9 CHAPTER 9: CONCLUSIONS

The principal objective of the assistance given to Bankorp by the SA Reserve Bank was to prevent Bankorp's problems causing a general crisis of the banking system. That is a normal objective of central banks and the Reserve Bank gave assistance to other banks with the same objective. It is noteworthy that, unlike three quarters of IMF member countries (including highly developed countries) in the past thirty years, South Africa actually experienced no major, system-threatening banking failures during the period.

However, although the decision to provide financial assistance to Bankorp was, for that reason, justified, the form and structure of Reserve Bank assistance to Bankorp over a decade from 1985 (including its continuation in the form of assistance to ABSA) was seriously flawed, when considered as a whole. It does not match present day standards for central bank assistance and it did not match the standards set by the contemporary practice of other comparable countries' central banks.

Most of the individual undesirable features of the assistance given to Bankorp were also found in the Reserve Bank's assistance to other banks, but their combined application to the extent seen in Bankorp is notable and an important flaw, successive packages of assistance spanning a long period, represents unusually favourable treatment for Bankorp and ABSA.

Central banks normally give assistance to banks to the extent that it is within their legal powers and consistent with their responsibilities for the soundness of the banking system. Such assistance is not automatically available and when it is given, the methods used to assist the bank are designed to meet clear objectives. Assistance may be given in three broad types of cases: solvent banks with liquidity problems; banks that risk insolvency but are able to be restored to a sound position; and banks which are fundamentally insolvent and require orderly liquidation or sale. However, a number of the principles involved were only clarified in the 1990s after the Bankorp decisions were taken.

The Reserve Bank's assistance to Bankorp was marked by a lack of clarity about which type of case was being addressed and a failure to adopt methods appropriate to either the actual or the supposed situation.

Bankorp in 1985 was a bank that had grown fast, partly by absorbing a number of weak banks. Its request for assistance in 1985 was a symptom of potential solvency problems and those underlying problems worsened during the course of the assistance. The Reserve Bank, however, gave assistance (package A) of a type that could at best address a pure liquidity problem and, even as such, did not meet the standards of best practice. Subsequently (package B), the assistance was of a type relevant for a bank facing a remediable solvency crisis, but for that purpose it did not match international good practice. Moreover under package B the Reserve Bank did not address the problem of a bank that was irremediably insolvent as Bankorp might have been. Package C was mainly a continuation of the assistance given in package B in new conditions when, as a result of being bought by ABSA, Bankorp did not represent a systemic risk due to liquidity or solvency.

Overall, the assistance was flawed by the following features of its form and structure:

1 The length of time for which assistance, in the form of successive packages, was given.

2 The willingness of the Reserve Bank to accept successive related requests for additional assistance

3 The continuing secrecy with which the assistance was covered even after the danger of systemic risk had passed, owing to the limiting provisions of section 33 of the S A Reserve Bank Act. However, the secrecy provisions of the S A Reserve Bank Act have been amended in 1997 to allow for some form of disclosure.

4 The use of a simulated transaction to disguise as a loan the Reserve Bank's assistance which was, in fact, a grant (donation).

5 The absence of measures to protect the interests of the Reserve Bank and thereby the taxpayers by the Reserve Bank securing a share of the equity of Bankorp in exchange for the capital contribution made as a grant.

6 The failure to give assistance with conditions that protected the banking system's depositors while penalising the shareholders and management of Bankorp. In fact, shareholders of Bankorp benefited from the assistance.

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

8 The failure, for half the duration of the assistance or longer, to monitor effectively the business of the beneficiary, Bankorp.

9 The failure to implement methods used successfully in other countries for alleviating banks' bad debt problems, such as creating a special institution to administer delinquent assets.

10 The involvement of the Minister of Finance with a potential conflict of interest. Since the then Minister, Mr B J du Plessis, was the brother of Mr A S du Plessis, a director of Sankorp, a subsidiary of the majority shareholder (Sanlam) of Bankorp, and indeed of Bankorp itself, the Minister should have recused himself in this matter.

In 1985, at the start of the first package of assistance, South Africa's banking system was suffering the shock of adjusting to international anti-apartheid sanctions, and Reserve Bank policy was conditioned by the government's "total strategy" against anti-apartheid forces. Although the problems experienced by Bankorp were not directly linked to those circumstances, the "total strategy" undoubtedly influenced the approach taken by the Governor and senior officers of the Reserve Bank in respect of the problems of Bankorp and other banks.

Moreover it is noteworthy that Reserve Bank assistance was initiated at a time when the Reserve Bank had no bank supervision department. Until 1987 responsibility for bank supervision lay with the Ministry of Finance and was recognised as ineffective. The Reserve Bank's knowledge of the circumstances of banks such as Bankorp would have come through the informal contacts that were, in those days, common sources of information for central bankers.

Under the S A Reserve Bank Act of 1989 the Reserve Bank was obliged to consult the Minister of Finance on certain matters. A meeting to seek the approval of the then Minister for the new assistance being offered to Bankorp was, in fact, held in 1990. That occasioned the above-mentioned flaw in the design of the assistance

packages, for the Minister should have recused himself in this matter owing to family relations.

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

The conclusion that the Reserve Bank acted *ultra vires* leads to a consideration of restitution, in which it is the view of the Panel that in principle restitution from the beneficiaries may be sought but that it is impractical to do so.

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

The details of these conclusions are summarised in the Report in relation to each of the terms of reference of the Panel. Those summaries are reproduced below:

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

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 agreement could never have acquired a legal existence.

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

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

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

- The quantum of the assistance.
- The extended period of the assistance with periodic renewals.
- Although shareholders were called upon to provide assistance in addition to the Reserve Bank, the shareholders survived intact to share in the future profits of the rescued bank.
- The assistance was continued when Bankorp was acquired by ABSA.

Another way of assessing the extent to which the assistance to Bankorp was consistent with the established policies and procedures of the Reserve Bank is to compare it with Dr Stals' eight principles highlighted at the enquiry into the affairs of Tollgate Holdings Ltd. Dr Stals' principles were, of course, enunciated some years after the first assistance to Bankorp was agreed. Nonetheless they purported to

represent the basis on which this assistance was given. It can be concluded that the assistance was in accordance with these principles to the extent that:

- failure of Bankorp could have caused system wide problems and contagion;
- the absence of deposit protection argued for intervention; and
- the existence of the assistance was kept confidential and thus a run on the bank and contagion effects on other banks were prevented.

However, the assistance was not fully consistent with these principles to the extent that:

- mismanagement was not corrected early enough or forcibly enough;
- the assistance protected the interests of shareholders as well as depositors;
- in packages B and C, the assistance did not take the form of a liquidity advance, but was in the form of solvency support;
- effective remedial action was not insisted upon for some years; and
- no effective exit for the S A Reserve Bank was provided for. Acquisition by ABSA was neither anticipated nor instigated by the Reserve Bank.

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

The review of internationally accepted principles of best practice leads to the following conclusions:

1 It is important to distinguish between the justification for a central bank intervening in respect of a distressed bank and the modalities of the intervention; between the validity of the ends and the means. In the case of Bankorp/ABSA the Panel finds that intervention with the objective of averting a systemic crisis of the banking sector was justified. However, by the standards of international best practice the methods were flawed. Whether providing liquidity support to Bankorp, as in the early stages of its intervention, or providing solvency support in the early 1990s, the S A Reserve Bank's methods did not conform with internationally accepted principles for dealing with distressed banks.

2 In so far as the assistance was designed as liquidity support:

- it was not short term; and

- it was not at a high interest rate;

and therefore did not meet international standards.

3 In so far as the assistance was designed as solvency support:

- The assistance was a grant for the direct benefit of shareholders that was disguised as a loan by means of a simulated transaction. The Panel has not found any reputable central bank using such techniques.
- Although it was a grant the Reserve Bank took no equity claim on future profits, as international best practice would require. As it turned out the assistance led to the continued operation of Bankorp, ultimately under the ownership of ABSA, and in the absence of such a claim all the benefits of the assistance accrued to shareholders.
- The Reserve Bank did not attempt to remove bad debts from Bankorp to a special institution charged with managing them separately, as was achieved elsewhere (for example by the publicly owned US Resolution Trust Corporation or by privately owned institutions — so-called “bad banks” — elsewhere).
- The Reserve Bank did not attempt to organise a merger with sound banking institutions, which would have been desirable under international principles; its takeover by ABSA was not prompted by the Reserve Bank.
- The assistance was provided over a period that was unusually long by international standards.
- The Reserve Bank did not require replacement of the managerial team of the distressed bank.

4 Looking at the whole period of liquidity support followed by solvency support, several overall features of the assistance methods were flawed by international standards:

- The total period of assistance was extremely long.
- The Reserve Bank accepted successive Bankorp requests for more assistance.
- Despite those successive requests the Reserve Bank did not adequately assess the risks pertaining to Bankorp.
- Similarly the Reserve Bank did not in a timely manner require Bankorp to reduce its balance sheet and did so only late in the process.

5 Dr Stals has argued that the Bankorp/ABSA assistance was normal international practice. The Panel concludes that its objective was, but its methods were deficient n

comparison with international best practice. Included in the defects the Panel has noted here, are two that warrant further comment in conclusion:

- A review of international experience before and after 1985, involving 104 cases of assistance to distressed banks and 23 countries, reveals no examples where solvency assistance has been given as a grant disguised as a loan by a simulated transaction. Although Dr Stals has argued that the Bank of Italy had such powers from 1974 in reality its power was different; a Ministerial Decree of 1974 empowers the Bank of Italy to give a grant in the form of a stream of net interest only in cases where an insolvent bank is being liquidated and the grant is to the bank acquiring the business of the failed bank and is, therefore, for the direct benefit of depositors (not, as in this case, the shareholders of a non- liquidated bank).
- The objective of all the international examples of bank assistance practice and principles reviewed here was to protect the banking system and its depositors. In the UK lifeboat committee there was clear recognition of the undesirability of protecting shareholders and that principle has been set out in central bankers' statements. In the Bankorp/ABSA case no such distinction is apparent. In fact the outcome of the assistance was to benefit shareholders, for the net asset value of Bankorp was raised by the assistance and the price they received when taken over by ABSA reflected that fully.

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

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

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

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

The Panel is of the view that ABSA paid for the continued assistance of Bankorp by the Reserve Bank and could not be regarded as beneficiaries of Reserve Bank assistance package. The fact that the calculated net asset value and the value of the Reserve Bank assistance package are equivalent, is coincidental. ABSA therefore paid fair value for Bankorp.

Due to the complex nature of the impact that the various packages might have had on the value of capital invested in Bankorp, it is difficult for the Panel to assess with utmost accuracy the quantum of the benefits derived by Bankorp shareholders. Evidence supports the conclusion that the major Bankorp shareholder was aware that it would have received no value or less value for its shareholding absent Reserve Bank assistance. Sanlam, as the major shareholder, was a major beneficiary of the Reserve Bank assistance package.

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

The Panel has concluded that the Reserve Bank's practices for dealing with banks in distress are much improved since the time of the Bankorp assistance packages and are now broadly in line with best practice elsewhere. It meets the tests, for example, set out by the Governor of the Bank of England in 1993, and, if followed consistently, should avoid the dangers encountered by many other countries with less robust approaches. The Panel sees no need, therefore for a new set of guidelines to govern practice in this area. Nonetheless, the Panel does consider that there continue to be improvements that need to be made to the overall architecture. Several countries have recognised the inefficiencies that can result from subjecting one financial group of companies or conglomerate to supervision by more than one agency. However, while the institutional arrangements need to reflect organisational changes, such as the growth of financial conglomerates within the financial sector, care needs to be taken before disturbing the present arrangements which work well. One reform that is now urgent, however, is the development of an effective and well-designed deposit insurance facility. The Panel recommends that this should be proceeded with now.

It will be important that there be greater transparency of assistance operations once the operational need for secrecy is past. In the Panel's view, the recent amendment to the S A Reserve Bank Act allows for this, and if measures to ensure intervention is fully recorded, it will make transparency possible. It is however recommended that section 33 of the S A Reserve Bank Act be amended further to allow for public disclosure when such disclosure is manifestly in the public interest. In the view of the Panel the best way in which such a provision could be drafted would be to allow the Governor, with the written consent of the Minister of Finance, to disclose any information referred to in section 33(1)(a) of the Act, when it is deemed to be in the public interest.

Finally the Panel recommends that the Reserve Bank should actively review the means by which central bank principles of bank supervision and assistance to distressed banks relate to South Africa's socio-economic priority of transformation.

To conclude, the Panel believes that this Report has brought to light all the material discoverable facts concerning Reserve Bank assistance to Bankorp/ABSA, and that public knowledge of them should end the uncertainty and misinterpretation that have been fuelled by the absence of previous thorough investigations in the public domain.