

CFI Stakeholders Workshop

Setting the scene: Regulation and supervision of CFIs

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6 August 2018



South African Reserve Bank

Prudential Authority

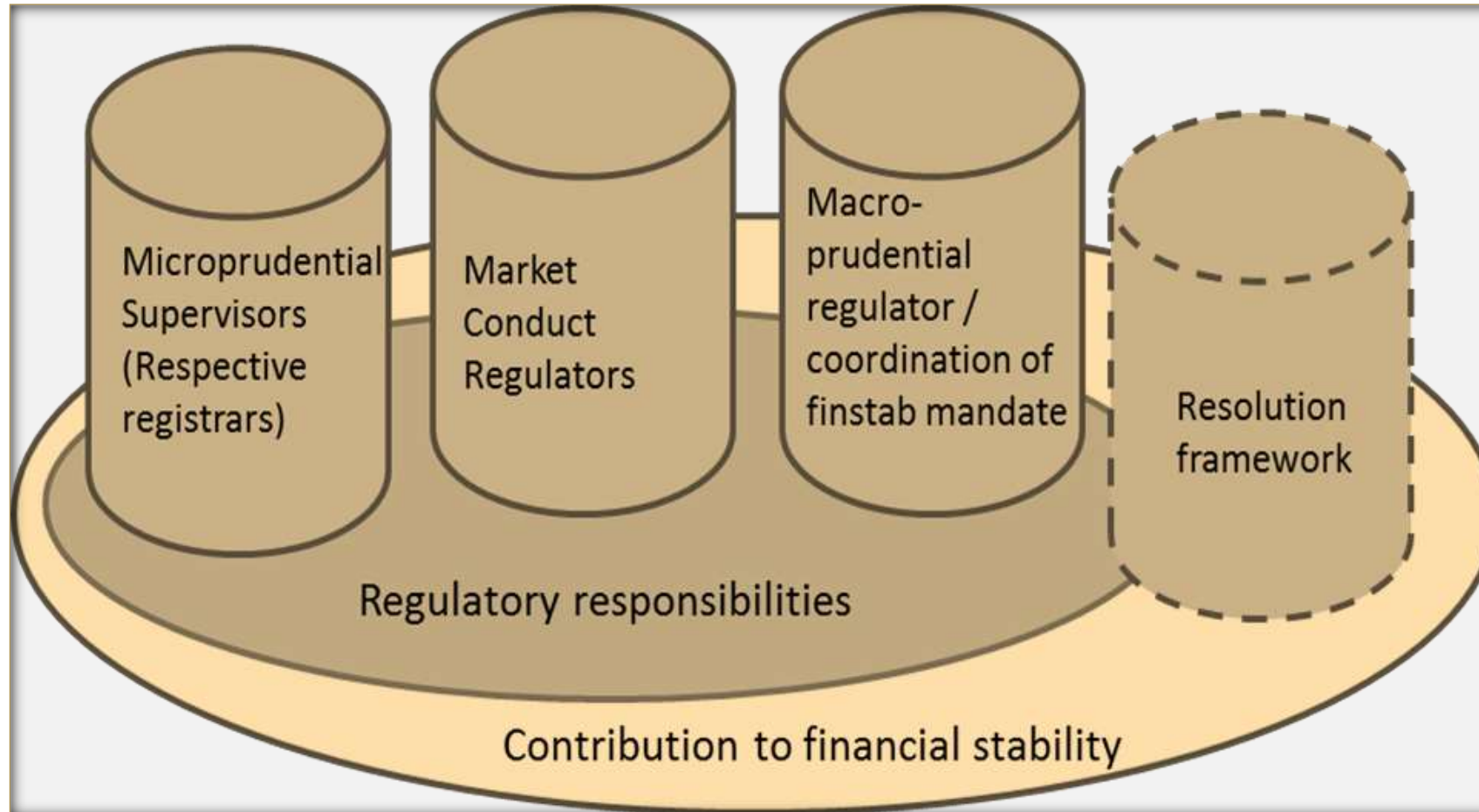
Overview of presentation

- Background
 - ✓ Twin Peaks model
 - ✓ Why Twin Peaks in South Africa
 - ✓ Twin Peaks in Law
- The PA transformation
- Instrument to achieve regulation and supervision
- Tiered approach to banking
- Banking legislation
- Why is the industry so comprehensively regulated
- The important role of CFIs
- CFIs in other jurisdictions
- Challenges
- The role of the PA, FSCA and the CBDA
- Conclusion



Background – the Twin Peaks model

- Twin Peaks is a comprehensive and complete system for regulating the financial sector.



Background – Why Twin Peaks in South Africa

Highly interconnected financial system – large financial groups



Few financial institutions leads to reduced competition



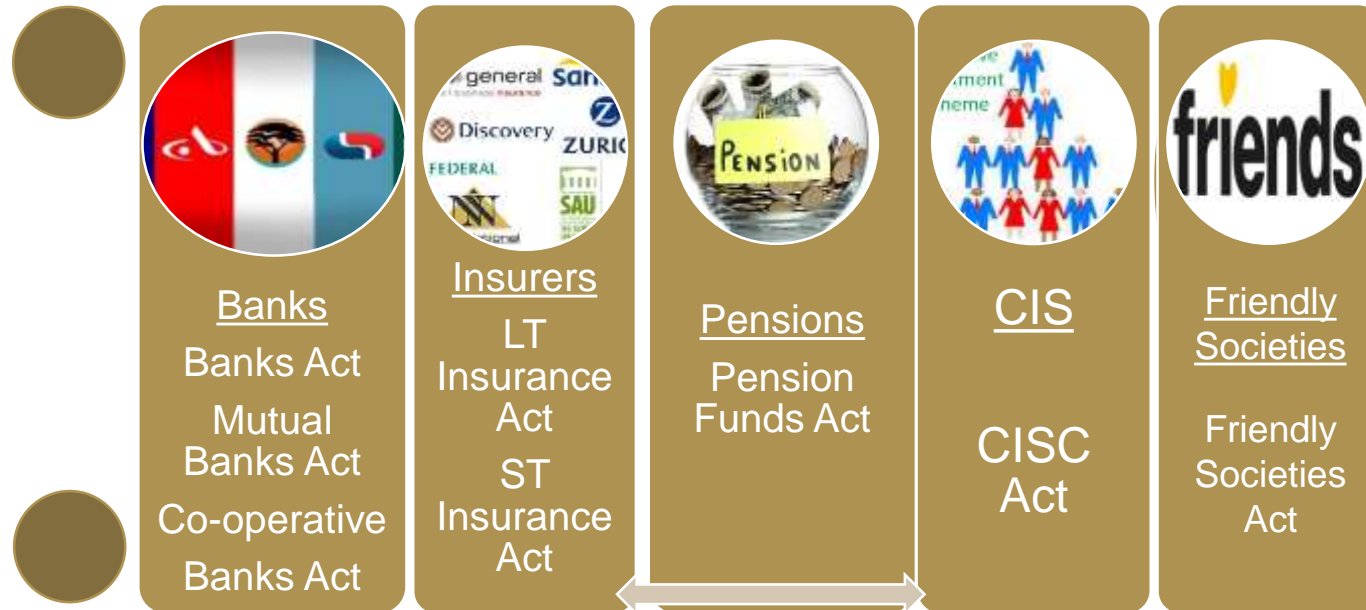
Sale of complex products with opaque fee structures and high prices



Financial institutions not providing financial services to all – financially excluded



Inappropriate or expensive financial services to low income sector



Fragmented legislation

Different regulators with a prudential mandate

Silo approach to regulation and supervision – regulatory arbitrage

Conduct regulation not applied to all financial institutions

Background – Twin Peaks in Law

The Financial Sector Regulation Act 9 of 2017 establishes the PA and the FSCA

Functions

- ❖ Regulate and supervise in terms of sector laws
- ❖ Co-operate with SARB, FSOC, FSCA, NCR and FIC
- ❖ Co-operate with CMS
- ❖ Support sustainable competition
- ❖ Support financial inclusion
- ❖ Review perimeter and scope of regulation – mitigate risk to objective
- ❖ Conduct and publish research

PA

Objective

- ❖ Promote and enhance safety and soundness of financial institutions that provide financial products and securities services; market infrastructures
- ❖ Protect customers against risk that financial institutions fail to meet their obligations

FSCA

Objective

- ❖ Enhance and support the efficiency and integrity of markets
- ❖ Protect customers – Promoting fair treatment, providing financial education., promoting financial literacy and ability of customers to make sound financial decisions

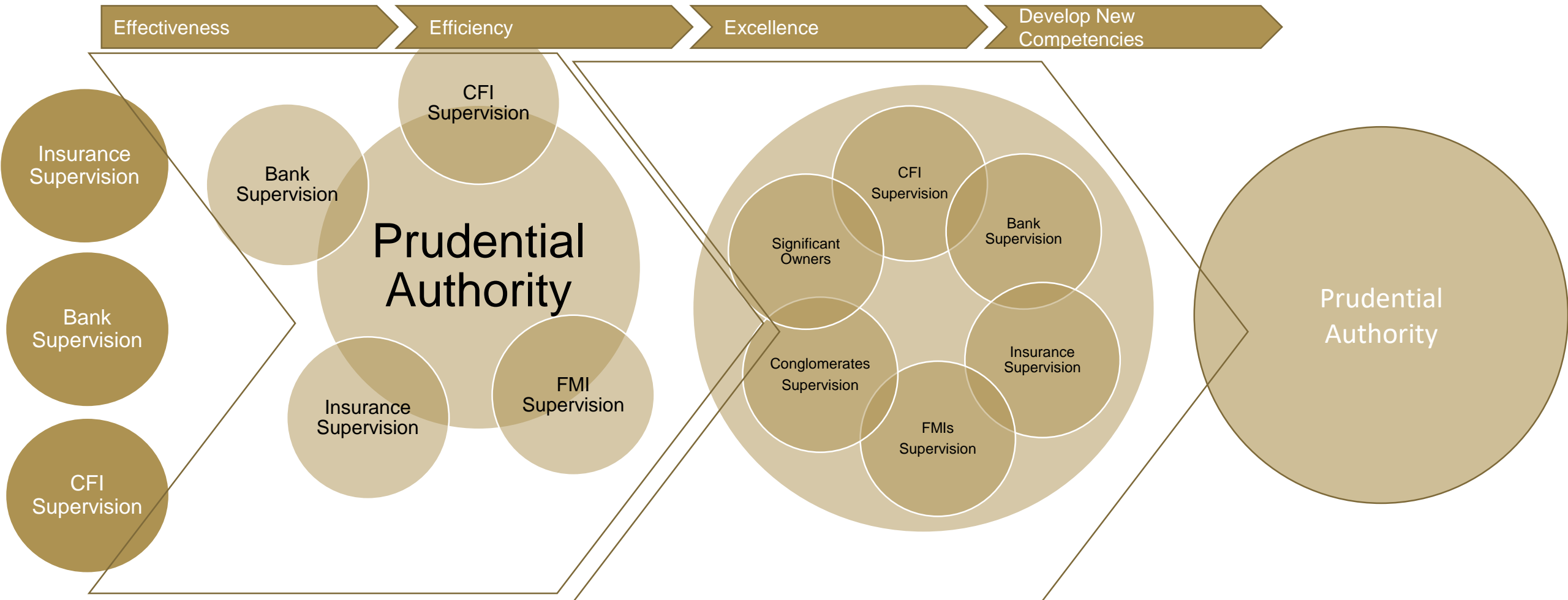
Functions

- ❖ Regulate and supervise in terms of sector laws - conduct
- ❖ Co-operate with SARB, FSOC, PA, NCR and FIC
- ❖ Co-operate with CMS
- ❖ Promote sustainable competition
- ❖ Promote financial inclusion
- ❖ Review perimeter and scope of regulation – mitigate risk to objective
- ❖ Conduct & publish research
- ❖ Monitor extent - there is deliver of fair outcomes for financial customers
- ❖ Formulate and implement strategies and programs for financial education

Assist in maintaining financial stability



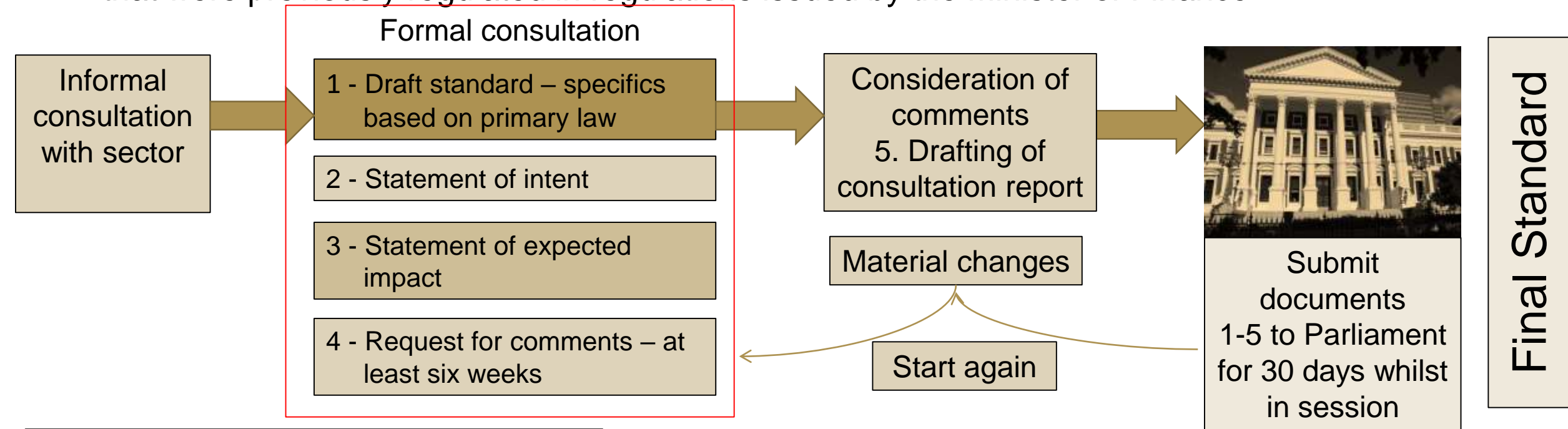
The PA transformation



Instrument to achieve regulation and supervision

➤ Standards

- The PA is empowered to make prudential or joint standards (with the FSCA) in respect of matters that were previously regulated in regulations issued by the Minister of Finance



Urgent standards specified cases – document 1, 2 and reason why we need an urgent standard. Consultation is 7 days and submit to Parliament for 7 days

Tiered approach to banking

➤ South Africa is characterised by a tiered approach to banking:



Banking legislation

Commercial Banks

- Banks Act 94 of 1990
- To provide for the regulation and supervision of the business of public companies taking deposits from the public
- Public company – owned by shareholders – not necessarily depositors/customers
- R 250 million capital requirement

Mutual Banks

- Mutual Banks Act 124 of 1993
- To provide for the regulation and supervision of the activities of juristic persons doing business as mutual banks
- Juristic person – owned by depositors (members) – exercise control
- R 10 million capital req.

Co-operatives

- Co-operative Banks Act 40 of 2007
- To promote and advance the social and economic welfare of all by enhancing access to banking services under sustainable conditions;
- Jointly owned and democratically controlled – common bond

- Co-op Banks
- 200 members
- Deposit of R 1million

- CFIs
- 200 members
- Share capital of R 100 k

Risk-based and proportional supervision

Why is the industry so comprehensively regulated

- Financial intermediation is critical to the economy
- Only effective if the system is safe/sound
- Depositors have trust and confidence and are protected
- Integrity of system is recognised
- The safety and soundness of the system is maintained through the effective regulation and supervision of entities taking deposits from the public
- PA is responsible for the registration/licencing deposit taking institutions



The important role of CFIs

- CFIs play a fundamental role in financial inclusion and access
- CFIs encourage members to save regularly, provide loans at low rates, and help members in need of financial advice and assistance
- CFIs are run by members known to the community and able to build trust and attract new membership
- The CFI model is based on limited scope – a basic business model - income generated is ploughed back into projects and services that will benefit the community and interests of its members. There is a common interest to grow the community on which the CFI is built
- The nature of the co-operative model and adherence to the co-operative principles – the common bond – makes the CFI risk-savvy
- CFIs can be competitive because of lower operating margins – competitive with microfinance institutions
- Based on these fundamental principles – a CFI as opposed to a Bank will be supervised proportionally based on risk
- A CFI that develops beyond the basic model and introduces new risk must be in a position to deal with the cost of regulation as such will increase proportionally



Credit unions are richer than ever

[The Times](#) - 12 hours ago

The value of assets held by credit unions across the country is at a record high, but lenders are struggling to make a return on their investments.

Credit unions have never had as much in assets - but there are far ...
[thejournal.ie](#) - 6 hours ago



Crisis for **credit unions**?

[CUinsight.com](#) (press release) - 2 hours ago

For credit unions, there are innovations on the horizon that will make current technologies and practices obsolete. The good news is that new ...



CFIs in other jurisdictions

	India	Kenya	Britain	South Africa	Seychelles
Worldwide					
68,000 credit unions in 109 countries with	1589 credit union	4 965 credit unions	350 credit unions	26 credit unions	1 credit union
235 million members.	20 million members	5 million members	1.2 million members	33 thousand members	13 thousand members
USD 1.7 trillion assets	Total assets of \$ 50 bn	Total assets of \$ 5 bn	Total assets of \$2 bn	Total assets of \$ 23 mn	Total assets of \$ 15 mn



Credit union assets reach record high but challenges remain

Irish Times - 02 Aug 2018

Assets in Irish credit unions have reached a record high of €17.2 billion, but challenges remain for the sector, according to a new report by the ...



Credit unions improving customers' financial lives with altruistic ...

Inside Tucson Business - 27 minutes ago

In the world of modern banking, it takes a team of talented minds to run a successful credit union. Credit unions, which are non-profit, ...

Challenges

- Attracting new members – diversity of membership
- FinTech developments
- Capacity issues
- Graduating to a co-operative bank or a mutual bank



The role of the PA, FSCA and the CBDA

- Risk-based and proportional supervision
- FSCA – promote financial inclusion, financial education and financial literacy
- CBDA – Capacity building for the sector
- The PA, FSCA and the CBDA will be working together to achieve objectives
- Memorandums of understanding will be finalised with the CBDA and the FSCA to ensure co-operation and collaboration in the regulation, supervision and development of the sector



Conclusion

- Development of a new framework for the regulation and supervision of CFIs
- This engagement will be an opportunity for CFIs to communicate their views on regulation and supervision
- Seen as informal consultation
- Open and honest discussions with evidence based and constructive solutions

Discussion



CFI Stakeholders Workshop

Transitional arrangements for CFIs

Suzette Vogelsang

Head: Banking, Insurance and Financial Market Infrastructure

6 August 2018



South African Reserve Bank

Prudential Authority

Overview of presentation

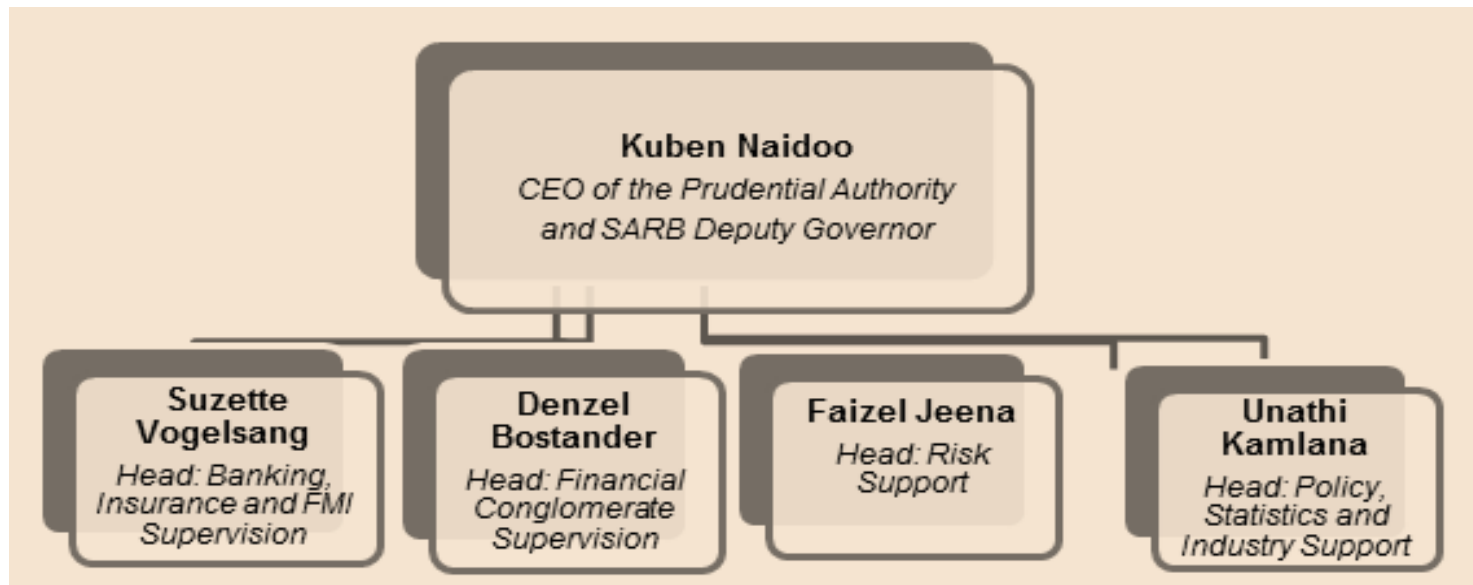
- The Prudential Authority and financial inclusion
- CFIs under the Prudential Authority
- Structure of the Banking, Insurance, FMI Supervision Department
- Old vs New
- CFIs vs Co-operative Bank
- Proposed transitional arrangements
- Standard – transitional arrangements
- Conclusion
- Discussion

The Prudential Authority and financial inclusion

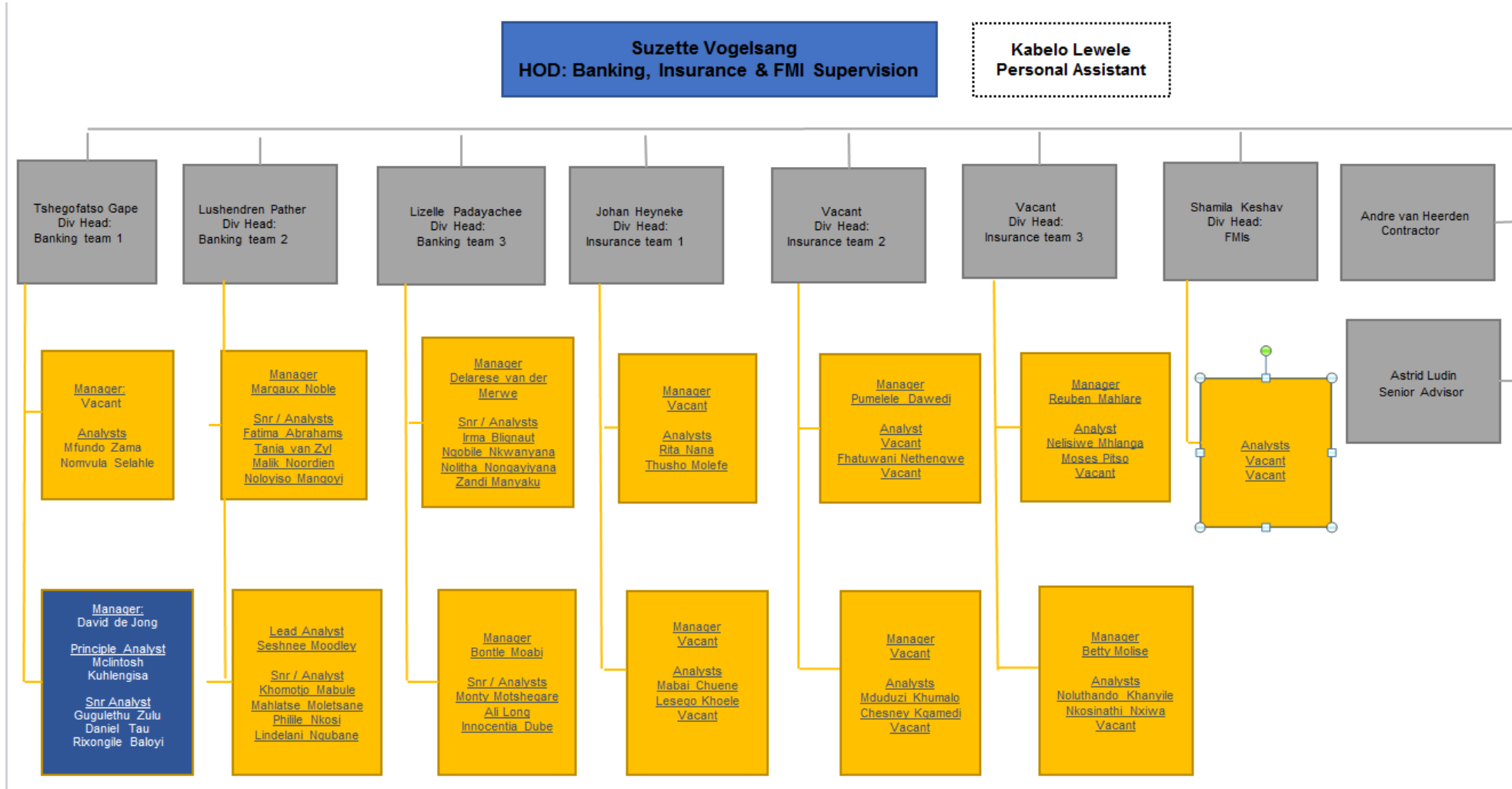
- Financial Sector Regulatory Act (FSRA) establishes a regulatory and supervisory framework that promote, amongst others –
 - ✓ financial inclusion
 - ✓ transformation of the financial sector
 - ✓ confidence in the financial sector
- FSRA also requires that the PA must support financial inclusion
- CFIs to be include through amendments to the Co-op Banks Act
- CFIs previously supervised by the CBDA (located at the National Treasury)
- Supervisory staff of the CBDA are now employed by the PA
- Supervision to fall within the Banking, Insurance and FMI Supervision Department

CFIs under the Prudential Authority

- Management structure of the Prudential Authority
- Role of HoDs with the Prudential Authority



Structure of the Banking, Insurance and FMI Supervision Department



Old versus new

Exemption notice	Co-operative Banks Act
Registration with the CBDA	Register with the PA
Rules for registration	FSRA - Registration
Prudential requirements	Prudential Standards
Moral suasion to rectify	Authority to sanction, impose fines
Deregistration from CBDA	Legislative power to oversee closure and liquidation in terms of FSRA
Limited conduct supervision	Work with FSCA – conduct matters and with the CBDA on capacity building
Thresholds – 200 members and R 100 000	Allows criteria to be developed

CFI versus Co-op Bank (Chapter VII)

CFI	Co-op Bank
Lower entry threshold	Higher entry threshold
Has not begun deposit taking	Minimum deposit threshold
Start up: Proportional requirement for human, financial and operational capacity	Established with minimum human, financial and operational capacity
Transitional Standard	Prudential requirements to become standards
Access to NPS via sponsor bank	Direct access to NPS

Proposed transitional arrangement

- Previous situation
 - Currently CFIs registered under the CBDA rules
 - Continue to comply with registration conditions
- 1 August 2018
 - Regulatory power derived from the FSRA to do examinations and supervision
 - Continue to comply with CBDA rules and registration requirements until transitional arrangement standard is approved.
 - Current registration will remain valid based on compliance with CBDA Rules until new applications received are finalised by the authority.
 - New applications will need to wait until the transitional standard is approved.



Prudential standard – Transitional arrangements

Standard is being developed based on CBDA Rules – formal consultation will occur

- Application to register a CFI with the Authority – form converted from CBDA form
- Reporting on financial performance and prudential requirements – quarterly
- Changes to constitution
- Thresholds to apply as a co-operative bank
- Maximum limits of deposits for CFI
- Alternative capital
- Prudential and operational requirements
- Fit and proper directors and management
- Inspections of CFI – Financial Sector Regulation Act
- Non-compliance with standards – Financial Sector Regulation Act



Conclusion

- CFIs should consider the draft standard on transitional arrangements when it is published for consultation.
- Comments on the standard can be sent to the PA.
- This session is an opportunity for engagement on the sector and its safety and soundness.

Discussion



CFI Stakeholders Workshop

Proposed framework for the regulation and supervision for CFIs

David de Jong and Kalai Naidoo

6 August 2018



South African Reserve Bank

Prudential Authority

- Provisions of the Co-operative Banks Act
 - ✓ Purpose
 - ✓ Registration
 - ✓ Thresholds, suspension, de-registration and winding-up
- Proposed CFI framework
- Conclusion

Provisions of the Co-operative Banks Act - Purpose

- Co-operative Banks Act
 - ✓ To promote and advance the social and economic welfare of all South Africans by enhancing access to banking services under sustainable conditions
 - ✓ to promote the development of sustainable and responsible co-operative banks and CFIs
 - ✓ to establish an appropriate regulatory framework and regulatory institutions for co-operative banks and CFIs that protect members of co-operative banks and CFIs
 - ✓ to provide for the registration of deposit-taking financial services co-operatives as co-operative banks and CFIs
 - ✓ to provide for the regulation and supervision of co-operative banks and CFIs and
 - ✓ to provide for the establishment of co-operative banks supervisors and a development agency for co-operative banks; and to provide for matters connected therewith



Provisions of the Co-operative Banks Act - Registration

- Application for registration as CFI
 - ✓ must apply to the PA, on the application form as prescribed and submit copies of documents and any other information as prescribed
- Requirements for registration
 - ✓ Qualify for registration/continued to be registered, a CFI must demonstrate on an ongoing basis that it has sufficient human, financial, requisite experience, knowledge, qualifications and competence to give effect to its obligations and operational capacity to function efficiently and competently.
 - ✓ it meets any prescribed threshold requirements in respect of membership, shares and deposits held; and any other applicable prescribed requirements
 - ✓ A CFI must, once it has reached a prescribed amt of members' deposits, apply for registration as a co-operative bank in terms of Co-op Bank Act.
 - ✓ From 1 August 2018, a CFI that qualifies to be registered in terms of this Act must apply for registration within 12 months

Provisions of the Co-operative Banks Act – Thresholds, suspension, de-registration and winding-up

- A CFI holds members' deposits exceeding a prescribed threshold, but which does not qualify to be registered as a co-op bank, must not hold members' deposits exceeding an amount determined by the PA - general threshold
- Suspension of registration or de-registration – The PA may de-register or, where appropriate, suspend the registration of a CFI where the PA is satisfied that the CFI
 - ✓ has not commenced operating as a CFI six months after the date of its registration as a CFI
 - ✓ has ceased to operate
 - ✓ obtained registration through fraudulent means
 - ✓ no longer meets the requirements for registration
 - ✓ is unable to meet or maintain its prudential requirements referred to in section 40B
 - ✓ has failed to comply with any condition imposed under this Act
 - ✓ has failed to comply with any directive issued under this Act
 - ✓ or is de-registered or wound-up under the Co-operatives Act
- Repayment of deposits on de-registration or lapsing of registration
- Winding-up or judicial management of CFI

Proposed CFI framework

- In August 2017 – A CFI working group comprising CBDA and PA was established
- Mandate to develop:
 - Supervisory framework
 - Prudential standards
- This is done by
 - Considering the legislative requirements (FSR Act and Co-op Bank Act)
 - Doing an international scan – ICURN report
 - Considering international best practice and or standards
 - Making recommendations
- Focus on
 - Meeting objectives of the applicable legislation
 - Applying proportionality
 - Progressive realisation of requirements

[Standards | Define Standards at Dictionary.com](https://www.dictionary.com/browse/standards)

<https://www.dictionary.com/browse/standards> ▼

Standard, criterion refer to the basis for making a judgment. A standard is an authoritative principle or rule that usually implies a model or pattern for guidance, by comparison with which the quantity, excellence, correctness, etc., of other things may be determined: She could serve as the **standard** of good breeding.



South African Reserve Bank
Prudential Authority

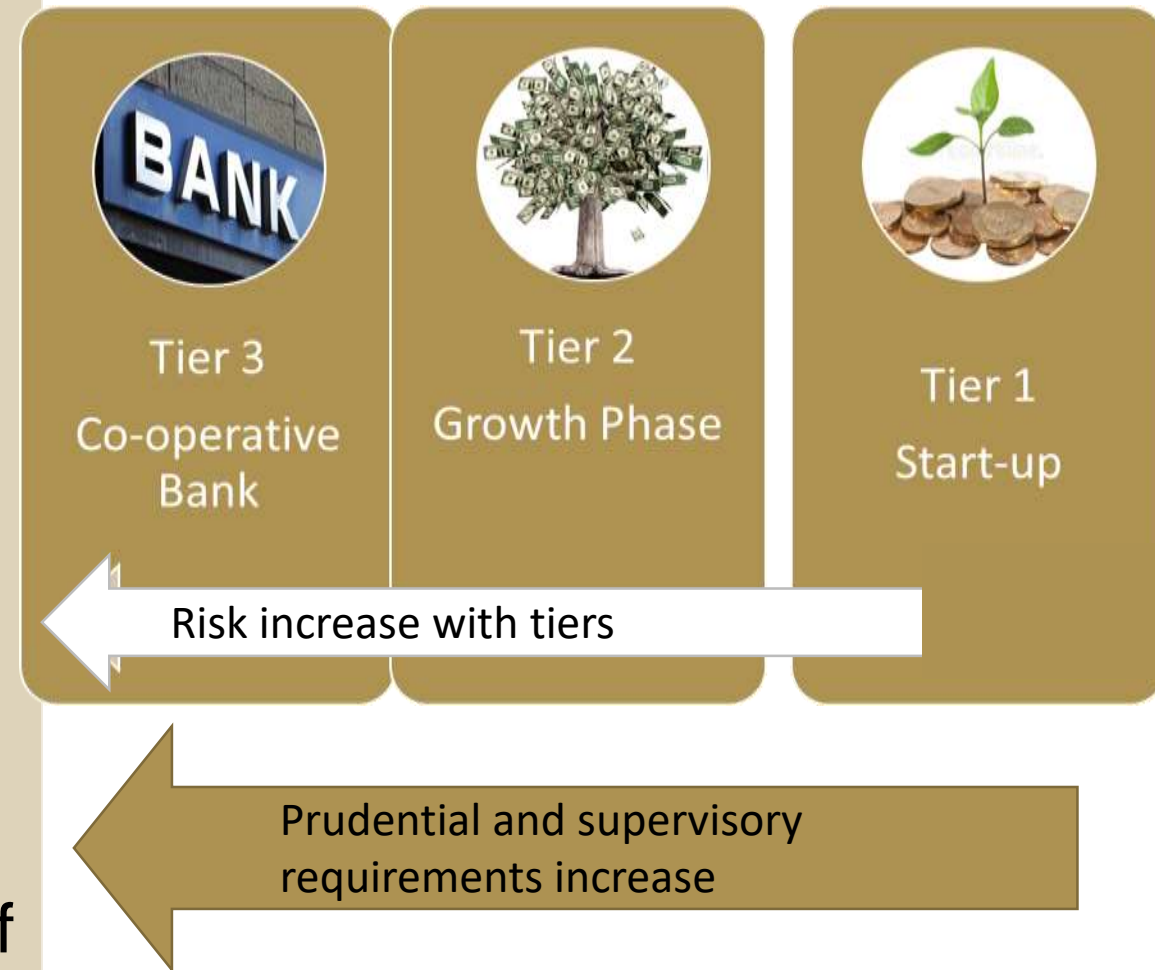
Proposed CFI framework

- This proposed framework accommodates
 - entrance of new CFIs
 - adopts a failure tolerance level, taking cognisant of the developmental nature of nascent CFIs
 - takes into consideration the PA's function to support financial inclusion
 - registration will be premised on business viability and feasibility of the individual applications



Proposed CFI framework

- The framework accommodates three tiers of CFIs/Co-op Banks, with the level of regulatory and supervisory oversight and complexity increasing with each tier.
- Tier 1 (start-up CFIs)
- Tier 2 (growth-phase CFIs)
- Tier 3 (Co-operative Banks)
- No expectation you must move to the next tier as long as you happy within your tier
- Should metrics increase into the next tier, it will be required to comply with the supervision and regulatory requirements of that tier.



Proposed CFI Framework

Table 1: Proposals for Minimum Registration Requirements for CFIs and Co-operative Banks			
	CFIs		Co-operative Banks
	Tier 1 (Start Up)	Tier 2 (Growing)	Tier 3 (Established)
Deposits	R100 to R2 million	R 2 million- to R50 million*	R5 million+ Must apply once R5 million is reached
Members	Min of 100	Min of 100	Min 100
Capital	R200,000 (equally contributed by members according to the constitution)	Min of R200,000 or Risk adjusted CAR of 6% (whichever is the greater of the two)	Risk adjusted CAR of 6%
Common Bond	Single common bond	Common bond can be expanded to up to three (3) subject to PA approval	Multiple Common bonds permitted subject to PA approval

Proposed CFI framework

External Borrowing	To be determined on a case by case basis by PA, and if approved, subject to specific conditions		
Activities	<ul style="list-style-type: none"> • Member Deposit Products • Member Loans (personal) • Prescribed investments • Member Shares 	<ul style="list-style-type: none"> • Member Deposit Products • Member Loans (personal +business) • Prescribed Investments • Member Shares *Additional products subject to PA approval 	<ul style="list-style-type: none"> • Member Deposits • Member Loans (including mortgages, vehicle financing, business) • Prescribed and additional Investments subject to PA approval) • Member Shares
Governance and operational requirements	To be applied proportionally subject to the nature, scale and complexity of the CFI/Co-operative Bank		

Conclusion

- The proposed framework will be captured in prudential standards
- Operational, risk management, governance and financial soundness standards
- Opportunity to contribute to the development of the standards to ensure a sector that achieves the object of the Co-operative Banks Act

Discussion

