

## **Residual Debt Services Limited (in curatorship)**

### **Statement by T Winterboer, curator of Residual Debt Services Limited, 16 February 2017.**

#### **Introduction**

This is the first update by the curator following the successful implementation of the transaction on 4 April 2016, in accordance with an Offering Information Memorandum (“OIM”) issued on 4 February 2016. The OIM, inter alia, created a new bank (African Bank Limited) and transferred the core assets and business to the new African Bank Limited, which received an injection of R10 billion from its new parent, African Bank Holdings Limited (the “Transaction”).

The material liabilities of Residual Debt Services Limited (“RDS”) were exchanged, as part of the Transaction, for new instruments held in African Bank Limited, together with certain residual claims on the assets of RDS – “senior stub instruments” and “sub-ordinated stub instruments” and a partial cash settlement.

The reader is referred to the Transaction documents. Nothing in this statement should be considered to alter legal terms and conditions agreed to and detailed in the Transaction documents.

#### **Audited Annual Financial Statements**

At the time of this statement, the audited annual financial statements of RDS have been issued for the year ended 30 September 2016. These financial statements include the results of RDS for the period from the Transaction. Highlights include:

- A loss from operations of R945 million (2015 a loss of R6,882 million). This comprises a loss for the first half of the year of R987 million and then subsequent to the Transaction effective date, a profit of R42 million for the second half of the year.
- A profit for the year of R2,366 million (2015 a loss of R7,212 million) after including various one off capital items, one of which includes a gain arising from the Transaction of R 2,654 million. This once off profit represents the difference between the fair value and the carrying values of the assets and liabilities transferred to the new African Bank.
- Assets at 30 September 2016 of R4,399 million, with unsubordinated liabilities of R5,018 million, including the senior stub instruments, and subordinated liabilities of R3,842 million, representing the contractual value of the subordinated stub instruments, resulting in negative equity of R4,461 million.

The full set of annual financial statements for the year ended 30 September 2016 can be accessed on the following link; [www.residualdebtsservices.co.za](http://www.residualdebtsservices.co.za).

#### **Auditor qualifications**

The auditors, Deloitte, in their report on the annual financial statements, have identified two areas for qualified opinion:

##### Fully written off portfolio of advances

Where loans held are substantially beyond their due date for payment without settlement by the debtor, it is the practice of RDS, in line with the approach adopted by the leading South

**T Winterboer was appointed as curator of Residual Debt Services Limited (“RDS”), previously named African Bank Limited on 14 August 2014 by the Minister of Finance of the Republic of South Africa and pursuant to the Banks Act No. 94 of 1990 (as amended) to manage the affairs of RDS subject to the supervision of the Registrar of Banks.**

African banks, to no longer recognise such amounts as assets. They are fully written down in the books of account. Notwithstanding this accounting approach, RDS continues to seek to recover such loans, and has been partially successful to date. However, since both the timing and quantum of any recovery is materially uncertain, it is considered prudent not to recognise such amounts as an asset. Deloitte disagrees.

Deloitte estimates that the recoverable amount of the previously written off book at 30 September 2016 is approximately R1,250 million. During the financial year to 30 September 2016 R766 million was recovered from the written off book (2015 R528 million).

### Split of assets

At the point of the Transaction, assets were transferred to the new African Bank Limited utilising a master list of assets agreed between RDS and African Bank Limited, based upon a credit scoring approach against the assets held at that time. The asset transfer is agreed between RDS and African Bank Limited, however Deloitte was unable to obtain sufficient appropriate audit evidence of the credit score calculated per the latest lending model.

In the interests of achieving the Transaction, the curator accepted a qualification from Deloitte on this matter.

### **SARB Loan**

As part of the Transaction, RDS received a loan from SARB of R3.3 billion, which enabled the appropriate asset transfer to give effect to the Transaction. This loan and interest arising ranked for payment prior to any payments to stub instruments.

This loan has been settled in full in the period up to 30 September 2016, representing a key initial success of the curatorship post the Transaction.

### **SARB indemnity guarantee**

As part of the Transaction, RDS has provided a R3 billion indemnity to the new African Bank Limited in respect of assets transferred, with such indemnity expiring on the 8<sup>th</sup> anniversary of the Transaction, effectively 4 April 2024. The SARB provided to RDS a matching supporting guarantee for this indemnity, so that the indemnity could be honoured even where RDS did not have sufficient funds to cover any claim arising.

Any claim arising to the SARB from these indemnity guarantee arrangements has a priority ranking claim on the assets of RDS, after operational costs arising in the ordinary course of the curatorship but before the stub claims.

Accordingly, having settled the SARB Loan, RDS has started to accumulate an indemnity reserve fund. Once this fund balance totals R3 billion, any further funds being available will be utilised to provide payment to the senior stub instruments. As at 31 January 2017, this indemnity reserve totalled R 1.7 billion, in addition to an additional operational float of R500 million. Current projections which are based on numerous assumptions indicate that this indemnity reserve could be fully funded by December 2017.

## Claims against the indemnity

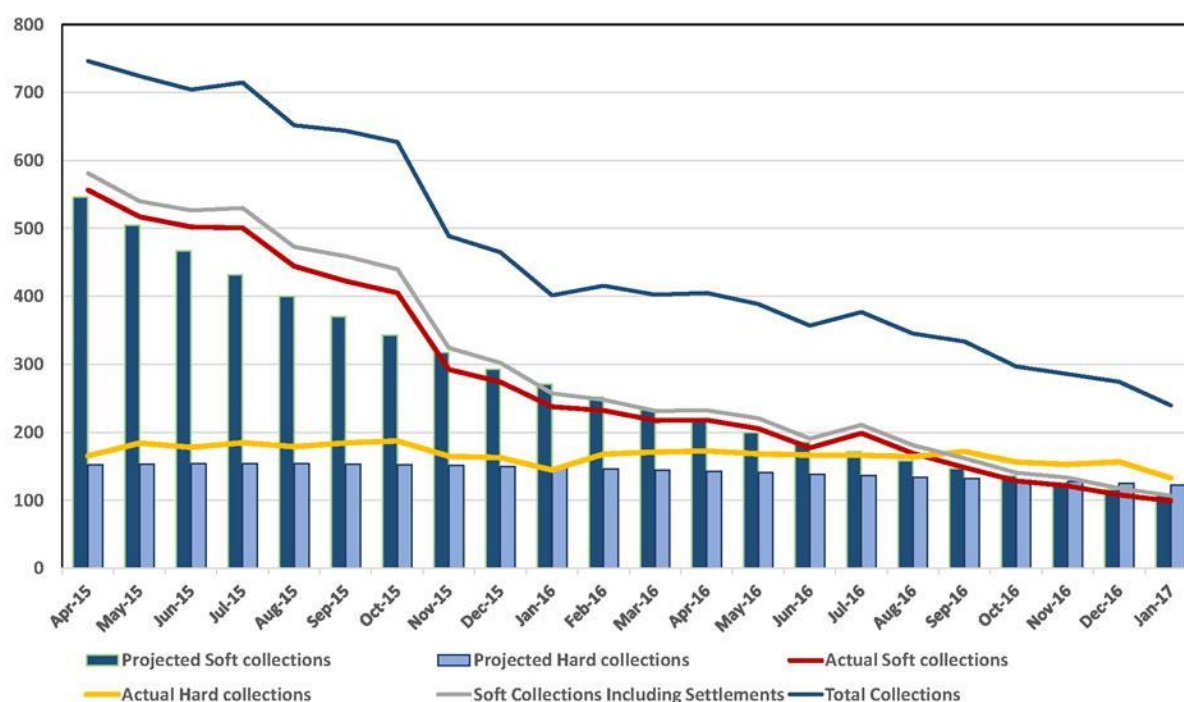
At the date of this statement, the curator has not received notice of any identified claim against the indemnity by the new African Bank Limited.

If, at the date of expiry of the indemnity, being April 2024, no notice of claim has been received, then the reserve would be available to provide payment against stub claimants in accordance with agreed waterfall mechanisms detailed in the Transaction.

## **Asset recoveries**

RDS continues to focus on recovery of the assets remaining held following the Transaction. The principal assets are loans made by RDS prior to the commencement of Curatorship that were not transferred to the new African Bank Limited.

The collections performance in the period to 31 January 2017 is included below:



African Bank Limited is contracted to lead the recovery of such assets for which it charges a fee based on a service level agreement entered into between RDS and African Bank Limited. Additionally the curator has retained the services of another independent service provider to provide a review and challenge to ensure that recovery approaches are optimal.

## **Valuation of stub instruments**

Note 34.3 to the annual financial statements include an assessment, in accordance with IFRS, of the fair value of the senior stub and sub-ordinated stub instruments.

### Base fair value

- The fair value is assessed as a discounted cashflow of forecast future receipts and payments
- It only includes the expected cashflows from RDS's advances book for a 60 month future period
- The "Base" forecast assumes that the indemnity will be called in full (R3 billion) spread over a three year period in six equal tranches starting from March 2017
- Any surplus arising after covering the indemnity is released to creditors every six months thereafter
- Future cashflows are discounted at an assessed weighted average cost of capital ("WACC") of 14.0%. A 1% sensitivity to the discount rate has also been provided.

Senior stub instruments  
Subordinated stub instruments

<b>30 September 2016</b>		
Fair value using 14.0% Rm	Fair value using 15.0% Rm	Difference Rm
2 725	2 642	(83)
Nil	Nil	Nil

### Indemnity reserve release fair value

The impact on fair value if the indemnity reserve, funded in full, is available to provide payment to creditors at the expiry of the indemnity arrangements in April 2024.

Senior stub instruments  
Subordinated stub instruments

<b>30 September 2016</b>		
Fair value using 14.0% Rm	Fair value using 15.0% Rm	Difference Rm
4 376	4 188	(188)
Nil	Nil	Nil

### Fair value summary

No dividend distribution to the shareholder of RDS, being African Bank Investments Limited (renamed African Phoenix Investments Limited), is forecast.

No payment to sub-ordinated stub holders is expected.

A partial settlement against the senior stub holders is anticipated, albeit that timing of payments and quantum will be reliant on future recovery performance and the extent of any claims against the indemnity arrangements. Any payment will first apply against interest accrued.

## **NCR and legal proceedings**

The NCR has announced an investigation into certain activities of RDS prior to curatorship, focussed on reckless lending allegations. RDS is co-operating fully with the NCR, whose review is ongoing. No liability arising has been identified at this time.

Other than the possible NCR outcome, no legal proceedings are ongoing at this time, or have been identified for future action.

If a liability does arise from the NCR investigation or other legal proceedings, any such claim would rank alongside senior stub claims.

## **SARS related matters**

RDS currently has open tax matters with SARS which primarily relate to the deductibility of historical impairments provisions. Due to the uncertainty relating to this matter and the future recovery, no deferred tax asset has been raised in the financial statement.

## **Conference call**

A conference call is being held to accompany this statement and the issuance of the annual financial statements for the year ended 30 September 2016. That call is being recorded and will be available via the company website [www.residualdebtsservices.co.za](http://www.residualdebtsservices.co.za) from Friday 17 February 2017.

## **Next Update**

It is expected that the curator will provide a further update in June 2017, together with interim financial statements.

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