



INTERNATIONAL CREDIT UNION REGULATORS' NETWORK

Peer Review Report  
of the Co-operative Bank Development Agency

January 2018

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Prepared for

Co-operative Bank Development Agency of South Africa



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## 1. Glossary

### 1.1. General

Acronym	Description
<b>ADI</b>	Authorised Deposit-taking Institution
<b>APRA</b>	Australian Prudential Regulation Authority
<b>BANKSETA</b>	Bank Sector Education and Training Authority
<b>CBDA</b>	Co-operative Banks Development Agency
<b>Central Bank</b>	Central Bank of Ireland
<b>CFIs</b>	Co-operative Financial Institutions
<b>CIPC</b>	Companies and Intellectual Property Commission
<b>CUSCAL</b>	Credit Union Services Company of Australia Limited
<b>DGF</b>	Deposit Guarantee Fund
<b>DGS</b>	Deposit Guarantee Scheme
<b>DSBD</b>	Department of Small Business Development
<b>FCS</b>	Financial Claims Scheme
<b>FSCs</b>	Financial Co-operatives or Financial Services Co-operatives
<b>ICT</b>	Information and communication technology
<b>ICURN</b>	International Credit Union Regulators' Network
<b>IMF</b>	International Monetary Fund
<b>KYC</b>	Know Your Customer
<b>MIS</b>	Management Information System
<b>NACFISA</b>	National Association of Co-operative Financial Institutions of South Africa
<b>NCUA</b>	National Credit Union Administration
<b>SAAS</b>	Software as a Service
<b>SACCOs</b>	SACCOs and Credit Co-operatives
<b>SAMAF</b>	South African Microfinance Fund
<b>SARB</b>	South African Reserve Bank
<b>SASRA</b>	SACCO Societies Regulatory Authority
<b>SEDA</b>	Small Enterprise Development Agency
<b>R</b>	South African Rand

### 1.2. Legislation

Acronym	Description
	Co-operative Banks Act of 2007 as amended by the and the Bank Act Exemption Notice of August 15, 2014;
<b>CBA 2007</b>	Co-operative Banks Act of 2007
<b>Exemption Notice</b>	Bank Act Exemption Notice 2014



Acronym	Description
<b>FSR Act</b>	Financial Sector Regulation Act 2017 (“FSR Act”)
	Co-operatives Act of 2005 (amended in 2013)
<b>BEN 620</b>	Bank Exemption Notice 620 of 15 August 2014 (the Exemption Notice)
<b>NCA 2015</b>	National Credit Act of 2005
	Co-operatives Act No 14 of 2005
<b>FICA</b>	Financial Intelligence Centre Act 2001 (FICA)
<b>FSLGA Act 2013</b>	Financial Services Laws General Amendment Act of 2013
	Kenya Co-operative Society Act
	Australian Banking Act (1959)



## 2. Executive Summary

### 2.1. Overview of Key Findings and Recommendations

This section sets out a high-level overview of key findings and recommendations of the ICURN Peer Review arising from the assessment and evaluation by the team of the legal, regulatory and supervisory framework of the Co-operative Bank Development Agency (“CBDA”) with particular reference to Co-operative Financial Institutions (“CFIs”).

The Peer Review team acknowledges the range and extent of the work undertaken by CBDA since its formation in 2008, in particular in establishing and making operational the regulatory and supervisory framework that applies to CFIs. It was evident from the discussions and interactions with the management and staff at CBDA that they took their mandate very seriously, supported by a clear commitment and belief in the role and value that both co-operative financial institutions and co-operative banks can play in the South African financial sector.

More broadly, we found that the sector stakeholders met during the on-site peer review – which included a range of government bodies, departments and agencies, CFIs (registered and de-registered) and a trade representative body – were all very open in sharing their views and opinions on matters relating to the co-operative financial sector. This included providing views on the background, context, current position and potential for the sector in supporting and enabling communities across South Africa, particularly from a financial inclusion perspective. The common theme and messages conveyed were the genuine passion, commitment and belief in financial co-operatives, together with an overwhelming desire and enthusiasm to develop and support CFIs with a view to ensuring that they can serve the needs of members and communities – both urban and rural. This level of belief and commitment is a significant and valuable asset and, with all sector stakeholders committed to working together towards this common strategic goal, should be a real enabler for the South African authorities to achieve the stated outcomes in relation to promotion and development of sustainable and responsible co-operative banks and financial institutions and advancing access to banking services.

Notwithstanding this well-articulated commitment, the size of the co-operative financial sector in South Africa remains very low – both in terms of numbers of registered CFIs and total asset size (further details in Section 4) and there was no evidence of any significant changes in this position over the short to medium term. The reasons that may be contributing to the low number of CFIs appear to be varied and multi-dimensional and need to be viewed and considered against the background of the South African environmental context – past and present<sup>1</sup>. From our analysis, which was informed by the on-site visit, a key issue to be addressed is the need for a clear and coordinated strategy for the

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<sup>1</sup> Stokvels are small local voluntary groups of natural persons (members) bound by a common cause, where members contribute fixed sums of money to a central fund on a weekly, fortnightly or monthly basis. They are unregulated and function as a savings scheme that pay out to members for specific events. There are various estimates on the number of stokvels, with some references that there could be in the range of 800,000 up to approximately two million.



co-operative financial sector with identified actions and timelines, involving all key stakeholders at national and regional level.

More specifically, in the context of this peer review which focussed on regulation and supervision by the CBDA, while during meetings with the various stakeholders they referred to a number of aspects of the registration and supervisory requirements as possible contributory factors to the lack of development of the sector, there was no evidence put forward that would clearly substantiate these assertions.

However, notwithstanding this, there are recommendations that the relevant authorities could consider at a strategic level, as well as improvements and refinements in areas of regulation and supervision, in order to seek to enhance the achievement of the overall strategic goal to develop and promote the co-operative financial sector.

At a high level, the recommendations can be summarised under four main areas:

1. The government should take the lead with the co-operative financial sector to develop an overall strategy for the sector.
2. CBDA should improve its communications and engagement with the entire CFI sector.
3. There should be an impact assessment conducted on the CBDA capacity building work to date so that it can better position its training and capacity development of CFIs. Accessibility of the trainings is also of key importance.
4. As the supervisory responsibilities for CFIs shift from CBDA to the Prudential Authority, the supervisory regime applied should be proportionate in its approach and tailored to take account of the size, degree of complexity and risk profile of CFIs.

### 2.1.1. Overall Strategy for Co-operative Financial Sector

This is an area where overall responsibility does not fall within the scope of the Supervisory Authority<sup>2</sup>, but which requires direction and coordination at a national level. For its part, the supervisory authority could seek to bring this forward for consideration by the relevant government authorities and to consider carefully the extent and scope of its role in the implementation of such a strategy, taking into account its specific legislative responsibilities on regulation and supervision.

### 2.1.2. Communications and Engagement

While a significant level of communication and engagement has been undertaken by CBDA with CFIs through a range of activities, including issuing of regulations, developing a risk based approach to supervision and annual on-site engagement programme, given the size and limited resources in many CFIs, it is important that communications and engagement with the sector are kept to the forefront of the CBDA agenda and that it is recognised that this is an area that requires regular review and

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<sup>2</sup> At the time of the on-site peer review, the CBDA was the Supervisory Authority for CFIs. This function will move to the new Prudential Authority at the SARB in 2018.



enhancement. This is to ensure that the regulatory and supervisory messages being delivered are clearly understood by CFIs and that supplementary information, explanations are provided to CFIs to support them in having a clear understanding of the risks, and actions that they need to take to address these matters. In addition, matters on the status of the banking platform including expected timelines for completion, costs and other issues arising should be clearly and regularly communicated to all CFIs involved in this project so that they are fully aware of all matters relevant to the management and operation of their reporting systems.

The Peer Review Team recognise that an increased focus on this area would place additional demands on the time of management and staff in the supervisory authority (see recommendation of development and training below). However, based on our experiences, we are of the view that it would be well worthwhile as it should result in clearer outcomes for the supervisor in terms of risks identified being addressed by CFIs as well as of benefit to directors and staff of CFIs in terms of their understanding of the relevance and importance of risks identified and the need to address them.

### 2.1.3. Resources – Development and Training

#### *CFIs*

This is an area where CFIs would benefit from more focussed and regular development and training to enable them to fully understand and manage the risks arising in their businesses. The training needs to be kept up to date, run frequently and tailored to the needs of individual CFIs. Given the role set out in legislation for the CBDA to provide capacity building, in order to ensure this support is targeted and relevant for CFIs, there should be a formal mechanism for the supervisory authority to receive feedback on particular areas of risks or other matters informed by its supervision of CFIs that capacity building can work on in order to develop the appropriate type, format and frequency of training. The range of methods of delivery of training should be considered – face-to-face, written, and online and the need to ensure that this continues to include a regional focus with travelling to regions. Recognising that there may be issues of confidentiality arising it would be important to put in place a memorandum of understanding between the supervisory authority and CBDA Capacity Building. However, before embarking too far on this path, we strongly recommend that an impact assessment of the agency's capacity building work to date be completed.

#### *Supervision / Capacity Building / Support*

Training and development needs for supervisory staff should be reviewed to ensure that there is a comprehensive range of training available to ensure that staff can keep up to date on supervisory areas and developments. This should cover both formal induction training for new staff as well as regular training for existing staff. Training should be both of a technical nature – covering regulations, supervisory approach, risk areas (e.g. operational risk, credit risk, and IT risk) as well as in non-technical areas such as decision-making, impact and influence, collaboration and leadership. The range of delivery should also be considered to include in-house training (class room based), on the job training, peer group training (sharing experiences) as well as on line computer based courses and mentoring and coaching. All staff should have the opportunity to drive the identification of their own development needs with an annual plan identifying the key areas of focus for the coming year and



consideration could be given to requiring a specified number of training / development days per annum.

We recognise that an increased focus on this area would also place additional demands on the time of management and staff in the supervisory authority, but are of the view that such investment is worth the commitment in terms of delivering high quality and effective regulatory and supervisory outcomes. Taking account of the impact of this recommendation, together with the recommendation on communication and engagement, as well as the more detailed recommendations set out elsewhere in this report, the authorities should consider the level of current resourcing and whether this will be adequate to address all matters to ensure effective risk based supervision with a credible threat of enforcement. Options should be considered to ensure that the regulatory and supervisory strategy can be delivered in the most effective and efficient way, taking account of relevant budgetary and operational requirements.

It is also recommended that training and development for staff involved in capacity building and support should be reviewed and kept up to date to ensure that the services and support being offered to CFIs remains focussed, relevant and meets the varying needs of individual CFIs.

#### 2.1.4. Regulation and Supervision

The supervisory authority should consider its approach to all regulatory and supervisory areas relating to CFIs (licensing, prudential requirements, methods of ongoing supervision, accounting and disclosure and enforcement), taking account of its current approach as well as the changes arising from the move to the new prudential authority including associated legislative changes. The ICURN guiding principles for effective prudential supervision of co-operative financial institutions should be used as a reference point to inform possible changes (see Section 7 for further details). In undertaking such a review, it is recommended that any changes to prudential requirements, supervisory approach and reporting recognise the particular features of CFIs; in particular, that the supervisory regime applied is proportionate in its approach and is tailored to take account of the size, degree of complexity and risk profile of CFIs. This approach should also take into consideration the overall policy objective for the co-operative financial sector and the appropriate role of supervision in facilitating delivery of this objective.

Further details on recommendations are included in the report as follows:

- Section 9 contains an analysis of and recommendations on issues that arose from the stakeholder meetings. These include registration requirements, common bond, deregistration, supervision focus, deposit insurance, collaboration with industry, capacity building and supervision, prudential requirements, transition from CFI to Co-operative Bank, CBDA and supervision industry engagement and taxation treatment.
- Appendix 3 provides information on how selected topics are dealt with in Australia, Ireland and Kenya, which may also be of assistance to the South African authorities in considering implementation of the recommendations in this report, and / or other areas that they may choose to consider in the future.



## 3. Scope & Methodology

The International Credit Union Regulators' Network ("ICURN") was engaged to conduct a peer review to determine the effectiveness of the CBDA in implementing its mandate, with a specific focus on regulation and supervision and the impact that this has had on the growth and stability of the CFI sector.

### 3.1. Basis of Review (including Terms of Reference)

The scope of the Peer Review included:

- (1) A review of the Co-operative Banks Act of 2007 as amended by the Financial Services Laws General Amendment Act of 2013 and the Bank Act Exemption Notice of August 15, 2014;
- (2) Review of the purpose, plans and strategies of CBDA;
- (3) An assessment of the effectiveness of the implementation the Co-operative Banks Act of 2007 and Bank Act Exemption Notice 2014 by CBDA;
- (4) The capacity and effectiveness of CBDA in carrying out its various mandates with a focus on the regulation and supervision of the CFI sector;
- (5) An assessment of the positive, negative or neutral impact of regulation and supervision by CBDA on the growth of the CFI sector;
- (6) Perceptions of the regulatory and supervisory processes of CBDA by a representative cross-section of the CFIs and rejected CFI applicants;
- (7) Practical recommendations drawing from the findings, practical recommendations for improving the regulatory and supervisory process in South Africa.

### 3.2. Peer Review team members

The members of the ICURN Peer Review team are highly skilled regulatory representatives from Ireland, Kenya and Australia. The Report was also reviewed and evaluated by the ICURN Review Task Force comprised of its Executive Director and Chairman. The biographies of all team members and reviewers are included in Annex 3.

### 3.3. Guiding Principles applied

Based on the above, the ICURN team prepared this peer review report, which includes an assessment of regulation and supervision with reference to the ICURN Guiding Principles for Effective Prudential Supervision of Co-operative Financial Institutions (which have been cross-referenced to the Basel Principles for Effective Supervision of Microfinance Activities). The assessment was based on the ICURN team's review and judgement of the information it received prior to, during and subsequent to the on-site engagement. The ratings referred to in Section 7 are not in any way to be taken or held out as assessments based on the International Monetary Fund ("IMF") methodology. A summary of the team's assessment is provided below:

### Summary of Assessment Ratings

Compliant	Number	Principle / Guiding Principle
Compliant (C)	2	13, 14
Largely Compliant (LC)	8	2, 6, 8, 9, 10, 15, 19, 20
Materially Noncompliant (MNC)	6	3, 11, 17, 21, 22, 23
Noncompliant (NC)	4	1, 7, 16, 18
Non-applicable (N/A)	5	4, 5, 12, 24, 25
<b>Total</b>	<b>25</b>	

The review report was made in the context of the South African CFI sector, recognising the specific and distinctive features of the sector at the time of the review. The assessment also acknowledges and welcomes the planned changes due to take place, in particular the forthcoming transfer of responsibility for regulation and supervision of CFIs from CBDA to the South African Reserve Bank.

### 3.4. On-site Engagement

The on-site evaluation of the regulatory impact and effectiveness of CBDA, which took place during the two weeks from the 2 to 12 October 2017, included a review of legislation, regulations and other documents as well as interviews with key stakeholders within regulatory agencies (CBDA, the South African Reserve Bank (“SARB”) and National Treasury), selected CFIs, CFI association, Provincial departments of economic development, government agencies / departments and development partners and trade associations (the list meeting and outcomes are provided in Annexes 2 and 3). The review sought to determine the effectiveness of the CBDA in implementing their required activities, with a focus on regulation and supervision and what impact, positive or negative, its regulation and supervision activities and requirements have had on the growth of the co-operative financial institutions sector. The review includes appropriate references to the ICURN Guiding Principles and to the CBDA’s published statements of its objectives, vision and focus.

### 3.5. Information provided

The ICURN team received requested data from CBDA prior to and during the on-site review to facilitate the assessment as well as clarifications on certain matters subsequent to the on-site visit.

## 4. Environmental Context

### 4.1. Overview of Banking Sector

South Africa appears to have a well-developed banking system, which, at the time of this report, is regulated and supervised by the South African Reserve Bank (“SARB”). South African banking is largely categorised into commercial banks, mutual banks and co-operative banks. According to the 2016



SARB Bank Supervision Department Annual report, the banking system had 17 banks, 36 local branches of foreign banks, three mutual banks and two co-operative banks.

The enactment of the Co-operative Banks Act of 2007 (Act No. 40 of 2007) was a developmental initiative by the South African Government with the goal of deepening financial inclusion through member-owned financial institutions.

Co-operative banks are thus designed to provide alternative access to financial services and thereby support the economic and financial empowerment of communities at the grassroots level. The policy motivation being that organic growth of co-operative banks holds the potential to increase effective participation of community members in the economy resulting from responsible member-based funding of new economic activities<sup>3</sup>. However, prior to being licenced by the SARB as a co-operative bank, the law provides for registration of CFIs allowing such newly registered institutions to grow and meet the minimum licensing requirements for co-operative banks.

## 4.2. Overview of Sector

A CFI is the umbrella term used for member-based deposit taking financial co-operatives owned and controlled by their members who have a common bond. CFIs therefore can also be described as Savings and Credit Co-operatives ("SACCOS"), Financial Co-operatives or Financial Services Co-operatives ("FSCs") or credit unions. As co-operatives, CFIs are incorporated under the Co-operatives Act of 2005 (amended in 2013) but their development and supervision is centralised at CBDA until they meet the minimum legal requirements to become Co-operative Banks, upon which supervision moves to SARB. This is enabled by the Co-operatives Banks Act of 2007 and Banks Act Exemption Notices 404 and 620 issued by SARB in May 2012 and August 2014 respectively.

The Banks Act Exemption Notice No. 620 effectively allowed CFIs to accept deposits from their members without meeting the stringent legislative requirements for co-operative banks. The minimum registration requirements administered by CBDA to become a CFI are at least 200 members, R100,000 in member share capital and there must be a common bond. Upon attaining regulatory requirements (described in detail in section 5.1) below, a CFI should apply to SARB to become a co-operative bank.

Table 1 below highlights CFI sector metrics as at February 2017 starting from 2011 as sourced from the annual reports published by CBDA<sup>4</sup>. The sector metrics as published include the co-operative banks and CFIs.

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<sup>3</sup> 2010/11 Combined Annual Report by Cooperative Banks Development Agency and South Africa Reserve Bank

<sup>4</sup> Available on the CBDA website at <http://www.treasury.gov.za/coopbank/publications/publications.aspx>

**Table 1: CFI Sector Metrics, 2011 to 2017**

Description	Feb 2017	2016	2015	2014	2013	2012	2011
<b>Number of CFIs</b>	30	30	26	26	35	21	18*
<b>Members</b>	29,818	29,752	24,722	33,391	38,084	31,481	28,034
<b>Assets, R M</b>	283.1	279.6	236.6	231.4	220.8	201.8	175.9
<b>Deposits, R M</b>	227.6	233.8	201.1	198.6	200.8	187.9	161.0
<b>Loans, R M</b>	NA	NA	152.1	140.5	142.3	128.7	107.3

\*Represents the CFIs that were met the minimum registration criteria, not necessary registered number

The sector has grown at a slow rate, as demonstrated in the table above and we understand that this remains well below CBDA expectations. Indeed, a total of six CFIs were deregistered by the CBDA over 2016-2017 for varying reasons (and we understand continue to operate outside the regulatory environment).

As at February 2017, financial performance of the CFI sector was as follows:

- Total lending assets for the CFI sector stood at R117,608,556 which is a slight increase from the prior year and the majority of lending is for terms greater than three years. Delinquency continued to trend down and was 5.48%. However, these are overall sector averages and as such do not highlight the financial challenges of some CFIs – especially among the smaller institutions.
- Sector liabilities are mainly deposits from members, although some CFIs receive funding from the Government and Provinces for the purpose of lending to small-medium enterprises. Over 31% of liabilities are invested in liquid assets, which are mostly deposits with commercial banks.
- Capitalisation remains sound relative to the 6% minimum requirement with the sector total capital adequacy at 18% of total assets. The same can be said for sector financial performance with the cost-to-income ratio below 80%, return on assets of 199 basis points and operating expenses to average assets less than 7% in recent years.

### 4.3. Agencies

The CBDA was established through the Co-operative Banks Act, 2007 in August 2008 to regulate promote and develop co-operative banking. In practice, this has included such activities as the development of core banking system for the industry, developing and delivering training and providing other support activities.

Recognising the need to separate prudential supervision and industry support, the Financial Sector Regulation Act 2017 (“FSR Act”), Act No.9 of 2017 will result in the regulation of the CFI sector moving from the CBDA to the Prudential Authority, underneath the SARB. At the time of the on-site review, supervision was in a transition phase, with the current frameworks and requirements unchanged, but going through review under the guidance of a specially formed technical committee.

There are also a number of other agencies and stakeholders providing financial and technical support to the CFI industry in South Africa. These include:



- ***Provincial Departments of Economic Development:*** They consider CFIs as critical players in the economic empowerment of the provincial communities, both in the townships and rural areas. They thus provide varying levels of support to CFIs and co-operatives in general.
- ***Department of Small Business (Co-operatives Development Division):*** Under the Department of Trade and Industry, this is an important stakeholder and currently represented on the CBDA Board.
- ***Small Enterprises Finance Agency:*** a national government agency under Department of Trade and Industry and provides funding to small business including through CFIs for enterprise lending.
- ***The National Association of Co-operative Financial Institutions of South Africa (“NACFISA”),*** established in 2013 is another important stakeholder and currently has nineteen CFIs affiliated to it. Besides its advocacy role, NACFISA also provides capacity-building support to the CFIs including a core system to automate business operations. It is currently working with the CBDA to seek to become an accredited organisation under the CBA of 2007.
- ***Small Enterprise Development Agency (“SEDA”)<sup>5</sup>,*** established in 2004, is an agency of the Department of Small Business Development, which provides non-financial support to small enterprises and co-operatives. SEDA’s mandate is to implement government’s small business strategy; design and implement a standard and common national delivery network for small enterprise development; and integrate government-funded small enterprise support agencies across all tiers of government.

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<sup>5</sup> Taken from the SEDA website: <http://www.seda.org.za/Pages/Home.aspx>



## 5. Legislation – Co-operative Banks Act of 2007 (as amended)

### 5.1. Introduction

The legislative environment for both industry participants and prudential regulators has been going through a period of change particularly since 2005. Being co-operatives by nature, CFIs firstly fall within the Co-operatives Act of 2005 (amended in 2013). This means that all CFIs must be registered with the Registrar of Co-operatives.

CFIs currently operate within the Banks Act Exemption Notice No. 620, which allows CFIs to undertake deposit taking without needing to meet the requirements for co-operative banks. The minimum requirements to become a CFI are at least 200 members, R100,000 in member share capital and there must be a common bond.

To become a co-operative bank, there are certain requirements contained within the Co-operative Banks Act of 2007 (amended in 2013) (the “CBA Act (2007)”). Minimum requirements to apply to become a co-operative bank include at least 200 members and R1 million in deposits. Once a registered CFI reaches R30 million in deposits, it must apply to become a co-operative bank. The CBA Act (2007) restricts CFIs from accepting further deposits over this limit until such time it has successfully been granted authority to operate as a co-operative bank by the SARB. In order to be granted a co-operative banking authorisation, in addition to the above criteria, the applicant must satisfy the SARB that it has the necessary financial, human and operational requirements to operate as a co-operative bank.

The Financial Sector Regulation Act 2017 (“FSR Act”) was assented to in August 2017, thereby amending the CBA Act (2007). A fundamental consequential amendment is that regulation and supervision of CFIs will move from CBDA to the newly established Prudential Authority.

CFIs also have other legislation and regulation to contend with outside of the prudential environment. For example, the National Credit Act of 2005 requires most credit providers to register with the National Credit Regulator.

### 5.2. Co-operative Banks Act 2007

The stated purpose of the Co-operative Banks Act 2007 (as amended) is to:

- promote and advance the social and economic welfare of all South Africans by enhancing access to banking services under sustainable conditions;
- promote the development of sustainable and responsible co-operative banks and CFIs;
- establish an appropriate regulatory framework and regulatory institutions for co-operative banks and CFIs that protect the interests of members of co-operative banks, CFIs and the public by providing for:



- registration of deposit-taking financial services co-operatives as co-operative banks or CFIs;
- appropriate and effective regulation and supervision of co-operative banks and CFIs and to protect member and the public interest; and
- establishment of a Development Agency for co-operative banks to develop and enhance the sustainability of co-operative banks and CFIs.

The amendments to the Act (reflecting the Financial Services Laws General Amendment Act, 2013 (Act No.45 of 2013)) now include a definition of CFIs and a new Chapter inserted (Chapter VIIA) which includes matters relating to application for registration, requirements for registration, suspension and winding –up. These were previously dealt with through the Bank Exemption Notice 620 of 15 August 2014 (the Exemption Notice) – see Section 6 for more details on status of Exemption Notice and matters arising.

Section 40B deals with the requirements for registration, which include demonstrating sufficient human, financial and operational capacity to function efficiently and effectively. This is an aspect where it would be useful to have some internal guidelines or checklists to assist the supervisor in assessing applications.

General powers and functions of the Prudential Authority include specific reference to CFIs (Section 45) as does the power to make standards (Section 46), to issue Directives (Section 48) and to issue administrative penalties (Section 49) which provides clarity and strengthening of powers for the regulation and supervision of CFIs. Supervision for CFIs was previously dealt with through the Bank Exemption Notice 620 of 15 August 2014 (the Exemption Notice) – see Section 6 for more details on status of Exemption Notice and matters arising.

Other areas of the Co-operative Banks Act which do not include specific reference to CFIs, should be looked at, in conjunction with findings and recommendations in Section 7 on assessment with ICURN principles, to see if these should be extended as appropriate to CFIs. Examples include:

- Chapter II Part 3 – Management of co-operative bank;
- Part 4 – Auditor of co-operative bank;
- Chapter III – Prudential Requirements and Large Exposures;
- Chapter IV – Deposit Insurance Fund.

### 5.3. Other observations – Section 55 of the Act - General Functions of the Agency (CBDA)

Section 55 (1) on General Functions of the CBDA includes the following three functions, which may warrant consideration as to exact purpose, objective practicality and interlinkages:

- (c) Promote the establishment of representative bodies and support organisations;
- (d) Register and regulate representative bodies and support functions;
- (e) Accredite and regulate support organisations.



Section 55 (1) also contains the following functions in relation to CFIs:

- (f) provide in consultation with the Authority financial support to co-operative banks through loans or grants;
- (h) assist in consultation with the Authority, co-operative banks with liquidity management.

Given the financial dimension to both of these functions, it would be important that there is a clear understanding of how these would operate in practice and would warrant consideration of putting in place Memorandum of Understanding between the Agency (CBDA) and the Authority as supervisor.



## 6. Regulatory and Supervisory Framework for CFIs

CFIs refers to any co-operative that takes deposits and chooses to identify itself by use of the name Savings and Credit Co-operative (“SACCO”), Financial Co-operative, Financial Services Co-operative or Credit Union.

The Bank Act Exemption Notice 620 of 15<sup>th</sup> of August 2014 allowed CFIs to take demand deposits without having to register as a bank. This was necessary to allow incubation and support to CFIs who would then apply to become a co-operative bank upon fulfilling the legal requirements. This effectively created a tiered structure for CFIs in South Africa.

The CBA 2007 and subsequent amendments through the Financial Services Laws General Amendment Act of 2013 provide explicitly that the regulation and development of CFIs into fully-fledged co-operative banks is the mandate of CBDA. The consolidation of regulatory and developmental functions was seen as a positive step towards building sustainable co-operative banks for the future.

### 6.1. Supervisory Tools

In order to effectively execute its regulatory and supervisory mandate, CBDA has developed and implemented a range of supervisory tools including rules and guidance notes as referred to below.

### 6.2. Supervisory and Regulatory Rules for CFIs Applying for Registration

The supervisory and regulatory rules are a summary of the legislative requirements for registration and operation of a CFI. They provide in non-technical language, details on the application process, and criteria for registration, reporting on performance and prudential requirements, performance monitoring through inspections, consequences of infringement, annual renewals and various regulatory returns and forms. These rules are available in the CBDA public portal on the [CBDA website](#)<sup>6</sup>, giving convenient access to CFIs who are spread across the country in cities, municipalities and townships.

The rules are complemented by a detailed easy to read [CFI Start-up Guide](#)<sup>7</sup> for persons wishing to start a CFI and thus covers such basic questions as:

- What is a CFI and what it is not?;
- Co-operative principles and what they mean;
- Rights and obligations of members of a CFI;
- What is a common bond in a CFI?;

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<sup>6</sup> <http://www.treasury.gov.za/coopbank>

<sup>7</sup> <http://www.treasury.gov.za/coopbank/CFI%20start%20up%20guide.pdf>

- CFI registration requirements;
- Steps in organising a CFI;
- Registration requirements of the CIPC;
- Legislative framework for CFIs and co-operative banks; etc.

### 6.3. Guidelines on Specific Legal and Regulatory Requirements

These are technical guidance notes that amplify the legal and regulatory requirements for ease of understanding and implementation by CFIs. CBDA has issued a total of sixteen guidelines which are categorised as Start-up guidelines and Operating guidelines, all of which are available on the [CBDA website](#)<sup>8</sup> for ease of access by any interested person. These enhance access to regulatory guidance for both prospective and existing CFIs.

Start-up Guidelines	Operating Guidelines
Application as a CFI	Risk management
Model constitution	Problem CFI Resolution
Financial Forecast - Start ups	Liquidity risk
Saving policy	Operational risk
Loan Policy	Market risk
Business Plan	Accounting & Disclosure
	Liquidation
	Returns

### 6.4. Supervisory Framework for CFIs

This framework sets out the supervisory approach adopted and applied by CBDA in supervision and regulation of registered CFIs to ensure protection of member deposits. Guided by the legal and regulatory framework, CBDA has developed and implemented a supervisory strategy with the following key processes.

- (1) **Application Processing:** This entails detailed off-site review of the application, pre-registration on-site assessment, developing a detailed institutional profile, recommendations on registration or otherwise and annual renewal based on performance and prudential compliance.
- (2) **Regular Monitoring:** This entails three distinct but interconnected dimensions namely *off surveillance, on-site examinations and problem resolution*.

For **off-site surveillance**, CBDA receives quarterly regulatory returns on CFIs' financial performance for periods ending February, May, August and November (year end for all CFIs is February). Ratios and trend analysis on CFI performance are generated by CBDA for each

<sup>8</sup> <http://www.treasury.gov.za/coopbank>



institution highlighting any compliance concerns. A quarterly sector performance report is generated and shared with CBDA management.

In *on-site examination*, CBDA applies both rules-based and risk-based approach to examination based on the deposit amount in Rand i.e. CFIs with deposits less than R1 million are subjected to rules based approach, while those in excess of R1 million in deposits are subjected to risk based approach. Key risks featured in the risk-based assessment are credit, interest rate, liquidity, operational, legal and strategic risks. A risk matrix and assessment is the generated and consolidated into the institutional profile of the CFI. The risk classification determines the supervisory review and evaluation process cycle, which ranges from minimum reviews to more intensive review for high risk CFIs. The final risk assessment report is provided to the CFI for review and comments before board meeting is scheduled for discussion of the findings with the Board.

Adequacy and effectiveness of the supervision approach and how it can be improved is outlined in Section 7 and Section 9.

**Problem Resolution:** CBDA currently lacks the formal resolution powers and tools necessary to ensure orderly closure of a CFI, where circumstances warrant this. It thus uses the de-registration process as the key tool to address.

In addition, CBDA had prepared a document entitled Problem CFI Resolution Framework (June 2016), setting out a guide to intervention in weak CFIs the purpose of which was to promote awareness and enhance transparency of the intervention process used for CFIs. However, they acknowledge that due regard is taken of the need to ensure that, in the absence of an enabling regulatory framework, interventions to date are largely based on moral suasion and infringement notices.

## 6.5. Capacity Building of CFIs

CBDA has an explicit legal mandate of developing the capacity of the CFIs as specified below:

- (1) Promote the establishment of representative bodies and support organisations;
- (2) Register and regulate representative bodies, accredit and regulate support organisations;
- (3) Consult and liaise with the South African Qualifications Authority and relevant structures; and
- (4) Facilitate, promote and fund education, training and awareness programmes for an effective, efficient and sustainable financial co-operative sector.

In order to carry out the above, CBDA has a functionally dedicated unit whose duty and responsibility is building institutional partnerships towards sector-wide standards and approaches and delivering capacity-enhancing support programmes.

Under the current strategic plan, the focus of the CBDA capacity-building unit is on pre-registration support and direct technical assistance to individual CFIs. In addition, CBDA has developed training



programmes targeted at both management and board members. This has been achieved through collaboration with stakeholders including representative bodies, BANKSETA<sup>9</sup>, universities and other development agencies.

**The absence of a coordinated sector-wide strategy may be undermining the success of the different interventions to grow and develop the CFI industry.** The functions, while well intentioned for a coordinated and harmonized capacity development in CFI sector, may prove a challenge in the absence of a sector-wide shared vision and goals with accompanying roadmap or strategies. This was noted in discussions with various stakeholders including government department / agencies and NACFISA. Evidently, each department and / or agency has progressive initiatives and ideas to support the CFI sector, including subsidized funds. For instance, the NACFISA system to support CFIs should be a source of serious concern to CBDA as there is a lack of coordination.

The proposed transfer of the CFI regulation mandate to the Prudential Authority at SARB with CBDA retaining its development mandate creates room for a policy discussion to find potential solutions to the aforementioned challenges. The proposed all-inclusive steering committee aims to ensure a coordinated approach to development of the CFI sector is commendable and should be supported by all sector stakeholders. However, the terms of reference for this committee should be guided by a documented Government policy on development of CFIs and co-operative banks. The ongoing discussions on transformation of the financial sector and the introduction of a twin peak regulation of the sector provides an opportunity for a policy review for the CFI sector.

## 6.6. Core Banking System for Registered CFIs

In furthering CBDA's mandate to develop the CFI sector, one of the strategic objectives in the current strategic plan is *"to enhance operational capability of the CFIs through common and shared management information system"*. The Banking Platform project, which commenced in 2015, is an industry project with CBDA as the implementing institution. Other participants include Small Enterprise Financing Agency, Department of Small Businesses, NACFISA and Gauteng Department of Economic department. SARB is also represented on the steering committee. Once complete, the Banking Platform is envisaged to automate key business reporting processes for CFIs including liquidity management, product development, reconciliations, settlement, accounting, credit processes, product development and compliance reporting.

Technical implementation started in 2016, with a total of 13 CFIs already participating in the platform. Eight CFIs have migrated their data and using the system in a limited way. CBDA is offering the banking software as a Service ("SAAS") with participating CFIs paying R50,000 per annum. The payment covers training, data migration and support.

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<sup>9</sup> BANKSETA is the Sector Education and Training Authority (SETA) for the banking industry.



While CFIs and supporting agencies / department were relatively positive about the Banking Platform, there appeared to be some concerns as to whether the system will deliver all of the envisioned benefits in business process improvements and eventual operational efficiency and the timeframe for delivery of finalised version.

Information and communication technology (“ICT”) projects are, by their nature, complex, as technology and scope are required to be reviewed and development and implementation progress affects original timelines. Effective communication becomes central in managing expectations of both the CFIs and the financiers. CBDA needs to convene a project steering committee to review the progress, challenges and what is required to fast track completion and phased roll-out in participating CFIs.

It is important also that CBDA reviews critically its long-term involvement in managing and developing the ICT platform considering the attendant risks and potential impact on its overall mandate.



## 7. Assessment of Effectiveness of Implementation by CBDA of the Co-operative Banks Act 2007 & Bank Exemption Notice 2014 by CBDA (with focus on regulation and supervision of CFI sector)

### 7.1. Overview

The Supervision Unit of the CBDA derives its mandate to supervise and regulate CFIs through the **Bank Exemption Notice 620 of 15 August 2014** (the Exemption Notice) –Designation of an activity not falling within the meaning of “the business of a bank”<sup>10</sup>. Annexure A of the Exemption Notice contains a schedule, which includes:

- Definition of common bond (section 1);
- Designated activity of CFIs (section 2); and
- Conditions applicable to CFIs including reference to being subject to requirements of Co-operatives Act No 14 of 2005 and supervision and regulation of CBDA (section 3 (a)).

CBDA has issued **Supervisory and Regulatory Rules for CFIs** (the “Rules”)<sup>11</sup> under section 3(a) of the Exemption Notice which cover areas including registration, renewals, reporting, alternative capital instruments, operational requirements, fit and proper directors and management, inspections, appeals, fees, forms and returns and two appendices covering minimum prudential standards and operational standards. In addition, CBDA has issued Guidelines to CFIs on a number of areas including Savings Policy, Loan Policy, Risk Management (including Liquidity, Market and Operational Risk) and Accounting and Disclosure.

On 25 May 2016, following the CBDA seeking an opinion on whether it could issue fines / penalties on CFIs who had transgressed their rules, a legal opinion was provided by the National Treasury’s legal department, indicating that the Registrar of Banks had acted outside its powers by mandating CBDA to discharge its supervisory powers through the Exemption Notice as CBDA was not a regulatory authority, but a statutory body that derived its mandate from an Act of Parliament. The Exemption Notice originated for self-regulatory organizations to enforce amongst their own members voluntarily joining the organization and agreeing to abide by its decisions, which was the way SACCOL enforced it. However, the CBDA is a statutory body which derives its mandate from an act of the Parliament. The opinion is essentially stating that the SARB has acted outside of its powers to give the CBDA the authority to regulate CFIs.

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<sup>10</sup> Introduced in order to be in line with the provisions of paragraph (cc) of the Banks Act, 1990, signed by Registrar of Banks

<sup>11</sup> First issued 20 July 2012, re-issued 1 July 2015



Subsequent to this, following developments towards “twin peaks”<sup>12</sup>, a directive was issued on 19 January 2017 requiring the CBDA supervision function to be placed under the Prudential Authority. At the same time, consequential amendments to the Co-operative Banks Act have been effected to provide for the regulation and supervision of CFIs through the Prudential Authority.

## 7.2. Self-assessment by CBDA of compliance with Basel Core Principles for Effective Supervision of Deposit Taking Microfinance Institutions

From 2012, CBDA has conducted a self-assessment of its compliance with **Basel Core Principles for Effective Supervision of Deposit Taking Microfinance Institutions**<sup>13</sup> and published a table in its Annual Report indicating those principles with which it was materially non-compliant with during base year 2013 and the subsequent initiatives taken to address those gaps. The 2017 Annual Report states that a robust consultation was made with the National Treasury legal office regarding enforceability of rules and that further engagements were made with the sector and other interested parties regarding amendments to the Co-operatives Banks Act. The Peer Review team were advised that the weaknesses uncovered associated with regulating through an exemption notice were addressed in the Financial Sector Regulatory Bill (FSRB) which was subsequently enacted as the Financial Services Regulation Act, 2017 gazetted on 22 August 2017<sup>14</sup>.

## 7.3. Assessment of Effectiveness of Implementation by CBDA of Co-operative Banks Act 2007 and Bank Exemption Notice 2014

An assessment of the CBDA’s effectiveness in implementing the Co-operative Banks Act 2007 and Bank Exemption Notice 2014 was undertaken as part of the Peer Review, having regard to CBDA’s most recent self-assessment of its compliance with the Basel Core Principles for Effective Supervision of Deposit Taking Microfinance Institutions and applying the relevant ICURN Guiding Principles. The description, comments, assessment and recommendations in relation to each Principle are based on the current position regarding legislation and powers of the supervisory authority – CBDA.

In considering the recommendations, it will be necessary for the supervisory authority to consider:

- (1) which are matters that will be addressed following the supervision of CFIs coming under the new Prudential Authority and the coming into force of the updated Co-operative Banks Act 2007 and Financial Sector Regulation Act; and

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<sup>12</sup> The twin peaks model of financial sector regulation will see the creation of a prudential regulator – the Prudential Authority – housed in the South African Reserve Bank (“SARB”), and a dedicated market conduct regulator – the Financial Sector Conduct Authority.

<sup>13</sup> Guidance issued by Basel on applying core principles to non-banks which are deposit-taking institutions explains that these should be subject to regulation and supervision commensurate to the type and size of their transactions – tailored by supervisors appropriate to risks and supervisory resources should be in regulatory proportion with suitable supervisory framework. (<http://www.bis.org/publ/bcbs175.pdf>).

<sup>14</sup> As of this writing, draft regulations for the Financial Services Regulation were published in December 2017 and it is anticipated that the Act will be implemented in phases.

- (2) which are matters that, notwithstanding the planned changes, may still require consideration in terms of changes to future legislation, standards or guidance as considered appropriate.

In making any changes to legislation, standards or guidance, it is recommended that the supervisory authority have regard to the need to ensure that any changes or new requirements are effective and proportionate, having regard to the nature, scale and complexity of CFIs. It is also recommended that any changes to standards or guidance are subject to consultation, e.g. with CFIs and any other relevant bodies that have expertise or knowledge of CFIs generally.

### 7.4. Summary Assessment (including Rating)

Following are the grading categories and criteria used in the observation of the Guiding Principles<sup>15</sup>.

Grade	Criteria
<b>Compliant</b>	An assessment of "compliant" is given when all criteria are met without any significant deficiencies, including instances where the Principle has been achieved by other means.
<b>Largely Compliant</b>	A "largely compliant" assessment is given when there are only minor shortcomings, which do not raise serious concerns about the authority's ability to achieve the objective of the Principle and where there is clear intent to achieve full compliance with the Principle within a prescribed period of time (for instance, the regulatory framework is agreed but has not yet been fully implemented).
<b>Materially Non-Compliant</b>	A Principle is considered to be "materially non-compliant" in case of severe shortcomings, despite the existence of formal rules and procedures and there is evidence that supervision has clearly not been effective, the practical implementation is weak or that the shortcomings are sufficient to raise doubts about the authority's ability to achieve compliance.
<b>Noncompliant</b>	A Principle is assessed "noncompliant" if it is not substantially implemented, several criteria are not complied with, or supervision is manifestly ineffective.
<b>Non-Applicable</b>	A category of "non-applicable" is reserved for those cases that the criteria would not relate to the country's circumstances. In addition, a Principle would be considered not applicable when, in the view of the assessor, the Principle does not apply given the structural, legal and institutional features of a country.

Principle / Guiding Principle	Rating	Recommendations
<b>Principle 1: Objectives, Independence, Powers, Transparency and Cooperation (Basel)</b>  <b>Guiding Principle 1: Objectives, Independence, Powers, Transparency and Cooperation (ICURN)</b>	NC	<ul style="list-style-type: none"> <li>Transferring regulation and supervision of CFIs to the new prudential authority should address legal issues with respect to the responsibilities and powers.</li> <li>The updated legislative framework should be reviewed and fully understood to ensure it is clear what powers are in place.</li> <li>The status, role and scope for guidance should be considered and all current guidance notes reviewed and updated as appropriate.</li> </ul>
<b>Principle 2: Permissible Activities (Basel)</b>  <b>Guiding Principle 2: Permissible Activities (ICURN)</b>	LC	<ul style="list-style-type: none"> <li>The supervisory authority should have the power to enforce against the use of the restricted terminology by unlicensed entities.</li> </ul>

<sup>15</sup> These assessment criteria were applied by the ICURN Peer Review Team in its Peer Review Report on Ireland in 2015.



Principle / Guiding Principle	Rating	Recommendations
<b>Principle 3: Licensing Criteria (Basel)</b>  <b>Guiding Principle 3: Licensing (ICURN)</b>	MNC	<ul style="list-style-type: none"> <li>• Need to ensure that the supervisory authority has the legal power to establish and enforce the necessary criteria for licensing new CFIs</li> <li>• The supervisory authority should have the power to impose prudential conditions or limitations on a newly registered CFI, where appropriate.</li> <li>• The supervisory authority should consider setting out some details by way of guidance on the sufficiency of human, financial and operational capacity to function efficiently and competently.</li> </ul>
<b>Principle 4: Transfer of Significant Ownership (Basel)</b>  <b>Guiding Principle 4: Ownership (ICURN)</b>	N/A	<ul style="list-style-type: none"> <li>• Consider ICURN guiding principle if the matter of second tier organisations arises in the future</li> </ul>
<b>Principle 5: Major Acquisitions (Basel)</b>  <b>Guiding Principle: N/A (ICURN)</b>	N/A	<ul style="list-style-type: none"> <li>• N/a</li> </ul>
<b>Principle 6: Capital Adequacy (Basel)</b>  <b>Guiding Principle 5: Capital Adequacy (ICURN)</b>	LC	<ul style="list-style-type: none"> <li>• Consider setting Standards whereby CFIs are required to consistently observe prescribed capital requirements, including the power to require additional capital where necessary.</li> </ul>
<b>Principle 7: Risk Management Process (Basel)</b>  <b>Guiding Principle 6: Risk Management (ICURN)</b>	NC	<ul style="list-style-type: none"> <li>• Consider developing a Standard on Risk Management, supplemented by guidance.</li> <li>• Consider working with the CFI sector in developing sample tools and / or best practices to supplement standards and guidance notes, in particular for smaller CFIs.</li> </ul>
<b>Principle 8: Credit Risk (Basel)</b>  <b>Guiding Principle 7: Credit Risk (ICURN)</b>	LC	<ul style="list-style-type: none"> <li>• Ensure that credit risk guidance is kept under review and up to date, reflecting any new risks arising or weaknesses identified from on-site examinations.</li> <li>• CFIs should focus on forms of lending they are capable of undertaking.</li> </ul>
<b>Principle 9: Problem Assets, Provisions and Reserves (Basel)</b>  <b>Guiding Principle 8: Problem Assets, Provisions and Reserves (ICURN)</b>	LC	<ul style="list-style-type: none"> <li>• Guidance should be reviewed and expanded to cover areas such as write-offs, triggers for early identification of deteriorating loans and for assessment of provisions to take account of value of any collateral held.</li> <li>• CFIs should ensure they are fully informed so that they understand the importance of adequate and timely provisioning.</li> </ul>
<b>Principle 10: Large Exposure Limits (Basel)</b>  <b>Guiding Principle 9: Large Exposures (ICURN)</b>	LC	<ul style="list-style-type: none"> <li>• Supervised entities need to understand the reason for having limits in place and that their policies and processes are adequate and consideration should be given to issuing guidance on this area.</li> <li>• Consideration could also be given to the basis for the maximum exposure limits.</li> <li>• Supervisors should have the power to intervene and take action if limits are breached.</li> </ul>
<b>Principle 11: Exposures to Related Parties (Basel),</b>  <b>Guiding Principle 10: Conflicts of Interest and Related Party Exposures (ICURN)</b>	MNC	<ul style="list-style-type: none"> <li>• The supervisory authority should have the power to establish rules to control conflicts of interest and related party exposures and the powers which would permit them to intervene where such rules are breached.</li> <li>• Requirements on related party transactions should include requiring disclosure and reporting of such transactions.</li> </ul>



Principle / Guiding Principle	Rating	Recommendations
<b>Principle 12: Country and Transfer Risks (Basel)</b>  <b>Guiding Principle: N/A (ICURN)</b>	N/A	<ul style="list-style-type: none"> <li>N/a</li> </ul>
<b>Principle 13 – Market Risks (Basel)</b>  <b>Guiding Principle 11: Interest Rate Risk and Market Risk (ICURN)</b>	C	<ul style="list-style-type: none"> <li>N/a</li> </ul>
<b>Principle 14: Liquidity Risk (Basel)</b>  <b>Guiding Principle 12: Liquidity and Funding Risk (ICURN)</b>	C	<ul style="list-style-type: none"> <li>N/a</li> </ul>
<b>Principle 15: Operational Risk (Basel)</b>  <b>Guiding Principle 15: Operational Risk (ICURN)</b>	LC	<ul style="list-style-type: none"> <li>Supervisory authority should review guidance on operational risk, taking account of the size and complexity of CFIs, consider including further areas such as contingency planning, and further details on outsourcing.</li> </ul>
<b>Principle 16: Interest Rate Risk in the Banking Book (Basel)</b>  <b>Guiding Principle 11: Interest Rate Risk and Market Risk (ICURN)</b>	NC	<ul style="list-style-type: none"> <li>A Standard should be put in place to require CFIs to have in place policies and processes to manage interest rate risk to which CFIs may be exposed.</li> <li>The supervisory authority should consider the interaction of this Principle with the Principles that cover Market Risks and Liquidity Risks, which will link with many of the key factors likely to give rise to interest rate risk.</li> </ul>
<b>Principle 17: Internal Control and Audit (Basel)</b>  <b>Guiding Principle 13: Internal Controls (ICURN); Guiding Principle 16: Internal Audit (ICURN)</b>	MNC	<ul style="list-style-type: none"> <li>The supervisory authority should consider, taking account of the nature, scale and complexity of CFIs, requirements for:               <ul style="list-style-type: none"> <li>an appropriate level of internal controls; and</li> <li>requiring an appropriately qualified, independent and adequately resourced audit function.</li> </ul> </li> </ul>
<b>Principle 18: Abuse of Financial Services (Basel)</b>  <b>Guiding Principle 14: Abuse of Financial Services (ICURN)</b>	NC	<ul style="list-style-type: none"> <li>CFIs should have policies and procedures in place that will prevent them from being used unintentionally for criminal activities including money laundering, including having KYC rules in place. These are monitored and enforced by the Financial Intelligence Centre of South Africa.</li> </ul>
<b>Principle 19: Supervisory Approach (Basel)</b>  <b>Guiding Principle 18: Supervisory Approach, Techniques and Resources (ICURN)</b>	LC	<ul style="list-style-type: none"> <li>Given the forthcoming move of supervision of CFIs to the new prudential authority, it is timely to review the supervisory approach, ensuring that it is sufficiently risk-focussed, with the required risk mitigating actions and timelines so that outcomes are measurable and time bound.</li> </ul>
<b>Principle 20: Supervisory Techniques (Basel)</b>  <b>Guiding Principle 18: Supervisory Approach, Techniques and Resources (ICURN)</b>	LC	<ul style="list-style-type: none"> <li>As set out under Recommendation 19 – Supervisory Approach</li> </ul>



Principle / Guiding Principle	Rating	Recommendations
<b>Principle 21: Supervisory Reporting (Basel)</b>  <b>Guiding Principle 19: Supervisory Reporting (ICURN)</b>	MNC	<ul style="list-style-type: none"> <li>The supervisor should have explicit powers to enable it in the collection, review and analysis of financial reports from CFIs and have those independently verified where its considers this necessary.</li> </ul>
<b>Principle 22: Accounting and Disclosure (Basel)</b>  <b>Guiding Principle 20: Accounting and Disclosure (ICURN)</b>	MNC	<ul style="list-style-type: none"> <li>The supervisory authority should consider introducing requirements to hold the boards of CFIs responsible for ensuring that financial statements are prepared in accordance with internationally accepted accounting policies</li> <li>The supervisor should consider requiring all CFIs to be subject to external audit, as well as seek powers on removal of auditors and veto of appointment of auditors where warranted.</li> <li>The supervisor should consider how it could ensure CFIs develop their knowledge and skills in this area including developing further guidance for the sector.</li> </ul>
<b>Principle 23: Corrective and Remedial Powers of Supervisors (Basel)</b>  <b>Guiding Principle 21: Corrective and Remedial Powers of the Supervisory Authority (ICURN)</b>	MNC	<ul style="list-style-type: none"> <li>The supervisor should have an adequate range of enforcement tools, including the ability to issue appropriate legal orders (e.g. directions), to impose restrictions on the operations and activities of CFIs and to impose fines.</li> </ul>
<b>Principle 24: Consolidated Supervision (Basel)</b>  <b>Guiding Principle: N/A (ICURN)</b>	N/A	<ul style="list-style-type: none"> <li>N/a</li> </ul>
<b>Principle 25: Home-Host Relationships (Basel)</b>  <b>Guiding Principle: N/A (ICURN)</b>	N/A	<ul style="list-style-type: none"> <li>N/a</li> </ul>

### Summary of Assessment Ratings

Compliant	Number	Principle / Guiding Principle
Compliant (C)	2	13, 14
Largely Compliant (LC)	8	2, 6, 8, 9, 10, 15, 19, 20
Materially Noncompliant (MNC)	6	3, 11, 17, 21, 22, 23
Noncompliant (NC)	4	1, 7, 16, 18
Non-applicable (N/A)	5	4, 5, 12, 24, 25
<b>Total</b>	25	

## 7.5. Detailed Assessment

### 7.5.1. Principle 1: Objectives, Independence, Powers, Transparency and Cooperation (Basel)

#### Guiding Principle 1: Objectives, Independence, Powers, Transparency and Cooperation (ICURN)



*An effective system of supervision will have clear responsibilities and objectives defined for each authority involved in the supervision of the industry. It is essential for each authority to have operational independence, transparent processes, sound governance and adequate resources and for it to be accountable in its discharge of duties. An effective legal framework is also necessary, including the powers for authorisation, supervision, powers to enforce compliance with relevant laws, safety and soundness and legal protection for supervisors. Where relevant, authorities must have the legal capacity to share information while protecting the confidentiality of information. (ICURN)*

**Description / Comment:**

At the time of the on-site visit by the Peer Review team, the CBDA was the designated regulator of CFIs, which did not meet the requirements of registration of a co-operative bank. The basis for this regulation is through Exemption Notice 620 issued on 15 August 2014 (replacing previous Exemption Notice 404 of 25 May 2012). In May 2016, arising from legal comments issued by the National Treasury, it was determined that the Exemption Notice does not provide sufficient scope and responsibilities and powers for the CBDA supervisor with respect to regulation and supervision and that any supervisor rules issued were not legally binding.

**Current Assessment:** NC

**Recommendations:**

The proposed transfer of regulation and supervision of CFIs to the new prudential authority should address the legal issue that had been identified with respect to the responsibilities and powers issue that had derived from the Exemption Notice.

It will be important that the updated legislative framework is reviewed and fully understood to ensure it is clear what powers are in place with regard to setting prudential rules, obtaining / access to information from CFIs and remedial actions where a CFI is not in compliance with regulations (other than just the deregistration power).

In addition reviewing / updating the current rules for other areas including recommendations from Peer Review report and conversion of current supervisory rules into Standards. The status, role and scope for guidance should be considered and all current guidance notes reviewed and updated as appropriate including taking account of recommendations from this Peer Review report. In addition, where relevant, the supervisory authorities should have the legal capacity to share information while protecting its confidentiality.

## 7.5.2. Principle 2: Permissible Activities (Basel)

### Guiding Principle 2: Permissible Activities (ICURN)



*The permissible activities of institutions that are licenced and subject to supervision must be clearly defined, and terminology used to describe the institutions undertaking these activities, such as credit unions, caisses populaires and SACCOs, must be restricted and controlled by the supervisory authority. The supervisory authority must have the power to enforce against the use of the restricted terminology by unlicenced entities. Business powers and permissible activities may be proportional to the institution's size and ability to manage the risks inherent in such services and compatible with its business objectives. (ICURN)*

**Description / Comment:**

The designated activities of CFIs are prescribed in Annexure A – Section 2.1 of the Exemption Notice. The Companies and Intellectual Property Commission (“CIPC”) will only register CFIs as financial co-operatives on the recommendation of the Supervisor (currently CBDA). The CBDA publishes a register of all registered CFIs on its website.

**Current Assessment:** LC

**Recommendations:**

The supervisory authority should have the power to enforce against the use of the restricted terminology by unlicenced entities. It should also be clear from legislation that use of the word “CFIs” and any derivations in this name<sup>16</sup>, including domain names, is limited to registered and supervised institution in all circumstances where the public might otherwise be misled.

### 7.5.3. Principle 3: Licensing Criteria (Basel) Guiding Principle 3: Licensing (ICURN)

*The supervisory authority must have the power to establish and enforce the necessary criteria for licensing entrants. At a minimum, the licensing process should consider ownership (must be a Co-operative structure), governance, fitness and propriety of board members and management, strategy, risk management and capital. This is not intended to be an exhaustive list, and supervisory authorities should consider additional criteria needed to facilitate effective supervision in their regimes. (ICURN)*

**Description / Comment:**

Under the current system there is a two-stage process to registration of a CFI whereby an applicant must receive authorisation to register as a CFI from the supervisor (CBDA) and then apply to be registered as a CFI with the CIPC. The criteria for registration requirements are set out in Rules issued under the Exemption Notice. These include procedural matters such as the various forms to be completed to accompany the Application for Registration (Form 001) as well as criteria for a business plan, policies on savings and loans and demonstration that it has sufficient human, financial and operational capacity to function efficiently and competently. A Board of Directors’ Commitments form (Form 003) must also be completed which confirms each individual director’s commitment to commit to completion of certain training, operation of the CFI in line with legislative requirements and rules

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<sup>16</sup> Including financial co-operative, financial services co-operative, credit union or savings and credit co-operative



and ensuring members are made aware at least annually on the activities of the CFI and co-operative principles. There is a minimum capital requirement of R100,000 and minimum membership of 200. All registered CFIs must apply annually for renewal of their licences. (It is envisaged that in the future this may change to the issuing of three-year provisional licences but this proposal still needs to be formally documented and adopted.) There is also a provision in the Rules whereby a registration may be revoked if found that false or misleading information was furnished in the application.

**Current Assessment:** MNC

**Recommendations:**

There is a need to ensure that the supervisory authority has the legal power to establish and enforce the necessary criteria for licensing new CFIs – which is not clear under the current framework – Exemption Notice and issuing of Rules under that Notice. At a minimum the licensing process should consider ownership (must be a co-operative structure), governance, fitness and propriety of board members and senior management, strategy, risk management and capital. This is not intended to be an exhaustive list and the supervisory authority should consider additional criteria needed to facilitate effective supervision in their regimes. If the criteria are not fulfilled or if the information provided is, inadequate the supervisory authority should have the power to reject an application.

The supervisory authority should have the power to impose prudential conditions or limitations on a newly registered CFI, where appropriate. If the criteria are not fulfilled or if the information provided is inadequate the supervisory authority should have the power to reject an application.

In terms of the current requirement that an applicant should demonstrate that it has sufficient human, financial and operational capacity to function efficiently and competently, the supervisory authority should consider setting out some details by way of guidance to expand on the type of items that it would expect to see under each of these areas in order to provide indicative examples both from the point of view of its assessment and to make it clear and transparent to prospective applicants.

#### 7.5.4. Principle 4: Transfer of significant ownership (Basel)

##### Guiding Principle 4: Ownership (ICURN)

*The supervisory authority should ensure the structure of any proposed institution complies with Co-operative principles, recognizing that some second-tier organisations have proportional voting for members. It is not appropriate for any individual or group of individuals to be in a position to exercise control from a minority position. Voting in credit union support organizations or associations may be proportional or representational. (ICURN)*

**Description / Comment:**



Considered not applicable in terms of Basel principle on power for supervisor to review and reject any proposals to transfer significant ownership or controlling interests held directly to indirectly in existing institutions (i.e. banks) to other parties.

The ICURN guiding principle on this area states that the supervisory authority should ensure the structure of any proposed institution complies with co-operative principles, recognising that some second tier organisations have proportional voting for members. It is not appropriate for any individual or group of individuals to be in a position to exercise control from a minority position. Voting in credit union support organisations or associations may be proportional or representational.

**Current Assessment:** N/a

**Recommendations:**

Consider ICURN guiding principle if the matter of second tier organisations arises in the future.

#### 7.5.5. Principle 5: Major Acquisitions (Basel)

Guiding Principle: N/a (ICURN)

**Current Assessment:** N/a

#### 7.5.6. Principle 6: Capital Adequacy (Basel)

Guiding Principle 5: Capital Adequacy (ICURN)

*The supervisory authority must establish and enforce the rules for an appropriate capital framework with which all regulated institutions must comply. The rules should balance Co-operative principles and objectives with the need to protect depositors. Accordingly, supervisory authorities will need to carefully consider what meets the criteria for capital and to ensure that capital instruments are able to absorb losses in the event of failure. When supervisors choose to align the capital requirements of credit unions to Basel standards, a simplified approach may be adopted for small or simple credit unions that are not allowed to hold complex financial instruments. For such institutions, compliance with the most advanced risk measurement techniques may be beyond their resources. Therefore, the regulator may require additional capital to support the limited information that may be available for supervisory authorities. (ICURN)*

**Description / Comment:**

Rules on CFIs place a minimum member share capital requirement of R100,000 in member shares for registration of new CFIs. Appendix 1A of the Rules defines capital as mandatory membership shares, indivisible reserves, retained earnings and any other non-distributable funds of a permanent nature as approved by the supervisor. The Rules provide for a minimum capital adequacy ratio (defined as capital less provisions over total assets) of 6%. In terms of powers to enforce, the capital adequacy rules are limited to de-registering CFIs.

**Current Assessment:** LC

**Recommendations:**

Consider setting standards whereby CFIs are required to consistently observe prescribed capital requirements including thresholds by reference to which a CFI may be subject to supervisory action. Such actions may include setting an agreed timeframe based on the circumstances and severity of the capital shortfall involved. Where a shortfall is likely to persist, the power should exist to issue a CFI with a formal notice setting out the supervisors concerns and requiring a detailed plan setting out specifications and timeline for restoring the capital adequacy position. Where the position is considered serious, powers to formally direct a CFI to restore its capital adequacy within a specified timeline should be available, failing which other action could be implemented (e.g. deregistration, other resolution tools).

**Other areas to consider for Standards:**

Power for supervisor to require additional capital (over the minimum requirements) for individual CFIs in cases where limited information available or where considered that circumstances warrant it.

**7.5.7. Principle 7: Risk Management Process (Basel)****Guiding Principle 6: Risk Management (ICURN)**

*Regulated institutions must have appropriate and adequate risk management processes and systems in place. The risk management system must be able to identify, evaluate, monitor, manage and control the risks to which the regulated institution may be exposed. Policies and limits for risk undertakings must be clearly established and periodically reviewed. The risk management system should be commensurate with the size and complexity of the institution and its activities. (ICURN)*

**Description / Comment:**

CBDA carries out a risk management review as part of its on-site examination process to assess the risk profile of CFIs including the quality of risk management over the types and levels of inherent risks arising and it is envisaged that, as the sector develops and CFIs grow in size and scope, they will develop and implement detailed risk management policies to monitor and manage risks in their operations. A guidance note on Risk Management was issued by CBDA to CFIs to provide advice on appropriate risk management processes in place, including minimum requirements for sound risk management practices and encompassing management of credit, interest rate, liquidity, operational, legal, compliance, strategic and reputational risks. However, there are no requirements for CFIs to have appropriate and adequate risk management processes and systems in place or what these should cover.

**Current Assessment:** MNC**Recommendations:**

The supervisory authorities should consider developing additional guidance and support to CFIs, beyond the current Guidance Note on Risk Management to cover the following:



- CFIs must have in place appropriate and adequate risk management processes and systems.
- The risk management system must be able to identify, evaluate, monitor, manage and control the risks to which the CFI may be exposed.
- Policies and limits for risk undertakings should be clearly established and periodically reviewed.
- The risk management system should be commensurate with the size and complexity of the CFI and its activities.

The Standard could be supplemented by updated guidance, building on that already issued, including for example provision of guidance on the use of a risk register to include risk description, risk area, risk mitigating systems and controls. In addition, the supervisory authority may also wish to consider working with the CFI sector in developing sample tools and / or best practices to supplement standards and guidance notes that may help CFIs, in particular smaller ones, to implement approaches commensurate with their size.

### 7.5.8. Principle 8: Credit Risk (Basel) Guiding Principle 7: Credit Risk (ICURN)

*Credit risk is generally the most significant risk for Co-operative financial institutions. Accordingly, supervisory authorities should ensure that regulated institutions have appropriate policies in terms of their accepted risk in specific undertakings and adequate systems to manage such risks. It is essential that regulated institutions are able to manage their credit portfolios effectively in terms of monitoring the performance of the portfolio and the collection of distressed facilities. The supervisory authority should also focus on ensuring that regulated institutions focus on forms of lending they are capable of undertaking, while avoiding areas that require expertise they do not possess. (ICURN)*

#### **Description / Comment:**

The supervisor has issued a guidance note on lending policy, which covers the matters that will be examined when reviewing the lending policy of a CFI and the supervisory manual sets out the approach to review of this area during on-site examinations. In addition, there is a section on credit risk included in the Risk Management Guideline referred to under Principle 7.

#### **Current Assessment:** LC

#### **Recommendations:**

Credit risk is generally the most significant risks for co-operative financial institutions. While the supervisor has issued guidance as referred to above and provides details in its supervisory manual on the on-site examination process for this area, it is important that these are kept under review to ensure that these are kept up to date and reflect any new risks arising or weaknesses in lending, credit control or credit risk practices arising from on-site examinations. The supervisor should also ensure that CFIs focus on forms of lending they are capable of undertaking and that they do not become involved in areas of lending where they do not have the required expertise.



### 7.5.9. Principle 9: Problem Assets, Provisions and Reserves (Basel)

#### Guiding Principle 8: Problem Assets, Provisions and Reserves (ICURN)

*Regulated institutions must have adequate policies and processes for managing problem assets and provision appropriately for such assets. It is essential for supervisory authorities to ensure that regulated institutions are adequately provisioned for troubled/problem loans and other impaired assets. Provisions should also be considered for untroubled loans to reflect historical loss experience and changes in economic conditions that may affect the quality of the loan portfolio as a whole. Some provision may be required for contingent liabilities, depending on the probability of a corresponding cash outflow. (ICURN)*

#### **Description / Comment:**

The supervisor has included a guidance note on the management of problem credits and provisioning policy (included in Risk Management Guideline referred to under Principle 7), which sets out details on classification and identification of problem assets in credit risk policy, provisioning policy and collection. CFIs are required to complete and submit a delinquency loan report on a quarterly basis. The guidance also advises that the supervisor may require a CFI to increase provisioning levels or capital requirements if there are concerns. For larger CFIs, the on-site examination review of loans includes monitoring credit quality.

#### **Current Assessment:** LC

#### **Recommendations:**

Guidance should be reviewed and expanded to cover areas such as write-offs, when a loan is considered impaired, examples of triggers for early identification of deteriorating loans and for assessment of provisions to take account of value of any collateral held. This is an area where supervisor should also ensure that CFIs are fully informed so that they understand the importance of adequate and timely provisioning.

### 7.5.10. Principle 10: Large Exposure Limits (Basel)

#### Guiding Principle 9: Large Exposures (ICURN)

*Regulated institutions should have appropriate and adequate policies and processes around large exposures (concentration risk). The supervisory authority should set rules around the definition and limit of large exposures to which regulated institutions can be exposed and should have the power to intervene should these be breached. (ICURN)*

#### **Description / Comment:**

The Rules set out maximum exposure limits (as a percentage of assets) for loan per member, board member loans collectively, individual share investment and individuals' savings deposit. CFIs are required to submit reports on board and staff loans on a quarterly basis to the CBDA. The on-site



examination for larger CFIs includes review of management information and reporting of large exposures.

**Current Assessment:** LC

**Recommendations:**

Supervised entities need to understand the reason for having limits in place and that their policies and processes are adequate. Consideration should be given to issuing guidance to CFIs on this area, which could cover need for policies, procedures, monitoring and reporting to board. Consideration could also be given to the basis for the maximum exposure limit ( currently percentage of assets – consider if capital would be more appropriate measure in terms of capturing the risk to a CFI capital). The supervisor should have the power to intervene and take action if limits are breached.

### 7.5.11. Principle 11: Exposures to Related Parties (Basel)

#### Guiding Principle 10: Conflicts of Interest and Related Party Exposures (ICURN)

*The supervisory authority should have the power to establish rules to control conflicts of interest and related party exposures. It should have in place powers that permit it to intervene where such rules are breached. Related party transactions should be required to be undertaken at arm's length, and there should be rules that require disclosure and reporting of such transactions. (ICURN)*

**Description / Comment:**

While guidance is provided in the Model Constitution for CFIs and there is reporting to CBDA on board and staff related loans, there are no specific requirements in laws or regulations giving powers to the supervisor to require that exposures to related parties may not be granted on more favourable terms than exposures to non-related counterparties.

**Current Assessment:** MNC

**Recommendations:**

The supervisory authority should have the power to establish rules to control conflicts of interest and related party exposures. It should also have powers that permit it to intervene where such rules are breached. There should be requirements on related party transactions including rules that require disclosure and reporting of such transactions.

### 7.5.12. Principle 12: Country and Transfer Risks (Basel)

#### Guiding Principle: N/a (ICURN)

**Current Assessment:** N/a

### 7.5.13. Principle 13 – Market Risks (Basel)

#### Guiding Principle 11: Interest Rate Risk and Market Risk (ICURN)



*Regulated institutions must have policies and processes in place to manage interest rate risk to which regulated institutions may be exposed. In particular, supervisory authorities should be attuned to the interest rate risk of fixed rate lending portfolios. (ICURN)*

**Description / Comment:**

The Supervisor has published guidance on standards with respect to management of market risk by CFIs including advising CFIs to identify types, limits and concentration of investments and to measure and provide for market impairments. Assessment of market risk is covered in the on-site examination process for larger CFIs.

**Current Assessment:** C

**Recommendations:**

Market risk link with interest rate risk – see recommendations at Principle 16.

#### 7.5.14. Principle 14: Liquidity Risk (Basel)

##### Guiding Principle 12: Liquidity and Funding Risk (ICURN)

*Regulated institutions must develop reasonable and prudent liquidity management strategies and contingency plans, including central bank borrowing, standby facilities and/or liquid reserves in a regulated central financial facility, which cover the funding of the institution and the ongoing monitoring of the regulated institution's liquidity/funding position. Supervisory authorities should have the ability to intervene when they believe a regulated institution has an excessively risky funding base or liquidity position. Liquidity risk should be addressed both on a per-institution and on a network-wide basis. Soundly managed network-wide liquidity and stability facilities are highly desirable. (ICURN)*

**Description / Comment:**

Rules provide for minimum liquidity ratio of 10% liquid assets to total deposits and guidance has been issued covering managing liquidity risk, the need for contingency plans and related areas.

**Current Assessment:** C

**Recommendations:** N/a

#### 7.5.15. Principle 15: Operational Risk (Basel)

##### Guiding Principle 15: Operational Risk (ICURN)

*Supervisors must be satisfied that credit unions have in place risk management policies and processes to identify, assess, monitor and control / mitigate operational risk. These policies and processes should be commensurate with the size and complexity of the institution and its activities. (ICURN)*

**Description / Comment:**



The guidance on Risk Management, referred to in Principle 7, includes a section on operational risk, requesting CFIs to implement a policy that addresses most likely operational risks commensurate with the size and complexity. It also covers the need for appropriate policies the need to address security and operational risk of management information systems and outsourcing. During on-site examination, CBDA reviews information technology processes and contingent planning for larger CFIs.

**Current Assessment:** LC

**Recommendations:**

Supervisory authority should review guidance on operational risk, taking account of the size and complexity of CFIs, consider including further areas such as contingency planning, and further details on outsourcing.

### 7.5.16. Principle 16: Interest Rate Risk in the Banking Book (Basel)

#### Guiding Principle 11: Interest Rate Risk and Market Risk (ICURN)

*Regulated institutions must have policies and processes in place to manage interest rate risk to which regulated institutions may be exposed. In particular, supervisory authorities should be attuned to the interest rate risk of fixed rate lending portfolios. (ICURN)*

**Description / Comment:**

There are no specific requirements in place on management of interest rate risk by CFIs. CBDA state that most CFIs have fixed interest rates and that during on-site examination savings and loan policies are assessed which can include an interest rate risk component.

**Current Assessment:** NC

**Recommendations:**

A Standard should be put in place to require CFIs to have in place policies and processes to manage interest rate risk to which CFIs may be exposed. Even where the type of CFI business being conducted does not give rise to circumstances in which significant interest rate risk arises, the supervisory authority should be attuned to the interest rate risk of fixed rate lending where this exists. Should interest rate risk become more of a material issue, the supervisory authority should also ensure that it has the appropriate and effective tools for identifying it – both through analysis of returns and during on-site examinations as necessary.

In addition, the supervisory authority should consider the interaction of this Principle with the Principles that cover Market Risks and Liquidity Risks, which will link with many of the key factors likely to give rise to interest rate risk.

### 7.5.17. Principle 17: Internal Control and Audit (Basel)

#### Guiding Principle 13: Internal Controls (ICURN)

#### Guiding Principle 16: Internal Audit (ICURN)



*Regulated institutions should have in place an appropriate level of internal controls commensurate with the size and complexity of the institution and its activities. This should include arrangements around delegations of responsibilities, authorizations, segregation of duties, reconciliations and accounting. (13, ICURN)*

*The supervisory authority should consider the need for an appropriately qualified, independent, and adequately resourced internal audit function. The internal audit function should focus on ensuring that the internal control function operates effectively. Where there is an internal audit function, it should report to an appropriate level within the regulated institution and must have direct access to the board where it considers this necessary. The scope of internal auditing within an organization may involve topics such as the efficacy of operations, the reliability of financial reporting, deterring and investigating fraud, safeguarding assets, and compliance with laws and regulations. (16, ICURN)*

**Description / Comment:**

The legislation does not have requirements in relation to internal controls, internal audit / compliance function or provide the supervisory authority with specific powers in these areas. In accordance with their constitution CFIs are required to elect an independent supervisory committee – however CBDA advises that the capacity of such appointees is largely poor. Functions envisaged by a compliance function are absorbed into other board committees and a review of minutes of such committees is included during on-site examination.

**Current Assessment:** MNC

**Recommendations:**

**Internal Controls** – CFIs should be required to have in place an appropriate level of internal controls commensurate with the size and complexity of the institution and its activities. This should include arrangements around delegations of responsibilities, authorisations, segregation of duties, reconciliations and accounting.

**Internal Audit** – The supervisory authority should consider, taking account of the nature, scale and complexity of CFIs, the need for requiring an appropriately qualified, independent and adequately resourced audit function which would focus on ensuring that the internal control function operates effectively.

Other areas, which could come within the scope of an internal audit function, include reliability of financial reporting, deterring and investigating fraud, safeguarding assets and compliance with laws and regulations.

Where there is an internal audit function it should report to an appropriate level within the CFI and must have direct access to the board where it considers this necessary.

### 7.5.18. Principle 18: Abuse of Financial Services (Basel)



### Guiding Principle 14: Abuse of Financial Services (ICURN)

*Regulated institutions should have policies and procedures in place that will prevent them from being used unintentionally for criminal activities, including money laundering. This should include having in place know-your-customer rules. Where the supervisory authority does not have responsibility for regulating such activities, it should ensure it has in place a process of regular liaison or a memorandum of understanding for working with the responsible authority. (ICURN)*

**Description / Comment:**

The Financial Intelligence Centre Act 2001 (“FICA”) deals with abuse of financial services. The regulatory authority over financial intelligence rests with the Financial Intelligence Centre. CFIs are not listed as accountable institutions under FICA. Accordingly, there are no provisions on this area within the scope of the supervisory powers of the current supervisor (CBDA).

**Current Assessment:** NC

**Recommendations:**

While the area of abuse of financial services is not within the remit of the current supervisor for CFIs notwithstanding this, in line with the ICURN guiding principle, as regulated institutions CFIs should have policies and procedures in place that will prevent them from being used unintentionally for criminal activities including money laundering. This should include having in place know-your-customer rules. Where the supervisory authority does not have responsibility for regulating such activities, it should ensure it has in place a process of regular liaison or a memorandum of understanding for working with the responsible authority.

### 7.5.19. Principle 19: Supervisory Approach (Basel)

#### Guiding Principle 18: Supervisory Approach, Techniques and Resources (ICURN)

*The supervisory authority should develop and maintain a thorough understanding of the operations of individual regulated institutions and should deploy an effective and ongoing combination of off-site and on-site supervisory techniques. The supervisory authority should have appropriately qualified and independent staff and be adequately resourced to implement its supervisory approach. (ICURN)*

**Description / Comment:**

The supervisor carries out examinations of all CFIs each year, taking account of the risk characteristic of the CFI (low risk, intermediate or high risk). As part of its compliance checklist, it monitors compliance with regulations and uses the PEARLS monitoring system.

**Current Assessment:** LC

**Recommendations:**

Given the forthcoming move of supervision of CFIs to the new prudential authority, it is timely to review the supervisory approach. In particular the review should cover the approach to off-site and on-site supervision to ensure it is sufficiently risk-focussed, that risks identified during on-site



examinations are clearly documented for the CFI together with the required risk mitigating actions and timelines so that outcomes are measurable and time bound.

In addition staffing levels should be reviewed to ensure that there are sufficient staff to deliver on all of the regulatory and supervisory functions, that all staff have the opportunity to develop their skills and expertise – through on the job training as well as regular and formal training and that there is succession planning in place for management and senior staff.

#### 7.5.20. Principle 20: Supervisory Techniques (Basel)

##### Guiding Principle 18: Supervisory Approach, Techniques and Resources (ICURN)

*The supervisory authority should develop and maintain a thorough understanding of the operations of individual regulated institutions and should deploy an effective and ongoing combination of off-site and on-site supervisory techniques. The supervisory authority should have appropriately qualified and independent staff and be adequately resourced to implement its supervisory approach. (ICURN)*

##### **Description / Comment:**

The supervisor uses a combination of off-site and on-site examinations to carry out its supervisory functions. On-site, work is primarily compliance based and includes a review of policies and procedures in place in the CFI. The findings of on-site examinations are communicated in writing to the CFI.

##### **Current Assessment:** LC

##### **Recommendations:**

As set out under Recommendation 19 – Supervisory Approach

#### 7.5.21. Principle 21: Supervisory Reporting (Basel)

##### Guiding Principle 19: Supervisory Reporting (ICURN)

*The supervisory authority should have the ability to collect, review, and analyse financial and/or statistical reports from regulated institutions in whatever form it requires. It should also have the ability to have such reports or forms independently verified where it considers this necessary. (ICURN)*

##### **Description / Comment:**

The required reporting forms for CFIs are prescribed in the Rules. There are no specific powers to compel reporting or for access to records. Returns are verified as part of on-site work. There are no



provisions on use of external experts by the supervisor for review of reports of CFIs or to bring material shortcomings to attention of supervisor.

**Current Assessment:** MNC

**Recommendations:**

The supervisor should have explicit powers to enable it in the collection, review and analysis of financial reports from CFIs. It should also have the power to have such reports independently verified where it consider this necessary.

## 7.5.22. Principle 22: Accounting and Disclosure (Basel)

### Guiding Principle 20: Accounting and Disclosure (ICURN)

*Regulated institutions should maintain adequate records that have been prepared in accordance with the relevant accounting laws in its jurisdiction. (ICURN)*

**Description / Comment:**

The primary legislation on co-operatives, the Co-operatives Act, includes a requirement (section 47) that an audit of the affairs of a co-operative must be conducted annually and that the accounts should be drawn up in conformity with generally accepted accounting practices. However, the financial reporting of CFIs financial statements is required to be in line with the requirements of the supervisor ( CBDA) and the supervisor has not required the financial statements to be compliant with recognised accounting standards and most CFIs are exempted from audit. There is a requirement to present the annual accounts to members at the annual general meeting.

A guidance note on Accounting and Disclosure has been issued which sets out responsibilities of CFIs in relation to accounts preparation, disclosure, valuations, policies and procedures.

**Current Assessment:** MNC

**Recommendations:**

Accounting, disclosures and independent opinions on these are a key element of providing transparency and protection to members of CFIs. In addition to the guidelines, the supervisory authority should consider introducing requirements to hold the boards of CFIs responsible for ensuring that financial statements are prepared in accordance with accounting policies and practices that are widely accepted internationally and that these are supported by record-keeping systems in order to produce adequate and reliable data. In addition, the supervisor should consider requiring all CFIs to be subject to external audit, as well as seek powers on removal of auditors and veto of appointment of auditors in circumstances where there are concerns in relation to auditor independence or skill sets and expertise.



Given the importance of this area and the potential complexity for CFIs in terms of accounting standards, the supervisor should consider how it could ensure CFIs develop their knowledge and skills in this area including developing further guidance for the sector.

### 7.5.23. Principle 23: Corrective and Remedial Powers of Supervisors (Basel) Guiding Principle 21: Corrective and Remedial Powers of the Supervisory Authority (ICURN)

*An adequate range of enforcement tools to facilitate timely corrective action should be at the supervisory authority's disposal. This includes the ability to issue appropriate legal orders, to revoke licences or to recommend revocation. This also includes the ability to impose restrictions on the activities and operations that institutions conduct. (ICURN)*

#### **Description / Comment:**

The main power that the supervisor can impose on a CFI that is not complying with laws, regulations or supervisory decisions is withdrawal of registration. It does not have powers to impose penalties or close down a CFI.

**Current Assessment:** MNC

#### **Recommendations:**

In order to facilitate timely corrective action the supervisor should have an adequate range of enforcement tools. These include the ability to issue appropriate legal orders (e.g. directions), to impose restrictions on the operations and activities of CFIs and to impose fines.

These areas should be considered in the context of the move from CBDA to the prudential authority and the legislation arising.

### 7.5.24. Principle 24: Consolidated Supervision (Basel) Guiding Principle: N/a (ICURN)

**Current Assessment:** N/a

### 7.5.25. Principle 25: Home-Host Relationships (Basel) Guiding Principle: N/a (ICURN)

**Current Assessment:** N/a

## 8. Assessment of the Impact of Regulation & Supervision by CBDA on the Growth of the CFI sector

The policy goal of introducing prudential regulation for CFIs and Co-operative Banks is stated as deepening financial inclusion through member-owned financial institutions and thereby support economic and financial empowerment of communities at the grassroots level<sup>17</sup>. Thus, in assessing the growth of the CFI sector, it would be logical to assess the sector performance over the period during which CBDA was operational. This performance would be reflected in the trend of metrics such as:

- Membership numbers of CFIs;
- Deposits mobilised by CFIs as well as co-operative banks;
- Loans and hence the assets accumulated by the regulated CFIs as well as co-operative banks;
- Registered CFIs – compliance with prudential requirements;
- Number of CFIs that have transitioned to co-operative banks.

Table 2 provides a growth trend of the CFI Sector over the seven-year period, 2011 – 2017, based on statutory annual reports published by CBDA<sup>18</sup>.

**Table 2: CFI Sector Metrics, 2011 to 2017**

Description	2017	2016	2015	2014	2013	2012	2011
<b>Number of CFIs</b>	30	30	26	26	35	21	18*
<b>Members</b>	29,818	29,752	24,722	33,391	38,084	31,481	28,034
<b>Assets, R 'Mn</b>	283.1	279.6	236.6	231.4	220.8	201.8	175.9
<b>Deposits, R'Mn</b>	227.6	233.8	201.1	198.6	200.8	187.9	161.0
<b>Loans, R'Mn</b>	NA	NA	152.1	140.5	142.3	128.7	107.3
<b>Average Savings, R</b>	NA	NA	8,135	5,948	5,274	3,686	2,951
<b>Deregistered CFIs</b>	3	1	-	-	-	-	-

\*Represents the CFIs that met the minimum registration criteria, not necessary registered by number.

**Growth in number of CFIs and Co-operative Banks:** The number of registered CFIs has exhibited a mixed trend over the seven-year period, 2011 – 2017, settling at 30 CFIs and co-operative banks over the last two years. CBDA, in line with the law, provisionally registers new CFIs, who may subsequently experience difficulties in maintaining compliance with prudential requirements and as a result it has been necessary to take action i.e. to deregister such CFIs. Table 3 below shows the compliance trend as report by CBDA.

**Table 3: CFIs Compliance Trend**

Description	2017	2016	2015	2014	2013
<b>Coop Banks</b>	2	2	2	TBA	TBA
<b>Eligible CFIs</b>	16	14	11	TBA	TBA
<b>Other CFIs</b>	12	14	13	TBA	TBA
<b>Total</b>	<b>30</b>	<b>30</b>	<b>26</b>	?	?

<sup>17</sup> 2010/11 Combined Annual Report By the Supervisors of CBDA and SARB

<sup>18</sup> Available on the CBDA website at <http://www.treasury.gov.za/coopbank/publications/publications.aspx>



**Membership in CFIs:** Number of members of customers using the CFI services is a useful indicator of financial access. Similar to the number of CFIs, it is apparent from Table 2 that membership in registered CFIs decreased from 2013 to 2015 and stabilised in 2016 and 2017. This is not a positive trend when assessed against the policy goal of having more households access financial services at the local community level, through the CFI. Significantly, the two CFIs which subsequently were authorised as co-operative banks have not experienced exponential growth in membership, as might be expected with regulation and supervision by SARB which may translate to higher public recognition and level of confidence.

**Savings Mobilization:** A positive trend has been noted on the deposit growth in consolidated terms amongst the CFIs including the co-operative banks. Significantly, the two banks accounted for the majority of the total CFIs deposit liabilities and amounted to 40.4% and 45.7% of the total sector deposit liabilities as at February 2016 and February 2017, respectively. This underscores the potential co-operative banks have in mobilising deposits even from the limited membership in their common bond.

Other points that warrant consideration by the authorities:

- Why are CFIs struggling to meet prudential requirements, leading to de-registration or delays in licensing by SARB?
- How has the deposit limitation of R30M impacted on deposit mobilization?
- Is the subdued growth due to stringent prudential requirements by CBDA?
- Is the common bond a limitation to growth in membership on CFIs?

## 9. Perceptions of the Regulatory & Supervisory processes of CBDA by a Representative Cross-section of the CFIs & Rejected CFI Applicants

The table below summarises the views expressed by stakeholders interviewed by the review team and includes the review team’s analysis for each point.

Issue	Detail	Analysis & Recommendations
<p><b>Registration requirements</b></p>	<p>Entities applying to register as a CFI are required, <i>inter alia</i>, to satisfy minimum criteria prior to approval. These include:</p> <ul style="list-style-type: none"> <li>• have at least 200 members;</li> <li>• have raised a minimum of R100,000 in share capital;</li> <li>• identify and define the common bond; and</li> <li>• demonstrate financial, human and operational capacity to operate a CFI.</li> </ul> <p>Almost all of the stakeholders interviewed noted dissatisfaction with the minimum member number requirement and the common bond. The minimum capital requirement was not highlighted as an issue.</p> <p>The need to have identified at least 200 members was viewed as being too high, or inappropriate. This was noted as a barrier to entry but little or no supporting argument made to demonstrate how a CFI could be viable with less than 200 members.</p> <p>The common bond requirement was one of the issues raised most frequently by participants interviewed, especially from those with a small geographic bond. Notwithstanding this, many were unable to articulate a case for change such as for example, that the current bond had been exhausted, which is limiting growth opportunities. Many of the examples provided were cases where some membership opportunities were lost because a potential member relocated to a different city or outside the country.</p>	<p>The review team is indifferent to the imposition of minimum requirements and their extent. It should be noted however, that any review of minimum requirements / limitations should be framed in the context of the Government’s vision for the CFI sector and the desire for it to grow and improve financial inclusion.</p> <p>If the requirements are reviewed, this can be informed by approaches taken in other jurisdictions.</p> <p>It is presumed that the requirement to have a minimum number of members is to address possible viability concerns. Rather than set a minimum number from the outset, applicants could present a business case which demonstrates viability within an agreed timeframe. It should be noted that critical to this, is an agreed set of financial triggers upon which the CFI would voluntarily exit the industry if breached. It would be incumbent on the regulator to challenge the reasonableness of the proposal and ask for sensitivity analysis to be completed.</p> <p>The common bond requirement is set to limit membership within known occupation (or reasonably well known) and / or geographic region and consequently limit growth. Operating in unfamiliar markets presents new risks and co-operatives should ensure that they have the requisite skills, knowledge and resources to manage these. It is understood that the CFIs can put a business case to the regulator to vary their common bond, although to date this has not happened. The review team are of the view that there may be some merit in discussing this option with the industry to clarify any misunderstandings.</p>



Issue	Detail	Analysis & Recommendations
<p><b>Deregistration</b></p>	<p>A number of CFIs have been deregistered by the CBDA for various prudential reasons including insolvency. However, some deregistered CFIs continue to operate illegally and accept deposits. We understand that there are cases where deregistered CFIs are operating while their financial conditioning worsen or indeed are possibly insolvent. There are others where the entity remains solvent and hopes to be registered again or indeed register as a Co-operative bank.</p> <p>General views from those operating legally were mixed. Some expressed frustration with the lack of enforcement action against such CFIs whilst others noted the importance of rehabilitation programmes to protect the name of the industry. It should be noted that there is currently no form of rehabilitation available and CFIs discussed not having the skills to address many of the issues raised by CBDA Supervision team.</p>	<p>Ultimately, the purpose of prudential regulation is to protect depositors. The review team is of the view that the current deregistration process may not be achieving this objective. Whilst acknowledging that deregistration was implemented as a means to fill prudential and resolution gaps (i.e. lack of enforcement powers), the result is giving rise to confusion and reputational risk and a worse outcome.</p> <p>We recommend that the deregistration power remain. Notwithstanding this, other supervisory tools are required to ensure that it is used in only the most extreme situation. In regard to resolution:</p> <ul style="list-style-type: none"> <li>• Define failure (i.e. orderly and disorderly) and the regulator’s appetite for these. This will inform the extent of rehabilitation versus resolution.</li> <li>• Collaboration between the CBDA capacity building and the Prudential Authority to address prudential concerns on an arm’s-length basis. This would include the capacity-building unit assisting CFIs on prudential issues.</li> <li>• The introduction of regulatory powers that may assist in reducing the likelihood of needing to resolve a CFI. The power to issue directions (for example, stop accepting deposits or making loans) will assist in reducing the need for resolution.</li> <li>• The CBDA define how and under what circumstances the stabilisation fund will be used.</li> <li>• Inclusion of CFIs in any proposed deposit insurance scheme to provide protection to depositors.</li> <li>• That deregistration requires cessation of deposit taking and there are sufficient powers and resources to follow-up on this.</li> </ul>
<p><b>Supervision focus</b></p>	<p>The review team asked CFIs and Co-operative Banks to discuss their experiences in working with the supervision team. This included the nature of the issues being raised, frequency of contact and how supervisory matters are explained.</p> <p>A section commented on the professional approach of CBDA supervision but most</p>	<p>There is scope to review the approach to supervision to ensure that the focus is on the idiosyncratic risks, within the risk appetite of the regulator guided by the Government vision for the CFI sector.</p> <p>Lack of scale and complexity of CFIs, combined with the nascence, their relative immaturity in</p>



Issue	Detail	Analysis & Recommendations
	<p>responses from those interviewed were as below:</p> <ul style="list-style-type: none"> <li>• The supervision team visit on average, every 12 months and the focus of topics covered seems to remain unchanged from year to year.</li> <li>• The nature of issues raised by the supervision team are frequently the same as from the prior on-site review.</li> <li>• Issues are not well explained. CFIs noted that they are being asked to address issues but in their view the reason for doing so is not well articulated to them.</li> </ul>	<p>terms of stage of development, is a case to refocus supervision effort. This includes:</p> <ul style="list-style-type: none"> <li>• Making quarterly financial analysis the focus of supervision effort. A worsening of the financial condition of CFIs should inform where the supervision team directs its review efforts. Fundamental to this is having data, which has been independently assured (i.e. audited) so that supervisors can generally rely on the information.</li> <li>• A supervision strategy (12 – 18 month time horizon) should be in place for each CFI, which articulates the key risks and actions to be taken to address these. This will keep supervision staff focussed on the top key risks within each CFI and ensuring the CFI fully addresses the underlying causes to minimize the risk.</li> <li>• Provide supervision staff with the opportunity to develop their skills through further training. This will assist in equipping supervision staff with the capabilities to target questions and issues and articulate clearly to CFIs how required actions address the identified risks.</li> <li>• The Supervisory agency could benefit from seeking regular feedback from its stakeholders, including the industry (e.g. through a stakeholder survey).</li> </ul>
<p><b>Deposit insurance</b></p>	<p>South Africa does not yet have a deposit insurance scheme of any form for Banks, although there are plans for it to be introduced with its coverage and operational elements yet to be finalised.</p> <p>The review team asked CFIs, Co-operative Banks and other stakeholders whether the scheme should apply to CFIs. There was a unanimous view that a deposit scheme should apply to the industry, as this would be a significant confidence measure for members.</p>	<p>The review team are of the view that there are benefits to including the CFI sector in any proposed deposit insurance scheme. The exclusion of the sector will result in market distortions and may lead to stunted growth – which would also be counterintuitive to any overall strategy that seeks to increase the number and spread of CFIs.</p> <p>The nature of the CFI sector, being small and relatively new, requires market confidence to attract members and mobilize deposits to scale. If this CFI of were excluded from depositor protection, it would send a signal to potential members that their investments are less safe and that CFIs are potentially higher risk.</p>
<p><b>Industry collaboration</b></p>	<p>Discussions with the industry highlighted that there are good intentions and drive to improving financial inclusion through the CFIs.</p>	<p>Other jurisdictions tend have well-functioning and effective lobby groups and service providers which represent a common voice for</p>



Issue	Detail	Analysis & Recommendations
<p><b>and industry vision / direction</b></p>	<p>Notwithstanding this, it was evident to the review team that industry is lacking collaboration and is not working towards a shared an overall vision to achieve a common goal.</p> <p>An industry body (NACFISA) has recently been established to provide lobbying and support services to the industry but it has not yet been accredited by the CBDA and will not represent the entire industry.</p> <p>Furthermore, at a broader level the Government's vision, or its expectations of the regulator for the CFI sector was not clear.</p>	<p>the industry. This can be particularly beneficial in the case of CFIs which are generally small, have limited resources and skills.</p> <p>The case for the requirement for CBDA to accredit Industry association was not entirely clear to the review team.</p> <p>If the approach is to have oversight of systemically important service providers to the industry, there are other options available. For example, requiring the industry to include a clause in outsourcing agreements giving the regulator access to the third party systems where the arrangement is considered to be material.</p> <p>The CFI sector is in a unique position. It typically serves markets which have high levels of financial exclusion. Furthermore, the growth of the industry has not met CBDA or other stakeholder expectations.</p> <p>Compounding this is the restructuring of prudential supervision responsibilities and the industry perception of over-regulation. It is therefore critical that the Government sets a vision for the CFI sector to provide it with direction and a common goal for all participants. Furthermore, consideration should be given to the relevant authorities issuing a statement of expectations setting out the context for how the CFI sector should supervised given the unique issues within this part of the market. This would facilitate the crafting of a risk appetite within the Supervisory Authority and guide frequency and intensity of supervision within the sector.</p>
<p><b>Capacity building and supervision</b></p>	<p>There was general feedback that the capacity building and supervision could be more effective in working together. This was raised in the context of collaborating to address supervisory concerns and achieving outcomes for the CFIs.</p> <p>Most CFIs and stakeholders interviewed acknowledged the limitations of CBDA in effectively delivering technical assistance to CFIs given its centralized administration in Pretoria, financial and logistical constraints.</p>	<p>With the forthcoming transfer of the supervision function from the CBDA to the Prudential Authority (at SARB), a memorandum of understanding setting out how the two institutions will collaborate and work together is critical to achieving both positive supervision outcomes and industry development.</p> <p>There is an opportunity for CBDA to review its capacity delivery approach for greater impact considering the nascent stage of the development of most CFIs. This includes</p>



Issue	Detail	Analysis & Recommendations
		<p>strategic partnerships with various departments, agencies and associations. This should be clearly articulated in a national development blueprint and vision for the CFI sector.</p>
<p><b>Prudential requirements</b></p>	<p>Prudential requirements were raised during meetings with various stakeholders.</p> <p>Board tenure (current maximum tenure is three years with two term maximum) was noted as being too short, particularly for the nature of the CFIs. The ability to attract, retain and develop directors in this sector can be challenging. The industry generally held the view that the maximum tenure should be lengthened.</p> <p>The majority of stakeholders raised the 15% limit which applies to external borrowings as being too restrictive. This was raised mostly in the context of the potential for available funding from government development agencies to exceed the maximum limit. The only outlier was one CFI which had a negative experience with material external borrowings and therefore is of the view that the current limit should remain.</p> <p>A number of CFIs raised the issue of the five percent fixed asset maximum. Some CFIs may be in a financial position to invest in their own head office but this may not be able to happen due to current regulatory limits.</p>	<p>The maximum board director tenure of three years is relatively short and we understand that a board member may be re-appointed one time for a total of six years. We believe an additional three-year term could be added so that directors can serve longer before being required to resign from the board.</p> <p>There is scope to review all prudential standards with the objective of retaining prescriptive limits where necessary but also having principles around each limit, upon which CFIs may be permitted to exceed certain limits in consultation with the supervisory authority. Prescriptive limits can serve a purpose but there should also be a provision for unique circumstances, or where the CFI demonstrates that it understands and can manage the underlying / increased risk and has the expertise and capability to do so. For example, the 15% external borrowing limit could still apply but take individual circumstances into consideration. The funding and liquidity risks of two counterparties (e.g. Government vs private) are different. Furthermore, there are other considerations such as term of borrowing and the lumpiness of the external borrowings portfolio.</p> <p>The review team understand the objective of the fixed asset limit (i.e. to keep CFIs focussed on core business rather than taking on other risks which they may not fully understand or appreciate). However, where there is a CFI seeking to invest in its infrastructure there may be scope for further consideration of the business case taking into account the risk profile of the investment.</p> <p>Investment in property such that, besides providing business premises the CFI earns net positive income, can be reclassified to investment property rather than a non-earning</p>



Issue	Detail	Analysis & Recommendations
		property in line with international accounting and reporting standards.
<b>Transition from CFI to Co-operative Bank</b>	<p>There is a requirement that once a CFI reaches R30 million in deposits, it either converts to a co-operative bank, or stops accepting deposits to remain within the limit.</p> <p>Some CFIs have successfully converted to a co-operative bank, whilst others have been unable to transition and were required to stop accepting deposits for a number of years.</p> <p>There are also other CFIs which are relatively large and wish to remain as CFIs but not be limited by the deposit restriction. In this case, there was recognition in the value of the CFI brand.</p>	<p>The review team understands the objective of the requirement to transition to a co-operative bank at a certain size. A larger and more complex financial institution generally has a greater impact on the sector or financial system were it to fail. Notwithstanding this, the team believe that the current approach, whilst achieving this objective, places unnecessary limitations on the industry.</p> <p>Rather than limit deposit growth, or require a conversion to a co-operative bank, as the size and complexity of a CFI increases, the prudential requirements should move accordingly. This could include for example, greater expectations regarding the management of capital and liquidity risk together with other non-financial risks. The extent of the expectations could be articulated in the supervisory risk appetite statement for the CFI and flow down to the supervision framework and prudential standards on a “principles” basis.</p>
<b>CBDA and supervision industry engagement</b>	A number of CFIs made comments which demonstrated a shortcoming in their understanding of key projects and legislative / prudential requirements. Examples included the status of the core banking system, cash versus accruals approach to completion of returns, the existence of a stabilisation fund and interpretations of how the common bond operates.	There is an opportunity to better engage and communicate with the industry, possibly using technology where infrastructure supports this form of communication.
<b>Other</b>	Some CFIs mentioned the possibility of a review of the taxation system to provide CFIs, as not for profit entities, with a tax incentive	This is a matter for the relevant authorities to consider if they think appropriate to do so.



*Annex 1 – List of meetings with Stakeholders*

Day	Activity	Contact	Location
<b>Tuesday, October 3</b>			
09:00 - 13:00	<p><b>Welcome, introductions and overview</b></p> <p>Meeting with CBDA            Review team to provide their backgrounds and experience.            Key CBDA participants to give introductions            Logistics for the review Overview of the agenda            CBDA to provide the review team with their objective of the assessment            Recap of the scope of the assessment</p> <p><b>Tour of CBDA office</b></p> <p><b>CBDA organisational and governance structures</b>            Organisational reporting lines, structure and resources            Responsibilities of functional units Governance committee responsibilities,            composition and structure            Current status of integration of CBDA with Reserve Bank of SA            Capacity Building Unit Banking Platform</p>	<p>CBDA-            Olaotse Matshane            (Managing            Director)            Mr David De Jong            (Supervisor CFIs)</p> <p>Ms Nomadelo            Sauli (Director-            CB)</p> <p>Mr Kobus Van            Niekerk            (Director)</p>	<p>27th floor, 240            Madiba Street,            Pretoria</p>
14:00 - 16:00	Continuation of CBDA overview		

Day	Activity	Contact	Location
<b>Wednesday, October 4</b>			
	<p><b>Overview of operating environment Current economic climate and outlook in South Africa</b></p> <p>Participants in the banking sector (banks, mutuals, etc)            Balance sheets and nature of core functions undertaken by            CFIs            Legislative/regulatory environment as it applies to CFIs            Internal environment CBDA mission/vision            Funding            Resources current and planned SWOT analysis            CBDA culture            Strategic initiatives (organisational) Strategic initiatives (industry)            KPIs and measures of success            Risk appetite and its implementation Organisational management of its own risk profile            Interaction with other regulators</p> <p><b>Supervision framework</b>            High level overview of the supervision framework            Delegation framework and decision making process            Powers and supervision tools            Current status of framework and its target state</p>	<p>Mr David De Jong</p>	<p>CBDA</p>



Day	Activity	Contact	Location
	Benchmarks and independent reviews Supervision strategies and outcomes Thematic review work Data submitted to the CBDA and its use Detailed walk through of supervision systems Review of sample supervision files include financial analysis and risk/compliance based prudential reviews.		
11:00 - 13:00	<b>Stakeholder Meeting:</b> Oranjekas CFI	Mr Buitendach (MD)	1241 Collins Avenue, Moregloed, Pretoria 012 754 5454
14:00 - 16:00	<b>Stakeholder Meeting:</b> Small Enterprise Finance Agency	Mr. Jacob Gumbo (Co-operative Specialist)	Eco Fusion 5, 1004 Witch-Hazel Ave, Eco-Park Estate, Centurion 072 429 2067

Day	Activity	Contact	Location
<b>Thursday, October 5</b>			
08:30 - 10:30	<b>Licensing process</b> Overview of the licensing process Recent licensing experiences Governance as it applies to licensing Review of recent licensing assessment Intelligence Sources of intelligence to support prudential supervision Use of data to inform analysis	Mr David de Jong	CBDA
11:00 - 12:00	<b>Stakeholder meeting:</b> SARB Supervision	Mr. Rob Urry	370 Helen Joseph Street, Pretoria 012 313 4468
14:00 - 15:00	<b>Stakeholder Meeting:</b> Co-operatives, Small Business Department	Mr. Jeff Ndumo Chief Director-Co-ops (DSBD)	77 Meintjies Street, Sunnyside, Pretoria, Gaute 079 876 4040

Day	Activity	Contact	Location
<b>Friday, October 6</b>			
09:30-11:00	<b>Stakeholder Meeting:</b> Gauteng Department of Economic Development	Mr. Mathopane Masha (Director-SMMes, Co-operatives Support & LED)	56 Eloff Street, Marshallto 011 355 8055/060 995 24
11:30-14:00	<b>Stakeholder Meeting:</b> Nehawu CFI, Young Women in Business CFI	Ms Patiswa Kruca (Manager) Ms.Ntabileng Likotsi (Manager)	14 New St, Bramley View, Johannesburg 073 879 9111



Day	Activity	Contact	Location
<b>Monday, October 9</b>			
08:30 - 9:15	Stakeholder meetings: Boikago CFI	Ms Beauty Gwabeni (Manager)	127 Provident Street, Old Mutual Building, Mafe 082 869 6214
10:30 - 11:30	Stakeholder Meeting: Motswedi CFI (not registered)	Mr Shadreck Kgosiemang (Manager)	127 Provident Street, Old Mutual Building, Mafe

Day	Activity	Contact	Location
<b>Tuesday, October 10</b>			
09:00 - 10:00	Stakeholder meetings: South African Reserve Bank/Prudential Authority	Mr Kuben Naidoo (Deputy Governor – SARB/Prudential Authority)	370 Helen Joseph Street, Pretoria 012 313 4468
10:00 - 12:00	CBDA : Oversight of implementation of recommendations/actions Recovery planning and resolution Supervision strategies in recovery planning Stress testing practices Tools and policies in resolving a CFI Depositor protection fund	Mr David de Jong	370 Helen Joseph Street, Pretoria 012 313 4468
12:00 - 13:00	Stakeholder meetings: KZN DED	Mrs Smangele Manzi Ms Nelisiwe Mokoena	Tele-conference (CBDA)
14:00 - 16:00	Stakeholder meetings: DGRV / Nacfisa Sector representative	Mr Mzwake Sikhosana (MD)	731 Jan Shoba Street, Hillcrest, Pretoria Contact No: *****

Day	Activity	Contact	Location
<b>Wednesday, October 11</b>			
09:00 - 10:00	Stakeholder meeting: Kladies CFI	Ms. Elizabeth Khumalo (MD)	Teleconference
10:15 - 11:15	Stakeholder meeting: Sibanye CFI (unregistered)	Mr. Victor Botha (rejected application)	Teleconference
12:00 - 12:45	Stakeholder Meeting: Ditsobotla Co-op Bank	Ms Sabi Padi (Managing Director)	Teleconference
14:00 - 15:00	Stakeholder Meeting: National Treasury	Mr. Roy Haveman (Chief Director - Financial Sector Policy)	CBDA



Day	Activity	Contact	Location
<b>Thursday, October 12</b>			
<b>09:00 - 12:00</b>	Follow-up on miscellaneous matters Debriefing meeting with CBDA	Ms Olaotse Matshane Mr David De Jong CBDA team	CBDA



## *Annex 2 – Brief Summary of Views Expressed by External Stakeholders during Meetings*

### *Oranjekas Savings and Credit Co-operative, Pretoria*

- The CFI has had its deposit taking activities restricted for a number of years as it has reached the threshold, which now requires it to become a co-operative bank. This threshold had been set at R30 million but was increased to R40 million. As a result, the CFI can no longer advertise for new deposits and this is impacting on its profitability.
- The CFI has applied to SARB for a licence to become a co-operative Bank a number of times but has to date, been unsuccessful. Another application will be made in the near term. The CFI noted that the SARB was clear in its expectations of the requirements to become a co-operative Bank.
- Throughout the initial registration process to become a CFI, it was expressed that the CBDA was responsive and available to provide assistance.
- In terms of ongoing supervision, issues raised by the CBDA supervision team during reviews are seen as being clearly articulated and add value to the CFI and engagement is seen as positive and professional.
- The CEO has attended training offered by the CBDA capacity-building division and found it to be very valuable. Feedback provided was that the training should be run again for other participants in the industry.
- It was expressed that the minimum criteria to become a CFI (i.e. membership, capital and common bond) are set at the appropriate level. On the requirement for annual registration, they expressed the view that a change to make it renewal of an existing registration rather than applying for a new registration may be preferable.
- On supervisory requirements, in relation to provisioning they suggested that it should be clear that provisions on impaired loans should take account of the value of any security held.
- It was noted that opening a bank account with a commercial bank can be a difficult process and CFIs seek to fill this gap for their members. They also expressed the view that there are opportunities for CFIs as co-operatives to fulfil the needs of their communities in small towns and that a co-operative can operate at lower cost than a bank and provide personal advice.
- The CFI noted that more could be done to promote the CFI sector to improve awareness as in their view it was not that well known as a concept in South Africa. The message needs to be communicated to include the value of a co-operative and greater details about starting a co-operative. It was noted that collaboration within the industry is one way sharing information.



- Oranjekas noted that it has a successful business model and is open to having other formative CFIs visit it for coaching and development purposes.
- Not being on the national payments system was highlighted by the CFI as a reason for it being difficult to attract new members.
- The CFI considers that a deposit insurance scheme for CFIs would be a good idea to build confidence in the industry.

#### *Small Enterprise Finance Agency (“SEFA”), Pretoria*

- A Government agency with a mandate to SEFA was once responsible for the regulation of CFIs before regulatory reform and consolidation.
- Now provide funding to qualifying small-medium enterprises and co-operatives through direct and wholesale channels.
- SEFA is currently participating in the banking platform and has provided capital to CBDA towards development of this system which will be used by the industry. Some concern was expressed with the pace of deliverables from the project. SEFA indicated that, as a member of the project steering committee, it needed to conduct a review of the project to establish if the project implementation is line with milestones before providing further development capital.
- SEFA observed that the culture of borrowing amongst CFI members is stronger than that of saving, yet CFIs have a forced saving policy. SEFA noted that external loans can enhance CFIs ability to lend to its members but the 15% prudential limit on external funding sources applied to CFIs as being restrictive to CFI. There are occasions where the Agency has the capacity to provide funding to CFIs in excess of the limit (for CFI to use for making business loans) but cannot due to the prudential limits.
- SEFA’s predecessor South African Microfinance Fund, (“SAMAF”) was once responsible for the regulation of CFIs before regulatory reform and consolidation.
- Their views regarding the current approach and regulation are as follows:
  - Current prudential standards are too tight for the nature of the business being regulated and were not subject to enough consultation when being developed;
  - The common bond requirement is limiting the growth of the CFIs;
  - CBDA Centralised operation undermines its effectiveness in capacity-building function as CFIs are across the provinces. SAMAF had regional offices enabling training and close monitoring of the CFIs;
  - CFIs are at a disadvantage as they cannot access the national payments system;



- Gaining access to the right experienced resources for rural CFIs can be a challenge ( e.g. ongoing need for access to training for board members and understanding by supervisors of CFI capabilities so that they can communicate effectively and ensure supervision messages are fully understood ;
- Perceptions of CFIs in the general public is that CFIs are for the underprivileged and this can impact on the product being more widely accepted;
- There is a role for CFIs – the way to facilitate the “unbanked” so that they can have access to loans. Can play an important role in the economy – in particular in many rural areas there are no banks;
- General perception is that the CBDA capacity building unit and industry body (NACFISA) are not working as well as they could together.

***Department of Small Business Development, (“DSBD”) (including Co-operatives), Pretoria (“CSD” Government agency)***

- DSBD which includes co-operatives is interested in seeing the co-operative sector, including CFIs grow. The possible ways that this can be enabled practically are to look to existing CFIs to join up with each other or alternatively create an environment where the sector grows organically.
- Government recognises role of co-operatives including CFIs in empowering the common citizenry through savings and ownership of capital to invest in enterprises.
- The development of the CFI sector has been held back, with no strong champions for co-operatives, partly owing to the history of South Africa.
- There is need to continually review the policy instruments to support CFI growth and development. Critical structures for co-operative growth and development would include Co-operative Development agency (similar to CBDA for other co-ops) Co-operative Education programme and Co-operative Tribunal.
  - There is currently no deposit insurance scheme covering CFIs. This would be beneficial in building confidence within the system.
  - The limit of R30 million on CFIs upon which an application must be made to convert to a co-operative bank is limiting the industry.
  - The CBDA as a capacity-building unit has very limited funding and there is doubt as to whether it can achieve its objectives at current resourcing levels.

***Department of Economic Development Gauteng Province (“DEDG” Provincial Government department)***

- DEDG has dedicated programme on CFIs growth and modernization with funding from the provincial government. The programme is designed to create awareness on CFIs and provide technical assistance through training, knowledge visits and support adoption of ICT in the sector.



- Department working with various stakeholders in the programme including trade associations for Stokvels<sup>19</sup> & Taxis; Universities & Schools; Churches etc.
- The DEDG sees the value in CFIs and is currently in the process of applying to establish a CFI itself focused on Gauteng provincial employees.
- Department notes CBDA has Vision2020 but industry programmes not synchronized so that Provinces can align their programmes and strategies.
- Notable challenge for many CFIs include manual processes and in some cases, using two different banking platforms.
- Next challenge for the industry is how to embrace digitisation of banking, given the industry not currently participating in the national payments platform.
- They expressed the view that they hope the regulatory framework can be supportive of CFIs. The R30 million deposit limit requiring that CFIs convert to a co-operative bank is viewed by the DEDG as being too limiting. So too is the requirement to have at least 200 members in order to register a CFI. However, the minimum capital level of R100,000 was not seen as a problem.
- The need to have a common bond was expressed by the DEDG as being a factor which can limit growth opportunities. They also expressed a view that some CFIs may be too small in size and that some consolidation may be required.
- They noted that there is a need to find ways to support development including sending those involved in management of CFIs to relevant conferences, provision of training and support for developing office infrastructure – in order to bring them to a level where they are operating on a stable basis.
- On potential actions that could be taken to further support and develop CFIs they mentioned – application of deposit insurance ( to promote confidence ) and for the CBDA to focus on becoming better known ( need a “face” for the CBDA) and that capacity building needs to respond to the needs of CFIs.
- In terms of regulation moving from CBDA to the prudential authority at SARB they welcomed this and should be positive in terms of views of CFIs – that now under the same regulator as co-operative banks and other banks.

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***Nehawu and Young Women in Business (joint CFI meeting)***

- The initial CFI registration process was noted as being relatively straightforward.
- Both CFIs quoted the minimum number of members required to register a CFI (200) as too high and difficult to achieve.
- It was noted that the current taxation system could be reviewed to provide not-for-profit entities such as CFIs a tax incentive.
- There was a perception that no stabilisation fund exists to support CFIs facing financial difficulties (even though this is not the case – there is a stabilisation fund at CBDA).
- The CFIs are trialling the core Banking Platform that is being developed by CBDA but have lost confidence in its functionality, deliverables and pace of delivery. Both are now using an alternate banking system.
- It was the view that the work undertaken by the supervision team when doing on-site reviews has some repetition from year to year and not focused. It was also felt that recommendations made in closing examination reports are not well explained or justified by CBDA.
- There was some dissatisfaction with the fact that a number of CFIs have been deregistered by the CDBA, but that they continue to operate and accept deposits. They also noted that some CFIs were allowed to register and commence business before they were ready and that the ongoing requirements to be met once registered should be clearer from the beginning.
- It is the view that the supervision team apply a one-size fits all approach and do not vary based on size and complexity.
- There needs to be a clearer link between supervision findings and the support offered by the CDBA capacity-building unit. In particular if certain risks are emerging as common risks there should be training provided on these areas.
- The CFIs have been requesting additional training from the CBDA but it has not been delivered.
- There was misunderstanding and divergent views on the basis for applied in accounting and financial reporting (whether a cash or accruals approach should be taken).

***Boikago CFI, Mafeking, North West Province***

- Local economic issues were noted as limiting the CFIs' ability to grow and the minimum prudential requirements including common bond limitation stifling growth in membership.



- They also raised the issue of deregistered CFIs continuing to operate.
- The CFI highlighted that there may be scope to further develop supervision staff so that they have skills and capabilities to better understand the practical operational aspects of a CFI, explain findings and target the right risk areas and to ensure that what CFI being asked to do is appropriate to size – i.e. CFIs are not competing with banks.
- It is the view that the same issues are being raised by supervision staff from year to year and that the focus of reviews remains unchanged from year to year.
- They advised that they were part of the banking platform project and had concerns about it including its ability to give the reports they need.
- Maximum board tenure of directors (three years was expressed as being too short as are just trained at that stage).
- Delayed completion of banking platform negatively affecting CFI business as they have high hopes in it. CFI biggest challenge remains the Management Information System (“MIS”) hence need for the platform to get functional.
- CBDA can learn from SACCOL in terms of capacity building and MIS.

#### ***Motswedi CFI (deregistered), Motswedi Village, North West Province***

- This CFI was deregistered by the CBDA because of reporting challenges; it operates a system of manual financial reporting and reports to CBDA became irregular. It also had difficulties with the accuracy of figures as it was operating manually and had some practical issues regarding its system.
- It was of the view that the banking platform was working satisfactorily and was upbeat about completion so it can apply to SARB to become a co-operative bank. It is part of the Banking Platform project and intends to apply to the prudential authority in 2018 for authorisation as a co-operative bank. It indicated that there was some question around the delivery date for the core banking system and that it may not be achieving targets.
- The CFI noted that the supervision team in CBDA appear not to work well with the capacity building division. They were also of the view that CBDA could do more to help CFIs for example they had understood that CBDA had mentioned that there would be internal audit for CFIs arranged by CBDA but that did not happen.
- CFI not clear of CBDA expectation post deregistration but business services to members continue as usual. Hence the desire to apply to SARB given levels of deposits held.



- There had been no subsequent communication to or from CBDA post deregistration.
- CFI expects to be licenced by SARB by February 2018 but uncertainty remains because of the banking platform.

***Department of Economic Development, Kwazulu Natal Province***

- Observation is that supervision and capacity building could work better together and they welcomed the provincial departments involvement. The challenges of KwaMachi CFI are a good reference and learning case for moving supervision to the Prudential Authority.
- Do not agree with registering CFIs and then as has happened in certain cases deregistering them a short time later.
- Not very optimistic on the current status of the core banking system (Banking Platform). There are no clear reporting processes in place to keep stakeholders updated with its progress.
- The common bond is viewed as being problematic as it restricts who can join a CFI.
- There are practical limitations in CBDA's capacity building as a national organisation to operate across all provinces – would be better if this could take place through a range of departments and provinces combining resources so that mutual can be developed- to include workshops on explaining requirements for registration
- The role and purpose of CFIs in South Africa is not well understood in comparison to other countries.

***National Association for German Co-operative Financial Institutions of South Africa, and Raiffeisen Confederation ("DGRC") and NACFISA***

- Formed in 2013 as a trade association for CFIs with nineteen members at the date of interview, seven of whom were CBDA registered.
- Meeting held jointly with German Co-operative and Raiffeisen Confederation, DGRV who are development and funding partners for NACFISA.
- NACFISA understands their mandate as advocacy and capacity development
- NACFISA submitted its application and is awaiting registration by CBDA but it is unclear who in the CBDA approves applications for registration as Lobby and Support organisations.



- Should be one term to define institutions in the sector and make it comfortable to be understood – at the moment too many terms – CFI, SACCO, co-operative Bank, village bank – this creates a “mist”.
- NACFISA concerned that there is no clear vision and strategy from the Government on the development of the CFI sector, for which they would also help guide supporting agencies of co-operatives. A national roadmap is required with a co-operative strategy and comprehensive approach so that outcomes can be delivered.
- NACFISA asserts that better clarity on identity of what to advocate for on behalf of CFIs is required for brand identity. It proposes that all CFIs be able to use the term “bank” – helping ensure a clearer way of marketing the sector.
- Prudential requirements for small CFIs are too high. There could be more use of risk-based supervision, tailored to size / risk of individual CFIs.
- Upon registration, emphasis should be on capacity support through incubation to enhance compliance.
- There are restrictions imposed on CFIs in the common bond.
- The inability to connect to the national payments system is proving problematic for CFIs and their ability to compete on an even playing level.
- A lot of financial education and marketing needed for CFIs. Had thought that CBDA would have a role in marketing e.g. a national campaign for co-operative banks.
- When a CFI is deregistered, there needs to be a stronger focus on its rehabilitation. Decline in the number of CFIs is a serious concern for the CFI industry.
- There are unclear issues in the delivery of the banking platform by the CBDA.
- They raised concerns on the Banking Platform including clarity of ownership, timeframe and costs. They are involved in putting forward an alternative for CFIs.
- NACFISA welcomes the transfers of supervision function to SARB as this will avoid the risk of conflict between the developmental mandate of CBDA with that of supervision.
- There could be tax incentives for CFIs given that they are not-for-profit organisations.
- A deposit insurance scheme for the CFI sector is critical for building confidence in the system.



*K-Ladies CFI, Kwa Zulu Natal Province*

- CFI acknowledges that the prudential supervision is assisting improve management capacity through reviews, examinations and feedbacks thereof.
- But some of the minimum standards too strict such as number of 200 members required to establish a CFI and this is discouraging CFIs.
- Closure of several CFIs in KNZ, a serious concern on reputation of CFIs including K-Ladies
- There seemed to be some misunderstanding of the operation of common bond. The CFI noted that when members move from the Durban metro area they must leave the CFI.
- A cap on total deposits of R30 million is very restrictive for those CFIs not wishing to convert to a co-operative bank.
- There needs to be more support from the CBDA in developing director skills.
- They had positive experiences from CBDA reviews including recommendations where risks need to be addressed.
- The Banking Platform is operational but not working as expected forcing CFIs to retain their old systems (thought it would be quicker).
- The inability to offer cards due to not having access to the national payments system is causing problems in attracting and retaining members especially salaried persons
- The reason for deregistration of CFIs is unclear and it is not helping the CFI industry – impact on reputation of CFIs and little communication on it from CBDA.
- CBDA should educate CFIs about the Stabilisation fund and its benefits to them so they can willingly contribute
- Deposit insurance, if introduced, will assist in enhancing confidence and reputation of CFI sector and thus attracting members to CFIs.
- People do not know too much about CFIs – there needs to be education including “word of mouth”, newspaper advertisements. Members of CFIs can be good ambassadors for CFIs.



***Sibanye CFI (deregistered), Capetown***

- A successful CFI that had started within a closed bond but opened up to microfinance lending with support of SEFA.
- The CFI had a positive experience with CBDA until delinquency for microfinance loan portfolio shot up to unsustainable levels leading to severe illiquidity – regulation and insolvency.
- CFI capacity building unit – prior to the deregistration was provided with a short-timeframe to rectify issues but situation worsened and finally it was deregistered.
- CFI noted that CBDA assistance to assist with a rehabilitation programme would have been useful and may have prevented issues from progressing.
- The CFI is of the belief that the external funding limit of 15% of assets is well served and should not be removed. Loan portfolio funded by borrowed funds should also be less than 20% of the CFI's loan portfolio.
- CFI observed that CFI sector in South Africa has a long way to go due to culture and socialization of members which tend to undermine growth of village banks and CFIs in general.
- CBDA and NACFISA working together have to spear a change process.

***Ditsobotla Co-operative Bank Lichtenburg, North West Province***

- The CBDA capacity building was noted as not providing enough support to the co-operative banks.
- Since its conversion to a co-operative bank, there have been a number of times where it has been left out of communications from the CBDA.
- They want to build their own premises but cannot due to the regulatory limit of 5% total fixed assets.
- The external borrowings cap of 15% is problematic as the bank has the ability to secure funding above the limit.
- They had positive views from CBDA supervision which had helped them in their interactions with supervision at SARB. In terms of being a CFI versus a co-operative bank they did not see any particular benefits
- In terms of advice for other CFIs – cut expenses to help make good surpluses and build reserves.
- The bank was unaware of the CBDA stabilisation fund.



### *Annex 3 - Biographies of Review Team*

*Elaine Byrne (Ireland)* is a Deputy Registrar in the Registry of Credit Unions at the Central Bank of Ireland (the “Central Bank”) with functional responsibility for Policy and Restructuring. She has been with the Central Bank of Ireland for 30 years and has 14 years of experience in divisional management positions, as well as 16 years of supervision and regulatory experience. In her current position, Elaine has developed an in-depth understanding of the credit union sector, together with involvement in developing the regulatory strategy to manage the key challenges arising. She undertook a key role on behalf of the Central Bank in developing and managing the peer review for Ireland, which was undertaken by ICURN in 2015. Elaine acted as team leader of the ICURN Peer Review.

*Peter Njuguna (Kenya)* is a leader with rich and diverse experience spanning over 15 years in the Kenya financial sector including Central Bank of Kenya, Insurance sector and Sacco subsector for the last decade. He joined the Kenya Sacco Societies Regulatory Authority in 2010 to start the supervision function as a Chief Manager, a position he has held since then. He is responsible for providing leadership in formulating and implementing operational and regulatory strategies to promote financial soundness of Sacco societies and deepen access to financial services.

*Shamus Cassar (Australia)* has 20 years’ experience in the banking and wealth management industries within Australia. Shamus is currently Senior Manager, Specialised Institutions Division with the Australian Prudential Regulation Authority (“APRA”), where he has gained 10 years’ experience as a prudential supervisor. Shamus leads a team of analysts responsible for the prudential supervision of a geographically diverse range of credit unions, banks, pension funds and general insurers. Prior to APRA, Shamus worked in the private sector in a number of product development and risk related roles.

#### **Biographies of the ICURN Peer Reviewers.**

*Dave Grace (United States)* is the Executive Director of ICURN and a credit union supervision consultant for the International Monetary Fund, World Bank and others. He has assessed the National Credit Union Administration (“NCUA”) in the United States and multiple jurisdictions in the Caribbean region and Africa utilizing ICURN Guiding Principles and the Basel Core Principles for Effective Supervision.

*Martin Stewart (United Kingdom)* is the ICURN Chairman and the Director of Banks, Building Societies and Credit Unions at the Bank of England. Martin brings 17 years of experience as a board member, advisor and regulator with UK and European operational experience, as well as worldwide advisory and regulatory insights.



### Annex 4 – Overview of Position in Australia, Ireland & Kenya on selected Regulatory / Supervisory Areas

	Australia	Ireland	Kenya
<b>Common Bond</b>	<p>There is no legislative or regulatory requirement for credit unions to have a common bond. Some institutions have a self-imposed common bond due to their founder (e.g. employer based) and this is articulated in the business' Constitution. For this to change, members would need to vote in favour of the amendment. From a risk perspective, APRA would expect that an institution would have the necessary plans and resources (financial, human and operational) when entering new markets (i.e. outside the core bond, or if not bound by a bond, a new State etc.).</p> <p>Necessary regulatory action could be taken under these circumstances. For example, changed supervisory stance, increased capital requirements, more intense supervision.</p> <p>APRA also assesses the strategic aspect around a limited market relating to a closed bond and would incorporate this into our supervisory requirements.</p>	<p>Admission to membership of a credit union restricted to persons who have in relation to all other members at least one of common bonds as defined in legislation (Section 6, Credit Union Act 1997 ("CUA")).</p> <p>The common bonds are:</p> <ul style="list-style-type: none"> <li>(a) following a particular occupation;</li> <li>(b) residing or being employed in a particular locality;</li> <li>(c) being employed by a particular employer or having retired from employment with a particular employer;</li> <li>(d) being a member of a bona fide organisation or being otherwise associated with other members of the society for a purpose other than that of forming a society to be registered as a credit union;</li> <li>(e) any other common bond approved by the Bank.</li> </ul>	<p>The legislation provides that a PERSON is qualified for membership in a Co-operative society if</p> <ul style="list-style-type: none"> <li>(a) <i>his / her employment, occupation or profession falls within the category or description of those for which the co-operative society is formed; and</i></li> <li>(b) <u><i>he or she is resident within, or occupies land within, the society's area of operation as described in the relevant by-law.</i></u></li> </ul> <p><b>The underlined words imply that the whole of Kenya can be the SACCO's area of operation.</b> Consequently, SACCOS have the legal flexibility define their common bond as business decision. It is then left to the Regulator to evaluate the financial and operational capacity of an individual SACCO to manage the risk associated with serving what we are today describing as open common bond. However, for most Kenya SACCOS operating nationally, it has been an organic business growth rather than through legal imperative.</p>
<b>Requirements to Establish (Number of Members / Financial)</b>	<p>At present there are no minimum requirements (i.e. number of members, share capital) to start a credit union.</p> <p>To apply for a banking authority, a minimum of A\$50m in share capital is required, although this is currently under review with the view to it being lowered.</p> <p>To enable FINTECHs to enter the market to trial ideas, APRA has just released a discussion paper regarding a revised licensing process. The proposal is to have a sandbox where a new entrant can operate for up to three years and there will be lower capital and prudential</p>	<p>A credit union must have at least 15 members who are of full age. (Section 6 (1)(c), CUA)</p> <p>The Central Bank may impose conditions on registration including:</p> <ul style="list-style-type: none"> <li>(a) to notify the Bank of any events of such significance that could materially affect the credit union including any change to the strategic plan of the credit union;</li> <li>(b) to operate a more limited business model agreed with the Bank;</li> <li>(c) to cause to be undertaken an independent review of the credit union's business within 12 months in order</li> </ul>	<p>For registration, the Kenya Co-operative Society Act requires a minimum of at least 10 members and a viable business case. This applies regardless of whether it is a financial or non-financial Co-operative.</p> <p>However, the regulatory requirements to undertake deposit taking SACCO business are much higher, as minimum core capital is KSH10m or about USD\$100,000 and audited financial statements for last three years are required. Hence, the two tier system of SACCOS in Kenya creates flexibility in that members can start a non-deposit</p>



	Australia	Ireland	Kenya
	<p>requirements, additionally there will be restrictions on deposit taking. There is also a strong focus on a credible exit plan. At the end of three years, the expectation is that the deposit taker would either transition to a “full” deposit taker or exit the industry. Under all licensing circumstances, it is APRA’s expectation that a sound and reasonable business case is presented and this form the basis of the depth and extent of supervision.</p> <p>Relevant links:  <a href="#">Authorisation guidelines</a>  <a href="#">August 2017 - Consultation on phased licensing for authorised deposit-taking institutions</a></p>	<p>to ensure that the credit union is complying with all legal and regulatory requirements. (Section 6A, CUA)</p> <p>A newly registered credit union shall establish and maintain an initial reserve requirement that:</p> <ul style="list-style-type: none"> <li>(a) is sufficient to meet the credit union’s anticipated growth over 3 years;</li> <li>(b) takes account of operating losses that can be expected to occur until the credit union reaches an operationally viable performance level; and</li> <li>(c) is at least €10,000.</li> </ul> <p>(Credit Union Act 1997 (Regulatory Requirements) Regulations 206 (“S.I. 1 of 2016”))</p>	<p>taking SACCO and remain at that for ever as there is no legal obligation to become a deposit taking SACCO.</p> <p>Non-deposit taking SACCOs are not subject to prudential requirements. This legal flexibility accompanied by ready capacity support from State Department of Co-operatives works to nurture small SACCOs up to that time when they can stand on their own and if they so choose, apply to SACCO Societies Regulatory Authority (“SASRA”) to start accepting demand deposits and operate transactional accounts.</p>
<b>Registration and licensing</b>			
<b>External Audit (Requirements / Payment)</b>	<p>Deposit takers are required by APRA to appoint an auditor to provide assurances regarding the data submitted to APRA and compliance with prudential standards. The prudential standard has fit and proper requirements, including specific experience regarding the appointed auditor. Each deposit taker is responsible for funding its own audits.</p> <p>Relevant links:  <a href="#">APS 310 Audit and Related Matters</a></p>	<p>At each annual general meeting a credit union shall, by a majority vote of the members present and voting, elect an auditor to hold office from the conclusion of that meeting until the next annual general meeting. (Section 113(1), CUA). In addition, there are various other requirements in legislation on appointment, eligibility and removal, resignation and auditors duty to report certain matters to Central Bank. (Sections 114 – 122, CUA)</p> <p>The cost of a credit union’s external audit is born by the credit union.</p>	<p>All Co-operatives are by law required to have their books of account audited and a general meeting held by 30th of April during which the audited accounts must be read.</p> <p>However, the Government has always had a department of Co-operative who provide a cost effective option for external audits for small SACCOs that may not afford to hire private auditors.</p> <p>However, this option is not available for deposit taking SACCOs who are licenced and regulated by SASRA. These ones have to hire private auditors as a regulatory requirement.</p>
<b>Board of Directors (Term of Office / Remuneration)</b>	<p>APRA currently places no limit (in prudential standards) regarding tenure. In other industries (i.e. pension funds) they have set a 12 year limit although this can be extended under certain circumstances. Deposit takers are required</p>	<p>The number of directors shall be specified in the registered rules and shall be:</p> <ul style="list-style-type: none"> <li>(a) not less than 7,</li> <li>(b) not more than 11, and</li> </ul>	<p>There is no legal provision in the Kenya Co-operative Societies Act or Rules thereunder that explicitly limits a director’s tenure in the Board of a SACCO or a Co-operative Society. However, the rules provide for rotation retirement</p>



	Australia	Ireland	Kenya
	<p>to have a “renewal” policy, which may include maximum tenure. In practice, if a credit union has directors with long tenure it will be raised through a supervision team.</p> <p>There are no specific limits on remuneration of directors. In practice, remuneration varies between credit unions from pro-bono (small credit union) to paid (large, relatively complex credit union).</p> <p>APRA’s focus in regards to boards is that collectively there is adequate skills and experience to govern the deposit taker. Remuneration is a decision for the board however if payment has a material impact on the financial viability of the institution then that would be taken up in a different context.</p> <p>Relevant links:  <a href="#">CPS 510 Governance</a>  <a href="#">Prudential Practice Guide APG 510 Governance</a></p>	<p>(c) an odd number. (Section 53(3) CUA)</p> <p>A member of a credit union may not be appointed or elected to the board of directors if he or she has served for more than 12 years in aggregate in the previous 15 years on either the board of directors or the board oversight committee of the credit union. (Section 53(12))</p> <p>Directors of a credit union may not serve more than 3 consecutive years in any one principal post and shall not be eligible for re-election thereto until after the expiry of one year since he or she last held it. (Section 53(14))</p> <p>Remuneration – there is none – can you find text from relevant provision on this... may just state that entitled to expenses?</p>	<p>every three years for succession planning, but the retiring directors are eligible for re-election. Therefore, it is not uncommon to have directors serving for more than 10 years.</p> <p>There is no legal guidance on remuneration of directors but SASRA regulations do provide for reimbursement of expenses to directors. Thus, the SACCOs are required to have a policy on directors allowances based on their ability to pay. The level of allowances paid to directors vary greatly depending on the size of the SACCO.</p>
<b>Payment for Supervision</b>	<p>All entities regulated by APRA are subject to an annual levy, which is based on total assets.</p> <p>Relevant links:  <a href="#">Levies</a></p>	<p>Credit unions pay an annual levy contribution towards the cost of supervision of 0.01% of total assets as reported in the credit union's annual return for the year before the current levying year. (This does not represent the full cost of supervision.)</p>	<p>All SACCOs regulated by SASRA are subject to annual licence fees and an annual levy based on the amount of deposit liabilities of last audited accounts.</p>



	Australia	Ireland	Kenya
<b>Deposit Insurance</b>	<p>The Financial Claims Scheme (“FCS”) is an Australian Government scheme that provides protection to deposits in banks, building societies and credit unions and to policies with general insurers, in the unlikely event that one of these financial institutions fails. The FCS can only come into effect if it is activated by the Australian Government when an institution fails. Once activated, the FCS will be administered by APRA. The FCS was established by the Australian Parliament in 2008.</p> <p>The objectives of the FCS are to protect depositors of banks, building societies and credit unions incorporated in Australia and policyholders of general insurers, from potential loss due to the failure of these institutions provide depositors with prompt access to their deposits that are protected under the FCS support the stability of the Australian financial system.</p> <p>Under the FCS, deposits are protected up to a limit of AU\$250,000 for each account holder at each bank, building society and credit union that is incorporated in Australia and authorised by APRA.</p> <p>If the FCS is activated by the Australian Government following the failure of a banking institution, APRA will endeavor to pay most account holders, or enable them to access, their FCS payments within seven calendar days. Payments to depositors are made ex ante and any shortfall will be recouped via levying the industry.</p> <p>Relevant links:  <a href="#">FCS depositor site</a>  <a href="#">APS 910 Financial Claims Scheme</a></p>	<p>Credit unions covered are covered by the Deposit Guarantee Scheme (“DGS”) up to €100,000 per member per credit union. Credit unions pay an annual risk based levy into the DGS.</p>	<p>The SACCOs Societies Act of 2008 does provide for establishment of a Deposit Guarantee Fund (“DGF”) but this has not been set up yet. SASRA has planned a technical review of the DGF legal framework with a view to coming up with implementable recommendations on it. However, it is important to point out that in Kenya the non-withdrawable or share deposits which are not withdrawable on demand form the bulk of member deposits and are pledged as collateral for loans to members. This coupled with other operating realities worked to slow down implementation of a DGF. It is a major policy concern now as the demand deposits held by SACCOs are growing rapidly.</p>



	Australia	Ireland	Kenya
<b>Transition from CFI to Co-Operative Bank</b>	<p>The use of the term “bank” is a restricted term in the Banking Act (1959) within Australia. In order to transition from a credit union to a bank, the entity must make an application to APRA to use the restricted term and have at least A\$50m in Tier 1 capital (this is currently under review). Additionally, as the organisation becomes larger and more complex, there is an expectation that its level of sophistication will move at the same pace. This includes having a greater level of contingent liquidity funding in place (i.e. self-securitisation). The same prudential standards apply to credit unions and banks, unless the institution has obtained advanced accreditation for the purpose of modelling capital requirements.</p> <p>There are no requirements for a credit union to convert to a bank once it has reached a certain size. This is a decision for the members of the credit union to vote on, and for APRA to grant authority to use the restricted term.</p>	<p>Credit union is the term used for registration under credit union legislation. There are no requirements for credit unions to convert to a different legal type (e.g. building society / bank) if they reach a certain asset size (i.e. there is no asset size limitation for “credit unions”).</p>	
<b>Regulation of Support Organisation or Trade Association</b>	<p>APRA do not authorise or supervise trade organisations.</p> <p>This is generally also the case for service providers, or material outsourcing arrangements as APRA can access these organisations (e.g. undertake prudential reviews) through the outsourcing agreement. Material outsourcing agreements are required to contain a clause, which gives the regulator access to the third party. The exception to this is APRA’s supervision of CUSCAL. CUSCAL is an Authorised Deposit-taking Institution (“ADI”), and provides to the mutual industry, card and acquiring products, mobile payments, fraud prevention, EFT switching and settlements, and an ATM network. In this case, CUSCAL is supervised by APRA due to the breadth of products it offers, material services and systemic importance to the mutual banking industry.</p>	<p>Representative bodies or associations are not authorised or regulated by the Central Bank of Ireland.</p> <p>On outsourcing there are requirements with which must comply. The Central Bank has powers of access in relation information on outsourcing as well as access to business premises of outsourcer.</p>	<p>The trade association for SACCOs is registered under the Co-operative Societies Act and files returns to the Registrar or Commissioner for Co-operatives. SASRA has no oversight its training, capacity building and / or advocacy activities.</p> <p>Currently, SASRA has not legal powers over organisations that provide business support services to its regulated entities except for external auditors. However, there is an ongoing discussion on getting some legal powers over providers of other critical business services such as services but SASRA will not regulate them per se but will require certain minimum standards and access rights to third systems and infrastructure used by the SACCO. This is different from regulation and / or accreditation.</p>



	Australia	Ireland	Kenya
<b>Other - Taxation</b>		Credit unions are exempt from taxation on their annual surpluses(profits)	