

3 CHAPTER 3: CHRONOLOGY OF EVENTS

3.1 Synopsis of the growth of and assistance to Bankorp

3.1.1 Introduction

In order to understand the genesis of the principal matter concerning the Panel — the S A Reserve Bank's assistance to the Bankorp Group between 1985 and 1995 — this chapter begins by outlining the development of Bankorp over the preceding years.

The Bankorp Group began life as Central Acceptances Limited in 1968, with Senbank as a subsidiary. Over the next 10 years the Group grew rapidly, acquiring Bank of Johannesburg, Federale Bank, Mercabank, Santam Bank, Sasbank and Trust Bank. Many of these banks had experienced operating difficulties while Trust Bank, the largest acquisition, had an aggressive lending policy, the effects of which had forced it to apply for and receive assistance from the S A Reserve Bank.

The Group's *Annual Report* for the year ending 30 June 1987 states that Bankorp had become the third-largest banking group in South Africa by 1986 as the result of organic growth. By 1986 the Group's subsidiaries included:

- Trust Bank, a commercial bank;
- Santambank, a general bank;
- Senbank, a merchant bank; and
- Mercabank, an investment and merchant bank.

In addition, Bankorp held a 50 per cent shareholding in Banbol (Pty) Ltd. This shareholding is of importance because Banbol was the company used since 1985 to channel to Bankorp the assistance of the S A Reserve Bank, the principal subject of this Report. Banbol was jointly owned by Bankorp and Boland Bank Limited and because both parties held a 50 per cent shareholding it was not necessary to consolidate the financial statements of Banbol into the accounts of either one of the shareholders in terms of the prevailing accounting practice at the time. Therefore, routing the SA Reserve Bank's assistance to Bankorp through Banbol was a measure contributing to the secrecy of the assistance.

After a change in management in 1990/91, the Group embarked on a restructuring aimed at focused business units within Bankorp. By 30 June 1991 its structure included:

- Trust Bank, a commercial bank;
- Senbank, a corporate and merchant bank;
- Bankfin, a specialist instalment finance bank; and
- Bankorp Treasury and International Banking, a specialised treasury and international banking service unit for the Group.

3.1.2 Bankorp's growth strategy

In the 1980s the Bankorp Group continued to expand rapidly. The mode of expansion changed from growth by acquisition to growth by an aggressive lending policy. This drive for asset growth resulted in a decline in the Group's asset quality and its eventual financial distress leading to the provision of assistance by the S A Reserve Bank described below.

Bankorp's strategy of asset growth has been elucidated in its *Annual Reports* on a number of occasions. Its report published in 1988 mentions that *the Bankorp group decided several years ago to increase its market share by means of organic growth in preference to take-overs and amalgamations. The balance sheet figures serve as proof of the success achieved in this regard. The group's total assets (including contingencies and repurchase agreements) increased by R 6 358 million ... an increase of 39,6 per cent for the year.* The report for 1989 states that *... having attained the critical mass ... to benefit from economies of scale ... the objective is to achieve superior returns on assets and shareholders' funds.* However, it continues *... earnings growth did not keep pace with asset growth ...*

Despite receiving S A Reserve Bank assistance, Bankorp grew its assets (excluding contingencies and repurchase agreements) in real terms by 7,41 per cent per annum between 1985 and 1990.

The strategy of superior returns did not materialise and in its *Annual Report* for the financial year ended 30 June 1990, Bankorp reported a loss of R 368,4 million, compared with a profit of R 131,6 million in the previous financial year.

By 1991 Bankorp was the smallest of the five major banking groups, but still substantially larger than the sixth largest banking group at the time (NBS Bank), which had assets amounting to R 8 171 million as at 31 December 1991. Bankorp's growth in assets relative to the total assets of the banking industry is highlighted in table 4.

Table 4: Total bank assets, R million

Year	CPI Index, 1986 = 100	Total industry as at 31 December +	Bankorp as at 30 June ex c and ra**	%	Bankorp as at 30 June inc c and ra*
1981	50,5	47 584	4 622,4	9,7	5 010,0
1982	57,9	55 614	6 172,1	11,1	6 721,1
1983	64,9	65 106	6 529,3	10,0	7 701,6
1984	72,5	80 337	8 200,1	10,2	10 744,1
1985	84,4	92 532	10 304,9	11,1	13 611,6
1986	100,0	116 575	10 947,8	9,4	14 436,4
1987	116,2	132 405	13 687,6	10,3	16 069,8
1988	130,9	170 443	19 274,8	11,3	22 427,6
1989	150,2	201 989	27 049,2	13,4	31 582,9
1990	171,9	240 171	30 007,4	12,5	34 785,8
1991	198,1	257 696	28 187,7	10,9	31 841,0
Average annual rate of increase					
1981 to 1985	13,70	18,09	22,19	-	28,39
1985 to 1990	15,29	21,02	23,83	-	26,49
1990 to 1991	15,24	7,30	(6,06)	-	(8,47)
Average annual real rate of increase					
1981 to 1985	-	3,86	7,47	-	12,92
1985 to 1990	-	4,97	7,41	-	4,64
1990 to 1991	-	(6,86)	(18,49)	-	(20,57)

+ including building societies

* c and ra: assets related to contingencies and repurchase agreements

** comparable with figure for total industry, including building societies

% Bankorp (ex c and ra) as percentage of industry

Sources: Bank Supervision Department, S A Reserve Bank

Research Department, S A Reserve Bank

Annual Reports, Bankorp Group (various years)

3.1.3 Concerns about Bankorp's asset growth

During the latter part of the 1980s the S A Reserve Bank voiced concern about the growth in credit extension by banks. Banks were urged to practise restraint in their financing of consumer goods and the provision of mortgage financing for luxury homes in particular.

The S A Reserve Bank addressed letters to Bankorp on at least two occasions in the late 1980s, voicing concerns about the rapid growth in its asset book. On 6 July 1989 the Governor (Dr Gerhard de Kock) wrote to the Chief Executive of Bankorp (Dr CJ van Wyk), conveying the Bank's displeasure about the excessive rate of increase in credit extension by Bankorp in recent months. This letter also mentioned that banks had been requested at meetings held on 9 March 1989 and 5 May 1989 to exercise restraint in their rates of credit extension. Bankorp was the only one of the five major banking groups at the time that did not adhere to the S A Reserve Bank's request for restraint. Bankorp was, therefore, requested in the letter to take immediate steps to curb credit extension. The letter concluded by saying that the co-operation of Bankorp is expected in the matter, particularly in view of the special assistance of the S A Reserve Bank to the Bankorp Group, without the S A Reserve Bank being compelled to penalise the Group for its excessive credit extension.

Moreover, after the appointment of a new Chairperson at Bankorp (Mr D Keys), the then Senior Deputy Governor, Dr A S Jacobs, wrote to Mr Keys on 13 November 1989, voicing concerns about the management of the banks within the Group, including contraventions of the exchange control regulations by Trust Bank; noting the bank's aggressive credit growth; the questionable quality of its credit; the expansion of its balance sheet; and its inability to comply with the requirements of the Banks Act since March 1989. Moreover, conditions at Trust Bank's London office had caused considerable embarrassment to the S A Reserve Bank with the Bank of England.

3.1.4 Bankorp's financial difficulties and the response of its management

Bankorp's strategy of asset growth coincided with a period of restrictive monetary policy from 1987, with concomitant rising interest rates and, for the first time in a number of years, sustained positive real interest rates. Moreover, the domestic

economy suffered a severe recession during the period 1990 to 1992 (three years of negative economic growth).

Borrowers of funds were not accustomed to paying a *real* price for funds and a number of households and businesses ran into financial difficulty and were unable to repay the lenders. The Bankorp Group in particular was affected negatively by the financial difficulties experienced by its customers. As a result of its strategy of asset growth, the Group inevitably ended up with assets of a more dubious nature and suffered financial setbacks as its customers defaulted on commitments. By 1990 it told the Reserve Bank that only about 52 per cent of its assets were profitable.

By that year the Bankorp Group reported that its strategy had been refocused from asset growth to one of containing such growth in favour of improving asset quality. Its *Annual Report* for the year ending 30 June 1991 states that ... *total assets, including assets relating to contingencies and reserves, decreased by 8,5 per cent to R 31 841 million ... this compares reasonably well with our target of 10 per cent which was set to improve the quality of the assets.*

3.1.5 S A Reserve Bank assistance to Bankorp

Since 1985 there have been a large number of transactions and agreements relating to assistance from the S A Reserve Bank to Bankorp and subsequently to ABSA, which acquired the Bankorp Group in 1992. These can be classified into three sequential assistance packages, referred to below as package A (1985 to 1990), package B (1990 to 1992) and package C (1992 to 1995).

It should be noted, however, that the assistance was advanced to Banbol, a subsidiary in which Bankorp held 50 per cent of the shares. Banbol, in turn, transferred the assistance to Bankorp on the same terms and conditions. This structure was used as it was not necessary for Bankorp at the time to consolidate the financial statements of Banbol. The secrecy of the assistance could, therefore, be protected.

3.1.5.1 Package A

In April 1985 Bankorp approached the S A Reserve Bank with a request to provide the bank with financial assistance of R 300 million in order to assist it in difficulties

encountered pursuant to certain bad investments and other non-performing assets which it had acquired with the takeover of Trust Bank in 1977 and Mercabank in 1984.

The first set of agreements (included in package A) commenced when the SA Reserve Bank, in a letter of 30 May 1985, granted assistance to Banbol (Pty) Ltd in the amount of R 200 million at an interest rate of 3 per cent per annum to assist Bankorp. Repayment of the loan had to commence as quickly as possible and be completed before 31 May 1990. A further condition was that Sanlam (at the time the ultimate majority shareholder in Bankorp) had to cede government bonds to the S A Reserve Bank as security for the loan.

On 18 April 1986 the S A Reserve Bank agreed to increase the financial aid previously granted to Banbol by a further sum of R 100 million to give further assistance to Bankorp (included in package A). The assistance was structured broadly on the same terms, conditions and interest rate as the assistance granted in 1985, again against security provided by Sanlam. It was agreed that the total sum of R 300 million would be repaid in three equal instalments of R 100 million per annum, payable from 1 July 1988 until the full amount of the assistance had been repaid on or before 31 May 1990.

During 1987, the Bankorp Group introduced a major rationalisation programme. To lend support to the programme, the S A Reserve Bank agreed to amend the terms and conditions for the loan and it became repayable in five equal annual instalments of R 60 million each, commencing on 1 April 1990. The other terms and conditions and the interest rate on the loan were not amended.

In November 1989 Sankorp (a 100 per cent subsidiary of Sanlam in which the latter consolidated its strategic investments) underwrote a rights issue of R 350 million by Bankorp, of which it subscribed R 229 million.

In March 1990 the S A Reserve Bank was informed that Bankorp was not in a financial position to commence repayments, and it was agreed that the date for the repayment of the first instalment on the loan would be extended from 1 April 1990 to 1 August 1990.

3.1.5.2 Package B

A further meeting was held on 1 August 1990 between the S A Reserve Bank, Bankorp and Bankorp's controlling shareholder, Sankorp. The S A Reserve Bank was represented by Dr CL Stals (Governor), Dr JA Lombard (Senior Deputy Governor), Dr BP Groenewald (Deputy Governor), Dr JH van Greuning (Registrar of Banks), and Mr SS Walters of the S A Reserve Bank as secretary. Bankorp and Sankorp were represented by Mr MH Daling (Chairperson of Sankorp), Mr PJ Liebenberg (Chief Executive of Bankorp), Mr HJ van der Merwe, Mr PJ Strydom and Mr AS du Plessis.

At the meeting it was explained that the financial position of Bankorp had deteriorated to the extent that the S A Reserve Bank was confronted with a situation where Bankorp no longer met the requirements of the Banks Act. Mr Liebenberg explained that:

- Bankorp had made no operating profit during the 1989/90 financial year;
- excessive asset growth during the year had led to a situation where only 52 per cent of total assets of some R 35 billion of the Bankorp Group was profitable;
- intangible assets were included in the balance sheet;
- Bankorp had been unable to resolve its historical financial problems; and
- provision would have to be made for the writing off of bad and doubtful debts to an estimated amount of R 1 billion.

Mr Liebenberg also mentioned that by placing R 1 billion worth of weak assets and doubtful debts in a risk portfolio, the balance of the asset portfolio could be expected to show a profit.

As a result of Bankorp's financial position, Bankorp and Sankorp requested the S A Reserve Bank to increase the existing loan of R 300 million by a further amount of R 750 million.

On 3 August 1990 an agreement was entered into between the parties in terms of which the S A Reserve Bank provided a package of aid to Bankorp (again via Banbol). The material terms of the agreement which was entered into included:

- The advance of R 300 million in place at the time remained in existence.

- A further amount of R 700 million would be provided and Bankorp had to invest the total amount of R 1 billion with the S A Reserve Bank in cash (to the extent of R 400 million) and in government bonds (to the extent of R 600 million) for a period of five years at a yield of 16 per cent on both elements. These investments served as collateral for the loan.
- As the loan of R 1 billion incurred an interest charge of 1 per cent, a margin of 15 per cent accrued to Bankorp, which would be for its benefit and against which the bad debts in question would be written off over the five-year period.
- Sankorp underwrote a rights issue of R 526 million by Bankorp, of which it subscribed R 419 million.
- Bankorp's cash dividends were limited to minority shareholders for as long as the facility continued. Sankorp was required to invest its share of the dividends in new capital in Bankorp.

In addition, the agreement provided that certain conditions would be applied in the administration of Bankorp. These included the closing of 70 of its branches by 31 December 1990, the reduction of its staff by approximately 3 000 before 31 December 1990, a reduction in total assets by R 5 billion by 30 June 1991, and periodic reporting to the S A Reserve Bank on the extent of bad and doubtful debts. The Managing Director of Bankorp was required to hold quarterly review discussions with the Bank Supervision Department of the S A Reserve Bank.

On 5 September 1991 Mr Liebenberg, acting on behalf of Bankorp, and Dr Stals, acting on behalf of the S A Reserve Bank, and Mr Daling, acting on behalf of Sankorp, entered into an agreement which amended the conditions of the 1990 agreement discussed above. The reason for this amendment was that it transpired that Bankorp's bad and doubtful debts had then amounted to R 1 635 million.

In terms of the amended agreement a further amount of R 500 million (bringing the total advance to R 1 500 million) was to be provided and advanced by the S A Reserve Bank to Bankorp (via Banbol). This amount would be utilised to buy additional government bonds in the amount of R 500 million. In terms of this further agreement Bankorp was to cede all its rights and titles in these additional bonds as security for the further capital amount loaned to it by the S A Reserve Bank, over and above the security for the earlier assistance described above.

Before this agreement was concluded, the financial assistance package was discussed with the Minister of Finance, Mr BJ du Plessis, at a meeting on 31 July 1991, attended by Dr Stals, Dr CJ de Swardt (Deputy Governor) and Adv MCJ van Rensburg (Assistant General Manager of the S A Reserve Bank).

When viewed in its totality the package yielded a net interest margin of 15 per cent and generated a benefit of R 225 million per annum for the five-year period 1991 to 1995, amounting to R 1 125 million in total.

The financial assistance which was provided to Bankorp in terms of the agreement was to be applied towards the writing off by Bankorp of an identified set of bad or doubtful debts as at 30 June 1991, with any further losses to be met from sources other than the Reserve Bank. The agreement contained a repayment provision in favour of the Reserve Bank which would have been triggered if the bad debts written off did not reach the agreed figure, but there was no other provision for any repayment by Bankorp of any or all of the total net interest income which accrued to it during the period of operation of the agreement.

This assistance was subject to a further condition that the majority shareholder (Sankorp) would have to provide the means to cover a substantial part of the total assistance required by Bankorp, i.e. the difference between the debts of R 1 635 million and the S A Reserve Bank's assistance amounting to R 1 125 million.

In 1991 Sankorp entered into an agreement with Bankorp to provide Bankorp an amount of R 510 million in total over ten years. That arrangement was structured in a manner similar to the Reserve Bank assistance, giving Bankorp the benefit of a stream of net interest of R 51 million per annum for ten years.

3.1.5.3 Package C

The acquisition of Bankorp by ABSA, which was effective as at 1 April 1992, was conditional upon the financial assistance from the S A Reserve Bank and Sankorp, arranged under package B prior to the takeover, remaining in place. In other words ABSA was to receive the future stream of net interest previously arranged for Bankorp. As a result of this takeover the agreement was renegotiated between 1992 and 1994. A new agreement was concluded in 1994 with retroactive effect to 1 April

1992. This agreement was similar to the previous agreement (package B), except that:

- ABSA replaced Bankorp as the beneficiary.
- The requirement that Sankorp had to reinvest all dividends was lifted.
- Bankorp was allowed to substitute a new statement of bad and doubtful debts as at 31 March 1992 (details of which had been audited) for the unaudited list of bad and doubtful debts as at 30 June 1991 in its reporting to the S A Reserve Bank.
- The debts of debtors which had been classified as bad or doubtful as at the beginning of June 1990 could, depending on the financial position of the debtors, be increased or decreased in the actual write-off of bad debts against the amounts of financial assistance provided by the S A Reserve Bank, with the proviso that in the case of any debtor a debt written off might not exceed the amount of total indebtedness to Bankorp as at 31 March 1992.
- ABSA's external auditors were required in each financial year during the tenure of the 1991 agreement to audit amounts written off in order to ensure that such write-offs conformed to the stipulated conditions.

In 1995 a further agreement was concluded which amended the 1991 and 1994 agreements. The reason for this was that part of the government bonds that served as security for the S A Reserve Bank's loan to Bankorp/ABSA would mature before the termination of the agreement. Accordingly, the S A Reserve Bank purchased the government bonds from ABSA and required ABSA to deposit the proceeds of R 1 100 million with it and to cede the deposit to the S A Reserve Bank as security for the loan extended to ABSA. ABSA would earn interest on the deposit at a rate exactly equal to the rate of interest it would have received on the government bonds. This agreement terminated on 23 October 1995 when the accumulated total of financial assistance generated in terms of packages B and C amounted to R 1 125 million.