CO-OPERATIVE BANKING SECTOR DEVELOPMENT STRATEGY

South Africa FSDRP II

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WORLD BANK GROUP
Finance, Competitiveness & Innovation

CO-OPERATIVE BANKS DEVELOPMENT AGENCY

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This document provides a strategy for how to develop the Co-operative banking sector in South Africa. The 2020 Co-operative Financial Institution and Co-operative Bank Member Survey and Potential Visions and Implementation Strategies for Growing Financial Co-operatives in South Africa provided key inputs to this strategy document along with the March 2021 National Indaba hosted by the Co-operative Banks Development Agency.

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I — BACKGROUND

1. **In March 2021 during a multi-day National Indaba over 100 participants from the financial co-operative sector reviewed, discussed, and selected a path forward for the movement.**

   The discussion at the Indaba was informed by a Members' Survey conducted by the World Bank and Co-operative Banks Development Agency (CBDA), a strategic options paper for the sector which was shared with participants in advance and through newsletter articles and a 2020 study by Rabo Partnerships, titled Development of the South African CFI Sector: Input for the ongoing discussions on the future of the CFIs in South Africa.

2. **There was unanimous support at the National Indaba for the vision which has a targeted approach for co-operatives financial institutions (CFI)/co-operative banks (CBs) to serve workers and communities.**

   Following the Indaba, a Strategy Development Working Group (see Annex 1 for a list of members) developed the components of this strategy by looking at how the sector should be organized, the immediate needs of the sector and how the strategy should be organized to develop co-operative banking.[1]

3. **This strategy for growing the CFI sector recognizes the broader environment in which financial services are occurring in 2021**.

   The most pressing and immediate challenge for financial services is the COVID-19 pandemic which has put pressure on consumers' ability to repay loans and financial service providers' operational and financial capabilities.

Economic and Financial Inclusion for Workers and Mixed-Income Communities through Quality Co-operative Banking

4. **The commercial banking and informal (stokvel) financial sectors are highly advanced and provide a competitive alternative to co-operative banks.**

   While regional and global comparisons of co-operative bank systems can be useful, most other co-operative banks did not face the level of banking sector sophistication during their early periods of growth. For example, in former Soviet bloc countries financial co-operatives started with significant donor support and were in competition with banks that were not service-oriented. In the SADC region and East Africa financial co-operatives have had a much longer history and more support for work-place based financial co-operatives. In contrast, the banks there have generally been less stable than in South Africa and many South African groups have desired to maintain their stokvels instead of growing it into a financial co-operative. The FinScope 2018 data for South Africa shows that 30% of adults use informal savings clubs and 37% borrow from family and friends and scope exists to formalizing these service offerings.

5. **There is a disproportionately high concentration of CFIs, more recently in the Gauteng province, where most members are already using a variety of products and services at commercial banks.**

   This aspect of parallel usage of CFIs and commercial banks is not unique to South Africa, as usage of CFIs exclusively often happens at either the very low end of the market, deeply rural areas, or with CFIs that are highly advanced. The World Bank's Global Findex survey indicates South Africa lags other upper-middle income countries with only 69% account ownership in South Africa compared to 73% upper-middle income countries as of 2018. In addition, Findex indicates that account ownership differences persist between the poorest 40% of the population which is 63% financially included and the richest 60% which is 74% financially included.

   The 2018 FinScope Fact Sheet indicates an even higher level of financial inclusion than Findex (80%) but with only 60% actively using their accounts as its common to withdraw cash immediately to avoid bank fees. Given the history of South Africa with regard to

[1] Throughout this document the inclusive term "co-operative banking" is used to reference financial services offered by co-operative financial institutions, savings and credit co-operative (SACCOs), credit unions and co-operative banks.

economic and financial exclusion, interest in financial inclusion in South Africa should not be limited on account ownership, but more critically to institutional ownership by the members.

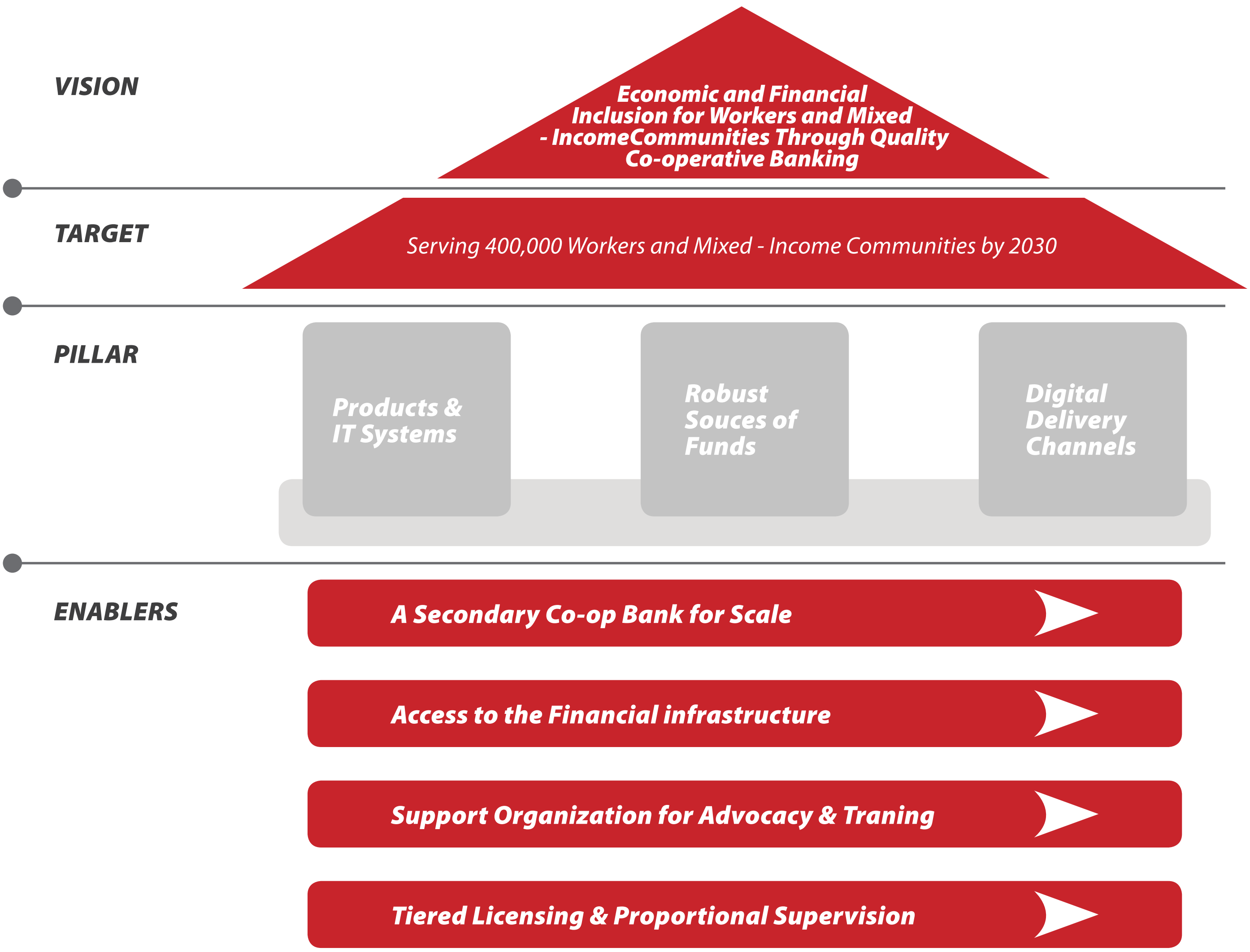
6. **A survey of what members and potential members are looking for in their co-operative banks was conducted to feed into the process of forming a direction for the sector.**

   The Co-operative Financial Institution/Co-operative Bank Members Survey (hereafter referred to as the Members Survey) was conducted online between July - October 2020 and it involved 63 quantitative entries.[2] In addition, 25 respondents were engaged on telephone and online video calls (20 minutes each) to expand on their qualitative insights obtained from the online survey. The survey was conducted in seven of South Africa's nine provinces of: Gauteng, KwaZulu Natal, Limpopo, Eastern Cape, Northern Cape, North West, and Western Cape. While 84% of members have a positive impression of their CFI/CBs, as of now most members use their CFI/CB more because of its structure and less because of its services.

7. **Following the National Indaba the Strategy Development Working Group identified the following key aspects of the Co-operative Banking Sector Development Strategy.**

   Figure 1 provides a high-level overview of the strategy which is described in more detail in sections IV and V.

Figure 1: Overview of Co-operative Banking Sector Development Strategy



[2] Although this survey was not intended to be statistically rigorous but rather inputs for the qualitative discussions, at the 95% confidence level the answers can be considered statistically valid, albeit with a 12% margin of error. A full version of the Co-operative Financial Institution/Co-operative Bank Members Survey 2020 is available via the CBDA's website.

Figure 2: Structural Characteristic to Achieve the Vision

Component	Element	Description
VISION	Economic and Financial Inclusion for Workers and Mixed-Income Communities Through Quality Co-operative Banking	Niche approach toward inclusion for workers and mixed-income communities and active promotion of co-operative banking, rather than a stepping stone to become commercial banks.
TARGET	Serving 400,000 workers and mixed-income communities by 2030	A target based on members (i.e., greater inclusion of people served, not assets, savings or number of CFIs/CBs). Achieving this will require products, systems, funds and channels.
PILLARS	Value Added Products and IT Systems	The core savings and loans need to become more attractive offerings. Most CFI/CBs need to make more good loans and make savings more accessible so people feel comfortable placing larger balances with CFIs/CBs and knowing they can get to the money quickly, if needed. IT systems need to support these products.
	Robust Source of Funding	Key to mobilizing deposits from members is having deposit products that are attractive to a mix of income groups.
	Digital Delivery Channels	People want to be able to access their funds/ information easily through smartphones, mobile money, ATMs, etc.
ENABLERS	A Second-Tier Co-op Bank for Scale	To facilitate technology services, access to the financial infrastructure and intermediate funds among CFIs/CBs.
	Access to the financial infrastructure	To compete with banks CFIs/CBs need to have direct access to the financial infrastructure as opposed to paying competitors for access through them.
	Support organisations for advocacy and training	There is a need for: 1) a strong representative body, 2) a Second-Tier Co-operative Bank (as discussed above), and 3) Support Organization(s) for training and to facilitate access to concessional funding.
	Tiered licensing and proportional supervision	Lighter touch regulation and supervision for small entities would help the sector focus more on the provision of services and fair outcomes for members as opposed to compliance.

8. This strategy was prepared at the request of the National Treasury under the SECO-funded Financial Sector Development Reform Program (FSDRP) II managed by the World Bank.[3]

This is not a World Bank strategy nor an endorsement by World Bank of a path for the co-operative bank sector in South Africa. Rather, the World Bank assisted the Strategy Development Working Group with documenting the direction the sector chose during the National Indaba in March 2021.

[3] The FSDRP II also supported the recent Rabo Partnerships paper on the financial co-operative sector.

II — ENVIRONMENT AND RECENT HISTORY OF CO-OPERATIVE BANKS IN SOUTH AFRICA

9. In the decade following the end of apartheid, development partners provided assistance to grow the co-operative bank system based on the model of credit unions whereby all users are members.[4]

These early efforts focused on developing a strong, independent association of co-operative banks that could aid with a "train the trainer" approach. By 2004 there were 40 financial co-operatives (then called savings and credit co-operatives or SACCOs) with 14,000 members. They operated under Exemption Notice No. 2173 from the Banks Act, which required membership in the Savings and Credit Co-operative League of South Africa (SACCOL) as a self-regulatory organization. With only moderate success, many international development partners scaled back support as their expectations were unmet and many of the initial financial co-operatives that were established closed.[5]

10. Despite the last 25 years and the passage of the Co-operative Bank Act in 2007 providing a legal framework for the sector, financial co-operatives serve only 29,500 members out of 40 million adults in South Africa – a number that has remained relatively flat (0.7% annual membership growth) over the past decade.

The sector had R433 million in deposits as of November 2019 and nearly 60% of the deposits are concentrated in just three institutions. While some of the decrease in membership in 2014-16 is attributed to cleaning up dormant accounts, the overall number of members in CFIs is still well below their smaller neighbours in Eswatini (50,000 members) and Lesotho (76,000 members) and far below peer countries such as Kenya (7.7 million financial co-operative members) and Brazil (10 million financial co-operative members). Notwithstanding having the largest economy and second-largest population in the Southern African Development Community (SADC) South Africa has the second smallest financial co-operative system in terms of members ranking just above the small island nation of Seychelles. In terms of the percentage of the adult population served by financial co-operatives, South Africa is at 0.08% (ranks last out of 118 countries) and had $30 million in assets in 2019.[6] In comparison, Colombia has a similar size economy and population, yet their financial co-operatives serve 9.5% of the adult population and had $7.6 billion in assets in 2019 (Figure 2). In comparison, financial co-operatives in South Africa are still relatively new (except for mutual banks) and have had to try to make headway in a market dominated by sophisticated commercial banks which have strong outreach strategies.

Figure 3: Cross Country Comparison of Financial Co-operatives in Peer Countries

Country	% of Adults with Account – 2018 Findex	Assets of Financial Co-operatives in USD - 2019	% of Adults with Accounts at Financial Coops - 2019
South Africa	69%	$30 million	0.08%
Kenya	82%	$10 billion	27.8%
Brazil	70%	$62 billion	7.5%
Colombia	46%	$7.6 billion	9.5%
Lesotho	46%	$7.3 million	5.7%

Sources: *World Bank's Global Findex 2018 and World Council of Credit Union Statistical Report 2018.*

[4] The first Co-operative Societies Act in South Africa was passed in 1908 with a focus on agricultural co-operatives but mutual banks have a history dating back to the 1880s in South Africa.
[5] In hindsight, these expectations lacked an acknowledgement and understanding of the uniqueness of South Africa's well-developed and technically advanced banking system and the cultural issues.
[6] 2018 Credit Union Statistical Report, World Council of Credit Unions.

CHALLENGES THAT CONTINUE IN FINANCIAL Co-operatives

11. There are several formidable challenges that financial co-operatives face regarding trust, managerial capacity and financial infrastructure.[7]

Although there has been commendable average annual growth in assets (18%) and deposits (15%) over the past 9 years (Figure 3), the number of members has grown annually at only 0.7%. Given that 11 million working-aged South Africans are unbanked there is significant untapped opportunity for growth and mobilization of their deposits.[8]

Figure 4: Sector Metrics, 2011 to Nov. 2019 - Assets, Deposits and Loans are in millions of Rand

Description	Annual Growth	Nov-19	2018	2017	2016	2015	2014	2013	2012	2011
Number of CFIs	2.8%	22	26	30	30	26	26	35	21	18*
Members	0.7%	29,547	27,831	29,818	29,752	24,722	33,391	38,084	31,481	28,034
Assets	18.3%	433.5	317.6	282.2	279.6	236.6	231.4	220.8	201.8	175.9
Deposits	15.3%	358	244.8	123.2	233.8	201.1	198.6	200.8	187.9	161
Loans	19.5%	274.9	NA	227.6	NA	152.1	140.5	142.3	128.7	107.3

Sources: *International Credit Union Regulators' Network (ICURN) Peer Review Report 2018 & Prudential Authority.*

12. The lack of public awareness and broader confidence in CFIs hinders their ability to attract deposits, grow loans and generate the resources needed for growth.

Based on World Bank consultant's initial discussions with CFIs in focus groups and the Members Survey from July - October 2020, there is no single reason for the slow member growth. Some CFIs don't want to grow beyond their small familiar group because it will require greater trust and risk taking. Members and potential members lack awareness and confidence in CFIs which are key constraints that inhibit deposit mobilization. In South Africa, like some other countries, CFIs have at times grown out of existing informal savings and credit groups (i.e., stokvels). Because stokvels are historically well-known and utilized, especially among the unbanked and underbanked, CFIs have struggled to clearly define their difference and advantages such as access to credit on demand, compared to stokvels where savings can be entrusted among close friends and colleagues and person has to wait his/her turn to access credit. The financial co-operatives have also failed to offer debit and ATM cards to facilitate easier access to funds – a service widely available from banks.

[7] The financial infrastructure includes the National Payment System, credit and debit card networks, deposit insurance, credit information system and emergency liquidity assistance.

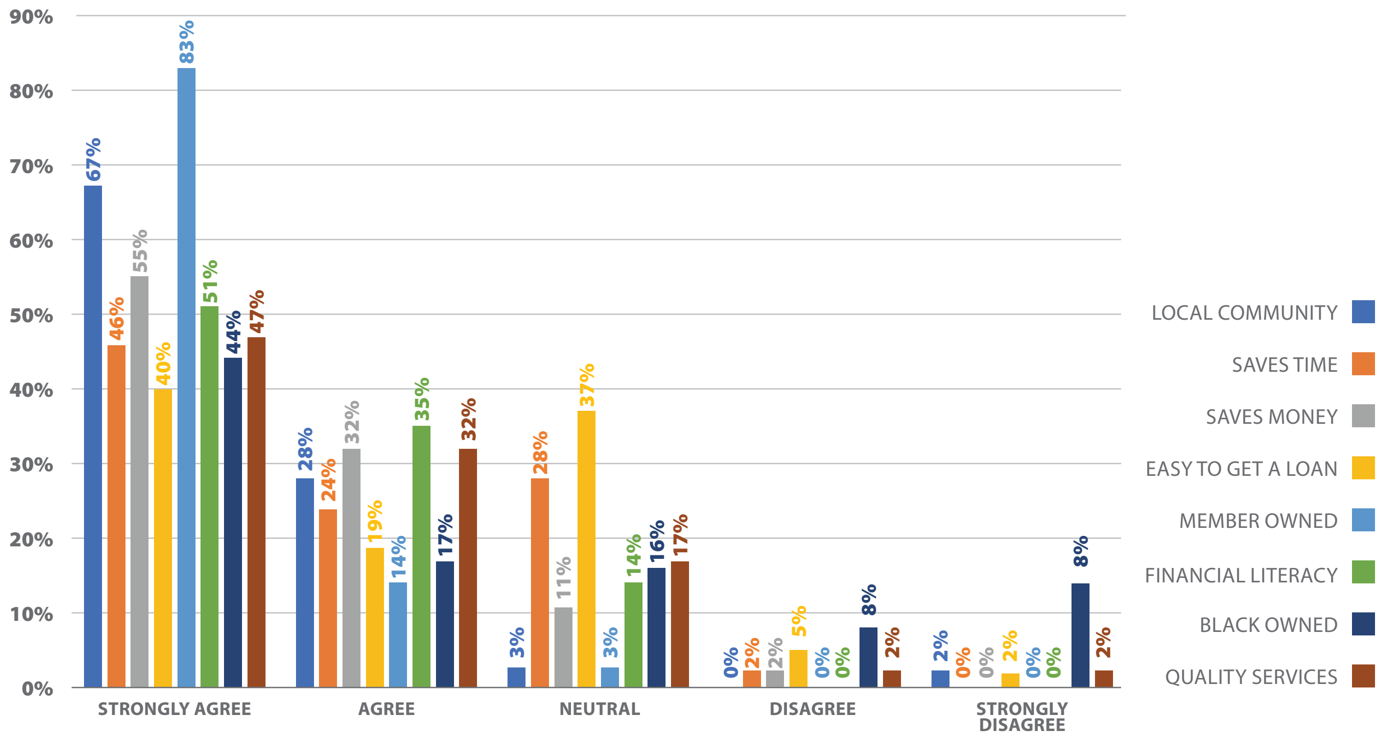
[8] Author's calculations based on Findex data of 69% inclusion and 36.9 million working-aged adults in South Africa.

13. Most members use their CFI/CB because of its structure and less because of its services.

Figure 4 from the Members Survey reveals that given the history of economic exclusion, the value proposition of CFIs/CBs is primarily about local ownership as was the case in similar studies in 2011. If CFIs/CBs had stronger service offerings the uptake of membership could be larger.

Figure 5: Value Proposition of CFIs/CBs

Why do you use a CFI/Co-operative Bank?



Sources: *Co-operative Financial Institution/Co-operative Bank Members Survey 2020, World Bank/CBDA.*

14. Given the small size of CFIs and niche communities they serve, many have struggled to attract and retain quality staff and board members.

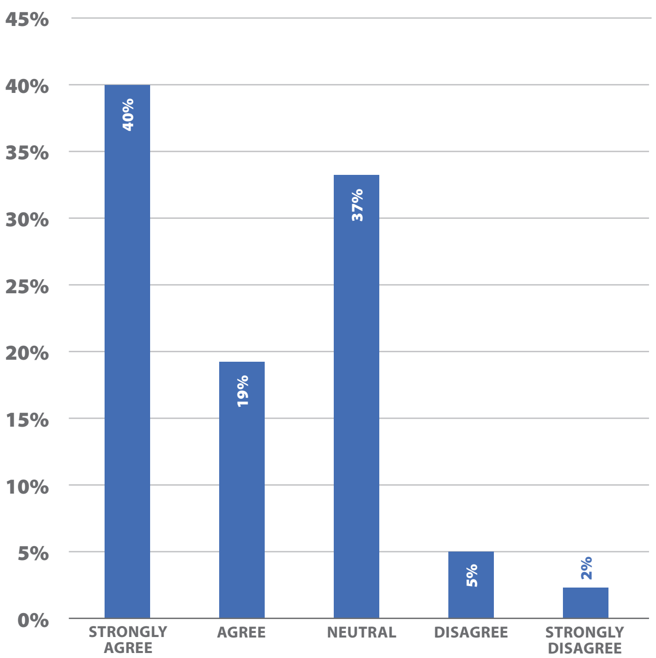
CFI boards have struggled to attract people who have financial skills and are willing or able to put in the time commitment needed as unpaid volunteers. Initially restrictive common bonds have limited the outreach to potential members and volunteers. Even if CFIs did pay board members a reasonable amount it still would be a challenge to attract individuals with the required skills in the rural areas where CFIs could prosper. The same has been true at managerial levels and is exacerbated by the small size and lack of resources within CFIs. As such, some CFIs have had to build the skills internally, only to see some of the best people leave for more lucrative opportunities. At times, support from the national or local governments which have tried to bolster the CFIs have created some dependency in CFIs on the skills of the people employed in these agencies.

15. The largest area of potential improvement identified in the Members Survey was granting of loans.

Both the quantitative and qualitative aspects of the survey revealed that members are experiencing frustrations with either their co-operatives not yet being granted authority to give loans from the National Credit Regulator or their financial co-operative not being easy to deal with for a loan. The long process for these institutions to obtain a loan license from the National Credit Regulator[9] means that some of the recently founded CFIs have not yet been issued a license to lend. Members, in particular board members, believe that their CFI applications for a loan licence were time consuming and create the impression that financial co-operatives cannot deliver the requested products.

This drives members or potential members to seek out loans from the commercial banking system or informal loan facilities. This is a key finding of the survey and has important ramifications for the sustainability of many CFIs. Figure 5 indicates that only 59% of members believe the process to get a loan at a CFI/CB is easy. In fact, at the end of 2019 only 54% of CFIs/CBs had 50% or more of their assets in loans to members. Of this sub-group, eight CFIs (or one-third of the sector) were not making any loans or only an insignificant amount of loans.

Figure 6: Ease of Getting a Loan at a Financial Co-operative



Sources: *Co-operative Financial Institution/Co-operative Bank Members Survey 2020, World Bank/CBDA.*

16. The small size and lack of human capacity in CFIs has hindered their ability to implement the financial and technical infrastructure necessary to grow.

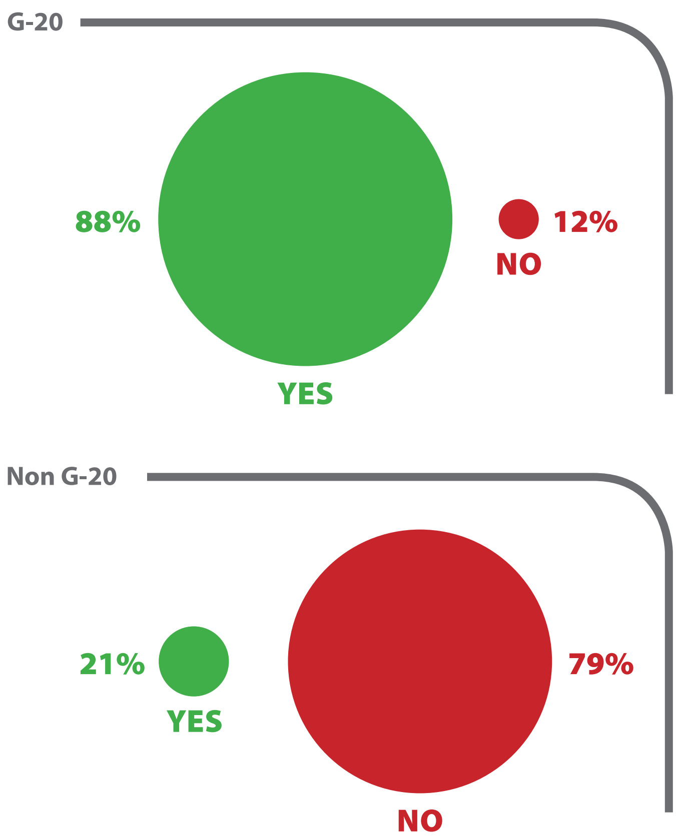
This includes not only core accounting and IT systems that allow for loan payments to be deducted at source, but also the ability to offer payment cards, internet and mobile-based financial services that members increasingly seek and expect. Even some larger co-operative banks lack facilities to deduct loan payments at source.

17. Deposit insurance in CFIs and co-operative banks could help improve confidence in the sector, but it alone will not be enough to spur growth.

International Credit Union Regulators' Network (ICURN), (Figure 6) shows that in 88% of G-20 countries financial co-operatives have deposit insurance. South Africa is a notable exception as neither banks nor financial co-operatives have deposit insurance as of this writing. However, the largest banks in South Africa continue to benefit from an implicit "too big to fail" guarantee and market confidence.

DO CREDIT UNIONS HAVE DEPOSIT INSURANCE IN YOUR COUNTY?

Figure 7: Deposit Insurance for Financial Co-operatives



Sources: *2020 ICURN Member Baseline Survey Results.*

[9] Although the National Credit Regulator is the reason for needing the additional license to lend, none of the survey participants mentioned this regulator by name. Which is indicative that many board members were not even clear on the channels needed to be fully licensed and that there is a special exemption for developmental finance.

18. The lack of public awareness, limited human capital, and weak capacity have created significant barriers for CFIs

While many of these challenges exist in other SADC countries, they are more pronounced in South Africa because the financial co-operative system here is younger, does not yet have an established public reputation, and the competition from large banks, non-bank credit providers and stokvels is more intense than when other CFI systems started.

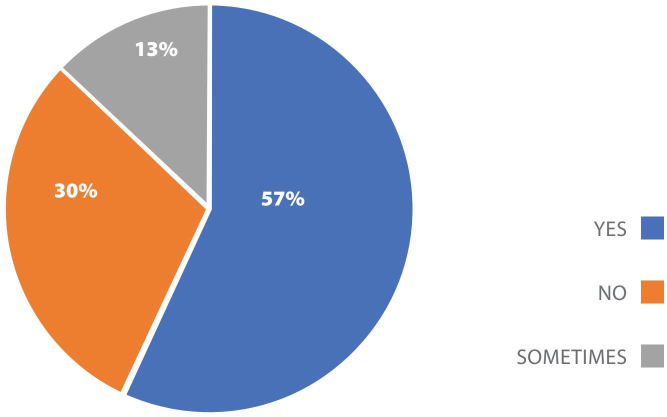
19. When non-members were asked in the Members Survey what their key considerations are for determining where they will save their money, the themes of confidence, safety and return arose – all areas of weakness for the CFIs/CBs today.

Negative perceptions of financial co-operatives are usually driven by a lack of information and knowledge about what they are. Some survey respondents noted that community financial co-operatives can be perceived as a poor man's alternative to banking, which in turn does little to attract young professionals. This poor perception is compounded as some financial co-operatives have shut down and people, especially the poor, have suffered great losses from the ones that have failed. Existing members felt that there is lack of information and understanding of what a financial co-operative is and does. A lack of confidence in financial co-operatives, as a result of the VBS Mutual Bank saga, has made people more sceptical about the sector.

20. Members are waiting to see the benefits of their decision to join a CFI and need a sense of security in relation to their funds before starting to save more with their CFIs/CBs.

Some respondents indicated that in an ideal world, there would be other members who want to save with their financial co-operative, but as some of these entities are relatively new there is a lack of confidence in them. Surety is one of the key barriers to saving, as past members mentioned that they have lost money through failed financial co-operative. Figure 7 indicates only 57% of members currently saving with the financial co-operative. While some of this could be impacted by the economic impact of COVID-19, confidence in financial co-operative remains a chief concern.

Figure 8: Currently Saving with your Financial Co-operative



Sources: *Co-operative Financial Institution/Co-operative Bank Members Survey 2020, World Bank/CBDA*

21. Unlike other countries during the startup phase of financial co-operatives, South Africa has imposed more restrictive prudential and operational norms that have hindered growth.

Kenya, Poland, USA, Brazil and Uganda all had limited prudential requirements and regulation for their financial co-operatives in the early years of their growth and did not have regulatory constraints on fixed assets and borrowings. This allowed them to be more creative, leveraged, and take on greater risks than the financial co-operatives in South Africa. Each of these countries introduced prudential supervision on financial co-operatives once they reached a critical mass of serving approximately 10% of the adult population and failure of the sector would create larger economic and social problems. In comparison, financial co-operatives in South Africa currently serve 0.08% of the adult population. This concern was highlighted in the results of the Members Survey where some financial co-operatives have found it difficult to register and operate because of the many requirements and processes they must follow in order to become operational. After what CFIs/CBs consider a daunting registration process, they then have to go through another long licensing process to issue loans.[10]

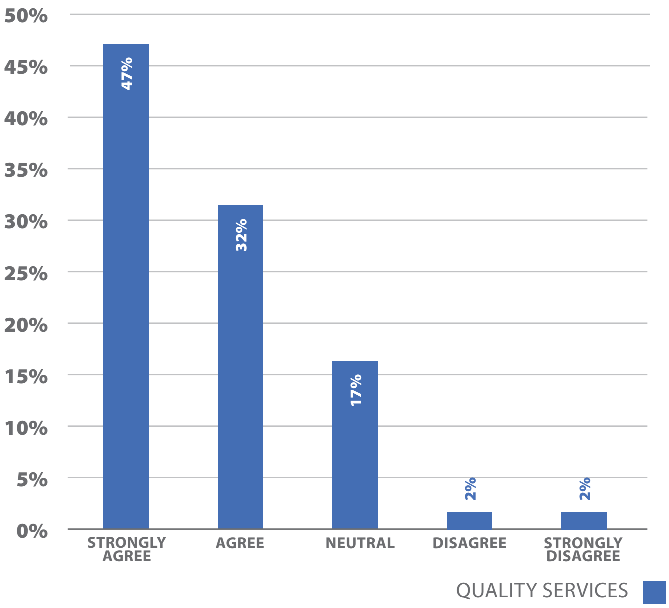
22. Less than half of survey respondents strongly agree that they use their financial co-operative because it provides quality services.

These members feel that they receive better services compared to commercial banks, and they also appreciate the personal relationships that are formed between members. Figure 8 indicates only 47% of

[10] This is unique in South Africa as the licensing process for a financial co-operative in most countries enables the organization to provide both savings and lending services without taking additional licensing steps.

members strongly agree with this statement. For an organization that relies on word of mouth for growth, this is a challenge. For members that were neutral regarding this view, it was usually because their financial co-operative was still in its infancy.

Figure 9: Quality of Services in Financial Co-operatives



Sources: *Co-operative Financial Institution/Co-operative Bank Members Survey 2020, World Bank/CBDA*

IV — VISION & TARGET FOR CO-OPERATIVE BANKING SOUTH AFRICA

23. A vision to put members and potential members at the center.

Deliberations from the post-Indaba Strategy Development Working Group generated a vision for the sector which recognizes economic and financial inclusion are what co-operative banking can achieve. The target markets for financial co-operatives are workers and mixed-income communities which may be financially vulnerable. All of this will only occur if co-operative banking can be done with high quality – an area that members currently see as lacking. As such, the vision for co-operative banking is:

Economic and Financial Inclusion for Workers and Mixed-Income Communities through Quality Co-operative Banking

24. An agreed premise among stakeholders is that co-operative banking can and should make a bigger positive impact in South Africa.

To make a significant impact upscaling of the current membership of 29,500 is needed. Rather than focusing a target on the assets, savings, loans or number of CFIs/CBs, the focus should be on people and a decade is needed to change the trajectory of the sector. If more members join and use the CFIs/CBs, savings, loans and assets in the sector will grow.

25. A target is being set to serve 400,000 members in the next 9 years.

This target of having 400,000 active members requires is an aggressive but realistic goal that requires more cooperation and funding to grow membership 13.5 times over nine years. Examples of such growth exist in Rwanda where, with aggressive support from government, the rural financial co-operative sector has grown to 3.8 million members in less than a decade.

26. While this vision may appear similar to the goal today, it requires greater coordination in back-office operations to make financial co-operative offerings more attractive.

This requires utilizing technology, grassroots marketing, highly trained employees, well-paid managers, and a strong second-tier co-operative bank that focuses on business services of IT, audit, and connection to the payment system to enable deduction at source payments. It also envisions that all co-operative banks and CFIs have a deposit insurance scheme at the Corporation for Deposit Insurance (CoDI). This could help provide confidence to CFI savers, but to make it cost effective, a 10-year premium holiday, or until the sector reached a certain size, should be provided to the sector. The costs for this premium holiday could be borne by other deposit insurance participants as part of required corporate social responsibility as has been the case in the UK.

27. To help achieve the vision of economic and financial inclusion it is essential to have many CFI boards and committees involved at the local level.

This approach envisions that financial co-operatives focus on serving mixed income communities in rural towns, trade unions, tightly affiliated groups of teachers and police officers, etc. Each financial co-operative will be managed independently and continue to have its own board and committees. While some new financial co-operatives may be needed, the target is not necessary to establish new entities but serving many more members in a sustainable manner without the same restraints of the common bond and prudential borrowing constraints.

V — PILLARS OF THE STRATEGY

28. There are three main pillars of the strategy which are necessary to grow co-operative banking. These are: 1) Value-added products and systems, 2) Robust sources of funds, and 3) Digital delivery channels.

The implementation of action items related to these pillars are imperative to effectively implement the co-operative banking strategy. The last section of the strategy provides the required action items, lead entity and prioritization.

PILLAR 1: VALUE ADDED PRODUCTS AND SYSTEMS

29. Members and non-members alike were clear that they expect financial co-operatives to provide quality products and services that add value.

Almost half of the CFIs either do not provide any loans or only a very limited amount of loans. In addition, most CFIs and co-operative banks do not have mobile banking, cards, and electronic payments/transfers that members and potential members are seeking.

30. In theory, financial co-operatives can reach more vulnerable communities because they don't have profit as their primary driver.

However, they still need to be able to offer products that are of value and meet the needs of the market. While financial co-operatives are subject to the costs in the broader market for labor, deposits, etc., successful financial co-operatives abroad find that members use them because they offer good services, a good deal and are easier to work with than banks and microfinance firms -- which also comes through in the Members Survey. Financial co-operatives can potentially reach low-income groups with reasonable rates and fees through internal cross-subsidization by other members. However, some degree of scale is needed to be able to effectively cross-subsidize the business model. For financial co-operatives to grow substantially they need to have a compelling value proposition.

PILLAR 2: ROBUST SOURCES OF FUNDING

31. The largest CFIs/CBs in South Africa deploy most of their assets in loans.

At the end of 2019 the four largest CFIs/CBs had 75% of their assets in loans to members. By comparison, CFIs with less than 10 million Rand in assets lent 40% of their assets and CFIs with less than 1 million in assets lent only 20% of their assets giving them very little in revenue and a narrow margin if any loans go bad. For the sector to grow it needs to have large and reliable sources of funds. For most financial co-operatives this usually means savings from members. However, in markets where financial co-operatives are in the start-up phase, where there are temporary needs for additional funds due to high loan demand or where there are specific public policy objectives which governments are trying to support (e.g., lower-income housing, MSME development, etc.) then financial co-operative often access external funds for on-lending. There are also many successful examples globally of non-deposit taking microfinance institutions which rely solely on borrowed funds at commercial and/or concessional rates for on-lending. As such, the hard prudential cap on external borrowing by the Prudential Authority at 15% of assets should be eliminated.

32. Key to mobilizing deposits from members is having deposit products that are attractive to a mix of income groups.

Like in commercial banks, most financial co-operatives have a concentration of deposits among a small group of members with higher savings balances. Based on a deposit-stratification survey conducted in 2021 by the World Bank, 63% of all deposits in South African CFIs are held by 3% of the members. While deposit concentration is typical in financial co-operative globally, its oftentimes 10%-20% of members that have 90%-80% of deposits. This concentration of deposits re-enforces the idea of needing members from a mix of incomes for co-operative banking to be successful.

33. Grant funding and donations can be helpful to achieve short-term policy objectives, but should not be required long-term as financial co-operatives are a self-sustaining model in the long-run.

This pillar of the strategy is not about long-term grant funding of the sector but rather sustainable sources of self-funding once CFIs have launched and established themselves.

34. A second-tier co-operative bank can help intermediate funds among CFIs/CBs and/or access commercial funding at favorable rates.

Nearly all well-developed financial co-operative systems have a second-tier co-operative bank(s) which helps facilitate access to money markets, technology and intermediates funds within the sector. This is a critical enabler of the sector and is discussed in greater detail below.

PILLAR 3: DIGITAL DELIVERY CHANNELS

35 In this age of digital commerce that has intensified with the COVID lockdowns, the sector is far behind where it needs to be in terms of offering products through digital channels.

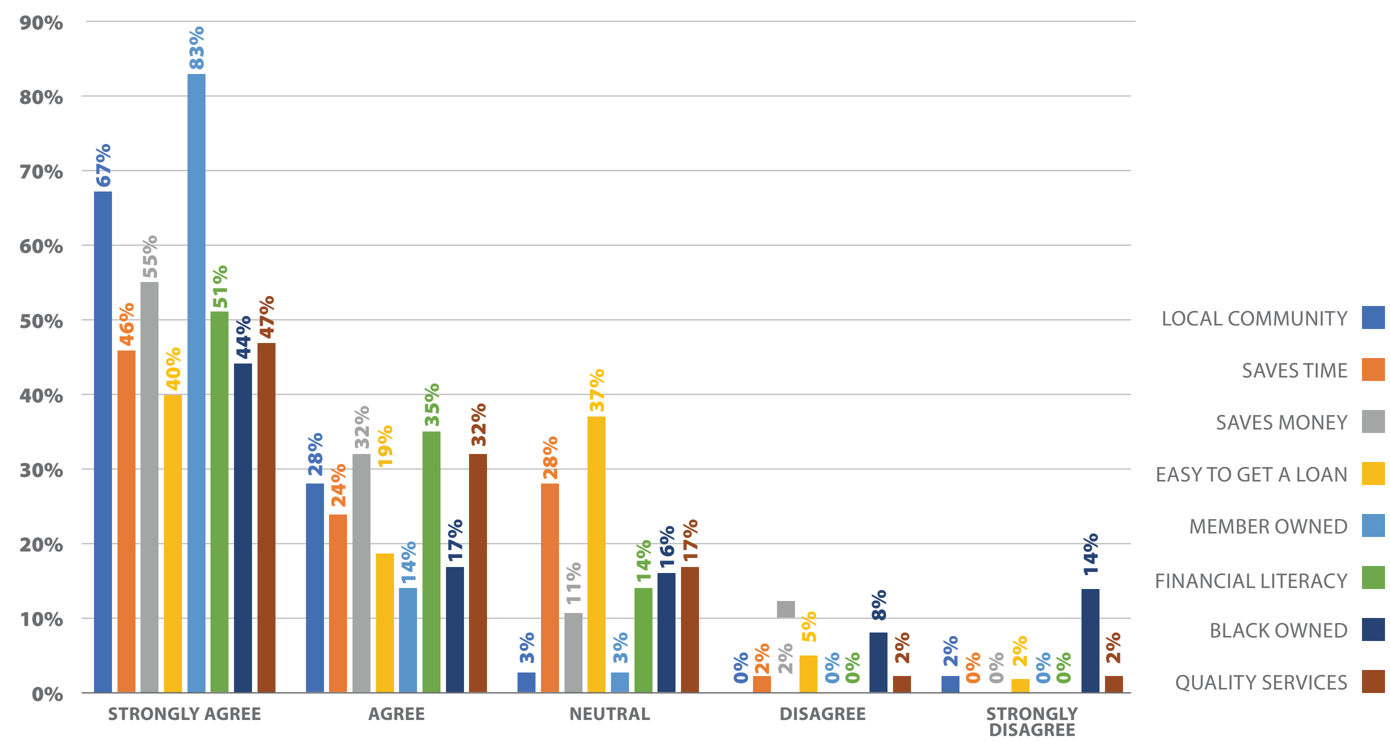
CFI/CB members indicated during the Member Survey that transactions could be more effectively handled digitally to allow members to easily transact from the comfort and safety of their homes. Be this through internet banking, mobile banking, mobile money, the issuance of credit/debit cards, etc. Figure 9 from the Member Survey also indicates that saving time, easy access to loans and quality service were not highly rated areas for CFIs/CBs at this time.

36 The "requirement" to offer digital services puts more pressure on small institutions to be able to keep up with expectations of members and potential members.

While local co-operative ownership is a huge value proposition for the sector, they need to have service that meet the needs of members. This has caused more interest in reaching scale through the a second-tier co-operative bank.

Figure 10:: Quality of Services in Financial Co-operatives

Why do you use a CFI/Co-operative Bank?



VI. ENABLERS OF THE STRATEGY

Four key activities enable implementation of the strategy's pillars. Although these activities support the pillars, they do not necessarily have to be completed before the pillars.

ENABLER 1: SECOND TIER CO-OPERATIVE BANK FOR SCALE

37. The purpose of the second-tier co-operative bank is to facilitate technology services, access to the financial infrastructure and intermediate funds among CFIs/CBs.

The second-tier co-operative bank should only be allowed to provide services to CFIs/CBs to ensure it remains focused on its core mission of enabling the success of the first-tier institutions. Restricting it from providing services to individual consumers or MSMEs will ensure that it does not end up competing with its members and ultimately loosing the trust of the first-tier institutions as happened in Sri Lanka and Kenya.

38. While the need for liquidity is often referred to as a single issue, there are generally considered four types of liquidity:

1) Emergency Liquidity Assistance to help deposit-takers under abnormal or stressed conditions,

2) Short-term liquidity from one night to one month to help settle payments or meet short term demands,

3) Medium-term structural liquidity generally from 3 months to 3 years to meet the consumer, agricultural and asset financing needs; core deposits and fixed deposits are a general source of medium term liquidity, and

4) Long-term liquidity over 3 or 5 years to meet housing finance or other long-term needs.

The second-tier co-operative bank can help with the last three types of liquidity needs while the Reserve Bank of South Africa is best positioned to provide Emergency Liquidity Assistance.

39. CFIs/CBs have weak deposit products, long wait times and poor channels for their members to access their funds which affects their medium-term liquidity and core deposits

During the National Indaba it was revealed that few, if any, CFIs/CBs allowed savings withdraws without prior notification. These notifications ranged from one day to one week. This is not a common practice globally by CFIs/CBs. As such, members diversify their funds among multiple institutions because of concerns of safety in co-operatives. A second-tier co-operative bank can help broker technology solutions to groups of CFIs/CBs to achieve scale and support the sector.

ENABLER 2: ACCESS TO THE FINANCIAL INFRASTRUCTURE

40. Direct access to the financial infrastructure is critical for CFIs/CBs to be able to compete with mainstream financial institutions as opposed to paying for access through their competitors.

In many markets financial cooperatives struggle with this if they are not regulated by the prudential authority. The prudential supervision by SARB and forthcoming deposit insurance system help in this regard, but most CFIs/CBs still don't have access to loan deduction at source systems with employers. This is a near-term very urgent need for the sector to help ensure loan repayments and collect deposits from members.

41. The lack of payment system access and the scale needed to offer competitive debit cards, ATMs, cheques, and linkages to mobile money platforms requires CFIs/CBs to work cohesively to bring down the incremental costs of the technology to offer such products.

Similar to other jurisdictions, improving the channels through which CFIs/CBs members can access their funds will improve accessibility and help bring in more deposits.

ENABLER 3: SUPPORT ORGANIZATIONS FOR ADVOCACY AND TRAINING

42. The Post-Indaba Strategy Development Working Group identified a unified and organized sector as one of the key enablers of the strategy.

[11] NACFISA was engaged by the Working Group and was consulted on the draft strategy and is seen as potentially fulfilling the role, if needed reforms can be made to the organization.

The Working Group identified the need for: 1) a strong representative body, 2) a Second-Tier Co-operative Bank (as discussed above), and 3) Support Organization(s) for training and to facilitate access to grant funding or other programs.

43. A representative body should advocate and lobby policymakers and regulatory authorities on behalf of the interests of the sector.

Given the small size of the sector today, its a challenge to gain the attention and time of policy markers/regulatory authorities. Through such an organization consensus policy positions need to be developed so that the sector is seen as speaking with "one-voice". The presence and history of the National Association of Co-operative Financial Institutions of South Africa (NACFISA) is noted but reforms are needed.[11]

44. In addition to advocacy from a support organization and financial/technology support from a second-tier co-operative bank, training and capacity building is needed from a support organization(s).
While some provinces have registered support organizations these are localized and do not have the reach or funding support to serve the entire nation.

45. With the supervision function moved to the PA, the Co-operative Banks Development Agency (CBDA) has been better positioned to fulfill the role of training and capacity building of the sector.

However, greater coordination between other support organizations of government such as the Small Enterprise Finance Agency (SEFA) and CBDA is needed. A combined entity could help facilitate trainings and access to concessional funding windows and/or credit guarantees.

46. Intensive consumer education of the sector is needed to build awareness and potential markets for CFIs/CBs.

The Member Survey highlighted the lack of awareness of the sector and lack of common branding (e.g., colors, fonts, logos, etc.) which could help building recognition and markets for the sector.

ENABLER 4: TIERED LICENSING & PROPORTIONAL SUPERVISION

47. Although this approach focuses on serving markets that are under-served by existing players, the common bond requirement would be optional.

A careful study of the current common bond requirements indicates that the rules provide a degree of flexibility as financial co-operatives grow. [12] However, the common bond rules have created a perceptual barrier and misunderstanding for some groups regarding the intention of financial co-operatives given that people are very familiar with stokvels. Regardless of a common bond or not, before a new financial co-operative starts its operations, it should have a strong understanding of the market need that it will fill, the size and shape of the customer segment it will reach, the services needed by the segment and how it will provide them. However, this approach does not need to be enshrined and limit growth through common bond regulations, but rather a requirement of obtaining a license should be a business plan which shows a clear understanding of the target market, and realistic projections for how this will occur as is required for new SACCOs in Rwanda, Kenya and Uganda. Given the availability of sophisticated credit information systems, more frequent job changes and flexible work arrangements, the concept of a common bond as a useful risk mitigation tool among thousands of consumers is outdated and no longer credible. As such, the implementation of a common bond should be optional among financial co-operatives as is the emerging practice in other countries. The only reason to enforce the common bond today is that it limits competition for commercial banks.

48. A lighter touch risk-based regulatory approach could help spur growth.

To a large extent South Africa has pursued a regulatory-led approach toward the development of the sector. There have been significant investments in the legal, regulatory and supervisory structure for financial co-operatives with the idea that an enabling policy environment would facilitate the growth of the sector. This led to strongly embracing some financial "recommendations" as prudential norms regarding borrowing, non-earning assets, liquidity and capital. As a result, there is a relatively strong, but extremely small financial co-operative system that may have comparatively higher compliance costs relative to larger firms. Re-calibrating this framework and investing more in the capacity and governance of the CFIs/CBs will be needed to reach the vision and target established here.

[12] The current common bond requirements allow for CFIs to apply to SARB to have their common bond expanded if they can show that they have the ability to serve the expanded common bond.

VII. POLICY ACTIONS TO IMPLEMENT THE STRATEGY

49. To implement the strategy, specific actions will need to be taken by the sector, support organizations, and policymakers/regulatory authorities.

Below is a prioritized list of action items that need to occur to implement this strategy.

No.	Policy Action	Responsible Entity	Priority
Pillar 1: Products & Systems			
1	Each CFI/CB adopts its own vision for growth over the next 5 years.	CFIs/CBs	High
2	Focus on improving existing basic and intermediate banking services – especially the issuance of good loans.	CFIs/CBs	Ultra-High
3	Obtain authorizations to have payroll deductions for loan repayments.	Sector & CBDA	High
4	Draw on experience/technical assistant of the international co-op banking sector to expand product offerings.	CBDA & Development Partners	High
Pillar 2: Robust Sources of Funding			
5	To grow core deposits, make savings more accessible by eliminating withdrawal notifications and expand channels/hours to make savings more accessible.	CFIs/CBs	Ultra-High
6	Medium-term introduce digital channels to make deposits and transfers more accessible.	CFIs/CBs	High
Pillar 3: Digital Delivery Channels			
7	Launch digital loan initiation products for members and shorten turn-around times on decisions.	CFIs/CBs	High
8	Implement core systems in CFIs/Co-op banks to facilitate digital delivery channels.	CFIs/CBs	High
Enabler 1: A Second Tier Co-operative Bank for Scale			
9	Develop value proposition document on second-tier co-operative bank.	Sector & CBDA	Medium
10	Develop and launch questionnaire on second-tier co-operative bank.	Sector & CBDA	High
11	Present to all stakeholders the objectives and required policy framework needed for a second-tier co-operative bank.	Sector & CBDA	High
12	Seek government and development partner support to hire staff and register second-tier co-operative bank.	Sector & Development Partners	Ultra-High
Enabler 2: Access to the Financial Infrastructure			
13	Engage with CoDI and PA on inclusion of all CFIs and CBs in deposit protection.	Sector, CoDI, PA	Medium
14	Engage with SARB on direction access to the National Payment system for the second-tier co-operative bank as the single point of access.	Sector & SARB	High

[16] The current common bond requirements allow for CFIs to apply to SARB to have their common bond expanded if they can show that they have the ability to serve the expanded common bond.

No.	Policy Action	Responsible Entity	Priority
Enabler 3: Support Organizations for Advocacy and Training			
15	Further engage NACFISA to assess it operations, strategy and programs for next 5 years.	Sector, NACFISA & CBDA	Medium
16	Develop and launch questionnaire on representative body.	Sector & CBDA	High
17	Determine if NACFISA is the right platform or if a new entity needs to be registered and launched.	Sector & NACFISA	High
18	Work on common branding (e.g., colors, fonts, logo, brand theme) to be used across the sector to build its awareness and intensive consumer education about CFIs/CBs.	Sector & CBDA	High
19	Ensure CBDA keeps a strong focus on the training needs for the sector, its boards and committees, facilitates access to funding and enables implementation of this strategy.	CBDA & Sector	Ultra-High
Enabler 4: Tiered Licensing & Proportional Supervision			
20	Revise the external borrowing requirements for CFIs and co-operative banks. Review requirements for liquidity, capital and non-earning assets.	PA	High
21	Review prudential and market conduct regulations to ensure they are applied proportionally.	PA, NCR, FSCA	High

ANNEX 1

Members of the Strategy Development Working Group

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Happy Hour Daniella
Restaurant
DStv