THE BANKING ASSOCIATION SOUTH AFRICA

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BANKING MATTERS

# 2019 AND BEYOND

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The Banking Association South Africa (BASA) works with regulators, legislators and stakeholders to make banking sustainable, profitable and better able to contribute to the social and economic development and transformation of the country.

Banking Matters, an occasional online publication of BASA, seeks to highlight and analyse some of the major trends that will confront the banking industry in the years ahead. In this edition, we look at how innovation and technological disruption in banking is challenging traditional ways of doing business and serving customers.

This digital disruption comes at a time when South Africa is undergoing significant social and political change. As responsible corporate citizens, South African banks recognise that their success depends on the country achieving sustainable, inclusive economic growth. As such, they often need to go beyond the employment equity and black economic empowerment targets set out for them in the Financial Sector Code.

The contributions to this publication come from banking executives, industry thought leaders and academics. They do not necessarily reflect the views of BASA and its members.

The topics range from the impact of increased competition in the banking industry, to social and political scenarios that speculate about the future of our country. Together, they provide insight into what banking in South Africa might look like in 2019 and beyond.

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# Technology: Hunting the big four

**Armed with digital innovations, new competitors are taking on the industry stalwarts. By Mike Brown.**

Bill Gates famously said: "We need banking, not banks." Today, banking is changing faster than ever, but it is only those banks that do not embrace this change that will find they are no longer needed.

The global banking industry is evolving in response to economic pressures, digital innovation and – most importantly – the changing way their customers use banking and financial services.

While their platforms are changing, banks remain relevant. I have no doubt that Bill Gates should rather have said: "We need efficient, digital banking platforms that focus on clients, not expensive bureaucracies focused on products."

Banks safeguard and transform the country's savings into investment and productive consumption, helping to grow the economy, boost employment and create wealth. Over the long term, this enables a sound, secure banking and regulatory system, improved levels of confidence in the country and the ability to attract higher levels of investment. This ultimately creates a more successful society with more inclusive economic growth.

The starting point of this system is trust – a critical competitive advantage for any participant in banking. South Africa has a robust financial services and banking system we can be proud of. It performed well during the financial crisis and both the system and its regulation are highly ranked globally.

New competitors in the banking sector have generally begun by targeting niche markets. More recently, competition has evolved from traditional competitors, to fintech disruptors, to "big tech" disruptors. These disruptors are revolutionising the banking experience for clients and, if traditional players do not respond, they will continue to capture more of the banking value chain.

*Brown is the Chair of BASA and Chief Executive of Nedbank*

Many fintech players have found it difficult to scale up and are increasingly partnering with traditional banks. But "big tech" disruptors have both the financial muscle and ability to grow, presenting a greater threat to traditional banks that do not embrace change and innovation. These trends are seen the world over.

The global banking industry is evolving in response to economic pressures, digital innovation and – most importantly – the changing way their customers use banking and financial services.

The "big four" – Absa, FNB, Nedbank and Standard Bank – have dominated the South African market for years, with Investec having a strong market share in its chosen specialist markets. The rapid rise of Capitec has upped the ante in personal lending and transactional banking. Now competitors from adjacent industries and non-financial service providers are gaining more market share from the bigger banks.

The emergence of other players in the financial services industry has created what PricewaterhouseCoopers defines as a "marketplace without boundaries". Non-traditional players are increasingly exploring new opportunities, enabling them to challenge incumbents and continually change the state of financial services in South Africa.

Bank Zero will be an app-driven bank that promises increased control and transparency for its clients. Others entering the industry include

Discovery Bank and Tyme, another digital player, which is backed by African Rainbow Capital. Postbank is also making forays into the local banking sector, particularly in the social grants space. This increased competition – in an already competitive market – can only bode well for consumers. For the incumbent traditional banks, these changes present challenging, but exciting, opportunities.

Long-term sustainable growth in the banking industry requires a departure from a sales and product-obsessed mind-set, to one that genuinely puts the customer at the centre of its operations. Business models then need to be aligned to deliver on this commitment.

**Agile systems and processes enable banks to better meet the evolving needs of their customers and provide them with a quicker, slicker experience.**

Core to this shift is improving organisational efficiency, processes and knowledge management. Digitised technologies and automated processes, continually enhanced through rich and accessible data, allow for swift decisions. Agile systems and processes enable banks to better meet the evolving needs of their customers and provide them with a quicker, slicker experience. But, while technology will enable a seamless banking experience, it does not remove the need for personal relationships with clients. An emotional connection, rooted in trust, is still important in banking and will be one of the key differentiators for attracting and retaining customers.

The future banking ecosystem will look very different from the one we have today, extending well beyond just core banking and expanded financial services.

Traditional banks will have to find the right partners, with the requisite skills and the freedom to innovate, to extend themselves well beyond traditional financial services. Banks that devise or tap into an easy-to-use ecosystem of services for their clients will deepen their customer relationships and, in so doing, gain access to valuable data they can use responsibly to refine their offerings and make their operations more efficient.

Banks will still need relationship managers and finance, risk and compliance skills, but key hiring choices will increasingly include behavioural psychologists, data scientists, engineers with artificial intelligence and machine learning skills, community advocates, digital marketers, among roles we have not even considered yet.

While the incumbent banks face challenges, they do have principal advantages: they have a sizeable share of South Africa's retail, business and corporate banking customers, as well as the financial strength to invest in the future. Most disruptors will find it difficult to reach scale without leveraging the customer base and capital that existing banks have already accumulated. Both can benefit from partnerships that reconfigure financial services value chains.

**Traditional banks will have to find the right partners, with the requisite skills and the freedom to innovate, to extend themselves well beyond traditional financial services.**

The South African banking environment of the future will consist of a combination of those banks that are able to evolve to keep pace with changing customer needs, as well as newer entrants that have successfully penetrated the local market and achieved scale.

The one thing all banks will have to contend with in the digital age is cyber risk. As cyber attacks continue to increase, banks will have to invest in increasing cyber-resilience programmes to ensure that the public's trust in the system is preserved.

In addition to dealing with these challenges, banks need to pay special attention to transformation, access to finance, financial inclusion, poverty alleviation and land reform. They need to accelerate transformation to remain relevant to the people they serve, while contributing to a sustainable economy and society.

The road ahead for banks is filled with uncertainty and complexity. But it also presents exciting challenges that require organisational agility, innovation, new skills and talents, and key partnerships that serve customers better.

Most banks are coming to the realisation that a growing fintech ecosystem, which was once perceived as a threat, can actually help them serve their customers better through emulation and collaboration. Disruptors, with their laser-sharp customer focus, have shown that it is possible to meet, and exceed, customer expectations. This lays the foundation for a future where traditional banking models, big-tech players and fintechs can co-exist and partner to create an even better banking system than we have today. ■

# A lost decade: The costly lessons learnt

**Banks need to continue to be active corporate citizens to ensure good governance in both the public and private sectors. By Cas Coovadia.**

It is now known that during the Zuma presidency the rhetoric of "radical economic transformation" was used by the corrupt and incompetent to cover their self-enrichment at the expense of the poor.

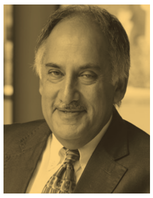
It is unfortunate that some parts of the governing African National Congress (ANC) adopted this populist and self-serving rhetoric to guide their economic policy, because it is clearly unable to effectively address the challenges of unemployment, poverty and inequality facing our country.

The hollowing of state capacity as a direct result of maladministration and corruption during the Zuma decade cannot be undone in a matter of months, especially since malpractice and networks of corruption persist in parts of government.

Public discourse has become increasingly acrimonious, as South Africans face rising prices of basic goods and a decline in the quality of essential public services. This is threatening efforts to foster a united nation.

In his February 2018 State of the Nation Address, President Cyril Ramaphosa called on South Africans to: "Put all the negativity that has dogged our country behind us because a new dawn is upon us... we should reaffirm our belief that South Africa belongs to all who live in it." This is important given the increasing racial and class polarisation the country saw under Zuma.

Ramaphosa went on to say: "We have to build further on the collaboration with business and labour to restore confidence and prevent an investment downgrade. Tough decisions have to be made to close our fiscal gap, stabilise our debt and restore our state-owned enterprises to health."



*Coovadia is Managing Director of BASA*

There is much that needs to be done. The Indlulamithi Scenarios 2030, launched in June 2018 and spearheaded by the Mapungubwe Institute for Strategic Reflection and Anglo American, focused on building social cohesion in South Africa. They identified three key drivers determining the future of social cohesion over the long term: social inequality, institutional capacity, and the "triple Rs" – reconciliation, resistance and resentment.

Public discourse has become increasingly acrimonious, as South Africans face rising prices of basic goods and a decline in the quality of essential public services. This is threatening efforts to foster a united nation.

The National Planning Commission, in its July 2018 review of the National Development Plan, highlighted the following areas for attention: strengthening governance, boosting demand for goods and services and driving high-priority improvements in education. It proposed a revitalisation charter to align stakeholders on what needs to be done most urgently in the next two years.

Government has made significant efforts to tackle corruption, improve governance and secure jobs and investment. We welcome the stimulus and recovery package announced by the president in September 2018, as well as the jobs and investment summits, which helped confidence.

However, political will and state capacity to implement quick economic and social wins that could stabilise the country and lay the basis for long-term development is still weak.

The Medium Term Budget Policy Statement, delivered by Minister Mboweni on 24 October 2018, was a good start in demonstrating political will. The address sent out a message of prudence, channelling funds to areas of activity that promote growth, economic activity and social development. It also took a clear stance that we must take the steps necessary to attract investment.

**While we recognise that the government of President Ramaphosa presents a new opportunity for the country, we must also hold him to the principles of good governance, rational, evidence-based policy, and the delivery of improved infrastructure and services to our people.**

But efforts to rebuild the country are vulnerable to attacks by populists and conservatives. This will continue as long as there is a lack of strong leadership articulating and implementing coherent economic and social development policies. This leadership must unite South Africans behind:

- An intense aversion to corruption.
- A commitment to enabling economic growth and building an environment where business and society work together to foster inclusive growth.
- A renewed commitment to constitutional principles, human rights and freedom of expression.
- Tackling crime in all forms – be it gangs in communities, boardroom malfeasance or gender-based violence.

South Africa's challenges will continue beyond the 2019 general election: society's dire needs and attempts by the corrupt to fight back will continue to define politics. The local government elections of 2021 will be an opportunity for the corrupt to secure public office.

In the face of the rampant corruption and maladministration of the Zuma government, the BASA board gave the association an unprecedented mandate to speak out against poor governance and state capture. While we recognise that the government of President Ramaphosa presents a new opportunity for the country, we must also hold him to the principles of good governance, rational, evidence-based policy, and the delivery of improved infrastructure and services to our people.

**The banking sector played a critical role, as part of broader organised business, in pushing back against state capture. The sector must remain active in rebuilding what was destroyed during the last decade.**

The banking sector played a critical role, as part of broader organised business, in pushing back against state capture. Financial institutions must remain active in rebuilding what was destroyed during the last decade by demonstrating that:

- They are committed to transformation and inclusive economic growth, as responsible corporate citizens and for sustainable business.
- They are well-regulated institutions that act in the public's interest by facilitating economic activity and – in the case of banks – protecting and growing the savings of ordinary South Africans.
- They are a source of resources and expertise for economic growth, job creation and social development.
- They are not competing for political power but have a democratic right to influence policy and speak out on governance.

It is only by remaining active corporate citizens that banks, and business in general, can help ensure a clean, capable and accountable government; inclusive economic growth and social development; and a non-racial and safe South Africa. ■

# Twin Peaks: Filling the gaps

**Banks, which are responsible for 20% of GDP, must be adequately regulated. By Kuben Naidoo.**

The financial sector affects each and every South African. Banks in particular play an important intermediation role in the economy, allocating capital from lenders to borrowers, managing financial risks, facilitating trade and offering access to the payment system.

It is critically important that the sector, which contributes about 20% to gross domestic product and employs about 154 000 people in the banking industry, is adequately regulated. The 2008 global financial crisis highlighted the extent to which the financial sector and problems in banks can negatively affect the real economy. The losses associated with the financial crisis were devastating in some developed economies – costing up to an entire year's gross domestic product in some cases. Many banks had to be bailed out by their governments.

The South African financial sector weathered the global financial crisis relatively well, with no major banks or other financial institutions having failed.

The South African financial sector weathered the global financial crisis relatively well, with no major banks or other financial institutions having failed. But this does not mean policy-makers and regulators can be complacent, particularly in light of the weaknesses identified in financial sector regulation in the lead up to the crisis and the lessons learnt thereafter.

*Naidoo is a Deputy Governor of the South African Reserve Bank and in charge of the Prudential Authority*

A peer review by the Financial Stability Board in 2013 highlighted that South Africa's institutional arrangements for financial sector regulation and supervision were relatively complex, involving multiple government agencies, as well as several advisory and oversight committees and self-regulatory organisations. This provided further impetus for the implementation of a new regulatory framework to address gaps and weaknesses.

A well-regulated, developed and stable banking system is vital for the achievement of long-term economic growth and developmental goals, as well as other public policy objectives like increased competition and the maintenance of financial integrity and stability.

Financial sector regulation aims to achieve the following public policy objectives:

- Safety and soundness of financial institutions (prudential regulation).
- Consumer protection and fair treatment of customers (market conduct regulation).
- Financial stability to prevent the collapse of the financial system (macroprudential regulation).
- Integrity and efficiency of the financial system.
- Prevention of financial crime.
- Financial inclusion and transformation.

Government, working with financial sector regulators, decided to strengthen the regulation of the financial sector by implementing the Twin Peaks framework. This proactive approach aims to strengthen the safety and soundness of banks and other financial institutions, and better protect customers and ensure that they are fairly treated. The framework was implemented on 1 April 2018, coinciding with the Financial Sector Regulation Act (2017) taking effect and the establishment of the Prudential Authority and the Financial Sector Conduct Authority (FSCA).

The Prudential Authority aims to promote and enhance the safety and soundness of market infrastructure and institutions that provide financial products and securities services. The focus of prudential regulation and supervision is to ensure that banks and other financial institutions comply with minimum prudential requirements – related to capital, liquidity and other relevant metrics – and to promote sound governance in the sector. Under the Twin Peaks framework, a consistent approach to prudential regulation will be applied across all relevant financial institutions.

Maintaining the safety and soundness of banks is an important public policy objective. A bank's failure could potentially require a government bailout, while depositors need to be protected, especially in the absence of an explicit deposit insurance scheme. This could come at a significant cost to public funds, as it is the fiscus that has to underwrite the costs of financial instability.

In this regard, the Prudential Authority's most important contribution to financial stability is effective microprudential regulation and supervision of banks and other financial institutions. This creates a financial system in which risks are well managed at an individual level to reduce systemic risk and boost confidence in the financial sector.

The FSCA is responsible for supporting the integrity and efficiency of South Africa's financial markets and protecting customers. The promotion of a safe and sound financial system is a necessary condition for financial stability, but it also requires transparent and accessible services and products so that consumers are protected. This is at the heart of the Authority's approach to treating customers fairly, particularly given the low levels of financial literacy among many vulnerable financial customers in South Africa.

While both the Prudential Authority and the FSCA are required to help maintain financial stability, the Financial Sector Regulation Act has given the South African Reserve Bank an explicit mandate to do so. The market structure of South Africa's financial system is dominated by a few large, interconnected financial institutions. This means that risks in individual systemically important banks, for example, could be transmitted quickly throughout the financial system, increasing risk. The Financial Sector Regulation Act helps ensure the stability of the financial system by establishing strong institutional arrangements through the Reserve Bank and other regulators.

Effective cooperation and coordination between the different regulators and the Reserve Bank is at the heart of the Twin Peaks framework. These regulators are members of the Financial Stability Oversight Committee, chaired by the Governor of the Reserve Bank, and the Council for Financial Regulators, chaired by the Director-General of the National Treasury. The framework provides for a harmonised system of licensing new financial institutions, consumer recourse, an appeal mechanism for regulated financial institutions, as well as coordinated supervision in areas of common interest.

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While the design of the regulatory architecture is important, it is not in itself a "silver bullet" for a stable and well-regulated financial sector. Regulators must also have the resources and experienced and competent staff to ensure there is effective regulation and supervision of banks and other financial institutions. Regulators also need to be appropriately and adequately funded in order to independently and effectively execute their mandate. In this context, a draft Levies Bill proposes the imposition of levies on financial institutions to fund both the Prudential Authority and the FSCA. The Reserve Bank is also required to provide adequate resources for the effective functioning of the Prudential Authority.

The Twin Peaks regulatory framework is expected to make a significant contribution to financial stability, the safety and soundness of individual institutions, the fair treatment and protection of customers, and confidence in the South African banking system. ■

# Financial inclusion:
# More than just bank accounts

**Financial inclusion has the potential to create enormous benefits for society and greater business opportunities for financial institutions. By Khulekani Mathe.**

Financial inclusion is big business for banks across the globe. The number of adults without bank accounts has fallen dramatically, from 2.5 billion in 2011 to 1.7 billion in 2017. A 2015 study by Accenture estimates "that bringing today's excluded adults and businesses into the formal banking sector could generate about $380 billion in new revenues for banks".

Similarly, in their 2013 paper, authors Sonja Kelly and Elisabeth Rhyne estimate that: "The bottom 40 percent of the population in low- and middle-income economies constitute a total spending market of $3 trillion, with major shares of the population in all regions of the world gaining enough disposable income to become interested in using formal financial services for the first time."

But existing infrastructure and traditional ways of doing business are completely inappropriate for the needs of those excluded from financial services. To realise the opportunities that financial inclusion presents, banks will need to think differently, taking a long-term view and making the necessary investment in people, systems and technology.

It is not enough to simply sign poor people up for bank accounts without creating services that meet their needs. Transaction platforms need to be simplified and products designed to consider the irregular nature of their incomes. The fact that many poor people earn their incomes in the informal sector, which has working hours that do not match the business times of traditional banks, is an important consideration. The cost of formal financial services is constantly highlighted as a factor that discourages low-income customers.

*Mathe is Head of Financial Inclusion at BASA*

Meaningful financial inclusion requires innovation and collaboration between industry players and regulators for the benefit of customers. The underutilisation of the energy, innovation, wisdom and resourcefulness of all South Africa's people, which is often the result of economic exclusion, is the biggest drag on the performance of the country.

The National Development Plan highlights the importance of adopting inclusive policies. It makes many wide-ranging, yet carefully selected, evidence-based proposals to create a more inclusive economy that is able to create opportunities for all. It envisages that by 2030 the "proportion of the population that is banked or has access to transactional financial services and savings facilities [will] increase from 63 percent to about 90 percent".

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The FinScope Survey has been measuring financial inclusion in South Africa since 2004. The percentage of adults (18+ years) with bank accounts has increased dramatically from 46 percent in 2004 to 77 percent in 2017. This increase was first driven by the Mzansi account – a low-cost transactional banking account developed in line with Financial Sector Charter commitments – and government's move to pay social grants electronically.

Despite this progress, some 8 million people remain unbanked. And when social grant recipients are included, the number of unbanked people increases sharply.

In addition, many low-income customers are not fully using their accounts, withdrawing all of their funds as soon as money is deposited. Many people do this to avoid paying bank charges and fees, which some view as the banks stealing from them. They also remove money quickly to avoid debit orders. The preference for cash is also driven by the absence of affordable and interoperable cashless transaction infrastructure in poor neighbourhoods.

Payment systems are essential for including all people in the formal financial sector. Having a bank account alone is not enough – people need to be able to perform their daily transactions, such as paying for goods and services or transferring money to family members, within or across borders. Payment systems enable small-scale farmers to buy seeds and fertilisers, and spaza shop owners to order and pay for stock from suppliers without having to leave their premises. For small businesses, it enables them to create a lasting record of their transactions and revenue streams, which means that lenders can assess their creditworthiness.

However, simply having a record of transactions will not be sufficient to address the lack of access to credit for small businesses. Mind-sets are changing, but not fast enough. Lenders need to innovate, take advantage of the available data, and find alternative credit-scoring methods that are more suited to the circumstances of small businesses, especially those in the informal sector.

There is now widespread acceptance that payment systems are a new front in the battle for financial inclusion. Beyond facilitating remittance flows, payment systems can also encourage people to access digital loans, savings and other financial services.

A growing body of research reveals the potential developmental benefits of digital financial services, including mobile money services, payment cards and fintech applications.

A study by the MasterCard Foundation estimates that: "Widespread use of digital finance has the potential to boost the annual GDP of emerging economies by US$3.7 trillion by 2025, with a third coming from additional investment in the micro, small and medium enterprise sector."

Some smart solutions in the market are not being adopted, largely because they are not appropriate for the needs of the poor: they are over-designed with too many complex features. Innovators have to put the customer at the centre of their designs, or risk sinking scarce capital into developing solutions that will merely gather dust.

"Widespread use of digital finance has the potential to boost the annual GDP of emerging economies by US$3.7 trillion by 2025, with a third coming from additional investment in the micro, small and medium enterprise sector."

Government's Vision 2025 identifies financial inclusion as one of the South African Reserve Bank's priorities and highlights the importance of cooperation among industry stakeholders to allow the national payment system to contribute to deepening financial inclusion.

From the Reserve Bank's perspective, financial inclusion entails access to electronic payments, savings, credit and insurance services. It may also involve providing greater access to cash services, like cash-in and cash-out remittance schemes, as a way to increase trust in formal financial products and help communities transition towards electronic payments.

While payment systems alone cannot guarantee greater financial inclusion, the presence of safe, efficient, interoperable and cost-effective electronic payment systems plays an important role in accelerating financial inclusion. Reaching the unbanked and including them in the financial system will require widespread collaboration across the financial services industry and the business community. Beyond that, it will require a deep understanding of the people of South Africa and their needs. ■

# Payments: Getting citizens online

A robust digital identity system can boost productivity and competitiveness. **By Kumaran Selvarajalu.**

Payments are the means through which value is transferred between economic entities, be it companies or individuals. The national payment system moves money and data from payers to beneficiaries, and maintains liquidity and certainty in the market. The vast, connected network of promises and contracts between economic entities, which keep society functioning, would quickly grind to a halt if the payment system failed.

The payment system is also a diagnostic tool, carrying accurate and current information on the state of the various participants and the system itself. This means it can act as a tool for intervention, providing the means to introduce, target and effect change in the economy and society.

For a long time, payments were seen primarily as a means of distributing value – a technology and back-office function – even at banks. In recent years, however, the focus on payment systems has intensified, driven by global events such as the attack on the World Trade Center, the 2008 global financial crisis, the fourth industrial revolution and the related growth in competition, and the rise of high-population countries like China and India.

The attack on the World Trade Center highlighted the importance of monitoring payments and tracking money laundering. It revitalised the efforts of the Financial Action Task Force, an intergovernmental organisation that works to combat financial crime. This monitoring function is set to grow as other regulators and stakeholders recognise the interconnected nature of payments.

*Selvarajalu is responsible for payments at BASA*

More recently, there has been growing interest in how to use the payment system to achieve political and regulatory objectives. This is partly due to the 2008 financial crisis, which highlighted the fallibility of the economic system and that – contrary to popular wisdom – the payment system is resilient and a tool for vital change.

In South Africa, the national payment system is expected to become a useful diagnostic tool and, more importantly, a means to intervene in the market to make financial inclusion more realisable.

**This increased interest in the payment system comes at a time when the world is experiencing the fourth industrial revolution, which is directly and indirectly affecting payment systems.**

This increased interest in the payment system comes at a time when the world is experiencing the fourth industrial revolution, which is directly and indirectly affecting payment systems.

The quality, quantity, shape and availability of data is improving. There is a move to hyper-connectivity that began with the internet and accelerated rapidly thanks to the mobile phone. Soon we will have fifth generation (5G) mobile connectivity, touted to be able to reach transfer speeds of up to 20 gigabits per second. This will radically influence the amount of data and content that can be moved around in real time. And we will need that bandwidth as the numbers of connected entities will dramatically increase due to the "internet of things" – in the broadest sense, the network of devices connected to each other and the internet.

Improvements in data have already resulted in new and enhanced business models, creating demand for even more data. This is one of the reasons non-banking technology companies are so interested in payment systems: they are a natural source of data that is high-quality, standardised, compulsory and linked to real-time economic activity.

A digital identity is a key requirement for anyone wishing to access the benefits of a digital society. If South Africa is to have a national digital identity, it must be of a suitable standard and be accessible to all entities in a country. Recording and providing proof of identity is difficult, so the state needs to intervene to ensure fairness and completeness, and to prevent foul play.

**Companies are at the forefront of innovation and are competing to establish national and international platforms that will control future data movements and digital identities.**

There are many payment solutions from western and eastern technology giants such as Google, Facebook, Microsoft and Amazon, as well as WeChat Pay and Alipay. These companies are at the forefront of innovation and are competing to establish national and international platforms that will control future data movements and digital identities. But the benefits can best be observed by looking at developments in India.

Aadhaar is the world's largest biometric enrolment and validation system, hosting more than 1.22 billion holders and processing 21.7 billion authentications, as at 4 August 2018. It is but one of the payment access methods available on India's Unified Payments Interface (UPI), a platform that facilitates real-time interbank payments and payment requests using mobile phones.

Aadhaar and UPI have catapulted India forward by removing the link between financial inclusion and literacy levels. By providing digital identities to everyone, India has moved closer to a digital society, ensuring greater productivity and competitiveness for its people and the nation.

Aadhar and UPI would not have been successful without the country's intentional nation-building efforts. India's financial inclusion and mobile priorities necessitated a national conversation that examined the needs of the country before modernising its payment systems. South Africa can draw several important lessons from India's experience:

- Consult broadly and ensure a complete understanding of the national need.
- Develop a robust and inclusive plan for digital identities, which must include biometric enrolment and authentication.
- Ensure the platform built is robust and can handle large volumes of data, transmits in real time and promotes competition.
- Target the smartphone.

It is tempting when looking at developments in payments to focus on the technology. But, while there are many advances being made in payment systems, we must ensure that the choices we make address the needs of South Africa. ■

# Risk: Innovate to end financial exclusion

**Lack of competition, de-risking and regulatory barriers hinder innovations that should make remittances, financial services and products more accessible and affordable for consumers. By Zakhele Hlophe.**

Migrants sent over $613 billion to their home countries in 2017, according to a World Bank report: *Migration and Remittances: Recent Developments and Outlook* (2018). This is more than double South Africa's gross domestic product in that year.

In fact, remittances caught up with foreign direct investments into developing countries in 2017 and are likely to surpass them in 2018. FinMark Trust research in 2016 revealed that South Africa sends R16.6 billion in remittances a year to countries in the Southern African Development Community.

Although the World Bank found that it is becoming more affordable for migrants to send money home, thanks to technological innovation, the costs remain prohibitive in sub-Saharan Africa. The *Migration and Remittances Factbook* (2016) found that it cost 19 percent of the remittance amount in fees to send $200 from South Africa to Zambia – six times more than the target set by the United Nations Sustainable Development Goals to reduce remittance costs to 3 percent by 2030.

High remittance costs in sub-Saharan Africa are said to be the result of insufficient competition in the financial services sector and risk-averse banks closing accounts to avoid having to comply with global standards to prevent money laundering and the financing of terrorism. Instead of complying with the laws and regulations, financial institutions around the world are increasingly "unbanking" particular groups of customers who increase their compliance costs or pose a reputational risk. This has become known as de-risking.

*Hlophe is an advisor to Parliament's Standing Committee on Finance*

Regulators and policy-makers should be cautious of the recent de-risking trend. The international standards set by the Basel Committee on Banking Supervision and those of the Financial Action Task Force, as well as South Africa's laws, envision a regime where banks manage the risks of money laundering and the financing of terrorism. But, banks not serving customers they consider to be unprofitable or high risk could exacerbate financial exclusion. In a developing country like ours, with the highest level of wealth and income inequalities in the world, financial services and products should be viewed as public goods and as essentials for socioeconomic development.

Financial institutions around the world are increasingly "unbanking" particular groups of customers who increase their compliance costs or pose a reputational risk. This has become known as de-risking.

Regulators need to closely monitor de-risking by South African banks. It is justifiable to close certain accounts based on legitimate reputational and regulatory concerns, as in the case of the Guptas, provided this is done within the law. However, using these laws for purposes other than combating crime could reverse the gains made in improving financial inclusion.

Lack of competition, de-risking and regulatory barriers hinder innovations that should make remittances, financial services and products more accessible and affordable for consumers in South Africa. The explosion of mobile money services, such as M-Pesa, which leveraged mobile network providers in East Africa, has been downplayed by many as something that appeals only to consumers in countries without sophisticated banking infrastructure.

But regulators appear to have been somewhat sceptical about developing policies that would support this kind of mobile money innovation for non-bank service providers. In 2009, the South African Reserve Bank released the Position Paper on Electronic Money, in which it said mobile money constituted deposit-taking activity that must only be facilitated through registered banks, as per South Africa's laws. As a result, non-bank institutions wanting to offer these services had to either apply for a full banking licence or collaborate with registered banks. This means that non-banks entered the financial sector to compete with banks but were forced to transact through them to offer their services.

When non-bank mobile banking operators were neutralised by regulation and failure in a non-competitive market, local banks developed their own mobile money products. The fact that these services are thriving is testimony to the demand for mobile money services in South Africa.

**When non-bank mobile banking operators were neutralised by regulation and failure in a non-competitive market, local banks developed their own mobile money products. The fact that these services are thriving is testimony to the demand for mobile money services in South Africa.**

Last year the Standing Committee on Finance and the Portfolio Committee on Trade and Industry compiled the First Report on the Transformation of the Financial Sector. The report included the following recommendation:

> *"The Committees believe that there should be more access to affordable basic financial services and transactional accounts in an environment where innovative, fast-paced and disruptive financial technologies (fintech) are emerging. The Committees believe that Government and regulators need to keep on actively monitoring and evaluating the fintech space and developing flexible, risk-based regulatory approaches to fintech activities, especially in areas which may potentially promote the entry of smaller players and ensure access to affordable financial services. While recognising that the financial institutions are part of a globalised financial system and have to conform to international regulatory standards, the Committees, once again, express their concern that National Treasury does not sufficiently consider the experiences of other developing countries, particularly on our Continent. The Committees welcome the SARB's statement at the hearings that there is a need to establish an appropriate regulatory framework for money remittance service providers or money transfer operators who are not necessarily banks and to review the overall access path for service provision in the payment system."*

This recommendation emphasises the need for a more flexible and enabling regulatory framework for money services from companies other than banks, given the experiences of other African countries. Many African countries are leading in basic fintech with their mobile banking services and have leapfrogged the brick-and-mortar phase of traditional banking. Central banks across the world are exploring the regulation of fintech and developing policies.

The Reserve Bank's release of a discussion paper, *Project Khokha*, in June 2018 was a welcome development. The paper explores approaches to the regulation of fintech, including blockchain and cryptocurrencies. It is hoped that it will also encourage thorough engagement on non-bank mobile money services. ■

# Development: Progress needs confidence and trust

**The private sector has a role to play in advancing development in society, but this is only possible where there is sufficient trust between business, government and other stakeholders. By Ralph Mathekga.**

Social cohesion is the belief by all that the survival of the collective guarantees the survival of the individual. This means the political and economic stability of any country depends largely on the relationship between competing stakeholders in society. The role of government is to create an environment in which these stakeholders play by the rules.

Social cohesion collapses when groups in society begin to believe that the removal of the system – "regime change" – rather than a change of administration is the only way for them to achieve their political goals.

In recent years, the South African government has lost the moral authority to provide a regulatory regime in which there is order and a commitment to collective survival. South Africa continues to be one of the world's most unequal societies due to the legacy of apartheid and the ANC government's failure to effectively transform society in the last 24 years.

There is an increasingly tense environment where policy proposals, such as expropriation of land without compensation, are framed as ultimatums: take it or leave it. Trust has broken down across society and many view the relationship between the private sector and government with suspicion.

When government seems to agree with the private sector, trade unions automatically suspect collusion against the interests of workers, while civil society organisations are suspicious of government's appetite for mega infrastructure projects because these are often a source of massive profits for private companies and enrichment for the corrupt.

*Mathekga is a fellow at the University of Johannesburg and a published author. His latest book is* Ramaphosa's Turn

So, even though South Africa needs to speedily build infrastructure if it is going to compete in the global economy, the exercise of executive authority in rolling out projects tends to elicit court challenges because government has lost the moral authority to claim to be acting in the people's interest. This is one of the scars left on society by a string of corruption scandals.

Banks and other financial institutions have been pulled into the fray. Some are blamed for facilitating transactions relating to state capture that they knew were not above board, at the expense of the poor and the working class. If the private sector is compromised in its relationship with government, it also suffers when the state experiences a legitimacy crisis in the eyes of voters.

**The South African government has lost the moral authority to provide a regulatory regime in which there is order and a commitment to collective survival.**

It is in this context that the private sector in South Africa needs to deeply reflect on its relationship with government. To recast its relationship with government and other stakeholders, business must think beyond conventional public relations.

If the relationship between government and business is not seen to be based on a common commitment to advancing the poor and vulnerable, it will create tensions with other social and economic stakeholders, like labour. The private sector has a role to play in advancing development in society, but this is only possible where there is sufficient trust between business, government and other stakeholders.

In labour disputes, for example, government can facilitate the speedy resolution of strikes to save the economy from further damage. But,

**Banks and other financial institutions have been pulled into the fray. Some are blamed for facilitating transactions relating to state capture that they knew were not above board, at the expense of the poor and the working class.**

if government is seen to be biased due to corrupt relationships with private companies, trade unions will not moderate their demands and strikes will drag on as employers and unions fail to reach a compromise.

It becomes difficult to swiftly implement policy where government has lost its legitimacy to provide a viable regulatory environment for different stakeholders. This often results in litigation by the industry, unions or communities, on the basis that proposed legislation and regulation is perceived to be arbitrary or unfair, and that there was not sufficient consultation. Whatever the outcome, such court cases invariably delay policy implementation.

South Africa's economy is bordering on a crisis. Some of the solutions, such as revamping the education system, will take a long time. However, mutual survival and the wellbeing of broader society demands immediate interventions. The relationship between the private sector and government needs to be redefined.

The private sector needs to imagine a relationship with government grounded in transparency, economic prosperity and social advancement. Such a relationship should be based on sustainability, shared values and the need for stable communities. Similarly, government should be open and honest in its relationship with the private sector, setting aside the misconception that business is not committed to the future of the country. Difficult as it might be, government should consult in a more meaningful way with the private sector and other stakeholders when crafting policies and designing regulatory frameworks.

Companies in the financial sector can lead the conversation about a new relationship between government, business, labour and civil society, based on new terms of engagement and shared values. At the centre of the new conversation should be the goal of building stable communities where social and economic development is evident. ■

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# Project Indlulamithi: Overcoming an unequal inheritance

**Twenty-five years into South Africa's democracy, the call for social cohesion remains a prominent feature of political policy and public discourse. By Beth Vale.**

The Indlulamithi South African Scenarios 2030 (sascenarios2030.co.za) project spent the past year talking to South Africans about social cohesion. It revealed a powerful picture of the contemporary psyche: one in which mistrust and alienation are endemic.

Indlulamithi participants spoke in great depth about the nature of inequality in South Africa, which they described as having both material and immaterial facets. As one participant said: "We don't see our common humanity because of the material conditions that separate us."

South Africans experience stark inequalities in income, access and assets. While rooted in a long history of colonialism and apartheid, these inequalities are also propelled by more contemporary forces, including climate change and new technologies, which are rendering certain jobs redundant.

About 10 percent of South Africans hold between 90 and 95 percent of the wealth. This is the biggest long-term driver of inequality. This inequality continues to entrench historical racial injustice, with white South Africans experiencing better quality of life on all major indices. A lack of assets, such as land, property and inheritance, makes the position of the middle class particularly volatile.

In South Africa, women are more likely to be poorer than men, and also most affected in times of crisis, from drought to rising costs, emerging epidemics and violent crime. According to the South African Demographic and Health Survey, one in five South African women experienced intimate partner violence in 2015.

*Vale is a researcher and writer at the Mapungubwe Institute for Strategic Reflection (MISTRA)*

Startlingly high – and rising – rates of unemployment have meant that for many men, particularly young men, getting married and becoming a household "head" has become increasingly unreachable. This raises important questions about the social alienation of working-age men, who are increasingly disconnected from homes and workplaces.

Rates of graduate unemployment are rising. Job-seeking youth were adamant that the reason they were without work was not simply a matter of not having the right skills – it was that they didn't know the right people. They felt that being networked was essential for getting a foot in the door with a potential employer.

> Meanwhile, the wealthier are increasingly likely to privatise their lives. They are choosing to opt out of public institutions, where queues are long and services unreliable, leaving little room for public participation or communion.

Meanwhile, the wealthier are increasingly likely to privatise their lives, seeking private health, education, energy supply, security, transport and entertainment. They are choosing to opt out of public institutions, where queues are long and services unreliable, leaving little room for public participation or communion.

Regardless of political or social positioning, there was widespread agreement among Indlulamithi participants that, despite the progress made since 1994, there had not been meaningful redress for the majority of South Africans. The Truth and Reconciliation Commission, many said, was not enough.

The effects of colonialism and apartheid continue to be felt today and are passed down from generation to generation. Young respondents felt that South African society today has inherited the "effects of an anti-black, unjust world". "It's a Rainbow Nation, but we are still fighting. We still have that anger."

Not only have we not achieved socioeconomic justice, but many feel we are unable to have the frank conversations necessary for meaningful reconciliation to take place. Indeed, the trust deficit between business and labour, black and white, men and women, and old and young, is perhaps better explained, as Professor Somadoda Fikeni does, as an honesty deficit.

Due to a lack of real dialogue, there was widespread feeling among participants that South Africans do not have a shared understanding of our history, nor do we agree on who has – or has not – benefited from the transition. Every race group appeared to have a case to make about why post-democratic South Africa did not "belong" to them, and the mechanisms of exclusion that make them feel unheard.

"There is no renewal of agreements," another participant said. "We need to renew trust relationships." Indeed, as the fragility of the transition and the compromises involved become more apparent, so too does the likelihood of its disruption.

There are already moments of rupture around decolonisation, mother-tongue education, farm murders, institutional racism and so on. Even within these movements, there have been fissures along gender and generational lines. At the same time, we have begun to wrestle with our Constitution and its ability to deliver justice, with emerging flashpoints around land, traditional leadership, sex work, language and access to information. Some might argue that these are the seeds of a more meaningful reconciliation, while others are less optimistic.

In the wake of the country's recent ethical and leadership erosion, Indlulamithi participants identified institutional capacity, of government, business and civil society, as a key determinant for the future of social cohesion. More than 88 percent of participants argued that any path towards social cohesion would demand strong leadership. Many wanted to see a new generation of young, vibrant leaders assuming positions in party politics, non-governmental organisations, social movements and the private sector.

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State capacity is critical for social cohesion, but it has been systemically undermined by corruption and poor skills at critical levels. Many participants worried about weaknesses in the public service. The looting of state-owned enterprises was also of particular concern. World Bank Development Indicators in 2017 suggested that South Africa's state capacity was worsening, while being shaken by private sector theft and fraud.

Institutional capacity manifests in the ability of South Africa's leadership to plan strategically and implement their decisions. Nearly half of Indlulamithi participants felt the country needed a more long-term view of policy-making. Policies are drafted but do not have time to bear fruit before new ones are put forward. Politics are guided by short-term interests and there has been a high turnover of government officials. In addition to a dearth of long-term thinking, participants believed there was little consensus on what was in the national interest. Here, participants argued, lies an opportunity for us to re-orient ourselves around the values of the Constitution.

What all the key drivers seem to indicate is that the future of social cohesion depends on our ability to allow honest public dialogue to flourish, to explore public history and to take social solidarity seriously. ■

# Past vs Present: South Africa in 2019 and beyond

**The president walks a tightrope as he juggles his role as leader of both the country and the ANC. By Mpumelelo Mkhabela.**

When Cyril Ramaphosa became president of the ANC – and South Africa – he took over a deeply divided party and a set of crumbling state institutions.

The circumstances of his rise to power presented the new president with a challenge: he had to manage a fractured party, while restoring shattered public confidence in institutions that had either been captured and corrupted or fallen victim to incompetence.

To an extent, these goals are currently mutually exclusive: to unite the ANC, he has to compromise on fixing the governance problems in state institutions.

Ramaphosa has retained several members of former President Jacob Zuma's Cabinet. This could prove to be a deft political strategy if it prevents some of them from continuing old habits. But there is a risk that they could later use their positions to strike against him. And the presence of his predecessor's ministers in Cabinet means the public is not fully convinced of the president's commitment to restore good governance.

The reality of the "semi-transition" from Zuma to Ramaphosa was not fully appreciated, which is why his rise to presidency was greeted with euphoria. There was misguided public, market and investor expectation that his ascendance would mark a complete, if not clean, break from the Zuma past.

This false assumption has since been confronted with the reality of the limits of his power, and the fact that state capture die-hards are not taking his clean-up campaign lying down. As many are cornered, we will witness dirty campaigns against the president and his allies.

*Mkhabela is a political analyst*

It is within the state that Ramaphosa stands a real chance of making a difference, by using the discretionary powers bestowed on the holder of executive authority. The ongoing inquiries into state capture, among others, have demonstrated his willingness to use these powers.

For example, he amended the terms of reference of the Zondo Commission of Inquiry on State Capture to make some of its evidence available for later prosecutions. His institution of the Nugent Commission on governance at the South African Revenue Service and a disciplinary inquiry against its former head, Tom Moyane, is another. His opportunity to appoint a new head of the National Prosecuting Authority provides Ramaphosa with a chance to fix this crucial institution.

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His appointment of Pravin Gordhan as Minister of Public Enterprises, and the subsequent changes in boards of several state companies, demonstrates that the authority of the president's office can be used for the right reasons.

These changes are still nascent, but they provide the president with an opportunity to make the transition much more substantive. They also give citizens an opportunity to judge his performance since taking office.

It is in the party-political sphere where Ramaphosa's governance reforms can be undermined, leaving him looking weak to those who want a clean break from the Zuma era. Governance failures in provinces and municipalities are overwhelming, especially where there are corrupt ANC factions who use the breakdown of rules for easy looting.

The beneficiaries of corruption will not let go easily – Ramaphosa will be challenged until after the 2019 elections. And, should the party struggle to maintain its electoral base, there is a possibility that Ramaphosa and his allies in the ANC's National Executive Committee could be blamed.

Internal party dynamics aside, the country is facing stagnant growth and record unemployment. There is an urgent need for a well-crafted growth plan.

Other than land reform – where Ramaphosa might find it difficult to extricate himself from the rhetoric of "expropriation without compensation" – he has sent the right signals to investors, including appointing investment envoys. But, while these are good things in themselves, they do not automatically translate into economic growth.

The elections will be held under very difficult circumstances, where there is a possibility of more qualifying voters giving up on voting because they are disappointed with continued unemployment and poor living standards.

While much attention is paid to the technical organisation of elections, to determine whether they are free or fair, the social legitimacy of polls – reflected in good voter turnout – is often overlooked. This type of legitimacy would mean the public owns the outcome and voters are willing to engage through existing institutional mechanisms to vent their grievances.

But what about the opposition? Can't they be "shock absorbers" for the disgruntled? The official opposition, the Democratic Alliance (DA), has failed to put in place policies that can challenge the ANC, preferring instead to continue their internal bickering about transformation.

The Economic Freedom Fighters (EFF), for its part, is hoping to increase voter support through racial and state-centric economic populism. While South Africans have a record of rejecting extremist parties, on both the right and the left of the ideological spectrum, the EFF has leaders that appeal to younger, disgruntled and jobless black voters.

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The parties whose policies can challenge the ANC – the United Democratic Movement and COPE – lack the resources of the DA and the charisma and youthfulness of the leadership of the EFF.

The prospects for realigning politics will largely depend on the performance of the ANC, particularly in Gauteng, which is likely to be the most hotly contested province. Should the ANC receive less than 50 percent of the vote in the province, it could throw everything at wooing the EFF and possibly form a broader national coalition.

But, if the EFF fears being absorbed into oblivion and the censure of voters angry with the ANC, it could choose to form a coalition with opposition parties, or at least support such a coalition in Gauteng.

The biggest challenge for all parties is to get large numbers to vote to ensure the social legitimacy of the elections, or else contend with intensifying social unrest in support of demands for jobs and inclusive economic growth. ■

# The Banking Association South Africa: Exercising our rights

**Trade associations are formed to promote the economic interests of their industry among its broader stakeholder community. Business has a legitimate right – along with trade unions and other interest groups – to interact with and try to influence government. By Yacoob Abba Omar.**

Strained industrial relations, political populism and elections, as well as increasing social instability as a result of poverty and inequality, can push government towards popular – but unsustainable – economic policies.

If this occurs, banks will have to protect and promote their interests among their broader stakeholder community, to ensure they have a social licence to operate and there is a legislative and regulatory environment that will allow them to run their businesses in a sustainable and profitable manner.

Trade associations, such as the Banking Association South Africa (BASA), are formed to protect and advance their members' economic interests and promote the industry among its broader stakeholder community. While trade associations are created by companies to serve their needs, its members are not usually involved in its day-to-day operations. Michael Barnett of Rutgers Business School explains that associations are usually managed by professional staff who seek to address industry issues, and this is not always in the interests of individual companies.

The South African Constitution requires the National Assembly and provincial legislatures to facilitate public involvement in legislative and other processes. The interaction between business and the legislature and the executive is legitimate. Corporate political action, advocacy and lobbying are the means through which companies and industries influence government policy to create a favourable business environment, which is necessary for investment, job creation and social development.

*Abba Omar is Head of Strategy and Communications at BASA*

The banks' relationship with government is critical. Venezuelan economist Ricardo Hausmann explains: "Business associations need to interact with government in order to identify those public goods that would make economic ecosystems more productive, so that they can create more value for stakeholders."

Hausmann points out that "what makes all of a firm's stakeholders behave in a way that maximizes value [is] a sense of a collaborative community of employees, managers, suppliers, lenders, distributors, service providers, customers, and shareholders, all cooperating to create value by better satisfying customer needs and aspirations". He guards against business taking a narrow approach that would "impel all other stakeholders to pursue their narrow interests as well, increasing strife and transaction costs".

> "Business associations need to interact with government in order to identify those public goods that would make economic ecosystems more productive, so that they can create more value for stakeholders."

In South Africa, banks have long acknowledged that they have a responsibility to help tackle the country's social and economic challenges. They know they cannot succeed if the country fails.

This is reflected in the mandate of BASA to advance the interests of the industry with its regulators, legislators and stakeholders to make banking sustainable, profitable and better able to contribute to the social and economic development and transformation of the country.

BASA has also adopted the Group of 30 (G30) principles contained in the report *Banking Conduct and Culture: A Call for Sustained and Comprehensive Reform*, which provides a framework for building a culture of ethical, values-based governance in banks. The G30 is an international group of financiers and academics that aims to deepen understanding of the consequences of economic and financial decisions. The BASA Board has proposed that South African banks adopt the principles of the report and implement them in a manner that aligns with all relevant banking codes, such as the Prudential Codes, the Code of Banking Practice and the Market Conduct Framework.

**In South Africa, banks have long acknowledged that they have a responsibility to help tackle the country's social and economic challenges. They know they cannot succeed if the country fails.**

The banks' relationship with the executive, legislature, regulators and bureaucracy is healthy, with BASA staff having professional and cordial relations with most regulators and bureaucrats in critical departments. This is despite the fact that the rapport with the executive went through some challenging times under the previous presidency.

In 2018, BASA established a Strategic Issues Committee to deepen relationships between the industry and key stakeholders. The committee aims to:

- Help formulate industry positions on social, political and economic challenges in the banking environment.
- Communicate and promote the interests of banks with stakeholders, regulators, legislators and the public.
- Proactively build the credibility of the industry and trust in its institutions, while identifying social and political risks to the reputation and business of banks.
- Be a platform where banks can share best practice.

The committee's activities are guided by the following principles:

- Advocacy and lobbying are a legitimate activity because public participation in the legislative process is an integral part of democracy. Interest groups should be consulted on legislation that affects them.
- Banks should always engage constructively in policy making, contributing to solutions that benefit society.
- There must be transparency, ethical behaviour and integrity in our advocacy work.
- We must engage on significant issues, for the collective attention of member banks.
- We need to be proactive in developing our positions.
- Regulatory advocacy cannot be outsourced to external consultants. The direct participation of relevant executives demonstrates genuine commitment.

**With a new president, the country has an opportunity to boost the economy and correct a decade of underperformance and poor governance.**

South Africa has endured 10 years of sluggish economic growth, policy uncertainty and low consumer and business confidence. With a new president, the country has an opportunity to boost the economy and correct a decade of underperformance and poor governance. But tough political and economic choices must still be made to achieve the difficult structural reforms needed for tangible, inclusive economic gains.

Business, labour, government and other stakeholders will have to work together – and negotiate compromises – to achieve reasonable outcomes that can be owned by all stakeholders. BASA is committed to being a credible, reliable and able partner in the revival of South Africa's social and economic development. ■