FM Cover Story

AFRICAN BANK

Out of the ashes

The new African Bank was unveiled this month. Yet the Reserve Bank continues to sit on the Myburgh report into why it collapsed. Moyagabo Maake and Rob Rose investigate

Leon Kirkinis, the charismatic former CEO of African Bank, which collapsed spectacularly in August 2014, still looks exhausted 20 months later. When the *Financial Mail* tracked down the 56-year-old banker, he was hovering over a computer in the low-key premises of a new finance company he established last year in Johannesburg's trendy Greenside neighbourhood.

UsPlus describes itself as an "alternative finance organisation, with a developmental agenda" — a lender "with a heart" that aims to provide finance to small and micro businesses.

WHAT IT MEANS

REGISTRAR WON'T SAY WHY HE HASN'T RELEASED MYBURGH REPORT

NEW BANK'S EXECUTIVE HAS MANY OF THE SAME PEOPLE

"We believe the key lies in banking the little guy. By giving access to affordable finance, (we help) small businesses to grow production, sales and employment," it says.

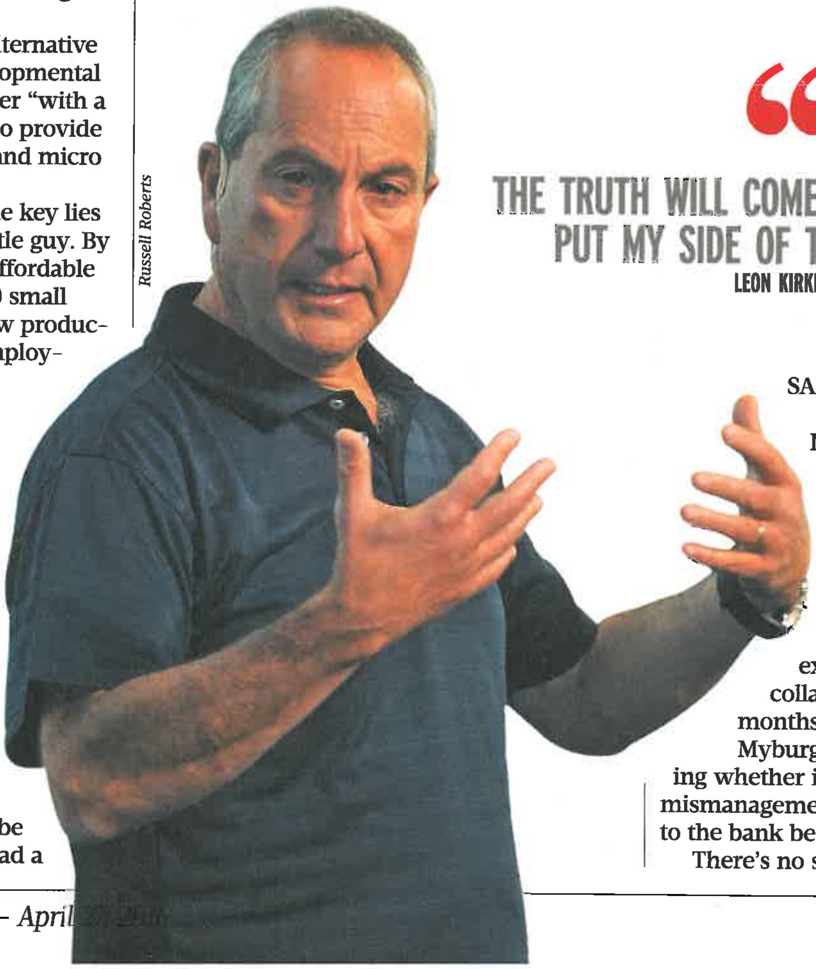
If you think you've heard that before, you have: it's pretty much the vision that drove Kirkinis, a talismanic and likeable merchant banker, to form African Bank Investments Ltd (Abil) in 1998, building it into SA's largest unsecured lender with more than 3.5m customers.

UsPlus is Kirkinis's first tentative step back into the finance game after what his friends describe as a horror two years. "Leon has had a hard time. He was once a darling of the media so he probably feels quite hurt by the whole thing," says one of them.

That's no exaggeration: analysts and journalists lapped up Kirkinis's rousing sermons on how African Bank was extending a hand to SA's lower-income groups who'd been shunned by the traditional banks. In the stuffy banking world, he was a maverick who eschewed suits in favour of jeans and open-necked shirts.

But the implosion of his unsecured lender seems to have left deep scars. Whereas once he was gregarious and willing to hold forth on any subject under the sun, now he is pensive and tight-lipped, uncomfortable with the spotlight.

"I can't say anything about what happened [at African Bank] right now. I have a signed confidentiality agreement with the SA Reserve Bank.



Russell Roberts

> "THE TRUTH WILL COME OUT, BUT I CAN'T PUT MY SIDE OF THE STORY YET
> LEON KIRKINIS

"The truth will come out, but I can't give my side of the story yet," Kirkinis says.

Part of the reason the truth hasn't come out, however, is because the Reserve Bank continues to sit on a report compiled by Advocate John Myburgh into why exactly SA's largest microlender collapsed so dramatically 20 months ago.

Myburgh was tasked with ascertaining whether it was fraud, reckless lending, mismanagement or plain bad luck that led to the bank being placed under curatorship.

There's no shortage of people who

25 **Unsecured lending**
Leaders of the pack

deserve an answer. The list includes nearly 20,000 shareholders of the bank who saw R32bn in value destroyed; 13,000 black-empowerment investors who lost R2bn; powerful institutions who bought its bonds and took an R8bn bath, and thousands of South Africans who saw their money-market investments tumble.

Myburgh interviewed more than 20 witnesses over many months, then handed his report to banking registrar René van Wyk and Reserve Bank governor Lesetja Kganyago in February last year.

Van Wyk remains mum on the inexplicable delay, saying only that he and finance minister Pravin Gordhan will "consider the next steps, once the minister has reviewed the findings".

However getting to the heart of why African Bank collapsed has assumed far greater urgency in recent weeks, following the launch of the "new African Bank" under the stewardship of former WesBank CEO Brian Riley.

At its launch on April 4 it boasted 1.5m customers who earn between R3,000 and R40,000 per month. Riley says it'll be a different animal from its predecessor.

Whereas the old African Bank was a primitive beast, specialising only in personal loans, Riley's bank will be multi-headed: it will add funeral insurance, transactional accounts, a stokvel product, investment products, and a new credit card.

The highly rated Riley has some firepower too, thanks to R10bn in new equity (from rival banks) and cash reserves of R24bn.

It's an ambitious plan — perhaps too ambitious considering the litany of unanswered questions swirling in the air.

For one thing, consumers are under more pressure than at any time since African Bank's rise to fame. So can it still make a profit now that unsecured lending has gone off the boil?

But perhaps more pertinently, Van Wyk's silence on the Myburgh report means that borrowers and the public have no clue whether the same people who might have hastened African Bank's demise still work at the new bank.

"Investors are likely to remain cautious until the Myburgh report has been released and the bank's new strategy has gained traction," says Nico Smuts, an analyst at 36One Asset Management.

Though Smuts expects curator Tom Winterboer would have seen the Myburgh report and "dismissed any employees found guilty of misconduct", no-one can say for certain.

Democratic Alliance finance spokesman David Maynier says this is unacceptable. "For more than a year details of the African Bank scandal have been swept under the carpet . . . We need to know whether a bunch of crooks were responsible for the collapse of African Bank."

However, having spoken to several sources with insight into the inquiry, the *Financial Mail* understands that Myburgh found:

- No specific criminal activity caused the bank to fail. Hence, the report does not recommend criminal charges against anyone;
- The skills and qualifications of the directors of African Bank Investments (Abil) were sharply criticised. They came under the

BRIAN RILEY

Good choice of driver

It may be one of the worst jobs in banking, but few disagree that Brian Riley is the right man to lead the relaunched African Bank as CE.

Educated in the UK, Riley worked at a number of UK banks, including Lloyds and Barclays, before being lured to SA to work at WesBank.

Early in his career he spent three years as an operational manager of an unsecured loan business.

And, when he was appointed CE of WesBank in 2007, he also chaired Direct Axis, a personal loan provider linked to FirstRand Bank.

"As CE, I had a deep interest in Direct Axis. WesBank holds the majority shareholding in the company on behalf of FirstRand and it performed very successfully," Riley says.

Another characteristic likely to benefit African Bank is Riley's bent towards action, rather than meetings.

"When I took over the reins in 2007 I made it public knowledge that I would stay for seven years.

"It created certainty for those aspiring to run the business one day. It also meant that to achieve the success I envisioned, it required a significant bias for action," he said in an interview a few years ago.

PSG Wealth portfolio manager Adrian Cloete says Riley did a fantastic job at WesBank. Patrice Rassou of Sanlam Investment Management says WesBank "makes a quarter of its profits from personal loans".

Nico Smuts, at 36One Asset Management, says Riley was instrumental in diversifying WesBank's sources of income.

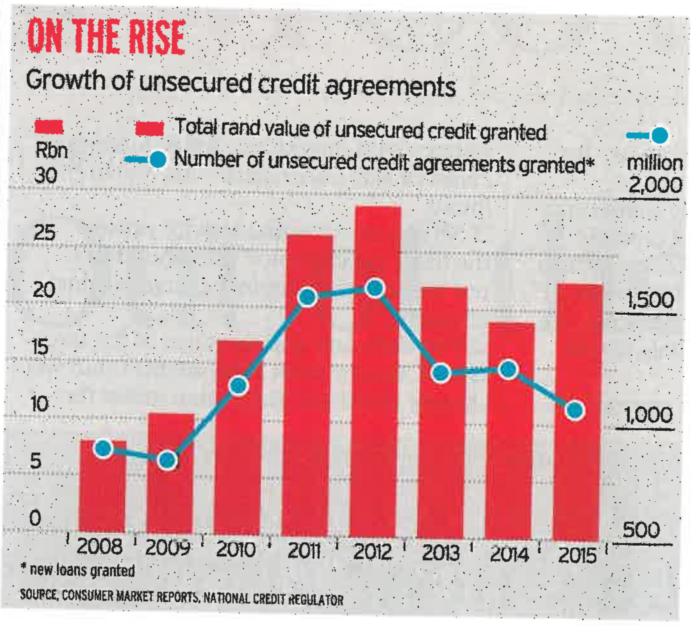
"WesBank earnings have historically been highly dependent on SA motor vehicle sales growth," he says.

"Riley was a key player in the diversification strategy that transformed the business, resulting in the profit contribution from outside [its] core SA vehicle-related lending business rising from below 25% in 2007 to over 60%."

Rob Rose and Moyagabo Maake

Russell Roberts

Brian Riley
Did a good job at WesBank



spotlight for allegedly failing to exercise better oversight of the executives — Kirkinis, in particular;

- Kirkinis, who testified at length, argued it was a simple case of "business failure" and that no reckless lending or criminal activity caused the bank to fail;
- Abil's ill-fated purchase of Ellerines for R9bn in 2008 was closely scrutinised as the retailer's severe losses were ultimately a key factor in driving Abil over the brink. In particular, the process by which Abil funnelled R70m/month to Ellerines in its dying months was flagged.

"The inquiry focused largely on the governance," says one person close to the process. "The upshot was the board allowed Leon free rein to operate unchecked, and accepted his assertions at face value rather than with a more critical eye."

What bolstered Kirkinis's case was the fact that he personally lost out big time, so it's not as if he made out like a bandit while his company collapsed.

At its height, Kirkinis owned R880m in Abil stock. But as the share price tumbled, he didn't sell, losing 98% of his fortune, along with all the other investors.

Of course, some of the reasons for African Bank's crash are already well known. Besides its lifeline to Ellerines, it hadn't set aside enough money to cover bad debts, gambling that its 3.5m customers could repay more debt than they actually could.

It was also a single-product business: unlike Capitec, which offered a full banking account, African Bank relied on external funders for cash, which it could on-lend.

One source says it's naive to look for skeletons when the answer is simple: "Ellerines was an awful acquisition. There were some flawed assumptions and Ellerines' management was terrible," says the source, a former employee. "To make it worse, Leon pushed to expand the loan book to R60bn from R35bn at exactly the wrong time."

But it would be astonishing if the Myburgh report lets all Abil's top brass off the hook. How could there be no accountability for such mega losses?

According to one banking executive it's no surprise that the report does not recommend criminal charges. "Of course there are calls for accountability, but if you look back to the 2008 financial crisis in the US not a single person has been prosecuted on Wall Street, either. And that caused far more damage than Abil."

With no obvious fraud at Abil (unlike, say, the Regal Bank collapse in 2001) it would be even harder to prosecute.

This week, Van Wyk ignored nine detailed questions we put to him about why the report hasn't been released — among them, whether there was criminal activity at the bank, "material nondisclosures" or questionable management practices.

Whether he did not answer so as not to compromise the new bank under Riley is unclear. Yet it's frustrating for those involved.

"There was incredible pressure put on everyone to finish it within six months," says one insider.

"The whole point was for the public to understand why this happened: was it the board, was it the auditors, perhaps there were issues of systemic risk.

"Now, nobody knows what happened."

The report will emerge sooner or later, whether Van Wyk wants it to or not. The *Financial Mail*, for one, has lodged an access to information request for it.

Further, Abil's BEE shareholders lodged a R2bn lawsuit against the company's former directors and auditor Deloitte in December — a test case for directors' personal liability.

These investors claim Abil's directors were party to the old bank's "reckless" trading, including the decision to lend R1.4bn to Ellerines "without making provision for security . . . where there was no reasonable prospect of the loans being repaid".

A *Financial Mail* analysis of the new African Bank shows that a number of the people who served on the credit side of the business under Kirkinis are in fact still at the bank — many on the executive committee.

Among them are chief financial officer Gustav Raubenheimer (previously head of credit), transactional banking executive George Roussos (ex-head of collections) and Vere Millican, who has been promoted to Raubenheimer's old post.

Piet Swanepoel remains chief risk officer, the job he was appointed to when Kirkinis resigned, in the highly charged days before then Reserve Bank governor Gill Marcus announced African Bank would be placed under curatorship in August 2014.

In an interview with the *Financial Mail*, Riley said he is "comfortable with each and every executive on my team — and I know that I enjoy the support of the board and the Reserve Bank for this team".

"There were some obvious gaps in the team when I arrived, but I am confident that we have filled them with skilled individuals from other businesses."

Among the new recruits is Mellony

John Myburgh
Tasked with ascertaining the cause of the collapse

Ramalho, who joined from listed insurer Liberty, as head of new insurance business.

Tactfully, Riley won't say much about the lending practices in the past, which crippled the bank. But he does say he is "comfortable with the accounting policies and credit criteria that are now applied within the new African Bank".

Myburgh's report will clarify to what extent the lending practices of the past were reckless or just bad business.

Not everyone is buying the rosy "relaunch" story, however. To suggest, as some have, that it's a case of a banking phoenix rising triumphantly from the ashes seems too generous. More accurate would be to liken it to a wounded crow, booted from the nest too early into a pitch black night.

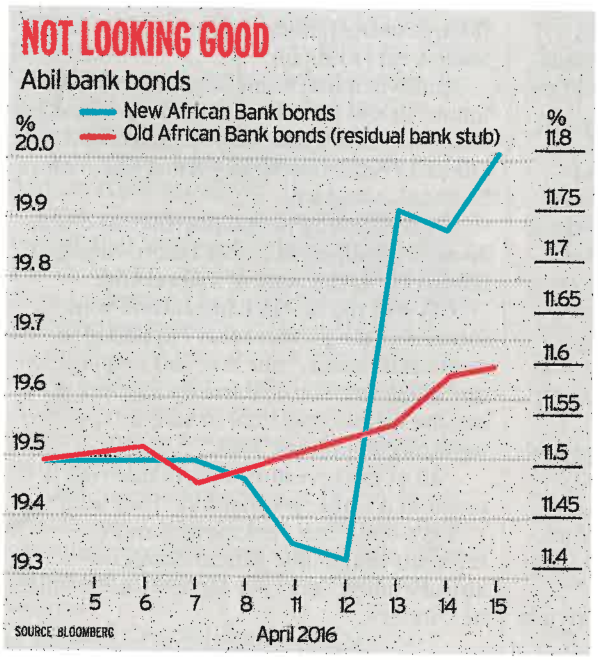
Investors are understandably wary, if the appetite for a series of new bonds launched this month to finance the bank is anything to go by (see graphic).

Ratings agency Standard & Poor's gave the bonds a junk rating of B+. S&P analyst Matthew Pirnie says one of the things he looked at when assessing the rating was the management team — Riley says S&P didn't raise any concerns on this front.

On the first day of trading, the bonds had a decidedly lukewarm response.

Wafeeqah Mallick, an investment analyst at Futuregrowth Asset Management, says this reflects "uncertainty around the business model and micro-lending sector", while the pricing of the bonds is "not adequate for the (bank's) current credit risk".

So has the new African Bank really changed the bank's risk management practices — or is the relaunch simply putting lipstick on the same old pig?



Riley argues it is a different business, saying that even before it collapsed in 2014, the bank had put in place "more conservative" lending criteria — even if it was too late to stop the crash.

"One of the first actions taken by the curator (Winterboer) was to assess the quality of loans that were extended, and he confirmed that he was comfortable with the actions already implemented," Riley says. "The board has since approved the credit risk appetite framework."

To tighten the bolts a bit more, Riley has put in place new "early risk predictors" to allow it to react more quickly to "unexpected" movements in credit performance.

"We have put in place profitability measures in all revenue generating channels, which ensures that the business is accountable for performance and quality at branch level," Riley adds. Governance and compliance are also "significantly improved".

So if the systems are stronger, the next question is whether there is enough (profitable) business out there for the bank to lend to riskier clients.

Analysts have yet to be convinced. Veteran investor David Shapiro says the danger is that to get clients the new bank may end up doing business with people the other banks won't touch, which increases its risk profile.

Adrian Cloete, a portfolio manager at PSG Wealth, says the new bank should also expect intense competition. "It will be hard for African Bank to have any competitive advantage above the other banks, which are very well positioned in the retail market."

Looming large is Capitec, the Stellenbosch-based bank that stole African Bank's lunch while its rival was in intensive care (see page 25).

It's an alarming contrast in fortunes.

In the past four years, Abil's share price plunged 99% from R40/share to just 31c when it was suspended in August 2014. Yet Capitec, which relied largely on the same customer segment, saw its stock treble from R200/share to R609 this week (see graph on page 24).


Russell Roberts

René van Wyk
Remains mum on the inexplicable delay

Riley says Capitec has executed its strategy "with great effect" but "is one of many very good competitors".

"We have our hands full bedding down the new bank and executing our strategy. We are confident that we have a solid foundation from which to start," he says.

Ultimately, Riley concedes his bank will be judged on the quality of its products. "There is no quick fix, we need to do the hard yards."

But even for banks with the right products it's a minefield out there right now. Interest rates have risen four times since African Bank collapsed, with the repo rate now 7%. Customers, even the well-heeled, are battling to keep a lid on their debts.

This was evident from Capitec's results for the year to February, released last month, which revealed a 75% spike in "rescheduled loans" — essentially those which customers are struggling to repay and which the bank agrees to postpone.

In all, R1.5bn of Capitec's loans were rescheduled during the year.

As Smuts says: "Margins and growth prospects for the personal loans business aren't what they used to be. African Bank has no choice but to diversify.

"And it doesn't have the luxury of waiting for better times."

Patrice Rassou, head of equities at Sanlam Investments, says maybe it's not such a bad thing for African Bank to be starting out now. After all, it's a banking cliché that bad loans tend to be written in good times, so perhaps it's better for African Bank to "start dipping its toes in the market" when the economy is spluttering.

The launch of the bank is the culmination of months of late nights for Winterboer, who says, euphemistically, "a number of lessons have been learnt along the way".

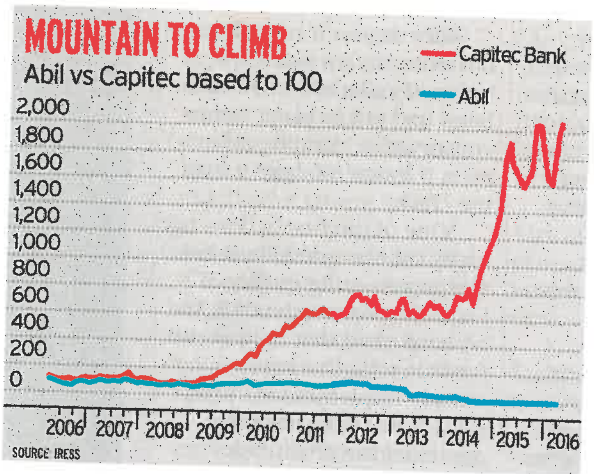
In a complex sleight-of-hand, the bank's good assets have now been moved into Riley's "new bank", while the "bad bank" includes historical debts of R4.8bn in what's now known as "Residual Debt Services". Those debts are still being collected.

Says Winterboer: "The outcome for African Bank, which limits 'new money' from being used to cover the historic liability issues of African Bank, and gets participation in the rescue from the affected creditors and the wider financial services community, is the desired model that the international community has identified."

The bank's new shareholders (indirectly every taxpayer) will have their fingers crossed that it works out.

Perversely, the Reserve Bank will own 50% of the new bank, which means government has in effect entered the microlending business.

This isn't by design but rather because



the R10bn in new capital was provided by the Reserve Bank, the Public Investment Corp (PIC) and a consortium of the country's six-largest banks.

The PIC will hold 25%, and the banks will own the other 25%.

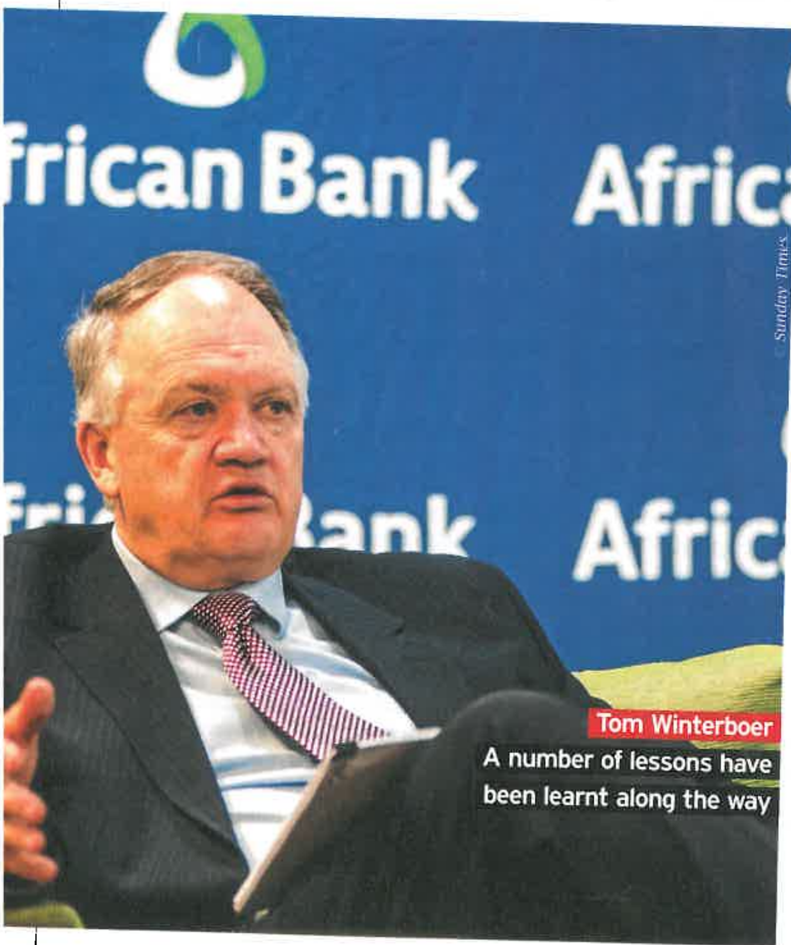
Comically, this means that Capitec, perhaps African Bank's biggest rival, now has a stake in African Bank's success.

Winterboer, a veteran banking partner at PwC and who has acted as curator for the past 20 months, says that in the next few years, that consortium of banks would hope to sell their stake in the "new bank" perhaps through a new listing on the JSE.

"The new African Bank is expected to take at least three years to stabilise, with any equity listing likely to be at least five years from the commencement of the new African Bank."

And if it doesn't work, then the consortium of banks could cut their losses.

Says Smuts: "If African Bank fails to transform itself into a business that appeals to investors, the current shareholders may opt to wind it down or break it up. In other words, everything is at stake for African Bank."



Tom Winterboer
A number of lessons have been learnt along the way

The bank's collapse and subsequent bailout by the six banks is a tale in itself, worthy of an entire semester at business school.

What's not known is just how bad the situation could have been had Africa[n] Bank been allowed to fail in the same way that Lehman Brothers di[d] in the US.

Winterboer is frank: its rescue averted as much as 50% in losses t[o] SA's wider community of money market investors and even a potential sovereign rating downgrade.

"Beyond the loss of direct employment on the bank of over 4,000 staff and the loss of credit pro[-]vision to African Bank customers, the losses for the SA fund community could have been as much as 50% of their debt investments in th[e] bank," he says.

The impact on money market funds "could have been quite extreme", leading t[o] clients potentially liquidating all their investments, which "could have been destabilising for a number of the money market fund groups".

This would have tripped the dominos: a[n] unmanaged failure of a bank would have cast the SA Reserve Bank and treasury's international reputation in a dim light, weakening SA's sovereign credit rating prospects, say Winterboer.

"This had the potential of leading to a downgrade, with possible effects for government and bank funding costs."

36One's Smuts says without the bailout, SA's financial system risked freezing up entirely. "African Bank would most likely have been liquidated, resulting in a large number of retrenchments," he says. "The realisation by customers that their deposits might be frozen typically leads to a run on the bank, which can easily spread to other banks and bring the entire financial system to a standstill. The resulting loss of confidence in the banking system would have taken years to repair."

And when one bank falls, others often follow. In the US, Lehman's collapse brought others to their knees, and in SA in 2002, the failure of Saambou nearly felled BoE, before Nedbank bought it.

It's frightening to imagine that all of this so nearly happened a year before Nenegate hauled SA to the edge of a fiscal cliff.

CEOs of the six SA banks aren't comfortable talking about what happened to them individually, but they did respond to questions as a consortium. As a group, they say the bailout was vital to save a "systemically important bank".

"All of the investors believe this will result in a viable proposition," they add.

Let's hope that sentiment is more than just tough talk. African Bank has already failed once — a second time would be careless.

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