THIRD-TIER BANKING REPORT

A review of the capacity, lessons learned and way forward for member-based financial institutions in South Africa

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Final

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PREAMBLE

ECI*Africa* was commissioned by the FinMark Trust to execute this study. Jan Schoeman, in his role of being a part of the sector for such a long time, did most of the fieldwork and data gathering and wrote the background reports. Rudolph Willemse took primary responsibility for the work on legislation, regulation and supervision. Gerhard Coetzee wrote most of the summary report and facilitated the study (and ensured that the discussions were lively but focused).

The lessons learned and the way forward are a joint effort by the three principal researchers and two groups of people who took part in discussions on the findings of the study, and on what it means for improving access to financial services for the poor in South Africa. We interacted with many people who all welcomed the initiative, and this provided for interesting discussions and much information. In many instances the data were also part of our institutional memory.

All three researchers are dedicated to bringing out change in the access to retail financial services for poor people in South Africa, and to the eventual integration of this focus in the overall financial market. This study gave us the opportunity to work in an area which we believe in and with which we are fascinated.

Jan Schoeman Gerhard Coetzee Rudolph Willemse

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LIST OF ABBREVIATIONS AND ACRONYMS

ABC	Agricultural Business Chamber
ABSA	Amalgamated Banks of South Africa
ACDI/VOCA	Agricultural Cooperative Development International/Volunteers in Overseas Cooperative Assistance
AFRACA	African Rural and Agriculture Credit Association
ASCA	Accumulating Savings and Credit Association
BBS	Bophuthatswana Building Society
CCA	Canadian Cooperative Association
CCUL	Cape Credit Union League
CDC	Cooperative Development Centre
CIDA	Canadian International Development Agency
CIPRO	Corporate and Intellectual Property Registration Office
COSAB	Council of South African Banks
COSATU	Congress of South African Trade Unions
DBSA	Development Bank of Southern Africa
DFID	Department for International Development
DGRV	Deutscher Genossenschafts- und Raiffeisenverband
DTI	Department of Trade and Industry
FAF	Financial Aid Fund, South African Sugar Association
FINCA	Foundation for International Community Assistance
FNB	First National Bank
FSA	Financial Services Association
FSC	Financial Services Cooperative
ICA	International Cooperative Alliance
IFAD	International Fund for Agricultural Development
IGPSA	Income Generation Projects for South Africa
ILO	International Labour Organisation
IMALI	Improved Microenterprise Access to Liquidity
MFRC	Micro Finance Regulatory Council
NAFU	National African Farmers' Union
NASASA	National Stokvel Association of South Africa
NCASA	National Cooperative Association of South Africa
NDA	National Department of Agriculture
NEDLAC	National Economic Development and Labour Council
NGO	Non-Governmental Organisation
RDP	Reconstruction and Development Programme
ROSCA	Rotating Savings and Credit Association
SACCO	Savings and Credit Cooperative
SACCOL	South African Credit Cooperative League
SAWA	South African Women's Association
SEF	Small Enterprise Foundation
SMME	Small Medium and Micro Enterprises
USAID	United States Agency for International Development
WOCCU	World Council of Credit Unions

EXECUTIVE SUMMARY

Financial intermediation, and especially the retail finance offering to the poor in South Africa, are indeed topical issues. While current efforts are focused on integrating these financial services into the broader financial market, and on ensuring that market-driven approaches are followed, they still have the potential to exclude large numbers of clients from the network. These clients could be those in remote areas not served by the commercial financial institutions, or those in urban areas without access to formal financial services.

The need and potential for an informal tier to the banking system have long been recognised by South African bank regulators. As early as 1994, an exemption to the Banks Act (No. 94 of 1990) allowed common bond organisations to take deposits under certain conditions. These included the requirement to be part of a recognised self-regulatory umbrella body, such as the South African Credit Cooperative League (for savings and credit cooperatives or credit unions) or the National Stokvel Association of South Africa (for stokvels). Housing clubs and stokvels acting as burial societies were exempted from these conditions. Later, further exemptions were promulgated, which made way for financial service cooperatives or Village Banks, with similar requirements of membership of a self-regulatory body. Substantial amounts of donor aid have been applied in the establishment of the Financial Services Association (FSA) and FINASOL, as well as the expansion of the Financial Services Cooperatives (FSCs) programme.

At present, however, there is an atmosphere of considerable disillusionment with and uncertainty about the existing FSCs, largely due to the collapse of two of the umbrella bodies, the FSA and FINASOL, and lack of clarity regarding the future regulatory structure or funding of the sector. Nevertheless, the third tier is still seen as an important potential solution, both by policy makers (as represented in the NEDLAC Financial Sector Summit Declaration) and by formal banks, as shown in the recent Interbank Project, which recognises the need for such institutions and for formal banks to relate to them.

The objective of this project is to document accurately and succinctly the development of the third-tier banking sector since the first exemption notice, including explicitly the reasons for the collapse of the FSA and FINASOL and the lessons arising from this. An appropriate framework for the future development of the sector is also proposed. This report reflects the history of the different institutions – based on interaction with all member-based financial systems in South Africa – and the reactions from these institutions to a draft report presented to them.

The report raised a number of lessons, which fall into in three categories: findings on the demand for financial services provided by member-based financial institutions, core lessons from the experience with supporting and facilitating institutions; and lessons regarding legislation, regulation and supervision.

Demand for member-based financial institutions

- The current volume of transactions and membership figures indicate that a large proportion of both the rural and urban population deals with member-based financial institutions.
- There is an estimated potential of at least 1 500 formal member-based financial institutions in the rural and urban areas in South Africa.
- Being a development programme by nature, the establishment of such a network of formal member-based financial service providers cannot be achieved in the short term and provision must be made for a long-term programme of establishment.
- These institutions can provide a core range of financial services to their members.

Core lessons

- An informal financial institution such as a stokvel will not necessarily become a formal member-based financial institution.
- The establishment process of formal member-based financial institutions needs to be conducted at a pace set by the community or group concerned to ensure effective ownership and control.
- Member-based financial institutions should not be forced to render services for which they do not have the necessary level of expertise.
- Self-regulation has not been successful, partly because of capacity and funding problems, but mainly due to a conflict of interests and the lack of oversight by the Registrar of Banks in that the self-regulatory bodies were left to their own devices.
- The sustainability of member-based financial institutions is dependent on proper support with capacity building during the establishment process.
- The development of a member-based financial sector will require substantial financial commitment, skills and resources.
- Support organisations are essential in the establishment and development of membership-based financial institutions.
- Almost all member-based financial institutions are linked to commercial banks in some way; none of them, except the conventional stokvels, can operate without this link.

Lessons regarding legislation, regulation and supervision

- Self-regulation has not had the desired outcome for membership-based financial organisations in South Africa.
- It is not advisable to have the same institution providing both functions of support and regulation, as they entail conflicting objectives.
- Effective external regulation is required to ensure legitimacy, stability, growth

and continued investment.

- Commercial banks and membership-based banks require different kinds of regulatory expertise.
- Deposit insurance is an essential component of the member-based banking sector.

- On the basis of these lessons the report covers two sets of proposals, one set reflecting proposals for legislation, regulation and supervision, and the second covering the support services needed.

Proposals concerning legislation, regulation and supervision

It is proposed that new legislation for membership-based financial institutions should be developed and the existing Mutual Banks Act be amended to provide a continuum of legislation for such institutions. Informal institutions could function under an exemption of the proposed Act. Registration will depend on size (membership figures), the nature of transactions, risks assumed and the ability to manage them, the locus of management control and whether or not the entity assumes a legal personality. A phased approach to such development is suggested, in a manner that allows the gradual addition of services and responsibilities over time.

It is further proposed that a Registrar dedicated to membership-based banks be appointed. There is no clear preference for the placement of such a position; however, it is argued that placement within the Reserve Bank may be advantageous in terms of shared support and expertise and mediation in last-resort arguments. This should be clarified during the next phase of work.

Registration of the business form (the cooperative) should still be with the Registrar of Cooperatives, and with the Micro Finance Regulatory Council for doing credit business outside the limits of the Usury Act.

As support organisations are crucial to the establishment and initial support of formalised membership-based banks, it is important to ensure that these are of the right capacity and quality. These requirements could be made part of the legislation.

Proposals on support

Support required for member-based financial institutions includes a range of activities. Departing from the lesson that the establishment and formalisation of formal institutions do not occur spontaneously, the approach followed is an incremental one with different levels of involvement throughout the life cycle of the organisation. At first, the support focuses on building capacity. Later, as the organisation becomes more mature, it focuses on how to disengage support and to ensure that the organisation continues in a sustainable manner.

This phased approach is outlined in the present report.

Importantly, the study also shows that external finance is needed to establish a support service of this nature to membership-based financial institutions. Firstly, these institutions cannot afford market-priced external support during the start-up phase and, secondly, there is not enough volume in the system in terms of the number of formalised member-based financial organisations to carry the cost of a second tier (or secondary cooperative) to do this. Once there is adequate volume in the system it will be important to phase out external financial support. The criterion applied is that membership-based institutions should be owned and controlled by their members, at all levels.

These findings, lessons and proposals have been discussed and are broadly supported, by the major role players in the sector. The next phase (supported by FinMark) will determine the cost of support and legislation, and workable implementation plans will be proposed.

1 INTRODUCTION

Financial intermediation, and especially the retail finance offering to the poor in South Africa, are indeed topical issues. While current efforts are focused on integrating these financial services into the broader financial market, and on ensuring that market-driven approaches are followed, they still have the potential to exclude large numbers of clients from the network. These clients could be those in remote areas not served by the commercial financial institutions. “Not served” has a twofold meaning. Firstly, lack of access may imply that the institution is located too far away from the client, who has to bear high levels of transaction and transport costs. This is especially so in rural areas. Secondly, the actual products, services and delivery systems might not be matched to client demand. This could be a problem in both rural and urban areas.

Despite the large volume of financial transactions between member-based financial institutions and their members, this sector generally does not receive the recognition it deserves. In South Africa, a wide array of member-based structures provide financial services to their members – ranging from the informal stokvel and burial society models to the more formal savings and credit cooperatives. These entities also include registered financial service associations, which in their most formal guise are categorised as mutual banks.

The formalisation of group approaches of this nature has a chequered history in South Africa. To date, growth in the sector has been characterised by largely uncoordinated approaches to support and expansion. This lack of coordination has led to a dearth of information on and indeed confusion over the specific history, status quo and future potential of the sector. The aim of this study is, therefore, to understand not only the background and history of the so-called third-tier banking organisations in South Africa, but also current efforts to support them. From this understanding it is projected that the potential of the market can be identified and a course plotted for the future in terms of a proposed framework for support and organisation.

Third-tier banking is defined in many ways. It could imply a sequence starting with the commercial banks as the first tier, followed by limited, designated or core and narrow niche banks as the second tier, with member-based institutions as the third tier. In cooperative finance terms, a third tier is the highest version or level and is owned by all the tiers below. To ensure consistent interpretation, we refer to *member-based financial institutions* in this report, a term which implies a continuum of institutions, ranging from informal to formal. This could include stokvels, burial societies, savings and credit cooperatives, credit unions and mutual banks under the Mutual Banks Act (No. 124 of 1993.)

1.1 TERMS OF REFERENCE AND APPROACH

The need and potential for an informal tier to the banking system have long been recognised by South African bank regulators. As early as 1994, an exemption to the Banks Act (No. 94 of 1990) allowed common bond organisations to take deposits under certain conditions. These included the requirement to be part of a recognised self-regulatory umbrella body, such as the South African Credit Cooperative League (SACCOL) for savings and credit cooperatives (SACCOs) or credit unions, or the National Stokvel Association of South Africa (NASASA) for stokvels. Housing clubs and stokvels acting as burial societies were exempted from these conditions. Later, further exemptions were promulgated, which made way for financial services cooperatives (FSCs) or Village Banks, with similar requirements of membership of a self-regulatory body such as FINASOL, the organisation rendering financial services to rural communities, or the Financial Services Association (FSA). Over the years, substantial amounts of donor aid have been applied in support of the umbrella bodies mentioned above, as they were seen as a means to promote sustainable community banking.

At present, however, there is an atmosphere of considerable disillusionment with and uncertainty at the third tier, arising in large part from the collapse of the FSA and FINASOL, and from lack of clarity regarding the future regulatory structure or funding of the sector. Nevertheless, the third tier is still seen as an important potential solution, both by policy makers (as represented in the NEDLAC Financial Sector Summit Declaration) and by formal banks, as shown in the recent Interbank Project, which recognises the need for such institutions and for formal banks to relate to them.

The objective of this project is to document accurately and succinctly the development of the third-tier banking sector since the first exemption notice, including explicitly the reasons for the collapse of the FSA and FINASOL, and the lessons arising from this. An appropriate framework for the future development of the sector is also proposed.

This project has two equally important components, which are interlinked.

The first part provides an accurate record of the following:The history of the development of the third-tier sector over the past nine years, in sufficient detail to substantiate the lessons learned for third-tier institutions, umbrella bodies, regulators, donors and other stakeholders. It focuses particularly on the experience of the FSA and FINASOL, through interviews with their board and staff members, as well as the experience of financial services cooperatives or Village Banks, regulators and link-bank staff involved, and by accessing relevant documentation where available. However, the historical review does not neglect to cover the longer experience of SACCOL and NASASA.

- Proposals for a high-level, feasible framework for the development of the third tier, based on these lessons, as well as on a realistic projection of its size and scope, taking into account other initiatives such as the Interbank

Project.

The second, forward-looking component includes the following:

- A projection of growth possibilities in terms of numbers of entities, numbers of underlying members and values of deposits in different scenarios, including the removal of the barriers and with reference to the proposed dedicated bank proposal at the second tier
- An outline of key barriers affecting the growth of the sector
- An outline of an appropriate and feasible regulatory regime at a conceptual level
- An outline of the financing requirements for the promotion and development of the sector

The report structure follows the required deliverables as outlined in the terms of reference.

2 HISTORY AND BACKGROUND

2.1 INTRODUCTION

Member-based financial institutions have long been known and active in South Africa. Miracle et al. (1980), reflecting on the collective action concept, illustrate it with references to different variants of informal rotating savings and credit institutions throughout Africa, including South Africa. A 1928 publication refers to the application of the credit union concept in KwaZulu-Natal by German missionaries, and to credit union-like structures recorded around 1880. These structures are in fact well known in many countries, with one of the most famous examples being the German cooperative movement, started by Schultse-Delius and Raiffeisen nearly 180 years ago (DGRV, 1966). The common denominator in all member-based financial institutions is the power of collective action. In this section we discuss these institutions and their more formalised versions in the South African context.

2.2 ROTATING SAVINGS AND CREDIT ASSOCIATIONS OR STOKVELS

2.2.1 Introduction

A rotating savings and credit association (ROSCA) can be defined as “an association formed upon a core of participants who agree to make regular contributions to a fund which is given in whole or in part to each contributor in rotation” (Ardener, in Schrieder & Cuevas, 1992). The ROSCA is a popular group financial activity known throughout the world. Although it is mostly described in the developing country context, it is found in different forms in many communities in developed countries. A member of the ROSCA who gets the contribution early on is in the position of a borrower, while receiving contributions at the end of the cycle is more like saving. The ROSCA has several variants throughout Africa – the South African version is called a “stokvel”. Lukhele (1990), describing the history and current profile of stokvels in South Africa, explains that although the concept is quite old, the name “stokvel” originated from the gatherings of people at stock fairs (auctions) in the Eastern Cape. The stokvel is more common in urban than in rural areas. This may be due to the dispersed nature of settlements in rural areas and the more consistent cash income in urban areas.

Stokvels are informal solidarity or self-help groups that offer many kinds of services, including rotating credit and savings, funeral insurance, social occasions or parties and so forth. According to the National Stokvel Association of South Africa (NASASA), there are an estimated 800 000 stokvels, burial societies and ROSCAs in South Africa, comprising about 8,25 million adults and accounting for about R400 million a month in savings.

Stokvels have been exempted under the Banks Act under the “common bond” exemption.[1] Entities who are members of self-regulating bodies and who comply

[1] Government Notice 2173, 14 December 1994.

with the terms of exemption are excluded from the provisions of the Banks Act and therefore are allowed to take deposits from their members only. Management of the associations is voluntary; during group meetings funds are distributed and deposits taken.

Stokvels are known for their social aspect, which makes them attractive to members. In South Africa, and especially in the urban areas, the member who receives a contribution usually hosts the gathering of the group and sells refreshments and food to the others. Non-stokvel members, or members of other stokvels, are also invited. The understanding is that the receiving member reciprocates in attending future gatherings of the other stokvels, and thus in the buying of refreshments and food (Lukhele, 1990). Stokvels are more popular among women, but mixed gender groups are known to exist.

2.2.2 National Stokvel Association of South Africa (NASASA)

NASASA, a non-profit organisation, was set up in 1988 as a lobby and umbrella group to represent the interests of stokvels. It provides education and public awareness programmes to low-income communities, encouraging them to save with the self-managed stokvels. It also develops management training materials for the members of stokvels.

Members of a stokvel or other social groups can join NASASA by paying an annual fee of R30. A stokvel can be affiliated to NASASA by paying a R1 500 subscription fee and an annual renewal fee of R850 thereafter. As an affiliate, a stokvel has to agree to operate its business according to a code of conduct drawn up by NASASA. In 1997, there were about 15 000 stokvels nationwide registered with the Association.

NASASA introduced a funeral insurance scheme (which is no longer functional) to which individual members could subscribe. Initially a few volunteers managed the Association. While the funeral scheme was active, sufficient income was received from premiums to employ a secretary, a finance officer and an insurance administrator. All other employees work a volunteer basis.

NASASA negotiated with commercial banks and other financiers to use the accumulated savings of individual stokvels as a basis for granting loans, in this way linking the informal institutions with the formal financial sector. Two reasons most frequently cited for the formation of informal financial institutions are either the absence or the inaccessibility of formal financial services, even though these services may be physically present in a specific setting. Most of the schemes established with formal banks are not functional at present.

NASASA has never developed into a regulatory institution and does not have the capacity to regulate its members. Its limited benefits have negatively affected membership and the potential impact the Association could have had. A new strategy and structure are currently being prepared through which the range of services and benefits, including transmissions and a burial scheme, can be expanded. Details are, however, not available as yet.

2.2.3 Stokvels – evolution and challenges[2]

Stokvels seem to be evolving from simple structures for savings mobilisation into more complex types, which are oriented towards income generation and are taking up some of the functions of formal banks. Interest rates seem to have stayed steady or fallen in some of the localities, but an average of 20-30 per cent prevails for a loan period of five or six months. Interest appears to run higher in areas with less competition in the informal finance market. The overall development of these groups into a more commercial form and towards share schemes may be held back by the prevailing ideology of mutual help and equality, which has resisted the principle of differential division of group assets. Members appear to decide on a manageable group size and manageable financial products, and then contain the groups' growth within these limits.

Findings from recent research suggest that stokvels, though being robust institutions, face a number of characteristic problems. The groups that do not have a strong webbing of overlapping social capital connections are most vulnerable to risks. Chief amongst these is financial management. The disappearance and misappropriation of funds are the most serious problems – in such cases, many groups were able to force their management or the guilty party to pay back the funds, and were either still operating or expected to resume operations shortly. Other groups that collapsed entirely were faced with losses due to misappropriation, lost their organiser, or suffered from a number of difficulties of an organisational nature.

Opportunities for mismanagement have proliferated as more complex forms of savings and credit operation requiring a high level of literacy and numeracy have taken over from the earlier types. However, some groups collapsed immediately after formation due to the embezzlement of the first take, indicating extremely weak social capital linkages and a lack of information on which to base member recruitment. This also links to information economics and the dangers of asymmetric information leading to adverse selection and moral hazard.

The risk to group survival from accumulating defaults appears to be less immediate than might be expected. Fireproofing rules being adopted by many groups seem to have reduced the risk to the group significantly.

Instead, the risk to group cohesion and survival often comes more directly from the procedural and leadership demands of running these relatively complex groups, which create serious internal stresses. These stresses are then absorbed or attenuated by the shock-absorbing webbing of social capital connections, which wire the better-organised groups together. However, there are also demographic and economic red flag factors at play, which can increase the standing tension within groups. Many of these emerge from the basic conditions of poverty, where people who do not fit the ideal profile for savings and credit activity still need to form such groups. Key constituencies at risk here may be people of pension age who are still raising young children, and unemployed single mothers without reliable incomes. On the other hand, as interviews in the Free State showed, some

[2] This section is based on Coetzee and Cross (2001).

groups were formed based on the rule that any prospective member must be unemployed. Here the cohesion was based on locality and social objectives to accumulate for specific needs, rather than to use the group capital to expand revenue streams.

How well these additional problems are offset by effective and wise management has a great deal to do with group survival. Some considerations include:

- An important factor in stabilising group management may be the availability of outside help or facilitation services, which may be enough to tip the balance towards maintaining operating transparency and good membership relations, and can also provide light for the group management on successful record keeping.
- Another possible dynamic here would be a role for savings and credit groups of the poor formed on a cooperative basis, with relatively lower interest rates and aiming at a wider clientele and relatively high turnover. In the example of village banking (which we discuss in detail in a later section), groups of this nature might provide some of the same kind of lower-priced competition for the present groups centring on well-educated people and charging relatively high interest rates.
- Training needs probably centre on wider dissemination of bookkeeping skills to enable members as well as leaderships to manage the complexities of contemporary loan books, and to deal successfully with tracking and managing interest accumulation. The lack of financial skills and systems may also provide the opportunity for using very basic standardised financial systems, especially for groups starting out to expand revenue streams from the provision of basic financial services.
- Results also suggest a clear need for capacity building of group organisers as the main leaders looked to by group members. These visionary individuals are not usually superseded as key leaders by formal office bearers, and may often lack the education and technical skills needed to oversee and run successful income-generating groups.

2.3 BURIAL SOCIETIES

2.3.1 Introduction

Most of the work in this section has been drawn from a study published by the DGRV (2003). Traditional burial societies are found mainly in the rural areas, while commercial burial societies are found mostly in the urban and peri-urban areas. Most are formed either by an individual or a group of people. In most cases, the founder of the burial society is also the chairperson, especially in the urban and peri-urban areas. The chairperson in the commercial burial society is not elected and remains in that position indefinitely. In traditional burial societies, a committee is elected and is given a term to run the society. Most of the burial societies in the study were formed by their current owners; a few were formed by the community.

Burial societies in South Africa have evolved in response to the social and economic stresses that resulted from migration and urbanisation, and are by nature directed at the low-income earners and the unemployed, less educated and usually unsophisticated consumers. This group is often vulnerable to exploitation and unethical practices. Although some burial societies were accused of questionable and fraudulent practices, it is also evident that burial societies generally perform important functions as networks of support and affirmation to the poor – socially, culturally and economically.

In most African societies, the ability to give one's next of kin a dignified burial is a very significant cultural event. People believe that by joining a burial society they can ensure a proper funeral for their family members, as the burial society covers most of the costs. Even the poorest of families place a high priority on burial society contributions.

It is believed that the dissociation between stokvels and burial societies may be due to stokvels having developed a subculture of their own, which sometimes involves extravagant parties, rhythmic music and unacceptable behaviour. Burial societies are no longer regarded as stokvels because of their more formal and dignified approach. Whereas the term "stokvels" is reserved for rotating savings and credit associations, burial societies focus on benefits on the death of a member or dependant, and are more like Accumulating Savings and Credit Associations (ASCAs). Both burial societies and stokvels are mutual assistance schemes, but differ in culture and function.

Burial societies consist of both male and female members, although the latter are the majority in most cases. Women bear much of the burden of the household and seek both economic and social support in burial societies. Likewise, in urban areas, migrant men may form and join a burial society to get support in their economic struggles.

Traditional burial societies differ from commercial ones in terms of structure and operation and their objective is not profit making. In many instances, commercial burial societies have been launched by African entrepreneurs who recognise both the financial advantages of a profit-making insurance brokerage company, and the continuing social and cultural attractions of burial societies. Like their traditional counterparts, these burial societies draw members together regularly and offer support and solace during the cultural rituals of burial and mourning. Unlike in traditional burial societies, however, members of hybrid societies have, to a large extent, forfeited control over their finances.

Membership of commercial burial societies often runs into thousands of people, most of whom are unknown to each other. The financial affairs of the society are frequently closed off to the scrutiny of ordinary members and remain the preserve of administrators running a central office. These officials are appointed rather than elected, and are only available to ordinary members to handle queries or problems. The inner workings of the burial society, therefore, remain inscrutable, in stark contrast to the openness and active participation that mark the more traditional burial societies.

The use of the term “burial society” in the commercial type of society creates the impression that members belong to an association that is identical in all respects to a burial society, except that they do not need to attend meetings, as the administrator sees to everything. In fact, the use of the name “burial society” to denote the commercial type of society should be allowed in terms of the Friendly Societies Act, as it may create confusion. These *commercial* schemes are merely individual life assistance policies sold by the administrator, although they may be aggregated into group life schemes.

The various burial societies might operate differently, but the majority of the people join them for similar reasons – predominantly the prospect of being able to afford a decent funeral. This is why payment to a burial society is viewed not only as a form of contributing money every month, but also as a saving option. Monthly premiums are affordable and things are done informally, as opposed to the formal procedures and high payments required by banks. In addition, members rely on the support of the other members and on having access to the equipment and services that burial societies provide. Although this assistance is the basis on which burial societies are formed and constitutes the agreement between the members and the owner, these terms and conditions are not always honoured. Over time the burial society may not offer all the services or provide the equipment that it had originally promised.

2.3.2 Positive and negative aspects

Burial societies are able to adapt their funding methods, benefit structures and contribution rates as the needs of their members change. The burial society movement is popular and serves an essential purpose in assuring the dignified burial of the deceased, and in fulfilling a social support role.

Some members feel that if the negative side to the burial society movement is not taken care of, the movement will be adversely affected. Mismanagement of funds is a serious problem among burial societies and culprits frequently go unpunished. Tension is also caused by factors such as the shortage of funds and members who fall into arrears with their contributions. Not all societies are able to resolve such situations amicably, with the result that members may start to drop out.

2.3.3 Scope and size

It is difficult to quantify the size of the burial society movement as many operate in rural areas, and even those operating in urban areas may not be registered or known. The median number of members of burial societies in townships around Pretoria was about 30. That would not be inconsistent with the national average of 80 as the population is highly skewed by a few very large societies. A survey in 1998 indicated that the percentages of black people belonging to burial societies varied with their living standard measure (LSM) categories, from 21 per cent at the lowest level (at which 32 per cent of respondents had no personal income), to 37 per cent at a relatively high level (LSM 4 to LSM 6), tailing off to 24 per cent at the highest level. Overall, membership was 28 per cent. This would suggest that considerably more than 600 000 people belong to burial societies in the major metropolitan areas.

The 2002 FinMark study suggests a higher membership of burial societies in South Africa. Of the total population of 43 million, membership is estimated at 8 million. Although the sheer size of the movement alone is not sufficient to ensure its survival in its present form, it bears testimony to the importance of burial societies in the life of the country and its poor people.

2.3.4 Support required

The DGRV study (2003) has revealed the history, scope, operations and structure of the burial society movement. The simplistic, informal character of the movement makes it difficult to map out definitive interventions. However, the findings make it clear that there are certain areas of support that will most definitely benefit burial societies in general.

Capacity-building support

The high level of fraudulent practices and the general lack of information on the financial affairs of burial societies suggest that they are lacking in terms of the financial management, control and monitoring activities required for efficient operation. Members should be informed of their rights, and appropriate control structures should be instituted to assist in minimising the mentioned problems. In all societies members should understand their own responsibilities, the functioning of the society and the information requirements. It is in this regard that capacity building and counselling initiatives are of the utmost importance.

However, all strategies will need to strengthen the burial societies to different degrees in the following areas:

- Leadership training and development
- Roles and responsibilities of members of societies
- Conflict resolution
- Bookkeeping, records and financial management
- Access, use and dissemination of information
- Transparency and accountability
- Empowerment and entitlements: this is important, as women form the majority membership of burial societies

Income-generation activities

More research needs to be undertaken to establish the ways in which burial societies' members can embark on income-generating activities instead of depending entirely on the paying out of contributions. There is a need to educate members on investment activities and entrepreneurial skills development. Many of the societies are evidently embarking on these activities with minimum insight into how they should approach new ventures.

Support focus

In addition to capacity building and specific financial and investment advice, it is important that burial societies have a mouthpiece and a forum where problems can jointly be raised and solved. In addition, members should also have recourse in cases where the Friendly Societies Act is being contravened. The National Cooperative Association of South Africa (NCASA) has been working on the formation of a Burial Society Association with the Congress of South African Trade Unions (COSATU). However, this is a long process and will not necessarily provide the right forum from the start, as associations are more focused on institutional structuring than on support issues during the formative period.

One way of structuring this forum is to provide it immediately as a support function. This can be done in the form of a periodic workshop and information session, which are advertised among burial societies. Those societies facing challenges will have an incentive to attend, and in this way an incremental process can build up to a good support function over time. Once the Burial Society Association has been structured and is mature enough, the forum can be included under the Association's umbrella.

2.3.5 Future challenges

The burial society product is essentially an insurance product and whether funds are sufficient to meet future obligations will become more of an issue as HIV/Aids impacts on these vulnerable institutions.

2.4 VILLAGE BANKS

2.4.1 Introduction

The terms of reference required the main emphasis of the study to be on financial service cooperatives, or Village Banks. Although we have expanded the study beyond this type of institution, a sizable proportion of the level of effort was spent on the research on Village Banks. When discussing this type of institution in South Africa there are three stories to tell – those of the Village Bank project, the FSA and FINASOL. This section provides a summary of our work on the Village Banks. It has been drawn from the detailed working document for the study attached as Annexure A.

2.4.2 The Village Bank project in South Africa

The Village Bank project in South Africa was initiated by the entry of the International Fund for Agricultural Development (IFAD) in South Africa after the Agricultural Bank in Bophuthatswana (now North West province) applied for membership of the African Rural and Agricultural Credit Association (AFRACA). IFAD financed the initial phase of a project to establish Village Banks in South Africa and Uganda. Subsequent phases were funded from different sources.

The first two phases of the project saw the establishment of three Village Banks from 1994 to 1996, all in the North West province.[3] Many institutions showed interest in this concept and a consultative group was formed existing of representatives from First National Bank (FNB), Amalgamated Banks of South Africa (ABSA), Bophuthatswana Building Society (BBS), the Community Bank, the regional Reconstruction and Development Programme (RDP) office in the North West province, Agribank, Agricor, the Development Bank of Southern Africa (DBSA), the Rural Finance Facility, Shade, and Income Generation Projects for South Africa (IGPSA). The purpose of this group was to advise and help mobilise support.

The Village Bank project came in response to the inability of private sector financial institutions to provide cost-effective financial services in rural areas. This was both a function of high transaction costs and a lack of information. One of the most important services –deposit facilities – was provided by commercial banks and the Post Office or Post Bank. Rural people incur high costs to deposit their savings; however, these savings leave the rural areas, creating a net outflow and little benefit for local communities.

The idea of a Village Bank was conceived to create a financial institution that would decrease transaction costs of savings mobilisation, increase the circulation of resources in the communities, reduce information costs, provide loans and thus reinvest funds in the areas in which they were mobilised. The Village Bank was seen as a community project and was based on a member-owned and controlled format or model. This approach built on the rural social experience and institutions that were embodied in stokvels, burial societies, labour and community groups and a myriad other collective action institutions.

The Village Bank was seen as the vehicle with which the community would be able to access a comprehensive range of financial services, and could interact with the broader financial sector at lower transaction costs through interlinking with commercial banks.

Although the Village Bank project targeted rural areas, it is understood that access constraints also present a problem for the urban poor. Moreover, the Village Bank targeted all members of a community. As a result, a range of permanent inhabitants became members, including pensioners, families of migrant workers, farmers, traders and shop owners, informal and formal businesses, schools and churches.

The purpose of the pilot project was to develop the Village Bank concept and products to the extent that it would be possible to evaluate its viability and prepare a national and/or regional strategic plan. At the inception of the project no structures, systems and procedures were in place and no final agreement had been reached with the commercial banks involved in the project regarding the nature and extent of their involvement. Particular attention was given to social, institutional, financial, economic and legal sustainability. The Village Bank concept

[3] Jan Schoeman was appointed by IFAD and played a central role in the establishment of these Village Banks, as well as the initial institutions in Uganda.

was new not only to the rural communities involved but also to the commercial banks and government departments participating in the project. (Refer to Annexure C for more detail.)

On average, the one-off cost of establishing a Village Bank is about R120 000, which includes social development and direct costs. Based on an average membership of 2 000, this translates into a one-off cost of R60 per member. In addition to the benefit of having access to banking services and the positive economic and social spin-offs in the communities, the direct benefits for members include a substantial reduction in the transaction costs (e.g. the cost of banking services, transport costs, bank charges and additional opportunity costs of holding cash rather than keeping it in bank accounts). These costs may add up to more than R60 per transaction.

Initiatives by the commercial banking sector to make savings and transfer services more accessible to the unbanked population are dependent on existing infrastructure. As indicated later in this report, these initiatives will not reduce the above-mentioned transaction costs to the intended clients, but will have a ongoing cost implication for the commercial banks, whether subsidised or not.

2.4.3 Financial Services Association (FSA)

On completion of the pilot project in the North West province in 1996, during which the establishment methodology, operational stationery, appropriate systems and procedures contained in a comprehensive operational manual, and unique statutes and bylaws were developed (see Annexure C for more detail), the first Village Banks were registered legally as service cooperatives. The need for a centralised support structure also became evident during the pilot project, resulting in the formation of the FSA by the existing Village Banks. As an association for Village Banks, the main function of the FSA was to provide support services to its members; to promote and support them through providing training and direct financial contributions for the development of new Village Banks; to develop and implement new products and services, also of a group nature; and to represent members' interests at regional and national level. For this reason a specific statute and bylaws were developed for the FSA, which operated under the ultimate control of a board of directors elected from its member Village Banks.

The very first task of the FSA was to make a submission to the Registrar of Banks (21 February 1996) in which a comprehensive overview of the pilot project was given. The objective was to obtain recognition for the Village Bank concept under a special exemption from the Banks Act. This exemption was finally published on 6 March 1998, and due to the self-regulating requirements contained therein the FSA also had to assume the responsibility of regulating its member Village Banks. A regulating framework was developed in conjunction with the Registrar of Banks which, after approval, led to the formal acknowledgement by the Registrar of Banks of the FSA as a self-regulating body for its member Village Banks.

Once funding for the programme expansion had been successfully mobilised, the legal structure of the FSA was reviewed. Due to the limitations of operating as an association the board decided to register under section 21 of the Companies Act, 1973, with the same membership base and board of directors as the FSA.

Funding of the FSA programme was intended to include grants, loans and service fees. On completion of the pilot project in June 1996, the next objective was to replicate the concept on a national scale. From the outset the Village Bank project was structured as a joint venture between the participating rural communities, the private sector and the government. As the rural communities do not have the financial ability to fund a project of this nature, it was decided to continue with this approach and the implementation plan provided for expanding and formalising the FSA. Submissions were made to various organisations, including the national Department of Agriculture (NDA), Khula and commercial banks. Although the project was supported in principle, it was only in August 1999 that the national Department of Welfare approved a project grant of R7 000 000 for the establishment of 70 Village Banks in seven provinces. This grant made it possible to formalise the activities of the FSA. This included the proper establishment of its structure and capacity, such as staffing and physical infrastructure. Over the funding period of 30 months, 29 communities were assisted in establishing financial services cooperatives.

At the end of the funding period further applications were made to the Department of Social Development for an extension of project funding. A project review by the Department revealed a lack of proper management, poor training of staff and inexperience in microfinance. Attempts to develop an effective social transfer system were also not successful due the Association's perceived lack of capacity. Consequently, the new funding application was not approved, resulting in the operational closure of the FSA in 2001/02. Despite this, the FSA was not deregistered as a legal entity.

The Village Banks established with the support of the FSA are, however, continuing with operations due to the level of capacity established and their independent nature. The closure of the FSA nevertheless impacted on the Village Banks: the group burial scheme was discontinued; no external auditing or further assistance with training, support and product development was received; and they no longer had a representative mouthpiece for the sector.

2.4.4 FINASOL

Following a request for the restructuring of the South African Sugar Association's Financial Aid Fund (FAF), the FINASOL model was initially developed with the intention to integrate and transform existing FAF operations into Village Banks registered as financial services cooperatives. With the mobilisation of financial support from the United States Agency for International Development (USAID) for the project, the South African Sugar Association decided not to continue with the transformation of the FAF's operations. Instead, it entered into an agreement with FINASOL. Amongst other things, this agreement provided for support to the programme, which included the utilisation of the computerised systems developed by the FAF as a platform for developing computerised loan and credit administration systems for FINASOL. The agreement also stipulated that FINASOL and the FAF would not compete for the same clients.

The USAID support programme, Improved Microenterprise Access to Liquidity (IMALI), provided for an American partner in the project, while Agricultural Cooperative Development International/Volunteers in Overseas Cooperative Assistance (ACDI/VOCA) supported FINASOL. The ACDI/VOCA's responsibilities included technical assistance and advice, and a full-time secondment of key staff to the project.

FINASOL was registered in January 1999 as a not-for-profit association under section 21 of the South African Companies Act. The FINASOL model was based on a "franchising system" whereby it was linked to Village Banks established on the same principles developed in the Village Bank pilot project. The franchising agreement provided for start-up assistance and continuing support by FINASOL, the franchisor, for a standardised service to a Village Bank, the franchisee, who was the owner/operator of the business. The Village Bank was, however, not required to purchase the franchise. FINASOL provided the training, information systems, audit and risk management services and ongoing support to financial services cooperatives at no initial cost. Once the system was up and running FINASOL and the Village Banks shared in the income received from transaction charges. The motivation for using the franchising concept was the frequent foundering of development initiatives as a result of a lack of ongoing support.

The franchising system introduced a high-level of integrity, standardised policy, procedures, products and management capacity with a proven track record for the delivery of financial services. It enabled communities to jump-start the provision of financial services in their areas without having to experience the trial-and-error period that normally accompanies an independent start-up.

Start-up assistance to a Village Bank involved a loan of R40 000 to cover the initial operating expenses and a grant of R8 000 for the purchase of a safe and as a contribution towards the initial set-up of the Village Bank office. The loan was only advanced to a Village Bank once it had an approved business plan.

In terms of the franchise agreement a Village Bank was required to acquire suitable premises and organise telephone and electricity connections. The Village Bank was responsible for the payment of all its operating costs and the employment of a teller or administrator, whom FINASOL would train.

The franchise agreement dealt with a Village Bank's link to a formal bank, its safety and security, day-to-day accounting procedures, business development, performance and management audits, certification and accreditation, fees and charges, and reporting. The franchise agreement was an important component of the financial services model, without which it would not have been possible to provide an information system and other related services enabling Village Banks to render the financial services as described.

FINASOL was also recognised by the Registrar of Banks as a regulatory body having more or less the same functions as the FSA.

FinaSol received financial assistance from USAID and the Department for

International Development (DFID), and technical assistance from the Deutscher Genossenschafts- und Raiffeisenverband (DGRV) and the Swedish Cooperative Centre. In 2001, DFID funding to the value of £1 million (through the Financial Deepening Challenge Fund) was facilitated by FNB for the FinaSol project. FinaSol's Head Office relocated to Johannesburg, a new management was appointed for the project and a Village Banking department was established in FNB. FNB's objective for the project was, however, not achieved, which created a reputational risk for the bank. Consequently, DFID funding was not utilised. Due to a lack of funding FinaSol's operations were discontinued in July 2002. As in the case of the Village Banks established by the FSA, most of the Village Banks established by FINASOL continued to operate.

2.4.5 Current situation

At present, 62 Village Banks are registered with the Registrar of Cooperatives, of which 32 were members of the FSA and 30 were members of FinaSol. A number of communities have established local structures, five of which have submitted requests for registration with the Registrar as cooperatives. No accurate and comprehensive information is available on the portfolio size and membership. It is estimated that the existing Village Banks have between 60 000 and 80 000 members, with a total portfolio of between R30 million and R40 million.

No support services are currently being provided to the existing Village Banks and it is reported that some of them are experiencing problems, including mismanagement of funds, administrative problems, lack of stationery and lack of training, and almost all are in dire need of auditing services. Notwithstanding these general problems some of the very first Village Banks are continuing to expand their portfolios, such as Motswedi with its 1 552 members and a savings portfolio of R1,8 million.

After the collapse of the FSA, in-house burial schemes within the Village Banks continued to operate without any underwriting; without proper evaluation and control this may be a potential disaster waiting to happen.

After the collapse of the FSA and FINASOL, the NDA took responsibility for supporting activities of the Village Banks, focusing on the establishment of a task team or action team consisting of representatives of the functioning financial services cooperatives. The NDA organised a summit and sponsored these representatives to attend. They are currently working on an action plan and strategies for organising themselves into a lobbying group. These activities, as well as the resilience of these institutions at the ground level, are a good indication of the demand for this type of institution and the success of the initial support.

2.4.6 Lessons learned from the FSA and FINASOL experience

The impact of member-based banking extends beyond mere financial services, as it also has a decided influence on empowerment at grassroots level, such as capacity building of human resources, organisational development and the ability to interact with the government and other stakeholders (Wakely, 1996). It is also clear that the contribution of members is an essential ingredient towards entrenching ownership and lowering transaction costs of the local-level institutions.

It is clear that individual Village Banks have neither the ability nor the capacity to represent themselves at the national or policy level, hence some structure to fulfil this role is needed. The major strength and value of Village Banks lie in their local-level organisation and activities that create the demand for membership. Further evidence of this is found in Village Banks' shareholder meetings during which the importance of efficient operational functioning dominates the agenda (Rouse & Von Pischke, 1997).

If indeed a new structure is needed, it should not be imposed on a community. The only way to achieve institutional sustainability is to allow a particular community to make the proposed new structure part of its institutional fabric. Enough members from the community must buy in to the idea and accept full ownership before any operational activities can commence. This is a social development process that requires substantial inputs and a pace of development set by the respective communities.

Moving away from the primary level of operations in a community increases the difficulty in maintaining effective ownership and control by that community. The level of operations at secondary level requires a degree of technical expertise beyond the general capacity of the local members and, if not managed properly, may create tension and endanger effective participation.

Gender, group or activity segregation reduces the potential for participation by the community at large and therefore affects the project's social and financial sustainability.

Normal bank-client relations between a Village Bank and commercial banks are easily established at branch level and in some cases even include training. Support beyond normal branch activities that may impact on branch resources are dealt with at corporate level, and cannot be negotiated by individual Village Banks.

At branch level commercial banks have limited discretion on activities outside their normal operational services. Their budgets are tight and performance is measured on branch profitability. Unless Head Office issues specific directives, together with financial provision for extraordinary activities, the branch management is limited in its support of the Village Bank programme or that particular Village Bank.

Establishing Village Banks is a development process and there is a small chance that this type of institution will be established without external support and funding. The experience of the Village Banks in South Africa has indicated that with the right initial support and emphasis during the establishment process, a Village Bank can operate independently after an initial support period.

Any scheme developed for the rural community must be based on the realities of rural life and not the commercial norms applicable to a First World environment. For example, the exclusion of people over a certain age basically means that the community must provide for them outside the scheme.

It was found that where support institutions focused exclusively on the banking side and not on community development issues, and where a lack of understanding for this balanced emphasis was evident, the institutions collapsed.

2.5 CREDIT UNIONS/SAVINGS AND CREDIT COOPERATIVES

2.5.1 History and background

A savings and credit cooperative (SACCO) is a member-driven, financial self-help organisation. It is democratic and member owned, controlled and managed. It pools funds from members and circulates them back into the community by lending out money to generate income. The financial and operational expenditure is covered by this income. All activities and members' profits from such activities are funded from internal sources. SACCOs in South Africa are registered with the South African Credit Cooperative League (SACCOL); the latter subscribes to recognised principles of the international credit union movement.

SACCOL was established in 1993 by the savings and credit cooperatives and credit unions[4] in South Africa. It evolved from the Cape Credit Union League (CCUL), which was formed in 1981 and was formally registered in 1998 as a second tier cooperative. SACCOL is owned and controlled by its member credit unions, which exercise proportional voting rights according to the size of membership. SACCOL is recognised as the representative of savings and credit cooperatives and credit unions in South Africa.[5]

SACCOL is a member of the African Confederation of Cooperative Savings and Credit Associations and the World Council of Credit Unions (WOCCU).

SACCOs are exempted under the "common bond" exemption of the Banks Act.[6] This means that members of SACCOL are exempted from the prohibition on taking deposits, to a limit of R9,9 million. This cap effectively places a limitation on growth of SACCOs.

From 1981 to 1994 SACCOL's main source of funding was the Canadian Cooperative Association. It had a primarily social emphasis, offering a low-cost

[4] The first published mention of credit union in South Africa was in 1928.

[5] Government Notice 2173, 14 December 1994.

[6] Ibid.

service to members (loans at 1 per cent per month) through a simple range of products. Donor policies and objectives were given priority and there was a lack of control over SACCOs, which impacted negatively on its viability.

In the period 1994 to 2001, SACCOL received a USAID grant of US$ 1,3 million and adopted a new strategy aimed at self-sufficiency. This included the opening of branches in Gauteng, Umtata and the Western Cape, with the emphasis on workplace or employer-based SACCOs and the consolidation and mergers of non-viable cooperatives. At the end of the period, the movement was 2 per cent self-sufficient and SACCOL had a staff of 15.

Without continued external funding a new strategy was adopted which entailed the growth of the movement from the bottom up. As a result, most of SACCOL's staff were redeployed in SACCO structures, leaving the organisation with only six staff members. In February 2002, SACCOL reached 80 per cent self-sufficiency with only four staff members. Their income base grew through increased membership fees as the consolidation of smaller SACCOs into fewer larger entities continued. At present SACCOL's limited capacity is becoming a constraining factor for (new) members that are still in the development phase, as they are not receiving adequate support. As a consequence the movement's capacity for growth is being hampered.

2.5.2 Lessons

The experience of the credit union movement in South Africa is a good example of the importance of striving to achieve self-reliance by a second-tier institution. Only when the movement changes its strategy to pursue self-reliance does the locus of control or influence shift from outside the institution to the inside. In fact, this echoes credit union experience in many parts of the world.

It is also clear that it is very difficult to start a support entity at full capacity with internal resources only. Initial support is needed but should also be provided in such a way that control of the institution and the movement stays with the members. Member control and, in effect, the cooperative approach, are important principles applied by SACCOL.

2.6 MUTUAL BANKS

The Mutual Banks Act (No. 124 of 1993) came about as a result of the need for a regulatory framework to accommodate the Community Bank and the Savings Help Bank (Cash Bank), and to find a home for the mutual building societies that operated under the repealed Mutual Building Societies Act. The Act allowed for a *sui generis* association (neither company nor cooperative) with various forms of interest-bearing shares.

The Mutual Banks Act was introduced to add greater depth to the South African financial system. For financial institutions in the informal sector, particularly development lenders, there had been no way to upgrade gradually to a fully fledged regulated bank. The Mutual Banks Act was supposed to facilitate this: "The emphasis [is] on the protection afforded by mutual membership in order to compensate for less onerous and stringent capital requirements" (Strauss 1996b: 59). The Mutual Banks Act (section 48) requires only R10 million as start-up capital.

The Mutual Banks Act has, however, not lived up to expectations. Only two mutual banks have been registered, namely VBS and GBS (SARB, 2002).

Mutual Banks have narrow parameters for growth, as they cannot mobilise venture or external capital due to their cooperative structure and their shares cannot be traded on the stock exchange. There are also excessive equity requirements and duties of disclosure and reporting, which smaller financial institutions find onerous and difficult to comply with. This problem is exacerbated by the SARB's view that the statutory R10 million is insufficient and that, in reality, a multiple of this figure is frequently required. At heart the regulatory framework has a cooperative or mutual structure, but its non-equity investment instruments have proved not to be conducive to allowing mutual banks to attract external funding.

The Strauss Commission (1996) cites five more reasons why this regulatory framework has been adopted by so few financial institutions, particularly in view of the fact that the Act was intended to accommodate development lenders, i.e. NGOs that required access to non-bank funding through wholesale deposits).[7]

- Registration is seen as a curtailment of independence by a "hostile" (state) institution.
- Banks do not enjoy a reputation amongst lower-income earners for being forthcoming to clients, so the legitimacy of the financial institutions might suffer.
- Registration incurs unreasonably high costs that are difficult for the institutions to bear.
- The high liquidity requirements act as an impediment to capital use.
- NGO executives have serious misgivings about a banking culture geared towards maximising its profits (Staschen, 1999).

The cooperative structure of the vehicle has also been criticised as being a limiting feature, especially where there is a need for the mobilisation of capital. However, in a new dispensation, a mutual bank under the Mutual Banks Act could serve as a structure into which member-based financial institutions could graduate within the appropriate timeframe, i.e. into first-tier membership-based banks. The Mutual Banks Act would, however, require amendments in order to meet this objective – this will be part of Phase II of the current project.

[7] For example, Altfin, King Finance, Rural Finance Facility, and SEF.

2.7 DEVELOPMENT LENDERS (NGOS)

We include some mention of development lenders or non-governmental organisations (NGOs) financial institutions in the report due to the group approach some of them follow in the provision of financial services. For instance, the Small Enterprise Foundation (SEF) in Tzaneen and the Foundation for International Community Assistance (FINCA) in Durban are based on the principles of collective action and group cohesion to effect lower transaction and information costs. The difference is that the clients are not the owners of the institution and the group approach is applied as financial technology, rather than an ownership structure. FINCA, specifically, is quite often referred to as a Village Banking model; however, this should not be confused with the Village Banks in the South African context, as discussed in this study. It is also important to note that these institutions do not take deposits other than as part of the security for a loan.

2.8 OTHER INSTITUTIONS

2.8.1 Public sector institutions

Registrar of Banks

In his annual report of 2002, the Registrar of Banks confirmed the need in South Africa to facilitate and extend access to banking and financial services on a wider basis than is currently possible. The Bank Supervision Department, therefore, envisages amending the regulatory framework to allow for the establishment of different classes of banking institutions, such as second-tier and third-tier banks.

While the pending legislation for dedicated banks is intended to address the need at the second tier, it is acknowledged that provision also needs to be made for institutions operating in the third tier. Third-tier banks are defined as community deposit-taking institutions, with full acknowledgement of the contribution these institutions can make in providing needed financial services to members of the community not served adequately or served at all by the first- and second-tier banks. The credibility and success of such community deposit-taking institutions are considered dependent on a sound regulatory framework and fair and affordable access to basic banking services. In a recent newspaper article, the Registrar of Banks confirmed this intended approach (*Sunday Times,* 2003).

The Registrar also confirmed that ruling by exemptions and relinquishing supervision responsibilities to self-regulators are under serious reconsideration by the Registrar's Office.

Micro Finance Regulatory Council (MFRC)

The MFRC was established under the 1999 Usury Act Exemption Notice, as part of the process of financial sector liberalisation, which had the objective of creating a regulating framework for both development lenders (NGOs) and so-called cash lenders advancing short-term loans. This liberalisation had come into existence as an unintended consequence of the Usury Act exemption.[8] The MFRC's purpose is to regulate the operations of institutions lending under its unrestricted interest rate window, in order to enable more effective consumer protection and regulation of microlenders' operations in a growing market. Although it currently regulates only lending activities (and not deposit taking), the MFRC was established with the ultimate objective of regulating deposit taking by microlenders in due course. There is a misconception that the MFRC only regulates microlenders; however, the bulk of microlending business is conducted by banks. Cooperatives and development lenders (NGOs) also fall within its regulatory net.

The MFRC is currently motivating for an exemption notice to be created within the regulations to the Banks Act, which would enable non-bank microlenders to raise funding from "wholesale depositors". The MFRC believes that its capacities allow it to be registered as the regulating body for such deposit-taking activities, which it wants to be extended to include also common bond institutions (or member-based institutions).

National Department of Agriculture (NDA)

During the pilot Village Bank project in 1994-95, the NDA participated in the consultative group in an advisory capacity. In 1995 the NDA reviewed existing financial delivery systems in agriculture and made recommendations for short-term improvements and long-term financial institutional development. An independent support organisation was proposed in support of the development and expansion of the Village Banks model as a system for delivering financial support for agricultural development.

In 1997 the Village Bank project was included in the South African-American Binational Commission of the Agriculture Committee. USAID funding was approved to assess the project; to develop a Village Bank business plan, materials and guidelines, as well as business plans for national and provincial governments; and to consult on restructuring the role of the Directorate of Financial Assistance and Land Administration.

An assessment report of the Village Bank model was subsequently prepared, existing Village Banks were audited and training material was developed by Technikon South Africa.

With the closure of the FSA and FINASOL the NDA was approached in 2002 for assistance, which led to the establishment of the Directorate for Financial Services and Cooperative Development in the NDA. The NDA facilitated road shows, preparation workshops and consultations to discuss the problems and challenges faced by the Village Banks. The objectives of the workshops were to refocus the Village Bank programme by devising a turnaround strategy for the regulation of Village Banks, capacity building, financial services, a financial services cooperative structure, the relationship with the government and other partners and donors, and the establishment of a Cooperative Development Fund.

[8] Government Notice R3451, 31 December 1992.

A national task team consisting of members of the Village Bank, the NDA and the Registrar of Cooperatives was established to address issues such as a strategic plan, policy engagements, a constitution, registration of financial services cooperatives, structure, capacity building, communication strategy, monitoring and evaluation and the Cooperative Development Fund.

The purpose of the Cooperative Development Fund is to promote the development and growth of financial self-help organisations by ensuring that rural deposits are mobilised and channelled into productive rural enterprises. This will be a “fund of funds” out of which the following products will emerge:

A *rural financial network* to assist in developing institutional arrangements necessary for the delivery of rural financial services to the agricultural sector through fostering the linkages in the three-tier banking system; strengthening the structural relationships in this system to ensure sustainability and efficient delivery of financial services; and fostering linkages between financial services and entrepreneurial development to facilitate the sustainability of the financial institutions and enterprises and to promote capital retention.

Business loans aimed at meeting the credit needs of member-based financial self-help groups whose savings contributions do not represent an appropriate critical mass for meaningful investment.[9]

Capacity development funds to assist in building the capacity of member-based financial self-help groups with respect to financial skills, procedures and policies; building the capacity of financial institutions to mobilise savings and consolidate them into a huge resource for investment purposes; and developing a management information system for tracking the loans and savings of members.

The NDA also developed a business model for an integrated cooperative system with the intention to create growth, wealth ownership and retention of capital in the local economy and cooperative system. Particular emphasis would be placed on facilitating and increasing the economic participation of the members of Village Banks; creating linkages between the Village Banks and producer, processing and trading cooperatives so as to create a sustainable institution with a strong economic base; creating value claims across the business activities of Village Bank members so as to break the cycle of poverty caused by low profit margins; and creating appropriate institutional arrangements for the cost-effective delivery of services to members of cooperatives. The need for a strong apex structure in support of the Village Bank development programme is acknowledged and supported.

[9] Note that a similar facility had been partly responsible for the collapse of the credit union movement in Latin America in the 1970s. The external funds exceeded the generation of internal funds and this created an incentive for imprudent behaviour by members in the allocation of credit.

Department of Trade and Industry (DTI) and the Registrar of Cooperatives

The DTI's cooperative development policy document states that the DTI shall be the government department at the national level with the overall responsibility for cooperative development and administration. A fully-fledged Cooperative Enterprise Development Division will be established within the DTI. The Registrar of Cooperatives' Office will be located in the DTI's Corporate and Intellectual Property Registration Office (CIPRO).

The functions of registration and deregistration of cooperatives will be decentralised to facilitate affordable and efficient procedure. The role of the Cooperative Enterprise Development Division is threefold and includes policy, coordination and promotion:

- *Policy and legislative administration:* Being the focal point for reviewing policies and strategies, and addressing barriers to cooperative development in partnership with stakeholders; ensuring that matters related to cooperative development are addressed through wide consultations with its partners; and administration of the Cooperative Act.
- *Coordination:* Coordination of the various government institutions dealing with cooperative enterprises; and coordination of donor initiatives in the area of cooperative development.
- *Promotion:* Provision and management of non-financial and financial cooperative support services, the management of privileges and incentives for cooperatives, and the collection, analysis and dissemination of statistics related to cooperative development; facilitating access to markets; facilitating access to credit; and promoting the concept and practice of cooperatives. Some of the promotional functions are, however, of a temporary nature and will be transferred to other actors in cooperative development as soon as possible.

The main functions of the Office of the Registrar are the registration and deregistration of cooperatives in as rapid, simple, affordable and efficient a manner as possible, as well as the legal supervision of cooperatives' compliance with laws and regulations.

National Treasury

The Director of Banking Development in conjunction with the Registrar of Banks has been tasked with the development of new legislation for third-tier banking by the end of 2003. The new legislation is intended specifically for common bond institutions and will not affect the current legislation for designated banks. The ultimate regulating responsibility for deposit taking is seen to remain with the Registrar of Banks, a ruling which may affect the Registrar's capacity. The complexity of the situation is understood and the need for an advisory body for regulating and developing microfinancial institutions has been identified. Provision is also made for an apex fund for the development of microfinance institutions. This is still being designed and it is not clear whether member-based financial institutions will be eligible for support from this apex once it is in operation. The fund is being designed by the DBSA as an agent of the Treasury. It is estimated that the fund will operate for three years and will have a budget of R120 million over this period.

Department of Social Development

In August 1999 an agreement was reached between the Department of Social Development and the FSA for a grant of R7 million to the FSA for a financial services cooperative expansion programme. The programme extended over a period of 30 months and provided for the establishment and operational costs of the FSA, including seven regional programmes, 70 new financial services cooperatives and a loan fund of R3 million.

The ambitious programme of establishing 70 new cooperatives would have been possible if substantial capacity had been developed within the FSA. Financial sustainability could not, however, be achieved at this level of operations. It was agreed with the Department of Social Development in principle that further support would be required to expand the programme to a level that would secure self-sufficiency.

The programme also provided for a steering committee headed by the Department of Social Development, which the project team would report to and through which active participation could be maintained. The steering committee was, however, never established. During 2000 various changes and restructuring took place in the Department, which also affected the programme. New staff members were appointed and external expertise was mobilised from the International Labour Organisation (ILO) to manage and review the development programme. The current management acknowledged a breakdown in communication within the Department, as well as with projects and a lack of appropriate expertise mobilised externally.

In addition, regular progress reports were not forthcoming from the FSA and the Department's evaluations of the programme indicated a lack of proper management, poor training of staff and inexperience in microfinance. Attempts to develop an effective social transfer system were also not successful due a perceived lack of capacity at Village Bank level. A new application for further funding was therefore not approved, although the Department still supports the development of microsave programmes for its target market. Further support will, however, be subject to an acceptable programme structure and the availability of development funding from the Treasury.

Post Office Bank (Post Bank)

The Post Office has the widest rural reach and its retail network plays an important role in pension and other social welfare pay-outs, as well as third-party payments, especially – though not exclusively – in the rural areas. In addition, the Post Office through the Post Bank currently plays an important part in the provision of rural financial services.

In terms of the government's commitment to the provision of a universal postal service and a basic national communications infrastructure, service provision in rural and sparsely populated areas should be retained. If this is not the case there would, for example, be no reason to establish a set of reserved (monopolistic) services, and the market would be free to provide these services only in the profitable urban and metropolitan areas. Instead, creative, yet more economical ways of providing a basic postal and communications service and/or subsidising the provision of these services need to be found (South Africa, 1997).

The Post Bank is currently reviewing its financial services and places high priority on the unbanked market. The current range of services includes a Flexicard (transmission account), Smart Save (a book-based account) and Maxi Save (a long-term savings account). Future products include Target and Term Save, debit and stop order facilities, loans, insurance and payroll distribution. Group savings schemes do not, however, feature.

Provision is made for the Post Banks to act as agents for development initiatives, and consideration will be given to agency agreements with cooperative banks. The developmental role of cooperative banking is acknowledged, as is the need to work with community-based structures, the need for increased debt capacity in rural communities and the value of group portfolios.

2.8.2 Private sector institutions

Banking Council

The Banking Council of South Africa is the industry body whose role is to establish and maintain the best possible platform on which banking groups can do responsible, competitive and profitable banking. As the representative body, the Banking Council constantly interacts with various government departments, consumer bodies and other interest groups regarding banking issues. As a member of the Financial Sector Task Team of the National Economic Development and Labour Council (NEDLAC), the Council represents the industry in the process of developing a support programme for cooperative banks.

The Banking Council is represented on the Interbank Initiative.

Interbank Initiative

The Draft Financial Service Charter reflects the commitment of the financial sector to work with the government and other stakeholders to make the economy inclusive and to do it in such a way that the stability and world-class standards of the financial sector stay intact. Furthermore, the banks will form a partnership with the government and use their existing infrastructure to bring savings and transaction services within reach (defined as within 20 km) of 80 per cent of the people of South Africa. The high fixed and overhead costs of existing infrastructure require an innovative or different approach towards a national microsavings scheme (subsidisation is not excluded). The initiative has been divided into two "workstreams". Workstream 1 aims at defining and developing viable business models providing affordable money transmission facilities to the unbanked market segment. Workstream 2 aims at defining and recommending microsavings options related to the underbanked and unbanked market segments.

No provision is made for cooperation with, or support to, third-tier banking or member-based financial institutions. This means, for instance, that any such services will be in competition with community-based institutions. This could reduce the sustainability of the local initiatives as they now have to compete with the formal banks. No provision is made for credit facilities for the target market through which mobilised savings can be recirculated.

2.8.3 National organisations

NEDLAC

In August 2002, NEDLAC's Financial Sector Summit Declaration noted that "while the large formal financial institutions have an important role to play in providing services for the poor they must interact with and support smaller institutions, especially cooperative banks and NGOs that can provide microcredit to the poorest households. We need to harness the energies of the existing institutions in our communities, such as stokvels and burial societies, in order to mobilise our people's savings. The smaller financial institutions serve to increase the diversity of the sector and broaden ownership" (NEDLAC, 2002).

The parties agreed on the need for new enabling legislation for so-called second- and third-tier deposit-taking financial institutions. They identified key principles for legislation on financial cooperatives, which would ensure that these institutions operate according to cooperative principles and enjoy adequate prudential oversight.

Following the Summit, the parties determined to put forward proposals on ways to enhance the developmental impact of the regulatory framework. The parties agreed that all the constituencies should seek to support financial cooperatives and microcredit providers. After the Summit, they would engage in a concrete support programme.

NCASA

The National Cooperative Association of South Africa (NCASA) is the only national apex organisation for cooperatives in South Africa. NCASA is a registered national apex cooperative with the goal of serving its members, which are predominantly emerging cooperatives (both primary and secondary). It accepts all kinds of cooperatives as members, including informal cooperative-type organisations.

Within its broad goal, NCASA promotes cooperative development, particularly local, regional and sectoral. Regional development focuses on the sustainability and viability of primary cooperatives through the establishment of cooperative development centres (CDCs). The Local development encourages close working relationships with local organisations and institutions, particularly local government. Sectoral development is promoted by facilitating vertical integration of primary and secondary cooperatives. It is mainly focused on agricultural, financial, worker, consumer and social service cooperatives. NCASA also promotes the mobilisation of non-cooperative organisations.

NCASA's membership consists of national cooperative organisations such as SACCOL, the South African Women's Association (SAWA), the Agricultural Business Chamber (ABC), and the National African Farmers' Union (NAFU). It also includes emerging primary cooperatives of different types, which are in the process of establishing sector cooperative organisations such as workers' cooperatives, health insurance cooperatives, housing cooperatives and burial societies.

NCASA's main activities include the following:

Training and education: This includes training of trainers and field workers attached to CDCs in the provinces. The training programmes are mainly conducted in collaboration with the ILO, universities and NGOs.

Networking and information: NCASA produces a quarterly cooperative magazine *(NCASA News)* which is aimed at informing members about recent developments and raising awareness of the cooperative movement in South Africa. The Board also publishes a monthly *Update,* specifically aimed at informing members of activities at the national level and about developments in the international cooperative arena. Baseline studies are conducted through surveys of members and reflect the state of the South African cooperative movement, including its needs and challenges. NCASA also convenes seminars and workshops to facilitate the sharing of information and networking amongst cooperatives.

Advocacy: NCASA co-hosted an international legislative conference in Johannesburg in June 2001. It was attended by international delegates from Botswana, India, Italy and Spain, along with government officials and South African cooperators. The conference enabled NCASA and its members to present a detailed proposal for the review of the Cooperatives Act (No. 91 of 1981). As a member of NEDLAC, NCASA and its members have also contributed to the formulation of legislation related to cooperatives, especially cooperative banking.

International linkages: NCASA is actively involved in increasing international involvement in the South African cooperative movement. Since 1997, the Association has worked in partnership with the Canadian Cooperative Association (CCA), the Canadian International Development Agency (CIDA), the International Cooperative Alliance (ICA), the ILO and other international organisations.

2.8.4 Donor organisations

Local and international donor or development organisations in the third-tier banking sector in South Africa were involved in two ways: direct involvement in specific programmes (e.g. IFAD, USAID, CCA and DGRV), and sectoral involvement, which is more of an advisory role (e.g. the ILO, DFID, USAID and DGRV).

While most of these institutions have a specific interest and capacity in becoming involved in microfinance, their policies, approaches and even time horizons differ. Some provide financial support and others technical support. The DGRV, for instance, prefers to work with groups on the local level, offering technical support, although providing support to the sector by financing and organising seminars and study tours.

While the involvement of these institutions in the sector is generally appreciated, concerns have been expressed by some stakeholders. These concerns range from some donors being too prescriptive or lacking understanding of local circumstances, to the most common problem of a lack of coordination of programmes and activities.

These organisations are, however, making a contribution by supporting the member-based financial sector and many local initiatives. International exposure of local practitioners is one of the most appreciated contributions, of which Germany is a good example. The challenge for these institutions is, therefore, to find a way in which their involvement can be optimised and coordination improved.

2.9 LEGISLATION, REGULATION AND SUPERVISION

2.9.1 The history of third-tier banking regulation since 1990

Provisions of the Banks Act

The Banks Act, previously named the Deposit-taking Institutions Act (No. 94 of 1990), prohibits the taking of deposits from the general public (section 11). “Deposit” is very widely defined to include any amount repayable, with or without interest (section 1). The reference to “general public” in section 1 specifically excludes banks. The wide scope of the prohibition was intentional, to create level playing fields for all those who were involved in deposit taking in one form or another. The Act also allowed the Minister to determine those activities that do not fall within the business of a bank, thereby effectively excluding or exempting certain activities from the prohibition on the taking of deposits.[10]

Common bond exemption

The first step in the regulation of third-tier banking was the publication of the “common bond” exemption notice,[11] which exempted certain activities from the prohibitions of the Banks Act. These included the activities of stokvels, housing savings clubs, credit unions (savings and credit cooperatives) and burial societies. The most significant condition was that certain of the exempted entities had to be members of a self-regulating institution. The notice imposed a limit of R9,99 million on the maximum value of subscriptions.

Financial services cooperative or Village Bank exemptions

The first Village Bank exemption was published on 6 March 1998.[12] That notice

[10] Paragraphs (cc) and (dd) (i) of the definition of the business of a bank in section 1 have been used in this regard. We will refer to these determinations as exemptions.

[11] Government Notice 2173, 14 December 1994, published in the *Government Gazette* 16167 of 14 December 1994.

[12] Government Notice 367, 10 March 1998.

was immediately replaced by an identical notice on 10 March 1998 for unknown reasons.[13] The terms of exemption for the Village Banks were similar to the terms of the common bond exemption. Notable differences are the emphasis on the services provided by "financial services cooperatives", the business arrangement with a "link bank" and the provision of financial services to members who are not serviced by banks. Again, the conditions held that the institution should be part of a self-regulatory body and that a maximum of R10 million in deposits may be held. The Village Bank exemption notice of 10 March 1998 was substituted by a further notice on 28 December 2000,[14] due to expire on 31 December 2003. The terms are essentially the same.

2.9.2 Evaluation of the existing regulatory framework

The demise of self-regulating institutions

Of all the self-regulatory structures established under the various exemption notices, only one is still functional as a self-regulator. NASASA, the self-regulatory body for stokvels, has no formal relationship with or control over members and can best be described as an entity wishing to represent stokvels. Both the FSA and FINASOL collapsed, while SACCOL, the self-regulating body for SACCOs or credit unions, is still functioning. As mentioned, two reasons for failure stand out: the lack of continued funding to enable regulatory entities to reach critical mass and sustainability, and the loss of critical expertise and capacity along the way. In the case of NASASA, the formal relationship as a regulator between the regulating entity and those regulated never came into existence. Notwithstanding the demise of regulatory structures, the Village Banks continued with their normal operations, and in some instances, achieved moderate success and growth. The failure in the main was in respect of the self-regulatory institutions and not the Village Banks themselves.

Conflicting functions of self-regulating institutions

One should question whether the idea of a self-regulating entity, which – in addition to its regulatory function – is tasked with the functions of promotion, advocacy, development, replication and service provision, is tenable. The regulatory function requires a measure of distance in order to discipline effectively without the fear of member entities moving over to another self-regulator or simply going their own way. The additional lack of statutory powers and funding to deal effectively with delinquent members raises questions about the appropriateness of a self-regulating model.

The role of the Registrar

The existing regulatory structure for third-tier institutions assumed the existence or development of effective self-regulatory organisations with the appropriate capacity and financing. The only functions of the Registrar of Banks would then be

[13] Government Notice 367, published in the *Government Gazette* 18741 of 10 March 1998, and due to expire on 31 December 2000.

[14] Government Notice R422, 28 December 2000, published in the *Government Gazette* of 28 December 2000.

to monitor these institutions and deal with delinquent ones that have dropped out of the self-regulatory net. The Registrar of Banks, on occasion, has been called upon to deal with delinquent institutions by SACCOL, but the untimely demise of FINASOL and FSA left it without a self-regulatory institution to liaise with. The necessary conditions under which regulation would have taken place thus fell through.

Rule by exemption

In South Africa the regulation of the provision of financial services to the poor has largely been based on exemption notices, both with regard to the conditions of funding and lending. The exemption notices in respect of deposit taking of the so-called third-tier institutions have been dealt with above. However, the advancing of loans at interest rates exceeding the maximum interest rate determined under the Usury Act (No. 73 of 1968) requires lenders (including membership-based financial institutions) to register with the MFRC. The lending activities of membership-based financial institutions are, therefore, also regulated by the provisions of the Usury Act exemption notice.[15] The establishment of the MFRC by way of exemption was, at the time, envisaged as an interim measure pending the review of the Usury Act and other credit legislation, notably the Credit Agreements Act (No. 75 of 1980), which was considered a long-term objective. It has, however, taken considerable time and effort to bring credit unions to register with the MFRC. None of the other membership-based institutions comply with the Usury Act exemption notice – assuming that the interest rates they charge exceed the maximum Usury Rate.

As a legal matter, exemptions are intended to deal with situations that were either not intended or envisaged under the applicable legislation. It should not create a regulatory dispensation for the bulk of an industry outside of the applicable law. The existence of numerous exemptions indicates that the scope of the applicable legislation is probably too wide or that the provisions are inappropriate. Exemptions – and the ease with which they could be withdrawn – create uncertainty for investors and are not conducive to the growth of an industry. Exemptions often suggest abdication of responsibility by regulators and imply the insignificance or irrelevance of that which is being exempted.

Duplicating regulatory responsibility

Financial services cooperatives are currently regulated by at least three controls. When establishing a cooperative of this nature, constituting documents need to be submitted to the Registrar of Cooperatives, as well as financial statements annually. He also needs to be informed of the appointment of new directors. Whether the Registrar of Cooperatives is the appropriate person for assessing the performance of financial services cooperatives is an open question. As far as lending activities are concerned, if these cooperatives exceed maximum rate determined by the Usury Act they need to register with the MFRC and adhere to its regulatory requirements. These include financial reporting, disclosure and other consumer protection requirements. Finally, financial services cooperatives need to comply with the regulatory requirements of the self-regulatory institution (indirectly,

[15] Government Notice 713, 1 June 1999.

the Registrar of Banks).

To summarise, the Registrar of Cooperatives is concerned primarily with constituting the institution into a proper legal entity; the MFRC is concerned with its activities as a lender; and the Registrar of Banks is concerned with its activities as a deposit taker. The burden of regulatory compliance should not be underestimated. While it is clear that different aspects are regulated, regulatory compliance and reporting will have to be streamlined.

Capping, tiers and terminology

The entities covered by the third-tier exemptions under the Banks Act referred to above are all membership-based organisations. In certain other dispensations – for instance in Canada, Germany and the United States, to mention a few – cooperative or membership-based banking institutions, not necessarily small, exist alongside with so-called equity or commercial banks. The capping on maximum deposits that may be held by third-tier institutions suggests to those investing in them that these institutions are destined to remain small. Size is important for systemic risk and intensity of regulation, and the capping of deposits at an appropriate level can be justified. However, there must be an opportunity to graduate into another dispensation, in order not to preclude expectations of growth. In this regard, an appropriately amended and renamed Mutual Banks Act, which would assume a cooperative legal personality, could serve as a next tier for membership-based institutions. It must not be assumed, however, that membership-based organisations wish to graduate to something that is not membership based.

The “tiers” concept emphasises horizontal and not vertical distinctions in banking institutions. Along vertical lines, a distinction is required between membership-based and non-membership-based institutions, and which transcends the tiers of banking institutions acknowledged in regulatory thinking. We will elaborate on this in the final section of this report.

2.10 SCOPE AND SIZE OF THE MARKET

In 1996, the South African Reserve Bank estimated that 60 per cent of the South African population was unbanked. These findings were recently echoed by FinMark (2003). The Interbank Initiative, concentrating on savings and transmission facilities for the unbanked, defines the mass market as consisting of individuals earning less than R3 000 per month. A distinction is made between urban and rural populations, which are further subdivided into the following categories:

Segment	Size	Urban	Rural	Banked	Unbanked
Employed/partially employed	5,2 m	67%	33%	48%	52%
Unemployed/unsupported	5,0 m	90%	10%	22%	78%
Township youth	3,0 m	100%	–	30%	70%
Supported family	2,4 m	5%	95%	33%	67%
Pension/grant	2,2 m	55%	45%	27%	73%
Totals		67%	31%	33%	67%
	17,8 m	12,3 m	5,5 m	5,9 m	11,9 m

Limiting the banking requirements of the so-called unbanked population to savings and transmission services ignores the circumstances and living environment of most of the target market. Thus, only part of the need and a small portion of the population will be addressed.

The scope for membership-based financial institutions therefore cannot be limited to the mass market because the need for banking services also includes insurance services, cash transaction facilities and credit. This need extends across the full spectrum of the market, including current clients of the formal banks in the rural and urban areas. The majority of SACCO members, for instance, also have an account with a formal bank. The limited footprint of the formal banks in the rural areas, as well as the limitations in banking services experienced by both urban and rural people, defines the scope for membership-based financial services or third-tier banking.

The following is a rough assessment of the supply side of the market by membership-based institutions:

Institutional format	Number	Members	Savings	Credit	Source
Stokvels	800 000	8,25 m	R400 m/month	?	NASASA
Burial societies	250 000 (est.)	8 m	R200 m/month	?	FinMark
Financial services cooperatives	62	80 000	R40 m	?	NDA
SACCOs	28	13 000	R20 m	?	SACCOL

To assess the scope for membership-based financial services, we studied the 2000 Census figures and calculated that 14,7 million people live in 8 119 rural villages. Some 960 of these villages have a population of more than 2 000 people over the age of 15 years. Most of these rural villages are, however, geographically grouped in bigger rural clusters of villages.

The table below gives an outline of the population distribution per area cluster of rural villages per province. This grouping does not reflect economic units, which would have been a more realistic way of defining the scope of the market, and is therefore very conservative.

Province	Total	Population per age group				No. of cluster villages in population categories (age > 15)								
	Population	0-14	15-64	65+	> 15	Total	'1000							
							>100	>50	>20	>10	>5	>2	>1	<1
North West	1 493 012	572 272	827 466	93 274	920 740	47	2	8	14	18	19	23	29	18

Mpumalanga	1 267 533	549 354	656 746	61 433	718 179	28	2	7	9	11	12	14	15	13
Limpopo	4 103 775	1 868 752	2 010 214	224 809	2 235 023	85	6	21	30	33	39	47	58	27
KwaZulu-Natal	3 969 612	1 773 414	2 004 777	191 421	2 196 198	132		14	43	56	66	86	102	30
Free State	299 115	112 675	168 924	17 516	186 440	4	1	1	2	2	2	2		4
Eastern Cape	3 643 727	1 696 187	1 717 948	229 592	1 947 540	125	1	11	35	44	58	76	84	41
Grand total	4 776 774	6 572 654	7 386 075	818 045	8 204 120	421	12	62	133	164	196	248	288	133

Source: Development Bank of Southern Africa.

The table does not reflect the rural population in the Western Cape, Gauteng and the Northern Cape because the small towns were not defined as rural villages in the statistics. The non-urban population (age 15-65) of these three provinces is 671 000 (Statistics South Africa, 2000) and, added to the statistics above, gives a total population of 8,87 million.

If we consider both the above information and the minimum cost structure that requires a certain level of income to break even for a typical financial services cooperative or SACCO, as well as experience with the Village Bank programme, we estimate that most villages with a population of more than 2 000 (age > 15) would probably be able to sustain a membership-based financial institution from its own operations. This implies that the scope exists for up to 1 000 membership-based financial institutions in the rural areas and an estimated 500 in urban areas.

A conservative estimate of the market potential for the number of membership-based financial institutions is 1 500, with a potential membership base of 2,25 million and a savings portfolio of R1,125 billion.

2.11 PROLIFERATION OF GOOD IDEAS AND INTENTIONS

No historical overview of the member-based sector will be complete without reflecting on the institutional relationships and heated debates that make this sector as interesting as it is today. It is also true that very often the institutional focus gets in the way of engaging on issues that will benefit the whole sector. Not surprisingly, people in this sector hold strong views, as they believe in what they do and wish to defend their position. This section unpacks these issues to ensure that the arguments are understood.

FINASOL and the FSA are probably the most talked-about initiatives, and although there were differences in approaches, their stories are remarkably similar. For both, it was a case of good intentions, based on the belief that a transaction backbone and focused approach to mobilisation and capacity building could make a difference. However, good ideas need good support. In a way these two institutions were always victims of the lack of financial support, and of the influence and demands of the financier. The lesson here is that member-based institutions cannot succeed if the locus of control does not lie with the members.

In addition, internal tensions and strategic errors in the allocation of emphasis could have contributed to the demise of these institutions. One cannot be a promoter or supporter and a judge at the same time; similarly, capacity building support and self-regulation are two opposing objectives. Trying to achieve both with the same institution is virtually impossible.

It is also interesting to observe the activities and issues of SACCOL, NCASA and the other cooperative support and promotion bodies. There is rivalry in terms of which cooperative form is the purest, and whether the purest cooperative form is indeed the answer to the expansion of financial services for the poor. At various times there were efforts to move nearer to different positions, but in general most of the actors subscribed to the same basic principles.

The emphasis by more "political" entities such as COSATU and NEDLAC on the cooperative approach softened the reputation of cooperatives as apartheid institutions, and it is clear that this form of financial enterprise is here to stay. Despite some differences, there is general consensus on the importance of member-based institutions. The increasing volume of research and the number of discussions on these topics are evident of this new emphasis.

Although there will always be competition amongst the various support institutions, the reality is that they have brought about an emphasis on and change in the member-based financial institution arena. Without these institutions we would neither have had the lessons that we bring to the table, nor the current number of functioning, formalised member-based institutions. These institutions have, in fact, been meeting twice a year since 1999 to discuss mutual concerns.

3 LESSONS LEARNED

3.1 INTRODUCTION

The lessons learned specific to each institutional format were highlighted in the relevant sections. In this section these are distilled into a limited number of core lessons. This section first tackles the issue of why the existence of and demand for member-based financial institutions in South Africa are justified, and examines whether the demand is met by the existing format of financial services. Thereafter we turn to core lessons, based on the earlier discussions of the individual institutions. Lastly, lessons in terms of legislation, regulation and supervision approaches are presented.

3.2 DEMAND FOR MEMBER-BASED FINANCIAL INSTITUTIONS

The current volume of transactions and membership figures indicate that a large proportion of both the rural and urban population deals with member-based financial institutions. This is true for areas where there are limited formal banking institutions and for areas where other banking institutions are present, and thus reflects a demand for member-based financial institutions.

Our analysis of the market potential shows a vast number of villages and settlements that will be able to carry viable member-based financial institutions. There is an estimated potential of at least 1 500 of new these institutions to be formed over the next decade.

In response to the question of how appropriate the format of intermediation is and whether it is sustainable, we assert that these institutions can fulfil the functions of financial institutions – the mobilisation of savings, mitigation of risk, facilitation of goods and services acquisition, monitoring of contracts and efficient allocation of resources. Levine (1992) argues that financial institutions are established to overcome information and transaction costs that inhibit the efficient functioning of financial markets. We state that the same motivations hold true in the formation and functioning of member-based financial institutioNs.

3.3 CORE LESSONS

An informal financial institution such as a stokvel will not necessarily become a formal member-based financial institution; if it does, the transition is usually not smooth. However, the concept of collective action, as experienced in stokvels, may serve as a catalyst for a stokvel becoming a member of a Village Bank or a credit union.

When the process of establishing a formal member-based financial institution starts, the timing of such establishment or transition is crucial for the survival of the institution. Institutions should not be forced to provide services for which they are not ready.

Self-regulation has not been successful, partly because of capacity problems, but mainly due to a conflict of interests and possibly ineffective oversight by the

Registrar of Banks. Once exempted, the self-regulatory bodies were to some extent left to their own devices.

Where institutions received initial support to start up, even without support institutions and regulations the effect of collective actions is strong at village level. For example, the Motswedi Village Bank is going strong without support. However, a close scrutiny of how institutions were formed led us to believe that formalised institutions will not be established by themselves, and thus need initial intervention and support from outside.

To develop a sector, financial commitment is required and skills and resources need to be made available.

Support organisations are essential in the establishment, development and management of membership-based financial institutions.

In the case of informal institutions providing services over and above their traditional functions, it is clear that support is needed to build capacity in financial management and leadership.

Almost all member-based financial institutions are linked to commercial banks in some way; none of them, except the conventional stokvels, can actually operate without this link. Thus the member-based financial institutions and members are already to some extent integrated with the broader financial sector. This integration differs between institutional formats in terms of the number and frequency of interventions with commercial banks, as is illustrated below.

Stokvel	**Burial society**	**Village Banks**	**Credit unions**	**NGO group types**
Limited incidence of transactions with the bank sector; however, there are more when more services are provided to members	Medium level of interaction with banks, deposits and withdrawals	Medium level of interaction with banks, deposits and withdrawals	High level of interaction with banks and deposits	Medium level of interaction with banks and deposits

Whereas most of the membership-based financial systems in the rest of the world form a second and third level, the strength of the commercial bank system in South Africa militates against the formation of a next level for funding flow and pooling reasons, but not in the case of support and capacity building. The problem of funding thus links this system to the same problems that microfinance in general experiences when interacting with the banks (e.g. lack of access to the payments system).

3.4 LESSONS ON LEGISLATION, REGULATION AND SUPERVISION

- Third-tier organisations are not homogeneous and regulatory differentiation is essential.
- Self-regulation has not had the desired outcome for third-tier organisations in South Africa.

- The functions of support and regulation should be differentiated. It is not advisable to have the same institution providing both, as they have conflicting objectives.
- Exemption alone is not effective regulation – legislation is required to ensure legitimacy, stability, growth and investment.
- Commercial banks and membership-based banks require different regulatory approaches.
- Deposit insurance is an essential component.

3.5 COMPARISON OF INSTITUTIONAL TYPES AND SERVICES PROVIDED

Service	Stokvels	Burial Societies	Village Banks	SACCOs	NGOs
Saving	Mostly rotation savings	Mostly target savings to cover burial cost	Unlinked savings	Mostly credit-linked savings	Mostly forced savings
Credit	Some intergroup lending	No credit unless also operating as a stokvel	Subject to risk capital and leverage ability	Subject to risk capital and leverage ability	Savings-linked credit
Transmissions	None	None	Possible with link-bank relationship	Possible with link-bank relationship	No transmissions
Cash transaction	No cash transactions	Cash collections and payments	Current account	No cash transactions	No cash transactions
Insurance	Planned group scheme	Mostly not underwritten	Group or individual schemes	Group scheme	No insurance
Economic empowerment	Group and individual empowerment	Group and individual empowerment	Group and individual empowerment	Group and individual empowerment	Individual empowerment
Social empowerment	Personal cohesion	Personal cohesion	Sustainable group structure	Sustainable group structure	Opportunity cohesion
Leverage	Ability low	None	Ability high	Ability high	None
Market	Unlimited	Unlimited	Primarily rural	Primarily urban	Mission target
Origin	Organic	Organic	External intervention	External intervention	External intervention
Gender	Open	Open	Open	Open	Mission target
Legal entity	No legal entity	No legal entity	Cooperative	Cooperative	No legal entity
Ownership	Informal	Informal	Formal shares	Formal shares	Informal
Group dependency	Group specific	Group specific	Not a specific group	Not a specific group	Group specific
Group use of a formal bank	Group account	Group account	Group account	Group account	Mostly no group account
Individual use of a formal bank	Minority; not compulsory	Minority; not compulsory	Minority; not compulsory	Majority; mostly compulsory	Minority; not compulsory
Accommodation of subgroups	No	No	Encouraged; also includes	No	No

Service	Stokvels	Burial Societies	Village Banks	SACCOs	NGOs
			stokvels		
Physical facility	Informal	Informal	Formal	Formal	Informal
Cohesion	Intergroup	Intergroup	Members to bank	Members to bank	Intergroup
Financial sustainability	All cost absorbed by the group	All cost absorbed by the group	Income dependence	Income dependence	Cost absorbed by the NGO
Social sustainability	Group ownership and control	Group ownership and control	Group ownership and control	Group ownership and control	Benefit dependence

4 THE WAY FORWARD

4.1 INTRODUCTION

The analysis of the market and the lessons listed in the previous session are sufficient argument for the support and expansion of member-based financial institutions as financial enterprise formats. We have seen the link with commercial banks and have stated that in most cases the banks connect these institutions to the formal financial sector. It can be argued that these institutions and their members are more part of and integrated into the formal financial sector than the clients of development lenders institutions, as these quite often strive to form a system outside of the formal financial system.

Based on the core lessons a few tentative suggestions are made on the way forward, and we differentiate between regulatory functions and support functions.

4.2 REGULATORY FUNCTIONS

4.2.1 Preconditions for regulation

Entities that are, by their very nature, informal cannot be regulated. It seems that within the so-called third tier, certain entities are capable of regulation whereas others are not. Stokvels, in the form of rotating savings schemes, are generally informal, have no employees or infrastructure, do not have or aspire to juristic personality, and the product range and associated risks are limited. These entities are not capable or in need of regulation while they function as rotating savings schemes. Any attempt at regulation would be futile. They are not regulated externally and the risks can be managed by their members. In addition, the number of entities involved in this category, the cost of regulation and any benefit that such regulation can offer militate against regulation. In effect, risks are not systemic, as they are contained within the membership of a stokvel. The same cannot be said of entities that assume a more advanced form of intermediation; that assume the risk of advancing members' funds from deposits taken; that have a greater growth potential; that could benefit from membership of and service provision by a central or secondary body; and that could be regulated effectively, given the capacity that will exist in those entities through the services contracted from central or secondary entities ("approved support organisations"). The Village Banks and SACCOs or credit unions fall into this category.

4.2.2 The need for legislation

Legislation is required to give statutory recognition and legitimacy to a second tier of member-based banking institutions. It is also necessary to provide stability, legitimacy, growth and investment.

It is not desirable to deal with the various types of member-based financial institutions in the same manner. While there is a need for certain third-tier entities to be regulated, other entities require exclusion because it is neither possible nor desirable to regulate them. The proposed legislation must, however, create the necessary conditions for their growth, and create the necessary confidence for investment in what is referred to hereafter as Limited Mutual Banks. This term acknowledges both the member-based nature and the limited services on offer by institutions such as Village Banks and SACCOs.

There are a number of factors determining the need for registration, and which relate to the number of members, the nature of the transactions, the risk assumed, the locus management control, and whether a legal personality has come into existence that assumes obligations in respect of individual members.

A member-based financial institution taking deposits from its members should not be allowed to continue to operate without being registered with the Registrar of Banks (or a new Registrar of Mutual Banks) as a Limited Mutual Bank under any of the following conditions:

- If the members adopt legal personality in some form or another; or
- there are more than 200 members; or
- the institution becomes externally managed (other than by way of an approved support organisation); or
- if loans are advanced that exceed the deposits made by the members.

If any of the above conditions apply, the member-based entity must register provisionally with the Registrar as a Limited Mutual Bank.

Provisional registration should only be granted by the Registrar if the member-based entity can prove that it has assumed an acceptable legal personality, has the minimum capacity to manage its business effectively, has concluded a support agreement with an “approved support organisation” and meets minimum requirements for “fit and proper” persons.

In terms of the proposed legislation, member-based entities such as stokvels not operating under the circumstances stipulated above should be allowed to continue operations under a special exemption.

Burial societies must be required to structure themselves as friendly societies or to obtain underwriting from a registered insurer as soon as their membership reaches 200, or if the scheme is no longer member managed, or if it adopts a legal personality. While burial schemes are required to be registered under the Friendly Societies Act, burial societies are exempted to the extent that they meet common bond exemption requirements. The burial scheme product is essentially an insurance product and should not be dealt with under banking legislation but under the Friendly Societies Act or insurance legislation.

The needs of housing savings clubs should be discussed further with the Department of Housing, but the same considerations regarding size, nature of the transactions, external management and legal personality should guide any regulatory dispensation.

4.2.3 A changing role for self-regulatory institutions or "approved support organisations"

It is virtually impossible for any regulator to attempt the regulation of membership-based institutions without having in place functional secondary bodies providing services to third-tier institutions. One should not assume the availability of electricity, computers or fax lines. The existing self-regulating bodies should continue to fulfil their advocacy, developmental and service provision functions. They should assist membership-based financial institutions in reporting to the Registrar, and assist the boards and members of these institutions in fulfilling their governance and control functions. This is a role no different than the one ordinarily provided by central or secondary cooperatives for different types of cooperatives in the international context. It is proposed that membership of such an entity should remain a condition for registration and that these institutions should also be subject to control to ensure that they have the capacity to perform their functions. Provision should also be made for the registration of approved support organisations, and they should have access to government funding under the conditions set out in the proposed legislation.

4.2.4 Deposit insurance

To allow people to put money in a Limited Mutual Bank requires a commitment by the government to back up deposits in these institutions – if not to the full extent, then at least to a substantial percentage. In this sector, exposure to the government, compared with its unwritten commitment towards the other tiers of banking, is currently still negligible (Malan & Willemse, 1996).

4.2.5 The funding of approved support organisations

The government also needs to commit itself to provide appropriate funding in support of the industry, particularly through creating capacity at the level of the approved support organisations. This would ensure appropriate capacity to create more Limited Mutual Banks. It is submitted that this would be more effective than creating a force of inspectors to police such banks.

4.2.6 The Registrar

In order for juridical personality to be established, and for that purpose only, registration with the Registrar of Cooperatives in terms of the new proposed Cooperatives Bill would be essential. Thereafter, functional regulatory control should vest in the new Registrar of Mutual or Membership-based Banks. The new proposed legislation for Limited Mutual Banks should override cooperative legislation where there is conflict, as is the case with the Banks Act and the Companies Act. The acceptability of the MFRC as a regulator of third-tier deposit taking is not supported by the Department of Finance or the Registrar of Banks. The sentiment seems to be that this function differs from the consumer credit protection function envisaged for the MFRC in the form of a proposed statutory consumer credit regulator. The current non-statutory nature of the MFRC also appears to be an issue. A further consideration seems to be the necessary role of central banks in giving legitimacy to alternative forms of banking and serving as a lender of last resort. Limited Mutual Banks should, however, remain subjected to the consumer protection measures currently contained in the Usury Act exemption or in the proposed consumer credit legislation. It is envisaged that approved support organisations providing services to their members could play an important role in reporting and in assisting members to comply.

4.2.7 Non-membership-based deposit taking

The issue of deposit taking by entities that are not membership based needs further consideration. In the first category, entities take wholesale deposits to fund their activities. It can safely be assumed that the activities of microlenders are not funded only by shareholders' capital or bank loans. When the MFRC was established, it was envisaged that an exemption from the Banks Act to allow deposit taking by microlenders in this sense would be forthcoming, on condition that such lenders would be accredited and regulated by the MFRC. While such a dispensation is envisaged by the authorities, it is tempered by a measure of caution, given the extent of malpractices in the industry. The second category of entities can be described as (donor-driven) development lenders or NGOs. While the MFRC in certain circles is associated only with the former category, it was conceptualised in the context of the latter. The deposits taken here are either microdeposits not linked to borrowings, or security deposits (i.e. deposits to secure the loans taken up by borrowers). The latter is not prohibited by the Banks Act.[16] Microdeposit taking by development lenders (e.g. the SEF) should remain prohibited in the absence of enforceable external guarantees approved by the Registrar to back up the entity's repayment obligations to depositors.

4.2.8 Consequences of registration

If it is accepted that Limited Mutual Banks are providing banking services proper, then simplistic prudential requirements pertaining to capital and liquidity would be essential. Registration and legitimacy also bring with them other statutory legal obligations such as taxation and Unemployment Insurance Fund obligations, to mention only two.

4.2.9 Thinking about banking tiers

It has become customary in South Africa to think of banking legislation in terms of horizontal tiers (Porteous et al., 1999.). The first layer of banking institutions would refer to the large commercial banks registered under the Banks Act of 1990, providing the whole range of banking services. These institutions are to remain competitive internationally and hence need to live up to Basle standards. The second tier would represent dedicated niche banks providing a limited range of services, such as savings and loans. Previously, this is where the African Bank, Unibank and Saambou belonged, but this space has now been earmarked for the proposed core and narrow banks, or dedicated banks as they are also called. Originally the Mutual Banks Act was seen as the haven for second-tier banks and the framework for the likes of the Community Bank and Cashbank. At the third tier, regulation took the form of exemption. The entities falling into that category at the time were the common bond (membership-based) entities and financial services cooperatives.

The fundamental shift that seems to be required is that one should no longer assume that membership-based entities have the desire to grow into a company

[16] Paragraph (ii) under the exclusions in the definition of "the business of a bank", section 1.

structure. It appears to us that over and above horizontal tiers it has become necessary to think also in terms of vertical distinctions. Internationally, large credit unions or cooperative banks exist alongside commercial banks. Any proposed banking regulatory structure therefore needs to allow membership-based structures to graduate into another tier of membership-based banks. Currently, the Mutual Banks Act allows for the registration of such banks. Although a Mutual Bank is not a registered cooperative, it has strong cooperative features. It has become clear that certain third-tier entities cannot graduate of their own accord and need to be regulated. It is also clear that financial services cooperatives should be regulated and that specific legislation is required. Such legislation would, in essence, create second-tier membership-based banks, or what we refer to as Limited Mutual Banks. These entities should then be able to graduate into (unlimited) Mutual Banks when their (risk-weighted) capital requirements reach R100 million. Mutual Banks need to have at least R10 million in capital in order to register, but in practice the Registrar requires at least R50 million. The Mutual Banks Act would, however, have to be amended to ensure a smooth graduation from a Limited Mutual Bank to an (unlimited) Mutual Bank. Consultation with the existing Mutual Banks would be necessary. The landscape for banking regulation would thus appear as follows:

Proposed thinking on tiers and deposit taking		
Tier	**Membership based**	**Non-membership based**
1	Mutual Banks under amended Mutual Banks Act	Commercial banks under the Banks Act
2	Limited Mutual Banks under the Membership-based Banks Act	Core and narrow Banks under the dedicated Banks Act
3	Exempted common bond entities	Microlenders[17] dispensation

4.2.10 Considerations for implementation of the Membership-based Banks Act

The implementation of legislation for Limited Mutual Banks requires the commissioning of studies on the funding and implementation of the support structures for such banks. A committee needs to be established to oversee the development or settling of draft legislation.

4.3 SUPPORT FUNCTIONS

4.3.1 Introduction

It is quite clear from the interviews and secondary data sources that focused support in different guises is important for the establishment and expansion of formal member-based financial institutions. It is further evident that this support is also necessary where informal member-based financial institutions evolve to include more services, or expand away from the core service. The main challenge

[17] This issue does not form part of this brief and is still under discussion.

is to identify the type of support needed and the institutional vehicle with which to provide it. What is clear is that support organisations should focus on support and not on regulatory responsibilities.

4.3.2 Support areas

For informal institutions

- Strengthening of financial management
- Strengthening of leadership and management
- Assistance to provide a collective voice for informal institutions

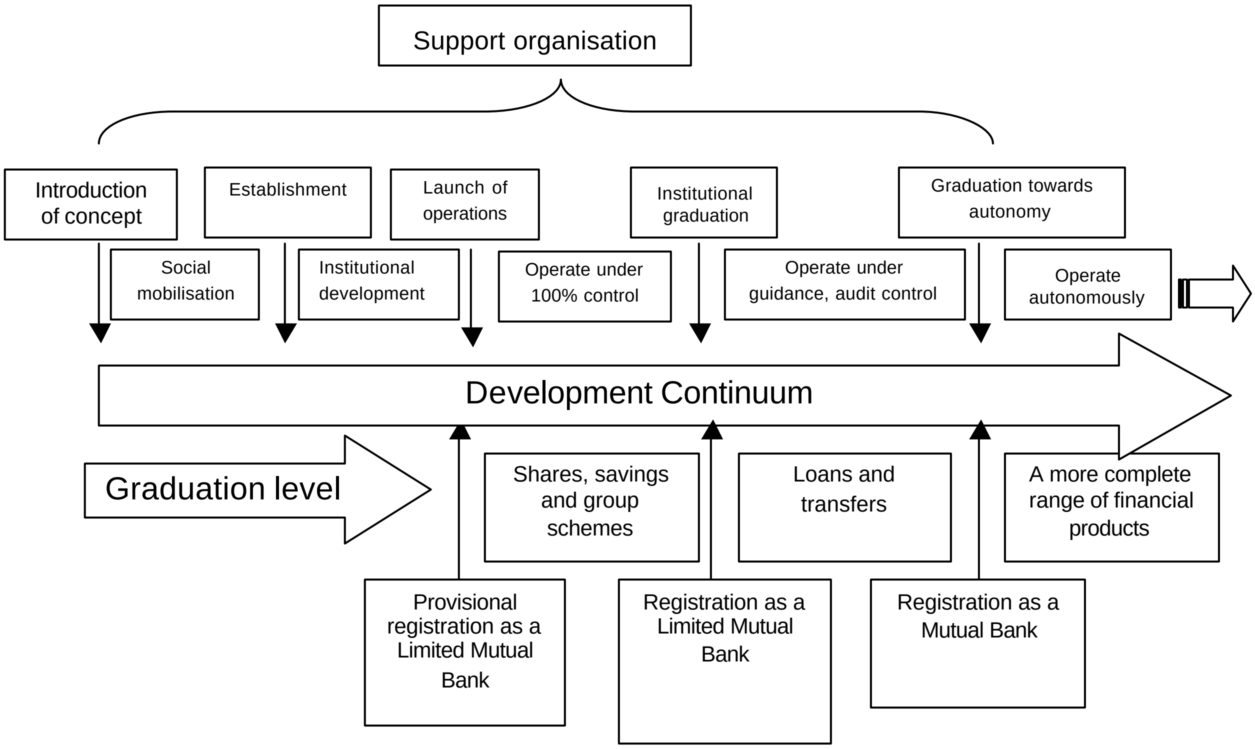
For formal institutions

- Assistance with formalisation and establishment (support and funding)
- Financial administration, management and other training
- Lobbying mechanism
- Group schemes
- Amalgamation and split arrangements
- Pooling of risk
- Accumulation, consolidation and dissemination of information

4.3.3 Institutionalisation of support and the possible roles of approved support organisations

An apex is an institution that is voluntarily supported by a range of formalised member-based institutions. Past experience has shown that the interventions of these institutions can be successful. The emphasis, however, should be on support and capacity building, rather than on acting as a regulator. It is further clear that any Registrar will find it difficult to execute this more developmental responsibility, and that it should be left to institutions that are funded and focused specifically on supporting the formalisation of member-based institutions.

The development continuum as summarised below also reflects on the support structure required, the level of services that can be provided and autonomy of the organisation. The latter, in turn, also determines the operational capacity and regulating structure required. Member-based financial institutions must receive recognition as formal institutions in the form of Limited Mutual Banks. The legislation needs to accommodate their position on the development continuum.



Graduation level 1 starts when a member-based financial institution has developed to a level of institutional proficiency allowing it to commence basic operations. It is recommended that only shares, savings and established group schemes be started at this stage, and that the approved support organisation be responsible for monitoring the provision of these services. At this stage the institution should register provisionally – this will indicate intent and will focus support services on the institution.

This arrangement is proposed to continue until graduation level 2, at which point the institution must be able to prove that it is operationally in control of its activities, can manage its risks effectively and can start with a loan and transfer programme. Although the approved support organisation will still provide support services such as auditing and guidance, it is recommended that the Limited Mutual Bank should now report directly to the Registrar.

Provision should also be made for Limited Mutual Banks that develop and grow to a point where they can satisfy the Registrar that they have all the required capacity in-house, can operate effectively without the help of the approved support organisation, and wish to loosen or break the relation with the organisation (graduation level 3).

This being a development process by its very nature, full recognition should to be given to the need for capacity building and the cost related to it. Without an effective level of operational proficiency the sector will never develop to its full potential. The specialised nature of banking services and the multisectoral reach and impact must be considered when structuring support and regulatory measures.

Limited Mutual Banks cannot operate in isolation from the commercial banks through which they effect transactions and with whom they invest their net savings portfolios. Commercial banks also become a window through which services not provided by member-based financial institutions can be mobilised and, at the same time, a window through which commercial banks can promote and provide alternative services.

The operational relationship between Limited Mutual Banks and the commercial banks must, however, be built on a commercial basis to ensure sustainability of the relationship. It is therefore important that Limited Mutual Banks not be perceived as possible competition but rather as a business opportunity. Moreover, it may be prudent for even big Limited Mutual Banks not to cut ties with the approved support organisation, as cooperation enhances the sustainability of the latter.

4.4 RELATIONSHIP WITH COMMERCIAL BANKS

Member-based institutions in South Africa benefit by their links with commercial banks. Except in the case of Village Banks, these links are voluntary and based on demand. Member-based financial institutions and their members are, therefore, an integral part of the financial market. These links can be made more efficient – this is an area in which the current Interbank Initiative can play a role.

One aspect that needs to be reconsidered is the notion (as reflected in the exemption notice) that commercial banks have a demarcated area in which only they can operate. It must be acknowledged that Limited Mutual Banks will operate alongside commercial banks.

4.5 FINANCING REQUIREMENTS FOR THE PROMOTION AND DEVELOPMENT OF THE SECTOR

As indicated in this report, the unbanked population in South Africa has a need for financial services. The informal alternatives grouped under the definition of stokvels will not develop organically into formal service providers and will remain at an unacceptable level of proficiency. The Village Bank and SACCO concepts have proved their sustainability at primary level and this report suggests a structured process in support of the development of the sector. The cost of this process is, however, beyond the financial and technical ability of the target market, which suggests the need for a process of intervention. While new and appropriate legislation is considered a prerequisite for the growth of the sector, this in itself will not result in an organic development process. The developmental nature of the process needs to be acknowledged, which requires further intervention in support of the promotion and development of a member-based financial services sector.

The areas suggested for support include the following:

- Development of new legislation
- Cost of regulation and supervision

- Development of an implementation plan
- Cost of network expansion, including community mobilisation and social development, and the direct cost associated with establishment, such as a start-up pack, a safe, initial administration costs and training
- Cost of network development, including the development of products, systems and network integration
- Cost of ongoing support during the period of sector establishment, including continued training, auditing and reporting
- Risk underwriting

4.6 EXTERNAL INTERVENTION

Ownership and control by members of member-based financial institutions are fundamental to the institutions' sustainability. The process of external intervention must therefore be arranged in a manner that will support the development process, sustain full ownership and control, and prevent dependence on support. The suggested involvement of government, funding and development organisations in the development process (other than through registration and regulation) increases the danger of affecting full ownership and control by the members, and requires careful consideration of the nature and extent of their involvement in the process. It is suggested that the government and funding organisations be involved through a coordinating body officially mandated and capacitated for its task.

4.7 INTERIM COORDINATING COMMITTEE

In the absence of an industry-owned and controlled coordinating body, it is suggested that an interim committee or body be established with the primary task of promoting and developing a sustainable member-based banking sector. The initial tasks of this committee would be to:

- Coordinate the participation of relevant government departments in the sector
- Develop an implementation plan for a national member-based banking sector
- Review the situation of existing formal member-based financial service providers
- Develop and implement a restructuring and support programme
- Identify and mobilise funding for the development and establishment of the sector
- Identify, mobilise and coordinate support for network expansion
- Promote and support the establishment of a sector-owned and controlled coordinating body that can take over the functions of the interim committee

Apart from a basic administrative and coordinating capacity, the interim coordinating committee should consist of members from the sector, government, participating funding and development organisations, the commercial banking sector through the Council of South African Banks (COSAB) and co-opted expertise.

ANNEX A: LIST OF INTERVIEWEES

Bank Supervision	Mr Christo Wiese and Mr Johan Delport
Registrar of Cooperatives	Mr Hector Rapoo
MFRC	Mr Gabriel Davel
NDA	Ms Jenetha Mahlangu
DTI	Ms Nweti Maluleke
National Treasury	Mr Nkosana Mashiya
Department of Social Development	Ms Reana Ally, Mantombi C. Mapulec & Sibogile Manana
Post Bank	Ms Marietjie Lancaster
DBSA	Mr Hein Prinsloo
Khula	Mr Sizwe Tati
COSAB	Mr Cas Coovadia and Mr Vish Suparsad
ABSA	Ms Sonja van Vliet
Ithala Limited	Mr Peet Marais
NASASA	Mr Steven Japp
SACCOL	Mr David de Jong
NCASA	Mr Mwedi Mkalipi
FNB (Interbank group)	Mr Johan van Wyk
Northwest Province FCSs	Mr Joe Leepo
FINCA	Mr Scott Graham
DGRV	Mr Bernd Harms
USAID	Mr Dorvin E. Stockdale
SUMS	Mr Barry Coetzee
FNB	Mr Mike Hillary
Consultant	Dr Richard Bates

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ANNEX C: BACKGROUND REPORT