



TROUBLED AND INSOLVENT BANKS POLICY -

**A Framework for Timely and Effective Responses to
Banking Problems**

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PREAMBLE

This policy provides a framework for implementing timely and effective responses to banking problems. By adopting and adhering to a well-reasoned policy, several benefits will be realized. First, regulatory responses will be applied in a fair and consistent manner; second, supervisory responses will be more transparent; third, the cost of resolving problems will be minimized; and last, the ultimate safety and soundness of the banking system will be maintained.

It offers practical guidance in problem identification, corrective action, resolution techniques and exit strategies. It is intended to be a guide to the examiners in the application of supervisory measures.

In this policy, a weak bank is defined as *“one whose liquidity or solvency is or will be impaired unless there is a major improvement in its financial resources, risk profile, strategic business direction, risk management capabilities and/or quality of management”*. In such cases, and given the need to maintain confidence in the financial system, the Reserve Bank will endeavor to preserve the value of the bank’s assets with minimal disruption to its operations, subject to minimising resolution costs. It may well be that the bank as a legal entity ceases to exist.

A supervisor must distinguish clearly between symptoms and causes of bank problems. Further, a supervisor must identify and tackle problems at an early stage before they become acute.

This policy considers the relevant sources of information and the avenues available for decision making by supervisors. While supervisors

have a range of corrective action tools at their disposal, primary responsibility for addressing weakness and problems rests with a banking institution's board and management.

This policy details how the Reserve Bank will use various supervisory assessment methodologies including risk-based supervision, early warning system and stress testing methodologies in early detection of symptoms of bank weaknesses.

Supervisory measures must be proportionate. Corrective action should fit the severity of the problem and be set within a clear time frame. A balance must be struck between rigid prompt corrective action regimes and general, less binding frameworks. **One effective combination would include “automatic” rules for pre-agreed acceptable supervisory actions as well as room for flexibility in particular circumstances.**

The supervisor should consider informal methods, where the bank's problems are less serious and bank management is co-operative and on the other hand, more formal actions that are binding on the bank, with penalties for non-compliance. Closure of the bank and revocation of the licence remain the ultimate sanction.

This policy details the corrective action programmes at the disposal of the supervisor. Corrective action plans must be detailed and specific, showing how the bank's financial position will be restored. A supervisor must be able to assess if there is satisfactory progress or if additional

actions are necessary. Options include the appointment of an Advisor, or Supervisor, or Curator in the problem bank resolution process for the banking institution.

Where the institution's condition has continued to deteriorate and prospects of insolvency are imminent, alternatives are necessary. These include a merger with or acquisition by a healthy bank; a purchase and assumption transaction; and bridge bank techniques. These alternatives are outlined in this policy.

However, if no investor is willing to step in or if the reimbursement of depositors is less costly than other options, repayment of depositors (in full or in part) and liquidation are unavoidable.

1 Legal framework

A. Responsibilities and Powers

The Registrar of Banking Institutions (Registrar) is, by law, "...responsible for registering [i.e. licensing] banking institutions and cancelling their

registration.....”¹ The Reserve Bank of Zimbabwe (Reserve Bank) is responsible for regulating the monetary system of Zimbabwe² and for monitoring and supervising banking institutions to ensure that they comply with the Banking Act³.

The primary duties and powers under the Banking Act and the Reserve Bank of Zimbabwe Act for responding to insolvent and troubled banks include:

- Amending, suspending and revoke banking licenses –
 - ✚ 13 Amendment of registration
 - ✚ 48(1)(f) Suspension of banking business
 - ✚ 14 Cancellation of registration
 - ✚ 48(1)(j) Recommending conditions or cancellation of registration
- Providing liquidity support loans –
 - ✚ 11, The Reserve Bank of Zimbabwe Act
- Exercise of other powers -
 - ✚ 48(1)(b, g) Appointment of an advisor or supervisor
 - ✚ 48(1)(c) Instruction to take remedial actions
 - ✚ 48(1)(d) Imposition of monetary penalties
 - ✚ 48(1)(e) Suspension or removal of directors/officers/employees
 - ✚ 48(1)(h) Call meetings of shareholders or owners
 - ✚ 48(1)(i) and 53 – 56 Place banking institutions under management of curator
 - ✚ 45(2), 47 and 49 Inspection, examination and analysis
 - ✚ 57 Application for winding up or judicial management
 - ✚ 58 Deposit of approved securities

2 Introduction and Background

1.1 Bank failures generally have adverse effects on the national economy, in comparison to the failure of any other company. They

¹ Section 4(2) of the Banking Act [Chapter 24:20].

² Section 6(1)(a) of the Reserve Bank of Zimbabwe Act [Chapter 22:15].

³ Section 45(1) of the Banking Act [Chapter 24:20].

are more damaging than other failures because of a fear that they may spread in domino fashion throughout the banking system, in the process felling solvent as well as insolvent institutions. The failure of an individual bank therefore introduces the possibility of system wide failures or systemic risks.

- 1.2 There is empirical evidence that notwithstanding the best efforts of authorities to properly license, supervise and regulate banking institutions, the potential for problem banks always exists. Banks can and do fail.
- 1.3 The local and international experiences have shown that problems worsen rapidly if not promptly and resolutely addressed. Bank failures and bank crises are by nature costly if not effectively managed.
- 1.4 The underlying reasons and presence of weak banks in a financial system are of concern to supervisors of any banking system.
- 1.5 The problems in troubled banks are more fundamental. They include but are not limited to, poor management; weak corporate governance arrangements; inadequate financial resources; absence of a long term sustainable business strategy; weak asset quality; and poor risk management systems and controls.
- 1.6 The Zimbabwean banking sector has seen some banking institutions facing serious liquidity and solvency challenges largely attributed to the following among others:
 - a) inadequate risk management systems;

- b) poor corporate governance;
- c) diversion from core business to speculative activities;
- d) rapid expansion not synchronized with the overall strategic initiatives;
- e) creative accounting thereby misrepresenting banking institutions' financial condition;
- f) overstatement of capital by under-providing for non-performing loans or falsifying transactions to conceal under-capitalisation;
- g) high levels of non-performing insider loans due to poor corporate governance practices, weak underwriting and monitoring standards;
- h) unsustainable earnings from engagement in non-core activities; and
- i) chronic liquidity challenges.

1.7 The task of the Reserve Bank therefore, is to identify these problems early, ensure preventive and corrective measures are adopted, and have a resolution strategy in place should preventive action fail.

1.8 The Reserve Bank currently has a range of corrective actions at its disposal. The Reserve Bank may do any one or more of the following—

- a) issue a warning to the institution;

- b) require the institution to appoint a person who, in the Reserve Bank's opinion, is qualified to advise the institution on the proper conduct of its business;
- c) issue a written instruction to the institution to undertake remedial action specified in the instruction;
- d) impose a specified monetary penalty for each day that the contravention has continued;
- e) instruct the institution to suspend or remove any of its directors, officers or employees from his duties;
- f) direct the institution to suspend all or any of its banking business;
- g) appoint a supervisor to monitor the institution's affairs;
- h) convene a meeting of the shareholders or other owners of the institution to discuss the remedial measures to be taken;
- i) place the institution under the management of a curator;
- j) impose any term or condition on the institution's continued registration, or the deletion of any such term or condition; or
- k) cancel the institution's registration.

3 General Concepts in Weak and Troubled Bank Resolution

Definition of a "weak bank" or "troubled bank"

"A weak bank is one whose liquidity or solvency is or will be impaired unless there is a major improvement in its financial resources, risk profile, strategic business direction, risk management capabilities and/or quality of management"⁴.

⁴ Adapted from Report of the Task Force on Dealing with Weak Banks, "**Supervisory Guidance on Dealing with Weak Banks**", BIS March 2002

- 2.1. The definition focuses on a bank where there are potential or immediate threats to liquidity and solvency, rather than one with observable weaknesses that are isolated or temporary and which can normally be corrected by appropriate remedial action.
- 2.2. Of course, all weaknesses, whatever their magnitude and character, must be addressed by the bank.
- 2.3. Weak banks do not occur overnight. Problems that seem to emerge rapidly are often the sign of financial or managerial weaknesses that have been allowed to persist for some time.
- 2.4. The task of the supervisor is to identify these problems early, ensure preventive or corrective measures are adopted, and have a resolution strategy in order to forestall contagion repercussions in the financial sector.

Principles When Dealing with Weak and Troubled Banks

- 2.5. In considering ways to address challenges of troubled banks, it is necessary to understand the principles behind the resolution methods. As a general proposition, the central objective of the bank supervision is to maintain stability and confidence in the financial system, thereby reducing the risk of loss to depositors and other creditors. Dealing effectively with weak banks fits neatly into this objective.

- 2.6. This objective translates into supervisory actions aimed at preserving the value of the bank's assets with minimal disruption to its operations, subject to minimising costs of resolution. The supervisor may consider closing the bank in order to achieve that objective.
- 2.7. The guiding principles for a supervisor when dealing with weak banks include:
- a. *Speed*. Supervisors should act promptly. It has been observed worldwide that regulatory and supervisory forbearance exacerbates problems of a weak bank. Problems may grow rapidly making the eventual resolution efforts more difficult and more expensive, if prompt action is not taken.
 - b. *Cost-efficiency*. The supervisor should consider the least cost criterion in deciding between alternative actions consistent with achieving the supervisory objectives.
 - c. *Flexibility*. It is important that legislation permits the supervisor to exercise some form of discretion in the deployment and timing of supervisory tools rather than a rules-based approach. This would enable the supervisor to act flexibly by considering the full range of powers available when faced with a weak bank.
 - d. *Consistency*. In order to avoid distortion of the competitive environment, the supervisor should adopt consistent and well-understood supervisory actions which will also minimise confusion and uncertainty in times of crisis.
 - e. *Avoiding moral hazard*. Supervisory action should not encourage other banks or shareholders to behave less prudently on the

expectation that they will receive cheap or free bailout if problems occur.

- f. *Transparency and cooperation.* It is imperative that bank supervisors and banks aim for a high degree of information sharing and transparency about their intended actions in order for correct supervisory action to be taken.

4 Identification of Weak and Troubled Banks

- 3.1. Early identification of problems and initiation of corrective strategies usually reduces the ultimate cost of correcting problems. Experience the world over has shown that if weaknesses in banks are undetected, they tend to grow. The Reserve Bank through its Risk Based supervision methodology seeks to identify weaknesses in banks before they become irreparable.
- 3.2. Successful identification of weak banks depends on the information availed to the Reserve Bank by banking institutions..
- 3.3. The framework for problem identification is anchored on the Risk-Based Supervision methodology which is used for both off- site and on-site examination on a continuum.

Risk-Based Supervision

- 3.4. Risk-based supervision is a forward-looking process designed to identify key risks to which a banking institutions is exposed; assess

the risk management policies and practices that are used to mitigate risk; and focus supervisory resources (including examination time) based on the risk profile of the institutions⁵.

- 3.5. The Risk-based supervision process adopts a structured system in the manner it considers all the key functional activities of a banking institution and evaluates the level, management, and direction of risk.
- 3.6. Risk-based supervision is more reliant on the supervisor's discretion and professional judgment rather than the traditional rules-based approach; hence attention is addressed to areas exhibiting material current and potential risks.
- 3.7. In identifying weaknesses in risk management before the deficiencies have adversely affected a banking institution's earnings and capital, the supervisor is able to impose appropriate corrective action timeously. In the process, banks are encouraged to continuously improve the management of risk and allocation of capital.
- 3.8. Off-site surveillance is an early warning supervisory instrument that is useful in the continuous assessment of a banking institutions' condition. Through its off-site surveillance activities, the Reserve Bank collates qualitative and quantitative information submitted by reporting institutions via standardized statutory returns.

⁵ This Part should be read in conjunction with the **Risk-Based Supervision Policy Framework**, 2006 issued by the Reserve Bank of Zimbabwe

- 3.9. On-site supervision involves site visits to banking institutions to evaluate their safety and soundness. On-site examinations validate information received off-site and facilitate in-depth evaluation of the banks' corporate governance arrangements and management's ability to identify measure, monitor and control risks. The frequency and scope of examinations is dependant on the bank's risk profile.
- 3.10. The on-site and off-site examination methods complement each other. Once weaknesses are identified through the off-site surveillance, the Reserve Bank will commission an on-site examination to assess the institution's condition. Similarly, any deficiencies noted through an on-site examination are monitored during off-site surveillance.
- 3.11. Prudential meetings with bank management give supervisors better understanding of institutions' problems, their severity and impact on the bank. Information obtained through reliable sources including market intelligence provides the Reserve Bank with leads into hidden problems in particular institutions.
- 3.12. Audit reports provide an independent review of institutions' internal control systems. Banking institutions are required by the Reserve Bank to required to submit internal and external audit reports.
- 3.13. The Consolidated supervision approach is used for those banking institutions that are part of a group. Consolidated supervision is an overall evaluation of both quantitative and qualitative, of the strength

of a group to which a bank belongs, to assess the potential impact of other group companies on the bank.

3.14. In order to enhance the on-going off-site surveillance process, early warning systems and stress testing models are used to identify trends in a bank or group of banks and signs of emerging weaknesses for early correction. Information derived from these tools helps examiners to monitor activities and trends in banking institutions and plan future examination activities and the scope of those activities accordingly. The stress test models encompass risk factors such as interest rate, exchange rate, credit, liquidity, and operational risk shocks. The major objective is to assess the impact of shocks on a bank's (i) earnings (income effect) and (ii) capital (economic value of equity effect.)

3.15. The on-going profiling of the banking institution's condition and performance through the Risk Assessment System and CAMELS rating system facilitate identification of weak and troubled banks.

3.16. In identifying these symptoms, the Reserve Bank use supervisory rating systems such as the CAMELS rating system and the Risk Assessment Systems (RAS). Similarly, Early Warning Systems and stress testing methodologies are employed to determine the banking institution's performance trend and detect problems early.

CAMELS Rating System

3.17. The Reserve Bank uses a standardised rating system known as the “CAMELS” system to evaluate the six major components of a bank: **C**apital Adequacy, **A**sset quality, **M**anagement, **E**arnings, **L**iquidity, and **S**ensitivity to market risk. Ratings are assigned to each of the six components and an overall composite rating of the institution’s safety and soundness is assigned.

3.18. The ratings are on a scale of 1 to 5 with a “1” rating indicating a safe and sound bank in all respects, while a “5” rating indicates a bank which is insolvent and/or in imminent danger of failure.

Ratings Characteristics

3.19. Characteristics of the various components for each of the five overall or composite ratings of the CAMELS rating system are shown in the matrix below:

CAMELS Ratings System						
Overall Rating	Capital	Assets	Management	Earnings	Liquidity	Sensitivity
1	Well above minimum and no adverse trends “well capitalized”	Very strong asset quality; low level classified assets	Fully effective and responsive; able to cope with any problems	Strong; sufficient to fully provide for potential losses and augment capital to match asset growth	Ample volume liquid assets and easy access, at reasonable rates, to external liquidity sources	Strong risk management practices; minimal potential for adverse impact on earnings or capital
2	At or slightly above minimum; no adverse trends “well capitalized”	Generally good assets quality; minimal level supervisory concern	Some deficiencies but performance generally acceptable	Average may be slightly above; generally static	Liquidity still acceptable but may be declining; and/or increased reliance on borrowed funds	Risk-management practices acceptable; moderate potential earnings or capital may be adversely

CAMELS Ratings System						
Overall Rating	Capital	Assets	Management	Earnings	Liquidity	Sensitivity
						effected
3	Below minimum and/or on declining trend; no "under-capitalized"	Unsatisfactory asset quality; high level classified assets to capital	Generally inferior; lacks competence and/or not fully responsive to problems	May be positive but erratic and/or declining; performance well below average and/or reliant on unstable income sources	Increasingly serious liquidity problem; funding ability inadequate or too costly to be sustained	Risk-management practices poor; high probability that earnings and/or capital will be adversely effected
4	Well below minimum; clearly inadequate; "significantly under-capitalized"	Asset quality poor; totally unacceptable; presents imminent threat to solvency	unacceptable; unwilling or unable to address problems and must be replaced or strengthened to avoid failure	Sustaining losses and operationally unprofitable; distinct threat to solvency in near future	Severe liquidity problem posing imminent threat to viability	Risk-management practices poor; high probability that earnings and/or capital will be adversely effected
5	Seriously inadequate and viability/solvency is threatened, "critically under-capitalized"	Asset quality poor; totally unacceptable; presents imminent threat to solvency;	Wholly unacceptable; unwilling or unable to address problems and must be replaced or strengthened to avoid failure	Sustaining losses and operationally unprofitable; distinct threat to solvency in near future	Severe liquidity problem posing imminent threat to viability; needs immediate financial assistance	Risk-management practices wholly unacceptable and expose earnings and capital to high risk; imminent threat to viability

Leading indicators of increasing risks

3.20. Capital

- a) Ratios below "well capitalised" or institutions under a Corrective Order or Memorandum of Understanding,
- b) Capital growth rate is less than total asset growth rate,
- c) Ratios significantly different from peer ratios,
- d) Declining capital levels or ratios,
- e) Dividend payout ratio is significantly higher than peer ratios,

- f) Concentration in non-traditional activities,
- g) Significant growth in off-balance-sheet activities.

3.21. **Asset Quality and Credit risk**

- a) Significant increase in loans to total assets ratio,
- b) Significant increase in loans to equity ratio,
- c) Significant change in portfolio mix,
- d) Significant upward or downward trend in the percent of the adversely classified loans to total loans ratio,
- e) High growth rates in total loans or within individual categories of loans,
- f) Significant increase in loan yields,
- g) Loan yields significantly higher than peer group,
- h) Downward trends in risk ratings among pass credits, or increase in special mention or classified assets,
- i) Increasing levels of past due and non-performing loans as a percentage of total loans,
- j) Significant changes in adversely classified loans to total loans ratio.
- k) Net non-performing assets in excess of 25% clearly demonstrates the poor asset quality of banks, which will have serious implications not only for current earnings but also its future income. Such a banking institution's charge on Net Interest Income for loan loss provisioning / write off will be substantial.

3.22. **Earnings**

- a) Significant increase or decreases in non-interest income.
- b) Significantly higher or lower average personnel expenses than peer banks,
- c) Significant variances in the Return On Assets (ROA), Return On Equity (ROE), or Net Interest Margin (NIM) from prior periods and as compared with peer group,
- d) Significant variances from budgeted amounts on income or expense items and balance sheet accounts.
- e) ROA at less than 0.25% indicates abysmal productivity of assets. The lower ROA may also be due to:
 - i) unsustainable level of NPAs, high cost-income ratio due to heavy non-operating expenditure including staff expenditure and inability of the bank to tap off-balance sheet business opportunities; and
 - ii) it could be possible that the bank suffered losses on account of interest rate and currency mismatches. Imprudent pricing of assets and liabilities without reckoning cost - yield relationship also leads to lower ROA.

3.23. Liquidity risk

- a) Significant increases in reliance on wholesale funding,
- b) Significant increases in Negotiable Certificates of Deposits, and deposits with rates higher than the market,
- c) Significant increases in borrowings,
- d) Significant increases in dependence on funding sources other than core deposits,
- e) Declines in levels of core deposits,

f) Significant decreases in short-term deposits.

3.24. **Sensitivity to Market Risk**

- a) Significant increases or decreases in the percent of long-term assets to total assets,
- b) Significant increases in the percent of non-maturity funding sources to long-term assets,
- c) High or increasing percent of asset depreciation to tier 1 capital,
- d) Capital falling below the level established by the board to support interest rate risk.

Risk Assessment System (RAS)

3.25. The Reserve Bank of Zimbabwe makes use of the Risk Assessment System (RAS) to evaluate and rate the level and direction of risk in a banking institution.

3.26. The RAS system provides an expanded method of identifying, evaluating, documenting, and communicating the supervisor's judgment about the quantity of all categories of risk, the quality of risk management, and the direction of risk.

3.27. It reflects an examiner's judgment about the current and future quantity of risk, the quality of risk management, and the direction of risk in each bank.

- 3.28. RAS therefore provides not only a current measurement of risk, but also a prospective view of the institution's risk profile, which is valuable in developing supervisory plans for problem banks.
- 3.29. In line with international best practice and in recognition of the need for enhanced granularity in risk-rating models, the Reserve Bank uses a five-tier colour-coded rating system, GLYOR.
- 3.30. The acronym GLYOR stands for Green, Lime, Yellow, Orange and Red wherein Green denotes Minor or Insignificant risk, Lime – Low risk, Yellow – Moderate risk, Orange – High risk, and Red – Extreme risk.
- 3.31. The RAS system seeks to determine the level of overall composite risk for each risk category based on the level of aggregate inherent risk and the quality of aggregate risk management systems in place to manage the risk.
- 3.32. The quantity or level of aggregate inherent risk, for each risk category is determined by assessing two main factors, namely the impact / effect (the potential harm that could be caused) and the probability of occurrence of the risk factor (the likelihood of the particular event crystallizing).
- 3.33. The five-tier rating model is also applied to the assessment of the adequacy or quality of aggregate risk management systems. The rating is determined by balancing the respective risk management

sub-ratings for the key components of a risk management system, namely: board and senior management oversight; policies, procedures and limits; comprehensive MIS to monitor and report on the risk; and comprehensive internal controls.

- 3.34. The quality and adequacy of aggregate risk management systems may be rated as “very strong”, “strong”, “acceptable”, “weak”, and “poor”, depending on the availability, completeness, suitability, and compliance with/of the risk management systems implemented in the banking institution.
- 3.35. The overall composite risk profile per each inherent risk is determined by balancing the observed quantity of aggregate inherent risk rating with the perceived strength of the related aggregate risk management systems rating for each inherent risk.
- 3.36. The overall composite risk may also be characterized as Minor, Low, Moderate, High, or Extreme risk.
- 3.37. The table below illustrates the determination of risk ratings under RAS:

Aggregate Risk Management Systems	Aggregate Inherent Risk				
	Minor	Low	Moderate	High	Extreme
	Overall Composite Risk				
Poor	Moderate	Moderate or High	High	High or Extreme	Extreme
Weak	Low or Moderate	Moderate	Moderate or High	High	High or Extreme
Acceptable	Low	Low or Moderate	Moderate	Moderate or High	High
Strong	Minor or Low	Low	Low or Moderate	Moderate	Moderate or High
Very Strong	Minor	Minor or Low	Low	Low or Moderate	Moderate

3.38. The table below details the characteristics of the ratings used in RAS:

Aggregate Inherent Risk...	
Ratings	Characteristics...
Minor	<ul style="list-style-type: none"> ➤ defines a risk whose probability of occurrence is remote and the potential negative impact on capital and earnings is insignificant; and ➤ usually exists when a functional area is insignificant, positions are immaterial in relation to the banking institution's resources, the volume of transactions is negligible or where the nature of the functional area is not complex.
Low	<ul style="list-style-type: none"> ➤ the probability of the risk occurring and the impact on capital

Aggregate Inherent Risk...	
Ratings	Characteristics...
	<p>and earnings is lower than average; and</p> <ul style="list-style-type: none"> ➤ Losses would have little negative impact on the banking institution's financial condition.
Moderate	<ul style="list-style-type: none"> ➤ the probability of the risk occurrence and the impact on capital and earnings is average; ➤ Potential losses arising from the occurrence of the risk could be absorbed in the normal course of business.
High	<ul style="list-style-type: none"> ➤ the probability of the risk occurring and the impact of loss is higher than average; ➤ High inherent risk could reasonably be expected to result in a significant and harmful loss to the banking institution.
Extreme	<ul style="list-style-type: none"> ➤ the probability of occurrence of the risk is imminent and the potential impact on capital and earnings if it occurs is catastrophic; ➤ Usually exists where the volume, nature, size of activity is such that in the absence of adequate controls, a risk event will almost certainly arise and have a drastically severe impact on the financial condition of the institution.
Quality of Risk Management Systems...	
Poor	<ul style="list-style-type: none"> ➤ Risk management systems are inadequate or inappropriate given the size, complexity and risk profile of banking institution; ➤ risk management systems are significantly lacking and call for more than normal supervisory attention; ➤ internal control systems are lacking in important aspects as indicated by continued control exceptions or by the failure to adhere to written policies and procedures; ➤ The internal control framework therefore must be improved

Aggregate Inherent Risk...	
Ratings	Characteristics...
	drastically and/or immediately. The institution has no appropriate management information systems.
Weak	<ul style="list-style-type: none"> ➤ Management of risk is barely effective and lacking to a high degree and management information systems are inadequate; ➤ Identified risk management weaknesses have not been addressed and management does not implement timely and appropriate actions in response to changing conditions; and ➤ Bank personnel lack knowledge on risk management and are inexperienced.
Acceptable	<ul style="list-style-type: none"> ➤ management of risk is largely effective but lacking to a modest degree; ➤ institution has minor risk management weaknesses which can be addressed during the normal course of business; and ➤ management information systems are generally adequate.
Strong	<ul style="list-style-type: none"> ➤ risk management systems are adequate for identifying, measuring, monitoring and controlling risks; ➤ While the institution may be having some insignificant risk management weaknesses, these have been recognized and are being addressed. Management information systems are adequate.
Very Strong	<ul style="list-style-type: none"> ➤ management effectively identifies and controls all types of risk posed by the relevant functional areas or per inherent risk. The board and senior management are active participants in managing risk and ensure appropriate policies and limits are put in place. The policies comprehensively define the bank's risk tolerance, responsibilities and accountabilities are effectively communicated.

Aggregate Inherent Risk...	
Ratings	Characteristics...
Overall Composite Risk...	
Minor	<ul style="list-style-type: none"> ➤ Assigned to minor inherent risk areas where the risk management systems are either strong or very strong; and to low inherent risk areas where risk management systems are very strong.
Low	<ul style="list-style-type: none"> ➤ would be assigned to low inherent risk areas. Minor risk areas may be assigned a low composite risk where risk management systems are acceptable or strong; ➤ Moderate risk areas may be assigned a low composite risk where internal controls and risk management systems are strong or very strong and effectively mitigate much of the risk.
Moderate	<ul style="list-style-type: none"> ➤ risk management systems appropriately mitigate inherent risk. ➤ For a given minor or low risk area, significant weaknesses in the risk management systems may result in a moderate composite risk assessment. ➤ On the other hand, a strong or very strong risk management system may reduce the risk so that any potential financial loss from the activity would have only a moderate negative impact on the financial condition of the banking institution.
High	<ul style="list-style-type: none"> ➤ risk management systems do not significantly mitigate the low, moderate, high or extreme inherent risk; ➤ activity could potentially result in a financial loss with a significant impact on the bank's overall condition, even in some cases where systems are considered strong.
Extreme	<ul style="list-style-type: none"> ➤ assigned to extreme inherent risk areas where the risk

Aggregate Inherent Risk...	
Ratings	Characteristics...
	<p>management systems are weak or poor; and to high inherent risk areas where risk management systems are poor;</p> <p>➤ risk management systems in place do not mitigate the effects of an adverse event occurring and resulting in a catastrophic impact on the bank's overall condition.</p>

3.39. The resultant assessment of overall composite risk is used in the planning of supervisory work and determining the scope of supervisory activities carried out as detailed in the table below:

Inherent Risk	Quality of Risk Management Systems				
	Very Strong Risk Controls	Strong Risk Controls	Acceptable Risk Controls	Weak Risk Controls	Poor Risk Controls
Extreme Risk	Moderate Aggregate risk Limited Review	Moderate to High Aggregate Risk Limited Review at a minimum	High Aggregate Risk Full Scope Review	High to Extreme Aggregate Risk Full Scope Review	Extreme Aggregate Risk Full Scope Review
High Risk	Low to Moderate Aggregate Risk Minimum review & broad testing on Target Areas	Moderate Aggregate risk Limited Review	Moderate to High Aggregate Risk Limited Review at a minimum	High to Extreme Aggregate Risk Full Scope Review	High to Extreme Aggregate Risk Full Scope Review

Inherent Risk	Quality of Risk Management Systems				
	Very Strong Risk Controls	Strong Risk Controls	Acceptable Risk Controls	Weak Risk Controls	Poor Risk Controls
Moderate Risk	Low Aggregate Risk No Review	Low to Moderate Aggregate Risk Minimum review & broad testing on Target Areas	Moderate Aggregate Risk Limited Review	Moderate to High Aggregate Risk Limited Review at a minimum	High Aggregate Risk Full Scope Review
Low Risk	Minor to Low Aggregate Risk No Review	Low Aggregate Risk No Review	Low to Moderate Aggregate Risk Minimum review & broad testing on Target Areas	Moderate to High Aggregate Risk Limited Review	Moderate to High Aggregate Risk Limited Review at a minimum
Minor Risk	Minor Aggregate Risk No Review	Minor to Low Aggregate Risk No Review	Low Aggregate Risk No Review	Low to Moderate Aggregate Risk Minimum review & broad testing on Target Areas	Moderate Aggregate Risk Limited Review

a)

The Relationship between the Reserve Bank and Banks' External Auditors⁶

⁶ This part should be read in conjunction with the **Framework on the Relationship Between Bank Supervisors and Banks' External Auditors** issued by the Reserve Bank of Zimbabwe in November 2004.

- 3.40. Due to the growing complexity of banking, the Reserve Bank has found it necessary to maintain greater mutual understanding with banks' external auditors in the risk management processes at banking institutions. To that end, a Framework on the Relationship between Bank Supervisors and Banks' External Auditors ("the Framework") was issued by the Reserve Bank in November 2004.
- 3.41. The Framework recognizes that bank supervisors make use of the results of the auditors' work, while external auditors make use of information provided by bank supervisors to enhance the discharge of their responsibilities in a more diligent and effective manner.
- 3.42. External auditors gather information on the effectiveness of bank's internal control systems and governance arrangements and apply relevant information in formulating their audit opinion. They also reinforce market discipline by issuing qualified or unqualified opinions, hence facilitating informed decision making by the public and other stakeholders.
- 3.43. Formal cooperation between bank supervisors and external auditors has gone a long way in enhancing the risk-based supervision approach to bank supervision.
- 3.44. External auditors have the responsibility⁷ to:

⁷ See section 43 (1) of the Banking Act

- a) plan and carry out audit procedures designed to detect irregularities and illegal acts in the conduct of a bank's business; and
- b) communicate to the institution's audit committee any evidence of irregularities or illegal acts committed in the course of the institution's business, whether or not they may have led to material misstatements in the institution's accounts or records; and
- c) communicate to the Reserve Bank, forthwith⁸, any evidence he may have that irregularities or illegal acts have been committed by any director of the institution; or any person, if there is a reasonable possibility that they may significantly damage the institution's financial stability.

3.45. The co-operation between the Reserve Bank and external auditors is facilitated through tripartite and bilateral meetings.

Tripartite Meetings

3.46. The Reserve Bank holds tripartite meetings with external auditors and banking institutions at least semi-annually.

3.47. During these meetings, each party provides information about areas of mutual interest and deliberations will be focused on the following;

- a) the financial condition of the bank;
- b) the results of work by both Reserve Bank and external auditors;
- c) responsibilities for corrective work; and

⁸ See section 43 (5) of the Banking Act

- d) implementation of internal and external auditors' recommendations.

Bilateral Meetings

3.48. The Reserve Bank of Zimbabwe and external auditors from time to time convene meetings to discuss issues of mutual interest. Furthermore, pre-examination and post-examination meetings are held to discuss the key challenges facing the banking institution, progress made in implementing internal and external audit concerns as well as discussing any regulatory concerns.

5 Symptoms and Causes of Weak and Troubled Banks

- 5.1 The ability of the supervisors to know how to read, react in a balanced and effective way the symptoms to the problems is critical in problem bank supervision.
- 5.2 It is important to distinguish clearly between symptoms and causes of weak banks.
- 5.3 Globally, there is evidence that weak banks result from a combination of factors and different symptoms often emerge together
- 5.4 This section discusses some of the most common identifiers of problems and the early warning systems and other monitoring tools that can be used to identify them.
- 5.5 The symptoms of troubled banks are usually poor asset quality, losses of capital, reputation problems, and/or liquidity problems. The different symptoms often emerge together. Experience in Zimbabwe and

elsewhere has shown that liquidity problems have seldom occurred alone and their emergence has generally been one aspect of broader difficulties.

5.6 Although a banking system can be prospering at one given point in time, history has shown that a bank's condition can deteriorate rapidly, underscoring the importance of early detection and timely resolution of supervisory concerns. The following are the major causes of bank failures:

a) Management Oversight Deficiencies

Although economic conditions are a major influence on a bank's well being, management is the dominant factor. Decisions made today can have far-reaching implications on a bank's future condition, and a strong management team will take steps to avoid or mitigate the severity of possible adverse economic forces. Examples of indicators of oversight or management deficiencies are:

- i) failure by bank management to take corrective action can result in rapid deterioration of the bank's condition;
- ii) the Chief Executive Officer's professional experience, particularly in managing the bank under adverse conditions and the specific expertise he or she provides to the bank
- iii) increased frequency of non-compliance with laws, regulations, or bank policies and practices is symptomatic of slippages in controls and compliance with systems; and
- iv) a weak planning process and the inability to respond to industry changes will expose a bank to additional strategic risk.

Supervisors should watch for lack of long-term planning, conflicting organizational goals, inadequate resources to achieve goals, and inadequate implementation plans.

b) Poor Corporate Governance

The indicators of poor corporate governance practices include:

- i. lack of separation between shareholders and management;
- ii. undue influence or dominance by shareholders who in some cases may also be involved in executive management;
- iii. improperly constituted boards of directors;
- iv. lack of effective board oversight;
- v. passive or uniformed and rubber stamping boards; and
- vi. use group structures or Special Purpose Vehicles or to evade regulation and engage in non banking business.

c) Deterioration in Economy

A clear correlation exists between bank performance and economic conditions in the markets served. Examples of specific economic indicators affecting banks most directly are; bankruptcies, business failures, income levels, inflation rates, interest rates, trade deficit, and country risks.

d) Poor Lending Practices

Poor lending practices such as poor underwriting skills or an overly aggressive loan expansion programme, compounded by the absence of incentives to identify problem loans at an early stage and to take corrective action leads to poor asset quality. In pursuant of

aggressive growth, many banks expose themselves to increased risks by not adhering to their underwriting standards, by excessive risk taking and excessive loan concentrations.

e) Strained Liquidity

Funding constraints can be precipitated by numerous causes, including deterioration in a bank's financial condition, fraud, or external economic events. A bank's liquidity situation may also become compromised if its reputation "on the street" is suspect either due to real or perceived shortfalls. In any event, the extent of a potential funding problem depends on the risk tolerance of a bank's funds providers.

The red flags that may signal potential liquidity strain and a need for additional analysis, monitoring, and contingency planning are:

- i) Low levels of on-hand liquidity (i.e. money market assets and net unpledged marketable investment securities);
- ii) Significant increases in large certificate of deposits, or deposits with above-market interest rates, particularly in banks that have been heavily retail-funded;
- iii) Significant increases in borrowings;
- iv) Funding mismatches (i.e. funding long-term assets with short-term liabilities);
- v) Higher costs of funds relative to the market;
- vi) Reduction in borrowing lines by correspondent banks;
- vii) Counterparty requests for collateral to secure borrowing lines;
- viii) Declines in core deposit levels;

- ix) Downgrades of credit rating by rating agencies;
- x) Withdrawal of funds by rate-sensitive providers; or
- xi) Unwillingness of counterparties and brokers to deal in off-balance-sheet or longer dated transactions.

f) Loose Controls On Connected Lending

The political objectives of governments or the personal interests of bank insiders (in the form of bank owners, directors or senior management) if allowed, can intrude on all aspects of bank operations, in the process, damaging bank profitability and proper and efficient operations.

The risks of insider or connected lending are primarily lack of objectivity in credit assessments and undue concentration of credit risk. The failure of a few large related borrowers, or the collapse of a particular sector of the economy, can wipe out the bank's entire capital.

g) Risk Management Deficiencies

Sound risk management systems are critical in risk mitigation by a bank. There is evidence that banks with well-developed risk management systems can better withstand changes in the macroeconomic environment than banks that have weak systems. Although risk management frameworks may vary from bank to bank, when assessing risk management, examiners consider:

- a) oversight of board and senior management;

- b) adequacy of policies and procedures e.g. internal standards, risk tolerance limits;
- c) efficacy of risk measurement, monitoring, management information systems e.g. processes, limits, validation testing; and
- d) adequacy of internal controls e.g. audits.

Examples of risk management deficiencies include:

- i) A loan policy that is not well defined or well understood;
- ii) An internal audit program that lacks independence;
- iii) Interest rate risk measurement tools that are too simplistic for the size and complexity of on and off-balance-sheet exposures;
- iv) Management that does not anticipate emerging technology needs; or
- v) Acquisition due diligence processes that do not consider the risks associated with new products and compatibility with corporate goals.

h) Excessive growth can strain the bank's underwriting and risk selection standards, as well as the capacity of management's internal control structures and administrative processes to identify, measure, monitor credit risk.

The following are the red flags for an institution getting into trouble as a result of excessive growth;

- i) If growth varies/deviates significantly from the bank's budget or strategic plan;

- ii) Bank underwriting and risk selection standards have been relaxed;
- iii) Minimal or no changes have been made to the bank's internal control structures in response to the changing environment;
- iv) Capital levels are declining rapidly;
- v) Funding sources are unstable or of short-term nature;
- vi) New products and activities are being pursued with little or no expertise or with inadequate risk management controls; or
- vii) Growth is influenced heavily by brokered or agent transactions.

i) Insider Abuse and Fraud

Insider abuse and fraud can quickly affect a bank's condition and undermine public confidence even in banks that are otherwise in sound condition. Financial institution fraud can occur throughout a bank's operations and is usually accompanied by a lack of oversight and controls.

6 Supervisory Enforcement Actions

- 6.1 Where an institution is found to have weaknesses either through off-site surveillance or through on-site examinations, the Registrar will issue a Corrective Order designed to correct the deficiencies.
- 6.2 Where it is determined that the deficiencies are stemming from poor corporate governance practices and there is need for new management, the Registrar may appoint a Supervisor or place the institution under curatorship in terms of the Banking Act.
- 6.3 A Curator or a Supervisor is appointed for a period not exceeding 180 days. The Curator is mandated to explore resuscitation options for the institution, ranging from mergers and acquisitions, purchase and assumptions, restructuring and re-organisation.
- 6.4 If the institution has not been resuscitated or a determination has been made that the institution is rated “5” that is, critical, the Reserve Bank may take any action in terms of section 48 including closure.

Purpose of Regulatory Enforcement Actions...

- 6.5 The basic equation of effective supervision is “identification + response”. Once aspects of supervisory concern are identified, the Reserve Bank will promptly initiate corrective actions. Supervisory concerns may range from modest to problematic and/ or severe. The latter two typically involve specifically- identified “unsafe and unsound” practices or condition.
- 6.6 A precise definition of “unsafe and unsound” is difficult since unsafe and unsound practices affect the entirety of a bank’s operations and

commonly lead to troubled condition. Generally speaking, however, “unsafe and unsound” embraces any action or lack thereof, contrary to prudent standards of operation and which causes, or may cause, inappropriate levels of risk exposure or loss for the bank, its depositors and creditors and its shareholders. The goal of supervisory authorities is to eliminate any such unsafe and unsound conditions or practices.

6.7 Reason and moral suasion have been, and remains the primary enforcement tool used by bank supervisory authorities. Consensus that a specified course of action is in the best interest not only of depositors and creditors of a bank, but also its owners and managers, enables supervisors to achieve the desired results.

6.8 More formal and legalistic regulatory enforcement tools can always be used if reason and moral suasion fail. Such other enforcement tools may include placing conditions on a bank’s licence, withholding approval for expansion (i.e. opening new branches) displacing and assuming the functions of management, and ultimately closure and liquidation. Regardless of which form of response is used, the ultimate goal is to promptly and effectively correct problems.

6.9 Several types of regulatory enforcement actions are available for responding to troubled, failing and insolvent banks and to banks which are experiencing problems which may not yet, but could, seriously threaten their soundness.

6.10 The fundamental goal of any such action is to:

- a) restore troubled, but viable banks to a healthy condition, and

- b) remove unsalvageable banks from the system expeditiously and in an orderly fashion.

6.11 The secondary goal of regulatory enforcement actions is to provide a deterrent to future misconduct.

General Principles for Prompt Corrective Actions

6.12 In essence, the following should guide supervisors in implementing corrective action:

- a) The fulfillment of supervisory objectives including financial stability and depositor protection.
- b) Corrective action should be timely. The bank and the supervisor should take prompt action to prevent the problems from growing and exacerbating the financial weakness of the bank.
- c) Management commitment. The management of the bank must be committed to the action plan for corrective action. Otherwise, the replacement of management should be considered.
- d) Proportionality. Corrective actions should be appropriate to the circumstances and scale of the problem.
- e) Comprehensiveness. Both causes and symptoms of weakness must be addressed by the corrective programme.

Implementation of Corrective Action

- 6.13 In formulating a plan of corrective action or Corrective Order, the Supervisor must assess the nature and seriousness of the weakness at the banking institution.
- 6.14 Where the weaknesses have been noted through off-site surveillance, an on-site assessment must be conducted to identify the full extent and nature of the problems faced by a bank.
- 6.15 Problem banks may mask their most significant troubles in a way that can only be detected by on-site work. An on-site examination also helps to uncover the underlying causes of a weakness rather than merely the symptoms. Depending on the circumstances, the Reserve Bank may require the assistance of external auditors and other independent expert advisers.
- 6.16 It is imperative that the supervisor makes an assessment to determine the bank's present and expected liquidity and capital position using stress test methodologies and evaluate the bank's contingency plans. This should include an assessment of the fair value of the bank's net assets.
- 6.17 In this regard, it is essential to measure correctly the quality of the loans, how many are impaired and whether collateral can be enforced; to determine the proper recognition of, and provisioning for, non-performing loans; and to assess the extent of insider and connected lending.

- 6.18 On the liabilities side, there is a need to verify whether their recorded values are adequate; that all contingencies are recorded; and all off-balance sheet items are known and under control. In the assessment, the bank should take into account the effects of netting and possible set-offs.
- 6.19 Where the Reserve Bank determines that there is an immediate and significant threat of illiquidity or insolvency, immediate corrective action is essential. On the other hand, where the bank is exposed to financial strain or other form of weakness but the assessment is that these threats are real but not immediate; the Reserve Bank's possible range of actions is much broader. This may require close monitoring of the situation.

Types of Enforcement Actions

- 6.20 Enforcement actions may be informal or formal.

Informal actions...

- 6.21 Three types of informal enforcement actions will be used. These are "Board Resolution", "Commitment Letter" and "Memorandum of Understanding". Each type is described below:-

Board Resolution

6.22 A Board Resolution is the least formal in format and uses ordinary resolution-style language. It is a “suggested” plan for correction of deficiencies which specifies actions to be taken by board of directors and management.

6.23 As applicable, it states who is responsible and sets a timetable and/or target levels for achievement. It is officially adopted and signed by members of the institution’s board of directors, although specific provisions will often be drafted or suggested by the Reserve Bank.

Commitment Letter

6.24 This is similar to a Board Resolution but considered a stronger supervisory response and is typically used for banks which posed moderate supervisory concerns. It is a formal letter from the board of directors to the Reserve Bank drafted by the Reserve Bank, and then accepted and signed by the board. It outlines specific actions to be taken and a timetable for accomplishment.

Memorandum of Understanding

- 6.25 A Memorandum of Understanding specifies actions to be done, the period within which the actions will be accomplished, and the responsible persons. It is adopted and signed jointly by the board of directors and the Reserve Bank.
- 6.26 A Memorandum of Understanding contains specific provisions written by the Reserve Bank, and then agreed to by the board; it is more formal in format and language but is not issued under specific provision of law.
- 6.27 Failure to comply, however will lead to subsequent enforcement action of a more formal and legal nature. A Memorandum of Understanding is typically used where problems are not of significant and/or where bank management has demonstrated a willingness and ability to correct identified weaknesses.

Formal Actions

- 6.28 Formal enforcement actions also referred to as Corrective Orders, will be used as and when circumstances require. Regardless of the specific form, Corrective Orders are generally described as follows:-
- “A Corrective Order is an “imposed” plan to correct deficiencies. It is formal in format and language in order to prepare, if necessary, for further regulatory sanctions if the board fails to comply with the Order”.*

- 6.29 It specifies actions, persons responsible, and a timetable and target levels for achievement of the specific actions.
- 6.30 It recites the unsafe and unsound practices and or condition which necessitated the Order. It is imposed unilaterally, by the Reserve Bank with directors acknowledging that they have received, read and understood the Order.
- 6.31 Typical Corrective Orders which will be used include: appointment of advisor or supervisor, suspending a director, officer or employee, amending, suspending or canceling a licence, closure and liquidation.

7 Prompt Corrective Actions

- 7.1 The Reserve Bank has put in place a Prompt Corrective Action programmes (PCAs) which will be initiated for all banks which exhibit financial or operational weaknesses, unsafe and unsound practices, non-compliance with applicable laws and regulations, or lack of adherence to prudent standards of operation.
- 7.2 Although PCAs are more of a rule-based approach, they leave room for the supervisor's judgment and each case will be determined on its own merits. This is meant to avoid the absurdity that may result from certain action being imposed on a banking institution.
- 7.3 Further, it addresses the circumstances that may involve large banks, which because of the impact their closure may have on the banking system, may require that the Registrar adopts a different strategy. However, as a general rule, banks exhibiting weaknesses of the same nature will be subjected to the same kind of treatment.

- 7.4 PCAs are tailored to the severity of inherent weaknesses. In general, the least restrictive / least punitive regulatory response which is still sufficient to produce the desired results will be pursued.
- 7.5 If a bank is rated “3”, “4”, or “5”, the Reserve Bank will take one or more formal actions depending on the unique circumstances of the banking institution. The Reserve Bank may also initiate corrective action on a “1” or “2” rated bank to address any adverse trends that may be evident.
- 7.6 Progressively harsher corrective measures will be used and may culminate in mandatory closure and liquidation of insolvent or imminently insolvent banks which cannot be recapitalized to an adequate level within a defined period.
- 7.7 In all cases, the Reserve Bank will require involvement of boards of directors and senior management, and, where necessary, principal shareholders, in developing and implementing appropriate corrective action programmes for a banking institution.
- 7.8 The final decision about the form of corrective action or amendment or cancellation of a banking institution’s licence will rest with the Registrar.
- 7.9 A table of PCA programmes showing the benchmarks put in place by the Reserve Bank and the mandatory actions that should be taken at every stage is attached hereto marked Annexure “A”.

Issuance of Corrective Order

- 7.10 Formal enforcement actions will be issued in a formal meeting of the board of directors specially called for that purpose. A Memorandum of Understanding, although an informal enforcement action, will normally be issued in the same manner. A letter will be sent to the board of directors advising of the time, date and purpose of the meeting.
- 7.11 The board will have been given an opportunity to make representations in the matter. If the Reserve Bank considers that immediate action is necessary to prevent irreparable harm to the bank, its depositors, creditor or shareholders, then Reserve Bank may, pursuant to authority granted in the Banking Act, take action as necessary before giving the bank an opportunity to make representations.
- 7.12 Informal actions (Board Resolutions and Commitment Letters) maybe issued by means of written correspondence to the bank's board of directors. However, a formal meeting with the directorate is the preferred method. Such meetings may be held at the relevant bank at a date convenient to the board, but unreasonable delays will not be permitted.
- 7.13 Meetings to issue formal enforcement actions will be held at the Reserve Bank and will normally be chaired by the Registrar or Deputy Governor or the Governor and any other members of the Reserve Bank as may be invited by the chairperson.

Monitoring Compliance with Corrective Order

- 7.14 All enforcement actions will be monitored by the Registrar who will assess the progress taken on remedial actions and improvement in a bank's overall condition. The Reserve Bank will review progress reports submitted by the bank and will conduct follow-up on site examination in accordance with risk-based supervision plan.
- 7.15 Where the Reserve Bank determines that a bank's condition has not improved or has deteriorated further, or if the underlying causes have not been eliminated, or if additional problems have arisen, the Reserve Bank will impose stricter conditions including, but not limited to, amending the form and content of the regulatory enforcement action.
- 7.16 If a bank is placed under the management of a Curator, or if a Supervisor is appointed to monitor a bank's affairs, additional progress reports will be provided by the Curator or the Supervisor.
- 7.17 However, the presence of a Supervisor will not suspend the requirement for the board of directors to submit periodic progress reports, nor will the presence of a Supervisor or Curator suspend the requirement that on-site examinations be conducted in accordance with this policy.

8 Resolution Management

- 8.1 Where the corrective actions have not produced the desired results, it may not mean that the bank is certain to fail. Accordingly, any reasonable opportunity for the bank's resuscitation in order to avoid

closure will be duly considered. However, the Registrar must consider and prepare to implement bank failure contingency scenarios.

- 8.2 In particular, where the Registrar considers that a bank's management and/or shareholders have failed and/or neglected to address the issues that have been raised for its attention and it is in the interests of the economy and depositors that other options be pursued, he will appoint a Supervisor or Curator.
- 8.3 The Supervisor or Curator is tasked with finding solutions to the institution's challenges and recommending resolution strategies. These may be in the form of a merger, purchase and assumption, conversion of debt into equity.
- 8.4 This section will provide an overview of the resolution management process where a bank's system and structures have failed to see resuscitation of a bank.
- 8.5 Further, it will highlight supervisory issues related to the various resolution strategies, legal review prior to closing, the formal bank closing procedures and the appeal process.

Appointment of Advisor or Supervisor

- 8.6 If the Reserve Bank determines that a bank is not being properly managed or has contravened any term or condition of its licence, any provision of the Banking Act, or any direction, or requirement, or Order made under the Banking Act, the Registrar may require that the bank appoints a person who is qualified to advise the bank on the proper conduct of its business.

- 8.7 Alternately, the Reserve Bank may appoint a Supervisor in terms of section 48 (1)(g) of the Act to monitor the bank's affairs. The advice of a person so appointed shall have the same force and effect and shall be deemed to be a direction of the Reserve Bank under the Banking Act.
- 8.8 When an Advisor or Supervisor is placed in a bank, the board of director and officers will remain in legal control of the bank and accountable for its condition, but they will conduct the affairs of the bank with guidance and direction from the Advisor or Supervisor. In so far as the general public is aware, the bank remains under the management and control of the board of directors.
- 8.9 The Advisor/Supervisor will, pursuant to the accompanying Corrective Order, have "veto" authority over proposed actions of the board or management which are not in the best interests of the bank or which may diminish capital. In this regard, the Reserve Bank will issue a direction to the bank stating that the bank may not, without the approval of the Advisor or Supervisor, transact in certain specified ways.
- 8.10 In resolving the challenges of a banking institution, a number of options remain. The Registrar may appoint a Curator.

Curatorship

- 8.11 Instead of appointing a supervisor in terms of the Banking Act, the Registrar may place the institution under the management of a curator appointed as such in terms of the Banking Act. However, having regard to the cost of this type of resolution strategy and the fact that it

tends to benefit the shareholders, more particularly in that all legal writs and liabilities are frozen, this option will not be the first resolution alternative.

8.12 However, where the Registrar has adopted this mode of resolution as the best in the circumstances, the institution shall be placed under curatorship for a period not exceeding ninety (90) days only.

8.13 During this period, the Curator, just like a Supervisor appointed by the Reserve Bank shall explore options of restoring the institution to viability which may include mergers and acquisitions, purchase and assumptions and other re-organization or restructuring exercises which may include conversion of debt into equity.

Merger or Consolidation

8.14 In some cases, a merger or consolidation with a strong, healthy institution may be appropriate in order to preserve market stability. In such instances, the Reserve Bank will respond promptly to a formal request.

8.15 However, the applicant bank must be in need of urgent financial assistance and the application must be made in a timely manner to allow for proper and thorough assessment.

8.16 Any proposed acquisition, merger, amalgamation or consolidation (referred to as a “merger”) will be handled similarly to an application for a new banking licence. The same criteria will be applied and all

requirements in the Banking Act and Regulations pertaining to mergers must be satisfied.

Forms of Merger Transactions...

8.17 Typical forms of mergers will include:

- a) Purchase of controlling ownership by another person(s) i.e. change of control); and
- b) Purchase of assets, in whole or in part, and assumption of the liabilities of the troubled bank by another.

Requirements for Recommending Merger...

8.18 In order for the Registrar to make a determination regarding approval or denial of an application for a merger transaction, the following requisites must be satisfied:

- a) Receipt of a completed, formal written application for approval of merger;
- b) Evidence of approval of the proposed merger by two-thirds or more of the shareholders of the applicant (troubled) bank and also of the target (healthy) bank;
- c) submission of a copy of the proposed purchase contract and/or merger agreement;
- d) compliance with all applicable provisions of the Companies Act, the Banking Act, and any other Act which may apply; and
- e) Satisfactory findings/conclusions by the Reserve Bank with respect to items (a) to (d) above and also;

- i. **Financial Condition** – consolidated financial condition and business plan of the resultant institution must comply with minimum prudential standards and must show reasonable probability of success, and such compliance and probability of success must be certified by an independent auditor acceptable to the Reserve Bank.
- ii. **Managerial Resources** – competence, experience and integrity of the officers, directors, and principal shareholders of the resultant institution must be acceptable in terms of the criteria applicable for new banking licences under the Banking Act and Banking Regulations, S. I. 205/2000.
- iii. **Risk Management Systems** – The Reserve Bank must be reasonably satisfied that the resultant institution will have adequate financial, operational and technological risk management systems in place prior to commencement as a merged entity.

Purchase and Assumption Transaction

- 8.19 If a private sector M&A is not forthcoming or cannot be arranged, a purchase and assumption (P&A) transaction may be considered. A P&A transaction is one where a healthy institution or private investor(s) purchases some or all of the assets and assumes some or all of the liabilities of a failed bank. The acquiring bank purchases the assets and liabilities of the failed bank but not its charter.
- 8.20 The transaction may be structured so that the acquirer purchases all assets and assumes all deposits. As with an M&A, this type of P&A

transaction can be attractive to an acquirer – because of the intangibles – even when the bank is insolvent. This form of assistance must be justified as the least cost alternative.

- 8.21 A P&A transaction may be arranged so that the acquirer purchases only a portion of assets and assumes a portion of the deposits. A clean bank P&A transaction occurs when the acquiring institution assumes the deposit liabilities and purchases ***the cash and cash equivalent assets, the “good” loans and other high quality assets of the bank. Assets not sold to the acquirer at resolution are passed on the liquidator for disposal.***
- 8.22 If non-performing loans and other risky investments are to be assigned to the acquirer, some arrangement will be needed to mitigate the consequent risk. This may take the form of a loss-sharing agreement or a put-back provision that allows the acquirer to return assets that become impaired within specified periods. In the sale of such assets, the acquirer must not be indemnified for all losses; otherwise there is no incentive for the acquirer to manage the bad loans to minimize losses, leading to a higher resolution cost.
- 8.23 Alternatively, the acquirer could be hired, with appropriate incentives, to manage the non-performing loans but not take them onto its balance sheet.
- 8.24 A P&A transaction should be completed as quickly as possible. This will avoid the interruption of business so as to preserve the value of the bank and resolution costs.

8.25 As with M&A, the acquirer should have the financial and organizational capability to combine with the failed undertaking. If there is more than one eligible acquirer, a winner could be decided by competitive bidding so that the best price is obtained for the net assets of the failed bank.

8.26 Closing the bank as a legal entity implies that the shareholders lose their investment and the management are removed. From this standpoint a P&A transaction is compatible with minimizing moral hazard.

8.27 The P&A type solution has the following benefits:

- a) Saves the value of the assets of the failed bank (thereby reducing the resolution cost);
- b) Minimizes the impact on the market by returning assets and deposits to normal banking operations with the acquiring bank quickly. It can typically be completed over the weekend.

8.28 However, if a bank can not be restored to a safe and sound condition within a reasonable period (generally not to exceed ninety days), and no alternative enforcement actions have been found to restore the bank to viability within the same period, the bank will be allowed to fail and exit the banking sector.

9 Termination of Enforcement Actions

9.1 Once an enforcement action has been issued, whether formal or informal it will remain in force until terminated, in writing, by the

Reserve Bank. Partial removal or rescission of enforcement actions, or replacement with an enforcement action of lower severity normally will not be considered.

9.2 Termination of an enforcement action will be considered only after a subsequent full-scope examination shows that the underlying causes and problems have been substantively eliminated and the bank's overall condition has improved to the extent that it is no longer of significant supervisory concern.

10 Monetary Penalties

10.1 Monetary penalties will be levied in terms of the Banking Act as read with the Banking Regulations for the following reasons:

- a) to achieve a remedial purpose; and
- b) to provide a deterrent to future misconduct.

10.2 If the Reserve Bank determines that criminal proceedings provided under the Banking Act are necessary to achieve the desired results, recommendations will be made to law enforcement agencies for prosecution of the bank, any one or more of its employees, officers, directors or shareholders , or any other responsible person(s).

10.3 Imposition of monetary penalties or prosecution will not preclude the Reserve Bank from pursuing any other enforcement action necessary

under the circumstances for responding to a troubled bank or individuals involved therewith.

11 Bank Closing Procedure

11.1 The Reserve Bank has put in place a step by step guideline to the exit of banking institutions from the banking institutions. This guidance seeks to ensure that banks approaching insolvency leave the market quickly and in an orderly fashion in order to counteract the adverse impact of systemic risk.

11.2 It limits the potential losses that might otherwise accrue to the public should action not be taken on time and aims to protect the assets of the institution. While bank closure might trigger systemic problems, the earlier the action is taken, the less the impact on the rest of the banking system.

11.3 The level of liquidity or solvency in a particular bank can threaten confidence not only in that particular bank but also, because of the possibility of contagion, in the safety and stability of the Banking system as a whole. The need to protect the public against the consequences of financial disruption and to limit the risk of contagion and, systemic instability, provides another rationale for establishing special mechanisms for handling bank crises.

11.4 Once it is clear that the efforts by the bank (management, directors, and shareholders), an Advisor, Supervisor or Curator appointed pursuant to a direction issued by the Reserve Bank have proven ineffective to restore viability of the institution, the Reserve Bank will

suspend the institution's banking business in terms of the Banking Act and facilitate liquidation of the banking institution.

Procedures for Takeover And/ Or Closure of A Banking Institution

11.5 Following a determination that the institution is in an unsound financial condition, is not operating in accordance with sound administrative, risk management and accounting principles and practices or has collapsed corporate governance structures and systems, the Registrar will notify the institution of his intention to suspend the institution's banking business pending liquidation. This would ordinarily be followed by cancellation of the institution's licence.

11.6 However, the requirement for notification may be dispensed with where the Reserve Bank considers that irreparable harm may be caused to the institution if immediate action is not taken.

11.7 At expiry of the notice to close the bank or immediately upon making the decision to close the institution, the following procedures will be followed:

Day of Closure

11.8 The Governor, the Registrar and senior Reserve Bank will meet the bank's Chairman and, inform him that the bank is being closed.

11.9 The chairman will be handed a letter explaining the course of action taken by the Reserve Bank. A copy of the letter will be given to the

Minister of Finance. In between, the Minister of Finance will be updated by the Governor through the standing meetings and regular reports.

11.10 Armed Police officers and/or Reserve Bank Security Officers will simultaneously be dispatched to all branches and Head Office to ensure that no one enters premises of the bank.

11.11 A letter will be sent to all commercial banks and other financial institutions advising that the bank has been closed. Clear instructions will be given on how to deal with the bank's cheques. This letter will only be released on the day of closing the bank before clearing takes place.

11.12 A press statement will be made and released on the day of closing.

11.13 The Registrar will assign members of Bank Licensing, Supervision and Surveillance Division (BLSS) to be at each bank's premises by 0730 hours. Security personnel will ensure that no one enters the bank until instructions to do so are given by the Examiner-in-charge.

11.14 The Reserve Bank team will be accompanied by staff of the bank and the bank's auditors. All the accompanying officials will have been given notice to the effect.

11.15 The Reserve Bank officials and key staff of the bank and any representatives from the external auditors will be the first to enter the premises at a specified time. (The other members of staff will be allowed to enter to collect their belongings in small numbers of, say, five at a time). They shall proceed to the manager's office where

closure instructions will be explained and the roles of key staff given by the Reserve Bank officials. An official of the Reserve Bank will place a closure notice on the door of the bank or branch.

Checklist for Closure

Manage stakeholders' expectations...

11.16 The management of stakeholders' expectations is key in this transitional period. The Examiner-in-Charge addresses the bank employees and management, outlining the modus operandi of the Corrective Action instituted.

Communication strategy...

11.17 A communication strategy is devised and agreed on to ensure a consistent message relayed to depositors and creditors. This is important in managing the expectation gap.

11.18 All incoming calls should be brought to the attention of the Examiner-in-charge and any telephone conversations between branch staff and outsiders should be closely monitored.

Secure bank assets and records...

11.19 The Examiner-in-charge shall obtain keys to all exterior doors from all personnel or messengers. The manager shall have a list of all key holders.

- 11.20 The Reserve Bank team establishes security procedures for all people going into and out of the building
- 11.21 The Reserve Bank team shall take control of the telex room, the vaults and the computer room by securing the keys. The officers in charge of the keys should sign in surrender of the keys.
- 11.22 The Reserve Bank team shall obtain keys to the managers' office and ensure that the office is under the control of the Examiner-in-charge.
- 11.23 Keys for any bank vehicle not being driven by one of the key staff members must be surrendered to the Reserve Bank representative and the vehicle left on the bank premises. If a lockable facility is not available, the vehicle must be left in full view of the police guards on duty at the branch.
- 11.24 Allocate responsibility for monitoring the use of the company's fixed asset especially motor vehicles.
- 11.25 Change the combination locks on all vaults and combination doors. All new combination numbers to safes must be secretly recorded.
- 11.26 A listing of all the fixed assets should be obtained from the institution and physical verification of all fixed assets must be performed.
- 11.27 At 11:00 hours the procedure for verifying the transactions for the closing of business the previous day should start.
- 11.28 The Reserve Bank team shall ensure, by checking cashiers stations, that all cash has been locked away after counting the cash and

countersigning. All cheque books and security documents must be recorded and put in a safe as well as all loan security documents. Also check waste bins, drawers within the confines of each cashier's station for ***any possible hidden cash, vouchers etc.***

Statement of affairs...

11.29 The Reserve Bank team shall obtain a computer printout of the day's General Ledger postings and all supporting vouchers and place them in the strong room. All computer printouts of the All Transactions List for the previous day and any unchecked list and supporting documentation must be placed in the strong room.

11.30 Prepare/obtain a statement of assets and liabilities of the bank as at the date of takeover.

- a) Obtain a list of all loans and advances as at date of takeover.
- b) Obtain a listing of all loans to management and staff as at date of takeover.
- c) Obtain a listing of all loans to insiders as at date of takeover.
- d) Obtain a listing of all deposits and liabilities to the public as at date of takeover.
- e) Obtain the sectoral analysis of loans and advances as at date of takeover.
- f) Obtain a copy of the repricing and gap analysis of the **bank's** assets and liabilities as at date of takeover.
- g) Obtain a listing of all investments and placements as at date of takeover.

- h) Obtain a listing of all investments and advances maturing within the current week/month.
- i) Obtain a schedule of all nostro account balances as at date of takeover.
- j) Obtain a listing of all local bank account balances as at date of takeover.

Information Technology...

11.31 The Reserve bank shall ensure back-ups are initiated.

11.32 Following completion of back-ups, the Reserve Bank team shall obtain back-up disks and tapes for the previous days work, or the latest complete day's work from the computer department and lock them in the strong room. Make copies for off-site storage.

Securities...

11.33 Count all securities (e.g. treasury bills and bankers acceptances) and ensure all are in safes under the Curator's control.

11.34 The Reserve Bank team shall ascertain the whereabouts of all negotiable securities including travellers cheques, blank draft forms, both local and foreign, test keys, promissory notes, non-negotiable securities and loan documents, numbered safety paper and ensure that there are properly locked up.

11.35 Reserve Bank representatives will take over all unsold TCs. Verify the outstanding numbers against the PC records on which both the

Reserve Bank representative and Branch custodians must sign, indicating correctness and noting any discrepancies on the record.

11.36 Perform a similar exercise (as on TCs) for all bank draft forms i.e. local bankers payments and foreign correspondent drafts. Scan all blank books to verify that no forms are missing.

11.37 Take-over and verify all blank customer cheque books i.e. current accounts etc. Both Reserve Bank representatives and branch custodians to sign the record indicating correctness. Record any discrepancies.

11.38 After being absolutely certain that all valuables have been placed in the vault, ensure that the door is properly locked.

11.39 The Reserve Bank representative must securely lock all doors and return keys for delivery to the Director.

11.40 All staff must leave the premises prior to the Reserve Bank representative leaving. Before leaving the representative should obtain a list of key personnel, their telephone numbers and/or residential addresses.

Cash management...

11.41 The Reserve Bank team shall open cash vault and count all cash, both foreign and local. Allow the staff to perform the count on the

note counting machines under the supervision of the Examiner-in-Charge.

11.42 The Reserve Bank team shall verify the cash totals against general ledger printout.

11.43 The Reserve Bank representatives and the branch custodians must sign against the general ledger totals indicating correctness. Record any exceptions or discrepancies against the totals.

11.44 The Reserve Bank representatives shall lock all cash into the steel chase in the vault.

11.45 Before leaving the premises, the Examiner-in-charge must ensure that the police have been given a clear explanation regarding their responsibility on guarding the premises and make it clear to them that no one is allowed in the premises until the Reserve Bank representative arrives the following morning or any other time.

11.46 Before leaving, the Reserve Bank team shall ensure that the proper closure notice has been prominently displayed on the front door of the premises.

DAY TWO

11.47 At 8:30 hours the Reserve Bank team shall arrive at premises and allow the pre-named key staff members to enter.

11.48 Complete any task carried forward from day one.

11.49 The Reserve Bank team shall arrange for change of locks to all exterior doors of the premises. Seek assistance from the branch manager. Examine new locksets upon arrival and ensure that all new keys are in your possession.

11.50 Change the combination locks on all vaults and combination doors. All new combination numbers to safes must be secretly recorded and carefully sealed in envelopes appropriately marked.

11.51 Deliver to the Registrar, computer printouts for closing day General Ledger and all transactions list and back up tapes of day's work and General Ledger.

11.52 Deliver all premises keys to the Examiner-in-charge.

DAY THREE

11.53A meeting to be chaired by the Examiner-in-charge should be arranged in the morning in order to review the operation and carry out any uncompleted assignments.

11.54A brief paper should be prepared on how the operation went and it should cover any other outstanding issues. The Governor must be informed accordingly.

Events after Closure

11.55 After securing the assets, the Curator in consultation with the Registrar of Banks shall from the date of taking over the institution consider implementing any of the options outlined in this policy framework

11.56 If the options are not applicable or they have failed, the Registrar will facilitate liquidation of the institution in terms *of the Banking Act*.

12 TENTATIVE CURATORSHIP PROCEDURES

12.1 Manage expectations of various stakeholders.

Reserve Bank of Zimbabwe...

a) Regularize appointment and clear liaison modus operandi

Bank employees and management...

a) Address employees and management to explain the curatorship process and allays fears.

Depositors...

- a) Take calls to manage shock and reduce expectations gap.
- b) Develop a communication strategy.
- c) Appoint the communication team.
- d) Develop consistent message to provide to depositors.

Other financial institutions...

- a) Establish position re-clearing of cheques (Interbank clearing committee).

12.2 Secure the bank's assets and records

Keys

- a) Cancel electronic door tags except for curator and selected staff. Curator to have second safe keys
- b) Establish security procedures for all people going into and out of the building.
- c) Change the combination locks on all vaults and combination doors. All new combination numbers to safes must be secretly recorded and carefully sealed in envelopes appropriately marked

1.1. Fixed assets

- a) Obtain full listing of motor vehicles and verify ownership and confirm their location.
- b) Obtain the full listing of fixed assets and request Internal Auditor to confirm their existence and location.
- c) Allocate responsibility for monitoring the use of the company's fixed asset especially motor vehicles.

Cash management

- a) Count all cash in vaults, tellers' cubicles and other places and place under the Curator's control in all branches.
- b) Obtain cash flow projections for the month to assess adequacy of the cash resources for immediate and future needs.
- c) Develop cash utilization procedures
- d) Arrange weekly cash reports
- e) Contact bankers about continued operations of accounts (Curator to counter-sign all cheques).

- f) All cheque books and security documents must be recorded and put in a safe as well as all loan security documents.

- g) Also check waste bins, drawers within the confines of each cashier's station for any possible hidden cash, vouchers etc.

Securities

- a) Count all securities (e.g. treasury bills and bankers acceptances) and ensure all are in safes under the Curator's control.
- b) The Reserve Bank team shall ascertain the whereabouts of all negotiable securities including travellers cheques, blank draft forms, both local and foreign, test keys, promissory notes, non-negotiable securities and loan documents, numbered safety paper and ensure that there are properly locked up.
- c) Reserve Bank representatives will take over all unsold TCs. Verify the outstanding numbers against the PC records on which both the Reserve Bank representative and Branch custodians must

sign, indicating correctness and noting any discrepancies on the record.

- d) Perform a similar exercise (as on TCs) for all bank draft forms i.e. local bankers payments and foreign correspondent drafts. Scan all blank books to verify that no forms are missing.

Information Technology

- a) Disconnect computer network so no unauthorized entries possible.
- b) Back-up all programmes and transaction files and deposit back-up tapes with the Reserve Bank of Zimbabwe
- c) Establish process for routine end of day and back-up procedures.
- d) The Reserve Bank team shall obtain a computer printout of the day's General Ledger postings and all supporting vouchers and place them in the strong room.
- e) All computer printouts of the All Transactions List for the previous day and any unchecked list and supporting documentation must be placed in the strong room.
- f) The Reserve Bank team shall obtain back-up disks and tapes for the previous days work, or the latest complete day's work from the computer department and lock them in the strong room. Make copies for off-site storage.

12.3 Closure Notice

- a) Before leaving, the Reserve Bank team shall ensure that the proper closure notice has been prominently displayed on the front door of the premises.

12.4 **Statement of affairs**

- k) Prepare/obtain a statement of assets and liabilities of the bank as at (the date bank was placed under curatorship)
- l) Obtain a list of all loans and advances as at date of curatorship.
- m) Obtain a listing of all loans to management and staff as at date of curatorship.
- n) Obtain a listing of all loans to insiders as at date of curatorship.
- o) Obtain a listing of all deposits and liabilities to the public as at date of curatorship.
- p) Obtain the sectoral analysis of loans and advances as at date of curatorship.
- q) Obtain a copy of the repricing and gap analysis of the **bank's** assets and liabilities as at date of curatorship.
- r) Obtain a listing of all investments and placements as at date of curatorship.
- s) Obtain a listing of all investments and advances maturing within the current week/month.
- t) Obtain a schedule of all nostro account balances as at date of curatorship.
- u) Obtain a listing of all local bank account balances as at date of curatorship.

12.5 **Bank Accounts**

- a) Advise all foreign (correspondent banks) (by fax) and local bank (by letter) of the appointments as Curator and the modus operandi for operating the bank accounts in the future.

- b) Make arrangements for new accounts to be opened with other banks as necessary.
- c) Curator to counter sign all cheques (cheques to be signed by three signatories including the curator)
- d) Suspend, with immediate effect, all payments to creditors and depositors.
- e) Final approval re: essential running expenses to be granted by the curator.

12.6 Loan Book

- a) Set in motion an appropriate collection plan.
- b) Arrange monthly report.
- c) Take a view on what additional provisions are required against doubtful loans.

12.7 Staffing and Premises

- a) Assess appropriateness of manning levels.
- b) Make arrangements for the payment of staff salaries.
- c) Consider optimal use of office space subject to security considerations and the landlord's approval.
- d) Secure all entrances and exits.
- e) Generally review the adequacy of security arrangements.

12.8 Compliance and Risk Management

- a) Assess adequacy of procedures to ensure full compliance with regulatory prescriptions.

- b) Obtain the latest risk management and compliance reports and review.
- c) Take appropriate action in response to (a) and (b)

12.9 General administration of the bank

- a) Constitute a management committee which should meet weekly to review the key issues affecting the bank.
- b) Establish the procedures for handling routine administration issues.
- c) Establish procedures for the payment of the customers' salaries which are paid through the bank.

12.10 Future of the Bank

- a) Review the financial, solvency and liquidity condition of the institution to determine the most appropriate way forward.
- b) Commence the assessment of the various options available to restore the institution to financial soundness.
- c) Make arrangements to explore any tentative proposals from potential new investors.

13 Appeals Process

13.1 Following a determination that the institution is in an unsound financial condition, is not operating in accordance with sound

administrative, risk management and accounting principles and practices or has collapsed corporate governance structures and systems, and a decision to close the institution has been made, the Registrar will notify the institution of his intention to suspend the institution's banking business pending liquidation.

13.2 Reasonable period will be given to the institution to make representations regarding the action to be taken for the Registrar's consideration.

13.3 However, the requirement for notification may be dispensed with where the Reserve Bank considers that irreparable harm may be caused to the institution if immediate action is not taken.

13.4 If the banking institution intends to lodge representations with the Registrar, it should do so within the period specified in the letter giving notice.

13.5 The Registrar will consider the representations and make his final decision.

13.6 Any person aggrieved by the decision of the Registrar in terms of the Act has a right to appeal to the Minister of Finance. Such an appeal must be lodged within thirty days after the aggrieved person was notified of the decision, proposal or action that he intends to appeal against.

13.7 Where the Registrar intends to cancel the institution's licence, he will consult the Minister of Finance and thereafter inform the institution of the Reserve Bank's intention to cancel the licence.

13.8 The banking institution has 30 days within which to appeal to the Minister of Finance against the Registrar's intention to cancel its licence.

13.9 At the expiry of the thirty day period or a determination being made on the banking institution's appeal by the Minister upholding the Registrar's decision, the Registrar may cancel the institution's licence. However, the Registrar may opt to liquidate the institution and subsequently cancel its licence.

ANNEXURE “A”

CATEGORY: Capital Adequacy

CATEGORY: CAPITAL ADEQUACY

1. Undercapitalised Banking Institution (Capital Adequacy Ratio (CAR) of more than 8% but less than 12%, Leverage ratio of 3% - 6%, The bank’s capital is less than the prescribed minimum capital requirements)

ACTION TO BE TAKEN

- a) Prohibit the banking institution from declaring or distributing any dividends, which would, in the opinion of the Reserve Bank (RBZ), result in the banking institution failing to comply with the minimum capital requirements;
- b) Undertake more frequent examinations of that banking institution in line with Risk Based Supervision framework;
- c) Prohibit payment of any management fees to any person with significant interest in that banking institution if, after making the payment, the banking institution would be undercapitalised.
- d) require submission of a capital restoration plan, which shall specify:
 - i. the steps the banking institution will take to become adequately capitalised;
 - ii. the levels of capital to be attained during the period in which the plan will be in effect;
 - iii. how the institution will comply with the restrictions or requirements in effect under these Regulations;
 - iv. the types and levels of activities in which the banking institution will engage in; and
 - v. any other information as the RBZ may require to be furnished.
- e) prohibit the banking institution from awarding any bonuses, or increments in the salary, emoluments and other benefits of all directors and executive officers of the banking institution;
- f) impose more frequent reporting.

ACTION TO BE TAKEN FOLLOWING NON-COMPLIANCE

If the institution’s financial condition deteriorates or the institution fails to submit the required capital plan, the RBZ may impose any or a combination of the following:

- a) prohibit the banking institution from opening new branches;
- b) impose restrictions on growth of assets or liabilities of the banking institution as deemed fit;
- c) the RBZ may proceed in terms of section 48 of the Banking Act.

2. Significantly Undercapitalised Banking Institution (CAR of more than 5 % and less than 8%, Leverage ratio of more than 2% and less than 3% The bank's capital is less than the prescribed minimum capital requirements).

ACTION TO BE TAKEN

- a) take any or all the actions prescribed for undercapitalized banking institutions above; or
- b) require the banking institution to alter, reduce, terminate any activity that the RBZ determines poses excessive risk to the institution; or
- c) direct the banking institution to rectify the significant undercapitalization status within such periods as the RBZ may order.

ACTION TO BE TAKEN FOLLOWING NON-COMPLIANCE

If at any time, the supervisor has determined that

- i. the banking institution has failed, refused and/or neglected to raise its capital to the levels necessary to rectify its significant undercapitalization; or
- ii. before the end of the period specified in the corrective order, the financial condition of the banking institution continues to deteriorate,

the RBZ shall without having to wait for the expiry of that period, place institution under curatorship and/or close the banking institution.

3. Critically Undercapitalized Banking (CAR less than 5%, Leverage ratio is below 2%. The bank's capital is less than the prescribed minimum capital requirements)

ACTION TO BE TAKEN

- a) take any or all the actions prescribed for significantly undercapitalized banking institutions above;
- b) Impose more frequent reporting as may be determined by the RBZ;
- c) prohibit the banking institution from making any payment of interest or capital on the banking institution's subordinated debt;
- d) prohibit the banking institution from doing any of the following without the RBZ's approval:
 - i. entering into any material transaction other than in the usual course of business, including any significant investment, expansion, acquisition, sale of assets, or other similar action which would result in the deterioration of the position;
 - ii. extending credit for any highly leveraged transaction; and
 - iii. making any change in its accounting methods.

ACTION TO BE TAKEN FOLLOWING NON-COMPLIANCE

The RBZ may:

- (a) appoint a curator to find solutions for the institution in reorganizations, restructurings or mergers and acquisitions; and/
- (b) close the banking institution.

CATEGORY: ASSET QUALITY

1. Watchlist Category- Banking Institution with the following characteristics:

- a) Non-performing Loans (NPLs) in excess of 10% of total loans but less than 15% of total loans;
- b) Significant increase in loans to total assets ratio, or significant increase in loans to equity ratio.

ACTION TO BE TAKEN FOLLOWING NON-COMPLIANCE

If the institution's financial condition deteriorates or there is no meaningful improvement the RBZ may;

- a) instruct that the institution's board credit committee, credit risk senior management and board of directors sign a written commitment of adherence to the corrective plan.

ACTION TO BE TAKEN

- a) Instruct the banking institution to:
 - i. reduce the stock of Non-Performing Loans (NPLs), contain further deterioration in NPLs and restrict loan portfolio growth;
 - ii. review and strengthen credit risk management policies / process / procedures/ prudential limits;
 - iii. determine the appropriateness of skills mix of credit personnel to perform competently present and anticipated duties; and
 - iv. submit a plan of action within a specified period in respect of upgrading credit appraisal skills and systems, reduce loan concentration.

2. Close Monitoring Category - Banking Institution with Non-performing Loans in excess of 15% but less than 25%

ACTION TO BE TAKEN

- 1. take any or all the actions prescribed for watchlist asset quality category;
- 2. Close monitoring;
- 3. Restrict branch expansion / undertaking new lines of business except with the approval of the RBZ;
- 4. Reduce / suspend dividends;
- 5. Instruct the institution to appoint an advisor to revamp credit administration.

ACTION TO BE TAKEN FOLLOWING NON-COMPLIANCE

The RBZ may direct that:

6. The bank should recall improperly booked loans.
7. A director(s) be removed/blacklisted for non-performing insider credits
8. Further loans to subsidiary/ related companies be stopped (where the subsidiary/related company is unhealthy)
9. Loans to subsidiary/related company be recalled
10. Bank should divest from the subsidiary/related company where the activities of the subsidiary/ related company are inimical to the health of the bank.

However, if the financial condition deteriorates further, and the safety and soundness of the banking institution is threatened, the RBZ may institute action in terms of section 48.

3.Mandatory Remedial Action Category - Banking Institution with Non-performing Loans in excess of 25%

ACTION TO BE TAKEN

- a) take any or all the actions prescribed under the Close Monitoring category;
- b) high frequency reporting including monthly progress reports; and
- c) Invoke section 48 of the Banking Act

CATEGORY: WEAK MANAGEMENT - Rated 4-5

1. Banking institution whose management exhibits the following characteristics:
 - a) corporate Governance structures not properly constituted;
 - b) failure to conduct banking business in accordance with proper accounting and risk management practices;
 - c) adopting undesirable methods of banking business;
 - d) continuous violation of laws, rules and regulations or by laws or monetary policies;
 - e) squabbles among shareholders, directors and officers that impact on the safety and soundness of the banking institution;
 - f) long standing industrial action preventing normal/regular operations;
 - g) persistent whistle blowing against management, board and the bank;
 - h) high turnover at senior management level; and
 - i) conducting banking business in an unsound and unsafe manner.

ACTION TO BE TAKEN

The RBZ may take any action or a combination of the following:

- a. removal of officers who are no longer fit and proper;
- b. refer any suspected cases of illegal and fraudulent activities to relevant authorities;
- c. the Registrar may instruct the institution to appoint directors and senior managers duly approved by the Reserve Bank within a period of as may be specified by the RBZ;

- d. direct institution to review and strengthen the institution's risk management policies, procedures and skills;
- e. direct institution to uphold sound corporate governance standards; and
- f. monitor, through on-site examinations, the institution's compliance to the revised policy.

ACTION TO BE TAKEN FOLLOWING NON-COMPLIANCE

- a) The RBZ may impose provisions of Section 48 of the Banking Act including appointment of a curator and/or closure.

CATEGORY: WEAK EARNINGS rated 4-5
Where financial losses present threats to Banking institution operations

ACTION TO BE TAKEN

- 1) The Registrar may take any action or a combination of the following:
 - a) Prohibit the banking institution from declaring or distributing any dividends, which would, in the opinion of the Registrar, result in the banking institution failing to comply with the minimum capital requirements;
 - b) Prohibit payment of any management fees to any person having significant interest of that banking institution if, after making the payment, the banking institution would be undercapitalised;
 - c) Instruct the institution to submit management accounts; and
 - d) Instruct the institution to submit a restoration plan demonstrating how the bank will be restored to profitability.
- 2) Frequent monitoring of the banking institution.

ACTION TO BE TAKEN FOLLOWING NON-COMPLIANCE

If there is no improvement in the institution's financial condition, the RBZ may take action in terms of section 48 including appointment of a curator and/or closure of the institution.

CATEGORY: WEAK LIQUIDITY rated 4-5
Where a banking institution exhibits any or a combination of the following:

- a) violation of prudential liquidity ratios;
- b) failure to meet maturing liabilities;
- c) failure to comply with internally set liquidity risk management bench marks including the contingent liquidity plans; and
- d) excess reliance on Lender of Last Resort by the banking institution.

ACTION TO BE TAKEN

The RBZ may take any action or a combination of the following:

- a) instruct the banking institution to submit a plan of action within a specified period to correct the identified deficiencies.
- b) impose high frequency reporting including daily, weekly, monthly progress reports depending on the severity of the liquidity problems; and

c) review and strengthen liquidity risk management policies, procedures and skills.

ACTION TO BE TAKEN FOLLOWING NON-COMPLIANCE

a) The RBZ may take any action in terms of section 48 including appointment of a curator and/or closure of the banking institution.

**CATEGORY: COMPOSITE RATING “4” i.e. Weak and Composite Rating ‘
“5” i.e. Critical**

ACTION TO BE TAKEN

- a) The institution will be dealt with in terms of the Troubled & Insolvent Banks Policy.
- b) The RBZ may take any action in terms of section 48 including appointment of a curator and/or closure.