April 30, 2015

PRESS RELEASE ON KASB BANK RELATED ISSUES

The State Bank of Pakistan as part of its mandate is responsible for protecting the interest of depositors and ensuring stability of the banking system. The implication of issuance of a banking license is allowing an entity to take deposits from general public for onward lending. With authority of taking public money comes responsibility. SBP as a matter of prudence and fulfilling its mandated responsibilities assesses fitness and propriety of every prospective investor in a bank beyond a defined threshold (currently 5%), so as to ensure that the investor is capable of fulfilling the fiduciary responsibilities and can be entrusted with the license to collect public deposits.

In case of KASB Bank SBP intends to:
(a) ensure the payment of over 150,000 depositors with Rs 57 billion, and
(b) resolve the bank amicably in the best interest of all the stakeholders but primarily depositors and for the sustainability of the banking system at large.

Historical Perspective of KASB Bank:

KASB Bank Limited (the "Bank") has been facing severe capital shortfall in terms of both Minimum Capital Requirement ("MCR") and Capital Adequacy Ratio ("CAR") since 2009. As of September 30, 2014 the Banks' MCR (free of losses) was in the amount of Rs. 0.958 billion with a CAR of negative 4.63% against the required levels of Rs. 10 billion and 10%, respectively (i.e. shortfall of Rs. 9.04 billion in respect of the MCR and shortfall by 14.63% in respect of the CAR.

As a result of supervisory process/assessment by SBP the banks are put on resolution in view of the issues of supervisory concerns. SBP started relevant measures when issues of supervisory concerns were detected in KASB Bank.

Considering the Bank's weak solvency position and serious regulatory violations, SBP imposed certain limitations on the bank and required the sponsors to inject capital.

However, neither capital was injected by the sponsors nor any serious resolution efforts were made. Rather, the bank failed to comply with the limitations imposed by SBP. Consequently, sponsors and Board of Directors were advised on 3rd June 2013 to sign an undertaking with SBP to fulfill several regulatory gaps and make up for deficient capital upto May 2014 in installments.

Unfortunately, the sponsors and Board of Directors, despite SBP's consistent persuasion through meetings and in writing, failed to meet their critical commitment of capital injection. Ultimately, they were suggested to merge the bank with any of the large banks, however, they failed to do that either. In 2014 the bank was again given an option by SBP to merge with any other bank in the domestic market as appropriate. However, the bank's sponsors failed to do the same also.

In addition to deficient capital base, serious governance issues including involvement of sponsors in the day-to-day affairs of the bank in violation of applicable regulatory instructions were noticed. The bank also transacted business with its related parties/ associated concerns on terms and conditions that were detrimental to the interest of its depositors. The sponsors' and management's self serving practices caused considerable erosion in the capital base, asset quality and earning capacity of the bank.

As already mentioned due to persistent losses for the last five years KASB bank's equity had eroded significantly and was much below the regulatory Minimum Capital Requirement, its Capital Adequacy as of 30-09-2014 has also turned into negative thus technically rendering it insolvent. Because of the weak financial health of the bank and inability of its sponsors to meet capital requirement State Bank, in the best interest of the depositors and other stakeholders, had to request Federal Government to place the bank under moratorium. The Federal Government imposed the moratorium on the bank and also directed State Bank to prepare a scheme of reconstruction / amalgamation in accordance with the law.

In 2010, NASB as a group introduced a restructuring proposal wherein, M/s. Asia International Financial Limited (AIFL) (a Chinese company), would be given 50% shareholding against fund injection in the group holding company viz. KASB Finance Limited. The injected funds were to be used for capital injection in the bank as well as for purchasing of certain group companies. To SBP's surprise, in 2014 it was communicated that AIFL's ownership structure has been changed and now it's being run by Pairdos (Buyer). The said transfer of ownership without SBP's approval was in violation of SBP's existing regulations. However, Pairdos being the prospective beneficiary proceeded with the acquisition of shares without seeking SBP's Fit & Proper Clearance.

Post Moratorium Development

In view of the financial position of the bank and weak management and board oversight, SBP had few possible options for resolution of the bank i.e.

(a) Market based solution by amalgamating the bank with and into another bank
(b) Liquidate the bank.

Liquidation, due to its adverse impact on the bank's depositors and the industry at large was not considered.

With a view to seek resolution of the bank via a market based solution, SBP concentrated on the option of merger of the bank in the larger interest of the depositors and the banking system. Four banks submitted their interest to SBP for acquiring the bank. These include:

i) Askari Bank
ii) Sindh Bank
iii) JS Bank
iv) BankIslami

SBP allowed the above banks to conduct due diligence of the bank. Post due diligence, the above banks came out with an estimated negative equity gap of Rs. 12 to 14 billion in addition to the shortfall in Minimum Capital Requirement (Rs. 10 billion). After conducting due diligence of the bank, apart from BankIslami, the other banks did not register interest to proceed further with the Amalgamation transaction.

While the amalgamation scheme was almost in final stage, the Honorable Islamabad High Court (IHC) on a writ petition filed by sponsors of the bank against the Federal Government, State Bank of Pakistan and others passed an order dated 24th February 2015, restraining SBP from selling shares of the sponsors of Bank and asked SBP to consider the proposal for restructuring/ amalgamation from any investor/ buyer introduced by the existing sponsors in accordance with law. However, the sponsors filed an application to withdraw their petition unconditionally on the day when the Court was about to give a final verdict on the case. Accordingly, IHC allowed unconditional withdrawal of the instant writ petition and dismissed the same on April 22, 2015.

Cybernaut Investment Group's Proposal

- After filing the writ petition against SBP in the IHC (Islamabad High Court) Mr. Nasir Ali Shah Bukhari (NASB) vide letter dated February 24, 2015, and March 2, 2015 informed SBP that they have identified an investor namely Cybernaut Investment Group (CIG) and requested for a due diligence approval.

- On receipt of a formal request through K-Corp we had formally requested for complete information on the group to establish its bonafide which was not provided and their request for a formal due diligence was declined due to the aforesaid reasons.

- However in view of the gravity of the situation and to protect the interest of the depositors they were offered to share relevant information along with arrangements of funds of Rs 5 Billion within a week on 10th March 2015. CIG completely ignored this offer and NASB filed a contempt application before the Islamabad High Court.

- On SBP's response the Cybernaut group requested for a meeting. In this regard a detailed meeting was held with them on April 03, 2015 at SBP, Karachi and it was clearly explained that as per existing law/regulations, any investor who intends to acquire 5% or more stake in a Pakistani bank requires to establish his fitness & propriety before conducting due diligence of a bank and/or signing of any formal agreement for transfer of 5% or more shares with existing sponsor shareholders.

- NASB vide its letter dated April 23, 2015 conveyed that Cybernaut has proposed to invest US $ 100 million in 12 months whereas Cybernaut vide its letter dated April 20th 2015 proposed to inject US $ 50 million by end of year 2015 and any shortfall in the MCR of the bank to be covered by the date agreed with SBP.

- Considering the fact that Cybernaut was not able to establish its bonafide even after elapse of considerable time their request was declined on 27th April 2015.

Recent Rumors:-

- State Bank of Pakistan has noticed that post withdrawal of the petition rumors have been spread that some Chinese investors have struck a deal with State Bank of Pakistan. State Bank denies any such deal and clarifies that a Chinese investor approached State Bank through the bank's existing shareholders. SBP informed the prospective investor to establish its bonafide and has to clear Fitness and Propriety criteria. They were also guided about the position of the bank and information required to be submitted in order to assess their request. However, they could not submit any of the required information. An entity whose beneficial ownership is not clear cannot be entrusted with the license of a bank.

- Although the prospective investor under discussion has indicated to bring in some investment by May 13, 2015 but in view of the quantum of deposits of the bank and the Minimum Capital Requirement the committed amount of investment is very meager. Further, the prospective investor did not share any information about how and from where the funds would be mobilized. State Bank of Pakistan, always welcomes the Foreign Direct Investment, however, this can be accepted only within the bound of laws and regulations prevalent in the jurisdiction.

- State Bank of Pakistan reassures the public at large that it is committed to strengthen the banking sector of the country. We need to realize that the business of banking is very different and sensitive from other businesses merely having cash to acquire an institution does not mean that the institution be handed over to person who are not fit to run the institution. The Chinese Investors need to realize the fact that it's just not about having US$ 50 million or US$ 100 million, for that matter, it's about fulfilling and respecting the mandatory requirements of different territories. SBP realizes the importance of the apparent FDI to be brought to Pakistan but it cannot compromise its responsibility towards safeguarding depositor's interest (in this case Rs 57 billion of more than

150,000 depositors in are at stake). SBP as a custodian of financial sector always endeavors to safeguard the depositors' interest and ensures financial stability. The State Bank is concerned about the safety of KASB Bank's depositors' money and wants to ensure that they are able to operate their accounts without any hindrance. Any delay in the resolution will jeopardize depositor's interest as well as market confidence.

Going Forward

- The State Bank is concerned about the safety of depositors' money and prompt payments to them. A good investor with public confidence is a key to a stable bank. Handing over the bank to a weak investor may lead to another moratorium.

- Under the current circumstances, merger with BankIslami remains a viable option wherein the bank's depositors' interest would be safeguarded and its problem would be resolved on a sustainable basis.

- SBP will continue to do everything possible to safeguard depositors interest whether its KASB or any other bank.