

2004-05-25

TO ALL BANKS, MUTUAL BANKS AND BRANCHES OF FOREIGN BANKS

BANKS ACT CIRCULAR 7/2004

(This circular replaces Banks Act Circular 6/99 dated 8 July 1999 and Banks Act Circular 10/2000 dated 29 November 2000)

PREFERENCE-SHARE INVESTMENT SCHEMES

EXECUTIVE SUMMARY

During July 1999, this Office issued Banks Act Circular 6/99 to advise banking institutions of its view on preference-share investment schemes. During November 2000, this Office issued Banks Act Circular 10/2000 in order to set out directives to banking institutions, with a view to regularising preference-share investment schemes. During September 2001, this Office issued Banks Act Circular 12/2001 in order to obtain information from banking institutions on the nature and size of preference-share investment schemes conducted by banking institutions.

This Office received a number of objections from certain banking institutions, as well as a number of legal opinions, following the issue of the above-mentioned circulars. This Office subsequently studied both the objections raised and the legal opinions received and also liaised with the Financial Services Board ("FSB") in order to ascertain the nature and extent, if any, of similar schemes that were being conducted by the insurance industry as was alleged by certain banking institutions. During January 2004, the FSB confirmed that, in its view, insurers were not conducting preference-share investment schemes, but were indeed investors in such schemes.

This Office is responsible for the administration of the Banks Act, 1990 (Act No. 94 of 1990 - "the Banks Act"), and is therefore obliged to ensure that the provisions of the Banks Act are interpreted in a manner consistent with the spirit and intention of the Banks Act. Section 1 of

the Banks Act defines "the business of a bank", which business entails, *inter alia*, the acceptance of deposits from the general public by an entity as a regular feature of its business.

In the light of the above, this Office is of the opinion that the creation of a trust, the procurement of investments from members of the general public and the pooling of such funds for the purchase of preference shares, for or on behalf of such investors, with the aim to repay the investors, with or without return, constitutes deposit-taking and, thereby, "the business of a bank", as defined in the Banks Act.

This Office is of the opinion that this form of deposit-taking activity is not confined to trusts, but that such deposit-taking activity seems to be prevalent in other entities, including companies incorporated in terms of the Companies Act, 1973 (Act No. 61 of 1973).

Therefore, most entities conducting such activity with the objective of purchasing preference shares are/could be conducting "the business of a bank" in contravention of the Banks Act if such entities are not registered as banks or mutual banks in terms of the Banks Act, or the Mutual Banks Act, 1993 (Act No.124 of 1993), respectively.

1. INTRODUCTION

One of the functions of this Office is to administer the Banks Act and the Regulations relating to Banks ("the Regulations"). In order to ensure strict adherence to the provisions of the Banks Act and the Regulations, this Office is required to prescribe guidelines on the interpretation of the provisions of the Banks Act.

This Office issued Banks Act Circular 6/99 dated 8 July 1999 to make banking institutions aware of its stance on preference-share investment schemes. During November 2000, this Office issued Banks Act Circular 10/2000 in order to set out directives to banking institutions, with a view to regularising preference-share investment schemes. During September 2001, this Office issued Banks Act Circular 12/2001 in order to obtain information from banking institutions on the nature and size of preference-share investment schemes conducted by banking institutions. This Office received a number of objections from certain banking institutions, as well as a number of legal opinions, following the issue of the above-mentioned circulars. This Office subsequently studied both the objections raised and the legal opinions received and also liaised with the FSB in order to ascertain the nature and extent, if any, of similar schemes that were being conducted by the insurance industry, as was alleged by certain banking institutions. During January 2004, the FSB confirmed that, in its view, insurers were not conducting preference share investment schemes, but were indeed investors in such schemes.

In the opinion of this Office, the preference-share investment schemes contemplated in Banks Act Circular 6/99 by trusts and/or subsidiaries of banks constitute deposit-taking and, therefore, "the business of a bank", as defined in the Banks Act. It would therefore be prudent for this Office to apply the above-mentioned stance to all preference-share activities, regardless of whether such activities are facilitated by institutions within the

banking sector through trusts, companies or any other form, or by institutions outside the banking sector through trusts, companies or any other form.

2. THE BANKS ACT

Section 11 of the Banks Act provides that no person shall conduct "the business of a bank" unless such a person is a **public company and is registered in terms of the Banks Act**. Therefore, should any entity, whether or not it is a public company that is regulated by any other legislation, conduct "the business of a bank" without that entity being registered as a bank in terms of the Banks Act, such an entity would be in contravention of the Banks Act. The Banks Act, therefore, has precedence over all other legislation in this regard, since an entity wishing to conduct "the business of a bank", would ultimately need to be registered as a bank in terms of the Banks Act, in addition to being a public company.

3. MANNER OF REGULATION

In the light of the above-mentioned legal position and the duties imposed upon this Office, the following directives are issued hereby:

3.1 Banking sector

All existing preference-share investment schemes conducted in South Africa via trusts or subsidiaries of banks shall be wound down or liquidated by 31 May 2005, since such schemes are accepting deposits from the general public in contravention of the Banks Act.

All preference-share investment schemes that are created or in operation as from 1 June 2005 and that are conducting "the business of a bank" will be in contravention of the Banks Act, and this Office will act against such structures in accordance with the provisions of the Banks Act.

3.2 Non-banking institutions

Since this Office is of the opinion that most preference-share structures constitute "the business of a bank", such structures have to be regulated in terms of the Banks Act. Should entities conduct "the business of a bank" without being registered as a bank in terms of the Banks Act, or should they not be in compliance with any exemption notice issued in terms of the Banks Act, such entities would be conducting such business illegally.

When such activities come to the attention of this Office, it will act against the entities conducting such activities in terms of the provisions of the Banks Act.

4. ACKNOWLEDGEMENT OF RECEIPT

Two additional copies of this circular are enclosed for the use of your institution's independent auditors. The attached acknowledgement of receipt, duly completed and signed by the chief executive officer of the institution and the said auditors, should be returned to this Office at the earliest convenience of the above-mentioned signatories.

E M Kruger

Registrar of Banks

The previous circular issued was Banks Act Circular 6/2004 dated 12 May 2004.