Understanding financial co-operatives: South Africa, Malawi and Swaziland

Final report, submitted to FinMark Trust
by Genesis Analytics

21 February 2013

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ACCOSCA	African Confederation of Co-operative Savings and Credit Associations	**MoIT**	Ministry of Industry, Trade and Enterprise Development
ATM	Automated Teller Machines	**MTEF**	Medium Term Expenditure Framework
CBDA	Co-operative Banks Development Agency	**MUSCCO**	Malawi Union of Savings and Credit Co-operatives
CCU	Central Co-operative Union	**NACFISA**	National Association of Co-operative Financial Institutions of South Africa
CDA	Co-operatives Development Agency	**NCR**	National Credit Regulator
CFF	Central Financial Facility	**SACCO**	Savings and Credit Co-operatives
CFI	Co-operative financial institutions	**SACCOL**	Savings and Credit Co-operative League of South Africa
CIPC	Companies and Intellectual Property Commission	**SADC**	Southern African Development Community
DGRV	German Co-operative Confederation	**samaf**	South African Microfinance Apex Fund
the dti	the Department of Trade and Industry	**SANACO**	South African National Apex Co-operative
FGD	Focus group discussions	**SARB**	South African Reserve Bank
FINASOL	Financial Solutions	**SASCCO**	Swaziland Association of Savings and Credit Co-operatives
FSA	Financial Services Association	**sefa**	Small Enterprise Finance Agency
FSC	Financial services co-operative	**SFPP**	SACCO Financial Protection Plan
FSRA	Financial Services Regulatory Authority	**SRIC**	Swaziland Royal insurance Corporation
IFAD	International Fund for Agricultural Development	**ToR**	Terms of Reference
ILO	International Labour Organisation	**WOCCU**	World Council of Credit Unions

EXECUTIVE SUMMARY

FinMark Trust commissioned Genesis to better understand the role and use of co-operative financial institutions (CFIs) as viable alternatives to the commercial banking sector for accessing financial services for lower income individuals in South Africa, Malawi and Swaziland, as well as best practices in the sector.

Interpretation of the Terms of Reference

Based on our research, and in the context of the CFI sector, we understand financial inclusion to mean financial empowerment, through the promotion of improved financial capability and financial freedom. Having the skills, knowledge and confidence required to make sound financial decisions, partnered with the appropriate opportunities and access to financial services, is an integral component of responsible, inclusive and sustainable financial systems. This is particularly relevant to the fundamental principles of CFIs, which enable communities to create self-managed financial services and provide education to members, elected representatives and employees.

We therefore view CFIs not as an alternative to commercial banking, but as one option or opportunity out of what should be an inclusive mix of financial institutions that provide appropriate financial tools based on people's needs.

Our interpretation of the focus of this study is therefore to better understand the role the CFI sector can play in achieving the objective of financial and economic empowerment in southern Africa, with the principles that underlie and guide co-operatives forming the heart of the sector's value proposition.

Methodology

An initial desktop review was completed at the study's inception. Following the development of research tools, research teams of one senior researcher and one junior researcher were deployed to South Africa, Malawi and Swaziland to conduct field research. This included key informant interviews with regulators, policy makers, apex bodies and CFI leadership, as well as focus group discussions with CFI members.

Country case studies

Detailed descriptions of the CFI sectors in each of South Africa, Malawi and Swaziland are provided according to:

- The history of the co-operative and CFI movements;
- An overview of the CFI sector today, in terms of number and types of CFIs, products, challenges and roles in the financial system; and,
- An assessment of the legislative and regulatory environment

The CFI sector in **South Africa** today is small and plays a very minor role in the country's overall financial system relative to other African countries. This has been attributed to a number of reasons, many of which relate to the sector's history in the country, the development of which has been short and troubled. Challenges include grant-based programmes that did not operate for long enough to ensure that managers and communities were equipped to run CFIs, resulting in misaligned incentives and rent-seeking in some cases;

poor management; insufficient capacity and top down approaches to development. The failure of many of the smaller CFIs, and a lack of publication of the few clear success stories, has also affected the level of people's trust in CFIs as safe and reputable financial institutions. The majority of CFI members in South Africa also have bank accounts.

Malawi is an example of a poor and predominantly rural country where CFIs provide an opportunity for people to use financial products and services they would not otherwise have had access to. Malawi has a strong apex body, the Malawi Union of Savings and Credit Co-operatives (MUSCCO), and donor support for the sector consisted mainly of capacity building, through the remuneration of staff, and education, training and development, rather than financial support. Given the limited resources of the state, the Ministry works closely with industry stakeholders, particularly MUSCCO, to achieve adequate regulation and supervision. The Malawian case demonstrates that developing a new regulatory framework with the Savings and Credit Co-operatives (SACCOs) and the apex body, after analysing and understanding the sector, is a more prudent way to formulate appropriate and accepted regulatory regimes.

The CFI sector in **Swaziland** grew off the back of large, employer-based organisations and continues to play an important role in the country's economy. CFIs make use of non-withdrawable savings that members can borrow against and they remain competitive with commercial banks. Most CFI members also have bank accounts but are loyal to their CFIs and apex body, and use their CFIs for asset-building and large expenses, such as school fees and lobola[1]. Recent changes in the regulatory environment have raised concerns amongst some CFIs who have expressed the need for these to be resolved and adopted shortly.

Building national CFI sectors

This section describes some of the better ways of promoting co-operatives, while at the same time enabling people to co-operate and build democratic structures. This includes:

1. Promoting and the model and building the sector from the bottom up
2. Structures of CFIs including a general assembly, board of directors, officers and employees
3. Integrity and financial integration of co-operatives, including internal controls and monitoring ratios
4. Structural needs at country level, including the role of apex bodies and educational institutions and programmes

Best practices

A number of best practices relating to CFI sectors have been identified and include:

- The value proposition of CFIs. This includes ownership and control, and the creation of self-managed savings-led financial services that provide education to members, elected representatives and employees. The main purpose of CFIs should be to benefit members rather than to maximise profit, while still operating as sound businesses. CFIs should be seen as drivers of financial inclusion, meaning financial empowerment, through the promotion of improved financial capability and financial freedom.

[1] Lobola is a traditional southern African custom whereby the man pays the family of his fiancée for her hand in marriage

- The role of major stakeholders, such as a self-sustaining apex body, the ability of governments to strengthen and regulate CFIs without overloading them, and the ability of the international development community to have patience and allow co-operative systems time to mature naturally. The state should also play a role in setting and maintaining standards, but should build sound, strong and strategic partnerships with the other relevant stakeholders in the sector that are responsible for capacity building, support and promotion of CFIs.

- CFIs should focus on savings-led, asset-building financial services offering that is competitive with alternative financial institutions in terms of price, flexibility and security. Leveraging existing structures, such as employers and existing functional multi-purpose co-operatives, can be an effective way to build a critical mass of CFI membership.

- Systematic performance enhancement, training and monitoring at institutional and country levels, including CFI boards and staff members being trained and re-trained regularly, intra-sector knowledge transfer and education on personal financial management and the benefits of CFIs, as well as a transition from manual to computerised systems.

- Appropriate legislative, regulatory and supervisory framework that takes into account the unique nature of CFIs and empowers them, enables their development and encourages outreach, while protecting owners and depositors.

Recommendations for FinMark Trust

Finmark Trust is well placed to consider the following potential avenues that will continue to support the growth of the CFI sector in the SADC region and southern Africa:

1. Identify particular case studies on successful examples of CFIs and details on their operational, governance and financial structures as well as their growth strategies that can be used as a 'guide' or 'toolkit' for others to learn from and apply.

2. Publicise the ILO standards for co-operative development which reflect the ways of building community leadership and social and economic development, and some guidance on contextualisation within the southern African context.

3. Encourage appropriate government stakeholders to commit to and promote the development of CFIs within each country, this includes appropriate financial and human resources to do so effectively. FinMark could potentially support some specific activities, such as the implementation of the banking platform for CFIs in South Africa.

4. Encourage and support CFI apex bodies and governments to create and promote incremental standards at country level that allow for stages in development of CFIs that build skills and awareness while minimising risk.

5. Develop sub-Saharan African contextualised materials/technical resources that can be used to support CFIs, including governance arrangements, operations and procedures. It is important to first ascertain what materials exist before anything new is developed. Materials development should be done in partnership with apexes to ensure they will be used and meet the needs of the sector. This includes prior consultations with apexes to ascertain what their priority needs are.

1. INTRODUCTION

A growing body of evidence shows that increased financial inclusion, through engagement with appropriate financial services, both formal and informal, can reduce the vulnerability of households, help increase income and spur small enterprise activity.[2] The potential for economic growth and poverty alleviation through the development of a more inclusive financial services sector has been recognised by leaders in developing and developed countries and is emerging as a priority issue on political agendas.

Through its purpose of initiating processes of change that lead to the development of inclusive financial systems that can benefit all consumers, FinMark Trust commissioned Genesis to better understand the role and use of co-operative financial institutions (CFIs) as viable alternatives to the commercial banking sector for accessing financial services for lower income individuals in South Africa, Malawi and Swaziland, as well as best practices in the sector.

FinMark believes that the provision of a safe and convenient interaction with financial services by CFIs for the unbanked and under-banked means that they can play an important role towards increased financial inclusion. However, the recognition of the role of CFIs as significant players in the financial services sector in emerging markets has been minimal for a number of reasons[3]:

- Knowledge gaps related to how CFIs are structured and function, and the role they play in financial inclusion;
- Inefficient oversight to support their operation;
- Most CFIs are not well integrated in the financial infrastructure of a country; and,
- To reap economies of scale, there is a need for strong second-tier networks that provide capacity building, liquidity support and access to payment or financial management systems.

In order to bring focus to the CFI model, and thus contribute to addressing some of these challenges, the scope of work for this study includes:

- Identification of a set of best practices in the CFI sector based on a review of literature and international case studies
- Research the following components in the CFI sectors in South Africa, Malawi and Swaziland:
    - Legislation and regulatory environment
    - Supply side environment
    - Demand side environment
- Understand the potential role of technology and innovation in the CFI sector
- Identification of potential interventions for FinMark Trust to strategically and catalytically intervene in the CFI sector in SADC

[2] World Bank (2013) Financial Inclusion: Helping Countries Meet the Needs of the Under-Banked and Under-Served
[3] World Bank (2013) as highlighted in the Terms of Reference

We have taken a very specific approach to this study, which is explained in the following section of this report. The report then provides an overview of the history and principles of co-operatives and the reach/penetration of the financial co-operative sector across the world. Overviews of the CFI sectors in South Africa, Malawi and Swaziland are then provided, including their histories, key statistics, major stakeholders, products and challenges, as well as an assessment of their legislative and regulatory environments. Following this, a number of best practices have been distilled from the country case studies and literature review, and translated into recommendations for FinMark Trust.

2. INTERPRETATION OF THE TERMS OF REFERENCE

The Terms of Reference (ToR) for this study introduces CFIs as well positioned to enhance access to affordable financial services to people that are unbanked and under-banked. CFIs therefore play an important role in financial inclusion. This is against a backdrop where banks and mobile operators are beginning to deliver financial services to lower income segments of the population, but this is more of an add-on to their existing business models. Through this study, FinMark would therefore like to better understand the role of CFI's as a viable alternative to the commercial banking sector for accessing financial services for lower income individuals.

There are cases where rural access to financial services is a challenge and a CFI provides the only opportunity for individuals in these areas to access certain products and services. Certain individuals may also be excluded from the formal financial system based on their credit history or income source. However, based on our research, and in the context of the CFI sector, we rather understand financial inclusion to mean financial empowerment, through the promotion of improved financial capability, financial freedom and products that are tailored for members' needs. Having the skills, knowledge and confidence required to make sound financial decisions, partnered with the appropriate opportunities and access to financial services, is an integral component of responsible, inclusive and sustainable financial systems. This is particularly relevant to the fundamental principles of CFIs, which enable communities to create self-managed financial services and provide education to members, elected representatives and employees.

The majority of the CFI members we met with do have bank accounts to receive their salaries and for daily transactions, in addition to their CFI membership, but their CFIs allow for a combination of savings-led investments, asset building, ownership and input into decision-making of the institution that other formal institutions do not provide. We therefore view CFIs not as an alternative to commercial banking, but as one option or opportunity out of what should be an inclusive mix of financial institutions that provide appropriate financial tools based on people's needs. In light of this, and the objectives of financial sector deepening, we have approached CFIs as not just options for low income individuals but for the entire population. Our interpretation of the focus of this study is therefore to better understand the role the CFI sector can play in achieving the objective of financial and economic empowerment in southern Africa, with the principles that underlie and guide co-operatives forming the heart of the sector's value proposition.

3. METHODOLOGY

An initial desktop review was completed at the study's inception. The purpose of this was twofold:

- To identify international learning and best practices in the CFI sector, based on a selection of country case studies
- To identify the key stakeholders to be interviewed in South Africa, Malawi and Swaziland

Research tools were then developed, including participatory tools for focus group discussions (FGDs). Research teams of one senior researcher and one junior researcher were deployed to each country to conduct field research. In addition to FGDs with CFI members, this included key informant interviews with the key stakeholders identified during the desktop review. Details of the organisations interviewed are given in the table below.

Table 1: Key stakeholders

Stakeholder group	South Africa	Malawi	Swaziland
Regulators/ Supervisors	• South African Reserve Bank • Co-operative Banks Development Agency (CBDA)	The Reserve Bank of Malawi	• The Central Bank of Swaziland • Financial Services Regulatory Authority
Policy makers	• National Treasury • Registrar of Co-operatives, Companies and Intellectual Property Commission (CIPC), dti • Director of Co-operatives, dti • KZN Department of Economic Development	Department of Trade and Industry	The Department of Co-operative Development, Ministry of Commerce, Trade and Industry
Apex bodies	National Association of Co-operative Financial Institutions of South Africa (NACFISA)	The Malawi Union of Savings and Credit Co-operatives (MUSSCO)	Swaziland Association of Savings and Credit Co-operatives (SASCCO)
CFIs	• Boikago SACCO • Ditsobotla Co-operative Bank • Webbers SACCO • MmetlaKhola Stokvel FSC • Alrode SACCO • Sibanye SACCO • Oranjekas Spaar en Krediet Koöperatief	• Ulimi SACCO • Mufuna SACCO • Trivuma Sunflower Oil Production Co-operative • Bvumbwe Community SACCO • Fincoop	• SNAT Co-operative • Sibonelo SACCO • Lubane SACCO • Simunye SACCO • Yetfu Sonkhe • Sambulelo Semaswati

Stakeholder group	South Africa	Malawi	Swaziland
Donors	DGRV	WE Effect, Swedish Co-operative Association	
External individuals, NGOs, Research Institutions	• BANKSETA • Centre for Inclusive Banking in Africa	Malawi Lake Basin Programme	

4. THE CO-OPERATIVE MOVEMENT

4.1. HISTORY

A co-operative is "an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise."[4] While there has been evidence of co-operatives dating back to Greek and Roman times, modern co-operatives can be traced to the mid-18th century in the US and to the mid-19th century in the UK and Europe. Primarily, the formation of co-operatives was the response of workers, farmers and artisans to exploitation by owners/capitalists in early industrial times. The early US co-operatives focused on financial services, whereas the UK's Rochdale Pioneers started retail stores which enabled workers to buy at lower prices than the stores run by their employers. In the case of artisans and small farmers that were out of business as a result of commercial producers, they saved jointly and lent to each other for tools and seeds and engaged in joint marketing of produce.

The Rochdale Pioneers were among the most resilient of the co-operatives. As others looked to their success, it was noted that the principles of co-operative operations were the cohesive factors that held the members and their endeavours together. In time, this learning spread and the values and principles (below) were widely adopted as a key platform from which to build successful co-operatives.

Table 2: The seven principles of co-operatives[5]

Voluntary and open membership	Co-operatives are voluntary organisations, open to all people able to use its services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.
Democratic member control	Co-operatives are democratic organisations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary co-operatives members have equal voting rights (one member, one vote) and co-operatives at other levels are also organised in a democratic manner.

[4] International Co-operative Alliance (2011) Co-operatives identity, values and principles
[5] Ibid

Members' economic participation	Members contribute equally to, and democratically control, the capital of the co-operative. This benefits members in proportion to the business they conduct with the co-operative rather than on the capital invested.
Autonomy and independence	Co-operatives are autonomous, self-help organisations controlled by their members. If the co-operative enters into agreements with other organisations or raises capital from external sources, it is done so based on terms that ensure democratic control by the members and maintains the co-operative's autonomy.
Education, training and information	Co-operatives provide education and training for members, elected representatives, managers and employees so they can contribute effectively to the development of their co-operative. Members also inform the general public about the nature and benefits of co-operatives.
Cooperation among co-operatives	Co-operatives serve their members most effectively and strengthen the co-operative movement by working together through local, national, regional and international structures.
Concern for community	While focusing on member needs, co-operatives work for the sustainable development of communities through policies and programmes approved by their members.

Based on these principles, some key characteristics of co-operatives that emerge are:

- They are member owned, driven by the needs of members and work for the benefit of members and the community;
- They are vehicles for social cohesion and the advancement of community;
- Equality among members and democratic control are central to the operations and governance; and
- Building primary (service level), secondary (support level) and tertiary (advocacy, regulatory and policy level) co-operatives are structural systems that are vital to the development of stable, well-functioning operations and services.

Over time co-operatives grew into strong vehicles for worker, farmer and artisanal empowerment taking their place alongside other enterprises in developed economies. In Germany and other European countries, financial co-operatives in particular became powerful vehicles of reconstruction after the World Wars. As these movements developed strong secondary and tertiary institutions, and with the growth of development aid after 1945, they were able to share their ideals and benefits across the developed and developing world.

4.2. CO-OPERATIVES AND CFIS

Many different types of co-operatives exist, which specialise in different business sectors. These include agricultural co-operatives – the most dominant form of co-operative - which help farmers in sourcing inputs needed to grow crops, keep livestock and to market and process their products, and housing co-operatives, which allow members to build their houses collectively and become their own landlords. Worker co-operatives fight for decent work, secure employment and decent pay, while consumer co-operatives provide their members with food and other products. In a similar pattern, financial co-operatives typically offer credit and savings facilities, and in some cases advanced services such as credit cards, investment and insurance services, but this is often through partnerships and in developed countries. CFIs include co-operative banks, financial services co-operatives (FSCs) and savings and credit co-operatives (SACCOs) or credit unions.

Since the establishment of the first co-operative in 1844 there has been an astonishing growth in the number of co-operatives around the world. The co-operative sector has become a major economic force in many countries. Today there are around 800 million individuals in over 100 countries who are members of co-operatives and 100 million people employed in the co-operatives sector.[6] In the European Union (EU) there are about 11,000 financial co-operatives that have more than 33 million members[7]. In terms of market share, CFIs rank 3rd after commercial and savings banks, accounting for approximately 17 percent of the EU's savings[8]. In Germany 28 percent of the savings market is accounted for by co-operative banks[9]. In the U.S., credit unions service a membership of 96 million people, around 44 percent of the economically active population[10]. In Africa, over 16 million people are members of credit unions, which is approximately 6.7% of those people in Africa that are financially included[11], with assets amounting to approximately USD 5.6 billion.[12]

A number of studies have shown that, before the 2007-8 financial crisis, co-operative banks[13] in Europe were as efficient and profitable as their competitors, and were more stable than investor-owned banks.[14] Co-operative banks continued to perform well during and following the crisis. Co-operative banks accounted for 7 percent of all the European banking industry write-downs and losses between the third quarter of 2007 and first quarter of 2011, even though they held 20 percent of the market. This was because of their limited exposure to sub-prime mortgages, and fewer investment activities. Between 2007 and 2010, the assets held by co-operative banks in Europe grew by 10 percent and the number of customers increased by 14 percent.[15] Among credit unions, the global sector has performed consistently in recent years, and grew in number of members, loans, reserves and assets between 2007 and 2011. Of course there are cases of financial co-operatives that have failed, but these examples emphasise the importance of good management and governance in financial institutions.

The resilience of financial co-operatives is often attributed to their essential elements of ownership and control, and that their main purpose is to benefit their members rather than to maximise profit.[16]

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[6] DIFID (2010) Working with Co-operatives for Poverty Reduction.
[7] Birchall (2004) Cooperatives and the Millennium Development Goals
[8] Ibid
[9] Ibid
[10] Anderson and Liu (2013) Banks and Credit Unions Competition Not Going Away
[11] Demirgüç-Kunt & Klapper (2012) Financial Inclusion in Africa: An Overview, World Bank.
[12] WOCCU (2012) Statistical Report
[13] Co-operative banks are also able to serve non-members in the countries studied
[14] ILO (2013) Resilience in a downturn: The power of financial co-operatives
[15] Ibid
[16] Ibid

5. SOUTH AFRICA

5.1. GENERAL OVERVIEW

South Africa is Africa's largest economy with an estimated population of 52.98 million and 63% of the population living in urban areas. The South African adult population is relatively young, with 41% of adults being younger than 30 years of age. Every second adult in South Africa receives a salary/wage, including those who work full-time (29%), those who work part-time (15%) and some of those who have piece jobs (11%). A third of adults receive money from others (e.g. from friends and family), and 29% receive a government grant, while 7% of adults in South Africa receive no money at all.[17]

Financial inclusion in South Africa increased considerably from 63% in 2005 to 81% in 2012, mainly due to an increase in the uptake of banking products. Women experienced a greater increase in financial inclusion, mainly due to the introduction of the new South African Social Security Agency (SASSA) grant system.[18] Almost 40% of South Africans use a combination of financial products and services (both formal and informal) to meet their financial needs. The FinScope Consumer Survey for South Africa in 2012 shows that 72% of adults are formally served, including the CFI sector. 67% of adults are banked in South Africa but only 24% of adults rely exclusively on banking services.[19] 51% of adults have or use informal mechanisms to manage their finances, while 19% do not have or use financial products or services to manage their finances.

There are significant differences between rural and urban levels of financial inclusion in South Africa. While 74% of adults are banked in urban areas; only 54% of adults in rural areas have or use commercial banking products.

5.2. HISTORY OF THE CO-OPERATIVE AND CFI SECTORS

5.2.1. Co-operatives

The co-operative movement in South Africa has its roots in the 19th century when agricultural workers organised themselves into agricultural societies. The first co-operative, the Pietermaritzburg consumer co-operative, was founded in 1892. The first Co-operative Act was passed in 1908 in the then Transvaal colony while other colonies registered co-operatives under the Companies Act. In 1922 the Co-operatives Act of 1908 became law and controlled co-operatives across South Africa. In its initial phase, the co-operative movement was focused on agriculture and trading co-operatives and the responsibility for the development of co-operatives fell to the Department of Agriculture. The Co-operatives Act in South Africa has since been revised a number of times. The Co-operatives Act of 2005 states that the responsibility for co-operative development support falls across national departments and agencies, under the leadership of the Department of Trade and Industry (**the dti**). This Act also provides for the registration of three levels of co-operatives – primary, secondary and tertiary. Despite the government's intentions to develop the sector, given its belief in the major role the

[17] Finmark Trust (2012) Finscope Consumer Survey South Africa
[18] Ibid
[19] Ibid

movement can play in economic and social development in South Africa, co-operatives remain largely misunderstood and failure rates have been high.

Based on a period of significant learning, the Co-operatives Amendment Act of 2013 aims to address a number of the challenges experienced in the sector. One of the most significant amendments is the introduction of a fourth level of co-operative – a national apex co-operative body, whose primary responsibility is advocacy on behalf of its members, but which adds another cost layer to the system. This role will be filled by the South African National Apex Co-operative (SANACO). SANACO has been given R3.5 million from **the dti** to professionalise its activities and tertiary co-operatives will form its membership base.[20] The 2013 Amendment also introduces/reforms a number of institutions to the co-operative sector. These include:

- A Co-operatives Development Agency (CDA), to provide financial and non-financial support to the sector.
- A Co-operatives Tribunal, responsible for conflict resolution, compliance, investigation and judicious management
- A Co-operatives Advisory Council – responsible for policy development and research, and to advise the Minister on the sector

Given that the Amendment was promulgated in August 2013, the formation of these institutions is still in its early stages and budgetary decisions are still being finalised. A clear vision is required on how the proposed CDA will work with the CBDA given that both will have a developmental wing. Approximately R2 billion is currently directed to the co-operatives sector, but this is not believed to be efficiently utilised[21]. **The dti** views co-operative banks as future funding sources for all types of co-operatives, and emphasizes the need for them to be capacitated to fill this role.

5.2.2. CFIs

The earliest financial co-operatives, specifically credit unions, in South Africa occurred in the 1920s in the then Transkei and Natal. Financial Co-operatives are a relatively new phenomenon in South Africa. CFIs were only legally acknowledged in the Co-operatives Act of 1981, though this Act did not allow co-operatives to accept deposits from members, which is one of the core principles of the financial co-operative movement where savers are the owners of the institution.[22]

The Reserve Bank’s first effort to deepen and broaden South Africa’s financial market was through its attempt to formalise “informal financial schemes” based on common bonds, including stokvels and CFIs, through the first exemption to the Banks Act in 1994. Under the condition that schemes are affiliated to a self-regulatory body, informal member-based groups could pool funds and utilize them to the benefit of their members.

In recent years, four programmes have contributed to the development of the CFI sector in South Africa:

[20] As reported in stakeholder interviews
[21] As reported in stakeholder interviews with government and industry representatives
[22] Kuhlengisa (2011) An evaluation of the regulation and Supervision of Cooperative Financial Institutions in South Africa. Research Master Thesis, Stellenbosch University.

- **Financial Services Association (FSA) and Financial Solutions (FINASOL)** both promoted Financial Services Co-operatives (FSCs), also known as “village banks”. They worked in the sector from 1996 to 2002;

- The **Savings and Credit Co-operative League of South Africa (SACCOL)** promoted the formation and establishment of SACCOs and Credit Unions. SACCOL was active from 1981 until 2011;

- The **South African Microfinance Apex Fund (samaf)** was established as a wholesale funding institution and has worked in the sector since 2006. It has been absorbed into the Small Enterprise Funding Agency (sefa);

- The **Co-operative Banks Development Agency** regulates and develops co-operative banks. It was established in 2009.

FSA

FSCs were popularly known as Village Banks. Their history dates back to the early 1990s, when the concept was introduced as a project to South Africa financed by the International Fund for Agricultural Development (IFAD). The Village Banks project came in response to the inability of the private sector financial institutions to provide cost effective financial services in rural areas. Village Banks were seen as a vehicle with which the community would be able to access a comprehensive range of financial services and could act as a link with the commercial banks.

The Financial Services Association (FSA) was then formed as an Association for the Village Banks in 1996, and was later formally acknowledged as a self-regulating body of its members.

In 1999 the National Department of Welfare approved a project grant of R7 million for the establishment of 70 Village Banks in seven provinces. With this funding, the FSA was able to formalise its activities, with staff and offices. Over the funding period of 30 months, 29 communities were assisted in establishing financial services co-operatives.

At the end of the funding period, a project review by the Department of Social Development revealed the following

- A lack of proper management of both the Association and the FSCs
- Poor training of staff within FSA
- A lack of experience in microfinance

Further funding for the project was denied and the Association eventually collapsed. In 2002, the FSA was closed down with a total of 32 registered member FSCs.

FINASOL

In January 1999, another not-for-profit organisation called FINASOL was registered under the South African Companies Act. The FINASOL model was based on a franchising system, the franchise provided for start-up assistance and continuing support by FINASOL (the franchisor) for standardised services to a Village Bank (the franchisee). FINASOL was also under an exemption notice to regulate its members.

FINASOL operations were made easier through financial assistance received from a number of organisations including USAID, DFID, DGRV, SCC and FNB. However, management challenges also resulted in poor performance. FNB pulled out of the programme and DFID funds were not utilized, leading to FINASOL closing down in 2002, leaving behind 30 registered members.

The few FSCs which survived experienced a number of problems including: mismanagement of funds; administration problems; in-fighting among members; lack of training; lack of auditing services; and lack of financial resources. In addition, those using the centralised information system of FINASOL suddenly had to revert to doing their books manually.

In 2003, National Treasury initiated a process of closing down non-viable FINASOL and FSA regulated Village Banks. Treasury availed R 5.3 million to refund the savings of those members of FSCs that had run into liquidity problems and had lost members' funds. At the time, the database revealed that there were 62 registered FSCs. Only 13 FSCs formally agreed to cease operations, while the rest continued operating, and some were then regulated by samaf under an exemption notice.

SACCOL

In 1981, a representative body of credit unions formed by Catholic Church parishes was formed. In the 1980s these credit unions faced a number of challenges, including high demand for loans but limited savings and share capital, and a lack of members willing to take up leadership positions in their credit unions. In 1991, when the World Council of Credit Unions (WOCCU) did an assessment of the viability of the movement in South Africa, they found that only three of the existing 47 SACCOs were viable[23]. This resulted in a shift in the movement towards a more business oriented approach focused on developing strong and sound SACCOs with the long-term interests of members in mind, rather than short-term gains. In 1993 the Savings and Credit Co-operative League of South Africa (SACCOL), a self-regulatory body for all SACCOs in the country, was thus formed.

SACCOs underwent a number of changes in the 1990s, including adopting the "one district, one SACCO" policy and increased focus on SACCOs in the workplace, which have become a number of the more successful SACCOs in South Africa today.

Samaf

Most FSCs and a few of the SACCOs were supported by samaf, which was established in 2006. Samaf's mandate was to create work opportunities and sustainable livelihoods through the facilitation and provision of affordable access to finance by micro, small and survivalist businesses to grow their income and asset bases. Samaf is now incorporated into the Small Enterprise Finance Agency (sefa) and is currently redefining their role in the CFI sector, but is a wholesale funding institution that views CFIs as valuable enterprise lending entities.

CBDA

Prior to the introduction of the Co-operative Banks Act of 2007, all co-operative societies operated under the framework of the Co-operatives Act of 2005. The Co-operative Banks Act applies to all co-operative banks registered under the Act and to any co-operative registered under the Co-operatives Act that takes deposits and has 200 or more members; and holds deposits of members to the value of R1 million or more. The common bond Exemption to the

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[23] www.saccol.org.za

Banks Act applies to CFIs that hold contributions from members in the aggregate of no more than R30 million.

Following the promulgation of the Co-operative Banks Act, the Co-operative Banks Development Agency (CBDA) was established in 2009, with the mandate to regulate and supervise primary Co-operative Banks that hold deposits of between R1 million and R20 million and have a membership of at least 200 members. In April 2012, the CBDA also took over the regulation and supervision of CFIs previously regulated by SACCOL and samaf that meet the registration requirements of R100 000 in shares and 200 members. This model promotes the evolution of financial co-operatives into banks.

The South African Reserve Bank (SARB) was mandated by the Act to regulate and supervise all primary Co-operative Banks holding deposits of over R20 million as well as all secondary and tertiary Co-operative Banks.

Before a prospective co-operative may register as a financial co-operative, it must be approved by the CBDA for registration and a deposit taking license. The application is then passed on to the Registrar of Co-operatives within the Companies and Intellectual Property Commission (CIPC) in **the dti** for issuance of a business license to operate as a financial co-operative. Some CFIs have raised concerns about the length of time these processes can take, which is important to address as delays in approval and licensing could cause members to lose confidence in the sector and delay implementation of prudential standards.

In addition to its regulatory and supervisory responsibilities the CBDA is also mandated by the Act to provide CFIs with technical assistance, training and capacity building programmes. The CBDA's Medium Term Expenditure Framework (MTEF) allocation has increased incrementally over the years to R16 million. While the sector is small relative to other financial institutions in the country, the development agency is resource constrained in terms of achieving its mandated objective of promoting the development of sustainable and responsible co-operative banks.

There are currently a number of developments taking place within the CFI sector. The most significant of these is the proposed move towards the twin peaks regulatory approach whereby the regulation of all Co-operative Banks will be centralised within the SARB and the regulation of all other CFIs will be the responsibility of the CBDA. Part of the CBDA's strategy going forward is to promote the CFI model in large employers, including parastatals and unions.

NACFISA

Following the demise of SACCOL in 2011, the CFI sector was left without an apex and advocacy body. Furthermore, SACCOs and FSC had been in separate camps. In order to form an umbrella body that is inclusive of SACCOs and FSCs, the National Association of Co-operative Financial Institutions in South Africa (NACFISA) was established in 2013 as a representative body that will represent and provide second-tier support to CFIs. NACFISA is a tertiary co-operative with provincial chapters made up of primary CFIs in each province and is currently being supported by the German Co-operative Confederation (DGRV). The current role of NACFISA in the CFI framework is to work with the CBDA to provide technical assistance, training and capacity building programmes for CFIs, with the long term view of absorbing this role completely, leaving the CBDA as a purely regulatory and supervisory body. While NACFISA is still in its early stages, many stakeholders believe its formation and rolling out of operations has been slow and could be improved, but this is most likely a result of limited resources.

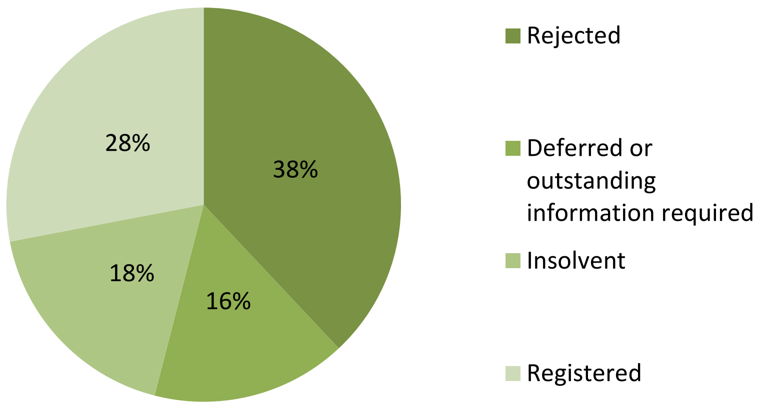
5.3. OVERVIEW OF THE CFI SECTOR TODAY

There were 163 financial co-operatives registered with CIPC prior to introduction of the new regulatory requirements, all of whom had to re-apply for a license through the CBDA.

By March 2013, 50 applications[24] had been received for registration as CFIs with the CBDA. The figure below provides a summary of the results of these applications.

Nineteen of the rejected applications were a result of the CFIs not meeting the minimum registration requirements of 200 members or R100 000 in share capital. Nine applications were rejected due to the CFIs being insolvent. Decisions regarding eight applications were deferred pending the receipt of information such as audited financial statements and management accounts. These CFIs were given deadlines for the submission of this information.

Figure 1: Summary of results of 50 CFI applications received[25]



As of 15 November 2013, there were 21 registered CFIs and 2 Co-operative Banks. There are also 2 CFIs that exceed the maximum deposit threshold of R30 million as stipulated in the Exemption Notice. Discussions are underway with the SARB to increase the threshold to bring these two CFIs within the regulatory framework. The Co-operative Banks, registered CFIs and above-threshold CFIs are estimated to account for 90% of the CFI sector in South Africa. The sector mainly services industry workers' groups, salaried individuals and the rural population.

Below is a summary of key statistics for the CFI sector in South Africa, as of February 2013.[26]

Table 3: Key statistics for the South African CFI sector[27]

Members	27 237	
Penetration[28]	0.17%	
Share Capital	R 9.8 million	USD 897 582
Total savings	R 181 million	USD 16.6 million

[24] This has since increased to 62, including repeat applications
[25] CBDA (2013) Annual Report 2012/2013
[26] Please note that these are aggregated figures, some of which have not been validated
[27] Based on ZAR/$ exchange rate on the 20 February 2014
[28] WOCCU (2012) Statistical Report

Total net loans	R 130 million	USD 11.9 million
Total assets	R 201 million	USD 18.4 million
Total liquid assets	R 8.3 million	USD 760 197
Net income	R 3.8 million	USD 348 042

According to the 2013 World Council of Credit Unions (WOCCU) Statistical Report, the CFI sector in South Africa is small with a penetration of 0.17%, which is low relative to other African countries. This has been attributed to a number of reasons, many of which relate to the sector's history in the country. These include grant-based programmes that did not operate for long enough to ensure that managers and communities were equipped to run CFIs, resulting in misaligned incentives and rent-seeking in some cases; poor management; insufficient capacity and a lack of coordination of the different stakeholders. The failure of many FSCs as described above, and a lack of publication of the few clear success stories, has also affected the level of people's trust in CFIs as safe and reputable financial institutions.

5.3.1. Products

Most CFIs provide regular or basic savings products to members along with special purpose contractual savings products, such as Christmas or school fees savings. Regular savings are withdrawable while, for the contractual accounts, a member agrees to deposit a fixed amount each month and then withdraws all the funds at a specified date. Many smaller CFIs would like to expand their savings products to include fixed deposit or more special purpose savings products. Faced with increasing competition from banks, some of the larger CFIs would like to broaden their service offerings to include more transactional services, such as debit cards, internet banking, as well as funeral and other insurance products.

Figure 2: Board members of Boikago SACCO

In terms of credit provision, loan sizes are often related to the level of savings of the member, but can also be decided on a case-by-case basis, or on the period spent working for an employer[29]. Credit terms generally range from 3 to 36 months. A few CFIs also lend to self-employed individuals. Enterprise loans often do not perform as expected, and there is likely a lack of capacity within CFIs (among other institutions) to create appropriate products for small and micro enterprises or to accurately assess and manage business loans.

The CFI members interviewed do not expect to use their CFIs for transactional purposes, but rather to save and borrow, particularly for specific assets or goals, such as improving or building houses, paying school fees or lobola[30], or buying a car.

5.3.2. Challenges

The majority of CFIs in South Africa use manual accounting and management information systems and many find that meeting regulatory compliance standards with these systems is extremely challenging. Computer-based accounting and operating systems would make a significant difference to CFI operations. The CBDA is investigating the feasibility of CFIs using a common banking platform, which is anticipated to address this challenge. It is hoped to be a pay-as-you-go system, that will allow the various CFIs to 'plug in', but resources for the development and initial implementation are yet to be defined.

Following the closures of FSA, Finasol and SACCOL, a number of CFI proponents realise that CFI management, board members and members lack the necessary technical skills to operate effectively. A number of agencies are thus currently investing in training and education programmes for co-operatives and their members. An example of this is the Certificate Course in Co-operative Financial Institution Management at the University of Pretoria for managers and board members. BANKSETA supports this programme and has in the past provided assistance to CFIs by paying for course fees, accommodation and travel costs.

There is a lack of development programmes for CFI start-ups that have not achieved the thresholds for registration. Due to a shortage of resources, most of the training and development is directed to those CFIs that are already working with the CBDA either as registered or close-to-registered CFIs. This has potentially contributed to a slow rate of growth in the sector.

Some provincial governments, in particular the KZN Department of Economic Development also proactively support the co-operatives sector, and respond to support requests from CFIs in the province. However; there is a widely held view that not enough government resources are dedicated to CFIs, which necessitates the involvement of a wide range of agencies and support programmes.

Another challenge that was cited by CFI respondents was that financial literacy levels amongst CFI members are low, and a number of CFIs felt that their members do not fully understand the benefits of being a CFI member. Many respondents also feel that members, and the broader population, need to learn the benefits of savings and being committed to an institution. While education is at the core of the co-operative values, there is considerable effort required from existing members to educate, inform and recruit new members. Given the failures in the

[29] This is the case for Webbers, which is an employer-based SACCO
[30] Lobola is a traditional southern African custom whereby the man pays the family of his fiancée for her hand in marriage

past and other financial scams in the environment, South Africans are naturally distrustful of unknown and untested financial institutions.

Many CFI sectors in other countries grew off the back of large public sector employer-based CFIs, which allowed for payroll deductions. As a result of over-indebtedness amongst the South African population, the government disallowed payroll deductions in 1999[31] and this is cited to be one of the reasons constraining the South African sector.

There is currently nothing in place to cover members' deposits should a CFI fail, i.e. a deposit insurance facility. The Co-operatives Bank Act stipulates the formation of a deposit insurance facility but Treasury's preference is for a banking sector deposit insurance fund. However, despite being discussed for a number of years, this has yet to come to fruition. The CBDA is therefore looking to set up a stabilization fund for CFIs, but resourcing for this has not been confirmed.

5.3.3. Role in financial system

The majority of CFI members interviewed in South Africa have bank accounts in addition to their CFI membership, but use their CFIs for specific goals, such as building and renovating houses, paying school fees, and paying lobola.

Box 1: Member of a South African SACCO explaining her experience

"I got to know about the SACCO when I was worried about how I was going to pay the fees for my son's medical school. The manager explained that I need to save a lump sum before I could borrow, which was very hard but I managed. Through my son's years at medical school, I was able to pay all the fees on time as I started saving more when I could. Not only am I the proud mother of a young doctor, my financial behaviour has changed. I now save a lot of money because I pay with savings rather than credit and my shares in the SACCO pay out dividends every year. I have helped all the teachers in the school where I am the principal as they all have accounts with the SACCO. They are stress free as they have low debt and always have some savings for emergencies."

The South African financial landscape is replete with extensive options for credit. CFIs therefore face broad competition from other financial institutions. However, all of the stakeholders interviewed believe that CFIs have a valuable role to play in the South African context, largely as a result of their value proposition of ownership, savings first, face-to-face interactions, inherent education, income from dividends and trust that a common bond provides.

CFIs are also considered to be more flexible than banks, and charge lower rates. Members also believe that CFIs promote discipline, particularly because they encourage savings.

Members are also attracted to the sense of ownership that comes with being a member of a CFI. They don't mind paying interest on their loans, because they understand that any profit made will be returned to them through dividends on their share capital.

Many respondents believe CFIs are a "hidden treasure" in South Africa, but that many people are unaware of the benefits of CFI membership or are suspicious of financial products or institutions they do not know or understand. Financial literacy and savings levels in South Africa are also low, which contributes to this knowledge gap.

[31] There are no restrictions on private sector entities

5.4. ASSESSMENT OF THE LEGISLATIVE AND REGULATORY ENVIRONMENT

The history of the development of the CFI sector in South Africa has been short and troubled. The sector today is small and plays an insignificant role in South Africa's overall financial system. While trying to jumpstart the sector, the bottom up approach of financial co-operative development had been eroded as donors and government have opted for more a top down approach. This is perhaps understandable from a policy perspective, but can unfortunately lead to weak co-operatives. It is important that through a self-driven building process, healthy and sound primary CFIs are formed at the heart of the sector. Building up a co-operative sector is a process as co-operative principles need to be explained, understood, internalised and applied in order for sustainable institutions to be formed. CFI development goes through various stages, as is shown in the figure below.

Figure 3: CFI development process

To facilitate these phases different sets of legislation and regulatory and supervisory framework are needed. The regulatory and legislative framework grows with the organization.

The introduction of formal regulation to the CFI sector in South Africa, and the creation of the CBDA, resulted in the number of registered CFIs decreasing significantly. The majority of stakeholders interviewed, including CFI members and employees, acknowledge the benefits of regulation, and believe it will have a positive long-term impact on the CFI sector, but with a number of difficult short-term impacts, including dissolution of institutions.

Whether the process above has been followed by South African stakeholders is unknown, but it is important to note that the formalised CFI sector has shrunk initially following the implementation of the current legislation and regulation. Some CFIs will inevitably choose informality rather than try to fulfil the regulatory requirements, while others will not be developed or sophisticated enough to do so. There is no doubt that the regulators in South Africa understand the dual role CFI regulation has to fulfil currently - to safeguard and protect the depositor and financial sector on the one hand and promote sector development on the other - but it seems that the latter in particular lacks resources. Ideally these two roles should be fulfilled by two separate entities, and this is the long term goal of the CBDA, but the dual mandate of the CBDA currently is dependent on available capacity and resources in the sector as a whole.

The tiered approach to a CFI sector (with functioning primary, secondary and tertiary institutions) usually makes supervision more cost effective, but with such a small number of registered CFIs in South Africa it just adds more layers and costs. A critical mass needs to be reached before the structure becomes effective.

More investment and support for bottom-up development is needed to promote and drive the establishment of a sound base of primary financial co-operatives in South Africa. The dissemination of the model is one of the first steps a government can support to inform its citizens about the financial co-operative institutional arrangement in order to establish a sustainable, bottom-up South Africa-specific CFI sector, that is then followed by regulation.

Consumer protection framework

The Consumer Protection Act of 2008 provides the overarching framework for consumer protection in South Africa. In addition to this, the National Credit Act of 2005 provides the regulatory framework for the credit industry and has mandated the National Credit Regulator (NCR) as the industry's regulator. The National Credit Act of 2005 specifically covers CFIs and their members and most CFIs are registered with the NCR. However, by the very nature of CFIs, consumers (clients) should be protected by their own ownership and empowerment in the governance and operations of the institution.

6. MALAWI

6.1. GENERAL OVERVIEW

Malawi is a small landlocked country in Southern Africa with a population of 13.1 million people[32]. Malawi's economy is dominated by the agricultural sector, with an estimated 84% of the country living in rural areas and engaged in subsistence agriculture[33]. Malawi is characterized by high rates of poverty (50.7%), the majority of which is concentrated in the country's rural areas. The country is also the least urbanised country on the African continent, whilst also having the highest urbanisation rate in the world. The population is relatively young with 50% of the adult population between 25 to 44 years of age.

The Malawian economy is highly reliant on donor aid as a driver of growth, and is thus vulnerable to donor aid fluctuations. The country's aid per capita amounts to US$ 68.6, higher than the averages for both sub-Saharan Africa and Africa as a whole.

More than half of the adult population of Malawi (55%) manage their lives without using any kind of formal or informal financial product. 45% of Malawians are financially included. 19% of individuals are banked, 7% use a financial product from a formal financial institution other than a bank (predominantly microfinance institutions) and 19% make use of informal financial products.[34] Included in the informal sector are those people that borrow from employers; people who get credit at shops; farmers who receive inputs from processors or input suppliers as credit; and members of community-based organisations such as churches and farmers' organisations.

There is a thriving informal financial services sector in Malawi, which has been inflated by poor outreach by the formal financial institutions. The 2008 Malawi FinScope Study noted that the main reasons adults do not have bank accounts are income-related. In the study, 98% of adults without a bank account stated they had insufficient money either before or after expenses. 19% also stated they could not maintain the minimum balance requirement. Less than 10% cite physical access as a reason for not being banked. However, since the majority

[32] FinMark Trust (2008) 2008 FinScope Malawi
[33] MUSCCO (2012) Presentation at the ACCOSCA Regulatory Workshop
[34] FinMark Trust (2008) 2008 FinScope Malawi

of those that are banked use public transport to reach the bank, cost of access was identified as a significant constraint to financial inclusion in Malawi.[35]

6.2. HISTORY OF THE CO-OPERATIVE AND CFI SECTORS

Agricultural co-operatives in Malawi date back to the 1940s. The state did not have much involvement in the early stages of the development of the co-operative movement. It was only after a Co-operative Symposium was held in Malawi in 1990 that government departments began to view co-operatives as vehicles for development. The recognition of the importance of co-operatives by the state saw the launching of the Co-operative Development Policy in 1997 by the Ministry of Industry, Trade and Enterprise Development (MoIT). The aim of this policy was the creation of an enabling environment for the sustainable development of co-operatives with the overarching goal of improving the lives of Malawians. This policy was followed by the introduction of the Co-operatives Act of 1998, which outlined the regulation and supervision of the co-operatives sector by the MoIT.

The philosophy of savings and credit co-operatives was introduced to the country by Canadian Catholic priests in the 1960s. Through the assistance of the church, 1973 saw the formation of the first SACCO known as Munjili in Mzimba. Following rapid uptake of this concept, there were 26 SACCOs with savings amounting to MK360 000 by 1980. These SACCOs came together and, with the assistance of the donor community, they formed the Malawian Union of Savings and Credit Co-operatives (MUSCCO), the national association for financial co-operatives in Malawi, now 33 years old.

Following extensive lobbying by MUSCCO for a financial co-operative-specific law, the government of Malawi passed the Financial Co-operatives Act in 2011, which saw the regulation and supervision of SACCOs shifted from the MoIT to the Central Bank.

MUSSCO

SACCOs become members of MUSCCO by contributing share capital to the organisation. Member SACCOs are divided into 3 chapters representing each of the three regions of Malawi (Northern, Central and Southern regions). Each of these regional chapters elects representatives to participate in the MUSCCO General Assembly Meeting and the board members of MUSCCO, which is made up of 5 directors and 3 external technical members.

Four main services are offered by MUSCCO, including:

- **Finance** - MUSCCO provides finance through its Central Financial Facility (CFF) which extends liquidity management services and short-term financing to SACCOs in times of trouble. The CFF also operates as a financial institution for SACCOs where they are able to invest and borrow at favourable rates. All member SACCOs are obligated to invest 10% and 15% of their share capital and deposits respectively in the CFF.

- **Operations** - MUSCCO plays the role of technical assistant to member SACCOs, providing them with services that help in enhancing the day-to-day operations of the organisations. These technical services include: auditing; business planning and

[35] FinMark Trust (2012) Taking financial inclusion beyond data

budgeting; training of staff and board members; community relations, design of programmes and member education.

- **ICT support services and technology transfer** - the apex provides ICT specific services to assist SACCOs with the transition from manual to computerised systems.
- **Auditing and supervision** - the introduction of the Co-operative Societies Act of 1998, saw the Registrar of Co-operatives delegating its responsibility of auditing and inspecting of all SACCOs to MUSCCO. Moreover, since the supervision and inspection of SACCOs has migrated to the Central Bank under the Financial Co-operative Act of 2011, MUSCCO is given a mandate to supervise all small SACCOs with less than MK75 million (USD 179 000)

The apex body is grounded in the ideology of SACCOs as an instrument of self-empowerment and is of the belief that the demand for SACCOs should be bottom-up as opposed to top-down. This has been the guiding philosophy in their work in the sector. In light of this the organisation has committed itself to playing more of a facilitator role, through the provision of training and capacity building.

Donor support

Donor agencies have played a significant role in the development of Malawi's SACCO sector. At first, the support of donor agencies was exclusively rural due to the understanding that this was where access to financial services was limited. This resulted in SACCOs that consisted mainly of members that derived their income from agricultural activities. Due to the seasonality of agricultural products, these SACCOs became unsustainable. This resulted in a move towards the encouragement of diversifying from a common bond in SACCO membership, as those with steady income streams allowed for the smoothing of incomes of the members based in the agricultural sector.

Donor support consisted mainly of capacity building, through the remuneration of staff, and education, training and development, rather than financial support. This focus on capacity building and development, rather than grant disbursement, contributed to the establishment of a sustainable and resilient SACCO sector. Over time, donor involvement in the SACCO sector has declined, but the sector is still growing. MUSCCO has operated on the principle that donor income should not be more than 33% of its income and this should be directed to the development of new services, which in turn supports some of the costs of the apex.

6.3. OVERVIEW OF THE CFI SECTOR TODAY

There are currently 47 SACCOs in Malawi, all of which are affiliates of MUSCCO, with a member base of around 116 122 individuals. The SACCOs can be categorised into two main types: community-based and employer-based. The employer-based SACCOs are characterised by homogenous groups, while the community-based SACCOs tend to be more heterogeneous, although given the size of the agricultural sector in Malawi, the majority of members are farmers. Community-based SACCO loans are normally used to buy inputs for farming, small business or for large expenses, such as school fees.

The membership within the SACCO movement is mixed, ranging from middle-income public and private sector employees to very poor subsistence farmers such as in the villages surrounding the towns of Salima and Mangochi. Geographically, SACCOs span both urban and rural areas. In terms of occupation, members include teachers, farmers, researchers, manufacturers, informal traders and small business owners.

Figure 4: Members of Mufuna SACCO

The table below provides some key statistics for the SACCO sector in Malawi today.

Table 4: Key statistics of Malawi's SACCO sector as at June 2013[36][37]

Members	116 122	
Penetration[38]	1.25%	
Share capital	MK 3 billion	USD 7.2 million
Total savings	MK 333 million	USD 799 200
Total net loans	MK 2.6 billion	USD 6.2 million
Total assets	MK 3.9 billion	USD 9.3 million
Net income (Half year earnings)	MK 73.4 million	USD 176 160

The drive by state institutions and donor organisations towards financial inclusion in Malawi has seen the promotion of a savings culture amongst the country's people. Many members of rural communities have responded by joining of the SACCO movement and SACCOs have played a sound role in bridging the financial inclusion gap. Large numbers of farmers are members of the SACCO movement and benefit from agricultural loans during planting season.

[36] Based on MK/$ exchange rate on the 20 February 2014
[37] MUSSCO (2013) Consolidated statistical report June 2013
[38] WOCCU (2012) Statistical Report

One of the main attractions of members to SACCOs is their localised nature. They are run by people from the community, allowing for service that is more personalized, with accountability of staff. Their proximity also makes them more convenient, particularly in rural areas.

Box 2: A Malawian woman in the Lake Basin Project to the heads of MUSCCO and the We Effect[39]

> *"Why did it take you so long to get here and help us to build these SACCOs. In just two years, I have learnt to plant and sell throughout the year, I have re-built my house, my children are well-fed and go to school and I have given my husband money to start a business. Imagine where we would be if you had come here 10 years ago!"*

Many of the members are also attracted to the sense of ownership that is associated with being a member of a SACCO. People prefer making loan repayments to their SACCO, because they understand that any profit made will be returned to them through dividends on their share capital. This differs from a commercial bank, where any profit made goes to the bank's shareholders, and not its customers.

Malawi is characterised by a large number of economically active individuals who are situated in the informal sector and are therefore not able to access financial services from commercial banks. SACCOs thus play a role in the extension of financial services to this segment of the population.

Products

SACCOs in Malawi provide savings and loan facilities to their members. The interest rates paid in SACCOs are not very different from those offered by commercial banks. A number of SACCOs that are situated in areas consisting of large farming communities are also able to structure their products in such a way as to accommodate the needs of their farmer members. An example of this is Ulimi SACCO, situated in the central region. Ulimi grants agricultural loans during November for members to buy inputs and fertilizers. These members are then given a grace period of six months and only start paying back their loans when they sell their harvest. The inherent risks of this business model would not be appealing to the more risk-averse commercial banking sector.

Given the lack of financial services, and in particular access to insurance products that hedge against unforeseen financial shocks, SACCOs in Malawi offer loan products that provide for unforeseen emergency situations that their members might face. Members are able to borrow in order to pay for the burial of a family member or healthcare expenses. These emergency loans are provided at favourable rates.

Management and governance structures

As in other countries, governance of SACCOs is a challenge in Malawi. The source of this problem has been identified as a lack of appropriate skills amongst members of the governance structures. There is a skills shortage nationally and those people with suitable qualifications are not particularly willing to relocate to remote rural areas where SACCOs are situated. Further, SACCOs are also often not able to afford appropriately skilled staff. Training is provided to elected board members on the management of financial co-operatives. However, board members can only be elected for a maximum of two consecutive terms of 3 years each meaning that once they've gained the experience required to work within the SACCO environment, they are obliged to step down, reducing the SACCO's ability to capitalise

[39] Formerly the Swedish Co-operative Centre

on this knowledge gain. MUSCCO's solution to this is to provide on-going training as each new board is elected. Through such practices, the knowledge base in the sector is enhanced and each new board is held accountable by members.

Technology

One of the problems impeding the progress of SACCOs in Malawi is the manual systems that are still being used by many of the organisations. In an attempt to computerise the day-to-day running of SACCOs, MUSCCO bought a new system with 39 software licenses in 2009. However, the cost of activation has been too high and to date only 12 SACCOs have implemented these systems. It is a stand-alone system and therefore requires that there be an IT person in each and every SACCO. MUSCCO has visions of introducing modern technology in the sector and has enquired about the installation of ATMs within the SACCOs. However, these are costly and the viability of these machines depends on a transaction rate of 25 000 transactions on each machine each month – a rate that doesn't exist currently. The potential maintenance cost of these systems is also prohibitively expensive, particularly because it will have to be paid in Euros.

Linkages

One of the major successes of the co-operative movement in Malawi is its ability to form viable and sustainable partnerships and linkages amongst co-operatives that operate in different sections of the value chain. Through joint efforts between MUSSCO, *We Effect* (formerly funded by the Swedish Co-operative Development Agency), Farmers Union of Malawi and the National Association of Smallholder Farmers of Malawi, collaboration between agricultural and financial co-operatives has been facilitated, particularly in the rural areas. These collaborations have proven to be successful in enhancing the social well-being of members. Through agricultural co-operatives, rural smallholder farmers have learnt methods of sustainable agriculture and crop rotation and are also able to access larger and stable markets, while through SACCOs they are able to borrow for inputs and then save and repay their debts during harvest seasons.

Challenges facing SACCOs

One of the challenges facing SACCOs in Malawi is the exposure to different types of agricultural activities. For example, in 2006 MUSCCO, in pursuance of its development objective, ventured into a new SACCO to serve farmers and urban traders. As tobacco is a favoured cash crop, the SACCO had a significant exposure to groups of tobacco farmers. The fall in the tobacco price in 2009 had a detrimental effect on the SACCO which is still recovering from the losses.

Some SACCOs have also faced low loan repayment and under-capitalisation challenges. In addition, the SACCO sector in Malawi is currently facing major liquidity problems particularly those SACCOs with a large share of its membership base consisting of civil servants. The source of this problem is the non-remittance of payroll deductions by government departments to SACCOs and other microfinance institutions. To date the Department of Education has failed to remit MK 915 million (USD 218 million) payroll deductions from employees to SACCOs and microfinance institutions. Under the Financial Services Act the central bank is mandated with the prosecution of those employers who fail to remit money that has been deducted from employee salaries. Whether this will happen remains to be seen.

Although many strides have been made in terms of the insurance offerings of Malawi's SACCO sector, there still remains some room for improvement, in particular the provision of deposit insurance to cover members in the case of a SACCO defaulting.

As mentioned above, affordability of ICT services is also a challenge for the SACCO sector. Licenses associated with the software applications required to move from manual to computerised systems can be purchased from MUSCCO but many of the organisations are finding it difficult to afford these.

6.4. ASSESSMENT OF THE LEGISLATIVE AND REGULATORY ENVIRONMENT

All forms of co-operatives in Malawi are regulated by the Co-operatives Societies Act of 1998. This Act states that all co-operatives, financial and non-financial should be registered with the MoIT. The Act bestows the role of regulator and supervisor on the Ministry, giving the Ministry the responsibility for the auditing, the arbitration and liquidation of co-operatives. The Act also calls for the promotion of co-operatives by the Ministry, the provision of education and training, the facilitation of linkages (e.g. linking financial co-operatives with commercial financial institutions) and product development. Given the limited resources of the state, the Ministry works closely with industry stakeholders, particularly MUSCCO, to achieve adequate regulation and supervision. For example, tasks such as auditing, promotion and the provision of education and training to SACCOs have been delegated to MUSCCO. The SACCO movement has been surprisingly independent and assumed a delegated supervisory function for its affiliated SACCOs until recently.

The Malawian government passed the Financial Services Act in 2010, adapting financial institutions to international requirements of an improved financial regulatory framework. Shortly thereafter, in 2011 the government of Malawi passed the Co-operative Financial Services Act aimed at regulating and supervising SACCO operations. The Act was introduced with the aim of promoting the safety, soundness and prudent management of the savings of SACCO members. Regulations to the new legal framework were published shortly thereafter dealing with licensing of registered SACCOs, conduct of business on premises, regulation and supervision, and a Deposit Guarantee Fund, among others. The industry understands the increase in prudential requirements and agrees that a balance with a regulatory framework and a reporting burden needs to be struck for the safety and soundness of the SACCO movement. With the introduction of this Act, the Registrar of Co-operatives in the MoIT is still responsible for the registration of all SACCOs, while the Reserve Bank is now responsible for their licensing. However, the supervision and regulation of SACCOs with assets less than MK75 million (USD 179 000) will be done by MUSCCO. In order to allow for the transition to the supervision requirements under this new Act, the Reserve Bank has granted pre-existing SACCOs provisional licenses which are set to expire in March 2015. There are currently 19 SACCOs with an asset base above the MK75 Million (USD 179 000) threshold.

Given that the first SACCOs in Malawi were founded in 1970 and MUSCCO was established in 1980, the financial co-operative sector developed for nearly forty years almost unregulated. Following the sector's growth over recent years, it has now reached a critical mass such that the government believes a more costly and hands-on intervention in the supervision of the SACCOs is justified.

Given that governance regulation was not stipulated previously, it was fortunate that the Malawian SACCO sector continued to perform as it did. However, MUSCCO and the donor community contributed a great deal in driving the movement towards professionalism and profitability over the last 30 years. The government recognises and continues to see MUSCCO as the guardian of a sound and safe SACCO movement. With reforms to their overall financial sector, it seems Malawi has recognised that the integration of the financial co-operatives into the overall financial sector is a necessity; and more importantly the government believes that regulating SACCOs will give them the credibility needed to enhance their potential for financial inclusion.

The Malawian case demonstrates that developing a new regulatory framework with the SACCOs and the apex body, after analysing and understanding the sector, is a more prudent way to formulate appropriate and accepted regulatory regimes.

One big question is how authorities will deal with MUSCCO's credit insurance product as, strictly speaking, MUSCCO is not registered as an insurance provider with the Central Bank. This is will be critical to address as MUSCCO also does not have a reinsurance mechanism in place, and in the event of a strike of an idiosyncratic risk, this could threaten MUSCCO's stability.

Consumer protection framework

The Consumer Protection Act of 2003 provides the general legal framework for safeguarding consumer welfare in Malawi. It elaborates consumer rights and responsibilities, and also specifies obligations on the part of government authorities, suppliers and traders. Section 28 of the legislation is specific to financial transactions and states that a consumer shall have access to banking and financial services including but not limited to opening and operating accounts; securing loans, mortgages, charges, insurance, health insurance cover, pension and other services, at affordable and lowest possible rates. The Act does not make specific reference to financial co-operatives.

7. SWAZILAND

7.1. GENERAL OVERVIEW

Swaziland is a landlocked country in southern Africa bordered in the north, south and west by South Africa and in the east by Mozambique. It is a very small country with a population of about 1.2 million[40], with 42% of the population under the age of 30 and 63% of the population being women.[41] The majority of people in Swaziland live in rural areas (63%) and there are stark differences characterising the population residing in rural and urban areas. These differences include access to basic services and infrastructure, sources and levels of income, as well as levels of education (16% of rural adults have no formal education compared to only 5% of urban adults), and the overall level of financial inclusion.

According to the latest FinScope survey[42], 43.9% of the adult population in Swaziland use commercial bank products, while 44.4% of individuals are financially excluded, using no formal or informal financial products to manage their financial lives. More than half of the Swazi adult population is dependent on others for their income or livelihoods (this includes 29% whose

[40] UN (2014) World Statistics Pocketbook
[41] FinMark Trust (2011) FinScope Consumer Survey Swaziland
[42] Ibid

source of income is from members of the household, 19% through remittances and 11% from state pension).

7.2. HISTORY OF THE CO-OPERATIVE AND CFI SECTORS

The first Co-operatives Proclamation was introduced in Swaziland in 1931. At this time the co-operative sector was limited to a handful of agricultural co-operatives. The Department for Co-operative Development and the Registrar of Co-operatives were then created in 1963. The Co-operative Societies Proclamation was introduced in 1964 and evolved into the Co-operative Societies Act of 2003, with accompanying regulations.

The history of the financial co-operatives movement in Swaziland dates back to the 1970s when small agricultural co-operatives came together to form an apex body called the Central Co-operative Union (CCU). A number of these farmers' co-operatives decided to form SACCOs with the intention of providing a financing vehicle for their agricultural activities. Given that most of the farmers did not have regular income, these SACCOs were not sustainable and many of them failed. Following a difficult period in the financial co-operative sector, government institutions and parastatals started forming SACCOs, with professions as their common bonds. For example, there were SACCOs formed by teachers, nurses, correctional services and the army. This started what has become a strong financial co-operative movement in Swaziland.

The Role of Government

The Swazi government has played a pivotal role in promoting co-operatives in the country and to create an enabling environment for their existence and development, so much so that a Department of Co-operatives was established. The Department was initially placed under the Ministry of Agriculture and Co-operatives, but was later transferred to the Ministry of Commerce, Trade and Industry. The Department of Co-operatives is headed by a Commissioner of Co-operatives. The primary responsibility of the Commissioner is the registration of all types of co-operatives. Other responsibilities as stated in the Co-operatives Act of 2003 are:

- To provisionally and fully register and deregister co-operatives
- To handle liquidations and dissolutions of co-operatives
- To ensure the enforcement of the provisions of the Act
- To assist in the creation of an environment conducive to the growth of co-operatives without affecting in anyway the rights to develop as autonomous and self-reliant enterprises.

The office of the Commissioner also has a mandate to provide training and development to co-operatives and to supervise their activities. It has carried out this responsibility in collaboration with the Swaziland Association of Savings and Credit Co-operatives (SASCCO). It carries out on- and off-site inspection of the SACCOs and audits small co-operatives that cannot afford the services of large external auditors. The office has not always been successful in fulfilling its full mandate, as a result of limited financial and staff resources.

SASCCO

In 1988 the financial co-operative apex body, the Swaziland Association of Savings and Credit Co-operatives (SASCCO), was formed. This association was initially assisted financially by the Central Co-operative Union (CCU), The African Confederation of Co-operative Savings and

Credit Associations (ACCOSCA) and the Konrad Adenauer Foundation, a German political foundation. It is registered as a secondary co-operative and is the only secondary co-operative to service SACCOs in the country.

SASCCO has responsibility to provide services to its affiliates, including advocacy and connecting the movement to the government and international bodies. SASCCO is a member of ACCOSCA and has a good professional relationship with WOCCU, even though it is not an official affiliate.

SASCCO also provides education and training to board members and members of its affiliates. This includes governance training, financial management, human resources management, office administration, and personal financial management for members, based on the needs of the SACCO. It also provides board orientation to newly appointed board members of SACCOs and assists the SACCOs in drafting policies and procedures. SACCO affiliates pay fees and dues to SASCCO based on their assets and member base, and so SASCCO does not charge the SACCOs for services. The SACCOs are expected to organise venues for training and to cover logistical costs. A few SACCOs that have the financial resources sometimes outsource training activities to other organisations.

SASCCO's main income stream is the fees and dues paid by its affiliates. It has other income generating activities, including the provision of insurance risk cover for its member affiliates for loans taken by individual members at a cost. To do that, SASCCO was registered as an insurance agent with the Swaziland Royal insurance Corporation (SRIC). SASCCO has since registered as an insurance broker and now has an opportunity to offer the services of a number of insurance companies. The insurance products they offer include death, permanent disability and motor insurance. SASCCO also generates income by offering a group pension scheme for all employees of SACCOs. These funds are invested with a private sector insurance company.

Even though SASCCO has achieved a number of successes, it has also faced some significant challenges. SASCCO is highly financially dependent on fees and dues and the income it derives from insurance products. This is not sufficient to finance all of its activities, which restricts its ability to reach out to SACCOs regularly and effectively. As a result of this SASCCO often works with the office of the Commissioner of Co-operatives to deliver training and collect data on SACCOs.

SACCO Regulation and Supervision

In a move to bring all non-bank financial institutions under one regulatory authority, the Financial Services Regulatory Authority Act was passed in 2010. The Act led to the formation of the Financial Services Regulatory Authority (FSRA), which is an integrated regulator with the mandate to license, regulate and supervise the activities of all non-bank financial institutions to foster stability, safety and soundness in the Swaziland financial system.

This move saw the regulation of SACCOs being moved away from the office of the Commissioner to FSRA, which is currently funded by the Ministry of Finance. Of particular concern to the SACCOs is section 83 of the Act, which states that "the Co-operatives Societies Act, 2003, shall not apply in relation to a SACCO".[43] However, this is currently not being upheld, and the Commissioner is continuing its role in relation to SACCOs, but it is still not

[43] Financial Services Regulatory Authority Act (2010)

clear what this role will be going forward. The Central Bank has no regulatory role in the SACCO sector in Swaziland.

Before the introduction of FSRA, SACCOS were not adequately regulated in terms of prudential requirements of solvency and stability. There was not enough attention paid to risk measurement given their high penetration rate and asset growth and this posed a potential systemic risk to the country's financial system. There have also been a few cases of fraud and misgovernance in some SACCOs in Swaziland, where members' funds were lost or stolen. The majority of the stakeholders interviewed therefore understand the value of regulation and believe it will have a positive effect on the financial co-operative sector. However, the main concerns of the SACCOs are related to the fees that will be required to be paid to FSRA, which SASCCO has already negotiated down on behalf of its members, as well as the lack of initial consultation with the SACCO movement during the drafting of the Act.

FSRA is currently developing a regulatory framework specifically for SACCOs. Draft Regulations have been drafted and presented to the SACCOs but have not yet been passed by parliament. Licensing and reporting Guidance Notes have been developed in the interim and are currently being presented to the SACCOs for inputs. A SACCO specific Bill is also currently being drafted.

7.3. OVERVIEW OF THE CFI SECTOR TODAY

Swaziland has seen significant growth in the number and size of SACCOs since they were first introduced in the 1970s, as a result of government support and member loyalty. Members of SACCOs also range from low income earners to middle- and upper-class class members of society. The formation of large SACCOs within government departments, parastatals, and the private sector has contributed to this. This has also inspired confidence in these institutions. There are very few community-based SACCOs in Swaziland.

As of 2012, there were 70 registered SACCOs in Swaziland, holding assets in excess of R 800 million. Below is a summary of key statistics for the SACCO sector in Swaziland.

Table 5: Key statistics for SACCOs in Swaziland[44][45]

Members	37 286	
Penetration[46]	4.46%	
Share capital	R132 million	USD 12 million
Total Savings	R668 million	USD 61.1 million
Total net loans	R552 million	USD 50.6 million
Total assets	R836 million	USD 76.6 million
Net income	R24.3 million	USD 2.2 million

[44] Commissioner of Co-operatives, Swaziland (2012)
[45] Based on ZAR/$ exchange rate on the 20 February 2014
[46] WOCCU (2012) Statistical Report

Figure 5: A member conducting a transaction at a branch of Sibonelo SACCO

According to a survey conducted by the Commissioner of Co-operatives, the most commonly cited reasons for a SACCO's success is member involvement, followed by high commitment and vision, patience, good corporate governance and cooperation among members. The most commonly cited reasons for failure include poor capitalization, poor member capacity and lack of technology.

According to FSRA, the largest 15 to 20 SACCOs control about 90% of the SACCO market and over 85% of the SACCOs in Swaziland are employer based. As at March 2013, there were 39 active affiliates to SASCCO.

A number of SACCOs in Swaziland are beginning to open their bonds. Some SACCOs have found that restricting membership to a single employer can be risky for the SACCO, because of the effect that job loss, employer losses, movement and retirement can have on membership numbers. However, interview respondents emphasised the importance of understanding when members receive their salaries if they fall outside of the initial common bond, so that stop orders can be set up to ensure timely payments to the SACCO, and to reduce the possibility of delinquency.

7.3.1. Products

Box 3: Member of Sibonelo SACCO describing her experience

"I joined the SACCO about 5 years ago. I make savings religiously every month and use the savings to get loans. In the last 5 years I have used my loans for personal projects and also big projects like building my house and starting a catering business."

Savings products

The products offered by SACCOs are very similar across the different institutions, although they are priced differently. Almost all the SACCOs offer savings products which are divided into withdrawable and non-withdrawable savings. SACCO members noted that the most popular savings products are the non-withdrawable savings products. These savings are used as collateral for loans and members are not allowed to withdraw them as long as they are members of the SACCO. The withdrawable savings products are mostly contractual, such as Christmas and school fees savings. Most of these are withdrawable at the end of a specified period because they are used mostly for life cycle needs, such as children's education, weddings, lobola[47], holidays, deaths etc. These types of savings are usually withdrawn at the end of the year, after 6 months, or even quarterly. There are very few SACCOs that offer savings products that allow for members to make regular or daily withdrawals.

As a matter of policy, members of the SACCOs make compulsory minimum savings to the SACCOs. These savings form part of the non-withdrawable savings and are made monthly by the members. While each SACCO sets its own minimum monthly savings, a member can decide to save a larger amount.

As a result of these savings products, SACCOS in Swaziland are able to mobilise sufficient funds to offer loans to their members. Most SACCOs do not rely on external borrowings to finance loans. There are very few SACCOs who occasionally run into liquidity problems. In fact, a few savings and credit co-operatives have found themselves over liquid because the uptake for loans from members sometimes does not match the level of savings mobilization.

SACCOs in Swaziland have a culture of ensuring sound returns to pay optimal dividends to their members. Dividends paid to members range between 5% and 12%. This is higher than the rates paid by commercial banks and other financial institutions and has given the SACCOs a competitive edge.

Loan Products

Since most of the savings products offered by the SACCOs in Swaziland are non-withdrawable, members usually use them as collateral for loans. Loans are taken by members to finance short- and long-term needs. Leaders of SACCOs have to have a high level of knowledge in credit management to ensure that good loans are given to members and that delinquency is reduced. The loan products are priced lower than the commercial banks and this has also given the SACCOs a competitive advantage.

Larger SACCOs are able to offer loans up to R 400 000. Short-term loans start from as little as R 100 paid over 1 month to up to R 2000 depending on the SACCO. All loans payable within 12 months are taken as short-term loans and they do not require any security. These loans are very popular in both rural and urban SACCOs.

Mid-term loans are loans that are payable over a period of12-36 months. Mid- and long-term loans require savings as collateral and the maximum loan amount is often a multiple of the value of savings held with the SACCO. These loans are used to finance household activities, important events such as weddings, house renovations or extensions, furniture, businesses, loan consolidations, vehicle repairs, lobola and sometimes children's education.

Some SACCOs in Swaziland are now able to offer large loans which are mostly used for asset financing. Members of SACCOs have taken long-term loans to buy cars, build houses and to start businesses. All long term loans require collateral. For loans taken to build or buy a house, the house itself is sometimes used as collateral.

[47] Lobola is a traditional southern African custom whereby the man pays the family of his fiancée for her hand in marriage

It was noticeable that business loans are not a popular product in Swaziland. This is a result of the lack of capacity to correctly appraise business loans and the responsibility to monitor the business activities to ensure that the business remains viable until the loan is fully paid. A few SACCOs offer business loans if the repayment comes from salary as opposed to income from the business.

Over 90% of the SACCOS in Swaziland offer funeral insurance. This is one of the most popular products which most SACCOs underwrite with external insurance companies. In some case, these products have assisted SACCOs to increase their membership.

General observation on products

One of the strengths of the movement in Swaziland is that almost all SACCOs encourage non-withdrawable savings. Members of the SACCOs are happy to make non-withdrawable savings as they build the base to access loans, using the savings as collateral. These savings also build wealth for members, and, in some cases, contribute to the dividends they receive each year.

There are a number of large public sector employer-based SACCOs in the country, and the government has allowed for payroll deductions for SACCO loan repayments and savings. This has kept delinquency at very low levels. However, the government is currently looking into outsourcing this function to an external service provider, which will create additional costs for these SACCOs. Many SACCOs are concerned about this.

However, there are a reasonable number of SACCOs that do not have the facility to have SACCO monies deducted from source. Interestingly, these SACCOs have also enjoyed equal success in keeping delinquency rates low by using a stop order or a debit order deduction from the banks. This is possible because almost all SACCO members have a bank account in addition to their SACCO membership and SACCOs make sure that members give the correct details of their salary payments to avoid members withdrawing all their funds from the bank before the SACCO stop order is paid. A few banks in Swaziland offer a facility where the SACCO pays a small fee to have its SACCO stop order payment prioritised by the bank.

The Swaziland experience also demonstrates that SACCOs are not for low income earners only. Their flexible nature has attracted interest from all members of society, including high income earners. Managers of big institutions use SACCOs to take advantage of the high returns on savings products and low interest rates on loans. However, it was noted that SACCO members cannot rely on the SACCO as their only financial intermediary. This is because the SACCOS are still not at a level where they can cater for all the financial needs of their members.

SACCOs are facing increasing competition from banks in Swaziland, with banks offering similar products to SACCOs, as well as a number of innovative products, such as debt consolidation. Most members of SACCOs do also have bank accounts. However, SACCOs are considered as valuable players in the financial system in the country, particularly because of their value proposition of ownership, member voice and flexibility.

7.3.2. Technology

Like many African countries, Swaziland has struggled to implement a loan management system that caters for all the needs of SACCO members. Some large SACCOs have tried a few off-the-shelf products, which have brought little or no success. One member of the SACCO movement has developed a loan management system that seems to provide good loan management services. The system is also able to produce statements for members for both their loan and savings products. Most SACCOs have adopted this system and they are happy to use it in the absence of any better system.

It is the dream of the SACCO movement to eventually get to a level where they can have technology that will allow for the issuance of bank cards and connectivity to Automated Teller Machines (ATM) in order to compete fairly with other financial institutions.

7.4. ASSESSMENT OF THE LEGISLATIVE AND REGULATORY ENVIRONMENT

Co-operatives provide an important financial service in Swaziland, and a large number of people save and borrow with these institutions. With the shift to the Financial Service Authority Act of 2010, and the planned SACCO-specific Bill, Swaziland is following the global trend to develop CFI-specific laws and regulations that shift responsibility away from generic co-operative development departments.

The enactment of the FSRA Act in 2010 was a significant development in the Swaziland insurance and broader financial sector. It was created to integrate the regulation of all non-bank financial services providers, as defined in the Act, under one umbrella regulator. The intention is that FSRA will remove fragmentation and set the basis for the levelling of the playing field across different types of providers according to a consistent set of rules and standards.

The move to more financial sector-oriented and SACCO specific legislation for financial co-operatives should lead to more transparency and standards in the sector. It appears that the FSRA does not envisage any delegated supervision, for example from SASCCO, and will do this directly. This can be a costly exercise when there are 70 SACCOs that require supervision and monthly returns analyses. Taking the low level of financial reporting of the primary CFIs into account, to include these in a standardised framework will be a complex task.

SASCCO and the Commissioner have faced a number of challenges with data collection and evaluating its financial performance to date. This might therefore be a challenge for the new FSRA and SACCOs may require significant capacity building to be able to fulfill their reporting requirements. Though guidelines have already been drafted to support SACCOs in providing this data, the implementation will most likely be difficult. Whether SASCCO can play a role in this remains to be seen.[48]

Having been unregulated since the formation of the SACCO movement, the SACCOs in Swaziland are not very comfortable about what the new regulation will mean for their existence, operations and ability to enjoy a service that has helped them for so many years. The majority of the SACCOs have expressed concerns that they were not adequately involved in the legislative development process and that there was not enough consultation to create awareness of what the regulation will entail. SACCOs do understand the need and benefits of regulation, but there will be a period of adjustment to the requirements of regulation and the fees and levies associated with it. There is still a need to continue educating members about the legislation, its importance and how it will bring integrity to the financial co-operative sector.

[48] The new legislation does not specify a role for SASCCO

A SACCO specific bill is still waiting to be passed. It will be of paramount importance to ensure buy-in and acceptance of the Bill from SACCO members, and for the allocation of responsibilities among the different authorities to be clearly resolved.

Consumer protection framework

The Finscope Consumer Survey for Swaziland in 2011 found that there is considerable imbalance of power between consumers and credit providers, consumer education levels are frequently low, and consumers are poorly informed about their rights and are unable to enforce such rights through either negotiation or legal action. Following this, the Ministry of Finance began formulating a National Credit and Consumer Protection bill in 2011, through consultation with Finmark Trust. The Ministry of Finance published a draft Consumer Credit Bill in 2013 which will provide the general legal framework for consumer protection in Swaziland's credit sector, including SACCOs.

8. SUMMARY OF FINDINGS ACROSS COUNTRIES

Table 6: Drivers of success and challenges in South Africa

Drivers of success	• South Africa has a SACCO specific legislation which has assisted in ensuring that CFIs are regulated based on activities in the sector • The Reserve Bank is highly involved in the regulation of co-operative banks. This will go a long way in ensuring that large CFIs are not a risk to the financial system of the country. • The CBDA assists in ensuring compliance to legislation. • The establishment of the apex body, NACFISA, will go a long way in promoting CFIs in South Africa. However it will be critical that it is well capacitated and coordinated. • The establishment of capacity building within the CBDA goes a long way in attending to training needs of the CFI sector. With a bit more funding, this department could offer these services to those CFIs that are aspiring to register as CFIs. • The collaboration of the CBDA and other entities like BANKSETA and the establishment of a CFI management training programme at the University of Pretoria also assist the sector in capacity building
Current challenges	• Legacy challenges of grant-based programmes that did not operate for long enough to ensure that managers and communities were equipped to run CFIs, resulting in misaligned incentives and rent-seeking in some cases; poor management; insufficient capacity and a lack of coordination of the different stakeholders. The resulting failure of many CFIs has also affected the level of people's trust in CFIs • The majority of CFIs in South Africa use manual accounting and management information systems • There is a lack of development programmes for CFI start-ups that have not achieved the thresholds for registration. • There is a widely held view that not enough government resources are dedicated to CFIs • Financial literacy levels amongst CFI members are low and people do not fully understand the benefits of being a CFI member. South Africans are also naturally distrustful of unknown and untested financial institutions. • Public sector payroll deductions have been disallowed • There is currently nothing in place to cover members' deposits should a CFI fail

Table 7: Drivers of success and challenges in Malawi

Drivers of success	• Donor support has consisted mainly of capacity building, rather than financial support, which contributed to the establishment of a sustainable and resilient SACCO sector. MUSCCO has also operated on the principle that donor income should not be more than 33% of its income • SACCOs have been able to reach large number of economically active individuals who are situated in the informal sector and rural areas and are therefore not able to access financial services from commercial banks. • The CFI sector has grown through the formation of viable and sustainable partnerships and linkages amongst co-operatives that operate in different sections of the value chain, particularly agricultural and financial co-operatives. • MUSCCO is a strong apex body and the government recognises and continues to see MUSCCO as the guardian of a sound and safe SACCO movement. • Malawi has a financial co-operative-specific law and regulatory framework that was developed in collaboration with the sector
Current challenges	• There is a lack of appropriate skills amongst members of the governance structures of SACCOs, which is a symptom of a skills shortage nationally. SACCOs are also often not able to afford appropriately skilled staff • Manual systems that are still being used by many of the organisations as the cost of activation of computerised systems is too high for many SACCOs • The CFI sector is exposed to different types of agricultural activities and is thus vulnerable to changes in commodity prices and other market dynamics. • The non-remittance of payroll deductions by government departments to SACCOs and other microfinance institutions to date poses a risk to the financial stability of a number of SACCOs • MUSCCO does not have a reinsurance mechanism in place, and in the event of a strike of an idiosyncratic risk, this could threaten MUSCCO's stability.

Table 8: Drivers of success and challenges in Swaziland

Drivers of success	• SACCO products are consciously not designed to cater for low income earners only. Members who benefit from SACCOs range from low income earners to middle- and upper-class class members of society. • The major savings made by the SACCO members are non-withdrawable. This has assisted in mobilizing a lot of savings and these savings are used as collateral for loans. These savings also build wealth for members, and, in some cases, contribute to the good dividends they receive each year. • All members of the SACCOs are expected to make compulsory minimum savings to the SACCOs each month. These savings form part of the non-withdrawable savings. This drives the understanding from members that success of a SACCO hinges on aggressive savings mobilization. • Most SACCOs are formed within government departments, state owned enterprises and the private sector according to their professions. This allows for salary deductions for both savings and loans repayments. • The government allows for payroll deductions from source. • A number of the larger, more developed SACCOs in Swaziland are beginning to open their bonds, giving them the opportunity to increase membership and reducing the effect that job loss, employer losses, movement and retirement can have on membership numbers. • SACCOs have kept delinquency rates low by using a stop order or a debit order deduction from the banks. This is possible because almost all SACCO members have a bank account in addition to their SACCO membership.
Current challenges	• The move to more financial sector-oriented and SACCO specific legislation for financial co-operatives should lead to more transparency and standards in the sector, but the direct regulation will most likely be a costly exercise. • There is a low level of financial reporting of primary CFIs, and including these in a standardised framework will be a complex task. • SACCOs have expressed concerns that they were not adequately involved in the legislative development process and that there was not enough consultation to create awareness of what the regulation will entail.

9. BUILDING NATIONAL CFI SECTORS - OPTIMAL STRATEGIES

In addition to the seven co-operative principles, co-operatives are driven by a spirit of self-determination. Yet co-operatives are also known to be effective structures for socio-economic development, developing leaders and strengthening the practice of democracy. In view of their core characteristics and the range of potential benefits, the question of how best to catalyse their development is complex. When international agencies or governments choose to promote co-operative development, what are the best ways of promoting co-operatives and at the same time enabling people to co-operate and build democratic structures?

In the context of developing countries, this becomes even more complex. How should promotion be managed when people have not had experience or knowledge of how co-operatives work or how to set them up? We have discussed the following areas that contribute to building national CFI sectors:

1. Promoting and the model and building the sector from the bottom up
2. Structures of CFIs
3. Integrity and financial integration of co-operatives
4. Structural Needs at Country Level

Promoting and the model and building the sector from the bottom up

The importance of placing decision-making and leadership at the level of the co-operative is recognised in the ILO's Standards for Co-operatives which recommends,

"The promotion and strengthening of the identity of cooperatives should be encouraged on the basis of:

a) *"Co-operative values of self-help, self-responsibility, democracy, equality, equity and solidarity; as well as ethical values of honesty, openness, social responsibility and caring for others; and*

b) *Co-operative principles as developed by the international co-operative movement."*

A clear strategy which facilitates informed choices by group members rather than "doing" or "deciding" is essential if the promoters are to facilitate sound independent structures that survive the exit of an external organisation.

Box 4: Case study - Malawi Lake Basin programme

A successful example is the case of the Malawi Lake Basin programme, a project run by MUSCCO and We Effect (formerly the Swedish Co-operative Centre) with the National Association of Smallholder Farmers and the Farmers Union. Firstly, materials on co-operatives were circulated in the target districts and interested people were requested to organise themselves into 'study circles'. From that starting point 'study circles' were created to learn about better agricultural methods as well as building a culture of savings to finance their new ventures. The principle at the heart of the development processes for these co-operatives was to expose people to the model, and when they indicated interest and initiative, the project supported them with learning and training about methods and structures. With materials to support their learning, the project staff then operated as facilitators rather than leaders, leaving decision making to the elected office bearers of each co-operative.

In situations where people have had little exposure to co-operating and are constrained by skills or literacy, interim phases of development may be necessary. For example, in the Malawi

Lake Basin Project, people are trained to run smaller savings and loans groups before they are introduced and supported to expand to larger SACCOs. In this building process, members build financial literacy and management skills gradually. The groups of savers and lenders are members of the SACCO and individuals may also become members of the SACCO. Such exposure enables people to learn and to participate in both levels of structures as and when they are ready.

On the other hand, while members are learning and implementing new farming methods, people also learn about establishing and running co-operatives for purchasing inputs and selling produce. The methodology used in the Malawi Lake Basin Project illustrates that partnerships are one of the fundamental basics for building a successful co-operative movement. In this case MUSCCO, We Effect, the National Association of Smallholder Farmers and the Farmers Union all contribute in their specific areas of expertise towards holistic development.

Slightly different from other co-operative sectors, one of the vital success factors for CFIs is the ability to build scale. While smaller co-operatives may work for production, purchasing or marketing, scale is essential for the success of financial co-operatives, in terms of members, deposits and loans. In one case in South Africa, the manager of a CFI claimed that 1000 members were needed in order to break even; however, this is dependent on the level of savings that is manageable per member.

Structures of CFIs

A key aspect of co-operative operations is establishing functional structures. While accumulating sufficient savings before they can on-lend, there is time to build structures and create policies for the operations of the co-operative.

While structures and their roles can be country specific (either determined by the apex body or government policies), the most common structures are as explained below. At minimum a financial co-operative will need the following structures

- General Assembly;
- Board of Directors;
- Set of Officers;
- Committee System; and in time the CFI will also need,
- Hired management/paid employees.

A General Assembly is the highest policy-making body of the co-operative and is the final authority in the management and administration of the affairs of the co-operative. It is composed of members who are entitled to vote, duly assembled and constitute a quorum.

The General Assembly has some exclusive powers, which cannot be delegated:

- To determine and approve amendments to the articles of co-operation and by laws;
- To elect or appoint the members of the board of directors, and to remove them for cause;
- To approve developmental plans of the co-operative; and
- Other matters requiring a 2/3 vote of all the members of the general assembly.

The Board of Directors is the body that formulates policies, directs, supervises and manages the business of the co-operative. It is generally composed of five to fifteen members elected by the general assembly. Their term of office is determined by the laws of the co-operative.

All regular members who meet the qualifications set by the laws of the co-operative can be elected to the board of directors. In the case of a CFI the roles of the Board and governance practices are key to growth and survival of the CFI, hence the need for skills and standards for regulation and supervision to maintain the integrity of the CFI.

Integrity and financial integration of co-operatives

Despite the fact that fundamentally, financial co-operatives had their roots in social change and increasing access to financial services for marginalised groups, as the institutions grow, they must try to ensure the safety and security of members' savings. Further, as CFIs have grown in stature and become more integrated into the financial systems of countries, compliance with regulation and supervision has also become necessary, and thus, minimum standards governance, internal controls, safety and soundness and for monitoring and evaluation of CFIs are promoted by WOCCU.

Governance tends to be one of most challenging areas in CFIs and also one of the most critical for maintenance of the integrity of the CFI. As CFIs are governed by members, the skill levels available among the group are critical. While training is essential, it is also necessary to make sure that boards are trained and re-trained regularly as elections and rotation takes place. The key areas where boards have to be competent and perform include:

- Employing and ensuring management of the CEO and a team;
- Ensuring that governance and supervision policies are adequate for the CFI;
- Devising, monitoring and revising corporate strategy including budgets and business plans;
- Ensuring appropriate risk policies;
- Setting and monitoring financial and performance benchmarks; and
- Reporting to members thereby ensuring accountability and transparency

Even with support from apex organisations, there is still a need for practices in each CFI which will ensure that funds are safe. These are internal controls, which include mechanisms, policies and procedures used to minimise and monitor operational risk, and include accounting and administrative controls.

This suggests that if CFIs want to maintain their position on the financial landscape, their internal management practices have to be on par with other formal financial institutions. It also suggests that the skill levels of staff have to be at levels of capability to implement the procedures accurately.

Beyond the controls that are necessary, other safety and soundness practices also need to be established in policy and practice:

- Regular tracking of delinquency to reduce and manage loan losses
- Policies for loan loss provisioning that will ensure safety of members' savings
- Capital adequacy – WOCCU recommends maintaining 10% of assets in reserve whereas the Basel Accord recommends 8%
- Minimising non-earning assets such land, buildings etc.

- Maintaining liquidity by ensuring a minimum of 15% of savings in easily accessible instruments and accounts
- Maintaining efficiency in operating costs so that loans can be priced competitively, and
- Diversify loan portfolios to minimise risk.

Clearly, operating a CFI requires broad ranging, in-depth skills and ability to instate and adhere to policies that will maintain safety and grow the financial assets of the members. In order to enable CFIs to implement the standards which have been set internationally through regular monitoring, a tool has been devised which summarises the standards outlined above into ratios and indicators. The tool is titled PEARLS. It is used to measure and monitor:

- **P**rotection – loan losses, delinquency, write-offs and solvency
- **E**ffective Financial Structure – extent of income covering costs, paying market level interest rates and covering capital adequacy
- **A**sset Quality – proportions of losses to total portfolio and non-earning assets to total assets
- **R**ates of return and costs
- **L**iquidity
- **S**igns of growth – increases and declines in member numbers and performance show member satisfaction and suitability of products for member needs.

With all the ratios and its comprehensive set of measures PEARLS is also used as a supervisory tool when CFIs graduate to being banks or indeed where CFIs simply want to maintain sound performance. This is a tool advocated and developed by WOCCU. Other international technical service providers, such as DRGV, CCA, and Rabobank track similar data and use similar monitoring systems to analyse CFI performance.

The range of practices outlined here reflects the necessity for systematic performance enhancement, training and monitoring at institutional and country levels if CFIs are to move into and maintain a place in national financial systems.

Structural Needs at Country Level

As CFIs grow in size and distribution the role of supervisors and regulators becomes key to the integrity of the sector as illustrated above. Central Bankers usually enter the CFI sector later in their development and apexes often play a major role in maintaining prudential standards.

Apex organisations should also play a key role in supporting sound governance. They should hold training programmes available when new board members are elected. Apex bodies also work with member CFIs in defining job descriptions and human resources policies. In some cases apex organisations also perform a range of functions that reduce the burden on individual CFIs such as product design, systems for financial management, design of data collection practices, and linked IT systems.

The range of functions of MUSSCO in Malawi is illustrative of these roles:

- "Technical Assistance support services: bookkeeping, accounting systems support; business planning and budgeting; policy formulation and promotion; SACCO linkages; SACCO education programs design; SACCO management and leadership training; ICT in SACCOs; general inspection and supervision of SACCOs, auditing and other consultancies;

- Central Finance Facility (CFF): share accounts; deposit accounts (ordinary, fixed or Liquidity) and credit facilities for agricultural lending and other revolving financing services;

- Advocacy and Lobbying and representation support: nationally and internationally. It is through this function that SACCOs' benefits to members and impact in the communities where they operate are made known world over.

- Insurance services to all member SACCOs covering their member loans and savings: SACCO Financial Protection Plan (SFPP) protects SACCO member savings and loans."

When considering the variety and comprehensiveness of these roles, a puzzling quandary is presented - which can and should be developed first – CFIs or apexes? Clearly there are no fixed formulae for such development processes especially as structures evolved in different ways in different places.

In a number of countries such as Kenya, the UK, Spain and Peru, formal educational institutions and programmes have been established for co-operative education. Given the range of areas of management and roles that CFIs and their support structures have to play, continuous learning is a necessity for developing the sector and maintaining standards of performance.

In addition to the learning programmes at country level, a range of structures (including WOCCU, the CCA and the ILO) exist and have learning tools and resources for CFIs. These are available through comprehensive development programmes or as specific programmes per area of learning.

10. THE POTENTIAL ROLE OF TECHNOLOGY FOR CFIS

A number of key developments in the financial services sectors in developing countries have resulted in more and more financial institutions engaging in innovative practices and technologies in order to maintain and grow their market shares.

Box 5: M-Sasa in Kenya

In Kenya, the rollout of agency banking in 2010 assisted many commercial banks with spreading into rural areas, which had previously been difficult and expensive to access. As such, the markets of many non-banking financial institutions in these areas have come under attack and the institutions are, as a result, rolling out a number of innovative mechanisms in response. For example, in order to widen the range of its services and lower transaction costs and thus protect its customer base, the Meru Farmers SACCO has upgraded its technology, including successfully adding mobile banking service M-Sasa to its service offering. This allows customers to deposit, withdraw money, make balance enquiries, and service their loans without going to the banking hall.

Box 6: FLASH Mobile cash in South Africa

In South Africa, FLASH SACCO, a rural home shop owner credit and savings co-operative, has contracted FLASH Mobile Cash to support transactions between members and between members and their SACCO. FLASH is, to our knowledge, the only primary co-operative using a model of this kind in South Africa.

The common bond between members of the SACCO is that they are all Take-it-Eezy home shop owners or their families. However, non-members who purchase a FLASH enabled SIM card are eligible for membership to the SACCO, and can operate as ATMs (home shop owners), wholesalers and/or end-users (home shop clients). Since its inception in October 2009, FLASH SACCO grew from 200 to 2000 registered members in December 2010 with assets of over R5 million.

The FLASH SACCO account is held with ABSA Bank, which provides the SACCO access to the national payment switch. The mobile technology allows FLASH SACCO to manage wholesalers, ATMs and end-users' mobile wallets and can distribute loans, savings and transfers of funds to and from members and non-members. FLASH Mobile Cash allows co-operative members direct access to either sell airtime, electricity or insurance to non-members, or purchase for their own consumption. It also allows individuals to pay third-party post-paid accounts, such as Woolworths and DSTV.

Thus far, the focus of research into the role of mobile and information technology has been largely limited to agricultural co-operatives. However, given the case studies mentioned above, this is an important field that is highly relevant to financial co-operatives, particularly in rural areas, where access to formal financial services is low. Of particular interest is how these types of initiatives can be structured so as to reach adequate scale and thus, sustainability.

11. BEST PRACTICES

Based on our research in each of the three countries above, as well as a review of global literature on financial co-operatives and developed and developing country experiences, we have distilled a set of best practices that apply to a strong and sustainable CFI sector.

CFI value proposition

The Malawi case demonstrates that there are cases where rural access to financial services is a challenge and a CFI provides one of the few opportunities for individuals in these areas to access certain products and services. Certain individuals may also be excluded from the formal financial system based on their credit history or income source and CFIs then become an alternative to commercial banks.

However, given that in South Africa and Swaziland most CFI members also have bank accounts, CFIs should be viewed not as an alternative to commercial banking, but as one option or opportunity out of what should be an inclusive mix of financial institutions that provide appropriate financial tools based on people's needs. CFIs should be seen as drivers of financial inclusion, meaning financial empowerment, through the promotion of improved financial capability and financial freedom.

In light of this, CFIs should therefore be seen as not just options for low income individuals but for the entire population, and which offer a particular value proposition. This value proposition centres around the essential elements of financial co-operatives, which are ownership and control, and the creation of self-managed savings-led financial services that provide education to members, elected representatives and employees. The main purpose of CFIs should be to benefit members rather than to maximise profit, while still operating as sound businesses.

An important element of this is to champion this value proposition that the CFI model offers. This requires both the promotion of examples of successful CFIs and the identification of individual “champions” or leaders in the sector that share their knowledge and experience and encourage other co-operatives to adapt and develop.

Major stakeholders

The relationship between governments, aid agencies and financial co-operatives is a complex one. They depend on each other, but the relationship is fraught with difficulty. It depends on the ability of governments to strengthen and regulate CFIs without overloading them, and on the ability of the international development community to have patience and allow co-operative systems time to mature naturally. Donor projects should be sanctioned if they are not going to guarantee an exit strategy when CFIs can maintain prudential standards and are effectively regulated. The state should play a role in setting and maintaining standards, but should build sound, strong and strategic partnerships with the other relevant stakeholders in the sector that are responsible for capacity building, support and promotion of CFIs.

The apex body should be seen as a strong vehicle for the support and promotion of the sector, and it is essential for the self-sufficiency of the apex to be maintained.

Products

CFIs should focus on savings-led, asset-building financial services offering that is competitive with alternative financial institutions in terms of price, flexibility and security.

As the Malawi and Swaziland cases demonstrate, leveraging existing structures, such as employers and existing functional multi-purpose co-operatives, can be an effective way to build a critical mass of CFI membership. An important element of this is understanding when members receive their salaries/income and adjusting payments around this timing.

Skills and capacity

Systematic performance enhancement, training and monitoring at institutional and country levels is essential if CFIs are to move into and maintain a place in national financial systems. CFI boards and staff members should therefore be trained and re-trained regularly and CFI knowledge transfer, within the sector and countries, should be encouraged.

Given the low levels of financial literacy in sub-Saharan Africa, and lack of awareness of the CFI sector, education, which is one of the core co-operative principles, on both personal financial management and the benefits of CFIs, along with demonstrable examples of highly successful CFIs, is critical to growing a strong and sustainable CFI sector.

A transition from manual to computerised systems contributes to developing the CFI sector, and in ensuring that data is accurately recorded and can be easily validated. This also requires a certain amount of upskilling in the CFI sector and a sound judgement of the correct time for this to be implemented, given the level of development of the sector.

Appropriate legislative, regulatory and supervisory framework

Financial cooperatives need a **clear legal foundation**, **appropriate regulations**, and **effective supervision** to function and grow sustainably. Appropriateness of regulation and supervisory arrangements vary with the size and volume of operations of financial co-operatives.

The **legal framework** for financial co-operatives plays a double role. The legal framework governing CFIs should empower them, enable their development and encourage outreach towards their target population. At the same time, the law has to ensure that financial sector rules are appropriately applied, particularly to protect owners and depositors against poor financial management.

In many countries, this role is recognised by bringing financial co-operatives under more than one law:

- Banking law: regulates the co-operative banks liquidity, solvency and risk management

- General co-operative law: regulates the use of surpluses and the constitution of reserves

- Financial Co-operative law: regulates everything else, including the governance and role of the apex organisations.

The legal framework may evolve over time and it has an important role in promoting growth of a co-operative financial system. Step-by-step development can be cumbersome, but worthwhile. At some stages of development of a financial co-operative sector, lifting restrictive legislation can be appropriate for CFIs in the early stages of development, and may be the most important step in promoting growth.

Also important is the legal framework for the financial sector as a whole, for example laws on property, bankruptcy laws, enforcement legal and social legitimacy.

Regulation and supervision are critical to the sustainability and growth of financial co-operatives. There is a public interest function to ensure solvency, to protect depositor funds and to ensure stability of the financial system. In order to ensure that the public interest is protected and that CFIs carry out their fiduciary responsibilities, regulation and supervision are needed. The details and areas to be covered are well documented by international bodies promoting financial co-operative development, such as WOCCU, DGRV and ACCOSCA, and as such will not be repeated here. Importantly, the following areas need to be considered when drafting a regulatory and supervisory framework for financial co-operatives.

Regulation addresses financial risk by requiring maintenance of prudential norms:

- Ratios for liquidity
- Equity to liabilities
- Provisioning of non-performing assets
- Range of products
- Collateral requirements (non-traditional)
- Rules to prevent concentration of credit risk in one sector, concentration of shares or deposits or loans in the hand of a few members
- Deposit insurance

Regulation also addresses governance risks, such as:

- Minimum qualifications of board members
- Fiduciary responsibilities of the board
- Audit requirements

There are International Credit Union safety and soundness principles, but there is still a long way to go before these are accepted worldwide. These include set standards for delinquency, loan loss provision, write offs, institutional capital, non-earning assets, liquidity and many more. Whether Basle II or even III should be applied by financial cooperatives is strongly contested and for the majority of the CFI sector, especially in Africa, believes this is too ambitious at this stage.

In general regulation should remain simple (at least initially) and not so detailed as to prevent the development and growth of CFIs. As financial co-operatives grow, regulatory requirements become more complex. There is still a large and risky gap in regulatory standards in many countries.

In order to ensure that financial co-operatives are adhering to the regulatory standards, virtually every country provides for external **supervision**. There are four types, which to depend on the country context and is a trade-off between cost effectiveness and risk:

- Direct supervision (public regulatory authority e.g. Central Bank, Ministry of Co-operatives
- Auxilary supervision (supervisory responsibility with a mandated government agency, but allows an apex body or an auditing firm to carry out the supervision)
- Delegated supervision (Central Bank or mandated agency fully delegates supervision to a private agent, such as a co-operative federation)
- Self-regulation (a federation of co-operatives performs control functions on a regulatory framework and monitoring processes are voluntarily accepted by the co-operatives.

Yet in many cases, financial cooperatives go essentially unregulated.

Although direct supervision is ideal, it is costly and often ineffective. Where financial co-operative are essentially banking institutions, they are usually supervised by the Central Banks as well as co-operative banks. Where financial co-operatives are supervised by the government's co-operative department, these departments may not apply the best practice audit standards to financial co-operatives. Self-regulation also presents several problems because this requires a legal mandate and significant capacity building. In some cases there may be too much supervision which can cause confusion, lead to multiple reporting requirements and dilute the impact of the supervision effort.

In general, indirect supervision (auxiliary or delegated) is often used for smaller, closed CFIs, while large and open CFIs are placed under banking authority supervision. Indirect supervision creates a bridge for the subsequent progressive integration of financial co-operatives into a supervision environment that uses general financial sector standards.

Clarity on the powers and duties of CFIs, and on regulatory and supervisory responsibilities is important, regardless of whether one law or several apply. Legal frameworks should evolve with the growth of the CFI sector. Regulatory requirements should reflect both the degree of complexity and degree of risk and should be accompanied by a supervisory arrangement that works and is cost effective. A specialised regulatory framework with a tiered supervisory regime appears to be a good practice.

It is important to note that the fundamental differences between banks, CFIs and microfinance institutions requires different legislation and regulation for consumer protection and appropriate operation and function. In the case of CFIs in particular, because members are owners, which brings some inherent challenges, such as agency problems reflecting in governance issues, and which need to be dealt with in the regulatory framework.

12. RECOMMENDATIONS FOR FINMARK TRUST

This research has shown that CFIs are institutions with significant potential for:

- Increasing financial inclusion and empowerment through democratic mechanisms
- Creating financial products and services that can better serve members than a range of other financial services for specific purposes
- Building skills and leadership among members and in the communities and groups who choose to participate in CFIs
- Link community financial services into the mainstream and build services that work for increasing incomes and for community upliftment
- In certain instances, better protection of members than other services that may be available

Some of the pre-conditions which promote the development and sustainability of CFIs include:

- Communities and groups that are keen to build and run democratic structures that work in the interests of the group
- Groups wanting to learn and change with strong values and a spirit of self-determination
- Groups and leaders who are willing to give time and effort into learning, building and maintaining CFIs at primary, secondary and tertiary level.

Against this background of opportunities and challenges, where CFIs work, they are beacons of empowerment. The reality is however; that to be successful, CFIs take significant levels of effort and commitment, this is particularly true when a sector is growing and when awareness and understanding is weak

In view of these Finmark Trust is well placed to consider the following potential avenues that will continue to support the growth of the CFI sector in the SADC region and southern Africa:

1. Identify particular case studies on successful examples of CFIs and details on their operational, governance and financial structures as well as their growth strategies that can be used as a 'guide' or 'toolkit' for others to learn from and apply.

2. Publicise the ILO standards for co-operative development which reflect the ways of building community leadership and social and economic development, and some guidance on contextualisation within the southern African context.

3. Encourage appropriate government stakeholders to commit to and promote the development of CFIs within each country, this includes appropriate financial and human resources to do so effectively. FinMark could potentially support some specific activities, such as the implementation of the banking platform for CFIs in South Africa.

4. Encourage and support CFI apex bodies and governments to create and promote incremental standards at country level that allow for stages in development of CFIs that build skills and awareness while minimising risk.

5. Develop sub-Saharan African contextualised materials/technical resources that can be used to support CFIs, including governance arrangements, operations and procedures. It is important to first ascertain what materials exist before anything new is developed. Materials development should be done in partnership with apexes to ensure they will be used and meet the needs of the sector. This includes prior consultations with apexes to ascertain what their priority needs are.

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