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To:
Select Committee on Finance

Attention:
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COMMENT

on the

FINANCIAL SECTOR LAWS AMENDMENT BILL (B 15–2020)

to the

Select Committee on Finance

SUMMARY OF OBSERVATIONS

There are very few specific details in the Bill on the actual arrangements for the resolution of systemically important financial institutions that may be unable to meet their obligations:

1. It is claimed that the Bill's statutory deposit-insurance scheme will reduce moral hazard. It will however, not do away with moral hazard. Indeed, the existence of such a scheme might even encourage it in certain quarters.

2. It is claimed that losses that are incurred due to failure of an institution will in the first instance be borne by shareholders and creditors "who are able to properly assess their investment risks" and "who had benefited from profits made by the institution as a going concern". Yet there is no indication in the Bill as to precisely how these persons or entities are to be defined or identified.

3. There is also no clear identification of which creditors can "assess their investment risks and benefits from bank profits". The justification given for targeting such creditors may well prove to be indefensible.

4. The Banks' duty to pay premiums and levies to meet the expense of insuring depositors' money will increase their overall costs and without doubt will be passed on to their customers, directly and/or indirectly.

5. The Bill aims to "assist" in maintaining financial stability and protecting the interests of depositors through the "orderly resolution" of banks, and other financial institutions. A designated institution will be placed in resolution if (in the opinion of the Reserve Bank) it is, or will likely be, unable to meet its obligations, whether or not it is insolvent.

6. The Reserve Bank then has extensive powers and "resolution functions" including cancelling or suspending contracts involving the institution and causing the institution to transfer assets or liabilities, amalgamate or merge, or cancel shares independently valued as worthless and issue new shares. The Bank can even reduce contractual amounts payable to other parties or cancel the contracts altogether. These wide discretionary powers bestowed upon bureaucrats are likely to violate the requirements of the Rule of Law.

7. Despite the sweeping powers vested in the staff of the Reserve Bank, their attempted resolution of an institution can still fail. There may then be bureaucratic "moral risk" in such persons being given power to subsequently apply to court for the winding-up of an institution in resolution, on the grounds that they have failed and that there are thus no reasonable prospects that the institution will ever cease to be in resolution.

8. The loss-absorbing-capacity (so-called flac or tlac) investment instruments for banks to hold have yet to be designed. A recent evaluation by the Basel Financial Stability Board of the effects of current "too-big-to-fail" bank reforms, haltingly conceded that while some reforms have made banks more resilient and resolvable, numerous intractable obstacles to resolvability remain. State support for failing banks using taxpayer money has therefore had to be continued and has not been eliminated by the proposals included in this Bill.

9. It is important to note that a late 2020 analysis for the World Bank about market appetite in South Africa for flac instruments was ambivalent about current take-up prospects.

10. Considerable improvement are required to be made to this Bill, not only to the proposed implementation of flac instruments, but also to resolution funding, to valuation of bank assets whilst in resolution, to continuity of operations and to access to financial-market infrastructure during periods of resolution.

11. With all of the above uncertain and unresolved matters, there is considerable doubt as to if or even when this Bill could be properly or effectively enacted.

12. The Bill is not accompanied by the required Socio-Economic Impact Assessment. It is therefore not possible for any person to assess whether or not the costs of deposit insurance and of the proposed resolution practices, all inevitably to be passed on to the public, will justify the claimed benefits.

Introduction

On 11 June 2020, the National Treasury announced[1] that the Cabinet had approved the tabling in Parliament of the Financial Sector Laws Amendment Bill (B 15–2020).

The Minister of Finance introduced the Bill in the National Assembly on 17 August 2020.

On 6 October 2021, Parliament's Select Committee on Finance invited interested persons to submit comments by 18 October on the Bill as amended by the National Assembly's standing committee on finance (B 15B–2020).

The Select Committee's Chair has granted us an extension until 25 October to comment. We comment as follows.

Headline observations

The global financial and banking crisis occurred in 2007–2009. But there is as yet no finality on this arrangement for the insurance of bank deposits and resolution of systemically important financial institutions which may be unable to meet their obligations.

It is said that the Bill's deposit-insurance cover will reduce moral hazard. But this statutory insurance scheme will not do away with moral hazard.

[1] South African Government, National Treasury, Media Statement, 11 Jun 2020, "Tabling of the Financial Sector Laws Amendment Bill, 2020" *https://www.gov.za/speeches/treasury-tabling-financial-sector-laws-amendment-bill-11-jun-2020-0000*

It is said that losses which are incurred due to failure of an institution will in the first instance be borne by shareholders, and creditors "who are able to properly assess their investment risks" and "who had benefited from profits made by the institution as a going concern". But there is no indication to this effect in the Bill. Nor is there a clear identification of which creditors can assess their investment risks and benefit from bank profits. This justification for targeting any such creditors may well be untenable.

Banks' duties to pay premiums and levies to meet the expense of insuring deposits will increase their overall costs, and be directly or indirectly passed on to their customers.

The Bill aims to "assist" in maintaining financial stability and protecting the interests of depositors of banks through the "orderly resolution" of banks, and other financial institutions designated as systemically important.

A designated institution will be placed in resolution if it is, or will likely be, unable to meet its obligations, whether or not it is insolvent. The Reserve Bank then has various powers and "resolution functions" including cancelling or suspending contracts involving the institution, and "resolution actions" including causing the institution to transfer assets or liabilities, amalgamate or merge, or cancel shares valued as worthless and issue new shares. The Bank can reduce contractual amounts payable to other parties or cancel the contracts. The Bank must merely ensure that no creditor or shareholder receives less than she would have if the institution had been wound up.

Despite all these sweeping powers vested in the Reserve Bank, its attempted resolution of an institution can fail. The Bank is given power to apply to court for the winding-up of an institution in resolution, on the ground that there are no reasonable prospects that it will ever cease to be in resolution.

Loss-absorbing-capacity (so-called *flac*) instruments for banks to hold must still be designed.

A recent evaluation by the Financial Stability Board (a Basel multinational committee of central bankers and supervisors) of the effects of the too-big-to-fail reforms tentatively concluded that (while reforms have made banks more resilient and resolvable, and benefits of the reforms outweigh their costs, and indicators of systemic risk and moral hazard have "moved in the right direction"), obstacles to resolvability of systemically-important banks remain, and improvements should be made to implementation of loss-absorbing-capacity instruments, resolution funding, valuation of bank assets in resolution, and continuity of operations and of access to financial-market infrastructure. State support for failing banks has continued.

A late-2020 analysis for the World Bank about market appetite in South Africa for *flac* instruments was inconclusive about current take-up prospects.

It is doubted when the Bill on enactment will ever be brought into operation.

We touch below on background documents, then identify pertinent clauses of the Bill.

Treasury Policy Doc 2011 – Need for special "resolution" laws to address liquidity and solvency problems affecting financial institutions deemed "too big to fail"

In February 2011 the National Treasury issued a Policy Document (*A safer financial sector to serve South Africa better*[2]) which stated:[3]

> **Policy priority 1: Financial stability**
> The South African financial services industry operates in a globalised environment where a crisis in one economy can easily spread to another, with devastating speed and impact. Increased international trade, vital to ensuring that South Africa creates jobs and continues to grow, will require the financial sector to be integrated further with the global economy. This, however, may introduce increased financial stability risks and the need for enhanced supervision of the financial sector.

The 2011 Policy Document noted, about the Financial Stability Board in Basel:[4]

> **[…] Financial Stability Board**
> The Financial Stability Board (FSB) has been established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies. It brings together national authorities responsible for financial stability in significant international financial centres, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts.
>
> All G-20 countries have between one and three seats on the FSB. South Africa has one seat, held by National Treasury. Other members of the FSB include the International Monetary Fund, the World Bank, the European Commission, the European Central Bank, the Bank of International Settlements and the Organisation for Economic Cooperation and Development.

The Policy Document observed that the Financial Stability Board had initial proposals for regulating "systemically important financial institutions" (SIFIs):[5]

> **Regulating systemically important financial institutions**
> During the financial crisis, governments were forced to bail out those banks that were systemically important, and whose collapse would have led to extreme turmoil in financial markets. The existence of financial institutions that are not subject to market discipline, however, creates the problem of moral hazard.
>
> Secure in the knowledge that they will be bailed out by the government, these institutions may face the incentive to undertake excessively risky investments.
>
> Concerns have been expressed that the measures taken to support institutions, particularly the global banking sector, during the crisis, has created significant moral hazard issues that will remain a challenge well into the future, and could sow the seeds of a future crisis. The regulation of global systemically important financial institutions (G-SIFIs) has become one of the biggest regulatory challenges in the post-crisis landscape.
>
> The Financial Stability Board has developed initial proposals for the regulation of such institutions – referred to as SIFIs – and presented these to G-20 leaders at the Seoul Summit in November 2010. Broadly speaking, the mechanisms seek to achieve the following objectives:
>
> - […]
> - **Improving the framework for resolution.** These measures seek to reduce the spread of contagion that results from the collapse of a large, cross-border financial institution, and to limit the use of taxpayer money in bail-outs. An effective resolution framework includes creating colleges of supervisors and

[2] National Treasury Policy Document, *A safer financial sector to serve South Africa better, 2011*, 23 Feb 2011, Pretoria.
[3] National Treasury, *A safer financial sector to serve South Africa better, 2011* (supra) p 5.
[4] National Treasury, *A safer financial sector to serve South Africa better, 2011* (supra) p 11 (Box 2.1).
[5] National Treasury, *A safer financial sector to serve South Africa better*, *2011* (supra) p 20–21.

"living wills", which explain how the institution is to be wound up if in distress, while still maintaining its core functions.

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The 2011 National Treasury Policy Document went on to lay out certain "principles" to guide reforms of the financial regulatory system in South Africa:[6]

> **Principles behind reforming the financial regulatory system**
> The proposed reforms of the financial regulatory system in South Africa are guided by the following "principles" or guidelines:
> […]
> **Principle 10: Special mechanisms are needed to deal with systemically important financial institutions (SIFIs).** The regulatory system must put in place special mechanisms to mitigate systemic risks posed by SIFIs. In particular, regulators must reduce the moral hazard risk inherent in financial institutions deemed "too big to fail" […], as well as reduce the possibility of requiring government-sponsored bail-outs of financial institutions. This may require special resolution legislation to deal with liquidity and solvency problems affecting SIFIs, as many generic laws cannot apply to SIFIs in a crisis.

As to deposit insurance, the Policy Document observed: that a number of challenges complicate the introduction of deposit insurance, but discussions were on-going.

> **Deposit insurance**
> *A number of challenges complicate the introduction of deposit insurance. Discussions are on-going*
> Deposit insurance seeks to protect bank depositors, in part or in full, in the event of a bank failure. It is one way to balance the often-conflicting policy objectives of financial inclusion and financial sector stability. Although National Treasury circulated a draft Deposit Insurance Bill in 2008 for comments, a range of challenges complicate the conclusion of this initiative. These include the need to take into account the specifics of the South African financial system – the domination of the sector by four big banks, and the leading role of corporate depositors in previous bank-run episodes.

Financial Stability Board's *Key Attributes of Effective Resolution Regimes*

In October 2011, the Financial Stability Board in Basel published *Key Attributes of Effective Resolution Regimes for Financial Institutions*.[7]

The Financial Stability Board's document *Key Attributes* states:[8]

> **Foreword**
> The Key Attributes […] set out the core elements that the FSB considers to be necessary for an effective resolution regime. Their implementation should allow authorities to resolve financial institutions in an orderly manner without taxpayer exposure to loss from solvency support, while maintaining continuity of their vital economic functions.

As to resolution's objective and purposes, the Board's *Key Attributes* document says:[9]

> **Preamble**
> The objective of an effective resolution regime is to make feasible the resolution of financial institutions without severe systemic disruption and without exposing taxpayers to loss, while protecting vital economic functions through mechanisms which make it possible for shareholders and unsecured and uninsured creditors to absorb losses in a manner that respects the hierarchy of claims in liquidation.

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6 National Treasury, *A safer financial sector to serve South Africa better, 2011* (supra) p 25–27.
7 Financial Stability Board, *Key Attributes of Effective Resolution Regimes for Financial Institutions*, Oct 2011, Basel.
8 Financial Stability Board, *Key Attributes of Effective Resolution Regimes* (supra) p 1, Foreword.
9 Financial Stability Board, *Key Attributes of Effective Resolution Regimes* (supra) pp 3–4, Preamble.

An effective resolution regime (interacting with applicable schemes and arrangements for the protection of depositors, insurance policy holders and retail investors) should:

(i) ensure continuity of systemically important financial services, and payment, clearing and settlement functions;
(ii) protect, where applicable and in coordination with the relevant insurance schemes and arrangements such depositors, insurance policy holders and investors as are covered by such schemes and arrangements, and ensure the rapid return of segregated client assets;
(iii) allocate losses to firm owners (shareholders) and unsecured and uninsured creditors in a manner that respects the hierarchy of claims;
(iv) not rely on public solvency support and not create an expectation that such support will be available;
(v) avoid unnecessary destruction of value, and therefore seek to minimise the overall costs of resolution in home and host jurisdictions and, where consistent with the other objectives, losses for creditors;
(vi) provide for speed and transparency and as much predictability as possible through legal and procedural clarity and advanced planning for orderly resolution;
(vii) provide a mandate in law for cooperation, information exchange and coordination domestically and with relevant foreign resolution authorities before and during a resolution;
(viii) ensure that non-viable firms can exit the market in an orderly way; and
(ix) be credible, and thereby enhance market discipline and provide incentives for market-based solutions.

Jurisdictions should have in place a resolution regime that provides the resolution authority with a broad range of powers and options to resolve a firm that is no longer viable and has no reasonable prospect of becoming so. The resolution regime should include:

(i) stabilisation options that achieve continuity of systemically important functions by way of a sale or transfer of the shares in the firm or of all or parts of the firm's business to a third party, either directly or through a bridge institution, and/or an officially mandated creditor-financed recapitalisation of the entity that continues providing the critical functions; and
(ii) liquidation options that provide for the orderly closure and wind-down of all or parts of the firm's business in a manner that protects insured depositors, insurance policy holders and other retail customers. […]

As to the scope of a resolution regime, the *Key Attributes* document recommends:[10]

1. Scope

1.1 Any financial institution that could be systemically significant or critical if it fails should be subject to a resolution regime that has the attributes set out in this document ("Key Attributes"). The regime should be clear and transparent as to the financial institutions (hereinafter "firms") within its scope. It should extend to:

(i) holding companies of a firm;
(ii) non-regulated operational entities within a financial group or conglomerate that are significant to the business of the group or conglomerate; and
(iii) branches of foreign firms.

1.2 Financial market infrastructures ("FMIs") should be subject to resolution regimes that apply the objectives and provisions of the Key Attributes in a manner as appropriate to FMIs and their critical role in financial markets. The choice of resolution powers should be guided by the need to maintain continuity of critical FMI functions.

As to a resolution authority and its functions, the *Key Attributes* document says:[11]

2. Resolution authority

2.1 Each jurisdiction should have a designated administrative authority or authorities responsible for exercising the resolution powers over firms within the scope of the resolution regime ("resolution authority"). […]

2.3 As part of its statutory objectives and functions, and where appropriate in coordination with other authorities, the resolution authority should:

[10] Financial Stability Board, *Key Attributes of Effective Resolution Regimes* (supra) p 5, Scope.

[11] Financial Stability Board, *Key Attributes of Effective Resolution Regimes* (supra) pp 5–6, Resolution authority.

(i) pursue financial stability and ensure continuity of systemically important financial services, and payment, clearing and settlement functions;
(ii) protect, where applicable and in coordination with the relevant insurance schemes and arrangements, such depositors, insurance policy holders and investors as are covered by such schemes and arrangements;
(iii) avoid unnecessary destruction of value and seek to minimise the overall costs of resolution in home and host jurisdictions and losses to creditors, where that is consistent with the other statutory objectives; and
(iv) duly consider the potential impact of its resolution actions on financial stability in other jurisdictions.
[…]
2.6 The resolution authority and its staff should be protected against liability for actions taken and omissions made while discharging their duties in the exercise of resolution powers in good faith, including actions in support of foreign resolution proceedings.
2.7 The resolution authority should have unimpeded access to firms where that is material for the purposes of resolution planning and the preparation and implementation of resolution measures.

As to the powers of a resolution authority, the Board stipulates:

3. Resolution powers

Entry into resolution

3.1 Resolution should be initiated when a firm is no longer viable or likely to be no longer viable, and has no reasonable prospect of becoming so. The resolution regime should provide for timely and early entry into resolution before a firm is balance sheet insolvent and before all equity has been fully wiped out. There should be clear standards or suitable indicators of non-viability to help guide decisions on whether firms meet the conditions for entry into resolution.

General resolution powers

3.2 Resolution authorities should have at their disposal a broad range of resolution powers, which should include powers to do the following: […]
(ii) Appoint an administrator to take control of and manage the affected firm with the objective of restoring the firm, or parts of its business, to ongoing and sustainable viability;
(iii) Operate and resolve the firm, including powers to terminate contracts, continue or assign contracts, purchase or sell assets, write down debt and take any other action necessary to restructure or wind down the firm's operations; […]
(v) Override rights of shareholders of the firm in resolution, including requirements for approval by shareholders of particular transactions, in order to permit a merger, acquisition, sale of substantial business operations, recapitalisation or other measures to restructure and dispose of the firm's business or its liabilities and assets;
(vi) Transfer or sell assets and liabilities, legal rights and obligations, including deposit liabilities and ownership in shares, to a solvent third party […]; […]
(viii) Establish a separate asset management vehicle […] and transfer to the vehicle for management and rundown non-performing loans or difficult-to-value assets;
(ix) Carry out bail-in within resolution as a means to achieve or help achieve continuity of essential functions either
(i) by recapitalising the entity hitherto providing these functions that is no longer viable, or, alternatively,
(ii) by capitalising a newly established entity or bridge institution to which these functions have been transferred following closure of the non-viable firm (the residual business of which would then be wound up and the firm liquidated) […]; […]; and
(xii) Effect the closure and orderly wind-down (liquidation) of the whole or part ofa failing firm with timely payout or transfer of insured deposits and prompt (for example, within seven days) access to transaction accounts and to segregated client funds).

Transfer of assets and liabilities

3.3 […] Any transfer of assets or liabilities should not:
(i) require the consent of any interested party or creditor to be valid; and
(ii) constitute a default or termination event in relation to any obligation relating to such assets or liabilities or under any contract to which the failed firm is a party […].

Bridge institution

3.4 Resolution authorities should have the power to establish one or more bridge institutions to take over and continue operating certain critical functions and viable operations of a failed firm […].

Bail-in within resolution

3.5 Powers to carry out bail-in within resolution should enable resolution authorities to:

(i) write down in a manner that respects the hierarchy of claims in liquidation […] equity or other instruments of ownership of the firm, unsecured and uninsured creditor claims to the extent necessary to absorb the losses; and to

(ii) convert into equity or other instruments of ownership of the firm under resolution (or any successor in resolution or the parent company within the same jurisdiction), all or parts of unsecured and uninsured creditor claims in a manner that respects the hierarchy of claims in liquidation; […].

Exercise of resolution powers

3.8 Resolution authorities should have the legal and operational capacity to: […]

(ii) apply different types of resolution powers to different parts of the firm's business (for example, retail and commercial banking, trading operations, insurance); and

(iii) initiate a wind-down for those operations that, in the particular circumstances, are judged by the authorities to be not critical to the financial system or the economy […].

5. Safeguards

Respect of creditor hierarchy and "no creditors worse off" principle

5.1 Resolution powers should be exercised in a way that respects the hierarchy of claims while providing flexibility to depart from the general principle of equal (*pari passu*) treatment of creditors of the same class, with transparency about the reasons for such departures, if necessary to contain the potential systemic impact of a firm's failure orto maximise the value for the benefit of all creditors as a whole. In particular, equity should absorb losses first, and no loss should be imposed on senior debt holders until subordinated debt (including all regulatory capital instruments) has been written-off entirely (whether or not that loss-absorption through write-down is accompanied by conversion to equity).

5.2 Creditors should have a right to compensation where they do not receive at a minimum what they would have received in a liquidation of the firm under the applicable insolvency regime ("no creditor worse off than in liquidation" safeguard). […]

6. Funding of firms in resolution

6.1 Jurisdictions should have statutory or other policies in place so that authorities are not constrained to rely on public ownership or bail-out funds as a means of resolving firms.

6.2 Where temporary sources of funding to maintain essential functions are needed to accomplish orderly resolution, the resolution authority or authority extending the temporary funding should make provision to recover any losses incurred

(i) from shareholders and unsecured creditors subject to the "no creditor worse off than in liquidation" safeguard […]; or

(ii) if necessary, from the financial system more widely.

6.3 Jurisdictions should have in place privately-financed deposit insurance or resolution funds, or a funding mechanism for ex post recovery from the industry of the costs of providing temporary financing to facilitate the resolution of the firm.

6.4 Any provision by the authorities of temporary funding should be subject to strict conditions that minimise the risk of moral hazard […].

6.5 As a last resort and for the overarching purpose of maintaining financial stability, some countries may decide to have a power to place the firm under temporary public ownership and control in order to continue critical operations, while seeking to arrange a permanent solution such as a sale or merger with a commercial private sector purchaser. Where countries do equip themselves with such powers, they should make provision to recover any losses incurred by the state from unsecured creditors or, if necessary, the financial system more widely.

10. Resolvability assessments

10.1 Resolution authorities should regularly undertake […] resolvability assessments that evaluate the feasibility of resolution strategies and their credibility in light of the likely impact of the firm's failure on the financial system and the overall economy. […]

10.2 In undertaking resolvability assessments, resolution authorities should incoordination with other relevant authorities assess, in particular:

(i) the extent to which critical financial services, and payment, clearing and settlement functions can continue to be performed; […]

Annex II

Resolvability Assessments

1. Defining resolvability

A [systemically important financial institution] is "resolvable" if it is feasible and credible for the resolution authorities to resolve it in a way that protects systemically important functions without severe systemic disruption and without exposing taxpayers to loss. […] For resolution to be credible, the application of those resolution tools should not itself give rise to unacceptably adverse broader consequences for the financial system and the real economy. […]

> **11. Recovery and resolution planning**
> 11.1 Jurisdictions should put in place an ongoing process for recovery and resolution planning, covering at a minimum domestically incorporated firms that could be systemically significant or critical if they fail.
> 11.2 Jurisdictions should require that robust and credible [Recovery and Resolution Plans] are in place […] for any […] firm that its home authority assesses could have an impact on financial stability in the event of its failure.

Financial Stability Board's 2015 Standard about loss-absorbing capacity

The Financial Stability Board in 2015 developed a Standard aimed at giving authorities and markets confidence that global systemically important banks (G-SIBs) are resolvable without exposing public funds to loss, and have sufficient capacity to absorb losses both before and during resolution.[12]

The Standard comprises—

(i) a set of Principles elaborating on the premise that there must be sufficient loss-absorbing and recapitalisation capacity available to G-SIBs in resolution to implement an orderly resolution that minimises impacts on financial stability, ensures the continuity of critical functions, and avoids exposing public funds to loss; and

(ii) a Term Sheet to implement those principles.[13]

The first Principle is:[14]

> **(i) There must be sufficient loss-absorbing and recapitalisation capacity available in resolution to implement an orderly resolution that minimises any impact on financial stability, ensures the continuity of critical functions, and avoids exposing taxpayers (that is, public funds) to loss with a high degree of confidence.**
> This is the main guiding principle from which the other principles flow. […]

The Term Sheet reiterates this: [15]

> The objective of this standard is to ensure that G-SIBs have the loss-absorbing and recapitalisation capacity necessary to help ensure that, in and immediately following a resolution, critical functions can be continued without taxpayers' funds (public funds) or financial stability being put at risk.

The FSB stated that it would monitor implementation of the Standard, and would undertake a review of the technical implementation of the Standard by the end of 2019.

The FSB in its 2019 review of the TLAC Standard said progress in implementation has been steady and significant, but further efforts are needed to implement the Standard fully and

[12] Financial Stability Board. "Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution, and Total Loss-absorbing Capacity (TLAC) Term Sheet", 9 Nov 2015.

[13] FSB. Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution and TLAC Term Sheet (supra), Foreword.

[14] FSB. Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution and TLAC Term Sheet (supra), Princ (i).

[15] FSB. Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution and TLAC Term Sheet (supra), Term sheet, Objective.

effectively.[16] The review demonstrates that continued efforts are needed to support the effective implementation of the Standard and address any remaining technical issues.[17]

FSB says resolution is not resurrection, but nor is it insolvency

The FSB, in its 2015 G-SIB Standard, says, "Resolution is not resurrection. But nor is it insolvency":[18]

> **(v) After the resolution transaction, to ensure continuity of critical functions, the entity or group of entities emerging from resolution must meet the conditions for authorisation, including any consolidated capital requirements, and be sufficiently well capitalised to command market confidence.**
>
> Resolution is not resurrection. But nor is it insolvency: the institution or successor institution (e.g., bridge institution) has to meet at least the minimum conditions for authorisation in order that supervisors may allow it to continue performing authorised activities, in particular critical functions. Moreover, the reorganisation or solvent wind-down that will be necessary following resolution may require a level of capitalisation above that required by supervisors so that counterparties continue to trade with the resolved firm and provide funding to it. Consideration of potential losses arising from post-resolution reorganisation should also be made.

None of the current 30 global systemically important banks (G-SIBs) are South African.[19] But the observation in the FSB's Standard that "Resolution is not resurrection, but nor is it insolvency" can fairly be said to apply to domestic systemically-important banks or other financial institutions. South Africa has domestic systemically-important banks.

(The Financial Sector Regulation Act, 2017[20] authorises the Governor of the South African Reserve Bank to designate a financial institution as systemically important.[21] The Governor has designated[22] six South African banks.[23])

Developments since Financial Stability Board's *Key Attributes* document

In August 2015, the National Treasury and South African Reserve Bank[24] published the discussion document *Strengthening South Africa's Resolution Framework for Financial Institutions*, which mentioned shortcomings in existing legislation, and recommended the

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16 FSB. Review of Technical Implementation of the Total Loss Absorbing Capacity (TLAC) Standard, 2 Jul 2019.

17 FSB. Review of Technical Implementation of the TLAC) Standard, 2 Jul 2019 (supra), *Executive Summary*.

18 FSB. Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution and TLAC Term Sheet (supra), Princ (v).

19 FSB. 2020 update of group of global systemically important banks (G-SIBs). 3 Nov 2020.

20 Financial Sector Regulation Act 9 of 2017.

21 Financial Sector Regulation Act s 29 (designation of systemically important financial institutions).

22 South African Reserve Bank, *Financial Stability Review*, Second edition Nov 2019, p 4.
See also *Business Day*, 28 Nov 2019: "Reserve Bank labels six SA banks as systemically important. Given their potential systemic effect on SA's financial system, it is important for the Reserve Bank to monitor their soundness, the Bank says".

23 Absa Bank Ltd, The Standard Bank of South Africa Ltd, FirstRand Bank Ltd, Nedbank Bank Ltd, Investec Bank Ltd, and Capitec Bank Ltd.

24 And the Financial Services Board, as it then was.

enacting of a special resolution Bill and minimal amendments to the 1936 Insolvency Act's creditor hierarchy so as to afford preference to guaranteed depositors and subordinate any total loss-absorbing capacity instruments (TLACs) in order to make them absorb losses in resolution.[25]

In May 2017, the Reserve Bank released *Designing a deposit insurance scheme for South Africa – a discussion paper*, recommending a privately-funded deposit-insurance scheme.

In September 2018, the National Treasury published for public comment the draft Financial Sector Laws Amendment Bill to implement these proposals.

In July 2019, the Reserve Bank's Financial Stability Department published a discussion paper: *Ending too big to fail: South Africa's intended approach to bank resolution*, which indicated how the Bank aims to implement the resolution of banks.

National Treasury outline of Bill

The National Treasury's media statement of 11 June 2020 says:

- The Bill introduces critical elements to the regulatory system on how to deal with a failing bank or other systemically important financial institution, to protect financial stability in a way that reduces reliance on the fiscus;
- The Bill enables South Africa to meet the basic international standards following the 2008 Global Financial Crisis, as endorsed by G-20 countries and outlined in a document by the Financial Stability Board[26] in Basel, *Key Attributes of Effective Resolution Regimes for Financial Institutions,* which sets out the international standard for resolution regimes to address the problem of banks that are considered "too big to fail";[27]
- The policy approach is in the National Treasury's 2015 policy paper *Strengthening South Africa's Resolution Framework for Financial Institutions*, and the Reserve Bank's 2017 policy paper *Designing a Deposit Insurance Scheme for South Africa*;[28]
- The Bill's first part introduces a comprehensive framework for resolving all banks as well as non-bank systemically important financial institutions that may be "too big to fail";
- Its second part introduces for the first time an industry-funded deposit-insurance scheme to protect qualifying depositors' funds up to a specified limit when a bank fails;
- These resolution and deposit-insurance measures have these significant policy objectives:
  - Public funds will no longer be the default source of funding to bail out failing banks and other large financial institutions;

[25] National Treasury, South African Reserve Bank, Financial Services Board. *Strengthening South Africa's Resolution Framework for Financial Institutions*, 13 Aug 2015.
[26] A multinational committee of central bankers and supervisors.
[27] That document by the Financial Stability Board *Key Attributes of Effective Resolution Regimes for Financial Institutions* is discussed more fully below.
[28] These 2015 and 2017 policy papers are referred to again below.

- A deposit insurance scheme will be established and managed by the Reserve Bank through a newly established Corporation for Deposit Insurance;
- Losses incurred due to a financial institution's failure will in the first instance be borne (through bail-in) by shareholders and creditors who are able to properly assess their investment risks and had benefited from profits by the institution as a going concern;
- The Reserve Bank will get additional legal tools to ensure that critical services continue and stability is maintained in the financial system in the event of a significant failure;
- Following international best practice, a modified creditor hierarchy for financial institutions falling within the scope of the envisaged framework is introduced, in terms of which covered depositors will rank as preferred creditors;

The protection of vulnerable depositors is a key element of the financial safety net in any country, and also contributes to financial stability. Qualifying deposits will be guaranteed up to an amount of R100 000 per depositor;

The certainty provided by explicit coverage, combined with clear coverage rules, will contribute to depositor confidence. This will foster an environment in which emerging banks can grow, thus enhancing competition in the banking sector;

These benefits are deemed to outweigh the cost of the depositor scheme to the banking sector, where significant efforts had been made to minimize the cost. Initial levies and premiums will amount to a combined amount of about 21 cents per year per R100 of deposits covered. This funding will be supplemented by funding in the form of interest-bearing deposits placed by banks with the Corporation for Deposit Insurance.

Pertinent clauses of the Bill (the Financial Sector Laws Amendment Bill B15B of 2020)

Deposit-insurance scheme

The Bill aims to insert[29] in the Financial Sector Regulation Act, 2017 a Chapter[30] that provides for *inter alia* a scheme for insuring covered deposits of a bank in resolution.[31]

The Bill will establish a Corporation for Deposit Insurance[32] and a Deposit Insurance Fund.[33]

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29 Financial Sector Laws Amendment Bill, 2020 cl 51.
30 Chap 12A (resolution of designated institution).
31 Chap 12A Pt 5 (covered deposits) ss 166AA–166AD, Pt 6 (Corporation for Deposit Insurance) ss 166AE–166BC, Pt 7 (Deposit Insurance Fund) ss 166BD–166BF, and Pt 8 (contributions to Fund).
32 Chap 12A s 166AE.
33 Chap 12A s 166BD(1).

Corporation for Deposit Insurance

The function of the Corporation for Deposit Insurance is to maintain and administer the Fund in the interest of holders of "covered deposits".[34] A covered deposit is the portion of a "qualifying deposit" covered by the Fund.[35] A qualifying deposit is a bank deposit.[36]

The Corporation's objective is, through the provision of deposit insurance, to support the Reserve Bank in fulfilling its responsibility for maintaining financial stability in terms of the Reserve Bank Act and Financial Sector Regulation Act. [37] The latter states that the Bank is responsible, if a systemic event[38] occurs or is imminent, for restoring financial stability.[39]

All banks will be members of the Corporation.[40]

The Corporation's affairs will be controlled by a Board of directors consisting of—

a representative from the National Treasury (appointed by the Director General),
a Deputy-Governor of the Reserve Bank (appointed by the Governor),
the Corporation's Chief Executive Officer,
the Commissioner of the Financial Sector Conduct Authority,
the Chief Executive Officer of the Corporation,
the Group Chief Financial Officer of the Reserve Bank, and
no more than two persons appointed by the Governor with the Minister's concurrence.

The Board will exercise the Corporation's powers and perform its duties.[41]

The Corporation will collect deposit-insurance premiums from member banks to enable the Fund to make the payments required[42] for the Corporation to ensure that depositors of a bank in resolution have reasonable access to their covered deposits.[43]

Where a bank is in resolution, the Corporation must, to ensure that the bank's depositors have reasonable access to their covered deposits, apply the Fund either to: Reimburse the bank in resolution for payments it has made in resolution to depositors for covered deposits; reimburse depositors for covered deposits; or make payments in terms of an agreement by the Corporation (which it may enter into only if it believes that the agreement will contribute to orderly resolution of the bank in resolution) which provides for: A secured loan to the bank to

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[34] Chap 12A s 166AF(2)(a).

[35] Bill cl 35 inserting definition of "covered deposit" in Financial Sector Regulation Act s 1 (definitions).

[36] Other than bearer deposits and deposits by financial institutions and government bodies. Bill cl 35 inserting definition of "qualifying deposit" in Financial Sector Regulation Act s 1 (definitions).

[37] Chap 12A s 166AF(1).

[38] The Financial Sector Regulation Act defines a "systemic event" as—

> an event or circumstance, including one that occurs or arises outside the Republic, that may reasonably be expected to have a substantial adverse effect on the financial system or on economic activity in the Republic, including an event or circumstance that leads to a loss of confidence that operators of, or participants in, payment systems, settlement systems or financial markets, or financial institutions, are able to continue to provide financial products or financial services, or services provided by a market infrastructure.

Financial Sector Regulation Act s 1(1) svv "systemic event".

[39] Financial Sector Regulation Act s 11(1)(b).

[40] Chap 12A s 166AG.

[41] Chap 12A s 166AI.

[42] Chap 12A s 166BG(1) read with s 166BD(5)(b) and (6)(a).

[43] Chap 12A s 166AA(1).

enable it to honour covered deposits; or sharing of loss between the Corporation and the bank or anyone assuming liability for covered deposits; or a guarantee to the bank in resolution, Reserve Bank or anyone else for the bank's covered-deposit obligations.

The limit of cover from the Fund that may be applied for a depositor of a bank in resolution is the lesser of: Amounts standing to the credit of the depositor's accounts with the bank when it was placed in resolution;[44] and the amount to be prescribed by the Minister by Regulation under the Financial Sector Regulation Act.[45] (As mentioned, the Treasury's media statement of June 2020 says deposits will be covered up to an amount of R100 000 per depositor.)

The Corporation can also charge member banks deposit-insurance levies to fund the operations of the Corporation and the administration of the Fund.[46]

Resolution of banks, and other financial institutions designated systemically important

The Chapter[47] that the Bill will insert[48] in the Financial Sector Regulation Act also provides for the resolution of banks and of other financial institutions designated as systemically important, and for covered deposits of banks in resolution.[49]

General provisions about designated institutions

As mentioned, the Act authorises the Governor of the Reserve Bank to designate a financial institution as systemically important.[50]

The Bill labels as a "designated institution"[51]—

- Every bank,[52]
- any financial institution so designated by the Governor as systemically important,[53]
- the operator and participants of a payment system which is designated as systemically important,[54]
- any holding company of a bank, financial institution designated as systemically important, or operator of a payment system designated systemically important,[55] and

44 Chap 12A s 166AB(1)(a)(i) read with (2).
45 Chap 12A s 166AB(1)(b) read with Financial Sector Regulation Act s 1(1) sv "Regulation" and s 288(1)(a).
46 Chap 12A s 166BC.
47 Chap 12A (resolution of designated institution).
48 Financial Sector Laws Amendment Bill, 2020 cl 51.
49 Chap 12A Pt 1 (general provisions with respect to designated institutions) ss 166A–166I, Pt 2 (placing designated institutions in resolution) ss 166J–166P, Pt 3 (resolution measures) ss 166Q–166Y, Pt 4 (protections) s 166Z, and Pt 5 (banks in resolution – covered deposits) ss 166AA–166AD.
50 Financial Sector Regulation Act s 29 (designation of systemically important financial institutions).
51 Draft Financial Sector Laws Amendment Bill cl 42 inserting s 29A (designated institutions).
52 Bill cl 42 s 29A(1)(a).
53 Bill cl 42 s 29A(1)(b), read with Act s 29.
54 Bill cl 42 s 29A(1)(c) and s 29B.
55 Bill cl 42 s 29A(1)(d).

if a bank or financial institution designated systemically important is a member of a designated financial conglomerate,[56] the conglomerate's other members[57] (unless the Governor by notice to a member of the conglomerate determines otherwise in that member's case[58]).

The Bill will amend the Financial Sector Regulation Act's provision about Prudential Standards for systemically important financial institutions,[59] by providing that, to mitigate the risk that designated institutions may need to be placed in resolution, the Reserve Bank may direct the Prudential Authority to make prudential standards specifying characteristics of "flac instruments" and to require specified designated institutions to hold flac instruments to a value specified by the Bank.[60] The Act will define flac instruments merely as financial instruments, issued by a financial institution, that comply with requirements prescribed by prudential standard for flac instruments and are of a kind not counted to determine if the designated institution satisfies applicable Banks Act or prudential-standard requirements.[61]

The Chapter that the Bill will insert in the Act states that the Reserve Bank is the resolution authority, and has the "resolution functions" conferred on it.[62] A resolution function is a function or a power conferred on the Bank for the purpose of, or performed by it in connection with, the "resolution" of a designated institution (including a function or power conferred or performed for the purpose of "reducing the risk that a designated institution may need to be placed in resolution".[63] And "resolution" is the management of the affairs of the designated institution as provided for in the Chapter.[64]

The objective of the Reserve Bank in performing its resolution functions is to "assist in" maintaining financial stability and protecting the interests of depositors of banks through the orderly resolution of designated institutions that are in resolution.[65]

To achieve the objective, the Bank "must" perform its resolution functions in relation to designated institutions, and ensure that affairs of a "designated institution in resolution" are managed so as to maintain financial stability "as far as practicable".[66] A "designated institution in resolution" means a designated institution for which a determination by the

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56 See Financial Sector Regulation Act s 160 (designation of financial conglomerates).
57 Bill cl 42 s 29A(1)(e).
58 Bill cl 42 s 29(A)(2).
59 Financial Sector Regulation Act s 30 (prudential Standards and regulator's directives i.r.o. systemically important financial institutions).
60 Bill cl 43(e) inserting s 39(1A).
61 Bill cl 35 inserting definition of "flac instrument" in Financial Sector Regulation Act s 1 (definitions).
62 Chap 12A s 166A (1).
63 Bill cl 35 inserting definition of "resolution function" in Financial Sector Regulation Act s 1 (definitions).
64 Bill cl 35 inserting definition of "resolution" in Financial Sector Regulation Act s 1 (definitions).
65 Chap 12A s 166B.
66 Chap 12A s 166C(1).

Minister to the Governor placing the designated institution in resolution[67] is current.[68] And "placing a designated institution in resolution" means making this determination.[69]

Without Bank concurrence: A designated institution's licence can't be cancelled; proceedings to wind it up can't commence; business-rescue proceedings can't commence; amalgamations or mergers, or compromise agreements with its creditors, can't be entered into; and financial-sector regulators can't reduce the value of outstanding claims against the institution or convert instruments issued by it to other instruments.[70]

The Reserve Bank "must", on the basis of risk analysis,[71] take adequate and appropriate steps to plan for the potential need for the "orderly resolution of a designated institution".[72] Orderly resolution of a designated institution means managing its affairs in a way that: "assists" in maintaining financial stability; ensures that the critical functions performed by the institution continue to be performed; and, if it is a bank, protects depositors' interests.[73]

The Bank may apply to court for the winding-up of a designated institution in resolution, on the ground that "there are no reasonable prospects that the institution will cease to be in resolution".[74] Only a person whom the Bank recommends may be appointed liquidator.[75] The Bank can appoint as adviser to the liquidator someone with suitable expertise in its opinion.[76] A liquidator may not set aside things done by the Bank in exercising resolution functions.[77]

Placing designated institutions in resolution

If, in the Bank's opinion, a designated institution is or will likely be unable to meet its obligations (whether or not it is insolvent), and it is necessary to ensure the orderly resolution of the institution to maintain financial stability, or (in the case of a bank, or member of a group of companies of which a bank is a member) to protect the bank's depositors, the Bank may recommend that the Minister place the institution in resolution.[78]

The Minister may, after considering the recommendation and if she considers that the designated institution is or will probably be unable to meet its obligations (whether or not it is insolvent), and that it is necessary to ensure the orderly resolution of the institution to

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67 Chap 12A s 166J(2).
68 Bill cl 35 inserting definition of "designated institution in resolution" in Financial Sector Regulation Act s 1 (definitions).
69 Bill cl 35 inserting definition of "placing a designated institution in resolution" in Financial Sector Regulation Act s 1 (definitions).
70 Chap 12A s 166D.
71 Conducted in consultation with a financial sector regulator.
72 Chap 12A s 166E.
73 Bill cl 35 inserting definition of "orderly resolution of a designated institution" in Financial Sector Regulation Act s 1 (definitions).
74 Chap 12A s 166H(1)(a).
75 Chap 12A s 166H(1)(b).
76 Chap 12A s 166H(2).
77 Chap 12A s 166H(6).
78 Chap 12A s 166J(1).

maintain financial stability or (in the case of a bank, or member of a group that includes a bank) to protect the bank's depositors, address a determination to the Governor of the Bank placing the institution in resolution.[79] The Bank must notify the institution's managing director or chair of its board of directors of the Minister's determination[80] and publish it.[81]

If a designated institution is in resolution and the Bank is of opinion that it is no longer necessary that it remain in resolution to maintain financial stability or (if it is a bank, or member of a group of which a bank is a member) to protect the bank's depositors, the Bank must recommend that the Minister revoke his determination placing the institution in resolution.[82] The Bank must publish the revocation.[83] A designated institution also ceases to be in resolution when a liquidator is appointed for it, unless the court orders otherwise.[84]

While a designated institution is in resolution, the Bank has power and authority to manage and control its affairs and exercise powers of its governing body and shareholders or a class of shareholders, even to exclusion of its governing body, officers and shareholders.[85]

They include powers to: Convene meetings of creditors of the designated institution to consult with them about the exercise and proposed exercise of those powers and the Bank's powers in terms of the Act; to negotiate with creditors of the institution with a view to final settlement of their claims; and to propose and implement arrangements or compromises between the institution and all its creditors, or all creditors in a class of creditors.[86]

The Reserve Bank must, as soon as practicable after a designated institution is placed in resolution, appoint a person to be the resolution practitioner for the institution while it is in resolution, and delegate specified powers and functions of the Bank to her.[87] However, the Bank may not make such an appointment if it is of the opinion that, in the circumstances, it is not necessary to do so to achieve the orderly resolution of the designated institution.[88]

Resolution measures

Before the Reserve Bank takes a resolution action concerning a designated institution in resolution or the institution takes such an action, the Bank must obtain a valuation regarding the assets or liabilities involved of the amount that in a winding-up of the institution would, in the valuator's opinion, be realised from each asset or be payable on each liability.[89]

79 Chap 12A s 166J(2).
80 Chap 12A s 166J(4).
81 Chap 12A s 166J(5).
82 Chap 12A s 166K(1), (2).
83 Chap 12A s 166K(3).
84 Chap 12A s 166K(4).
85 Chap 12A s 166M(1).
86 Chap 12A s 166M(2).
87 Chap 12A s 166O(1) read with s 166I(2)(c).
88 Chap 12A s 166O(2).
89 Chap 12A s 166Q(1)(a) and (b).

The Bank may take any of the following resolution measures, only if it determines that it is necessary to do so for the orderly resolution of a designated institution in resolution:

The Bank may, by notice to the other parties to an agreement to which a designated institution in resolution is a party, and which came into effect before the institution was put in resolution, cancel the agreement with effect from a stated future date,[90] without affecting accrued rights of the other parties.[91]

The Bank can cancel such agreement, only if the agreement prefers one creditor of the designated institution over another creditor of the same class, or is "unreasonably onerous" on the institution; or is a lease of property entered into before the institution was placed in resolution; or is a guarantee issued by the institution before it was placed in resolution (other than one to be made good within 30 days after the institution was placed in resolution).[92]

The Bank can suspend for a reasonable period the instituting of claims for damages for loss resulting from cancellation of the agreement, by notice to claimants.[93]

The Bank can also suspend, for a reasonable period,[94] legal or arbitration proceedings to which a designated institution in resolution is a party, by notice served on the other parties and filed with the court or arbitrator.[95]

Finally, the Bank may, by notice published in the Financial Sector Information Register maintained by the National Treasury, prohibit for a reasonable period the commencement of specified legal or arbitration proceedings against a designated institution in resolution.[96]

If the Bank (in consultation with the Prudential Authority) determines it is necessary for the orderly resolution of a designated institution in resolution that the institution enter into a particular transaction, the institution may enter into the transaction despite any law or agreement that would otherwise restrict or prevent it from doing so, including one requiring someone's consent or approval.[97] Such a transaction includes: a transfer or dealing in any way with assets and liabilities of the institution;[98] and (but the Competition Commission must nevertheless be consulted[99]) an amalgamation or merger, or scheme of arrangement referred to in the Companies Act, that involves a designated institution as a party.[100]

90 Chap 12A s 166R(1)(a).
91 Chap 12A s 166R(3).
92 Chap 12A s 166R(2)(a),(b),(c),(d).
93 Chap 12A s 166R(1)(c) read with s 166R(4).
94 Chap 12A s 166R(4).
95 Chap 12A s 166R(1)(b) read with s 166R(4).
96 Chap 12A s 166R(1)(e) read with s 166R(5) and Financial Sector Regulation Act s 256.
97 Chap 12A s 166S(1) read with s 166S(3)(a).
98 Chap 12A s 166S(2)(a).
99 Chap 12A s 166S(3)(b).
100 Chap 12A s 166S(2)(b).

Bonds, pledges, guarantees or instruments to secure future advances or facilities by an amalgamating or merging party remain in force as securing future advances or facilities by the amalgamated or merged entity.[101]

Other transactions with an amalgamating or merging party also as a rule remain in force as transactions with the amalgamated or merged entity,[102] but the designated institution in resolution may, in the amalgamation or merger's terms and conditions, stipulate that specified transactions will "not be retained in force" after the amalgamation or merger.[103]

A designated institution in resolution may, if the Bank determines that it is necessary to do so for orderly resolution of the institution, cancel shares of the institution that in liquidation would be valued at zero, or (on terms approved by the Bank) issue new shares.[104]

If a designated institution in resolution is party an agreement, the Reserve Bank may (without giving rise to any rights by other parties[105]) reduce amounts that in terms of the agreement are or may become payable by the institution to other parties, or (without affecting other parties' accrued rights[106]) cancel the agreement[107] (but may not take either action with unsettled exchange-traded transactions, derivative instruments, deposits of the Corporation for Public Deposits, or transactions between settlement-system participants[108]).

The Bank, in exercising or taking any such resolution powers or resolution actions regarding a designated institution in resolution, may substitute any liability of the institution with a shareholding in the institution, or incorporate a "bridge company"[109] and substitute the liability with a shareholding in the bridge company[110] and (if it facilitates the institution's orderly resolution) transfer the Bank's shareholding in the bridge company to the creditor.[111]

The Reserve Bank must not take a resolution action regarding a designated institution in resolution (and must ensure that the institution does not) if it appears to the Bank that the action would result in a reduction in the value of a claim of a creditor of the institution.[112] This (the "no creditor worse off" rule) does not apply to shareholders' claims, or if the claims of creditors and shareholders that "rank lower in the creditor hierarchy" have been reduced to zero.[113] When the Bank takes resolution action regarding the institution it must treat equally the claims of creditors and shareholders that would have the same ranking in insolvency (and

[101] Chap 12A s 166S(4)(c)(ii).
[102] Chap 12A s 166S(4)(c)(i).
[103] Chap 12A s 166S(5).
[104] Chap 12A s 166S(6)(a), (b).
[105] Chap 12A s 166S(10).
[106] Chap 12A s 166S(8).
[107] Chap 12A s 166S(7)(a), (b).
[108] Chap 12A s 166S(9).
[109] Chap 12A s 166F(1).
[110] Chap 12A s 166T.
[111] Chap 12A s 166F(2).
[112] Chap 12A s 166U(1).
[113] Chap 12A s 166U(2)(a), (b).

ensure that the institution does so too),[114] unless the Bank "determines that it is necessary to treat the claims differently to effect the orderly resolution of the designated institution".[115]

The Reserve Bank must not take resolution action regarding a designated institution in resolution that would result in a creditor or shareholder of the institution receiving less than she would have received if it had been wound up.[116] Failure to comply will not invalidate an acquisition of property by a *bona fide* purchaser for value who is not aware of the failure to comply (but "may give rise to a right to compensation in the creditor or shareholder").[117]

If the Bank (having regard to a valuation, obtained after the institution ceases to be in resolution, of assets and liabilities that were dealt with in the resolution action) considers that the creditor or shareholder received less than she would have received if the institution had been wound up, the Bank must determine the amount of the shortfall, and the creditor or shareholder shall thereupon be entitled to recover the shortfall amount from the institution, without limiting any claim that she may have for additional amounts.[118]

Claims against a designated institution in resolution, whether arising before or during resolution, rank in the order in the Insolvency Act.[119]

If a designated institution is wound up, the liquidator must apply the free residue to pay, in this order:

- First, preferred creditors provided for in the Insolvency Act;
- then claims proved against the estate for covered deposits;
- then unsecured creditors;
- then claims proved in connection with *flac* instruments; and
- finally claims proved concerning debt instruments designated as regulatory capital under a financial sector law, in the order prescribed in that law (or ranking equally if no such order is prescribed).[120]

The Reserve Bank must apply any money of the designated institution in resolution that "becomes available to the resolution authority" in paying the cost of resolution and creditors' claims which arose before resolution.[121]

The Bank may recover from a designated institution in resolution, or from it after it ceases to be in resolution, amounts the Bank incurs in performing resolution functions concerning the institution while in resolution.[122]

[114] Chap 12A s 166U(4)(a), (b).
[115] Chap 12A s 166U(4)(c).
[116] Chap 12A s 166V(1).
[117] Chap 12A s 166V(3).
[118] Chap 12A s 166V(4)(a)(b), (5), (6).
[119] Chap 12A s 166W(1).
[120] Chap 12A s 166W(2).
[121] Chap 12A s 166W(4).
[122] Chap 12A s 166Y.

Obstacles to resolvability remain; market appetite for *flac*; when will Bill commence?

A June 2020 evaluation by the Financial Stability Board of the effects of the too-big-to-fail reforms tentatively concludes that (while the reforms have made banks more resilient and resolvable, benefits of the reforms outweigh their costs, and indicators of systemic risk and moral hazard have "moved in the right direction"), obstacles to the resolvability of systemically-important banks remain: Improvements could be made to implementations of loss-absorbing-capacity instruments, resolution funding mechanisms, valuation of bank assets in resolution, operational continuity and continuity of access to financial-market infrastructure. State support for failing banks has continued.[123]

A December 2020 analysis for the World Bank about the market appetite in South Africa for *flac* instruments at this stage was inconclusive about take-up prospects.[124]

The Bill states that it will come into effect after enactment on a date to be determined by the Minister.[125]

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[123] Financial Stability Board, 28 Jun 2020: *Evaluation of the effects of too-big-to-fail reforms: Consultation Report*.

[124] PricewaterhouseCoopers Assurance Services (Pty) Ltd, 18 Dec 2020: "World Bank. 2020. Feasibility and Cost-Benefit Analysis of Using Bail-In as a Recapitalisation Mechanism in South Africa."

[125] By notice in the *Gazette*. Financial Sector Laws Amendment Bill, 2020 cl 63(1).
Different dates may be determined for different provisions to come into effect. Bill cl 63(2).