

Minimal impact of African Bank on your money market investments



14 August 2014

Last week Wednesday, 6 August 2014, African Bank Investment Limited (ABIL) issued an announcement forecasting a loss of at least R6.4 billion in the 2014 financial year, the resignation of their long-time CEO and the need to raise at least R8.5 billion in additional capital. This in turn raised questions around the future of African Bank as a going concern.

The share price reacted negatively and moved from R6.86 at the close of business on 5 August 2014 (i.e. right before the announcement) to R0.31 as at close of business on Friday 8 August 2014.

On Sunday, 10 August 2014 the South African Reserve Bank (SARB) issued a statement to say that African Bank has been placed under curatorship and the stewardship of Tom Winterboer of PricewaterhouseCoopers.

While the recent news flow surrounding African Bank has been unsettling, the SARB has responded to calm the market concerns and the clients of the bank through the provision of significant financial support. African Bank will essentially be divided into a “good” bank and “bad” bank and these two sections will be financed separately.

The “good” vs the “bad”

During the global financial crisis, one of the methodologies adopted by the authorities to deal with troubled banks was to split them into a “good” bank and a “bad” bank. While the difficulties within African Bank are completely unrelated to the global financial crisis, the SARB has adopted the same principle in providing assistance.

The “bad” bank portion of African Bank, which has a net loan book of around R17 billion, will be ring-fenced and effectively “sold” to SARB for R7 billion. Within the “bad” bank, the curator will endeavour to collect all outstanding loans. This means that existing customers will have to repay their credit facilities in line with their legal obligations. This portion of the bank will eventually cease to exist.

The “good” bank, which has a net loan book of around R26 billion, will continue to operate as African Bank, but with certain conditions and oversight from the SARB.

To support the “good” bank, there is a commitment of R10 billion from the consortium of commercial banks (namely ABSA, Standard Bank, Capitec, Investec, Nedbank, and FirstRand) and Public Investment Corporations to underwrite its capital raising in the market. The financial support from the consortium will bolster the capital base of the “good” bank.

Impact on the money market investor

The portfolios with exposure to fixed interest instruments are impacted by a write-down in the value of those fixed interest instruments, referred to as the “haircut”. The senior debt has been written down by 10%, while the subordinated debt and preference shares have been written off altogether. This is as per the recapitalisation agreement and the guidelines issued by the SARB on 10 August 2014.

We wish to point out our money market funds had no exposure to preference shares or subordinate debt. Our robust investment and credit processes ensure that each debt issue undergoes strict selection process from the credit risk and liquidity points of view. This process resulted in the limited exposure to African Bank in our money market funds.

This is the list of our money market funds and the impact of the “haircut” is detailed below:

	Exposure before write-down on Friday 8 August (%)	Exposure post write-down on Monday 11 August (%)**	Impact on the market value of the fund (%)*	1 year returns net of fees to 12 August (%)
STANLIB Money Market Fund (fee class R)	1.72	1.56	-0.16	5.03
STANLIB Institutional Money Market Fund (fee class B1)	0.71	0.68	-0.07	5.33

* Please note that this is not an arithmetic difference, but a weighted difference.

** The write-down of ABIL’s fixed interest instruments was effective on first trading day after the SARB announcement, prior to the market opening on Monday 11 August.

So as an example, looking at the STANLIB Money Market Fund, the overall impact on the fund return for the year to 11 August will be - 0.16%. The return with the haircut taken into account is 5.03% for the year, and it would have been 5.19% had it not been for the African Bank write down.

Please note that the STANLIB Corporate Money Market Fund has no exposure to African Bank and therefore is unaffected by this event.

Last week’s events reinforce the benefits of a well-diversified money market portfolio. Investing across many different instruments and issuers spreads the risk and diminishes the impact of an adverse event, such as we have seen with African Bank. So while the impact on African Bank’s debt instrument has been significant, the impact on your STANLIB portfolio is marginal.

How will this reflect on your statement

The regulations that govern money market unit trusts (in particular FSB Board Notice 90 of 2014 paragraph 7) as well as STANLIB’s supplementary deed documents prescribe that we treat this haircut in a certain manner. The resultant reduction in the market value of your investment will be reflected as a proportional reduction in the number of units you own. This will be a once off adjustment in your August statement.

Example – for a portfolio of 1000 units invested in the STANLIB Money Market Fund, the impact of -0.16% will translate into a reduction of 1.6 units.

Looking forward

The SARB announcement has brought some stability to the debt market and a measure of certainty for the future of African Bank. The write-down and its impact have been fully accounted for in the affected funds. African “good” Bank will continue its operations as “business as usual”.

We will continue to engage with all the relevant stakeholders and will keep our investors informed regarding any significant new developments.

Regards

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