Capitec Bank Limited: The Viceroy reports

Presentation to Parliament
May 2018

South African Reserve Bank
Prudential Authority

Agenda

1. Overview and background

2. Viceroy reports' allegations and management responses

3. SARB assessment

South African Reserve Bank
Prudential Authority

Overview and background

Capitec Bank Holdings Limited

1999/025903/06

Registered bank controlling company incorporated in RSA and listed on the JSE bank sector

100%	100%	100%	100%	19.43%	33.33%
Capitec Bank Limited 1980/003695/06 Incorporated in RSA Retail bank	**Capitec Properties Proprietary Limited** 1998/007658/07 Incorporated in RSA Property holding company	**Keynes Rational Corporate Services Proprietary Limited** 1999/0014817/07 Incorporated in RSA Dormant	**Keymatrix Proprietary Limited** 1999/010617/07 Incorporated in RSA Dormant	**Creamfinance** HE 335345 Incorporated in Cyprus	**Praelexis Proprietary Limited** 2012/149960/07 Incorporated in RSA

GlobalOne
Money Management

transact
Main transaction/savings account

save
4 savings plans defined by you

insure
Credit insurance
Capitec funeral plan (to be launched in the 2019 financial year)

credit
Choose personalised credit plans

Products and business model

credit
- Personal loans
- Credit facility
- Credit card

save
- Transaction/savings account
- Flexible savings account
- Tax-free savings account
- Fixed-term savings account:
  - single deposit
  - multiple deposit

Key financial and strategic indicators

18%
headline earnings increase

3 858 cents
headline earnings per share

R19 billion
shareholders' funds

36%
cost-to-income ratio

81%
net transaction fee income to operating expense

1 470 cents
total dividend per share

27%
return on ordinary shareholders' equity

5.7%
arrears to gross loans and advances

5%
decrease in arrears

12.2%
provision for doubtful debts to gross loans and advances

Extract: Capitec Bank Holdings Limited Integrated Annual Report 2018

Viceroy reports' allegations & management responses (1)

Viceroy report: A wolf in sheep's clothing	
Viceroy allegation	**Management response**
Fabrication of new loans and collections	Incorrect calculations and assumptions made
Approves loans to delinquent customers in order to repay existing loans = reckless lending	• Rescheduling of loans and consolidated loans are based on prescribed criteria • Consolidated loans not granted for loans in arrears • Reckless lending allegations: makes no mention of Capitec's comprehensive responses in each of the court cases against Capitec
Overstatement of loan book	Writte-off policy; earliest of 90 days or more in arrears or legal hand-over which differs significantly from other credit providers
Outcome of reckless lending test case could trigger a multi-party litigation refund (class action)	Speculation of the highest nature and premature
Credit Facility = discontinued Multi-loan Facility (seen as reckless lending)	• Credit facility operations = credit card facility (except termination after 9 months of credit facility) • Credit facility; comprehensive credit assessment performed • Fees are within NCA requirements.
Capitec operations = its ill-fated predecessors, including African Bank	• Capitec; significant retail deposit book (unlike African Bank) = low reliance on wholesale funding • Capitec; far more conservative approach to providing credit than African Bank
Former employees comments: outright loan-shark operation, where fees are key.	Former employees can make false claims. Patently untrue that Capitec fired any employees 'for not deceiving borrowers'

Viceroy reports' allegations & management responses (2)

Viceroy report: A rolling loan gathers no loss	
Viceroy allegation	**Capitec correspondence**
Offers new larger loans to pay off secondary lender in order to cover the client's arrears and make themselves current	New clients are subject to a full credit assessment
Datasets of debt counselling firms; consumers were able to get new loans after paying down their arrears the day prior	Models distinguish between clients in arrears due to reasons outside their control, as apposed to behaviour reasons
Artificially generating "cures" and unsustainably increase its loan book [Well over half (70% - 80%) of Capitec consumers in debt counselling were issued new loans prior to repaying their existing loans]	• Viceroy confuses "period since paying up arrears" with "period in arrears" which is what the 2 months to cure, refers to
Amendment of the number of allowable loans per customer occurred after the 1st Viceroy report	• The number of loans does not affect the overall credit risk of the client • All existing loans are taken into consideration when performing a new credit assessment
Intentional abuse of the debit order system to ensure its debits take priority ahead of other lenders	No formal allegation against Capitec to confirm the assumption

Viceroy reports' allegations & management responses (3)

Viceroy report: Concerns to the Audit Committee	
Viceroy questions	**Capitec's Audit Committee response**
Are loans really trending towards the long-term?	• Yes. Viceroy's analysis is incorrect; effect of the credit card on the shorter end of the loan book not taken into account. • Credit cards are fundamentaly different in nature to a term loan.
Nature of internal consolidations	• Outcome of that full credit assessment process is either: ➢ consolidation loan (additional credit applied for), ➢ new separate loan, or ➢ no new loan granted
Decrease in bad debt provisioning vs increase in bad debts	• Bad debt written off: backward-looking • Bad debt provisioning: forward-looking • Viceroy ignores taking into account the significant increase in bad debts recovered.
Provisioning method changed	• Provisioning methodology has not changed whatsoever. ➢ CD1 = one instalment in arrears ➢ CD3 = three instalments in arrears
Deterioration in loan book quality	• The audit committee is comfortable with management's analysis of loan book quality. ➢ Bad debt recovery - The absolute value of bad debts recovered did indeed increase, supporting management's comments. ➢ Curing - Viceroy's analysis muddles 'flow' amounts with period-end balances. Improvement in balances falling into arrears as a proportion of the total balances that could fall into arrears took place.
Financial impact of IFRS 9	• IFRS 9 to be implemented for financial years commencing from 1 January 2018, meaning first year of adoption for Capitec is 2019 financial year. • First-half year results of the 2019 financial year will disclose more information on the impact of IFRS 9. • Direction: dr Retained earnings cr Provisions (i.e. increase)

SARB assessment

- Continued analysis being performed to monitor concerns raised.
- Viceroy appears to formulate a specific perspective based on selected information.