4. CHAPTER 4: LEGALITY OF THE ASSISTANCE TO BANKORP/ABSA

(First term of reference: to determine whether the S A Reserve Bank, in providing financial assistance to Bankorp, has contravened the provisions of the S A Reserve Bank Act, No 90 of 1989, or any other Act)

4.1. Enquiry into the lawfulness of the S A Reserve Bank/Bankorp/ABSA assistance agreements

4.1.1 Introduction

The essential facts are set out in Chapter 3. An examination of the legality of the S A Reserve Bank's assistance requires an analysis of these three sets of agreements, package A, package B and package C, respectively. The differences in the terms and counterparties of the three assistance packages imply that their legal status may differ. Therefore this chapter examines each package in turn.

4.1.2 The legal nature of the powers of the S A Reserve Bank

The key question that then arises concerns the legal nature of the transactions contained in the various sets of agreements. To answer this question, the legal status of the S A Reserve Bank and consequentially its powers to give assistance require examination.

The S A Reserve Bank was established in terms of section 9 of the Currency and Banking Act, No 31 of 1920. Subsequently the Bank was regulated in terms of the S A Reserve Bank Act, No 29 of 1944, which was replaced by the S A Reserve Bank Act, No 90 of 1989 ("the Act").

Section 2 of the Act provides that the Bank is a juristic person. Its powers are derived from statute and thus it has no residual powers derived from the common law. In short the S A Reserve Bank is a creature of statute (Malan, 1997: 307).

4.1.3 The powers of the S A Reserve Bank to act as lender of last resort

In order for any transaction to be lawful, the S A Reserve Bank must have been authorised by the Act to have concluded such a transaction. As a creature of statute, the Bank has only those powers which are vested in it in terms of the enabling legislation. In order for a transaction to which the Bank is a party to be lawful, the Bank must have been authorised by the legislation to have entered into the transaction. This section considers the powers of the S A Reserve Bank to make loans.

Section 10(1) of the Act empowers the Bank to grant loans or advances, provided that unsecured loans and advances may be granted only in the following cases:

- *an unsecured loan… to a company* [which has been formed with the object of making banknotes or coining coins, and with any object incidental thereto (section10(1)(b))] or, *with the approval of the Board, to any company in which the Bank has acquired shares…;*
- *…to an officer or employee of the Bank… .*

The section does not appear to place any restriction upon the rate of interest to be charged by the Bank in respect of a loan or advance. The only caveat to this submission would be that the imposition of a rate of interest at a nominal, low level was not in accordance with customary central banking practice in circumstances of lender of last resort. That is an issue which is examined elsewhere in this Report.

The second question raised in terms of this section concerns the nature of security for the loan. The S A Reserve Bank/Bankorp/ABSA transaction, clearly, did not fall within either of the exceptions of subparagraphs (i) or (ii) of section 10(1)(f) and it follows that, in order for the transaction to have been authorised lawfully by the provisions of section 10(1)(f), it must have required of Bankorp/ABSA that it furnish to the Bank proper and adequate security for the repayment of the loan.

Section 10(1)(f) allows the Bank to grant loans or advances against security, that is it may also grant loans or advances against the tender of, *inter alia,* government bonds as security for the repayment of the loan or advance. The subsection may well permit a loan where the proceeds thereof are employed to purchase the bonds, or other interest-bearing securities, which then constitute the required security for the loan or advance itself. However, that then raises the question as to the nature and purpose

of the transaction and whether it can fairly be classified as a loan. In short, if any of the agreements were of a simulated nature, then the question arises as to whether section 10(1)(f) is applicable.

While it is arguable that the first set of agreements (package A) fell within the scope of section 10(1)(f), in that the Bank imposed a condition of security and further that by 1990 no repayment had actually occurred under package A, the second set of agreements (package B) thereafter governed the entire arrangement. Therefore, it becomes essential to examine the legal basis of the second set of agreements (package B). In 1987 the first agreements (package A) had been amended to provide, *inter alia*, that the loan was to be repaid in five instalments beginning on 1 April 1990. By the time the second set of agreements was concluded, the entire legal arrangement was now governed by the second set.

When package B (and package C) are examined by way of an analysis of the relevant accounts of the Reserve Bank, it would appear that, save for R 400 million which was secured by the deposit with the Reserve Bank itself, the Reserve Bank funds were physically paid to Banbol and employed to purchase government bonds which were immediately ceded by Banbol to the Reserve Bank. At the termination of the applicable loans, set off would then take place such that the bonds held by the Reserve Bank as security would be employed as the means to repay the loans. When the substance of the transactions is examined, it is significant that no cash from the capital of these loans was available to the borrower. The borrower had no rights to employ the capital. Thus the only benefit which flowed to the borrower was the net interest passed on by the Reserve Bank to the borrower.

To the extent that package A stands to be examined, it is important to take account of the fact that these agreements were concluded prior to the application of the S A Reserve Bank Act of 1989. Therefore the question arises as to whether the powers under the S A Reserve Bank Act of 1944 were substantively different. In terms of section 8(1) of the Act of 1944 the Bank may, subject to the provisions of section 9©, grant loans and advances. It further states in section 9(e) that the Bank may not make unsecured loans and advances, except to the Government. The Act of 1944 thus empowered the Bank to grant loans and advances without limitation as to recipient with the exception of the Government, where the loan could be unsecured. Although the Act of 1989 did not make such a differentiation, there appears to be no difference between the two acts which would justify a different conclusion.

The second and third sets of agreements (package B and C) could be legally justified either in terms of section 10(1)(f) or in terms of section 10(1)(s) of the Act of 1989 if the packages are interpreted as loans.

4.1.4 Legal nature of a loan transaction

The question arises whether the agreements in packages A, B and C were in fact loans as purported. Briefly stated a loan is a contract whereby one person delivers some fungible thing to another person who is bound to return the former thing or one of the same kind or quality (Wille et. al., 1992: 576). Depending upon the terms of the contract, interest may be levied (Cactus Investments (Pty) Ltd v CIR 1999 (1) SA 315(SCA) at 319-320).

In essence, if the agreements in the packages A, B and C were to be classified as loans, they would have had to be classified as either a loan for consumption whereby the borrower consumes that which has been borrowed and returns a thing of the same kind or a loan for use whereby he uses the thing borrowed and then returns it at the end of the agreed period. See page 576 in *Wille's Principles of South Africa Law* (1992) and the cases cited.

The parties to the 1991 agreement (package B) refer to an *Assistance Agreement* and of the assistance as constituting a loan by the S A Reserve Bank to Bankorp. The agreement provides for interest accruing to Bankorp. Whilst the agreement might have been worded and constructed in such a way as to convey the impression that the capital amount of R 1 500 million which was advanced by the Bank to Bankorp constituted a loan as it is traditionally understood, on a proper construction of the agreement the transaction which it embodied cannot be said to have constituted a loan. Most important in this regard are the facts that no cash was available to Bankorp/ABSA pursuant to the provisions of these agreements save for the payments of the net interest over the period of the agreements. Further as set out above, repayment of the loans took place by the employment of set off, the bonds having been converted from security for the loans to the means of repayment of the loans.

As the written agreement provided, upon termination of the agreement, the capital amount of the loan was deemed to have been repaid by Bankorp/ABSA to the Bank.

In addition, in the event of the redemption value of the government bonds and investment with the Bank either falling short of or exceeding the capital amount of the loan, such disparity was, to all intents and purposes, to be ignored and the loan was to be treated as having been repaid in its exact amount.

The critical point was that the Reserve Bank then paid over all interest accruing from such bonds (less a charge of 1 per cent) to Bankorp/ABSA. When the transaction is examined as whole, the true nature of the transaction amounted to a donation or grant by the Reserve Bank to Bankorp/ABSA pursuant to the provisions of the agreement, that is, an amount of R 1 125 million. Significantly, in arbitration proceedings relating to whether the S A Reserve Bank's assistance to the Cape Investment Bank (CIB) amounted to a loan (the structure appears to have been similar to that employed in the Bankorp case), the Bank described the loan as a gift, a description which was accepted by the arbitrator, former Chief Justice PJ Rabie.

It is now necessary to establish whether the transactions as set out in the written agreements should be classified as simulated transactions.

The courts in a number of cases have classified a simulated transaction as one in which *the parties to a transaction endeavour to conceal its true character. They call it by a name, or give it a shape, intended not to express but to disguise its true nature.* As the court noted in CCE v Randles Brothers and Hudson Ltd 1941 AD 369 at 395, the parties to such a transaction have as their purpose the concealment of the true nature of the agreement. See also ERF 3183/1 Ladysmith (Pty) Ltd and another v CIR 1996 (3) SA 942 (A).

In the case of packages B and C, the Reserve Bank and Bankorp (and later ABSA) clearly concealed the fact that the monies which passed to Bankorp/ABSA from the Bank constituted a donation rather than a loan. This could not have been contemplated by the Legislature in enacting section 10 of the Act of 1989.

The counter argument is that section 10(1)(f) does not qualify the rate of interest that must be charged upon such loan. Hence a low rate of interest may well be permissible – a point made by the previous Governor of the S A Reserve Bank, Dr Stals, in his evidence to the enquiry in terms of section 417 of the Companies Act into the affairs of Tollgate Holdings Ltd.

Hence if a low rate of interest is permissible, can the same not be said about agreements structured to constitute a gratuitous disposition? The difficulty with the analogy (on the assumption that notional interest rates are permissible) is that if a transaction is, in substance, a donation of money, then it must be classified as such and not as a loan accompanied by a charge of a lower than market-related interest rate. In the view of the Panel, packages B and C amounted to a donation of money by the Reserve Bank; the determination of the quantum thereof depended upon the return on the bonds over the nominal rate of interest charged to Bankorp/ABSA.

4.1.5 S A Reserve Bank powers to make donations

Section 10(1)(s) does not specifically vest the Bank with the power to make donations. The only avenue by which the Bank might conceivably have been so authorised is in terms of the stipulation of section 10(1)(s) that the Bank may *perform such other functions of bankers and financial agents as central banks customarily may perform.*

Read in a restrictive manner, section 10(1)(s) does not extend to test on the basis of some comparator of conduct between central banks as lenders of last resort or lifeboat lenders whether the Bank's conduct was legal. The section deals only with functions of bankers and financial agents conducted by other central bankers and does not cover loans which fall to be governed in terms of section 10(1)(f). Interpreted thus, section 10(1)(s) fails to come to the assistance of the Bank and to render the donation of Bankorp either authorised or lawful. Even if effect is given to the true nature of the transaction, it remains both unauthorised and unlawful.

Assuming that section 10(1)(s) is interpreted to read out the words *bankers and financial agents*, then the test turns on an investigation as to the conduct of central banks in dealing with banks in distress during the relevant period. In his submission to the enquiry in terms of section 417 of the Companies Act into the affairs of Tollgate Holdings Ltd, Dr Stals justified the second set of agreements (package B) and, therefore, by implication the first set (package A) by reference to the practice of central banks as lenders of last resort. For the loans to Bankorp (particularly package B) to fall within the scope of section 10(1)(s), a court will have to be satisfied that the manner in which the assistance was given in the specific circumstances which pertained at the time of the conclusion of the various agreements, can be justified in terms of such international good practice.

To be so satisfied, a court will require convincing evidence of the existence and nature of such practice. As Corbett said in Golden Cape Fruits (Pty) Ltd v Fotoplate (Pty) Ltd 1973 (2) SA 642 ©:

… the evidence required to establish a trade usage must be clear, convincing and consistent. It must, moreover, amount to something more than mere opinion: instances of the usage having been acted upon should be provided in order to establish the fact of the existence of the usage. No rule can be laid down as to the number of witnesses required. … in the nature of things the Court would not readily act upon the evidence of a single witness, even if uncontradicted (at 647H).

For this reason, if the S A Reserve Bank's actions are to find justification in terms of section 10(1)(s), the nature of the evidence of how central banks, adopting good practice as it pertained at the time and would have acted in similar circumstances, should be examined. This issue is dealt with in Chapter 6 of this Report.

These agreements, particularly packages B and C which replaced package A, were not authorised by the express provisions of the Act, unless the evidence of comparative good practice by central banks is of sufficient weight to bring the transactions within the scope of section 10(1)(s). If not, the S A Reserve Bank acted *ultra vires* in entering into the agreements which then become unlawful and void *ab initio.* As Chapter 6 concludes that the S A Reserve Bank's assistance did not accord with good international practice, it is concluded that the assistance was *ultra vires*.

Whatever the standing of package B in terms of international practice, since package C was concluded with ABSA which was in a stronger financial position than that of Bankorp, it may be that the manner in which package C was structured would have found less favour with central banks committed to good central bank practice than would package B.

4.1.6 Delegation of powers within the S A Reserve Bank

Following on the conclusion that packages B and C were not authorised by the enabling legislation, the question never arises whether the powers of the Bank to conclude them were properly delegated by the Board to the Governors. No greater powers could have been delegated by the Board to the Governors than the Bank itself had. If the Bank was neither empowered nor authorised to conclude the agreements,

then no power to do so could have been delegated by the Board to the Governors. Any attempt on the part of the Bank to conclude the agreements would necessarily have been *ultra vires* and the agreements themselves would have been unlawful and void *ab initio.*

4.1.7 Conclusion

As the first set of agreements (package A) was structured on the basis of a low interest loan and its Act does not appear to preclude the Bank from charging interest at a rate lower than the market rate, the Panel cannot conclude that the S A Reserve Bank acted outside the scope of its powers in concluding the agreement.

Package B and C constituted simulated transactions which in law amount to donations of money. There is no legal basis by which the S A Reserve Bank could have entered into such agreements, save if the action can be brought under section 10(1)(s) of its Act. As Chapter 6 concludes that the S A Reserve Bank's assistance did not accord with good international practice in several respects, it is concluded that the assistance was *ultra vires*.

The consequence of an unlawful agreement is that it was rendered void *ab initio.* It must surely be the case that it was rendered void *ab initio,* and not merely voidable at the instance of either of the parties, because, where one of the parties to the agreement, in the first place, was not authorised to be such a party, the transaction could never have acquired a legal existence.

That being so, the beneficiaries of the assistance packages obtained benefits from the actions of the S A Reserve Bank to which, in law, they may never have been entitled. This raises the question of restitution which is covered in Chapter 7 of this Report.