CHAPTER 1

REGISTRAR'S REVIEW

The year under review was marked by the unprecedented decline in the South African currency during the latter part of 2001. Although the impact thereof on the South African banking sector does not appear to have been significant, it is deemed appropriate to examine other effects of and possible reasons for the decline in the rand in this review.

A brief overview is also given of South African banking data, discussed in more detail in Chapter 3 of this Annual Report. Other issues of interest addressed in this review include, amongst others, the separation of macro-prudential and micro-prudential oversight into separate departments of the South African Reserve Bank, the debate surrounding the possible establishment of a single financial regulator in South Africa, considerations in the resolution of weak banks and the findings of external investigations into failed banking and financial institutions in South Africa.

need for enhanced corporate governance

The need for enhanced corporate governance and for compliance with standards and legislation is a theme that runs through this Annual Report, albeit not always expressed explicitly. It is for this reason that some comments on corporate governance, to be heeded by banking supervisors and bankers alike, are highlighted on the verso of the title page of this Annual Report.

OVERVIEW OF SOUTH AFRICAN BANKING SYSTEM

remained fairly stable

During 2001, the South African banking system remained fairly stable, and, in general, banks appeared to be sound. South African banks are well managed and, generally, have in place sophisticated risk-management systems and corporate-governance structures. The banks are well capitalised, and the average risk-weighted capital-adequacy ratio for the system as a whole stood at 11,4 per cent at the end of December 2001, compared to the required minimum ratio of 10 per cent.

growth remained strong

Growth in the total balance sheet remained strong throughout the year under review. By the end of December 2001, the total funds of banks – comprising capital, reserves, deposits and loans – had increased by 27,6 per cent (measured over a 12-month period), to a level of R1 046 billion. The growth in total assets was due to an increase of 22,4 per cent in total loans and advances, boosted by the depreciation of the South African rand. Foreign-currency loans and advances increased by 96,7 per cent to a level of R109,9 billion. Of these total assets, 69,5 per cent was concentrated in the four biggest banks. Foreign banks, the participation of which in the local banking industry has grown during the past five years, held about 7,7 per cent of the total assets of all banks conducting business in South Africa.

Total non-bank deposits increased slightly to 9,8 per cent in December 2001, from 7,5 per cent in December 2000. The composition of non-bank deposits remained largely unchanged during the past year.

profitability under pressure

Despite the disruptions caused by relatively unstable international financial markets, particularly after the 11 September tragedy, the South African banking system remained profitable. More recent statistics, however, have shown that the profitability of banks has increasingly come under pressure. By the end of December 2001, the average return on equity was 10,0 per cent, down from 13,3 per cent in December 2000. The return on assets also decreased, from 1,1 per cent in December 2000 to 0,8 per cent in December 2001, and the interest margin amounted to 3,5 per cent in December 2001 (down from 4,4 per cent in December 2000). The efficiency of the banking sector also started showing signs of deterioration during the past year and weakened from 62,5 per cent in December 2000 to 64,2 per cent in December 2001.

adequate levels of liquidity

South African banks maintained adequate levels of liquidity. In December 2001, banks' liquid assets (calculated on the basis of total liabilities less capital and reserves) amounted to 113,5 per cent of the liquid assets required to be held, compared to a level of 105,9 per cent in December 2000.

non-performing loans decreased

During 2001, the non-performing loans of the total banking sector decreased by R192,4 million, to a level of R26,2 billion at the end of December 2001. Provisioning by banks against these non-performing loans was adequate, even in terms of international requirements. Specific provisions covered about 46 per cent of all overdues. Net overdues (gross overdues less specific provisions) as a percentage of net qualifying capital and reserves decreased to 17,3 per cent in December 2001, which was well within the international benchmark of 25 per cent. An analysis of the quality of banks' assets during 2001 revealed that 78,3 per cent of the banking sector's assets earned a reasonable margin and that 5,9 per cent earned a small margin, whereas the remaining 15,8 per cent, including infrastructure, earned no margin.

CURRENCY DEPRECIATION AND IMPACT ON SOUTH AFRICAN BANKING SECTOR

economy more vulnerable to swings

South Africa has made great strides in opening its economy to foreign investment. This, however, has made the country's economy more vulnerable to swings in global growth. It is clear that South Africa cannot escape the consequences of an international economic slowdown, exacerbated by the tragic events in the United States of America on 11 September 2001. Most analysts, rating agencies and commentators agree that the unprecedented decline in the South African rand during the latter part of 2001 is not justified by the country's solid economic fundamentals, including sound fiscal and monetary policies. The lack of an economic rationale for the rand's decline remains a source of vulnerability, and the currency's decline appears to be due primarily to a problem of perceptions.

pronounced declines in last quarter

During the past two calendar years, the exchange rate of the South African rand declined on a bilateral basis against not only a large number of currencies, but also the trade-weighted index (TWI) value of the rand. The currency performed relatively strongly during the first half of the 2001 calendar year. The decline in the external value of the rand, however, gained momentum in the second half of the year, and more pronounced declines were registered in the last quarter of 2001, particularly in December 2001. During the first half of 2001, the rand declined by 6,5 per cent, whereas the second half of the year saw a decline of almost 50 per cent, 16,8 per cent of which occurred in December 2001. Against the TWI, the rand lost 34,5 per cent during 2001.

factors mentioned

Over the longer term, the South African rand was expected to decline to lower levels by virtue of the South African authorities' decision to liberalise existing exchange controls, as well as the policy to reduce the net open foreign-currency position (NOFP) of the South African Reserve Bank (SARB). The objective of these policy actions was to reduce the negative perceptions stemming from the above-mentioned factors, in view of their impact on, amongst others, South Africa's perceived ability to attract foreign direct investment and the need to improve the country's credit rating.

There does not appear to be a single, plausible explanation for the unprecedented decline in the exchange rate of the rand during the last two to three months of 2001. Among the factors that have been mentioned are the deteriorating political and economic conditions in some neighbouring countries, an element of non-resident risk aversion and use of the rand as a proxy hedge for exposures in other emerging markets. Other reasons commonly cited by market participants include:

other reasons

- The emerging-market contagion caused by the Argentinian debt crisis. Traders cited worries about Argentina's financial crisis, which might affect investor appetite for other emerging markets, as being negative for South Africa. South Africa's financial markets are among the most sophisticated and liquid in the developing world, making the rand an easy and open target. The currencies of other emerging markets, however, have not suffered to the extent that the rand has. For instance, the Brazilian currency declined by only 20 per cent, despite the country being Argentina's neighbour.

- Political and economic conditions in countries neighbouring South Africa. Despite the South African Government's strongly stated assurance that it would not tolerate lawlessness similar to that evident in neighbouring Zimbabwe, the current political and economic instability in that country negatively affected investor confidence in some Southern African countries.

- The outstanding NOFP of US$4,8 billion. As clearly stated on 21 December 2001, the Government will draw down a full syndicated loan of US$1,5 billion to reduce the NOFP further. Since the NOFP is expected to be expunged entirely during 2002, any effect that it may have had on the rand's decline should be eradicated.

- Progress with the privatisation of State assets. Questions have been raised about the Government's commitment to privatisation.

SARB statement

The monetary authorities became increasingly concerned that excessive volatility in the foreign-exchange market during the third quarter of 2001 negatively influenced inflation, business decisions and the economy as a whole. Therefore, the SARB issued a statement on 14 October 2001 that "the Reserve Bank stands ready to take appropriate firm steps against trading activities inconsistent with existing rules and regulations. The enforcement of existing rules serves to ensure that only legitimate transactions take place in the foreign exchange market. This does not restrict, for example, the ability of a non-resident investor to either hedge or repatriate the sale proceeds of an investor in South Africa. It does, however, exclude the financing of short rand positions in the domestic markets, which is consistent with the requirements that domestic borrowing by non-resident investors is subject to certain restrictions".

sensitive about exchange controls

Some market participants appear to have misinterpreted this statement to mean that the stricter enforcement of existing exchange controls amounted to an effective tightening of such controls. It was subsequently noted that many market participants, both locally and abroad, had become sensitive about issues relating to exchange controls. The SARB is communicating with the foreign-exchange market in order to explain the rationale for the above statement and, in consultation with banks, is finalising requirements for certain compliance letters to be provided to local authorised dealers. Despite these consultations, some offshore banks may have decided, as a precautionary measure so as to avoid finding themselves in contravention of exchange-control rules, to reduce their level of activity in South Africa's markets. This may have had a negative impact on market liquidity.

turnover declined

The figures reported to the SARB indicate that the net daily turnover in the domestic foreign-exchange market declined from an average level of US$7,4 billion in October 2001 to

US$5,5 billion in November, but increased again to a level of US$6,1 billion during December 2001. Despite these lower activity levels, it may be too soon to conclude that turnover has declined on a sustainable basis, especially since December turnover figures tend to be somewhat distorted in the South African foreign-exchange market because of the holiday period.

Although it is accepted that turnover alone is not a perfect measure of liquidity, it does represent a reasonable proxy. When turnover is assessed together with a widening bid/offer spread, ranging from 50 points to, at times, 1 000 points, it would appear that liquidity in the South African markets has been affected. It is, however, not possible to attribute such a reduction in liquidity to a single reason or event.
It is similarly difficult to be definitive about speculation in the South African markets. Although such speculation cannot be excluded, the rate of the depreciation of the currency may have given rise to legitimate hedging transactions.

impact on banking sector negligible

The impact of the decline in the external value of the rand on the South African banking sector appears to have been negligible. South Africa has a well-developed banking system, which sets the country apart from many other emerging markets globally. It is a more mature market, with a moderate level of private indebtedness and a good regulatory and legal framework. During the East-Asian crisis of 1998, the South African banking sector proved to be remarkably resilient in the face of the global financial turmoil and its impact on local economic conditions. South African banks, however, have been shielded from other consequences of the contagion, since they do not have large direct or indirect credit exposures outside the country. In addition, the level of net external liabilities is low. Therefore, any withdrawal of funds by foreign investors does not expose South African banks to exchange-rate risks, directly or indirectly.

FINANCIAL STABILITY

increased macro-prudential emphasis

It has become increasingly clear in recent years that micro-prudential supervision, although essential, is in itself insufficient to ensure stability of the financial system as a whole. Bank supervisors, therefore, now rely less on the assumption that, if all banks are sound, the system must be sound. For this reason, the Bank Supervision Department has gradually increased its macro-prudential emphasis over the past three years. As discussed in the Department’s two previous Annual Reports, this new emphasis led to the formation of a financial stability unit in the Department.

new specialist department

In the first quarter of 2001, the South African Reserve Bank (SARB) decided to separate the macro-prudential oversight function from the Bank Supervision Department and to form a specialist department, called the Financial Stability Department (FinStab). This move is in line with a clear trend among non-regulatory central banks in particular to place a more explicit focus on financial-system stability as a natural second objective of a central bank. The move is also in support of the mission statement of the SARB, namely, the achievement and maintenance of financial stability, which includes both monetary (price) stability and financial-system stability.

The two elements of a central bank’s task, that is, price stability and financial stability, are inextricably intertwined. Price stability, although necessary, is not a sufficient condition for financial stability. Similarly, a strong financial system cannot ensure price stability. Failure to maintain one provides a very uncertain operating environment for the other, with causality running in both directions.

micro-prudential and macro-prudential oversight are very interdependent

Similarly, micro-prudential supervision and macro-prudential oversight are very interdependent. The Bank Supervision Department, therefore, envisages cooperating closely and exchanging information with FinStab. Since several staff members of the Bank Supervision

Department have moved to FinStab, information is exchanged, albeit on a largely informal basis. A challenge for the future is to formalise the mandates, responsibilities, powers and rights surrounding this continuing interaction to ensure that it is entrenched in either agreements or legislation and does not remain dependent on interpersonal relationships.

difference in focus and responsibilities of the two departments

The difference in the focus and responsibilities of the two departments is clear. The Bank Supervision Department is responsible for the day-to-day supervision of banks, in pursuit of its objectives of the soundness of banks and, thereby, the protection of depositors. The Department's focus is on the risk profiles and risk-management processes of individual banks. FinStab's function, on the other hand, is to oversee the stability of the financial system as a whole. The purpose of FinStab is to identify inherent weaknesses and the build-up of risks that may result in financial-system disturbances, with potential macro-economic costs. FinStab will use the aggregated data about the banking system that the Bank Supervision Department provides. Unlike the Bank Supervision Department, however, FinStab will place a special focus on non-idiosyncratic risks, that is, those risks to which the whole banking system is exposed. More importantly, FinStab will integrate such aggregated micro-prudential data of the banking and financial system with other indicators of financial-system weakness. These indicators include certain macro-economic variables and data such as aggregated data on Government, non-bank corporate and household balance sheets.

intention is not to duplicate functions

Although there may be a period of ambiguity and possible overlap between the work of the two departments, the intention is not to duplicate functions. The Bank Supervision Department intends to make use of the macro-prudential analyses of FinStab, whereas FinStab does not intend to become involved at the institutional level. The Bank Supervision Department focuses on micro-prudential supervision in the context of reliable information on the stability, or otherwise, of the financial system as a whole. The inputs received from FinStab, however, will make the system considerably more robust.

DEBATE ON REGULATORY ARCHITECTURE

As reported in the Bank Supervision Department's previous Annual Report, there has been a debate about alternative institutional arrangements for financial regulation in South Africa since March 1999. In particular, the debate has centred on whether South Africa should establish a single financial regulator outside the South African Reserve Bank (SARB). During the 2001 parliamentary session, the Minister of Finance specifically commented that the Government intended establishing such a single regulator. It is therefore deemed appropriate to revisit some of the arguments surrounding the issue of a single financial regulator.

The rationale for establishing an integrated financial regulator remains the following:

rationale for integrated financial regulator

- Convergence in financial markets and the need for a more consistent approach to the regulation of financial conglomerates.
- The need for greater consistency in the application of policy across different industries.
- The ability to make more effective use of scarce regulatory resources.

There are four main sources of market failure in the financial system:

four main sources of market failure

- *Anti-competitive behaviour* - The first source of market failure gives rise to the need for competition regulation to be designed so as to ensure that markets remain competitive and contestable.

- *Market misconduct* - The second source gives rise to regulation that is directed at disclosure of information and the prevention of fraud, market manipulation and other forms of false and misleading behaviour.

- *Asymmetry of information* - The third source arises when buyers and sellers of financial products are unlikely to be on an equal footing, regardless of the amount of information that is disclosed. When the disparity between buyers and sellers and the potential damage that may arise from the failure of a financial institution are sufficiently great, this source of market failure warrants prudential regulations that are aimed at reducing the probability of failure to an acceptable level.

- *Systemic instability* - The final source of market failure, systemic instability, is peculiar to financial markets. These markets often function efficiently only to the extent that participants have confidence in the ability of markets to do so. A sudden loss of confidence in some institutions can be sufficiently damaging as to cause otherwise unrelated and sound institutions to fail and, in special circumstances, may even threaten the stability of the entire financial system. The risk of this type of contagion is greatest in the payment system, but may well extend beyond payments in times of crisis.

single-regulator model

In the single-regulator model, the regulator would be given responsibility for correcting each of the four sources of market failure and for supervisory oversight of all institutions that are subject to such failure. A single regulator as defined here can, however, not be found anywhere. The most common structure is that in which prudential regulation is allocated to separate regulatory agencies according to institutional groupings. Integrated regulators around the world have in common that they bring together, under one roof, all major forms of prudential regulation.

Most integrated regulators can be classified as versions of the functional approach to regulation in that a regulator is assigned to each source of market failure. The global trend toward integrated regulation can thus be viewed as a restructuring of regulatory agencies along functional lines.

wide range of responsibilities, powers and organisational structures

A single financial regulator will generally have a wide range of responsibilities, powers and organisational structures. The power to make regulatory policy and responsibility for supervisory oversight should vest in the same agency. The regulatory powers should include authorisation and licensing, the power to inspect and to request information and enforcement powers, such as the authority to give directions, to suspend operations and to appoint a curator to a regulated institution.

A single regulator is not, in and of itself, a solution to regulatory failure. Correction of regulatory failure requires better regulation. This, in turn, requires the setting of more appropriate prudential and market-conduct standards, improved surveillance and strengthening of enforcement. A single regulator may help to facilitate this process, but does not, by itself, cause these changes to occur.

The most obvious advantage of a single regulator is that it brings the various regulated components of financial conglomerates under one agency. Common standards across industry groupings for large exposures, intragroup exposure and capital adequacy help to promote the stability of the financial sector.

primary long-term objective

The primary long-term objective of a single regulator is the development of an approach to regulation that looks through the institutional structure of financial entities and imposes regulatory requirements on the basis of risk. The linking of regulatory responses to risk is fundamental to the risk-based approach to prudential regulation. This approach assumes that any financial institution can be viewed in terms of the extent to which it retains the following core risk types:

core risk types

- *Credit risk* - the risk that creditors will default on their obligations.
- *Market risk* - the risk of loss arising from fluctuations in the market value of assets, together with the risk of liabilities arising from movements in market prices.
- *Insurance risk* - the risk of loss from underwriting and reinsurance.
- *Governance risk* - the risk of loss arising from inadequate internal controls, lack of accountability within an institution, operational failure and poor management.

cannot provide assurance of absence of failures

Although the extent of these risks may vary between banking, insurance and markets, a case can be made for the regulator to treat similar risks in a similar manner. No single regulator, however, can provide the assurance of a financial system with a complete absence of failures and, in particular, no regulator has the capacity to eliminate fraud.

The most important factor governing a single regulator's effectiveness is the prudential framework of laws, standards and operational procedures covering inspection and analysis. Globally, the necessary legislative reforms in associated industry laws and regulatory powers have lagged well behind institutional reforms.

In South Africa, we would be well advised to learn from the single regulatory agencies around the globe. South Africa should therefore first put into place the legal structure and powers necessary to ensure that scarce resources are retained in order to develop policies that are appropriate to the rapidly evolving financial scene. All stakeholders should be invited to participate in the development of a strategic framework with a view to ensuring an efficient and orderly process of integration. In order to achieve the sustainability of such a regulatory agency, there should be extensive public debate on both the funding of the integration process and the agency's future funding.

success will depend on cooperative arrangements

Ultimately, however, the success of a single regulator will depend on the cooperative arrangements between the regulator, the Minister of Finance/National Treasury and the SARB. All three pillars of economic management need to be assured of a flow of information that will enable each one to operate effectively, especially in times of stress.

RESOLUTION OF WEAK BANKS

task of banking supervisor

Weak banks are a worldwide phenomenon. The task of the banking supervisor is to identify the problem at an early stage, agree on a plan for corrective action with the directors of the bank concerned, devise resolution techniques if the corrective action proves not to be working or to be too late and have ready an exit strategy if all fails.

weak bank defined

A weak bank can be defined as a bank whose solvency will be threatened unless the bank can achieve a major improvement in its financial resources, strategic business direction and/or quality of its management in the near future. Given the need to maintain confidence in the financial system, the supervisor must try to preserve the value of a weak bank's assets with minimal disruption to its operations. At the same time, the resolution costs should be minimised. The result may well be that such a weak bank ceases to exist as a legal entity.

The supervisor has to distinguish clearly between the symptoms and the causes of a bank's problems. These problems have to be identified and addressed at an early stage, before they become acute. The relevant sources of information have to be identified, and the tools required to obtain and to handle the data have to be available or be developed.

range of corrective tools

Although the supervisor has available a range of corrective tools to resolve a weak bank, the primary responsibility rests with the bank's board of directors and, through the directors, the management of the bank. Not only should the supervisory measures be proportionate to the problem, but the corrective actions should also fit the scale of the problem and be set within a clear time frame. A balance has to be struck between rigid, prompt corrective actions and general, less binding frameworks. An ideal approach would include rules for pre-agreed acceptable supervisory actions, whilst allowing flexibility in particular circumstances. A balance also has to be struck between informal methods, normally when a bank's problems are less serious and its management is cooperative, and more formal actions, which are binding on the bank and which include penalties for non-compliance. Revocation of a bank's registration and licence remains the ultimate sanction.

action plans

The action plans for the resolution of a weak bank have to be detailed and specific. Such plans also need to show how the bank's financial position will be restored. Furthermore, the supervisor has to be able to assess continually whether there has been satisfactory progress, or whether additional action is necessary.

consult and inform

The supervisor should have in place agreed mechanisms to consult and inform the government of the action plans required to resolve distress in a bank. Other supervisory agencies, both domestic and foreign, should also be informed. When disclosure is considered, the overriding consideration has to be whether such disclosure will contribute to the supervisor's objective of resolving the weak bank.

private-sector solutions

If the prospect of a bank's insolvency remains, the supervisor has to consider private-sector solutions. These include a merger with a healthy bank, recapitalisation and a change of management, or ring fencing of the bad debts into a separate legal entity, funded by long-term debentures or preference shares. If no investor is willing to step in, or if reimbursement of a weak bank's depositors is less costly than other options, repayment of depositors through a curatorship and, eventually, liquidation become unavoidable.

emergency liquidity assistance

In certain circumstances, public funds could be used to provide liquidity support to a weak bank, as discussed comprehensively in the 1999 Annual Report of the Bank Supervision Department. The central bank may consider the discretionary provision of emergency liquidity assistance, in addition to the normal accommodation facilities, to an illiquid but solvent bank. Since such assistance will involve the use of taxpayers' money, the decision should be made and funded by government and not the central bank. Such support should be linked to other, more permanent measures, such as a change in the ownership structure of the bank concerned at a future date.

In some cases, for example, when a weak bank is part of a larger group or is a foreign-controlled bank, the supervisor has to take into account particular factors of relevance. Possible options, such as ring fencing of the bank, also have to be considered.

INVESTOR PROTECTION

As reported in the 1997 and 1998 Annual Reports, the Commission of Inquiry into the Affairs of the Masterbond Group and Investor Protection in South Africa, chaired by the Honourable Mr Justice H C Nel and generally known as the Nel Commission, was appointed by the then State President in 1992. This appointment followed a public outcry in the wake of the failure of the Masterbond group of companies during the early 1990s. Over a number of years, these companies had attracted approximately R1 billion in investments by promising secured and thus purportedly safe investments. After the collapse of the Masterbond group, many small investors lost their entire life savings, resulting in financial disaster for many of the victims. The above-mentioned Annual Reports made mention of the findings of the Nel Commission's report of November 1997.

issues addressed

In another report released during October 2001, Judge Nel made a number of recommendations aimed, amongst others, at protecting the interests of investors. Among the issues addressed were greater controls on the auditing and accounting professions and the establishment of a single financial regulator.

role of auditing profession

In addressing the role of the auditing profession, the report noted that, during the 20th century, public confidence in the auditing profession and the veracity of audited financial statements had started to decline. It was further noted that this decline had led to the creation of an independent oversight body for the profession in the United Kingdom and that similar steps had been recommended in the Republic of Ireland. It was recommended that a local independent public oversight body be created for the auditing and accounting professions. This body should have all such powers as would be necessary to regulate and oversee the respective activities of auditors and accountants. The creation of such a body would be likely to increase the level of, amongst others, accountability within these professions. The Bank Supervision Department would welcome the establishment of, and maintain an active relationship with, such a body. This is all the more necessary in view of the reliance placed on the work and integrity of external auditors in the methodology followed in the supervision and regulation of banks.

independent public oversight body

more holistic regulation

A need for more holistic regulation of the financial industry was also identified. The report stated that a fragmented system of financial regulators could not deliver the standards of investor protection and supervision to which both the industry and the public were entitled. Accordingly, the report recommended the establishment of a single autonomous regulatory authority, which should incorporate the various fragmented functions of a variety of financial regulators. The recommendation was that such a single regulatory authority should have wide-ranging powers to make rules, in support of the following objectives, amongst others:

objectives

- Investor protection.
- Maintenance of fair, efficient, transparent and orderly investment markets.
- Maintenance of public confidence in financial markets.
- Minimisation of financial crime and misconduct.
- Reduction of systemic risk, that is, the risk of a collapse of markets.
- Assistance to the Government in maintaining the stability of monetary and financial systems.

CURATORSHIP OF REGAL TREASURY PRIVATE BANK LIMITED

run on Regal Bank

During the second quarter of 2001, Regal Treasury Private Bank Limited (Regal Bank), one of South Africa's small banks, was subject to unusually large-scale withdrawals by its depositors. This run on Regal Bank is believed to have been caused by the external auditors of the bank's controlling company rescinding their approval of the company's 2001 financial statements. The concomitant outflow of funds led to Regal Bank finding it extremely difficult to maintain the required levels of liquidity. Consequently, the bank had to be placed under curatorship on 26 June 2001.

appointed commissioner to investigate

On 13 July 2001, the Registrar of Banks appointed Advocate J F Myburgh SC as commissioner in terms of section 69A of the Banks Act, 1990 (Act No. 94 of 1990), to investigate the affairs of Regal Bank, its dealings, business and assets and liabilities, as well as corporate-governance issues and the roles of the bank's Chief Executive Officer, directors and external auditors. Section 69A was introduced into the Banks Act in 1994 to address the problem of delays previously experienced with the investigation of possible improper conduct by the directors, executive management and other employees of a bank placed under curatorship. In essence, section 69A of the Banks Act provides for the appointment of a commissioner to investigate the business of a bank under curatorship, and prescribes a period of five months from the date of appointment of the commissioner for the investigation to be completed. Section 69A also provides for such a commissioner to submit a written report within 30 days of the completion of an investigation.

hearings

Key to the Commissioner's investigation were the hearings conducted between 20 August and 17 October 2001, at which 53 witnesses gave evidence. Some of the preliminary issues covered during the hearings included a ruling by the Commissioner that the hearings were open to the public unless there were justifiable grounds for a witness's evidence, in whole or in part, to be heard in camera. During the hearings, 3 516 pages of oral evidence were heard and transcribed, and some 16 000 pages of documents were handed in as exhibits.

The investigation was completed on 15 November 2001, upon completion of a 645-page written report, which was submitted to the Registrar of Banks and the Minister of Finance. The Commissioner also handed a 90-page list of criminal charges, including 18 counts of fraud, to the Directorate of Public Prosecutions, which, at the time of this Annual Report, had not yet made a final decision on the action to be taken.

Commissioner's report

The Commissioner's report consists of three parts. Part 1 contains an executive summary and a detailed indictment against the perpetrators. Part 2 covers events pertaining to Regal Bank from 1991, when Mr Jeff Levenstein, the bank's former Chief Executive Officer, first made application to establish a bank, to the events leading to the bank's curatorship in 2001. Part 3 is an analysis, per subject matter or issue, of the evidence and documents presented to the Commissioner. The full report is available on the South African Reserve Bank's Internet Website.

Some of the recommendations made in the report included the following:

recommendations

- Regal Bank should continue to be remain under curatorship pending the outcome of negotiations with another bank to conclude, in the interests of the depositors, a scheme of arrangement, rather than the bank being placed into liquidation.

- The Registrar of Banks should refer the Commissioner's report to the Public Accountants' and Auditors' Board (PAAB), with the request that the PAAB, firstly, hold an enquiry in terms of section 20(8) of the Public Accountants' and Auditors' Act, 1991 (Act No. 80 of 1991), against the responsible auditors of the bank who had failed to perform their duties with care and skill, or who had performed negligently and, secondly, conduct a disciplinary hearing into the conduct of those auditors.

- The Banks Act should be amended to increase the powers of the Registrar of Banks in order to enable the Registrar to take action, such as removing a director from office, when standards of corporate governance in a bank had been found wanting, before a stage of curatorship being necessary was reached.

- The Registrar of Companies should open a register of delinquent directors in accordance with the recommendations of the draft report of the second King Commission on Corporate Governance, on which report more detail is given in Chapter 2 of this

Annual Report. The names of Messrs Levenstein and Jack Lurie, the former Chairman of Regal Bank, should be placed in such a register as persons disqualified from acting as directors under the Companies Act, 1973 (Act No. 61 of 1973).

- Criminal prosecutions should be instituted as soon as possible against some directors and officers of Regal Bank and of the bank's controlling company, Regal Treasury Bank Holdings Limited, on several counts of fraud and contraventions of the Companies Act and the Banks Act.

timing of decisive action critical

The report also found that the timing of decisive action was critical in addressing the problems faced by Regal Bank. The Bank Supervision Department will therefore ensure that greater focus is placed on this issue in the future.

FINANCIAL ASSISTANCE PACKAGE TO BANKORP LIMITED

panel of experts

In an effort to lay to rest ongoing speculation about the role of the South African Reserve Bank (SARB) in providing financial assistance to Bankorp Limited (Bankorp) during the mid-1980s and the mid-1990s, the Governor of the SARB appointed a panel of experts on 15 June 2000. This panel was chaired by the Honourable Mr Justice D M Davis and is generally known as the Davis Panel. In the interests of transparency, the Bank Supervision Department deems it important to highlight the most important findings of the Davis Panel.

findings and recommendations

legitimate part of function to assist a bank

After a thorough investigation, the Davis Panel submitted its findings and recommendations to the Governor of the SARB during October 2001. The Davis Panel expressed the opinion that it was a legitimate part of the function of a central bank to assist a bank experiencing problems in order to avert a general crisis in the banking system. Such assistance should therefore always be within the legal powers of a central bank and should be consistent with its responsibility for the soundness of the banking system.

supported supervisory principles and practices currently used

early supervisory intervention

The practices and procedures employed in extending such assistance should be in line with best international practice. In this regard, the Davis Panel supported the regime of supervisory principles and practices currently used by the SARB and the Bank Supervision Department. The current principles and practices were found to be in line with international trends and in accordance with the Core Principles for Effective Banking Supervision issued by the Basel Committee on Banking Supervision, as well as related documents issued by the Bank for International Settlements. The Davis Panel highlighted an important element in the application of the Basel Core Principles as being the supervision of management's ability to exercise best practice in the management of risk. Another element of importance that the Panel identified was the requirement for early supervisory intervention in banks with deteriorating positions, an issue also addressed earlier in this chapter.

criticised shareholding structures in banks

The Davis Panel concluded that, in the final analysis, ABSA Bank Limited (ABSA), which bought Bankorp in 1992, could not be regarded as a beneficiary of the assistance package, since ABSA was the party responsible for providing continued assistance to Bankorp. In expressing its opinion, the Panel concluded that although the calculated net asset value of Bankorp and the value of the SARB's assistance package were equivalent, this was coincidental and that ABSA had paid fair value for Bankorp. The Davis Panel, however, criticised the shareholding structures in banks and, in particular, expressed reservations about the position of the shareholders of Bankorp.

deposit-insurance scheme

Furthermore, the Davis Panel advised that an effective and well-designed deposit-insurance scheme should be implemented urgently in South Africa. In this regard, it should be noted that the Work Group on the development of a limited, explicit, mandatory deposit-insurance scheme for South Africa continued its work during 2001. The Work Group has developed a consultative paper and will host a workshop in early 2002 to introduce the issues relating to deposit insurance to the relevant interest groups. The comments received will be incorporated into a final proposal, which the Policy Board for Financial Services and Regulation will submit to the Minister of Finance, for consideration, during 2002.

PROGRESS WITH IMPLEMENTATION OF 2005 HUMAN-RESOURCE PLAN

As reported in the previous two Annual Reports, the Bank Supervision Department is shaping its employment plan to accord with the philosophy of promoting equity through diversity, in line with the 2005 human-resource (HR) plan of the South African Reserve Bank (SARB). This plan may briefly be stated as contemplating, by the year 2005, a staff complement at all levels of, at least, an equal ratio of black staff (that is, Africans, Coloureds and Asians) and white staff, as well as one-third female staff.

aims to promote employment equity and to ensure competent workforce

The main aims of the 2005 HR plan are to promote employment equity in the SARB and to ensure a competent and motivated workforce. In the case of the Bank Supervision Department, this implies a workforce that is capable of performing the required regulatory and supervisory tasks, in the interests of the larger South and Southern African enterprise. The Department, therefore, regards its efforts to train not only its own staff, but also bank supervisors from, amongst others, the member countries of the East and Southern Africa Banking Supervisors Group as according with the spirit of the 2005 HR plan of the SARB. The policy implemented includes accelerated development and promotion, in a constructive manner, of employees with potential from the designated group (that is, blacks, females and disabled persons).

good progress

The Department is making good progress towards bringing the profile of its workforce in line with the requirements of the 2005 HR plan. At the end of 2001, 49 per cent of the Department's workforce was black. In terms of gender, males and females constituted 53 per cent and 47 per cent, respectively, of the workforce. The relatively high staff-turnover rate of 10,2 per cent in 2001, however, is a cause for concern. In order to address the resulting loss of competence, as well as the pressures arising from new developments in banking supervision, the Department will continue with initiatives such as the following:

initiatives

- Head hunting to recruit senior managers should no successful candidates be identified in the normal process of recruitment.
- Fast tracking of deserving current employees from the designated group and continued intake of cadets. During the year under review, the Department appointed ten cadets (eight from the designated group) as staff members, and three new cadets (two from the designated group) are currently participating in the cadet-training programme.

increase capacity

In order to help to increase capacity, an organisational restructuring of the Department was approved and is currently being implemented. As part of this process and to fill the vacancies arising from four senior staff members joining the new Financial Stability Department, additional positions were created, particularly at the managerial levels. The Department envisages filling these positions during 2002, in line with the SARB's 2005 HR plan.

ISSUES THAT WILL RECEIVE PARTICULAR ATTENTION DURING 2002

During 2002, the Bank Supervision Department will focus on, amongst others, the following issues, which are discussed elsewhere in this report:

focus areas

- Detailed study of the proposed new Capital Accord to determine the changes required to the regulatory framework and supervisory procedures, as well as participation in a forum to discuss implementation issues.

focus areas

- Continued participation in the work of the Core Principles Liaison Group, particularly as regards countries' compliance with the Core Principles for Effective Banking Supervision.
- Ongoing review of banking legislation to ensure that it keeps pace with local and international developments and standards, including particular emphasis on corporate-governance issues.
- Ongoing refinement of the procedures for the consolidated supervision of banking groups, focusing particularly on qualitative aspects.
- On-site reviews of banks' risk-management practices, with particular emphasis on credit and counterparty exposures.
- Finalisation, in collaboration with the Financial Services Board, of guidelines on incentive schemes applicable to financial institutions.
- Further participation in forums to facilitate the provision of finance to all, as well as research on a relevant regulatory framework and environment in that regard.
- Ongoing investigation and combating of illegal deposit-taking schemes.
- Continued monitoring of local developments with anti-money-laundering measures and the implications thereof for the banking regulatory framework.
- Continued monitoring of banks' liquidity profiles, as well as surveillance of banks' trading activities and positions.
- Monitoring of the implications of electronic commerce for the banking regulatory framework and the banking sector.
- Implementation of the Regulations relating to Representative Offices.
- Analysis of existing preference-share investment structures, with a view to finalising the regulatory requirements in that regard.
- Research on credit-derivative instruments to provide for the regulation thereof.
- Coordination of the twelfth biennial International Conference of Banking Supervisors, which will be hosted in Cape Town, during September 2002.
- Continued participation in the activities of the East and Southern Africa Banking Supervisors Group (ESAF), including hosting and presentation of courses in banking supervision for ESAF members and other supervisors.

A WORD OF THANKS

Once again, I wish to express my sincere appreciation to the Minister and Deputy Minister of Finance for their valued inputs to requests in terms of statutory requirements. My particular thanks for their support and guidance go to the Chairperson of the Policy Board for Financial Services and Regulation and the Governor and Deputy Governors of the South African Reserve Bank. My staff and I also wish to record our gratitude for the cooperation that we received from the many organisations and individuals, locally and abroad, with whom we had contact during the past year. In this regard, I wish to make particular mention of the Chief Executive of the Financial Services Board and his staff, the senior executives of banking institutions, The Banking Council South Africa, the Standing Committee for the Revision of the Banks Act, 1990, the staff of the South African Reserve Bank and other supervisory and regulatory authorities worldwide.

A special word of thanks goes to Mr André Bezuidenhout, who was Deputy Registrar of Banks from 1 November 1995 until the end of June 2001 and who now heads the new Financial Stability Department. Besides all the other tasks and responsibilities that he shouldered with enthusiasm and dedication, we owe him particular gratitude for the important role that he played in ensuring that the computerised systems of banking institutions in South Africa were year 2000 compliant and in formalising a methodology for the consideration of the wide range of factors relevant in proposed banking mergers. We wish him well with his new responsibilities and challenges.

It gives my great pleasure to welcome Mr Errol Kruger as the new Deputy Registrar of Banks. He was appointed to the position on 1 September 2001, and we look forward to a long and fruitful association with him.

Finally, I wish to thank my staff for continuing to handle the diverse challenges with which they are faced and their ever increasing workload with the professionalism, dedication and enthusiasm to which I have become accustomed.

C F Wiese
Registrar of Banks, and General Manager: Bank Supervision Department