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DECONSTRUCTING THE DEBATE AROUND BANK ACCOUNT CLOSURES ON THE PRETEXT OF INSTITUTIONAL REPUTATIONAL RISK

Submitted in partial fulfilment of the requirements for the degree of Master of Laws by Coursework and Research Report at the University of the Witwatersrand, Johannesburg.

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UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG | WITS SCHOOL OF LAW

DECLARATION

I, **0707774M** declare that this Research Report is my own unaided work. It is submitted in partial fulfillment of the requirements for the degree of Master of Laws (by Coursework and Research Report) at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in this or any other university.

I have submitted my final Research Report through TurnItIn and have attached the report to my submission.

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ABSTRACT

The Supreme Court of Appeal in *Bredenkamp v Standard Bank* found that a bank has a contractual right to close a client's accounts on reasonable notice, and that a bank is entitled to exercise this right if it perceives that a continued relationship with the client may result in reputational and business risks to the bank (albeit may be premised on allegations which the client denies).

Banks have regulatory obligations to (amongst others): (i) manage their reputational risk; and (ii) take steps to avoid their accounts being used by clients to facilitate the proceeds of unlawful activities. Banks are at the receiving end of scrutiny for the latter, including from the media.

Banks' actions of closing accounts for institutional reputational risk are however, often challenged by clients on the basis that these decisions are informed by untrue allegations and are contrary to public policy. A particular consideration is the potential consequences of the clients becoming 'unbanked'. There are also other issues of contention including that reputational risk is an elusive reason.

The competing interests and public policy considerations at play have not yet been adjudicated by our courts. This research report argues that the complexities involved necessitates legislative reform to ensure certainty and fairness on *both* sides.

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I. INTRODUCTION

Many South Africans were shocked by the revelation of allegations of corruption between government officials and the Gupta family outlined in the 'State of Capture' report issued by the Public Protector in October 2016.[1] This shock escalated as the magnitude and extent of corruption became known through testimony led at the subsequent commission of inquiry chaired by Chief Justice Raymond Zondo from August 2018 ('Zondo Commission').[2] The major banks (Absa, Nedbank, Standard Bank and FirstRand) testified at the Zondo Commission and explained their individual decisions to close bank accounts owned by the Gupta family and related individuals/entities.[3]

The Zondo Commission report concluded that evidence demonstrated that the Guptas and their associates undertook a co-ordinated campaign of theft against South Africa.[4] The Zondo Commission report went on to state that, 'until the banks stopped them from doing so, were using the banks as their vehicles for this purpose. It is equally clear that, when this looting became notorious in the public sphere, the banks were obliged by law to act against the Guptas and did so for that reason'.[5] In their respective testimonies, the banks explained that their decisions were informed by reputational and business risks and that their decisions were, in turn, in accordance with applicable domestic and international regulatory requirements aimed at combatting financial crime.[6]

From a common law perspective, in 2010, the Supreme Court of Appeal ('SCA') in the case of *Bredenkamp v Standard Bank*[7] ('*Bredenkamp*') ruled that where a bank perceives reputational and business risks from a client relationship, a bank is contractually entitled to

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[1] 'State of Capture', available at *http://www.saflii.org/images/329756472-State-of-Capture.pdf*, accessed on 4 August 2022;

[2] Judicial Commission of Inquiry into State Capture Report: part I – part VI, available at *https://www.statecapture.org.za/site/information/reports*, accessed on 4 August 2022; Mark Gevisser 'State capture: the corruption investigation that has shaken South Africa' *The Guardian* (11 July 2019), available at *https://www.theguardian.com/news/2019/jul/11/state-capture-corruption-investigation-that-has-shaken-south-africa*, accessed on 29 January 2023.

[3] Testimony of Standard Bank available at *https://www.statecapture.org.za/site/files/transcript/12/September_17_2018_Session_1_-_2.pdf*; testimonies of FirstRand and Absa available at *https://www.statecapture.org.za/site/files/transcript/21/18_September_2018_SESSION_1_%E2%80%93_2.pdf*; testimony of Nedbank available at *https://www.statecapture.org.za/site/files/transcript/19/19_Sept_2018.pdf* - accessed on 4 August 2022.

[4] Judicial Commission of Inquiry into State Capture Report op cit note 2 at part VI-vol 1 para 770.

[5] Ibid.

[6] Banks' testimony at the Zondo Commission op cit note 3.

[7] 2010 (4) SA 468 (SCA).

terminate that relationship by closing the client's accounts, provided that the client is given reasonable notice of the bank's decision.[8]

Arguments that often feature in ongoing challenges against banks' closure of accounts include an assertion that the adverse allegations relied on by banks are usually untrue, and an assertion that these clients' inability to find alternative banking facilities result in dire consequences to their businesses.[9]

This research report explores the practice of bank account closures[10] on the basis of institutional reputational risk, which banks argue forms part of their reputational risk management processes. The regulatory landscape that informs and influences this practice, and the common law that has endorsed it, will be discussed. It will be argued that the competing interests and public policy considerations at play necessitate legislative reform to introduce certainty and ensure fairness in relation to both banks and clients.

II. DEFINING REPUTATIONAL RISK

a. Reputational risk in the banking context

A bank's reputation reflects how it 'is perceived by various stakeholders, including but not limited to, the media, investors, clients, employees, competitors and regulators'.[11] Reputational risk, however, encompasses more than *a risk* that the bank's reputation may be adversely impaired – as will become evident through the discussions in this research report.

Given that banks are regulated, understanding the concept of reputational risk in the banking sector is impossible without first having regard to banking regulations, as these inform how banks understand and treat reputational risk. A primary piece of legislation governing

[8] *Bredenkamp* supra note 7 para 64.
[9] Ibid paras 55 and 63 ; *Annex Distribution (Pty) Ltd and Others v Bank of Baroda* 2018 (1) SA 562 (GP) para 22; founding affidavit in *Mohammed Iqbal Survé and Others v Absa Bank Limited and Others* (EC01/2022) – yet to be heard – paras 98, 99 and 111.
[10] Reference to bank account closures envisages termination of the contractual relationship between a bank and its client. This takes the form of closure of transactional accounts on notice and can take the form of varied approaches in relation to any existing credit agreements depending on the specific terms of the credit agreement concerned.
[11] Nedbank Group Risk and Capital Management Report 31 December 2020 at 19, available at *https://www.nedbank.co.za/content/dam/nedbank/site-assets/AboutUs/Information%20Hub/Integrated%20Report/2021/2020%20Pillar%203%20Risk%20and%20Capital%20Management%20Report%20(1).pd*f, accessed on 4 August 2021.

banks is the Banks Act 94 of 1990[12] ('Banks Act'). Regulation 39(1) and (2) of the Banks Act requires banks to exercise effective risk management.[13] Regulation 39(3) describes the business of a bank as entailing 'on-going management of risks' and lists 'reputational risk' amongst the risks contemplated.[14]

The Bank for International Settlements ('BIS') sets standards and guidelines for the prudential regulation of banks through its Basel Committee on Banking Supervision ('BCBS').[15] The Basel Framework is a set of standards issued by the BCBS, which the members of BIS (including the South African Reserve Bank) have agreed to implement.[16] Section 30.29 of the Basel Framework defines reputational risk as –

> 'the risk arising from negative perception on the part of customers, counterparties, shareholders, investors, debt-holders, market analysts, other relevant parties or regulators that can adversely affect a bank's ability to maintain existing, or establish new, business relationships and continued access to sources of funding... Reputational risk is multidimensional and reflects the perception of other market participants...'[17]

Section 30.33 of the Basel Framework recognises that 'market confidence and a bank's ability to fund its business are closely related to its reputation'. In terms of sections 30.34 and 30.35, banks are required to have mechanisms to identify sources of reputational risk. In addition, Principle 15 of the Basel Framework, which deals with risk management, requires banks to have policies and processes to assess 'material risks' – including reputational risk.[18]

It is evident that reputational risk can arise from the conduct of a bank and can also arise from a bank's association with a cause or third party.[19] It is the latter type of reputational risk by association (and in particular, association with its clients) that forms the focus of this research report. Reputational risk by association can result from *existing* or *potential* concerns. An overview of testimony led by Absa, Nedbank, and Standard Bank[20] at the Zondo

[12] 'Regulated Institutions', South African Reserve Bank Prudential Authority, *https://www.resbank.co.za/en/home/what-we-do/Prudentialregulation/regulated-institutions*, accessed on 5 August 2022.
[13] Regulations Relating to Banks in GN R1029 *GG35950* of 12 December 2012.
[14] Ibid.
[15] BIS website *https://www.bis.org/bcbs/index.htm?m=2625*, accessed on 5 August 2022.
[16] Ibid.
[17] Ibid 'The Basel Framework' at 1272.
[18] Ibid 'The Basel Framework' at 1273.
[19] In its testimony before the Zondo Commission, FirstRand explained that reputational risk can arise from: (i) a bank's non-compliance with regulations; (ii) a bank's engagement in activities considered immoral/unethical; or (iii) a bank's association to clients who may bring reputational risk to the bank. See FirstRand testimony op cit note 3.
[20] Testimony led by FirstRand was consistent with the other banks.

Commission in 2018 regarding their respective closures of accounts held by the Gupta family and related individuals/entities, provides useful illustrations of this:

- Absa explained that its relationships with the Oakbay Group (owned by the Gupta family) were reviewed as part of its regulatory risk management processes. Absa's decision to terminate these relationships was for the following reasons: (i) Absa was not the primary banker and thus had a limited ability to understand the transactional activity which included 'unexplained' large transfers between Oakbay Group accounts and associated entities at other banks; (ii) adverse media, resulting in reputational and conduct risks; and (iii) revenue generated from this client declined as a result of increased costs of monitoring the clients' accounts.[21]

- Nedbank explained that, following an escalation in adverse media against the Gupta family, it aggregated ongoing reviews previously done for the matter to be considered by members of Nedbank's executive committee. Of particular relevance in the escalating adverse media was a statement issued on the Ministry of Finance Letterhead containing an allegation that the then Deputy Minister of Finance was offered the position of Minister of Finance by the Gupta family. Nedbank also highlighted that it was significant that KPMG (auditors of Gupta companies) and SAFIN (sponsoring broker) had also terminated their respective relationships with these clients. Nedbank explained that it was likely that KPMG was privy to information that Nedbank was not privy to – and that Sasfin was in a similar position. The matter was deliberated upon by a sub-committee of Nedbank's executive committee and a decision was made to terminate these client relationships as the reputational and business risks were too great.[22]

- Standard Bank explained that a bank remains on guard to ensure that it does not inadvertently facilitate corrupt payments or proceeds of crime – through media monitoring for adverse media against clients, and account monitoring for suspicious transactions. If either leads to a suspicion that a client could be involved in unlawful activities, a review is conducted. If information gathered provides compelling reasons, the relationship is terminated. If information gathered is inconclusive, further

[21] Absa testimony op cit note 3 at 50-1.
[22] Nedbank testimony op cit note 3 at 6-8.

engagements are held with the client. In either instance, the matter is deliberated and decided upon by a senior committee. Standard Bank's reasons for closing the accounts of Gupta businesses included the following: (i) KPMG announced that they would be terminating their relationship, and one could assume that a client's auditors would have insights into their client's business; (ii) allegations by government officials that they received offers from the Gupta family for other appointments; (iii) adverse media reports on corruption; and (iv) concerning transactions.[23]

From the above testimonies, it also appears that, in addition to banks' regulatory obligations to manage reputational risk, banks consider it necessary to close accounts for institutional reputational risk due to additional regulatory obligations aimed at combatting financial crime.

b. The debate

i. Demonstrating evidence of reputational risk

There are competing definitions of *risk* (depending on the discipline).[24] A common theme is that *risk* involves a possibility or a potential occurrence – as opposed to describing something that has manifested. It follows that banks may not always be able to demonstrate or provide evidence of 'reputational risk' when they close accounts to *avoid* reputational risk. Managing threats that have manifested is better described as 'crises management' as opposed to risk management.[25]

Reputation is of the most important intangible assets of a business.[26] Adverse publicity around a bank's business practices/associations may (irrespective of the veracity) result in a loss of public confidence and the integrity of a bank.[27] Reputational risk is more difficult to manage than other risk types (given that reputation is abstract and difficult to quantify).[28] In the banking context, the relationship between reputational risks and other risks (including

[23] Standard Bank testimony op cit note 3 at 10-12.
[24] C Mazri '(Re) Defining Emerging Risks' (2017) 37(11) *Risk Analysis An International Journal* 2054.
[25] R G Eccles, SC Newquist & R Schaltz 'Reputation and its Risks' (February 2007) *Harvard Business Review*, available at *https://hbr.org/2007/02/reputation-and-its-risks*, accessed on 8 August 2022.
[26] M Sarstedt, P Wilczynski & TC Melewar 'Measuring reputation in global markets – A comparison of reputation measures' convergent and criterion validities' (2013) 48(3) *Journal of World Business* 329.
[27] Eward Jnr Hayes *A bank's right to terminate its relationship with its customers in light of reputational risk* (unpublished LLM thesis, University of Pretoria, 2020) 11.
[28] E Swanepoel, J Esterhuysen & G van Vuuren 'Assessing Reputational Risk: A Four Point Matrix' (2017) 10(2) *Journal of Economic and Financial Sciences* 315.

business risks and regulatory risks) adds further complexities. Deloitte describes reputational risk as 'a strategic concern because it is connected to and magnified by other business risks'.[29]

Examples of possible manifestations of reputational risk include loss in revenue, regulatory action, loss of current/potential client business, and a reduced ability to retain employees.[30] Some manifestations may be subtle, such as existing clients not renewing a bank's mandate, prospective clients approaching an alternative bank, and international banks ceasing to use the bank as their correspondent bank.[31]

There is undoubtedly an element of discretion and subjectivity, coupled with incorporating lessons learnt from past experiences and competitors, that is involved in arriving at a decision to terminate a client relationship to mitigate institutional reputational risk.

It is plausible for a client to demand evidence of reputational risk alleged by a bank. However, based on the above quoted definition of reputational risk, coupled with the nature of *risk* (from a risk management perspective), it appears unreasonable for clients to seek to challenge a bank's assessment of potential reputational risk that may arise from a continued association with a client. Courts support this view and have held that it is not for a court to second guess a bank's *perceived* reputational and business risk.[32]

Media reports criticising banks for ignoring adverse allegations against clients and suggesting that banks are complicit in the unlawful/unethical activities of their clients illustrates the need for banks to adopt a pro-active approach to reputational risk management. A statement by the Daily Maverick on 19 March 2020 is a good example, 'The final red flag was that for a substantial period of time during which Estina operated its Standard Bank account, it was already widely reported in the media that there were concerns with the project. By June 2013, amaBhungane had dug deep into the project, detailing compelling evidence of suspicious activity'.[33]

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[29]Deloitte 'Reputation risk', available at *https://www2.deloitte.com/bd/en/pages/governance-risk-and-compliance/articles/reputation-risk.html*, accessed on 8 August 2022.
[30] Heads of Argument of First National Bank in *Ayo Technology Solutions Limited v First National Bank* (2021) ZAGPJHC (case number: 2021/18763) 29 April 2021 para 49.
[31] Ibid para 49.
[32] *Bredenkamp* supra note 7 para 65; *Hlongwane and Others v Absa Bank Limited and Another* [2016] ZAGPPHC 938 (unreported, case number 75782/13) 10 November 2016 para 30.
[33] Estina's Banks *Daily Maverick*, 19 March 2020, available at *https://www.dailymaverick.co.za/article/2020-03-19-the-estina-dairy-projects-banks-part-one/*, accessed on 8 August 2022.

ii. Unfair treatment

As reputational risk is about perception, it goes without saying that certain clients (based on their public profile) may carry greater reputational risks than others.

In *Hlongwane v Absa Bank Limited* ('*Hlongwane*'),[34] the court acknowledged the heightened reputational risk associated with banking Politically Exposed Persons ('PEP'). The BCBS highlights that 'Business relationships with individuals holding important public positions and with persons or companies clearly related to them may expose a bank to significant reputational and/or legal risks'.[35]

It appears that clients are considered on a case-by-case basis in relation to due diligence reviews and deliberations for potential terminations. A 'case-by-case' approach is also in accordance with recommendations issued by the Financial Action Task Force which guards against terminating relationships with *categories of clients* in an attempt to avoid (as opposed to manage) money-laundering and terrorist-financing risks.[36] It also appears that banks consider risk mitigating factors in the course of their reviews. In the Equality Court application instituted by Dr Survé and related parties against major banks, it was argued that his companies were subjected to discriminatory treatment, in that other companies such as Steinhoff Limited, EOH Limited, and Tongaat Hulett Limited 'have been found guilty of fraud and various other offences' and yet continue to be banked.[37] Without commenting on whether these companies were clients, Nedbank's response suggested that it takes into account, *inter alia*, company restructures, acknowledgment of past wrongdoing, whether implicated persons were dismissed or have since resigned, and other remedial action (including repayments to alleged victims).[38]

iii. Banks act in collusion

It is not uncommon for banks to appear to act in succession in closing accounts of a particular client. As explained by the appellants in *Bredenkamp*, other major banks would likely refuse

[34] [2016] ZAGPPHC 938 (unreported, case number 75782/13) 10 November 2016.
[35] Basel Committee on Banking Supervision 'Customer Due Diligence for Banks' (2001) 10, available at *https://www.bis.org/publ/bcbs85.htm*, accessed on 14 August 2022.
[36] 'FATF clarifies risk-based approach: case-by-case, not wholesale de-risking' (23 October 2014), available at *https://www.fatf-gafi.org/documents/documents/rba-and-de-risking.html*, accessed on 14 August 2022.
[37] Founding affidavit in *Mohammed Iqbal Survé and Others* supra note 9 para 807.
[38] Nedbank's answering affidavit in *Mohammed Iqbal Survé* supra note 9 para 34.1.8.

to accept them as clients upon the appellants disclosing that Standard Bank had terminated its relationship with them.[39]

It is equally not uncommon for clients to challenge banks' ability to close accounts on the basis that the clients will become 'unbanked'. Courts have thus far been unapologetic to this argument.[40]

This research report argues that since banks operate in the same regulatory environment, have the same categories of stakeholders, and are subject to the same risk management and other standards – it is unlikely that banks will arrive at drastically different decisions in relation to their respective client reviews.

In relation to the testimony led by major banks at the Zondo Commission, it was found that there was no reason to 'doubt the veracity and cogency' of the said evidence and further that the probabilities were 'strongly against the white monopoly capital, anti-competitive, collusion narrative'.[41]

iv. The concept of reputational risk (as a reason for termination) is elusive

It will be shown through the discussion below, on the regulatory landscape, that reputational risk that arises from an association to a client does not exist in a vacuum. There are numerous consequences for a bank that could arise from that relationship (which could, in turn, result in further reputational risk). In other words – reputational risk does not only refer to the reputational damage that could occur from a mere association to a client, but it also encompasses potential reputational damage that may be occasioned by other risks and/or events that the particular client relationship may cause.

[39] *Bredenkamp* supra note 7 para 55.
[40] *Bredenkamp* supra note 7 para 60, *Annex Distribution* supra note 9 paras 18 and 22.
[41] Judicial Commission of Inquiry into State Capture Report op cit note 2 at part VI-vol para 769.

III. REGULATORY LANDSCAPE

a. Overview

The banking industry is of the most regulated and supervised industries.[42] Banks are subject to ongoing monitoring and supervision by various regulators.[43] The discussion below will be limited to regulations more frequently referred to by banks.

i. Banks Act and Regulations

As stated above, Regulation 39 of the Banks Act which requires banks to conduct ongoing management of their risks, specifically lists 'reputational risk' as one of such risks. Regulation 50 requires banks to maintain 'robust' policies and processes to guard against being used for, amongst other things, 'financial crimes such as fraud, financing of terrorist activities and money laundering'.[44] It also states that policies and processes should be adequate to, amongst other things, ensure compliance with legislation, identify clients and recognise suspicious clients, report suspicious clients/transactions, and maintain high ethical standards in business.[45] Section 60B of the Banks Act requires banks to develop and maintain 'an adequate and effective process of corporate governance' to ensure compliance with applicable laws/regulations.

ii. Financial Intelligence Centre Act 38 of 2002 ('FICA')

The FICA is the primary legislation governing banks' monitoring and reporting obligations in relation to money laundering and other financial crime.[46] Regulation 21 of the FICA, read with Guidance Note 3A,[47] requires banks to apply a 'risk-based approach' to client identification and verification requirements. Banks are thus required to identify 'high-risk' clients and subject these clients to enhanced due diligence and heightened scrutiny in light of the risks posed.[48]

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[42] RC Hardy 'Regulatory Capture in Banking' *IMF Working Paper on Regulatory Capture* (2006) 3, available at *https://www.imf.org/external/pubs/ft/wp/2006/wp0634.pdf*, accessed on 8 August 2022.
[43] Ibid.
[44] Regulations Relating to Banks supra note 13.
[45] Ibid.
[46] *Annex Distribution* supra note 9 para 35.
[47] Financial Intelligence Centre 'Financial Intelligence Centre Guidance Note 3A Guidance for accountable institutions on client identification and verification and related matters' (2005), available at *https://www.fic.gov.za/Documents/Forms/DispForm.aspx?ID=26*, accessed on 8 August 2022.
[48] Ibid.

Failure to comply with FICA results in substantial penalties and severe administrative sanctions.[49] Fabricius J in *Annex Distribution v Bank of Baroda* stated –

> 'Given these stiff penalties for failures to comply with FICA, even inadvertently, or due to lack of resources, the logical means to avoid these risks is to terminate the banking relationship with clients that are deemed to be of unusually high risk. I agree with this contention. It is sound and it is based on the regulatory provisions that I have referred to. Such decision by a bank would also enhance the integrity of the financial system, support openness rather than subversion and enhance the Rule of Law rather than undermine it.'[50]

In addition to section 21A which relates to banks' obligations to identify and verify clients' identities, section 21C requires ongoing due diligence reviews.[51] The level of the due diligence depends on the client's risk profile. The due diligence process includes, inter alia, adverse media monitoring[52] and transactional monitoring (taking into account the client's source of funds and whether transactions appear to be for a valid commercial purpose).[53] The due diligence process should assist the bank in understanding 'who' it is doing business with[54] (and the risks, if any, posed by that client). If a bank is unable to verify the identity of the client or conduct the required due diligence, section 21E *requires* a bank to terminate that relationship.[55] Section 29 of FICA deals with the reporting of suspicious and unusual transactions in relation to 'proceeds of unlawful activities and money laundering or terror financing'.[56] FIC Guidance Note 4A describes 'suspicion' as 'a state of conjecture or surmise where proof is lacking'.[57]

Guidance Note 3A confirms banks' obligation to comply with international standards contained in the FATF Recommendations and standards issued by the BCBS.[58] Due to the global reach of FATF and BCBS, Hayes notes that international lenders are likely to include covenants in loan agreements requiring adherence to anti-money laundering and anti-

[49] *Annex Distribution* supra note 9 para 36.
[50] Ibid para 37.
[51] Gabriela Narotzky *The Unilateral Termination of the Bank-Client Contract by the Bank* (unpublished LLM thesis, University of Johannesburg, 2018) 25.
[52] Banks' testimony at the Zondo Commission op cit note 3.
[53] G Narotzky op cit note 51 at 26.
[54] EJ Hayes op cit note 27 at 10.
[55] G Narotzky op cit note 51 at 26. The words used in section 21E is 'must terminate'.
[56]Financial Intelligence Centre 'Guidance Note 4A' at 10, available at *https://www.fic.gov.za/Documents/171002_FIC%20Guidance%20Note%2004A.PDF*, accessed on 8 August 2022.
[57] Ibid at 11.
[58] FIC Guidance Note 3A op cit note 47 at 24-5.

corruption laws.[59] As such, a failure to adhere can, in turn, result in operational and financial risks.

iii. FATF Recommendations

South Africa is a member of the FATF, which develops international standards for combatting money laundering, other financial crime, and threats to the integrity of the global financial system.[60] A bank's failure to adhere to FATF Recommendations could result in it being excluded from the global financial payments system.[61] The FATF has set recommendations in relation to due diligence and provides that a bank should terminate a client relationship, where it is unable to conduct such due diligence.[62]

iv. Basel Committee Core Principles

FIC Guidance Note 3A specifically highlights Principle 15 which obliges banking supervisors to ensure that banks have adequate policies and processes to enable them to know their clients, and avoid being used for criminal purposes.[63]

v. Basel Committee on Banking Supervision ('BCBS')

According to the BCBS, client due diligence is a critical component of a bank's controls and the failure to conduct same may result in a bank being subject to 'reputational, operational, legal and concentration risks'.[64]

vi. Anti-corruption legislation

Banks are subject to various anti-corruption legislation. In Nedbank's affidavit in *Minister of Finance*, Nedbank explained the link between measures aimed at combatting money laundering

[59] EJ Hayes op cit note 27 at 28.
[60] 'Treasury on South Africa's anti-money laundering mutual evaluation report released by the Financial Action Task Force' (7 October 2021), available at *https://www.gov.za/speeches/treasury-south-africa%E2%80%99s-anti-money-laundering-mutual-evaluation-report-released-financial#:~:text=South%20Africa%20became%20a%20member,money%20laundering%20and%20terrorist%20financing.*, accessed on 14 August 2022.
[61] Nedbank's answering affidavit in *Minister of Finance v Oakbay Investments (Pty) Ltd and Others; Oakbay Investments (Pty) Ltd and Others v Director of the Financial Intelligence Centre* 2018 (3) SA 515 (GP) para 55.
[62]The FATF Recommendations (updated March 2022) 14-15, available at *https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf*, accessed on 13 August 2022.
[63] FIC Guidance Note 3A op cit note 47 at 25.
[64] Customer Due Diligence for Banks op cit note 35 at 3.

and measures aimed at combatting bribery/corruption.[65] Banks may be used by their clients to facilitate acts of corruption and launder its proceeds.[66]

The Prevention and Combating of Corrupt Activities Act 12 of 2004 ('PRECCA') is the primary anti-corruption legislation in South Africa. PRECCA makes it a criminal offence for a person in 'position of authority' for failing to report a 'suspicion' of corrupt activity.[67]

The Foreign Corrupt Practices Act 1977 in the US and the UK Bribery Act 2010 have extraterritorial application and, where applicable, could result in South African banks receiving significant fines, if they 'inadvertently facilitate' transactions in contravention with these statutes.[68]

vii. Code of Banking Practice 2012 ('Code')[69]

The Code provides that a bank will not close an account without reasonable notice. The exceptions include a closure compelled by law or international practice, a reasonable belief that the account is being used for an illegal purpose, or an account that has remained unused for 'a significant period of time'.[70]

The Code is silent on what constitutes 'reasonable notice'. Guidance provided by the Ombudsman for Banking Services is that 1 to 2 months, in respect of personal accounts, and 2 to 3 months, in respect of business accounts, would be considered reasonable – depending on 'the nature of the account' and 'the number and nature of transactions on the account'.[71]

viii. Conduct Standards issued in terms of the Financial Sector Regulation Act 9 of 2017 ('FSR Act')

The Financial Sector Conduct Authority ('FSCA') was established by the FSR Act, in 2018. The mandate of the FSCA includes to 'enhance the efficiency and integrity of financial markets,' and 'promote fair customer treatment by financial institutions' (amongst

[65] *Minister of Finance* supra note 61 para 60.
[66] Ibid.
[67] Section 34 of PRECCA.
[68] Nedbank's answering affidavit in *Minister of Finance* op cit note 61 para 66.
[69] 'Code of Banking Practice' The Banking Association of South Africa (2012), available at *https://www.banking.org.za/wp-content/uploads/2019/04/Code-of-Banking-Practice-2012.pdf*, accessed on 12 August 2022.
[70] Ibid at 18.
[71] 'Bulletin 3 Closure of Bank Accounts' Ombudsman for Banking Services South Africa, available at *https://www.obssa.co.za/wp-content/uploads/2018/02/Bulletin-3-Closure-of-bank-accounts-Final-30.01.2018.pdf*, accessed on 12 August 2022.

others).[72] Included in the FSCA's priority focus areas is, 'a robust regulatory framework that promotes fair customer treatment', and included in its overall objectives is 'financial inclusion'.[73]

The FSCA issued Conduct Standard 3 of 2020 for banks in July 2020 ('Conduct Standards').[74] In a press release issued by the FSCA on 8 July 2020, the FSCA referred to its mandate as that 'of regulating and supervising the way banking institutions conduct themselves in relation to the provision of financial products and services to customers.' The FSCA explained that the Conduct Standards were developed in terms of this mandate, and 'risks identified' by the FSCA in the banking sector. The rationale of the Conduct Standards is described as to 'enable it to supervise banks'.[75] Section 9 of the Conduct Standards is relevant to banks' closure of accounts and has introduced the following obligations on banks:

- A bank must implement processes for its refusal to provide, or withdrawal of, financial products/services to a client;
- A bank may not withdraw a financial product/service without providing reasonable notice and reasons. Exceptions include that the withdrawal is compelled by law, or that the bank has a reasonable suspicion that the financial product/service is being used for an illegal purpose (and the bank has lodged the necessary reports with relevant authorities);
- The bank's contracts with the client must specify the circumstances in which the financial product/service may be withdrawn.

What remains unclear is whether the mere mention of 'reputational risk' satisfies the requirement for the bank to provide reasons. What qualifies as a 'reasonable notice period' is left for a bank to determine. In the absence of anything to the contrary, it appears that the determination of a reasonable period depends on 'the nature of the account' and 'the number and nature of transactions on the account' as recommended by the Ombudsman for Banking Services. This research report argues that the determination of a reasonable period should not

[72] Financial Sector Conduct Authority, available at *https://nationalgovernment.co.za/units/view/98/financial-sector-conduct-authority-fsca*, accessed on 6 August 2022.
[73]Ibid.
[74] Conduct Standard 3 of 2020, available at *https://www.banking.org.za/wp-content/uploads/2020/07/Conduct-Standard-3-of-2020-BANKS-Annexure-A.pdf* , accessed on 6 August 2022.
[75]FSCA press release (8 July 2020), available at *https://www.fsca.co.za/News%20Documents/FSCA%20Press%20Release%20-%20Conduct%20Standard%20for%20Banks%208%20July%202020.pdf*, accessed on 6 August 2022.

depend on whether the client, in its particular circumstances, *due to its reputation* is experiencing difficulty in obtaining alternative banking facilities.

It is noteworthy that notwithstanding the FSCA's mandate, priority focus areas, and overall objectives (quoted above) – section 9 does not place any obligation on a bank to provide a client with an opportunity to be heard.

b. Link between the regulatory landscape and banks citing 'reputational risk' as a reason for closing accounts

The core elements of the regulatory landscape in which banks operate include that banks are required to have an ongoing knowledge and understanding of their clients, mitigate and manage various risks, and actively take steps to guard against the *possibility of* inadvertently facilitating the proceeds of money laundering and other financial crime. Nedbank notes in its affidavit in *Minister of Finance* that it is challenging for banks to distinguish between legitimate business transactions and transactions associated with money laundering/corruption.[76]

The regulatory framework in which banks operate provides insights into the potential causes of reputational risk by association to certain clients. These include, inter alia: (i) a bank inadvertently failing to comply with its regulatory obligations (including its reporting obligations and obligations to avoid the facilitation of proceeds of unlawful activities); (ii) reputational risk caused by regulatory sanctions should a bank inadvertently fail to adhere to regulations; (iii) reputational risks resulting from a perception that a client alleged to engage in financial crime activities is using or could potentially use the facilities of the bank to facilitate transactions from unlawful proceedings; and (iv) reputational risk resulting from a bank's association with a client alleged to be involved in financial crime.

The impact of regulatory obligations on a bank-client contractual relationship resonates with Froneman J's reasoning in the case of *Beadica 231 CC and Others v Trustees for the time being of the Oregon Trust and Others* ('*Beadica*').[77] He averred that – 'Atiyah documented the decline of the rigid conception of the freedom of contact as a process by which "[f]reedom of choice was whittled down in many directions, government regulation replaced freedom [of]

[76] Nedbank's answering affidavit in *Minister of Finance* op cit note 61 para 61.
[77] *Beadica 231 CC and Others v Trustees for the time being of the Oregon Trust and Others* 2020 (5) SA 247 (CC), dissenting judgment paras 48-203.

contract . . . and paternalism once again was the order of the day". This process still continues in different forms.'[78]

c. The debate

i. Banks close accounts on mere allegations of a client being involved in financial crime

It is evident from the discussion that follows that banks do not have the luxury of ignoring allegations against their clients and awaiting convictions before taking steps to terminate the client relationship.

After providing an overview of the regulatory landscape in which banks operate, Nedbank's answering affidavit in *Minister of Finance* summarises that, 'It is accordingly important for banks not only to comply with their statutory reporting obligations (as provided for in FICA and PRECCA) but to be able to terminate a banking relationship with clients on *suspicion* of involvement in bribery and/or corruption'[79] (own emphasis).

The Zondo Commission report includes a letter from Standard Bank to the ANC, dated 6 May 2016, reflecting discussions between ANC and Standard Bank on 5 May 2018 at a meeting called by the ANC.[80] With reference to sanctions that could be levied under FICA[81] and offences under PRECCA[82], it states that the 'best and most logical way' for a bank to avoid such fines and prosecutions 'is to simply not have any dealings with persons who foreseeably could be or become involved in suspicious transactions generally and corrupt activities in particular'. It mentions that Standard Bank was cautioned by the USA government against advancing finance to a client who had a subsidiary associated with Iran's Nuclear Program failing which, Standard Bank could face economic sanctions.[83] The letter also refers to Standard Bank having been investigated by the US Department of Justice (for possible bribery of a foreign public official) and the UK Serious Fraud Office (for the possible contravention of failing to prevent bribery). These investigations were the result of Standard Bank's subsidiary

[78] Ibid para 121. Froneman J was referring to Atiyah 'Essays on contract' as cited in Kimel 'Neutrality, Autonomy, and Freedom of Contract' (2001) 21 *Oxford Journal of Legal Studies* 473.
[79] Nedbank's answering affidavit in *Minister of Finance* op cit note 61 para 69.
[80] Judicial Commission of Inquiry into State Capture Report op cit note 2 at part VI-vol 1 at 221.
[81] In relation to FICA, Standard Bank highlighted that the failure to report a suspicious transaction is a criminal offence that carries a fine of R10 million or 15 years imprisonment.
[82] In relation to PRECCA, Standard Bank highlighted that 'Section 20 creates the offence of dealing in property or using property known or suspected to be part of any "gratification" which is the subject of a corruption offence.'
[83] Judicial Commission of Inquiry into State Capture Report op cit note 2 at part VI-vol 1 at 222.

in Tanzania engaging with a Tanzanian company partly owned by PEPs to secure government business. The matter was settled through payment of fines and penalties and an amount of $38 million to the government of Tanzania.[84]

The significant scrutiny that banks have been subjected to by investigative journalists and activists, for their alleged failure to avoid money laundering and their alleged complicity in state capture, further highlights the necessity for banks to take action in response to allegations (and not await convictions). 'Open Secrets', in their publication titled 'The Enablers', alleged that banks wilfully ignore suspicious transactions 'in the interests of profits'.[85] The Enablers explained that this is specifically a risk in circumstances where banks' reports of suspicious transactions to authorities do not result in any further action being taken by these authorities. It is alleged in The Enablers that, 'In such cases, banks can fall back on the minimum requirement of reporting transactions while calculating that they can continue the client relationship with little likelihood of follow-up'.[86]

ii. Clients do not understand what banks mean when banks refer to 'reputational risk' or 'reputational and business risks' as the reasons for account closures

Section 9 of the Conduct Standards arguably assists in addressing the concern raised by clients, that they are taken by surprise upon receiving a notice of termination from a bank citing 'reputational risk' or 'reputational and business risks'.

However as noted earlier, an issue which remains unresolved is whether merely advising the client that the banks' reasons for closing the clients' accounts are 'reputational risk' or 'reputational and business risks' is sufficient. These terms could be meaningless to a client especially considering the dynamic and complex nature of reputational risk. However, it is also understandable why a bank would prefer not delving into all the specifics of its decision as this could inevitably result in a client reacting with more scrutiny (thus inviting legal risks). In the event of suspicious activity on a clients' accounts, banks need to tread carefully so as not to be seen to be 'tipping off', in contravention of section 29 of FICA.

[84] Ibid at 222.
[85] Open Secrets *The Enablers* (April 2020) 21-2, available at *https://www.opensecrets.org.za/what_we_do/investigations/the-enablers/*, accessed on 12 August 2022.
[86] Ibid at 23.

IV. ADVERSE ALLEGATIONS

a. Banks' reliance on adverse media

Banks conduct media monitoring as part of their due diligence processes. Given banks' regulatory obligations to form an understanding of their client and their clients' business, it would be counter-intuitive if banks did not factor adverse media into their processes – albeit media reports are not always credible. FIC Guidance Note 4A requires a bank to conduct 'reactive reporting' which is reporting 'following an external prompt without a prior suspicion having been formed on the basis of the circumstances in which a particular transaction/activity or series of transactions/activities have been conducted'.[87] Amongst the external prompts listed that give rise to reactive reporting is, 'seeing information in the media that may adversely affect a particular customer'.[88]

In *Bredenkamp*, Standard Bank factored the appellants' SDN listing and various allegations against the appellants in its deliberations – whilst accepting the possibility that these allegations may be untrue.[89] The court accepted that Standard Bank was not required to establish the veracity of the allegations as 'reputation is not necessarily based on fact but often on perception'.[90] In *Annex Distribution*, the applicants sought to distinguish their case from *Bredenkamp* on the basis that the main factor relied on by Standard Bank was OFAC's listing of Bredenkamp and his companies which they argued 'had an objective quality' whereas the allegations against the applicants did not follow a similar 'objective process' – as these were media allegations which were 'subjective'.[91] The applicants attempted to argue that OFAC was a credible source of information whereas the media was not. The court rejected this argument and found that a bank is not required to conduct 'an objective-fact finding exercise' – a bank need not rely on the veracity of the allegations.[92] Despite the lack of elegance in the applicants' attempted categorisation of 'objective' and 'subjective' allegations, it is difficult not to criticize the court for not delving into the issue of credibility of *sources* of the allegations.

If it is accepted (as it is in our common law) that the veracity of the allegations are irrelevant as the mere existence of allegations is sufficient to create a perception and, in turn,

[87] FIC Guidance Note 4A op cit note 56 at 27.
[88] Ibid.
[89] *Bredenkamp* supra note 7 para 18-9.
[90] Ibid.
[91] *Annex Distribution* supra note 9 para 12.
[92] Ibid.

taint the reputation of a client – then this principle assumes that all allegations, irrespective of the publication source, will have the same effect. This cannot however be the case, since different publications have differing audiences and public credibility. It appears whimsical not to take these factors into account in determining potential reputational risk.

b. Accountability

This research report argues that the 'serious problem with causation' that was identified by the court in *Bredenkamp* in response to the appellants' argument that Standard Bank's closure of the appellants' accounts would, in turn, result in them becoming 'unbanked'[93] is of particular significance. The court in *Bredenkamp* explained that it was the appellants' listing by OFAC (and not Standard Bank's closure of their accounts) that would be the *cause* of the appellants becoming 'unbanked'.[94] It is difficult to criticize the court's approach. On this approach, the apparent lack of challenge against allegedly 'untrue media' appears to be a significant cause for concern.

Dr Survé and his Sekunjalo Group of companies were the subjects of significant adverse media allegations for years, and which heightened around the publication of the report by the Judicial Commission of Inquiry into Public Investment Corporation ('Mpati Commission') during June 2020.[95]

The issue of causation that was highlighted by the court in *Bredenkamp* is acceded to by Dr Survé (perhaps unintentionally so) in the following words, '…It is as a direct consequence of such false media reporting that the termination of banking relationships of the big companies in the Sekunjalo Group has resulted'.[96] Yet remarkably, none of the media houses were joined as parties to the application.

Furthermore, it is common practice for reputable media houses to engage with parties involved in a story to obtain their respective versions of events. It goes without saying that a bank is less likely to place weight on a bare denial then it is on a detailed version by the client that may be included in the media article.

[93] *Bredenkamp* supra note 7 para 58.
[94] Ibid para 58.
[95] *Mohammed Iqbal Survé* supra note 9 para 341-352.
[96] Ibid para 805.

c. Nature of adverse media

Given banks' regulatory obligations to report on and avoid facilitating financial crime, and to avoid perceptions of them failing in these duties, adverse media allegations implicating clients in financial crime allegations is of paramount importance. The relevance of allegations unrelated to financial crime, appears to depend on the exact nature of the allegations. Allegations of clients engaged in significant human rights abuses are also likely to cause reputational harm. It appears that allegations unrelated to financial crime on the part of banks' clients cannot be ignored in light of banks' obligations to manage their reputational risk.

d. Banks' reliance on allegations emanating from other forums

Clients also challenge allegations included in testimonies given at Commissions of Inquiry as being untrue. This research report argues that a bank cannot be faulted for placing more reliance on evidence given at a Commission of Inquiry or outcomes contained in its report as compared to a contrary version that may be presented by the client to the bank. This is so as Commissions of Inquiry are official investigative authorities equipped to interrogate evidence given under oath. To deny the banks' the ability to rely on such allegations would undermine the integrity of such proceedings.

V. THE COMMON LAW

a. *Bredenkamp and Others v Standard Bank of SA Ltd* 2010 (4) SA 468 (SCA) ('*Bredenkamp*')

Bredenkamp is the common law authority, relied upon by banks, that a bank has a contractual right to close a client's accounts on reasonable notice (based on either an express term of contract or an implied term applicable in indefinite contracts). *Bredenkamp* is also authority for the position that a bank is not required to show good cause for its decision. A bank is entitled to exercise its contractual right to terminate if it perceives that a continued relationship with the client may result in reputational and business risks. A detailed discussion is warranted –

i. Background

Mr Bredenkamp and his companies (the appellants) had received notice from Standard Bank that their bank accounts would be closed.

ii. Standard Bank's argument

Standard Bank argued that it was entitled, in terms of an express contractual term, to close the appellants accounts on reasonable notice. It also argued that in terms of an implied term,[97] an indefinite contractual relationship could be terminated on reasonable notice.[98] Standard Bank's reasons for closing the accounts were as follows:[99]

- The appellants were listed as 'specially designated nationals' ('SDN') by the US Department of Treasury's Office of Foreign Asset Control ('OFAC'). This was due to the appellants' alleged association to President Mugabe of Zimbabwe, and having advanced financial and logistical support to his regime (which undermined democratic processes in Zimbabwe).
- Adverse allegations that Mr Bredenkamp was involved in, inter alia, tobacco trading, grey market arms trading and trafficking, diamond extraction, and equity investments.
- Standard Bank was concerned that domestic and foreign stakeholders would suspect that accounts held by it were used to facilitate unlawful and/or unethical acts.
- Material business risks in that many international financial institutions with which it conducted business were obliged to comply with OFAC requirements and therefore imposed strict obligations on correspondent accounts (such as that held by the bank). A failure to adhere could result in a seizure of funds or an adverse report being lodged with OFAC.

iii. The appellants' argument

The appellants accepted that the contractual terms in question were fair and reasonable and thus did not infringe any constitutional values.[100] The appellants' argument and objections were whittled down to the following[101] –

- Standard Bank's *exercise* of its contractual term was *unfair*.
- Alternative banks would not provide banking facilities in light of Standard Bank's decision – resulting in the applicants becoming 'unbanked'.

[97] An implied term is a term implied by law in similar contracts.
[98] *Bredenkamp* supra note 7 para 6.
[99] Ibid para 12-20.
[100] Ibid para 27.
[101] Ibid para 26-63

- Standard Bank may only close an account on good cause. Standard Bank's fears about its reputation and business were unjustified.
- Standard Bank was not entitled to rely on Mr Bredenkamp's reputation as the allegations were untrue.
- Standard Bank was not entitled to make moral judgments.
- The appellants were entitled to a hearing before Standard Bank took its decision.

iv. The outcome

The court decided as follows –

- On the issue that Standard Bank's *exercise* of its contractual right was unfair, the court found that *Barkhuizen v Napier*[102] ('*Barkhuizen*') was not authority for the appellants' purported reliance on 'fairness' as a standalone standard.[103] The court added that *Barkhuizen* did not find or purport to hold 'that the enforcement of a valid contractual term must be fair and reasonable even if no public policy consideration found in the Constitution or elsewhere is implicated'.[104]
- On the issue that the appellants would be rendered 'unbanked', the court found that it is not the closure of the accounts by Standard Bank that would cause the appellants to become 'unbanked' – instead, it was the appellants' listing by OFAC that would result in same.[105]
- On the issue that Standard Bank needed good cause to close the accounts, the court found that Standard Bank exercised its contractual right in a *bona fide* manner.[106] It explained that Standard Bank perceived reputational and business risks, assessed these risks, and gave the appellants reasonable notice which afforded them an opportunity to find alternative bankers.[107] The court added, 'I do not believe it is for a court to assess whether or not a bona fide business decision, which is on the face of it reasonable and rational, was objectively "wrong" where in the circumstances no public policy considerations are involved. Fairness has two sides. The appellants approach the matter from their point of view only. That, in my view, is wrong'.[108]

[102] 2007 (5) SA 323 (CC).
[103] *Bredenkamp* supra note 7 para 27.
[104] Ibid para 50.
[105] Ibid para 58.
[106] Ibid para 64.
[107] Ibid.
[108] Ibid para 65.

- On the issue that the allegations against Bredenkamp were false, the court held that even if the allegations were untrue 'reputation is not necessarily based on fact but often on perception' (and Standard Bank had not asserted that the allegations were true).[109]
- On the issue that Standard Bank was not entitled to take moral considerations into account, the court held that Standard Bank did not make moral judgments. Standard Bank had taken a business decision to protect its reputation.[110]
- On the issue that the appellants were entitled to a hearing, the court found that a hearing in the form of a discussion would be 'an exercise in futility'.[111]

b. *Hlongwane and Others v Absa Bank Limited* [2016] ZAGPPHC 938 (unreported , case number 75782/13) 10 November 2016 *('Hlongwane')*

Adv Hlongwane fell under the category of a PEP and was implicated in allegations involving arms procurement contracts.[112] The Arms Procurement Commission ('Commission') also requested information about the applicants from Absa.[113]

The court stated that Absa made its decision to close the applicants' accounts on becoming aware of Adv Hlongwane's PEP status, and it acknowledged that there were reputational and commercial risks had the bank retained them as clients.[114] The court added that the bank 'had no obligation to retain a client whose monitoring in terms of money laundering measures in place would be more onerous when compared with the benefit, in terms of fees, it would receive from the applicants'.[115] The court referred to *Bredenkamp* and found that the *bona fides* of Absa could not be questioned.[116]

c. *Annex Distribution (Pty) Ltd v Bank of Baroda* 2018 (1) SA 562 (GP)

The court accepted Bank of Baroda's ('BoB') argument that it was attracting risk to itself in relation to law enforcement agencies should it ignore the allegations against the applicants.[117] It stated that BoB was not required to conduct a fact-finding exercise or an investigation and that it is solely for a bank to decide the extent to which it is amenable to allow damage to its

[109] Ibid para 19.
[110] Ibid para 63.
[111] Ibid para 61.
[112] *Hlongwane* supra note 34 para 30.
[113] Ibid para 33.
[114] Ibid para 30.
[115] Ibid.
[116] Ibid.
[117] *Annex Distribution* supra note 9 para 12.

reputation by allegations of criminal activities against its clients.[118] The court dismissed the applicants' argument that there was no evidence that BoB would be prejudiced by a continued relationship with the applicants.[119]

d. Analysis

i. The question of whether a bank's enforcement of its contractual right to close a client's account (for reputational risk) can be said to violate public policy or constitutional rights has not as yet been decided by our courts:

In *Bredenkamp,* the court stated that the appellants accepted that Standard Bank was contractually entitled to terminate the relationship on reasonable notice 'for any reason' and that such term 'did not offend any constitutional value'.[120] The appellants however, raised issue with the fairness of the banks' 'exercise' of the term (which they argued would leave them 'unbanked').[121] In disagreeing that fairness could be used as a standard, the court explained that the matter was analogous to a bank seeking to enforce a contractual term for repayment of a loan and where a debtor argues that the bank's *exercise* of the term could lead to the debtor's sequestration and is therefore 'unfair'.[122] The court was mindful that a contractual term would need to pass constitutional muster and not be contrary to public policy (the determination of which 'requires a balancing of competing values')[123] – but this was not raised as an issue before the court.

The court in *Beadica* provides an invaluable summary of the common law developments on the issues of good faith, reasonableness and fairness in the context of contracts.[124] In relation to *Bredenkamp, Beadica* stated –

> 'The Supreme Court of Appeal viewed *Barkhuizen* as authority for the proposition that, where a constitutional value is limited by the terms of a contract, or by the enforcement of those terms, it must be determined whether the limitation is "fair and reasonable". Applying this principle to the facts in *Bredenkamp*, the Supreme Court of Appeal found that the termination of the banking contract "did not offend any identifiable constitutional value and was not otherwise contrary to any public policy consideration'.[125]

[118] Ibid para 12.
[119] Ibid para 13.
[120] *Bredenkamp* supra note 7 para 24.
[121] Ibid paras 27 and 55.
[122] Ibid para 28.
[123] Ibid para 38-9.
[124] *Beadica* supra note 77 para 20-90.
[125] Ibid para 41.

Whilst clearly not the court's intent, the above synopsis of *Bredenkamp* carries the risk of misleading one into assuming that *Bredenkamp* considered the issue of whether a bank's termination of a client's account offended a constitutional value and if so whether same was fair and reasonable – and reached a finding that it did not offend any constitutional value and was not contrary to public policy. This is however, not the case – since *Bredenkamp* did not consider this issue as it was not the appellants case that any constitutional rights were offended or that public policy was infringed.

ii. Relevant considerations in the context of public policy/constitutional challenges brought against banks' closure of client accounts for institutional reputational risk

Beadica held that – 'a court may not refuse to enforce contractual terms on the basis that the enforcement would, in its subjective view, be unfair, unreasonable or unduly harsh…It is only where a contractual term, or its enforcement, is so unfair, unreasonable or unjust that it is contrary to public policy that a court may refuse to enforce it'.[126] The court went on to state that these values are important considerations in 'the balancing exercise' to be conducted in determining whether a contractual term or its exercise is contrary to public policy. *Bredenkamp* referred to it as 'a balancing of competing values'.[127]

In cases discussed above, the main argument put forward by the juristic clients is that they will lose the ability to trade (as they will become 'unbanked'). The argument raised by the applicants in the Dr Survé and Sekunjalo Group Equality Court application is that the banks' exercise of their contractual right to terminate infringed the applicants' constitutional rights to trade and human dignity.[128] Nedbank argued with reference to case law that these rights don't apply to juristic entities.[129] However, *Beadica* points out that for a contractual term to be contrary to public policy, it is not a requirement that a constitutional right be infringed.[130] It remains to be seen as to how juristic clients will articulate these arguments in future.

The issue of causation that was highlighted in *Bredenkamp* – being that the factors leading to a client's negative reputation is the cause of a client becoming 'unbanked'– cannot

[126] *Beadica* supra note 77 para 80. In a dissenting judgment, Froneman J held (at paragraph 155) that *Bredenkamp* 'should not be read as saying that fairness is not a free-standing requirement for the exercise of a contractual right when the validity of the right is attacked as being in conflict with constitutional values or other public policy considerations'.
[127] *Bredenkamp* supra note 7 para 38.
[128] *Mohammed Iqbal Survé* supra note 9, applicant's heads of argument para 67.
[129] Ibid, Nedbank's heads of argument paras 161 and 165.
[130] *Beadica* supra note 77 para 87.

be ignored and would arguably also need to feature in a court's consideration. A related consideration is that it is unlikely that a client would object to a bank's exercise of its contractual right to terminate in circumstances where the client has a redeemable reputation (as the client would not have difficulty in acquiring an alternative bank). This begs the question as to what is the basis upon which a bank should be prejudiced (and retain a client against its will) due to a client's inability to maintain a good reputation.

It also remains to be seen as to how courts will balance the interests of maintaining the integrity of the financial system which underlies banks' regulatory obligations (on one hand), and the job losses that may result from juristic clients having to cease doing business (on the other hand). The issue of job losses in this context is complex. Courts would need to have regard to transformative constitutionalism[131] but without forgetting the need for uniform application of the law.[132] Job losses could also result from a company deciding to downsize or cease business following a bank's refusal to provide additional finance (due to credit risk associated with the client). This raises the question as to why job losses pursuant to a banks' decision to close a company's accounts (due to reputational and business risks) should be treated differently.

Beadica reminds one that, 'the notion that there must be substantial and incontestable 'harm to the public' before a court may decline to enforce a contract on public policy grounds is alien to our law of contract'.[133] Unfortunately in the context of banks closing accounts for institutional reputational risk – the aforesaid applies to arguments that can be raised by both clients as well as the banks.

In addition to balancing the *rights and interests* of the banks and clients – this research report argues that courts cannot ignore the regulatory obligations on banks. This calls for a nuanced approach of the traditional 'balancing of interest' exercise because it involves the additional dynamic of regulatory obligations and requirements informing and influencing the exercise of contractual rights. The unavoidable question in the circumstances is whether perhaps a client should bear the onus of proving that a continued relationship will not result in any *further* reputational or business risks to the bank and the reasons therefor (such as, for example, remedial actions underway).

[131] Ibid paras 209, 216 and 218.
[132] Ibid para 76.
[133] Ibid para 90.

iii. The absence of a requirement for a bank to provide a client with an opportunity to be heard

The court in *Bredenkamp* felt that had Standard Bank provided the appellants with a hearing prior to making its decision, it would have been 'an exercise in futility'.[134] The Zondo Commission disagreed and in noting that banks are not legally obliged to provide clients with a hearing prior to closing their accounts, expressed a view that it was 'unacceptable' for a bank not to provide clients with an opportunity to be heard (either through a discussion or in writing).[135] There is however no suggestion that a bank is obliged to take the client's word. This much is evident in the words, 'The bank may be persuaded or it may not be persuaded'.[136] This research report supports the view expressed in *Bredekamp* but argues for a purposive approach. This research report argues that where a bank has determined that the reputational and business risks are so significant that it is not prepared to await potential remedial actions that may be undertaken by the client, requiring the bank to provide the client with a hearing is futile. The same applies where a bank identifies correlations between transactions in the client's account and transactions mentioned in adverse media. It is however argued that a hearing is necessary in circumstances where a bank has concerns either about adverse allegations about the client or questions about transactions on the client's account – but where it is unable to reach a determination on the potential reputational and business risks.

The Zondo Commission acknowledged the contractual nature of relationships between banks and clients but compared it to employment relationships in respect of which 'Parliament intervened to induce the notion of fairness in the relationship'.[137] The Zondo Commission report mentions leases and illegal occupation as further examples, and states that even those accused of rape/murder are given a hearing.[138]

It is interesting that the Zondo Commission referred to these specific examples which generally contemplate a hearing chaired by an impartial chairperson/adjudicator – notwithstanding its earlier comment that the 'hearing' between a bank and client could either be a discussion or in writing, and notwithstanding its comment that *a bank* may or may not be persuaded.[139] It is also interesting that the Zondo Commission insinuates that the act of a bank

[134] *Bredenkamp* supra note 7 para 61.
[135] Judicial Commission of Inquiry into State Capture Report op cit note 2 at part VI-vol 1 para 796.
[136] Ibid para 796.
[137] Ibid para 797.
[138] Ibid para 797.
[139] Ibid para 796.

providing a client with an opportunity to be heard will introduce *fairness into the process*.[140] This research report however argues that this cannot be the case if a bank has unfettered discretion in relation to its treatment (or dismissal) of the representations made by a client.

The Zondo Commission's recommendation is articulated as follows, 'It is therefore recommended that relevant existing legislation governing banks be amended to introduce *this requirement* of fairness or, if warranted, a new piece of legislation be enacted which will make *this a requirement*.'[141] This research report supports the need for legislative development but argues that more is required then simply making it a requirement for banks to provide clients with an opportunity to be heard (which is likely to be futile). This research report further argues that the legislative development should aim to incorporate fairness for *both* clients and banks.

VI. THE NEED FOR LEGISLATIVE REFORM

This research report argues that, despite the highly regulated environment in which banks operate, where regulations encroach upon and inform multiple facets of the contractual relationship between banks and their clients, an unduly simplistic approach has been adopted in the context of bank account closures for institutional reputational risk. Section 9 of the Conduct Standards is an illustrative example. Notwithstanding the FSCA's mandate to ensure the integrity of financial markets (on one hand) and to promote fair customer treatment (on the other hand), banks are left with unfettered discretion in relation to client terminations for institutional reputational risk. Hoexter and Penfold note that, 'To say that somebody has a discretion "presupposes that there is no unique legal answer" to the problem.'[142] It is argued that this cannot be the case in a situation where regulatory obligations have contributed to the 'problem'.

The Zondo Commission identified the need for fairness to be introduced into the process. One cannot, however, lose sight of the fact that fairness 'has two sides', as stated in *Bredenkamp*.[143] The court in *Beadica* highlights that parliament has taken active steps to mitigate the 'harshness of contract' in certain scenarios by incorporating fairness through the enactment of legislation (such as the Consumer Protection Act and the National Credit Act).[144] The irony is that the perceived harshness, in the context of bank account closures for

[140] Ibid para 796-8.
[141] Ibid para 798.
[142] C Hoexter and G Penfold *Administrative Law in South Africa* 3 ed (2021) 63, with reference to Prof J Jowell, C Donelly and Ivan Hare et al *De Smith's Judicial Review* 8 ed 2018.
[143] *Bredenkamp* supra note 7 para 65.
[144] *Beadica* supra note 77 para 219.

institutional reputational risk, is largely attributable to banks adhering to their regulatory obligations. This research report argues that regulatory reform, that enables regulatory supervision on this issue, is both logical and necessary to mitigate the perceived harshness. It argues that regulatory reform is also necessary to alter the current lens through which banks are judged – which lens is, in turn, informed by current risk management, anti-money laundering and anti-corruption standards.

As is evident from the discussions above, there are multiple competing public interest considerations at play. *Beadica* highlights that the Constitutional Court has repeatedly warned against 'overzealous judicial reform' and that the common law should be developed 'in an incremental fashion as the facts of each case require.'[145] Given the multiple considerations involved in banks' closing accounts for reputational risk, common law developments are likely to be a slow and complex process. This research report argues that regulatory reform would be more appropriate, in the circumstances, than awaiting common law developments.

This research report further argues that the proposed regulatory reform needs to take the form of principles and standards that set the boundaries and the ambit within which banks can close accounts for institutional reputational risk. It is further argued that these principles and standards will ensure certainty and predictability which will, in turn, serve as a deterrent against financial crime and enhance accountability within the relevant stakeholder relationships (including employers being held accountable for the jobs of their employees, and media being held accountable).

VII. CONCLUSION

This research report has explored the definition of reputational risk in the banking context and shown that banks' closure of accounts for reputational risk encompasses a consideration of various other risks and events that may result from a particular client relationship. The regulatory landscape and impact and influence of regulations on banks' closure of client accounts for institutional reputational risk was also discussed. The common law was then set out and assessed. Various debates and issues of contention were explored. The need for regulatory reform is evident when one considers these debates against the broader context of reputational risk management, regulatory obligations on banks, and the common law. Finally,

[145] Ibid para 76.

the report recommends that the regulatory reform proposed needs to take into account the current regulatory obligations imposed on banks, coupled with various levels of competing public interest considerations.

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