Ex parte:

AFRICAN BANK LIMITED

In re:

INVESTIGATION IN TERMS OF s69A OF THE BANKS ACT, 94 OF 1990

REPORT IN TERMS OF s69A(11) OF THE BANKS ACT

CHAPTER 1 : APPOINTMENT AS COMMISSIONER

1. On 30 August 2014 I was appointed as Commissioner in terms of s69A(1)[1] of the Banks Act, 94 of 1990 (Banks Act) by Mr R van Wyk, the Registrar of Banks (Registrar), for the purpose of investigating the business, trade, dealings, affairs or assets and liabilities of African Bank Limited (under curatorship) (African Bank or the bank) or of its associate or associates. The letter of appointment provided that:

- the Commissioner had the powers and duties provided for in s69A and sections 4 and 5 of the Inspection of Financial Institutions Act, 8 of 1998 (IFIA);
- the Commissioner was required to complete the investigation within a period of five months and was further required within 30 days after the completion of the investigation, to prepare a written report in which, inter alia, should be stated whether or not, in the Commissioner's opinion:

(i) it was in the interest of the depositors or other creditors of the bank that it remains under curatorship;

(ii) it was in the interest of depositors or other creditors of the bank that the Registrar, in terms of s68(1)(a) of the Banks Act, applied to a competent court for the winding up of the bank;

[1] An analysis of the provisions of s69A appears in annexure "A" hereto.

(iii) it appeared that any business of the bank was conducted recklessly or negligently or with the intent to defraud depositors or other creditors of the bank or any other person, or for any other fraudulent purpose, in particular whether the business of the bank involved questionable management practices or material non-disclosure; and

(iv) should it appear that any business of the bank was conducted in a manner contemplated in paragraph (iii), whether or not any person identified by the Commissioner was a party to the conduct of the business of the bank in such a manner.

CHAPTER 2: THE MANNER IN WHICH THE INVESTIGATION WAS CONDUCTED

2. The Registrar subsequently appointed adv V Maleka SC and Mr B Abrahams as assistants to the Commissioner in terms of s69A(1)(b) of the Banks Act. Mr C Moraitis, Ms A Berman and Ms Z Mthiyane of Werksmans acted as instructing attorneys. Ms Z Mshengu and Mr K Mohale of the South African Reserve Bank (SARB) assisted the Commission.

3. The manner in which the investigation was conducted was the following:-

(i) A notice was prepared in which each potential witness was required to prepare a draft statement before a certain date and to provide the Commissioner with a list of names and contact details of any person the witness wanted the Commissioner to interview.

(ii) The notice informed the witness that:

- after the witness had submitted the draft statement, the Commissioner or the assistants might require the witness to deal in the affidavit (referred to below) with matters raised by them;
- at some stage after the submission of the draft statement the Commissioner would give the witness notice to convert the draft statement into an affidavit, which was to be submitted to him on or before the date referred to in the notice;
- at some stage after the delivering of the affidavit the Commissioner would give the witness notice to be examined orally under oath;
- the witness could inform the Commissioner of any facts or matters which the witness wished to bring to his attention;

- the draft statement and the affidavit, as a minimum, had to contain certain information.

4. Meetings were arranged with members of the board of directors and executives of the bank, both past and present, investors, material shareholders, Deloitte and PWC at which the notices were handed out and the procedure explained. All the witnesses agreed to co-operate. In some cases, the notices were emailed to witnesses. With few exceptions, the witnesses were represented by attorneys and, in some cases, by counsel.

5. Before and after the draft statements were received witnesses were asked to amend their draft statements by providing additional answers to questions which were put to them in writing.

6. Documents were obtained from the South African Reserve Bank (SARB), the bank, Deloitte, PWC, witnesses, and others. Copies were made of SENS announcements and media reports. The documents were placed in files and paginated. (References in the footnotes are to the bundle number and the page in the bundle eg AB(22)53.) In total 119 lever-arch files of documents were obtained, and information was provided to the Commission in electronic format. A chronology is attached hereto marked “D”.

7. A search was performed by the Commission team on the contents of the laptops and workstations of the executive members. The electronic data was extracted by PwC using Intella-forensic software used for the extraction and interrogation of data. This data included emails exchanged between the parties concerned, Microsoft documents (Excel, Word, PowerPoint, etc.) and PDF files stored on their computers. The search was confined primarily to the 2012-2014 period. Searches conducted included impairments (including *in duplum*) and liquidity (including capital adequacy) for the bank and the Ellerines transactions (including the sale of the financial services business) for the furniture retailer. Any information relevant to the investigation was printed.[2] Access was electronically obtained to selected working papers of Deloitte.

8. Statements or affidavits were obtained from 51 witnesses. The schedule of witnesses is attached hereto marked "B".

9. Interviews were conducted with 26 witnesses. Their evidence was recorded and transcribed. (The transcript is referred to as "T").

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[2] Files AB(51)-(53)

10. On 12 January 2015 the attorneys representing certain witnesses were given notice that the Draft Report would be made available for comment from 19 to 30 January 2015 at Werksmans between 09h00 and 17h00 on week days. Any comments were to be made on or before 30 January 2015. The attorneys and their clients were required to give an undertaking that the Draft Report would not be copied or removed and that its contents would be kept confidential.

11. The events of the period 19 to 30 January 2015 are dealt with in some detail below. At the end of the period submissions were received from various witnesses (the Submissions) which were inserted in a filed marked E20.

12. The process followed by the Commission was severely criticised by some of the witnesses or attorneys acting on their behalf, for example:-

    12.1 Hogan Lovells, representing Mr Schachat, contended, *inter alia*, in a letter dated 30 January 2015[3] that the process was unfair and fell short of the principles of natural justice; wrong and damaging findings and conclusions of fact and law were made against Mr Schachat without Mr Schachat having been given the opportunity of dealing with the evidence and assumptions upon which the Commission evidently relied on in preference to Mr Schachat's

[3] E(20)4.1

evidence; co-operation between the legal advisors representing different directors was prohibited by the Commission; the purpose of the letter was to record that Mr Schachat maintained that the draft report and any final report which contained the same fundamental flaws as the draft report amounted to and would amount to a failure of justice, which entitled Mr Schachat to challenge the integrity and validity of the report itself.

12.2 Tugendhaft Wapnick Banchetti and Partners (TWB), representing Mr Mabogoane, in a letter dated 30 January 2015,[4] contended that it was impermissible and improper to make findings (contained in the Draft Report) without those findings having been put to Mr Mabogoane when he gave evidence (on 12 November 2014).

12.3 On 30 January 2015, TWB, acting on behalf of Mr Tugendhaft, wrote a letter to the Commission[5] in which they contended that the findings made against their client were improperly made and made contrary to basic principles of natural justice (and hence they sought sight of the Final Report before it was submitted to the Registrar). TWB further contended that findings made against their client were irregular and improper since, in almost every case, no such suggestions were put to him by the Commission

[4] E(20)8
[5] E(20)16

and accordingly he had no opportunity to defend himself against such accusations.

12.4 In a letter dated 30 January 2015,[6] Knowles Husain Lindsay Inc (KHL), representing seven present or former directors of Abil and the bank, contended that any meaningful comment on the Draft Report had largely been frustrated by the Commissioner's and Werksmans' directors (in regard to the terms relating to the inspection of the Draft Report between 19 to 30 January 2015). The obligation on the Commissioner "to observe the principles of natural justice and therefore act fairly were afforded mere lip service."

12.5 Mr Kirkinis submitted an affidavit dated 30 January 2015.[7] He had fundamental objections to the Commissioner's process and the Draft Report. He gave a brief overview of the most "egregious aspects":-

(i) Making the Draft Report available, including findings, was not a fair, just, reliable, adequate or even authorised substitute for fair process. It could not make up for denial of proper and timeous access to the documents and the transcript, the right to question witnesses during the hearings and to make submissions <u>prior</u> to the Commission forming its views and publishing the Draft Report.

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[6] E(20)55
[7] E(20)68

(ii) He was advised that decision-makers were reluctant to change preliminary views that they had firmly formulated, and for that reason the right to be heard required that representations be made to the decision-maker before he made any decision, and not afterwards.

(iii) The unfairness in the process manifested itself when witnesses were shown the incorrect documents during the hearing, had to deal with lengthy and complex documents under huge pressure, were in effect ambushed during the hearings in regard to the sequence of events that took place over seven years ago, and were handled in an unfairly aggressive manner.

(iv) Those misdirections led to wrong findings and tainted the Commission's impression of the credibility, integrity and probity of the relevant directors' conduct.

(v) The Draft Report included derogatory and demeaning descriptions of Mr Kirkinis, eg "hubristic", "delusional", "unrepentant" and "unapologetic". Those descriptions could not be helpful and simply harmed his reputation without justification. Their inclusion brought into question whether the Commission was sufficiently objective and dispassionate.

(vi) Mr Kirkinis and his legal team had not been able, in the time and circumstances, to deal with the Draft Report on a comprehensive basis. The process was not fair.

13. In view of the criticisms of the process that was followed in investigating the affairs of the bank (and the veiled threat of litigation), it is necessary to deal with the law and facts in detail.

14. In terms of s69A(1) of the Banks Act a Commissioner is appointed to conduct an "investigation". "Investigation" is defined as "The action or process of investigating; systematic examination; careful research" (Shorter Oxford English Dictionary, 6th ed); "The activity of trying to find out the truth about something, such as a crime, accident, or historical issue;…" (Black's Law Dictionary, 10th ed); "…a formal or official examination of some specific occurrence or event in a quest for the truth. *Investigation* implies a systematic tracking down of facts and circumstances, typically from a variety of sources, in hopes of putting together an account that answers, as far as possible, what happened." (Garner's Dictionary of Legal Usage, 3rd ed).

15. The powers that are conferred on the Commissioner in terms of s69A of the Banks Act and sections 4 and 5 of IFIA give an insight on how an

investigation in terms of s69A(1) may be conducted. The Commissioner has the following powers:

(i) to examine any person under oath or otherwise who is, or formerly was, a director, servant, employee, partner, member or shareholder of the bank (s69A(5));

(ii) to examine any person under oath or affirmation if the Commissioner has reason to believe that such a person may be able to provide information relating to the affairs of the bank (s69A(5A));

(iii) the power to summon before the Commissioner any such person as the Commissioner may examine in terms of subsection (5) (s69A(7));

(iv) at any time without prior notice to enter and search any premises occupied by the bank and require the production of any document relating to the affairs of the bank (s4(1)(b) of IFIA);

(v) cause to be opened any strongroom, safe or other container in which he reasonably suspects any document of the bank is kept (s4(1)(c) of IFIA);

(vi) examine and make extracts from and copies of any document of the bank or against the issue of a receipt, remove such document temporarily for that purpose (s4(1)(d) of IFIA);

(vii) against the issue of a receipt, seize any document of the bank if the Commissioner is of the opinion that the document contains information relevant to the inspection (s4(1)(e) of IFIA);

(viii) retain any seized document for as long as it may be required for any criminal or other proceedings (s4(1)(f) of IFIA):

(ix) on the authority of a warrant, at any time without prior notice:

(a) enter any premises and require the production of any document relating to the affairs of the bank;

(b) enter and search any premises for any documents relating to the affairs of the bank;

(c) open any strongroom, safe or other container which he suspects contains any document relating to the affairs of the bank;

(d) examine, make extracts from and copy any document relating to the affairs of the bank or, against the issue of a receipt, remove such document temporarily for such purpose;

(e) against the issue of a receipt, seize any document of the bank relating to the affairs of the bank if the Commissioner is of the opinion that the item contains information relevant to the investigation;

(f) retain any seized document for as long as it may be required for criminal or other proceedings, but the

Commissioner may proceed without a warrant, if the person in control of any premises consents to the actions contemplated in this paragraph (s5(1)(b) of IFIA).

16. The investigation in terms of s69A is *inquisitorial*, and not *accusatorial* or *adversarial*, in nature. The difference between the two is highlighted by the respective definitions:

(i) *Inquisitorial:* “2 of a system of criminal procedure in which the judge has the duty to investigate the facts”, *accusatorial*: “of a system of criminal procedure: in which the facts are ascertained by the judge or jury from evidence presented by the prosecution and the defence” (Shorter Oxford English Dictionary);

(ii) *Inquisitorial* system: “A system of proof-taking used in civil law, whereby the judge conducts the trial, determines what questions to ask, and defines the scope and extent of the inquiry”; adversary system: “A procedural system, such as the Anglo-American legal system, involving active and unhindered parties contesting with each other to put forth a case before an independent decision-maker.” (Black’s Legal Dictionary).

17. In considering whether the investigation was conducted in accordance with the rules of natural justice, the following principles are relevant:-

(i) The gist of the rules of natural justice is contained in the maxim *audi alteram partem*.[8]

(ii) According to this rule a party to an administrative hearing or proceeding which may lead to action affecting his or her rights, privileges and liberties, is entitled to present his or her case and must be given an opportunity to do so.[9]

(iii) The duty to act fairly is nothing more than the duty to observe the principles of natural justice expressed in more fundamental terms.[10]

(iv) According to Colman J in Heatherdale Farms (Pty) Ltd v Deputy Minister of Agriculture[11] "…a person who is entitled to the benefit of the *audi alteram partem* rule need not be afforded all the facilities which are allowed to a litigant in a judicial trial. He need not be given an oral hearing, or allowed representation by an attorney or counsel, he need not be given an opportunity to cross-examine; and he is not entitled to discovery of documents. But on the other hand (and for this no authority is needed) a mere pretence of giving the persons concerned a hearing would clearly not be a compliance with the Rule…What would follow…is, firstly, that the person concerned must be given a reasonable time to assemble the relevant information

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[8] LAWSA, 2nd ed, Vol 1 para 107
[9] LAWSA, 2nd ed, Vol 1, para 107
[10] Baxter, Administrative Law, p595
[11] 1980 (3) SA 476 (7) at 486E-G

and to prepare and put forward his representations; secondly, he must be put in possession of such information as well render his right to make representations a real, and not illusory one."

(v) Baxter, supra, comments that Colman J's dismissal of the normal features of a trial, such as cross-examination etc, is put a little too strongly. Everything depends upon the circumstances.[12]

(vi) "Where a duty to observe the *audi alteram partem* rule does arise, it may still be subject to important qualifications. The rules of natural justice are not rigid norms of unchanging content, and their ambit may vary according to the context."[13]

(vii) The procedure followed in the investigation must be judged as a whole in order to determine its fairness.[14]

(viii) A balance has to be struck between fairness and efficiency.[15]

(ix) In Pergamon Press Ltd[16] inspectors were appointed by the Board of Trade to conduct an investigation under the Companies Act 1948 (of the United Kingdom) into the affairs of Pergamon Press Ltd. It was contended on behalf of the directors of the company that they had a right to see the transcripts of the evidence of the witnesses adverse to them;

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[12] p546
[13] de Smith's Judicial Review of Administrative Action, 4th ed, p163
[14] Chairman Board on Tariffs and Trade v Brenco Inc 2001 (4) SA 511 (SCA) para [50]; JR de Ville, Judicial Review of Administrative Action in South Africa
[15] De Ville, supra, p243, Chairman Board of Tariffs and Trade, para19.5
[16] [1970] 3 All ER 535 (CA); referred to with apparent approval by Corbett CJ in du Preez ao v Truth and Reconciliation Commission 1997 (3) SA 204 (AD) at 232G-233B

they had a right to cross-examine; that they ought to see any proposed finding against them before it was included finally in the report; and whenever the inspectors thought of deciding a conflict of evidence or of making adverse criticism of someone, they should draft the proposed passage of their report and put it before the party for his comments before including it. Lord Denning rejected those submissions. He accepted that the inspectors were obliged to act fairly but he emphasised that the inquiry was not a court of law; it was an investigation in the public interest.[17] Having held that the inspectors 'must be masters of their own procedure', Lord Denning continued: "They should be subject to no rules save this: they must be fair. This being done, they should make their report with courage and frankness, keeping nothing back. The public interest demands it. They need have no fear because their report, so far as I can judge, is protected by an absolute privilege."

18. The issue, in simple terms, is whether the process adopted in the investigation was fair, and in particular, whether the *audi alteram partem* rule was applied. In my view the procedure was eminently fair:-

18.1 The context is that the investigation is *inquisitorial*, not adversarial. The investigation is not a court of law.

[17] p539

18.2 The *opinions* expressed by the Commissioner in terms of s69A(11) are not *decisions*. The opinions are not binding on anyone.

18.3 Within the time available to the Commission and with the resources at hand, the Commissioner conducted a detailed and comprehensive investigation. This is apparent from the nature and content of the report.

18.4 A full and detailed enquiry will take place if civil or criminal proceedings are instituted after the investigation has been completed and the report submitted to the Registrar and the Minister of Finance in terms of s69A(12).

18.5 In this investigation the witnesses, except for two witnesses who were not material witnesses and who elected not to have legal representation, were legally represented at all times.

18.6 All the witnesses were given at least two opportunities to present their cases: initially in the draft statements, and subsequently in affidavit form.

18.7 Twenty-six material witnesses were given a third opportunity when they gave oral evidence.

18.8 A fourth opportunity was given to certain witnesses, including all the witnesses whose conduct was criticised, when they were given the opportunity to comment on the draft report.

19. I now deal with the specific complaints in regard to the unfairness of the procedure.

20. The Hogan Lovell's letter, written on behalf of Mr Schachat, contained two complaints:

(i) wrong and damaging findings were made without Mr Schachat's having been given an opportunity to deal with them; and

(ii) co-operation between the legal advisors representing different directors was prohibited by the Commission.

In regard to the second complaint, the Commission did not prohibit co-operation between the legal advisors. In regard to the first complaint, Mr Schachat was given the opportunity to deal with the findings when the Draft Report was made available to him.

21. The TWB letter written on behalf of Mr Mabogoane contended that it was impermissible and improper to make findings without the findings having been put to him when he gave evidence. This complaint crystallises the difference between a civil trial and an investigation. By the time a witness is called in a civil trial, the preparation (or investigation) has been completed and it is possible to put adverse propositions to a witness. In an investigation that is not always possible: new facts and possible findings emerge as the investigation proceeds.

It is impractical to recall a witness every time a possible adverse finding emerges to put it to the witness. One possible way of doing so would be to recall all the witnesses at the end of the process and put the possible adverse findings to them. Another, and just as effective, is to prepare a draft report and give it to the witnesses to comment on it. They can comment, having had the benefit of receiving legal advice. And again: they can do so in their own words and after reflection.

22. The TWB letter written on behalf of Mr Tugendhaft contains a similar complaint. The answer is the same.

23. The KHL letter is mainly directed at a criticism of the terms of which the witnesses and their legal representatives were given access to the Draft Report. The one limitation was that the Draft Report was available only at Werksmans and could not be copied. That limitation was intended to avoid the Draft Report leaking. The Commissioner's report is "private and confidential" in terms of s69A(13). The other limitation, which Mr Knowles of KHL, found particularly irksome was the time limit of two weeks. Firstly, some time limit had to be imposed: if the period was left open-ended the investigation would not have been completed within five months. Secondly, all the witnesses had had two or three opportunities to put their case by then. Thirdly, had Mr Knowles made full use of the two-week period he would have had sufficient time to represent his

clients' interests. According to the records of Werksmans he attended at their offices on one occasion for about two hours with his assistant, Mr Tzarevski, who attended for five hours, and returned on a subsequent occasion for about two hours.

24. In the affidavit of Mr Kirkinis containing his Submissions a number of "fundamental objections" to the process were made:-

(i) *He should have been given access to the documents*. The documents were contained in 119 lever arch files. If Mr Kirkinis was entitled to 119 files of documents, then so was every witness. There were 51 witnesses, of whom 26 were interviewed. The cost of copying that number of files for that number of witnesses would have been prohibitive. In addition, confidentiality needed to be maintained. It bears emphasis that an investigation is not a civil trial. Mr Kirkinis was, however, granted access to the bank for obtaining all the documents he required and he was provided with a harddrive of the contents of his personal laptop.

(ii) *He should have been given the right to question witnesses*. If he had that right then all the witnesses had that right. Eight teams of legal representatives, counsel and attorneys, represented the 26 witnesses who gave evidence. To satisfy this requirement a venue large enough to accommodate eight teams of lawyers and their 26 clients would have to be found; dates would have to be arranged that suited all the lawyers (virtually an impossible task in Sandton); and then each team would have to be given the opportunity to question all the witnesses. It must again be stressed that the process is inquisitorial and confined to a five month period.

(iii) *He should have been entitled to make submissions* <u>*before*</u> *the Draft Report was prepared*. Mr Kirkinis was one of the witnesses who had three opportunities to make his case. He did so at length:-

(a) His first statement was 101 pages long. He provided four lever-arch files of documents, including the statement.

(b) His affidavit, filed subsequently, consisted of 121 pages. He provided three lever-arch files, including the affidavit.

(c) He gave evidence for a whole day – no-one else did. His evidence was recorded on 155 pages of transcript.

(iv) The allegations that witnesses were shown wrong documents and were in effect ambushed are denied.

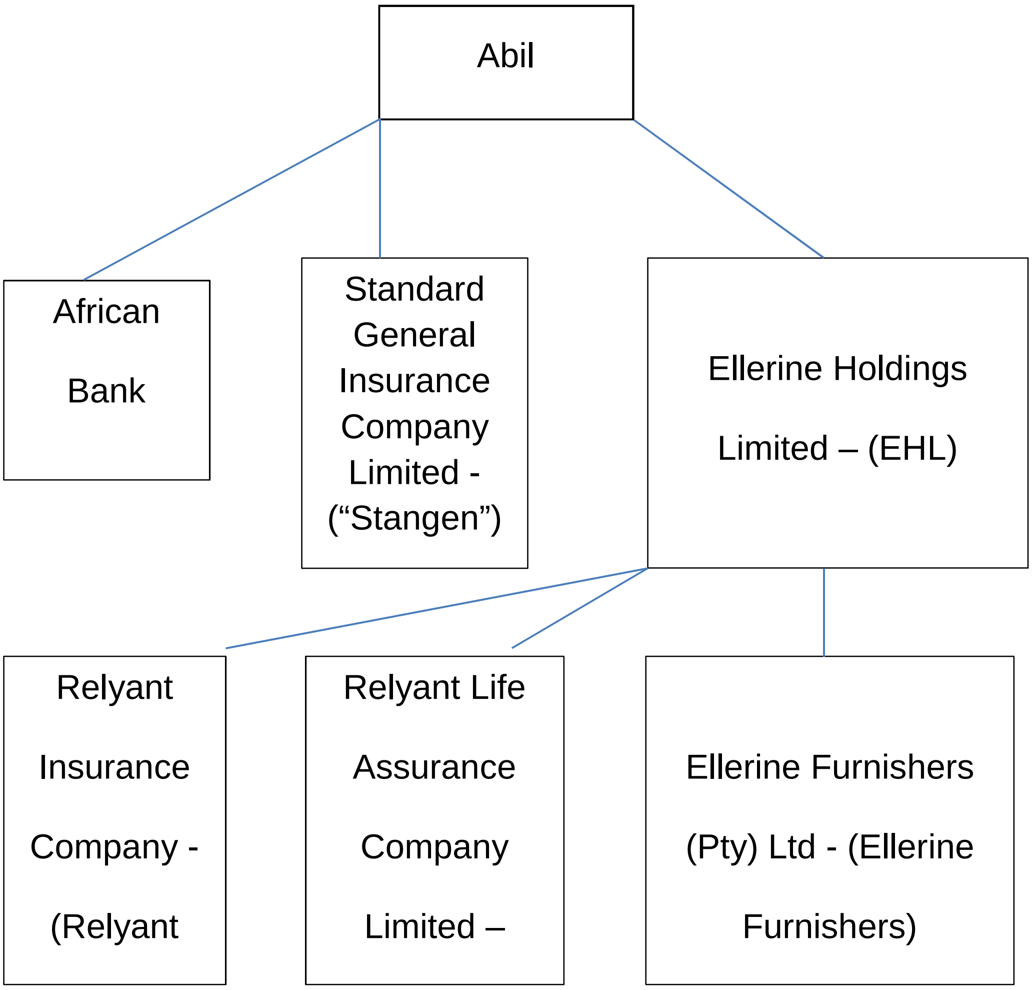
(v) A complaint is that Mr Kirkinis and his legal team could not deal with the Draft Report on a comprehensive basis. In the two weeks made available to the parties: according to the records kept by Werksmans: the attendances were as follows: Mr Kirkinis every day; Ms Wapnick every day but one, but not always for the full day; Mr Ralph of TWB every day for the full day; adv Cane SC every day for the full day; adv Loxton SC on at least three occasions.

(vi) The allegation that the Commission relied on press reports is incorrect.

(vii) The allegation is made that the Commissioner's mandate was to answer the questions put to it and that the remarks made about Mr Kirkinis were not within the ambit of the Commission's mandate. Section 69A(11) is clear that the Commissioner must report "inter alia" on the specified topics. The Commission was obliged to consider the corporate governance of the bank and was entitled to make findings on the role and character of the CEO and directors of the bank.

CHAPTER 3 : AFRICAN BANK

25. African Bank is a wholly owned subsidiary of African Bank Investments Limited (Abil). The Abil group corporate structure is this:



26. According to Abil’s annual report for financial year (FY) 2013,[18] this is the history of Abil and the bank:

1993: formation of Theta Securities

1994: formation of an investment trust with Hollard Holdings

1995: transmuted listing of Baobak Solid Growth Limited

1997: Baobab acquires controlling interest in Altfin, King and Unity Name changed to Theta Group Limited

[18] AB(12)2268

<u>1998</u>: acquisition of African Bank Limited; Boland Bank book acquired for R1,7 billion

<u>1999</u>: Theta Group Limited changed its name to Abil, Stangen was acquired

<u>2001</u>: Abil offered its first retail debit order product; government payroll deductions closed to all credit providers

<u>2002</u>: demise of Unifer and Saambou; Abil acquired the R2,8 billion Saambou personal loans book

<u>2003</u>: Abil achieved investment grade credit rating

<u>2005</u>: Eyomhlaba, Abil's first R600 million black equity ownership programme announced, African Bank launches its price/volume elasticity strategy, with its first set of price reductions

<u>2006</u>: African Bank launches its first credit card; advances of R7,7 billion

<u>2008</u>: Abil acquires the EHL group for R9,1 billion; the credit card portfolio reaches R1 billion; Abil launches its second BEE programme, Hlumisa

<u>2010</u>: Ellerines financial services integrated into African Bank; credit card portfolio reaches R3 billion

<u>2011</u>: African Bank lists USD 300 million maiden bond on the London Stock Exchange

<u>2012</u>: African Bank issues its first Swiss bond; Abil wins The Banker of the Year award

2013: Advances reach R59 billion; Abil announces a R5,5 billion rights offer underwritten by Goldman Sachs International (Goldman Sachs) and sub-underwritten by the International Finance Corporation (IFC), part of the World Bank Group.

To which must be added:

2014: 7 August 2014: Ellerine Furnishers commenced business rescue proceedings

10 August 2014: African Bank was placed under curatorship

27. The history of the bank goes back further than 1993. In 1975 African Bank submitted an application for registration as a general bank to the Registrar. The business was to include the financing of hire purchase transactions and the granting of loans against the security of fixed property or surety bonds. The business of the bank would be conducted via a branch system under the close control of the CEO and the board of directors along traditional conservative lines.[19]

28. Twenty years later, on 9 September 1995, African Bank was placed under the curatorship of Mr John Louw of KPMG. According to Mr Louw the collapse of the bank was as a consequence of the following:-

(i) poor management;

(ii) lack of controls;

[19] E(15)

(iii) poor liquidity management;

(iv) poor credit risk management;

(v) insider abuse;

(vi) fraudulent behaviour.[20]

29. As at 15 March 2014 the bank had 5771 employees, 513 branches, 3 150 985 customers, and 50 depositors.[21]

30. According to Deloitte and Touche (Deloitte)[22], the bank is a mono-line bank, which means that it offers and earns monies from only one product: unsecured loan finance. It does not provide and earn fees from any transactional services. The bank is therefore not a traditional bank. It obtains "wholesale funding" from institutional investors and relies on that to fund its business. The bank offers loans and credit cards to a predominantly formally employed and banked market. The bank maintains a substantial collections infrastructure, such as a call centre comprised of about 1300 employees. The bank is funded through corporate and capital market borrowings. It raises money from the wholesale market by issuing different kinds of debt instruments.

[20] E(15)
[21] SARB(4)293
[22] Deloitte is the statutory auditor of the bank.

31. In a report prepared by the South African Reserve Bank (SARB) dated 12 March 2014,[23] it was said that the bank was regarded as systemic to the South African banking system, mainly on the basis of its extensive client base (over 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 light of the fact that part of its wholesale funding was sourced offshore. Because the bank was a listed company on the JSE,[24] it was much more exposed to any negative publicity, which also affected its peer listed bank operating in the same environment.

32. The risks that were associated with the bank were:

32.1 according to Investec Asset Management:-[25]

(i) <u>credit risk</u> (the extent to which impairments on bad business eroded gross lending margins);

(ii) <u>funding risk</u> (the extent to which wholesale funders were prepared to fund the lending activities of the bank);

(iii) <u>solvency risk</u> (the extent to which there was a sufficient capital buffer to protect the interests of funders in the event of a sharp deterioration in the lending environment);

32.2 according to the PIC:[26]

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[23] SARB(4)260
[24] Johannesburg Securities Exchange
[25] Investec Asset Management (Pty) Ltd
[26] Public Investment Corporation

(i) <u>concentration risk</u> where revenues were dependant on one product line (unsecured lending) with little diversification in the form of more stable transactions business revenues;

32.3 according to Coronation[27:]-

(i) Abil's board did not have sufficient depth and required strengthening;

(ii) Abil's concentration of funding was seen as a risk which it needed to diversify over time;

(iii) Abil's revenue yields had been pulled down too low for the level of risk assumed and therefore needed to be increased and the term of the book shortened so as to restore profitability to appropriate levels;

(iv) the lack of depth in management at a senior level was identified: Abil undertook to strengthen their senior team through new appointments;

32.4 according to Mr Raubenheimer[28] the risks associated with the bank's business model included the following:-

(i) a sole dependence on unsecured credit and, therefore, no differentiation of revenue streams;

(ii) credit risk, i.e. the risk of customers not repaying their loans, which left the business vulnerable to macro-economic events

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[27] Coronation Asset Management (Pty) Ltd

[28] Group Executive : Credit

as well as the bank's customer base being saturated with credit;

(iii) a change in regulation could impact the margins necessary to make the risk that the bank accepted profitable;

(iv) liquidity risk, i.e. the risk that the bank could not obtain the required funding in the market;

(v) operational risk, i.e. the risk that internal controls failed to ensure that initiatives (strategic and factual) were implemented correctly;

(vi) model risk i.e. the risk that decisions were made and implemented based on financial models that did not sufficiently represent the financial reality of such decisions;

(vii) retention risk, i.e. the risk of employees with critical skills resigning from the organisation;

32.5 according to Mr Swanepoel,[29] the risks and the steps necessary to mitigate the risks are the following:

(i) credit risk: underwriting and impairments done with models; effective collections; continual improvement of underwriting models;

(ii) liquidity risk: the need to fund ongoing operations and growth and assets properly manage mismatch risks;

[29] Chief Risk Officer

(iii) capital risk: proper capital models should be sustained; dividends should be limited to grow capital;

(iv) reputational risk: the correct information should at all times be given to investors and stakeholders;

(v) operational risk: cost has to be reduced;

(vi) financial risk: accounting has to improve especially regarding impairment policy so as to give true value of assets

32.6 according to Mr Mthombeni,[30] the risks unique to Abil and the bank can be found in the rights issue circular; many of those risks, especially those relating to the liquidity of the bank, did in fact realise. The risks included the following:-

(i) Abil is exposed to a variety of commercial and market risks and its risk management policies and procedures may fail to adequately manage those risks;

(ii) Abil's net impairment charges may increase as a result of deterioration in the credit quality of its customers or growth in Abil's loan portfolio;

(iii) Abil relies to a significant degree on wholesale funding and any loss of reputation or investor confidence could make it difficult for Abil to access additional sources of funds on acceptable terms or at all;

[30] Independent non-executive director (NED)

(iv) volatility in interest rates may adversely affect Abil's interest income and cost of funds;

(v) Abil is exposed to operational risk;

(vi) Abil may be unable to recruit, retain and motivate key personnel;

(vii) Abil relies on the performance, reliability and integrity of key information technology systems;

(viii) Abil is exposed to the risk of fraud, bribery and corruption;

(ix) any downgrade of the credit rating of the bank or the credit rating of South Africa could have an adverse effect on Abil's liquidity source and cost of funds;

(i) Abil's operations may be disrupted by increased trade union activity in South Africa;

(x) Abil may be adversely affected by a proposed IASB accounting pronouncement on the impairment of financial instruments;

(xi) Abil's financial statements are based in part on assumptions and estimates which, if wrong, could cause losses in the future.

32.7 according to Mr Sithole:[31]

(i) Credit risk: This relates to how the business managed its exposure to credit losses, given that the provision of unsecured loans and credit card finance was the primary financial opportunity for the business. In 2009 the Group had a growth

[31] Former Independent NED and chairman of the Group Audit Committee

target of reaching R75 billion loan size through reduction in yield (interest ratios and insurance income) which would be offset through overall loan book growth achieved by granting new loans to new and existing customers as they become more affordable (economics of scale). This strategy of growing advances appeared to result in poorer loans being granted, resulting in worse bad debts charge than before.

(ii) Capital, liquidity and funding risks: These risks included the ability of Abil to maintain adequate capital levels to safeguard its operations and stakeholders and to allow it to grow as well as to finance its ongoing operations, growth and upcoming maturity commitments.

(iii) Operational risks: This refers to direct or indirect losses resulting from inadequate or failed internal processes, systems or external events.

(iv) Market risks: The main market risks for the bank were interest rate risk and foreign currency risk.

(v) Human capital risk: The attraction, recruitment and retention of top talent is critical to running the business and ensuring that the key activities are efficiently carried out.

(vi) Regulatory compliance risk: A bank is a highly regulated business and it is critical that it is in compliance with all regulations, failing which a bank risks having its licence withdrawn.

(vii) Returns to stakeholders: A business requires adequate returns to stakeholders (shareholders, staff and bond providers) or it will not attract capital to grow the business and retain its staff.

(viii) Responding to competitors' actions and the external environment: The ability for a business to be dynamic and respond to its external environment and/or competitors' actions in a timeous and effective manner is a key risk for a bank.

CHAPTER 4 : THE BANK PLACED UNDER CURATORSHIP

33. On 10 August 2014 Ms G Marcus, the Governor of the SARB, announced that the Registrar and the Minister of Finance had decided to place the bank under curatorship.[32] The Governor said that the Registrar and his team had intensified their active engagement with the management of the bank in late 2012. The concerns they expressed particularly focused on the bank's liquidity; the bank's impairment and provisioning policy; the rapid credit growth; and the need for a strategic rethink of the business model. Given those concerns, regular discussions were held by the Governors with the Banking Supervision

[32] SARB(1)482

Department (BSD) to ensure close monitoring of developments affecting the bank. The meetings commenced in May 2013. The measures taken by the bank as a result of this engagement included:

(i) a higher level of provisioning for non-performing loans (NPLs);

(ii) a review of their provisioning policy;

(iii) a rights issue that raised R5,5 billion in December [2013]; and

(iv) management was requested to dispose of EHL. EHL had been a significant drain on Abil, requiring funding or support of a minimum of R70 million a month.

34. Mr Tom Winterboer was appointed as curator. The curatorship gave SARB the legal means to implement a plan capable of ensuring that the business of the bank gained "a secure perspective for the future as a lending institution with a transformed business model". The bank was to be split into two parts:

(i) a good bank which would be recapitalised with R10 billion, which had a book value of R26 billion nett of portfolio impairments ("the good bank");

(ii) the bad book, with a book value net of specific impairments of R17 billion, for which SARB would pay R7 billion, would be housed in a vehicle with the support of SARB.

CHAPTER 5: SARB

35. SARB is the central bank of South Africa. It derives its authority and status from s223 of the Constitution,[33] is an organ of state, and is imbued with juristic personality in terms of s2 of the SARB Act.[34] The primary objective of SARB is to protect the value of the currency in the interest of balanced and sustainable growth in South Africa.[35] In terms of that primary objective, SARB must perform its functions independently without fear, favour or prejudice.[36]

36. The Banks Act provides for the regulation and supervision of all banks in South Africa. Responsibility for the application and administration of the Banks Act has been assigned to the Office of Banks, more familiarly known as the Bank Supervision Department (BSD), with the Registrar as its head. As head of the BSD the Registrar is appointed and charged with the obligations of performing the functions assigned to him in terms of the Banks Act and the SARB Act.[37]

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[33] Constitution of South Africa Act, 101 of 1992
[34] South African Reserve Bank Act, 90 of 1989
[35] s224(1) of the Constitution
[36] s224(2) of the Constitution
[37] E(15) para 21

37. The BSD is tasked with ensuring a sound, financial stable, well-functioning and internationally competitive banking system. The primary objectives of the banking legislation[38] are, inter alia, to:

(i) ensure a stable financial environment, which is essential for the effective functioning of the economy;

(ii) achieve financial efficiency, and

(iii) ensure depositor protection.

38. In terms of the Banks Act,[39] the Registrar is required to implement and maintain a supervisory review process, which may include:

(i) an on-site examination, inspection or review of a bank or a controlling company and its respective branches, subsidiaries, joint ventures or related entities, within or outside South Africa;

(ii) an off-site review of a bank or controlling company and its respective branches, subsidiaries, joint ventures or related entities, within or outside South Africa;

(iii) discussions with the CEO, an executive officer, or the employee in charge of the risk management function or compliance or internal audit of the bank or controlling companies;

(iv) discussions with a member of the board of the bank or a member of a board-appointed committee of the bank or controlling company;

[38] Banks Act and SARB Act
[39] s4(4)

(v) a review of the work done by the external auditors of the bank or controlling company;

(vi) a review of reports submitted in terms of the Banks Act by a bank or controlling company or banking group.

39. In terms of s63 of the Banks Act:

(i) when the external auditor of a bank furnishes a report in terms of s20(5)(b) of the Auditing Profession Act[40] to IRBA[41] relating to an irregularity or suspected irregularity in the conduct of the affairs of the bank, the auditor is required to furnish the Registrar with a copy and particulars of the report;

(ii) the external auditor is required to inform the Registrar in writing of any matter relating to the affairs of the bank which:

- the auditor became aware in the performance of the auditor's functions as auditor of the bank;
- in the opinion of the auditor might endanger the bank's ability to continue as a going concern or might impair the protection of the funds of depositors or might be contrary to principles of sound management or amounts to inadequate maintenance of internal controls.

[40] 26 of 2005
[41] Independent Regulatory Board for Auditors

40. The Registrar is bound by s89 of the Banks Act to inform the Minister of Finance and the Governor of SARB of any matter that, in the Registrar's opinion, might pose significant risk to the banking sector, the economy, financial stability or financial markets in general.

41. The compliance officer, the risk and capital management committee, and the board of a bank are responsible for ensuring the timely, accurate and meaningful disclosure of the matters material to the business of the bank to the BSD.[42]

42. The BSD exercises its supervisory function by adopting and following the Supervision Review and Evaluation Process (SREP) as contained in the SREP manual to supervise banks in South Africa. The SREP manual is an over-arching manual for both on- and off-site analysis.[43]

43. In line with the BSD"s approach to risk-based supervision, the BSD's supervision of Abil took into account its systemic relevance in relation to the banking industry and also key risk areas such as credit risk, liquidity risk and capital. Meetings were held with the following key people of Abil:

    (i) the CEO on matters such as strategy, budgets and key risk areas of concern;

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[42] s64A

[43] E(15) para 48

(ii) the head of internal audit on matters such as key audit findings relating to internal policies and controls;

(iii) head of compliance on matters such as key compliance issues and matters relating to laws and regulations;

(iv) the board of directors in regard to "flavour of the year" topics, such as unsecured lending, information technology, market conduct, anti-money laundering, and the combating of financial terrorism;

(v) Deloitte, the external auditor of Abil and the bank, on their key findings.[44]

44. In addition to those "in the ordinary course of business" meetings, meetings took place from May 2013 to consider the affairs of Abil and the bank:-

(i) the Project Phoenix meetings which included the Governor, the Deputy Governors, the Registrar, representatives of the BSD, and on occasions the CEO and board of Abil;

(ii) the Registrar held discussions with some of the major banks requesting them to extend their existing deposits/facilities;

(iii) the SARB convened regular meetings between senior officials of SARB and National Treasury to assess the situation on a continual basis;

[44] E(15) para 49

(iv) meetings of the Governors' Executive Committee (GEC);

(v) meetings of the Governors' Committee (GC);

(vi) meetings of a committee within the BSD to focus on the bank's liquidity and ability to attract new funding.

45. The Governors' Committee was established specifically to look into the affairs of the bank, and consisted of the Governor, the Deputy Governors, SARB's general counsel, the Registrar, two deputy Registrars, and the head of SARBs financial market division.

46. The Registrar makes the point in his affidavit that the BSD has a supervisory function only; it does not manage banks; and therefore cannot guarantee their safety. Banks manage the risk to which they are exposed in such a way that they maximise the returns on shareholders' funds. In some cases, the risk appetite of a bank may endanger its ability to recover from the downside of a particular risk, thereby placing depositor's money at risk. A bank may have a successful business model for a number of years, but this does not guarantee that it will continue to do so when conditions change.[45]

[45] E(15) para 382

47. The BSD took the following steps in its oversight role:-

(i) the BSD raised its concerns about the rising levels of impairments at various formal meetings with Abil's executive management and board of directors since August 2011;

(ii) the BSD's concerns about the quality of the loan book and its view of the level of impairment were highlighted to Abil and Deloitte;

(iii) when Abil and the bank ran into difficulties in September 2013 due to losses as a result of impaired loans, the BSD required Abil to develop a credible liquidity and capital plan, which resulted in a successful rights offer;

(iv) the BSD formally requested Abil and the bank to increase the minimum capital adequacy ratio requirement from 20,5% to 25% from 1 January 2014;

(v) on 6 June 2014 the BSD formally requested Abil to dispose of Ellerine Furnishers;

(vi) from August 2013 the BSD monitored the bank's liquidity position on a daily basis.

CHAPTER 6 : THE DIRECTORS

The law

The Banks Act

48. Each director, CEO and executive director of a bank owes a fiduciary duty and a duty of care and skill to the bank of which such person is a director, CEO or executive officer.[46]

49. Each director, CEO and executive officer of a bank owes a duty towards the bank to:
   (i) act bona fide for the benefit of the bank;
   (ii) avoid any conflict between the bank's interests and the interests of such a director, CEO or executive officer, as the case may be;
   (iii) possess and maintain the knowledge and skill that may reasonably be expected of a person holding a similar appointment and carrying out similar functions as are carried out by the director, CEO or executive officer of that bank; and
   (iv) exercise such care in the carrying out of his or her functions in relation to that bank as may reasonably be expected of a

[46] s60(1)

diligent person who holds the same appointment under similar circumstances, and who possesses both the knowledge and skill mentioned in (iii) and any such additional knowledge and skill as the director, CEO and executive officer in question may have.[47]

50. The board of directors and executive officers of a bank shall establish and maintain an adequate and effective process of corporate governance, which shall be consistent with the nature, complexity and risks inherent in the activities of the business of the bank concerned.[48]

51. The process of corporate governance shall be established with the objective of achieving the bank's strategic and business objectives efficiently, effectively, ethically, and equitably (within acceptable risk parameters), to ensure-

(i) compliance with the strategic framework and guidelines established for the bank or controlling company;

(ii) commitment by the executive officers of the bank or controlling company to adhere to corporate behaviour that is universally recognised and accepted as correct and proper;

(iii) a balance of interests of the shareholders and other interested parties who may be affected by the conduct of directors or

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[47] s60(1A)
[48] s60B(1)

executive officers of the bank or controlling company within a framework of affective accountability;

(iv) that mechanisms and procedures are established and maintained to minimise or avoid potential conflicts of interests between the business interests of the banks or controlling company and the personal interests of directors or executive officers of the bank or controlling company;

(v) responsible conduct by the directors and executive officers of the bank or controlling company;

(vi) the achievement of the maximum level of efficiency and profitability of the bank within an acceptable risk profile for the bank or controlling company;

(vii) the timely, accurate and meaningful disclosure of matters that are material to the business of the bank or controlling company or the interests of the shareholders or other persons having an interest in the bank or controlling company;

(viii) that the board of directors retains control over the strategic and business direction of the bank or controlling company, whilst enabling its executives to manage the bank's or controlling company's operations and the achievement of the agreed strategic and business objectives; and

(ix) compliance with all application laws and regulations.[49]

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[49] s60B(2)

52. A bank shall establish and maintain the process of corporate governance in accordance with any requirements that may be prescribed in the Regulations relating to banks.[50]

53. Regulation 40 of the Regulations relating to banks[51] provides:

"(1) Every director of a bank or controlling company shall acquire a basic knowledge and understanding of the conduct of the business of a bank and of the laws and customs that govern the activities of such institutions. Although not every member of the board of directors of a bank or controlling company is required to be fully conversant with all aspects of the conduct of the business of a bank, the competence of every director of a bank shall be commensurable with the nature and scale of the business conducted by that bank and, in the case of a director of a controlling company, as a minimum, shall be commensurable with the nature and scale of the business conducted by the banks in the group.

(2) All directors and executive officers of a bank or controlling company shall perform their functions with diligence and care and with such a degree of competence as can reasonably be expected from persons holding similar appointment and carrying out similar functions as are carried out by the relevant director or executive officer, provided that

[50] s60B(3)
[51] Published under Government Notice R1029 in Government Gazette 35950 on 12 December 2012

none of the provisions or requirements contained or specified in these Regulations, including this regulation 40, shall be construed as derogating from any other relevant provision or requirement relating to directors and executive officers that may be contained or specified in any other law or code of conduct.

(3) In view of the fact that the primary source of funds administered and utilised by a bank in the conduct of its business is deposits loaned to it by the general public, it shall be the duty of every director or executive officer of a bank to ensure that risks that are of necessity taken by such a bank in the conduct of its business are prudently managed.

(4) The-

(a) directors of a bank shall annually report to the Registrar whether or not:

(i) the bank's internal controls-

(a) provide reasonable assurance as to the integrity and reliability of the bank's financial statements; and

(b) safeguard, verify and maintain accountability of the bank's assets;

(ii) the internal controls are based on established policies and procedures and are implemented by trained, skilled personnel, whose duties are duly segregated;

(iii) adherence to the implemented internal controls is continuously monitored by the bank;

(iv) all bank employees are required to maintain high ethical standards, thereby ensuring that the bank's business practices are conducted in a manner that is above reproach;

(v) the bank implemented and continuously maintained compensation policies, processes and practices that, as a minimum, comply with the requirements specified in regulation 39(16)(a);

(vi) anything came to their attention to indicate that any material malfunctions, as defined and documented by the board of directors, which definition shall be submitted to the Registrar, in the functioning of the aforementioned controls, procedures and systems has occurred during the period under review:

(b) directors of a bank shall annually report to the Registrar that there is no reason to believe that the bank will not be a going concern in the year ahead, and should there be reason to believe so, such reason shall be disclosed and explained;

(c) directors of a bank shall submit the reports on the internal controls and going-concern aspect of the bank within 120 days after the financial year-end of the bank;

(d) external auditors of a bank shall annually report to the Registrar whether or not they concur with the reports mentioned in paragraphs (a) and (b) above, provided that when the external auditors do not concur with such reports, they shall provide reasons therefor.

(5) The provisions of subregulation (4) shall mutatis mutandis apply to any controlling company.

(6) For the purposes of this regulation, “director” includes an alternate director.”

Companies Act[52]

54. In terms of s76(3), subject to subsections (4) and (5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of director:

(i) in good faith and for a proper purpose;

(ii) in the best interests of the company; and

(iii) with the degree of care, skill and diligence that may reasonably be expected of a person-

- carrying out the same functions in relation to the company as those carried out by that director; and
- having the general knowledge, skill and experience of that director.

55. Section 76(4) provides that in respect of any particular matter arising in the exercise of the powers or the performance of the functions of director, a particular director of a company-

[52] Companies Act, 71 of 2008

(i) will have satisfied the obligations of subsections (3)(b) and (c) if:

- has taken reasonably diligent steps to become informed about the matter;
- either-

  (aa) the director had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter; or

  (bb) the director complied with the requirements of s75 with respect to any interest contemplated in subparagraph (aa); and
- the director made a decision, or supported the decision of a committee or the board, with regard to that matter, and the director had a rational basis for believing, and did believe, that the decision was in the best interests of the company; and

(ii) is entitled to rely on-

- the performance by any of the persons –

  (aa) referred to in subsection (5); or

  (bb) to whom the board may reasonably have delegated, formally or informally by course of conduct, the authority or duty to perform one or more of the board's functions that are delegable under applicable law; and

- any information, opinions, recommendations, reports or statements, including financial statements and other financial data, prepared to presented by any of the persons specified in subsection (5).

56. In terms of s76(5), to the extent contemplated in subsection (4)(5), a director is entitled to rely on-

(i) one or more employees of the company whom the director reasonably believes to be reliable and competent in the functions performed or the information, opinions, report or statements provided:

(ii) legal counsel, accountants, or other professional persons retained by the company, the board or a committee as to matters involving skills or expertise that the director reasonably believes are matters–

- within the particular person's professional or expert competence; or
- as to which the particular person merits confidence;
- a committee of the board which the director is not a member, unless the director has reason to believe that the actions of the committee do not merit confidence.

King III[53]

57. The following principles are of relevance:-

2.14 The board and its directors should act in the best interests of the company.

2.16 The board should elect a chairman of the board who is an independent non-executive chairman.

2.17 The board should appoint the CEO.

2.18 The board should comprise a balance of power with a majority of non-executive directors. The majority of non-executive directors should be independent.

4.1 The board should be responsible for the governance of risk.

58. The philosophy of the report revolves around leadership, sustainability and corporate citizenship key aspects are:

(i) Good governance is essentially about effective leadership. Such leadership is characterised by the ethical values of responsibility, accountability, fairness and transparency. Responsible leaders direct company strategies and operations with a view to achieving sustainable economic, social and environmental performance.

[53] The third report on corporate governance in South Africa

(ii) Sustainability is the primary moral and economic imperative of the 21st century. It is one of the most important sources of both opportunities and risks for businesses.

The Abil Charter

59. On 19 September 2008 the Abil board adopted a charter. The charter included the following provisions:

"1.2 Good corporate governance is regarded as critical to the success of the business of the Group and the Board is unreservedly committed to applying the fundamental principles of good corporate governance – transparency, integrity, accountability and responsibility – in all dealings by, in respect and on behalf of, the Group.

3.2 The Board should exercise leadership, enterprise, integrity and judgment in directing the Group so as to achieve continuing prosperity for the Group and its shareholders, and shall at all times act in the best interests of the Group in a manner based on transparency, integrity, accountability and responsibility.

3.3 The Board's primary responsibilities include determining the Group's purpose and values and giving strategy direction to the Group, identifying key risk areas and key performance indicators of the Group's business, monitoring the performance of the Group against agreed objectives, advising on significant financial matters and reviewing the performance of executive management against defined objectives and applicable industry standards.

3.4 The Board must specifically:

3.4.1 retain full and effective control over the Group, and monitor management's implementation of the strategic plans and financial objectives as defined by the Board;

3.4.2 define levels of materiality, reserving specific powers to itself and delegating other matters, with the necessary written authority, to management;…

3.4.6 regularly review and evaluate the risks to the business of the Group and ensure the existence of comprehensive, appropriate internal controls to mitigate against such risks;

3.4.7 exercise objective judgment of the business of the affairs of the Group, independent from management but with sufficient management information to enable a proper and informed assessment to be made;

4.2 In determining the optimum composition of the Board, the Board shall seek to ensure that it collectively contains the skills, experience and mix of personalities appropriate to the strategic direction of the Group and necessary to secure its sound performance.

5.1 In discharging their role, directors of the Group must satisfy the following primary requirements. A director must always act:

5.1.1 in good faith, and in a professional manner, having regard to his fiduciary duties and responsibilities to the Group;

5.1.2 independently, in what he personally believes to be the best interests of the Group as a whole;

5.1.3 with the degree of care, diligence and skill that may reasonably be expected from a person of his knowledge and experience;

5.1.4 intra vires, i.e. within the scope of his authority as prescribed by the memorandum and articles of association of the Group; and

5.1.5 as a member of the board

5.4 Executive directors will receive no additional fees, but will be paid as employees of the Group in accordance with their contracts of employment."

<u>The facts</u>

60. As shown in annexure 'C' hereto, in the period 2007 to 2014:

(i) the directors of Abil and the bank were precisely the same;

(ii) the majority of the directors were non-executive directors (NEDs);

(iii) the majority of the NEDs were independent directors;

(iv) Mr Kirkinis was the CEO of Abil;

(v) Mr Kirkinis was the CEO of Abil and the bank, except for the period February 2008 to August 2009 when Mr Woollam was the managing director of the bank.

61. In the period 2007 to 2014:

<u>2007</u>: Mr Steffens and Mr Steele were members of both the Audit Committee and the Risk Committee;

<u>2008</u>: Mr Steele and Mr Adams were members of both committees;

<u>2009</u>: Messrs Adams, Symmonds, Sithole and Steele were members of both committees;

<u>2010</u>: Messrs Symmonds, Adams and Sithole were members of both committees;

<u>2011</u> to <u>2014</u>: Messrs Adams and Symmonds were members of both committees.

62. The boards of Abil and the bank met in the period 2007 to 2014 at the same time, i.e. joint meetings were held.

<u>The qualifications of the directors</u>

63. The directors of the bank were asked for:

(i) their qualifications;

(ii) details of their careers.

64. The executive directors were asked by the Commission what knowledge and skill they had to be directors of the bank.

65. The non-executive directors were asked:

(i) what knowledge and skill they had to be directors of the bank;

(ii) what knowledge they had of banking;

(iii) what experience they had of banking.

66. The directors of the bank as at 30 September 2013 were:

Mr Mogase (chairman)

Mr Kirkinis (CEO)

Mr Fourie (executive director)

Mr Sokutu (executive director)

Mr Nalliah (financial director)

Mr Adams (NED)

Mr Mthombeni (NED)

Mr Symmonds (NED)

Ms Gumbi (NED)

Ms Langa-Royds (NED)

Mr Koolen (NED)

67. Save for Mr Koolen,[54] from whom no statement or affidavit was received, the directors supplied the following information in response to the questions put to them:-

[54] Mr Koolen was too ill to give a statement or affidavit.

68. Mr Mogase

(i) He has a B.Comm degree; attended an executive development programme, and has a diploma in corporate governance.

(ii) During the course of his career he worked at one time for Nedbank Corporate. His duties included analysing financial statements. In 1992 he worked for six months for Chase Manhattan Bank in New York. In 1994 he established the corporate financial function within the commercial section of ABSA. Later, he was asked to establish ABSA's micro-lending business. In 1998 he established Vantage Capital Group.

(iii) He was appointed a NED of Abil and the bank in 2007. In 2009 he was appointed chairman of Abil and the bank.

69. Mr Kirkinis

(i) He has a B.Comm degree; a B.Acc degree and is a chartered accountant (CA).

(ii) In January 1986 he joined UAL Limited, a merchant bank. In June he left UAL Limited to form Theta Securities (Pty) Ltd; in 1997 he became managing director of Theta Limited, which bought African Bank, which was renamed Abil. In addition to being the managing director of Abil, he became the managing director of African Bank.

70. Mr Sokutu

(i) He had the following degrees: B.Sc and BSc Honours (in Botanical Studies); and M.Sc. He attended various courses at Harvard University, the University of the Witwatersrand, and INSEAD.

(ii) He was an academic, lecturing at the University of the Transkei (1989-1991), and then doing research at the University of Cape Town (1991-1992). In 1993 he worked for the African National Congress (ANC). For four months in 1994 he worked for the Development Bank of South Africa. In March 1995 he joined the civil service, first in Mpumalanga, then the Department of Water and Forestry Affairs, until he was appointed Director-General (DG) of the Department of Public Works in 1991, a position he held until 2002.

(iii) In September 2002 he was appointed Chief Operations Officer of African Bank and managing director designate. In May 2003, so he says, he was appointed managing director of the bank and executive director of Abil. Later he was appointed Chief

Risk Officer, and was an executive director of Abil and the bank.

(iv) Mr Sokutu said that while he was not a banker by training he believes that he was appointed as a director of the bank and Abil in recognition of his vast experience in strategic leadership in different organisations and the success he achieved in those positions. His appointment was endorsed by SARB. Also the business leadership was dominated by accountants and bankers, and the business required some diversification in the mix of leadership skills at board level. During the course of his career he moved in different sectors; new sectors in which he had neither prior experience nor qualifications for, and he made a success of what he had to do. He believed that in the Abil group he brought different insights that had been developed over time as a result of his background and career experience. As the Chief Risk Officer he employed his experience from the senior roles he played in the public service where he was responsible for the risks that were associated with achieving the goals of the various departments he worked in.[55]

[55] E(3)135-6

71. Mr Nalliah

(i) He has two degrees and two diplomas. He is a chartered accountant. In January 1987 he joined Deloitte. He became a partner at Deloitte in 1994. He advised on the taxation and commercial aspects of various transactions including acquisitions, mergers, restructuring corporate finance, funding etc and specialised in consulting to financial institutions. Abil was one of his client from about 2003.

(ii) He joined Abil in April 2006 as the Chief Financial Officer (CFO) reporting to Mr Woollam, the then Financial Director. At one time he was the CFO of the bank. He became Group CFO in about January 2008. He was appointed Financial Director of Abil on 5 May 2009.

72. Mr Fourie

(i) He became an executive director of Abil and the bank in November 2003 and held that role until 6 February 2014. He became the CEO of Ellerines on 1 January 2008.

(ii) Mr Fourie stated in his affidavit that at the time of joining he had no technical banking skills. However, given the strategy the bank wanted to follow, he was employed for his skills and experience in general management, marketing, sales, distribution operations, customer centricity and low cost low margin operating models. Any banking/unsecured lending skills were developed on the job over time.

(iii) He commenced his career in July 1981 as an Executive Trainee at Edgars. During his career he worked for Edgars (July 1981-March 1984); OK Hyperama (April 1984 to August 1988); Truworths (September 1988 to December 1989); Checkers (January 1990 to December 1990): Massmart (January 1991 to July 1999); Connection Group Holdings (August 1999 to September 2003). At Massmart he was the CEO of Dion and Group Deputy CEO Massdiscounters. At Connection Group he was the CEO of Software Connection USA.[56] He acquired a BComm studying part time at UNISA.

73. Mr Adams

(i) He has B.Comm and B.Comm (Honours) Financial Accounting degrees. He is not a chartered accountant . He was articled to Deloitte 1982-1985; was a director/partner of Deloitte Management Consultants (1989-1995); was director of the

[56] E(3)154,180

Hollard Group 1995-1996; and then joined Baobab Solid Growth Limited, which became Theta and then Abil.

(ii) From 14 February 2000 to 18 March 2003 he was a NED of Abil and the bank and again from 1 September 2008 to the present.

(iii) His knowledge of banking comes from:

- he was involved in the early days of the credit lending industry and the growth of African Bank from inception;
- his activities and consulting experience gave him good exposure to business management;
- his detailed knowledge of banking as relevant to African Bank has been acquired through initial director orientation, GIBS banking leadership courses; and ongoing exposure to legislative and banking practices.

74. Mr Mthombeni

(i) He became a director of Abil and the bank on 16 September 2013.

(ii) He has the following degrees: B.Juris, B.Proc, LLB and MBA.

(iii) From 1999 to September 2012 he was the CEO of entities within the Momentum Group of Companies: Momentum Manager of Managers (February 1999 to June 2007);

Momentum Group Business (July 2007 to June 2008); Momentum Investments (July 2008 to September 2012). From December 2010 to September 2012 he served on the boards of Momentum Group Limited, Metropolitan Holdings Limited and MMI Holdings Limited.

75. Mr Symmonds

(i) His qualifications are B.Com (Hons), CA.

(ii) He has been the managing director of Lombard Insurance Group since January 2004. For two years he was the CEO of Mercantile Lisbon Bank Holdings Limited, a small retail bank (July 2001 to July 2003): He was a director of Hollard Holdings (Pty) Ltd from January 1999 to July 2001. He was the partner in charge of the Financial Institutions Services Team at Deloitte from September 1997 to December 1999. He was a partner in that team from January 1996 to August 1997.

76. Ms Langa Royds

(i) She has BA and LLB degrees.

(ii) She has had a long career in the corporate world as a human resources (HR) specialist. She has worked in that capacity, for example, for Nampak Ltd and the SABC where she was Chief-Executive, HR. Since March 1994 to the present she has been employed as director/owner of Nthake Consultants CC. For the last 14 years she has served as a NED on various boards.

(iii) She says she has no knowledge of banking other than that obtained during her tenure on the Abil board. She has no experience of banking.

77. Ms Gumbi

(i) She has B Proc and LLB degrees.

(ii) She was a NED of Abil and the bank from 1 March 2011 to 10 August 2014.

(iii) She describes her experience of banking in these terms:

"My experience of banking is quite varied. Mr first real contact with issues relating to banking was when the bank in my hometown, refused to extend a loan to my Mother, which money she needed to pay for my sister's schooling. I did not understand the reasons for such refusal, in light of the fact that she held freehold title to a large farm, which she put up as collateral. I only got to know much later that her farm was a target for illegal repossession by the apartheid regime, a fact which the bank must have known about, while my family was in the dark. This unpleasant experience led to my interest in finding out how banks operate. Especially why poor people are regarded as having a higher risk profile by virtue only of their poverty.

My further involvement with banking was at the global level, when I served as the Personal representative of then President Thabo Mbeki on the G8 Plus Five Group and we worked on developing policies around more effective banking regulation, in light of the developing problems in the global banking system at the time particularly in the southern European countries.

I also worked with a team to create a banking product which leveraged pension funds on the African Continent to create a fund which we finally placed with the African Development Bank in Tunisia, created for inter-State infrastructure programmes.

I am currently working on a project for the United Nations Economic Commission for Africa which, among others, examines how banks facilitate the movement of illicit funds. In this regard, I have been investigating the implementation by banks of legislation which is meant to flush out illegal money, such as the Dodd-Frank Act in the United States. In the work I am doing, I have been working with Central Bank Governors from across the world."

Former directors

78. David Gibbon

(i) He was a director of Abil and the bank from 1 July 2003 until 31 March 2011. He was an independent non-executive director. Throughout that period he was the chairman of the Group Audit Committee and a member of the Directors' Affairs Committee.

(ii) He is a Chartered Accountant (CA) who was an audit partner of Deloitte from 1972 until he retired in 2003. Prior to retiring from Deloitte he was the lead partner for NBS Bank, which later became NBS Boland Bank, which became BoE Bank. He was the lead audit partner for Marriott Merchant Bank and the Bank of Baroda.

(iii) He is currently an independent non-executive director of the insurance companies in the Abil Group and in the Bidvest Group.

79. BPF Steele

(i) He was a director of Abil and the bank from July 2003 until May 2009. He was an independent non-executive director. He was a member of the Group Audit Committee, the Group Risk

Committee, the Directors' Affairs Committee, and a committee he described as the "BEE Committee".

(ii) He is a CA with an MBA from the Stanford University. He was employed by Barlow Group Limited from 1980 to 1993, he was the Group Financial Director of Malbak Limited from 1993 to 1997 and Group Financial Manager of Barloworld Limited from 1997 to 2002.

80. David Woollam

(i) He joined Abil on 1 November 2002 as Group Financial Director of Abil, Financial Director of the bank, and a director of Stangen. In October 2006 he handed over his responsibilities to Mr Nalliah, but retained his directorships. He was appointed managing director of the bank in February 2008, a position he retained until August 2009. He remained a director of Abil and the bank. He continued to serve on the Abil Exco. During 2009 and 2010 Mr Woollam was off work from time to time due to ill health. He resigned as director of Abil and the bank in December 2010.

(ii) He is a CA with B.Comm and B.Acc degrees. In the early 1990s he moved from the accounting profession into the City of London where he worked for various international investment banks. In 1999 he returned to South Africa to join BoE Bank Ltd as Chief Financial Officer (CFO). He subsequently became the CFO of the holding company, BoE Limited. In 2001 he was appointed as an executive director of BoE Limited. His portfolio included executive responsibilities for the BoE Bank treasury division, which managed both the funding of the bank and its trading activities.

81. Ashley Tugendhaft

(i) He is a practising attorney with the BA LLB degrees, who has been an attorney since 1973. He was the managing director, and later chairman, of Moss Morris. In October 2004 he established TWB. Over the years he has been a non-executive director of listed and private companies. He was a member, and for some years chairman of the audit committee, the risk committee, and the remuneration committee of Imperial Holdings Limited (Imperial) and the audit and risk committee of Pinnacle Technology Holdings (Pinnacle). He is currently a member of the social ethics and transformation committee and the remuneration and nomination committee of Imperial and the remuneration committee of Pinnacle.

(ii) He was appointed a NED (not an independent NED) of Abil and the bank on 1 April 2003 and retired on 31 March 2011. He was chairman of the Group Remuneration and Transformation Committee from 28 March 2006 to 6 November 2008; member of the Group Risk and Capital Management Committee from 2 September 2003 to 15 February 2011; and member, and later chairman, of the Directors' Affairs Committee from 17 March 2004 to 24 February 2011.

82. Ashley Mabagoane

(i) He became a NED and chairman of the boards of Abil and the bank on 19 November 1999. He resigned on 1 April 2009. He served on the committees he described as the Remuneration Committee, the human resources and transformation committee, and the Directors' Nominations Committee (Directors' Affairs).

(ii) He matriculated in 1976. He holds a Diploma in Business Management. His business career started as a salesman for Africhem (Pty) Ltd, a cosmetic manufacturing company in Springs. He became Sales and Marketing Manager, and later a director. Thereafter he joined Norton Abrasives (Pty) Ltd in their marketing division. He was later promoted to Product

Engineer : Coated Abrasives. About 20 years ago he joined the South African Black Taxi Association (SABTA) as a marketing manager. In April 1993 he became the Group Marketing Director of the Fabcos Group. He was appointed CEO of Fabcos Investments (Pty) Ltd. In 1996 he and four others formed an investment company, New Seasons Investments Holdings Limited. He has served on the boards of listed and unlisted companies.

(iii) He says he did not possess any specific banking skills at the time of his appointment as NED and chairman of Abil and the bank, but he had extensive business management skills and experience particularly at board level which qualified him to be appointed a director of African Bank.

83. Gordon Schachat

(i) He was appointed as the Executive Deputy Chairman of Abil and the bank on 3 May 1999. He held those positions until his retirement on 30 September 2012.

(ii) He attended university but did not complete a degree. From 1973 to 1981 he worked for Schachat Cullum (Pty) Ltd, a company in the construction industry. He started as a bricklayer, then became manager of a branch, then became involved in marketing, sales strategy and methodology. Between 1981 and 1986 he was involved in the designing, developing and installing Construction Computing Solutions software. Between 1986 and 1997 he 'partnered' a broad range of skilled entrepreneurs providing mentoring, strategic impact and capital.

(iii) He was one of the founding fathers of Abil and the bank.

(iv) Mr Schachat did not have an office at the bank, nor did he work there. He mainly discharged his duties from his office in Oxford Road, Forest Town. He stated that he attended at the offices of the bank frequently where he interacted with his fellow directors, and mainly with Mr Kirkinis. He also spoke to him telephonically on a daily basis. His experience and the contribution he made were of a strategic nature. Part of his role was to identify talented and skilled individuals who were able to contribute positively to the business of the bank such as Messrs Woollam, Chemel, Mogase, Mabogoane, and Symmonds.

(v) At his interview Mr Schachat was asked for his contracts of employment with Abil and the bank. He did not have a copy of either contract. He said he had signed a contract of employment with the bank two or three years after he was appointed Executive Vice Chairman.[57] The Commission

[57] T566-7

requested the bank to provide a copy. The bank was unable to find the contract of employment. Mr Schachat suggested that SARB be approached for a copy. The Commission did so. SARB could not find the contract of employment.

84. Samuel Sithole

(i) He was an Independent NED of the Abil and bank boards from 21 May 2009 until 16 September 2013. He became chairman of the Group Audit Committee.

(ii) He was an audit partner with Deloitte from 1 June 2004 to 31 May 2008. During that period he was a partner on the audits of Abil and its subsidiaries for FY2005, FY2006, FY2007, serving as lead audit partner in 2006 and 2007. In mid-2008 he was appointed FD of Brait SE, a position he still holds.

<u>The remuneration of the directors</u>

85. The directors were asked for full details of their remuneration. This is the information they supplied:-

Mr Mogase (Chairman)

86. For FY2014 he received R1 548 750, the same as for FY2013. That was the total for serving on the boards of Abil and the bank and on the Group Committees.

Mr Kirkinis (CEO)

87. His remuneration, he said, was the following:

1/11/2006 – R3 000 000

1/11/2007 – R3 500 000

1/11/2008 – R2 500 000

1/11/2009 – R1 500 000

1/10/2009 – R3 500 000

6/8/2014 – R251 961 (leave pay)

88. He stated that his salary had remained largely unchanged since January 2010. This was because he held the view that he was adequately compensated by way of dividends due to the success of the business. Mr Kirkinis did not initially say what amount of dividends he had received. When he was requested to provide details of the dividends his attorneys, TWB, provided the following information: dividends received in his personal capacity in total R49 636 917,20; dividends

received by the Ubombo Trust, of which he is a beneficiary and trustee, in total R236 511 643,30; dividends received by the Ubombo Developments Trust, a charitable trust of which he is not an income beneficiary, but is a capital beneficiary, in total R7 811 400.[58] Excluding the last trust, the total of the dividends received by Mr Kirkinis and the Ubombo Trust is R286 148 5650,50 (R286 million). In TWB's letter the Commission is requested to note that Mr Kirkinis, in his personal capacity as well as in his capacity as a beneficiary and trustee of the Ubombo Trust has seen the value of his and that trust's investment in Abil fall from a peak of about R650 million to a present value of R7 million.

Mr Fourie (Executive Director)

89. Mr Fourie's remuneration consisted of salary, an annual incentive, and LTIP payments. He commenced employment in October 2003 at an annual salary of R1,7 million. As at 1 October 2011 his annual salary was R4,4 million. His annual incentives were R1,6 million (2005); R2 million (2006); R2 million (2007); R1,5 million (2008); R1 million (2009); R1,04 million (2011) and R900 000 (2012). The total amount of LTIP payments he received each year was approximately R5,8 million (2005):

[58] E(10)230.1

R9,8 million (2006); R16,3 million (2007); R5,4 million (2008); R4,6 million (2009); R11,4 million (2010); R3,2 million (2011); R4 million (2012).[59] According to Mr Nalliah[60] the total gain Mr Fourie made on the exercise of share options in FY2007 was R10 840 000.

Mr Sokutu (Executive Director)

90. Mr Sokutu provided a schedule which dealt with "Salary Adjustments" and amounts realized from sales of share options and LTIP[61] payments. His "Salary Adjustment" for each year was the following:

1/9/2002	R1 500 000	
1/8/2003	R1 600 000	
1/10/2003	R1 700 000	
1/10/2004	R1 768 000	
1/10/2005	R1 856 400	
1/11/2005	R1 300 000	(Annual Incentive)
1/11/2005	R1 300 000	(Annual Incentive)
1/10/2006	R1 967 784	
1/11/2006	R1 400 000	(Annual incentive)
1/11/2006	R1 400 000	(Annual Incentive)
1/10/2007	R2 105 529	

[59] E(3)181
[60] Submissions E(20)48
[61] Long Term Share Incentive Programme

1/11/2007	R1 450 000	(Annual Incentive)
1/11/2007	R1 450 000	(Annual Incentive)
1/4/2007	R2 800 000	
1/10/2008	R2 996 000	
1/11/2008	R1 087 500	(Annual Incentive)
1/10/2009	R3 175 760	
1/11/2009	R900 000	
1/10/2010	R3 302 790	
1/10/2011	R3 500 964	
30/11/2011	R1 000 000	(Annual Incentive)
1/11/2012	R700 000	(Annual Incentive)

91. Adding the "Salary Adjustment" to the "Annual Incentive", Mr Sokutu earned the following:

2005	R4 456 400
2006	R4 767 784
2007	R5 005 529
2008	R6 883 500
2009	R4 075 760
2010	R3 302 790
2011	R4 500 964
2012	R700 000

92. The total amount he received from the sale of share options and the LTIP was R89 488 122 (R89 million).

Mr Nalliah (Financial Director)

93. Mr Nalliah's remuneration was made up of annual salary, annual short term incentive, and LTIP payments:

1/4/2006	Starting salary	R1 600 000
1/10/2006	Revised annual salary	R1 696 000
1/11/2006	Annual short term incentive	R640 000
1/10/2007	Revised annual salary	R2 001 280
1/11/2007	Annual short term incentive	R1 000 000
1/10/2008	Revised annual salary	R2 141 370
1/11/2008	Annual short term incentive	R1 000 000
2/10/2009	Revised annual salary	R2 750 000
1/11/2009	Annual short term incentive	R1 000 000
1/10/2010	Revised annual salary	R3 245 000
1/10/2011	Revised annual salary	R3 437 704
30/11/2011	Annual short term incentive	R1 350 000
1/10/2012	Annual salary	R3 437 704
1/11/2012	Annual short term incentive	R975 000
1/10/2013	Annual salary	R3 437 704

94. The total of the LTIP payments he received was R11 117 746 (R11 million).

Mr Adams (NED)

95. As a founding Executive Director in 1998 he received 5 million Baobab shares (which became Abil shares). At the time his remuneration was R240 000 pa. In 2001 the NEDs were granted 2000 Abil shares. From 2000 to 2003 he received R210 250 as NED fees. He received no share options. Since his reappointment in September 2008 he has received a total of R3 502 375 (R3,5 million) as director's fees.

Mr Mthombeni (NED)

96. He has earned R273 148 as a NED since his appointment on 16 September 2013.

Mr Symmonds (NED)

97. He earned R178 583 in his first term as director (14 February 2000 to 19 May 2003) and R2 755 469 (R2,7 million) in his second term (21 May 2009 to present). He received 12 500 Abil shares in his first term. He has never traded in those shares.

Ms Gumbi (NED)

98. She received the following fees for attending board meetings and the meetings of the four board committees on which she served:

2011	R275 167,32
2012	R457 386,29
2013	R390 929,97
2014	R314 744,07

Ms Langa-Royds (NED)

99. During her tenure (March 2011 to August 2014) she received a total of R1 894 838 in director's fees.

Mr Gibbon (former NED)

100. For the year ending February 2011, his final year as a NED, his total remuneration for that year was R568 716:

Abil	R110 670
African Bank	R332 010
Insurance Companies	R126 036
	R568 716

He received lesser amounts in the prior years.

Mr Steele (former NED)

101. His remuneration from the bank for the years ended February was:

2004	R118 333
2005	R167 375
2006	R209 625
2007	R233 531
2008	R179 317
2009	R201 360
2010	R125 000

He received no share options from Ail or the bank.

Mr Woollam (former ED)

102. His remuneration included cash package, short-term incentives, and long-term incentive. His total remuneration in respect of all three components for each year was:

2003	R3 625 000
2004	R3 435 000
2005	R5 978 000
2006	R6 729 000

2007	R5 825 000
2008	R7 333 000
2009	R6 766 000
2010	R2 347 000
2011	R796 000

According to Mr Nalliah[62] the gain made by Mr Woollam on the exercise of share options in FY2007 was R18 555 000.

Mr Tugendhaft (former NED)

103. Based on information which has been provided to him by the bank, the total remuneration which he derived as a director on the boards and committees of Abil and the bank was R2 413 583. He did not receive any share options.

Mr Mabagoane (former Chairman)

104. His total remuneration for his tenure on the Abil and bank boards was R5 613 833,00 according to information furnished to him by Abil.

[62] Submissions E(20)48

Mr Schachat (former Deputy Executive Chairman)

105. His remuneration consisted of a cash package, retirement and medical contributions, and annual cash bonus. His total remuneration for each year as at 30 September was the following:

1999	R300 000
2000	R300 000
2001	R307 596
2002	R3 000 000
2003	R2 900 000
2004	R3 700 000
2005	R3 724 000
2006	R4 501 000
2007	R5 000 000
2008	R4 000 000
2009	R3 200 000
2010	R3 036 500
2011	R4 831 000
2012	R4 550 000

106. Mr Schachat’s net profit after tax on the sale of his Abil shares was R121 391 311,72 (R121 million)[63]

[63] “E(6.1)483

107. Mr Sithole (former Independent NED)

His aggregate fees as a NED of Abil and the bank were R1 911 000, which is an average of R450 000 a year.

CHAPTER 7 : THE EXECUTIVES

108. Senior executives, who are not members of the Abil and bank boards, are, in alphabetical order:

Markus Borner

Charles Chemel

Gavin Jones

Lindiwe Miyambu

Hament Nagar

Gustav Raubenheimer

George Roussos

Muller Strauss

Piet Swanepoel

<u>Qualifications</u>

109. Markus Borner (Executive Balance Sheet Management)

(i) He is a CA, having obtained a BComm degree from the University of Natal and Post Graduate Diplomas in Accounting and Taxation from the University of Natal.

(ii) Prior to joining the bank in March 2012, he worked for KPMG (January 1989-April 1993); Imperial Chemical Industries (June 1993-April 1994); UBS (London) (May 1994 to March 2002), the last position he held at UBS was Director Operational Risk Control; Nedbank, Head of Strategic Capital Management (April 2005 – February 2010); ABSA, Head of Group Balance Sheet Management (March 2010 – February 2012).

110. Charles Chemel (former Executive Front-end)

(i) He has the following degrees: B.Sc Hons (Statistics), University of the Witwatersrand; MSc (Statistics), University of Edinburgh; Master of Business Leadership (MBL), UNISA. He has attended the Advanced Management Program at Harvard University.

(ii) His work experience includes working for the National Institute for Personnel Research (1976-1988) as a Senior Research Specialist in Psychometrics; Standard Bank (1988-1995) as General Manager: Planning Human Resources; Standard Bank (1996-2003) as Director: Mass Markets and Retail Africa; Banking Association (2004); African Bank from 2005 to present.

111. Gavin Jones (Executive : Funding and Liability Management or Treasurer)

(i) He has the BA LLB degrees from the University of Cape Town and a Higher Diploma in Tax Law (University of the Witwatersrand).

(ii) He was employed in the tax department of Arthur Andersen Inc (1990 to 1995); by a company Mettle Ltd which he and some colleagues established (about 1995 to 2007); he managed private projects for his own account for just over a year; towards the end of 2008 he did some consultation work for the innovation team within Deloitte.

(iii) He commenced employment with Abil. Since the end of 2009 he has been Treasurer.

112. Lindiwe Miyambu (Executive : Human Capital)

(i) She qualified with a Bachelors degree from the National University of Lesotho.

(ii) Her employment since March 1999 has been in human resources: McCarthy Motor Holdings: Training and Development Manager (March 1999 to November 2000); World Bank : Consulting (Team Learning Coach) Africa (2006-2008); Nedbank Corporate (Property Finance) (2008-2010); African Bank : Executive : Human Capital (1 September 2010 to date).

113. Hament Nagar (Head : Group Legal)

(i) He has the following academic qualifications : BComm (University of Natal), LLB (University of Natal), Higher Diploma in Tax Law (University of Witwatersrand); Higher Diploma in Company Law (University of Witwatersrand); LLM in Banking and Stock Exchange Law (University of Johannesburg). He is an admitted attorney, on the non-practising roll.

(ii) He was employed by NK Ranched Attorneys (June 1992 to April 1994), Bhika Incorporate Attorneys (about May 1994 to December 2000); Standard Corporate and Merchant Bank

Limited (January 2001 to April 2002); Arthur Anderson and KPMG (May 2002 to September 2003).

(iii) He commenced employment with Abil in September 2003 as Head: Group Legal; from 20 November 2007 to 1 February 2008 he also acted as Group Company Secretary; from April 2009 to August 2012 he was Group Compliance Officer; from September 2012 to date he has been Head : Group Legal.

114. Gustav Raubenheimer (Group Executive : Credit)

(i) He is a CA, having been an articled clerk at Deloitte from 1993 to 1995.

(ii) He was employed as a financial manager by Africon (January 1996 to July 1998); a business analyst, credit risk manager, and head of the retail credit lab by Nedbank Limited (December 2001 to February 2008); head of retail credit and chief risk officer of the ABSA retail and business bank (March 2008 to September 2012).

(iii) He commenced employment with the bank on 1 October 2012: from that date until 28 February 2014 as Head of Group Credit and a member of the bank Exco; from 1 March 2014 as Group Executive : Credit and a member of the Abil Exco.

115. George Roussos (Executive: Central Support Services)

(i) He is a CA having obtained the degrees of BComm and BAcc from the University of the Witwatersrand.

(ii) He was a Senior Manager at Roussos and Company (1990-1998); part of the team at Altfin Limited (July 1998 to January 1999) that acquired and drove integration into African Bank; from January 1999 to present has been employed as Treasurer (January 1999 to June 2001); Executive Administration Order Collections – Collections Business Unit (June 2001-August 2002); Executive Collections – Collections Business Unit (August 2002 – January 2004); Executive Legal Collections – Collections Business Unit (January 2001-February 2006); Executive in charge of Collections Business Unit (February 2006-December 2010); Executive in charge of Central Support Services (December 2010 to date).

116. Muller Strauss (Chief Financial Officer (CFO)

(i) He is a CA, having obtained the B.Compt and B.Compt (Hons) degrees from the University of the Free State. He was articled with Deloitte.

(ii) He joined King Finance Corporation Limited, which was later incorporated in Abil, in March 1998. He was employed as financial manager by the King Finance division of the bank (November 1998-April 2000); as the financial manager of the bank (May 2000- to September 2003); as General Manager: Finance of Abil (October 2003 to September 2008); as CFO of the bank and Stangen (September 2008 to the present).

117. Piet Swanepoel (Chief Risk Officer)

(i) He commenced employment with the bank as Chief Risk Officer on 1 June 2014.

(ii) He has a B.Comm (Marketing Management) degree. He has attended the Advanced Management Programme at Templeton College, Oxford University and the Negotiation Dynamics Programme at INSEAD, Singapore.

(iii) He has been employed in the financial services as follows: Stannic (1987 to 1988); MLS Bank (1988 to 2003); Imperial Bank Limited (2003 to 2010) and Nedbank Limited (2010 to 2012). In his career he has been an Executive Director (Finance, Credit and Risk, Systems) at MLS Bank; Divisional Head (Property Finance and Professional Finance) at Imperial

Bank, and Head: Business Bank Professional (Nedbank Limited).

Remuneration

118. Markus Borner

His “cost to company/share options” yielded remuneration as follows:

March to September 2012: R2 250 000 pa

October 2012 to September 2013: R2 306 256 pa

October 2013 to current: R2 456 172 pa

119. Charles Chemel

(i) His remuneration, the details of which he obtained from the HR department of the bank, was the following:

Year	Annual Salary (R)	LTIPs issued	LTIPs Paid	Cash bonus (R)	Other (R)
2005	1 700 000	1 300 000	0	800 000	650 000 “Take on”
2006	1 800 000	2 000 000	432 790	1 800 000	5 309 487 “Sign on options”

2007	1 908 000	1 900 000	1 371 436	1 800 000	7 553 512 “Sign on options
2008	2 041 560	2 100 000	1 769 228	1 100 000	9 674 252 “Sign on Options”
2009	“2 347 794	2 000 000	2 606 033	1 000 000	7 687 822 “Sign on Options”
2010	2 500 000	2 000 000	3 278 863	2 000 000	-
2011	3 250 000	5 142 000	2 886 620	1 058 750	-
2012	3 445 000	4 000 000	1 659 700	950 000	-
2013	3 445 000	0	313 641	0	-
2014	3 445 000	0	0	0	-

(ii) It follows that in the following years Mr Chemel received in total (salary, LTIPs paid and cash bonus) (excluding “sign on options”) the following amounts:

2006	R4 032 790
2007	R5 079 436
2008	R4 910 788
2009	R5 953 827
2010	R7 778 863

2011	R7 195 370
2012	R6 054 700
2013	R3 758 641

120. Gavin Jones

Date	Form of Remuneration	Amount (R)
1/5/2009	Take-on salary	1 750 000
1/10/2009	Salary adjustment	1 855 000
1/10/2009	LTIP payment	514 964
1/11/2009	Annual incentive	250 000
1/10/2010	Salary adjustment	2 003 400
1/10/2010	LTIP payment	660 374
1/10/2010	LTIP Payment	243 923
1/11/2010	Annual Incentive	1 000 000
1/10/2011	Salary adjustment	2 203 752
1/10/2011	LTIP payment	707 676
1/10/2011	LTIP Payment	259 272
1/10/2011	LTIP Payment	390 513
30/11/2011	Annual incentive	1 250 000
1/10/2012	Salary adjustment	2 324 964
1/10/2012	LTIP Payment	733 633
1/10/2012	LTIP Payment	265 178

1/10/2012	LTIP Payment	380 959
1/10/2012	LTIP Payment	349 635
1/11/2012	Annual incentive	900 000
1/10/2013	Salary adjustment	2 476 092
1/10/13	LTIP Payment	117 615

(i) It follows that in the following years Mr Jones received in total (salary, LTIPs and annual bonus) the following amounts:

2010	R3 907 697
2011	R4 811 213
2012	R4 954 369

121. Lindiwe Miyambu

Date	Form of remuneration	Amount (R)
1/9/2010	Salary	1 400 000
1/10/2010	LTIP Payment	275 153
1/11/201	Short term bonus	200 000
1/3/2011	Salary adjustment	1 600 000
1/10/2011	Salary adjustment	1 800 000
1/10/2011	LTIP Payment	272 467
1/10/2011	LTIP Payment	149 697
30/11/2011	Annual Incentive	825 000

1/10/2012	Salary Adjustment	2 016 000
1/10/2012	LTIP Payment	299 129
1/10/2012	LTIP Payment	146 034
1/10/2012	LTIP Payment	227 277
1/11/2012	Annual Incentive	550 000
1/7/2013	Retention bonus	529 986
1/10/2013	Salary adjustment	2 147 040
1/10/2013	LTIP Payment	132 674
1/3/2014	Increase: promotion to Group Executive: Human Capital	2 600 000

122. Hament Nagar

Mr Nagar's remuneration since 2010 (he commenced employment in 2003) has been the following:-

Date	Form of Remuneration	Amount (R)
1/4/2010	LTIP Payment	179 547
1/10/2010	Salary adjustment	1 226 862
1/10/2010	LTIP Payment	129 758
1/10/2010	LTIP Payment	142 906
1/10/2010	LTIP Payment	146 354
1/10/2011	Salary adjustment	1 328 088

1/10/2011	LTIP Payment	139 138
1/10/2011	LTIP Payment	153 142
1/10/2011	LTIP Payment	155 563
1/10/2012	Salary adjustment	1 407 768
1/10/2012	LTIP Payment	158 760
1/10/2012	LTIP Payment	159 107
25/11/2012	Incentive	360 000
1/10/2013	Salary adjustment	1 513 356
1/10/2013	LTIP Payment	70 569
1/6/2014	Salary adjustment	1 700 000

123. Gustav Raubenheimer

Date	Form of Remuneration	Amount (R)
1/10/2010	Take-on Salary	3 000 000
1/10/2012	LTIP Payment	674 665
1/11/2012	Annual incentive	200 000
1/2/13	Retention bonus	1 500 000
1/10/13	Salary	3 195 000
30/11/113	Guaranteed bonus	1 000 000

124. George Roussos

His total salary, cash incentive, and LTIP received for each year since 2010 (he commenced employment in 1999) was:

2010	R6 115 208,47
2011	R6 574 857,09
2012	R5 055 861,00
2013	R4 612 330,51
2014	R3 000 000 (salary only)

125. Muller Strauss

His remuneration for the income tax years (ended 28 February) consisted of salary, provident fund, cash bonus, LTIP payments and 'other'. The total remuneration for each year from 2010 was:

2010	R3 092 643
2011	R3 466 448
2012	R4 125 474
2013	R4 010 800
2014	R2 734 840

126. Piet Swanepoel

Mr Swanepoel receives an annual salary of R2,5 million, with no share options. A once-off guaranteed bonus of R1 million is payable in November 2014.

CHAPTER 8 : THE CHANGE IN FORTUNES OF ABIL AND THE BANK

127. If one has regard to the afs of Abil and the bank, the change in the fortunes of the bank was dramatic.

128. On 21 December 2012, in its annual report for FY2012, Abil described "2012 in perspective":

(i) 20% return on equity;

(ii) 53% increase in economic profit to R755 million;

(iii) 18% growth in headline earnings to R2,8 billion;

(iv) 18% growth in HEPS to 342,5 cents; and

(v) 33% growth in advances.[64]

129. In that annual report, dated 30 September 2012, Abil disclosed a profit of R2,8 billion and economic profit of R765 million. According to the

[64] AB(12)2144

bank's annual report for FY2012, the *bank* made a profit of R1,3 billion (subsequently restated to be R1,6 billion). The following key shareholder ratios, amongst others, were given:

		2012	2011	2010	2009
Profit for the year	R million	2803	2371	1942	1855
Headline earnings	R million	2754	2339	1890	1810
Headline earnings per share	cents	342,5	291	235,2	225,2
Economic profit (loss)	R million	755	494	78	(95)
Return on equity	%	20	18,4	15,6	15,2

130. In Abil's trading statement published on SENS on 2 May 2013,[65] however, shareholders were advised that:

(i) both headline earnings and earnings per share for the six months to 31 March 2013 were expected to decline by between 25% and 28% relative to the R1,370 million reported for the equivalent six months to 31 March 2012;

(ii) headline earnings per share and earnings per share were expected to decrease by between 25% and 28% relative to the comparable 170,4c per share;

(iii) headline earnings for the bank declined by between 19% and 22%;

65 SENS(2)859

(iv) the bank showed positive advances growth and maintained good control over operating and funding costs. These improvements were however negated by:

(a) a lower yield, partially as a result of higher suspension of interest and fees;

(b) an elevated charge for bad and doubtful advances, particularly on the furniture credit portfolio, as a result of higher provisions due to an increase in risk;

(c) substantially increased insurance claims and provisions resulting from the group broadening the range of insured events;

(d) while these trends were evident in the first five months of the year, the negative impact on the results was exacerbated by Abil's decision:

- to write-off an additional amount of non-performing loans in March; and
- to augment the NPL coverage post the write-off which amplified the bad debt charge.

131. In the Abil annual report for the year ended 30 September 2013[66] the following equivalent key stakeholder ratios were given, some of the figures being restated:

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[66] AB(12) 2284

		2013	2012	2011	2010	2009
Profit for the year (loss)	R million	(4199)	3090	1765	1677	1855
Headline earning	R million	365	3041	1733	1625	1810
Headline earnings per share	cents	45,1	378,2	215,6	202,2	225,2
Economic profit (loss)	R million	(1522)	1230	54	(85)	(95)
Return on equity	%	2,9	24,3	15	14,2	15,2

132. So, from making a profit of R2,8 billion or R3 billion in FY2012, a year later, Abil made a loss of R4,2 billion.

133. According to the bank's 2012 annual financial statements the profits for FY2011 were R1,2 billion and for FY2012 were R1,3 billion[67]. In the 2013 annual financial statements the profits for 2012 were restated to be R1,6 billion and the bank was shown to have made a loss in FY2013 of R4,5 billion.[68]

134. So, the bank, after making a profit of R1,3 billion or R1,6 billion in FY2012, made a loss in FY2013 of R4,5 billion.

135. Abil's trading statement, published on SENS on 2 May 2014[69], advised shareholders that Abil expected:

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67 AB(15)397
68 AB(15)469
69 SARB(1)380

(i) a headline loss of between R3,1 billion and R3,3 billion relative to the R604 million restated headline earnings for the equivalent six months to 31 March 2013;

(ii) the headline loss per share was expected to be between 239 cents and 254 cents relative to the comparable restated headline earnings of 62,3 cents per share;

(iii) the basic loss was expected to be between R4,3 billion and R4,5 billion in relation to the R602 million restated basic earnings for the comparative period;

(iv) the bank was expected to show a headline loss of between R1,9 billion and R2 billion due to:

(a) an increase in specific provisions of approximately R600 million driven by NPL emergence on business written pre-July 2013 being at a higher than anticipated levels; the total NPL formation in this reporting period was approximately R6 billion which was about R600 million more than the level anticipated;

(b) an increase in specific provision coverage on NPLs of over 1% from 30 September 2013 to 31 March 2014. This was due to seasonal factors that impacted collections and a continued challenging collections environment;

(c) a decision to significantly increase the general provision for credit impairment relating to the performing loans by approximately R2,5 billion.

136. On 6 August 2014 Abil and the bank published their quarterly operational update for the quarter ended 30 June 2014.[70] The following was announced:-

(i) the resignation of Mr Kirkinis;

(ii) the board had decided to more closely align certain aspects of the bank's impairment provisioning practices to the industry standard. Amongst these, the most significant was the moving of the point of impairment from the current contractual delinquency CD4 to CD0. The additional impairment provision that was required for all changes in practices was R3 billion;

(iii) Abil's equity and core Tier 1 Capital ratios were below the levels achieved following the rights offer in 2013. In addition, the anticipated costs associated with insulating Abil from further impact of Ellerines and any additional provisions that might be taken on the lending book following an independent review, would further decrease its equity and core 1 ratios. In order to remedy that situation, Abil would engage with shareholders and

[70] SENS(3)1868

other stakeholders in the coming weeks about a capital raise which was expected to be a minimum of R8,5 billion;

(iv) the banking unit forecasted a basic and headline loss of at least R4,6 billion;

(v) the retail unit forecasted a basic loss of at least R2,9 billion and a headline loss of at least R1,7 billion;

(vi) the Group was expected to show a basic loss of at least R7,6 billion and headline loss of at least R6,4 billion for the full year.

137. According to the latest information provided by the Curator as at 10 February 2015:

(i) the loss the bank made in FY2013 of R4,5 billion might be increased (when the FY2014 afs are published) by at least R1,339 billion made up as follows:

(a) definition of incurred loss event: R485 million;

(b) removal of emergence factors in the calculation of IBNR: R139 million;

(c) PD migration: R116 million;

(d) *in duplum* adjustment to "flow" LGD used in calculation of IBNR: R172 million;

(e) GL versus model difference at 30 September 2013: R427 million;

(ii) the loss in aggregate for FY2013 might therefore be at least R5,8 billion;

(iii) for the period pre-FY2013 (and the bank disclosed a profit in the FY years 2008 to 2012) the afs might be restated to reflect an additional accumulative charge of at least R2,465 billion;

(iv) the impact on the pre-2013 financial years of the cumulative charge of at least R2,465 billion would reduce the cumulative profits and might have the effect of converting the disclosed profits in some of those years to losses.

CHAPTER 9 : A COMPARISON BETWEEN AFRICAN BANK AND CAPITEC BANK

138. Capitec Bank Limited (Capitec Bank) is a wholly owned subsidiary of Capitec Bank Holdings (Capitec Holdings).

139. On 29 September 2014 Capitec Holdings published on SENS its unaudited financial results for the six months ended 31 August 2014. Headline earnings were up 21% to R1,173 billion; headline earnings per share were up 21% to 1018 cents; the interim dividend per share was up 21% to 246 cents; and the return on equity was 25%. The share price on that day was R184.

140. By that time African Bank was under curatorship. In the last quarterly update published by Abil and African Bank on 6 August 2014 the banking unit forecasted a basic loss of at least R2,9 billion and a headline loss of at least R1,9 billion. The Abil share price on 7 August 2014 was 31 cents.

141. In Capitec Holdings' annual report for FY2014 (for the year ended 28 February 2014) it was disclosed that Capitec Bank had revenue of R13,5 billion (2013: R10,7 billion); profit after tax of R2 billion (2013: R1,6 billion) and total assets of R46,2 billion (2013: R38,3 billion).

142. Those results must be compared to those of African Bank in FY2013 (for the year ended 30 September 2013) when the profits for 2012 were restated to be R1,6 billion and the loss for FY2013 was R4,5 billion. According to the latest information provided by the Curator,[71] the balance sheet (and accordingly retained earnings) as at the 2013 year-end might have been overstated by at least R3,8 billion in that:-

(i) pre-2013 figures might have been overstated by at least R2,5 billion; and

(ii) FY2013 figures might have been overstated by at least R1,3 billion.

[71] E(21)25

143. A comparison is made between the two banks:

- they both operate in the unsecured microlending industry;
- Capitec's share price decreased after the Abil announcement of 2 May 2013;
- when African Bank was placed under curatorship, Moody's downgraded Capitec Bank's credit rating by two notches and placed it under review for possible further downgrades.

144. In a report dated 16 May 2013 prepared by the BSD a comparison was made between Abil and Capitec Bank.[72]

145. The comparison was done after the trading statement of 2 May 2013 issued by Abil and African Bank, which had shown that both headline earnings and earnings for the six month period to 31 March 2013 for Abil were expected to decline by between 25% and 28% relative to the R1,370 billion reported for the six months to 31 March 2012. Headline earnings for African Bank declined by between 19% and 22%.

146. The BSD report contained the following analysis :

<u>Business models</u>:

(i) The two main areas in which Abil operated were the provision of unsecured credit through the grant of personal loans to the

[72] SARB(3)21

formally employed emerging market (African Bank) and the sale of furniture and appliances for cash and credit (Ellerines).

(ii) Capitec Bank was a retail bank which focused on banking services and provided a single banking facility, which included:

- savings accounts;
- personal loans (unsecured lending);
- cash withdrawals;
- debit orders;
- transfers;
- debit card transactions.

Share price movements:

(a) Abil's share price decreased by 17,56% from R28,99 to R23,90 after 2 May 2013; the price reduced to R21,19 as at 16 May 2013, which represented a total decrease of 26,91% since 2 May 2013.

(b) Capitec Bank's share price decreased after the Abil announcement on 2 May 2013 by 6,87% from R219 to R204; reduced to R202 on 6 May 2013, and thereafter increased to R215 on 9 May 2013.

Quality of Capital

(i) The total capital adequacy ratio (CAR) for African Bank was 27,27% for March 2013, above the 24,5% regulatory minimum requirement. As the bank continued to grow its balance sheet at its historic high rates, further pressure would be felt on its capital and the ability to continue to meet the minimum Basel 3 capital requirements.

(ii) The total capital held by Capitec Bank as at 31 March 2013 amounted to R10,9 billion. Capitec Bank's approach towards holding capital was conservative and in the calculation of their capital they included holding capital against both future expected as well as unexpected losses, whereas the tendency by other banks was to hold additional capital only against future unexpected losses.

Composition and risk profile of funding

(i) The bank was funded through bond issues. As at March 2013 the total value of bonds in issue was R22,2 billion. African Bank's total deposits for March 2013 stood at R49,12 billion: of that amount corporate customers contributed R44,6 billion and banks R1,49 billion. African Bank's dependence on funding from its ten largest depositors was 75,34% at the end of March 2013, and was significantly higher than its peers. African Bank was highly dependent on wholesale funding which could pose potential concerns in terms of concentration of risk.

(ii) 77% of Capitec Bank's total funding was derived from savings and fixed and notice deposits. Capitec Bank had more reliance on funds from retail customers as opposed to corporates and banks which differentiated Capitec Bank from its peers. This reduced the concentration risk experienced as funding was derived from various small clients as opposed to a few large corporates.

<u>Credit risk</u>

(i) Abil: the level of impaired advances to loans and advances ratio as at March 2013 was 29,39% (March 2012: 28,08%), while the coverage of specific impairments (coverage ratio) stood at a mere 49,36%. Despite the high balance sheet growth, the ratio of impaired advances to total advances increased further from 28,08% in March 2012 to 29,39% in March 2013.

(ii) African Bank wrote off loans where no cash was received for 17 consecutive months.

(iii) African Bank's book was totally unsecured and its only protection was provisions and the coverage ratio appeared to be low.

(iv) Capitec Bank: the level of impaired advances to loans and advances ratio as at March 2013 was 5% (2012: 4%), while the coverage of specific impairments stood at 53,52%. Despite the high balance sheet growth rate of 63%, the ratio of impaired advances to total advances increased further from 4% in March 2012 to 5% in March 2013.

(v) Capitec Bank's management of credit risk was very efficient due to its accelerated provisioning and write-off policy. The policy of the bank was to raise a provision on the first payment default, i.e. 30 days.

147. In his article in SIM Global Review on 19 August 2014 Kokkie Kooyman criticized Moody's for downgrading Capitec Bank. He pointed out that:

(i) Capitec Bank's capital and reserve ratios were consistently much higher than those of African Bank;

(ii) Capitec Bank's business model differed from that of African Bank:

- it had a more diversified lending book and earnings stream;
- it controlled credit granting directly;
- it did not have the drain of a "bleeding" furniture chain;
- it was adequately capitalised and reserved;
- it had consistently been more aggressive in its recognition and write-off of NPLs for accounting purposes;

(iii) African Bank's problem was the rapid growth of its loan book just before the strikes started and unemployment began to rise: it wrote loans to clients whose circumstances changed and were unable to repay their loans.

(iv) In normal circumstances, this would have resulted in one year's poor results, but the combination of:

- a backlog in terms of reserving;
- a bleeding Ellerines; and
- insufficient capital levels, proved lethal.

(v) There was a risk that bad debts at Capitec Bank would increase, but :

- it was adequately provided in terms of loan loss reserves;
- it had more than adequate capital;
- it had a solid shareholder base.

(vi) African Bank highlighted a vital lesson:

- unsecured lending was a specialised business;
- it allowed high yields, but required excess capital and reserves and strong shareholders.

CHAPTER 10 : THE EVENTS OF LATE 2012, 2013 AND 2014

148. At a prudential meeting between the BSD and Abil on 1 October 2012, before the FY2012 results were published, Mr Kirkinis, according to the BSD, "indicated that the bank had recently noticed a risk emergence in terms of the deterioration of the asset quality of the unsecured loans and credit cards granted and had therefore put risk mitigants in place, in particular through decreasing loans granted to customers employed by the Government". The BSD "was also informed that certain risk

cutbacks and pricing adjustments had been made due to the risks emanating from increased competition and the prevailing economic environment".[73]

149. On 15 November 2012, at a meeting of the boards of Abil and the bank,[74] according to the minute of the meeting, Mr Kirkinis said that the Abil business had become a robust and resilient business that stood strong despite having faced a challenging year. The Group Audit Committee reported that, although Deloitte had issued an unqualified audit opinion, they had raised concerns, one of which related to a lack of conservatism in the credit impairment model: they felt that the provisions were understated by between R150 million to R250 million.

150. On 23 November 2012 the Registrar addressed a letter to Mr Kirkinis in which he referred to the *in duplum* rule contained in section 103(5) of the NCA.[75] which had been disclosed at a Compliance meeting on 24 October 2012. The Registrar recorded that Mr Nagar had said at the meeting that Abil was compliant as far as the loan book was concerned; that the historical credit card business remained non-compliant; that the necessary adjustments would be made by Abil and that the anticipated implementation date was November 2012.[76]

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73 SARB letter to ABIL 30/10/2012: SARB(1)120
74 AB(24)562
75 National Credit Act, 34 of 2005: See Chapter 5
76 SARB(1)123

151. Mr Kirkinis is reported to have told the Group Executive Committee (Group Exco) at its meeting on 29 January 2013[77] that the forecast for FY2013 for the banking unit[78] was that Company 5[79] sales would be reduced to R23 billion; and that the bank budget had been "haircut" from R3,33 billion to approximately R3 billion (including *in duplum*).

152. On 30 January 2013 Abil published a trading update for the quarter ended 31 December 2013. The bank's total credit disbursements were "flat" at R7,43 billion; the average loan size declined from R12,650 to R11,444; and the average loan term reduced from 48 and 46 months. Reference was made to a "slowdown in customers' appetite and capacity (through reduced affordability) for credit"; gross advances increased by 8% to R57,3 billion from R53 billion in September 2012; more subdued competitor activity reduced external settlements".[80]

153. At a Group Audit Committee meeting on 7 February 2013 it was minuted[81] that:

(i) the headline earnings for Q1[82] were R79 million behind budget due mainly to R203 million reduction in sales; the bad debt

[77] AB(43)98
[78] African Bank and Stangen
[79] Company 5 was the financial services division of Ellerines which had been transferred to the bank in 2010
[80] SENS(2)823; SARB(1)129
[81] AB(6)263
[82] Financial Quarter

charge was R212 million higher than budget as a result of lower collections on the NPL portfolio;

(ii) disbursements at the bank had been R1,06 billion below budget due to tougher market conditions and a management decision to reduce sales in order to " de-risk" the business given the increase in the supply of credit in the market;

(iii) the 7% increase in NPLs was higher than expected and that to improve NPL coverage, provisions were being increased by an additional R20 million a month.

154. At a meeting of the Group Risk Committee and Capital Management Committee (Group Risk Committee) held on 7 February 2013[83] management told the committee that a major short term priority for the bank was to stem the migration of performing loans (PLs) to NPLs and to reduce the bad debt rate. Mr Kirkinis said that the level of provisions would be increased through the year. Mr Raubenheimer illustrated that the performance of the portfolio of loans disbursed in the last quarter of 2011 was worse than the loans disbursed in the first quarter of 2011.

155. On 7 February 2013, so the BSD was informed by the executive management of the bank, it was leaked that the National Credit Regulator (NCR) had referred a case of reckless lending at the Dundee

[83] AB(4)227

branch of the bank to the National Consumer Tribunal (NCT) and had recommended a fine of R300 million.

156. In response, Abil and the bank issued a statement on SENS[84] on 8 February 2013 in which they referred to the NCR's allegation of reckless lending and the proposed fine of R300 million, and stated that in November 2011 an internal investigative team of the bank had found that the bank's systems had been fraudulently breached by agents at the bank's Dundee Branch. The bank disputed the allegations of reckless lending.

157. On 13 February 2013 Mr Kirkinis informed the boards of Abil and the bank that, following on the announcement of the fine of R300 million proposed by the NCR:

- pricing on African Bank bonds had increased by approximately 60 basis points (and since recovered by 25 basis points);
- the Abil share price had declined by 6%;
- a formal objection would be sent to the Minister of Finance, the Minister of Trade and Industry, SARB, and the NCR regarding the inappropriate conduct of the NCR in handling the matter and the consequent reputational and financial damage done to Abil.[85] The evidence given in this investigation, for example, by Mr Nithia

[84] SARB(3)156
[85] AB(24)567

Nalliah, the financial director of Abil, was that Abil had to cancel a European Medium Term Note (EMTN) bond issue which was being priced at the time in London as a result of the NCR announcement.

158. Mr Nalliah told the Group Exco on 1 March 2013 that forecasted earnings for the bank unit were R1,265 billion. Mr Kirkinis added that provisions for the full year would be increased by R300 million.[86]

159. On 14 March 2013 Mr Petros, the Deputy Registrar of Banks (the Deputy Registrar), wrote a letter to Mr S E Sithole, the chairman of the Group Audit Committee, referring to the trilateral discussions held on 21 February 2013. Mr Petros noted that Deloitte had advised that one of the outstanding items from the September 2012 audit was compliance with the NCA involving credit cards not flagged as *in duplum*.[87]

160. On 19 March 2013 Mr Raubenheimer reported to Messrs Kirkinis, Nalliah and Strauss that the projected gap at year end was:

- R723 million based on a R700 million a month NPL migration;
- R1,099 billion based on a R800 million a month NPL migration [88]

161. On 2 April 2013 Mr Raubenheimer drafted an email addressed to "Dear Impairment Stakeholders" in which he stated that the average net NPL

[86] AB(43)106
[87] SARB(1)131
[88] AB(53)47

migration was expected to be at least R830 million per month for the next six months. The gap projected at the end of the year would be R1,218 billion. Once one took into account a "mistake" and a "rethink" the predicted gap was above R1,529 billion.[89]

162. At a Group Exco meeting held on 12 April 2013 it was minuted[90] that:

(i) overall the provisions gap was R820 million;

(ii) notwithstanding the extra R600 million provision budgeted for FY2013, the gap continued to increase due to:

(a) the decline in collections from October 2012 to February 2013;

(b) the provisions models being recalibrated; and

(c) the increase in the migration from PLs to NPLs;

(iii) the reasons for the increased risk emergence were:

(a) the discontinuation of settlement readvances in the market that masked a lot of risk;

(b) the bank stopping SRAs[91] and term extended products;

(c) the increase in fraud;

(d) suboptimal collections processes;

(e) risk in African Bank underwriting models;

(f) systems issues exacerbated by fraud issues;

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[89] AB(53)46
[90] AB(43)101
[91] Settlement Re-advance Loans

(g) with the increase in competition and the increase in the supply of credit, the level of predictability of African Bank underwriting models had diminished.

163. At the Group Exco on 16 April 2013[92] a discussion was held on the appropriate level of impairment provisions, and the following was noted, inter alia:

(i) there was a R489 million shortfall in impairment provisions;

(ii) provisions could be increased by R350 million for the first half of FY2013, provided that higher claims were achieved in Stangen;

(iii) the additional R350 million provision would increase NPL coverage from 59,1% to 60,3% and result in headline earnings for the banking unit declining by 20,5%;

(iv) Abil headline earnings were 26% lower than the previous year and were expected to be 32% down in the second six months;

(v) due to the uncertainty of cash collections and the migration to NPLs it was appropriate to take a more conservative approach and not send a message to the market that results were expected to improve in the second half of the year;

(vi) Mr Nalliah stated that SARB and the board of directors would have to be informed of the significant decline in earnings.

[92] AB(43)103

164. Mr Nalliah presented the interim results at the Group Exco meeting on 29 April 2013:[93]

(i) Abil's headline earnings declined by 26% to R1,015 billion;

(ii) the Group would make an economic loss of R47 million;

(iii) the banking unit's total income yield declined from 34,6% to 32,8%;

(iv) in relation to the capital requirements of the bank, it was noted that SARB was concerned about the capital levels within the bank being too close to the regulatory minimum.

165. In Abil's trading statement published on SENS on 2 May 2013[94] shareholders were advised that:

(i) both headline earnings and earnings per share for the six months to 31 March 2013 were expected to decline by between 25% and 28% relative to the R1,370 million reported for the equivalent six months to 31 March 2012;

(ii) headline earnings per share and earnings per share were expected to decrease by between 25% and 28% relative to the comparable 170,4c per share;

(iii) headline earnings for the bank declined by between 19% and 22%;

[93] AB(43)104

[94] SENS(2)859

(iv) the bank showed positive advances growth and maintained good control over operating and funding costs. These improvements were however negated by:

(a) a lower yield, partially as a result of higher suspension of interest and fees;

(b) an elevated charge for bad and doubtful advances, particularly on the furniture credit portfolio, as a result of higher provisions due to an increase in risk;

(c) substantially increased insurance claims and provisions resulting from the group broadening the range of insured events;

(v) while these trends were evident in the first five months of the year, the negative impact on the results was exacerbated by Abil's decision:

- to write-off an additional amount of non-performing loans in March; and
- to augment the NPL coverage post the write-off which amplified the bad debt charge.

166. By <u>6 May 2013</u> the question was being asked by the media whether African Bank's profit warning on 2 May 2013 meant the unsecured lending party was over. It was described as "a shocking performance". The bank had been "punished" with a 17% fall in its share price the

following morning. The bank's returns to SARB revealed that between December 2012 and February 2013 the bank's lending book grew 2,5% but the credit impairments line grew 3,8%.[95]

167. In an article dated 7 May 2013 it was reported that Abil extended its losses on the Johannesburg Stock Exchange (JSE) with its market capitalization falling by about R5 billion "as the market stressed over the scale of soured debt held by the bank".[96]

168. On 8 May 2013 Abil published additional information on SENS[97] : Abil had indicated in its third quarter trading update in August 2012 that the significant increase in unsecured lending during 2012 had introduced risk to certain segments of its customer base. Abil's response was to forgo volume growth for a reduction in risk through lower offer rates; smaller loan sizes; and increased pricing. The current increase in bad debts and claims predominantly related to the sales in the first half of 2012. African Bank showed positive advances growth and maintained good control over operating and funding costs, but those improvements were negated by the income yield decline; the charge for credit losses had increased; and insurance claims and related provisions increased.

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95 Media(1)143
96 Media(1)143
97 SENS(3)817

169. At the Group Risk Committee meeting on 9 May 2013,[98] Mr Raubenheimer presented the impairment provisions as at 3 March 2013, which included:

(i) an increase in NPLs from about 2,2% to 2,4% which was driven by an increase in the migration of PLs to NPLs;

(ii) NPLs grew by 13% whereas gross advances grew by 11%;

(iii) there was a risk of the model gap increasing should cashflows not improve substantially from the second half of the year;

(iv) backtesting on the ML[99] book confirmed the view that the book was overvalued. Mr Nalliah expressed the view that the Group would have to consider doing a rights offer to raise additional capital at the appropriate time.

170. Abil released its unaudited interim results for the six months ended 31 March 2013 on SENS on 20 May 2013.[100] Two of the "features" were that headline earnings had declined by 26% to R1,015 billion (2012: R1,370 billion) and there was an economic loss of R47 million (2012: economic profit of R390 million). The "highlights" included a 25% growth in advances to R59 billion. The "challenges" included:

(i) subdued economic outlook;

(ii) slowing consumer demand;

(iii) tough collections environment;

[98] AB(4)230
[99] Memorandum ledger
[100] SARB(1)137; SENS(3)878

(iv) regulatory uncertainty;

(v) growing the customer base;

(vi) balancing growth, shareholder returns and capital requirements.

171. On 21 May 2013 Mr Mogase passed on a report by RMB Morgan Stanley to Mr Kirkinis and various board members.[101] Some of the comments were that Ellerines was a mess; the share price was down 40% that month. The conclusion was that this was a very profitable business "…even after the once-off write-offs. There is pervasive uncertainty as to what the future holds and the market has lost faith in management after poor guidance." (Emphasis is added.)

172. At a Project Phoenix[102] meeting on 26 May 2013[103] it was noted that it seemed that the trigger of the declining share price of ABIL was the announcement that the bank was facing a possible fine by the NCR. It was agreed that the Governor would speak to the Minister of Finance to engage his counterpart in the Department of Trade and Industry (DTI) on whether it fell under the market conduct regulator (FSB); the financial system stability concerns, and the possible speeding up of the NCT process.

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[101] AB(52)110

[102] "Phoenix" was the name given to Abil or the bank within SARB to protect the confidentiality of information during internal distribution of documents and the scheduling of meetings.

[103] SARB(3)53

173. At a Project Phoenix meeting on 3 June 2013,[104] Mr Kirkinis said:

(i) they got worried last year when credit extension was rising fast and signalled this to the market publicly and to the BSD;

(ii) Abil began to see a lot of consolidation loan products from their competitors: this had negative spill-overs to their collections; with competitors cancelling debit orders at times;

(iii) earlier that year Abil was on a road show for a $300 million bond issue, which was oversubscribed;

(iv) when they were about to price the bond the NCR made an announcement on investigations and a possible fine of the bank;

(v) Abil thought that the NCR announcement was price sensitive and as such decided not to go ahead with the bond issue at that time; they then raised R2 billion in the local market instead;

(vi) February 2013 saw an improvement in collections; nevertheless Abil decided in April 2013 to increase provisioning and also to cut the dividend in order to preserve capital: all those things were viewed negatively by the market when the finances were released in May 2013 – that was the beginning of the slide in the share price;

[104] SARB(3)67

(vii) there was very little appetite to fund Abil further in the year from their existing funders;

(viii) depositors were not keen to roll-over their deposits and Abil had recently experienced withdrawals at a rate of about R400 million a week.

174. The following was minuted in regard to what was said at a Bank Exco meeting on 7 June 2013:[105] "…we were caught in a perfect storm. In hindsight Leon Kirkinis admits he could have communicated more a little earlier (i.e. how much provisions). Although we did warn that bad debts would be higher, it came as a shock and surprise to the market. The result is that my own credibility is not high at this time…"

175. On 12 June 2013 Mr Woollam, who was no longer employed by Abil, sent Mr Kirkinis an email, the subject of which was "Banking unit performance analysis".[106] He attached a spreadsheet. He extracted the following comments from the spreadsheet:

(i) growth had been the dominant driver in the business and this had been at the expense of both yield and credit quality;

(ii) the advances growth had come primarily from loan size and term expansion;

[105] AB(7)252
[106] AB(51)48,56

(iii) Tier 1 capital had grown by a compounded 17%, half of that of advanced growth; this had put the gearing levels too high with no margin for safety in the capital adequacy; this coupled with diminishing RoAs[107] made the business very vulnerable to stocks;

(iv) tangible RoAs had fallen from 15% in 2005 to 3,2% in 2012, which, whilst offset to some extent by increased gearing, had resulted in the tangible RoE falling from 45% to 25%;

(v) two key ratios that highlighted the problem were:

(a) credit losses to total revenue, which had increased from 16% to 45% over the past eight years;

(b) RoA to credit losses;

(vi) the business had maintained its singular focus on unsecured lending and had not been able to diversify its revenue sufficiently to complement the reducing margins from lending.

176. On <u>20 June 2013</u> Abil and the bank announced on SENS that the bank had issued R1 billion of senior unsecured bonds.[108]

177. On <u>21 June 2013</u> it was reported in the media that the market had given “a thumbs-up” to the bank by oversubscribing the unsecured lender’s

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[107] Return on Assets

[108] SENS(3)933; SARB(1)173

latest bond issue. The bank's share had fallen 56% over the past 12 months.[109]

178. In the discussion at a Project Phoenix meeting held on 29 June 2013[110] it was said by the Deputy Registrar that the trigger of the falling share price of Abil seemed to have been the NCR announcement on 8 February 2013, made worse by the results announced on 2 May 2013, which showed a major change in expected impairments and provisioning, signalling a material deterioration in assets quality and profitability. The advice should be to reduce asset growth to an adequate or sustainable level of growth, which the BSD had already nudged Abil to start doing. An important first step was to deal with the uncertainty of the NCT process. The following was noted: "We need to understand the sustainability of the business model and specifically whether the institutions are making adequate provisions aligned with the growth they are experiencing. For example, their approach to changing provisioning at once seems they were not done appropriately."

179. On 30 June 2013 Mr Sithole tendered his resignation as an NED from the boards of Abil and the bank in a letter of that date.[111] (His resignation in the result only became effective on 16 September 2013). In the resignation letter Mr Sithole referred to the fundamental

[109] Media(1)151
[110] SARB(3)135
[111] E(3)384

differences that he had with management on the state of the business. Included in the letter were these three sections:-

Historical background

178.1 Mr Sithole referred to a monthly board conference call on 24 April 2013 in which management informed the board of the following developments:-

(i) Abil would be 26% down from prior years for the 6 months to 31 March 2013;

(ii) sales were down and collections had significantly come off;

(iii) Company 005, the Ellerines channel, continued to perform badly and weighed down results;

(iv) an additional R350 million of provisions had been booked and therefore it was unlikely that the business would pay dividends in the first half;

(v) it was management's view that this was a once-off bleep and the second half results would be back on track and the business expected to pay the full dividends at the end of the year.

178.2 Mr Sithole described how he believed that a special board meeting should have been held; he requested that Deloitte review the adequacy of provisions before the planned release of the trading statement on 29 April 2014; but this request was blocked by management; at a meeting on 29 April 2013 he strongly cautioned against taking an overly optimistic tone on the second half results as the state of the business was not as good as management were making it out to be.

178.3 Mr Sithole described the "root of the problem" to be: "By denying or not being aware of the true condition of the business, management postponed urgent corrective steps that could have been taken to address the situation…an opportunity was missed to disclose to the shareholders and the market the true condition of the business and appeal for shareholder support in raising capital. Instead management took what I believe is an overly positive tone which basically conveyed the message that the 31 March 2013 [results] were a once-off, that the business was well-capitalised and strong, and results would be back on track for 30 September 2013."

178.3 Mr Sithole said that the 31 March 2013 results were a shock to the market as the market expected Abil "…to have the foresight to trade with a safety buffer and not be caught by sudden market changes."

<u>What is the true state of the business</u>?

178.4 Mr Sithole's view was that there were fundamental problems with the business which would take both time and adequate capital to resolve. Those issues included:

(i) the 31 March 2013 results represented the first time the bank's results had gone backwards, pointing to major problems in the core part of the business, rather than just being Ellerines driven problems;

(ii) although the business made a R1 billion profit for the 6 months, it actually made a R47 million economic loss, meaning the business did not generate enough returns to meet the shareholders' cost of equity;

(iii) the R350 million additional provisions were conveyed as additional insurance benefits; in reality these were provisions for bad debts, and, even more worryingly could not be passed through the bank as the bank did not have sufficient capital for the charge without falling below SARB's minimum capital requirements – a red light signal if ever the business needed one;

(iv) dividends had to be either drastically reduced or not paid at all because the group only had R144 million of excess capital above the regulatory minimum threshold; this was not a choice between being able to pay the dividend and choosing to strengthen the capital base as was communicated to the market;

(v) from December 2013 collections previously trending below expected levels dramatically worsened with the business unable to ignore the crisis in terms of additional provisions for its half-year results; although the group's capital levels could withstand R350 million of additional provisions, there was no capital to provide for the additional R500 million short-fall on the ML book valuation; this R500 million had been postponed to the second half of the year; this obviously assumes that nothing goes wrong or that the credit environment does not worsen;

(vi) from around 2007/2008 the business embarked on a mission to reduce yield so as to benefit from price/volume elasticity, manifesting itself in the R75 billion advances target; but this preoccupation with sales over profitability has been very negative for the business in the following ways:

(a) yields have fallen more than budgeted for every year since 2007, and this has been reflected in the declining ROA;[112]

(b) from 2007 the yield has fallen by 33% from 49,2% to 32,8% while bad debt charge has increased as a percentage of total yield by 151% from 18,1% in 2007 to 45,4%; in short, the business is taking in much less in terms of yield but losing much more in terms of bad debts;

(c) the drive for the R75 billion target resulted in longer term sizes and larger loans to the same customers, which notched up the risk for the business;

[112] Return on Assets

(d) the bank's economic profit had not materially changed since 2008; the normal profit increased from R1,442 billion in 2008 to R2,580 billion in 2013; but economic profit decreased from R1,060 billion in 2008 to R945 million at 30 September 2012; in summary, the business had gone backwards since 2008 but now has the added headache of a R59 billion book producing sub-optimal returns and NPLs have ballooned by almost four times from R4,5 billion in 2008 to R17 billion in 2013 with a miniscule buffer for increased bad debts;

(vii) the business commenced some aggressive accounting around 2008 which boosted profits through the ML book, which now stands at around R2,1 billion; management have agreed to stop this accounting treatment, but the point proves that the business had fundamental issues as far back as 2008, and the ML book accounting treatment first postponed some hard decisions that needed to be taken at that crucial stage;

(viii) collections have not been to the levels expected; the past few year-end audits have focussed more on convincing Deloitte of the expected future benefits to collections from recent investments in the collection personnel; this will be difficult to do after the 31 March 2013 results;

(ix) the Ellerines acquisition has not been a success and has proved to be drag on the overall business and on management focus.

<u>November is a make or break deadline</u>

178.5 Some of the points made by Mr Sithole are the following:-

(i) EHL is likely to produce worse sales than at half-year;

(ii) the forced pull back in sales due to the current liquidity crunch has a negative impact on the bad debt situation;

(iii) there is a high probability that the regulatory capital threshold will be breached at year-end due to the poor results;

(iv) the R4 billion EHL goodwill will be hard to justify to Deloitte and the market, and needs to be written off;

(v) Deloitte might be of the view that the R900 million loan to EHL is not recoverable in full and some provision is required at year-end;

(vi) Collections are improving but have been below target levels for the past 12 months or so, resulting in Deloitte requesting more provisions.

180. Mr Kirkinis testified that he replied to Mr Sithole's letter of 30 June 2013. He handed in an undated letter.[113] Mr Sithole has no recollection of receiving the letter.[114] In the letter Mr Kirkinis stated, *inter alia*: "Your

[113] E(3)392.1, T680S
[114] E(3)406.1

reasons for your proposed actions are detailed in your letter, so I won't dwell on them in detail. What I propose to do in my response is to clarify certain assumptions and conclusions…I think you have come to your conclusions prematurely…It has never been my intention to drag things on until February, we do not have that luxury…In times like we are facing it is imperative that as Directors and leaders we remain calm, level headed and cognisant of our responsibilities to each other, our staff, regulators, shareholders, funders and other stakeholders."

181. On 2 July 2013 Mr Raubenheimer sent an email to Messrs Roussos, Muller and Nalliah, which was copied to Mr Kirkinis.[115] Mr Raubenheimer referred to a meeting which had been held the previous Friday. He called on his colleagues to let him know if his email did not accurately reflect the discussion. He stated that Mr Nalliah had explained that some issues in Abil's financials – which had been inherited from his predecessor – were not ideal: eg the accounting of the ML value on the balance sheet and discounting the *in duplum* accounts at zero as the effective interest rate. Those issues had also been noted by Mr Kirkinis as areas of concern which needed to be dealt with. Mr Raubenheimer "once again" expressed his concern around the following issues that were problematic in the Abil provisioning methodology and were not being given the right level of focus and attention:

[115] AB(51)67

(i) discounting *in duplum* accounts at zero;

(ii) calculating an IBNR reserve for all accounts up to CD3;

(iii) ignoring fees paid to EDCs[116] in calculating cash flows;

(iv) ignoring insurance premiums paid over to Stangen in calculating cash flows on NPLs. Mr Raubenheimer stated that he would be more comfortable if:

- it was acknowledged that Abil was underprovided;
- the under-provision was quantified;
- a plan was made to address the situation;
- the acknowledgement, the quantification, and the plan were communicated to Deloitte, the Group Risk Committee and SARB.

182. On 4 July 2013 Abil and the bank announced on SENS that Moody's Investors Service (Moody's) had changed the outlook for the ratings of the bank from stable to negative.[117]

183. It was reported in the media on 5 July 2013[118] that the release of poor results earlier that year, including a decision to write down R445 million of bad loans and cut its first half dividend by 71% to 25 cents per share, saw Abil's share price plunge more than 50% in 2013 and triggered substantial fears over the sustainability of the unsecured lending sector.

[116] External Debt Collectors
[117] SENS(3)944
[118] Media(1)154

184. On 9 July 2013 the Registrar wrote a letter to the NCT about the NCR and African Bank matter. He advised that "…in view of financial stability concerns, it is imperative that this process should not suffer any further delays."[119]

185. On 31 July 2013 Mr Nalliah sent Mr Petros a document, "Abil: Liquidity and related issues".[120] Mr Nalliah listed 16 major issues which faced Abil and the bank, including the following:

(i) post the release of the interim results, market sentiment towards Abil and the unsecured lending industry had changed for the worse;

(ii) their drop in market capitalisation from R24 billion to R12 billion had posed challenges for some funders;

(iii) the drop in roll overs of maturities of money market funding in June [2013] to about 55% from historic levels of 75% to 85 excluding new funding had resulted in a cut in sales of new loans/credit to customers; this action was one within the control of the executives, but there was a risk that too deep cuts for prolonged periods might damage the franchise permanently;

(iv) the planned capital raise of about R3,5 billion, which would be announced at the time of the third quarter trading update on 5

[119] SARB(3)144
[120] AB(51)69

August 2013 was hoped to restore confidence in the capital base of Abil/African Bank for the funders.

186. A meeting was held between the boards of directors of Abil and the bank, the BSD and Deloitte on 1 August 2013.[121] The Deputy Registrar made a presentation in which it was noted that:

(i) African Bank's funding structure was different from the peer group in that 72% of funding consisted of long-term bonds and promissory notes, whereas the peer group had only 1% of long-term bonds;

(ii) the increasing trend in credit losses was due to an increase in the migration of loans from the performing to the non-performing category together with a reduction in the amount of rehabilitated non-performing loans;

(iii) the bank reported a year to date profit before tax of R610,4 million in May 2013, versus R942,9 million in May 2012, mainly owing to the increase in credit losses.

187. In its slide presentation[122] Abil described the year as "tough", which related to:

(i) the NCR proposed fine;

(ii) disappointing results:

[121] SARB(3)168
[122] SARB(3)175

(iii) headline earnings declined by 26%;

(iv) return on equity declined by 14%;

(v) ordinary dividends per share declined by 71%;

(vi) a 50% decline in Abil's share price. The BSD raised its concern regarding the increase in the percentage of impaired advances to gross loans. But it was said it was important to maintain perspective:

(a) Abil remained resiliently profitable, R1015 headline earnings for 2013 HY;[123]

(b) Abil's balance sheet had been strengthened further – increased dividend cover;

(c) Abil raised long-term 3 to 5 year funding of R4,9 billion during FY2013;

(d) rated "best buy" by the analyst community – showed sustainability;

(e) the PIC, Genesis and Coronation had increased their stakes in Abil;

(f) leadership remained stable and committed.

188. On 2 August 2013 the Deputy Registrar addressed a letter to Mr Kirkinis in which he referred to what had occurred at a credit risk prudential meeting on 19 June 2013.[124] Abil had indicated at the meeting that

[123] HY = Half Year
[124] SARB(1)170

provisions for bad debts were governed by the incurred loss methodology as follows:

- all non-performing loans (substandard to loss) were provided for; and
- provisions on the performing portfolio were in the form of an incurred-but-not-reported component. With regard to impairment models, Abil advised that it utilised cashflow projections and performed back-testing on 2011 data. Abil indicated that external settlements from competitors had overstated their collection rates during the second and third quarters of 2012. The decline in the collections performance during December 2012 was largely due to debit order disputes and customers switching their accounts. It was noted that Abil's write-offs had increased from R1,8 billion during the first half of 2012 to R3,5 billion during the first half of 2013 due to the introduction of the collections scorecard.

189. On 5 August 2013 Abil announced on SENS its intention to raise up to R4 billion in equity capital: Abil had entered into a standby underwriting agreement with Goldman Sachs International (Goldman Sachs) for up to R4 billion.[125]

[125] SARB(3)202

190. On the same day, 5 August 2013, Abil and the bank issued their quarterly update for the third quarter ended 30 June 2013.[126] The banking unit's operational performance showed:

(i) gross advances growth continued to slow, growing by 19% to R60,3 billion year-on-year relative to the 25% year-on-year growth as at 31 March 2013;

(ii) the number of loans disbursed for the 9 months to June 2013 decreased by 11% to 1,4 million;

(iii) average net loan size increased by 2% to R12 300;

(iv) average term was 50 months, relative to 49 months for the first half of 2013.

191. It was described by the media on 11 August 2013[127] as "one of the most remarkable about-turns in recent years, but African Bank is playing down the sale of troubled retailer Ellerines, which it bought only five years ago for R9 billion." The article went on to point out that African Bank's share price fell 53,4% from R32,20 to R15, while its NPLs spiked up to 30,2% of its total advances. The article referred to Ellerines having been "an albatross" for the bank almost since the day it was bought.

[126] SARB(3)203
[127] Media(1)161

192. A bilateral meeting between the BSD and Deloitte took place on 22 August 2013. In a letter dated 17 September 2013[128] from the Registrar to Mr Jordan of Deloitte the matters discussed at the meeting were described. It was indicated that the following were of concern with respect to Abil's future viability and required careful monitoring:

(i) liquidity management;

(ii) increase in bad debts and the resultant effect on Abil's headline earnings;

(iii) net advances growth had been moderate compared to five years before and therefore income streams had decreased;

(iv) a decrease in Ellerines' sales and resultant losses;

(v) capital management;

(vi) settling the alleged reckless lending accusation by the NCR as soon as possible;

(vii) the BSD requested Deloitte to review the following on its behalf in regard to advances:

(a) Abil's loan and credit card origination process for effectiveness of controls';

(b) the nature and extent of the increase number of fraudulent loans at Abil.

[128] SARB(1)183

193. On <u>28 August 2013</u> Mr Raubenheimer sent an email to Messrs Kirkinis and Nalliah on "impairment conversations".[129] He referred to a conversation with them on the Thursday morning when the following was debated:

(i) He had indicated that his view was that they would end FY2013 with a shortfall of the GL[130] compared to the IAS39 model of R1,029 billion on NPLs and R121 million on MLs;

(ii) Deloitte had indicated that they would accept the gap that existed on the ML, provided that the gap was closed off by the time that they had to sign the financial statements. Mr Raubenheimer calculated that the ML gap should be reduced to zero by November 2013 if write-offs continued between R500 and R600 million for the months August to November.

(iii) His view remained that they had no choice but to increase impairments in the balance sheet to the level required by the model on the NPL book. Failure to do so constituted a misstatement of the Abil financial statements.

(iv) His views were informed by:

(a) the knowledge that the models were aggressive insofar as they discounted *in duplum* accounts at zero;

(b) the current model back tests compared to actual cash flow on a historical basis;

[129] AB(52)134
[130] General ledger

(c) all indications were that the consumer was under more financial pressure and higher indebtedness which would reduce future recoveries,

(d) Abil's coverage of 60% on NPLs was low compared to the market (ABSA-65%; Standard Bank-70%; FNB-85%) whereas Abil's collections methodologies were similar and its risk appetite was much higher;

(v) all participants agreed that discounting *in duplum* accounts at zero was not defendable;

(vi) he predicted that write-offs would amount to R7,7 billion during FY2014, which was R.7 billion more than previously forecasted. This increased his forecasted impairment charge for 2014 from R8 billion to R8,4 billion;

(vii) after being asked for additional calculations he reduced his estimation of the NPL gap from R1,29 billion to R831 million.

194. In Abil's quarterly results presentation on 4 September 2013[131] the "consumer environment" was described as "challenging" as "evidenced by":

(i) elevated levels of indebtedness and deterioration in consumers' affordability;

[131] SARB(3)334

(ii) disposable incomes eroded by fuel, utility tariffs and higher than anticipated inflation;

(iii) consumer confidence impacted, leading to lower demand for credit and for durable goods;

(iv) industry-wide slowdown in the granting of unsecured lending;

(v) short term woes should not detract from long term growth view of the middle market of South Africa.

(vi) The outlook for the banking unit was:

(a) trading conditions expected to remain challenging;

(b) advances growth would continue to slow towards the lower end of the target range of 18% - 22%;

(c) collections remained tough but were stabilising;

(d) the risk charge was to remain elevated for 2013; risk reduction measures should benefit charge from 2014;

(e) incoming yield was higher and the credit card *in duplum* charge effect was diluting;

(f) operating costs and funding cost growth should remain well contained;

(g) marginally higher impairment charge, lower sales, and share incentive scheme hedge costs were likely to result in lower H2 profits from H1;

(h) changes in Abil's offering boded well for risk-adjusted returns over medium term.

195. At the Group Audit committee meeting on 4 September 2013[132] Mr Nalliah advised that funders might raise concerns about the bank's continued funding of Ellerine Furnishers, considering Ellerine Furnishers' current trading position and its ability to repay the loan, and consequently withdraw funding from the bank.

196. On 10 September 2013 the Governor addressed a letter to the Minister of Finance,[133] in which she expressed the view that liquidity was Abil's biggest risk in that it was funded in the wholesale and capital markets, and was entirely dependent on maturities being rolled over or being replaced by new funding. She stated that it was important to keep in mind that the bank was currently solvent, adequately capitalised with a capital adequacy ratio of 27,27% and recorded profit of R505 million for the six months ended 31 March 2013. The Governor concluded by stating that it was important that the uncertainty relating to the NCR charges against the bank be resolved without any further delays. In order to expedite the resolution of the matter she proposed that an urgent meeting between the Minister of Finance, the Minister of Trade and Industry and herself be convened as soon as possible.

[132] AB(6)272
[133] SARB(3)375

197. On 12 September 2013, an article was published, "South Africa's Chelsea Flower Show, team leader 'sacked for being drunk on the job,'" in which it was reported that Mr Sokutu, then chairman of the National Biodiversity Institute, had been so inebriated that he had to be kept away from guests at a reception at the Chelsea Flower Show to celebrate the team's latest gold medal win in May.[134] Mr Sokutu, an executive with African Bank, was quoted as admitting that "a few of us were drunk and I happened to be the chair and therefore noticeable." The office of the Minister of Environmental Affairs issued this statement: "The Minister has recently learnt of an incident that allegedly occurred in May 2013, pertaining to the chair being under the influence of alcohol at the Chelsea Flower Show. In discussing these allegations with Tami Sokutu, the Minister and Sokutu agreed that Sokutu should be released from his position as chairman of the board."

198. In reply to a request from Mr Roussos for "a recon of all the adjustments reconciling the gap",[135] Mr Raubenheimer stated on 15 September 2013 that the projected gap at year end was R1,129 billion, which, after taking into account "IAR168, two additional debits to IS400 and 68 expected additional claims, would be R497 million." Mr Raubenheimer expressed the view that even R497 million was unacceptable. The problem was

[134] Media(1)165.1
[135] AB(51)75

much greater after taking into account *in duplum*, IBNR, and post-default advances into account.[136]

199. A meeting of the boards of Abil and the bank took place on 16 September 2013.[137] Mr Kirkinis reported that a number of options for the disposal of EHL were being considered. He said, in regard to "budgets" that to a large extent the emergence of higher than anticipated NPLs and a higher risk charge had been the cause of the poor performance. Mr Nalliah, in presenting the FY2013 forecast stated that:

(i) the Group experienced a difficult year mainly as a result of:

(a) a higher bad debt charge;

(b) yield on advances decreasing due to the suspension of income and lower fee income from SRAs and consolidated loans; and

(c) declining furniture sales.

(ii) The Abil group forecasted an economic loss of R674 million compared to a budgeted economic profit of R959 million.

(iii) Forecasted headline earnings for the banking unit were R1,710 billion, which were 47% below budget and 34% lower than the previous year. Mr Roussos noted the following in regard to NPLs:

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136 AB(51)75

137 AB(24)578

(a) the high level of NPLs was as a result of poor collections that commenced 9 months before and had been exacerbated by changes to underwriting;

(b) as at 31 August 2013 NPLs were at 32% of advances;

(c) collections were the key to NPL performance.

200. Abil and the bank issued their trading statement on results to 31 August 2013 on SENS on 18 September 2013.[138] It was stated that the South African economy and operating environment within which both the retail and credit businesses operated continued to prove challenging with little respite expected in the next year. In light of those market conditions the board had implemented further prudent and definitive actions at Ellerines and the banking unit "which provide a solid underpin for a recovery into the latter part of 2014 and beyond." In regard to the banking unit it was reported that in light of the current economic climate the impairment provision against NPLs was expected to be increased by between 2,5% and 3,5% of the NPLs, from the 60% coverage reported at 31 March 2013. The after tax headline earnings impact of that increase was expected to range between R350 million and R500 million.

201. On 3 October 2013 Abil and the bank announced on SENS that African Bank had agreed to pay R20 million to the NCR in settlement of the

[138] SENS(3)987; SARB(1)187; SARB(3)383

Dundee matter [in which the NCR had proposed a fine of R300 million].[139]

202. It was reported in the media on 4 October 2103 that after the announcement of the settlement with the NCR, that shares in Abil had gained 5,43% to R19,40 the previous day.[140]

203. A meeting between the BSD and Mr Kirkinis took place on 14 October 2013.[141] Mr van Deventer of the BSD told Mr Kirkinis that the main concerns of the Governors were:

(i) impairment issues;

(ii) the Governors had requested:

- a detailed liquidity plan; and
- a detailed capital plan, especially in view of the breach of capital requirements.

The update Mr Kirkinis gave included the following:

(i) everything was on track with regard to the rights issue;

(ii) at the end of the previous year the provisions were 60% but would be increased to 62,5% and 63,5%;

(iii) Deloitte were “going the other way”: they based their argument on four issues:

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139 SARB(3)447
140 Media(1)166
141 SARB(3)480

- models and the prediction of cash into the future: Kirkinis said that they (Abil) still believed in their models;
- valuation of the written-off portfolio;
- incurred but not reported (IBNR) reserve;
- *in duplum* discounting, which had grown to around R1 billion. Mr Kirkinis said Deloitte wanted Abil to provide an additional R700 million more, which added up to R1,4 billion. He said that they (Abil) would settle for R500 million more. He advised that Abil had written off R7 billion more during 2013 than 2012.

204. An undated report was prepared by the office of the Registrar at the request of the Governors at a meeting held on 11 October 2013.[142] The background to the report was that the Registrar was informed by Abil in a letter dated 11 October 2013 that the minimum capital-adequacy requirement might be breached for the following reasons:

(i) Abil's operational risk capital floor of 12% of risk-weighted assets;

(ii) the projected dividend payment of about R200 million between January and February 2014, subject to Abil's year-end results;

(iii) the raising of additional impairments of about R700 million:

(iv) the bank : R550 million;

[142] SARB(1)192, SARB(3)449

(v) Stangen : R150 million.

The report indicated that:

(i) the BSD was prepared to decrease temporarily the operational risk capital floor from 12% to 6% for the period 30 September 2013 to 31 December 2013;

(ii) given that Abil would be the operating very close to their ICR[143] of 24,5%, the successful rights issue in late November 2013 or early December 2013 of R4 billion was critical to restoring Abil's capital adequacy to satisfactory levels. The view was expressed that if Abil raised the additional R700 million impairments requested by Deloitte, the ICR of Abil and the bank would not be breached.

205. A special meeting of the boards of Abil and the bank was held on 18 October 2013.[144] The purpose of the meeting, so said Mr Kirkinis, was to update the boards on recent developments within the business primarily relating to provisions for impaired loans. Following an extensive review by Abil and Deloitte of the loan impairment provisions methodology, it was concluded that an additional R1,7 billion of provisions was required largely due to an *in duplum* adjustment. The total amount of the *in duplum* adjustment was R2,2 billion, of which about R800 million related to the written-off portfolio and about R1,4

[143] Individual Capital Requirements
[144] AB(24)584

billion to the non-performing portfolio. Management had undertaken a significant write-off on NPLs in the current financial year by changing the write-off criteria from no payments in the last 17 months to last 12 months. Given the magnitude and impact of the cumulative adjustments, the financial statements for the year ended 30 September 2012 would be restated. Mr Pinnock and Mr Jordan of Deloitte advised the boards that although the *in duplum* issue did not make sense commercially, the adjustment to provisions was necessary in terms of IFRS[145] accounting standard IAS39.[146]

206. On 22 October 2013 Mr Kirkinis (Abil) wrote a letter to the Registrar[147] in which he stated that Abil had finalised the impact of year end provision entries on the treatment of *in duplum* loans " … on which in terms of the National Credit Act, African Bank is no longer entitled to charge interest and fees ("*in-duplum* loans") and provisions for "incurred but not yet reported" ("IBNR") losses in the insurance activities in the group". The additional provisions amounted to about R2,375 billion and were raised in the bank as an additional provision of about R2,175 billion and in Stangen as an IBNR loss of about R200 million. This would negatively impact capital adequacy. Abil requested a lowering of the capital adequacy ratio.

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[145] International Financial Reporting Standards
[146] International Accounting Standard
[147] SARB(3)580

207. The Registrar agreed to reduce both Abil's and the bank's ICR from 15% to 11% as reflected in a letter from the Registrar to Abil on 23 October 2013.[148]

208. On 25 October 2013, Abil and the bank published on SENS their trading update for the financial year ended 30 September 2013.[149] "Key features" were:

(i) core operating business stable through September 2013 year end;

(ii) risk reduction measures and focus on collections were beginning to improve asset quality;

(iii) no material change risk profile of the advances book;

(iv) recognizing an incremental loan impairment provision of R1,3 billion and a decrease of R0,8 billion in the value of the written down book through changes in relation to non-cash flow items;

(v) increase in IBNR for credit risk by R0,3 billion;

(vi) adopting a more conservative write-off policy;

(vii) increasing the NPL coverage rate to 66% for FY2013, relative to 60% in FY2012;

(viii) goodwill impairment of R4,6 billion;

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148 SARB(3)583

149 SENS(3)1004; SARB(1)216

(ix) expected headline earnings of between R300 million to R400 million and an expected basic earnings loss of between R4,2 billion and R4,3 billion for FY2013;

(x) increasing the rights offering size to R5,5 billion underwritten by Goldman Sachs;

(xi) Tier 1 and Total Capital ratios post the rights offering and inclusive of the impairment estimated to increase to between 25% to 26% and 33% to 34% respectively.

209. The trading update disclosed that Abil had decided to implement certain non-cash flow measures which would affect the financial results for the full financial year:

(i) a change in the loan provisioning methodology;

(ii) an increase in IBNR reserves for credit risk;

(iii) a change to the write-off policy of impaired loans;

(iv) a change to Abil's IBNR accounting policy for credit life insurance;

(v) an exceptional non-cash charge for impairment of goodwill.

210. The trading update dealt with "Restatement following a change in the loan impairment provisioning methodology" as follows:

"In terms of the NCA, once a credit agreement goes into arrears, a credit provider cannot raise interest, fees and charges in excess of the total outstanding amount of the balance determined at the time that the first arrears occurred. ABIL has applied this requirement consistently across all its portfolios when defaulting loans reach the "*in duplum*" threshold (threshold loans).

For the purposes of calculating the impairment provisions against the non-performing and written off loans on a portfolio basis, accounting standard IAS39 does not have an alternative treatment for situations where no interest and fees are permitted to be charged and requires the application of the effective interest rate of the loans at origination for purposes of the present value calculation. ABIL historically applied a lower weighted average effective interest rate to calculate the present value of impaired loans, taking into consideration the fact that no interest or fees are being charged on the threshold loans. As a result of the growth in the threshold loans over time, the difference between the two provisioning methodologies has cumulatively become material for the financial year 2013. The group has therefore changed its provisioning methodology to discount all forecast cash flows at the original effective interest rates. Accordingly, ABIL intends to recognize an increase in impairment provisions relating to current year credit losses in financial year 2013. The total impact of the adjustment as at 30 September 2013 is expected to amount to R2 175 million and resulted in an expected increase in provisions of R1 353 million held against the NPL portfolio and a further write down in the written off book of R822 million. The expected net income statement impact is R2 175 million pre-tax for the financial years up to 2013 or R1 566 million post tax of which R608 million will be recognized in 2013 and R958 million will be recognized in prior years."

211. A meeting of the Group Risk Committee was held on 29 October 2013.[150] The following was noted:

Core competencies

(i) in the past, the bank's core competency had been credit underwriting, however, this no longer appeared to be the case;

(ii) previously the business was predominantly sales driven but there had been a change to rather focus on the quality of returns; with the increase of competition in the unsecured credit industry, the business lacked an understanding of the level of risk being introduced into the industry and lost control [of] risk;

(iii) even though the business had cut back on risk, it was not proactive enough in doing so, and there had been poor detection of early warning signs;

(iv) notwithstanding the implementation of biometrics, external fraud involving staff collusion, remained a serious concern;

(v) bad faith loans which were used as an indicator for fraudulent activity, had reduced from an average of R65 million to R25

[150] AB(4)239

million a month due to the rollout of biometrics and other preventative action.

Liquidity risk

(i) Mr Kirkinis noted that liquidity remained a major risk until the close of the rights offer and receipt of the additional capital;

(ii) a decline in funding roll rates was seen following the release of the interim results and the subsequent fall in the Abil share price, roll rates had since improved to levels of around 80%;

(iii) Investec, who was the bank's largest funder, seemed to be maintaining a stable funding strategy: they were rolling about 75% of their funding;

(iv) it was estimated that a negative cash balance of R250 million would be received by mid-November 2013; in the event that roll rates decreased to around 45%, a negative cash balance of R422 million was estimated;

(v) the final lever would be to pull back on sales to reduce liquidity pressures.

Collections

(i) There had been a significant improvement on collections of new business due to improved risk profiling;

(ii) collections on the existing book had stabilised but at a lower level;

(iii) customer affordability was still under pressure;

(iv) a correlation was seen between the increase of risk in the business and the increase of competition in the industry;

(v) the organisational mindset had changed from driving sales to driving value and areas where value was created and destroyed had been identified.

Impairment provisions

(i) There had been an increase in bad debts as a result of some internal data issues that occurred from September to October 2012 that impacted the scorecard and risk distribution;

(ii) R3 billion had been written off; the percentage of NPLs decreased from 32,7% to 28,6%;

(iii) adopting a write-off policy to 12 months recency was prudent;

(iv) the practice was to discount loans that were *in duplum* at 0% which had since been changed to the original effective interest rate; the change had a significant impact and resulted in a R2 billion charge;

(v) changes to the provisions methodology had been implemented for loan accounts that received no payments for more than 12 months, resulting in a R3 billion write off;

(vi) a total of R7 billion of NPLs were expected to be written off in the next financial year.

212. On 1 November 2013 Abil and the bank published on SENS their reviewed financial results for the eleven months ended 31 August 2013:[151]

(i) headline earnings and headline earnings per share decreased by 88% to R320 million (2012: R2,763 billion restated) and 39,6 cents (2012: 343,7 cents restated) respectively;

(ii) the banking unit was negatively impacted by slower disbursement and advances growth, as well as deteriorating asset quality with commensurate higher credit impairment charges and credit life insurance claims;

(iii) Ellerines generated a headline earnings loss of R226 million (2012: profit of R200 million).

213. On the same day, 1 November 2013, Abil announced on SENS a R5,5 billion rights offer.[152]

214. On 4 November 2013 in an article referring to the reviewed results for the eleven months ended 31 August 2013 and the R5,5 billion rights,[153] it was stated that the rights offer was expected to save the Group from what could have been inevitable bankruptcy. After falling 6% after the announcement, Abil's shares were flat at the close at R17. The share price fell to a low of R14,20 in July 2013 as bad debt soared and

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151 SENS(3)1041
152 SENS(3)1074; SARB(3)598
153 Media(1)169

advances growth was curtailed. A banking analyst was quoted as saying: “Realistically speaking, Abil shares could not go any lower.” Abil management expressed confidence on Friday, 1 November 2013, that the group had now finally turned the corner.

215. On 11 November 2013 Abil and the bank announced on SENS their reviewed financial results for the year ended 30 September 2013:[154]

(i) the return on equity was 2,9% (2012: 24,3%);

(ii) headline earnings declined by 88% to R365 million (2012: R3 billion);

(iii) the bank’s gross advances grew by 11% to R59 billion (2012: R53 billion);

(iv) there was an economic loss of R1,5 billion (2012: economic profit of R1,2 billion);

(v) exceptional non-cash items which negatively affected the 2013 results were:

(a) a change in the loan impairment provisioning methodology;

(b) a change in accounting policy to account for the IBNR on balance sheet;

(c) the write-off of goodwill;

(d) changes to the write-off policy;

(e) a charge for the LTIP; and

[154] SENS(3)1092; Media(1)171

(f) an increase in the credit IBNR portfolio provision;

(vi) the bank's headline earnings reduced by 77% to R654 million (2012: R2,9 billion) and generated an economic loss of R879 million (2012: economic profit of R1,4 billion);

(vii) Ellerines generated a headline earnings loss of R284 million (2012: profit of R249 million);

(viii) in "Looking ahead" it was stated that in the next financial year Abil's response to address the challenges was beginning to produce the desired results and "should provide a solid underpin for a recovery into the latter part of financial year 2014 and beyond, barring significant additional economic headwinds."

216. On 20, 22 and 25 November 2013 Abil announced on SENS that Mr Kirkinis had sold Abil shares and would use net proceeds, after taxation, towards the exercise of all of his allocated rights in Abil's rights offer.[155] The sales were R44 423 505,78; R10 966 864,39, R29 101 976,92 and R2 787 913,35.

217. In the SENS announcement of 25 November 2013, Mr Kirkinis is quoted as saying.[156]

[155] SENS(3)1130, 1133, 1142
[156] SENS(3)1143

"I am confident that we have taken the required action over the past few months to position the business for improved profitability over the medium to long term."

218. On 28 and 29 November 2013 Abil announced on SENS that Mr Kirkinis had sold Abil shares for R30 093 595; and purchased Abil shares for R112 438 200, and R1 750 643,42.[157]

219. A meeting of the Asset and Liability Committee meeting (ALCO) was held on 3 December 2013. (ALCO is a management committee.) The following was highlighted in regard to Ellerines:

(i) the sales for October 2013 ended the month being down 36% relative to the prior year;

(ii) the November sales for the month to date were down 21% relative to November 2012;

(iii) should the sales trends continue, Ellerines would breach the African Bank facility by 8 January 2014;

(iv) a resolution would be put to the bank board on 7 December 2013 motivating an increase in the facility.

220. The Abil and bank boards held a meeting via teleconference on Saturday, 7 December 2013.[158] Mr Nalliah advised that the

[157] SENS(3)1147,1150
[158] AB(24)586

consolidated adjustment for the Abil group was R552 million, taking headline earnings to R1,5 billion. The major risks to achieving the FY2014 budget were:

(i) the banking unit's sales were below budget; the yield increase had not fully materialised; and the bad debt charge being higher, gave rise to a total adjustment of R200 million;

(ii) Ellerine's sales growth of 5% was not being achieved; about R290 million after tax profit from short term loans; and additional value share from the bank, with the implication that Ellerines could make a loss of about R73 million;

(iii) the bad debt charge had been increased by about R1,2 billion to ensure that the tolerance of the provisions gap was reasonable in relation to Deloitte's materiality assessment of the bank; the increase had reduced headline earnings for the banking unit from about R2,5 billion in the previous budget to about R1,8 billion in the revised budget.

221. On 9 December 2013 Abil published on SENS the results of the rights offer: the offer was oversubscribed by 64,11%; Abil raised the full R5,5 billion from Abil shareholders.[159]

[159] SENS(3)1159

222. In an article which was published on <u>10 December 2013</u>[160] reference was made to the fact that Abil had paid Goldman Sachs R192 million to underwrite the R5,5 billion rights issue. Mr Borner, Abil's executive for balance sheet management, said the fee was worth it. He was quoted as saying: "We believe that the confidence in the company has been restored. We are now moving forward from here."

223. On <u>31 December 2013</u> an article was published[161] in which the following points were made:

(i) several Abil executives saw their remuneration halve in FY2013;

(ii) Abil had announced plans to sell loss-making Ellerines, which it had bought five years before for R9,1 billion;

(iii) in 2013 Abil took a R4,6 billion impairment in goodwill on Ellerines;

(iv) Abil's R5,48 billion rights issue in December [2013] would be used to shore up the company's balance sheet and position it for growth after a tough year in which its earnings fell dramatically;

(v) the Group made an economic loss of R1,5 billion in FY2013 compared with a profit of R1,2 billion in FY2102;

(vi) Abil's share price closed at R12,05.

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[160] Media(1)175
[161] Media(1)180

224. On 28 January 2014 Abil announced on SENS that the PIC had increased its holding in Abil from 14,982% to 15,327%.

225. Abil and the bank published their trading update for the first quarter ended 31 December 2013 on SENS on 5 February 2014.[162] In relation to the banking unit the following was stated:-

(i) loan term and loan size increased on a year-to-year basis reflecting the move to lower risk customers;

(ii) the quality of new business had improved;

(iii) while collections remained challenging, the stabilising trend over the past few months remained intact;

(iv) the impact of the business written pre-June 2013 (the month in which the Group implemented drastic new credit granting measures) continued to negatively impact NPL formation;

(v) the overall impact was likely to be a significant reduction in profitability for the first half of FY2014 compared to the restated first half earnings of R604 million in FY2013;

(vi) they anticipated a recovery in profitability in the second half of FY2014.

In relation to Ellerines, it was stated that:

[162] SENS(3)1187

(i) there was a 21% decline in merchandise sales from R1,48 billion to R1,18 billion on a year on year basis;

(ii) profitability was expected to be considerably lower for the first half FY2014 in relation to the comparative period of the previous financial year. Mr Kirkinis was quoted as saying: “The group has emerged in a stronger position from an extremely challenging year and has now entered a new chapter in its history. On strategic actions undertaken in 2013, and the improvement in the quality of the new business written, are expected to produce improved results in the second half of FY2014.

226. A meeting between the BSD, Mr Kirkinis and Mr Nalliah was held on 6 February 2014.[163] Abil stated the following:-

Funding (market perceptions)

(i) roll rates were depressed but would stabilise;

(ii) there was a R2,5 billion bond that would come off in February 2014.

Profitability

(i) Out of the book of R64 billion, R12,2 billion had come out of the new book written after June 2013;

(ii) Abil was still feeling the pre-June 2013 business;

[163] SARB(1)228

(iii) the bulk of the NPLs would be out of the system by the end of the first half of FY2014 ie by March 2014;

(iv) the average interest rate that Abil charged was 21%, which was lower than the limit of 30%;

(v) two issues had impacted on profits:

(vi) (a) the investigation into insurance pricing;

(vii) (b) the affordability guidelines;

(viii) in terms of the budget for the first six months to 31 March 2014, Abil was slightly behind due to the volume of sales being a bit lower than what Abil had expected as the demand side was lower and Abil was lending less as a result of its strict credit criteria.

Ellerines

Ellerines would once again make a loss.

227. At a Group Risk Committee meeting on 7 February 2014:[164]

(i) Mr Chemel reported that a number of initiatives were underway to drive sales;

(ii) Mr Kirkinis reported that local funders had deliberately been reducing their exposure to the bank;

(iii) Mr Nalliah advised that Deloitte had been requested to audit impairment provisions for February 2014 to pre-emptively

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[164] AB(4)244

determine whether provisions were in line with Deloitte's valuation;

(iv) Mr Roussos advised that the gap between the model and GL was R925 million.

228. A Group Audit committee meeting was held on 7 February 2014.[165] The following points, amongst others, were highlighted:

Abil:

(i) Group headline earnings for the first quarter of FY2014 were R129 million 84% below budget and 95% below the prior year's restated comparative;

(ii) Ellerines suffered a headline loss of R25 million;

(iii) the credit impairment charge was R2,590 billion, R122 million higher than budget, mainly due to lower collections and a higher required NPL coverage;

Banking unit

(i) Generated headline earnings of R96 million, 44% lower than the budget of R170 million and 77% lower than the restated comparative period headline earnings of R416 million;

(ii) the bank generated a loss of R322 million, Stangen generated a profit of R453 million;

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[165] AB(6)278

(iii) sales in the bank at R5,6 billion were 25% lower than the R7,5 billion in the prior period;

(iv) PLs had increased by 2% whereas NPLs grew by 11%, representing 29,9% of gross advances;

(v) the facility from the bank to EHL had been increased from R800 million to R1,2 billion: "When the increase was approved by the Abil board, NN [Mr Nalliah] raised a question regarding the recoverability of the loan from EHL."

229. On 10 February 2014 Mr Raubenheimer provided Mr Kirkinis with his comments and critique of a document. Included in his comments were the following:-

"Decisions are made by three people. Excos are ineffective.

Nobody is responsible for P and Ls.[166]

We can't compete in the Low Risk space (where the Banks play) because we insist on subsidising High Risk.

3 Biggest challenges in Credit:

- We don't have a mandate to take decisions. Charles has a veto right over every decision…

3 Biggest challenges Abil faces:

- EHL to contribute value…
- Regulatory changes…

[166] Profits and losses

- We have no strategy…

Cultural change we need to undertake:

- 3 People make all the decisions…
- There is an attitude that accounting can be manipulated. The emergency write-offs, shadow gap accounting, to ML or not to ML…[167]

230. The Abil and bank boards held a meeting on 13 February 2014.[168] As part of the "Strategic Review" it was noted that a more client focused strategic direction could be embarked on by broadening the business from being only a credit provider to a financial services provider which encapsulated insurance and savings products. An in-depth review of the core business was required and immediate consideration be given to the choices between yield, sales volume, risk and increased collections initiatives, each of which had trade-offs. Mr Nalliah presented the forecasted 2014 interim and final results, highlighting, amongst others, the following:

(i) the Group's headline earnings for the six months would be R119 million, which was 80% below the restated results for FY2013;

[167] AB(51)94
[168] AB(24)589

(ii) headline earnings for the banking unit at R359 million were expected to be 41% lower than the comparative period;

(iii) Ellerines was forecasted to have a loss of R109 million after implementation of the deferred tax recovery initiatives;

(iv) the provisions gap based on the variance between the model and the general ledger at the end of September 2013 was R925 million. Mr Kirkinis notified the board of "the serious indication of interest from Shoprite Checkers to combine their business with that of Ellerines…".

231. On 13 February 2014, in an email to Messrs Kirkinis and Nalliah, Mr Jones expressed the belief that "…we are heading for a serious liquidity crisis within the group. This crisis is not very imminent, but is very real…the timing of this email is to give you the option of warning the board during your meeting today that funding is "difficult" at the moment."[169]

232. On 14 February 2014 Mr Jones reported on the "Funding Position" to Mr Nalliah (copied to Mr Kirkinis).[170] Mr Jones summarised what funders such as Allan Gray, Coronation, Stanlib, Sanlam and Momentum had told him. He said that Investec Asset Management were very concerned. They were disappointed with the trading update as their

[169] AB(51)104
[170] AB(51)105

impression from their meeting with Mr Kirkinis and the team earlier that month had not indicated that the historical book was still under performing; the results were worse than they had anticipated. They expressed frustration that Abil had not provided for more future NPL emergence during the 2013 year, particularly in view of the rights offer. They were also concerned about the continued deterioration of EHL and the impact of the funding requirement from EHL on the bank.

233. On 17 February 2014 Mr Kirkinis sent an email to a large group of employees with the greeting "Hey guys".[171] He mentioned the "leadership plug-in" which was to take place the following day:

"We need to find ways to lift the spirits and the energy of the people we lead and grow our unique culture positively…Tomorrow my hope is that I find a leadership team that shows up out of purpose and commitment, as opposed to attendance by way of your designated levels…Our people need to be led by a committed leadership team that is united in our purpose. Neutrality is not an option."

234. Later that afternoon Mr Jones set out his views on the Leadership Plug-In – what to expect" in an email to Mr Kirkinis.[172] Having stated that he was absolutely committed to the purposes of the bank, he continued:

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[171] AB(51)111
[172] AB(51)110

235. “I cannot, however, be committed to a business that is not prepared to change the content, method and process of the things we have done in the past that have led us to this low point in the history of this business…If other key pockets of our leadership cannot see the ugly warts of what we (they) have done in the past and commit to doing it differently in the future, then how can I be expected to unite with them in commitment to the business?”

236. In a document prepared by Deloitte for a SARB Trilateral meeting dated 20 February 2014[173] under the heading “Audit Finding: Impairments” the following was noted:

(i) the bank experienced a significant deterioration in credit quality during FY2013, particularly early in the year;

(ii) the following impairment modelling matters were identified and addressed:

(a) correcting the discount rate applied to defaulted advances that reached the *in duplum* threshold by processing a R2,2 billion adjustment;

(b) revising and updating inputs used in the IBNR calculation, resulting in a significant increase in impairment held for PLs;

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[173] SARB(4)99

(c) addressing the gap between impairment models and the financial records that were due to management discretion factors;

(iii) previous collection strategies had had limited success and the collection initiatives in the current year were still in their infancy. This was an area of significant judgment affecting the Group's financial results. Deloitte advised the Group Audit Committee to establish firmer guidance on the extent of the use of management discretionary factors pertaining to future cash uplifts;

(iv) there was room for improvement in the governance processes around the credit impairment and modelling processes;

(v) Deloitte expected the Group Audit Committee, and subsequently the board, to formally sign off on the nature and extent of cash uplifts embodied in the credit impairment models, as was the case in FY2013;

(vi) Deloitte was of the view that, though reasonable and adequate overall, the impairment provision remained on the less prudent side of their assessment of critical judgments, although there had been notable and encouraging improvement from 2012.

237. On 20 February 2014 Mr Jones, in an email to Messrs Kirkinis and Nalliah and others, warned that, despite the rights offering cash

received in December, total cash offerings had once again dipped below the minimum threshold of R2 billion. At the close of business the previous night the free cash balance stood at R1,813 billion. After anticipating that the cash position would be restored over the course of the next week, he continued:

"Obviously, we are not out of the woods yet – funders are very jittery. …"[174]

238. At a meeting of the bank Exco on 21 February 2014[175] Mr Kirkinis:

(i) Informed the meeting that that was the last meeting of the bank Exco in its present format;

(ii) requested each Exco member to submit a "one-pager" documenting "what went wrong". "What human behaviour and what data caused us to do what we did in extending too much inappropriate credit that has given rise to the NPL problem?"

239. The BSD prepared a document dated 21 February 2014 in regard to Abil and the bank: "Possible action plan going forward"[176] in which the following information was provided:

Balance sheet

(i) The bank's balance sheet grew by 9,22% (R5,9 billion) during the 12 month period ending November 2013;

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[174] AB(51)113
[175] AB(7)286
[176] SARB(4)185

(ii) The growth was due mainly to the unsecured terms loans that increased by R2,5 billion;

Credit risk

(i) The bank's total gross loans increased year-on-year by 13,11%;

(ii) impaired advances increased by 5,97% from R18,6 billion in December 2012 to R19,7 billion in December 2013;

Profitability

(i) The bank made a profit before tax of R80,9 million in December 2012 compared to a loss before tax of R192,7 million in December 2013;

(ii) the bank reported a year to date loss before tax of R446,4 million in December 2013 versus a profit of R101,9 million in December 2012. The decrease in profit could be attributed to the fact that credit losses increased from R1,8 billion in December 2012 to R2,6 billion in December 2013.

240. On 12 March 2014 the Registrar wrote a letter to Mr Symmonds, the acting chairman of the Group Audit Committee.[177] The Registrar referred to the trilateral discussions held on 20 February 2014. He

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[177] SARB(4)257

stated that Deloitte had explained that the following impairment modelling matters had been identified and addressed:

(i) correcting the discount rate applied to defaulted advances that had reached the *in duplum* threshold;

(ii) revising and updating input used in the IBNR calculation;

(iii) addressing the gap between impairment models and the financial records that had been caused by management discretion factors.

Deloitte said there was room for improvement in the governance processes around the credit impairment and modelling processes.

Abil forecast that Ellerines would incur a trading loss before taxation in 2014 of R389 million.

241. On 13 March 2014 a meeting took place between executives of the bank and the BSD.[178] The "Internal Notes" contained the following information:

Balance sheet:

The bank's total assets increased year on year by 7,72% from R65,6 billion in January 2013 to R70,6 billion in January 2014.

Profitability

[178] SARB(4)290

(i) the bank reported a year to date loss before tax of R540,6 million in January 2014, versus a profit of R198,7 million in January 2013;

(ii) the RoE ratio decreased from 9,99% in January 2013 to 9,38% in January 2014.

Liquidity risk

The roll rates of the bank decreased from 66,59% in November 2013 to 38,23% in February 2014.

Capital adequacy

The bank's capital adequacy ratio increased due to the rights issue from 26,54% in January 2013 to 31,66% in January 2014.

Credit risk

Impaired advances as a percentage of total loans on-balance sheet remained high for the period under review (12 months ending January 2014). The ratio decreased from 29,09% in January 2013 to 26,93% in January 2014.

Overall

Based on the low roll rates it would appear as if the investors/market confidence in the bank was then at an extremely low level which posed a huge risk on the future viability of the bank, which might call for more drastic action plans from the bank to avoid a total collapse.

242. At a Project Phoenix meeting held on 15 March 2014[179] it was noted that:

(i) the bank needed to issue bonds of R1,5 billion in April 2014 and R3,5 billion in June 2014: the success of those placements were dependant on the bank's interim results;

(ii) the assessment of the BSD was that the bank was likely to run short of liquidity in April/May 2014 if the bank did not successfully rollover their current funding and/or issue a replacement bond;

(iii) rollover rates steadily declined to 38%, improving to 60% in March 2014, of a now substantially reduced amount;

(iv) although the bank had had a successful capital raising in late 2013, with full disclosure to the market, it could not be said that the capital raising had restored market confidence in the bank;

(v) the assessment was that the profitability of the bank had not improved and was likely to deteriorate further given the rising impairments;

(vi) the bank was making a loss; but

(vii) the bank was solvent.

243. In his response to the "Strategic Tactical Initiative 2014-2017", Mr Roussos, in a document dated 17 March 2014, commented in regard to

[179] SARB(4)293

"Accountability": "this is a very weak area in my view, this "gentleman's agreement" approach doesn't and has not worked and I would strongly recommend that you please put in place individual performance contracts for each of the Exco members. …only two members of the previous Abil Exco have been willing to take some responsibility for some of the decisions that were taken."[180]

244. Mr Marais' comment was: "The theory sounds great. The question remains who and how will it be executed…the 2014 objectives are not new. …Sorry, but I have too much muscle memory."[181]

245. At a Project Phoenix meeting on <u>20 March 2014</u>[182] Mr Kirkinis said:

(i) the rights issue, though successful, did not result in the stabilisation of liquidity in the business;

(ii) June/July 2013 were the low points for the bank in terms of liquidity; impairments rose; "these were the key reason behind the loss making situation";

(iii) one of the issues had been a generally negative outlook and nervousness in the domestic markets;

(iv) there had been negative views communicated in Parliament during the NCA amendment bill process;

[180] AB(51)121
[181] AB(51)119
[182] SARB(4)313

(v) the interim financial results expected to be announced on 19 May 2014 could be potentially disappointing due to the current work being done with Deloitte on impairments;

(vi) the bank had increased the provision for impairments to R2,2 billion.

The five months forecast for the past financial year was for NPLs totalling R4,4 billion, whereas the actual number was R4,8 billion, which resulted in more provisions of R250 million.

246. On 20 March 2014 Mr Jones sent an email to Mr Nalliah, copied to Messrs Kirkinis and Borner, in regard to whether "…we really should be taking a bond to the market".[183] He expressed his frustration "…around the continual risk that we assume in this business as we are required to wait for an outcome of a decision around provisioning…I simply cannot believe that we are applying best practice here, I'm sorry."

247. At an ALCO meeting on 1 April 2014[184] it was minuted that it was projected that in the month of August 2014 Ellerines would breach the bank facility of R1,2 billion.

248. In an email dated 22 April 2014 to Mr Kirkinis, Mr Chemel stated that, outside of provisions, he was particularly worried about the impact of

[183] AB(51)123
[184] AB(13)85

sustained negative performance from EHL on the profitability of the group. He went on: "While I assume the provisions correction will result in a final catch up of the charge, I am not persuaded that…we fully understand the extent of the drain that EHL is and will be on the economics of Abil and also on the Bank, given the very low RoE of its lending. I think that the Abil Exco needs a clearer picture here."[185]

249. On 25 April 2014 Mr Kirkinis circulated the "Prioritisation of strategic and tactical initiatives" document.[186] Some of the priorities were to stem NPL rolls, lift collections on PLs, lift collections on NPLs, and help backward migrations to PLs, deal with the *in duplum* PLs, restore EHL to profitability.

250. In a "Business Update" of 25 April 2014 Mr Kirkinis listed the "Immediate 2014 priorities", referring to collections and sales and concluded: "Exciting times lie ahead and I am confident of a bright and shining future for all of us. Please help me and our Exco team to focus and deliver on these priorities as we head into a future where we can sustainably contribute positively to people's lives."[187]

251. A meeting was held on 29 April 2014 which was attended by the BSD, Deloitte and Messrs Kirkinis and Nalliah to discuss the interim reporting

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[185] AB(51)124
[186] AB(51)126
[187] AB(51)140

for the six months ending 31 March 2014.[188] Abil advised that, as a prudent measure, to cover the migration of PLs to NPLs in the next six months and beyond, Abil would like to raise up to R2,5 billion in respect of an IBNR reserve for the period ended 31 March 2014. Mr Kirkinis said that a loss of R3,8 billion was projected for the whole year.

252. On 2 May 2014 Abil and the bank issued a trading statement on SENS for the six months to 31 March 2014.[189] Shareholders of Abil were advised that:

(i) Abil expected a headline loss of between R3,1 billion and R3,3 billion relative to the R604 million restated headline earnings for the equivalent six months to 31 March 2013;

(ii) the headline loss per share was expected to be between 239 cents and 254 cents relative to the comparable restated headline earnings of 62,3 cents per share;

(iii) the basic loss was expected to be between R4,3 billion and R4,5 billion in relation to the R602 million restated basic earnings for the comparative period;

(iv) the basic loss per share was expected to be between 331 cents and 347 cents per share compared to the restated basic earnings of 62,1 cents per share for the comparative period;

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[188] SARB(1)254,269
[189] SENS(3)1213; SARB(1)380

(v) the banking unit was expected to show a headline loss of between R1,9 billion and R2 billion due to an increase in specific provisions of about R600 million due to the following factors:

(a) NPL emergence in business written pre-July 2013 being at higher than anticipated levels: the total NPL formation was about R6 billion, which was about R600 million more than the level anticipated;

(b) an increase in specific coverage on NPLs of over 1% from September 2013 to 31 March 2014 due to seasonal factors that impacted collections and a continued challenging collections environment;

(c) a decision to significantly increase the general provisions for credit impairment relating to the PLs by about R2,5 billion;

(vi) Ellerines was expected to make a headline loss of between R1,2 billion and R1,3 billion.

253. In Abil's capital and liquidity plan dated 4 May 2014,[190] it was stated that Abil and the bank had produced disappointing financial results at interim in March 2013, final in September 2013 and interim March 2014. "The

[190] SARB(1)382

sole reason for these disappointing financial results is the credit impairment losses and provisions may exceed expectations."

254. It was minuted at a meeting of ALCO held on 6 May 2014 that Messrs Kirkinis and Nalliah had signed the guarantee provided by Abil to Standard Bank.[191] The minute to that effect is below the heading: "Ellerines Cash Flow Scenario."

255. On 6 May 2014 a meeting was held between the Registrar, the BSD, and Deloitte.[192] Deloitte stated that:

(i) they were comfortable with the level of provisions (impairments) that had been raised with regard to NPLs;

(ii) with regard to PLs they felt that the level of provisioning was still less prudent compared to other banks: the emergence period used by African Bank was CD4,[193] whereas other banks raised provisions as early as CD1; the bank had been aggressive in using CD4, which had resulted in a delay in raising provisions; there was, however, no requirement in IFRS that precluded the bank from using CD4; but should the bank use CD1 rather than CD4, this would result in a significant increase in provisions, which would significantly impact the bank's profitability and capital adequacy ratio;

[191] AB(13)90
[192] SARB(1)409
[193] Contractual default

(iii) an item of concern, particularly around the time of the finalisation of the September 2014 year-end audit, would be the assessment of the bank's ability to continue as a going concern.

256. At a Group Risk Committee meeting held on 8 May 2014[194] Mr Raubenheimer presented the impairment provisions as at 31 March 2014, which included the following:

(i) loans written in 2013 indicated a better risk profile than loans written in 2012;

(ii) roll rates were deteriorating, thereby contributing to persistent NPL migrations;

(iii) the maximum loan term had been reduced from 84 months to 60 months;

(iv) while gross advances had grown by 4%, NPLs as a percentage of gross advances had grown by 13%;

(v) the new specific impairment model increased the provision requirements by R296 million;

(vi) impairments as at 31 March 2014 reflected a general ledger with an amount of R315 million in excess of the model requirement.

[194] AB(4)248

257. At a Group Audit Committee meeting on 8 May 2014[195] Mr Nalliah expressed management's disappointment in the results for the six months ended 31 March 2014 with the major impact being the credit impairment charge: a significant improvement in collections was required to reduce the charge in the short term. Mr Mahomed said that the headline loss for EHL of R1,186 billion was R1,074 billion worse than the forecast.

258. On 14 May 2014 Mr Kirkinis (Abil) wrote a letter to the Registrar requesting a temporary lowering of the minimum Pillar 2b[196] add on for Abil and the bank to 10,5% from the current level of 15%.[197] His motivation included the assertion that the financial performance of Abil and the bank for the six months ended 31 March 2014 had been extremely disappointing, having been exacerbated by the performance of EHL, which together with an increase in the credit impairment provisions of R2,5 billion, had resulted in the capital adequacy ratios being reduced at both Abil and the bank. The Registrar acceded to the request in a letter dated 15 May 2014 on certain conditions.[198]

[195] AB(6)284
[196] A capital requirement
[197] SARB(1)414; SARB(4)531
[198] SARB(1)430; SARB(4)553

259. On 19 May 2014 Abil and the bank published their unaudited interim results for the six months ended 31 March 2014.[199] Financial features included the following:

(i) headline loss of R3,1 billion;

(ii) HEPS[200] loss of 240,7 cents;

(iii) basic loss of R4,4 billion;

(iv) return on equity a negative 54,6%.

260. At an ALCO meeting held on 27 May 2014[201] it was recorded that it was anticipated that Ellerines' total facility with the bank of R1,4 billion would be exceeded on 8 June 2014, and that using the current cash projections, the total facility would need to increase to R2 billion by September 2014.

261. On 30 May 2014 Abil and the bank announced on SENS that Moody's had downgraded the bank's local and global credit ratings by one notch.[202]

262. After the SENS announcement Mr Kirkinis wrote "A Note from Leon" dated 30 May 2014, in which he asserted that the Moody's downgrade was "…a direct, and expected, result of the decision we took to make

[199] SARB(1)432; SENS(3)1224
[200] Headline earnings per share
[201] AB(13)95
[202] SENS(3)1255; SARB(1)433

the R2,5 billion general provision….It is very pleasing to notice that our funders and major shareholders are sticking with us through this tough cycle. They believe in us, continue to support us and we still prove it to them! Yours in resilience and courage. Leon."[203]

263. On 2 June 2014 Mr Kirkinis sent Jo-Anne Milla an email and Questions and Answers.[204] In the email he wrote: "The board, our Exco and myself are aware of how hard it is to deal with a downturn in our environment and we are confident that the steps we have taken will protect us. Already we are seeing an improvement in our cash position. We are collecting R1 billion more than we are paying away." In answer to the question:

"Why is African Bank showing an expected headline loss of around R3 billion in the first half-year results of 2014?, the answer that was given was that Abil's banking unit was expected to show a headline loss of between R1,9 billion to R2 billion as a result of taking a decision to increase provisions by R3,1 billion: "We have done this to protect the business, absorb potential future losses now and to position it for recovery in the future." Ellerines was expected to report a loss of R1,2 billion to R1,3 billion.

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[203] AB(51)139
[204] AB(51)134

264. On 2 June 2014, in commenting on the Moody's downgrade, it was reported in the media[205] that the bank had issued four Swiss bonds of about R4 billion since 2010 in addition to the 29 local bond issues of R25 billion in total. Abil's share price fell more than 9%, closing at R8,40.

265. In one of four articles published on 6 June 2014[206] a comparison was drawn between Abil, African Bank and Capitec. While Abil's share price had plunged 17% on the previous Friday, Capitec "…has been looking increasingly strong over the past year. It was the third best performing share on the JSE last month, with a gain of 17%, and has recorded earnings per share growth of 15% over the past year."

266. On 6 June 2014 the Registrar formally requested Abil to dispose of EHL.[207]

267. On 9 June 2014 Sanlam Investment Management (Pty) Ltd increased its holding in the shares of Abil from 4,86% to 5,08%.[208]

268. On 10 June 2014 Mr van Velze, Head of Investments, Stanlib, wrote a letter to Mr Mogase, the chairman of the bank.[209] He stated that urgent

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[205] Media(1)182
[206] Media(1)184, 185, 186, 188
[207] SARB(1)434
[208] SENS(3)1258; SARB(1)435

steps were needed to address the deterioration of the bank's financial position and wealth destruction to shareholders. This entailed, but was not limited to, adjusting the business model back toward more manageable loan sizes (Rand value) of shorter duration, at commensurately higher yield to cover for expected bad debts and to deliver an appropriate return on capital. In regard to "Governance" Stanlib was encouraged by the appointment of a Chief Risk Officer as well as two independent board appointments by September 2014: "Our strong advice on this matter is that these be credible appointments with the requisite skills and experience in banking, particularly in the risk function."

269. On 11 June 2014 the PIC increased its holding in the shares of Abil from 14,815% to 15,052%.[210]

270. At a meeting of ALCO on 26 June 2014 Mr Mahomed reported that Ellerines would experience a funding pressure point on 30 June 2014 which was forecast to be in excess of the facility with the bank of R1,4 billion. Mr Jones reported that Abil guarantees had been provided to Standard Bank and FirstRand Bank in respect of general banking facilities provided to Ellerines Furnishers.[211]

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[209] AB(51)145
[210] SENS(3)1262
[211] AB(13)99

271. On 1 July 2014 PricewaterhouseCoopers Advisory Services (Pty) Ltd (PWC) wrote an engagement letter to the Board of Abil[212] in which it gave as background that Abil had had a number of recent financial shocks arising from losses in the credit books of the bank and ongoing operational losses in EHL. This had resulted in capital adequacy and liquidity concerns for Abil. The board had requested the assistance of PWC Advisory Services in assessing and reviewing options available to Abil.

272. On 7 July 2014[213] Abil and the bank published a cautionary announcement on SENS that Abil had entered into negotiations for the possible sale of EHL.

273. On 7 and 8 July 2014 the media reported on the "surge" in Abil's share price in the hope of a sale of Ellerines.[214]

274. On 11 July 2014 Mr Kirkinis (Abil) wrote a letter to the Registrar in which Abil requested a further extension to 6 August 2014 for the ability to continue with the reduced individual capital requirement as per the Registrar's letter of 15 May 2014.[215] One of the reasons given for the date (6 August 2014) was that it was anticipated that there would be a

[212] SARB(1)439
[213] SENS(3)1266; SARB(1)464
[214] Media(1)194, 196, 199
[215] SARB(1)465

signed agreement for the disposal of EHL by then. The Registrar acceded to the request in a letter dated 15 July 2014.[216]

275. On 17 July 2014 Mr J D Wiese acting on behalf of Bon View Trading 164 (Pty) Ltd informed the Registrar that they were approached by Abil regarding Abil's attempt to dispose of EHL. The proposed purchase would be R1. The net asset value (NAV) of EHL was required to be R3 billion.[217]

276. On 24 July 2014 Mr Jones informed colleagues, including Messrs Kirkinis and Nalliah, that the cash balance was significantly below R1 billion. In terms of the ALCO policy the Group Risk Committee had to be informed.[218]

277. On 6 August 2014 Abil and the bank published the quarterly operational update for the quarter ended 30 June 2014.[219] The following was announced:-

(i) the resignation of Mr Kirkinis;

(ii) the boards had decided to more closely align certain aspects of the bank's impairment provisioning practices to the industry standard. Amongst these, the most significant was the moving

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[216] SARB(1)468
[217] SARB(1)470
[218] AB(51)180
[219] SENS(3)1268

of the point of impairment from the current contractual delinquency CD4 to CD0 (sic). The additional impairment provision that was required for all changes in practices was R3 billion;

(iii) Abil's equity and core tier 1 capital ratios were below the levels achieved following the rights offer in 2013. In addition, the anticipated costs associated with insulating Abil from further impact of Ellerines and any additional provisions that might be taken on the lending book following an independent review, would further decrease its equity and core 1 ratios. In order to remedy that situation, Abil would engage with shareholders and other stakeholders in the coming weeks about a capital raise which was expected to be a minimum of R8,5 billion;

(iv) the banking unit forecasted a basic and headline loss of at least R4,6 billion;

(v) the retail unit forecasted a basic loss of at least R2,9 billion and a headline loss of at least R1,7 billion;

(vi) the Group was expected to show a basic loss of at least R7,6 billion and headline loss of at least R6,4 billion for the full year;

(vii) Abil would engage with shareholders and other stakeholders about a capital raise which was expected to be a minimum of R8,5 billion.

278. On the same day, 6 August 2014, an article appeared in the media,[220] commenting on Abil's operational update of that day. The article pointed out that Abil's shares fell 62,21% to an all time low of R2,60:

"The market is likely to ask for answers after Mr Kirkinis assured the market only a few months ago that Abil had turned the corner. At the time he said he had no intention of resigning and emphasized African Bank would seek to sell its retail Ellerines division as soon as possible. This was also a turnabout as he had previously denied that he intended to sell Ellerines."

279. On that day, 6 August 2014, Mr Nalliah, acting CEO of Abil, informed the Registrar[221] that negotiations relating to the disposal of EHL were progressing at a very slow pace and that Abil had not been able to comply with his condition of delivering written proof of detailed and legally binding agreements for the execution of Abil's strategic capital plan.

280. On 7 August 2014 Abil and the bank announced on SENS[222] that Ellerine Furnishers (Pty) Ltd (Ellerine Furnishers), a wholly owned subsidiary of EHL, a wholly owned subsidiary of Abil, had commenced

[220] Media(1)201
[221] SARB(1)478
[222] SENS(3)1282

with voluntary business recue proceedings as provided for by s129 of the Companies Act.[223]

281. On the same day, 7 August 2014, it was reported[224] that Abil's share price was down to R2,92. "It was known that Mr Kirkinis ran Abil as a tight ship, expected unwavering loyalty from top management, but some questioned the renewed huge lending spree after 2009 that led to the present debt headache."

282. On 7 August 2014 the Governor informed Mr Nalliah that SARB had no objection to the bank utilizing its total cash reserve balance of R1,203 billion until no later than 31 August 2014.[225]

283. On 10 August 2014 the bank was placed under curatorship.

CHAPTER 11 : NATIONAL CREDIT ACT (NCA)

284. The NCA had a significant impact on banks, including African Bank, in that the Act:

(i) placed a limit on the charges and the rate of interest which a bank could charge an individual (not a juristic person) to whom the bank lent money;

[223] 71 of 2008
[224] Media(1)205
[225] SARB(1)479

(ii) prohibited reckless lending;

(iii) introduced a statutory *in duplum* provision; and

(iv) established the NCR with the power to investigate and evaluate alleged contraventions of the Act.

285. The NCA came into operation on 1 June 2007.

286. The NCA repealed the Usury Act, 73 of 1968, the Credit Agreements Act, 75 of 1980, and the Integration of Usury Laws Act, 75 of 1996.[226]

287. The purposes of the NCA are to promote and advance the social and economic welfare of South Africans, promote a fair, transparent, competitive, sustainable, responsible, efficient, effective and accessible credit market and industry, and to protect consumers.[227]

288. The NCA applies to every credit agreement between parties dealing at arm's length and made within, or having an effect, within South Africa, with certain exceptions (which are not relevant for the purposes of this Report.)[228]

289. A credit agreement must not require payment by the consumer of any money or other consideration, except:

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[226] s172(4)
[227] s3
[228] s4(1)

(i) the principal debt;

(ii) an initiation fee;

(iii) a service fee;

(iv) interest;

(v) loss of any credit insurance;

(vi) default administration fees;

(vii) collection costs, all of which have prescribed limits.[229]

290. A credit provider must not enter into a reckless credit agreement with a prospective consumer.[230]

291. A credit agreement is reckless if, at the time that the agreement was made, or at the time when the amount approved in terms of the agreement is increased:

(i) the credit provider failed to conduct an assessment;

(ii) the credit provider, having conducted an assessment, entered into the credit agreement with the consumer despite the fact that the preponderance of information available to the credit provider indicated that:

(iii) the consumer did not generally understand or appreciate the consumer's risks, costs or obligations under the proposed credit agreement; or

[229] s101(1)
[230] s79(1)

(iv) entering into that credit agreement would make the consumer over-indebted.[231]

292. A consumer is over-indebted if the preponderance of available information at the time a determination is made indicates that the particular consumer is or will be unable to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party, having regard to that consumer's:

(i) financial means, prospects and obligations; and

(ii) probable propensity to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party, as indicated by the consumer's history of debt repayment.[232]

293. Despite any provision of the Consumer Law or a credit agreement to the contrary, the amounts contemplated in s101(1)(b)-(g) that accrue during the time that a consumer is in default under the credit agreement may not, in aggregate, exceed the unpaid balance of the principal debt under that credit agreement as at the time that the default occurs. The amounts contemplated in s101(1)(b)-(g) are an initiation fee, a service

[231] s80(1)
[232] s79(1)

fee, interest, cost of any credit insurance, default administration fees, and collection costs.[233]

294. Section 103(5) was interpreted by the Supreme Court of Appeal (SCA) in Nedbank ao v National Credit Regulator ao[234] as follows:

" Once the amounts referred to in s101(1)(b) to (g) that accrue during the period of default, whether or not they are paid, equal in aggregate the unpaid balance of the principal debt at the time the default occurs, no further charges may be levied. It is not that a moratorium against payment is introduced by s103(5): no amount in respect of the fees, costs and charges may 'accrue' any further. Put differently, no enforceable right to the charges outlined in s101(1)(b) to (g) thereafter arises."

295. Section 103(5) has its roots in the common law, in what is called the *in duplum* rule: unpaid interest on a debt which is due but not yet paid should not exceed the outstanding capital. Once unpaid interest is equal to the outstanding capital, interest ceases to run. Capitalised interest does not lose its character as interest and does not form part of the capital amount for purposes of the *in duplum* rule. If the debtor repays part of the interest and as a result the amount of the interest reduces below the amount of the outstanding capital, interest can run

[233] s103(5)
[234] 2011 (3) SA 581 (SCA) at 607

again until it equals the outstanding capital. The *in duplum* rule is suspended *pendente lite*; the lis commences upon service of the initial process, whereafter interest runs again.[235]

296. The NCA established a body to be known as the National Credit Regulator (NCR).[236] The NCR is responsible to promote and support the development, where the need exists of a fair, transparent, competitive, sustainable, responsible, efficient and accessible credit market and industry to serve the needs of historically disadvantaged persons; low income persons; and remote, isolated or low density populations and communities, in a manner consistent with the purposes of the NCA.[237] The NCR must enforce the NCA inter alia:

(i) by investigating and evaluating alleged contraventions of the NCA;[238] and

(ii) referring matters to the National Consumer Tribunal (NCT).[239]

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[235] LTA Construction Beperk v Administrateur, Transvaal 1992 (1) SA 473(A) at 482A-C; Standard Bank of South Africa Ltd v Oneanate Investments (Pty) Ltd 1998 (1) SA 811 (SCA); Casey ao v FirstRand Bank Ltd 2014 (2) SA 374 (SCA); Paulsen ao v Slipknot Investments 777 (Pty) Ltd 2014 (4) SA 253 (SCA) para [17]; Margo ao v Gardner ao 2010 (6) SA 385 (SCA) para [12].

[236] s12(1)

[237] s13(1)

[238] s15(f)

[239] S15(i)

CHAPTER 12 : THE NCR'S FINDING OF RECKLESS LENDING AT THE DUNDEE BRANCH OF THE BANK AND THE PROPOSED FINE OF R300 MILLION

297. On 7 February 2013, so the BSD was informed by the executive management of the bank, it was leaked that the NCR had referred a case of reckless lending at the Dundee branch of the bank to the NCT and had recommended a fine of R300 million. The bank issued a statement on SENS on 8 February 2013 in response to the leak. The bank stated that in November 2011 an internal investigative team of the bank had found that its systems had been fraudulently breached by agents at the Dundee branch. The bank disputed the allegations of reckless lending.

298. On 13 February 2013 Mr Kirkinis informed the boards of Abil and the bank that following on the announcement of the fine of R300 million and the allegation of reckless lending, pricing on African Bank bonds had increased by about 60 basis points and that Abil's share price had declined by 6%. The evidence given on behalf of the bank in this investigation was that as a result of the announcement the bank had to cancel an EMTN bond which was being priced in London at the time.

299. At a Project Phoenix meeting on 26 May 2013 it was noted that the trigger of the declining share price of Abil was the announcement that the bank was facing a possible fine by the NCR. It was agreed that the Governor would speak to the Minister of Finance to engage the Minister of the DTI on the future of the market conduct regulator; the financial stability concerns; and the possible speeding up of the NCT process.

300. One of the matters raised by Mr Kirkinis at a Project Phoenix meeting on 3 June 2013 was that at a time when Abil was on a roadshow for a $300 million bond issue, the NCR made the announcement of the possible fine of the bank. Abil thought the announcement was price sensitive and decided therefore not to proceed with the bond issue at that time.

301. On 9 July 2013 the Registrar wrote a letter to the NCT about the NCR's complaint of reckless lending and the proposed fine of R300 million: he advised that "…in view of financial stability concerns, it is imperative that this process should not suffer any further delays."

302. In a letter to the Minister of Finance dated 10 September 2013 the Governor stated that it was important that the uncertainty relating to the NCR charges against the bank be resolved without further delays. In order to expedite the resolution of the matter she proposed that an

urgent meeting between the Governor, the Minister of Finance and the Minister of the DTI be convened as soon as possible.

303. On 3 October 2013 Abil and the bank announced on SENS that the Dundee matter had been settled with the NCR.

304. The history of the matter went back to November 2011.

305. At the beginning of November 2011 Ms Wheatley, a senior manager attached to the credit department of the bank, requested assistance with an inquiry into the involvement of certain sales consultants at the Dundee branch in data manipulation or reckless lending. The allegation was that the bank's IT system, the Phoenix system, had been manipulated to allow repeat customers to be granted new loans without first settling their existing loans.

306. A member of Group Forensic Services, Mr Chetty, and Ms Nerasha travelled to Dundee on 17 November 2011 to investigate the matter. Five employees were interviewed by them. They all denied that any data manipulation had occurred, and no proof that there had been data manipulation could be found. In order to avoid any risk of that occurring

in the future, the Dundee branch was moved off the Phoenix system onto the Gazelle system on 18 November 2011.[240]

307. On 19 June 2012, Mr Nagar, then the Group Compliance Officer, wrote a letter to Mr Pashou of Gobodo[241] in which he referred to the "NCR Investigation."[242] He described the events of November 2011: "At this particular branch [the Dundee branch], sales consultants found a way to manipulate the Bank's systems to the effect that an additional loan or loans could be granted to a consumer, ignoring one or more of the consumer's existing credit obligations, at the time, to the Bank. This manipulation, we believe, may have led to some consumers being provided with credit in excess of the consumer's affordability and contrary to the credit granting rules of the Bank."

308. On 23 October 2012 Mr Roussos, Executive: Central Support Services, in a letter to Gobodo, referred to the "NCR investigation into specific matters identified by the NCR."[243] Mr Roussos referred to data which the bank had supplied to Gobodo: "On supplying the data requested, African Bank highlighted the fact that we had identified a "rogue" branch…in Dundee that had worked out a way to manipulate the IT system to increase the amount of affordability that the customer had

[240] AB(48.1)1-5
[241] Gobodo Forensic and Investigative Accounting (Pty) Ltd
[242] AB(48.1)6
[243] AB(48.1)36

available. African Bank in turn, started a forensic investigation but whilst we could identify the number of loans and clients impacted, we found it impossible to replicate the process. In order to stop this problem from increasing and impacting the business further, a decision was taken to immediately switch the Dundee branch onto the origination platform." Mr Roussos referred to 699 loans where the affordability might have been manipulated : 651 (93%) were generated by the Dundee branch. He concluded that the problem "was only prevalent to a large extent in Dundee."

309. Gobodo presented its final report to the CEO of the NCR on 24 October 2012.[244] The report referred to a meeting on 16 October 2012 with the bank: "During the meeting it was agreed by all that the Phoenix system was manipulated to provide loans to consumers in respect of which the consumer could not afford such. African Bank advised that their current system indicated that the problem was mostly restricted to the Dundee branch. However, they concluded that this 'manipulation' could have occurred in the Phoenix system at other branches as well." An investigation was done in respect of nine complainants. The report came to a number of conclusions, including the following:

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[244] AB(48.1)44

(i) 58 of the 113 loans sampled were granted recklessly and not in accordance with African Bank policy. They were all granted at the bank's Dundee branch or Ellerine's Dundee store;

(ii) utilising African Bank's own affordability calculation Gobodo established that 58 loans granted to nine consumers were reckless in that the consumers were over-indebted even prior to the new loan being granted. Subsequent to the issuing of the draft report the bank confirmed that loans granted via the Phoenix system could have been manipulated to allow the bank to grant loans to consumers who could not afford the loans. However, based on the interrogation of the Phoenix system and the reconciliation of the Phoenix system to Exactus, it was apparent that the majority of those loans were granted at the Dundee branch.

310. On 20 November 2012 the CEO of the NCR wrote a letter to Mr Kirkinis (African Bank) in which she proposed that a consent order be entered into between the NCR and the bank. A comparison between the proposal of 20 November 2012 and the settlement agreement of 3 October 2013, to which the NCR was a party, of course, reveals the following:

Proposal	Settlement
1. The registration of the Dundee branch be suspended for 12 months	1. Not included.
2. The NCR would appoint a firm of auditors to conduct an audit of all the branches of African Bank registered with the NCR. The cost of the audit would be borne by the bank.	2. Not included.
3. The bank would write-off all credit advances to consumers under all credit agreements as listed in Schedules 1, 2 and 3. In the event of credit agreements having been repaid in full or in part by consumers, the bank would refund those consumers all such monies within a period of 30 days.	3. Not included, but by then the bank had written off 480 loans and rescheduled 219 loans by writing off that portion of the loan that the consumer could not afford and rescheduling affordable instalments to the original period of the loan.
4. The bank would, at its own expense, apply to the competent courts for the rescission of all judgments taken against consumers in respect of the credit agreements listed in Schedules 1, 2 and 3.	4. The bank would, at its own expense, apply to the competent courts for the rescission of all judgments taken against consumers in respect of the loans referred to in paragraph 3 above.

5. The bank would notify all credit bureaux of all consumers who were listed in respect of outstanding repayments arising from the credit agreements listed in Schedules 1, 2 and 3 and have such listings removed by the credit bureaux from their records of such consumers.	5. The bank would notify all credit bureaux of all consumers who were listed in respect of outstanding repayments arising from the loans referred to in paragraph 3 above and have such listings removed by the credit bureaux from their records of such consumers.
6. An administrative fine of R300 million.	6. The bank agreed to pay R20 million to the National Revenue Fund. The settlement agreement related to two matters, the Dundee matter and the Ntambeni matter, in which the proposed fine was R5 million.

311. On 6 October 2014 Werksmans at the instance of the Commission addressed a letter to the CEO of the NCR in which she was required to provide the following information:

(i) What was the response of the NCR to the accusation that the NCR had leaked its investigation of allegations against African Bank to the media?

(ii) Did the NCR intimate that it intended to propose the imposition of a fine of R300 million to the NCT against the bank?

(iii) If so,

- did the NCR make the recommendation to the NCT?
- what was the ultimate fine imposed by the NCT?
- was there a settlement of R20 million between the bank and the NCR or NCT?
- is the determination of the NCT at the disposal of the NCR? If so, a copy is required.

312. The NCR did not reply to the letter. Instead, the CEO wrote a letter to the Registrar in which she:

(i) expressed the view that the letter from Werksmans not only undermined the NCR's regulatory authority and decision-making powers but also exceeded the scope of the investigation given to this Commission by the Registrar;

(ii) requested the Registrar to request Werksmans to withdraw their letter to the NCR.

313. The Registrar did not make the request; Werksmans did not withdraw the letter; and the NCR did not take the opportunity offered to her of putting her case to the Commission.

314. There is no evidence of who leaked the information that the NCR had referred a case of reckless lending to the NCT and proposed a fine of R300 million. It can safely be assumed that African Bank did not do so.

315. The leak, and the publicity that it attracted, was inevitably damaging to the bank. The bank was not only being accused of reckless lending, a sensitive subject at the best of times, but the proposed fine of R300 million pointed to a particularly egregious case of reckless lending.

316. And the bank did suffer prejudice:-

(i) the pricing on Abil bonds increased by about 60 basis points;

(ii) Abil's share price declined by 6%;

(iii) the bank had to cancel an EMTN bond which was being priced in London at the time.

317. This is a graph of the Abil share price between 2000 and 2014:

318. The matter was taken seriously by the Governors of the Reserve Bank:

(i) At the Project Phoenix meeting on 26 May 2013 it was agreed that the Governor would speak to the Minister of Finance to engage the Minister of the DTI on the future of the market conduct regulator; the financial stability concerns; and the possible speeding up of the NCT process.

(ii) The Governor wrote to the Minister of Finance on 10 September 2013 in which she proposed an urgent meeting between herself, the Minister of Finance and the Minister of the DTI to discuss the matter (which by then remained unresolved since early February 2013, a period of seven months).

(iii) The bank's version of what had happened, as recorded in the settlement agreement, does not appear to have been disputed by the NCR:

- 651 loans were granted as a result of the manipulated of the Phoenix system by rogue employees of the bank;
- the total loss suffered by the bank in writing off the whole or portion of the tainted loans was R13 740 400,60;
- the bank replaced the Phoenix system with the Gazelle system throughout its organisation;
- the rogue employees at Dundee were no longer in the employ of the bank.

319. The terms of the settlement agreement of 3 October 2013 were inconsistent in three material respects with the proposed consent order of 20 November 2012:

(i) the proposed deregistration of the Dundee branch was not included in the settlement agreement;

(ii) the proposed audit of all the bank's branches at the cost of the bank was not included in the settlement agreement;

(iii) the proposed fine of R300 million was settled at R20 million, less than 10% of the fine proposed.

CHAPTER 13 : RECKLESS LENDING

320. Having regard to:

(i) the rapid growth in the bank's book in the last few years; and

(ii) its difficulties in making collections, which resulted in massive credit impairments, it was possible that the bank had been guilty of reckless lending in contravention of the NCA. The Commission did not have the capacity nor the time to investigate possible reckless lending by the (513) branches of the bank.

321. The one body whose duty it is to investigate alleged contravention of the NCA is the NCR. So, on 6 October 2014, in the letter referred to earlier, the NCR was requested to respond to the following questions:-

(i) When did the allegations of reckless lending by African Bank come to the attention of the NCR?

(ii) How did the NCR acquire notice of those allegations?

(iii) What was the nature and extent of allegations of reckless lending made against African Bank?

(iv) What investigation did the NCR undertake in respect of allegations made against Abil?

(v) Did the NCR produce any record of its investigation?

(vi) Did the NCR inform African Bank of allegations made against it?

(vii) Has the NCR found cases of reckless lending by the bank? If so, please explain.

322. For the reasons set out earlier the NCR refused to answer those questions.

323. The evidence of Mr Chemel was that at branch level a customer's information was entered onto a computer. His or her payslip was obtained. The information on the payslip was captured onto the computer. The customer had to make an expense declaration.[245]. Neither the sales consultant nor the branch manager had authority to approve an application for a loan. That was done at a central point at head office. There were five or six queues, such as an affordability queue, a credit exception queue, an employment confirmations queue, a contactability queue, and a fraud queue. If the application did not pass the fraud queue it was rejected outright. If it passed all the other queues it was approved. The process took about two to three days. An application for a loan would be assessed according to scorecards and rules approved by the relevant committee, such as the credit committee. The object of the exercise was to ensure that the rules were

[245] Mr Chemel T389-390

programmed into the system. There were two systems that mattered: Phoenix or Gazelle in the bank and a decision system called Capri, which was the system that managed the scorecards and a whole lot of the rules. The bank's rules were designed to prevent reckless lending.[246] It was part of the bank's checks and balances that the bank employed Quality Control Specialists (QCS's) who would visit the branches from time to time to look at the deal quality in a branch. In addition branch audits took place annually or once every two years.[247]

324. Mr Roussos testified that for so long as staff complied with the loan approval policy the bank would not have had reckless lending. Staff did not comply if data was captured wrongfully either by over-stating income or understating expenditure. When a complaint of reckless lending was received it was channelled to one of the risk functions such as head of legal or the compliance department. The bulk (90 to 95%) came from debt counsellors. The bank received about 60 to 80 complaints of reckless lending a month. Prior to August 2014 the bank was granting between 100 000 and 120 000 loans a month.[248]

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[246] T393-397
[247] T399-400
[248] T427-430

CHAPTER 14 : *IN DUPLUM*

325. As set out in Chapter 11 there was a rule in common law from well before the establishment of African Bank known as the *in duplum* rule. From 1 June 2007 a statutory *in duplum* rule, in the form of s103(5) of the NCA, came into effect. The bank was obliged from that date to give effect to its provisions.

326. The statutory *in duplum* rule had an impact on the bank in two ways:

(i) in how it was applied in relation to its customers; and

(ii) in how it was accounted for in financial statements, leading eventually in 2013 to an impairment of R2,2 billion.

327. The way the rule was applied, in relation to the bank's customers, was described in a letter dated 3 April 2014 which the bank wrote to the NCR.[249] The letter drew a distinction between credit card accounts and loan accounts:-

Credit cards

(i) A material adjustment was made in April 2013 with regard to *in duplum* calculations. Those corrections affected 163 860 customers. The sum of fees and charges that were processed and reversed was R620 738 027 (R621 million).

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[249] SARB(4)350

Loan accounts

(i) After the judgment of the Supreme Court of Appeal in the Nedbank matter on 28 March 2011 a major system change was implemented during August 2011 whereby all accounts that defaulted since inception of the NCA were corrected. All accounts were recalculated and any amount overcharged was reversed. Where accounts had already been settled or closed, the overcharged amount was refunded to the customers. By omission the bank continued to apply the previous *in duplum* interpretation to all new accounts created since July 2011. This resulted in some customers being overcharged. The omission was detected during July 2013 when the bank embarked on another project to recalculate all affected accounts created since July 2011. A correction was made during November 2013. A total of 314 686 accounts were affected. Three of the outcomes were:

- interest, fees and insurance to the value of R404 million were credited to customer’s accounts;
- 2674 accounts had credit balances to the value of R1,138 million as a result of the account being settled or closed before the correction. Those amounts were refunded to customers;

- the net effect on the bank's income statement after reversal of the previous and accrued interest on the affected accounts was R39,9 million.

328. Mr Swanepoel provided the following information:

<u>August 2011</u>

(i) Application of *in duplum* correction to all *loan* accounts opened after June 2007 to date.

(ii) Customers affected : 696 158.

(iii) Fees and charges reversed : R706 million

(iv) Income statement effect : R336 million (after impairments)

<u>April 2013</u>

(i) Application of *in duplum* correction on *card* accounts opened after June 2007.

(ii) Customers affected : 163 860

(iii) Fees and charges reversed: R620 million.

(iv) Income statement effect – R51,8 million.

<u>November 2013</u>

(i) Application of *in duplum* correction to all loan accounts since July 2011. All loans originated via Gazelle still included receipts as part of running balance. This was corrected.

(ii) Customers affected : 314 686.

(iii) Fees and charges reversed: R405,138 million.

(iv) Income statement effect: R39,9 million.

(v) Refunds: R1,138 million.

<u>April 2014</u>

(i) Application of *in duplum* on all card accounts.

(ii) Customers affected : 211 792 (including 163 860 corrected in April 2013).

(iii) Fees and charges reversed : R83,9 million.

(iv) Income statement effect: -R15,2 million.

(v) Refunds : R17,178 million

<u>October 2014</u>

(i) Application of *in duplum* on all loan and card accounts.

(ii) Income statement affected: -R50 million.

329. The statutory *in duplum* rule, in so far as a possible impairment was concerned, was a topic of debate between the bank, Deloitte and the BSD in the period November 2012 to February 2014:-

(i) At a Compliance meeting on 24 October 2012 Mr Nagar (the bank's legal advisor) said, in regard to *in duplum*, that the bank was compliant as far as the loan book was concerned; that the credit card business remained non-compliant; that the necessary adjustments would be made by Abil; and that the anticipated implementation date was November 2012.[250]

(ii) Mr Kirkinis told a Group Exco on 29 January 2013 that the bank budget had been "haircut" from R3,33 billion to about R3 billion, including *in duplum*.[251]

(iii) On 21 February 2013 Deloitte informed the BSD and the Group Audit Committee that one of the outstanding items from the September 2012 audit was compliance with the NCA involving credit cards not flagged as *in duplum*.[252]

(iv) At a meeting between the BSD and Mr Kirkinis on 14 October 2013[253] Mr Kirkinis said that *in duplum* discounting had grown to about R1 billion.

(v) Mr Kirkinis told a special meeting of the boards of Abil and the bank on 18 October 2013[254] that an additional R1,7 billion of provisions were required largely due to an *in duplum* adjustment. The total amount of the *in duplum* adjustment was R2,2 billion, of which about R800 million related to the written-off portfolio and about R1,4 billion to the non-performing portfolio. According to the minute of the meeting, Mr Pinnock and Mr Jordan of Deloitte advised the boards that although the *in duplum* issue did not make sense commercially, the

[250] SARB(1)123
[251] AB(43)98
[252] SARB(1)131
[253] SARB(3)480
[254] AB(24)584

adjustment to provisions was necessary in terms of IFRS accounting standard IAS39.

(vi) In a letter dated 22 October 2013[255] Mr Kirkinis (Abil) informed the Registrar that Abil had finalised the year-end provisions, one of which related to *in duplum* loans, and the other to IBNR losses in the insurance companies in the Group. The total came to R2,375 billion: R2,175 billion for the bank, and about R200 million for Stangen. The provisions would have a negative impact on capital adequacy.

(vii) In its report to the Group Audit Committee, Deloitte stated:

"We have previously reported our concerns about the discount rate applied to In Duplum advances in prior years. Management still contends that the required treatment is not economically viable and that the accounting standard (IAS39) does not foresee the unique legal situation that exists in South Africa. We consulted extensively on the correct treatment in terms of IAS39, including the possibilities of a fair presentation override in terms of IAS1 or the possibility of derecognising the initial contract by the In Duplum event. It was concluded that the original effective interest rate, normally the interest rate at inception of the loan, should be used to discount future cash flows."

[255] SARB(3)580

(viii) It was minuted at a Group Risk Committee on 29 October 2013 that the practice had been to discount loans which were *in duplum* at 0%, which had been changed to the original effective interest rate: the change had a significant impact and resulted in a R2 billion charge.[256]

(ix) In a document dated 20 February 2014 prepared by Deloitte for a Trilateral meeting one of the impairment modelling matters which had been identified and addressed in FY2013 was correcting the discount rate applied to defaulted advances that reached the *in duplum* threshold by processing a R2,2 billion adjustment.[257]

330. In his affidavit[258] Mr Nalliah stated that the bank's 2013 financial results were largely negatively impacted by certain trading and economic conditions but much more fundamentally by the significantly increased judgment credit impairment provisions and were further impacted by exceptional non-cash items including the change in loan impairment methodology related to the discount rate used to discount future projected cash flows on loans that were in *in duplum* status:-

(i) Accounting Standard IAS39 deals with the method of calculating the credit loan impairment provisions and provides for the discounting of all future projected cash flows at the

[256] AB(4)239
[257] SARB(4)99
[258] E(14)

effective interest rate (EIR). EIR is the interest rate, calculated at the inception of the loan, that discounts all contractual cash outflows and inflows to zero without taking into account any expected credit losses.

(ii) The rationale for discounting future cash flows at the EIR is that each future payment includes future interest (future to the current point of determination of the impairment provision), and the future interest has to be excluded as it has not been raised on the customer's account as yet at the point of determination of the impairment provision.

(iii) Accounting standard IAS39 does not deal with the situation where a legal principle precludes a credit provider from charging interest on a loan that is contractually an interest bearing loan, as is the case in South Africa under the *in duplum* principle, which , as far as Mr Nalliah is aware, is unique to South Africa. Abil introduced, before he joined Abil, the practice for loans that were in *in duplum* status, to discount the future cash flows at 0% discount rate on the basis that no part of future payment comprised interest, fees, etc. This practice was applied consistently until August 2013 as the amount (being the difference if the future cash flows were discounted at the EIR) was not regarded as material in the context of Abil, based on estimates and the overall credit impairment provisions were regarded as being adequate. All other loans, on a portfolio basis, were discounted at the EIR, which resulted effectively in a blended rate being applied to discount future cash flows on the entire impaired loan advances book.

(iv) Two specific events altered this practice:-

- In the Nedbank case the SCA held that s103(5) of the NCA, according to Mr Nalliah, essentially extended the *in duplum* principle in the case of credit agreements further in that no further interest, fees, and charges may be levied in excess of an amount equal to the default capital regardless of any payments that may be made that reduces the balance to below the default capital for so long as the account remains in arrears. *In duplum* thus applied not only to interest but also to initiation fees, service fees, credit insurance, default administration charges and collection costs. The common law principle of *in duplum* was extended further effectively making a loan interest free once the loan balance reaches twice the default capital regardless of subsequent payments as long as the account remains in arrears. This means that all future cash receipts once the loan has reached *in duplum* status are allocated 100% towards reducing the balance outstanding and no part of such payment relates to future interest, fees, etc.

- Deloitte previously accepted the use of the *mora* rate to discount future projected cash flows that were in "Legal and Admin" status. In 2013 Deloitte considered that the EIR calculation needed to be quantified as it was felt that it would be material given the increase in the total value of loans that were then in the *in duplum* status. The fact of the *in duplum* loans being discounted at 0% rather than the EIR was reported by Deloitte in their report to the Group Audit Committee from FY2009. The response of management, consistent with that from the time that such practice was adopted, was that no interest occurred once the *in duplum* threshold was reached. Therefore, the future projected cash flow did not have to be discounted at EIR as there was no interest to unwind from future receipts. However, in each year, Deloitte concluded that the total credit impairment provisions were adequate. If the NPV[259] of future cash flows (assuming the full debt was repaid) were determined using the EIR at inception, then the NPV of future cash flows based thereon would be less than the face value of the debt, the result of which would show a "loss" (impairing the face value down to the NPV). But this would then result in a "profit" if the customer paid the total

[259] Net Present Value

outstanding thereafter (receipt in excess of the carrying value of the loan). Commercially no profit or loss would be earned or suffered on such loan under this circumstance.

(v) The previous approach of discounting the relevant debt at 0% discount rate was a commercially logical practice, as no loss of capital would be suffered if the customer repaid the full amount over time (i.e. recovery of the full face value of the loan), excluding the effects of the time value of money.

(vi) On the basis of an analysis done by Mr Nalliah, over the period of time of cash flows, the end result on both methods is the same. The negative impact on earnings is the greatest in the first year if discounted at the EIR, but the total negative impact reverses resulting in a positive impact on earnings over the remaining years for which cash flows are projected.

(vii) In so far as the bank's business of loans receivable is concerned, IAS39 is not directed at fair value accounting but rather the determination of amortized cost. Amortized cost is determined by deducting from the face value of the loan receivables, a due allowance for impairment provisions and excluding future interest from future cash flows.

(viii) Deloitte's audit reports were discussed with the BSD each year during the Trilateral meetings and management's response was shared with the BSD.

(ix) Consequently, in 2013 during the finalisation of the full year results, the impact of discounting the *in duplum* loans was performed and this amount, on a cumulative basis, was deemed to be material by Deloitte. There were various debates with Deloitte around the commercial correctness of this application. Their response was that while they were sympathetic to the commercial and logical rationale for management discounting these loans at 0%, IAS39 did not make any provision for the *in duplum* scenario in that it did not envisage that a lender would be legally precluded from charging interest (notwithstanding that such future interest may not be received) and therefore there was no room to use any other rate than the EIR.

(x) The effect of discounting the loans that were *in duplum* was calculated. This was discussed with the Registrar on or about 18 October 2013. Those present were Messrs Pinnock, Jordan and Crowther of Deloitte, Mr Kirkinis and Mr Nalliah. Deloitte said that given their audit materiality they could sign off the financial results if the bank processed a minimum of R1,7 billion in relation to the R2,2 billion impact. Everyone at the meeting agreed that the adjustment of R1,7 billion would be processed in the FY2013 results with the necessary restatements to the prior published figures.

(xi) There was concern on the regulatory minimum capital adequacy ratio of the bank and Abil as a result of this adjustment. SARB was advised that management would make a written request for condonation of the regulatory minimum capital adequacy ratio to be reduced to a level so that the bank and Abil remained above the regulatory revised minimum capital adequacy ratios after the processing of this adjustment.

(xii) Management advised SARB and Deloitte that the rights issue that was in process at the time with Goldman Sachs would be increased to cater for the impact of this adjustment on regulatory capital. The full impact of the adjustment is explained on p45 of the Reviewed Annual Results for FY2013.

331. In his Submission[260] Mr Nalliah provided "Loans *in duplum* timelines

June 2007":

Implement system changes for Loan to cater for *in duplum* in debtors system, only applicable to loans created after 1st June 2007. (Exclude ABMC loans from *in duplum*).

Nov 2009

Remove receipts from Running balance.

June 2010

[260] E(20)52

Change *in duplum* to have different rules for Ellerines (exclude receipts for Ellerines, include receipts for loan) as per current Ellerines practice.

July 2011

Exclude receipts from running balance, change rules so that *in duplum* can only start and end on Period End, introduce rule to always move ID start date back to the 1st of the month, introduce pro-rata calcs into threshold calc.

August 2011

Application of *in duplum* correction to all loan accounts opened after June 2007 to date

Customers affected 696 158

Fees and charges reversed R706m

Income statement effect. R0 (After impairments)

April 2013

Application of *in duplum* corrections on card accounts opened after June 2007

Customers affected 163 860

Fees and charges reversed R620m

Income statement effect – R51.8

November 2013

Application of *in duplum* correction to all loan accounts since July 2011. (all loans originated via Gazelle still included receipts as part of running balance, this was corrected).

Customers affected 314 686

Fees and charges reversed R405,138m

Income statement effect – R39.9m

Refunds R1.138m

April 2014

Application of *in duplum* on all card accounts

Customers affected 211 792 (incl 163 860 corrected in April 2013)

Fees and charges reversed R83.9m

Income statement effect – R15.2m

Refunds R17.178m

October 2014

Application of *in duplum* on all loan and card accounts

Income statement affected +- R50m

332. In its affidavit[261] Deloitte dealt with the change in the loan impairment provisioning methodology as follows:

(i) The NCA incorporated the common law *in duplum* rule. This rule limits the amount of interest and fees (i.e. initiation fees, service fees, credit insurance fees, default administration charges and collections costs) that a creditor may charge on an account that is in arrears.

[261] E(16)

(ii) As applied under the NCA, the *in duplum* rule holds that interest and fees should stop accumulating as soon as unpaid interest and fees equals the outstanding capital amount of the loan. In other words, the collection of interest and fees in the aggregate should not exceed the unpaid balance of the principal debt, importantly to be determined at the time of default (however small the balance may be).

(iii) Unfortunately, however, the international accounting framework provided for by IAS39 does not cater for the effect of the *in duplum* rule, which is peculiar to South Africa. IAS39 states that the impairment of a financial asset carried at amortised cost is measured using the financial instruments original effective interest rate. It does not allow for an exception (such as is created by the *in duplum* rule) which has the effect that interest and fees at some point stopped running and, therefore that the effective interest rate (yield) over the life of the loan is substantially reduced.

(iv) In relation to loans forming part of the NPL and the ML books (of which *in duplum* loans form a slight percentage), their NPV is determined using a discount rate based on the effective interest rate over the life of the loan. IAS39 requires the use of the original effective rate. However, the bank's management considered that treatment of the NPL and ML books using only the original effective interest rate was unrealistic, since it did not reflect the economic reality that the effective interest rate of an *in duplum* loan was zero from the time it became *in duplum*.

(v) For that reason, historically the bank's management reduced the effective interest rates of NPL portfolios which were classified *in duplum* to 0%. This meant that the bank historically applied a lower weighted average effective interest rate to calculate the present value of the whole bucket of impaired loans (i.e. NPLs and MLs) including *in duplum* loans.

(vi) Deloitte, since 2009, regularly raised with management, the Group Audit Committee and the BSD the fact that this methodology did not comply with the requirements of IAS39. Management was of the view that since an *in duplum* loan would (for legal reasons) no longer generate revenue for the bank, yields should be reduced to reflect that fact. In addition, management viewed *in duplum* as a contractual feature of credit agreements in terms of the NCA which (if correct) would entitle them to adjust the original effective interest rate. Deloitte continued to disagree with this view:

- in the Deloitte management report for the 2009 financial year;[262]
- in the Deloitte audit committee report for FY2009;[263]

[262] E(16.5)
[263] E(16.2)243

(vii) at a Trilateral meeting on 12 August 2010, attended by the board of the bank and the BSD , Deloitte noted that an issue Deloitte had raised in regard to the 2009 audit was still unresolved, namely, the reduction of the discount rates that are used in the impairment models in respect of *in duplum* accounts: see the BSD letter to Deloitte dated 27 September 2010[264] and the presentation Deloitte made at the meeting;[265]

(viii) a memorandum dated 8 November 2010 in which Deloitte responded to queries sent to Deloitte by Mr Sithole;[266]

(ix) the Deloitte audit committee report for FY2010;[267]

(x) the Deloitte interim audit committee report for FY2011;[268]

(xi) the Deloitte management report for FY2011[269] management commented, at the time, that: "*In duplum* loans have a low impact on the revenue models as the revenue models are only effective for loans that are still within their contractual term"; and

(xii) the Deloitte management report for FY2012;[270] management repeated the same comment.

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[264] E(16.5)
[265] E(16.3)33
[266] E(16.5)
[267] E(16.2)291
[268] E(16)349
[269] E(16.5)
[270] E(16.5)

333. Up to FY2012, and despite the *in duplum* issue, Deloitte did not regard the overall impairments to be materially misstated taken as a whole.

334. As a result of the growth in the aggregate amounts of the *in duplum* loans over time, the difference between the two provisioning methodologies became material for the FY2013 results.

335. At the insistence of Deloitte, the Abil group then changed its provisioning methodology in 2013 to discount all forecast cash flows at the original effective interest rates.

336. In other words, in relation to NPLs and MLs, the valuation methodology previously discounted the future cash flows at a weighted average discount rate which took into account that a portion of loans earned no fees or interest. In FY2013, the discount rate was changed to the original effective interest rate (in accordance with the Deloitte interpretation of IAS39).

337. According to a Deloitte report,[271] in prior years management of the bank had not run a model to quantify the possible effect of the discount rate applied to *in duplum* advances. Deloitte performed a rudimentary reasonability test to assess the possible impact, and came to the

[271] E(16)116

conclusion that the impact was substantially larger than initially expected. Management then quantified the impact on previous years, resulting in the following adjustments to the NPL and ML impairments:

	Original	Restated	Difference (*in duplum*)
2011 & before	R6,567 billion	R8,222 billion	R1,655 billion
2012	R8,863 billion	R10,193 billion	R1,333 billion
2013	R8,391 billion	R10,566 billion	R2,175 billion

338. Deloitte received management's models to determine the accuracy of profit in the periods and were satisfied that they were reasonable.

339. Mr Raubenheimer stated that until FY2012 cash flows attributed to accounts that had reached an *in duplum* status were discounted at zero. This practice was not aligned to IAS39, which required cash flows on impaired accounts to be discounted at the original effective interest rate. On 29 October 2013 he presented to the Group Risk Committee that the impact of this change in the bank's accounting policy had resulted in a charge of R2,175 billion. His presentation contained a table which showed the total valuation impact per financial year:

<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>
R660 million	R932 million	R1,685 billion	R1,300 billion	R2,175 billion

340. The evidence given during the interviews on the *in duplum* accounting was the following:-

(i) Mr Symmonds: "…my understanding was…that the statement IAS39 was quite clear and we were not complying with the standard",[272]

(ii) Mr Strauss: "I wanted the *in duplum* adjustment to go through…I recall it being north of R2 billion";[273]

(iii) Mr Roussos: "…my view has always been and had always been that discounting cash flows at zero percent was not correct…";[274]

(iv) Mr Raubenheimer said that it was Mr Nalliah's view that discounting of *in duplum* accounts at zero was not defendable;[275]

(v) Mr Nalliah's evidence was that he agreed with the correction of the *in duplum* accounting,[276] and that he had said that he "was not comfortable with" the way the bank had accounted for *in duplum* advances prior to 2013;[277]

(vi) Raubenheimer: "Until the 2012 financial year, cash flows attributed to accounts that had reached an *in duplum* status, were discounted at zero. This practice was not aligned to

[272] T189
[273] T353
[274] T421
[275] T536-7
[276] T821
[277] T836

IAS39, which requires cash flows on impaired accounts to be discounted at the original effective interest rate."[278]

341. When Abil changed its accounting methodology in 2013 to discount all forecast cash flows at the original effective interest rates in accordance with IAS39 the quantum of the impairment was R2,2 billion, which had a significant negative impact on the bank's results. Had the bank taken Deloitte's advice, and complied with IAS39, the input each year from 2009 would have been significantly less dramatic: the total valuation impact each FY year pre-tax would have been:

2009: R660 million

2010: R932 million

2011: R1,7 billion

2012: R1,3 billion.

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[278] E(13)6

CHAPTER 15 : THE EXPLANATIONS GIVEN DURING THIS INVESTIGATION FOR THE FAILURE OF THE BANK

The board

Non-executive directors

Mr Mogase (Chairman)

342. Post the bad results posted in March 2013 and a further unexpected increase in provisions for the full year, there was a loss of confidence in the Group. Short-term funders started reducing their roll-over rates on maturation, with some not rolling at all. It became difficult to raise new bonds in terms of the bank's bond programme. The board believed a strategic equity partner was needed in the circumstances both to give the bank additional capital and to restore confidence. Pursuant thereto he met with Sanlam, Old Mutual, RMI and MTN. He was unsuccessful in his efforts. There were some significant maturities of bonds that were becoming due and given the cash holding and the then current cash flow, it became obvious that these could not be met. Following discussions with SARB, it was decided that it would be best to place the bank under curatorship.

Mr Adams (Independent NED)

343. A contribution of factors, economic and otherwise, contributed to the poor ongoing reported results and market perceptions. These included:

(i) significantly increased competition, particularly in 2012 and early 2013; settlements and consolidation loans were common and this disguised collection fraud; subsequent loans by others to the banks customers reduces their ability to pay;

(ii) the bank aggressively competing to maintain sales and market share, which impacted the quality of business written;

(iii) longer terms of loans meant they were increasingly badly affected in worsening conditions;

(iv) ongoing deteriorating economic circumstances, with high job losses, unemployment and inflation and low salary increases;

(v) strikes and labour action;

(vi) increased fraud and syndicated activity;

(vii) changing environment in transaction banking:

(a) traditional transactional bankers were not active in the unsecured lending market; they were happy to process African Bank debit orders; that changed dramatically;

(b) growth of new banks and competitive marketing increased ability and willingness to change transactional bankers:

- this meant that African Bank debit strikes failed as the old bank account had been closed;
- where the bankers also provided loans it appears that the banks perhaps encouraged, and at least made it very easy, to cancel African Bank debit orders and there was a rapid increase in debit orders cancelled;

(viii) credit cards amnesty; these announcements and the popular press created the perception, particularly amongst the less sophisticated borrowers, that loans were being written off and need not be paid;

(ix) increasingly difficult to collect through the legal and other systems:

(a) voluntary debt mediation was terminated;

(b) many courts were unco-operative;

(c) garnishee orders positioned branded as bad;

(x) extensive “noise” positioning lenders as bad, borrowers as victimized; this significantly affected the likelihood of those who could afford to pay to choose not to pay; issues included:

(xi) Marikana: blamed on the high level of loans affecting take-home pay;

(xii) NCR matter: reckless lending allegations, subsequently unproved, were widely communicated;

(xiii) credit life and affordability discussions and regulatory proposals highlighted the perception of customers as victims;

(xiv) Parliamentary finance portfolio hearings;

(xv) garnishee positioned as bad;

(xvi) cost and availability of borrowings was affected by international and local market sentiment, in addition to the poor African Bank results; Moody’s negative ratings changes;

(xvii) the poor trading results, ongoing pessimism about the future trading environment, and reduced share price triggered very significant non-trading and often non-cash adjustments; these included:

(xviii) goodwill write-offs;

(xix) deferred tax write-offs;

(xx) the *in duplum* court ruling and the subsequent accounting adjustments;

(xxi) increased conservatism in write off, NPL and provisioning methodologies;

(xxii) extra stock provisions at EHL;

(xxiii) LTIP hedge adjustments;

(xxiv) BEE scheme funding support.

Ms Langa-Royds (Independent NED)

344. It is her understanding that the bank went into curatorship because SARB put it into curatorship and that this option was marginally better than putting the bank into liquidation. In fact PWC, the advisors appointed by the bank to assist in the resolution of the impending crisis, had recommended this route as the best option to safeguard what was left of shareholder value.

Ms Gumbi (Independent NED)

345. In her view, there were a number of reasons that led to the bank being placed under curatorship. These included the following:

(i) Over the past few years, at least, the "big banks" have aggressively moved into the unsecured lending space, where in the past African Bank was a major player. Once the "big banks" moved into unsecured lending, with their advertising muscle, most of the bank's low risk customers moved to those banks, in particular because they were able to access other transactional services in those banks.

(ii) There was a period earlier in 2012 when the bank wrote business that turned out to be bad, which negatively affected the rate of bad debts. Management subsequently corrected this and assured the board that the vintage graphs were showing a definite turnaround in the formation of NPLs.

(iii) A new competitor in the form of Capitec also made its presence felt. African Bank was not inclined to advertise its offerings; it was largely a “word of mouth” operator. Capitec, on the other hand, advertised its offering aggressively.

(iv) The downturn in the economy hit the bank’s clientele hard.

(v) The national debate about the possibility of writing off some credit bureau listing caused some confusion, with a lot of talk in the media that the government was going to write off people’s debt. This seems to have led to a propensity not to pay back debt.

(vi) The manner in which the settlement of the matter with the NCR was reported suggested that the bank had conducted its business recklessly.

(vii) The acquisition of Ellerines Furnishers, which needed substantial support from the Abil group.[279]

[279] E(3)299

<u>Mr Symmonds (Independent NED)</u>

346. The bank was placed under curatorship to protect its liquidity so that solutions could be sought for a viable, solvent business; the liquidity issues forced by the bank arose from the following:

(i) from an overall perspective, South Africa experienced very poor economic conditions over a sustained period from 2012;

(ii) the bank had grown significantly in 2012, taking on credit risk;

(iii) collections performance, at one time one of the bank's strengths, showed a marked decline from December 2012 onwards; the following additional comments are relevant:

(a) external settlements up until then masked risk emerging in the portfolio;

(b) the worsening economic conditions made it increasingly difficult for the bank's customers to pay;

(c) the disputing and reversing of debit orders was made easier by banks which made an already difficult collections environment significantly worse;

(d) regulatory changes around unsecured lending created a propensity not to pay;

(e) labour unrest in Marikana spotlighted unsecured lending as one of the causes of discounted exacerbated this propensity not to pay;

(f) there was an increase in fraud, both internal and external;

(g) whilst an increased focus on collections and various collections' initiatives steadily improved collections' performance, the improvements were slow;

(h) collections' performance drives the provisioning models; a worsening collections performance led to increased NPLs which led to increased provisioning and then worsening financial results;

(iv) the NCR matter created more reputational damage and uncertainty around the bank;

(v) the poor results in the bank were exacerbated at a group level by poor trading performance at Ellerines;

(vi) this bad news started to have an impact on liquidity and roll-rates started to decrease;

(vii) the worsening financial results started to have an impact on capital and various alternatives for recapitalising the bank were explored; a rights issue was agreed as being the correct approach and this was announced to the market in August 2013;

(viii) the rights issue, eventually set at R5,5 billion and underwritten by Goldman Sachs, was intended to bring stability to the market and improve the roll-rates on liquidity;

(ix) roll rates did not improve and confidence in the bank was not restored by the rights issue; his sense was that the market was waiting for the announcement on the half-year results to see whether the trading had improved;

(x) for some time, from before the September 2013 financial results announcement, the board and executives had been taking steps:

(a) to sell Ellerines;

(b) to find a strategic shareholder for the group;

(xi) these steps intensified as the financial position deteriorated; despite a significant effort, nothing was able to be concluded;

(xii) when the results for the 2014 half-year reflected the need for further provisions as the collections environment had deteriorated further, the liquidity position worsened;

(xiii) the market was then anticipating an announcement on the recapitalisation of the group; when this announcement was made it reflected the extra provisions referred to above, the impact of a possible Ellerines sale and some changes to align the bank's provisioning policy more with the banking industry; the extent of the capital requirement, in the absence of another funding solution, meant that that liquidity situation became so severe as to make curatorship inevitable.[280]

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[280] E(3)268

Executives

Leon Kirkinis (CEO)[281]

The trigger

347. According to Mr Kirkinis, a central issue concerns the impairment provisions made during September 2013, March 2014, and 5 August 2014, and the market's reaction to those provisions.

348. Abil's methodologies regarding write-offs and provisions had been stable over many years, but were unfortunately the subject of some significant changes in 2013 and 2014. During December 2013 the additional provisions for FY2013 were finalized at about R2,5 billion. Total provisions were then over R10 billion on a gross book of about R60 billion. The R2,5 billion refers to *additional provisions* raised in 2013 due to a growing book (new advances in FY2013) and the more conservative view on provisioning. Deloitte:

- gave an unqualified audit report, and
- was satisfied that the bank was a viable going concern for the next 12 months.

[281] E(10)48-98

349. In December 2013 Abil had a very successful rights issue in which R5,5 billion was raised, with the offer being almost twice oversubscribed. Mr Kirkinis and his family trust followed all their rights, demonstrating his belief and confidence in the future of Abil.

350. In March 2014, for various reasons, including that it was considered prudent to create a buffer to protect the business in the event that the tough conditions continued into the second half of the year, a further provision of R2,5 billion was raised, in consultation with Deloitte. Deloitte still held the view that the business was a going concern. Management expected this this was the last major change; that shareholders would accept it for that reason; that the bad news was behind them; and that from there on out they would generate a profit on a clean slate.

351. Mr Kirkinis had access to the most up to date, detailed, sophisticated data and forecasts that showed that material trends had recently made a positive turn, and that the business continued to be viable, profitable and a positive cash generator: indeed there was no reasonable indication to the contrary. This is a business with a 25 year history, 2 million active customers, and 3 million loans. It is a sizable, sophisticated operation, with highly refined models and systems.

352. Nevertheless, on the recommendations of PWC, R3 billion of additional provisions were announced on 6 August 2014 (contrary to his views that it was unnecessary, being overly conservative and concerning re effect on the Abil risk profile). The most material aspect of the additional provisions related to issues that had been considered by the board and debated with Deloitte at the time that the previous provisions had been decided upon. The most significant change related to when an impairment event occurred: traditional banks use a contractual delinquency on one month (CDI); PWC recommended that Abil did the same. Historically, however, Abil had used a contractual delinquency of four (CD4) or more, which was entirely appropriate for this business, which was quite distinguishable from the big banks.

353. It is Mr Kirkinis' view that those changes created more risk than was necessary and gave a far worse view of the underlying credit risk than was appropriate, particularly given the recent turnaround in the trends. He urged caution. The board took a different view, deferring to PWC, which he regarded with immense reservation. He had communicated his views to PWC, SARB and the board on numerous occasions. He felt that in the context of recent and significant changes to methodologies, an announcement of yet further provisions was bound to

create much more risk than was necessary. It would also increase the capital requirement unnecessarily.

354. Once the announcement of 6 August 2014 concerning the further provision of R3 billion was made, the market lost confidence, the share price plummeted, and the bank would have been unable to raise new funding. No further liquidity based on existing deposit could be relied upon either. Once sentiment turned, maturing investments were being withdrawn, and would continue to be withdrawn. Immediately after the announcement, Coronation, who controlled a 20% stake, dumped its shares. The share price fell to 31 cents per share before suspension, notwithstanding that the NAV was about R3,33 per share. Thus the announcement of 6 August 2014 triggered the curatorship.

The causes of the bank being placed under curatorship

355. What follows is a summary of the views of Mr Kirkinis.

356. In his view what caused the bank to be placed under curatorship was the compounding of internal and external factors that ultimately affected the confidence of Abil's funders, resulting in them declining to roll their maturing deposits with the bank.

357. The events described below took place in the context of:

- a substantially weakening economy;
- the Marikana tragedy (which resulted in negative sentiment against the micro-lending industry);
- the NCR's proposal of a fine of R300 million for reckless trading;
- devastatingly negative and unfair statements by the press; and
- various regulatory and government voices decrying lenders.

358. The events described by Mr Kirkinis are, briefly stated, these:

(i) Prior to June 2007 the banking industry was getting ready for the NCA. As tougher credit criteria were about to be introduced, the mainstream banks drove a significant growth in secured lending. That industry experienced rising bad debts, stagnant growth, and static returns on assets. So, the unsecured lending industry started to become particularly attractive.

(ii) Consolidation loans were used extensively by competitors. This caused the bank's market share to decline rapidly from 35% to 29%. In June 2012 competitors settled R350 million of the bank's loans to customers.

(iii) The bank continued to lose market share.

(iv) It became prudent to track the bank's customers' total instalment load on the credit bureaus based on activity by other lenders. It was decided to make public the risks. This was done at an investor conference on 6 August 2012. They communicated that they were seeing signs of customer distress within pockets of their loan book. The Abil share price dropped that very afternoon.

(v) During 2012 to date another form of competitive activity became problematic: with increasing frequency and numbers, customers began disputing the debit orders processed on their bank accounts.

(vi) African Bank was the only bank that did not do transactional banking: as such it was being prejudiced by this behaviour.

359. From September 2012 the bank's rate of collections began to fall in comparison to previous years.

360. A factor that drove sentiment was the role of short sellers and the negative impact of that on the share price.

361. Adverse sentiment had a significant impact on the trustees of funds that were placed with asset managers, who were instructed to withdraw funds on the next maturity date : thus a perfect storm started evolving.

362. The fall in the share price aggravated the liquidity position. Abil experienced weaker results through higher bad debts and continually increasing provisions.

363. After the successful rights issue in December 2013 confidence started to return and funding roll-overs started to improve. But Abil lost ground after the announcement in May 2014 of the extra R2,5 billion general provision.

364. There was a need for fresh capital of between R2 billion and R5 billion. That also depended on a few other variables:

- whether Abil could dispose of EHL;
- whether Abil could attract a strategic shareholder;
- whether Abil needed to hold the same capital as the bank, as the EHL losses were affecting the group capital more than the bank's capital.

365. In about June 2014 Goldman Sachs and JP Morgan were engaged to assist with a further capital raise. Goldman Sachs began performing a

due diligence. Before they completed it, the joint managers were initially of the view that the total capital required would be between about R7,5 billion and about R10 billion. It was the view of Mr Kirkinis that:

- this was too much;
- being overly conservative in and of itself created risk.

366. On the night of 5 August 2014 the Liquidity and Capital Committee (LACC) made the decision to raise a minimum of R8,5 billion of capital, which included the R3 billion recommended by PWC. Mr Kirkinis felt this was a step too far : the maximum should have been R5 billion.

367. On 6 August 2014 the trading update for Q3 of FY2014 was published on Sens: a minimum capital requirement was announced of R8,5 billion, which was not to be underwritten, and the resignation of Mr Kirkinis was announced.

368. Immediately after the announcement, Coronation, who controlled a 20% stake, dumped its shares. The share price fell to 31 cents per share before suspension, notwithstanding that the NAV was R3,33 per share.

369. Mr Kirkinis described what he meant by “the perfect storm” in his interview.[282] He referred to the NCR matter in February 2013; the

[282] T635-

announcement in early May 2013; “short sellers coming into the share and pushing the share down”; short sellers effectively owned up to 25% and at a peak 30% of the shares; the roll rate of maturing deposits fell; in August 2013 they announced the rights issue, the sale of Ellerines, and initiatives that they were putting in place to strengthen the business; when the interim results were announced in 2013 the share price fell dramatically; they were suffering significant negative press which was feeding off the fall in the share price; the Marikana tragedy; the changes in provisions in about October 2013 – the auditors wanted to put through R1,7 billion more provisions; in 2014 they had a tough collections period for the first six months; in January there was a high migration of PLs to NPLs; in February the specific coverage on the NPL portfolio was lifted by 1,6%; those two events resulted in an increase in provisions above the budget of R600 million; Moody’s downgraded the bank; there was debate around the CD1/CD4 impairment event; in March 2014 he decided to put through a R2,5 billion provision to which the board agreed; May to August 2014 was a tough period in terms of the roll-overs of maturing deposits; the negative publicity continued; when PWC was appointed they adopted a different methodology to the provisioning and income recognition policies; he did not agree with PWC; on 5 August 2014 the board took a different view and accepted his resignation; on 6 August 2014 his resignation and the extra R3 billion in provisions were announced – he believes that was an incorrect decision.

Mr Nalliah (Financial Director)

370. In Mr Nalliah's view, banking is about the confidence on the part of depositors. Once the confidence is dented or eroded, the deposits can be withdrawn very quickly leaving equity investors with a rapidly falling share price as was evident during the global financial crisis. A number of factors, amongst those highlighted below, had a profound impact on the business of the bank and the share price of Abil as a result confidence being eroded. What follows is the (very) short version of Mr Nalliah's statement:-

(i) Banking and Financial Services Environment

(a) The financial crisis of 2009/2010 led to increased competition in the unsecured lending sector given the lack of growth in secured lending (mortgages and vehicle finance).

(b) During 2011/2012 there was a very high level of settlement by competitors of the loans granted by African Bank to its low-risk customers as a result of predatory marketing practices.

(c) With the increased competition, there was an increased level of debit order disputes and cancellation by customers of African Bank loan repayments with their various banks.

(d) During this period, the practice of “pay-day lending” grew approximately 124%. A pay-day loan is granted on condition that it is fully repayable when the individual received his or her next salary.

(ii) <u>Socio-economic environment</u>

The Marikana strike and ensuing massacre in August 2012 had a profound effect on the South African economy and market sentiment, perception and confidence.

(iii) <u>Regulatory environment</u>

From mid 2012 to the end of 2013 the NCR:

(a) introduced draft “Affordability Guidelines” for credit providers which contained specific processes to be adopted by credit providers to address consumer affordability when granting credit; this would have meant that many customers of African Bank who had previously qualified for loans and could afford them, would have been precluded from accessing credit going forward;

(b) released the proposal of the R300 million proposed fine for reckless lending;

(c) advised the market that it was intending to introduce a further credit amnesty which would grant relief to millions of consumers by providing them with a clean credit record enabling them to "have a second chance" with regard to their bad debts;

(d) advised the market that it would be introducing a cap on credit life insurance, which the media reported would significantly reduce the profits of Abil in respect of its insurance business.

(iv) Internal factors within the bank

Ellerines

(a) A factor that had a profound impact on the business of the bank and the share price of Abil from mid-2012 to end 2013 was the losses that were incurred in Ellerines together with the failure to secure its sale to a third party.

(b) The Q3 update of 6 August 2012 reflected the signs of significant customer distress in the Ellerines loan book with the credit impairment charge increasing from 18,5% of the book to 31,8%. This was of concern to the market which was then reacting more negatively to the fact that the performance of Ellerines was adversely impacting the bank.

Collections

(a) Changes in collections processes were too slow to respond to changes in market, eg timing of letter of demand or legal action should have been accelerated in a weakening environment.

(b) The collections levels were lower each month for the remainder of 2012 in relation to 2011, with the collections in January 2013 being especially low even after taking seasonality into account.

(c) Collections in February and March 2013 did not recover sufficiently to compensate for the very low collections of January 2013.

(d) Deteriorating collection resulted in significantly increased impairment provisions, which negatively affected earnings and investor confidence as the bank's competitors were not reflecting similar trends.

<u>Credit Underwriting model</u>

(a) The credit underwriting model was not forward-looking as it assessed affordability at a point in time and did not factor in any potential economic or environmental changes, such as increased in food and transport costs.

(b) The fact that collections were significantly lower in 2013 and 2014, not only in comparison to prior years' collections' figures, but also in comparison to those of its competitors, points in hindsight to the nature of the credit policies in place at any time, which resulted in the higher credit risk being written from 2012 to 2014, resulting in lower collections.

Repeated reduction in Repo Rate

The interest rate cap reduced from June 2008 to July 2012. This meant that new loans that were being priced at the caps, now had a lower price applied, notwithstanding that the risks remained unchanged or had in fact increased.

Funding

(i) Relentless concerns about the unsecured lending industry, the economic outlook, and political developments in South Africa, resulted in funders publicly stating that they would cut their exposure to the unsecured lending industry.

(ii) This resulted in the rollover of maturing deposits steadily reducing from early 2013 through to August 2014.

Significant drop in earnings for the reporting period ended March 2013, September 2013 and March 2014

The effect of the significant drop in earnings for three reporting periods, together with an increase in the credit impairment provisions led to a significant erosion of investor confidence resulting in the drop in the Abil share price from April 2013 to 11 August 2014.

Mr Sokutu (former Chief Risk Officer)

371. As he left the bank before curatorship, his views are based on his tenure at the bank. This was long coming. Of the cocktail of factors that contributed to this eventuality, the drying up of funding to fund the activities of the bank was a critical factor as sales depend on availability of funds. Diminishing capital to meet capital adequacy requirements of SARB could have been another factor. At the same time there was a gradual increase in NPLs; higher debt than normal. The profit warning in 2013 led to a rapid loss of confidence by investors and shareholders in management. The timing of the profit warning about higher NPLs than expected took the market by surprise coming as it did about a month before the half year results.

372. Funding became a problem as more and more funders became uncertain about the performance of the bank and whether they would get their money back. He says this because while he was still in the bank, after the profit warning in May 2013, the bank's treasury began to battle to raise funds. Even those funders who normally rolled over the funds at maturity for months, one by one, started to refuse to roll the funds over. The bank started to struggle to issue bonds, while before then the bank had issued bonds with relative ease. And it issued bonds practically anywhere in the world.

373. It is also Mr Sokutu's considered view that the above resulted from loss of confidence by the market – i.e. investors, funders and shareholders – in executive management, specifically following the profit warning in May 2013. The profit warning followed meetings with investors and shareholders in February. Investors and shareholders were disappointed that the information about higher levels of NPLs was not disclosed in the February meetings with the bank. This was in contrast to prior years when investors and shareholders were attracted to the bank due to the bank's consistent profits. The profit warning also came at a time when the regulators, particularly the NCR, were tightening regulations on micro-lending. This created uncertainty in the market about the future of micro-lending in general.[283]

[283] E(3)198

Mr Voogt (Internal Auditor)

374. In his view, and with the benefit of hindsight, events leading up to the curatorship were probably precipitated by a combination of the following factors:

(i) continued disappointing results to the stakeholders (expectation management);

(ii) liquidity pressure relating to funding obtained;

(iii) continued losses from retailer [Ellerines];

(iv) capital squeeze;

(v) market conditions.

Mr Schenk (Head: Group Forensic Services)

375. From what he heard or read in the media or was communicated to bank employees by Mr Kirkinis (CEO) or Mr Winterboer (Curator), he deduced, maybe incorrectly, that the curatorship was caused by:

(i) a liquidity crisis;

(ii) a decrease in sales (loans);

(iii) the quality of the business written;

(iv) the inability to collect on deals written;

(v) imperfect credit scorecard/affordability assessments;

(vi) a single revenue stream;

(vii) a non-diversified set of banking products;

(viii) inadequate provisions for bad debts;

(ix) weak economic growth;

(x) high consumer indebtedness levels.

Shareholders/funders

Coronation Fund Managers

376. The causes of the bank being placed under curatorship included:-

(i) the 6 August 2014 trading update revealed Abil's situation to be totally at odds with what its management had guided expectations to be, and revealed a financial situation that prompted Coronation to conclude that the bank was, fundamentally, no longer a going concern;

(ii) the bank incurred very high risk losses relative to the capital base, arising from:

(a) poor credit management;

(b) inappropriate risk pricing;

(c) inappropriate risk appetite;

(iii) in the opinion of Coronation, these losses meant the business was no longer solvent and it would need to raise a significant amount of capital for a second time within a twelve month period; the absence of any explicit support from SARB or major funder made the bank's survival improbable;

(iv) over the last two years Abil presented the status of its books to imply a state of affairs that was completely at odds with what emerged on 6 August 2014;

(v) this called into question the reliability of their credit information systems as well as their ability to implement any sustainable turnaround in the business;

(vi) the exit of Abil's CEO meant that there was no longer a capable management team in place to manage the bank during this period of difficulty; whilst the CEO had faults, the principal one being excessive optimism, he did at least have a long term track record of having managed the bank through prior cycles; given the scale of the problems at Abil and the lack of an announcement of a credible successor and the lack of management depth, the prospect of a successful turnaround was all the less likely.

Allan Gray

377. What caused the bank to be placed under curatorship:

(i) the accumulation of NPLs was worse than management expected and had provided for in the accounting statements;

(ii) the losses from Ellerines put additional strain on the capital position of the business;

(iii) these credit and operational losses caused investors to lose confidence in management and the business;

(iv) this lack of confidence caused significant selling of the Abil shares and the share price collapsed;

(v) this placed significant doubt on the ability of Abil to raise further equity capital which then made it impossible for the bank to fund itself.[284]

PIC

378. The PIC believes that the failure of the bank was as a result of aggressive loan growth that was done at the expense of disciplined credit risk management resulting in massive credit losses with the consequent erosion of capital and investor confidence.

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[284] E(5)57

Investec Asset Management

379. In the view of Investec Asset Management, what caused the bank to be placed under curatorship was an ill-advised trading update on Wednesday, 6 August 2014, advising that Abil required a significant rights issue which was not underwritten, resulting in a precipitous fall in the Abil share price, which resulted in a crisis of confidence and placed at risk the functioning of the funding market for the bank. The business was not insolvent at the time of the trading update.

Stanlib[285]

380. In the opinion of Stanlib, the bank's problems can be attributed to the granting of bigger size loans for longer duration into a worsening consumer environment together with the distraction from the Ellerines acquisition, which introduced a different underwriting risk/client than the bank's traditional customer. Jittery financial markets also added to the bank's problems as the rolling of credit lines became a challenge.[286]

[285] Stanlib Asset Management Ltd
[286] E(5)42

Deloitte (External auditors)

381. In broad terms, the bank became distressed because it was too thinly capitalized to support the high risk appetite and aggressive loan book growth in recent years. This was caused by:

(i) inadequate appreciation of the (rising) risks inherent in the aggressive growth;

(ii) inadequate pricing for such risks;

(iii) changes in the loan book mix;

(iv) changes in the Ellerine collections model;

(v) a funding mismatch that developed because of changes in the loan mix;

(vi) severely negative market reaction when the consequences of these issues were reflected in Abil's results;

(vii) the negative market reaction led to:

(a) a reduction in Abil's ability to "roll" funding;

(b) more expensive funding; and

(c) ultimately an inability to raise capital due to a decline in the share price;

(viii) the negative market reaction constrained the options of Abil to replenish lost capital or to raise affordable loan funding;

(ix) market disappointment caused by unrealistic expectations created in management communications, leading to a loss of management credibility and confidence in the bank.

382. The bank's mono-line business did not allow for a portfolio effect to cushion the impact of the many negative factors which impacted on the increasing risks; these factors included:

(i) increased competitive pressures from other banks and lenders;

(ii) the aggressive extension of loan terms and loan size;

(iii) the need for increased wholesale funding from local and foreign sources coupled with the recent development of a timing mismatch between the term of the loan book and the term of the funding;

(iv) significantly increased volatility in cash flows and consequently decreased reliability of the bank's impairment model;

(v) continued advancing of loans to higher risk customers, compounded by a higher tolerance to non-debit order business leading to a higher proportion of cash-paying customers;

(vi) inability to price appropriately for the high risk, due to the NCA caps;

(vii) a declining trend in customers' propensity to pay since 2012, impacting cash flows and profitability;

(viii) a significant increase in settlement re-advances which led to the effective "re-aging" or "curing" of potentially impaired accounts masking the true quality of the loan book;

(ix) an increasing incidence of cancellation of instalment debt orders;

(x) the dependency of customers on a line of credit from the bank to fund the furniture retail operations which were running at a loss; this detracted from its ability to deploy the resources more productively;

(xi) the impact of the economy and socio-political environment on the bank's operations, in particular:

  (a) the events at Marikana;

  (b) the increasing incidence of industrial action (particularly in late 2013 and the first half of 2014);

  (c) increased levels of consumer over-indebtedness leading to deteriorating cash flows experienced since early 2013;

  (d) the increasing negative perception about the unsecured lending market and increased regulatory scrutiny;

(xii) a particularly bad book written in the period between August 2012 and February 2013;

(xiii) delays in the upload of credit information in the fourth quarter of the 2012 calendar year, resulting in advances to individuals with outdated credit information;

(xiv) the dispersed nature of Abil's share ownership structure;

(xv) the general worsening of the credit environment amplified the effect of aggressive accounting policies and judgements eg the dramatic increase in impairments caused by *in duplum* loans.

SARB

383. The Registrar is of the view, in summary, that the following were the primary reasons for the collapse of the bank:-

(i) lending criteria were not appropriate for the market conditions;

(ii) in hindsight, it was a poor investment decision to acquire Ellerines, including its subsidiaries such as Ellerine Furnishers, increasing “same-way risk”;

(iii) there was insufficient challenge by the board of directors with regards to strategy, risk appetite and risk management practices;

(iv) the same board members for Abil were also the board members for the bank: this resulted in a conflict of interest in terms of the directors’ fiduciary duties to ensure that the bank remained a sound institution and was not exposed to risks from group companies, eg the drainage of funding by Ellerine Furnishers on the bank’s liquidity and capital position;

(v) the impairments and write-offs were less conservative;

(vi) too much focus was placed on the ability to collect outstanding debt instead of ensuring that the underwriting policies were adequate;

(vii) the mono-line business meant no diversification in product lines;

(viii) the concentrated funding model meant that the majority of funding was derived from wholesale funders such as fund managers, who are astute investors and react quickly to negative news;

(ix) there was no shareholder of reference to rely on in times of trouble or that could question the actions of the board and management;

(x) increasing impairments raised from September 2013 resulted in losses, which added to negative market perceptions on the sustainability of the business model; and

(xi) there was a deterioration in the economy, job losses, and industrial action, resulting in an increase in non-performing or impaired loans.

CHAPTER 16 : ELLERINES

2007

384. A document, "Feedback on research into opportunities for growth," prepared by Messrs de Ridder and Woollam, was presented to the board at its meeting on 20 July 2007.[287] The benefit to Abil acquiring a large credit retailer was described as "significant"-

"- We believe on the whole we can offer their customers a better deal than they do.

- We would gain access to a new customer base – approximately 1 million new customers.
- Better loan offerings would create a spin-off to their retail sales and operating margins.
- The restructuring of the balance sheet offers significant low hanging time to unlock value, which [they] seem incapable or unwilling to do.
- There are undoubtedly some cost efficient synergies – but we are cautious not to hang a deal on these."

The document recorded that there were "significant risks" with a "complete takeout."

- "We do not have experience in running a retail business.

[287] E(7)128

- Both businesses have regulatory clouds over them and we don't know the extent of the damage.
- Shareholder resistance and holding out for a higher price has resulted in a number of deals failing.
- Management are unlikely to be completely friendly, and therefore there will be an element of hostility.
- Do we have the management capacity to handle such a deal?"[288]

385. At the meeting of the Abil board on 20 July 2007[289] there was discussion around the potential acquisition of one of the existing credit retailers as part of the growth strategy. The board was supportive of exploring such an initiative and granted approval, in principle, to management to engage potential parties in discussion. All directors were advised not to deal in any securities of EHL or JD Group while such exploratory discussions were under way.

386. On 6 August 2007 an email was sent by Corinne Kirkinis to Mr Kirkinis with the names of the Due Diligence team and the Brief.[290] Each member of the team was given an area of responsibility, eg Mr Chemel: underwriting, Mr Roussos : collections activities, and so on. The Brief included: "Examine the capabilities, capacities, and strengths and weaknesses of the areas mentioned above."

[288] E(7)128)
[289] AB(23)352.1
[290] AB(51)2

387. On 8 August 2007, Mr Kirkinis, on behalf of Abil, applied to the Registrar for the approval of the acquisition of EHL by Abil.[291] In the introduction to the application it was stated that the information obtained regarding EHL was "extracted from the interim results of Ellerines published for the 6 month period ended 28 February 2007, Ellerine's annual report for the financial year ended 31 August 2006 as well as high level discussions with Ellerine's top management, which we have used to derive a forecast for 2007 and 2008."

388. The application provided "brief reasons for the acquisition". What is significant is the description of Ellerine.

"2.4.1 Ellerine is a well established furniture retail group, targeting customers in similar market segments to Abil's target market. The products sold within the group are primarily sold on credit with payment terms between 12 and 24 months. It is a very profitable business and is expected to generate post tax profits in excess of R900 million for the year ended 31 August 2007. In addition the group is very cash generative, with the majority of the above profits in a cash form. The business is conservatively geared with approximately 80% of its assets funded by equity. Approximately 70% of the business's profits are

[291] SARB(2)18

generated by its financial services activities, and as a result, Abil regards the acquisition of Ellerine as being a complimentary (sic) fit."

389. The application alleged that the R9,5 billion purchase consideration included approximately R2 billion in surplus capital which would be released once the regearing process was complete: of the R7,5 billion net investment, approximately R5 billion represented the value of the financial services business and R2,5 billion represented the value of the retail operations.

390. On the same day that the s52 application was made, namely 8 August 2007, the Deputy Registrar of Banks wrote a letter to Mr Kirkinis as "Managing Director" of Abil in which he was advised that the Office of the Registrar, based on the information provided at a meeting held on that day, confirmed that it did not foresee regulatory constraints in considering the possible acquisition by Abil of an interest in EHL in terms of s52 of the Banks Act.[292]

391. In a presentation to the Abil board at a special meeting on 13 August 2007[293] the "Reasons for Ellerines" were given as:

- Access to a differentiated risk and price model that will lead to elasticity of credit and facilitate greater spending power for clients

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[292] SARB(2)17
[293] E(1)43@49

  - Reduced price of credit to certain client segments
  - Increased sales of merchandise resulting in better retail margins
- Improved credit underwriting and collections
  - Increase in terms and therefore affordability to certain client segments
- Threat of disintermediation removed – vulnerability of entire Ellerines group reduced
- Leadership vacuum issues resolved
- Extended client life cycle as a result of increased utility to clients (access to more products, distribution)
- Reduced cost base through synergies and economies of scale
- Increased credit utility through Abil's credit capability
  - Better price
  - More credit
  - More credit products

The "Risks" were stated to be:

- Lack of retail skills, competencies and knowledge in Abil
- Culture fit
- Different business models
  - Balance sheet structures
  - Profit levers
  - Cycles

- Inability to determine turning point in current downward retai8l, consumer credit and investment cycle
- Inability to separate Finco from Retailco without hurting either company
- Potentially excessive client overlap
- Ellerines potential exposure to NCA compliance issues
- Management capacity and expertise
- Shareholder resistance
- Lack of management buy-in

392. Of the fourteen directors of Abil, six “attended” the meeting by way of teleconference. Mr Kirkinis told the meeting that, based on the mandate given by the board on 20 July 2007, management had considered various options. The board resolved unanimously to support the proposed acquisition of EHL. Based on various valuation models presented to the board for consideration, the proposed price was R85 per Ellerines ordinary share, which translated into R9,85 billion. The intention was to settle the price by way of an issue of new Abil ordinary shares.[294]

393. On 20 August 2007 Abil and EHL published on SENS a cautionary announcement about the proposed acquisition by Abil of the entire

[294] AB(23)353

issued share capital of EHL.[295] The proposed purchase consideration was said to be based on an offer price of R85 per EHL ordinary share, which translated into R9,85 billion. Abil intended to settle the purchase consideration by way of an issue of new Abil ordinary shares. This was the description of EHL: “The Ellerines Group is a successful and established retail business operating a number of well-known household brands through some 1300 outlets…Abil estimates that approximately 70% of Ellerine’s profits are derived from its financial services activities (credit and insurance) and 30% from its retail activities. The joining of the two businesses under a single ownership structure will optimize the opportunities to play a leading role in the reshaping of the retail and financial services offering to this market. Ellerines has a proven and experienced retail expertise, and Abil is confident that the retail business will continue to grow and increase its market share, powered by an enhanced financial services offering.”

394. The following graph tracks the share price of EHL from January 2005 to October 2007:

[295] AB(47)1

296

395. On 21 August 2007 Mr de Ridder sent an email with the subject "Ellerines due diligence : terms of reference" to a number of people, including Messrs Fourie, Chemel and Nalliah. He asked for "…your revised version by close of business today if possible".[297]

396. On 24 August 2007 Mr Nalliah informed Mr Klindt by email that "…we did not value Abil… we merely valued Ellerine…".[298]

397. Mr Naidoo, a Bank's Analyst at JP Morgan, published an assessment of the Abil acquisition of Ellerines on 24 August 2007 under the title :

[296] AB(23)352.3
[297] AB(52)50
[298] AB(52)54

"African Bank Investments Limited: ABILity to unlock value.[299] His article included the following statements:

- "Management believes that the retail and financial services operations within the enlarged group can be self-sufficient, with no cross-subsidisation. …
- "Quality of Ellerines book- management's preliminary view of the book is that the underlying quality is good and within Abil's acceptable risk tolerance levels. …The due diligence process should provide further insight into the quality of the book."

398. On 30 August 2007 an email exchange took place between Mr Squires, the CEO of Ellerines, and Mr Schachat, in which Mr Squires described Mr Fourie as "…an outstanding young man, whom I would be privileged to have as my successor."[300]

399. On 5 September 2007 Abil and EHL announced on SENS Abil's offer to buy the shares of EHL.[301] Abil and Ellerines shareholders were advised that they had "…now completed satisfactory reciprocal due diligence investigations on each others businesses." Accordingly, Abil had submitted to the board of EHL a notice of its firm intention to make an offer to acquire the shares of Ellerines. It was stated that KPMG Services (Pty) Ltd (KPMG) had been appointed by the board of Ellerines

[299] AB(53)1,7
[300] AB(51)4
[301] AB(47)40

to advise on whether the terms of the offer were fair and reasonable to the Ellerines shareholders. It was further alleged that the board of Abil had considered the terms and conditions of the offer and "unanimously recommend that Abil shareholders vote in favour of the offer at the Abil general meeting."

400. A "High Level Due Diligence Report" (Due Diligence Report) dated September 2007 was produced, *after* the board had already decided to support the acquisition of EHL.[302] The objectives were said to be a high level due diligence, including a detailed book analysis, conducted by the African Bank due diligence team, with the aim of:

- identifying any show stoppers that would in isolation or in combination with others result in an unforeseen financial impact of more than R250 million (post tax) on the June 2007 NAV of the business, and therefore require an adjustment to the offer price;
- identifying any major reputation/compliance issues imbedded in the business that needed to be factored into the thinking prior to a firm offer being made.

401. The bank's due diligence team consisted of Mr de Ridder and six teams. Three of the team leaders were Messrs Nalliah, Chemel, and Fourie.

[302] Kirkinis ADD; Schachat E(6)270

Mr Woollam was not a member of the team, but gave instructions to Mr Nalliah that "the fronting of insurance income" was to be excluded as Mr Woollam had taken that into account in the purchase consideration.[303]

402. The Due Diligence Report contained the recommendation that Abil proceed with a firm offer on the same terms as the existing indicative offer: no major issues emerged that were judged to be of such a material nature as to warrant either:

- reconsideration of the proposed acquisition; or
- any adjustments to the terms or offer price for the acquisition of the Ellerines Group. The report contains these two comments:
- "The general impression gained by all teams during management's consultations and discussions with the external auditors was one of a reasonably well governed, managed and controlled retail and credit operation with very experienced and solid operational managers in charge of all the key areas."
- "Retail business: The business operates effectively and is managed in a disciplined manner. No material risks in relating to the scope of the due diligence were identified."

[303] T858

403. The Due Diligence Report was discussed at a meeting of the Abil board on 19 September 2007.[304] KPMG, who had concluded the due diligence exercise and the fair and reasonable exercise on African Bank on behalf of Ellerines had found the deal to be fair and reasonable to Ellerines. The Ellerines board was in unanimous support of the transaction. As part of the process applications for regulatory approval would be made to SARB, the FSB and the Competition Commission. The chairman of the board, Mr Mabogoane, on behalf of the board congratulated the management team. Mr Kirkinis thanked the board for their support.

404. On 21 September 2008 Abil and the bank, represented by Mr Kirkinis and Mr Nkosi, the Compliance Officer, made application to the Registrar for the acquisition by Abil of EHL.[305] The covering letter referred to the application of 8 August 2007 as “the preliminary application.”

405. The major opportunities and advantages that emerged from the combining of the two groups were said in the scheme of arrangement of 27 September 2007[306] to be the following:

(i) greater critical mass for the financial services businesses of the two groups would double the joint client base to more than two million active credit clients and increase the gross advances book to approximately R16 billion. The benefits of this critical

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[304] AB(23)355
[305] SARB(2)100
[306] AB(47)151

mass would allow the group to become more cost efficient and thereby allow it to further reduce the cost of credit to the market;

(ii) a greater distribution footprint with approximately 1900 branches and outlets, improving client accessibility and service;

(iii) the ability to introduce Abil's greater price and risk differentiation underwriting models into the Ellerines distribution channel. This created greater credit capacity for lower risk clients, which in turn created greater purchasing power for consumers in the furniture retail market;

(iv) improve product offerings and flexibility for Ellerines clients. Abil intended to implement and further innovate its card-based technology to offer retail clients a more flexible credit offering with greater convenience. This would also give Abil the opportunity to achieve critical mass in its card operations.

(v) Ellerines operated in a wider target market through the increased distribution footprint and gain experience in these areas;

(vi) Abil estimated that there was approximately R2 billion of surplus capital in Ellerines that could over time be more effectively funded via debt and secondary capital instruments. This in turn would lower the weighted average cost of capital, enabling more competitive product pricing to the credit markets.

406. On 23 October 2007 the Registrar approved Abil's acquisition of EHL.[307]

407. The annual report of EHL for the FY2007 was signed on 5 November 2007.[308] The "Financial Highlights" included the following:

(i) the group, after its long history of 57 years, had achieved the significant milestone of R1 billion profit after tax, an increase of 13% over the previous year;

(ii) despite the tough trading conditions revenue increased by 9% to R8,3 billion, with the operating profit at R1,5 billion reflecting an increase of 15% and an improved operating margin at 17,6% (2006-16,8%);

(iii) the gross profit margin at 44,7% remained unchanged from 2006 and operating expenses were well controlled at R3,2 billion, an increase of only 3,5% over the previous year.

408. At the Group Audit Committee meeting held on 7 November 2007[309] it was minuted that Mr Nalliah and the Deloitte technical team would be working on a resolution of the potential accounting issues and the alignment of accounting policies between Ellerines and the bank - *after* the issue of the SENS announcement of 7 September 2007.

[307] SARB(1)202; SARB(2)204
[308] AB(47.1)118
[309] AB(6)107

409. The boards of Abil and the bank held a meeting on 8 November 2007.[310] In discussing the "Abil Group Financials" it was highlighted that the Ellerines transaction was seen as an opportunity for "this business."

410. On 19 December 2007 the Competition Tribunal approved the merger between Abil and EHL.[311]

<u>2008</u>

411. The effective date of the Ellerines transaction was 1 January 2008.[312]

412. Abil's management took control of Ellerines on 14 January 2008.[313]

413. At a meeting of the board of Abil held on 31 January 2008[314] Mr Kirkinis updated the board on the "Ellerines merger":

(i) major changes in accounting policies were expected;

(ii) the accounting policy changes were material and would affect the take-on balance sheet of Ellerines;

(iii) the final purchase price was R31,01 per Abil share.

Mr Schachat reported that as discussed at a Directors' Affairs Committee meeting held earlier that day, Mr Kirkinis would surrender his

[310] AB(23)358
[311] AB(50)180
[312] AB(23)371
[313] AB(23)371
[314] AB(23)370

role as managing director of the bank and remain CEO of Abil, while Mr Woollam was to become CEO of the bank.

414. The Group Risk Committee held a meeting on 20 February 2008.[315] In regard to “Credit” it was noted that the profile of the Ellerine customer in the lower end of the market had changed since the implementation of the NCA which had increased the credit risk; a number of issues had been raised in Ellerines regarding unvalidated income : this was of concern as it raised the question of possible “reckless lending”.

415. The Group Audit Committee met on the same day, 20 February 2008.[316] Mr Nalliah summarized the three major accounting policy differences between Abil and Ellerines as follows:

- insurance income recognition;
- recognition of income on “Admin and Service” fees;
- debtors provisioning, which would be brought in line with Abil policy.

416. At a meeting of the Abil board on 3 March 2008[317] Mr Fourie, the CEO of Ellerines, summarized his presentation on the Ellerines business *inter alia* as follows:

(i) Ellerines was “over-branded, over-stored and over-structured”;

[315] AB(4)91
[316] AB(6)113
[317] AB(23)376

(ii) the cost structure was high;

(iii) the market share of the group had declined over the past few years;

(iv) productivity ratios were worse than the direct competitor;

(v) debtors' costs had increased significantly over the past year and the forecast looked poor;

(vi) credit granting policy had changed due to the NCA;

(vii) sales and margins were under pressure and below budget;

(viii) trading profit was below budget and was anticipated would be below budget to year-end;

(ix) head office costs were high and were planned to be reduced by consolidation of the various offices across the country over time;

(x) supply chain and logistics was a challenge and a top logistics person needed to be recruited;

(xi) there were leadership and skills challenges within the business, especially in the area of merchandise, logistics and at the divisional level.

417. Mr Woollam summarized the concerns regarding the Ellerines insurance division, according to the minute of the meeting, in these terms:-

(i) the accounting methods used to bring income into account in the insurance company post NCA was legally flawed and required correction back to June 2007;

(ii) this method of income recognition was agreed by Ellerines auditors and insurance advisers;

(iii) this was also raised at the time of the due diligence as an issue;

(iv) the correction of income recognition would have a material effect on the financial numbers of the Ellerines division for the half year: the amounts were about R200 million for the period June to August 2007 and R900 million for the period September to December 2007;

(v) the R900 million would be accounted for as an adjustment to the purchase price in the books of Abil;

(vi) the financial statements of the insurance companies for the year end 31 August 2007 would need to be withdrawn and restated;

(vii) the various regulators, including the JSE and the FSB, would need to be informed;

(viii) the communication to the market needed to be carefully worded.

418. In his statement and during his interview Mr Woollam said that the minutes of the meeting was incorrect in that the words “purchase price”

should be replaced by “purchase price” allocation between the net assets and goodwill.”[318]

419. On 7 May 2008 Abil released an announcement on SENS[319] in order to give investors an insight into the acquisition date financial statements of Ellerines and to provide a more meaningful understanding of the effect that Ellerines would have on the interim results of the consolidated Abil group to be published on 26 May 2008:

(i) the financial statements of Ellerines for the 12 month period ended 31 August 2007 disclosed a NAV, including goodwill and intangible assets, of R5,160 billion;

(ii) the NAV of Ellerines for the 4 month period to 7 January 2008 was R5,422 billion prior to the realignment of the accounting policies;

(iii) Abil had made a number of adjustments to the financial statements of Ellerines as at 7 January 2008, in order to bring those in line with Abil’s accounting policies including:

- the effect of the change in relation to insurance income recognition was a provision of R339 million for unearned premiums;

[318] T102
[319] SENS(1)19, SARB(1)19

- a provision for deferred administration fees of R109 million would be incorporated in the acquisition date financial statements;

(iv) the fair value of the purchase consideration for the Abil shares issued to Ellerine shareholders was R9,139 billion.

420. At an Abil board meeting on 22 May 2008[320] Mr Kirkinis summarized the results announcement as including the following:

(i) headline earnings for the group were R805 million; R652 million for the bank; and R153 million for Ellerines;

(ii) economic profit for the group was R265 million; for African Bank R471 million; and Ellerines produced an economic loss of R205 million.

421. A meeting of the board of Abil was held on 30 July 2008.[321] Mr Fourie presented the proposed strategy for Ellerines, which included the 4 to 5 year strategy:

(i) to double retail sales;

(ii) to achieve an after tax return on sales of 10% in the retail business;

(iii) to achieve a productivity increase of 15 to 20% year-on-year on space, people and stock;

[320] AB(23)384
[321] AB(23)391

(iv) separate credit and retail model.

422. Mr Fourie was quoted by the media on 19 August 2008 as saying that Ellerines was "…back where African Bank was three or four years ago…credit was granted a little more liberally than it should have been."[322]

423. Mr Fourie presented the budget to EHL for the 12 months to 30 September 2009 at an Abil board meeting held on 19 September 2008:[323]

(i) revenue was budgeted at R9 billion;

(ii) profit before tax was budgeted at R1,158 billion;

(iii) headline earnings were budgeted at R754 million;

(iv) financial services revenue was budgeted at R2,482 billion.

424. At a Group Risk Committee meeting on 10 September 2008,[324] Mr Sokutu summarized the high level risks as including:

(i) loss of focus by bank staff while attending to issues at Ellerines;

(ii) collections remained under pressure at Ellerines, although initiatives had been put in place to correct the situation;

(iii) there was a shortage of skilled people in Merchandise and Credit at Ellerines;

[322] Media(1)32
[323] AB(23)396
[324] AB(4)104

(iv) there was no full understanding of the levels of indebtedness of clients and staff.

425. In Abil's annual report for FY2008 (ended 30 September 2008)[325] goodwill relating to EHL was R5,292 billion, and related to the various Ellerines furniture store brands, such as Ellerines, Town Talk, FurnCity, Beares, Lubners, Furniture Store, and so on.[326]

426. A meeting of the Abil board was held on 21 November 2008.[327] Mr Kirkinis presented the "Abil group financials":

(i) the trading and credit granting environment in Ellerines was very difficult; as a result the financial results were below expectations;

(ii) earnings were R1,810 billion of which Ellerines' contribution was R368 million and the bank's R1,442 billion. Mr Fourie highlighted the following in regard to Ellerines' " financials" for FY2008:

- the financial results were disappointing;
- headline earnings were R368 million, retail generating a loss of R223 million;
- the merchandise sales were down by 13% compared to the previous year;

325 AB(11)1251
326 AB(11)1467
327 AB(23)401

- operating costs were 6,6% higher than the previous year;
- bad debt levels remained high;
- financial services generated a profit of R591 million, mainly from the sale of insurance products.

427. For the nine months ended 30 September 2008 EHL produced the following financial results:

(i) Headline earnings

(a) Retail	-R223 million
(b) Financial Services	R591 million[328]
(ii) Economic loss (including goodwill in Abil):	-R737 million[329]

2009

428. At the Abil board meeting on 23 February 2009[330] three presentations were made relevant to Ellerine:-

(i) The first was by Mr Fourie. He updated the board on Ellerines' performance and strategy, which included the following:-

- sales performance was below budget (24% down on budget) and was under severe pressure to achieve targets;

[328] AB(11)1279, AB(11)1308
[329] AB(11)1308, 1547.
[330] AB(23)412

- financial services income was under pressure due to low sales, lower yield and increased bad debts;
- credit granting criteria had changed significantly since the implementation of the NCA and certain processes were still hindering potential credit sales;
- poor and liberal credit granting towards the end of 2007 was now being realised as bad debts and was affecting profitability;
- collections were under pressure;
- a number of stores were to be closed during the year;
- the budget had been replaced by the current forecast, as the current budget was clearly not achievable;
- an estimated additional R200 million fair value provision had been made in respect of bad debts relating to pre-acquisition debtors: the amount had to be quantified and confirmed by the auditors before the interims;

(ii) Mr Nalliah presented the Abil consolidated financial results, which included:

- the bank was ahead of budget by R31 million;
- Ellerines was below budget by R180 million;
- bad debts in Ellerines were higher than expected;

(iii) Mr Nalliah summarised the results for EHL for the quarter ended December 2008, which included:

- income from operations was R1,2 billion down on budget by 18,6%;
- charge for bad debts was R197 million;
- profit before tax for the whole company was R118 million;
- profit before tax in the financial services division was R48 million;
- profit before tax in the retail division was R70 million;
- impairment provisions amounted to R1,6 billion;
- total liabilities equated to R3 billion;
- total assets equated to R7,6 billion.

429. At a Group Audit Committee meeting held on 12 March 2009[331] Mr Nalliah mentioned that there were three items which might affect the interim results of Abil, two of which were:

(i) the impairment testing of goodwill in Ellerines had been raised as a concern by the auditors;

(ii) an additional R200 million had been raised in the "at acquisition fair value provision" for bad debts as at March 2009.

430. On 6 April 2009 the Deputy Registrar wrote a letter to Mr Kirkinis in his capacity as CEO of Abil drawing his attention to regulation 43 of the Regulations relating to Banks.[332] The regulation required a bank and its

[331] AB(6)147
[332] AB(20)281

holding company to disclose in its afs and other disclosures to the public "reliable, relevant and timely qualitative and quantitative information that enabled users of that information to make an accurate assessment of the bank's and holding company's financial condition, including its capital adequacy position, and financial performance, business activities, risk profile and risk management practices." Mr Kirkinis was required to advise the office of the Registrar where the disclosures in terms of regulation 43 were published.

431. At a meeting of the Abil and bank boards on 19 November 2009[333] the EHL results presentation reflected, amongst others, the following:-

(i) sales declined by 15%;

(ii) higher bad debt charge was stabilising;

(iii) credit penetration had improved;

(iv) headline earnings for retail and financial services were down to R285 million from R368 million;

(v) the economic loss was R415 million;

(vi) the outcome of the results was driven by sales decline and yield erosion;

(vii) return on sales: the retail division generated a loss of R185 million for the year; year-on-year sales declined by 15%.

[333] AB(23)423

432. For the FY2009 EHL produced the following results:

(i) Headline earnings	
(a) Retail	-R185 million
(b) Financial Services	R470 million
(ii) Economic loss (including goodwill in Abil))	-R1,165 billion
(iii) Forecast profit (after tax)	
(a) Retail	-R118 million
- Actual worse than forecast	-R67 million
(b) Financial Services	R552 million
Actual worse than forecast	-R72 million
(c) Total worse than forecast	-R139 million
(d) % of total	32%[334]

2010

433. At a Group Audit Committee meeting on 10 February 2010 the management accounts for the three months ended 31 December 2009 were presented for EHL, and included:

(i) sales of merchandise were down 5%;

(ii) bad debts were R15 million above budget;

(iii) profit after tax was R80 million to R90 million below budget but R27 million above the previous year.[335]

[334] AB(33)562,570
[335] AB(6)173

434. A meeting of the Abil and bank boards was held on 16 February 2010.[336] Mr Kirkinis highlighted that the bank and EHL were behind budget, being affected by:

(i) lower sales than anticipated, resulting in lower income;

(ii) the suspension of income due to higher bad debts. In presenting the EHL board report, Mr Fourie highlighted, amongst others, that:

- trends had improved compared to the previous year;
- the real issues which required attention were sales and yields;
- sales were up 5,3% on a like for like basis;
- migration of financial services into the bank continued.

435. On 29 March 2010 the bank and Ellerine Furnishers concluded a Management Agreement.[337] In terms of the agreement Ellerine Furnishers appointed the bank to manage certain aspects of its financial services customer relationship.

436. A strategy meeting of the boards of Abil and the bank was held on 17 May 2010.[338] The following were identified as “big NO’s for Abil”:

[336] AB(23)442
[337] AB(47)392
[338] AB(23)447

(i) Abil would continue its operations and strategy in South Africa (excluding EHL);

(ii) Abil would only engage in unsecured lending;

(iii) Abil would not engage in transactional banking:

"- Overcapacity in the market with regard to transactional capability.

- The business wants to specialise in credit.

- In a transactional business, a very robust system is required.

- [The bank] does not have system integrity to be a transactional business.

- Abil will not enter primary banking services."

437. At a meeting of the Abil and bank board on 20 May 2010[339] Mr Kirkinis presented the Abil group results, which included:

(i) the bank credit model had had a positive effect in Ellerines stores and the EHL retail restructuring was starting to deliver results;

(ii) the headline earnings were R914 million: the bank contributed R713 million and Ellerines R201 million. Mr Fourie presented the EHL results for the six months ended 31 March 2010, which included:

[339] AB(23)452

- like for like sales increased by 6,5%;
- credit sales increased from 55% to 59%;
- operating costs reduced by R170 million;
- gross advances were up 6%.

438. A Group Exco meeting was held on 29 July 2010.[340] With regard to "the sale of the book" to the bank it was recorded that:

(i) the bank would pay the net book value for the book;

(ii) the bank would purchase the book with recourse, ie assume the loss in EHL; EHL would write off the loss and then claim the VAT back;

(iii) the benefit for EHL was for the bank to buy the book at a net book value without the goodwill.

439. It was minuted at a meeting of the boards of Abil and the bank held on 12 August 2010 that in terms of the proposed transaction to acquire the financial services division of Ellerine Furnishers the bank would acquire the 7 September 2010 advances book, the credit right and goodwill from Ellerine Furnishers for about R7 billion.[341]

440. On 18 August 2010 Abil wrote a letter to the Deputy Registrar concerning the final proposed steps for the bank to acquire the entire

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[340] AB(43)6
[341] AB(23)461

financial services business from Ellerine Furnishers.[342] Some of the facts set out in the letter were that:

(i) Ellerine Furnishers was indebted to the bank for about R1 billion of which R500 million would be set off against the R7 billion owing to Ellerine Furnishers;

(ii) this would leave a balance of R6,5 billion owing by the bank to Ellerine Furnishers of which the bank would pay about R1,1 billion to Ellerine Furnishers to enable it to settle all funding from Standard Bank, First National Bank, Absa Bank. Nedbank and Investec Bank.

441. On 24 August 2010 the bank and Ellerine Furnishers concluded a Sale of Business Agreement.[343] In terms of clause 5 of the agreement Ellerines Furnishers sold to the bank the business as a going concern. The business was defined as the financial services activities of Ellerine Furnishers. Clause 6 provided that the purchase price would be an amount equal to the aggregate of:

(i) the net asset value of the business; and

(ii) R4 billion rand.

(iii) In terms of clause 10 the purchase price would be discharged by the bank:

[342] SARB(2)333
[343] AB(47)399

(iv) assuming the transferring liabilities as contemplated in clause 22; and paying:

- to or on behalf of Ellerine Furnishers an aggregate amount not exceeding R2,5 billion;
- the remainder of the purchase price would remain payable by the bank to Ellerine Furnishers on loan account.

442. On 13 September 2010 Abil announced on SENS that the bank would acquire the financial services business of Ellerine Furnishers for about R7,3 billion, composing primarily:

(i) its net advances books of about R3 billion;

(ii) the related deferred tax asset of R.3 billion;

(iii) the right to grant credit in all the South African stores of Ellerine Furnishers; and goodwill relating to the financial services business of R4 billion.[344]

443. At a Group Audit Committee meeting held on 16 September 2010 Mr Nalliah commented that one of the possible year-end concerns could relate to the R4 billion in goodwill which had been transferred from Ellerine Furnisher to the bank.[345]

[344] SARB(1)80; SENS(2)385
[345] AB(6)188

444. The Group Audit Committee met again on 11 November 2010.[346] It was again minuted that R4 billion of the goodwill attributed to the acquisition by the bank of the debtors' book and the financial services business of Ellerine Furnishers had been transferred to the bank.

445. For the FY2010 EHL produced the following results:

(i) Headline earnings	
(a) Retail	R124 million
(b) Financial Services	R261 million[347]
(ii) Economic loss (including goodwill in Abil):	R924 billion[348]
(iii) Forecast profit (After tax)	
(a) Retail	R145 million
- Actual worse than forecast:	-R5 million
(b) Financial Services	R371 million
- Actual worse than forecast	-R110 million
(c) Total worse than forecast	-R115 million
(d) % of total	23%[349]

[346] AB(6)196
[347] AB(12)1801
[348] AB(12)1779
[349] AB(35)916-918

2011

446. At a meeting of the Abil and bank boards on 24 February 2011[350] Mr Kirkinis highlighted that EHL was on track to deliver a profit of between R700 million and R800 million for the year.

447. It was minuted at a bank Exco meeting held on 30 June 2011[351] that Mr Roussos was concerned that the bank did not have the capacity "to run with the EHL carve-outs and kiosks in terms of policing deals that are being written. George's 'police force' will be a structure within JH's environment, in place to audit review and ensure that controls are in place to manage the quality of deals coming in from EHL."

448. Mr Fourie gave a presentation on EHL's results for the year ended 30 September 2011 at the meeting of the Abil and bank boards on 17 November 2011.[352] He highlighted, amongst others, the following:-

(i) headline earnings increased by 46% to R190 million;

(ii) merchandise sales grew by 5% to R4,7 billion compared to R4,5 billion in 2010;

(iii) credit sales had shown positive growth of 13% and comprised 64,3% of total sales (2010 : 59,5%).

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[350] AB(24)479
[351] AB(7)141
[352] AB(24)501

449. For the FY2011 EHL produced the following results:

(i) Headline earnings	
- Retail	R190 million[353]
(ii) Economic loss	-R211 million[354]
(ii) Forecast profit (after tax)	
(a) Retail	R352 million[355]
- Actual worse than forecast	-R162 million
(b) % of total	46%

<u>2012</u>

450. At a meeting of the Abil and bank boards on 17 May 2012[356] Mr Kirkinis was reported as saying that for Ellerines RoE was approaching 15% "which was a great achievement and the target for next year was to get that number above 20%." "The economic loss was R5 million and hopefully by year-end, the business would turn a profit or breakeven according to the forecasts. Headline earnings were just under R200 million, up a third from last year."

353 AB(12)2061
354 AB(12)2061
355 AB(37)825,832
356 AB(24)537

451. At an ALCO meeting on 5 June 2012[357] it was minuted that the board had approved the increase of the Ellerines facility with the bank from R600 million to R900 million at the May 2012 meeting.

452. It was minuted at an ALCO meeting on 25 July 2012[358] that there was an increasing concern from funders as Ellerines lost about R40 million in June 2012 and increased its borrowing from the bank.

453. A meeting of the Abil and bank boards was held on 27 September 2012.[359] In the EHL budget for FY2013 the value share increased marginally to R432 million from R428 million. Mr Adams, in giving the report of the Group Risk Committee, "emphasized the issue relating to the technical insolvency of Ellerine Furnishers that needed to be managed."

454. Abil and the bank released a Voluntary Trading Statement on SENS on 31 October 2012[360] in which it was said that EHL experienced sluggish sales as the economy slowed and consumers came under increasing pressure. However, its improving efficiencies and solid margins helped maintain the positive momentum achieved through operating leverage in the first half of the year.

[357] AB(13)10
[358] AB(13)20
[359] AB(24)557
[360] SARB(1)127

455. At a meeting of the Abil and bank boards on 15 November 2012[361] Mr Sithole, in reporting on a meeting of the Group Audit Committee, stated that EHL was not adequately profitable as a standalone business and yielded a negative return. Mr Fourie emphasized that the contribution received from the credit granted through the EHL network should also be taken into account when assessing the business and the benefits from the value share that were expected to be realized over the next three years.

456. At the same meeting of the two boards a resolution was passed[362] that the bank, at any time and from time to time, might provide (directly or indirectly) financial assistance to Ellerine Furnishers up to an aggregate capital amount of R900 million on certain conditions, one of which was that the loan would be unsecured. It was recorded that the board of the bank was satisfied that the financial assistance was "fair and reasonable to African Bank."

457. For the FY2012 EHL produced the following results:

Headline earnings	R257 million[363]
- Retail	

[361] AB(24)562
[362] AB(24)564, AB(50)2
[363] AB(12.1)61

(ii) Economic loss (including goodwill in Abil)	- R139 million[364]
(iii) Forecast profit (after tax)	
(a) Retail	R317 million[365]
- Actual worse than forecast	- R69 million
(b) % of total	22%

2013

458. On 13 February 2013 a meeting of the Abil and bank boards was held.[366] Mr Fourie reported that the main challenges at EHL related to the profitability, liquidity and solvency of Ellerine Furnishers. The following was minuted in regard to the solvency of Ellerine Furnishers: "EHL management are consulting with Webber Wentzel…[who] have recommended restructuring options which could alleviate the solvency issue" in Ellerine Furnishers. Wetherleys and Furniture City were expected to incur after tax losses of about R55 million.

459. At an ALCO meeting on 4 April 2013 the following was noted in regard to "Ellerines cash flow scenarios":

(i) an analysis performed on the cashflows at EHL reflected that, for every 1% reduction in EHL turnover, a R3,5 million to R4 million decline in available cash per month arose;

[364] AB(12.1)86
[365] AB(39)953
[366] AB(24)567

(ii) sales were expected to drop between 8% and 10% for the full year and EHL was consequently expected to have significant liquidity constraints from September 2013;

(iii) in late March 2013 the bank board had approved an increase in the bank facility from R900 million to R1,3 billion.[367]

460. At a meeting of the Abil and bank boards on 15 May 2013,[368] the bank board passed a resolution increasing the amount which the bank could lend to Abil from R734,5 million to an amount not exceeding R1,9 billion on certain conditions, which included the following:-

(i) the loan would be interest free;

(ii) the loan would be unsecured.

461. At that meeting of the boards, the Abil results included:-

(i) headline earnings for the six months were R1,015 billion;

(ii) consumer demand had slowed down due to pressure on disposable income, higher levels of indebtedness and consumer confidence impacted;

(iii) supply of credit from the bank had slowed down due to a variety of actions by Abil to reduce risk, resulting in offer rates continuing to decline as a result.

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367 AB(13)46
368 AB(24)573, AB(50)14

462. Mr Kirkinis reported at a meeting of the Abil and bank boards on 16 September 2013[369] that a number of options on the disposal of EHL were being considered. A number of potential buyers had shown interest. RMB and Goldman Sachs were potential advisers on the deal.

463. In the Abil annual report for FY2013 dated 30 September 2013 it was reported that the entire R4 billion goodwill at African Bank was impaired.[370]

464. On 1 November 2013 Abil and the bank published on SENS the reviewed financial results for the eleven months ended 31 August 2013.[371] Ellerines generated a headline earnings loss of R226 million (2012: profit of R200 million).

465. At an ALCO meeting on 4 November 2013[372] it was noted that the October 2013 sales of Ellerines had decreased 20% relative to October 2012: if this trend continued Ellerines would require an increase in facilities in February 2014.

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369 AB(24)578
370 AB(12)2501
371 SENS(3)1041
372 AB(13)77

466. Abil and the bank published their reviewed financial results for the year ended September 2013 on SENS on 11 November 2013:[373] Ellerines generated a headline earnings loss of R284 million (2012: profit of R249 million).

467. At an ALCO meeting on 3 December 2013[374] it was reported, in regard to "Ellerines Cash Flow Scenarios":

(i) the sales for October 2013 ended the month being down 36% relative to the prior year;

(ii) the November 2013 sales for the month to date were down 21% relative to November 2012;

(iii) should the sales trends continue Ellerines would breach the African Bank facility by 8 January 2014;

(iv) a resolution would be put to the bank board on 7 December 2013 motivating an increase in the facility.

468. At the teleconference meeting of the Abil and bank boards on 7 December 2013[375] the bank board passed a resolution that:

(i) the bank would be entitled to lend up to a total aggregate amount of R1 billion to Abil on certain conditions, two of which were that:

- the loan would be interest free; and

[373] SENS(3)1092
[374] AB(13)82
[375] AB(24)586, AB(50)34

- the loan would be unsecured;

(ii) the bank would be entitled to provide financial assistance to EHL up to a total aggregate amount of R1,2 billion.

469. For the FY2013 EHL produced the following results:

(i) Headline earnings

- Retail -R284 million[376]

(ii) Economic loss (including goodwill in Abil) -R706 million[377]

(iii) Forecast profit:

(not available)

2014

470. On 5 February 2014 the bank and Abil published on SENS their trading update for the first quarter ended 31 December 2013.[378] Ellerines showed a 21% decline in merchandise sales and a 32% decline in credit sales. Ellerines' profitability was expected to be considerably lower for the first half of FY2014 in relation to the comparative period of the previous financial year.

[376] AB(12)2333
[377] AB(12)2431
[378] SENS(3)1187

471. At the Group Audit Committee meeting on 7 February 2014[379] Mr Nalliah reported that for the three months ended 31 December 2013 Ellerines had suffered a headline loss of R25 million. Mr Sinclair presented the management accounts for EHL, including:

(i) for the first quarter of FY2014, EHL had a headline loss of R26 million, which was R95 million lower than the budget of R69 million, after tax;

(ii) sales of R1,175 billion were R110 million below budget and 21% below the comparable period the previous year;

(iii) solvency of Ellerine Furnishers had been addressed largely through the restructure of the insurance companies but the issues of profitability and liquidity still remained;

(iv) Ellerine Furnishers would run out of cash on 8 June 2014, unless the reinsurance structure was changed and the value share could be paid directly into Ellerine Furnishers rather than via RLA [presumably Reliant Life Assurance] which was the current arrangement.

472. Under the heading "Financial Assistance in terms of s45 of the Companies Act" it was minuted at that meeting of the Group Audit Committee that the facility from the bank to EHL had been increased from R800 million to R1,2 billion. "When the increase was approved by

[379] AB(6)278

the Abil board, NN [Mr Nalliah] raised a question regarding the recoverability of the loan from EHL." [380]

473. At a meeting of the Abil and bank boards on 13 February 2014[381] Mr Nalliah highlighted that the operational risk in the EHL structure was significant with regard to fraud, logistics, and the amount of change in the business. Mr Kirkinis informed the boards that a serious indication of interest from Shoprite Checkers to combine their business with that of Ellerines had been received.

474. At that meeting of the boards of Abil and the bank, the bank passed a resolution[382] that it was authorized to provide one or more guarantees to Absa Bank Limited, Nedbank Limited, First National Bank Limited, The Standard Bank of South Africa Limited, and Investec Bank Limited (the Subject Banks) in relation to any amount that might become owing to one or more of the Subject Banks by Ellerine Furnishers, to up a maximum of R1,1 billion.

475. In the trading statement of Abil and the bank released on SENS on 2 May 2014[383] it was disclosed that Ellerines' headline loss was expected to be between R1,2 billion and R1,3 billion for the six months to March

[380] AB(6)280
[381] AB(24)589
[382] AB(24)591, AB(50)43
[383] SENS(3)1213

2014 in relation to the normal profit for the corresponding period. The statement was made that Abil continued to work towards the disposal of Ellerines.

476. On 12 May 2014 the EHL board passed a resolution that EHL could provide financial assistance to Ellerine Furnishers by making a facility available in an amount not exceeding R1,4 billion.[384]

477. A minute of the meeting of the bank board which was scheduled to take place on 13 May 2014 has not been provided. In the file containing resolutions of the bank board there is a resolution which was to be placed before that board on that date.[385] In term of that resolution the bank was to be entitled:

(i) to lend up to a total aggregate amount of R550 million to Abil;

(ii) to provide financial assistance to Ellerine Furnishers and EHL Limited to an amount of R100 million in relation to a particular guarantee;

(iii) to make a facility available to EHL in an amount not exceeding R1,4 billion;

(iv) the aggregate amount of financial assistance by the bank to Abil and EHL was not to exceed R2,5 billion.

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[384] AB(51)222,223

[385] AB(50)63

478. On 20 May 2014 the Abil board, the sole shareholder of the bank, passed a special resolution approving the provision by the bank from time to time of financial assistance to the bank's related companies:-

- the aggregate capital amount of which to the EHL group of companies would not exceed R1,5 billion;
- the total value of loans, debts, obligations, or assistance by the bank to the related companies, including the EHL group, would not exceed R2,5 billion.[386]

479. At a meeting of ALCO on 27 May 2014 Mr Mahomed updated ALCO on the current status relating to Ellerines' liquidity and solvency position:

(i) the loan by the bank to Ellerines Furnishers would be repaid by Ellerine Furnishers and advanced to EHL;

(ii) an additional R440 million would be advanced by the bank to EHL;

(iii) that funding would be lent to Ellerine Furnishers on a subordinated basis;

(iv) Ellerine Furnishers would place this cash on deposit with the bank;

(v) it was anticipated that the total facility of R1,4 billion would be exceeded on 8 June 2014;

[386] AB(51)187

(vi) using the current cash projections, the total facility would need to increase to R2 billion by September 2014.[387]

480. On 3 June 2014 the bank and EHL concluded a Facility Agreement.[388] In terms of clause 2 all amounts owing by EHL to the bank as a result of any loans made by the bank to EHL prior to the signature date would be treated as advances under the agreement. Interest was payable on advances (clause 4).

481. On 6 June 2014 the Registrar formally requested Abil to dispose of EHL.[389]

482. On 17 June 2014 Mr Kirkinis, the CEO of the bank, addressed a letter to the Registrar, giving an update on the disposal of EHL.[390] He stated that discussions had been held with the JD Group, through its parent, Steinhoff International; Shoprite Holdings; the Lewis Group and Pepkor. The negotiations with Steinhoff International "… had seen the business being sold for a consideration of R1 with Abil clawing back its loan (approximately R900m) over three to five year period…We believe discussions with Steinhoff could resume if Abil commits to partly funding the R1,5-2bn working capital requirement."

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387 AB(13)95
388 E(10.1)585
389 SARB(1)434
390 AB(51)219

483. A minute of the meeting of the bank board which was scheduled to take place on 20 June 2014 has not been provided. In the file containing resolutions of the bank board there is a resolution which was to be placed before the board on that date. In terms of that resolution the bank was to be entitled:

(i) to lend Abil up to a total aggregate amount of R950 million (interest free and unsecured);

(ii) to provide financial assistance to Ellerine Furnishers in an amount of R100 million in relation to a particular guarantee;

(iii) to make a facility available to EHL in an amount not exceeding R1,4 billion;

(iv) the aggregate amount of financial assistance by the bank to Abil and EHL was not to exceed R2,5 billion.[391]

484. In an undated document: “Abil : Solvency and liquidity”, the NAV of Abil was said to be R15 billion and the cash balances available R22 million at 31 May 2014; Abil had a loan facility from the bank of R950 million, of which R447 million had been utilized.[392]

[391] AB(50)92
[392] AB(51)192

485. At a meeting of ALCO on 26 June 2014 Mr Mahomed[393] reported that Ellerines would experience a funding pressure point on 30 June 2014, which was forecast to be in excess of the facility limit of R1,4 billion.

486. A minute of the meeting of the bank board which was scheduled to take place on 29 June 2014 has not been provided. In the file containing resolutions of the bank there is a resolution which was to be placed before that board on 29 June 2014. In terms of that resolution the amount to be lent to Abil was reduced to R600 million and the facility available to EHL was to be increased to R1,6 billion.[394]

487. On 17 July 2014 adv J D Wiese, on behalf of Bon View Trading 164 (Pty) Ltd, wrote a letter to the Registrar in which it is said that that company was in the process of making an offer to acquire all the shares in and claims against EHL for R1. The NAV of EHL as at the date of the proposed acquisition was required to be R3 billion.[395]

488. Mr Kirkinis explained that negotiations with potential purchasers of EHL, such as the Steinhoff Group, became more difficult. Abil's loan, primarily via the bank, to EHL had increased to R1,4 billion. The counter-parties in the negotiations were a consortium of retailers that Christo Wiese controlled and led, which consisted of the PEP Group

[393] AB(13)99
[394] AB(50)107
[395] SARB(1)470

and the Shoprite Checkers Group. Mr Kirkinis was in parallel discussions with Steinhoff. At a later point Mr Wiese pulled Steinhoff into the consortium. The consortium came to the conclusion that Abil would have to forego its loan and make a further amount of R1,6 billion available to EHL, which would be written off. This was too drastic a demand. Abil's counter-proposal was to put R2,5 billion at risk. To the extent that the other benefits that were to come out of a broader agreement were realised, Abil would write off the R2,5 billion. In that event, Abil's shareholders would have received an equivalent amount of value.[396]

489. On 24 July 2014 Mr Schlesinger, the chairman of EHL, sent an email to Mr Kirkinis, in which he referred to Mr Kirkinis' confidence that the sale transaction would be signed very soon and that "…it was most pleasing to receive [Mr Nalliah's] advice that the Abil board has approved the capitalisation of R1,4 billion group loan to EHL and its conversion to equity.[397]

490. On 2 August 2014 ENS provided advice in writing to the board of EHL on s45 financial assistance in respect of EHL and the applicability of s22

[396] E(10)pp65-66
[397] AB(51)185

and s129(7) to the business of Ellerine Furnishers and EHL, insofar as might be applicable.[398]

491. On 7 August 2014 Abil and the bank gave notice on SENS of application for business rescue of Ellerine Furnishers.[399]

492. The evidence in relation to Ellerines and Mr Fourie, the CEO of Ellerines, was the following:

> Mr Mthombeni: "From a purely cash flow perspective each loan provided by the bank to EHL was a drain on the bank in the short run because it was only likely to be repaid after successful turnaround of EHL and its subsidiary some time in the future";[400]
>
> Mr Woollam: "…the only thing I will say is that Toni Fourie is a man of great words and very little substance…[401]; Ellerines was "a sub-optimal business which had relied…on a high diet of rich financial services income cross-subsidising a weak and unprofitable retail business";[402]
>
> Mr Mogase agreed with Mr Sithole that the Ellerine business had not been a success;[403]

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[398] AB(51)237 - Those sections are to be found in the Companies Act.
[399] SENS(3)1282
[400] T89
[401] T95
[402] T98
[403] T269

Mr Strauss also agreed with Mr Sithole: "…it is hard to say that a loss-making business is not a drag on a Group";[404]

Mr Gibbon agreed that: Ellerines never made the profit it said it would make; each year it made an economic loss measured in hundreds of millions of rand; this turned out to be a bad investment;[405]

Mr Tugendhaft: "…the retail business made a profit in 2010…Toni Fourie met those challenges…the budget was a very, very big stretched budget…the remarkable thing I think about Toni Fourie is that notwithstanding very, very depressed market conditions he managed to make a profit…he turned the business around…"[406]

Mr Raubenheimer: "So I think it was a well known fact that Ellerines was making losses and to make matters worse, the Ellerines book itself…the company 5 [book], was also making losses. So we did not make [profits] in the retailer, and we did not make [profits] on the book itself either…";[407]

Mr Kirkinis: "obviously the Ellerines operational losses affected the group capital [but] did not affect the bank capital but the bank itself needed to restore the confidence of the

[404] T345
[405] T449
[406] T477-479
[407] T553

investors…";[408] Mr Kirkinis disagreed with Mr Woollam's opinion of Mr Fourie: "I think that Toni is a very capable person and he proved to be so over many years…He took on a very complex job and performed it better than most would be able to do. He is a very competent person…"[409] He said that Abil did turn around the Ellerines business.[410]

Mr Nalliah: "So furniture retailers generally tend to either not make any profit on the retail business or the profit that they make is negligible in relation to the financial services."[411] Mr Nalliah advised the Commission on 2 December 2014 that the estimated effect on the alignment of Ellerines policies with Abil's was to reduce headline earnings of R1 billion in 2007 by R553 million.[412]

The impact of Ellerines on the bank

493. Deloitte are of the view that certain factors flowing from the acquisition might have had an indirect adverse impact, which gradually manifested after the acquisition:

(i) the consequences of the transaction diverted the attention of Abil's executive management;

[408] T645
[409] T665
[410] T672
[411] T861
[412] E(14.4)4

(ii) the transaction contributed to the banks move into a different market segment, being customers in lower LSM[413] categories, to which the bank's management had not previously been exposed;

(iii) Abil's management lacked the depth of experience in the furniture retail sector;

(iv) the transfer of the loan book of Ellerines Furnishers to the bank resulted in higher impairment losses for the bank because, generally speaking, the Ellerine book was of poorer quality than the bank's;

(v) after acquisition, Ellerines introduced changes in the way credit was granted in-store, eg granting credit in excess of the value of the goods purchased; and debt-collection was centralised, which led to a loss of personal contact with the customer at store level;

(vi) Abil and Ellerine were unable to develop an appropriate model of sharing value (i.e. gross revenue minus expenses) between the bank and Ellerines;

(vii) the bank granted credit to in-store customers in excess of the value of goods sold to customers by Ellerines;

[413] Living standards measure

(viii) after the acquisition, Ellerines' external commercial bank facilities were renegotiated; and in many instances were refinanced by the bank;

(ix) the impact of the global financial crisis and consequent recession in South Africa led to trading losses by Ellerines, which had to be funded indirectly by the bank (as Abil's most significant asset); Ellerine Furnishers incurred a loss of R1,112 billion after tax during FY2013 and had accrued by that time a loss of R2,3 billion; in 2014 further losses were sustained; the loan by the bank to Ellerine Furnishers (R525 million as at 31 May 2014) might not have been recoverable;

(x) the acquisition led to significant costs related to:

- consolidation of the brands;
- employee costs;
- the establishment of several high cost distribution centres; and rebranding of the in-store credit kiosks, indirectly funded by the bank.

494. According to the Registrar:-

(i) Ellerine Furnishers was dependant on the bank to fund and sustain its operational cash flow;

(ii) at the time of curatorship, Abil's exposure to Ellerine Furnishers was approximately R1,5 billion;

(iii) Ellerine Furnisher's monthly operational requirement funded by Abil was between R80 to R100million;

(iv) Abil provided guarantees to other commercial banks on behalf of Ellerines to the value of R550 million;

(v) this had a drain on the Abil group in terms of monthly liquidity;

(vi) the R1,5 billion exposure of the bank to Ellerine Furnishers consumed additional regulatory capital, which was already under pressure;

(vii) it allowed for a deviation of focus of the executive management team of Abil and the bank from the core business of the bank and insurance entities;

(viii) Ellerine Furnishers was loss making, which lead to a drain on the bank and the group's capital and liquidity resources.

495. Mr Nalliah was of the view that the losses that were incurred in Ellerines together with the failure to sell it to a third party had a profound impact on the business of the bank and the share price of Abil from mid-2012 to end 2013. The Q3 update of 6 August 2012 reflected the signs of significant customer distress in the Ellerines loan book with the credit impairment charge increasing from 18,5% of the book to 31,8%. This was of concern to the market which was then reacting more negatively to the fact that the performance of Ellerines was adversely affecting the bank.

496. Mr Kirkinis made the following case:-

(i) Loans written in the ordinary course of business to the customers of EHL ranged from a peak of about R350 million a month to about R125 million a month as at July 2014. They were priced to cover the risks relevant to the customers of EHL. This notwithstanding the loans to traditional African Bank customers generated better returns and therefore as liquidity got tighter, they rationed the loans to the customer bases that yielded the best returns. Thus it became necessary to effect proportionally higher cuts to the EHL customer base.

(ii) This had a knock-on effect in that it resulted in lower sales of furniture by EHL. This caused an increase in its operating losses, given the high fixed-cost base, which losses had to be funded. EHL's funding requirement was forecast to continue growing and hence he requested a more radical turnaround strategy.

The financial support from the bank to EHL took the form of interest bearing loans which were regulated by the Facility Agreement of 3 June 2014 up to a maximum amount of R1,4 billion.

(iii) Any draw-down from the facility would affect the bank in that it would fund such amount in terms of the Facility Agreement.

Initially, and up until the end of June 2014, such financial support was comfortably accommodated and provided for by the bank's Treasury. From July 2014, and as the liquidity conditions worsened, the extra funding requirement from EHL began to have more of an impact on the bank. Just as they started to pull back on loan disbursements to the bank's customers, so too they had to consider EHL's funding requirements. It became apparent that there could be no further substantial increases in the funding to EHL until the 6 August 2014 announcement regarding capital and the disposal of EHL had been made.

(iv) The monthly draw-down in terms of the facility was between R70 million and R100 million.

(v) EHL was notified that the facility would remain capped at R1,4 billion and that no increase above that amount would be granted unless and until the liquidity situation improved.

(vi) At no stage did the funding compromise the bank. It only represented about 2% of its assets.[414]

497. By the end of 2010 Abil had been running the retail division, i.e. the furniture business, of Ellerines for three years. The financial results of the retail business from 2010 to 2014 were the following-

[414] E(10)158

495.1 Profit/loss after tax:

2010: a profit of R124 million;

2011: a profit of R190 million;

2012: a profit of R257 million;

2013: a loss of R284 million.

The value share that the banking unit (the bank and Stangen) paid before tax in each year to Ellerines as at 30 September was:

2010: R176 million

2011: R561 million

2012: R633 million

2013: R537 million.[415]

But for the value share, Ellerines would have made a loss after tax in the "profitable years," according to Mr Nalliah as follows:

2010: R3 million

2011: R214 million

2012: R199 million

But for the value share the loss in 2013 would have been R671 million.

495.2 Economic loss

Mr Woollam described "economic loss" as not "…an accounting convention, it is something I believe in strongly…there are

[415] E(8)375

probably 30% to 40% of the companies listed right now on the JSE who do not make economic profit. They proudly will report their profits [but] they might be earning a less than 10% ROE…In which case they are destroying…shareholder value."[416]

This is the economic loss including the goodwill in Abil that Ellerines made each year:

2010: R924 million

2011: R211 million

2012: R139 million

2013: R706 million

495.3 Budget

In not one of the FY years 2010 to 2013 did Ellerines make the forecasted profit.

498. Abil was unable to dispose of the retail business. It is unclear what steps were taken in that regard in 2013, but in 2014 a number of potential buyers were approached. Nothing came of those approaches. In about July 2014 a consortium led of Mr Christo Wiese "…came to the conclusion that Abil would have to forego its loan [of R1,4 billion] and make a further amount of R1,6 billion available to EHL…"[417]

[416] T115
[417] E(10)66

499. It was to this ailing furniture business that the bank provided the following financial support:-

(i) The bank advanced loans to Ellerines customers, who were a greater credit risk than the bank's customers.

(ii) The bank lent Ellerines in total R1,4 billion. The loans were unsecured.

(iii) The banking unit (the bank and Stangen) paid the value share[418] to Ellerines of R1,9 billion in aggregate in the period 2010 to 2013.

(iv) The bank bought the financial services of Ellerines in 2010 for R7,3 billion.

(v) In the period April to July 2014 Abil signed guarantees for the facilities Ellerine Furnishers had with Standard Bank (R150 million),[419] FirstRand Bank Limited (R200 million),[420] ABSA Bank Limited (R100 million)[421] and Investec Bank Limited (R100 million)[422] Those guarantees would have been underpinned by the assets of the banking unit (African Bank and Stangen).

500. An impairment of the loan to EHL of R1,423 billion was processed in FY14. The debate is whether the balances existing at 30 September

[418] Mr Nalliah pointed out in his Submissions (E(20)50) that the value share comprised two components: a reimbursement/compensation of costs incurred by Ellerines in originatin the credit on behalf of the bank and commission for credit sales and collections done by Ellerines for the benefit of the bank.
[419] AB(50)48
[420] AB(50)96
[421] AB(50)111
[422] AB(50)127

2013 and 2012 of R529m and R461m respectively were already impaired on those dates and should have been booked in the afs for those years. The Curator was still in the process of deliberating this within the bank.

CHAPTER 17: IMPAIRMENTS

501. An analysis of the documents provided to the Commission reveals that the issue of impairments was a topic of discussion, and increasing controversy, from at least November 2012 to August 2014:-

(i) On 15 November 2012 the Group Audit Committee reported to the boards of Abil and the bank that, although Deloitte had issued an unqualified audit opinion, they had raised concerns, one of which related to a lack of conservatism in the credit impairment model: they felt that the provisions were understated by between R150 million to R250 million.[423]

(ii) At a Group Audit Committee meeting on 7 February 2013 it was minuted that the bad debt charge was R212 million higher than budget as a result of lower collections on the NPL portfolio.[424]

(iii) Mr Kirkinis told the Group Risk Committee on 7 February 2013 that the level of provisions would be increased during the year.[425]

[423] AB(24)562
[424] AB(6)263

(iv) At a meeting of the Group Exco on 1 March 2013 Mr Kirkinis said that provisions for the full year would be increased by R300 million.[426]

(v) On 19 March 2013 Mr Raubenheimer reported to Messrs Kirkinis, Nalliah and Strauss that the projected gap [between the model and the general ledger] at year-end was:

- R723 million based on an R700 million a month NPL migration;
- R1,099 billion based on an R800 million a month NPL migration.[427]

(vi) In an email sent by Mr Raubenheimer to "Dear Impairment Stakeholders" on 2 April 2013 he stated that the average NPL migration was expected to be at least R830 million per month for the next six months. The gap projected at the end of the year would be R1,218 billion. Once one took into account a "mistake" and a "rethink" the predicted gap was above R1,529 billion.[428]

(vii) At a Group Exco meeting on 12 April 2013 it was minuted that:

- overall the provisions gap was R820 million;
- notwithstanding the extra R600 million provision budgeted for FY2013 the gap continued to grow.[429]

(viii) At a Group Exco meeting on 16 April 2013 it was noted that:

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[425] AB(4)227
[426] AB(43)106
[427] AB(53)47
[428] AB(54)46
[429] AB(43)101

- there was a R489 million shortfall in impairment provisions;
- provisions could be increased by R350 million for the first half of FY2013 provided that higher claims were achieved in Stangen;
- the additional R350 million would increase NPL coverage from 59,1% to 60,3% and result in headline earnings for the banking unit declining by 20,5%.[430]

(ix) In the SENS announcement on 2 May 2013 there was reference to:

- an elevated charge for bad and doubtful advances, particularly on the furniture credit portfolio, as a result of higher provisions due to an increase in risk;
- Abil's decision to write off an additional amount of NPLs in March and to augment the NPL coverage post the write-off which amplified the bad debt charge.[431]

(x) On 8 May 2013 Abil published additional information on SENS. In explaining the bank's results it was said that the charge for credit losses had increased.[432]

(xi) At a Group Risk Committee meeting on 9 May 2013 Mr Raubenheimer presented the impairment provisions as at 3 March 2013, which included:

[430] AB(43)103
[431] SENS(2)859
[432] SENS(3)817

- an increase in NPLs from about 2,2% to 2,4% which was driven by an increase in the migration of PLs to NPLs;
- NPLs grew by 13% whereas gross advances grew by 11%;
- there was a risk of the model gap increasing should cashflows not improve substantially from the second half of the year;
- backtesting on the ML book confirmed the view that the book was overvalued.[433]

(xii) At a Project Phoenix meeting on 3 June 2013 Mr Kirkinis mentioned that although February 2013 saw an improvement in collections Abil had decided in April 2013 to increase provisioning.[434]

(xiii) On 2 July 2013 in an email to Messrs Roussos, Muller and Nalliah and copied to Mr Kirkinis, Mr Raubenheimer "once again" expressed his concern around the following issues that were problematic in the Abil provisioning methodology and were not given the right level of focus and attention:

- discounting *in duplum* accounts at zero;
- calculating an IBNR reserve for all accounts up to CD3;
- ignoring fees paid to EDC in calculating cash flows;
- ignoring insurance premiums paid over to Stangen in calculating cash flow on NPLs. He stated that he would be more comfortable if:

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[433] AB(4)230
[434] SARB(3)67

- it was acknowledged that Abil was underprovided;
- the underprovision was quantified;
- a plan was made to address the situation;
- the acknowledgement, the quantification, and the plan were communicated to Deloitte, the Group Risk Committee and SARB.[435]

(xiv) On 28 August 2013 Mr Raubenheimer sent an email to Messrs Kirkinis and Nalliah on "impairment conversations".[436] He referred to a conversation with them on the Thursday morning where the following was debated:

- he had indicated that his view was that they would end FY2013 with a shortfall of the GL compared to the IAS39 model of R1,029 billion on NPLs and R121 million on MLs;
- Deloitte had indicated that they would accept the gap that existed on the ML, provided that the gap was closed off by the time that they had to sign the financial statements. Mr Raubenheimer calculated that the ML gap should be reduced to zero by November 2013 if write-offs continued between R500 and R600 million for the months August to November.
- his view remained that they had no choice but to increase impairments in the balance sheet to the level required by the

[435] AB(51)67
[436] AB(52)134

model on the NPL book. Failure to do so constituted a misstatement of the Abil financial statements.

- his views were informed by:

  (a) the knowledge that the models were aggressive insofar as they discounted *in duplum* accounts at zero;

  (b) the current model back tests compared to actual cash flow on a historical basis;

  (c) all indications were that the consumer was under more financial pressure and higher indebtedness which would reduce future recoveries,

  (d) Abil's coverage of 60% on NPLs was low compared to the market (ABSA-65%; Standard Bank-70%; FNB-85%) whereas Abil's collections methodologies were similar and Abil's risk appetite was much higher;

- all participants agreed that discounting *in duplum* accounts at zero was not defendable;
- he predicted that write-offs would amount to R7,7 billion during FY2014, which was R.7 billion more than previously forecasted. This increased his forecasted impairment charge for 2014 from R8 billion to R8,4 billion;
- after being asked for additional calculations he reduced his estimation of the NPL gap from R1,29 billion to R831 million.

(xv) Abil and the bank issued their trading statements on results to 31 August 2013 on SENS on 18 September 2013. In regard to the banking unit it was reported that in light of the current economic climate the impairment provisions against NPLs was expected to be increased by between 2,5% and 3,5% of the NPLs from the 60% coverage reported at 31 March 2013. The after tax headline earnings impact of that increase was expected to range between R350 million and R500 million.

(xvi) A meeting took place on 14 October 2013 between the BSD and Mr Kirkinis.[437] Mr van Deventer of the BSD told Mr Kirkinis that one of the main concerns of the Governors was impairment issues. The update Mr Kirkinis gave included the following:-

(a) At the end of 2012 the provisions were 60% but would be increased to 62,5% and 63,5%;

(b) Deloitte were “going the other way" they based their argument on four issues:

- models and the prediction of cash into the future: Mr Kirkinis said they (Abil) still believed in their models;
- valuation of the written-off portfolio;
- the IBNR reserve;
- *in duplum* discounting, which had grown to around R1 billion. Mr Kirkinis said that Deloitte wanted Abil to

[437] SARB(3)480

provide an additional R700 million more, which added up to R1,4 billion. He said that they (Abil) would settle for R500 million more. He advised that Abil had written off R7 billion more during 2013 than in 2012.

(xvii) At the special meeting of the boards and Abil and the bank on 18 October 2013 (referred to earlier) where the *in duplum* adjustment of R2,2 billion was discussed, it was minuted that management had undertaken a significant write-off on NPLs in the current financial year by changing the write-off criteria from no payments in the last 17 months to last 12 months.

(xviii) On 25 October 2013 Abil and the bank published their trading update for FY2013 on SENS. "Key features" included:

- recognising an incremental loan impairment provision of R1,3 billion and a decrease of R0,8 billion in the value of the written down book through changes in relation to non-cash items;
- increase in IBNR for credit risk by R0,3 billion;
- adopting a more conservative write-off policy;
- increasing the NPL coverage rate to 66% for FY2013, relative to 60% in FY2012;
- a goodwill impairment of R4,6 billion.

(xix) At a meeting of the Group Risk Committee held on 29 October 2013 the following was noted in regard to impairments:[438]

[438] AB(4)239

- there had been an increase in bad debts as a result of some internal data issues that occurred from September to October 2012 that impacted the score card and risk distribution;
- R3 billion had been written off;
- the percentage of NPLs decreased from 32,7% to 28,6%;
- adopting a write-off policy to 12 months recency was prudent;
- changes to the provisions methodology had been implemented for loan accounts that received no payments for more than 12 months, resulting in a R3 billion write off;
- a total of R7 billion of NPLs were expected to be written off in the next financial year.

(xx) On 11 November 2013 Abil and the bank announced their reviewed financial results for FY2013:[439]

- exceptional non-cash items which negatively affected the 2013 results were:

(a) a change in the loan impairment provisioning methodology;

(b) a change in accounting policy to account for the IBNR on balance sheet;

(c) the write –off of goodwill;

(d) changes to the write-off policy;

(e) a charge for the LTIP; and

[439] SENS(3)1092; Media(1)171

(f) an increase in the credit IBNR portfolio provision.

(xxi) The Abil and bank boards held a meeting via teleconference on Saturday, 7 December 2013.[440] Mr Nalliah advised that the bad debt charge had been increased by about R1,2 billion to ensure that the tolerance of the provisions gap was reasonable in relation to Deloitte's materiality assessment of the bank. The increase had reduced headline earnings for the banking unit from about R2,5 billion in the previous budget to about R1,8 billion in the revised budget.

(xxii) At the Group Risk Committee meeting on 7 February 2014 Mr Roussos reported that the gap between the model and general ledger was R925 million.[441]

(xxiii) A Group Audit Committee meeting was held on the same day, 7 February 2014.[442] In regard to Abil it was noted that the credit impairment charge was R2,590 billion, R122 million higher than budget, mainly due to lower collections and a higher required NPL charge. In regard to the banking unit it was noted that PLs had increased by 2% whereas NPLs grew by 11%, representing 29,9% of gross advances.

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[440] AB(24)586
[441] AB(4)244
[442] AB(6)278

(xxiv) In a document prepared by Deloitte for a SARB Trilateral meeting dated 20 February 2014 under the heading "Audit Findings: Impairments" the following was recorded:[443]

- the bank experienced a significant deterioration in credit quality during FY2013, particularly early in the year;
- two of the impairment modelling matters that were identified and addressed were:
  - (a) revising and updating input used in the IBNR calculation, resulting in a significant increase in impairments held for PLs;
  - (b) addressing the gap between impairment models and the financial records that were due to management discretion factors;
- Deloitte was of the view that, although reasonable and adequate overall, the impairment provision remained on the less prudent side of their assessment of critical judgements, although there had been notable and encouraging improvement from 2012.

(xxv) The BSD prepared a document dated 21 February 2014 in regard to Abil and the bank, "Possible action plan going forward."[444] Under the heading 'Credit Risk' it was stated that the bank's gross loans increased year-on-year by 13,11% and

[443] SARB(4)99
[444] SARB(4)185

impaired advances increased by 5,97% from R18,6 billion in December 2012 to R19,7 billion in December 2013.

(xxvi) Mr Kirkinis told a Project Phoenix meeting on 20 March 2014 that:

- June/July 2013 were the low points for the bank in terms of liquidity; impairments rose: “these were the key reasons behind the loss making situation”;
- the interim financial results expected to be announced on 19 May 2014 could be potentially disappointing due to the current work being done with Deloitte on impairments;
- the bank had increased its provision for impairments to R2,2 billion.[445]

(xxvii) The BSD, Deloitte and Messrs Kirkinis and Nalliah held a meeting on 29 April 2014 to discuss the interim reporting for the six months ending 31 March 2014.[446] It was reported that, as a prudent measure, to cover the migration of PLs to NPLs in the next six months and beyond, Abil would like to raise up to R2,5 billion in respect of an IBNR reserve for the period ended 31 March 2014.

(xxviii) On 2 May 2014 Abil and the bank issued a trading statement for the six months to 31 March 2014. Shareholders of Abil were

[445] SARB(4)313
[446] SARB(1)254,269

advised that there was an increase in specific provisions of about R600 million due to the following factors:

(a) NPL emergence in business written pre-July 2013 being at higher than anticipated levels. The total NPL formation was about R600 million more than the level anticipated;

(b) an increase in specific coverage on NPLs of over 1% from September 2013 to 31 March 2014 due to seasonal factors that impacted collections and a continuing challenging collections environment;

(c) a decision to significantly increase the general provisions for credit impairment relating to the PLs by about R2,5 billion.[447]

(xxix) In Abil's capital and liquidity plan of 4 May 2014 it was said that "the sole reason" for the disappointing results at interim in March 2013, final in September 2013 and interim March 2014 was "the credit impairment losses and provisions may exceed expectations."[448]

(xxx) On 6 May 2014 a meeting was held between the Registrar, the BSD, and Deloitte.[449] Deloitte stated that:

(a) they were comfortable with the level of provisions (impairments) that had been raised with regard to NPLs;

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[447] SENS(3)1213; SARB(1)380
[448] SARB(1)382
[449] SARB(1)409

(b) with regard to PLs they felt that the level of provisioning was still less prudent compared to other banks: the emergence period used by African Bank was CD4, whereas other banks raised provisions as early as CD1; the bank had been aggressive in using CD4, which had resulted in a delay in raising provisions; there was, however, no requirement in IFRS that precluded the bank from using CD4; but should the bank use CD1 rather than CD4, this would result in a significant increase in provisions, which would significantly impact the bank's profitability and capital adequacy ratio;

(c) an item of concern, particularly around the time of the finalisation of the September 2014 year-end audit, would be the assessment of the bank's ability to continue as a going concern.

(xxxi) In a letter to the Registrar dated 14 May 2014 Mr Kirkinis' motivation for a request to lower a capital adequacy requirement included the statement that there had been an increase in the credit impairment provisions of R2,5 billion.[450]

(xxxii) On 6 August 2014 the bank and Abil published the quarterly operational update for the quarter ended 30 June 2014. It was announced that the boards had decided to more closely align

[450] SARB(1)430; SARB(4)553

certain aspects of the bank's impairment provisioning practices to the industry standard. Amongst these, the most significant was the moving of the point of impairment from the current CD4 to CD0 (sic). The additional impairment provision that was required for all changes in practices was R3 billion.[451]

502. The credit impairments, according to Deloitte, were:

<u>FY2011</u>: R7,4 billion (as restated in the FY2013 afs from R6,6 billion)

<u>FY2012</u>: R9,8 billion (as restated in the FY2013 afs from R8,9 billion)

<u>FY2013</u>: R10,6 billion

<u>31/3/14</u>: R15,7 billion (as appears from the bank's unaudited half-year results)

<u>30/6/14</u>: R14,9 billion (as appears from the bank's unaudited management accounts). To which must be added:

<u>6/8/14</u>: R17,9 billion (adding the R3 billion referred to in the quarterly update to the R14,9 billion as at 30 June 2014).

503. Deloitte gave examples of what they said might be considered questionable conduct, including:

(i) management's resistance to making proper provisions for impaired advances during 2012 and 2013;

[451] SENS(3)1868

(ii) aggressive (although permissible) deviances from industry practice in relation to impairment modelling; and

(iii) increased risk taking in relating to the size and term of loans as well as the quality of credit risk assessments.[452]

504. In the section of the Deloitte statement, “Debates around impairment in relation to 2012 and 2013,”[453] Deloitte stated, for example:

<u>2012</u>

(i) The audit in relation to FY2012 was the first occasion on which Deloitte experienced significant conflict with management on issues relating to impairment. While disagreements with management were ultimately resolved to the satisfaction of Deloitte, the outcome of the 2012 impairment assessment was less prudent than Deloitte would have preferred, although still remaining within an acceptable range. Importantly, it alerted Deloitte to the fact that management would be likely to underestimate impairment in a cyclical down-turn.

(ii) The final assessment of Deloitte was, therefore, that although within an acceptable range, management’s evaluation of credit impairments was still towards the less prudent side of that acceptable range.

[452] Para356 p137 of First Statement
[453] First Statement, pp76-122

<u>Early 2013</u>:

(i) By about August 2013 Deloitte became increasingly concerned about:

- the continuing poor cash collections;
- the emergence of poorly performing loan vintages caused by aggressive loan origination from August 2012;
- ongoing concerns around the treatment of *in duplum* loans; and
- the gap between the bank's impairment model and the general ledger.

<u>September 2013</u>

(i) On 30 September 2013 several members of the Deloitte team met with Mr Raubenheimer, who said that:

- his "gut feel" was that provisioning in an amount of R4 billion was needed;
- he had made a presentation which argued for provisioning of R5 billion;
- He would have preferred a much more conservative banking practice, which would have provided for:
  (a) an impairment point at CD1, not at CD4;
  (b) correction of the *in duplum* issue;
  (c) filling of "the gap";
  (d) writing off the ML book so that it carried no value; and

(e) tightening of the credit extension policy.

October 2013

(i) Deloitte held numerous lengthy and contentious meetings with Messrs Kirkinis, Nalliah, Roussos, Symmonds and Adams. The contentious issues related mainly to the Deloitte view that managements' assessment of impairments was materially understated by between R2,6 billion and R3 billion. Mr Kirkinis' initial view (apparently shared by Messrs Nalliah and Roussos), from which he did not budge until the middle of October, was that there was no underprovision of impairments. Deloitte made it clear that unless the bank increased their provisioning significantly, Deloitte would modify its audit opinion to the effect that the advances were materially overstated for the year ended 30 September 2013.[454]

(ii) On 2 October 2013 at a meeting attended by Messrs Nalliah, Strauss and Raubenheimer, Deloitte discussed the impairment point, i.e. whether default would be considered at CD1 or CD4, as well as the emergence period. Mr Raubenheimer expressed the view that those issues should be aligned with industry practice, which would have increased the impairment provisions. Mr Nalliah was non-committal on Mr

[454] Para268-271 p96 First Statement

Raubenheimer's views. Deloitte cautioned that the treatment was aggressive and, overall, less prudent than generally adopted banking practice.

(iii) Immediately after the meeting Deloitte met with Mr Kirkinis. He adopted the attitude that the views of Deloitte and Mr Raubenheimer were unrealistic; the current provisions were adequate; and that he would strongly resist any attempts, such as advocated by Mr Raubenheimer, to change the "impairment point" or the length of the emergence period: That sort of inconsistency with previous years' treatment was unwarranted by the bank's business model. Mr Kirkinis contended that it would "sink" the bank if Deloitte continued to hold its stated position, primarily because it would lead to a breach of the capital adequacy requirements.[455]

(iv) At a meeting on 3 October 2013 Mr Nalliah raised the possible reputational damage to the bank if the full year results for 2013 were too inconsistent with the SENS announcement of 18 September 2013. Deloitte maintained its position and Messrs Kirkinis and Nalliah continued to disagree strongly with the Deloitte position, raising arguments in relation to the *in duplum* issue; the gap between the impairment model and the general ledger, and the credit IBNR. In the meantime, management

[455] Paras 275-278

continued to update their current model as accurately as possible with the available information and "to close the gap" in FY2014 primarily by "trading out of it."[456]

(v) On 7 October 2013 Deloitte met first with Messrs Kirkinis and Nalliah and then with Messrs Symmonds and Adams. Deloitte explained its position to Messrs Symmonds and Adams. They then stepped out to a separate meeting with management. Messrs Symmonds, Adams, Kirkinis and Nalliah then returned to the meeting. Messrs Symmonds and Adams conveyed to Deloitte that management had persuaded them that the Deloitte view in regard to impairments was too conservative. They proposed an additional provision of R200 million, which Deloitte rejected.[457]

(vi) It became clear to Deloitte at the meeting on 7 October 2013 that certain constraints were forming the view expressed by management, and Messrs Symmonds and Adams:

(a) the rights offer might not be successful if the proposed level of provisioning was adopted; this would threaten the viability of the bank;

(b) the loan covenants in relation to one of the funding instruments would be breached, triggering cross-defaults in relation to their funding;

[456] Para 280 pp99-101
[457] Paras 281-282

(c) Abil and the bank would no longer meet capital adequacy requirements;

(d) the FY2013 results would differ starkly from the guidance issued on SENS on 18 September 2013, denting credibility in the market;

(e) the required impairments would require the bank to report a loss which would trigger a further credit rating downgrade and would strain their ability to raise funds in future.[458]

(vii) In the period 14 to 17 October 2012 Deloitte met with the BSD and management. On 17 October 2013 management accepted the proposed *in duplum* provision (partly by way of the prior years adjustments) of R2,2 billion and the IBNR provision of R300 million.[459]

(viii) On 28 October 2013 Deloitte convened a meeting of the ten partners who had participated in the audit. They decided that Deloitte would be in a position to sign an unmodified audit opinion once it had received amongst others, the following:

(a) vetting and approval of the collections initiatives supporting the additional cash uplift by the board;

(b) successful completion of the rights offer.

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[458] Para 283
[459] Paras 287-296

(ix) In its report dated 28 October 2013 to the Group Audit Committee, Deloitte commented, in regard to "Impairment threshold":

"While we recognise that micro-lending customers do typically miss a payment from time to time, we are nevertheless of the opinion that CD4 is less prudent. This has significant impact on the IBNR calculation of performing book impairment levels (i.e. CD0 to CD3)."[460]

(x) In Deloitte's 2013 credit impairment review Deloitte explained why they considered the modelling aggressive although not unreasonable.[461]

505. In his Submission[462] Mr Nalliah criticized the Draft Report for "…its failure to attribute any significance at all to the fact that the auditors, Deloitte, at the most critical moments, after all was said and done, and all views and counters expressed, formed the opinion that the accounting policies of the bank were within the acceptable range, were compliant with the necessary standards, and were such to allow an unqualified audit report. This was the view formed by Deloitte as late as the meeting of 6 May 2014 with respect to impairments and does not in itself appear to be challenged by the report."

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[460] P119

[461] Para 316, annexure "24"

[462] E(20)45

506. The primary responsibility for the fair presentation of financial statements, however, is that of the directors of a company. That was in fact acknowledged by Abil and the bank in their annual reports. For example, the FY2013 annual report of Abil, signed by Mr Mogase, chairman, and Mr Kirkinis, CEO, the directors' responsibilities were said to include "selecting and applying appropriate accounting standards" and "maintaining adequate accounting records and an effective system of risk management".[463] In the bank's FY2013 annual report, signed by Mr Kirkinis, CEO, and Mr Nalliah, Director, the directors' responsibilities were said to include "selecting and applying appropriate accounting policies" and "making accounting estimates that are reasonable in the circumstances".[464]

507. The auditor, Deloitte, in the words of the bank's FY2013 annual report, "… is responsible for reporting on whether the annual financial statements are fairly presented in accordance with the applicable financial reporting framework"[465] and in the words of the FY2013 annual report of Abil, the auditor "… is responsible for reporting on whether the annual financial statements are fairly presented in accordance with International Financial Reporting Standards and the Companies Act".[466]

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[463] AB(12)2431
[464] AB(15)459
[465] AB(15)459
[466] AB(12)2431

508. There were broadly three categories of credit impairments:

(i) the *in duplum* impairments which came to R2,2 billion in 2013 (see Chapter 14);

(ii) the CD1/CD4 impairment of August 2014 which made up the bulk of the R3 billion impairment which was announced on 6 August 2014; and

(iii) the impairment due to "the lower collections and a higher required NPL charge." The third category is referred to as "the bad debt impairments".

509. Mr Kirkinis in his Submissions[467] disputed what he called the "dismissive remark" in the Draft Report that he was "the only one in step" and the "derogatory" remark that the CD1/CD4 impairment was "a case of the chickens coming home to roost":-

(i) It was only after the PWC recommendation in August 2014 that Mr Nalliah, who had supported his views up to that point, decided that they could not go against what PWC was recommending.

(ii) Mr Symmonds' evidence was to the same effect, ie that he had never believed that a CD4 to CD1 provision was necessary as he never believed that it was appropriate to compare the bank with the "big banks". His belief had always been that CD4 was

[467] E(20)79

appropriate given the bank's collections capability. He said that this view was supported by "internal evidence" and by the auditors, who considered this to be in line with accounting standards. He said that he was party to the 5 August 2014 decision because it was difficult to go against the advice of PWC.

(iii) Deloitte had always accepted that whilst the bank deviated from market practice in relation to the definition of "default" (CD4 vs CD1), the bank had a different business model to other banks in SA, and that the business model was sustainable.

(iv) Other industry competitors (such as Transaction Capital Limited) applied the same methodology. Provisioning on the basis of CD4 was not out of kilter with the practice in the <u>unsecured</u> lending industry. Adams described that the big banks entered this industry after the bank had operated successfully therein for many years. They sought to apply their existing policies applicable to their existing business and using a different model to that used by the bank.

510. Mr Kirkinis is not correct in asserting that Mr Nalliah had supported his views up to August 2014. In the Deloitte Statement[468] reference was made to a meeting on 30 September 2013 at which Mr Raubenheimer

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[468] E(16)95

had said that he would have preferred a much more conservative banking practice, which would have provided, inter alia, for an impairment point at CD1 not CD4. When that evidence was put to Mr Nalliah, he testified: "…the question of being more conservative. I agree. I had shared that view. I think the difference of opinion between Mr Raubenheimer and myself was Mr Raubenheimer's view was that this needed to be fixed all in one go, and I said to him that the extent or quantum of these amounts that one needs to fix to move from a so-called aggressive to a more prudent approach, would require this to be done over a period of two to three years…I did not agree with CD1. I agreed that it needed to be brought forward somewhere from a 4."[469]

511. The Deloitte's position on CD1/CD4 was canvassed in their original statement and in the evidence of Mr Jordan:-

(i) Deloitte said that the bank considered a loan as 'performing' until the customer had (cumulatively) missed more than three instalments. At the big four banks a loan was generally considered performing if no instalment had been missed. This was one aspect in relation to which the bank's impairment practices were aggressive in comparison with the banking industry as a whole.[470]

[469] T820-1
[470] E(16) para159.1 p57

(ii) Deloitte referred to meetings between Mr Jordan and Mr Nalliah held in July 2013 at which Mr Jordan discussed with Mr Nalliah the fact that the bank deviated from market practice in relation to the definition of "default" (CD4 vs CD1) and NPL write-offs. Mr Jordan encouraged Mr Nalliah to strive towards a further alignment of the impairment model to market practice, although he accepted that the bank had a different business model to the other banks in South Africa.[471]

(iii) At a meeting of the Group Risk and Capital Management Committee on 8 May 2014[472] it was noted that management had applied a credit impairment point of CD4. Deloitte had indicated that this definition was more aggressive than the market which generally used CD1 as the impairment point. Nevertheless based on the motivation and data supplied by management for selecting the impairment point it was not inconsistent with the requirements of IAS39.

(iv) When this minute was put to Mr Jordan he advised that the minute was accurate but pointed out that that was in reference to the September 2013 review. "So this was just a reflection of our comments at the conclusion of 2013."[473]

(v) Mr Jordan testified that in discussions with Messrs Kirkinis and Nalliah Deloitte had expressed the view that the bank's

[471] E(16) para 242 p87
[472] AB(4)248
[473] T879-880

accounting policies were aggressive. Deloitte had compared African Bank to the big four banks "…because it was our contention that over a number of years African Bank was in competition with the big four banks for the same clientele and the same products and so it was appropriate for us to use that as a proxy more and more at each developing stage."[474]

512. Mr Kirkinis' contention that African Bank CD1/CD4 methodology was also applied in the unsecured lending industry did not apply to Capitec Bank. The policy of Capitec Bank is to raise a provision on the first payment default, ie 30 days.

513. The CD1/CD4 impairment of August 2014 was a case of the chickens coming home to roost. Deloitte had advised management for years that it was more prudent to use CD1 rather than CD4. The advice was ignored. In August 2014 the board took the advice of PWC and announced the additional R3 billion provision, moving the impairment point from CD4 to CD0. Mr Kirkinis was not supported by Deloitte, PWC, Mr Nalliah, the board, Mr Swanepoel or Mr Raubenheimer.

514. The bad debt impairments were blamed by board members on a range of causes, which included a downturn in the economy; increased

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[474] T885

competition, and labour unrest. Prudent management should have foreseen that any one of those causes could occur at some stage. The risk of that occurring should have been properly managed.

515. A major cause of the bad debt impairment was the rapid growth of the book, i.e. the total amount of loans advanced in 2012 from R33,4 billion to R44,8 billion. This was the evidence in that regard:

Mr Symmonds: "There is no question that we grew the book in particularly 2012 too quickly."[475]

Mr Raubenheimer: "I do not know to what extent the book increased but what I can confirm is that in the last quarter of 2012 we were booking between 2 and R2,5 billion a month of new business…it contributed to the higher than expected NPL migrations that we had seen and obviously the higher the book the higher the impact of any of the accounting adjustments we had to make. Unfortunately these accounts were poorer quality as well than the account preceding or thereafter… they were about 20% worse quality so that again contributed to the higher NPL migration."[476]

Mr Kirkinis: "…we grew more than we should have in hindsight, but I would not define it as aggressive…gross advances grew by 33% over

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[475] T208
[476] T558-9

the year…with the benefit of hindsight I believe that we should have made further cuts in the October, November, December period…"[477]

516. According to the latest information provided by the Curator:[478]

(i) the loss the bank made in FY2013 of R4,5 billion might be increased (when the FY2014 afs are published) by at least in aggregate R1,339 billion made up as follows:

(a) definition of incurred loss event: R485 million;

(b) removal of emergence factors in the calculation of IBNR: R139 million;

(c) PD migration: R116 million;

(d) *in duplum* adjustment to "flow" LGD used in calculation of IBNR: R172 million;

(e) GL versus model difference at 30 September 2013: R427 million;

(ii) the loss in aggregate for FY2013 might therefore be at least R5,8 million;

(iii) for the period pre-FY2013 and the bank made a profit in the FY years 2008 to 20113) the afs might be restated to reflect an additional accumulative charge of at least R2,465 billion;

(iv) the impact on the pre-2013 financial years of the cumulative charge of at least R2,465 billion would reduce the cumulative

[477] T765-6
[478]

profits and might have the effect of converting the disclosed profits in some of those years to be losses.

CHAPTER 18 : LOSS

Coronation[479]

517. Coronation manages funds on behalf of several thousand investors. Between June and July 2013 Coronation increased its holding in Abil to around 4,5%, which peaked in February 2014 when client funds held in aggregate about 22,7% of the issued equity share capital of Abil, which reduced to 19,6% in April 2014. From 6 to 8 August Coronation sold down its clients' holding in Abil from 19,6% to 8,3%.

518. The accumulated loss incurred on all Abil shares bought on behalf of Coronation's clients was R3,52 billion.

519. The accumulated loss incurred on the fixed interest instruments was R31,6 million.

520. The total dividends received amounted to R5 749 456.[480]

479 Coronation Asset Management (Pty) Ltd
480 E(5)220

Stanlib[481]

521. Stanlib's clients incurred an aggregate loss in the amount of R706 542 768,24 in respect of Abil ordinary shares and a loss of R4 838 617,84 in respect of Abil preference shares.

522. Stanlib's clients received R465 925 634,35 as dividends in respect of Abil ordinary shares and R20 172 275,96 as dividends in respect of Abil preference shares.[482]

PIC

523. The PIC's investment in Abil shares reduced in value by R4 billion.

524. A total of R1 113 837 106 was received in dividends since 31 March 2005.

Allan Gray[483]

525. As at 15 September 2014 Allan Gray's clients owned 101 066 791 Abil shares, i.e. 6,7% of the shares in issue.

526. Allan Gray's estimate is that its clients have incurred losses as a result of owning Abil shares of about R893 million, net of dividends.

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[481] Stanlib Asset Management Ltd
[482] E(5)1
[483] Allan Gray (Pty) Ltd

527. Allan Gray's clients have lost 10% of their senior debt investment, which equates to about R250 million. That does not take into account accrued interest, which could increase the amount.

528. Allan Gray's clients received:

- a total of R1 225 856 in dividends;
- 229 253 Abil shares in lieu of dividends.[484]

<u>Eyomhlaba[485] and Hlumisa</u>[486]

529. Eyomhlaba and Hlumisa are the two Black Economic Empowerment (BEE) investment vehicles created by Abil in 2005 and 2008 exclusively to warehouse Abil ordinary shares acquired by the two companies for the benefit of some 13 000 individual black investors. The shareholders of Eyomhlaba and Hlumisa are black individuals who include employees, former employees, customers, the general public and depositors, as well as small shareholders in the original African Bank (which went into curatorship and was later rescued by Nail, BoE and Metlife in 1996).

[484] E(5)63
[485] Eyomhlaba Investment Holdings (RF) Limited (E(4))
[486] Hlumisa Investment Holdings (RF) Limited

530. Eyomhlaba and Hlumisa asserts that in terms of the Memorandum of Incorporation (MOI) of the two companies they were "handcuffed":

(i) they were obliged to use the bulk of the dividends received for operation costs and to buy more Abil shares (see below); and

(ii) Abil enjoyed rights.

531. Accordingly, Eyomhlaba and Hlumisa assert that:

(i) in a period of nine years they received R712,9 million in dividends, but could only distribute R28,1 million. The two companies were obliged to use the balance of R684,8 million for operating costs and to buy more Abil shares;

(ii) in May 2014 some of their directors proactively sought the Abil board's permission to set a stop loss: for Eyomhlaba it was R9 an Abil share and for Hlumisa it was R11. Permission was denied.

532. A high level overview of Eyomhlaba is this:

(i) Eyomhlaba has about 5 000 individual investors;

(ii) Eyomhlaba owns 48,2 million Abil shares, i.e. 3,2% of Abil's issue ordinary shares;

(iii) in the period before Abil's trading statement of 30 April 2013, Abil's 30 day Volume Weighted Average Price (VWAP) was R28,15;

(iv) on 10 August 2014 the share price was 31 cents;

(v) based on the VWAP price of R28,15 Eyomhlaba has lost R1,3 billion of value;

(vi) Eyomhlaba has been left no other significant asset of value;

(vii) instead Eyomhlaba has been left with a preference share funding obligation of R104 million.

533. A high level overview of Hlumisa is:

(i) Hlumisa has about 8 000 individual investors;

(ii) Hlumisa owns 25,9 million Abil shares , i.e. 1,7% of Abil's issued ordinary shares;

(iii) Based on the VWAP price of R28,15 Hlumisa has lost R729 million;

(iv) Hlumisa has been left with no other significant asset of value;

(v) Instead Hlumisa has been left with a preference share funding obligation to the bank of R61 million.

CHAPTER 19: CORPORATE GOVERNANCE

A. The executive directors

534. During the crisis years of 2012, 2013 and 2014, the executive directors who served on the Abil and bank boards were:

2012: Messrs Kirkinis, Nalliah, Fourie and Sokutu;

2013: Messrs Kirkinis, Nalliah, Fourie and Sokutu;

2014: from February to August: Messrs Kirkinis and Nalliah.

Mr Fourie

535. Mr Fourie stated in his affidavit that at the time he joined the bank in October 2003, and became a director in November 2003, he had no technical banking skills. He was employed for his skills and experience in general management, marketing, sales, distribution operations, customer centricity and low cost low margin operating models. He remained a director of the bank until January 2014 with the tile: Executive Director Strategy.[487] In answer to the question whether he regarded himself as qualified to be a director of a bank, he said: "At the time, no, but the reason for my appointment was not for my experience and expertise as a banker…Specifically they brought me in because I was not a banker…So they employed me because of my expertise in distribution-based business, end-user based business…".[488]

536. From January 2008 Mr Fourie was the CEO of Ellerines. In answer to the question why he remained a director of the bank after January 2008 the evidence that was given was the following:-

[487] E(3)154-5
[488] T2

(i) Mr Fourie: "…the standard practice at the bank that all the Abil directors were also [bank] directors and they operated as a unitary board… I do not know [why I remained a director of the bank]…It was just standard practice." He said that from 2008 he did not do any work for the bank and he did not attend any Bank Exco meetings. It was only at board meetings that he applied his mind to the considerations that came before the bank.[489]

(ii) Mr Mogase, the chairman of the bank board, was not aware that Mr Fourie was a director of the bank. In answer to the question how could he not know that Mr Fourie was a director of the bank, Mr Mogase replied: "Because when he moved to Ellerines, I mean that was his day to day job, he did not have much to do – obviously he did some work from a strategy point of view for the bank and the group."[490]

(iii) Mr Schachat, the Executive Vice-Chairman, could not explain why Mr Fourie remained on the bank Board: it was never questioned.[491]

(iv) Mr Kirkinis testified that Mr Fourie had a dual role: he was CEO of Ellerines and he was head of Strategy for the bank and for the group.[492]

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[489] T3-4
[490] T247
[491] T569
[492] T651

(v) Mr Nalliah's evidence was that Mr Fourie's role at the bank was confined to strategy, he was not involved operationally in any way.[493]

537. In the KHL letter of 30 January 2015 it was stated that Mr Fourie's banking and unsecured lending expertise was developed over time following his appointment in November 2003. By the time the bank began to experience problems Mr Fourie had accumulated over ten years of experience not just in banking generally, but also in the business and banking models of the bank specifically.[494]

538. Mr Kirkinis, in his Submissions said that as head of strategy Mr Fourie was required to fulfil that function. He would have had a duty to ensure that the bank was not "caught blind" if there were issues in Ellerines that could affect the bank. This is precisely what Mr Symmonds said he relied on. In fact, Mr Fourie fulfilled this role and did keep the bank fully informed of all issues in Ellerines that could affect the bank.[495]

539. On the undisputed facts placed before the Commission:

(i) At the time of his appointment to the board of the bank Mr Fourie was not qualified to be appointed: he was appointed because he was to *not* a banker, according to him, but because

[493] T869
[494] E(20)58
[495] E(20)90-1

of his expertise in distribution-based business, end-use based business.

(ii) Mr Fourie's role at the bank was confined to strategy. He was not involved operationally in any way.

(iii) From the time he was appointed CEO of Ellerines in about January 2008, Mr Fourie:

(a) did not do any work for the bank;

(b) did not attend Bank Exco meetings; and

(c) did not apply his mind to the considerations that came before the bank, except at board meetings.

540. So, of the four executives, during the years of 2012 and 2013, one of them , Mr Fourie:

(i) had a full-time job managing Ellerines, which was itself having major problems; and

(ii) could not contribute to resolving any of the *operational* issues that the bank faced, as he was not qualified to make any contribution.

Mr Sokutu

541. The first, bizarre, issue is whether Mr Sokutu was ever managing director of the bank. In his affidavit he stated that he was appointed managing director of the bank six months after joining the bank in

September 2002.[496] In his evidence he confirmed that he had been managing director of the bank. The following evidence was given about the period for which he was managing director:

"Q: How long were you m.d. of the bank?

A: Since that six months until I resigned.

Q: No, how long were you the managing director of the bank?

A: Eleven years.

Q: …I am asking you for how long you were managing director of the bank?

A. I believe it was six- I think it was six years…Sorry, sorry, it was eleven years.

Q: Eleven years you were managing director of the bank?

A; Yes, sir."[497]

542. Mr Schachat could not recall Mr Sokutu being managing director of the bank.[498]

543. Mr Kirkinis testified that Mr Sokutu was not appointed managing director: "…I forget which year but it would probably be sometime around 2003 or 2004, he held the title managing director but…he was not in the strict terms the managing director of the bank…"[499]

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[496] E(3)135,136
[497] T226-7
[498] T570
[499] T652

544. On 26 November 2014, TWB, Mr Kirkinis' attorneys, wrote a letter to the Commission in which it was stated that Mr Kirkinis was taken by surprise by the question relating to Mr Sokutu being the managing director of the bank. Mr Kirkinis had since established from the company secretary that Mr Sokutu was appointed on 19 May 2003 as the managing director of Retail Lending, one of the money lending divisions of the bank. During 2004 Mr Sokutu's role changed to being responsible for group risk, the strategic positioning of the group, and so on.

545. The second issue relates to Mr Sokutu's qualifications to be the Chief Operating Officer of the bank (his first appointment); managing director of Retail Lending; and Chief Risk Officer, a position he filled for ten years from 2004 to 2014.

546. Mr Sokutu stated in his affidavit that while he was no a banker by training he believed that he was appointed as a director of Abil and the bank "…in recognition of my vast experience in Strategic leadership in different organisations and the success I achieved in those positions…As a Chief Risk Office I employed my experience from the senior roles I played in the public service where I was responsible for

the risks that were associated with achieving the goals of the various departments I worked in."[500]

547. During his interview he said he was not qualified as a banker but he was qualified as a senior person. "I felt that I had the experience to lead people…and I was positioned…it was a leadership position and I felt I could lead people."[501]

548. Mr Kirkinis gave evidence that he regarded Mr Sokutu to be qualified on "the basis that he was head of risk for the bank. There is the traditional risk roles that one finds within a bank, with the traditional banks, as a market leader in our space, in our environment we have some significant risks to deal with which relate to the regulatory space that we operate in, a changing regulatory environment and we needed someone who was able to deal comfortably in the regulatory environment, had deep relationships with the various regulators and had a deep [affinity] for the business given his early years involved and mired in poverty."[502]

549. Mr Kirkinis, in his Submissions,[503] made the point that Mr Sokutu had a highly competent team of individuals beneath him, which included Marilyn Budow (Group Compliance), Harment Nagar (Head: Group

[500] E(3)135-6
[501] T225
[502] T652
[503] E(20)92

Legal) and Anton Voogt (Internal Audit). Mr Kirkinis referred to the evidence of the Registrar. Mr van Wyk testified, in regard to the qualifications of a chief risk officer:

"Well generally speaking it would have to be a person that has got the relevant experience in risk management, a good background of having in the area of risk management the required experience and years. I would also look at issues such as reputation in the market … and I would look at the structure that falls beneath the function of a risk officer that will enable to support that chief risk officer. Qualifications do play a part but not exclusively".[504]

550. Mr Kirkinis further referred[505] to this evidence of Mr Nalliah:[506]

"… at the credit strat com for example [Mr Sokutu] did raise concerns about the risk. He was responsible for co-ordinating through people that report to him, the sections that [are] referred to as the high level risks in the risk packs across the business, both from the bank and Ellerines, so he had that put together. He did attend the risk committee meetings. …he used to go out to branches and regions to investigate what is going on with risk because fraud was a big issue … And the engagements with Regulator [the NCR], once the announcement I think was made by

[504] T920-1
[505] E(20)94-5
[506] T870

the Regulator of the R300 million fine, he played a role in developing [a] relationship with the Regulator …"[507]

551. Mr Sokutu's qualifications to be the Chief Risk Officer for the bank may be compared to those of his successors. Mr Marais was acting Chief Risk Officer from October 2013 to June 2014. Prior to joining the bank in February 2006 he worked in various capacities for Trust Bank of Africa, Allied Building Society, Allied Bank, ABSA Bank, and Nedcor Bank for a period of about 20 years. While employed by African Bank he held a number of different positions, including Head of Risk Management (February 2000 to May 2003) and Group Risk Officer (June 2003 to December 2006).[508] Mr Swanepoel commenced employment with the bank on 1 June 2014 as Chief Risk Officer. Over a working life spanning 30 years, Mr Swanepoel's exposure to the banking industry was that he worked for Stannic, MLS Bank, Imperial Bank Limited and Nedbank Limited.[509]

552. It is appropriate to deal here with the reliance by a number of the directors on the "approval" of the Registrar of the appointment of a director of the bank or the chief risk officer. Firstly, SARB made the point in its Submissions that the Registrar does not "approve" an

[507] T870
[508] E(8)311
[509] E(11)1

appointment: he only "does not object to proposed appointments."[510] Secondly, even if the Registrar did approve of or not object to a particular appointment, that does not preclude the Commission from examining the appropriateness of the appointment and the subsequent conduct of the appointee.

553. It is clear on all the evidence that Mr Sokutu was not qualified to be the chief risk officer of a *bank*. The justification for his appointment by Mr Kirkinis that Mr Sokutu had to deal with significant risks in the "regulatory space" and that he was supported by a competent team:

(i) implicitly accepts that Mr Sokutu was not qualified in the conventional sense to be the chief risk officer of the bank;

(ii) does not make up for his lack of qualifications:-

(a) the chief risk officer of a bank has many risks to assess, not just "regulatory" risks;

(b) he is not meant to act as a conduit for the input of his subordinates or, in the words of Mr Nalliah "for co-ordinating through people that report to him";

(c) in order to discharge his responsibilities Mr Sokutu needed a good understanding of the underlying processes and principles of risk management in a bank, which he did not have.

[510] E(20)2

554. The third issue relates to Mr Sokutu's drinking problem. There were two well-publicised incidents:-

(i) The first related to the May 2013 Chelsea Flower Show in London. It was reported on 12 September 2013[511] that Mr Sokutu, the former chair of the National Biodiversity Institute, was reported to have been so inebriated that he had to be kept away from guests at a reception to celebrate the team's last gold medal. Mr Sokutu was quoted as admitting that he had been drunk during the event: "This week, the 49 year old banker was summoned to a meeting [with the Minister of Environmental Affairs]. A terse statement from the minister's office revealed afterwards that he had been fired."

(ii) The second was published on 17 August 2014: "Fxxx the poor" is the message from a top executive at African Bank."[512] The article quoted Mr Sokutu as saying "in response to the plight of thousands of borrowers who had been ruined:" "Fuck them, fuck them." During the interview, according to the article, Mr Sokutu "…repeatedly boasted about how he had made millions and was now globetrotting. He had three houses in South Africa, including holiday homes in Port Alfred and Cape Town, and another in Portugal. He said he did not need to work

[511] Media(1)165.1
[512] Media(2)15.1

again. Sokutu also boasted about owning six cars, including a Porsche, which was parked 'somewhere in the world – I don't know where.' He also owns a Hummer H2, a turquoise Bentley, a BMW M6, a Mercedes-Benz A class and a Mercedes S500…He said he lived lavishly with 'no regrets'…".

555. In regard to the incident at the Chelsea Flower Show Mr Sokutu in his interview said that he was not fired by the Minister, he stepped down. He admitted that he had been drunk at the Chelsea Flower Show. He attended as the chairman of the South African Biodiversity Institute. He was drowning his problems in drunkenness.[513]

556. In regard to the "fuck the poor" incident, Mr Sokutu testified that he could not remember what he said in the interview because he was too drunk to remember. He granted the interview because he was drunk. He denied the assertion in the article that he had "made more than R50m in share options:" he said he made R40 million over eleven years. He admitted that he owned four properties and six motor vehicles.[514]

557. The impression the Commission had was that he was under the influence of liquor during his interview. In reply to the question whether he had a drinking problem, he said: "when you call it a problem…I was

[513] T234-6
[514] T230-232, T242-3

drinking before this interview but I am not sure…when you call it a problem I do not know what the problem is.” [515] His attorney, Mr Knowles, asked for a five minute adjournment to speak to his client. On his return Mr Knowles told the Commission that Mr Sokutu denied that he had been drinking – contradicting what he had said a few minutes ago, and contrary to the impression he gave.[516]

558. There was conflicting evidence about:

(i) whether he was off sick from August 2013 to February 2014;

(ii) the reason for his (paid) absence from work.

559. According to Mr Sokutu he resigned at the end of August 2013 because he “had decided to leave work at that time…because of technical reasons they said I must make it February 2014 when the AGM happened|.”[517] Mr Sokutu said that it “so happened that unfortunately I got sick…I had a problem with my stomach at the same time when I decided to turn off.”[518] Mr Knowles later asked for a second adjournment. After speaking privately to Mr Sokutu he asked the Commission for an adjournment. Mr Sokutu however insisted on proceeding with the interview.[519]

[515] T232
[516] T233.
[517] T233
[518] T232
[519] T240-1

560. Mr Kirkinis told the commission that before he read the Chelsea Flower Show article he discovered that Mr Sokutu had arrived at the office under the influence of liquor: "He arrived one day at the office and his eyes were bloodshot and he was not totally coherent."[520] Mr Kirkinis put him on extended sick leave. Mr Kirkinis believes that Mr Sokutu went to a rehabilitation clinic in India.[521]

561. Mr Kirkinis had not known at the time that Mr Sokutu had gone to London to attend the Chelsea Flower Show.[522]

562. Another aspect of Mr Sokutu's conduct relates to his evidence that he was employed by the Department of Environmental Affairs for about six years – for no remuneration – while he was a full time employee of the bank : he had two jobs.[523] Mr Mogase, the chairman of the bank board, was unaware that Mr Sokutu was employed by the Department of Environmental Affairs.[524]

563. So, if we return to consider the three issues raised earlier:-

(i) Mr Sokutu believes that he was managing director of the bank, for a period of eleven years. He was never managing director of the bank.

[520] T652
[521] T656
[522] T653
[523] T235
[524] T251

(ii) Mr Sokutu was not qualified to be the Chief Risk Officer of the bank. So, for the whole period of ten years that Mr Sokutu had the title of Chief Risk Officer, there was in effect no Chief Risk Officer as one would understand that term in the banking industry. And this was *the* bank which needed an experienced, qualified, person to occupy that position.

(iii) Mr Sokutu had a severe drinking problem. His behaviour at the May 2013 Chelsea Flower Show was an embarrassment. The "fuck the poor" article, published 15 months after the Chelsea Flower Show incident, painted the picture of a drunk fat cat who had made a pile of money when many thousands, of investors had lost money. Both the journalist and Mr Sokutu got it wrong: he did not make R40 million or R50 million: on the sale of share options and the LTIP he received in total R89 million. And during the period 2005 to 2011 he earned, in salary and bonuses, each year in aggregate: 2005: R4,4 million; 2006: R4,7 million; 2007: R5 million; 2008: R6,8 million; 2009: R4 million; 2010: R3,3 million; 2011: R4,5 million

564. So, in the crisis years of 2012 and 2013, of the four executive directors, one, Mr Sokutu, was either unable to make when sober, or incapable of making when under the influence of liquor, any meaningful contribution to resolving the crises the bank faced.

565. That left two executive directors. Messrs Nalliah and Kirkinis.

Mr Nalliah

566. Mr Nalliah is a chartered accountant who had as one of his clients, Abil, from about 2003 until he joined Abil in April 2006. For the next three years or so, at various times, he was the Chief Financial Officer (CFO) of the bank and Abil. He became an executive director of the bank and financial director of Abil on 5 May 2009.[525]

567. While Mr Nalliah was an experienced chartered accountant, and an extremely hard working member of the Abil and bank boards, particularly in 2013 and 2014, he was not one of the inner circle which ran the bank, the members of which were Messrs Kirkinis, Roussos and Chemel.

568. Mr Nalliah also emphasised that he was not "involved in the details with regard to the credit risk side, there are specialists that were responsible for that…with regard to the credit impairment that was run by the credit impairments team within the credit department and that department was under the authority of the credit and collections executive for a while,

[525] E(14)1-2

prior to that the credit executive, and at no time did that department operate under my supervision; so they produced the output and then presented to me what the results were, what the challenges were, and what the model variations were, and where judgments needed to be made."[526]

569. In the Draft Report it was stated that until late in the day, ie in July/August 2014, Mr Nalliah went along with Mr Kirkinis even where he disagreed with him, and where he, Mr Nalliah, agreed with Deloitte or Mr Raubenheimer:-

(i) Deloitte and Mr Raubenheimer were of the view that the bank's practice of fixing the point of impairment at CD4 was aggressive and should be CD1, in line with the banking industry. Mr Nalliah agreed that it should not be CD4, and that it should be brought forward from CD4, but not to CD1.[527] But he said, his view did not prevail: Mr Kirkinis conferred with Mr Woollam, and "[Mr Kirkinis'] experience and wisdom often prevailed."[528]

(ii) Deloitte and Mr Raubenheimer were of the view that cash flows attributed to accounts that had reached an *in duplum* status should be discounted at the original effective interest rate. Until 2013, however, the bank had discounted those *in duplum* accounts at zero. Deloitte had since 2009 pointed out to

[526] T793-795
[527] T821
[528] T814,816

management that the bank's accounting practice in this regard was not in compliance with the requirements of IAS39. Mr Nalliah, the Financial Director of Abil, had, in the years 2009 to 2012, acted contrary to the views of Deloitte. When Mr Nalliah was interviewed, however, he said that he was "not comfortable" with the bank's treatment of *in duplum* accounts. He agreed with what Mr Raubenheimer had told Deloitte at a meeting on 30 September 2013 that the *in duplum* issue needed to be corrected.[529]

(iii) The bank's practice was "to bring the written off book at fair value…onto the balance sheet."[530] Mr Nalliah disagreed with that: he stated that the normal practice in business once you have written off a loan it stayed off balance sheet, and you accounted for any cash recoveries as and when you receive the cash.[531] It was another practice that he had inherited.[532]

(iv) Mr Nalliah testified that he had on many occasions told the board and Mr Kirkinis that the credit policy needed to be tightened, and the loan size needed to be reduced. Mr Kirkinis disagreed: his view was that "you cannot do that radically, you will damage the brand, which I accepted…But my view was that

[529] T821, T835
[530] T833
[531] T833
[532] T834

we needed to start the journey to make those changes, which subsequently had happened."[533]

(v) In March 2013, so said Mr Nalliah, he had debated extensively with Mr Kirkinis whether the additional provision should be R450 million, which Mr Nalliah wanted, or R350 million, which Mr Kirkinis wanted. Mr Kirkinis was of the view that in his experience "which I could not challenge" that the second half of the year was always better.[534]

(vi) Mr Nalliah said that he was of the view that the bank should not subsidise Ellerines, but Mr Kirkinis said 'we will get credit right, we will get it fixed…we will crack it and the board…with the experience he has got as the founder of the business, rightly so, gave more credence to his views than mine."[535]

570. In his Submissions Mr Nalliah protested at the statement in the previous paragraph that "Mr Nalliah went along with Mr Kirkinis even where he disagreed with him".[536] Mr Nalliah dealt with each sub-paragraph in detail and then summarised his contentions as follows:

"4.9 In short, the conclusions and comments in the Draft Report about Mr Nalliah simply 'going along with' Mr Kirkinis even where he disagreed with him:

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[533] T822
[534] T826
[535] T850
[536] E(20)39-41

4.9.1 are not supported by the instances cited to illustrate this;

4.9.2 unfairly ignore the fact that the disagreement was expressed, manifesting independence, even if these views did not carry the day; and

4.9.3 unfairly disregard the extent to which it was indeed reasonable not to have been overly dismissive of Mr Kirkinis' experience in light of his success in the past".

571. In view of Mr Nalliah's Submissions the statement in the Draft Report that "Mr Nalliah went along with Mr Kirkinis even where he disagreed with him, and where he, Mr Nalliah, agreed with Deloitte and Mr Raubenheimer", must be reconsidered. The following is a revealing passage in Mr Nalliah's Submissions:

"Acknowledging the value of Mr Kirkinis' track record and experience, and his status as the founder of the bank, in commenting on why his views might have found greater favour with the board than those of Mr Nalliah when there was a disagreement on matters of judgement, merely displays a lack of presumption and absence of arrogance, not any culpable degree of supine acquiescence."

572. Accepting that he might have needed time to settle in at Abil, by the time he was appointed Financial Director on 5 May 2009, he should have felt confident and qualified enough to express his views – even if they

conflicted with those of Mr Kirkinis – to the Group Audit Committee and the Abil and bank boards. The directors would have expected nothing less. Had his views not prevailed, so be it.

Mr Kirkinis

573. Mr Kirkinis was one of the founders of Abil and the bank. From inception until 6 August 2014 he was the CEO of Abil. At the same time he was CEO of the bank for that period except for the short period when Mr Woollam was managing director.

574. His annual remuneration from 2006 was modest in relation to the other executives of Abil and the bank. He took the view, so he said, that he was adequately compensated by way of dividends due to the success of the business. The total of dividends received by him and his family trust was R286 148 560,50 (R286 million).

575. According to Mr Kirkinis the value of his and the trust's investment in Abil fell from a peak of about R650 million to a present value of R7 million. He submits that the value of his investment in Abil, which has been lost, far outweighs the dividends that he and the trust received.[537]

[537] E10(230.4)

576. On 4 September 2014 an article, "Abil's Kirkinis beach house on sale for R60m", appeared in the media.[538] It was reported that a luxury seaside property in Rooi Els in the Western Cape "linked to Leon Kirkinis" was on sale for R60 million . In reply to questions put to him by the Commission Mr Kirkinis stated:

(i) Erf 115 Rooi Els was purchased by Upbeatprops 167 (Pty) Ltd, which is wholly owned by The Ubombo Trust, of which he is a trustee and beneficiary.

(ii) The purchase price was R3,7 million. Together with transfer duties and legal fees the total cost was R4 085 767.

(iii) The cost of improvements effected on the property during the period 2000 to 2014 was R49 436 861 (R49,4 million).

(iv) No funding was obtained from Abil or the bank.

(v) A mortgage bond was registered over the property in the amount of R20 million.

(vi) The house has not been completed and has never been occupied.[539]

577. The financial benefits Mr Kirkinis derived from Abil and the bank may be compared to the prejudice suffered by stakeholders of the bank:-

(i) The jobs of the 5700 bank employees were placed at risk.

[538] Media(2)25
[539] E(10)169-171

(ii) The 13 000 investors in Eyomhlaba and Hlumisa were black individuals who included employees, former employees, customers, the general public and depositors. They all lost their initial investment. Based on a share price of R28,15 Eyomhlaba lost R1,3 billion in value and Hlumisa lost R729 million.

(iii) Thousands, if not hundreds of thousands, of ordinary South Africans invested their savings in Abil shares through asset managers. The asset managers, some of whom were major shareholders in Abil, informed the Commission that the losses incurred on Abil shares were billions of Rand: eg Coronation – R3,52 billion; Stanlib – R706,5 million; PIC – R4 billion; Allan Gray – R893 million. The dividends that clients of the asset managers received were: Coronation – R5,7 million; Stanlib – R486 million; PIC – R1 billion; Allan Gray – R1,2 million and 229 000 shares in lieu of dividends.

578. The personality and management style of Mr Kirkinis were described as follows:

(i) Mr Raubenheimer: "Mr Kirkinis is a very amicable guy, he is somebody that you cannot help but to like…He had a massive presence in the organisation…He had that energy and persona. I think that he as the CEO was rather ineffective…he struggled with delegation , he struggled with keeping people accountable; he struggled with managing such a large organisation…the thing became too big and too complex for him to handle effectively;"[540]

(ii) Mr Nalliah said that he had told Mr Kirkinis that he was too nice a person. Mr Nalliah expressed the view that Mr Kirkinis did not have the ability to dismiss people.[541] Mr Kirkinis was a very hands-on CEO. By nature he was very optimistic. He was very trusting of people. He could not deal with people who were not performing. He did not like confrontation.

(iii) Mr Roussos described Mr Kirkinis as "…extremely charismatic…he was not dominant but he was influential in his approach and his mannerisms and had the ability to rally the troops and…take the business along with his ideas and his vision. Leon was extremely hands on, very operationally focussed; he was and wanted to be involved in most of the decision-making process; so he would initiate discussions around collection strategies or how we would drive sales or impairments and how impairments were to be calculated, so he was very, very hands on in the process, very knowledgeable,

[540] T560
[541] T840

and being also the founder of the business he had the IP[542] and the history to back up a lot of his decision-making."[543]

579. In responding to the description of him given by Mr Raubenheimer and Mr Roussos, Mr Kirkinis said: "I have always been comfortable with different views and people disagreeing, I think it makes for better decision making…I am quite a hands-on person. I obviously have a deep history with the bank being one of the founders and therefore I do have a fair amount of knowledge in terms of IP. I am definitely not a dominating person, I like to listen to people's views, I do not believe any one person is a custodian of all the rights decisions. I definitely like to inspire, leading from the front and I definitely have a deep, deep infinity for the people – the troops as he calls it, the people in the business, is something I value immensely. If the implication is that I made all the decisions that is not correct…"[544] "I do not believe that the business was too big for me, and…I am by my very nature a consensus seeker, so I do like to get different views from people and try and get a uniform decision but when decisions need to be taken and you cannot get consensus, decisions are taken. The 2.5 billion decision in March 2014 was my decision. The decision to change the credit cut-backs in June 2013 was my decision."

[542] Intellectual Property
[543] T419-420
[544] T662, 664

580. Mr Kirkinis was the dominant personality in management and on the boards of Abil and the bank:-

(i) He was one of the founders of Abil and the bank.

(ii) He was CEO of the holding company, Abil, and for most of the time, of the bank, from inception until 6 August 2013.

(iii) He held a substantial shareholding in Abil.

(iv) He was the director who had the most operational experience of the bank; there was no other director, including Mr Schachat, who knew as much about the bank as Mr Kirkinis did.

(v) Until early 2013 on the disclosed figures he seemed to have a magic touch: the bank was thriving; shareholders were receiving generous dividends; funders were being repaid; loans were being advanced to some 3 million consumers who may not have had access to funds in the past; the bank was an employer of some 5000 employees.

(vi) There was no material decision taken prior to August 2014 which did not carry his support. He was *the* person who had to be persuaded, whether it was about *in duplum* accounting or the extent of the credit impairment or the need for the rights issue in 2013, to give a few examples.

581. An insight into how closely Mr Kirkinis identified himself with Abil is the application which he made for the approval of the Ellerines acquisition of

8 August 2007. The application is dealt with in detail later in this chapter. For present purposes it is sufficient to say that the application was made in the name of Abil when the board had neither considered nor approved the acquisition. Either Mr Kirkinis regarded himself as Abil or he assumed the board would meekly go along with the recommendation of management that the acquisition be made.

582. Another incident which is illuminating is the reaction of Mr Kirkinis to Mr Sithole's letter of 30 June 2013. A summary of the letter is contained in para 164 of the Report. At the time of the letter Mr Sithole was an independent NED and chairman of the Group Audit Committee. He was not a person whose views could be ignored or dismissed without careful consideration. In his interview he explained in detail – as he had in his letter – what his concerns were. One of them was that he believed, as did the Governor, that the bank or Abil should raise capital, a view with which Mr Kirkinis did not agree.[545]

583. During his interview Mr Kirkinis handed in a letter which he said he had written in reply to Mr Sithole's letter.[546] The letter is undated. Mr Sithole has subsequently informed the Commission that he has no recollection of receiving the letter.[547] Mr Kirkinis did not respond to Mr Sithole's letter in detail: "Your reasons for your proposed actions are detailed in your

[545] T596-599
[546] T680, E(3)392.1
[547] E(3)406.1

letter, so I won't dwell on them in detail. At the outset, I would like to assure you that I'm not trying to avoid the issues that you have raised nor trying to paper over them." The letter contained this patronising sentence: "In times like we are facing it is imperative that as Directors and leaders we remain calm, level headed and cognisant of our responsibilities to each other, our staff, regulators, shareholders, funders and other stakeholders."

584. Mr Kirkinis described Mr Sithole as becoming "highly upset" as a result of a "strat session" held in June 2013: "…he was in a highly emotional state of mind when he wrote this letter. He was very upset and so this letter (ie the 30 June 2013 letter] must be viewed in the context of his emotional state of mind at the time."[548] Mr Kirkinis then took the Commission through Mr Sithole's letter, disputing almost every aspect of it: Mr Kirkinis' evidence in this regard is recorded on 13 pages of transcript.[549]

585. The first point to be made relates to Mr Kirkinis' assertion that when Mr Sithole wrote the letter he was in " a highly emotional state of mind." That explains the passage in Mr Kirkinis' undated reply quoted earlier where he spoke of the need for directors to "remain calm, level headed and cognisant of our responsibilities." Mr Sithole's letter, read

[548] T683
[549] T689-702

objectively, is not emotional. The letter consists of eight pages of detailed, reasoned, concerns. Nor did Mr Sithole, in giving evidence, come across as being upset or emotional. Mr Kirkinis was wrong in being dismissive of the letter.

586. There is no need to consider in detail the Sithole letter and Mr Kirkinis' rebuttal in evidence. It is sufficient for the purposes of the Report to make only these points:-

(i) There was a rights issue in late 2013 which raised R5,3 billion, which restored capital and liquidity, which is what Mr Sithole supported and Mr Kirkinis did not support until later.

(ii) Mr Kirkinis may disagree with Mr Sithole's criticisms of the management of the bank, but the truth is that without the rights issue the bank would not have survived beyond 2013, and in August 2014 was placed under curatorship.

587. Deloitte drew a distinction between "prudent" and "aggressive" accounting practices adopted by the bank; eg:

(i) the bank's "impairment practices were aggressive in comparison with the banking industry as a whole";[550]

(ii) the bank used a 7 day emergence period whereas the big four banks generally use a 30 day emergence period: "This is

[550] E(16)57

another important aspect in relation to which the Bank's impairment practices were aggressive compared to the banking industry as a whole";[551]

(iii) "Deloitte cautioned that the treatment [in relation to the impairment point at CD4] was aggressive and overall, less prudent than generally accepted banking practice";[552]

(iv) "The final assessment of Deloitte was…that although within an acceptable range, management's evaluation of credit impairments was still towards the less prudent side of that acceptable range."[553]

588. Mr Kirkinis disputed that a practice described by Deloitte as one of "the banking industry" was in fact one of the banking industry: he contended that the practice was one adopted by the big four banks only and not the banking industry as a whole. He also did not believe that African Bank should be compared to the big banks. Mr Kirkinis said, for example, in regard to the CD1/CD4 debate: "Traditional banks use an earlier metric to do that. We are not a traditional bank, and as I said in my statement to slavishly copy what everyone else does is inappropriate if it is done in the absence of the business model. We…dedicate 40% of our financial

[551] E(16)58
[552] E(16)97
[553] (16)80

resources and a third of our staff to collections. It makes our business quite unique…"[554]

589. The evidence for Deloitte was given by Mr Jordan: "…it was our contention that over a number of years African Bank was in competition with the big four banks for the same clientele and the same products. And so it was appropriate for us to use that as a proxy more and more at each developing stage."[555]

590. Mr Raubenheimer told the Commissioner that Mr Kirkinis "…often referred to [African Bank] as a small bank and I then corrected him and said 'no, we are now a big bank and it is – and the business was becoming more and more complex."[556]

591. In his Submissions[557] Mr Kirkinis persisted with his contention that a comparison should not be drawn between African Bank and the big four banks:

"I submit that [the Commission] has failed to appreciate the most significant issue, namely the extent to which the bank's business model differed from that of the big banks. The bank did not take deposits from members of the public, as did the big banks. It relied on wholesale

[554] T644
[555] T885
[556] T560
[557] E(20)109

funding from sophisticated investors. It focused solely on unsecured credit. It focused on its collections expertise. Its business was riskier, the returns were higher than the big banks – the model thus had to be different. This type of entrepreneurial venture is what created employment and opened new opportunities. It cannot be compelled, in retrospect, to fit within the 'big-bank' mould. Had that been the requirement (which it never was, not from SARB, or from Deloitte, or from the investors), the bank could not have existed in the SA environment at all. Yet it did so, successfully, for some 20 years."

592. While it is true that African Bank was not the same size as the big four banks, it was undoubtedly a “big bank”: by 2013 it had a book of some R60 billion rand, 3 million customers and about 5700 employees.

593. Above all it was a *bank*: its accounting policies should have been *prudent* rather than *aggressive*.

594. On 5 August 2014 the board eventually stood up to Mr Kirkinis; additional R3 billion in impairments were announced on 6 August 2014, Mr Kirkinis was asked to resign; and the bank was placed under curatorship on the 10th. Mr Kirkinis, both in his affidavit and in his evidence:

(i) expressed his strong disagreement with the board and PWC (who had recommended the additional R3 billion impairment); and

(ii) contended that, but for the announcement of 6 August 2014, the bank could have continued to conduct business.

595. In his affidavit. Mr Kirkinis stated *inter alia*:

"- R3 billion of additional provisions were announced on 6 August 2014 (contrary to my views that it was unnecessary, being overly conservative and concerning re the effect on the Abil risk profile);[558]

- In my view these changes created more risk than was necessary and gave a far worse view of the underlying credit risk than was appropriate, particularly given the recent turnaround in the trends. I urged caution. The Board took a different view, deferring to PWC, which I regarded with immense reservation. I had communicated my views to PWC, SARB and the Board on numerous occasions…[559]

- Page 3 of Annexure 10 is management's financial forecast for the 2015 to 2018 years. This analysis was prepared in July 2014, and indicated a sustainable business into the future. This was a

[558] E(10)p14
[559] E(10)14-15

bottoms-up forecast prepared by a large team of skilled people with intimate knowledge of the business.[560]

- Abil's forecasts and cash flow models were prepared by a large team of approximately 75 skilled employees. This was a sophisticated operation. This teams' job was to predict and model future cash flows. The forecasts were based on up to date, detailed, sophisticated data. The most recent forecasts showed that material trends had made a positive turn, and that the business was viable.[561]
- By 2015 African Bank and Stangen were forecast to make a profit of R1,2 billion after tax, and was forecast to grow to R3,1 billion by 2018.[562]
- A provision of a further R3 billion would have implied that the previous provisions, as reviewed by Deloitte, were inadequate – which they were not. Unless there had been a radical change in circumstances- which there was not – such a material additional provision was inappropriate and had the effect of significantly increasing the risk profile of the bank"[563]

596. In evidence Mr Kirkinis repeated what he had said in his affidavit. For example:

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[560] E(10)44
[561] E(10)74
[562] |E(10)44
[563] E(10)41

“- So [PWC] held a view that our income was overstated by some R800 million, they were wrong.[564]

- In addition to that [PWC] held the view that…the impaired event needs to occur earlier than the CD4 that we had used. Again I do not agree with that figure. It had been extensively discussed, it was not new news, it was something that we had debated over many years with Deloittes. What we were doing was in line with the IFRS and confirmed in March 2014. In the end the board took a different view…I had the energy, the commitment and still do, to actually see the business through a difficult time…”[565]

597. Mr Kirkinis’ view that the impairment point should be CD4 was not supported by Deloitte; PWC; the Financial Director of Abil, Mr Nalliah; senior executives of the bank, Mr Swanepoel and Mr Raubenheimer; and by early August 2014, by the boards of Abil and the bank.

598. In considering the personality of Mr Kirkinis the word “hubris” comes to mind: “Hubris often indicates a loss of contact with reality and an overestimation of one’s own competence, accomplishments or capabilities, especially when the person exhibiting it is in a position of power.”[566]

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[564] T646-7
[565] T647
[566] AB(51)162

599. Mr Kirkinis believed that: *he* was right; everyone else was wrong; the impairment point should be CD4 and not CD1; the bank had a future; the R3 billion additional impairment should not have been announced; and the capital requirement was no more than R5 billion (whereas R8,5 billion was announced).

600. But by early August 2014 Mr Kirkinis enjoyed no support from the boards of Abil and the bank, the Governor of the Reserve Bank, or the Registrar of Banks. By then the bank had faced a financial crisis since early 2013; the share price of Abil had declined dramatically; the market had lost confidence in Abil and the bank; the Governors' committee had been monitoring the situation since May 2013 (an indication of the extent of the crisis); and by early August 2014 the bank faced a capital and liquidity crisis.

601. Mr Kirkinis is mistaken if he believes either that the bank had a future or that he could remain CEO of the bank.

B. <u>The non-executive directors</u>

602. The non-executive directors in the period 2012 to 2014 were:

- for the whole of that period: Messrs Mogase, Adams, Symmonds, Ms Gumbi, Ms Langa-Royds and Mr Koolen;

- from 16 September 2013 Mr Mthombeni;
- to mid-September 2013, Mr Sithole.

603. On 10 June 2014 Stanlib, a major shareholder, wrote to Mr Mogase, giving ‘strong advice’ that the two independent board appointments “ be credible appointments with the requisite skills and experience in banking, particularly in the risk function.”[567]

604. In its submission to the Commission, Coronation stated that one of the “key risks” they identified in Abil was that “Abil’s board did not have sufficient depth and required strengthening.”[568]

605. Mr Mogase testified, in dealing with the Stanlib letter “…we wanted to bring more people onto the board specifically to deal with those matters…obviously with all the stuff that was happening in the market that would have been a perception that the risk function needs to be strengthened and so I think it was fair comment.” [569]

606. Having said that Mr Kirkinis was the dominant person on the board, he did not dominate *all* the members of the board all the time:-

[567] AB(5)145
[568] E(5)223
[569] T259-260

(i) Mr Sithole wrote the letter of 30 June 2013, which reflected is disagreement with a number of material aspects of the management of the bank.

(ii) In early 2014 Ms Gumbi requested Mr Kirkinis to resign: "I thought that the bank under his leadership had lost the confidence of the market, and whatever plan or story we can put before the market will not be accepted, only because it was him presenting it."[570]

(iii) Ms Gumbi also said that during the latter part of 2013 and early 2014 she felt that she was bringing a lot of negative energy on to the board. She agreed with some of the reasons advanced by Mr Sithole for stepping down.[571]

(iv) Mr Mthombeni was of the view that the lack of transactional banking services was a strategic weakness.572 Mr Kirkinis had always been strongly opposed to the bank offering transactional services: Mr Chemel said that that was a "no-go area" for Mr Kirkinis.[573]

[570] T124
[571] T128-9
[572] T55
[573] T407

C. The board as a whole

607. Evidence was given that at the time of the Ellerines acquisition in 2007/2008 it was the intention of Abil to integrate the financial services division of Ellerines into the bank and to sell the retail – the furniture – business.[574] The bank acquired the financial services of Ellerines in 2010 for R7,3 billion, but Abil did not dispose of the retail business. It was not until May 2013 that the Abil board took the decision to sell the retail business, a sale which never eventuated. In the meanwhile the bank propped up the Ellerines retail business in a number of respects canvassed elsewhere in the Report.

608. The composition of the Abil and bank boards was identical and they held meetings at the same time. That was acceptable until the bank began providing financial assistance to Ellerines, such as loans, the value share and guarantees. When that happened the board of the bank and the board of Abil were conflicted: what might be in the best interests of Abil, the owner of the Ellerines furniture business, would not necessarily be in the interests of the bank.

609. The issue of conflict was canvassed with all the directors: with the exception of Mr Mthombeni, they disputed that there was a conflict.

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[574] Fourie T32

They said they were able to discharge their fiduciary duties to the bank, while at the same time discharging their fiduciary duties to Abil. The proof is in the pudding.

610. One example will suffice. By the time that Ellerines was placed in business rescue, Ellerines owed the bank R1,4 billion. Had there been a separate board for the bank, the board would have asked some simple and obvious questions, such as:-

(i) Why was the bank, a micro-lender, advancing loans of hundreds of millions of Rand, in aggregate R1,4 billion?

(ii) Why was the bank lending money to a business in the furniture industry, an industry which was struggling?

(iii) Why was the bank lending money to a furniture business which:

- in the good years made a profit on the back of the value share, and without the value share, would have made a loss;
- in 2013 made a loss?

(iv) What security did the furniture business give?

(v) What prospect was there of the furniture business repaying a loan of R1,4 billion?

611. Without satisfactory answers to those questions, a bank board which was independent of the Abil board, would not have authorised the loans.

612. Those questions were canvassed with members of the board. This is an example of their responses:-

Mr Fourie: (CEO of Ellerines and director of the bank):

(i) Ellerines gave the bank no security.[575]

(ii) The loan (in September 2013, R900 million) was "part and parcel of changing the balance sheet."[576]

(iii) All the modelling indicated that EHL would be able to repay the loan..[577]

(iv) EHL borrowed from African Bank, rather than commercial banks, because loans from a commercial bank would be on call account, and it was believed that that was too risky.[578]

Ms Gumbi

(i) "…the bank was issuing loans through the Ellerines footprint, so it needed that asset for its own survival."[579]

(ii) She thought that the bank would get reimbursed the R1,4 billion by the potential buyer of Ellerines.[580]

(iii) That belief was based on the value of Ellerines.[581]

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575 T37
576 T38
577 T38
578 T38
579 T126
580 T126-7,
581 T127

Mr Adams

(i) "The bank and the furniture business were from a value perspective inextricably linked…So it made sense for the bank to make sure that the furniture business was successful."[582]

(ii) "Ellerines operated in a very negative furniture environment, so from the time that Ellerines was bought to the present the furniture industry has been in decline. The view of most analysts is that there must be a time when the furniture industry improves and the view was that Ellerines was not a lost cause, so it was a bit as if it was trading in a bad cycle, with time that would improve and it would be a profitable business again ad it could repay its loans."[583]

(iii) "The forecasts…were that by 2019 there would be…good cash positive generation by Ellerines…"[584]

Mr Symmonds

(i) "…so we always felt as though we would be able to recover the money from Ellerines….Ellerines was a very important distribution system which was of benefit to the bank…it was providing a source of business for the bank as well as a source of collections and so a revenue stream and a cash flow stream into the bank."[585]

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[582] T150
[583] T151
[584] T151
[585] T195

(ii) "…There certainly were a number of business cases presented to us where Ellerines turns around. Not only in dreamland…we believed the forecasts were realistic."[586]

Mr Mogase

(i) "…up to quite a late stage management believed that it would be able to sell Ellerines for a reasonable amount and that the money would be recovered in that process. So obviously the bank had bought – in fact the group had bought Ellerines specifically to grow the bank's business so there was a kind of like a natural relationship between the two entities…the projections that were on the table for profit were there, so the business was also being re-focussed and expenses cut, so it was a variety of these things…"[587]

Mr Gibbon[588]

(i) "The decision to pump in was always to be based on the potential of recovery and the potential benefit from that extra money of keeping the thing afloat."[589]

Mr Schachat

(i) At the time Mr Schachat retired on 30 September 2012 the bank had lent Ellerines about R450 million "or thereabouts."

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586 T190
587 T280-283
588 Mr Gibbon was a director until 31 March 2011
589 T457-8

(ii) "Now the reason I rationalised that that was not a bad thing for the bank at that point in time is that because the Ellerines distribution network which is where we made the insurance profits and the financial services profits…had to be protected…The question of ongoing lending that is a different discussion, but by the time I left I felt that the quantum and the rationale for making that decision was justified…Ellerines had been repaying portions of the loan…I think it was in that 2012 year."[590]

Mr Sithole

(i) "…we [are] lending support to Ellerines because that will increase the distribution channel for the bank…The value to the bank was that it was a distribution channel for the bank to increase profitability for the bank…when we advanced the loans at that point we believed that it will be able to repay."[591]

613. In the Submissions of Mr Nalliah it was concluded that when the bank made the loans to Ellerines:-

(i) "…the fates of EHL and the bank were very much interwoven, for better or for worse, and that some R8bn of the bank's book was exposed to the fortunes of EHL … the financial assistance allowed the bank to originate credit through the Ellerines

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[590] T590-1
[591] T605-6

channel, which, after all, was a core component of the rationale for the acquisition in the first instance. …it was for these reasons undeniably in the interests of the bank that EHL should be given every opportunity to thrive, and an eminently reasonable thing for the bank to do all things reasonably possible to assist…"[592];

(ii) EHL had two major insurance companies that were very profitable which had declared dividends of almost R500 million to EHL in the 2012 and 2013 financial years;[593]

(iii) significant repayments were made each month by Ellerines and re-advances which was an important factor that the directors took into account on recoverability.[594]

614. The directors of African Bank:

(i) owed a fiduciary duty and a duty of care and skill to the bank;[595]

(ii) owed a duty to the bank to act bona fide for the benefit of the bank;[596]

(iii) were obliged to exercise the powers and functions of director:

in good faith and for a proper purpose;

in the best interests of the bank;

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[592] E(20)43
[593] E(20)43)
[594] E(20)44
[595] s60(1) of the Banks Act
[596] s60(1A) of the Banks Act

with the degree of care, skill and diligence that may reasonably be expected of a person-

- carrying out the same functions in relation to the bank as those carried out by that director; and
- having the general knowledge, skill and experience of that director.[597]

615. In approving the loans from the bank to Ellerines, the directors of the bank board:

(i) acted in breach of their fiduciary duty to the bank;

(ii) did not exercise the required care and skill;

(iii) did not act for the benefit of the bank;

(iv) did not act in the best interests of the bank.

616. The reasons for those findings are the following:-

(i) The loans grew from about R450 million in September 2012 to about R900 million in September 2013 to R1,4 billion in July 2014.

(ii) The aggregate amounts of the loans increased at the very time that the bank was producing poor results in 2013 and 2014.

(iii) The bank was a micro-lender: it lent modest amounts of money to (3 million) mainly salaried employees: it did not lend hundreds of millions of Rand to corporates.

[597] S76(3) of the Companies Act

(iv) At the time of the acquisition of Ellerines in 2007/2008 it was not envisaged that the bank would lend money to the retail business, let alone that it would advance hundreds of millions of Rand to the retail business. In the application of 8 August 2007 to the Registrar in the Abil pro forma balance which was attached to the application, it was indicated that about R2 billion would be provided by external funders.[598]

(v) No reasonable banker would have lent R450 million or R900 million or R1,4 billion to a furniture business which was unprofitable or barely profitable in an industry which was struggling, without security: and no security was given.

(vi) A reasonable banker would not have granted loans in any amount, let alone R450 million, R900 million or R1,4 billion, without being satisfied that the loans would be repaid.

(vii) A reasonable banker would not have been satisfied that the loans would be repaid:-

(a) The expectation that a loan of those dimensions would be recouped from a potential purchaser of the furniture business was pure fantasy. On what hard facts was that expectation based? There were none. The furniture industry was not one to instil confidence in any potential investor. Abil was not able to find a purchaser. And when

[598] SARB(2)73,74

a written proposal was eventually made in July 2014 it was Abil who would have had "to pay" the purchaser money – not the other way round – and the amount was a mere R3 billion!

(b) The proposition that the bank would have been repaid when the furniture industry recovered or when Ellerines had successfully "turned around" (in 2019?) is rejected. The directors should have had regard to the past performance of Ellerines rather than future unrealistic forecasts.

(c) Despite the profitable insurance companies which Ellerines had and the repayments, the fact is that the loans kept growing until they eventually reached in aggregate R1,4 billion.

(viii) The contention that it was in the best interests of the bank to continue to advance loans of hundreds of millions of Rands to Ellerines because of the "symbiotic" relationship between the two and that their fates were interwoven is rejected. The question is whether a reasonable banker in those circumstances would have nevertheless advanced large sums of money without security and with no realistic prospect of repayment. This answer is 'no'.

D. The acquisition of Ellerines

The s52 application of 8 August 2007

617. Mr Kirkinis testified that he made the application of 8 August 2007 on the authority of the Abil board: "…we had discussed it on the 20th July and had a number of subsequent discussions with board members…which obviously are not minuted… I would not have acted without an authority of the board…". He said that he had had the informal authority of the board since 20 July 2007.[599]

618. Mr Mabogoane in his Submissions[600] made two points:-

(i) He referred to the s52 application which contains this passage:

"The Registrar has also requested that this Section 52 application be submitted to it on an expedited basis, prior to ABIL and Ellerine entering into more detailed discussions and negotiations regarding acceptable pricing levels, structuring of the acquisition and any other relevant details normal to a negotiation process."[601]

[599] T667-8
[600] E(20)10
[601] SARB(2)1.3p21

(ii) A strategy had already been approved at the board meeting held in July 2007 for the transaction and as such approval had already been given to Mr Kirkinis.[602]

619. Mr Tugendhaft in his Submissions[603] referred to his letter of 24 November 2014 in which he had advanced the following contentions:-

(i) He referred to s1.2 and 1.3 of the s52 application of 8 August 2007. Paragraph 1.3 is referred to in the previous paragraph in sub-paragraph (i). This was paragraph 1.2:

"The Registrar has requested Abil to submit this application to the Registrar prior to making any cautionary announcements on SENS regarding any potential acquisition of all of the shares of Ellerine."

(ii) In the light of these requirements of the Registrar it would not have been permissible for the board of Abil first to have approved the conclusion of the transaction, prior to the submission of the s52 application. Once the board approved the transaction in principle, it would be obliged when it issued the letter of intent to the EHL board, to issue a cautionary announcement in terms of s34A, as read with s3.9 of the JSE Listing Requirements.

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[602] E(20)11
[603] E(20)30

(iii) It was only, therefore, in consequence of the prior approval of the Registrar as required in terms of s52(1)(9) of the Banks Act, that management could propose the transaction to the Abil board, which was done on 13 August 2007.

(iv) In terms of 52(1)(9) of the Banks Act a bank is not permitted, without the prior approval of the Registrar and in accordance with any conditions imposed by him "to enter into an agreement" to acquire a subsidiary. That is an absolute prohibition, and it would be contravened, even if that agreement was made subject to the subsequent approval of the Registrar.

620. Mr Kirkinis, in his Submissions,[604] contended that "the finding that the application for the approval of the Ellerines acquisition was made without the authority of the ABIL board is clearly wrong." The reasoning, on my understanding, is this:-

(i) the s52 application of 8 August 2007 was the "preliminary" application, referred to as such in paragraph 493 of the Registrar's affidavit.[605]

(ii) the "preliminary" s52 application had been made during a "preliminary" meeting which he had with Mr Errol Kruger, the Registrar at the time, sometime after 20 July 2007 but before 8 August 2007 to gauge his response to the proposed

[604] E(20)120
[605] E(15)192

transaction. There was no point in going further if it did not carry the Registrar's support;

(iii) that the 8 august 2007 application was a preliminary application and that the final application was only submitted on 21 September 2007 is irrefutable having regard to the documents themselves;

(iv) by 8 August 2007 the methodology for converting the options issued under the Ellerines' share option schemes had yet to be designed. The method of incentivising Ellerines' management had been resolved by the time of the application of 21 September 2007;

(v) it was not possible to set out a timeline at the preliminary stage. Abil undertook to submit a detailed proposal once it had progressed discussions at the appropriate stage. The timing was provided in the final application;

(vi) as at 8 August 2007 a due diligence had not been conducted. Abil undertook to do so, and to inform the Registrar of the results. By 21 September 2007 the due diligence had been completed; the Registrar was advised thereof and that it had been conducted by Abil's internal staff, and the report was furnished as the new schedule 8 to the application;

(vii) as at 8 August 2007 there was no Circular to shareholders in existence. By 21 September 2007, it had been prepared and constituted schedule 9 to the final s52 application;

(viii) Abil's covering letter to the final application of 21 September describes the 8 August 2007 document as a "preliminary application".

621. Each proposition is now analysed and rejected.

The Registrar's request that the s52 application be submitted on an expedited basis

622. The Registrar's request did not confer Abil's authority on Mr Kirkinis nor was it a justification for not having the authority of the board.

The strategy meeting of the board in July 2007 approved the transaction

623. At the meeting of the Abil board on 20 July 2007 the following was minuted:[606]

> "There was discussion around the potential acquisition of one of the existing credit retailers as part of the growth strategy. The board was supportive of exploring such an initiative and granted

[606] AB(23)352.2

> approval, in principle, to management to engage potential parties in discussions. All directors were however advised not to deal in any securities of Ellerines Holdings Limited as JD Group whilst such exploratory discussions were underway."

624. All the board gave was "approval, in principle, to management to engage potential parties in discussions." The board did not agree, for example, to EHL being the proposed target, let alone any of the terms referred to in the s52 application of 8 August 2007, such as a purchase consideration of R9,5 billion.

In light of the Registrar's requirements it would not have been permissible for the board of Abil first to have approved the conclusion of the transaction prior to the submissions of the s52 application

625. The s52 application of 8 August 2007 was made in the name of Abil: it could only be made in the name of Abil if Abil had agreed, inter alia, on EHL being the target of the acquisition and the various terms, including the purchase price. The requirements of the Registrar did not confer Abil's authority on Mr Kirkinis nor were the Registrar's requirements a justification for not having the authority of the board.

The application of 8 August 2007 was a preliminary s52 application; the actual application was made on 20 September 2007 for which Mr Kirkinis did have the authority of the Abil board.

626. In terms of s52(1)(a) of the Banks Act a bank shall not without the prior written approval of the Registrar establish or acquire a subsidiary. Section 52(2) provides that to obtain the prior approval of the Registrar that there shall be lodged with the Registrar a written application.

627. Section 52 does not provide for a "preliminary" s52 application.

628. The reliance on the affidavit of the Registrar is misplaced:-

(i) The Registrar did not describe the application of 8 August 2007 as a "preliminary" application.

(ii) Paragraph 492 of his affidavit, relied on by Mr Kirkinis, was as follows:

"The *initial* application, as presented, did not comply with section 52 of the Banks Act, however, a formal application was subsequently forwarded to the BSD as prescribed by the provisions of section 51(1)(a) of the Banks Act"[607]

(iii) The Registrar's affidavit then went on to state that all s52 applications require the prior approval of an internal committee

[607] E(15)192

of SARB, known as the "Section 52 Committee"; in assessing applications in terms of section 52, the Section 52 Committee endeavours to achieve certain outcomes; Abil's application, dated 21 September 2007 was tabled at a Section 52 Committee meeting on 19 October 2007; after taking various considerations into account, and given the fact that the BSD had no reason to refuse Abil's s52 application, the BSD's consent was granted.

(iv) The Registrar's affidavit did not refer to the approval his predecessor gave on 8 August 2007.

(v) The Registrar did not state that the Section 52 Committee had considered the application of 8 August 2007.

(vi) The application of 8 August 2007 was responded to by the Office of the Registrar on the same day,[608]

(vii) One is left with the impression that the Section 52 Committee did not consider the application of 8 August 2007.

629. The application of 8 August 2007 was not a "Preliminary Application":-

(i) The covering letter refers to "… the section 52 application in regard to the transaction we are proposing".[609]

(ii) The application has the heading: "Application" not "preliminary application".

[608] SARB(2)17
[609] SARB(2)18

(iii) Application is expressly made "under section 52(3)of the Banks Act … for the approval in terms of section 52(1)(a) of the Banks Act of the Registrar for the acquisition by Abil as a wholly owned subsidiary…".[610]

(iv) Paragraph 2 of the application has the heading "Section 52(1)(9) Application".

630. The s52 application of 8 August 2007:

(i) was made in the name of Abil;

(ii) Abil was identified as the acquirer;

(iii) brief reasons for the acquisition were given;

(iv) key features of the transaction related to shareholdings and control; terms of the acquisition; major suspensive conditions to the acquisition; funding; price exposure to loss; acquisition costs as a percentage of shareholders' capital and size of Ellerine in relation to the Abil Group; main activities to be conducted; management;

(v) various undertakings were given; and

(vi) it was stated that Abil would conduct a due diligence on Ellerine prior to completing the transaction.

[610] SARB(2)19

631. There was no Abil board meeting between 20 July 2007 and 8 August 2007.

632. Mr Kirkinis could not, therefore, have been given authority by the Abil board at a board meeting.

633. Mr Kirkinis could not have been given "informal" authority by the Abil board. The board had no power to "informally" authorise any acquisition let alone one of this magnitude.

634. In any event, for the Abil board to have given Mr Kirkinis 'informal' authority the members of the board would have had to know, as a minimum, that it was EHL that was to be acquired; what the "key features" of the transaction would be; and that the price was R9,8 billion. There is no evidence that the directors of the Abil board possessed such knowledge prior to 8 August 2007.

635. On a fair reading of the s52 application of 8 August 2007, the Registrar must have assumed that the Abil board:

(i) had properly considered the terms of the proposed offer;

(ii) had agreed to all the terms;

(iii) had decided to make an offer on those terms.

636. The truth, however, is that as at 8 August 2007, the board of Abil had not:

(i) considered the terms of the proposed offer;

(ii) agreed that it was EHL that would be acquired;

(iii) decided to make an offer on the proposed terms, including the purchase consideration of R9,8 billion.

The board meeting of 13 August 2007

637. According to the minute of the meeting[611] management, based on the mandate given by the board at the 20 July 2007 meeting, considered various options. Mr Kirkinis took the Board through the presentation referred to earlier. It was resolved that:

"The board unanimously supports the proposed acquisition of [EHL]. Abil will submit a letter to the board of [EHL] expressing interest in acquiring the entire ordinary share capital of [EHL]."

638. This was the only meeting of the Abil board at which approval of the acquisition of EHL was given.

[611] AB(23)353

639. Six of the fourteen directors attended the meeting ‘via teleconference’. The inference is that the meeting was not a scheduled meeting and was called without sufficient notice to allow the directors to attend in person.

640. The point was made by a number of the directors in their Submissions that the meeting of a board by teleconference is common in the business community and therefore is above criticism.

641. It was not, however, the practice of Abil to do so. Abil did so, on this exceptional occasion because, so it is inferred, the meeting was not a scheduled meeting and was called without sufficient notice to allow all the directors to attend in person. The debate and decision-making process of a meeting of a board of directors in which six out of fourteen directors are at the end of a telephone cannot be as effective as a meeting which all the directors attend in person. And this was the only meeting at which approval was given for a R9.8 billion acquisition.

642. The decision to acquire EHL – taken at the meeting of 13 August 2007 – was taken without a due diligence having been concluded.

643. The Draft Report contained the statement that the resolution of the board was not subject to a due diligence being conducted.

644. Mr Tugendhaft and Mr Kirkinis took great exception to that statement, and referred, for example to the s52 application of 8 August 2007 and the SENS announcements of 20 August and 5 September 2007.

645. The fact of the matter is that the resolution of 13 August 2007 did *not*[612], provide that the acquisition was conditional upon, or subject to, a due diligence being conducted. And the resolution of 13 August 2007 was not revisited at the board meeting on 19 September 2007 when "a high level summary of key finding arising from the Ellerines due diligence exercise was presented to the board"[613]

646. At best for the Abil board, by *implication*, its decision was subject to a high level due diligence investigation being done, in the words of the September 2007 report, with the aim of:

(i) identifying any show stoppers that would in isolation or in combination with others result in an unforeseen financial impact of more than R250 million (post tax) on the June 2007 NAV of the business, and therefore require an adjustment to the offer price; and

(ii) identifying any major reputational/compliance issues imbedded in the business that needed to be factored into the thinking prior to a firm offer being made.

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[612] AB(23)353
[613] AB(23)356

647. No *independent* due diligence was done. The reason, so the Commission was told, was that it was unnecessary as Abil and the bank had all the necessary skills to conduct a due diligence: a third party, such as a firm of auditors, could not have done a better job.

Non-disclosure

648. At the Abil board meeting on 3 March 2008, two months after Abil had taken over Ellerines, Mr Fourie described the Ellerines business *inter alia* as follows:

(i) Ellerines was “over-branded, over-stored and over-structured”;

(ii) the cost structure was high;

(iii) the market share of the group had declined over the past few years;

(iv) productivity ratios were worse than the direct competitor;

(v) debtors’ costs had increased significantly over the past year and the forecast looked poor;

(vi) credit granting policy had changed due to the NCA;

(vii) sales and margins were under pressure and below budget;

(viii) trading profit was below budget and was anticipated would be below budget to year-end;

(ix) head office costs were high and were planned to be reduced by consolidation of the various offices across the country over time;

(x) supply chain and logistics was a challenge and a top logistics person needed to be recruited;

(xi) there were leadership and skills challenges within the business, especially in the area of merchandise, logistics and at the divisional level.

649. According to the minutes of the meeting Mr Woollam summarized the concerns regarding the Ellerines insurance division in these terms:-

(i) the accounting methods used to bring income into account in the insurance company post NCA was legally flawed and required correction back to June 2007;

(ii) this method of income recognition was agreed by Ellerines' auditors and insurance advisers;

(iii) this was also raised at the time of the due diligence as an issue;

(iv) the correction of income recognition would have a material effect on the financial numbers of the Ellerines division for the half year; the amounts were about R200 million for the period June to August 2007 and R900 million for the period September to December 2007;

(v) the R900 million would be accounted for as an adjustment to the purchase price in the books of Abil;[614]

(vi) the financial statements of the insurance companies for the year end 31 August 2007 would need to be withdrawn and restated;

(vii) the various regulators, including the JSE and the FSB, would need to be informed;

(viii) the communication to the market needed to be carefully worded.

650. In his statement and during his interview Mr Woollam said that the minute of the meeting was incorrect in that the words "purchase price" should in effect be replaced by "purchase price allocation between net assets and goodwill".

651. The evidence of directors of Abil at the time of the acquisition of Ellerines was that the facts disclosed at the meeting of the Abil board on 3 March 2008 were known to them prior to the acquisition: Mr Woollam: "… I think the essence of the issues that were discussed at this time post the effective acquisition date were largely issues that we were fully aware of and were fully understood and were in essence the reason why we made the acquisition because we believed that the business

[614] In his Submissions, Mr Nalliah stated that the minute should read "purchase price allocation".

required overhauling, it required optimism and it required a new strategy…”,[615] Mr Gibbon: “…it was not an alarming discussion to the directors…it was a case we can improve the supply chain…there was a lot of opportunity here…none of this rang alarm bills…”;[616] Mr Tugendhaft: “…what the due diligence did indicate and also what the presentation indicated at the time is that there were certain risks in respect of this business…And as a board we were certainly aware that this business did require a lot of restructuring, but that it presented a great opportunity…I say that the board was aware generally of challenges that this business faced…”;[617] Mr Mabagoane: “And there were a number of areas that required attention, which were also brought to our attention, but none of these were matters in our view that the management team were not aware of before the acquisition…and the fact that we were given…the assurances that there were not problems that management were unable to deal with effectively…,”[618] Mr Schachat: “We were aware that Ellerines was not optimally operational, it had its weaknesses and it is one of the reasons from our point of view it was actually one of the upsides that- potential synergy upsides in our ability to actually cut costs and improve that business, it was not top of the pack in the furniture retailers. So we were aware that there were bloated costs, performance that was not optimal and we saw that as

[615] T96-97
[616] T447-8
[617] T473-4
[618] T507

potential upside…"[619] Mr Kirkinis: all the problems highlighted by Mr Fourie at the meeting on 3 March 2008 did not come as a surprise to him; he knew about it before that meeting: " I mean obviously not in as much detail as we would have had once we had taken over but this – the condition of Ellerines did not come as a surprise to us… The billion rand profit [of Ellerines in FY2007] is an overstatement of profit… So the billion rand profit…is not really a sustainable rand profit once you change the accounting policies…They have made a billion rand profit under the accounting policies they had at the time…"[620]

652. At the time Mr Kirkinis made the s52 application to the Registrar of 8 August 2007, he knew, as a minimum, what had been presented to the board of Abil at its meeting on 20 July 2007, namely, that there were "significant risks" with a "complete takeout", which were:

"- We do not have experience in running a retail business.

- Both businesses have regulatory clouds over them and we don't know the extent of the damage.
- Shareholder resistance and holding out for a higher price was resulted in a number of deals failing.
- Management are unlikely to be completely friendly, and therefore there will be an element of hostility.

[619] T582-3
[620] T671-3

- Do we have the management capacity to handle such a deal?"[621]

653. The description Mr Kirkinis gave of Ellerines in his letter to the Registrar was in these terms:

"Ellerine is a well established furniture retail group, targeting customers in similar market segments to Abil's target market. The products sold within the group were primarily sold on credit, with payment terms between 12 and 14 months. It is a very profitable business and its expected to generate post tax profits in excess of R900 million for the year ended 31 August 2007. In addition the group is very cash generative, with the majority of the profits in a cash form."[622]

654. In the s52 application of 8 August 2007 Mr Kirkinis did not disclose to the Registrar his view that the R1 billion of profit disclosed by Ellerines in its afs for FY2007 was "an overstatement of profit".

655. In his Submissions Mr Kirkinis denied that the adjustment arose as a result of "overstatement of profits" : "it arose as a result of EHL's policy of up-front income recognition, whereas ABIL preferred to recognise the relevant insurance income over time. The take-on net-asset value would therefore be reduced in ABIL's books and the goodwill increased in ABIL's books."

[621] E(7)128
[622] SARB(2)23

656. This is, however, what Mr Kirkinis said in evidence:

"The billion rand profit [disclosed by Ellerines in the FY2007 afs] is an overstatement of profit … The billion rand profit that you are referring to is not really a sustainable billion rand profit once you change the accounting policies… They have made a billion rand profit under the accounting policies that they had at the time … we changed those accounting policies when we took over Ellerines."[623] (The underlining is provided).

657. In the SENS announcement of 20 August 2007,[624] which was a cautionary announcement, the Ellerines group was described as "…a successful and established retail business operating a number of well known household brands through some 1300 outlets. Ellerines has a proven and experienced retail expertise, and Abil is confident that the retail business will continue to grow and increase its market share…".

658. In his Submissions[625] Mr Kirkinis stated that the risks identified by management were publically disclosed to investors, shareholders, the Registrar and SARB in that the SENS announcement of 20 August 2007 invited investors to download a slide presentation from Abil's website. If

[623] T672-3
[624] SARB(1)14
[625] E(2)126-7

investors had done so they would have seen from slide 12 that the "Risks of the acquisition" were disclosed:

"- Lack of retail skills, competencies and acknowledged in ABIL

- Cultural fit or lack of management buy-in

- Different business models: Balance sheet structures, profit levers, credit cycle

- Inability to separate Finco from Opco without hurting either business

- Potentially excessive client overlap

- NCA compliance issues

- Management capacity and expertise at ABIL."

659. This is what the SENS announcement of 20 August 2007 disclosed:

(i) The "Benefits from the Transactions", such as greater critical mass for the financial services business and the combined group; a greater distribution footprint; the ability to introduce Abil's greater price and risk differentiation underwriting models into the Ellerines distribution channel; improved product offerings and feasibility for Ellerines clients.[626]

(ii) Under the heading "Conference Call" it was stated:

"Leon Kirkinis, Abil CEO, will conduct a conference for investors on Tuesday, 21 August 2007. Participants are invited to

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[626] SARB(2)84

download a slide presentation from the company's website prior to the conference call at www.africanbank.co.za".

660. The SENS announcement of 20 August 2007:

(i) did not *in the body of the announcement* disclose:

(a) the "Risks" that were considered by the Abil board at its meeting on 13 August 2007;

(b) the "overstatement of profit" of R900 million referred to by Mr Kirkinis;

(ii) was misleading if the intention was to make disclosure of the risks in slide 12 of the slide presentation: only participants in the conference call were invited to down-load the slide presentation;

(iii) did not state that the risks were to be found in the slide presentation.

661. On 5 September 2007 Abil and EHL made an announcement on SENS of a firm intention to make an offer for the entire issued ordinary share capital of Ellerines and withdrawal of cautionary announcement.[627] Abil and EHL shareholders were advised that they had completed satisfactory reciprocal due diligence investigations on each others businesses.

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[627] AB(47)40

662. The Abil due diligence report is dated September 2007.[628] Contrary to the risks of acquiring EHL and the negative description of the business of EHL which were considered by the board of Abil at its meetings of 20 July 2007, 13 August 2007 and 3 March 2008, the "high level" due diligence report:

(i) made the following recommendation:

"Proceeding with the acquisition: Based on the above conclusions no major issue(s) emerged that are judged to be of such a material nature as to warrant either:

- Reconsideration of the proposed acquisition; and/or
- Any adjustments to the terms or offer price for the acquisition of the group.

It is therefore recommended that Abil proceeds with a firm offer on the same terms as the existing indicative offer."

(ii) contained "Overall impressions and findings in regard to Governance and Management":

"The general impression gained by all teams during management consultations and discussions with the external auditors was one of a reasonably well governed, managed and controlled retail and credit operation with very experienced and solid operational managers in charge of all areas. All these

[628] E(6.1)270

managers had good knowledge of the areas they are responsible for, had most of the key information at hand and willingly and openly discussed both negative and positive aspects of the business. No material risks/exposures were identified in respect of ….Financials."

(iii) The "Retail Business" was given this description:

"The business operates effectively and is managed in a disciplined manner. No material risks in relation to the scope of the due diligence were identified."

663. The circular to Abil shareholders was dated 21 September 2007. The Ellerines group was described as "a successful and established retail business."[629]

664. The facts that were placed before the Abil board at its meeting on 3 March 2008 (set out in paragraphs 648 and 649 hereof), and which the directors said were known to them prior to the acquisition, were not, in that amount of detail, disclosed in the SENS announcements of:

- 20 August 2007;
- 5 September 2007;
- 21 September 2007.

[629] E(6)168

CHAPTER 20: THE CURATORSHIP OF THE BANK

665. On 10 December 2014 Abil and the Curator issued an update on the restructuring of African Bank and its engagement with shareholders on SENS.[630] The update contained the following information:

(i) The curatorship of the bank was intended to provide a stable platform to enable the restructuring of the bank and to provide stability to the banking sector as a whole. The Curator confirmed that the bank continued to operate and to grant and collect loans, albeit with a lower appetite for credit risk. The Curator had maintained operational focus on offering sustainable levels of credit to appropriate customers and optimising collections on the lending book.

(ii) All payments of interest and capital on all debt remained suspended, with the exception of retail deposits and trade creditors.

(iii) A consortium of six South African banks, together with the Government Employees Pension Fund (represented by PIC), had undertaken, on terms, to underwrite a capital raising exercise in the amount of R10 billion, to be used for capitalisation of a new "Good Bank" to be formed. The Good

[630] E(20)11

Bank would be a new registered bank and a wholly owned subsidiary of a newly established holding company, which was intended to be listed on the JSE in due course. The core lending assets of the bank, referred to in the SARB announcement of 10 August 2014 as having a book value of R26 billion, which was net of portfolio investments, would be transferred to Good Bank. It was intended that Stangen would be sold at fair value to become a subsidiary of the new holding company.

(iv) It was the Curator's intention to conclude the restructuring exercise during the first quarter of 2015. This was subject to a number of regulatory and stakeholder approvals and processes, the outcome of which might well affect the ultimate timing.

666. On 14 January 2015 the Curator provided the Commission with a report.[631] The report covered two areas:

(i) an overview of the bank's progress since his appointment as curator on 10 August 2014, and

(ii) his views on whether the bank should remain in curatorship.

667. The overview of the bank's progress included the following information:-

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[631] E(20)1

(i) The effective opening free cash balance of the bank on 11 August 2014 was R143 million. By the end of August 2014 the free cash balance had risen to R1 billion. The closing free cash at the end of December 2014 amounted to R2,5 billion.

(ii) As a result of currency purchases and the maturity of various hedges that bought foreign currency from free cash, the bank had another R1,7 billion of cash held in foreign currency.

(iii) The bank held cash and statutory assets at SARB of R3,7 billion, and held net "collateral cash", where cash had been received from the hedge counterparties, of around R0,9 billion.

(iv) In total, therefore, cash and liquid resources amounted to around R8,6 billion as at 14 January 2015.

(v) Consequently, from a liquidity perspective, the bank was in a very stable position (bearing in mind the moratorium on payment of interest and repayment of capital on the bonds).

(vi) The bank had around 5700 employees as at early August 2014. At the end of December 2014 the bank had just under 5000 employees.

(vii) The monthly sales level (ie new loans) fell to around R700 million since curatorship, compared to the peak in 2013 of about R2 billion a month.

(viii) The Curator was pleased with the continued performance of the bank's collections. Cash collections have trended slightly ahead of expectations.

(ix) Other operations within the bank, such as IT, retail operations and HR, continue to function effectively.

(x) With most of the Ellerines stores closed, bank staff are actively managing the former Ellerines loan customers. While there has been an inevitable deterioration in collection performance on these customers, it is not sufficiently significant to the bank to change the Curator's view on the overall performance of the bank.

668. In the Curator's opinion, the bank should remain under curatorship:-

(i) No credible alternative proposals which have the support of SARB have been received.

(ii) The main change to emerge from discussions with the consortium and the relevant authorities is that instead of SARB purchasing a substantial portion of the non- and under-performing assets and other high risk loans (together the "bad assets") the intention (as at 14 January 2015) was that the bad assets would remain in the bank after the purchase of the performing loans and assets by Good Bank; Good Bank would act as servicing agent of the bank for the run-down of the bad assets and earn a market based fee for the services performed.

(iii) As at 14 January 2014 the bank was operating in a stabilised environment which should be maintained to allow time for final agreement and implementation of the proposed resolution measures.

(iv) Subject to the passing of the Banks Amendment Bill 2014[632] the implementation of the resolution was in the best interests of the bank's deposit holders, creditors, and employees.

(v) However, execution of the proposed resolution was still some months away, depending on:

- the complexities of the mechanics for implementing the proposal;
- the need to reconcile the divergent interests of certain creditor groups and the consortium;
- the parliamentary and legislative timetable to pass the Banks Amendment Act, 2014.

669. Based on:

(i) the above facts; and

(ii) the reasons advanced by the Curator for the bank remaining under curatorship,

[632] E(20)16

(iii) I am of the view that:

(iv) it is in the interests of the depositors or other creditors of the bank that it should remain under curatorship; and

(v) it is not in the interests of depositors or other creditors of the bank that the Registrar should apply to a competent court for the winding up of the bank.

670. In a letter dated 10 February 2015[633] the Curator informed the Commission of the following:

(i) Significant accounting issues would be disclosed in the bank's afs for the year ended 30 September 2014.

(ii) The account issues related to the three main areas:

(a) credit impairments;

(b) impairment of the loan to EHL;

(c) impairment of the deferred tax asset.

(iii) In terms of IFRS adjustments are made if there is a "change in estimate" or in the event of a "material error". The adjustments had been distinguished on this basis in the schedule to the letter.

(iv) The numbers in the schedule were provisional. The exact numbers were being finalised by the bank's financial team.

[633] E(21)25

(v) Credit impairments of R2,062 billion (FY13: R485 million; pre-FY13: R1,577 billion) related to the change of the bank's impairment definition of loans in CD4, 3, 2 and 1 together with loans with high probability of default in CD0 were made for the 9 months ended 30 June 2014, but reflected as a current charge for FY14. The new impairment definition was disclosed in Abil's SENS announcement on 6 August 2014.

(vi) Issues 1(b) (removal of emergence factors in the calculation of IBNR CD1, 2, 3); 1(c) (PD migration (90, 60, 30 days) and 1(d) (adjustment (*in duplum*) to "flow" LGD used in calculation of IBNR) amounted to, respectively, R448 million (FY13: R139 million; pre-FY13: R309 million); R349 million (FY: R116 million; pre-FY1: R233 million) and R518 million (FY: R172 million; pre-FY13 R346 million), totalling R1.315 billion. These issues would result in the profit in the income statements being reduced and balance sheets adjusted for those purposes.

(vii) Issue 1(g): The shortfall relating to the understatement of the provisions in the general ledger (GL) compared to the impairment model of R427 million in FY2013 (an initial shortfall of R927 million was initially identified in FY13 of which only R500 million could be justified) and was only booked for FY14. This should have been corrected in FY13.

(viii) An impairment of the loan to EHL of R1,423 billion was processed in FY14. The debate was whether the balances existing at 30 September 2013 and 2012 of R529 million and R461 million respectively were already impaired on those dates and should have been booked in the afs for those years. The Curator was still in due process of deliberating this within the bank.

(ix) The deferred tax asset of R2,830 billion was impaired in the FY2014 afs. The balance at the 2013 year-end R186 million. The debate was whether sufficient evidence existed at that date to justify the asset of R186 million. The Curator was still in the process of deliberating this within the bank.

(x) The numbers in the schedule might change as the Curator finalises his work.

(xi) These amounts were material, and although some of them were accounted for as current year events (without adjustment for prior year errors) for FY14, it was market sensitive information. Consequently this information should not be shared until such time as the bank released its results for FY14, expected to be during March 2015.

671. On 16 February 2015, Deloitte provided the Commission with its Response to the Curator's letter of 10 February 2015.[634] Deloitte made the following preliminary points:-

(i) Deloitte is the external auditor of the bank for FY2014 (ending on 30 September 2014). Its audit in relation to FY2014 is currently in progress. It would not be possible, and would be inappropriate, for Deloitte to express at this stage, a final view on the presentation of the 2014 financial statements. Accordingly, what is set out below in relation to the 2014 statements are preliminary views, subject to further audit work and revision.

(ii) The bank's management is still in the process of quantifying the effect of these accounting issues and determining the "split" between 2012, 2013 and 2014 financial years. Only after management has finished its quantification, will Deloitte audit the quantification and "split". Deloitte cannot therefore express a view on the quantification or "split" of the matters in the Curator's letter, but only on the principles involved.

(iii) Mr Sihlalo Jordan was the audit partner in charge of the bank's audit from 2009 to 2013. With effect from 27 August 2014, Mr Lito Nunes was appointed as the Deloitte partner in charge of the audit of the 2014 afs. The new audit team must apply its

[634] E(22)1

mind independently to various issues and circumstances which are vastly different from those of previous audits, for example:-

(a) The previous audits (particularly in 2012 and 2013) were carried out in circumstances where management and the audit committee were generally resistant to changes in accounting treatment or policy which would result in higher impairments. Obviously, the old management had an incentive to resist impairments and adopted more aggressive practices in relation to provisioning for impairments (in then current years) as they would affect profitability negatively.

(b) The current audit is being carried out under circumstances where the new management, as led by the Curator, is tasked with making the "good bank" saleable. The new management therefore has an incentive to be as conservative as possibly allowed by accounting standards in relation to impairments; and, in particular, to apply the same conservative treatment with retrospective effect in order to achieve consistency across the relevant financial years.

(c) Because the Curator and new management not only have the incentive to "clean out" the books, but also the luxury of time to do so thoroughly, the new management has built entirely new and refined credit impairment models. That, and the significantly longer time allowed for the finalisation of the annual financial statements, have enabled the new management to apply more intense dedicated scrutiny to all aspects relating to impairments than would be the case where an entity is subject to the normal reporting deadlines flowing from listing on a securities exchange.

(iv) It has been known publically that the bank would change certain of its accounting policies and treatment since August 2014: see the SENS announcement of 6 August 2014[635] and the SENS announcement of 23 December 2014.[636]

(v) In relation to certain of its accounting issues highlighted by the Curator, in particular those relating to the impairment point (the issues 1(a)-1(d) and the "gap" (issue 1(g)), management's subjective judgment plays a large role. The bank's impairment policies are governed by IAS39. IAS39 is notoriously complex and difficult to apply. For this reason, financial institutions around the world and in South Africa have adopted differing impairment points and accounting treatments in relation to impairment. These vary from the aggressive end of the spectrum (where the bank found itself in 2012 and 2013) to the conservative (where the bank finds itself now).

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[635] E(22)1
[636] E(22)25

(vi) Partly because of the interpretative leeway allowed by IAS39 , the Registrar issued a directive on 1 December 2014 to mandate greater consistency amongst South African banks for purposes of the calculation of regulatory capital requirements.[637]

(vii) It is fundamentally management's choice whether to be "aggressive" or "conservative" in relation to impairments; the function of the external auditor is to opine on whether the eventual result of the impairment exercise is within an acceptable range. As Deloitte did not and could not qualify the accounts drawn by the old management on the basis that it would have preferred a more conservative treatment, Deloitte would not wish now to qualify the accounts drawn by the new management on the basis that its treatment of impairments is now far more conservative.

672. In light of the above, the views of the previous Deloitte audit team in relation to judgements made in the 2012 and 2013 financial years remain unaffected by the proposals set out in the Curator's letter. At this stage, the current Deloitte audit team does not in general – and subject to qualifications as set out below – disagree with many of the principles set out in the Curator's letter:-

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[637] E(22)26

(i) *Issues 1(a) to 1(d): moving the impairment point:*

(a) The Curator proposed to move the impairment from CD4 to CD0. During the ongoing audit of the 2014 afs, current management presented evidence to Deloitte suggesting that the probability of default (PD) of loans which are in the CD0, CD1, CD2 and CD3 "buckets" is relatively high, and has been so during the preceding financing years. The current Deloitte audit team considers that the Curator's view that a relatively high PD constitutes such an actual loss event may eventually be justified. The current Deloitte team does not at this stage disagree with the Curator's classification of issues 1(a), 1(b) and 1(d) as giving rise to prior period restatements.

(b) Issue 1(c) (PD migration 90.60.30 days) is more complex, because there is a cogent argument that this in reality concerns a choice of accounting convention. For this reason, the current Deloitte team considers there to be an equally compelling argument that issue 1(c) could be disclosed as a change in estimate, rather than a prior period restatement.

(c) Deloitte is unable to express a view on the quantification or "split" in relation to these issues.

(ii) *Issues 1(e) and 1(f): changes in modelling methodology*

The current Deloitte team agrees with the classification of these changes as changes in accounting estimates. Deloitte is unable to express a view on quantification in relation to these issues.

(iii) *Issue 1(g): the "gap"*

The current Deloitte audit team considers that, based on the evidence presented to them during the 2014 audit, and considering cumulatively the bank's collection experience in FY2013, the fact that when back-tested in 2014 the bank's credit impairment model in 2013 was shown to have over-predicted cash collections and the general economic circumstances, a residual "gap" ought not to have been permitted. For these reasons, the current Deloitte team audit team does not disagree with the Curator's classification issue of 1(g) as giving rise to a restatement.

(iv) *Issue 1(h): double-counting of insurance proceeds*

The current Deloitte audit ream cannot express any view as yet on the quantification of the "double-counting" but agrees in principle that is gives rise to a prior restatement.

(v) *Issue 1(i): accounting for premium in LGD calculation*

In the view of the current Deloitte audit team, there are three technically permissible ways to calculate the LGD in relation to this issue under IAS39. At the risk of oversimplification, they may be stated as follows:

(a) including the expected premium outflows and also the expected insurance proceeds derived from it;

(b) exclude the expected premium outflows and also the expected insurance proceeds derived from it; and

(c) exclude the expected premium outflows but include the expected insurance proceeds derived from it.

The Curator decided to adopt the second of the abovementioned option. Both the technical bases for this decision as well as the quantification of its impact are still under discussion in the audit. Deloitte therefore cannot state that it agrees (at this stage) with the Curator's assessment that "if material", this should be disclosed as a prior period restatement.

(vi) *Issue 2: impairment of loans to Ellerines*

During the 2014 financial year, Ellerines was put into business rescue. As a result, the outstanding balance of the loan from the bank to Ellerines at the date of business rescue ie August 2014 (R1,423 billion – unaudited) was fully impaired. The real issue is whether the outstanding balances as at 30 September 2013 (ie R529 million) and 30 September 2012 (ie R461 million) ought to have been impaired as at those dates. The current

Deloitte audit team is in the process of reviewing the 2013 working papers in relation to the turnaround strategy for Ellerines. It cannot currently express a view in regard to (old) management's decision at the time not to impair the R529 million loan to Ellerines as at 30 September 2013.

(vii) *Issue 3: impairment of deferred tax assessment*

During FY2013 , the bank made a loss for the first time in its current incarnation. This gave rise to a deferred tax asset (as at 30 September 2013) of R186 million. Because of further losses during FY2014, the deferred tax asset grew to R2,830 billion (unaudited) as at 30 September 2014. The Curator's letter indicates that the deferred tax asset will be impaired in the 2014 afs. This indicates a judgment that the bank is unlikely to utilise this asset in the future through making taxable profits. Given the current condition of the bank, Deloitte cannot disagree with this assessment. The real issue is whether the reflection of a deferred tax asset in FY2013 (of R186 million) was justified. The current Deloitte audit team is not aware of any cogent reason why the deferred tax asset of R186 million as at 30 September 2013 ought to have been impaired (or more correctly, not reflected, as this was the first time the bank made a loss). It follows that the current Deloitte audit team does not, at the moment, consider that issue 3 gives rise to a prior period restatement.

CHAPTER 21: s45 OF THE COMPANIES ACT

673. In terms of s45(2) of the Companies Act, a board may authorise a company to provide direct or indirect financial assistance to a related or inter-related company or corporation. "Financial Assistance" includes lending money, guaranteeing a loan or other obligation, and securing any debt or obligation (s45(1)(a). The board may not authorise any financial assistance unless the board is satisfied that:

(i) immediately after providing the financial assistance, the company would satisfy the solvency and liquidity test; and

(ii) the terms under which the financial assistance is proposed to be given are fair and reasonable to the company (s45(3)(b)).

674. In terms of s4(1), for any purpose under the Companies Act, a company satisfies the solvency and liquidity test at a particular time if, considering all reasonably foreseeable financial circumstances of the company at that time:

(i) the assets of the company, as fairly valued, equal or exceed the liabilities of the company, as fairly valued; and

(ii) it appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of 12 months after the date on which the test is considered.

675. On 20 June 2014 the board of the bank passed a resolution that the bank would be entitled to make a facility available to EHL ("**the EHL Facility**") in an amount not exceeding R1,4 billion.[638] One of the terms of the EHL Facility was that the EHL Facility would be immediately repayable on the earlier of any demand made after 30 June 2015 or on the disposal of EHL by Abil. On 29 June 2014 the board of the bank passed a similar resolution except that the amount of the EHL Facility was not to exceed R1,6 billion.[639]

676. The making available of the EHL Facility in terms of the resolutions of 20 and 29 June 2014 was the provision of financial assistance to a related or inter-related company in terms of s45(2) read with s45(1)(a) of the Companies Act.

677. Accordingly, the board was not entitled to authorise the EHL facility unless it was satisfied that:

(i) immediately after authorising the EHL Facility the bank would satisfy the solvency and liquidity test, namely, that:

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638 AB(50)92
639 AB(50)107

(a) the assets of the bank, as fairly valued, equalled or exceeded, the liabilities of the bank, as fairly valued; *and*

(b) it appeared that the bank would be able to pay its debts as they become due in the ordinary course of business for a period of 12 months after 26and 29 June 2014; *and*

(ii) the terms under which the EHL Facility were granted were fair and reasonable to the bank.

Did it appear that the bank would be able to pay its debts as they become due in the ordinary course of business for a period of 12 months after 26 and 29 June 2014?

678. Mr Nalliah, in response to questions which were put to him by the Commission,[640] stated:

(i) Various scenarios were used in preparing cash flow forecasts. The scenarios had regard to the historic roll rates of meeting deposits and the board's expectations on new funding going forward having regard to the recovery strategy for the bank. There was no indication to the board at that stage (late June 2014) that there would be no funding or zero rollover of maturing liabilities, as it became evident on 7 August 2014, as maturing deposits were still being reinvested partially and some

640 E(19)1

new funding was still being received as is evident on pages 14 and 15 of the ALCO pack (E(14.3)218-219).[641]

(ii) All maturities of listed bonds were taken into account with no assumptions made for any maturities of such bonds being rolled to a new future maturity date. All money market deposits and bilateral maturities were also taken into account, some with certain assumptions on roll over of maturing deposits.[642]

679. In the supporting documentation which was attached to the directors' resolution of 20 June 2014, it was stated:

"After applying an extreme liquidity stress scenario, including management intervention with respect to sales pathways, the cash balance is expected not to drop below R1bn during the 12 month period after any payments that may be made in terms of the guarantee resolution; African Bank should have access to funding in the open market, which it has historically drawn on regularly and to a large degree has been discounted from this particular stress scenario."[643]

680. Mr Nalliah in answer to the Commission's questions stated:

"The reference to extreme stress is a significantly reduced roll over rate of maturing deposits, little to no new funding, no issue of new listed bonds, etc. The extreme stress scenario that was performed had

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641 E(19)30-31
642 E(19)32
643 AB(51)194

reduced the forecast roll rates of maturing deposits down to 12% in September 2014 before increasing to 30% per month thereafter (See annexure 3 tab 1). In addition, the management intervention related to sales being reduced each month to a low of zero in January 2015 before increasing once again. New funding was assumed to be a nominal R200 million per month with the issue of new listed bonds in September 2014, February 2015 and March 2015 by which time it was expected that confidence would have returned following the execution of the planned capital raise.

A further extreme (unlikely) situation was also performed which would have resulted in sales of new loans, roll over of maturing deposits and new funding would all drop to zero from July 2014, but the cash balance would even under that scenario remain positive for 12 months into the future. See annexure 3 tab 2."[644]

681. Mr Kirkinis in answer to the Commission's questions stated:

"As set out in paragraph 9.1 above, the solvency and liquidity tests were performed on a thirteen-month forward projection of the Bank's balance sheet. The cash stress tests were additional supporting information to inform the Board's decisions. The Board did take into account the future maturities of bonds and future funding plans, and therefore was of the

644 E(19)39

view that immediately after providing the financial assistance contemplated in the resolutions of 20 and 29 June 2014, the Bank could continue to pay its debts in the ordinary course of business for the ensuing twelve months.

The expected scenario performed in early July 2014, termed the base case scenario, of the cash stress test is contained in annexure 44, as described in paragraphs 9.2 and 9.3 above. It reflects a cash balance at the end of May 2015 of R3,4 billion – significantly above the R1 billion threshold – and after taking into account the Bank's forward funding plans. This scenario assumed roll rates increasing from levels of 20% to 30%, to levels of 40% and 60% from October 2014 through to May 2015. These were detailed bottom-up calculations based on the maturities of deposits by different institutional investors and the Treasury's best estimate of the future based on the assumptions that were considered to be the most likely, given the known and the reasonably foreseeable financial circumstances.

The base case scenario contained the new funding initiatives in the local and the international markets and was based on discussions that the Treasurer had with our funding advisors. I fully expected the Bank's roll rates to improve from those levels to our previous historic levels of 80% or more through the latter part of 2015 as confidence returned on the back of improving financial results, as set out in paragraph 5.32.6 of my statement, and based on our strategic initiatives gaining momentum. Therefore, I was of the view that immediately after providing the financial assistance contemplated in the resolutions of 20 and 29 June 2014, the Bank could continue to pay its debts in the ordinary course of business for the ensuing twelve months."[645]

"In assessing the financial position of EHL, its balance sheet was evaluated as well as its group structure. As in the Banking Unit, the most profitable element of the EHL group was the insurance companies, which were wholly owned by EHL. Ellerines Furnishers, the operating subsidiary, was the entity that incurred the losses, hence the subordination by EHL of its loan to Ellerines Furnishers. The cogency of the EHL board-approved turn-around plan was assessed, as well as the other strategic initiatives underway."[646]

682. Mr Nalliah, in his Submissions,[647] highlighted the following:- The factors mentioned in the Draft Report as to why the board ought not to have been satisfied that the bank would be able to pay its debts as and when they became due in the next 12 months, completely failed to assess or even take issue with, the extreme liquidity stress scenario testing in the Draft Report. Those tests yielded a result on the worst case scenarios

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[645] E(19)90-91
[646] E(19)85
[647] E(2044). See, too, Mr Kirkinis' Submisions E(20)99

(with extremely pessimistic outcomes plotted) that showed a meeting of the solvency and liquidity requirements, which would therefore mean that s45 was satisfied despite the factors listed in the Draft Report.

683. In his Submissions[648] Mr Kirkinis stated that no weight had been given in the Draft Report to the fact that other banks' loans to Ellerines were unsecured and amounted to R550 million. The other banks only asked for guarantees at a very late stage on 20 June 2014.

684. The immediate past to the resolutions of 20 and 29 June 2014 was the following:

(i) On 2 May 2014 Abil and the bank issued a trading statement on SENS for the six months to 31 March 2014.[649] Shareholders of Abil were advised that:

(a) Abil expected a headline loss of between R3,1 billion and R3,3 billion relative to the R604 million restated headline earnings for the equivalent six months to 31 March 2013;

(b) the headline loss per share was expected to be between 239 cents and 254 cents relative to the comparable restated headline earnings of 62,3 cents per share;

[648] E(20)101
[649] SENS(3)1213; SARB(1)380

(c) the basic loss was expected to be between R4,3 billion and R4,5 billion in relation to the R602 million restated basic earnings for the comparative period;

(d) the basic loss per share was expected to be between 331 cents and 347 cents per share compared to the restated basic earnings of 62,1 cents per share for the comparative period;

(e) the banking unit was expected to show a headline loss of between R1,9 billion and R2 billion due to an increase in specific provisions of about R600 million due to the following factors:

- NPL emergence in business written pre-July 2013 being at higher than anticipated levels: the total NPL formation was about R6 billion, which was about R600 million more than the level anticipated;
- an increase in specific coverage on NPLs of over 1% from September 2013 to 31 March 2014 due to seasonal factors that impacted collections and a continued challenging collections environment;
- a decision to significantly increase the general provisions for credit impairment relating to the PLs by about R2,5 billion;

(f) Ellerines was expected to make a headline loss of between R1,2 billion and R1,3 billion.

(ii) In Abil's capital and liquidity plan dated 4 May 2014,[650] it was stated that Abil and the bank had produced disappointing financial results at interim in March 2013, final in September 2013 and interim March 2014;

(iii) On 6 May 2014 a meeting was held between the Registrar, the BSD, and Deloitte.[651] Deloitte stated, inter alia, that an item of concern, particularly around the time of the finalisation of the September 2014 year-end audit, would be the assessment of the bank's ability to continue as a going concern.

(iv) At a Group Risk Committee meeting held on 8 May 2014[652] Mr Raubenheimer presented the impairment provisions as at 31 March 2014, which included the following:

(a) loans written in 2013 indicated a better risk profile than loans written in 2012;

(b) roll rates were deteriorating, thereby contributing to persistent NPL migrations;

(c) the maximum loan term had been reduced from 84 months to 60 months;

(d) while gross advances had grown by 4%, NPLs as a percentage of gross advances had grown by 13%;

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[650] SARB(1)382
[651] SARB(1)409
[652] AB(4)248

(e) the new specific impairment model increased the provision requirements by R296 million;

(f) impairments as at 31 March 2014 reflected a general ledger with an amount of R315 million in excess of the model requirement.

(v) At a Group Audit Committee meeting on 8 May 2014[653] Mr Nalliah expressed management's disappointment in the results for the six months ended 31 March 2014 with the major impact being the credit impairment charge: a significant improvement in collections was required to reduce the charge in the short term. Mr Mahomed said that the headline loss for EHL of R1,186 billion was R1,074 billion worse than the forecast.

(vi) On 14 May 2014 Mr Kirkinis (Abil) wrote a letter to the Registrar requesting a temporary lowering of the minimum Pillar 2b[654] add on for Abil and the bank to 10,5% from the current level of 15%.[655] His motivation included the assertion that the financial performance of Abil and the bank for the six months ended 31 March 2014 had been extremely disappointing, having been exacerbated by the performance of EHL, which together with an increase in the credit impairment provisions of R2,5 billion, had resulted in the capital adequacy ratios being reduced at both

653 AB(6)284
654 A capital requirement
655 SARB(1)414; SARB(4)531

Abil and the bank. The Registrar acceded to the request in a letter dated 15 May 2014 on certain conditions.[656]

(vii) On 19 May 2014 Abil and the bank published their unaudited interim results for the six months ended 31 March 2014.[657] Financial features included the following:

(a) headline loss of R3,1 billion;

(b) HEPS[658] loss of 240,7 cents;

(c) basic loss of R4,4 billion;

(d) return on equity a negative 54,6%.

(viii) At an ALCO meeting held on 27 May 2014[659] it was recorded that it was anticipated that Ellerines' total facility with the bank of R1,4 billion would be exceeded on 8 June 2014, and that using the current cash projections, the total facility would need to increase to R2 billion by September 2014.

(ix) On 30 May 2014 Abil and the bank announced on SENS that Moody's had downgraded the bank's local and global credit ratings by one notch.[660]

(x) On 6 June 2014 the Registrar requested Abil to dispose of EHL.[661]

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656 SARB(1)430; SARB(4)553
657 SARB(1)432; SENS(3)1224
658 Headline earnings per share
659 AB(13)95
660 SENS(3)1255; SARB(1)433
661 SARB(1)434

(xi) On 10 June 2014 Mr van Velze, Head of Investments, Stanlib, wrote a letter to Mr Mogase, the chairman of the bank.[662] He stated that urgent steps were needed to address the deterioration of the bank's financial position and wealth destruction to shareholders. This entailed, but was not limited to, adjusting the business model back toward more manageable loan sizes (Rand value) of shorter duration, at commensurately higher yield to cover for expected bad debts and to deliver an appropriate return on capital.

685. It should not have appeared to the board of the bank on 20 and 29 June 2014 that the bank would be able to pay its debts as they became due in the ordinary course of business for a period of 12 months after June 2014:

(i) The board relied on "historic roll rates"; "the board's expectations on new funding going forward"; and the bank "should have access to funding in the open market"; assumptions of roll rates improving from 20% to 60%; "the cogency of the EHL board – approved turn-around plan", and so on.

(ii) The assumptions made by the board: on the future performance of the bank and Ellerines; on future funding on the

[662] AB(51)145

open market; on improved roll rates; and so on, were unreasonably and unrealistically optimistic. The assumptions ignored performance of Abil, the bank and Ellerines since early 2013; the drop off in roll rates; and the immediate past since 2 May 2014, in particular the following:

(a) in the trading statement of 2 May 2014 it was disclosed that:

- Abil expected a headline loss of between R3,1 and R3,3 billion;
- the banking unit was expected to show a headline loss of between R1,9 billion and R2 billion;
- Ellerines was expected to make a headline loss of between R1,2 billion and R1 billion.

(b) On 6 May 2014, at a meeting between the Registrar, the BSD and Deloitte, Deloitte expressed a concern, particularly around the time of the finalisation of the September 2014 audit about the bank's ability to continue as a going concern.

(c) On 14 May 2014 Mr Kirkinis requested a temporary lowering of the capital requirement of the bank.

(d) In the interim results of Abil and the bank published on 19 May 2014 a headline loss of R3,1 billion and a basic loss of R4,4 billion were disclosed.

(e) The other banks which had previously advanced monies to Ellerines required security from Abil.

(f) By late June 2014 the funders and the market had lost confidence in the bank.

(iii) It was unreasonable for the board to have relied on the extreme liquidity stress scenario testing as the stress scenario testing provided for zero sales over 11 months in the relevant 12 month period. If the bank was not providing loans and was therefore not conducting the business of a bank it cannot be said that the bank would be able to pay its debts as and when they arose in the ensuring 12 month period *in the ordinary course of business*.

(iv) At the very time that the other banks asked for guarantees in late June 2014 the board of the bank made the unsecured loans to EHL.

Were the terms under which the EHL Facility granted fair and reasonable to the bank?

686. One of the terms of the EHL Facility was that the loans advanced by the bank in terms of that facility would not be secured. That term was not fair and reasonable to the bank as there was no reasonable prospect of the bank being repaid the loans.

CHAPTER 22 : REPORT IN TERMS OF THE LETTER OF APPOINTMENT

Is it in the interests of the depositors or other creditors of the bank that it remains under curatorship?

687. Yes.

Is it in the interests of depositors or other creditors of the bank that the Registrar, in terms of s68(1)(a) of the Banks Act, applies to a competent court for the winding up of the bank?

688. No.

Does it appear that any business of the bank was conducted recklessly or negligently or with the intent to defraud depositors or other creditors of the bank or any other person, or for any other fraudulent purpose, in particular whether the business of the bank involved questionable management practices or material non-disclosure?

689. There was no evidence that the business of the bank was conducted with the intent to defraud depositors or other creditors of the bank or any other person or for any other fraudulent purpose.

690. Mr Kirkinis in his Submissions[663] submitted that:

(i) the word "questionable" in the phrase "questionable management practices" means "doubtful as regards truth or quality … not clearly in accordance with honesty, honour or wisdom" and the phrase "questionable financial deals" as meaning "likely to be dishonourable or morally suspect";

(ii) the management practices of the bank were not "questionable" given the ordinary meaning of that word. Those submissions are accepted.

691. The business of the bank was conducted negligently in the following respects:-

(i) the retention of Mr Fourie as an executive director of the bank after he had been appointed CEO of Ellerines in early 2008;

(ii) the appointment of Mr Sokutu as

- executive director of the bank and Abil;
- MD of Retail Lending;
- Chief Risk Officer of the bank;

(iii) from the time that the bank began providing financial assistance to Ellerines, the bank board and the Abil board were conflicted;

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[663] E(20)87

(iv) by not making prudent, appropriate provisions from time to time;

(v) in not properly managing reasonably foreseeable risks such as a downturn in the economy, increased competition and labour unrest;

(vi) by aggressively growing the book;

(vii) by allowing themselves to be dominated by Mr Kirkinis.

692. The business of the bank was conducted recklessly in making loans to Ellerines in aggregate R1,4 billion:

(i) without security;

(ii) when there was no reasonable prospect of the loans being repaid.

693. Abil and the bank 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.

Who was a party to the conduct of the business of the bank or Ellerines in the manner described above?

694. The boards of Abil or the bank, generally, were a party to conduct described in the findings that:

(i) the directors of the bank acted in breach of their fiduciary and other duties to the bank (s615);

(ii) the business of the bank was conducted negligently (s689);

(iii) the business of the bank was conducted recklessly in making loans to Ellerines in aggregate of R1,4 billion (s690);

(iv) Abil and the bank acted negligently (s691);

(v) the board of the bank acted in breach of s45 of the Companies act (s683).

695. In expressing that opinion, the Commission does not make a finding that all the board members were responsible – equally or otherwise – for such conduct. The Commission did not have the time nor the capacity to investigate each board member's individual conduct in the period 2007 to 2014 in order to ascribe individual responsibility. But it must be borne in mind that in terms of s66 of the Companies Act, the business and affairs of the bank had to be managed by or under the direction of its board, which had the authority to exercise the powers and perform any of the functions of the bank.