

Annual report by Registrar (section 10)

Amending subsection (2) as follows:

> "(2) The Minister shall **[lay]** table a copy of the report referred to in subsection(1) **[upon the Tables]** in Parliament within 14 days after receipt of such report, if Parliament is then in ordinary session, or, if Parliament is not then in ordinary session, within 14 days after the commencement of its next ensuing ordinary session."

Authorisation to establish a bank (sections 12 and 13)

The findings made by the Review Board and the court's judgment will be studied to identify possible amendments to sections 12 and 13 of the Banks Act, 1990.

Use of the name bank (section 22)

Amend subsection (1) as follows:

> "(1) Subject to the provisions of subsection (2), an institution which is registered as a bank or a foreign institution which is authorized under section 18A to conduct the business of a bank by means of a branch in the Republic or an institution which is registered as a representative office of a foreign institution under section 34 shall not:–
>
> (a) in the case of such bank use, or refer to itself by, a name other than the name under which it is so registered, [or]
>
> (b) in the case of such foreign institution, in respect of the branch concerned use, or refer to the branch by, a name other than the name under which the conduct of the business of a bank in the Republic was so authorised, or
>
> (c) in the case of such foreign institution, in respect of the representative office use, or refer to the representative office by, a name other than the name under which the representative office was so registered,
>
> or any literal translation or abbreviation of such name which has been approved by the Registrar: Provided that the Registrar may, if he or she deems it desirable, authorise the use of a name by which such bank or foreign institution is otherwise generally known."

Cancellation or suspension of registration by Registrar (section 23)

It is proposed that provision be made in the case of a material contravention of the Financial Intelligence Centre Act for the suspension or cancellation of the registration of a bank. The amendment is necessitated by a recommendation made by the FATF in its report following an assessment of AML/CFT measures in South Africa during 2008.

Registration of shares in the name of nominees (section 38)

Subsection (2) to be amended as follows:

"(2) Subsection (1) shall not affect the allotment or issue, or the registration of the transfer, of shares in a bank or controlling company –

(a) [in the name of a trustee of a unit trust scheme as defined in section 1 of the Unit Trusts Control Act, 1981 (Act No. 54 of 1981), or of a nominated company of the trustee approved by the Registrar of Unit Trust Companies;]

in the name of the manager or trustee of a collective investment scheme as defined by section 1 of the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002), or of a nominated company of the manager or trustee approved by the Registrar of Collective Investment Schemes;

(b) in the name of any executor, administrator, trustee, curator, guardian or liquidator in the circumstances mentioned in section 103(3) of the Companies Act;

(c) for a period of not more than six months, in the name of a stock broker [or of a company established by such stock broker for a purpose mentioned in section 12(3) of the Stock Exchanges Control Act, 1985 (Act No. 1 of 1985)] as defined in section 1 of the Securities Services Act, 2004 (Act No. 36 of 2004), or of a company controlled by the bank or of an employee of the bank, if it is necessary that the shares be so allotted, issued or registered in order to facilitate delivery to the purchaser or to protect the rights of the beneficiary in respect of those shares or where the beneficiary is not known;

(d) in the name of a person in other special circumstances determined by the Minister by notice in the Gazette; or

(e) in the name of a central securities depository as **[defined in section 1 of the Safe Deposit of Securities Act, 1992]** provided for in the Securities Services Act, 2004 (Act No. 36 of 2004)

Application of Companies Act to banks and controlling companies (section 51)

The Department expects that the appointed consultants will propose amendments to this section that will conform to the New Companies Act.

Compromises, amalgamations, arrangements and affected transactions (section 54)

The Taxation Laws Amendment Bill, 2009, as introduced by the Minister of Finance on 1 September 2009 contains a provision that aims to amend section 54 of the Banks Act, 1990 as follows:

"90. Amendment of section 54 of Act 94 of 1990, as substituted by section 6 of Act 42 of 1992 and amended by sections 12 and 25 of Act 9 of 1993, Proclamation

No. 132 of 1994, section 36 of Act 26 of 1994, section 5 of Act 55 of 1996, section 36 of Act 19 of 2003 and section 13 of Act 20 of 2007 –

Section 54 of the Banks Act, 1990; is hereby amended by the substitution for subsection (8A) of the following subsection:

"(8A) No transfer duty, **[stamp duty]** securities transfer tax, registration fees, licence duty or other charges shall be payable in respect of –

(a) a transfer contemplated in subsection (8) taking place in the execution of a transaction entered into at the instance of the Registrar in the interest of the effective supervision of banks or the maintenance of a stable banking sector; or

(b) any endorsement or alteration made to record such transfer, upon submission to the Registrar of Companies, or the Master, office or person referred to in subsection (8), as the case may be, of a written confirmation by the Registrar of Banks that the Minister, on the recommendation of the last-mentioned Registrar and after consultation with the Commissioner **[for Inland Revenue]** of the South African Revenue Service has consented to the waiver of such tax, fees or charges."

Directors and officers of a bank or controlling company (section 60)

This Department expects that the appointed consultants will propose amendments to this section that will conform to the New Companies Act.

This Department will prohibit banks from using the title "director" in respect of persons not duly appointed as company directors in terms of the Companies Act, 2008.

Amendments are also considered in respect of the process provided for in subsections (5) and (6) to provide for the Registrar to stay the period in the case where it is necessary to obtain further information.

Appointment of auditor (section 61)

The reference to "Public Accountants' and Auditors' Board" is to be replaced with "Independent Regulatory Board for Auditors".

Functions of auditors in relation to Registrar (section 63)

The reference to "Public Accountants' and Auditors' Board" is to be replaced with "Independent Regulatory Board for Auditors".

Concentration risk (section 73)

It is proposed that section 73 of the Banks Act, 1990 be amended to include the term "major risk exposures" as prescribed by principle 8 of the Core Principles.

3.5 Amendments to the Regulations relating to Banks

The key internationally agreed strategic focus areas that will, or are likely to, require amendments to the regulatory framework and the Department's response thereto are set out in further detail as follows:

	Key international focus area	Bank Supervision Department response or action required
	1. On 13 July 2009, the Basel Committee issued a final package of measures to strengthen the 1996 rules governing banks' trading-book capital and to enhance the three pillars of the Basel II framework.	The Department is in the process of amending its regulatory and supervisory framework and will, in accordance with international agreement, implement the amended Pillar 1 capital requirements and Pillar 3 disclosure requirements on 1 January 2011.
The Basel II enhancements	The Basel II enhancements include • higher capital requirements to capture the credit risk of complex trading activities; • a stressed VaR requirement; • strengthening the treatment for certain securitisations in Pillar 1 (minimum capital requirements); • higher risk weights for resecuritisation exposures to better reflect the risk inherent in these products; • raising the credit conversion factor for short-term liquidity facilities to certain off-balance-sheet conduits; • requirements for banks to conduct more rigorous credit analyses of externally rated securitisation exposures; • supplemental guidance under Pillar 2 (the supervisory review process), that include the FSB's *Principles for sound compensation practices*; and • enhancements to the framework's third pillar (market discipline) to strengthen disclosure requirements for securitisations, off-balance-sheet exposures and trading activities.	The further Pillar 2 supplemental guidance either already forms part of the Department's regulatory and supervisory framework or is in the process of being incorporated. The Department will issue draft documents of the proposed amended Regulations relating to Banks during 2010 for review and comment by key role players.
Pillar 1 and Pillar 3 enhancements	The Pillar 1 and Pillar 3 enhancements must be implemented by the end of 2010, while Pillar 2 risk management standards became effective immediately.	
	2. Raise the quality, consistency and transparency of the Tier 1 capital base. The proposal is to strengthen that component of the Tier 1 capital base which is fully available to absorb losses on a going concern basis, thus contributing to a reduction of systemic risk emanating from the banking sector. For example, under the current Basel Committee standard, banks may hold as little as 2 per cent common equity to risk-based assets, before the application of key regulatory adjustments.	No material amendment to the regulatory framework is currently foreseen in respect of the quality, consistency and transparency of the primary or the Tier 1 capital base. At present South African banks are required to maintain a minimum primary capital or Tier 1 ratio of 7 per cent, well above the Basel II requirement of 4 per cent, with strict requirements related to the qualifying components or composition of the primary or Tier 1 capital base. At present South African banks generally have primary or Tier 1 capital ratios well in excess of the minimum requirement of 7 per cent.

Key international focus area	Bank Supervision Department response or action required
	The Department will continue to monitor international developments regarding the quality, consistency and transparency of the Tier 1 capital base, and amend its regulatory framework when or where necessary.
3. Introduce a leverage ratio as a supplementary measure to the Basel II risk-based framework with a view to migrating to a Pillar 1 treatment based on appropriate review and calibration.	The average leverage ratio of South African banks is less than 20 times, well below the international trend of between 30 times and up to 60 times. At present the leverage ratios of South African banks are being monitored as part of the Department's SREP, but the existing regulatory framework does not prescribe a specific limit in respect of a leverage ratio. Once finalised by the Basel Committee, requirements related to the calculation and limit of a leverage ratio will be incorporated into the regulatory framework. It is envisaged that South African banks are likely to be well within any proposed recommendations or internationally agreed requirement.
4. Develop a framework for countercyclical capital buffers above the minimum requirement.	The current regulatory framework already makes provision for additional capital requirements to be specified in addition to the minimum requirement. Once finalised by the Basel Committee, specific requirements related to countercyclical capital buffers above the minimum requirement will be incorporated into the regulatory framework.
5. Implement strong international compensation standards aimed at ending practices that lead to excessive risk-taking. Compensation should be aligned with prudent risk-taking and long-term, sustainable performance.	The supplemental guidance under Pillar 2 of the Basel II framework, issued by the Basel Committee during July 2009 as part of the enhancements to the Basel II framework, also incorporates the FSB Principles for Sound Compensation Practices, issued by the FSB in April 2009. In September 2009 the FSB published the FSB Principles for Sound Compensation Practices: Implementation Standards.

current regulatory framework already makes provision for additional capital requirements

Key international focus area	Bank Supervision Department response or action required
	The further Pillar 2 supplemental guidance issued by the Basel Committee in July 2009 either already forms part of the Department's regulatory and supervisory framework or is in the process of being incorporated. The requirements related to banks' compensation practices issued by the FSB in September 2009 will be incorporated in the amended Regulations relating to Banks to become effective in January 2011.
	Furthermore, in view of the risk posed by inappropriately structured incentive schemes, the Department focused extensively on remuneration practices during the past years.
	For example, the Department's 2007 *Annual Report* opened with some cautionary remarks on remuneration practices and informed the banking industry of the Department's intention to perform a review on incentive schemes during 2008.
	During 2008, the Department engaged with all South African banks and conducted a thematic review in respect of their compensation schemes which is reported on in paragraph 1.6.3 of this report.
6. Enhance and expand the scope of regulation and oversight of OTC derivative instruments.	The framework used during the aforesaid discussions with banks was similar to the proposals now issued internationally.
	The current regulatory framework contains extensive reporting requirements related to derivative instruments, including OTC derivative instruments.
	Once finalised by the Basel Committee, any relevant further requirements related to OTC derivative instruments will be incorporated into the regulatory framework.
7. Commit to conducting robust and transparent stress tests as required.	The current regulatory framework contains extensive requirements for banks and banking groups to conduct stress testing.
	Furthermore, stress testing is performed by the Department on a "business-as-usual" basis, as part of its SREP.

the Department focused on remuneration practices during the past years

stress testing performed by the Department as part of its SREP

Key international focus area	Bank Supervision Department response or action required
	In addition, the Department's stress-testing methodology is being refined on an ongoing basis. Once finalised internationally, any relevant further requirements related to stress testing will be incorporated into the regulatory framework.
8. Implement minimum global standards for funding liquidity that includes a stressed liquidity coverage ratio requirement, underpinned by a longer-term structural liquidity ratio.	The current regulatory framework contains extensive requirements related to banks' contractual mismatches, "business-as-usual" mismatches and bank-specific stress mismatches, available sources of stress funding, potential concentrations in funding, and explicit minimum requirements related to liquid assets. However, the regulatory framework does not contain minimum requirements related to a stressed liquidity coverage ratio or a structural liquidity ratio. Nevertheless, banks' alignment with the *Principles for Sound Liquidity Risk Management*, issued by the Basel Committee in 2008, was a "flavour-of-the-year" topic that was discussed with banks' boards of directors in 2009. In December 2009 the Basel Committee issued a consultative document titled *International Framework for Liquidity Risk Measurement, Standards and Monitoring* which deals with key measurements including a liquidity coverage ratio, a net stable funding ratio and monitoring tools with regard to liquidity. Once finalised in the course of 2010 by the Basel Committee, these requirements related to a stressed liquidity coverage ratio or a structural liquidity ratio will be considered for incorporation into the regulatory framework. However, ultimately, liquidity in the South African financial sector is mainly a structural matter that is likely to require extensive dialogue between various key role-players such as the National Treasury, the central bank, the Financial Services Board and the Department.

extensive requirements related to banks' contractual mismatches, "business-as-usual" mismatches and bank-specific stress mismatches

liquidity in the South African financial sector is mainly a structural matter

3.6 Illegal deposit-taking

One of the auxiliary functions of the Department is to inspect and investigate persons and institutions suspected of taking deposits from the general public in contravention of the provisions of the Banks Act, 1990.

In brief, the taking of deposits from the general public by persons neither registered as a bank nor falling within or complying with one of the exemptions provided for in the Banks Act, 1990 is a criminal offence. The ultimate prosecution of a person committing a contravention of the Banks Act, 1990 falls within the area of responsibility of the South African Police Service (SAPS) and the prosecuting authorities.

The role and function of the Department in this regard are clearly set out in the Banks Act, 1990. As a creature of statute, the Department is permitted to perform only the duties and functions for which the Banks Act, 1990 makes provision. The Department is afforded certain powers in terms of the provisions of sections 81 to 84 of the Banks Act, 1990 to "control" the activities of unregistered persons. These "activities", however, are confined to illegal deposit-taking.

The rationale for the above-mentioned powers is the following:

it would be irresponsible to allow unregistered persons to take deposits from the general public

- Banks, duly registered in terms of the Banks Act, 1990, may accept deposits from the general public and are subject to strict regulation and supervision in terms of the Banks Act, 1990 and the Regulations relating to Banks. It would be irresponsible to allow unregistered persons to accept deposits from the general public while not registered and not subject to intense regulation. The Department is therefore empowered to institute action against unregistered persons.
- Besides the fact that the acceptance of deposits from the general public by an unregistered person is a criminal offence, such schemes are generally operated on a fraudulent basis and are harmful not only to the established and regulated banking system, but also to the economy as a whole.

In order, therefore, to prevent the development of a secondary illegal, harmful and fraudulent "banking" system, it is necessary for the Department to be afforded the above-mentioned powers. The funds obtained by means of an illegal deposit-taking scheme are sometimes transferred to accounts in other countries in contravention of the regulations pertaining to exchange control and the evasion of taxation provisions is also common place within such schemes.

the Department can act only when complaints are received

Since the Department does not register, regulate or supervise unregistered persons, it is generally not aware of such illegal deposit-taking schemes unless it is informed of them by members of the public and/or other regulators. In general, therefore, the Department can act only when complaints are received, provided that such complaints contain sufficient detail and documentary evidence to justify the Department invoking its powers in terms of the Banks Act, 1990.

In many instances, however, illegal deposit-taking schemes are not reported to the Department, but are handled independently – more often than not without the knowledge of the Department – either by the SAPS in terms of a criminal investigation and prosecution or, when a scheme is liquidated, by the liquidator appointed to wind down the scheme.

In such cases, the Department merely provides assistance when requested to do so. When a scheme has been liquidated, the provisions of the Insolvency Act, 1936 (Act No. 24 of 1936) take precedence over the provisions of the Banks Act, 1990 in respect of the repayment process. However, the Department has the power to recommend to the Master of the High Court whom to appoint as liquidator in cases where the Department is in the process of investigating the scheme in question.

Staff members of the Department were also subpoenaed to provide evidence in court proceedings relating to the prosecution of persons allegedly contravening the Banks Act, 1990. The Department also forwarded information to other regulatory bodies to ensure that all possible contraventions that might have been committed by unregistered persons were brought to the attention of the appropriate authorities. Furthermore, departmental employees gave presentations on illegal deposit-taking as part of the SAPS's course on Commercial Crime Level 11 as well as to prosecutors, at the Commercial Crime Court in Durban.

In the opinion of the Department, the continued prevalence of illegal deposit-taking schemes may be ascribed to factors such as greed, on the one hand, and a lack of financial literacy, on the other, on the part of some investors. Some of the schemes are operated by well-educated individuals in such a manner that the investment opportunity appears to be legitimate. Members of the general public are thus misled and regard such schemes as trustworthy investment opportunities.

schemes are operated by well-educated individuals in such a manner that the investment opportunity appears to be legitimate

The Department has compiled a five-year review of the schemes investigated from January 2005 to December 2009 (refer Table 3.1 and Figure 3.1 below). During the aforementioned period, the Department received 66 new complains relating to illegal deposit-taking schemes, while 27 schemes were carried over from years prior to 2005.

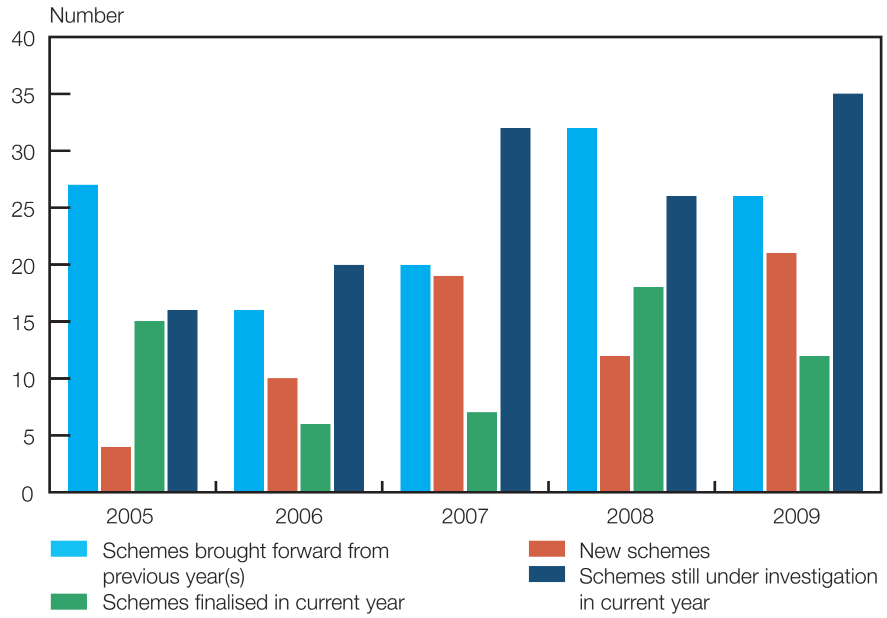
During 2009, 21 new investigations, together with 26 investigations carried over from previous years, were undertaken. Of this total of 47 investigations 12 were completed during this period and 35 still remained under investigation as at 31 December 2009.

during 2009, 21 new investigations were undertaken

Table 3.1 Inspections relating to illegal deposit-taking

Year	Schemes brought forward from previous year(s)	New schemes	Schemes finalised in current year	Schemes still under investigation in current year
2005	27	4	15	16
2006	16	10	6	20
2007	20	19	7	32
2008	32	12	18	26
2009	26	21	12	35

Figure 3.1 Inspection of illegal deposit-taking



However, this information does not project a complete picture of the prevalence of illegal deposit-taking as it only shows schemes that were reported to the Department.

billions of rands are invested in these illegal deposit-taking schemes

Billions of rand are invested in these illegal deposit-taking schemes every year to the detriment of the banking sector and the general economy. In most instances the funds available in these schemes to repay investors are either limited or non-existent. The costs related to the inspection of these schemes are borne by the Department in that it appoints temporary inspectors to assist with the forensic investigation of such schemes. These inspections are funded via the budget allocated to the Department by the Bank.

During the past five years the public invested approximately R13,7 billion in illegal deposit-taking schemes that were investigated by the Department, at an associated cost, as at the date of this report, of approximately R59,3 million in the form of payments to appointed temporary inspectors. These associated costs will further escalate pending finalisation of the investigations pertaining to the number of current schemes as reflected in Table 3.1.

3.7 The New Companies Act, 2008 (Act No. 71 of 2008)

the New Companies Act was signed into law on 8 April 2009

The New Companies Act was signed into law by the President of the Republic of South Africa on 8 April 2009 and gazetted on 9 April 2009. According to General Notice No. 1663 of 2009 dated 22 December 2009 issued by the Minister of Trade and Industry, the Act will come into legal force in 2010 through a proclamation to be issued by the President. The proclamation will provide a specific date on which the Act will come into effect upon which it will repeal the Companies Act, 1973 (Act No. 61 of 1973), subject to transitional arrangements set out in Schedule 5 thereof.

In terms of the provisions of section 5(4)(a) of the New Companies Act, if there is any inconsistency between any provision of the New Companies Act and provisions of the Banks Act, 1990, then the provisions of both Acts apply concurrently to the extent that it is possible to apply and comply with one of the inconsistent provisions without contravening the second. Section 5(4)(b)(i)(gg) of the New Companies Act further provides that in respect of the Banks Act, 1990, to the extent that it is impossible to apply or comply with one of the inconsistent provisions without contravening the second, then the Banks Act, 1990 shall prevail.

It is against this background that the Department mandated an external legal firm in September 2009 to conduct an assessment of the implications of the New Companies Act in relation to the Banks Act, 1990. In terms of the mandate, the external legal firm was required to identify

the Department mandated an external legal firm to conduct an assessment of the implications of the New Companies Act in relation to the Banks Act

- direct conflicts between the New Companies Act and the Banks Act, 1990, and make recommendations on how to resolve such conflicts;
- areas of duplication or overlap between the two Acts and make recommendations on how these Acts should be reconciled; and
- any gaps between the two Acts, being areas in which the exercise by the Registrar of his or her powers and functions will not be effective without amendments to those statutes, as a result of changes to corporate law brought about by the New Companies Act, and make recommendations on how these gaps should be dealt with.

Arising from its assessment, the external legal firm produced a comprehensive matrix of its key findings identifying inconsistent, overlapping and duplicated provisions, and they made recommendations on how to address identified problem areas.

In general, the external legal firm found that the provisions of the New Companies Act and the Banks Act, 1990 could be applied concurrently and that in isolated instances where it was not possible, this should not be problematic because the New Companies Act provided for general provisions governing all companies, whereas the Banks Act, 1990 provided for specific requirements applicable to banks and controlling companies.

In the event that there may be an inconsistency, which may only come to light when the New Companies Act comes into effect, it will be covered by

- section 5(4)(a) of the Companies Act, 2008, as outlined above; and
- section 51 of the Banks Act, 1990, which in effect allows the Companies Act, 2008 to apply to banks and their controlling companies to the extent that such provisions are not inconsistent with any provisions of the Banks Act, 1990.

Preparations are under way to address the inconsistent, overlapping and duplicated provisions identified. The Department will consider the following key provisions:

the Department will consider key provisions

- Implementing legislative amendments to the Banks Act, 1990 where, for example,
  - reference is made to the "Companies Act", which is defined in section 1 of the Banks Act, 1990 as the 1973 Companies Act;
  - reference is made to obsolete terminology in the Companies Act, 1973 which is utilised in the Banks Act, 1990, such as "Registrar of Companies" and "memorandum of association" and be replaced with analogous terminology in the New Companies Act;
  - provisions are defined with reference to the Companies Act, 1973, such as "subsidiary";
  - definitions in the New Companies Act, which have either a wider or a more restricted meaning than in the Companies Act, 1973 and would have a consequential effect on terms used in the Banks Act, 1990, for example, the wider definition of "subsidiary" would have a consequential effect on a term such as "holding company" in the Banks Act, 1990;
  - the New Companies Act contains new definitions not previously included in the Companies Act, 1973; the Department may need to consider whether these terms should be incorporated into the Banks Act, 1990; and

  - the New Companies Act allows companies extensive freedom and flexibility, which may be problematic when applied to the Banks Act, 1990. Similarly, the flexibility in requirements for the passing of special and ordinary resolutions may enjoin the Department to consider a framework for all banks and controlling companies to specify requirements regarding special resolutions in respect of banks and controlling companies.

- Section 51(2) of the Banks Act, 1990 provides that the Minister of Finance (with the concurrence of the Minister of Trade and Industry) may declare by way of notice in a *Government Gazette* that certain provisions of the Companies Act, 2008
  - shall not apply to any registered bank or controlling company;
  - shall only apply subject to adjustments; or
  - the administration of which vests with the Registrar of Companies, shall in respect of companies registered as banks, vest in the Registrar of Banks.

- As part of the consultation process with banks, the Department plans to facilitate a workshop in 2010 to discuss the proposed amendments to the Banks Act, 1990 and other issues concerning the New Companies Act.

<u>Regulations pursuant to the New Companies Act</u>

The Regulations pursuant to the New Companies Act were published for public comment per *Government Gazette* No. 32832, on 22 December 2009. Members of the public were invited to submit their comments by no later than 1 March 2010.

the Regulations provide guidelines to implementing chapters of the Companies Act

According to General Notice 1664 of 2009, the Regulations provide guidelines to implementing chapters of the Companies Act, 2008 and provide details about, among other things,
- reserving, transferring and registering company names, including defensive names;
- what documentation is required when incorporating a company or amending its constitutional documents, together with a number of short and long standard forms of Memoranda of Incorporation for certain different company types;
- the record-keeping requirements for companies, including accounting records to be maintained, information to be retained concerning directors and details of how such records may be accessed;
- the financial reporting standards that apply to different company types and the requirements for “audits” or “independent reviews” of annual financial statements (where applicable);
- how the conversion of par value shares to no par value shares should be dealt with;
- what information must be kept in a company's securities register and in what form;
- the conversion of certificated securities into uncertificated securities and the duties of the company in this regard;
- how the holders of beneficial interests may cast their votes;
- the wide range of senior company personnel who will constitute “prescribed officers” and therefore be subject to the same liabilities to which directors of a company are exposed;
- when a public or state-owned company will be exempted from the obligation to have a social and ethics committee and if not exempted, details regarding such committee’s composition and functions;
- the requirements for offers for the subscription or sale of securities, including details regarding prospectus requirements and contents;
- requirements applicable to fundamental transactions and affected transactions;

- the establishment of a Business Rescue Practice Regulatory Board to regulate the appointment of business rescue practitioners and the required qualifications for a person to be appointed as a business rescue practitioner; and
- how complaints, applications and Companies Tribunal hearings under the 2008 Act are to be made and dealt with.

The Regulations also contain the format of the Memoranda of Incorporation of the different types of companies envisaged in the Act, being profit and non-profit entities. Profit companies include state-owned, private, public and personal liability companies. But companies will not be compelled to make use of these prescribed forms and are free to compile their own document provided that the document is consistent with the Act. No other statutory forms that will be used for the ongoing administration of companies have yet been published for comment.

3.8 Update regarding co-operative banks

The Co-operative Banks Act, 2007 (Act No. 40 of 2007) (CBA) was assented to by the President on 18 February 2008 and published as Government Notice No. 737 in *Government Gazette* No. 30802 on 22 February 2008. The short title of the CBA, however, provides that it will come into operation on a date determined by the Minister of Finance by notice in the gazette, which was 1 August 2008.

The CBA seeks to create a development strategy and a regulatory environment for deposit-taking financial co-operative institutions. The CBA defines a 'co-operative bank' as

> a co-operative registered as a co-operative bank in terms of the Act whose members:–
>
> a. are of similar occupation or profession or who are employed by a common employer or who are employed within the same business district; or
> b. have common membership in an association or organisation, including a business, religious, social, co-operative, labour or educational group; or
> c. reside within the same defined community or geographical area.

Section 54 of the CBA establishes the Co-operative Banks Development Agency (CBDA). On 15 August 2008, the Minister of Finance, acting in terms of section 58 of the Act, appointed the following persons as the board members of the CBDA:

section 54 of the CBA establishes the Co-operative Banks Development Agency

1. Mr Sifiso Mthwalo Ndwandwe (Chairperson): Chief Executive Officer of Mineworkers Development Agency (MDA).
2. Ms Gugulethu Princess Africa (Deputy Chairperson): Regional Manager of South African Revenue Service (SARS).
3. Mr Vishwas Satgar: Executive Director of the Co-operatives and Policy Alternative Centre (COPAC).
4. Ms Daphne Hamilton: Head of Research and Development at the Institute of Bankers.
5. Adv. Neville John Melville: Admitted advocate and a consultant in the Office of the Public Protector.
6. Mr KeaObaka Mahuma: Founder and currently Chief Executive of Grandstone Group, an accounting, tax consulting and transaction advisory services firm.
7. Mr Jan Theron: Practising attorney and a part-time co-ordinator of Labour and Enterprise Project, Institute of Development and Labour Law at the University of Cape Town.

8. Adv. Edith Jabulile Zanele Kuzwayo: Head: Regulations Division of the Bank Supervision Department of the Bank.
9. Ms Nelisiwe Mokoena: Deputy Manager in the Co-operatives Unit at the KwaZulu-Natal Department of Economic Development.
10. Ms Olaotse Matshane: Director of Financial Inclusion in the Financial Sector Development Unit (FSDU) at the National Treasury.
11. Ms Nomvula Masango-Makgotlho: Director of Co-operative Development at the Department of Trade and Industry.

The CBDA is currently housed at National Treasury, 241 Vermeulen Street, Pretoria. Ms Sharda Naidoo is its Managing Director.

The CBA provides for the following four types of co-operative banks:

i Primary savings co-operative bank.
ii Primary savings and loans co-operative bank.
iii Secondary co-operative bank.
iv Tertiary co-operative bank.

the CBDA supervises primary co-operative banks that hold deposits of R20 million or less

The CBDA supervises primary co-operative banks that hold deposits of R20 million or less. Primary co-operative banks that hold deposits of above R20 million, secondary and tertiary co-operative banks are supervised by the Co-operative Banks Division of the Financial Stability Department (FinStab) of the Bank.

For the CBDA, Mr David de Jong was appointed as the Supervisor, while Mr André Bezuidenhout, head of the FinStab, is the Supervisor of the primary co-operative banks that hold deposits of above R20 million, secondary and tertiary co-operative banks.

Among other functions, both Messrs de Jong and Bezuidenhout are responsible for overseeing the registration of new co-operative banks falling within their respective jurisdictions, as well as developing and managing the regulatory guidelines, policies and procedures for monitoring, supervising and regulating co-operative banks.

the Regulations relating to Co-operative Banks were signed into law on 1 July 2009

The Regulations relating to Co-operative Banks were signed into law by the Minister of Finance and came into effect on 1 July 2009.

On 1 July 2009 the draft Co-operative Banks Act Combined Rules were published for public comment in terms of sections 46(1) and 57(1) of the CBA. The rules have now been published as final, and are entitled the Co-Operative Banks Act Supervisors' Rules, as per *Government Gazette* No. 32860 on 12 January 2010. The release of the rules will facilitate the registration of co-operative banks by the CBDA and the Bank.

3.9 Developments regarding Postbank

Postbank operates under an exclusion provided for in section 2(vii) of the Banks Act, 1990

Postbank is a division of the South African Post Office (SAPO) and is currently regulated by the Postal Services Act, 1998 (Act No. 124 of 1998) Chapter VI (sections 51 to 58) of the Postal Services Act, 1998 under the auspices of the Department of Communications. It operates under an exclusion provided for in section 2(vii) of the Banks Act, 1990. The exclusion notice was published in *Government Gazette* No. 13744 of 24 January 1992. It does not operate under a special exemption from the provisions of the Banks Act, 1990, as is erroneously stated in the *White Paper on Postal Policy* of 14 May 1998.

White Paper stipulates the government's intention to restructure its banking interest in the Post Office

The White Paper stipulates the government's intention to restructure its banking interest in the SAPO and proposes that such restructuring should be implemented in a three-phased process:

- Phase I envisages that Postbank would operate as a profit centre providing greater autonomy within the existing divisional structure, and it was further proposed that the savings product range be expanded.
- Phase II envisages that Postbank would operate as a fully owned subsidiary of the SAPO or Government, providing a complete range of payment and funds transfer services, and also to expand the deposit service range.
- Phase III envisages that Postbank would operate as a savings bank that is an autonomous company owned by the SAPO or government and operated as a fully-fledged savings bank extending lending facilities.

What is of importance to note is that the White Paper further envisages that the Bank shall exercise supervisory control over the activities of Postbank in terms of the reporting requirements of the Banks Act, 1990.

An MoU between the then Minister of Finance, Mr Trevor Manuel, and the then Minister of Communications, the late Dr Ivy Matsepe-Casaburri, was signed in 2005 to give effect to the stipulations in the White Paper. The MoU governs the principles and process to be followed in the restructuring and corporatisation of Postbank and includes milestones to be reached until the process is finalised.

To that end, the National Treasury has convened a working committee involving representatives of several stakeholder organisations, including the Department, to process the details, legal issues and practicalities required to complete the project. The milestones identified in terms of the project include
- reaching agreement on the minimum prudential regulatory requirements with the Department and to present them to Postbank;
- establishing an interim regulatory framework pending the promulgation of the Dedicated Banks Bill; and
- registering Postbank in terms of the New Companies Act and listing it as a public entity in terms of the Public Finance Management Act, 1999 (Act No. 1 of 1999).

As part of the first milestone, the Department made a submission setting out the minimum criteria for the registration and supervision of a bank that would also be applicable to Postbank if it were to be registered and supervised by the Department.

minimum criteria for the registration and supervision of a bank would also be applicable to Postbank

As part of the second milestone, the Department, in the same submission as the one referred to above, further outlined the possibility of supervising Postbank by means of an exemption to the Banks Act, 1990, subject to certain conditions that could be supervised by the Department. These conditions included an independent board of directors, appropriate corporate governance structures, appropriate risk management structures, and compliance with the same capital requirements and information systems as those required of banks. These requirements have to date not been met by Postbank.

The process regarding the third milestone is currently under way as the South African Postbank Bill was tabled in Parliament in November 2009. The Department supports the Bill in principle as it believes it will be a first step in the process of corporatising Postbank. However, the Banks Act, 1990 requires that a person conducting the business of a bank must be a public company. In view of the provisions of the New Companies Act which defines “public company” as “a profit company that is not a state-owned company, a private company or a personal liability company”, the Department is of the view that this development could result in amendments being made to the above-mentioned project.

The restructuring of SAPO’s banking interests, and the future legislative and supervisory framework under which it will operate, will be closely monitored by the Department during 2010, with specific focus on the resolution of outstanding legal issues and practicalities required to complete the project.

3.10 The King Report on Corporate Governance for South Africa – 2009

The King Committee is acknowledged to be the standard-setting body for corporate governance in South Africa, and is among one of many such bodies in this regard internationally. The Department monitors, on an ongoing basis, developments emanating from the committee and other such international bodies.

The King III Code will come into effect on 1 March 2010, replacing the King II Code.

The King III Code was inspired by, and its release coincides with, the New Companies Act which is discussed in section 3.7 of this report.

King III Code applies to all entities regardless of the manner and form of incorporation or establishment

In contrast to the King I and II codes, the King III Code applies to all entities regardless of the manner and form of incorporation or establishment, and whether in the public, private or non-profit sectors. All entities, including banking institutions, are expected to apply the principles set out therein and consider the best practice recommendations.

The King III Code applies to entities incorporated and resident in South Africa. The code recommends that foreign subsidiaries of local companies should apply the code to the extent prescribed by the holding company and subject to entity-specific foreign legislation. The King III Code comprises 114 principles covering the following topics:

- Ethical leadership and corporate citizenship.
- Boards and directors.
- Audit committees.
- The governance of risk.
- The governance of IT.
- Compliance with laws, rules, codes and standards.
- Internal audit.
- Governing stakeholder relationships.
- Integrated reporting and disclosure.

According to the King III Code, each principle is of equal importance and, together, will form a holistic approach to governance. The Department is in the process of considering the King III Code in order to determine whether any amendments to the Banks Act, 1990, and/or Regulations relating to Banks would be necessary or appropriate.

3.11 Decision of the Board of Review in the review of the decision of the Registrar in respect of an application for authorisation to establish a bank

In 2006 the Department received an application for authorisation to establish a bank. The Department refused the application on the grounds that the Applicant could not satisfy many of the prescribed requirements.

3.11.1 Board of Review

the Department's decision was taken on review to the Board of Review

The Department's decision was taken on review to the Board of Review (established in terms of section 9 of the Banks Act, 1990) by the Applicant. The Department opposed the application. The hearing of the matter took place on 11 and 12 February 2008, and the decision was delivered by the Honourable Mr Justice F C Kirk-Cohen on Wednesday, 23 April 2008.

The findings were as follows:

- The decision confirmed that the Board's jurisdiction was confined to establish whether or not, in deciding to refuse the application for authorisation to establish a bank, the Registrar exercised his discretion properly and in good faith.
- Whether or not the Registrar acted in "good faith" was never an issue raised by the Applicant and the Board found that it was common cause that the Registrar acted in good faith.
- The only issue that had to be decided upon by the Board was whether or not the Registrar exercised his discretion "properly". The Board not only found that the Registrar had exercised his decision properly, but also that his decision was correct as the Applicant had not complied with the legal requirements in this regard.
- The Board could not set aside or vary the decision of the Registrar where he had exercised his discretion properly (and correctly). More specifically, the Board found that it could not direct the Registrar to grant the Applicant the authority in terms of section 13(1) of the Banks Act, 1990 to establish a bank.
- The Board unanimously refused the review application by the Applicant and confirmed the Registrar's decision.

3.11.2 High Court application

In August 2009 the Applicant brought an application in the High Court (Pretoria) for the review of both the Registrar's and the Board's decisions.

application in the High Court for the review of both the Registrar's and the Board's decisions

The Applicant averred that the Registrar's decision to decline the application for authorisation to establish a bank was "materially influenced by an error of law" and that the decision was "so unreasonable that no reasonable person could have exercised that power or performed the particular function".

In his judgment, the Honourable Mr Justice Bill Prinsloo, however, agreed with the Board's decision and stated that "where bona fides is not an issue, the Board is therefore confined to establishing whether or not, in the taking of the relevant decision, the Registrar exercised his or her discretion properly.".

A key finding in relation to the consideration of an application for the registration as a bank by the Department is to be found in the following remarks made by the judge:

> Counsel for the Registrar point out, correctly in my view, that the Registrar plays a crucial role with regard to the stability and soundness of the South African Banking System. As such his role as "gatekeeper" with regard to the authorisation of prospective applicants to establish a bank is paramount. The Registrar has a duty to ensure that when an applicant ultimately progresses to the stage of consideration for registration as a bank, he can be content that he has taken all reasonable steps to assure himself that the bank will operate successfully as such, and is unlikely to fail or conduct itself in a manner which might place the South African Banking System at risk. These sentiments are in harmony with the provisions of section 13(2) of the Act.

The judge referred to the reasoning of the Department in its conclusion that the application for authorisation to establish a bank by the Applicant should be dismissed and stated that the Board, "in its comprehensive and well-reasoned judgment, came to the same conclusions. I see no basis for interfering with the findings of the Board".

The Applicant's application to the High Court to have the Registrar's decision set aside by the Board was dismissed with costs.