# Banking, Finance & Projects and Corporate Debt, Turnaround & Restructuring

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## In this issue

SOUTH AFRICA



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# Why banks are different, and why it matters

Commercial banks (as defined in the Banks Act 94 of 1990) aren't like other public companies registered in terms of the Companies Act 71 of 2008. A South African commercial bank might look similar to other listed companies on the Johannesburg Stock Exchange (JSE), but underneath the surface, their business model is fundamentally different. And that difference matters – especially when things go wrong.

Here's why commercial banks are unique, especially in South Africa's economic environment:

### 1. Banks borrow far more than other companies

Take a typical JSE-listed company. Most of their funding comes from shareholders (equity), with some debt to support operations or expansion. Now compare that with a large commercial bank. Commercial Banks operate with balance sheets that stretch into trillions of rands, and most of that is borrowed money, not shareholder funds. This debt comes in the form of taking deposits from ordinary people and businesses. In short: while most companies are funded primarily by equity, commercial banks are funded primarily by debt. And that has big implications. Most of a bank's value is owed to others, not owned by shareholders.

### 2. Their debt is short-term, and withdrawable on demand

The majority of a commercial bank's debt comes from taking deposits from the members of the public, which can be withdrawn at any time. Your transactional or savings account? That's a liability for the bank (money it owes you). And it's repayable as soon as you tap your card or hit "*withdraw*". By contrast, most companies borrow over years, not days. Commercial banks constantly have to manage the risk of people pulling their money out – liquidity risk – which other companies rarely face on the same scale.

### 3. People treat bank debt like it's risk-free

When you deposit R100 at a commercial bank, you don't usually worry that the commercial bank might not pay it back. You just expect it to be there. This isn't how people treat other forms of lending, like buying shares or investing in a bond. Why do we trust commercial banks like this? Because of strict regulation, track records, and now, deposit insurance (more on that later). Commercial banks benefit from the public perception that deposits are safe – which only works if they behave prudently.

## What banks should do with your money

So, if commercial banks raise enormous amounts of short-term funding that people see as low-risk, what should they do with that money? They shouldn't take wild bets. A commercial bank isn't a venture capital fund. It's not supposed to gamble on the next big startup or pour money into risky projects. Why? Because its funding isn't built for risk-taking; it's short-term and expected to be safe.

# Why banks are different, and why it matters

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## Safe, predictable and diversified lending

What the depositors expect is for the commercial banks stick to the basics. That means:

- Lending money into the real economy through home loans, car finance, business loans and working capital.
- Holding senior claims: these are usually secured debts, so if something goes wrong, the commercial bank is first in line to get repaid from the security it holds.
- Spreading risk by lending to many borrowers across different sectors, so a few bad loans don't sink the ship.

This model works because it matches the commercial bank's obligations (safe, short-term deposits) with predictable, income-generating assets (loans).

## When banks forget what they're for

History shows what happens when commercial banks misuse depositors' money.

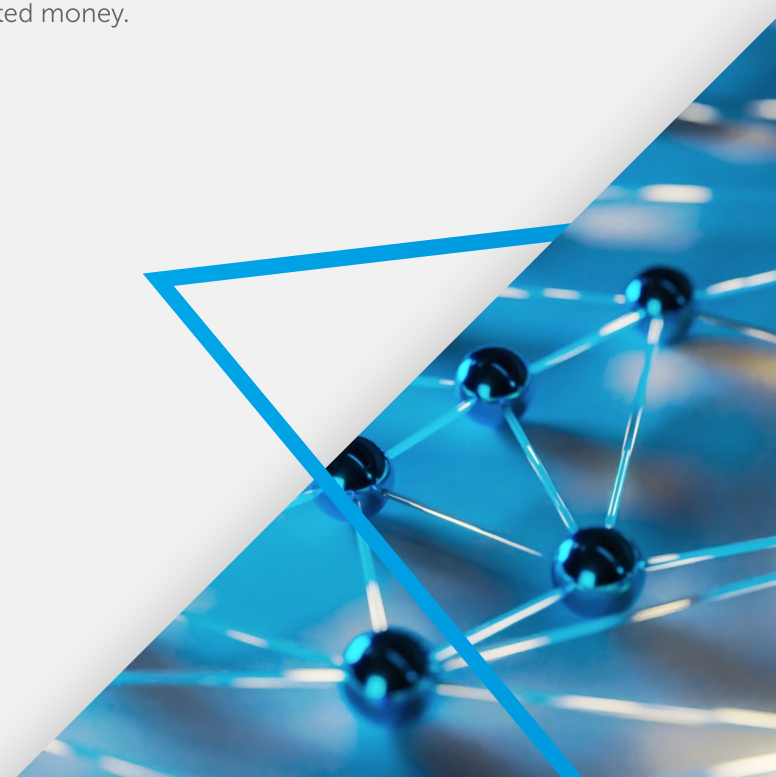
### VBS Mutual Bank (2018)

VBS went spectacularly off-course. It made large, risky loans to politically connected individuals, municipalities (without complying with the banking regulations of a bank), and related parties. Many loans were unsecured or fictitious. The result? Collapse, and massive losses for depositors and investors, some of whom, if not the majority, were pensioners with their life savings gone forever.

### Habib Overseas Bank (2023)

Habib Overseas Bank (HOB), a local unit of the Pakistani bank, was placed in final liquidation after the South African Reserve Bank's Prudential Authority (PA) found the bank to be "*hopelessly insolvent*". This decision was made following a period of curatorship, during which HOB's governance, compliance, and operational failures were addressed. The PA, after considering the curator's report and the bank's declining financial health, deemed it in the best interest of creditors, who primarily include depositors, to proceed with liquidation. This again highlighted how important regulatory oversight is in protecting depositors and keeping commercial banks in check.

In both cases, the fundamental banking rule was broken. The lesson: banks shouldn't take chances with short-term, trusted money.



# Why banks are different, and why it matters

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## What happens to your money if a South African bank fails?

In the past, if a local bank failed, Government might intervene, but there were no guarantees. Depositors could wait months or years to recover some funds, depending on how much was left in the failed bank's estate.

That changed on 1 April 2024, when the Corporation for Deposit Insurance (CODI) was officially launched. CODI manages the Deposit Insurance Fund (DIF).

## How CODI protects you

CODI, a wholly owned subsidiary of the South African Reserve Bank (SARB), is mandated by law to protect qualifying bank depositors by using the DIF to give depositors up to R100,000 insofar as they have positive balances in their accounts in qualifying products, in the unlikely event of their commercial bank failing.

This means:

- If you have less than R100,000 in your bank account(s), you're fully protected.
- If you have more, you'll get the R100,000 automatically and claim the rest from the failed bank's estate like any other creditor.

The vast majority of South African depositors fall within this coverage. CODI brings South Africa in line with many developed economies by offering this clear, upfront protection to the depositors.

## Why this matters

South Africans often take for granted that their money is safe in the commercial banks. And most of the time, it is. But banking works on trust. That trust is earned by prudent bank behaviour and protected by strong oversight.

When banks follow their purpose – responsible lending, diversified risk and liquidity management –everyone benefits. When they don't, the consequences affect not only depositors but the entire financial system.

With CODI in place, and a robust regulatory framework from the SARB and PR, South Africans can have greater confidence that the system is designed to protect them – even in the rare event of a commercial bank failure.

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