

How guaranteed is a VBS guarantee?

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Without Prejudice

On 11 March 2018, the Governor of the South African Reserve Bank (the SARB), announced that the SARB, in consultation with the Minister of Finance, had placed VBS Mutual Bank (VBS) under curatorship.

The announcement followed the SARB noticing a large increase in deposits made to VBS from various municipalities for investment purposes. The Municipal Finance Management Act 56 of 2003 prohibits municipalities from investing taxpayers' money in mutual banks such as VBS, and these deposits were therefore irregular. The reason for this is that mutual banks are not as strictly regulated as ordinary banks, and investments with mutual banks carry greater risk.

The National Treasury therefore instructed municipalities to withdraw deposits made to VBS, resulting in more than ZAR1 billion worth of deposits being withdrawn in a short period of time. This pushed VBS into a liquidity crisis and, ultimately, led to the bank being placed under curatorship.

Companies and individuals that hold bank guarantees with the financially compromised VBS may doubt whether these guarantees are still enforceable should they need to cash-in. However, from what the legislation tells us, that door is not completely closed.

What is curatorship?

VBS was placed under curatorship by the Governor and Minister in line with section 69 of the Banks Act 94 of 1990, which empowers them to do so, on suspicion that a bank may be unable to honour its obligation to pay out deposits.

Curatorship may be equated to a business rescue process in that the aim of curatorship is, as is the case with business rescue, to try and salvage the ailing business. This is in contrast with liquidation, where the aim is to essentially close down the institution. A recent notable example of curatorship in the banking space was in the case of African Bank. A portion of African Bank was ultimately salvaged and is now out of curatorship.

The effect of curatorship over VBS is that the current board and the management have been relieved of their powers. They now vest in the curator, subject to the supervision by the SARB.

The curator will perform a management function in such a manner as the Registrar may deem to best promote the interests of the creditors of the bank. In doing so, the curator will recover and take possession of all of the assets of the bank, however the curator is not permitted to dispose of any of the bank's assets, unless this is in the ordinary course of the bank's business, or he has obtained consent from the Minister or Registrar.

The curator will ultimately assess if the bank is still salvageable and the options it will have going forward. The curator may have to restructure the entire business model of the bank and make decisions that affect interested parties, such as those who hold guarantees with VBS.

Powers of the curator to cancel bank guarantees

On 4 July 2018, the Governor of SARB announced that retail deposits amounting to ZAR100 000 per depositor were guaranteed, and that clients should not panic, as the curator would ensure that all loans due to creditors were paid out. He further stated that the bank would continue to operate as normal in all respects. However, this only relates to retail deposits, so what about bank guarantees?

Section 69(3) of the Banks Act states that the Minister may empower the curator of a bank to cancel any bank guarantee that may have been issued, prior to it having been placed under curatorship. The only exemption to this is that the curator may not cancel a bank guarantee that was due for redemption within 30 days of the bank being placed under curatorship. Therefore, all guarantees that were due for redemption from VBS up to and including 11 April 2018 may not be cancelled.

VBS guarantees due for redemption outside of this 30-day period, or which are yet to fall due for redemption, are still vulnerable to cancellation by the curator, should it be deemed necessary and in the best interests of the bank. If the bank is sufficiently restructured to pay off its debts, then there may be no need to cancel the bank guarantees.

The only way to determine whether a bank guarantee is still enforceable or whether it has already been cancelled is by making an enquiry with the curator of VBS, being the auditing firm SizweNtsalubaGobodo Advisory Services (Pty) Ltd.

Legal action against VBS Bank

Should an unfortunate creditor have had their bank guarantee with VBS cancelled by the curator, there is still an alternative available. In terms of section 69(6) of the Banks Act, those creditors will retain the right to claim damages from VBS in respect of any losses they have suffered as a result of the cancellation.

There are two caveats to this option. Firstly, once a bank has been placed under curatorship, a moratorium for a period of 12 months is placed on all pending legal actions and no new legal proceedings may be instituted against the bank within this period. Accordingly, any claim for damages may only be instituted against VBS after the expiry of a period of one year from the

date of the cancellation of the guarantee.

Secondly, the right to claim damages may not be exercised while VBS is still under curatorship. In the event of the curatorship failing and the bank being placed into liquidation, the holder of such a bank guarantee will become a creditor in the bank's insolvent estate. Holders of bank guarantees will stand in line with other concurrent creditors, and therefore it is doubtful whether they will receive the full value of their bank guarantees.

In the event of VBS being removed from curatorship, creditors will be able to institute legal proceedings against VBS for the recovery of the full value of their bank guarantees, as long as a period of 12 months has passed since the bank was placed under curatorship, being after 11 March 2019.

It is not certain when, or if, VBS will be removed from curatorship. On the probability of VBS being salvaged and removed from curatorship, Deputy Reserve Bank Governor Kuben Naidoo has stated that "the level of confidence we have that the bank can be saved and is salvageable is lower than the day it started the curatorship. I am not saying zero, I'm not saying there's no chance, we'll continue to work in that direction".

The success of curatorship depends on the severity of the liquidity crisis at hand and the availability of additional funding to rescue the business. Following an application for liquidation in the Johannesburg High Court by the curator of VBS due to the misappropriation of approximately ZAR1.5 billion from VBS depositors by its largest shareholder, Vele Investments, it was ordered on 31 July 2018 that Vele Investments be immediately liquidated. It is hoped that this will begin the process of recovery of as much as half of the misappropriated funds.

The Acting Deputy Judge President of the Johannesburg High Court stated: "It's a great milestone for the curatorship, it's a step in the right direction to potentially recover assets that rightfully belong to the VBS depositors".

In light of this recent development, there may be a higher probability that VBS will come out of curatorship and creditors, especially those who hold guarantees with VBS, have reason to be more optimistic than before.

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