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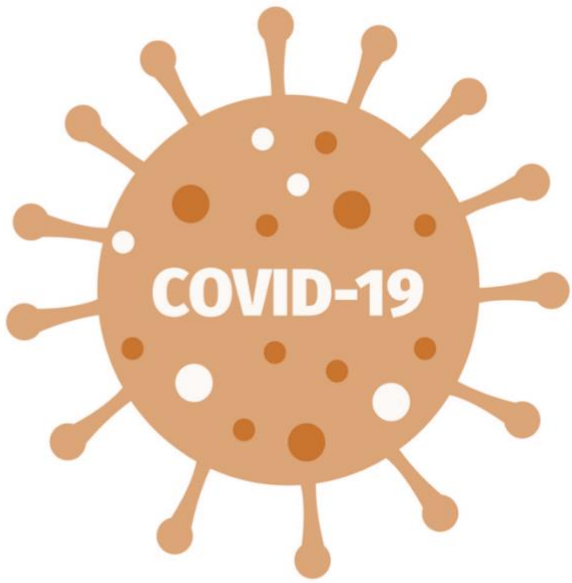
IMPLICATIONS OF THE COVID-19 PANDEMIC ON THE BANKING INDUSTRY AND THE ROLE THAT MERGERS AND ACQUISITIONS MAY PLAY



TANZANIA POSTAL BANK PLC
&
TIB CORPORATE BANK LIMITED

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TPB BANK PLC'S MERGER WITH TIB CORPORATE BANK LIMITED AND ITS IMPLICATIONS ON THE BANKING INDUSTRY AMID COVID-19

The recent announcement of TPB Bank Plc's (**"TPB"**) merger with TIB Corporate Bank Limited (**"TIB'**) was met with much optimism especially within the Tanzanian banking and media industry. This is owed to the fact that TPB has now joined a unique group of commercial banks operating in Tanzania that hold assets amounting to TZS 1 trillion (approximately USD 431 million) or more. This follows the government owned lender's acquisition of the assets and liabilities of TIB, which is also a government majority owned bank.

This signals a continued shift towards consolidation within the banking industry but also further raises questions of the implications of the COVID-19 pandemic on the banking industry and the role that mergers and acquisitions may play in its consequences.

The evidentiary shift to mergers within the banking industry is highlighted by the fact that TPB on its own has been party to three mergers within the past two years in which Twiga Bancorp Limited ("Twiga Bancorp"), the Tanzania Women's Bank and now TIB have all been subsumed under its control.

One of the main reasons cited for the merger between TPB and TIB has been the need to increase efficiency and reduce operational costs. However, the standout issue appears to be the fact that TIB had one of the highest levels of nonperforming loans in the market potentially leading to expensive and drawn out litigation in recovering said loans.

In light of COVID-19, this is a problem that a substantial number of banks may have to encounter due to the downturn in business and commercial activity. **One of the main duties of a commercial bank in Tanzania is to protect the deposits of its customers as per section 39(1) of the Banking and Financial Institutions Act, 2006 (the "BFIA").** Having high levels of **non-performing loans ("NPL's")** puts such protection at risk, as more money is likely to be going out than coming in. Consolidation via mergers or acquisitions between banks may be the most viable way to spread and manage the risk of NPL's for struggling banks especially. This is in addition to the more stringent capital adequacy requirements that the Bank of Tanzania (the **"BOT"**) has put in place to reign in any instability in the banking sector.

As to date, there are at least 40 commercial banks operating in Tanzania, yet only 5 hold just over 50% of the assets held by Tanzania banks. The same 5 also hold a majority share in customer deposits arguably creating an oligopoly. The Fair Competition Act, 2003 (the **"FCA"**) seeks to provide and encourage effective competition in the market including the banking industry. Banks which have been unable to operate as viable alternative to banks with dominant market share may utilize FCA provisions to bundle up their entities not only to counter their larger competitors but to facilitate their own survival.

With only 5 banks holding a majority of the asset base and customer deposits in banking in Tanzania, there is a realistic risk that some of the remaining banks may be unable to fend off the downturn in the global economy and the COVID-19 pandemic. Turning to mergers & acquisitions will allow banks in Tanzania to reduce operational costs, improve economies of scale and build synergies between one another where applicable. For example, the recent TPB and TIB merger has allowed the latter's employees to retain employment and consequently, avoid potential costly litigation vis-à-vis the acquiring bank.

With market share so currently concentrated, there may be ample room for smaller and struggling players to pass legal and regulatory muster in order to consolidate, provided all necessary requirements are complied with. The BFIA requires that any bank seeking to obtain majority ownership in another bank whether through merger or acquisition will require approval from the BOT. More specifically, to effect any voluntary merger, consolidation or other reorganization of its business or affairs with another bank or to transfer to any other institution the whole or any of its assets or liabilities in Tanzania will require written authorization of the BOT. The BOT in evaluating such deal will have regard to the ability of the applicable bank to effectively supervise the entities, both separately and on a consolidated basis, the financial condition and ownership structure of the investing bank, any risks to the bank in which the interest is acquired that could arise from such ownership or control and proven good track record as may be ascertained by a regulatory board under which the bank operated for at least 10 years.

Any envisaged merger would also come under the purview of the FCA for approval owing to the broad definition of '**acquisition'**, which includes merger, which is not specifically defined in the FCA and provided a merger met the asset and turnover threshold under the same. This could prove to be a stumbling block for smaller banks looking to merge who may be unwilling to part ways with substantial filing fees associated with obtaining approval from the Fair Competition Commission (the **"FCC"**) under the FCA.

TPB's recent flurry in merger activity reflects the government's priority in improving the performance of public institutions. But it also reflects the government's ability to expedite the regulatory approvals with respect to state owned entities, where essentially one entity is dealing with the decision-making process. This is in contrast to privately owned commercial banks where ownership is more decentralized, which may explain the indifference or slow-moving nature of merger activity between banks, who may be struggling to stay afloat. Privately owned banks may seek to emulate similar cooperation in order to achieve financial stability.

However, there may be inherent risks in banks agreeing to merge especially during the COVID-19 period. Larger banks may seek to take advantage of smaller banks who are currently struggling but still have the potential to recover from any economic fall out that the pandemic has temporarily created. This concern is highlighted for example in the fact that certain lawmakers from the United States have sought or suggested passing legislation that would put a temporary moratorium on any mergers or acquisitions in order to protect any vulnerable companies until such time that they would recover. It would be up to the authorities such as the FCC to determine whether such concerns are applicable in Tanzania.

In any event, BOT's actions in recent years to shore up capital adequacy ratios and the prevalence of NPL's coupled with the ongoing downturn in the global economy due to COVID-19 has made it increasingly difficult for banks to comply with the law, as evidenced by 5 banks being liquidated in the space of 1 year due to being undercapitalized, while other banks such as Twiga Bancorp were brought under statutory management of the BOT. Increased instances of this necessitate renewed thinking among banking stakeholders in turning to and utilizing mergers and acquisitions as a legal and commercial enterprise that may not only rescue banks but spur their growth.

For further enquiry, please contact our:

Thomas Nguluma – t.nguluma@rexattoreys.co.tz

Heri Mwapachu – h.mwapachu@rexattorneys.co.tz