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THE BANKING ASSOCIATION SOUTH AFRICA SUBMISSION ON TRANSFORMATION IN THE FINANCIAL SECTOR

1. INTRODUCTION

- 1.1. The Banking Association South Africa (BASA) welcomes the opportunity to appear before Parliament to discuss transformation in the financial sector. In a country with a history such as ours, transformation is a critical and valid issue, but must be approached carefully in the spirit of our constitution and in the national interest. These hearings, hosted in the hallowed grounds of parliament, hosted by the representatives of the South African people, is an apt moment to reflect on transformation in the financial sector specifically as well as how far we have transformed economically as a country.
- 1.2. We must, in our opinion, resist the temptation of certain positions and utterances impeding progress to address legitimate concerns about the slow pace of progress in transforming our universities, spatial settlements, quality of service, the economy and labour markets, the persisting high levels of unemployment, poverty and inequality. These national concerns should propel us to make policy decisions that serve the best interest of the country in the long-term. We approach these hearings in this productive spirit in the hope

that by June we shall have collectively added to the discourse which is raging around us on how to take our country on a higher and inclusive growth path.

- 1.3. As the banking industry, our starting point is that much progress has been made across sectors and as a country we must celebrate our successes without burying our collective heads in the sand about remaining challenges. To ensure that we successfully address remaining challenges, we should undertake a thorough analysis and understanding of factors that frustrate our progress and embark on multi-stakeholder dialogue to find sustainable solutions. It is in this spirit that we approach these hearings.
- 1.4. In this submission, we provide an overview of the banking sector, its main functions, how it is regulated, the contribution it makes to the economy and society at large, and present our progress report on transformation. We demonstrate that significant progress has been made and that our commitment to the transformation project is unwavering. We acknowledge areas where the performance of the banking industry is below agreed targets, and talk to initiatives to address these.
- 1.5. Any suggestion that the banking industry is the least transformed industry or refuses to transform is incorrect. As demonstrated through the CEO Initiative, in which the banking industry is a critical participant, we believe that while transformation remains a challenge, if we work together in a spirit of cooperation, rather than embarking on a blame game, we can create an inclusive and growing economy that works for all our people.

2. POINTS OF DEPARTURE

- 2.1. The financial sector is the custodian of the nation's savings; it serves the important function of financing major infrastructure projects, ensures that as a country we pay for the goods and services we import from other countries and receive payments for the goods and services we export to other nations. Banks are an integral part of any successful economy and make an invaluable contribution to the well-being of our economy and society.
- 2.2. Banks and other financial institutions collect deposits from all sectors of society, including workers, corporates, high net-worth individuals and others and use these resources to finance various activities with an expectation to earn an income to compensate the savers and cover the costs of providing this important function.
- 2.3. Banks' infrastructure enables transactions between various stakeholders in the economy, ensures that workers can send remittances to their homes in rural areas and across borders, enables the payment of social grants, among many other functions. Having a reliable and well-functioning banking system gives workers the certainty that when their employers pay their wages the money will be available on pay day. Similarly, when people



queue at till points with their plastic cards, it is the banking system that ensures that they are able to conduct a range of transactions on a real-time platform.

- 2.4. Banks play an important role in enabling job creation. They assess entrepreneurs' business plans to determine the feasibility of what they plan to do and to repay the loans advanced to them. Banks enable entrepreneurs to achieve their ambitions and assist, through that, to create jobs, and they also finance projects across a spectrum from very small businesses to large infrastructure projects.
- 2.5. During the State of the Nation Address in 2016, President Jacob Zuma recognised the importance of the financial sector. He said, "We are proud of our Top 10 ranking in the World Economic Forum competitiveness report with respect to financial services. Maintaining and indeed improving our ranking is important to our competitiveness as a country. It is also fundamental to our ambition to become a financial centre for Africa" (SONA, 2016).
- 2.6. One of the measures identified in the Budget Review 2017 through which government, working with business, labour and civil society, can act to boost investment is to reinforce "South Africa's commitments to global standards in financial sector regulation. South Africa needs to maintain its position as an investment destination, supported by a sophisticated business and financial sector, and adherence to financial standards." (National Treasury, 2017).
- 2.7. Banks are accountable for what they do with depositors' money. To ensure that they remain true to their responsibilities and protect depositors' money, banks are subject to a significant number of regulations. There are approximately 244 pieces of legislation that banks actively monitor and comply with. This in itself makes it difficult for new entrants to enter and be successful in this industry; but it is important to recognise that onerous as the regulation of the banking industry may seem, it is designed to protect the money entrusted to banks by, workers, households, ordinary persons and owners of capital. We are of the view that the debate should move to how we enable a more diversified financial sector, with the participation of financial institutions, appropriately regulated, to service specific markets.
- 2.8. Banks are the primary channel through which the Reserve Bank implements monetary policy to keep inflation in check by adjusting interest rates and controlling the supply of money in the economy. An unhealthy banking system is a risk to the financial system and the economy as a whole.

3. THE SOUTH AFRICAN BANKING INDUSTRY

- 3.1. The South African banking industry is made up of 37 banks licensed by the South African Reserve Bank and is broken down as follows:



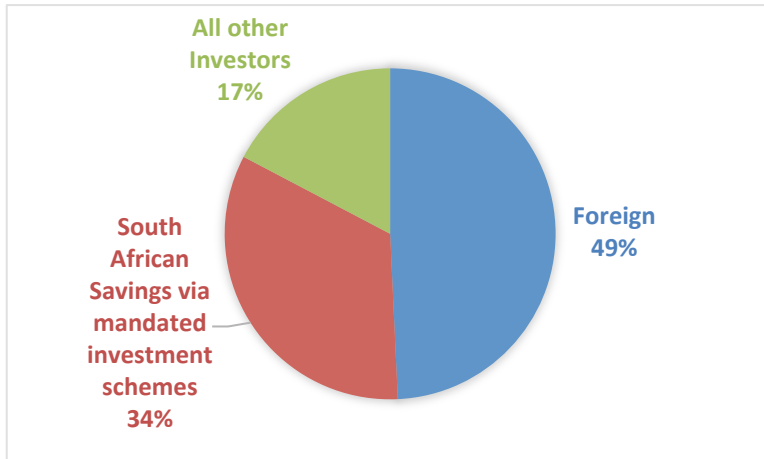
TABLE 1: BREAKDOWN OF CATEGORIES OF BANKS

Locally and Foreign Controlled Banks	Local Branches of Foreign Banks	Mutual banks	Cooperative Banks
16	15	3	2

Source: South African Reserve Bank

- 3.2. The banking industry employs 153 846 of employees, which is 3% of all personal income tax payers in South Africa. Banks also make a significant contribution to corporate income tax. In 2014 alone, banks contributed R23 billion, and since 2005, they have contributed over R102 billion.
- 3.3. Through the services banks provide to other industries and sectors, the industry's indirect contribution to jobs is much higher. For example, of the R200 billion invested in renewable energy projects, 84% of the total debt finance was sourced locally, with commercial banks funding 64% of such debt finance (R58 billion). This indirectly contributed to the creation of 20 000 temporary construction jobs and 35 000 operational jobs. In addition to this, commercial banks have invested an additional R60 billion into green finance projects such as green buildings, green bonds etc. Through the various Corporate Social Investment funding, banks contribute to many jobs in various non-profit organisations. The banks channel over R500 million to corporate social investment initiatives annually. Additional information on the banking industry's contribution to corporate social investment is provided later in the document.
- 3.4. The largest share of the top six South African banks is owned by foreigners, followed by mandated investment schemes such as the Public Investment Corporation (PIC) and the remaining 17% is owned by all other categories of investors, including individuals. A racial breakdown of the ownership of South African share of banks is provided in a later section. These ownership patterns are not limited to banks as the Top 100 companies listed on the JSE also reflect a similar trend of foreign ownership and in addition show that in 2016 for the first time black ownership on the JSE at 23% surpassed white ownership at 22%.



FIGURE 1: OWNERSHIP OF SOUTH AFRICAN BANKS

Source: BASA calculations based on latest published information

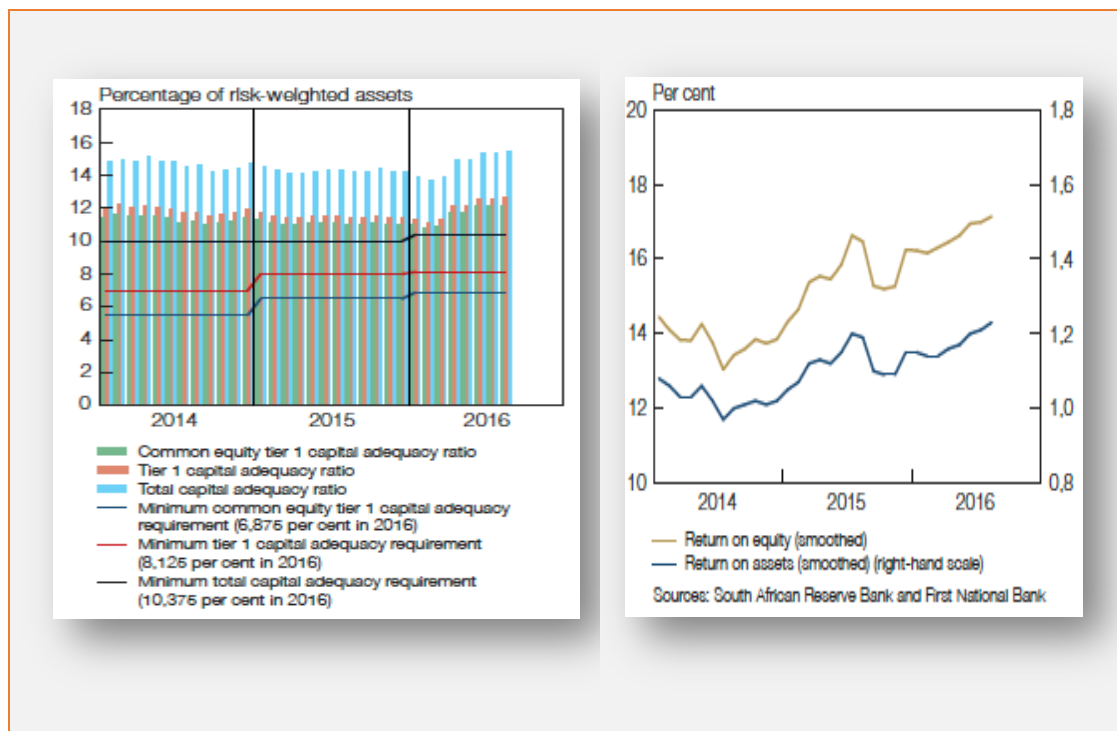
- 3.5. The extent of foreign ownership of our banks indicates the extent to which our banking industry is regarded globally for its soundness and its ability to generate healthy returns on investment.
- 3.6. The commitment of our government to adopt international best practices has led in no small part to the financial sector contributing to the overall improvement in the ranking of our country. Our standing is, however, negatively impacted on by globally low ratings in areas like education. The banking sector has returned to the number 2 position in the category of soundness of banks, in the World Economic Forum Global Sustainability Report, which measures banking sectors in both developed and developing countries.
- 3.7. In these world rankings, our banks hold the number 2 position for meeting the needs of business and the number 12 position for ease of access to loans, with affordability of our financial services ranked at number 27 out of 138 countries.
- 3.8. The size of the banking industry measured by total assets is R4.8 trillion; deposits make up R3.9 trillion or 80% of total liabilities. The South African banks are profitable, with profit before tax of R66 billion in 2016 which represents a return on assets (ROA) of 1.35% or a return on equity (ROE) of roughly 17% which is approximately 3% above the estimated cost of equity for the sector and represents the premium shareholders earn for the risks they take. The profitability ratios for Indian Private Sector Banks are 1.50% ROA and 13.81% ROE; while the ratios for US Banks are 1.02% and 9.07% respectively.
- 3.9. Banks have invested R530 billion into government debt in the form of Bonds and Treasury Bills which is equivalent to 25% of total government debt.
- 3.10. According to the Financial Stability Report (SARB, 2016b) South African banks maintained capital adequacy ratio of 12.2% for common equity tier 1 capital (vs 6.875%



regulatory requirement); 12.7% capital adequacy ratio for tier 1 (vs 8.125% regulatory requirement); and total capital adequacy ratio of 15.7% (vs 10.375%). Our banks have capital adequacy ratios that exceeded all the regulatory requirements. This bodes well for the industry's ability to withstand and manage any shocks as well as contribute to inclusive growth in the economy.

- 3.11. The volume of transactions processed by banks each year have grown significantly over the past 15 years, indicating the deepening of financial inclusion of many previously unbanked people. In 2002, banks processed 148 million ATM transactions and by 2016 this had grown to 446 million (200% growth). Similarly, in 2002 banks processed 4 million debit card point of sale transactions compared with 195 million by 2015 (4327% growth). The volume of credit card transactions grew by 974% from 56 million in 2002 to 605 million in 2015. Finally, EFT transactions grew by 132% from 387 million in 2002 to 899 million in 2015.

FIGURE 2: CAPITAL ADEQUACY & PROFITABILITY



Source: SARB, *Financial Stability Report, Second Edition, 2016*

- 3.12. National economies struggle to develop champions which they can rally the rest of the country around. The South African banking sector consists of such champions, whose successes need to be celebrated while its shortcomings criticised and overcome.

4. REGULATORY ENVIRONMENT

- 4.1. South Africa has a sound regulatory framework that governs the licensing and general operations of banks. A complex web of domestic and global regulations and standards

have been adopted since the global financial crisis of 2007. Every aspect of the business of banking is tightly regulated to ensure the stability and integrity of the financial system, protect depositors, ensure confidence in the system and grow its contribution to economic growth.

- 4.2. In a highly-regulated industry such as banking, banks cannot compete in abiding by the myriad of regulations they must comply with. However, they do compete robustly in the wide range of products and services they offer. Their brand differentiation and the channels, products, and strategies different banks employ to deliver these products differ significantly and are highly competitive.
- 4.3. One of the key functions of the SARB Bank Supervision Department is to protect the depositor with accounts at the bank, recognised as being less financially sophisticated than investors who buy specialised products. In executing this mandate, the SARB checks everything banks do, including the approval of directors on their boards and the type of products offered to the consumer. Banks have to submit daily, weekly, monthly reports on everything they do. The SARB conducts on-site supervision, have regular engagements with boards and senior managers and control the amount of capital and liquidity banks have to hold.
- 4.4. Banks recognize and accept the need for regulation. However, regulations can impose a direct cost on customers through the fees they have to pay for services and to society. For this reason, we appear before a number of portfolio committees challenging regulations that make it difficult for us to perform our mandate in a profitable, competitive and sustainable manner and to represent the interests of our depositors, shareholders and borrowers to reduce burdensome and costly regulation.
- 4.5. The National Credit Act (NCA), introduced in 2007, contributed to the fact that South Africa banks remained relatively unscathed during the Global Financial Crises of 2008/2009. This was furthermore expanded through the banks and the National Credit Regulator (NCR) working together as part of a task team to address the over-indebtedness of consumers through the implementation of additional measures in the debt review arena, including the restructuring of consumers' debt portfolios. The total debt review portfolio across BASA's retail member banks has a value of R 47,8 billion as at the end of January 2017 which includes relief in terms of industry agreed concession rules (reducing of interest rates, charges and fees) for over-indebted consumers that go beyond the prescriptions of the NCA. Since 2010 the banks have invested more than R130 million in debt review related projects and remain committed to addressing and relieving over-indebtedness.
- 4.6. Banking in general has evolved over the past 20 years, and in South Africa this has seen changes to the laws and regulations influenced by a number of developments. The Asian



crisis of the late 90s and the Global Financial Crisis of the late 2000s had a major impact on banking which has shaped the industry as we now know it. South Africa had its own mini banking crisis in the early 2000s which saw a failure of number of smaller banks such as Saambou which precipitated a contagion effect in the industry and led to a run on deposits at BOE. Non-banking events such as the Marikana tragedy had an impact on the some aspects of the business of banks. Table 2 below gives a timeline of some of the major developments over the past 23 years.

TABLE 2: MAJOR EVENTS THAT IMPACTED BANKING

Year	Events	Impact
1994	Banks Act Amended	<ul style="list-style-type: none"> • After amendments made, the representative offices and subsidiaries of international banks were established in SA • Branches of International banks established in SA • International participation in the local banking industry increased
1997	Asian Crisis	<ul style="list-style-type: none"> • The South African financial sector remained resilient to the Asian crisis • Share prices rose in local currency until mid-1998 • The interest rate remained stable and bond prices not severely affected • There was a large net inflow of foreign capital
1998	National Payment Systems Act	<ul style="list-style-type: none"> • Set out the regulation of the functioning of payment systems • SARB establishes Payments System Management Body (PSMB) under NPS Act, PASA recognized as the PSMB
1999	Banks faced liquidity pressures	<ul style="list-style-type: none"> • Many medium to small banks exited the banking system • The Saambou Bank problem arose as a result of the liquidity crisis and Saambou bank was placed under curatorship. • Loss in confidence resulted in BOE Bank withdrawing • From last quarter of 1999 to 2002 about 22 banks exited the South African banking system
2001	The Financial Intelligence Centre Act	<ul style="list-style-type: none"> • The Financial Intelligence Centre Act 38 of 2001 (FIC Act) gives effect to the standards proposed by FATF • The primary purpose of the Act is to create mechanisms to prevent money laundering and the financing of terrorist and related activities. • The FIC Act places an obligation on financial institutions and other designated non-financial businesses (deemed vulnerable to money laundering and terrorist financing activities) to report suspicious and unusual transactions to the FIC. • SA applied to join the Financial Action Task Force (FATF)



		and became a member in 2003
2002	The Financial Services and Intermediary Services Act	<ul style="list-style-type: none"> The activities of all financial services providers actively regulated FSP's now all required to have licenses and compliance with legislation
2004	Financial Sector Charter	<ul style="list-style-type: none"> Charter commits the sector to certain quantifiable transformation targets (details of this are provided later in this report)
2005	National Credit Act	<ul style="list-style-type: none"> The National Credit Act (35 of 2005) is designed to protect the consumer in the credit market and make credit and banking services more accessible. The National Credit Act (NCA) was introduced to promote and advance the social and economic welfare of South Africans, promote a fair, transparent, competitive, sustainable, responsible, efficient, effective and accessible credit market and industry, and to protect Consumers.
2006	Basel II published	<ul style="list-style-type: none"> Expanded measurement of risk for capital held by banks
2006	Banking Enquiry	<p>Investigated:</p> <ul style="list-style-type: none"> the level and structure of charges made by banks, as well as by other providers of payment services the feasibility of improving access by non-banks and would-be banks to the national payment system infrastructure any other aspect relating to the payment system or the above-mentioned charges which could be regarded as anti-competitive.
2007/8	Global Financial Crisis	<ul style="list-style-type: none"> Efficiency and productivity in banking sector deteriorated Bank Supervision Annual report (2009) described the SA financial sector as "remaining vigilant". Roughly 1 million jobs lost leading to an increase in credit impairments
2010	Basel III framework	<ul style="list-style-type: none"> Market risk capital requirements revamped and stiffer capital requirements implemented. Global Systemically Important Financial Institutions (SIFIs) introduced and Domestic Systemically Important Banks (D-SIBs) introduced
2010	Recommendations of the Banking Enquiry Panel implemented	<ul style="list-style-type: none"> The penalty fees were lowered on dishonored debit orders Ensure greater transparency of banking fees and charges Switching bank accounts between banks made easier by implementing a standardized switching code Customer education improved



2015	The failure of the collapse of the African Bank Investments Ltd.	<ul style="list-style-type: none"> • This prompted South Africa's banking regulator to review its oversight procedures and supervision
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Source: Compiled by BASA from publicly available information

5. TRANSFORMATION JOURNEY OF THE SOUTH AFRICAN BANKING INDUSTRY

- 5.1. The financial sector of which banking is a part led the way with regards to transformation. On 17 October 2003, the sector voluntarily signed a transformation charter before the transformation codes were promulgated. The charter was the product of the 2002 Financial Sector Summit convened by Nedlac. After intense negotiations, the Nedlac partners signed a summit declaration in August 2002 which became the basis of the Financial Sector Charter.
- 5.2. The following pillars were agreed to in the Financial Sector Charter with targets relating to each:
- i) Human Resources Development
 - ii) Procurement
 - iii) Enterprise Development
 - iv) Access to Financial Services
 - v) Empowerment Financing
 - vi) Ownership in the Financial Sector
 - vii) Management Control in the Financial Sector
 - viii) Corporate Social Investment

TABLE 3: TIMELINE OF THE FINANCIAL SECTOR CHARTER PROCESS

Year	Event
2002	<ul style="list-style-type: none"> • Financial Sector Summit convened • Financial Sector Summit declaration signed on 20 August
2003	<ul style="list-style-type: none"> • Financial Sector Charter signed on 17 October
2004	<ul style="list-style-type: none"> • Financial Sector Charter comes into effect on 1 January
2005	<ul style="list-style-type: none"> • Financial Sector Charter Council is established
2006	<ul style="list-style-type: none"> • In September, the Financial Sector Council publishes its first annual review of transformation in the financial sector
2007	<ul style="list-style-type: none"> • Codes of Good Practice promulgated February. Sector charters given 12 months transition period to align
2008	<ul style="list-style-type: none"> • Financial Sector Charter is reviewed and discussions of revised targets begin

2009	<ul style="list-style-type: none"> Last report under voluntary charter published
2010	<ul style="list-style-type: none"> Impasse - October Finance Minister and Trade & Industry Minister provide a way forward.
2011	<ul style="list-style-type: none"> Phase I draft aligned sector code (excluding ownership)
2012	<ul style="list-style-type: none"> November – new Financial Sector Code gazetted under section 9(1) Empowerment Financing and Access to Finance targets are reviewed and new ones agreed
2013	<ul style="list-style-type: none"> Revised Codes of Good Practice promulgated in October with a one year transition period for sector codes
2014	<ul style="list-style-type: none"> Extension of transition period
2015	<ul style="list-style-type: none"> Draft revised sector code submitted to dti
2016	<ul style="list-style-type: none"> March – section 9(5) gazette of the revised Financial Sector Code for public comment Review of comments by dti and engagement with relevant stakeholders
2017	<ul style="list-style-type: none"> Further engagement with dti on deviations and agreement Awaiting gazetting of final code

Source: Financial Sector Council reports (various)

5.3. In its first annual review, amongst the observations made by the Financial Sector Charter Council (2006) it noted that:

- i) Progress has been rapid in areas of greatest familiarity for the sector, that is funding and financing reasonably conventional commercial transactions: by year-end of 2005 the sector had virtually achieved its R50 billion target for funding major BEE transactions, set to be achieved only in 2008, and bettered its R5 billion 2008 target for financing black SMEs.
- ii) The sector averages 16% direct black ownership and appears set to meet its 2008 target of 25% being 10% direct and 15% indirect.
- iii) The financial sector spent a reported R15,9 billion with black or BEE accredited suppliers last year, 36% of its total combined procurement bill (although nearly three-quarters goes to companies in which black shareholders hold minority interests – a finding that will require further consideration)

5.4. By the time of the mid-term review in 2008, the following had been achieved:



TABLE 4: BANKS' PERFORMANCE AGAINST SELECTED FINANCIAL SECTOR CHARTER INDICATORS, 2008

<i>Transformation Pillar</i>	Element	Target	Achievement
Employment Equity	Senior Management	20 – 25%	25.79%
	Black Women	4%	8.23%
	Skills spend	1.5%	1.63%
Procurement and Enterprise Development	Procurement and Enterprise Development	50%	55.29%
Empowerment Financing	Targeted investments	R 32.0 billion	R 53.3 billion
	BEE Transaction Financing	R 50.0 billion ¹	R 87.9 billion
Ownership	Direct	10%	23.35%
Access to financial services	Banking services	80 % of LSM 1-5 within 10 km radius	77%
	Origination of loans for low cost housing	R42 billion	R47.5 billion
	Origination of loans for agriculture	R1.5 billion	R1.8 billion
	Origination of loans to Black SME	R5 billion	R12.8 billion

^{1.} This was the target for the entire financial sector, and the total achievement against this target was R101 billion for the sector of which R87.9 billion was contributed by the banking industry alone.

Source: Financial Sector Charter Council (2009)

- 5.5. The table above demonstrates that by 2008 the financial sector had achieved most of its targets. In the foreword to the 2008 Annual Review, the FSC Council remarked that “[A]s the detailed analysis contained in the report will illustrate, the sector has performed well overall in many areas of transformation performance and Charter targets have been exceeded.” (FSC, 2008). This level of performance provides clear evidence that the banking industry is not resistant to transformation and a careful analysis will show that compared to other sectors, the banking industry has performed very well. The banking industry has since 2008 continued its efforts in respect of transformation as a key priority of the financial sector.



- 5.6. The 2013 KPMG Annual BBBEE Survey which tracks performance of various sectors against the prevailing DTI current and revised codes shows that the financial sector (of which banks are a part) was among the best performers on most of the transformation pillars. Comparing the financial sector with the retail, construction, manufacturing, ICT and mining sectors, the findings of the survey are as follows:
- i) On the ownership and management control pillars, the financial services sector is second only to construction;
 - ii) On employment equity, the financial services sector is second only to retail;
 - iii) On the skills development pillar, the financial services sector is third after construction and retail sectors respectively;
 - iv) On preferential procurement, financial services sector is second only to construction sector;
 - v) On enterprise development, the financial services sector is second only to construction; and
 - vi) On socio-economic development, the financial sector holds a joint second place together with retail sector, after construction and ICT who jointly hold the first position.
- 5.7. Due to its unique nature, the financial services sector has two additional pillars namely, empowerment financing and access to financial services. This is because banks have a dual role in the transformation project: (a) to ensure that their industry is transformed as well as (b) to finance transformation in other industries. Financing transformation comes with considerable risk in the event of major economic shocks in sectors to which they are exposed and this should be taken into account in judging the banks performance overall.
- 5.8. It is noteworthy that respondents to the KPMG survey across the sectors highlighted the ownership pillar as the most costly to comply with and the employment equity as the most difficult to achieve. This indicates that an economy-wide conversation about how to accelerate performance on these difficult pillars is necessary.
- 5.9. An important point to understand is that ownership deals are usually financed through loans by banks to black individuals or groups. This is extremely inefficient for the economy because the capital employed for this cannot be leveraged. What this actually means is that for every R10 of capital a bank uses to finance a new black shareholder, approximately R80 is removed from financing a black business. This is because banks have to reserve capital for certain types of activity and thus removes its ability to deploy capital to more broad-based initiatives. So, a choice must be made between financing of black ownership and increasing financing in the real economy.
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TABLE 5: VALUE GENERATION IN BEE DEALS OF THE TOP 100 COMPANIES ON THE JSE BY SECTOR

SECTOR	R' BILLION
Mining	R101.00
Banks	R57
Industrials	R57
Financials	R32
Telecoms	R17
Healthcare	R14
Investment Companies	R10
Pharmaceuticals	R10
Property	R9
Retail	R8
Travel & Leisure	R2
TOTAL	317.00

Source: Intellidex, 2015

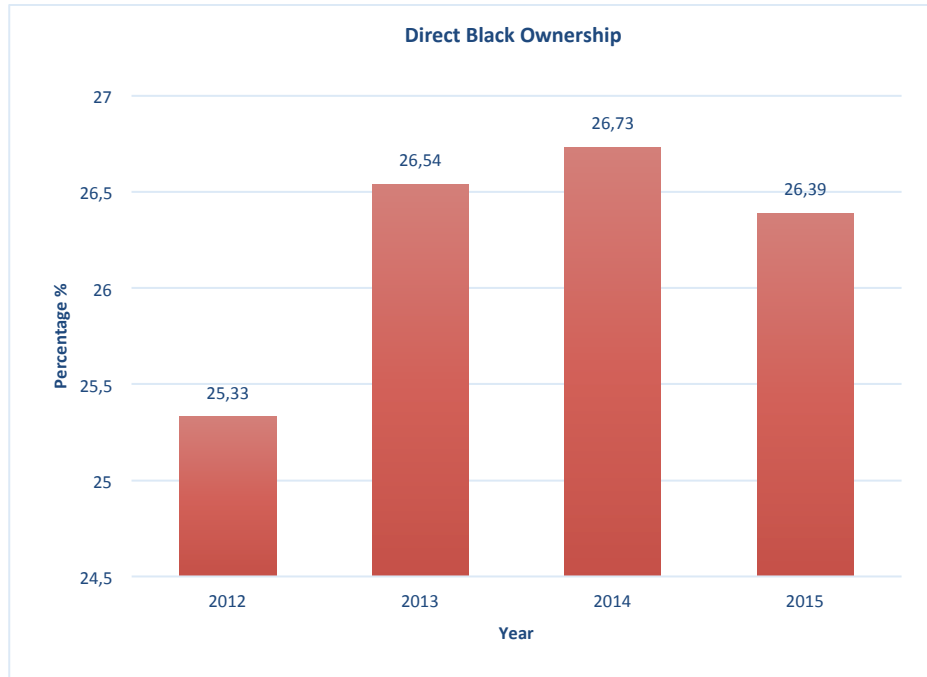
- 5.10. In addition to meeting their transformation targets set out in the Financial Sector Charter, a study by Intellidex (2015) assessing BEE deals undertaken by the top 100 companies listed on the JSE, found that they had generated R317bn in total value attributable to beneficiaries. It found that the mining sector had generated most value with a total of R101bn followed by banks and industrials with R57bn each as indicated in Table 4.

6. PROGRESS TO DATE

- 6.1. There was a period, after 2008, when the industry did not submit reports to the Financial Sector Council as the agreement was not reached on the revised codes. Although banks and other industries in the financial sector continued to implement transformation initiatives for the period 2009 – 2011, data in relation hereto is not readily available. The remainder of this section is informed by data for the period 2012 to 2015/6, subject to availability.
- 6.2. Progress is reported against ownership, management control, employment equity, preferential procurement, empowerment financing, housing, credit extension, socio-economic development, and access to financial services.



FIGURE 3: OWNERSHIP



Source: BASA calculations based on data from member banks

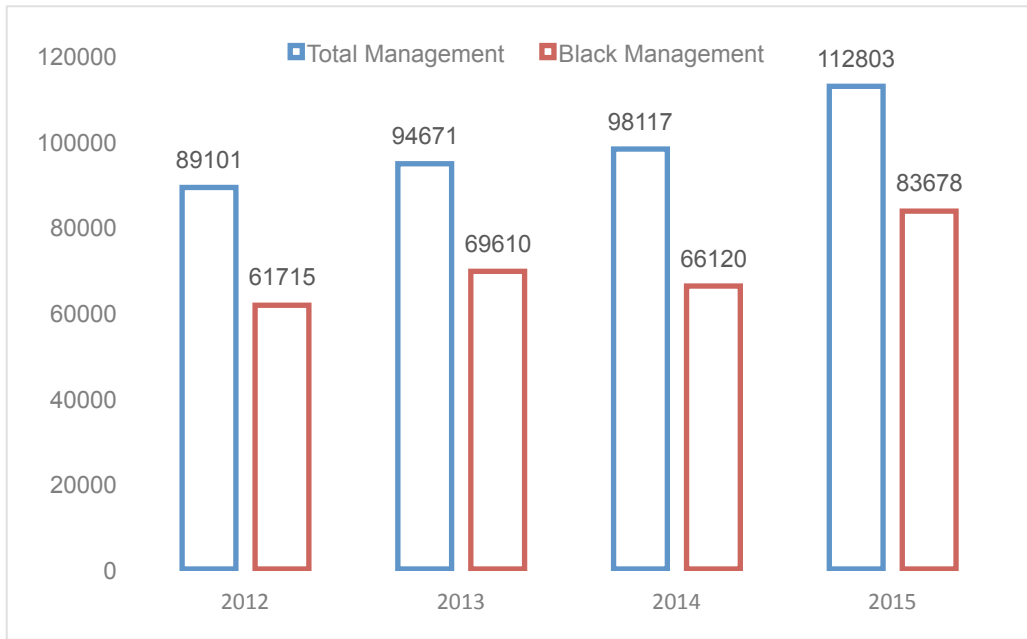
- 6.3. After the 2008 mid-term review a target for black ownership was set at 25%, comprising 10% direct and 15% indirect ownership. Between 2012 and 2015, the share of black ownership of banks was above the target and reached 26.7% in 2014 which was the highest point over the period before declining marginally in 2015. The overall performance of the banking industry since 2008 on the ownership pillar is above target despite the fact that some of the earlier empowerment deals matured and the black investors sold their shares.

MANAGEMENT AND CONTROL

- 6.4. The racial profile management in the banking industry has undergone major changes since the advent of the Financial Sector Charter. Figure 4 shows that black people, constitute the majority of all managers in the banking industry. Most of the gains have occurred at the junior to middle management levels. Different institutions have put in place initiatives to fast-track the development of top managerial skills to close the gap at the top.



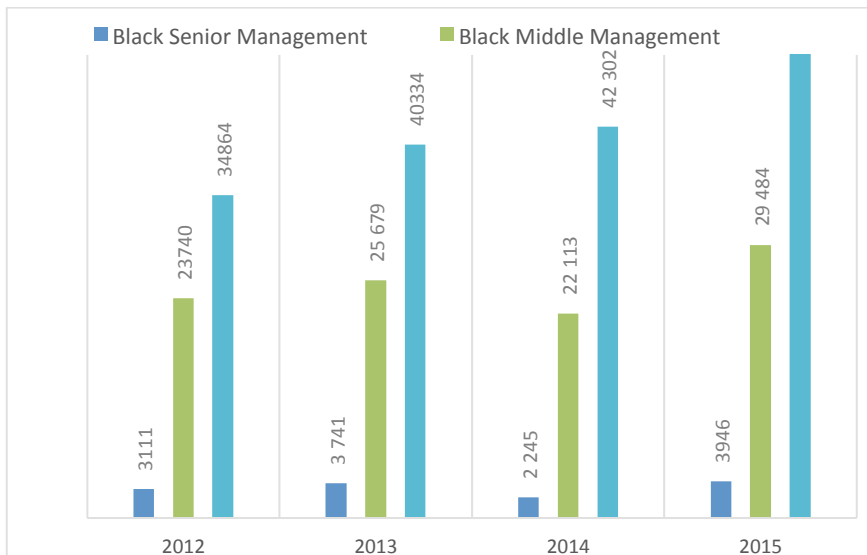
FIGURE 4: CHANGING MANAGEMENT DEMOGRAPHICS



Source: BASA calculations based on data from member banks

6.5. Figure 5 below demonstrates that while all categories of black managers have experienced some growth, the category of junior followed by middle managers have grown fastest.

FIGURE 5: CHANGES IN THE DIFFERENT CATEGORIES OF BLACK MANAGERS

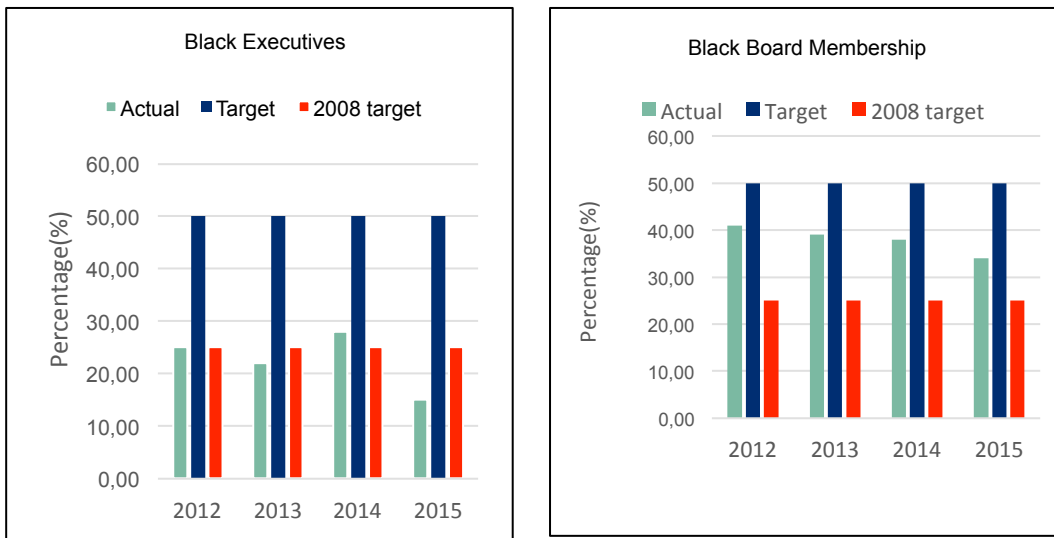


Source: BASA calculations based on data from member banks

6.6. By 2015, there were roughly 800 more black senior managers compared with 2012; 6 000 more black middle managers and 16 000 more black junior managers.



FIGURE 6: BLACK BOARD MEMBERS AND EXECUTIVES



Source: BASA calculations based on data from member banks

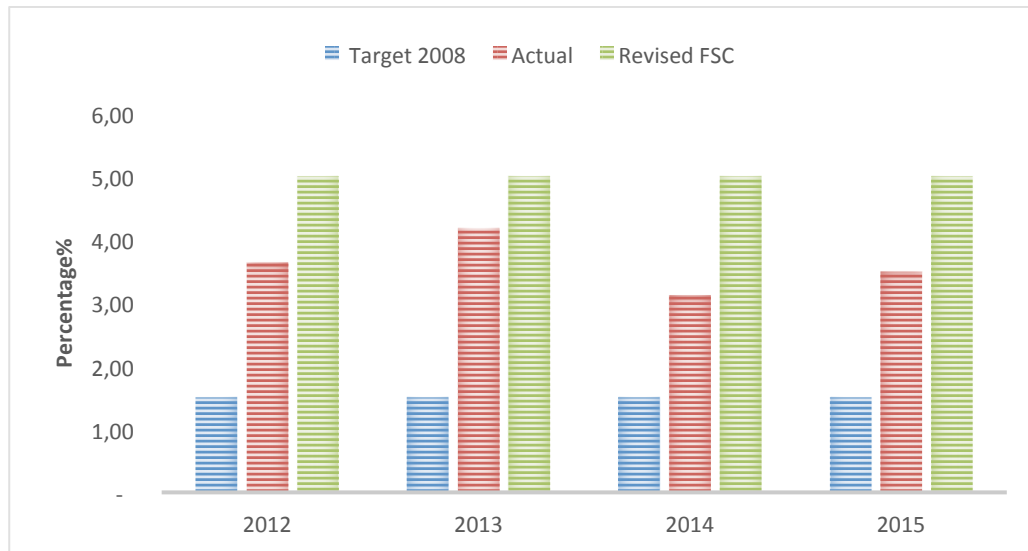
- 6.7. Progress has been slow at board and executive levels. The performance of banks on both measures are better than the 2008 targets except for black executives in 2015.
- 6.8. The overall number of women in senior management positions in the banking industry has shown a gradual increase from 2012 to 2015. The number of black women senior managers declined marginally over the period. Black women make up 8.4% of the total women in senior management positions in the banking industry which is below the target of 10%.
- 6.9. Employment equity remains a critical area despite the many initiatives undertaken by various banks. As indicated earlier, it is an area in which many other sectors are struggling, which indicates a need for government, business and labour to engage in dialogue with a view to find a solution.

SKILLS DEVELOPMENT

- 6.10. Banks have consistently scored above the 3% target of the skills development target in the past 4 years (2012 to 2015). This effort to improve the skills and racial profile of the sector has been supported by R7.4bn spent by banks on skills development. According to the Charter, banks are required to spend 3% of their payroll on the skills development of black employees. This is intended to grow the pool of black professionals with relevant sector skills and thereby grow the pool of black professionals within the industry.



FIGURE 7: SKILLS DEVELOPMENT INVESTMENT



Source: BASA calculations based on data from member banks

PREFERENTIAL PROCUREMENT

- 6.11. In terms of preferential procurement, the banking industry outperformed the current target with a combined amount of R200 billion spend on black-owned and black women-owned enterprises. Procurement spend on all measured categories has been on the rise in the period from 2012 to 2015, with Total Measured Procurement spend rising from R38 billion in 2012 to R60 billion in 2015.

TABLE 6: BREAKDOWN OF PREFERENTIAL PROCUREMENT SPEND

	2012	2013	2014	2015
Procurement BBBEE	R32bn	R54bn	R61bn	R71bn
Procurement QSE and EME	R9bn	R11bn	R11bn	R12bn
Black Owned	R4bn	R7bn	R9bn	R13bn
Black Women Owned	R2bn	R3bn	R4bn	R8bn
Total Measured Procurement	R38bn	R54bn	R58bn	R60bn

Source: BASA calculations based on data from member banks

EMPOWERMENT FINANCING

- 6.12. Between 2012 and 2015, banks spent R69bn on transformational infrastructure; R41bn on Black SME financing; R7bn on black agriculture financing; and R94bn on affordable housing. The figures for black agriculture financing have been quite volatile reflecting the

financing constraints due to lack of security of tenure and/or lack of agricultural support programmes which lenders rely upon from a risk management perspective

TABLE 7: BREAKDOWN OF EMPOWERMENT FINANCING

Year	Transformational Infrastructure	Black SME	Black Agriculture	Affordable Housing
2012	R5bn	R5bn	R186mil	R8bn
2013	R15bn	R12bn	R535mil	R26bn
2014	R22bn	R15bn	R5bn	R29bn
2015	R26bn	R9bn	R700mil	R31bn

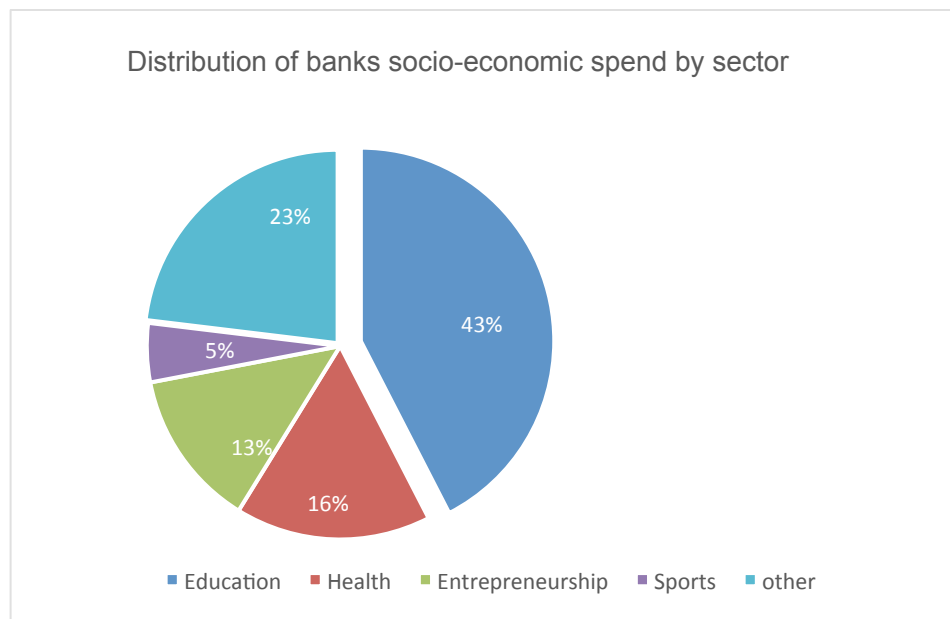
Source: BASA calculations based on data from member banks

- 6.13. Black SMEs share of financing rose from R5 billion in 2012 to a high of R15 billion in 2013 but had fallen back to R9 billion by 2016 which reflects the current tough business environment. Black SMEs with a turnover below R1 million accessed R14 billion worth of credit in the period 2011 to 2016.

SOCIO-ECONOMIC DEVELOPMENT

- 6.14. Banks have contributed R2bn to corporate social investment between 2012 and 2015. Figure 5 below shows that education received the largest share (43%) of the industry’s socio-economic development spend, followed by health, and entrepreneurship.

FIGURE 8: SOCIO-ECONOMIC DEVELOPMENT SPEND, 2012 - 2015



Source: BASA calculations based on data from member banks

- 6.15. In education alone, there is a long list of initiatives supported by banks such as the Adopt-A-TVET College programme by Absa, Ikamva Youth by Capitec, FirstRand Foundation's Maths Education Chairs initiative, Investec's Pro Maths programme, Nedbank's My Future My Career programme, Standard Bank's Adopt-A-School programme, the National Education Collaboration Trust, a number of early childhood development (ECD) initiatives, and in addition each of the major banks have bursary schemes that support tertiary education students. Banks also fund various health initiatives such as the Walter Sisulu Cardiac Centre for Africa, One-Voice initiative to engage young people around health issues such as HIV/AIDS, among many others. Banks also fund environmental, agriculture, small scale green projects and sports.
- 6.16. As a response to the call by National Treasury to improve financial wellness and fitness of different segments of the population as one of the priorities of the nation to advance Financial Inclusion, and therefore transformation, the industry established StarSaver™ formerly known as Teach Children To Save South Africa™. StarSaver™ is a generic financial literacy program intended to inculcate a culture of saving in young people and promote voluntarism and collaboration in the banking industry and the broader financial sector. StarSaver™ has become well-known locally, regionally and internationally, as one of the emerging best practices in financial literacy and in enabling collaboration in a competitive financial education space.
- 6.17. StarSaver™ is an official part of the Economic Management Science (EMS) subject area of the school curriculum. The programme's Lesson Plan which is developed jointly with the Department of Education accommodates generic financial literacy as well as Islamic Finance to include the concepts of money in Islam because Islamic Banking is a growing phenomenon in the country. StarSaver™ has reached approximately 2 million learners in more than 4 thousand schools in South Africa alone with the participation of 23 Banks and 43 Financial Institutions.

LENDING PERFORMANCE

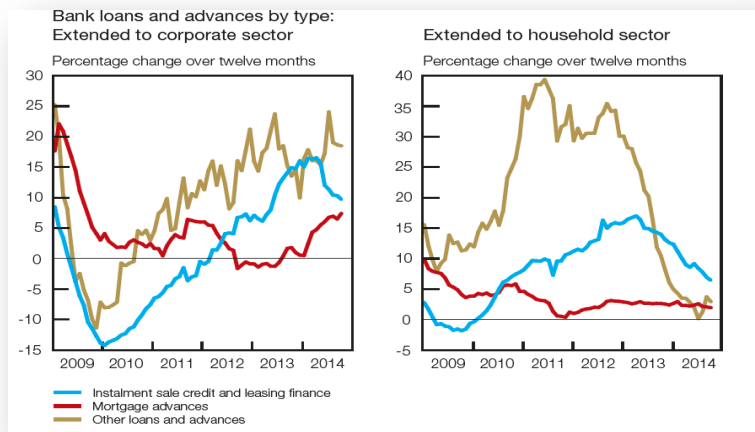
- 6.18. The data demonstrates a decline or muted performance in lending to various categories of customers as well as on empowerment financing. A number of factors need to be taken into account in understanding this trend.
- i) In 2014, African Bank, a major lender to the lower Living Standard Measures (LSM) customers was placed under curatorship and the impact of this is reflected in the 2014 to 2015 figures.
 - ii) The SARB increased the repurchase rate twice – from 5 per cent to 5,50 per cent in January, and further to 5,75 per cent in July 2014.



- iii) There was a sharp deterioration in business confidence, driven mainly by negative developments in mining including the five-month long strike in the platinum sector, with production only increasing in the third quarter of that year.
- iv) The manufacturing sector experienced a slowdown in production in the beginning of 2014, due to the platinum-mining industry and the four-week-long strike in the steel and engineering industry in July 2014.
- v) Weak economic performance and unemployment resulted in weak uptake of credit by the household sector.
- vi) More stringent affordability assessment criteria were introduced by the National Credit Regulator in September 2015. The implementation of the criteria by the credit providers caused less consumers to qualify for access to credit.
- vii) In May 2016, the Limitation of Fees and Interest Rates regulations, as prescribed by the dti, became effective and sought to make credit more accessible and affordable, but resulted in less credit being extended to low-income earners due to banks having to price for higher risk consumers.

6.19. The SARB data shows that lending to the corporate sector remained strong despite the difficult economic conditions described above. Loans extended to households have been under pressure since 2012.

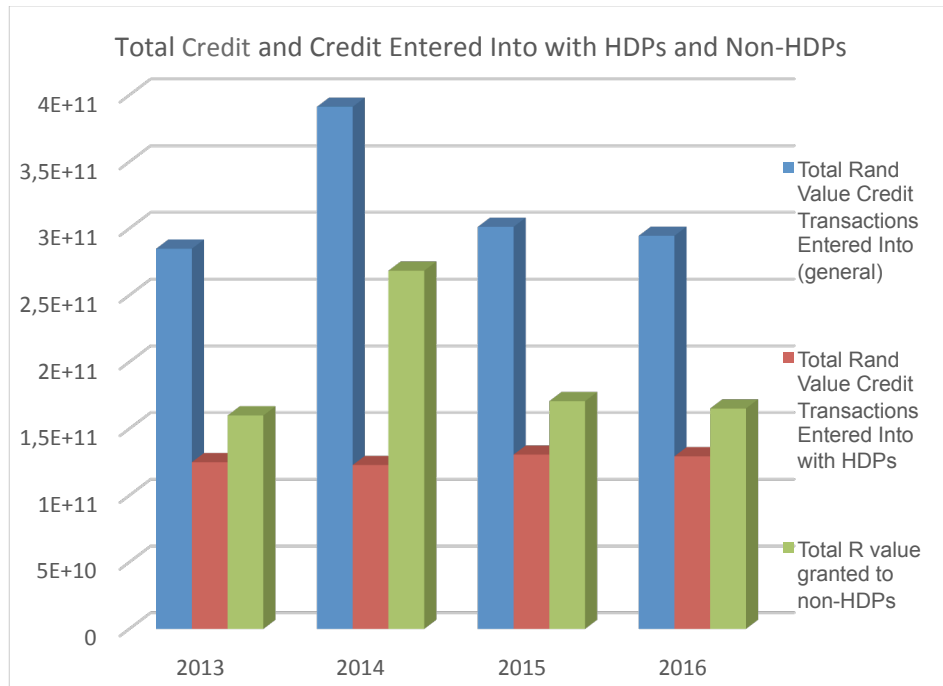
FIGURE 9: BANK LOANS TO HOUSEHOLDS AND CORPORATE SECTOR



Source: SARB, Quarterly Bulletin, December 2014

6.20. The data for the six largest retail banks which represent more than 90% of the banking industry shows that between 2013 and 2016 more than 58 million credit agreements were entered into for different lending products. This includes new loans as well as credit limit increases on existing credit facilities. The total value of the credit agreements was over R1,2 trillion, with R216 billion being unsecured credit.

FIGURE10: TOTAL CREDIT AGREEMENTS



Source: BASA calculations based on data from member banks

- 6.21. Since 2014, there has been a notable decline in the number of credit applications approved and the overall value of the credit transactions. This indicates the weak economic performance, monetary policy tightening and the effect of the amended NCA and regulations.
- 6.22. The legislation regulating credit extension is having the desired effect as the number of credit agreements under unsecured lending category has been dropping for the last two years.
- 6.23. On the other hand, the value of mortgage loans has been on the rise for the past 3 years.

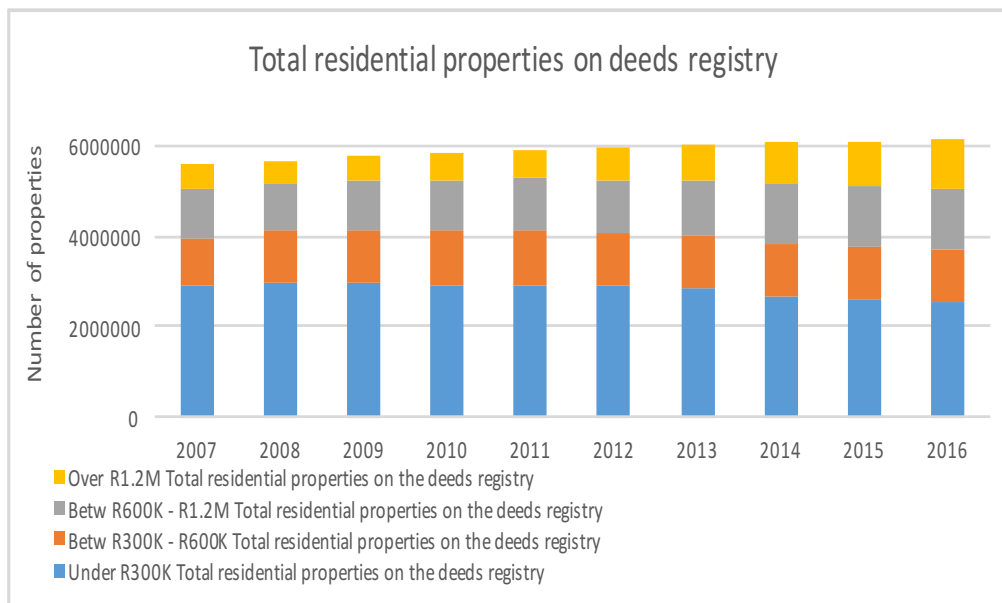
OVERVIEW OF MORTGAGE LENDING (NUMBER OF LOANS)

- 6.24. In this section we provide an overview of developments in the housing market and the role played by banks within it. The data collected by the Centre for Affordable Housing Finance in Africa show that since 2007 banks have financed 1 166 386 transactions, comprising 258 234 new homes and 908 152 homes in the resale market, to a total value of R993 billion. South Africa's residential property market is the largest component of the South African property market, comprising the majority of property assets within the country, and an important component of household wealth. The South African deeds registry comprises 7 million properties, worth almost R6 trillion. Of this, about 6,1 million registered properties, or 87%, are considered residential, ranging from sectional title and freehold properties, to estates; including government-sponsored homes, homes occupied by their

owners or rented to others, and holiday homes; and found across the country, from rural areas, to mining towns, to small and secondary cities, to metro municipalities.

- 6.25. The majority of the residential property market – 62% in 2015 – includes homes valued at less than R600 000. Of this, two thirds (or 43% of all properties) are homes that are valued¹ at less than R300 000, of which the majority are estimated to be government sponsored homes: clear evidence of the significance of government’s subsidised housing programme and the sheer volume of property assets transferred to qualifying beneficiaries since 1994.
- 6.26. About 57% of the total formal residential property market is found in the eight metro municipalities. One third of all properties are found in Gauteng.

FIGURE 11: TOTAL RESIDENTIAL PROPERTIES ON THE DEEDS REGISTRY



Source: Centre for Affordable Housing Finance in Africa

- 6.27. By number, the affordable market dominates our residential property sector. By value, however, it is the conventional market that dominates. This is to be expected: higher value properties would translate into greater value in the market.
- 6.28. Between 2007 and 2015, there were over 2 million transactions across all market segments. These comprised:
 - i) 542 198 new transactions (i.e. new properties registered on the deeds registry); of these, 203 111 were new government sponsored properties that appeared on the deeds registry in the nine years between 2007 and 2015.

¹ CAHF segments the market into four market segments, using Lightstone’s valuation methodology.

ii) 1 468 139 resale transactions (resales of existing properties). Of these, 141 147 (almost 10%) were the formal resale of existing government sponsored properties.

6.29. The 542 198 new transactions can be broken down as follows: 258 234 were financed with a mortgage, 31 456 (12%) of these new bonded transactions were valued below R300 000, 103 387 (40%) were valued between R300 000 – R600 000, 75 681 (29%) were valued between R600 000 – R1.2 million and 47 710 (18%) were valued above R1.2 million.

6.30. The remainder of the new transactions (283 736) were financed without a mortgage (i.e. with cash or equity, or were the 203 111 government sponsored properties). 184 533 were valued below R300 000, 41 354 were valued between R300 000 – R600 000, 32 684 were valued between R600 000 – R1.2 million and 31 711 were valued above R1.2 million.

FIGURE 12: AVERAGE TRANSACTION PRICE (AS INDICATED IN THE DEEDS RECORD), BY VALUE BAND IN 2015

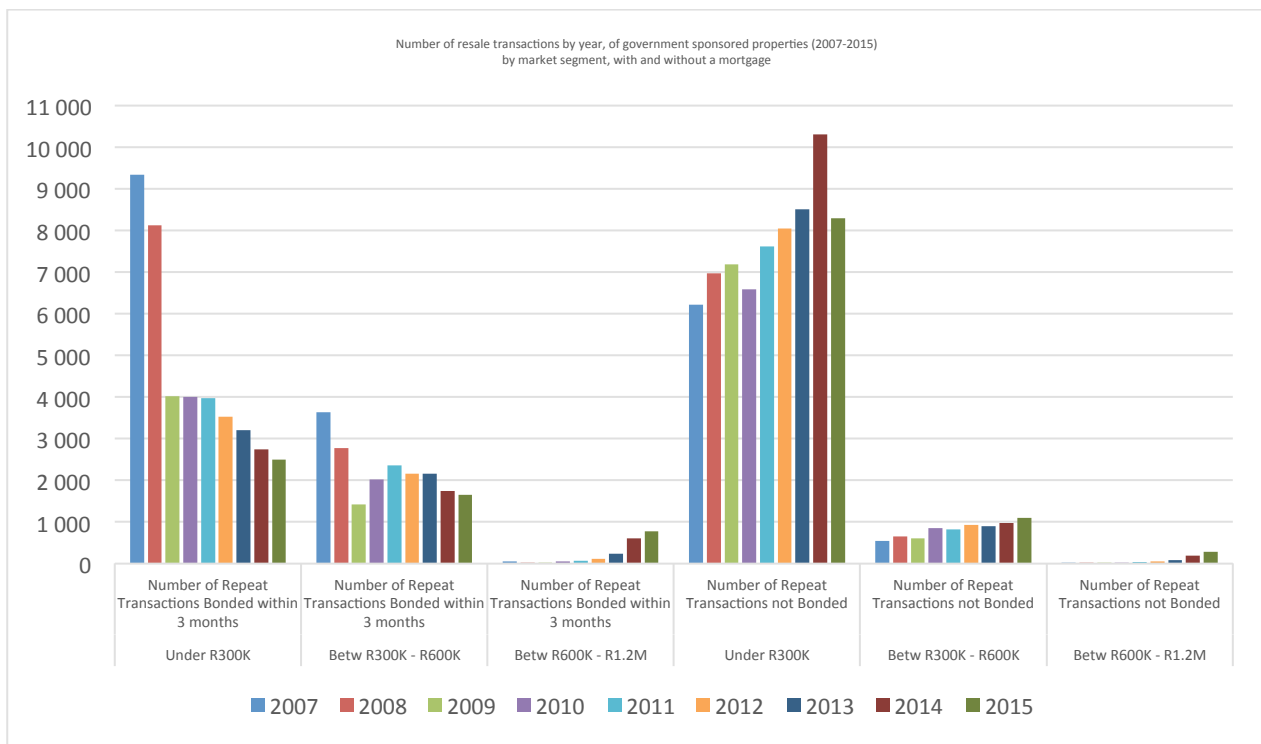


6.31. Of the 1 468 139 resale transactions, 908 152 were financed with a mortgage and were valued as follows: 88 847 (10%) below R300 000, 237 427 (27%) were valued between R300 000 – R600 000, 342 621 (38%) were valued between R600 000 – R1.2 million, and 235 020 (26%) were valued above R1.2 million.



- 6.32. The remainder of the resale transactions (559 796) were financed without a mortgage (i.e. with cash or equity) and were valued as follow: 131 438 below R300 000, 131 792 were valued between R300 000 – R600 000, 165 127 were valued between R600 000 – R1.2 million, and 131 439 were valued above R1,2 million
- 6.33. Of the 141 147 formal resale of existing government sponsored properties 63 290 were financed with a mortgage. In 2015, the average value of a mortgage-financed, resale transaction of a government sponsored property was R376 524.

FIGURE 13: NUMBER OF RESALE TRANSACTIONS BY YEAR, OF GOVERNMENT SPONSORED PROPERTIES (2007-2015) BY MARKET SEGMENT, WITH AND WITHOUT A MORTGAGE



Source: BASA calculations based on data from member banks

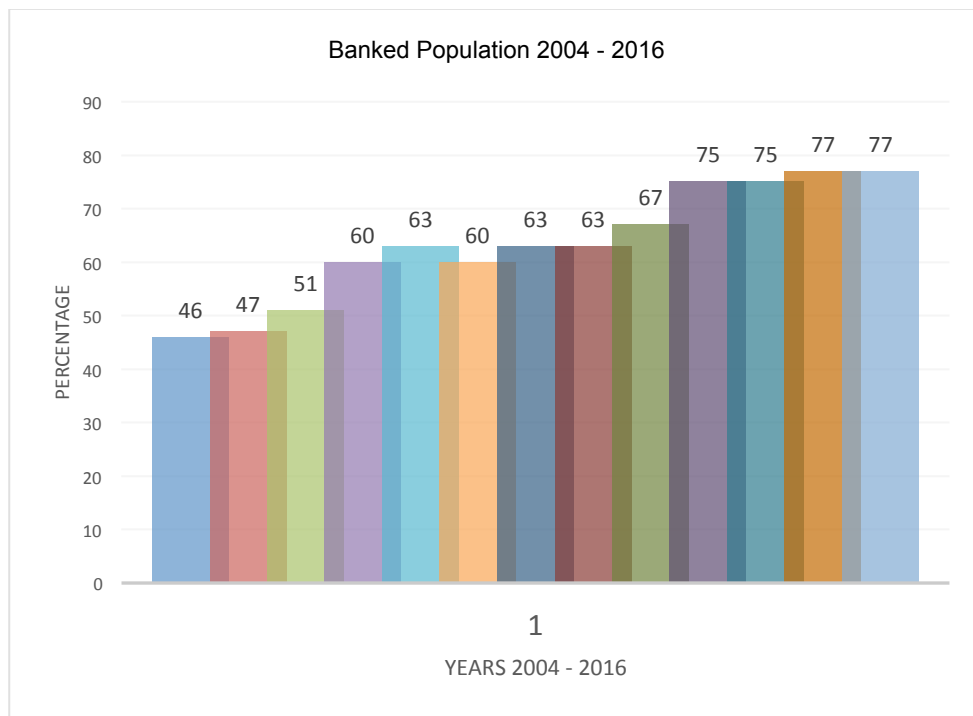
- 6.34. Of the remainder of the formal resale of existing government sponsored properties 77 857 were financed without a mortgage (i.e. with cash or equity). In 2015, the average value of a resale transaction of a government sponsored property that was not financed with a mortgage was R207 487.
- 6.35. The impact of mortgage lending from a value perspective is significant. Across the board, the value achieved by a transaction when it is financed with a mortgage is higher than when it is financed without a mortgage.
- 6.36. The prices achieved with mortgage financing in the <R300 000 resale market, and the R300 000 – R600 000 resale and new build markets show that resale prices are significantly higher when they are financed with a mortgage.



ACCESS TO FINANCIAL SERVICES

6.37. The latest FinScope Survey (2016) shows that 77% of adult South Africans over the age of 15 have bank accounts compared with 46% in 2004. In 2014, only 26% of adults in Sub-Saharan Africa owned accounts with formal financial institutions. This makes South Africa one of the best performers on this measure of financial inclusion compared to other emerging markets. Other challenges remain in relation to the usage of financial services.

FIGURE 14: PERCENTAGE OF BANKED ADULT POPULATION



Source: FinMark Trust, FinScope Survey (various years)

6.38. The banking industry reaches 80% of households in the LSM 1 – 5 with sales points, service points and transaction points within 5 km; 90% of households in the LSM 1 – 5 with service points and sales points within 10km and 95% of households in the LSM 1 – 5 with sales points within 15km. On this measure the industry performs much better than the target set. This is illustrated in Table 7 below.

TABLE 7: NATIONAL COVERAGE OF HOUSEHOLDS LSM 1 - 5

National Coverage of Household with Sales Points, Service Points and Transaction Points		National Coverage of household Service Points and Sales Points	
Year	LSM 1-5 (5km)	Year	LSM 1-5 (10km)
2012	78.08%	2012	90.65%
2013	79.08%	2013	90.36%
2014	79.18%	2014	90.29%
2015	80.38%	2015	91.23%
2016	79.97%	2016	89.97%
National Coverage of household with Sales Points			
Year	LSM 1-5 (15km)		

2012	96.27%
2013	96.28%
2014	96.24%
2015	95.98%
2016	94.70%

Source: AFRIGIS Geographic Reach Analysis (various years)

REVISED FINANCIAL SECTOR CHARTER

- 6.39. The banking industry is absolutely committed to transformation and as part of the Financial Sector Council has actively participated in the development of a revised Financial Sector Code (FSC) that is largely aligned to the Department of Trade and Industry's (dti) generic codes on principles and definitions. There are, however, some deviations.
- 6.40. As in the generic codes, ownership, skills development and enterprise supplier development (ESD) are the priority elements. Banks and life offices have proposed their ESD funding targets under Empowerment Financing pillar as their third priority element. This is mainly because banks and life offices contribute to the broad based empowerment process through activities as opposed to downstream beneficiation.
- 6.41. The Financial Sector Code has four different scorecards for generic entities: a scorecard for banks and life offices, for short-term insurers, for other financial institutions and a scorecard for specialised entities. The points for each of the scorecards are weighted to align to the DTI recognition levels.
- 6.42. In the revised FSC, profit based targets are calculated based on the audited Net Profit after Tax (NPAT) figures of the previous year, as opposed to dti Codes which applies to the current year's estimates. This is mainly due to the unpredictable capital markets and the sensitivities that arise from using management accounts figures.
- 6.43. One of the criteria for the definition of an empowering supplier is the requirement that at least 85% of labour cost should be paid to South African employees by the services industry. The revised FSC refers to Leviable amount instead of Labour costs. The reason for this is that the term Leviable amount has a formal legal definition that is different to what is intended in the revised FSC.
- 6.44. Another difference is on requirement that an empowering supplier spends at least 12 days assisting entities or developing suppliers through skills transfer. The FSC has tiered the target number of days ranging from 1 day for an entity with less than 20 employees to 12 days for entities with more than 500 employees. This is intended to ease the burden for smaller entities with a limited number of employees but wishing to provide the support to other entities that need their expertise.



6.45. The table below depicts a summary of the comparative scorecards for the generic codes and the sector code:

Priority elements

ELEMENT	DTI		SUGGESTED NEW FSC				
	Main	BONUS POINTS	Life offices and banks	Short Term Insurers	Other	Bonus points all	Note
OWNERSHIP	25	0	23	20	20	5	2
MANAGEMENT CONTROL	19	0	20	20	20	0	3
SKILLS DEVELOPMENT	20	5	15	15	15	3	4
PROCUREMENT	40	4	15	20	20	4(8)	5
ENTERPRISE AND SUPPLIER DEVELOPMENT FUNDING			0	15	15		
EMPOWERMENT FINANCING (15 SECTOR SPECIFIC 10 ESD)		0	25	0	0	4(0)	6
ACCESS TO FINANCIAL SERVICES		0	12	12	0	0	
SOCIO ECONOMIC DEVELOPMENT	5	0	5	5	5	3	7
	109	9	115	107	95	19	

Source: Financial Sector Council (Revised Sector Code)

6.46. The recognition of ownership after the sale of shares by Black participants has been amended in the revised FSC. Entities will only be able to carry forward ownership points on the net value created through the ownership transaction, post exit of the empowerment shareholder. This is aligned in principle to the generic code continuing consequences provisions.

6.47. In addition, and based on certain preconditions such as the fact that entities must have previously met direct ownership targets:

- i. If they are entities with designated investments, (banks and life offices) they supplement the difference between the net value created and their target net value by providing Black Business Growth financing as an equity equivalent; or
- ii. If they are entities without designated investments, they can supplement the difference between net value created and their net value target through additional enterprise development or higher education funding;
- iii. Measured entities may elect to lose the relevant points or do another BEE transaction.

6.48. The above dispensation is created as a pragmatic solution to enable financial institutions with regulated capital requirements, to maintain Generic Code ownership levels, post the exit of empowerment partners. In essence as a result of capital requirements such as BASEL III, potential top up deals required by BBEE legislation, would have the effect of



significantly reducing the sector's ability to provide catalytic funding to enable the broad based empowerment of the SA Economy.


- 6.49. The generic codes incorporates the segmentation of the various race groups included in the definition of Black through the use of the Economically Active Population (EAP) formula. This has been done to ensure the workforce reflects the country's demographics with African being in the majority. The Financial Sector further believes this must be done in line with the Employment Equity Act (EEA) and the Constitution of South Africa. Having taken regard of the Supreme Court of Appeal of South Africa judgment, case No: 165/13, in the matter between Solidarity On behalf of Mrs R M Barnard and the South African Police Service, the revised FSC instead incentivises institutions to employ African people through additional points that can be earned over and above the points Black representation.
- 6.50. The generic codes have a target of 6% of payroll spending on skills development for all employment equity segments combined. The FS Code has tiered targets ranging from a lower target of 2% for higher levels of management to 8% for non-management staff. The skills development target in the FSC is tiered in order to ensure that, for progression purposes, a lot of learning and development is targeted at lower levels in the entities.
- 6.51. The revised FSC includes mandatory sectoral training in skills development. It is however, still limited to 15% of the total spend. Mandatory training facilitates staff progression, which is the main objective of the skills development element.
- 6.52. The socio-economic development element in the FS Code differs slightly in that it contains a component of consumer education. Consumer education is also a unique element of the financial sector and critical for our country.

OVERALL COMMENT ON PERFORMANCE

- 6.53. The period between 2012 and 2015 has been challenging on many fronts. The South African economy recorded one of its worst performances with both business and consumer confidences taking a huge knock. Credit impairments have remained stable but credit lending and credit extension have been muted due to the myriad of regulatory changes, as well as the collapse of African Bank, one of the biggest lenders to previously disadvantaged consumers. Transformation is difficult under the best conditions, and becomes even harder when there is a general underperformance in the economy and the political environment is volatile.
- 6.54. Banks have demonstrated that they are committed to helping South Africa overcome the challenges by playing a leading role in the CEO Initiative among others.



7. CONCLUSION

- 7.1. Having sound financial and banking systems is important for the well-being of the economy. We should draw lessons from recent international experiences.
- 7.2. The 2008 financial crisis triggered a significant drop in Irish asset prices that resulted in the failure and bailout of all Irish banks other than foreign owned banks. House prices dropped by over 50% and commercial real estate prices by 65%. The Irish government in order to avert the banking crises guaranteed all Irish domestically owned bank liabilities, including subordinated debt. This proved to be disastrous because the government had to ultimately meet these liabilities as some large banks balance sheets were beyond repair. As a consequence, government debt to GDP rose from a low of 23% in 2006 to a peak of 120% by 2012.
- 7.3. The Irish government had to obtain support from the European Commission, European Central Bank and the IMF (the troika) to the tune of €68b. The acceptance of this support required the Irish government to implement an austerity programme which inter alia saw civil service pay drop by 25%. In addition to the recapitalization of the banks, the banks were unable to raise liabilities and obtained liquidity from the European Central Bank's funding schemes. The issue at the end of the day was strong growth and benign conditions over a 20 year period resulted in over leveraged and poorly managed banks collapsing, resulting in the financial collapse of the whole country. The knock-on effect of this was no availability of credit, massive increase in unemployment to about 15%, a very harsh austerity programme driven by the troika bail out conditions. The Irish economy has since recovered with unemployment down to 6.5%; GDP got back above its 2008 level in 2015 primarily due to the tough austerity programme and strong international corporate sector. Ireland is a very good example of how a weak, overly aggressive banking system took a country down.
- 7.4. This submission has attempted to explain the centrality of the banking sector in socioeconomic growth and development. It has also demonstrated the significant progress on most areas of transformation, and has been frank about areas in which work must be intensified.
- 7.5. There must not be a trade-off between transformation and the soundness of the banking sector. Our banking industry is the second most safe and sound banking system in the world because we are regulated according to global best practice, and the primary consideration is how to conduct our business so as to protect depositors' funds. We have an excellent banking infrastructure as a country, we should be proud of this and strive to be the safest and most sound sector.
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- 7.6. So, legislators, regulators and the sector must cooperate to ensure we maintain, and consistently improve, our soundness and transform to ensure the sector is relevant to the majority of our people. The two priorities are complimentary!
- 7.7. We look forward to substantive engagement with the two committees on these issues and thank you for your attention.

