Cooperative Banks Annual Report 2015/16

South African Reserve Bank

Mission

Promote the soundness of the cooperative banking sector through the effective regulation and supervision of cooperative banks in the interests of their members and the economy.

Regulatory philosophy

The Supervisor of Cooperative Banks (Supervisor) follows a coordinated approach with stakeholders to ensure the consistent application of the Cooperative Banks Act 40 of 2007; to ensure the safety, soundness and stability of cooperative banks; to protect depositors; and to circumvent regulatory arbitrage.

The Supervisor's objective is to apply appropriate regulatory and supervisory standards to cater for the unique needs of the domestic cooperative banking sector.

The Supervisor operates through a relationship of mutual trust and cooperation with all role players in an effort to enhance and promote the accessibility of sound financial services to all South Africans.

Cooperative Banks Annual Report 2015/16 for the financial year ended 31 March 2016 in terms of section 52 of the Cooperative Banks Act 40 of 2007

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Contents

Figures

Tables

Abbreviations

Chapter 1: Introduction and the overview of the Supervisor of Cooperative Banks

1.1 Introduction

The *Cooperative Banks Annual Report 2015/16* begins with an overview of the organisational developments at the South African Reserve Bank (SARB) in the period under review. Chapter 2 provides data and an analysis of the aggregated information of cooperative banks, while Chapter 3 provides an overview of the interactions with stakeholders during that time.

1.2 Overview

The total assets of cooperative banks exceeded R100 million for the first time in the period under review. The combined results of the two registered cooperative banks have continued to increase every year on a year-on-year basis since their registration, as has their performance.

The total income of the cooperative banking sector increased by 14,4 per cent from R10,2 million at the end of February 2015 to R11,7 million at the end of February 2016. Total assets increased by 13,1 per cent during the period, from R95,0 million to R107,4 million, which was mainly driven by growth in loans. Total capital also increased, by 30,1 per cent, from R9,7 million as at 28 February 2015 to R12,6 million as at 29 February 2016, which was attributed to increased retained earnings and reserves. The capital adequacy ratio (CAR) of the cooperative banking sector increased from 8,1 per cent at the end of February 2015 to 9,5 per cent at the end of February 2016, which was well above the required 6,0 per cent.

1.3 Organisational developments at the South African Reserve Bank

1.3.1 Introduction

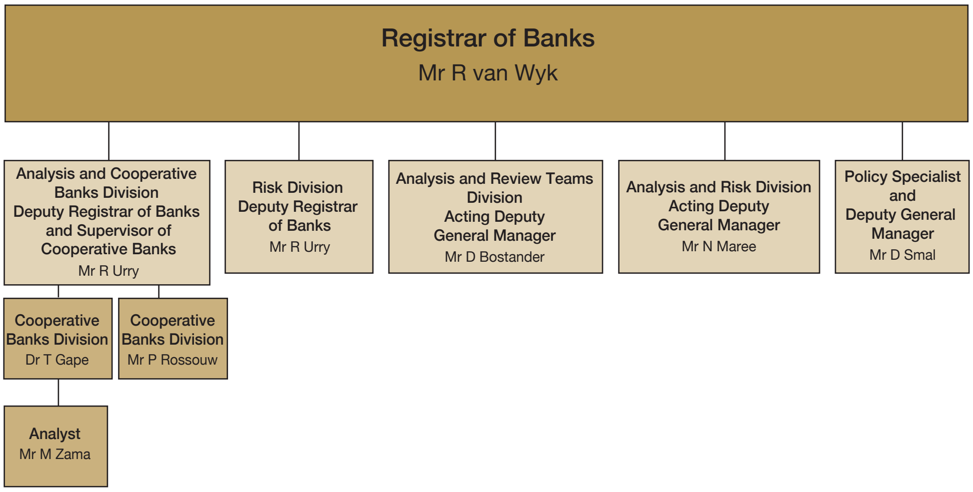
The previous Supervisor of Cooperative Banks (Supervisor) and an Analyst resigned during the period under review, and suitable successors were appointed.

1.3.2 Structure of the South African Reserve Bank

The Supervisor has the authority to exercise the powers and perform the functions afforded by the Cooperative Banks Act 40 of 2007 (Cooperative Banks Act). Mr N Mashiya, who was the Supervisor as well as the Deputy Registrar of Banks in terms of the Banks Act 94 of 1990 (Banks Act), resigned from the SARB in August 2015. He was replaced by Mr R Urry. During the period under review, Mr Urry was assisted by Mr P Rossouw and Dr T Gape, who had regulatory and supervisory responsibilities respectively. An Analyst resigned from the SARB in July 2015 and the position has since been filled.

The structure of the Cooperative Banks Division at the SARB is expected to change once the Twin Peaks model of financial regulation is implemented through the promulgation of the Financial Sector Regulation Bill. Suitable transitional arrangements are in place to ensure that the SARB continues to discharge its duties under the Cooperative Banks Act.

Figure 1 Structure of the South African Reserve Bank as at 31 March 2016



Chapter 2: Overview of the cooperative banking sector

2.1 Introduction

This chapter provides an overview of the financial performance of the two cooperative banks that make up the cooperative banking sector, for the financial year ended 29 February 2016. Increases and decreases indicate year-on-year fluctuations for the period under review, unless explicitly stated otherwise.

During the year under review, the cooperative banking sector experienced solid growth in its asset base, which was largely supported by growth in deposits, the injection of capital, and the retention of profits. On a year-on-year basis, the total assets of the cooperative banking sector increased by 13,1 per cent and its liabilities increased by 11,2 per cent, driven mainly by an increase in members' deposits. Aggregate profit before taxation increased by 47,0 per cent, primarily due to an increase of 14,4 per cent in total income, while total operating expenses increased by 5,4 per cent.

2.2 Membership and shareholding

Before they can transact with a cooperative bank, customers must first become members (by meeting the eligibility criteria) and purchase membership shares in the cooperative bank. This results in customers becoming both members and owners of the cooperative bank.[1]

The membership of the cooperative banking sector increased by 5,4 per cent from 2 142 as at the end of February 2015 to 2 258 as at the end of February 2016.

Share capital amounted to R736 567 as at 29 February 2016, which was an increase of 5,0 per cent from R701 320 as at 28 February 2015.

Table 1 Membership and share capital in 2014/15 and 2015/16

	2014/15	2015/16	Percentage change (%)
Number of members	2 142	2 258	5,4
Share capital	R701 320	R736 567	5,0

2.3 Balance-sheet analysis

Assets and liabilities in the cooperative banking sector recorded solid growth during the year under review. Total assets increased from R95,0 million to R107,4 million, driven mainly by growth in loans. The growth in liabilities was primarily due to increased member deposits, which accounted for 99,0 per cent of total liabilities. Capital increased in proportion to the rest of the balance sheet and consisted primarily of retained earnings and reserves.

Table 2 provides further detail on the balance sheet of the cooperative banking sector during the period under review.

1 It should be noted that members of cooperative banks do not have a right to the cooperative bank's accumulated retained earnings and reserves, but each member's share value is paid back at nominal value when membership is terminated. It is also important to note that section 24(1) of the Cooperatives Act 14 of 2005 determines that, despite any provisions contained in its constitution, if a cooperative bank determines that the repayment of shares would adversely affect its financial well-being, it may direct that the repayment be deferred for a period not exceeding two years after the effective date of the notice of withdrawal.

Table 2 Balance-sheet growth during the period under review

	28 February 2015 (R)	29 February 2016 (R)	Percentage change (%)
Assets			
Loans	58 773 842	71 300 137	21,3
Liquid assets	31 435 880	31 020 969	-1,3
Fixed assets	1 224 429	1 401 861	14,5
Investments	1 783 846	1 924 772	7,9
Other assets	3 323 710	1 792 005	-46,1
Total assets	96 541 707	107 439 744	11,3
Liabilities and capital			
Liabilities			
Deposits	84 641 004	94 455 907	11,6
Other liabilities	646 861	347 597	-46,3
Total liabilities	85 287 865	94 803 504	11,2
Capital			
Members' shares	701 320	736 567	5,0
Retained income	5 584 409	6 779 321	21,4
Reserves	3 399 532	5 120 350	50,6
Total capital	9 685 261	12 636 238	30,5
Total liabilities and capital	94 973 126	107 439 742	13,1

As at the end of February 2016, 84,6 per cent of the gross loans were long-term loans and 99,0 per cent of the gross loans were secured by collateral in the form of deposits, mortgage bonds and guarantees.

Figure 2 Composition of gross loans as at 29 February 2016

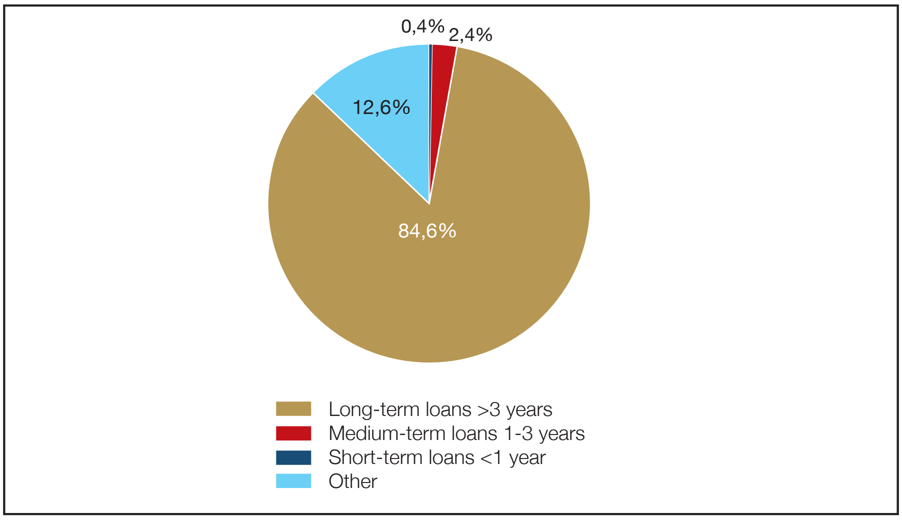
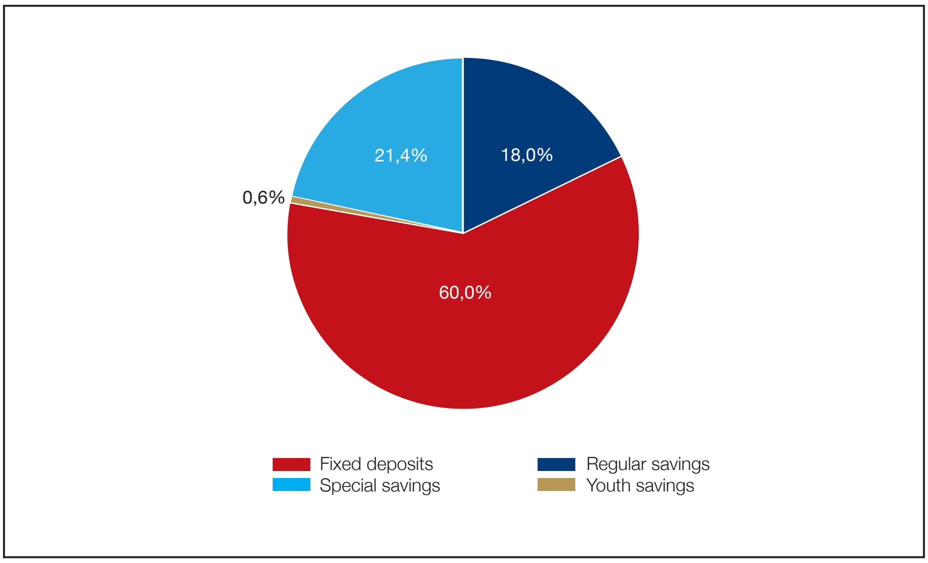


Figure 3 reflects the composition of the cooperative banking sector's deposits as at 29 February 2016 in terms of deposit type. Fixed deposits, which are deposits with maturity dates of up to six years, constituted 60,0 per cent of members' deposits. Special savings, which are funds that have been accumulated during the year for a particular purpose (such as school fees or seasonal expenses), accounted for 21,4 per cent of total deposits. Regular savings are deposits payable on demand and stood at 18,0 per cent. Youth savings, which are savings of people under the age of 21, made up only a fraction of the total savings in the cooperative banking sector.

Figure 3 Composition of deposits as at 29 February 2016



2.4 Capital and capital adequacy

Total capital comprises member share capital, retained earnings, and reserves.

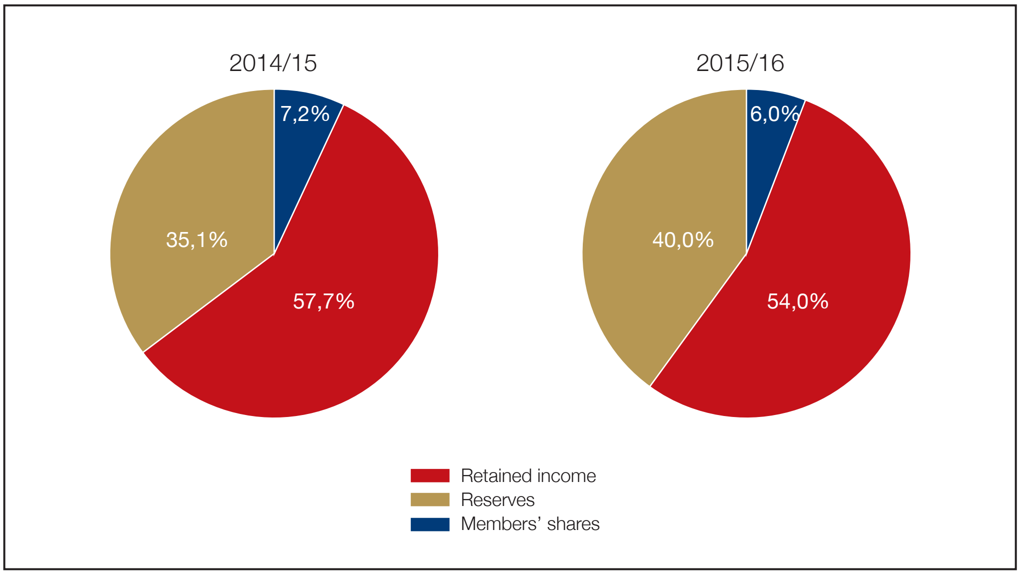
Total capital for cooperative banks increased by 30,5 per cent from R9,7 million as at 28 February 2015 to R12,6 million as at 29 February 2016. This growth was attributable to increased members' shares and a significant increase in retained earnings. The CAR[2] of the cooperative banking sector increased from 8,1 per cent at the end of February 2015 to 9,5 per cent at the end of February 2016.

Table 3 Capital adequacy ratio change during the period under review

	28 February 2015 (%)	29 February 2016 (%)	Percentage change (%)
Required capital adequacy ratio	6,0	6,0	0,0
Actual capital adequacy ratio..........................	8,1	9,5	1,4

2 The capital adequacy ratio is calculated by subtracting the amount of provision made for delinquent accounts from total capital and expressing it as a percentage of total assets. Regulation 4(2) of the Regulations relating to Cooperative Banks allows only members' shares, reserves held in terms of section (3)(1)(e) of the Cooperative Banks Act 40 of 2007, retained income (non-distributable reserves created or increased by appropriations of surpluses but excluding loan-loss provisioning), and non-distributable reserves of a permanent nature, as approved in writing by the Supervisor of Cooperative Banks, to qualify as capital for the purpose of calculating the capital adequacy ratio.

Figure 4 Composition of capital in 2014/15 and 2015/16



2.5 Liquidity

The prudential requirements for liquidity measure the cash and other liquid financial assets that cooperative banks hold to meet their short-term commitments as and when they fall due. Effective liquidity management, which includes both quantitative and qualitative elements, is crucial to the continued viability of cooperative banks and is considered a critical element of the ongoing supervisory oversight of cooperative banks and their obligation to protect depositors.

The average liquidity ratio of the cooperative banking sector exceeded the minimum regulatory requirement of 10,0 per cent of total deposits, at 30,0 per cent for the end of February 2016 (February 2015: 37,0 per cent).

2.6 Asset quality

Delinquent loans accounted for 5,6 per cent of the cooperative banking sector's gross loans at the end of February 2016, a decrease from 6,7 per cent in the previous financial year. The sector continued to provide sufficiently for potential losses in accordance with regulatory requirements during the period under review.

Table 4 Risk classification of loans for the years ended 28 February 2015 and 29 February 2016

	28 February 2015		29 February 2016	
	Amount (R)	Percentage (%)	Amount (R)	Percentage (%)
Non-delinquent loans	54 819 995	93,2	67 277 672	94,4
Delinquent loans between 1 and 6 months................................	2 282 079	3,9	1 910 109	2,7
Delinquent loans between 6 and 12 months..............................	989 500	1,7	718 572	1,0
Delinquent loans >12 months............	682 269	1,2	1 393 784	1,9
Total loans	58 773 843	100,0	71 300 137	100,0

Figure 5 Composition of delinquent loans as at 28 February 2015 and 29 February 2016

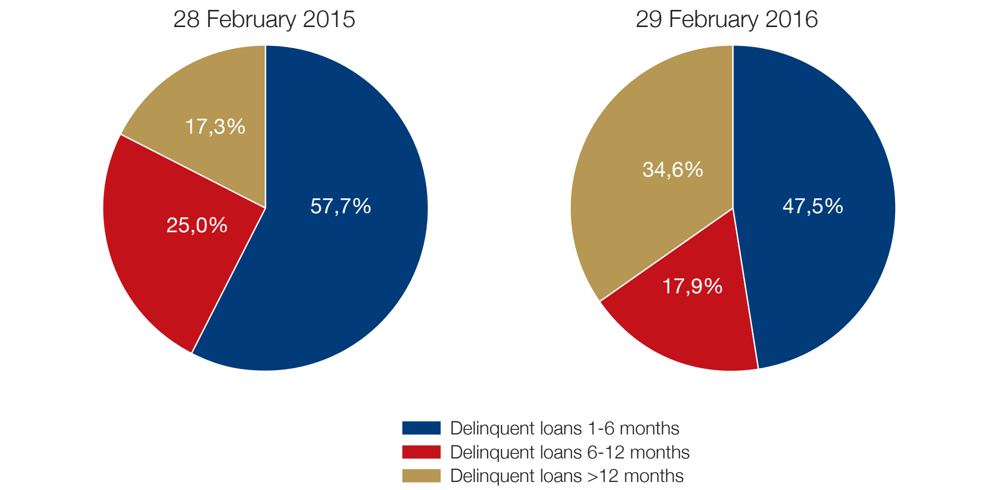


Table 5 Provisions for delinquent loans as at 29 February 2016

	Loans (R)	Regulatory requirement (%)	Provision required (R)	Actual provision (R)
Total loans	71 300 137	2	1 426 002	1 426 002
Delinquent loans between 1 and 6 months	1 910 109	35	668 538	668 538
Delinquent loans between 6 and 12 months	718 572	50	359 286	359 286
Delinquent loans >12 months	1 393 784	100	1 393 784	1 393 784
Total provisioning			3 847 610	3 847 610

2.7 Income-statement analysis

2.7.1 Profitability

The cooperative banking sector remained profitable in the year under review, with income before taxation increasing by 47,0 per cent from R1,4 million at the end of February 2015 to R2,1 million at the end of February 2016, driven significantly by increased interest income on loans.

The cooperative banking sector's return on assets was 1,9 per cent at the end of February 2016 compared to 1,5 per cent at the end of February 2015; its return on equity was 16,5 per cent at the end of February 2016 compared to 14,7 per cent at the end of February 2015. The cost-to-income ratio decreased to 45,9 per cent at the end of February 2016 from 54,1 per cent at the end of February 2015.

2.7.2 Income

The total income of the cooperative banking sector increased by 14,4 per cent from R10,3 million at the end of February 2015 to R11,7 million at the end of February 2016. This was driven primarily by increased interest income, which accounted for 91,8 per cent of the cooperative banking sector's total income for the 2015/16 financial year, down by 0,2 per cent from the 92,0 per cent recorded in 2014/15.

2.7.3 Expenses

The total expenses of the sector increased by 9,1 per cent from R8,8 million at the end of February 2015 to R9,6 million at the end of February 2016.

Table 6 Income and expenditure in 2014/15 and 2015/16

	2014/15		2015/16	
	Rand (R)	Percentage of total income (%)	Rand (R)	Percentage of total income (%)
Interest income	9 413 034	91,8	10 733 685	91,6
Non-interest revenue	840 786	8,2	997 865	8,4
Total income	**10 253 820**		**11 731 550**	
Interest expenses	5 637 197	55,0	5 998 612	51,1
Operating income	**4 616 623**		**5 732 938**	
Provision for loans	**697 680**	**6,8**	**1 010 333**	**8,6**
Operating expenses	**2 498 294**	**24,4**	**2 633 449**	**22,4**
Personnel	1 480 304	14,4	1 544 344	13,2
Governance	346 413	3,4	331 392	2,8
Marketing	9 630	0,1	476	0,0
Administration	498 332	4,9	609 198	5,2
Auditing	140 649	1,4	132 434	1,1
Depreciation	22 966	0,2	15 605	0,1
Total expenses	**8 833 171**	**86,1**	**9 642 394**	**82,2**
Operating profit/income before taxation	**1 420 649**	**13,9**	**2 089 157**	**17,8**

2.8 Performance rating

The Supervisor applies the Capital Adequacy, Asset Quality, Management Quality, Earnings and Liquidity (CAMEL) rating system to assess the soundness of cooperative banks. At the end of February 2016, one cooperative bank was assigned an overall rating of 3, denoting 'fair', while the other cooperative bank was assigned a rating of 2, denoting 'satisfactory'.

2.9 Inherent risks

The risks inherent to the cooperative banking sector include credit risk, liquidity risk, interest rate risk, operational risk, legal and compliance risk, strategic risk as well as reputational risk. During the year under review, cooperative banks continued to improve in all risk areas, with adequate risk management policies and strategies in place to meet regulatory and reporting requirements.

Chapter 3: Interaction with stakeholders

Besides conducting formal on-site visits to cooperative banks, the Supervisor is expected to participate in the activities of international bodies and authorities whose main purpose is to develop, advance, and promote the sustainability of cooperative banks, and to cooperate with these international bodies and authorities in respect of matters relating to cooperative banks.[3]

The Supervisor undertook five on-site visits to cooperative banks during the period under review. These visits focused on ensuring compliance with regulatory standards. The subsequent reviews undertook to ensure that systems, processes and relevant risk frameworks were in place and functioning as they should be.

The on-site visits focused on other areas too, including the boards of directors and their effectiveness and subcommittees, and ensuring that policies were up to date and adhered to.

Between 12 and 17 July 2015, a member of the supervisory team attended the Annual World Council of Credit Unions Conference and the International Credit Union Regulators' Network Conference, both in Denver, Colorado. Members of cooperative financial institutions (CFIs) from across the globe dealt with topics such as leveraging operational data, changes, trends, and best practice to build a successful rewards programme; mobile devices and the reshaping of banking and fraud; risk-based capital and supplemental capital for credit unions; developments in anti-money laundering compliance and the Financial Action Task Force; and the reinvention and repositioning of credit unions. Union regulators from all over the world met to gain a global perspective on regulatory issues and best practice, and to discuss issues common among peers in a closed forum. Emerging risks from different regions were also explored.

From 15 to 16 October 2015, the supervisory team attended the 5th Annual Cooperative Banks Indaba in Bloemfontein. Delegates came from different spheres of government, business, and the cooperative banking sector at large. The indaba covered a wide range of topics, including the impact of the CFI movement in South Africa, the relevance of the CFI model in the modern African economy, and the requirements to build viable, competitive and sustainable CFIs.

3 As prescribed by section 55(2) of the Cooperative Banks Act 40 of 2007

Abbreviations

Banks Act	Banks Act 94 of 1990
CAMEL	Capital Adequacy, Asset Quality, Management Quality, Earnings and Liquidity
CAR	capital adequacy ratio
CFI	cooperative financial institution
Cooperative Banks Act	Cooperative Banks Act 40 of 2007
Dr	Doctor
ISSN	International Standard Serial Number
Mr	Mister
R	rand
SARB	South African Reserve Bank
Supervisor	Supervisor of Cooperative Banks