Banking on Reform - An African Case Study

The ongoing curatorship of African Bank has perhaps arisen at a fitting time, when what was historically feverishly slow and sparse insolvency reform across the African continent may just be showing signs of awakening (the recent enactment of the new Insolvency Act 2015 in Kenya and introduction of Chapter 6 Business Rescue proceedings into the new Companies Act in South Africa being but two examples of this).

The often stark contrast between local practices (which can vary greatly across the African continent's different jurisdictions) and that which is more closely aligned toward international regimes (UNCITRAL model law and cross border insolvency regimes being of relevance here) remains a key challenge.

As investors seek to capitalise on growth opportunities across Africa (but at the same time view the risk of insolvency and a lack of clarity over insolvency outcomes and or workout mechanisms available to them as key impediments), never so more than today has insolvency reform and transparency been more pertinent, for both local and foreign stakeholders alike.

In his keynote address at the recently held INSOL Africa Roundtable conference in Cape Town, the honorable John Jeffery, MP, Deputy Minister of Justice and Constitutional Development, South Africa reminded us of a recent High Court judgement by Acting Judge Katz, who held that "although the law of insolvency is generally concerned with protecting the rights of and interests of the creditors, insolvency, necessarily and appropriately, is shifting from being a creditor-driven regime to focusing on the interests of other stakeholders involved in and affected by the insolvency proceedings."

This sentiment was further echoed in the Cork Report on English Insolvency reform, which states that a modern system of insolvency law must consider three parties, namely the debtor, the creditor and society.

Further on in this article, we provide a few highlights of the African Bank curatorship to date and explore the timely re-invigoration of a push towards insolvency reform across the African continent.

South African Restructuring and Insolvency Law

In South Africa presently, restructuring and insolvency law is principally governed by four areas of legislation, namely the new Companies Act 71 of 2008 (the new "Companies Act"), the Companies Act 61 of 1973 (the "Old Act"), the Insolvency Act 24 of 1936 (the "Insolvency Act") and to a much lesser extent, the Cross-Border Insolvency Act 42 of 2000 (the "Cross-Border Insolvency Act").

Whilst incorporating the provisions of the UNCITRAL model law on insolvency, the Cross-Border Act has yet to contain specific countries or states designated by the Minister (as required in the Act), and as a result remains of limited use in assisting on cross-border insolvency matters. Notwithstanding any adoption of or specific reference to UNCITRAL's model law, once a foreign creditor, representative or other stakeholder has gained access to the South African legal system via the Cross-Border Insolvency Act, they will have to abide by the relevant South African regulations and rules.

That said, in the context of the above, matters continue to be dealt with on a case by case basis. A strong example of this was the Overseas Shipholding Group Inc (listed on the New York Stock Exchange), where the South African courts granted an order for the US' bankruptcy code to be applied, including recognition of the automatic stay incorporated therein.

The main change to the South African insolvency rules brought about by the Companies Act (introduced in May 2011) is that judicial management is repealed and replaced with business rescue, referenced in part to the United

States' Chapter 11 bankruptcy regime, in addition to which schemes of arrangement (now referred to as "compromises") have also been updated.

Although the liquidation, winding up or management of distressed or insolvent banks, insurance companies and pension funds is governed in part by the Insolvency Act and Companies Act, there is also specific legislation which pertains to the administration of such institutions in such circumstances, and is contained mainly within the Banks Act 94 of 1990 (the "Banks Act") (including curatorship as referenced in section 69 of the said Act), the Long-term Insurance Act 52 of 1998, the Short-term Insurance Act 53 of 1998 and the Pension Funds Act 24 of 1956.

The African Bank Curatorship – A Snapshot

On 10 August 2014, African Bank was placed into curatorship by the South African Reserve Bank (the "SARB") and the Minister of Finance.

African Bank is a wholly owned subsidiary of the Johannesburg Stock Exchange listed controlling company African Bank Investments Limited ("ABIL"). The Bank specialises in the provision of unsecured lending in the form of personal loans and credit cards to middle and lower income customers across South Africa.

In the months leading up to the curatorship, ABIL announced a significant financial loss, prompted by significantly deteriorating profitability within African Bank, its losses in turn being attributed to both higher provisions arising from non-performing loans (and declining collections from its existing loan book) as well as the increasing loss making position of one of the main group entities, Ellerine Furnishers Limited ("EFL").

On 7 and 21 August 2014, EFL and Ellerine Holdings Limited ("EHL"), the holding company of EFL, filed for Chapter 6 Business Rescue proceedings respectively. Separate practitioners, independent from the curatorship, were appointed over both entities.

The possible impact that a collapse of the Bank might have had on money-market funds invested in African Bank, alongside an assessment of the appetite for and ability to execute a bail out or bail in, were key upfront considerations. Support from the consortium of banks exposed to the Bank (the "Consortium") for the proposed transaction was also influenced by the desire to provide certainty of outcome to the money-market funds and other fund managers exposed to the same entity (both locally and overseas). Of prime importance was maintaining stability for South African debt, particularly in the international bond market.

The Curator's appointment by and principal mandate from the South African Minister of Finance was to stabilise the operations of the Bank and to implement the SARB restructuring proposal, under the direction and supervision of the Registrar of Banks. Over the course of the past year, significant work has been undertaken to further develop and refine the SARB restructuring proposal (with input from the relevant stakeholders).

Emanating from initial considerations as to the appropriateness of curatorship and how such a mechanism might meet the restructuring mandate and wider SARB goals, a number of key considerations and issues were highlighted, including:

1. Agreement as to the role of the SARB and Regulator (both from a transaction and monitoring and intervention point of view);
2. Immediate review of wholesale versus depositor funding mix (a gradual withdrawal of funding rollovers by the lenders would need to be forecast and the impact on liquidity managed), alongside an assessment of the interbank positions and likely impact curatorship could have thereon;
3. Amendments to the Banks Act would be required in order to allow the agreed transaction to be effected, further resulting in improved flexibility across the wider South African banking system;
4. Any changes to the law would need to promote a stable but not over-regulated banking sector. In addition to this, any tension between the principal Acts (Insolvency Act, Companies Act and Banks Act) would need to be managed;
5. There was a prerequisite to balance the initial liquidity crisis and the ultimate need to drive stability through the banking system;
6. There were (and remain) a number of interdependent and complex factors which would need to be concurrently managed whilst ensuring "business as usual". These included transaction and restructuring related issues, the impact of the business rescue proceedings in fellow group companies on the Bank, regulatory issues (for example licensing in Good Bank), operational issues (such as the transfer of

customer loans and employees and disbursement control) and moral hazard risk (contagion) across the loan book.

The proposed transaction (which at the date of this publication had not yet been completed), features a number of standard international market conventions, comprising, inter alia:

1. The formation of a Consortium (comprised mainly of the existing local lenders and SARB) to support and underwrite the restructuring of the Bank (through an equity injection into a newco);
2. A split out of the African Bank loan book into a "good book" and a "residual book" (the latter of which it is intended will remain in the old legacy Bank entity (the "Residual Bank"));
3. The transfer of key operational assets and liabilities of the Bank, as well as the good book to a newco (the "Good Bank") (with concerns around ongoing contamination of legacy issues and contingent liabilities being a key driver of this tested mechanism);
4. Transfer of the existing debt to the newco by way of exchange offer (being the non-renounceable offer that will enable senior funders to exchange their existing debt instruments for new and stub debt instruments in Good Bank and Residual Bank respectively. Likewise, for the subordinated lenders, the offer is to allow such lenders to exchange a specified portion of their existing debt instruments for new debt (and or shares) in Good Bank and retain the remaining portion of their existing debt in Residual Bank);
5. The acquisition of the residual book by a vehicle supported by the SARB; and
6. Effecting of certain amendments to the Banks Act (in the main to allow for the transfer of the good book/business to Good Bank).

The above reflects and plays testament to the ongoing need for flexibility within the Banks Act (or equivalent) and related laws (and application thereof) so as to ensure advantageous resolution planning and the successful implementation thereof, on a case by case basis.

Insolvency Reform in South Africa – New Draft Bill

South Africa's principal insolvency law came into effect on introduction of the Insolvency Act 24 of 1936. Further, insolvency law is also set out across a number of Acts and is often in conflict with each other. As such, an opportunity exists to reform and harmonise certain areas of the legislation. A similar approach to insolvency reform is further taking place or expected across a number of other African jurisdictions.

In addition to the overall modernisation of legislation, there are a number of areas which further require development. For example, the complexity and mostly obsolete structure for taking security over movable assets in South Africa provides a clear example of this. Here, security over such assets can take the form of liens, special and general notarial bonds, pledges, cessions and or hypothecs to name a few. This creates the opportunity for confusion, lack of transparency and impracticalities for calling on and realising such assets in an efficient and effective manner.

In contrast, in a number of other jurisdictions, it is generally accepted that "floating charge jurisdictions" typically provide more advantageous environments in which lenders can call on (and recover from) this type of security.

In this context, it is further worth noting that a number of jurisdictions across the African continent draw from Roman-Dutch, German, Portuguese and English law (for example Mozambique's legal system is based on Roman-Dutch and German law, whilst Botswana, by way of illustration, is predicated on a mixture of Roman-Dutch and English common law principles). This provides, in some ways, for increasing alignment to a number of common international principles (and hence improved clarity for foreign stakeholders), particularly as reform continues to take place.

With the above in mind, some of the main features of the proposed insolvency bill include the following:

- Fair and effective procedures for all stakeholders, including an alignment of legislation in respect of entities and natural persons;
- Creation of an oversight body for and more regulation over the appointment of liquidators (all liquidators to be members of "accepted" professional bodies);
- Incorporation of the Cross-Border Insolvency Act into the draft bill; and
- Incorporation of Chapter 6 Business Rescue proceedings to extend to commercial entities with "10 or more employees".

Concluding Remarks

Overall, both in South Africa and sub-Saharan Africa, we expect the number of restructurings and insolvencies to remain high as we look towards 2016 and beyond.

With the prospects for economic growth becoming increasingly weak and unemployment and consumer debt levels on the rise, domestic and international lenders have expanded across sub-Saharan Africa in recent years. As such, they have been keen participants in funding commodity and oil and gas projects. Weak commodity and oil prices are expected to lead to an increase in cross border restructurings in both these and related sectors.

In addition, there continues to be ongoing refinancing and restructuring activity as leveraged borrowers seek to re-base deals concluded in the period leading up to the global financial crisis in the late 2000's. A rising interest rate environment (locally or on foreign denominated debt) could trigger the requirement for a series of major restructuring opportunities, particularly in the mining or commodity sectors here in Africa.

Whilst a number of insolvency regimes across the more developed jurisdictions provide a sound and sensible platform from which local insolvency frameworks can be (and are being) developed, it remains critical to recognise and incorporate such local custom and challenges within such regimes (for example job creation and protection, alongside the promotion of economic growth remain, rightly so, key priorities and the ultimate goal of reform). Indeed, empirical studies across both developed and less mature nations suggest a strong correlation between improved availability, accessibility and cost of financing and that of tested and effective insolvency regimes.

In addition to the example of African Bank as briefly discussed in this article, a number of high profile and important mining sector cases across the African region are increasingly coming to the forefront (the iron ore industry in Sierra Leone where a number of banks had exposure to London Mining plc (in administration) as well as the Pamodzi Gold and Blyvooruitzicht Gold Mine rescues provide examples of a few recent prominent failures which have impacted stakeholders both within and passed local borders).

It will be interesting to see just how quickly reform is considered and implemented across the African continent. Further, insolvency reform will need to be accompanied by clear and consistent precedence, mechanisms to allow agility and flexibility to the application of law by those qualified to do so, ongoing skills and education development and a robust, respected body responsible for regulatory oversight.

For now, at least, the trajectory for insolvency reform across the African continent seems to be gathering pace.

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