Combined Annual Report of the Supervisors of the Co-operative Banks Development Agency and the South African Reserve Bank

2011/12

CO-OPERATIVE BANKS DEVELOPMENT AGENCY

South African Reserve Bank

Mission

For the Supervisor in the Co-operative Banks Development Agency (CBDA) to focus primarily on the registration and development of sustainable and responsible co-operative banks and, together with the Supervisor in the South African Reserve Bank (SARB), to promote the soundness of the co-operative banking sector through effective regulation and supervision of co-operative banks in the interests of their members and the economy.

Business philosophy

The Supervisors of co-operative banks, appointed by the CBDA and the SARB, follow a co-ordinated approach to ensure the consistent application of the Co-operative Banks Act, 2007 (Act No. 40 of 2007) (the Act), and to circumvent regulatory arbitrage. The Supervisors' objective is to gain a proper understanding of the operation of co-operative banks, and to apply and, where necessary, adapt international regulatory and supervisory standards to cater for the unique needs of the domestic co-operative banking sector. The Supervisors operate through a relationship of mutual trust and co-operation with all role-players in an effort to promote and enhance the accessibility of sound financial services to all South Africans.

Combined Annual Report of the Supervisors of the Co-operative Banks Development Agency and the South African Reserve Bank for the financial year ended 31 March 2012 in terms of section 52 of the Co-operative Banks Act, 2007 (Act No. 40 of 2007).

ISSN (print): 2223-9154
ISSN (online): 2223-9162

Available on the Internet at: http://www.reservebank.co.za and http://www.treasury.gov.za/coopbank/

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Chapter 1: Introduction and the Supervisors' overview

1.1 Introduction

In this *Combined Annual Report of the Supervisors of the Co-operative Banks Development Agency and the South African Reserve Bank (Combined Annual Report*), the Supervisor in the Co-operative Banks Development Agency (CBDA) and the Supervisor in the South African Reserve Bank (SARB) report on the exercise and performance of their powers and functions in terms of section 52 of the Co-operative Banks Act, 2007 (Act No. 40 of 2007) (the Act).

Chapter 1 provides an overview of the organisational developments in the SARB and the CBDA, and the most notable developments in the co-operative financial institution (CFI) sector during the year under review.

An analysis of the aggregated information of the emerging co-operative banking sector, which comprises only two registered co-operative banks, is provided in Chapter 2. Although both co-operative banks are solvent, additional capital is required by one of them to reach the minimum regulatory requirement. The overall risk exposure of the sector was moderate and stable for the year under review.

Chapter 3 provides an overview of the most prominent regulatory developments during the period under review, including an examination of the Act, the Financial Services Laws General Amendment Bill, the Co-operatives Amendment Bill, and the exemption notices issued in terms of the Banks Act, 1990 (Act No. 94 of 1990) (the Banks Act, 1990). The international developments impacting on the domestic co-operative banking sector are also discussed.

In Chapter 4 the Supervisors' report on the implementation of their Co-operation and Co-ordination Plan for the 2011/12 financial year is presented in accordance with section 42 of the Act. The Supervisors' Co-operation and Co-ordination Plan for the 2012/13 financial year is also presented and the activities of the CBDA's Regulatory and Oversight Advisory Committee (ROAC) are discussed.

Finally, the matters that require specific attention during the 2012/13 financial year are identified and discussed in Chapter 5. Such matters include the potential consequences of the proposed amendments to the Act which, if approved by Parliament, would result in the SARB being the sole supervisor of co-operative banks. Issues concerning deposit insurance, the Appeals Board, a twin peaks model for financial regulation, potential abuse of the Act and the application of the Core Principles for Effective Banking Supervision (the Core Principles) on microfinance activities are also discussed in Chapter 5.

1.2 Organisational developments

1.2.1 Introduction

The CBDA and the SARB established separate co-operative banks supervision units to consider applications for registration as co-operative banks, and to regulate and supervise these co-operative banks once registered. The CBDA also established a capacity-building unit, the primary aim of which is to assist CFIs in meeting the requirements for registration as co-operative banks. All applications received by the supervision units that are rejected for registration as co-operative banks are referred to the CBDA Capacity Building Unit. However, as deposit-taking institutions, such applicant CFIs continue to operate under Banks Act Exemption Notice No. 887 and Exemption Notice No. 1176 (the Exemption

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Notices),[1] and are therefore still regulated by their respective self-regulatory bodies, namely the Savings and Credit Co-operative League of South Africa (SACCOL) and the South African Microfinance Apex Fund (samaf). The current organisational structures for the regulation and supervision of cooperative banks in the CBDA and the SARB are discussed below.

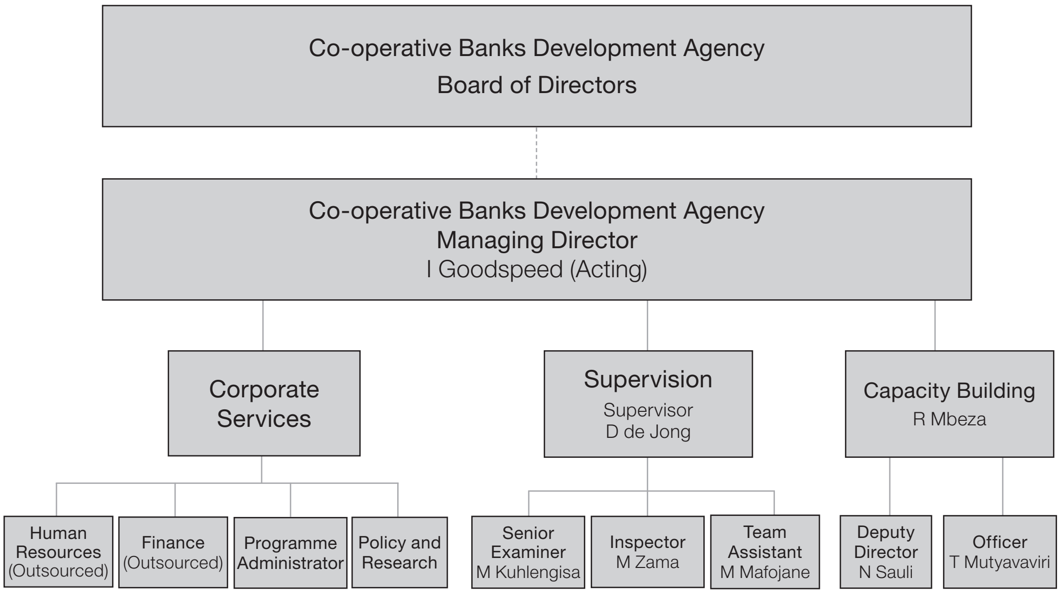
1.2.2 Structure of the Co-operative Banks Development Agency

As explained in greater detail in the 2010/11 *Combined Annual Report,*[2] the CBDA was established to accredit representative bodies and support organisations, and to supervise and regulate primary co-operative banks with deposits of between R1 million and R20 million and with at least 200 members.

The Minister of Finance is the executive authority of the CBDA and appointed the CBDA Board of Directors (the Board) to manage and guide the activities of the CBDA in terms of section 58 of the Act. With the approval of the Minister of Finance, the Board appointed a Managing Director of the CBDA to manage the CBDA's day-to-day affairs, and a Supervisor of Co-operative Banks to exercise regulatory and supervisory powers and functions in accordance with the Act.

The regulatory and supervisory function of the CBDA is located in the CBDA Supervision Unit. The CBDA Supervision Unit is headed by the Supervisor, Mr D de Jong, appointed by the Minister of Finance in 2009, and is supported by one Senior Examiner, Mr M Kuhlengisa, and one Inspector, Mr M Zama. Secretarial support and assistance are provided by Ms M Mafojane. The current structure of the CBDA is depicted in Figure 1.

Figure 1 Structure of the Co-operative Banks Development Agency



Two additional posts have been created in the CBDA Supervision Unit for the next financial year in anticipation of the CBDA's mandate being extended to include the registration and monitoring of all CFIs currently operating in terms of the above-mentioned Exemption Notices.

1 Exemption Notice No. 887 was published in *Government Gazette* No. 31342 dated 22 August 2008 and Exemption Notice No. 1176 was published in *Government Gazette* No. 29412 dated 1 December 2006. Refer to section 3.5 of this *Combined Annual Report* for more information regarding the Exemption Notices.

2 Available at http://www.resbank.co.za/Publications/Reports/Pages/CombinedAnnualReport.aspx. and http://www.treasury.gov.za/coopbank/publications.

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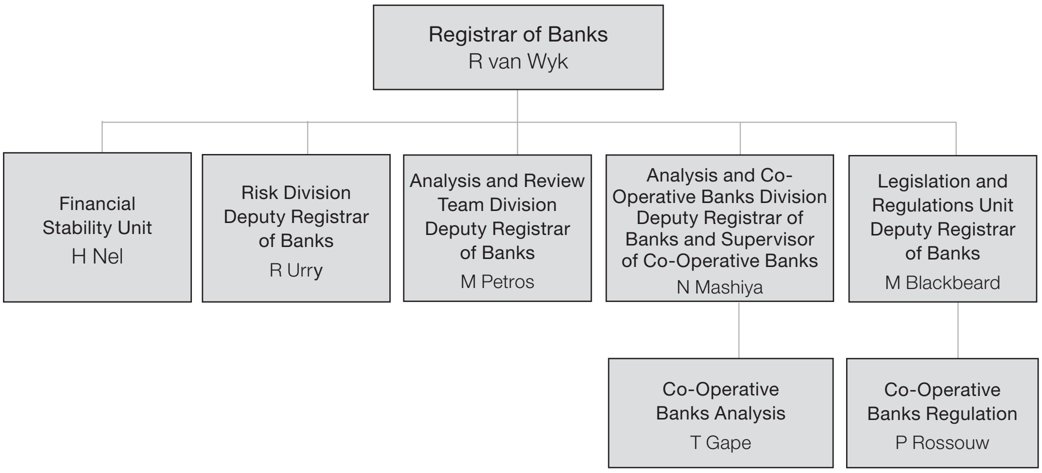
1.2.3 Structure of the South African Reserve Bank

The SARB Supervisor has the authority to exercise the powers and perform the functions afforded by the Act in respect of primary co-operative banks that hold deposits in excess of R20 million, secondary co-operative banks and tertiary co-operative banks.[3] On 13 December 2011, the Minister of Finance approved the appointment of Mr N Mashiya as the Supervisor of Co-operative Banks, following Ms Y Singh's retirement in October 2011. Mr P Rossouw and Dr T Gape were employed to assist the Supervisor with the respective regulatory and supervisory responsibilities in accordance with the Act. The primary functions in this regard include the effective use of powers to enforce compliance with legislation and to supervise co-operative banks effectively through on- and off-site supervision.

Figure 2 Structure of the South African Reserve Bank



1.3 The financial co-operatives sector

1.3.1 Introduction

Registered co-operative banks, financial services co-operatives (FSCs) and savings and credit co-operatives (SACCOs) operating under the Exemption Notices comprise the CFI sector in South Africa. *Stokvels*[4] are not regarded as CFIs. CFIs operating under the Exemption Notices could potentially be allowed to register as co-operative banks in future. To date, of the 18 CFIs that had to apply to register as co-operative banks in terms of section 3 of the Act,[5] only 2 qualified, namely Ditsobotla Primary Savings and Credit Co-operative Bank Limited (Ditsobotla) and OSK Koöperatiewe Bank Beperk (OSK).

1.3.2 Features of the co-operative financial institution sector

As at 29 February 2012, there were 106 CFIs with a total of R217,5 million worth of assets and 53 240 members. As highlighted in Table 1, CFIs with deposits of R1 million or more comprised 20 per cent of the CFI sector and held 93 per cent of the CFI sector's total assets during the period under review. An estimated 10 per cent of the smaller CFIs are regarded as being inactive.

3 The members of secondary or tertiary co-operatives must either consist of at least two or more co-operative banks; two or more CFIs that take deposits; or one co-operative bank and one CFI that takes deposits.

4 A *stokvel* is essentially a savings club where members contribute fixed amounts of money on a regular basis, normally either weekly, fortnightly or monthly. The total amount of money collected for the specific period is then paid to members on a revolving basis. Members rarely default on their contributions as they know they will forfeit their turn to receive payment.

5 Section 3 of the Act stipulates that if a CFI holds deposits of at least R1 million and has at least 200 members, it is obliged to apply for registration as a co-operative bank.

Table 1 Classification of sector assets by size of co-operative financial institutions

CFIs*	Deposits	Number of CFIs	Total sector assets (per cent)
Very large	> R20 million	3	61
Large	R1 million – R20 million	18	32
Small	R150 000 – R1 million	13	5
Very small	< R150 000	72	2
		106	100

* Including the two registered co-operative banks

During the year under review, the Supervisors focused primarily on CFIs that met the minimum requirements for registration as co-operative banks, that is, more than R1 million in member deposits and at least 200 members. Details of these CFIs are reflected in Table 2.

Table 2 Consolidated statistics for eligible co-operative financial institutions as at 29 February 2012*

CFI	Type	Province	Members	Deposits (R)	Loans (R)	Total assets (R)
OSK	Co-operative bank	Northern Cape	593	48 986 108	36 382 615	54 021 899
Ditsobotla	Co-operative bank	North West	980	6 523 744	5 515 084	7 569 026
Total co-operative banks			1 573	55 509 852	41 897 699	61 590 925
Oranjekas	SACCO	Gauteng	732	38 684 394	27 301 589	41 179 597
Kleinfontein	SACCO	Gauteng	356	36 673 229	32 778 407	37 443 039
Kathorus	SACCO	Gauteng	1 911	10 458 640	6 174 568	9 889 423
Motswedi	FSC	North West	3 632	7 121 614	202 000	8 284 101
National Education, Health and Allied Workers Union (NEHAWU)	SACCO	National	4 536	7 106 412	4 623 715	6 473 097
Sibanye	SACCO	Western Cape	3 002	5 389 434	5 033 546	6 358 548
South African Municipal Workers Union	SACCO	National	2 267	5 066 731	1 866 609	5 317 959
Flash	SACCO	Western Cape	4 845	1 832 277	316 483	4 634 780
Ziphakamise	SACCO	KwaZulu Natal	480	3 071 787	1 556 944	4 059 632
Central Finance Facility	SACCO	National	34	2 898 007	2 404 422	3 442 571
Lotlhakane FSC	FSC	North West	1 251	1 538 638	72 030	2 275 161
Mathabatha	FSC	Limpopo	2 191	1 682 638	957 972	1 954 670
Kraaipan	FSC	North West	1 392	3 551 207	212 500	1 907 663
Mayibuye	SACCO	Eastern Cape	223	1 315 290	1 054 126	1 475 283

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Table 2 Consolidated statistics for eligible co-operative financial institutions as at 29 February 2012* (continued)

CFI	Type	Province	Members	Deposits (R)	Loans (R)	Total assets (R)
Boikago	SACCO	North West	671	1 182 365	935 440	1 460 830
K Ladies Empower	FSC	KwaZulu Natal	528	1 003 474	383 125	1 407 841
Disaneng	FSC	North West	495	1 451 752	191 775	1 034 577
Beehive	SACCO	Mpuma-langa	1 056	1 235 261	561 075	824 631
Lehurutshe	FSC	North West	306	1 176 242	209 797	808 744
Total SACCOs and FSCs			29 908	132 439 392	86 836 123	140 232 147
Total			31 481	187 949 244	128 733 822	201 823 072

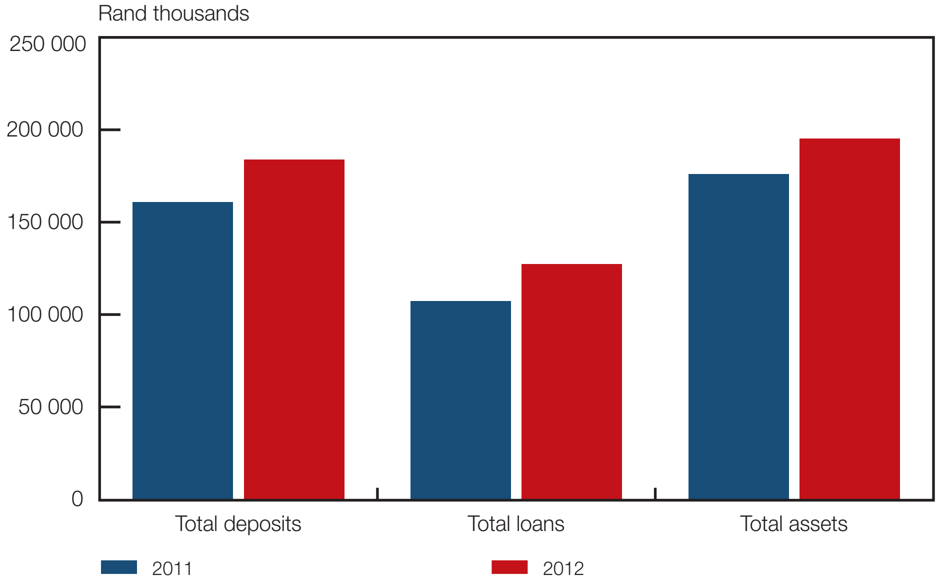
* Statistics were collated from compliance reports submitted to self-regulatory bodies SACCOL and samaf, and the CBDA Capacity Building Unit

During the year under review three additional eligible CFIs were identified and an eligible CFI registered as a co-operative bank, bringing the number of co-operative banks to two and the number of eligible CFIs to nineteen. The three additional eligible CFIs are yet to apply for registration as co-operative banks according to section 3 of the Act.

Membership of co-operative banks and eligible CFIs increased by 12,5 per cent from 28 034 members to 31 481 members year on year. The increase was driven by significant growth in membership numbers at three CFIs, namely Nehawu, Sibanye and Flash, and an increase in the number of eligible CFIs.

Deposits of the two co-operative banks and nineteen eligible CFIs increased by 17 per cent to R187,9 million during the year under review, from R161 million in the previous year. This was due to the larger institutions showing strong deposit growth.

Figure 3 Consolidated statistics for eligible co-operative financial institutions



Total net loan levels increased by 20 per cent year on year and totalled R129 million at the end of February 2012.

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1.3.3 Assessments of eligible co-operative financial institutions

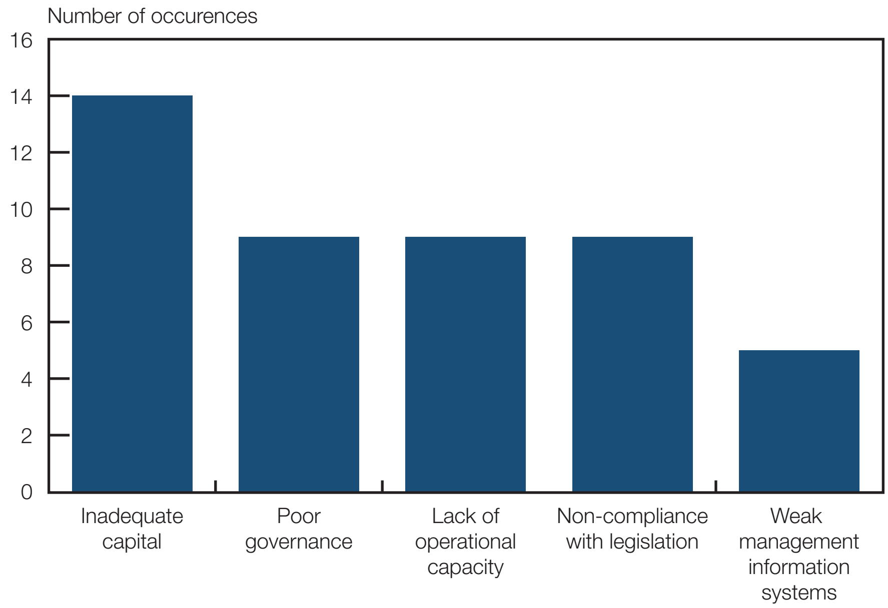
As already mentioned, the Supervisors primarily focused on CFIs that became eligible for registration as co-operative banks during the year under review. However, none of the applicant CFIs that were assessed during the 2011/12 financial year managed to address the weaknesses pointed out by the Supervisors sufficiently and did therefore again not qualify for registration as co-operative banks.

Institutional assessments[6] were jointly conducted by the CBDA's Capacity Building and Supervisory units in respect of three eligible CFIs that had not applied for registration, but that met the minimum registration criteria. The CBDA Capacity Building Unit is in the process of providing these three CFIs with developmental support to assist them in qualifying for registration as co-operative banks.

A further three CFIs were found to be insolvent following joint investigations conducted by samaf and the CBDA Supervisor. The CBDA Supervisor recommended that these CFIs be liquidated. However, the provincial Departments of Economic Development elected to rehabilitate these CFIs. As a result, the CBDA Supervisor will only liquidate these CFIs should the identified interventions not be provided in a timely manner. This will be done to protect the depositors and maintain confidence in the CFI sector.

The weaknesses preventing eligible applicant CFIs from registering as co-operative banks were highlighted in the Supervisors' 2010/11 *Combined Annual Report*. As was the case during the previous financial year, the primary challenges faced by applicant CFIs were inadequate capital, poor governance and weak management information systems. The most prominent weaknesses identified during the assessments of eligible CFIs are reflected in Figure 4.

Figure 4 Most prevalent weaknesses of co-operative financial institutions



The CBDA's Capacity Building Unit is currently working with all the eligible applicant CFIs to address the identified weaknesses and to realise the developmental objectives of the Act.

6 Institutional assessments are conducted at CFIs to determine, *inter alia*, the reasons for non-compliance with section 3 of the Act, that is, the submission of an application to the Supervisor for registration as a co-operative bank. Pre-registration assessments are conducted on CFIs that have submitted all documents required for registration.

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Chapter 2: Co-operative banking-sector overview

2.1 Introduction

This chapter provides an overview of the financial performance of the two co-operative banks comprising the co-operative banking sector for the financial year ended 29 February 2012. Unless explicitly stated otherwise, increases and decreases indicate year-on-year fluctuations for the period ended 29 February 2012. Further information on the financial performance of the two registered co-operative banks prior to registration in 2011 is provided in Appendix C.

During the year under review, the co-operative banking sector experienced significant growth in its asset base, which was largely supported by growth in deposits, the injection of capital and the retention of profits. Although the capital-adequacy ratio increased, a lower liquidity ratio was recorded. Total assets grew year on year by 18 per cent, loans by 20 per cent, liabilities by 16 per cent and member deposits by 17 per cent. However, profit before tax declined by 25 per cent.

2.2 Membership and shareholding

Co-operative banks' member shares are held by their members, who are both the co-operative banks' owners and customers. During the period under review, members' share value[7] increased by 38 per cent.

The co-operative banking sector had a total of 1 573 members at the end of February 2012 (February 2011: 1 276), representing an increase of 23 per cent from the previous year. The value of paid-up shares amounted to R300 725 at the end of February 2012 (February 2011: R217 818) and comprised 6 per cent of the sector's total capital.

Table 3 Membership and share capital

	Period		Percentage change
	2010/11	2011/12	
Number of members	1 276	1 573	23,3
Share capital (R)	217 818	300 725	38,1

2.3 Balance-sheet analysis

The total assets of the co-operative banking sector grew from R52 million in February 2011 to R61 million at the end of February 2012. Gross loans increased from R35 million in February 2011 to R42 million at the end of February 2012, while liquid assets remained at R16 million over the same period. Fixed assets grew significantly by 49 per cent to R1,4 million at the end of February 2012 (February 2011: R0,9 million). Total deposits grew by 17 per cent from R48 million in February 2011 to R56 million at the end of February 2012. The growth in deposits was mainly as a result of aggressive marketing campaigns adopted by institutions and increased confidence of community members following the registration of the two co-operative banks during the 2010/11 and 2011/12 financial years respectively.

7 As explained in section 3.7.2, members of co-operative banks do not, however, have a right to the co-operative bank's reserves, which remain in the co-operative bank in order to cover its commitments.

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Table 4 Balance sheet

Description	Period		Percentage change
	2010/11	2011/12	
Assets			
Loans	35 020 573	41 897 699	19,6
Liquid assets	15 741 193	15 668 178	-0,5
Fixed assets	937 505	1 392 651	48,5
Investments		1 876 431	100
Other assets	185 010	381 241	106,1
Total assets	51 884 281	61 216 199	18,0
Liabilities and capital			
Liabilities	48 007 800	55 784 975	15,9
Deposits	47 589 821	55 509 853	16,6
Accounts receivable	417 979	275 122	-50,4
Capital	3 876 481	5 431 224	45,2
Members' shares	217 818	300 725	38,1
Retained income	777 910	1 158 285	48,9
Reserves	2 880 753	3 972 214	37,9
Total liabilities and capital	51 884 281	61 216 199	18,0

Figure 5 shows that long-term loans constituted 90 per cent of gross loans as at the end of February 2012. Loans supported by collateral in the form of deposits, mortgage bonds or guarantees accounted for 96,7 per cent of gross loans, while 3,3 per cent of the co-operative banking sector's loans were unsecured at the end of February 2012. It should be noted that short-term loans that are not granted in accordance with the relevant co-operative bank's policy guidelines for short-term loans are classified as special loans. These loans, irrespective of the amount concerned, require approval from the credit committee of the relevant co-operative bank and are normally granted at interest rates higher than those applicable to short-term loans due to the higher risk associated with them.

Figure 5 Term of gross loans

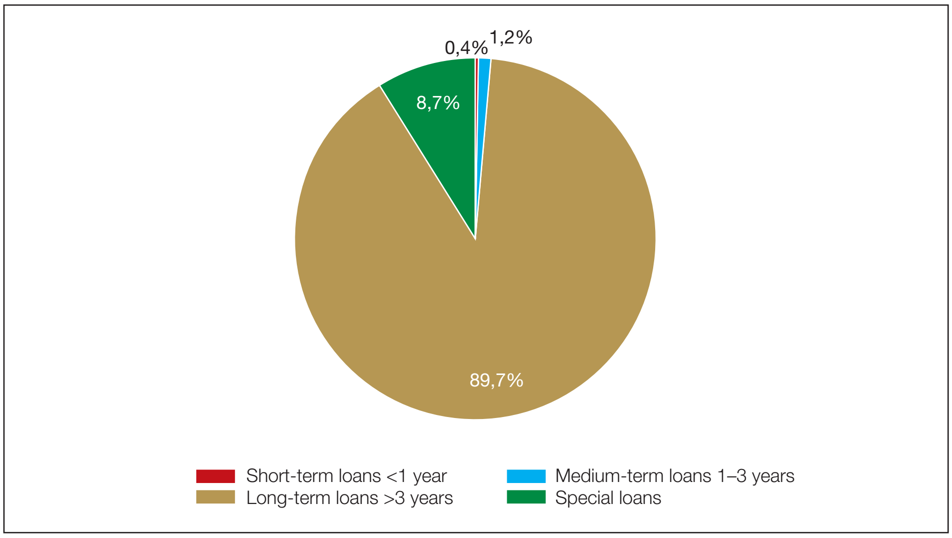

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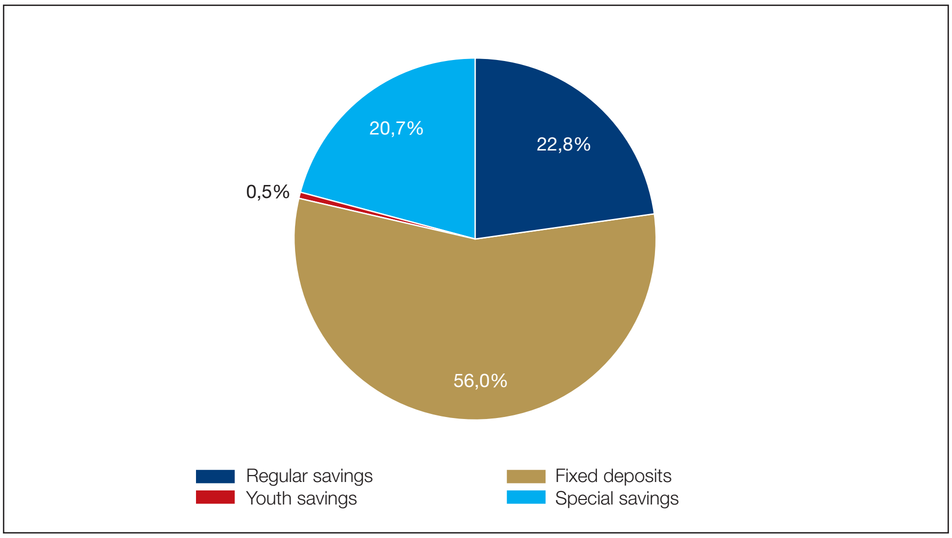
Figure 6 depicts the composition of the sector's deposits as at 29 February 2012. The composition of the sector's deposits remained stable throughout the 2011/12 financial year. Fixed deposits constituted 56 per cent of total deposits as at February 2012. Regular deposits can be withdrawn on demand, while fixed deposits have maturity dates of up to six years. Youth savings are deposits for people under the age of 21 years. Special savings are funds that have been accumulated during the year and are normally withdrawn either at the end or the beginning of the year to pay for seasonal expenses such as school fees, textbooks and holidays.

Figure 6 Composition of deposits



2.4 Asset quality

Delinquent loans accounted for 8,5 per cent of gross loans at the end of February 2012. The sector has provided for potential losses in accordance with regulatory requirements. Data for previous years are not comparable with the data for the year under review as the current methods used to determine delinquencies and to provide for delinquent loans differ from those used previously.

Table 5 Risk classification of loans

Description	Amount	Percentage
Non-delinquent loans	38 347 947	91,50
Delinquent loans between 1 and 6 months	1 668 540	4,00
Delinquent loans between 6 and 12 months	1 168 845	2,80
Delinquent loans >12 months	712 367	1,70
Total loans	**41 897 699**	**100,00**

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Figure 7 Composition of delinquent loans

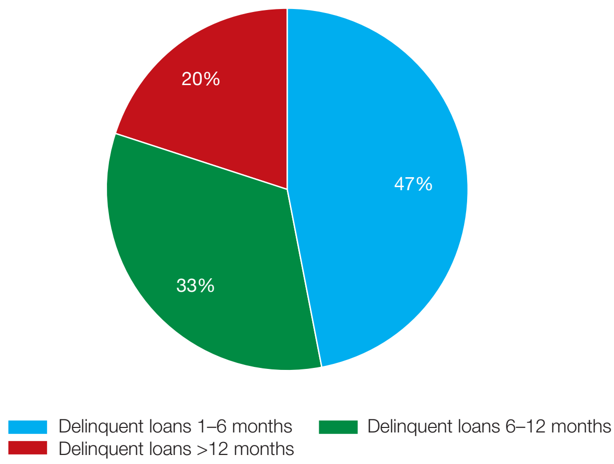

Table 6 Provisions for loans

Description	Delinquent loans	Regulatory requirements (per cent)	Provision required	Actual provision	Shortfall/ surplus
Total loans	38 347 947	2	766 959	766 959	0
1–6 months	1 668 540	35	583 989	583 989	0
6–12 months	1 168 845	50	584 423	584 423	0
>12 months	712 367	100	712 367	712 367	0
Total	**41 897 699**		**2 647 738**	**2 647 738**	**0**

2.5 Capital and capital adequacy

Total capital comprised share capital, retained earnings and reserves during the period under review. Total capital increased by 45 per cent from R3,7 million at the end of February 2011 to R5,4 million at the end of February 2012. The increase in capital can be attributed to increased member shares, the retention of profits and the revaluation of fixed assets. The co-operative banking sector's capital-adequacy ratio[8] improved from 3,0 per cent at the end of February 2011 to 5,8 per cent at the end of February 2012, which is still below the 6 per cent minimum regulatory requirement. The decision was taken by the Supervisor concerned to register one co-operative bank subject to the condition that the minimum capital-adequacy ratio of 6 per cent would have to be achieved within three years from its date of registration. Such a decision was based on the co-operative bank's sustained profitability and growth in deposits and members during preceding years, as well as the likelihood that the target capital-adequacy ratio would be reached within the period mentioned above.

8 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 Co-operative Banks (the Regulations) only allows members' shares, reserves held in terms of section (3)(1)(e) of the Act, 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 by the Supervisor in writing to qualify as capital for purposes of calculating the capital-adequacy ratio.

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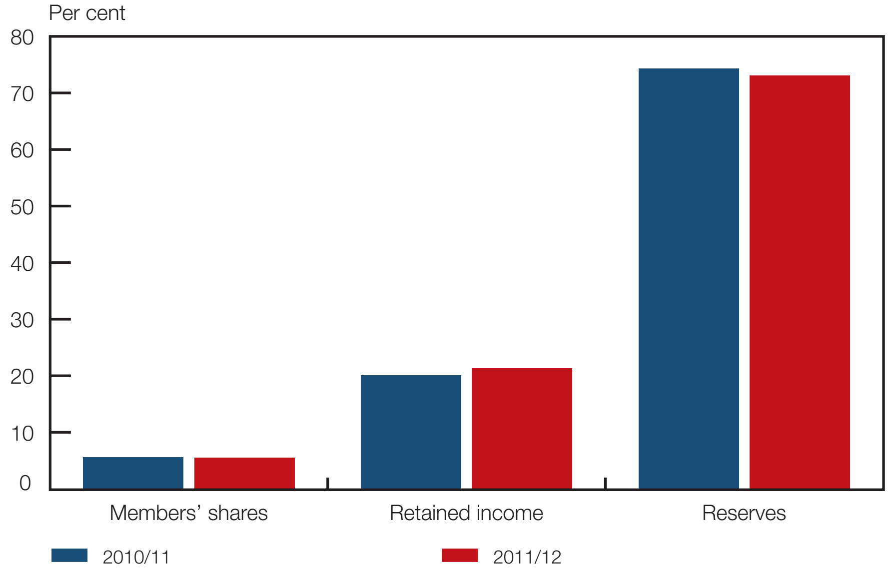
Table 7 Capital

Description	Period		Percentage change
	2010/11	2011/12	
Members' shares	217 818	300 725	38,0
Retained income	643 090	1 158 285	80,1
Reserves	2 880 753	3 972 214	37,9
Total capital	3 741 661	5 431 224	45,2

Table 8 Capital-adequacy ratio

Description	Period		Percentage change
	2010/2011 (per cent)	2011/2012 (per cent)	
Required capital-adequacy ratio	6,0	6,0	0,0
Capital-adequacy ratio	3,0	5,8	2,8
Shortage in capital-adequacy ratio	3,0	0,2	2,8

Figure 8 Composition of capital



2.6 Liquidity

Liquidity is essentially the cash and other liquid financial assets that co-operative banks hold. Such assets can easily be liquidated in order to make provision for operational cash flows, such as members' withdrawals. Liquidity is therefore crucial to the continued viability of co-operative banks. The co-operative banking sector's average liquidity ratio again significantly exceeded the minimum regulatory requirement of 10 per cent of total deposits,[9] closing at 28 per cent at the end of February 2012 (February 2011: 33 per cent). Both registered co-operative banks met the minimum liquidity ratio during the period under review.

9 The Regulations issued in terms of section 86 of the Co-operative Banks Act, 2007 (Act No. 40 of 2007) prescribe that co-operative banks should hold a minimum of 10 per cent of total deposits in prescribed investments with a tenure not exceeding 32 days and convertible into cash at any time, without incurring any penalty or being subject to a discount rate substantially higher than the average rate that applies to liquid assets with a similar term.

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2.7 Profitability

The co-operative banking sector's income before tax decreased by 25 per cent from R646 410 at the end of February 2011 to R487 873 at the end of February 2012. The negative growth was largely due to the adjustment to the provision for delinquent loans, which was previously not adequately provided for. The sector's return-on-assets and return-on-equity ratios decreased to 0,5 per cent and 6,1 per cent respectively at the end of February 2012 (February 2011: 0,8 per cent and 11,7 per cent respectively). The sector's cost-to-income ratio increased from 90 per cent in February 2011 to 93 per cent at the end of February 2012.

2.7.1 Income

Total income increased by 9 per cent from R6,4 million at the end of February 2011 to R7,0 million at the end of February 2012. This was due to an increase in interest on loans by 8,6 per cent from R5,8 million in February 2011 to R6,3 million at the end of February 2012. Interest income accounted for 91 per cent of total income for both the 2010/11 and 2011/12 financial years. The increase in interest income is attributable to the expansion in the amount of credit extended to members.

2.7.2 Expenses

Total expenses increased by 13 per cent from R5,7 million at the end of February 2011 to R6,5 million at the end of February 2012, while interest expenses increased from R3,2 million to R3,5 million over the same period. Operating expenses, which include salaries and wages, governance, marketing, administration, auditing and depreciation, increased from R2,5 million in February 2011 to R3,0 million at the end of February 2012.

Table 9 Income and expenditure

Description	2010/11	Percentage of total income	2011/12	Percentage of total income
Net interest income	2 598 929		2 843 315	
Interest income	5 832 007	91,2	6 330 985	90,6
Non-interest revenue	560 946	8,8	658 782	9,4
Total income	6 392 953		6 989 767	
Interest expenses	3 233 078	50,6	3 487 669	49,9
Operating expenses	2 513 465	39,3	3 014 225	43,1
Provision for loans			671 155	9,6
Personnel	1 001 546	15,7	1 149 134	16,4
Governance	206 925	3,2	402 469	5,8
Marketing	42 420	0,7	74 009	1,1
Administration	1 197 269	18,7	614 913	8,8
Auditing	38 000	0,6	95 508	1,4
Depreciation	27 305	0,4	7 036	0,1
Total expenses	5 746 543	89,9	6 501 894	93,0
Operating profit/ Income before tax	646 410		487 873	

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2.8 Performance rating

The Supervisors apply the Capital Adequacy, Asset Quality, Management Quality, Earnings and Liquidity (CAMEL) rating system to assess the soundness of co-operative banks. Both co-operative banks were assigned overall ratings of 3, which is satisfactory, at the end of February 2012.

2.9 Inherent risks

The inherent risks associated with the co-operative banking sector include credit risk, liquidity risk, interest rate risk, operational risk, legal and compliance risk, strategic risk and reputational risk. During the year under review, co-operative banks improved their information systems, and risk management policies and strategies in order to meet regulatory and reporting requirements. Institutions have also put in place risk mitigation strategies. Generally, risk management processes and procedures appeared to be adequate and effective.

2.10 Compliance with regulatory requirements

Both registered co-operative banks were non-compliant with the prudential requirements, outlined in section 4(1)(d) and section 5 of the Regulations. Section 4(1)(d) prohibits co-operative banks from accepting deposits from a single member or related person in excess of 25 per cent of the co-operative bank's capital, while section 5 prohibits co-operative banks from investing more than 25 per cent of their capital with a single member or related person. Moreover, one co-operative bank did not meet the capital-adequacy ratio regulatory requirement at the end of February 2012.[10] All other regulatory requirements, including prudential requirements, were complied with during the period under review.

10 Refer to section 2.5 of this *Combined Annual Report* for more information in this regard.

Chapter 3: Regulatory developments

3.1 Introduction

This chapter provides an overview of the recent regulatory developments, including proposed amendments to the Act, the issuance of a new Exemption Notice, the Financial Services Laws General Amendment Bill, 2012 (Omnibus Bill) and relevant international developments.

3.2 Review of the Act

A detailed review of the Act was undertaken in order to determine those areas that required refinement or amendment. Box 1 reflects the proposed amendments to the Act and the Regulations issued in terms thereof. The proposed amendments to the Act in terms of Part 10 of the Omnibus Bill are not included. This matter is discussed in greater detail in section 3.3 on page 17. The Supervisors decided to delay the proposed amendments as outlined in Box 1 and to combine such amendments with any further subsequent amendments that may become necessary should Part 10 of the Omnibus Bill be approved by Parliament in terms of which the SARB would become the sole regulator of co-operative banks.[11]

Box 1

Proposed amendments to the Co-operative Banks Act, 2007

Reference to the Act and a brief description	Discussion
Definition of "Rule": Rule in relation to: (a) the Supervisor, means a rule prescribed by the Supervisor under section 46; and (b) the Agency, means a rule prescribed by the Supervisor under section 57.	The definition of "Rule" implies that the Supervisor must issue Rules relating to Co-operative Banks (the Rules) on behalf of the Co-operative Banks Development Agency (the Agency), but section 57 of the Act requires the Agency to prescribe its own rules. The wording must be revised to read "prescribed by the Agency under section 57".
Definition of co-operative bank: "Co-operative bank" means a co-operative registered as a co-operative bank in terms of this Act whose members– (a) are of similar occupation or profession or who are employed by a common employer or who are employed within the same business district; or (b) have common membership in an association or organisation, including a business, religious, social, co-operative, labour or educational group; or (c) reside within the same defined community or geographical area.	In many instances, the Supervisors have been approached to consider the possible registration of entities that provide turnkey solutions that are based on technological capacity. These solutions are mostly driven top down, with a commercial model underpinning their development, contrary to the principle of self-help. The underlying objective of some of these solutions is clearly to gain access to the national payment system, while for others the motive is simply to establish a bank without any regard for co-operative principles. The definition of a co-operative bank should be aligned with the definition of "common bond" as proposed in the new Exemption Notice.

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11 Refer to section 3.5 on page 18 for more information in this regard.

Box 1 Proposed amendments to the Co-operative Banks Act, 2007	
Reference to the Act and a brief description	Discussion
Definition of support organisation: "Support organisation" means a representative body accredited under section 38.	Section 38 makes reference to accreditation of a support organisation and not a representative body. The Act should read "support organisation means a support organisation accredited under section 38". Furthermore, in terms of section 55(1), the Agency must, in addition to its other functions provided for in the Act, support, promote and develop co-operative banking, including deposit-taking co-operatives, irrespective of the provisions of section 3(1) of the Act. The Act needs to cater for a support organisation including both co-operative banks and deposit-taking co-operatives. There is an opinion that primary co-operatives should belong to accredited support organisations prior to registration. The benefit of this will be that conditions can be stipulated by the Supervisor whereby specific weaknesses must be addressed by the relevant support organisation.
Sections 1 and 32: Representative bodies	The proposed National Co-operative Banking Association (NCBA) needs to be accredited by the Agency. In terms of section 55 (1), the Agency must, in addition to its other functions provided for in the Act, support, promote and develop co-operative banking, including deposit-taking co-operatives, irrespective of the provisions of section 3(1) of the Act. In view of the proposed NCBA, the Act should cater for the establishment of a support organisation that also supports financial services co-operatives accredited by the Agency. The proposed NCBA should ideally be a representative body accredited by the Agency.
Section 13: Clarification of the role of governance and supervisory committees Only the responsibilities of the Audit Committee are specified, meaning those of the Governance Committee and the Supervisory Committee are not.	In practice some of the functions of these committees overlap due to a shortage of members that are willing to serve on the boards. The matter is currently being investigated and the Supervisors will propose that certain responsibilities of the committees to attend to all the necessary functions be considered for inclusion in the Act.
Section 23(1): Large exposures This section states that a co-operative bank may not, without the approval of the Supervisor, make an investment with any one person or grant a loan to any one member that exceeds the prescribed limits.	Section 23 deals with investments and loans and not with deposits. While this matter is covered in the Regulations, it should be added to the Act.

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Box 1

Proposed amendments to the Co-operative Banks Act, 2007

Reference to the Act and a brief description	Discussion
Section 24: Contributions to the Fund A co-operative bank must pay to the Co-operative Banks Deposit Insurance Fund (the Fund) such deposit insurance contributions as may be prescribed by the Minister of Finance.	The section includes secondary and tertiary co-operative banks, but it is unclear whether the intention was not that only deposits held by primary co-operative banks should be insured. If this was the intention, the Act should be amended accordingly.
Section 31(1): Application for registration as representative body This section states that a representative body must apply on the application form prescribed by the Agency to the Agency for registration. According to subsection 31(3), the Supervisor may require a representative body to furnish him or her with additional information or documents.	It is unclear as to who is registering and regulating representative bodies: the Agency or the Supervisor. Section 31(3) should therefore read "The Agency may require a representative body to furnish him or her with additional information or documents".
Section 36(3): Application for accreditation as support organisation This section states that the Supervisor may require a support organisation to furnish him or her with additional information or documents; or a report by an auditor or by any other knowledgeable person approved by the Supervisor, on aspects relating to the application.	The word "Supervisor" must be replaced with "the Agency".
Section 37: Support organisation In order to qualify for accreditation, a support organisation must demonstrate, to the satisfaction of the Agency, that it has two or more co-operative banks as members.	By requiring a support organisation to have co-operative banks as members, it excludes certain organisations from applying for accreditation as many do not operate as member based organisations, such as information technology companies. Clarity will also be sought regarding the intent of this clause, bearing in mind the requirement to support other deposit-taking co-operatives as well.
Section 48: Directives: Approval from the SARB This section states that the Supervisor may, in order to ensure the implementation and administration of the Act or to protect members and the public in general, issue a directive to a co-operative bank. Subsection 48(3) states that a directive issued in terms of subsection 48 (1) takes effect on the date determined by the SARB.	It is unclear as to which individual within the SARB, besides the Supervisor, has the authority to issue directives to co-operative banks. The Supervisor within the SARB is only responsible in terms of the Act to supervise and regulate primary co-operative banks with deposits in excess of R20 million, and secondary and tertiary co-operatives, with no specific authority to act on behalf of the Agency Supervisor. The Act must be amended so that the words "Reserve Bank" are replaced with "Supervisor".
Section 57(2): Rules issued by the Agency Rules may apply to co-operative banks, representative bodies or support organisations.	While there is currently a mutual understanding to liaise with each other prior to the issuance of Rules, the Agency should obtain prior written approval from the Supervisors before issuing Rules pertaining to co-operative banks.

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Box 1 Proposed amendments to the Co-operative Banks Act, 2007	
Reference to the Act and a brief description	Discussion
Section 83: Certification of documents Any document that must be submitted to the Supervisor by a co-operative bank in terms of the Act must be certified as correct by the managing director and, in the case of financial information, also by the auditor of the co-operative bank.	The requirement for an auditor to certify every document containing financial information will be costly. It is unlikely that the auditor will certify a document without an audit. As an interim measure the Rules define financial information as "audited financial statements" to overcome the costly and impractical consequences of the Act.
Compliance with the Financial Intelligence Centre Act, 2001 (Act No. 38 of 2001) (FICA) not covered in the Act Compliance with the FICA will be costly and cumbersome.	The latest amendments to FICA exclude co-operative banks and Supervisors as "accounting institutions" and "supervisory bodies" respectively. The latest guidelines issued by the Basel Committee on Banking Supervision (the Basel Committee)[12] require FICA compliance. The Supervisors, however, insist on basic know-your-client requirements for registration purposes. Consideration will be given to issue a directive in this regard in due course.
Issue of membership Membership in primary co-operative banks is not defined.	It may not be desirable for institutions such as companies or close corporations to be members of primary co-operative banks (which is currently the case), whereas groupings such as *stokvels*, burial societies and clubs may be acceptable. This matter is not pertinently addressed in the Co-operatives Amendment Bill. A policy decision is accordingly required in this regard.

3.3 Financial Services Laws General Amendment Bill

On 9 March 2012, the National Treasury published for public comment the Omnibus Bill, as approved by the Cabinet at its meeting of 22 February 2012. The Omnibus Bill amends 11 financial sector laws[13] to address legislative gaps highlighted after the 2008 global financial crisis and to align these laws with the new Companies Act, 2008 (Act No. 71 of 2008) and other relevant legislation.

The most notable proposed amendment to the Act is the intention to transfer the supervisory function of the CBDA to the Supervisor of Co-operative Banks located in the SARB, thus making the SARB the sole supervisor of all co-operative banks. In a media statement issued by the National Treasury on 9 March 2012,[14] it was indicated that the proposed amendments reflect the architectural shift towards a twin peaks model of financial regulation.

However, the inclusion of the above-mentioned proposed amendments to the Act in the Omnibus Bill is regarded as an opportune time to address the regulation of co-operative

12 The Basel Committee is a committee of banking supervisory authorities which was established by the central bank governors of the Group of Ten countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. It usually meets at the Bank for International Settlements in Basel, Switzerland, where its permanent Secretariat is located.

13 These Acts include the Financial Services Board Act, 1990 (Act No. 9 of 1990); the Inspection of Financial Institutions Act, 1998 (Act No. 80 of 1998); the Financial Institutions (Protection of Funds) Act, 2001 (Act No. 28 of 2001); the Long-term and Short-term Insurance Acts, 1998 (Acts No. 52 and 53 of 1998); the Pension Funds Act, 1956 (Act No. 24 of 1956); the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002) and the South African Reserve Bank Act, 1989 (Act No. 90 of 1989).

14 Available at http://www.info.gov.za/speech/DynamicAction?pageid=461&sid=25740&tid=59727.

banks and should be read in conjunction with the proposed amendments to the Exemption Notices as highlighted in section 3.5. The proposed transfer of the supervisory function of the CBDA to the SARB was debated and the SARB sent written comments to the National Treasury in this regard.

3.4 The Co-operatives Act Amendment Bill

The Co-operatives Act Amendment Bill (the Bill) has been approved for tabling in Parliament to amend the Co-operatives Act, 2005 (Act No. 14 of 2005) (the Co-operatives Act). According to a statement released by the Cabinet, the Bill seeks to introduce additional regulations for the co-operatives sector so as to encourage growth. Government wants co-operatives to contribute towards the creation of jobs, poverty alleviation and economic growth. The proposed setting up of the Co-operative Development Agency is also highlighted in the Bill and aims to

- help with the governance and management of the co-operatives sector;
- lend support to the development of co-operatives as an organised sector;
- provide financial and non-financial support to the co-operatives sector; and
- provide business support services, including pre-registration support, business plan development, mentorship and post-registration support to co-operatives.

The Bill also provides for the establishment of a co-operatives tribunal. The tribunal would be tasked with handling disputes and conflicts, and ensuring compliance.

3.5 Exemption Notices

The deposit-taking activities of CFIs are exempted from the provisions of the Banks Act in terms of the Exemption Notices. One of the conditions of the Exemption Notices is that CFIs must operate under the supervision of an approved regulatory entity. In terms of the Exemption Notices, FSCs are currently supervised and regulated by samaf, while SACCOs operate under the auspices of SACCOL. However, neither samaf nor SACCOL will forthwith fulfil their regulatory and supervisory responsibilities in terms of the Exemption Notices.

In February 2011, the President announced the intention to combine samaf, Khula Finance Enterprise and the Industrial Development Corporation in order to improve lending to smaller business enterprises. The merger became effective on 1 April 2012, resulting in samaf relinquishing its regulatory role of FSCs and the forming of the Small Enterprise Financing Agency (SEFA).

SACCOL is a self-funded, member-based organisation and has indicated that it will be unable to continue with its mandated role of regulating and supervising the activities of SACCOs due to capacity constraints. Its mandate, in addition to supervising and regulating SACCOs, includes supporting, developing and representing SACCOs across South Africa. As a member-based institution, with 25 member SACCOs, SACCOL relies on its members' contributions, fees and dues to be financially sustainable.

In order to ensure that CFIs remain regulated and supervised, the National Treasury proposed that the CBDA be designated as the regulatory and supervisory authority of all CFIs that do not meet the minimum requirements of the Act to register as co-operative banks. To give effect to this proposal, the National Treasury requested the Minister of Finance to repeal the Exemption Notices relating to FSCs, SACCOs and *stokvels*, and to replace them with a proposed exemption notice that will designate the CBDA as the regulatory agency of CFIs. *Stokvels* will remain in the domain of the National Stokvel Association of South Africa (NASASA). Designating the CBDA as regulatory authority of all CFIs will also assist the CBDA in performing its function of developing financial co-operatives as prescribed by section 55 of the Act. Should such a proposal come into effect, it would mean that the regulation and supervision of CFIs operating in terms of the Exemption Notices would vest solely with the CBDA.

3.6 International developments

3.6.1 Guiding Principles for Effective Prudential Supervision of Co-operative Financial Institutions

On 16 September 2011, the International Credit Union Regulators' Network (ICURN)[15] published the "Guiding Principles for the Effective Prudential Supervision of Co-operative Financial Institutions" (the Guiding Principles).[16] The document takes into account the unique nature of financial co-operatives and mirrors, to a large extent, the Core Principles.[17] The 21 Guiding Principles are considered conducive to developing an effective supervisory system for credit unions, *caisses populaires,*[18] savings and credit co-operatives, co-operative banks, savings and credit associations, and other global financial co-operatives. The Guiding Principles are categorised into six groups, namely

- Group 1: objective, independence, powers, transparency and co-operation;
- Group 2: licensing and ownership;
- Group 3: prudential regulation and requirements;
- Group 4: methods of ongoing supervision;
- Group 5: accounting and disclosure; and
- Group 6: enforcement.

ICURN recommends the adoption of these Guiding Principles by all jurisdictions supervising financial co-operatives. However, the Guiding Principles recognise that supervisors operate within different financial systems and, accordingly, concede that they may not always be applicable or relevant in all circumstances. ICURN therefore encourages supervisory authorities to focus on the objectives of the Guiding Principles. The Supervisors are in the process of studying these Guiding Principles in conjunction with other international standards, and will introduce measures for the South African scenario where deemed appropriate.

3.6.2 The Basel III framework and co-operative banks

During July 2009 the Basel Committee issued three documents that materially impacted on the regulation and supervision of banks and banking groups, namely

i. "Enhancements to the Basel II Framework";[19]
ii. "Revisions to the Basel II Market Risk Framework";[20] and
iii. "Guidelines for Computing Capital for Incremental Risk in the Trading Book".[21]

These three documents are commonly collectively referred to as "Basel II.5". Furthermore, on 16 December 2010, the Basel Committee issued a further two documents, namely:

i. "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems";[22] and
ii. "Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring".[23]

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15 ICURN is an independent international network of credit union regulators which promotes the guidance given by the leaders of the Group of Twenty nations for greater international co-ordination among financial services regulators.

16 Available at http://curegulators.org/curegulators_resources.

17 Available at http://www.bis.org/publ/bcbs30a.htm.

18 *Caisses populaires* are primarily found in the province of Quebec in Canada, and are essentially the francophone equivalent of a credit union.

19 Available at http://www.bis.org/publ/bcbs157.htm.

20 Available at http://www.bis.org/publ/bcbs158.htm.

21 Available at http://www.bis.org/publ/bcbs159.htm.

22 Available at http://www.bis.org/publ/bcbs189.htm.

23 Available at http://www.bis.org/publ/bcbs188.htm.

These two documents are generally collectively referred to as the "Basel III framework". One of the main objectives of the Basel III framework is to raise the quality, consistency and transparency of banks' capital base by defining criteria to absorb losses better and to ensure that banks hold high-quality capital. Owing to the complexity of the Basel III framework and its significant cost implications, at this stage it cannot be applied to the South African co-operative banking sector. However, the Supervisors take cognisance of the importance of evaluating the risks faced by co-operative banks and will ensure that the Regulations appropriately address the issue of loss absorption by stipulating that risk exposures should be backed by a high-quality capital base.

The democratic principle of "one person one vote" applied by co-operative banks means that capital ownership divided among a large number of members of co-operative includes members in the decision-making process, especially during annual general meetings. Co-operative banks should have the ability to continue to operate when members join and resign. Members of co-operative banks are free to join and leave at any time. Because member shares, which are redeemable at their nominal value, cannot be traded on a formalised share exchange, members are not automatically replaced with other members following their resignation. With the exception of the voluntary liquidation of a co-operative bank, members of co-operative banks do not, however, have a right to the co-operative bank's reserves, which remain in the co-operative bank in order to cover its commitments. Co-operative banks aim to hold a sufficient amount of capital to satisfy the minimum capital requirements as outlined in the Regulations.

In the case of South African co-operative banks, only members' shares, reserves held in terms of section (3)(1)(e) of the Co-operatives Act, retained income,[24] and non-distributable reserves of a permanent nature as approved by the Supervisor in writing qualify as capital for the purposes of calculating the capital-adequacy ratio. It is also important to note that section 24(1) of the Co-operatives Act determines that despite any provisions contained in its constitution, if a co-operative 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.

These regulatory restrictions placed on co-operative banks' qualifying capital in terms of the Act, the Regulations and the Co-operatives Act aim to ensure that co-operative banks hold stable and secure capital.

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24 Retained income is non-distributable reserves created or increased by appropriations of surpluses, but excluding loan loss provisioning.

Chapter 4: The Supervisors' Co-operation and Co-ordination Plan

4.1 Introduction and plans

Section 42 of the Act provides that "the Supervisors appointed under sections 41(1) and 41(2) of the Act must co-operate with each other and co-ordinate their approach to exercising their powers and functions in terms of the Act to ensure the consistent application of this Act" and that the Supervisors must "engage with each other in activities of research, publication, education, staff development and training; engage with each other in staff exchanges or secondments and provide technical assistance or expertise to each other". These extracts essentially form the basis of the Supervisors' Co-operation and Co-ordination Plan.

In terms of section 52 of the Act, the Supervisors must also report on the implementation of the Co-operation and Co-ordination Plan referred to in section 42 of the Act. Appendix A provides details on activities regarding the implementation of the Co-operation and Co-ordination Plan for the period ending March 2012.

Some of the joint activities that were conducted include

- weekly co-ordination meetings;
- meetings with stakeholders, interested parties and regulatory authorities;
- comments on relevant proposed financial regulation Bills;
- issuance of statutory reports and guidance notes;
- review of compliance with international standards;
- assessment and evaluation of applications; and
- co-ordination of manuals and administrative systems.

Appendix B depicts the details of the Co-operation and Co-ordination Plan for the period ending March 2013.

4.2 Regulatory and Oversight Advisory Committee

In the period under review, the membership of the ROAC was extended to include a representative of the National Treasury. Other members include the SARB Supervisor, the CBDA Supervisor, the Managing Director of the CBDA, the Registrar of Co-operatives and representatives of the CBDA Board.

The responsibilities of the ROAC were reviewed, resulting in the key duties of the ROAC being articulated as follows:

- Review the applicable primary and secondary legislation
- Ensure a consistent approach to fulfilling the obligations and exercising the powers and functions in terms of the applicable primary and secondary legislation
- Provide advice on policy matters affecting CFIs and co-operative banks
- Co-ordinate efforts between the Registrar of Co-operatives, the CBDA Board, the CBDA and the SARB regarding the development, regulation and supervision of FSCs and co-operative banks
- Make recommendations to any other regulatory authority relating to the co-ordination and harmonisation of compliance by FSCs and co-operative banks with the relevant financial legislation
- Promote the sustainability of CFIs and co-operative banks, and enhance access to financial services in general by, *inter alia*, engaging in discussions with any person or authority.

South African Reserve Bank

In order to ensure a consistent approach by both Supervisors, a policy was adopted at the last ROAC meeting that sets out the broad framework for the Supervisors in applying the minimum prudential requirements for registration purposes, given the nature and size of the applicants. The policy document also sets out the action to be taken by the Supervisors with regard to non-compliance with registration requirements.

4.3 Participation in local and international forums

The Supervisors are expected to participate in the activities of international bodies and authorities whose main purpose is to develop, advance and promote the sustainability of co-operative banks, and to co-operate with these international bodies and authorities in respect of matters relating to co-operative banks.[25] While the Supervisors' participation in events is listed in Appendix B, the following forums[26] should be highlighted:

4.3.1 African Confederation of Co-operative Savings and Credit Associations Regulatory Framework Workshop held in Nairobi, Kenya, from 15 to 17 June 2011

The African Confederation of Co-operative Savings and Credit Associations (ACCOSCA) held a three-day regulatory framework workshop in Nairobi, Kenya, from 15 to 17 June 2011. The workshop aimed to address existing gaps in the regulation of SACCOs in Africa. ACCOSCA acknowledged the role that South Africa played in ensuring a prudent financial services co-operative sector and requested South Africa's participation at the workshop as one of the keynote presenters. It was confirmed that at the time of the workshop only three African countries, namely South Africa, Malawi and Kenya, had independent regulatory frameworks in place. The workshop was further aimed at improving policies, regulatory and supervisory frameworks, and strengthening the governance of SACCOs in Africa. The formation of SACCO-specific legislation to improve SACCOs' safety and soundness was also encouraged at the workshop.

4.3.2 World Council of Credit Unions International Credit Union Regulators Network ICURN held in Washington DC, United States, from 8 to 10 June 2011

The conference was hosted by the World Council of Credit Unions (WOCCU) and took place at the offices of the National Credit Union Administration, the regulatory agency for federal credit unions in the United States. ICURN invited 50 regulators from 21 countries to this forum.

The roundtable discussions included presentations and networking to address issues faced by both mature and emerging co-operative banking systems. The topics discussed included the following:

- Update from the Basel Committee
- Successful tactics in restoring problem institutions
- Challenges for the co-operative model
- Governance and access to capital
- Financial co-operative mergers
- Strengthening capital
- Over-indebtedness
- Cost of supervision
- Emerging risks facing financial co-operatives.

25 This is prescribed by section 55(2) of the Act.
26 Apart from one forum, the Supervisors were invited to attend these forums at no cost.

From a South African perspective, the seminar was attended with a view to informing the Supervisors' approach towards improving the supervisory framework. The following issues were considered particularly relevant to the South African context:

- The Basel III framework and the increased capital requirements prescribed by it are an issue for all supervisors to consider in the design of supervisory frameworks. However, regulators of smaller jurisdictions should take cognisance of the fact that the Basel III framework is intended to address the failure of systemically important banks, specifically those with cross-border ties, and is not intended to be uniformly implemented across all banks. Regulators need to evaluate the risk of the activities of member-based banks and ensure that regulations primarily address the issue of loss absorption and meeting depositors' withdrawal requirements.
- The focus of many supervisory agencies is being directed towards ensuring better governance. In addition, those elected as custodians of members' funds are increasingly seen as being crucial to the many other issues specific to financial co-operatives.
- One of the defining features of the traditional financial co-operatives model is that it is typically limited in its ability to raise additional capital. Financial co-operatives primarily rely on member shares and retained earnings as sources of capital. It was argued during the debate on the strengthening of capital that CFIs should not get too caught up in explicitly defining their regulatory requirements, but should rather keep in mind that the intention is to hold levels of capital that has, above everything else, the ability to absorb losses during difficult times. The focus is therefore on reducing costs to bring about increased retained earnings to meet the required capital requirements.

4.3.3 Financial Co-operatives Indaba held in Cape Town, South Africa, from 19 to 21 October 2011

Representatives of the supervisory units of the CBDA and the SARB attended a financial co-operative indaba hosted by the CBDA in Cape Town from 19 to 21 October 2011. The theme was "Creating a Strong and Vibrant Co-operative Banking Sector that Broadens Access to and Participation in Diversified Financial Services Towards Economic and Social Well-being". The opening statements were made through a media link by the South African Minister of Finance, after which the Deputy Minister of Finance provided the opening address to over 150 representatives from local CFIs and international guests.

While the conference covered a wide range of topics, the supervisory and regulatory issues that were highlighted included the paucity of quality applications received by the Supervisors for registration purposes, the status of CFIs that had been assessed and challenges faced by CFIs with regard to meeting the minimum registration requirements. The attendees were informed that most of the CFIs had failed to meet the registration requirements primarily due to weak and inadequate capital levels, weak governance structures, inadequate credit risk management practices and weak operational capacity. CFIs were also implored to improve on the reporting of their financial performance to the regulatory authorities.

As already mentioned in Box 1 in section 3.2, one of the key outcomes of the conference was the decision taken by SACCOL to form an inclusive representative body, namely the NCBA. It is anticipated that this new body would be the sole representative body and support organisation for all FSCs and co-operative banks.

With regard to prescribed investments stipulated by the Act, the National Treasury also officially launched its co-operative retail savings bond for CFIs, including co-operative banks, in order to provide a safe investment alternative. See Box 2 for a more detailed explanation in this regard.

Box 2

RSA Financial Co-operatives Retail Savings Bonds

As part of the National Treasury's initiative to promote financial inclusivity by providing financial services to the poor, it launched a retail bond specifically designed for CFIs. This provides CFIs with a safe investment that offers good returns and in which they are able to invest at no additional cost. The bonds are available with terms ranging from one to three years; they offer a floating interest rate; and they can be invested in through a minimum investment of R1 000. The interest rate on the bonds is derived from the six-month effective Treasury Bill rate, which is adjusted semi-annually.

These bonds should assist CFIs in strengthening their liquidity by affording them the opportunity to invest in government bonds as an alternative investment option. The bonds also have unique features that take into account the financial co-operative model. These features include top-ups[27] and early withdrawals to assist them with their liquidity needs. The following conditions will apply:

- Co-operative banks and CFIs will have access to their funds after six months, on condition that they can only withdraw their investments twice during a financial year
- No penalty is charged on withdrawals
- The bonds can be used as collateral when borrowing money.

4.3.4 Savings and Credit Co-operatives of Africa congress held in Accra, Ghana, from 2 to 5 October 2011

The conference was organised by ACCOSCA and was hosted by the Co-operative Union Association of Ghana in collaboration with the Government of the Republic of Ghana and the Canadian Co-operative Association. The annual Savings and Credit Co-operatives of Africa (SACCA) congress brought together approximately 300 stakeholders within the co-operative movement from across Africa to deliberate issues affecting the sector.

The congress focused on issues that could potentially increase the mobilisation of the continent's savings, and the engagement of other stakeholders to transform available resources into meaningful and sustainable vehicles for economic empowerment. This congress was held following 2012 being announced as the International Year of Co-operatives.[28] It was for this reason that the theme "Empowering Africa through Financial Inclusion of SACCOs" was chosen. Participants discussed the role that SACCOs played in providing financial services to their communities. More specifically, the objectives of the congress were to

- highlight the role played by CFIs as mitigating agents to the challenges affecting the achievement of goals;
- bring together the co-operative sector's stakeholders to articulate a common goal that leads to social, economic and political empowerment on the continent;
- promote effective governance structures within the sector through the establishment of appropriate regulatory frameworks; and
- encourage sustainable development of the co-operative sector by engaging the youth and narrowing gender disparity.

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27 A registered holder shall be entitled to "top up" the capital amount on a current co-operative retail savings bond. The maturity date for the additional capital shall be the same as that of the original investment's maturity date of the co-operative retail savings bond into which the payment was made.

28 On 21 December 2009, the United Nations General Assembly declared 2012 as the International Year of Co-operatives. The designation serves to highlight the contribution co-operatives have made in reducing poverty, creating jobs and promoting social integration. The theme for the International Year of Co-operatives is "Cooperative Enterprises Build a Better World".

Further discussions by the panel[29] focused on the two main topical issues that affected the sector, namely legislative developments, and understanding and mitigating the effects of HIV/AIDS.

For the panel discussion on “Governance and Legislative Development: A Wake-up Call for SACCOs in Africa”, various presentations were made by representatives from different countries. Mr D de Jong, the CBDA Supervisor, presented a paper on “The Impact of Co-operative Supervision: Analysing South Africa’s Progress”. The following were concluded from the discussions:

- Legislative development needs to focus more on the quality of leadership, effective supervision, and audit, capital and reporting requirements
- There is a strong need to improve the capacity of stakeholders involved in developing or implementing legislative frameworks
- The overall objective of developing legislation relating to SACCOs should include protecting members’ deposits, encouraging the mobilisation of members’ funds and promoting consumer confidence in SACCOs
- It is necessary to adapt clear legislative provisions to handle weak SACCOs effectively, which may include administrative sanctions, de-registration, removal of management and liquidation.

4.3.5 African Confederation of Co-operative Savings and Credit Associations: Third SACCO Leadership Forum, held in Gaborone, Botswana, from 21 to 23 March 2012

ACCOSCA, in collaboration with Botswana’s Department of Co-operatives, hosted the Third SACCO Leadership Forum at the Gaborone International Conference Centre. The theme of the conference was “Basics and Beyond: Transitional and Transformational Leadership for Co-operatives”.

The conference brought together CFI leaders, academics, government officials and researchers from across Africa for the purposes of sharing information and networking. The 118 participants from 18 African countries were exposed to prudent ways of managing their CFIs, which included the following objectives:

- Promoting dynamic and effective leadership within CFI
- Encouraging leaders to support good governance principles and initiatives
- Evaluating operational strategies.

The keynote address was entitled “Thinking Beyond the Box: Why a Paradigm Shift is Necessary for Co-operative Leaders in Shaping Organisational Culture”. It was presented by Mr J Nyaga, Kenya’s Minister of Co-operative and Marketing Development. The CBDA Supervisor, Mr D de Jong, presented an overview on the topic of “Analysing Quality of Management Decision Through the Supervisors’ Lenses”, while Mr R Mbeza, from the CBDA’s Capacity Building Unit, delivered a presentation on the topic “Understanding CFI Performance: Membership Base, Loan Portfolio, Liquidity Portion, and Capitalisation of CFIs as Parameters”. Other presenters were from Canada, the United Kingdom, Ghana, Nigeria, Kenya, Uganda, Malawi, Cameroon and Botswana.

29 Panel members were Mr D Emmanuel, Chief Executive Officer (CEO) Ghana Credit Union Association, Mr A Samuel, Internal Auditor Cameroon Credit Union League Limited, Mr C Ademba, CEO SACCO Society Regulatory Authority (Kenya), Mr S Kadzola, CEO Malawi Union of Savings and Credit Cooperatives and Mr D de Jong, CBDA Supervisor.

Chapter 5: Issues requiring particular attention during 2012/13

5.1 Exemption Notices issued in terms of the Banks Act, 1990

As already mentioned in section 3.5, the CBDA Board supported the proposal to designate the CBDA as the regulatory authority of all CFIs and has, accordingly, incorporated the proposal into its 2012/13 strategic plan. The CBDA is already in the process of developing the Exemption Notice Programme policy framework through which its new regulatory and supervisory mandate will be implemented.

5.2 Deposit insurance

Deposit insurance is a system established by governments to protect depositors against the loss of their deposits placed with banks in the event that a bank is unable to meet its obligations to depositors. Deposit insurance provides insured depositors with defined protection, usually limited in scope, against the consequences of a bank failure. The main objectives of most deposit insurance schemes are to protect smaller individual depositors and to contribute to financial stability.

Between 2003 and 2007, several South African CFIs collapsed due to a lack of regulation and supervision, and other forms of financial mismanagement. This resulted in members of these institutions losing their deposits. The National Treasury repaid depositors, which significantly compromised the public's confidence in the sector.[30]

The promulgation of the Act represents the first formal step taken to instil confidence in the co-operative banking sector and empower regulators to take necessary steps if there is a threat to the sector's stability. Section 25 of the Act makes provision for the CBDA to establish and manage the Fund.

In June 2008 the National Treasury appointed WOCCU to assist in designing and establishing the Fund. The National Treasury held various workshops with various stakeholders, including the CBDA and the SARB, regarding WOCCU's recommendations. The National Treasury is in the process of finalising a policy for the establishment of the Fund.

It should be noted that without a deposit insurance scheme, the expectation might be that the National Treasury implicitly insures the qualifying deposits placed in co-operative banks should such banks become unable to meet their obligations to their respective members. It was, however, brought to the attention of the registered co-operative banks that they would only be covered by the Fund if the mandatory contributions have been made to it. Details of the mandatory contributions to be made in terms of section 24 of the Act will be communicated to the co-operative banks by the CBDA once they become available.

5.3 Appeals Board

Section 76 of the Act makes provision for the establishment of an appeals board, with at least three members appointed by the Minister of Finance. The Appeals Board will provide an opportunity for co-operative banks, representative bodies and support organisations to appeal against any decision of the Supervisor or the CBDA regarding the registration or accreditation, or the cancellation of the registration or accreditation, of a co-operative bank, representative body or support organisation. The National Treasury is in the process of setting up the Appeals Board.

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30 Between 2003 and 2007 the National Treasury contracted a local audit firm and SACCOL to conduct a detailed audit of the sector with the primary objective of determining the viability of CFIs. The National Treasury offered a payout of member deposits of the non-viable CFIs registered with the Department of Trade and Industry that had opted to cease operations. As a consequence, a total of approximately R5 million was repaid to the depositors of 16 of the 63 CFIs in an attempt to close them down.

5.4 Twin peaks model of financial regulation

In February 2011 the National Treasury outlined South Africa's broader financial-sector reform in a policy document entitled "A Safer Financial Sector to Serve South Africa Better".[31] The policy objectives identified in the document include maintaining financial stability, strengthening consumer protection, combating financial crime and ensuring that financial services are appropriate, accessible and affordable. In order to achieve these objectives, an architectural shift towards a twin peaks regulatory framework is required, according to which the SARB will be responsible for prudential regulation under one "peak", while the Financial Services Board (FSB) will be responsible for market conduct under the other peak.

In line with the twin peaks model, the National Treasury is in the process of introducing amendments to the Act in order to move the supervisory function of the CBDA to the SARB as explained in section 3.3 of this *Combined Annual Report*. With the transfer of this function to the Supervisor of Co-operative Banks located in the SARB as the sole supervisor of all co-operative banks, the focus of the CBDA will shift towards its new mandate of regulating CFIs that operate outside the ambit of the Act, but in compliance with a new exemption notice. This new Exemption Notice is in the process of being prepared for publication in the *Government Gazette* and will replace the previous Exemption Notices.

5.5 Potential abuse of the Act

The Supervisors have been approached by a number of entrepreneurs who have identified the use of the co-operative banking model to provide turnkey solutions to prospective members that will enable them to form CFIs and co-operative banks, usually through the use of cellular telephone technology. It is of paramount importance that co-operative banks adhere to the internationally recognised co-operative principles, which have been incorporated into the Act. These principles include independence, autonomy and self-help. While the Supervisors encourage innovation in the sector, it is argued that the need for such initiatives should emanate from the members of CFIs or co-operative banks, which may include service level agreements with third parties. Therefore, the existence of an independent relationship between service providers and CFIs or co-operative banks is important to ensure that making a profit and gaining access to the national payment system are not the main driving forces behind such initiatives. An amendment to the Act's definition of a "co-operative bank" in relation to its "common bond" is currently being considered.

5.6 Application of the Core Principles on Microfinance Activities

The Basel Committee's Microfinance Workstream developed guidelines on the application of the Core Principles[32] to assist countries in developing a coherent approach to regulating and supervising microfinance activities. The Supervisors used the Core Principles to conduct a self-assessment during the 2011/12 financial year. It was found that although the Supervisors were fully compliant with most of these principles, there were still some Core Principles with which they were only regarded as largely compliant. In this regard, attention will be given to address the shortcomings that were identified during the self-assessment. In line with the Basel Committee's recommendations, the main focus will be to issue additional Rules that will provide legal backing to compel co-operative banks to follow prescribed procedures and to set minimum policy standards relating to the risks to which they are exposed.

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31 Available at http://www.treasury.gov.za/public%20comments/default.aspx.

32 The Core Principles on Microfinance Activities are identified in the Basel Committee's document entitled "Microfinance Activities and the Core Principles for Effective Banking Supervision" (August 2010). The document is available at http://www.bis.org/publ/bcbs175.htm.

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The self-assessment indicated that the Supervisors were only non-compliant with one of the Core Principles due to the fact that co-operative banks are not defined as one of the ‘accountable institutions’ in terms of Schedule 1 of FICA. The decision not to include them can primarily be ascribed to the reduced risk of member-based institutions, given their nature, size and complexity compared to commercial banks at this particular time. Notwithstanding any legal obligation, the know-your-client principle is enforced by Supervisors and co-operative banks have been instructed to report suspicious transactions with the assistance of the Supervisor, if required. However, no suspicious transactions have been reported to date.

Appendix A: Report on the implementation of the Supervisors' Co-operation and Co-ordination Plan for the period ending March 2012

Report on the Implementation of the Supervisors' Co-operation and Co-ordination Plan for the period ending March 2012 as required in terms of section 42(3) of the Act	
Description	**Implementation**
Section 42(1): Co-ordination of Supervisors' approach in exercising their powers and functions in terms of the Act.	
1. Conduct regular meetings between the Supervisors (or designated members) on at least a monthly basis to ensure a co-ordinated approach in the exercising of powers. Conduct ad hoc meetings whenever necessary.	• Supervisors conducted bi-weekly meetings. • Supervisors liaised on an ongoing basis through electronic media or telephonically regarding matters of mutual interest. • Ad hoc meetings were held whenever necessary to ensure close co-ordination and that similar approaches were followed by the Supervisors in the exercising of their duties.
2. Co-ordinate and co-operate with each other regarding the publication and issuance of Rules, guidance notes and directives to co-operative banks.	• There were no amendments to the Act, Regulations and Rules. No guidance notes and directives were issued to co-operative banks. • No directives have been issued to date.
3. Reach consensus on proposed amendments to the Act, Regulations and Rules for subsequent approval and publication by the Minister.	• Consensus has been reached on various proposed amendments to the Act. To date, the proposed amendments have not been regarded as obstructing the day-to-day exercising of the Supervisors' duties and will only be proposed once the Omnibus Bill has been finalised. • To date there has been no need to amend either the Regulations or the Rules. However, various additions are envisaged following the results of the self-assessment.
4. Reach consensus on the issuance of guidelines on the application and interpretation of the Act and on the issuance of circulars containing information relating to co-operative banks.	• No guidelines were issued. • Further guidance notes, especially regarding capital requirements, are in the process of being drafted.
5. Consider applications to register as co-operative banks in a co-operative manner.	• Supervisors agreed to consider applications to register as co-operative banks in a co-operative manner. A panel consisting of both Supervisors and their team members consider pre-registration assessment reports of applicant CFIs on an ongoing basis. The panel also makes recommendations to the Supervisor concerned for consideration.
6. Attend ROAC meetings and other committees concerned to co-ordinate efforts between the Registrar of Co-operatives, the CBDA board, and the Supervisors.	• The ROAC meetings scheduled were attended.
7. Establish the necessary procedure and strategy when co-operative banks migrate between SARB and CBDA supervision in accordance with section 41(3) and (4) of the Act.	• The necessary procedure and strategy when co-operative banks migrate between SARB and CBDA supervision in accordance with section 41(3) and (4) of the Act will be attended to when it becomes necessary.
8. Co-operate in a crisis situation in order to establish and facilitate the actions and the timely decision-making process of the authorities responsible for the management and resolution of the crisis, including the CBDA Deposit Insurance Fund, once established.	• The Supervisors have adopted a "problem banks resolution framework" to co-operate in a crisis situation in order to establish and facilitate the actions and the timely decision-making process of the authorities responsible for the management and resolution of the crisis. The framework will be finalised once the Fund has been established.

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<table>
<tr><th colspan="2">Report on the Implementation of the Supervisors' Co-operation and Co-ordination Plan for the period ending March 2012 as required in terms of section 42(3) of the Act</th></tr>
<tr><th>Description</th><th>Implementation</th></tr>
<tr><td colspan="2">Section 42(2) (a): Engaging with each other in activities of research, publication, education, staff development and training.</td></tr>
<tr><td>1. Co-ordinate discussions regarding compliance by co-operative banks with other financial regulatory authorities such as the FSB, the Financial Intelligence Centre (FIC) and the National Credit Regulator (NCR).</td><td>• Discussions were held with the FSB and the NCR regarding registered co-operative banks and their requirements to register with the FSB. Both Supervisors co-ordinated their efforts to ensure compliance by the registered co-operative banks with the aforementioned authorities.</td></tr>
<tr><td>2. Provide feedback to each other on matters of mutual interest and concern after the attendance of conferences, workshops and seminars, both locally and internationally.</td><td>• The following were attended:
– WOCCU International Credit Union Regulators Network (ICURN) held in Washington DC, United States, from 8 to 10 June 2011.
– Report on ACCOSCA regulatory framework workshop held in Nairobi, Kenya, from 15 to 17 June 2011.
– Financial Co-operatives Indaba held in Cape Town, South Africa from 19 to 21 October 2011.
– SACCA congress held in Accra, Ghana, from 2 to 5 October 2011.
– ACCOSCA Third SACCO Leadership Forum, held in Gaborone, Botswana, from 21 to 23 March 2012.</td></tr>
<tr><td>3. Submit joint statutory reports to the Minister on the following basis:
– The 2011/12 Combined Annual Report to be submitted by 31 May 2012. This report will incorporate the implementation of the Co-operation and Co-ordination Plan for the period ending March 2012 in terms of section 42(3) of the Act. The possibility of incorporating the report of the SARB Supervisor in terms of section 52 of the Act into the annual report relating to banks and mutual banks will be considered.
4. In accordance with regulation 7(a), submit joint quarterly feedback regarding the performance and operations of co-operative banks on the following basis:
– Quarter ending 31 May 2011 to be submitted by 31 July 2011.
– Quarter ending 31 August 2011 to be submitted by 31 October 2011.
– Quarter ending 30 November 2011 to be submitted by 31 January 2012.
– Quarter ending 29 February 2012 to be submitted by 30 April 2012.</td><td>• The following statutory reports have been submitted or are included as part of the Combined Annual Report:
– The Co-operation and Co-ordination Plan to the Minister of Finance for the period ending March 2013.
– The implementation of the Co-operation and Co-ordination Plan to the Minister of Finance for the period ending March 2012.
– Quarterly feedback reports on the performance and operations of co-operative banks for the periods ending 31 May 2011, 31 August 2011, 30 November 2011 and 29 February 2012 (to be submitted by 30 April 2012) have been submitted to the Minister of Finance.</td></tr>
<tr><td>5. Encourage research relating to co-operative banks, whether conducted by the CBDA or the SARB, or by third parties, institutions or persons appointed as consultants.</td><td>• The Capacity Building Unit of the CBDA conducted research on existing FSCs and supplied the Supervisors with its findings.</td></tr>
<tr><td>6. Provide relevant training to staff members of the SARB and the CBDA supervision units.</td><td>• The CBDA provided specific training to the examiner appointed in 2011.
• On-the-job training is conducted as joint evaluations and inspections take place.</td></tr>
</table>

Report on the Implementation of the Supervisors' Co-operation and Co-ordination Plan for the period ending March 2012 as required in terms of section 42(3) of the Act	
Description	Implementation
Section 42(2)(c): Provide technical assistance or expertise to each other.	
1. Conduct joint pre-registration assessments of proposed co-operative banks.	• Three joint pre-registration assessments were conducted in respect of applications received.
2. Collaborate with each other on the design and implementation of on-site examination processes of co-operatives banks.	• The design of an on-site examination manual was finalised.
3. Collaborate with each other on the design and implementation of an off-site examination process of co-operative banks.	• The design of the off-site examination process was finalised.
4. Share information on the methods of analysis used in the assessment of the various co-operative banks.	• To date, the same method of analysis has been followed by both Supervisors.
5. Conduct a joint self-assessment based on the Basel Committee's Core Principles.	• A joint self-assessment based on the Basel Committee's Core Principles was conducted.

Appendix B: Supervisors' Co-operation and Co-ordination Plan for the period ending March 2013

Supervisors' Co-operation and Co-ordination Plan for the period from 1 April 2012 to 31 March 2013 as required in terms of section 42(3) of the Act
Section 42(1): Co-ordination of Supervisors' approach in exercising their powers and functions in terms of the Act.
1. Conduct regular meetings between the Supervisors (or designated members) on at least a monthly basis to ensure a co-ordinated approach in the exercising of powers. Conduct ad hoc meetings whenever necessary.
2. Co-ordinate and co-operate with each other regarding the publication and issuance of Rules, guidance notes and directives to co-operative banks.
3. Reach consensus on proposed amendments to the Act, Regulations and Rules for subsequent approval and publication by the Minister of Finance.
4. Reach consensus on the issuance of guidelines on the application and interpretation of the Act, and on the issuance of circulars containing information relating to co-operative banks.
5. Consider applications to register as co-operative banks in a co-operative manner.
6. Attend ROAC meetings and other committees concerned to co-ordinate efforts between the Registrar of Co-operatives, the CBDA Board and the Supervisors.
7. Establish the necessary procedure and strategy when co-operative banks migrate between SARB and CBDA supervision in accordance with section 41(3) and (4) of the Act.
8. Co-operate in a crisis situation in order to establish and facilitate the actions and the timely decision-making process of the authorities responsible for the management and resolution of the crisis, including the CBDA Deposit Insurance Fund, once established.
Section 42(2)(a): Engaging with each other in activities of research, publication, education, staff development and training.
9. Co-ordinate discussions regarding compliance by co-operative banks with other financial regulatory authorities such as the FSB, the FIC and the NCR.
10. Provide feedback to each other on matters of mutual interest and concern after the attendance of conferences, workshops and seminars, both locally and internationally.
Supervisors' Co-operation and Co-ordination Plan for the period from 1 April 2012 to 31 March 2013 as required in terms of section 42(3) of the Act
11. Submit joint statutory reports to the Minister on the following basis: – The 2012/13 *Combined Annual Report* to be submitted by 31 May 2013. This report will incorporate the implementation of the Co-operation and Co-ordination Plan for the period from 1 March 2012 to 28 February 2013 in terms of section 42(3) of the Act. The possibility of incorporating the report of the SARB Supervisor in terms of section 52 of the Act into the annual report relating to banks and mutual banks will be considered.
12. In accordance with regulation 7(a), submit joint quarterly feedback reports regarding the performance and operations of co-operative banks on the following basis: – Quarter ending 31 May 2012 to be submitted by 31 July 2012. – Quarter ending 31 August 2012 to be submitted by 31 October 2012. – Quarter ending 30 November 2012 to be submitted by 31 January 2013. – Quarter ending 28 February 2013 to be submitted by 30 April 2013.
13. Encourage research relating to co-operative banks, whether conducted by the CBDA or the SARB, or by third parties, institutions or persons appointed as consultants.
14. Provide relevant training to staff members of the SARB and the CBDA supervision units.
Section 42(2) (b): Engaging with each other in staff exchanges or secondments.
15. In order for Supervisors to learn from each other and to gain knowledge in the process, the Supervisors' Co-operation and Co-ordination Plan includes jointly conducting examinations; assessing or inspecting proposed or registered co-operative banks; and jointly conducting training workshops and road-shows. No staff exchanges or secondments are envisaged.
Section 42(2) (c): Provide technical assistance or expertise to each other.
16. Conduct joint pre-registration assessments of proposed co-operative banks.
17. Collaborate with each other on the design and implementation of on-site examination processes of co-operatives banks.
18. Collaborate with each other on the design and implementation of off-site examination processes of co-operative banks.
19. Share information on the methods of analysis of the various co-operative banks.
20. Issue the necessary Rules and guidance notes, following the outcome of the self-assessment exercise conducted during the 2011/12 financial year, which was based on the Basel Committee's Core Principles.

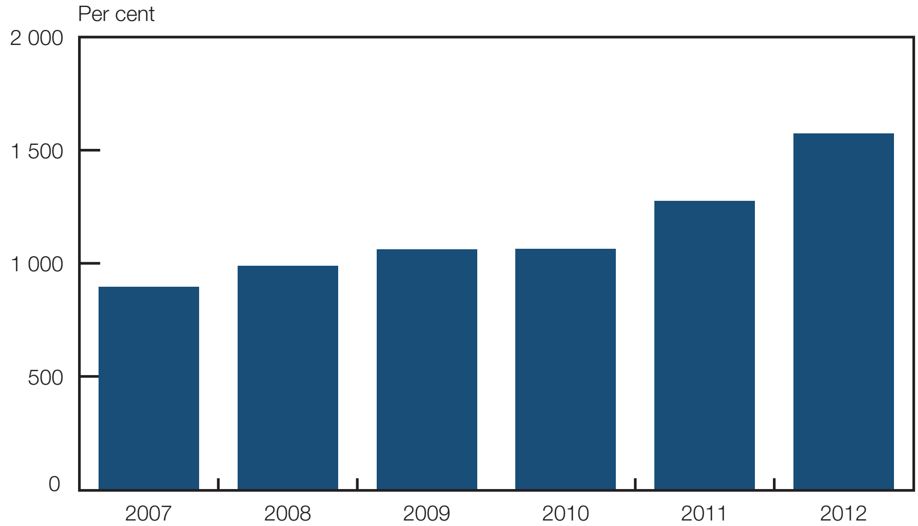
CO-OPERATIVE BANKS DEVELOPMENT AGENCY

Appendix C: Performance of co-operative banks over the past six years

1. Membership and shareholding

Membership of co-operative banks increased from 896 members in February 2007 to 1 573 at the end of February 2012. The value of the paid-up membership shares at the end of February 2012 was R300 725 (February 2007: R127 065), reflecting growth of 137 per cent since 2007.

Figure C.1 Membership of co-operative banks

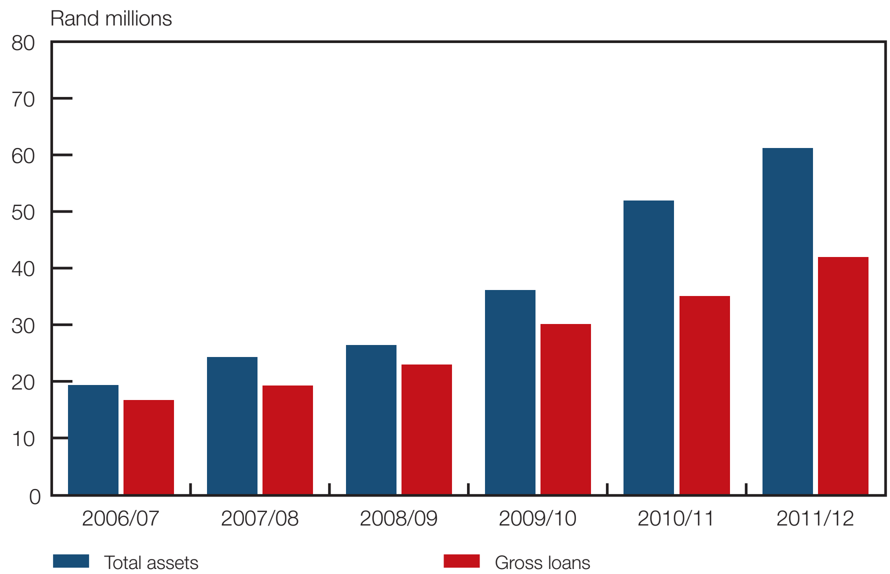


2. Balance sheet

2.1 Assets

Figure C.2 reflects total assets of R61 million at the end of February 2012 (February 2007: R19 million), an increase of 216 per cent since to February 2007. Gross loans increased by

Figure C.2 Total co-operative banking-sector assets and gross loans



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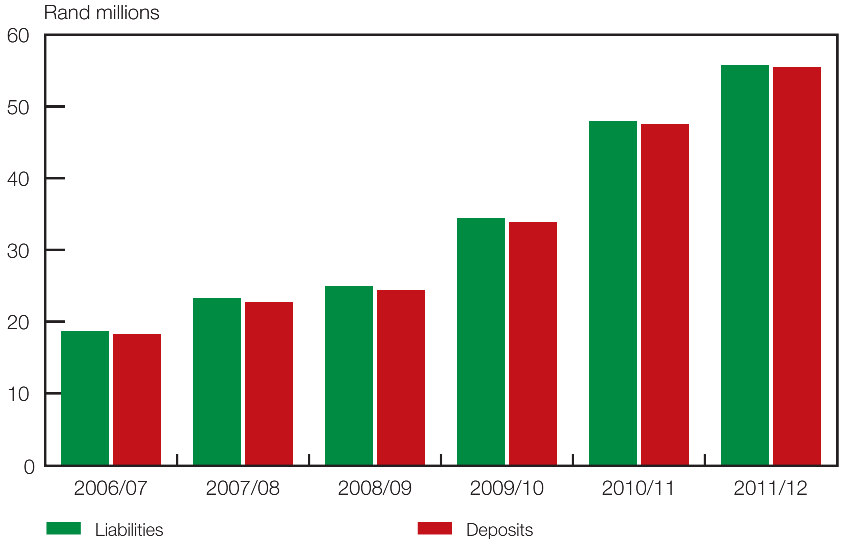
151 per cent over the last six years to R42 million (February 2007: R17 million). Gross loans represented 68 per cent of total assets at the end of February 2012, down 18 per cent from February 2007. Liquid assets, investments, fixed assets and other assets represented 26 per cent, 3 per cent, 2 per cent and 1 per cent of total assets respectively as at 29 February 2012.

2.2 Liabilities

Figure C.3 reflects total liabilities of R56 million at the end of February 2012, an increase of 197 per cent compared to the R19 million reported in February 2007. Deposits increased by 205 per cent from R18 million at the end of February 2007 to R56 million at the end of February 2012.

Figure C.3 Total co-operative banking-sector liabilities and deposits



3. Profitability

The co-operative banking sector was profitable over the last six years. Net interest income increased by 107 per cent, loan loss provision by 596 per cent, operating profit by 2977 per cent, non-interest revenue by 87 per cent, operating expenses by 76 per cent and income before tax by 3177 per cent from February 2007 to February 2012. The sector's return-on-assets and return-on-equity ratios increased from 0,1 per cent to 0,5 per cent, and 1,5 per cent to 6,1 per cent respectively over the six-year period ended 29 February 2012. Although the cost-to-income ratio showed an improvement from 99 per cent in 2007 to 93 per cent in 2012, it remains very high.

CO-OPERATIVE BANKS DEVELOPMENT AGENCY

Table C.1 Income and expenditure for the past six years

Period ending	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
Net interest income	1 374 949	1 634 831	1 973 064	1 922 077	2 598 929	2 843 315
Interest income	2 505 712	3 229 824	3 858 490	4 409 580	5 832 007	6 330 985
Interest expenses	1 130 763	1 594 993	1 885 426	2 487 503	3 233 078	3 487 669
Non-interest revenue	352 779	348 894	409 342	445 691	560 946	658 782
Gross operating income	1 727 728	1 983 725	2 382 406	2 367 768	3 159 875	3 502 098
Credit losses	0	0	0	0	0	0
Operating expenses	1 711 872	1 874 900	2 065 409	2 025 327	2 513 465	3 014 225
Indirect tax	0	0	0	0	0	0
Operating profit	15 856	108 825	316 997	342 441	646 410	487 873
Income before tax	15 856	108 825	316 997	342 441	646 410	487 873
Direct taxation	0	52 078	68 714	108 292	207 359	156 119
Net income after tax	15 856	56 747	248 283	234 149	439 051	331 754

Figure C.4 Composition of the income statement

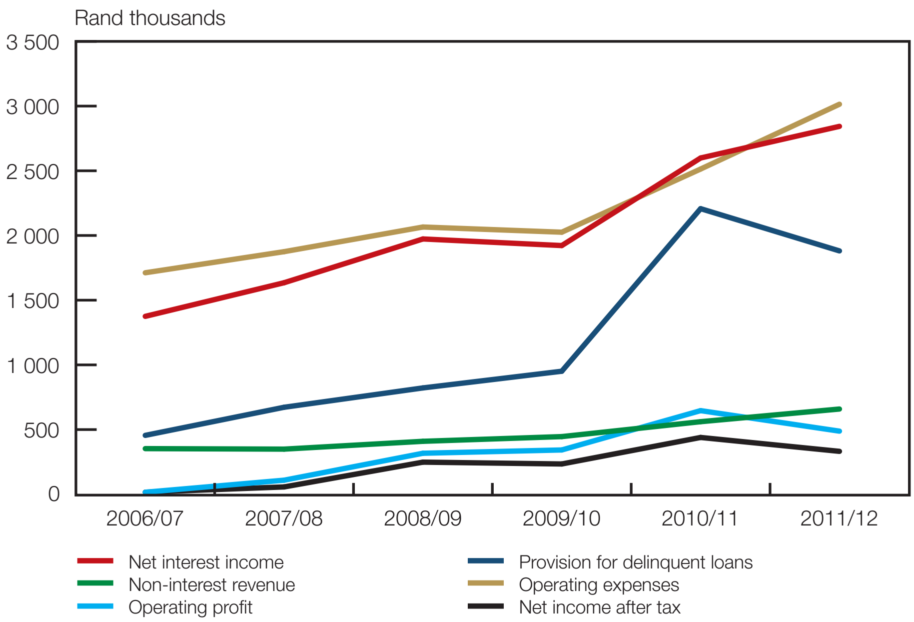


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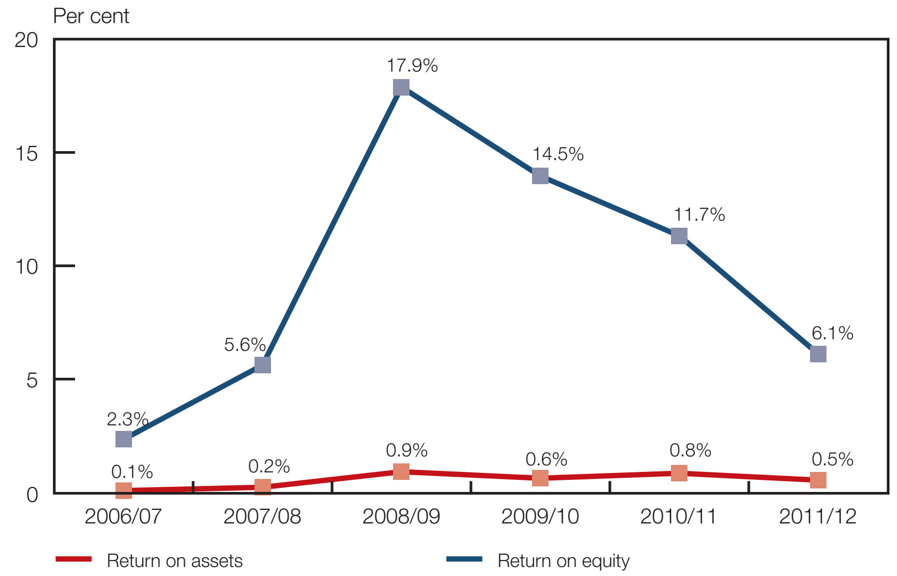
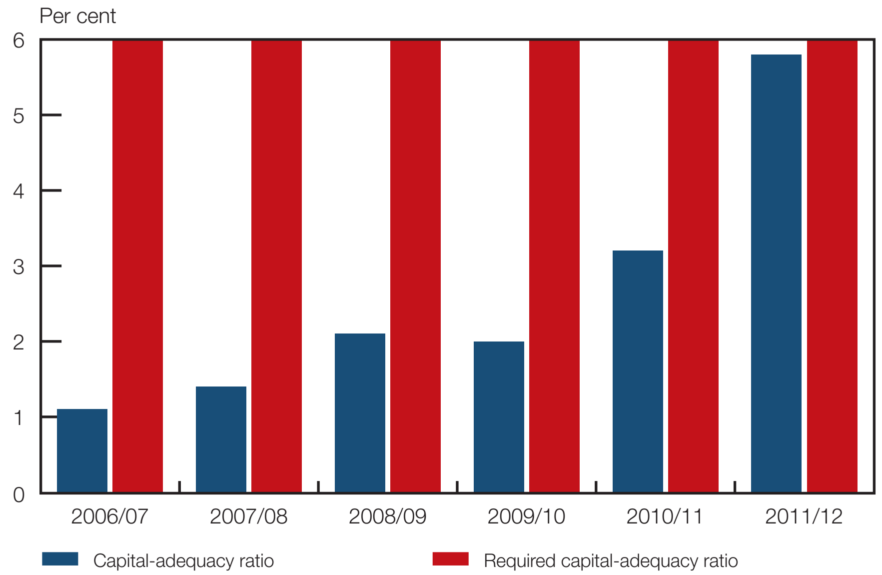
Figure C.5 Return-on-assets and return-on-equity ratios



The capital-adequacy ratio of the co-operative banking sector increased from 3,0 per cent in February 2007 to 5,8 per cent at the end of February 2012. The increase was due to an increase in retained income over the six-year period. Capital adequacy has also improved significantly since the registration of the two co-operative banks. Provisions for delinquent loans were not adequately accounted for prior to registration of the CFIs as co-operative banks. The sudden reduction of the capital-adequacy ratio in 2011 was as a result of a substantial increase in assets after registration. Although Figure C.6 shows that the capital-adequacy ratio was below the regulatory requirement of 6 per cent, it should be noted that the regulatory requirement only became effective once the co-operative banks were registered in 2011.

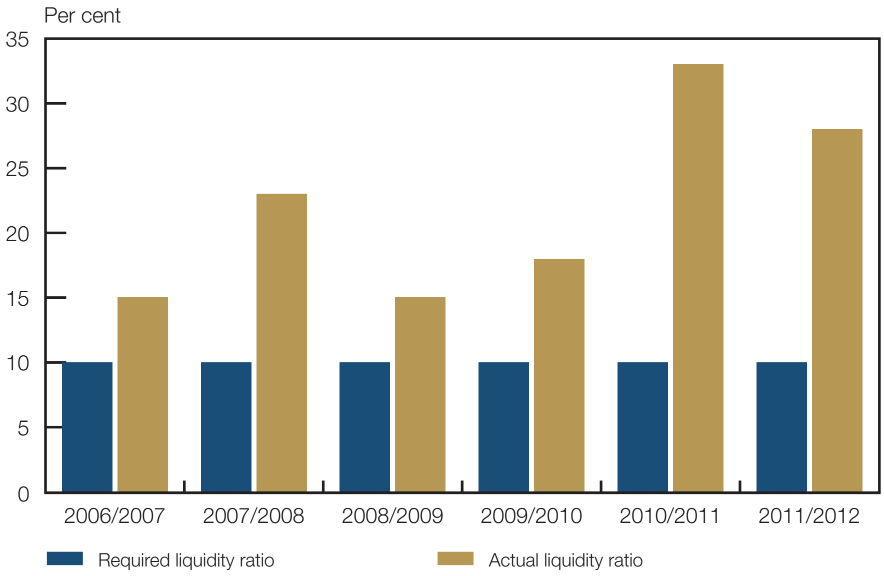
Figure C.6 Capital-adequacy ratio



3.1.1 Liquidity

As depicted in Figure C.7, the average liquid assets held by the co-operative banking sector as a percentage of total deposits significantly exceeded the required liquidity ratio of 10 per cent throughout the six-year period. This is despite the fact that the regulatory requirement only became effective after the institutions had been registered as co-operative banks.

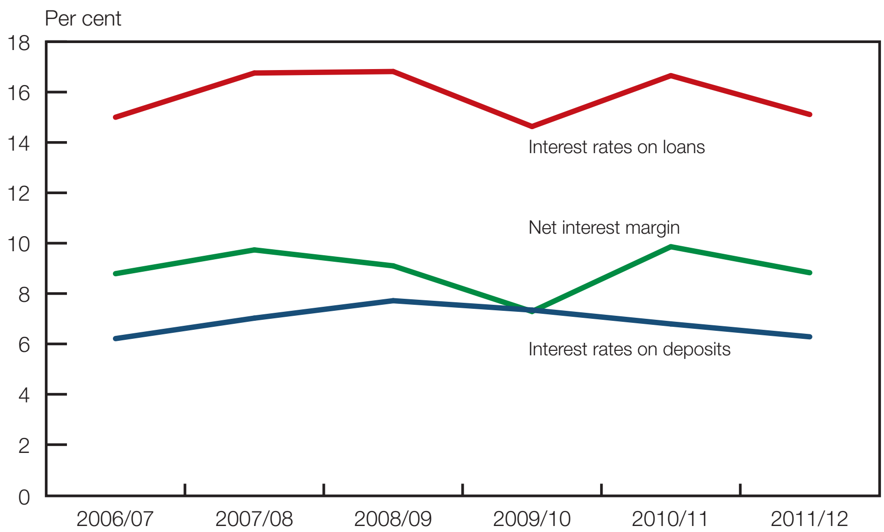
Figure C.7 Liquidity ratios



3.1.2 Interest rates

There is a marked correlation between interest rates on loans and deposits as reflected in Figure C.8. An average net interest margin was maintained at 9 per cent over the last six years by the co-operative banking sector.

Figure C.8 Interest rates



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Abbreviations

ACCOSCA	African Confederation of Co-operative Savings and Credit Associations
CAMEL	Capital Adequacy, Asset Quality, Management, Earnings, and Liquidity
CBDA	Co-operative Banks Development Agency
CEO	Chief Executive Officer
CFI	Co-operative Financial Institution
FIC	Financial Intelligence Centre
FICA	Financial Intelligence Centre Act, 2001 (Act No. 38 of 2001)
FSB	Financial Services Board
FSC	financial services co-operative
ICURN	International Credit Union Regulators' Network
NASASA	National Stokvel Association of South Africa
NCBA	National Co-operative Banking Association
NCR	National Credit Regulator
NEHAWU	National Education, Health and Allied Workers Union
OSK	OSK Kööperatiewe Bank Beperk
ROAC	Regulatory and Oversight Advisory Committee
RRSSC	Regulation, Registration, Supervision and Stabilisation Committee
SACCA	Savings and Credit Co-operatives of Africa
SACCO	savings and credit co-operative
SACCOL	Savings and Credit Co-operative League of South Africa
samaf	South African Microfinance Apex Fund
SARB	South African Reserve Bank
SEFA	Small Enterprise Financing Agency
WOCCU	World Council of Credit Unions

Glossary

Combined Annual Report	*Combined Annual Report of the Supervisors of the Co-operative Banks Development Agency and the South African Reserve Bank*
Co-operatives Act	Co-operatives Act, 2005 (Act No. 14 of 2005)
Co-operatives Act Amendment Bill	Co-operatives Amendment Bill (B-2010) published in *Government Gazette* No. 33942, dated 21 January 2011
Discussion Document	Discussion Paper-Proposed Prudential Regulations for Co-operative Banks
Ditsobotla	Ditsobotla Primary Savings and Credit Co-operative Bank Limited
Exemption Notices	Exemption Notice No. 887 published in *Government Gazette* No. 31342 dated 22 August 2008 and Exemption Notice No. 1176 published in *Government Gazette* No. 29412 dated 1 December 2006
Omnibus Bill	Financial Services Laws General Amendment Bill, 2012
the Act	Co-operative Banks Act, 2007 (Act No. 40 of 2007)
the Agency	Co-operative Banks Development Agency
the Banks Act, 1990	Banks Act, 1990 (Act No. 94 of 1990)
the Basel Committee	Basel Committee on Banking Supervision
the Bill	Co-operatives Act Amendment Bill
the Board	Board of Directors [of the Co-operative Banks Development Agency]
the Co-operatives Act	Co-operatives Act, 2005 (Act No. 14 of 2005)

CO-OPERATIVE BANKS DEVELOPMENT AGENCY

the Core Principles	The Basel Committee on Banking Supervision's Core Principles on Microfinance Activities
the Fund	Co-operative Banks Deposit Insurance Fund in terms of section 25 of the Co-operative Banks Act, 2007
the Guiding Principles	Guiding Principles for the Effective Prudential Supervision of Co-operative Financial Institutions
the Regulations	Regulations relating to Co-operative Banks issued in terms of section 86 of the Co-operative Banks Act, 2007 (Act No. 40 of 2007)
the Rules	Rules issued in terms of section 45 of the Co-operative Banks Act, 2007 (Act No. 40 of 2007)

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