

APPLICATION IN TERMS OF SECTION 37 OF THE BANKS ACT, 1990 (ACT NO 94 OF 1990) BY NEDCOR LIMITED FOR THE ACQUISITION OF SHARES IN STANDARD BANK INVESTMENT CORPORATION LIMITED

1. INTRODUCTION

On 30th November 1999 Nedcor Limited (“Nedcor”), through the Office of the Registrar of Banks, submitted an application, for my consent, as Minister of Finance, for its proposed acquisition of shares of more than 49 per cent of the total nominal value of the issued shares in Standard Bank Investment Corporation Limited (“Stanbic”) (“the proposed acquisition”). Stanbic is the bank controlling company of The Standard Bank of South Africa Limited (“The Standard Bank”).

Section 37(4) of the Banks Act, 1990 (Act No 94 of 1990) (“the Banks Act”) is peremptory in its requirement that permission for the proposed acquisition not be granted, unless the Minister of Finance is satisfied that the proposed acquisition **will not:**

- (a) be contrary to the public interest; and
- (b) be contrary to the interest of the bank concerned; or
be contrary to the interest of the depositors; or
be contrary to the interest of the controlling company concerned.

On the 6th June 2000 I afforded Nedcor, Stanbic and SASBO (SA Society of Bank Officials), a bank employees’ union, an opportunity to make oral presentations on the proposed acquisition to me, Deputy Minister Mpahlwa and officials of the Department of Finance led by Ms Maria Ramos, the Director-General: Finance. The Registrar of Banks was also present at the meeting with the banks.

The Minister of Finance is required by the provisions of section 37(2)(b) of the Banks Act to decide on the proposed acquisition after consultation with the Competition Commission (“the Commission”). I have been advised that the effect of this peremptory requirement is that I should in good faith give proper consideration of the views and/or advice of the Commission. However, having given proper consideration to its views and/or advice, I remain at liberty to make a decision which may be contrary to such views and/or advice.

I have considered the views of the Commission as set out in its report which is an annexure to the report of the Registrar of Banks. On 15th June 2000 I had the opportunity of also meeting with the Commission led by the Commissioner, Adv Menzi Simelane, and it confirmed the advice set out in its report.

I have also considered the advice of the Registrar of Banks set out in his report on the proposed acquisition.

I would at the outset express my concurrence with the view of the Registrar of Banks set out on page 7 of his report, that: *“(u)ltimately, after due consideration of the objective factors and analysis, the decision remains a judgment call, informed by the process, but not solely determined by it.”*

2. BACKGROUND

On 15th November 1999 Nedcor issued an announcement of its *‘firm intention to make a Partial Offer (“the Partial Offer”) to the shareholders of Stanbic with a view to combining the two businesses’*.

By both the accounts of Stanbic’s representatives and those of Nedcor, Stanbic is a profitable company and The Standard Bank is one of the most recognised brands in South Africa.

Nedcor is well aware that Stanbic is not an ailing company in need of a rescue plan. Indeed Nedcor has emphasised that, in its view, there are major efficiency gains to be achieved by a merger of Stanbic and Nedcor. Nedcor is also of the view that the proposed acquisition is good for our country and region as the merged entity will result in the creation of a “national champion”.

Stanbic’s opposition to the proposed acquisition has essentially been to the effect that the potential of the risks of such merger, bearing in mind the two companies’ information technology incompatibilities, the lack of a shared vision, the need, in its view, to preserve *“the existing level of competition amongst South African banks ensuring continued world-class innovation and breadth of affordable product choice for South African customers”*, that a failure of the merged entity would, in its view, have a *“catastrophic national impact”*, outweigh the potential of its success.

SASBO is opposed to the proposed acquisition on the ground that, in its opinion, the merger of Stanbic and Nedcor will result in job losses on a major scale.

It is common knowledge that at the end of last year, Stanbic sought an order from the Pretoria High Court to the effect that the Competition Act, 1998 (Act No 89 of 1998) (“the Competition Act”) be declared to apply to the proposed acquisition.

That High Court, later supported by the Supreme Court of Appeal, declined Stanbic’s application, ruling that the proposed acquisition stood to be dealt with in terms of the Banks Act by the Minister of Finance and that accordingly, the Competition Act does not apply to it.

It further reiterated that, in respect of the proposed acquisition, all that was required of the Minister of Finance was to act after consultation with the Commission in accordance with section 37(2)(b) of the Banks Act.

On 5th June 2000, the Registrar of Banks furnished his report to the Minister of Finance together with the advice provided to me by the Commission.

I express my gratitude to the Registrar of Banks and the Commission for their reports. I also thank the representatives of Nedcor, Stanbic and SASBO for the submissions they made on this matter.

3. ISSUES

In order to arrive at a decision whether or not permission be granted to Nedcor for the proposed acquisition, I have given serious consideration to the preemptory requirements of section 37(4) of the Banks Act. I address them as follows:

3.1 ***Will the proposed acquisition of shares be contrary to public interest: (section 37(4)(a));***

3.1.1 **The proposed acquisition's possible impact on competition:**

It is common knowledge in the banking industry and beyond, that Stanbic, with banking assets valued at 31st December 1999 at about R184,3 billion and shareholders' funds of R20, 4 billion, is the largest of the four very large banks (i.e. Stanbic, ABSA, FirstRand and Nedcor). Nedcor, the fourth largest bank, had at 31st December 1999, assets valued at about R129,8 billion and shareholders' funds of R10,1 billion. A merger of Nedcor and Stanbic would therefore result in an entity with the a total asset value (shareholders' funds included) of about R344,2 billion. It will undoubtedly, be bigger by far than its closest competitors, ABSA and FirstRand.

South Africa belongs to a group of countries with a relatively high level of concentration in the banking sector. If the merger is approved the Herfindahl-Hirshmann index ("H-Index"), widely used to measure concentration and the extent of competition in the banking sector, would increase from the current level of 0,15 to 0,21. This would leave South Africa with an even more concentrated banking sector and well outside accepted international thresholds.

Because of this, the Registrar of Banks has advised that the proposed merger could be viewed negatively by international observers. Such observations may result in lower assessments of the long term viability of the banking system in South Africa.

The Commission supports this view. It has advised that:

"whatever threshold is used the levels of concentration have been unacceptably high from an international perspective in the current, pre-merger market situation and will be even less acceptable after the merger."

In small business retail banking, for example, the merged entity is likely to have more than 50 per cent of South African customers and thereby have a market share advantage of more than 26 per cent over its closest competitor.

There is no doubt that competition between Stanbic and Nedcor plays a vital role in stimulating innovation in the retail banking sector. It is for this reason that there is concern for the high probability, as suggested by the Commission, that a merger of Stanbic and Nedcor *"is likely to substantially prevent or lessen competition in all product markets in the categories of: Retail banking – personal banking and Retail banking – small business banking."*

Nedcor has, however, submitted that a number of technology and efficiency gains would outweigh the anti-competitive effects outlined above.

According to Nedcor, such potential gains would result in a merged entity with a cost-to-income ratio of 48 per cent and a return on equity of 30 per cent. The cost-to-income ratios of Nedcor and Stanbic are currently 54 per cent and 61 per cent, respectively. Nedcor is also of the view that the merged entity would set the efficiency standards for the banking industry as a whole and that this would in turn result in lower bank charges for customers.

While there may indeed be the possibility of such efficiency gains, I remain concerned that, as suggested by the Commission, "*the supposed gains from achieving economies of scale are in fact gains from improved efficiency along a normal average cost curve*". There can be no guarantee that benefits derived from efficiencies realised as a result of the merger of Stanbic and Nedcor will indeed be passed on to consumers.

I am accordingly of the view that the efficiency gains which Nedcor suggests are to be derived from the proposed merger, do not outweigh the very real possibility of the significant anti-competitive effects of such merger.

Another undesirable effect of the over-concentration that will result from the merger of Nedcor and Stanbic on the banking system is the possibility that the small banks would have difficulty in attracting deposits.

I am advised that this is already a structural problem experienced in the banking system. There is also the possibility that the size of the merged entity will further reduce smaller banks' ability to fund themselves.

Even in other foreign jurisdictions, proposed mergers which would lead in the over-concentration of economic power in the hands of a merged entity have not been allowed to go through.

Paul Martin, the Canadian Minister of Finance, has himself previously turned down an application for a proposed merger saying: "*The mergers would lead to unacceptable concentration of our economic power in the hands of fewer, very large banks.*"

3.1.2 The proposed acquisition's likely impact on consumers

Access to basic banking services

Nedcor is of the view that the overall accessibility for customers to branches and ATMs will be much improved by a merger of itself and Stanbic. Nedcor has further submitted that such merger will not affect the retention of branches in rural areas as there will be about 670 ATMs relocated to enhance services to the underbanked.

It needs to be noted that Stanbic has also invested heavily in ATM access. It has about 2 400 ATMs, 2,5 times the number of Nedcor's 940 ATMs.

I am of the view that the proposed relocation of 670 ATMs is likely to result in a shrinkage of access in existing areas which may not necessarily be in the public interest.

Of particular concern is the possible impact on banking services to the underbanked and rural areas.

Product lines and service delivery

Generally, economies of scale are likely to improve after a merger. Where unit costs can be reduced and such cost reductions passed on to the consumer, they may be regarded as a public-interest benefit.

The pursuit of efficiencies may result in the rationalisation of the product lines of both Nedcor and Stanbic with some cost benefit for the consumers.

There may, however, be instances where the rationalisation of product lines in pursuit of efficiencies and profitability may work against the public interest. An example would be the case where a product that is less profitable is discontinued even if it serves a public need.

3.1.3 The Liberty Group / Old Mutual issue

The approval of the merger would give Old Mutual Plc (“Old Mutual”) an overly dominant position in South Africa’s financial sector, and this may affect policyholders of the Liberty Group (“Liberty”) adversely.

- There are risks for the Liberty policyholders, in that a key distribution channel for Liberty, The Standard Bank, will possibly disappear after the merger, since there is a strong possibility that the merged entity will dispose of Liberty.
- The above would have the effect of impairing the growth of Liberty and could prejudice its policyholders.
- Furthermore, the cost structure of Liberty is likely to remain essentially the same, but its income stream would possibly diminish until alternative channels are identified and put into place.
- The effect on Liberty could therefore be fairly damaging and could neutralise it as a serious competitor of Old Mutual.

3.2 *Will the proposed acquisition be contrary to the interest of the bank concerned (The Standard Bank) or the bank controlling company (Stanbic): (section 37(4)(b));*

The Standard Bank brand is highly recognised in South Africa. Moreover, the Standard Bank’s profitability has not been questioned by Nedcor.

Among South Africa’s four big banks however, Nedcor, has the lowest cost-to-income ratio of 51 per cent. Stanbic has suggested that this is because Nedcor has in part limited its risk through focusing on the middle to upper income market. This is in line with its corporate identity.

On the other hand, Stanbic has focused its vision on the mass market.

There is a marked difference in the corporate outlook and culture of the banks concerned which may lead to operational difficulties in a merged entity with possible loss of focus. Stanbic has also emphasised that there exists no shared vision between it and Nedcor.

Further, given the systemic risk which is outlined more fully below in the event of a failure, as sometimes happens, I am not satisfied that it would be in the interest of Stanbic and The Standard Bank to force such a highly reputable and successful bank and a reputable and successful bank controlling company, to take a risk which the Stanbic board unanimously holds to be contrary to their interests.

3.3 ***Will the proposed acquisition be in the interest of the depositors: section 37(4)(a)***

As stated above, the size of an entity arising from a merger of Stanbic and Nedcor and its total asset value is large by South African banking standards. These factors may be seen as pointing towards a reduction of the probability of the failure of the merged entity.

However, given that no guarantees can be given that such a merger would not fail and the size of the merged entity, I must give serious consideration to the possibility of the challenge which the authorities would have to face in the event that the merged entity fails.

The Registrar of Banks has advised me of his concern for the level of risk during the integration phase, particularly in the light of the fact that Stanbic considers Nedcor's bid as being hostile.

I would again emphasise that I am very concerned that given the size of the entity that would arise from a merger of Stanbic and Nedcor, there exists the possibility of a medium to high adverse impact on the ability of the authorities to stem a systemic crisis, should it arise.

To put it simply, given the fact that a merged entity would have the majority of South African bank users as its depositors, there would be an expectation that the authorities would not allow it to fail.

I am unable however, to advise the South African banking public that I am satisfied that in the event of failure, their interests would be properly protected.

There is particular concern that there is at least a perception that the merger would have an adverse effect on the ability to retain key staff at critical times during the integration and "bedding down" phase of the merger, should such merger be pursued.

The Registrar of Banks has expressed the view that stability considerations flowing from a merger between Stanbic and Nedcor pose a major concern. It is further important to note that the Registrar of Banks has advised that once approval has been granted for a merger of the present magnitude, it would be almost impossible to reverse such merger and get to the *status quo ante*.

4. CONCLUSION

South Africa's banking system, although undoubtedly in need of improvements in certain areas if it is to effectively meet the challenges posed by globalisation and the resultant need for more efficient banks, is in my view, healthy.

As stated above, Nedcor's achievements are a pride not only for itself, its depositors and shareholders, but also for the country as whole. The Registrar of Banks is therefore correct in saying Nedcor's track record constitutes a strong argument for *“regulators not to impede the ability of the market to decide on the ownership of a bank, provided that the owners meet the criteria set out in legislation”*.

As stated earlier, section 37(4) of the Banks Act is peremptory in its requirement that permission for the proposed acquisition be granted only if I am satisfied that it will not be contrary to the factors set out therein.

A further sensitive issue related to the proposed merger is that of its likely impact on employment in the banks concerned. The estimates of the number of job losses resulting from the merger range between 10 000 to 15 000.

It has been pointed out that the natural staff attrition or average turnover of staff, in the banking sector is between 12-13 per cent per annum. This would translate to 18 000 employees for both banks over a three year period.

The Competition Commission has ruled against the proposed merger. It has expressed itself in this regard as follows:

“In conclusion, therefore, the Commission is of the view that the proposed transaction should be prohibited on the grounds that it will have significant social costs (primarily) potential abuse of market power in the retail banking market and potential job losses), which represents a net loss to society, which cannot be offset by any potential efficiency gains or public interest considerations.”

I have considered the Commission's report and have noted its conclusion.

The recommendation of the Registrar may be summarised, and I quote, as follows:

“I am of the opinion that the risks of the application outweigh the merits. Accordingly, I recommend that the application by Nedcor to acquire more than 49 per cent of the shares of Stanbic, not be approved.”

The Registrar has advised that:

“Nedcor has not provided conclusive evidence that the potential efficiency gains and public interest considerations would exceed the social costs of potential market abuse and job losses.”

Having carefully considered the recommendations of the Registrar and the Commission as well as the submissions of Nedcor, Stanbic, and SASBO, I would reiterate that I am not satisfied that the potential efficiency gains would exceed the public interest concerns of

diminished competition, potential market concentration and job losses, the attendant risks if the merged entity were to fail.

That the proposed acquisition is considered to be hostile by Stanbic is merely one of the factors taken into consideration in my decision. Given the factors outlined above regarding the concentration of economic power that would arise from a merger and the attendant risks outlined above, I would remain extremely concerned even if there was a friendly interaction between Stanbic and Nedcor.

I accordingly decline to grant permission for Nedcor to acquire over 49 per cent of the total nominal value of the issued shares in Stanbic as set out in its application in terms of section 37 of the Banks Act.

TREVOR A MANUEL, MP
MINISTER OF FINANCE