# Chapter 3: Developments relating to banking legislation

## 3.1 Introduction

The Department continually strives to ensure that the legal framework for the regulation and supervision of banks and banking groups in South Africa remains relevant and current. Ideally the legal framework pertaining to banking regulation has to reflect local and international market developments and should comply with the applicable international regulatory and supervisory standards, and best practices. The Department therefore reviews all banking legislation, including the Banks Act, the Mutual Banks Act, 1993 (Act No. 124 of 1993 – the Mutual Banks Act), the Regulations issued in terms thereof and other pieces of related banking legislation on an ongoing basis and makes recommendations to the Minister of Finance to effect the necessary amendments thereto.

## 3.2 The Banks Act, 1990

The Banks Act was last amended on 1 January 2008, mainly to comply with the requirements and principles of the Basel II framework. Since then, the Department has been monitoring, among other things, the developments relating to the G-20 discussions and publications and directives issued by the Basel Committee and the FSB. Other developments relating to the new Companies Act, *King III* and court decisions were also observed in order to identify possible areas that would necessitate further amendment of the Banks Act.

In terms of section 92 of the Banks Act, the Minister of Finance appoints a standing committee to review the Banks Act from time to time and to advise him/her with regard to amendments to the Banks Act. During 2011 the Standing Committee for the Revision of the Banks Act, 1990 (the Standing Committee), was provided with details of the background to, and the reasons for, various amendments required in respect of the Banks Act. The Standing Committee agreed to the proposals in principle and the Department proceeded with the drafting process.

Draft 5 of the Banks Act Amendment Bill, 2010 was discussed by the Standing Committee during a meeting held in August 2011. Subsequently, draft 6 of the Banks Act Amendment Bill was forwarded to the Minister of Finance in order to obtain the necessary approval and to initiate the parliamentary approval process during the first half of 2012. However, as a result of ongoing developments in terms of the Basel III framework, the Department, in consultation with the National Treasury, has decided to first incorporate the necessary further Basel III-related amendments into the Banks Act Amendment Bill before presenting it to Parliament during the second half of 2012.

## 3.3 The new Companies Act, 2008

The new Companies Act was promulgated in April 2009 and became effective on 1 May 2011. Due to the fact that banks are also public companies, the provisions of the new Companies Act have a profound effect on banks and some of the provisions of the Banks Act. The provisions of the new Companies Act have already been incorporated into the Banks Act Amendment Bill, 2010 where applicable and appropriate.

## 3.4 Update regarding amendments to the Regulations relating to Banks

As already mentioned in section 1.2.1 of this Report, the Department comprehensively amended the Regulations during 2010 and 2011. This was firstly done in accordance with the departmental mission of promoting the soundness of the banking system and contributing to

the Department comprehensively amended the Regulations during 2010 and 2011

financial stability, and secondly in order to ensure that the regulatory framework for banks and banking groups remains relevant and current and is based on:

- the latest internationally agreed requirements, best practices and standards issued by international standard-setting bodies such as the G-20, the FSB and the Basel Committee; and
- the three documents commonly collectively referred to as 'Basel II.5', namely, "Enhancements to the Basel II Framework", "Revisions to the Basel II Market Risk Framework" and "Guidelines for Computing Capital for Incremental Risk in the Trading Book".[65]

Furthermore, during 2010 and 2011, the Department received various proposed amendments to the Regulations from banks, auditors of banks, departmental risk specialists and analysts, and other departments within the Bank. The Department also took various internal policy decisions in respect of specific matters that have an impact on the regulation and supervision of banks that need to be incorporated into the Regulations. In this regard, the Department identified the following areas in the Regulations that require either correction or further clarification:

- Based on the importance of their cross-border banking activity or their regional influence, the BIS invited a number of additional countries, in particular from emerging markets, including South Africa, to participate in the process of collecting information regarding international banking statistics. For this purpose, specific forms and related directives that are essentially based on standardised information requirements with regard to international banking statistics on external debt, which were developed jointly by the BIS, the IMF, the OECD and the World Bank, had to be developed and incorporated into the amended Regulations.
- The Department's consolidated supervision analysts and risk specialists requested that the information requirements related to foreign operations of South African banks be expanded to provide information users with a better understanding of the nature of the business conducted and the related risks incurred by such foreign operations.
- The IMF's ROSC, discussed in section 1.6 of this Report, recommended that certain improvements be effected to the Department's regulatory framework, particularly in the areas of country risk and transfer risk, and exposures to related parties.

Based on the above the Department issued for comment drafts 1, 2, 3 and 4 of the proposed amended Regulations on 15 March 2010, 30 June 2010, 17 December 2010 and 20 April 2011 respectively.

The background to and the specific details of the aforesaid respective draft Regulations were presented to, discussed and considered by the Standing Committee at its quarterly meetings during 2010 and 2011.[66] On 3 August 2011, draft 5 of the proposed amended Regulations was presented to the Standing Committee for their consideration and approval. The Standing Committee unanimously approved the draft, whereafter it was presented to the Minister of Finance for his consideration and approval.

the amended Regulations were implemented with effect from 1 January 2012

The amended Regulations were subsequently approved by the Minister of Finance on 31 October 2011, after which it was published in *Government Gazette* No. 34838 on 15 December 2011 and implemented with effect from 1 January 2012.

In addition to the various proposed amendments to the Regulations received from various key players, the amended Regulations also give effect to Basel II.5, and aim, among other things, to:

- strengthen the risk coverage of the capital framework;
- reduce risks from certain securitisation and off-balance-sheet activities;
- discourage excessive lending;
- strengthen board and senior management oversight in banks and banking groups;
- increase public disclosure; and

65 Refer to section 1.2.1 for more information in this regard.
66 Refer to section 3.2 for a more detailed discussion regarding the Standing Committee.

- strengthen the oversight of bankers' remuneration through incorporating the requirements stipulated in the FSB's document entitled "FSB Principles for Sound Compensation Practices". These principles are intended to better align the incentives for senior managers with the long-term sustainability, and hence better risk management practices, of the institution.[67]

Extensive consultation has already commenced between the Department, the National Treasury, the banking industry and other stakeholders on the required amendments for the phased-in implementation of the Basel III framework that will commence on 1 January 2013.[68] The first draft of the new proposed amended Regulations will be released during the first half of 2012.

Finally, the Department continues to monitor, among other things, the developments relating to the G-20 discussions, and the press releases, publications and directives issued by the Basel Committee and the FSB. This includes further work conducted by the Basel Committee in terms of the Basel III framework and the Core Principles[69] in order to identify possible further areas that would necessitate amendments to the Regulations. The Department is committed to remain fully compliant with international standards and market best practices relating to the regulation and supervision of banks and banking groups.

the Department remains fully committed to complying with international standards and best practices

## 3.5 Illegal deposit-taking

The Banks Act governs, among other things, the acceptance of deposits from the general public by institutions that are registered in terms of the Banks Act. Any person or institution that is not registered as a bank and who conducts the business of a bank as defined in section 1 of the Banks Act may be doing so in contravention of the Banks Act.

In terms of the Banks Act, the Department is mandated to investigate any person or institution who is suspected of taking deposits in contravention of the Banks Act, including institutions not in compliance with the relevant exemption notices as published in the *Government Gazette*.

During the year under review the Department received a number of enquiries and complaints, with supporting documentary evidence, pertaining to the business activities of certain institutions that were suspected of accepting deposits from the general public without being registered as a bank.

Experience has shown that in most cases, when an institution is found to be in contravention of the Banks Act, the likelihood exists that it is also in contravention of other legislation, for example, the Income Tax Act, 1962 (Act No. 58 of 1962), the Value-Added Tax Act, 1991 (Act No. 89 of 1991), the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002), and other Acts administered by the Financial Services Board.

The Department therefore endeavours to share any information it receives with other regulatory bodies to ensure that all possible contraventions that may have been committed by unregistered persons are brought to the attention of the appropriate authorities. Furthermore, the Department routinely shares information with other regulatory authorities to limit the duplication of investigations and to promote and sustain a good working relationship with such authorities.

the Department shares information it receives with other regulatory bodies

Staff members of the Department are regularly subpoenaed to provide evidence in court proceedings relating to the prosecution of persons who are allegedly contravening the Banks Act. The Department, together with the appointed temporary inspectors or managers, also provides assistance to the prosecuting authorities if and when required or requested to do so.

In cases where a scheme has been liquidated, the provisions of the Insolvency Act, 1936 (Act No. 24 of 1936) take precedence over the provisions of the Banks Act. When schemes are thus liquidated, the investigation in terms of the Banks Act is ended by the Department and the winding-up thereof becomes the responsibility of the appointed liquidator.

Section 84(1A)(d) of the Banks Act, however, affords the Department the right to nominate a person as the liquidator of a company when such a company has been directed to repay the

67 Refer to sections 1.5 and 2.6.3 for a more detailed discussion in this regard.
68 Refer to section 1.2.2 for more information regarding the implementation of the Basel III framework.
69 The latest developments in respect of the Core Principles are discussed in greater detail in section 1.2.2.5.

funds obtained in contravention of the Banks Act and if managers have been appointed to manage the repayment process. Once the Master of the High Court has appointed the person nominated as liquidator by the Department with the assistance of the appointed manager, the Department will assist the appointed liquidator if and when requested and required to do so.

the Department compiled a five-year review of schemes investigated

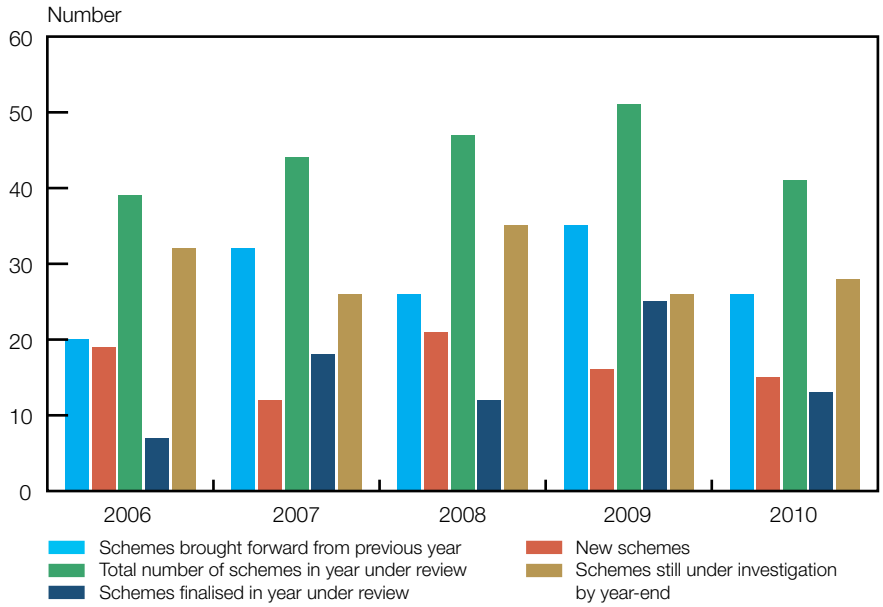
The Department compiled a five-year review of schemes investigated from January 2007 to December 2011 (refer to Table 3.1 below). During this period the Department received 83 new complaints relating to illegal deposit-taking schemes. A total of 139 schemes were carried over from previous years and 75 schemes were finalised in this five-year period. In total, 222 schemes were investigated during the five years under review.

During 2011, 15 new investigations, together with 26 investigations carried over from previous years, were undertaken. Of the total of 41 investigations, 13 were completed and 28 still remained under investigation as at 31 December 2011.

Table 3.1 Inspections relating to illegal deposit-taking schemes

| Year | Schemes brought forward from previous years | New schemes | Total number of schemes in year under review | Schemes still under investigation at year end | Schemes finalised in year under review |
|---|---|---|---|---|---|
| 2007 | 39 | 32 | 20 | 19 | 7 |
| 2008 | 44 | 26 | 32 | 12 | 18 |
| 2009 | 47 | 35 | 26 | 21 | 12 |
| 2010 | 51 | 26 | 35 | 16 | 25 |
| 2011 | 41 | 28 | 26 | 15 | 13 |

Figure 3.1 Number of inspections relating to illegal deposit-taking schemes




Some of the schemes under inspection received coverage from both the local and international media; however, the Department has become aware of the fact that some media reports were not entirely accurate.

The Department has furthermore noted that there seems to be a misconception regarding the appointment of managers in terms of section 84 of the Banks Act, which states that:

> (1) Simultaneously with the issuing of a direction under section 83(1), or as soon thereafter as may be practicable, the Registrar shall by a letter of appointment signed by him or her appoint a person (hereinafter in this section referred to as the manager) to manage and control the repayment of money in compliance with the direction by the person subject thereto. [70]

The common perception appears to be that once appointed, the appointed managers are responsible for the day-to-day management of the company. This, however, is not correct since the main responsibility of the appointed managers is to ensure that the funds that were invested in the scheme are repaid to investors.

Some of the more prominent inspections that the Department dealt with during 2011 are briefly outlined below:

prominent inspections that the Department dealt with during 2011

## 3.5.1 Realcor Holdings (Pty) Limited

The Department appointed PricewaterhouseCoopers Forensic Services (Pty) Limited (PwC) as temporary inspectors to investigate the business activities of Realcor Holdings Limited (Realcor). After receiving and considering the report from PwC, the Department concluded that Realcor had contravened the Banks Act by taking deposits from members of the general public while not being registered as a bank. The Department subsequently issued a directive in terms of section 83(1), read with section 84 of the Banks Act to Realcor to repay the investors. PwC was accordingly appointed as managers in terms of section 84 of the Banks Act to control and manage the process of repaying investors' funds.

Certain creditors, however, lodged applications with the High Court in Cape Town for the liquidation of certain companies within Realcor. The application was successful and a provisional liquidation order for Realcor was issued during December 2011. The Department has therefore retracted the directive issued to Realcor and relieved the managers of their duties.

## 3.5.2 Sharemax Investments (Pty) Limited

Following an inspection into the affairs of Sharemax Investments (Pty) Limited (Sharemax) and the various property syndication companies (PSCs) it had promoted, the Department concluded that the funding models used by Sharemax were in contravention of the Banks Act. It should be noted that this is an administrative finding and is in no way a conviction of criminality of the persons involved in the scheme. For this reason the findings of the Department will be reported to the appropriate authorities in due time.

Nevertheless, during September 2010 the Department issued directives to Sharemax and the PSCs it had promoted to repay the funds obtained from members of the public. The Department appointed two managers, namely Mr Jaco Spies of Facct Forensic Consulting (Pty) Limited and Mr Neels Alant of Hahn & Hahn Attorneys, to take control of the assets of Sharemax and the PSCs and to manage the repayment process. However, owing to the majority of funds having been invested in fixed property, it was clear that it would be impossible to immediately give effect to the directives to repay investors. The only option available at that stage that would have allowed the immediate repayment of investors' funds was to liquidate the companies and to repay the investors, which would undoubtedly have resulted in the devaluation of investors' funds.

In the months following the issuing of the directives, however, the PSCs appointed new, independent directors to their boards of directors who requested the Department to afford them additional time to consider alternative options. The Department granted the new boards of directors a reasonable period of time in which to seek alternative options to effectively comply with the directive to repay investors. In the prevailing circumstances this concession was deemed to be both responsible and reasonable as it aimed to preserve the inherent value in the PSCs for the benefit of the investors.

the PSCs appointed new, independent directors who requested additional time to consider alternative options

The boards of directors opted to resolve the matter by means of schemes of arrangement as contemplated in section 311 of the Companies Act. The Department had no objection to the

70 The Presidency, *Government Gazette* No. 30474 (Pretoria: The Presidency, November 2007).

proposal in principle as schemes of arrangement not only require approval by the vast majority of shareholders or investors, but also the sanctioning thereof by the High Court.

In light of the above it is clear that the Department is in no way party to any of the schemes of arrangement. The facts provided, the views expressed and the proposals made in terms of Sharemax were so provided, expressed and made by the boards of directors of the PSCs. As a result, such facts, views or proposals should not be construed as having been provided, expressed or made by the Bank, the Registrar, or the appointed managers.

When the Companies Act became effective on 1 May 2011, it introduced the concept of 'business rescue' which was also considered by the boards of directors of the PSCs and applied in certain instances. From the outset the Department realised that any repayment plan would entail the incurrence of costs and expenses. To this end the Department insisted on a detailed expense budget for the schemes of arrangement and it allowed the payment of such expenses with the strict condition that the boards of directors satisfy themselves that every payment made was necessary, reasonable, in the interests of the investors, and that it was legal to do so. The payment of expenses in this regard was also monitored closely by the appointed managers. The costs associated with the schemes of arrangement and business rescue were funded by available funds in the PSCs.

The fees and costs of the inspection and management of Sharemax and the PSCs were paid for by the Department. The Department is satisfied with the professional and competent manner in which the appointed inspectors, who were subsequently appointed as managers, conducted their respective appointments. It is hereby confirmed that the appointed managers performed their duties in the interest of the Department, the Bank and the investors.

Neither the Department, the Bank nor the appointed managers will henceforth have any involvement with the PSCs concerned. The future success of, and the risk and reward associated with, the PSCs will be dependent on various factors, such as the economy in general and the quality of their management in particular.

### 3.5.3 Ingede Mineral Holdings (Pty) Limited

Ingede collected over R70 million from more than 3 000 investors

One of the inspections that sparked the media's interest was Ingede Mineral Holdings (Pty) Limited (Ingede). Ingede was a scheme operated by a certain Mr Nsikayomuzi Goodman Goqo, who collected over R70 million from more than 3 000 investors. Temporary inspectors were appointed and after it was proved that Ingede was contravening the Banks Act, managers were appointed to manage the repayment of the funds collected from investors.

On 26 April 2011, the Master of the Kwazulu-Natal High Court in Durban, Honourable Madam Justice K Pillay, appointed Mr T W van den Heever (Mr Van den Heever) of D & T Trust (Pty) Limited as the provisional liquidator of Ingede. Mr Van den Heever was nominated by the Department in terms of the provisions of section 84(1A)(d) of the Banks Act. The final sequestration of the joint estate of Mr Goqo and his wife was issued on the same day as the final liquidation of Ingede, thereby ending the inspection by the Department.

### 3.5.4 Conclusion

The Department annually inspects various schemes similar in nature to those discussed above. Actions taken by the Department in this regard depend on the facts and circumstances of each case, and all schemes are dealt with in accordance with the applicable legislative framework.

Experience has shown that illegal deposit-taking schemes benefit only a few individuals. Such persons are usually the operators of the scheme, their agents (who earn commission from attracting investments) and a few individuals who either invested with the scheme during the initial stages and who actually received the promised returns, or who were fortunate enough to have had their investments repaid with interest.

in most instances illegal deposit-taking schemes do not generate real income

Regrettably, the truth is that in most instances illegal deposit-taking schemes do not generate real income since money collected from investors is merely 'rolled', meaning that new investors' funds are used to pay the returns of the initial investors. The main pitfall of this type of scheme,

however, is that it is impossible to maintain the scheme due to the fact that when the scheme becomes larger in size, an ever-increasing number of new investors are required to enable operators to maintain repayments to the initial investors. The fact that the promised returns are usually absurdly high and utterly unattainable means that the repayments thereof become impossible to maintain as the number of investors increases. Furthermore, funds collected from investors are not actually invested but are instead used to finance the living costs of the scheme's operators. For example, in one inspection over which the Department presided, over R5 million was used to purchase luxury cars for the operator of the scheme, while in another inspection approximately R14 million was spent on gambling. Inevitably, however, the schemes fail and investors lose their funds.

In order to inform the public about the risks and dangers of illegal deposit-taking schemes, the Department, with the help of the Strategy and Communications Department of the Bank, will conduct a public awareness campaign during 2012.

the Department will conduct a public awareness campaign during 2012

## 3.6 Exemption of banks in terms of the Consumer Protection Act, 2008

The provisions of section 14 of the Consumer Protection Act, 2008 (Act No. 68 of 2008 – the CPA) in part provide for the expiry and renewal of fixed-term agreements which, from the perspective of the banking industry would include, among other things, fixed-deposit agreements. While transactions between a bank and all juristic persons are excluded from the scope of the provision by virtue of section 14(1) of the CPA, it does not exclude transactions between a bank and individuals.

Despite the fact that it is ostensibly targeted at contract abuse by, for example, cell phone or health club service providers, section 14 of the CPA also confers a general right on the individual consumer to cancel his or her long-term and fixed-deposit contracts with a bank. The current practice is that the right to cancel these contracts vests with the bank. The bank has the discretion to release funds ahead of the contractual term on the grounds of some element of hardship based on the financial circumstances prevalent at the time. However, section 14(2)(b)(i)(bb) of the CPA, as it currently stands, removes that discretion and instead affords the individual a statutory right to cancel a fixed-term deposit contract by giving 20 days' notice.

In terms of section 14(2)(b)(i)(bb), the CPA provides that:

> … if a consumer agreement is for a fixed term despite any provision of the consumer agreement to the contrary, the consumer may cancel that agreement at any other time, by giving the supplier 20 business days' notice in writing or other recorded manner and form, subject to subsection (3)(a) and (b).[71]

The clause can therefore lead to substantial unintended consequences such as the following:

- It undermines the 'best regulatory practice' of encouraging banks to hold increasing proportions of their deposits in medium- and long-term contracts.
- It empowers the consumer to re-price the investments at any time during the contract period (specifically in a rising interest rate period).
- It is likely to oblige banks to report their retail deposits with a medium- or long-term contractual maturity as notice or short-term deposits (that is, 20 business days). This will force banks to downgrade and reclassify all medium- and long-term retail deposits to short-term deposits, which would consequently lead to a substantial increase in not only liquidity risk and liquid asset requirements, but also a restriction in lending capacity.

While the CPA and the Regulations relating thereto provide that a supplier (bank) may keep the fixed-term agreement intact, the burden of proof nevertheless rests with the bank as the supplier of the service to demonstrate the financial benefit to the individual consumer. In essence, it denies a bank the right to invoke its common law remedies in the case of a breach of contract.

71 The Presidency, *Government Gazette* No. 32186 (Pretoria: The Presidency, April 2009).

Should a bank fail to show financial benefit to the individual consumer, and a determined consumer proceeds to give 20 business days' notice of the cancellation of a fixed-term deposit, further unintended consequences may result, for example, liquidity risk management could be adversely affected. Since a bank presumes that the vast majority of fixed deposits will be retained until maturity, it funds itself with the fixed-rate (and by definition fixed-maturity) deposits as a partial hedge against fixed lending. However, should a future financial crisis cause panic in the market and result in a run on banks, the cancellation of fixed-term deposit contracts in terms of the CPA will result in a bank not being able to sustain its liquidity ratio for long periods, which may result in the failure of the bank, and in turn add to the risk of failure of the entire banking system. This is because banks typically rely on stability in the deposit base, which is provided by fixed-maturity deposits, to manage their net cash flow in order to satisfy customer demands for funds as they fall due. Since banks submit statutory returns based primarily on the contractual obligations to and from clients, the option to cancel a fixed-term agreement introduced by the CPA can render this information meaningless.

the Registrar expressed concerns about the unintended consequences that section 14(2)(b)(i)(bb) of the CPA may have on banks' liquidity risk management

The Department lodged an application with the Minister of Trade and Industry in April 2011 to raise the above-mentioned concerns. In the application, the Registrar expressed concerns about the unintended consequences that section 14(2)(b)(i)(bb) of the CPA may have on banks' liquidity risk management and the resultant systemic risk to which it could lead. The Registrar's application also addressed the general concern that prudential oversight of the banking industry might be compromised.

Subsequent to the above-mentioned application, the Minister of Trade and Industry, in *Government Gazette* No. 34399 dated 27 June 2011, issued Government Notice 532 in terms of section 5(4) of the CPA, exempting all banks registered in terms of the Banks Act, mutual banks registered in terms of the Mutual Banks Act and co-operative banks registered in terms of the Co-operative Banks Act, 2007 (Act No. 40 of 2007) from the provisions of section 14 of the CPA.

## 3.7 Developments regarding Postbank

The Postbank Act, which took effect on 19 July 2011, aims to transform Postbank from a division of the South African Post Office (SAPO) to a separate entity registered in terms of the new Companies Act. This is but one of the steps necessary to overcome the barriers preventing Postbank from qualifying to register as a bank in terms of the Banks Act.

The passing of the Postbank Act is the culmination of a process that was begun prior to 2005 by the signing of a memorandum of understanding between the then Minister of Communications and the then Minister of Finance, setting out a phased approach towards restructuring Postbank.

the Department has initiated a process to address the contentious clauses in the Postbank Act

The Department welcomes these developments and is set to honour the ultimate objective of the legislation, that is, for the Office of the Registrar of Banks to exercise supervisory control over the activities of Postbank in terms of the reporting requirements of the Banks Act. For this reason, the Department has initiated a process to address the contentious clauses in the Postbank Act, the envisaged end result being the removal of inconsistencies in the Postbank Act to ensure that it complies with the Banks Act and is aligned with the banking regulatory and supervisory framework in South Africa which is based, among other things, on the Basel Committee's Core Principles and the Basel framework. The Department anticipates the review process to be conducted in parallel with the ongoing process of registering Postbank as a separate entity in terms of the new Companies Act. It is expected that the review process will culminate in the registration and licensing of Postbank in terms of the Banks Act. The rationale behind taking this step is to avoid creating the impression that the Department is displaying leniency towards Postbank by waiving its powers in terms of the Banks Act. If the inconsistencies in the Postbank Act are not removed, the impression could easily be created that the Department will not only condone Postbank's non-compliance with the strict licensing criteria when it awards a banking licence to Postbank, but also not require it to undergo the same rigorous supervision as other banks registered in terms of the Banks Act.