

SOUTH AFRICAN RESERVE BANK

27 March 2023

Q&A relating to Habib Overseas Bank Limited

1. Why was Habib Overseas Bank Limited placed under curatorship?

Over the past four years, several investigations and reviews have been conducted, most of which have confirmed Habib Overseas Bank Limited's (Habib) non-compliance with various financial sector laws.

Owing to weaknesses in the governance processes and significant weaknesses in the control environment within the bank, it was not prudent, nor in the interest of Habib's depositors, to allow Habib to continue to operate in the manner in which it had been operating. Habib was placed under curatorship due to the safety and soundness reasons outlined below:

1.1. Forensic investigation

In 2019, the forensic investigation by BDO Advisory Services (Pty) Limited (BDO) found that, inter alia, Habib's structures, policies, processes and procedures to guard against the bank being used for purposes of market abuse such as insider trading and market manipulation and/or financial crimes such as fraud, financing of terrorist activities and money laundering were not robust enough. Consequently, Habib had contravened the requirements of regulation 50 of the Regulations relating to Banks.

1.2. External auditors

Significant deficiencies in Habib's control environment were observed by its previous external auditors, Deloitte, during the December 2019 financial year audit which resulted in the following:

- Deloitte not being able to design and perform audit procedures to obtain sufficient and appropriate audit evidence to enable them to express an opinion on the 2019 annual financial statements (AFS);
- the resignation of Deloitte while the audit was still underway; and
- the issuance of a Reportable Irregularity (RI) report, in terms of section 252 of the Financial Sector Regulation Act 9 of 2017 (FSR Act), to the

Independent Regulatory Board for Auditors (IRBA) relating to a potential contravention of financial sector laws.

BDO was then appointed and requested to finalise the audit process. This resulted in the submission of the AFS and supporting regulatory reports being delayed. Similar to Deloitte, numerous section 252 RI reports relating to a potential contravention of financial sector laws were issued by BDO to the IRBA.

BDO issued an unqualified audit opinion on Habib's 2021 AFS which were signed off on 31 October 2022 due to BDO's concerns on the continuity of the bank, and the level of support which was required from the current shareholders to ensure Habib had sufficient capital resources to meet capital adequacy requirements and to continue as a going concern over the next 12 months from the AFS' sign-off date.

BDO also expressed a concern about keeping the audit assignment due to the risk that it posed to the firm. In addition, no Trial Balance for December 2022 has been made available to the auditors, resulting in the auditors not yet being able to commence with the audit

1.3. National Payment System Department

The SARB's National Payment System Department (NPSD) is concerned with the International Organization for Standardization (ISO) 20022 Project, a default which occurred in the South African Multiple Option Settlement (SAMOS) system on 25 January 2023, and Habib's non-compliance in all areas in the SAMOS system, that is, disaster recovery (DR) testing, straight-through processing (STP) compliance and SAMEXWeb user audits. NPSD indicated its concern that Habib's resources that NPSD deals with are the same, irrespective of whether they are in the testing phase, compliance or production.

1.4. Financial Intelligence Centre

In July 2020, the Financial Intelligence Centre (FIC) advised that it would get the Hawks to investigate the allegations of possible money laundering/irregularities regarding additional funds that were received by the Pakistan military officers who attended a military training course in South Africa and received payments from the Pakistan High Commission bank account held at the Habib Fordsburg Branch.

1.5. Arbitration

Owing to the numerous contraventions which took place under the leadership of the previous Managing Director (MD) and Chairperson of the Audit Committee (Audit Comm), the Prudential Authority (PA) referred the matter to the Arbitration Foundation of Southern Africa to determine whether adequate reasons existed for the termination of their appointment, but both individuals subsequently resigned before the arbitration process was finalised. However, both the previous MD and previous Audit Comm Chairperson had been re-appointed as consultants on a contract basis.

1.6. Financial information and capital adequacy ratio

Habib's profits have been declining since February 2020 and the bank has been loss-making since April 2020 due to the economic downturn, a decrease in its client base, and a reduction in revenue – particularly as a result of interest income, high operating costs owing to various projects, the implementation of the new core banking software, and high staff salaries.

Habib's balance sheet size has also been declining since 2020, mainly due to the decline in its client base.

During 2022, Habib had not managed to maintain its own internal capital adequacy ratio (CAR) target of 14% until the injection of a R20 million tier 2 capital in the form of a subordinated loan by an entity that intended acquiring a 100% shareholding interest from Habib in 2021. However, this sale transaction fell through in August 2022 due to disagreements between the parties involved.

Between September 2021 and October 2022, the shareholders injected R10 million and R13 million to ensure that Habib could meet its minimum capital requirements. However, the high cost-to-income ratio, significant losses, a R6.2 million bad debt that was written off in the December 2022 reporting period and increased operating expenses had begun to erode capital which resulted in the minimum capital requirement of 11.75% being breached in December 2022 (11.57%) and declining further in January 2023 (10.41%).

The shareholders remediated the breach with an injection of R14 million and R4 million of the R18 million Standby Bank Letter of Credit in February 2023 and March 2023 respectively.

With an average monthly burn rate of approximately R5.6 million, Habib was advised that an additional R40 million capital may be required to avert breaching capital in future. The forecast submitted to the PA indicated that the CAR would be breached by March 2023 and that the shareholders will consider whether they will inject the capital.

1.7. BA returns

The PA has recently noted numerous material reporting errors on BA returns, submission of inaccurate information, and late or no submissions of BA returns. Consequently, the PA has reasonable grounds to believe that the financial information provided by the bank can thus not be relied on.

1.8. Core banking system – Temenos 24

Habib has been implementing a new banking system – Temenos 24 – since November 2017 and finally migrated from the old core banking system (PIBAS) in February 2022. The new system has not been fully implemented due to numerous issues raised post-migration, even with the assistance from consultants at GCI Consulting Limited (a Temenos implementation partner based in the United Arab Emirates).

1.9. BCBS 239 Principles on Risk Data Aggregation and Risk Reporting (RDARR principles)

Regardless of numerous extensions granted to Habib to comply with the RDARR principles, the bank has not been able to reach a full compliance state since 2018 and highlighted, inter alia, the unsuccessful implementation of the Temenos 24 core banking system as a hinderance.

1.10. Vacancies and human resources

Habib Overseas Bank has been experiencing difficulties attracting and retaining suitably skilled and experienced staff due to its current size and financial position. Habib has placed a freeze on new appointments as the current focus is on filling only key positions.

- The Company Secretary position has been vacant since 2021.
- The Head of Risk resigned, effective from 31 January 2023.
- Three persons have resigned from the position of Head of Compliance and Money Laundering Control Officer since 2020. A successor was recently appointed, effective from 1 January 2023.
- Habib only managed to fill the Chief Financial Officer (CFO) position in January 2023, following the previous CFO's resignation in March 2021.
- The Executive Director (Chief Operations Officer) has resigned and his last day is 30 April 2023.

1.11. Board of Directors and subcommittees

All three independent non-executive directors resigned from the Board of Directors (Board) on 24 February 2023, giving the current status quo and the significant concerns within the bank as a reason for their resignations. Consequently, the following committees have been dissolved:

- Directors Affairs Committee;
- Social and Ethics Committee;
- Audit Committee; and
- Risk and Capital Management Committee.

2. Who is Habib's curator?

PricewaterhouseCoopers Inc. (PwC), with director Craig du Plessis as the representative who will be responsible for the curator team of Habib. With the appointment of the curator, the Board and management of Habib were relieved of their powers and these are now vested with the curator.

3. Are the depositors' funds safe?

Habib as the bank is liquid. Therefore, in the PA's assessment, there are no immediate concerns for the depositors. The first task of the curator would be to conduct an assessment, and if needed, the SARB will engage the National Treasury to provide a government guarantee, in terms of government policy.

4. Can customers withdraw their entire balance when they come to Habib?

While in the process of assessing and stabilising the affairs of the bank, in order to protect the liquidity of the bank, the curator may place some temporary restrictions on fund withdrawals.

5. Can I close my account at Habib and go to another bank of my choice?

It is within the rights of customers to close their accounts and go to another bank; however, as stated earlier, Habib is liquid and there is no need for customers to close their accounts with Habib.

While in the process of assessing and stabilising the affairs of the bank, in order to protect the liquidity of the bank, the curator may place some temporary restrictions on account closures.

6. What happens to customers who have loans with Habib?

These accounts will remain with Habib and customers are still obliged to pay the monthly instalments in full.

7. What is the total value of all retail depositors' claims?

The total value is R690 million as at the end of January 2023.

8. How many customer accounts does Habib have?

There are approximately 2 906 customer accounts.

9. Which Habib branches will remain open?

The curator will be assessing this in the coming days.

10. What is the mandate of the Prudential Authority?

The PA regulates financial institutions (banks, cooperative financial institutions and insurers) and market infrastructures to promote and enhance their safety and soundness, and to protect financial customers against the risk that those financial institutions may fail to meet their obligations and support financial stability.

The PA plays this role to protect consumers of financial products and services, and to support the SARB's mandate of achieving and maintaining financial stability.

11. What triggers a curatorship?

Curatorship is triggered at a point where the PA is of the opinion that a bank cannot continue to operate either through financial information available to the PA that

indicates such or due to governance concerns to protect depositors, and to ensure an orderly resolution of the bank.

The PA will make a recommendation to the Minister of Finance, who may, if he deems it appropriate in the public interest, notify the Chief Executive Officer or the Chairperson of the Board of that bank in writing, and to appoint a curator to the bank.

12. What is the role of the curator?

Section 69 of the Banks Act 94 of 1990 (Banks Act) refers.

On appointment of a curator:

- a. the management of the bank concerned shall vest in the curator, subject to the supervision of the PA, that any other person vested with the management of the affairs of that bank shall be divested thereof; and
- b. the curator shall recover and take possession of all the assets of the bank.

Additional information (Banks Act)

The curator shall:

- a) *subject to the supervision of the PA, conduct the management of the affairs of that bank in such a manner as the PA may deem to best promote the interests of the creditors of the bank concerned and of the banking sector as a whole and the rights of employees in accordance with relevant labour legislation;*
- b) *comply with any direction of the PA;*
- c) *keep such accounting records and prepare annual financial statements (AFS), interim reports and provisional AFS as the bank or its directors would have been obliged to keep or prepare if the bank had not been placed under curatorship;*
- d) *convene the AGM and any other meeting of members of the bank provided for by the Companies Act and, in that regard, comply with all the requirements with which the directors of the bank would in terms of the Companies Act have been obliged to comply if the bank had not been placed under curatorship; and*
- e) *have the power to bring or defend in the name and on behalf of the bank any action or other legal proceedings of a civil nature and, subject to the provisions of any law relating to criminal proceedings, any criminal proceedings.*

The curator may:

- (i) dispose of any of the bank's assets;*
- (ii) transfer any of its liabilities; or*
- (iii) dispose of any of its assets and transfer any of its liabilities,*
- (iv) in the ordinary course of the bank's business.*

Except in the circumstances contemplated above, the curator may not, notwithstanding the provisions of section 112 of the Companies Act:

- (i) dispose of any of the bank's assets;*
- (ii) transfer any of its liabilities; or*
- (iii) dispose of any of its assets and transfer any of its liabilities, otherwise than in accordance with the provisions of section 54.*

In seeking consent for a disposal of assets or transfer of liabilities or such disposal and transfer, the curator shall report to the Minister or the PA, as the case may be, on the expected effect on the bank's creditors and whether:

- (i) the creditors are treated in an equitable manner; and*
- (ii) a reasonable probability exists that a creditor will not incur greater losses, as at the date of the proposed disposal, transfer or disposal and transfer, than would have been incurred if the bank had been wound up under section 68 of this Act on the date of the proposed disposal, transfer or disposal and transfer.*

13. What are the requirements for capital and liquidity in the Banks Act?

Capital

A bank is required to manage its affairs to maintain a prescribed minimum sum of share capital and unimpaired reserve funds. The capital is comprised of additional layers of capital, which are prescribed in the Regulations relating to Banks. These layers are based on the risk faced by a bank due to its business model and risks encountered. This is determined through various assessments that the bank supervisors perform as well as the capital adequacy assessment that the bank itself performs.

The prescribed amount of such funds may not fall below the greater of R250 million and a prescribed minimum percentage of the sum of amounts relating to the different categories of assets and other risk exposures (i.e. credit risk, counterparty credit risk, market risk and operational risk). Each bank has a specific prescribed capital adequacy requirement based on the risk profile of the bank.

Liquidity

The liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) should each not be less than 100%.

Furthermore, banks are required to hold Level 1 high-quality liquid assets (HQLA) to a value not less than the sum of amounts calculated as percentages not exceeding 20% of different categories of its liabilities.

14. What is the importance of capital requirements in a bank?

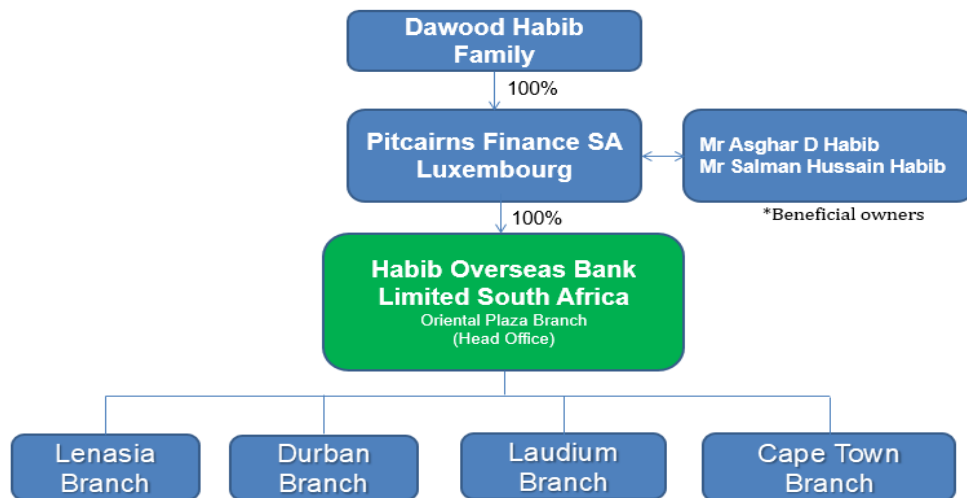
Capital is a key ingredient for safe and sound banks because banks take on risks and may suffer losses if the risks materialise. To stay safe and protect depositors, banks have to be able to absorb such losses and keep going in good times and bad. Capital acts as a buffer against unexpected losses. The CAR measures a bank's capital requirement in relation to its risk-weighted assets.

15. What is the history behind Habib Overseas Bank?

Habib was licensed as a bank in 1990. Owing to disagreements within the Habib family, there were divisions that led to two separate banking operations in South Africa owned by the Habib family, namely Habib Overseas Bank Limited and Habib Bank AG Bank Zurich (HBZ).

Group shareholding

As depicted in the group structure below, Habib is wholly owned by Pitcairns Finance Société Anonyme (Pitcairns) based in Luxembourg. The holding company was established to hold the equity interest in Habib; it is not involved in any other business activities. Individual members of the Dawood-Habib family (Pakistani nationals) own Pitcairns.



Though not depicted in the above structure, Habib wholly owns its subsidiary N77 Oriental Plaza Limited (N77), which owns a property from which Habib undertakes its business operations.

16. What products and services does Habib offer?

The current business model of the bank is to raise deposits and to on-lend to customers, with the main source of deposits being the retail market. The focus of the bank is to increase its deposit base through current retail market and wholesale funding.

The products and services offered by Habib are as follows:

- current, savings, call, fixed and notice accounts, and deposit accounts for corporate/banks and private customers;
- purchase and sale of foreign currencies;
- finance by way of term loans, overdrafts and other credit facilities to the corporate/banks and private sector;
- acceptance of funds and placements in the money market;
- short-term finance of foreign trade through letters of credit and negotiation of bills of exchange;
- sale of American Express travellers cheques, including Saudi Royal

- travellers cheques;
- remittance and transfer of funds;
- remittance and collection of commercial paper and allied instruments;
and
- correspondent banking.

17. Who banks with Habib?

Habib's target market includes:

- retail clients, including staff;
- small and medium-sized enterprises; and
- corporates and banks;