



AN INCLUSIVE FINANCIAL SECTOR FOR ALL

Draft for consultation



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA



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LIST OF ACRONYMS, FIGURES, AND TABLES

LIST OF ACRONYMS

ABSIP	Association of Black Securities and Investment Professionals
AML/CTF	Anti-Money Laundering and Combating the Financing of Terrorism
ATM	Automated Teller Machine
ASISA	Association for Savings and Investment South Africa
BASA	Banking Association South Africa
B-BBEE	Broad-Based Black Economic Empowerment
BIAC	Black Insurance Advisors Council
BIOA	Black Insurance Owners Association
CFI	Cooperative Financial Institutions
DFI	Development financial institutions
FIA	Financial Intermediaries Association
FICA	Financial Intelligence Centre Act
FSC	Financial Sector Code
FSCA	Financial Sector Conduct Authority
GDP	Gross Domestic Product
G20	Group of Twenty
G2P	Government to Persons
IMF	International Monetary Fund
I-SIP	Inclusion, Stability, Integrity and Protection
NASASA	National Stokvels Association of South Africa
NT	National Treasury
NDP	National Development Plan
NEF	National Empowerment Fund
OECD	Organisation for Economic Co-operation and Development
<i>RICIA</i>	Regulation of Interception of Communications and Provision of Communication-Related Information Act
<i>SAIA</i>	South African Insurance Association
SEDA	Small Enterprise Development Agency
SEFA	Small Enterprises Finance Agency (SEFA)
SMME	Small, medium and micro enterprise
SWIFT	Society for Worldwide Interbank Financial Telecommunication

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EXECUTIVE SUMMARY

The objective of this document is to establish the policy framework for financial inclusion in South Africa and to sketch the approach to its implementation. The document outlines Government's policy to shape regulatory approaches, the evolving Financial Sector Code (FSC), and sector market practices in general. It also outlines Government's plans to respond to the global coronavirus (COVID-19) pandemic from a financial inclusion perspective.

Financial inclusion refers to the delivery of financial services at an affordable cost to vast sections of the population that are historically excluded or under-served by the formal financial sector. This policy considers financial inclusion as the mechanism to target these disadvantaged individuals and business enterprises, as they will have a pressing need for such services and will benefit the most when this policy is rolled out.

In the South African context, the segments of society that underutilise financial services are inadequately provided for. Even if the services exist, they are often not easily accessible to the excluded and under-served. Furthermore, financial services are a significant enabler for a society's social and economic development. Effectively, including people in the financial sector not only requires the availability of financial products and services, it also needs them to be convenient, affordable, fair and trusted. In addition, most South Africans must be able to use them.

At an individual and household level, financial inclusion is a necessary component towards eliminating inequality and improving the quality of life of low-income people. The appropriate use of financial services by small, medium and micro-sized enterprises (SMMEs)¹ improves their prospects, and positively impacts on the economic environment of the societies in which they operate. The benefits of financial inclusion in South Africa speak directly to positively addressing some of the effects of past historical imbalances – that have prevented previously economically marginalised South Africans from participating in the economic mainstream – and the resultant societal inequalities and high levels of unemployment.

This policy document assesses the current state of financial inclusion in South Africa, puts forward general principles to guide sustainable improvement in financial inclusion, and embeds those principles in specific pillars – which are detailed later – in support of the policy objectives. Taking into account lessons learned from financial inclusion approaches used internationally, a series of specific interventions are proposed by the National Treasury in which financial inclusion can be taken forward responsibly and sustainably.

The headline data on financial inclusion in South Africa reflects positively on the country's achievements in this area over the last decade. At least 91 per cent of South African adults have been formally included in its financial system, with only about 2.9 million still excluded. Of those included, 81 per cent have a bank account, 78 per cent use other non-bank channels, and approximately 61 per cent still use informal channels. If South Africa's nearly 5.3 million social grant beneficiaries are excluded from banking institutions, then only 68 per cent of adults are considered banked.²

However, significant underlying problems still prevail around using financial services. The ways in which financial services are utilised, as well as ongoing inadequate access to certain financial services, are problematic. Low-income earners, although included, still do not engage meaningfully with financial institutions. Abusive practices by unscrupulous financial service providers have also harmed a lot of people that the financial sector should be helping. SMMEs are only marginally served.

1 The National Small Business Amendment Act, 2003 (Act No. 26 of 2003), and amendment to the National Small Business Act, 1996 (Act No. 102 of 1996) defines (SMMEs) according to five categories, namely; industrial sector and subsector, size of class, equivalent of paid employees, turnover and asset value – excluding fixed property.

2 Finscope, 2019.

EXECUTIVE SUMMARY

As a result, financial inclusion levels have not adequately translated into improvements in the quality of life and economic environment of low-income South Africans. This document proposes various projects that will be prioritised to support the successful achievement of the three pillars that support the policy objectives, and their priority areas, as identified during the policy's development (see Table 1 for a summary of pillars, priorities and projects). The proposals contained in this policy paper would be concluded and adopted following a public consultation process. This will be followed by the drafting of the National Financial Inclusion Strategy as well as a monitoring and evaluation framework for financial inclusion (i.e. an annual financial inclusion monitor that summaries data and survey findings).

To complement the policy, the Financial Sector Conduct Authority is expected to improve the use of financial services by developing a strong national focus on financial literacy and market conduct. The Twin Peaks³ regulatory regime model has strengthened the regulatory framework and should further improve appropriate access to, and usage of, financial services by the low-income market, in support of the policy outlined here.

It is intended that a financial inclusion sub-working group will guide the development and implementation of the National Financial Inclusion Strategy. This will need to include a sequenced and prioritised action plan with a lead agency, resourcing, and the development of a monitoring and evaluation framework to help evaluate the impact of the adopted policies over time. A focused approach to sustainably improve financial inclusion will not only benefit low-income and vulnerable South Africans, but all of society.

Table 1 - List of the financial inclusion policy pillars, priorities and proposed projects for development

Priority	Proposed projects for development
PILLAR ONE - DEEPENING FINANCIAL INCLUSION FOR INDIVIDUALS	
Priority 1: Promote the beneficial use of transactional accounts	<ul style="list-style-type: none"> • Conduct demand-side research to understand blockages and impediments to account usage. • Coordinate a stakeholder workshop to explore affordable and effective cash-in options, considering especially the potential benefits to improved cash-in facilities, current blockages and market experiences.
Priority 2: Build appropriate payment options to drive usage	<ul style="list-style-type: none"> • Develop a payment ecosystem that is accessible and serves all the users of financial services, covering transactional accounts, mobile payments, small-value payments and remittances services (both domestic and cross-border). • Develop innovative ways to assist small merchants to acquire affordable payment devices and to enable a variety of interoperable point-of-payment channels. • In line with the National Payments System Act - Provide non-banks with access to the payment and settlement system so these entities can directly provide payment services. • Develop a national strategy for interoperability, identifying a national vision and the steps required to get there. This could focus on the critical levers highlighted, including leveraging off large-scale payments like transit and implementing the national standard. • Explicitly allow for e-money in the National Payments System. It will be enabled and regulated by the South African Reserve Bank and cater for e-wallets and other purely digital forms of value stores.

³ South Africa has started implementing a new regulatory regime for the financial sector. Known as the Twin Peaks, the new approach is designed to address weaknesses in the other models commonly used to regulate banks and the financial services sector.

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Priority	Proposed projects for development
<p>Priority 3: Position remittances as a springboard for further financial inclusion</p>	<ul style="list-style-type: none"> • Investigate the feasibility of an interoperable domestic remittance system, including allowing non-banks to provide domestic remittances without the backing of a bank (as is currently required). Interoperability in this context does not imply a single system, but rather that money can flow seamlessly between different platforms and service providers. • Using relevant regional integration structures investigate the feasibility of an interoperable person-to-person money transfer system in the Southern Africa Development Community (SADC) region. Such a system should ideally leverage existing infrastructure to the extent possible. The system should take into account all stores-of-value and make full use of mobile technology capabilities. It should also embed a proportionate and risk-based approach to applicable international standards, ensuring that the implementation of these standards by regulators and financial institutions does not have unintended consequences for financial inclusion. The Department of Home Affairs should be brought into the solution. • Undertake a risk assessment to set thresholds and requirements for different type of transactions, ensuring alignment with projects undertaken in pursuit of Priority 8. • Prioritise the collection of data on remittance flows, including estimates of transfers through unregulated channels, published as remittance indicators as part of the financial inclusion monitor. • Ensure that customer education on safe and efficient ways of sending and receiving money is identified as part of the National Financial Education Strategy.
<p>Priority 4: Support increased formal savings for low-income earners</p>	<ul style="list-style-type: none"> • With the aim of tapping the massive informal savings pool in South Africa, perform a diagnostic on available savings mechanisms. This will take into account market failures, including those relating to product design and distribution, and making recommendations for possible savings models like those applied in India. It will also include the design of savings products that support regular small-value savings, the extension of the product range for stokvels (a type of credit union), and distribution improvements.

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Priority	Proposed projects for development
<p>Priority 5: Promote appropriate credit for assets and investment over consumption</p>	<ul style="list-style-type: none"> • Coordinate a stakeholder workshop between Government, development finance institutions (DFIs) and industry, to unpack the issues, hear experiences of market participants and international counterparts, and explore options for addressing these issues, with the aim of reaching concrete recommendations. • Explore how the new Financial Sector Conduct Authority, set up under Twin Peaks, could work hand-in-hand with the National Credit Regulator (NCR) in monitoring the conduct of credit providers as regulated by the National Credit Act. The NCR will proactively and pre-emptively monitor credit providers for conduct risk, and the body will respond to poor conduct practices before they become systemic. • Review the Financial Sector Code to set access to finance targets for specified developmental loans. Loans needed for students from low-income families should be informed by Government's approach to improve funding for tertiary education. The following approaches should be considered: <ul style="list-style-type: none"> • Reduce the credit risk for lenders by setting up a facility where Government shares the loss on default (this in effect is a partial credit guarantee scheme for education loans, similar to what is proposed in more detail in Pillar Two Priority 9). • For student loans use the student's future income generation capability as the primary way of assessing affordability, rather than the current ability of another party, typically a parent or guardian. • In support of wealth creation among people currently un- or under-served, while increasing the level of home ownership in South Africa, explore the feasibility of using types of security like PTO (permission to occupy) tenure as acceptable collateral for financial institutions seeking to provide home loans or mortgages. Currently a person cannot get a home loan or mortgage using a PTO as security.
<p>Priority 6: Promote appropriate, affordable and quality insurance</p>	<ul style="list-style-type: none"> • Conduct demand-side research to understand blockages and impediments to the take-up and use of insurance, which may relate to factors such as product suitability, distribution channels and overall affordability. • Develop minimum product standards for a simplified product that meets the needs of low-income South Africans and can be provided under the new insurance act's micro-insurance framework. This product should inform FSC targets and be supported by consumer protection measures like standardised point-of-sale disclosure documents. • Assess the conduct of the insurance market. This could cover issues like excessive pricing, lower claim ratios, adverse selection and claims procedures.

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Priority	Proposed projects for development
<p>Priority 7: Increase the financial inclusion impact of social grant distribution</p>	<ul style="list-style-type: none"> • Support the Department of Social Development to explore a long-term and sustainable solution for grant payments in support of financial inclusion. In doing so, conduct research to consider the appropriate role of banks (state and commercial), other payment service providers and transactional accounts in the payment distribution chain, in order to: • Utilise existing infrastructure as far as possible, particularly payment and identification infrastructure. • Encourage the extension of that infrastructure for the benefit of all. • Take a systemic approach to grant distribution and encourage the development of beneficial ecosystems, particularly around the distribution aspect and small enterprises within communities where grant recipients reside. • Enable access to, and use of, further appropriate financial services in a fair and competitive environment.
<p>Priority 8: Improve efficiencies in financial services' client on-boarding</p>	<ul style="list-style-type: none"> • Explore the impediments to client validation services and establish one that is centralised. This system will explore the use of the national identity system (Department of Home Affairs) and consider a customer's ID as their unique identifier in the payment system. This should be done to reduce the potential for fraud and to support other consumer protection measures like switching across product suppliers. • Explore the potential to synchronise the two Acts, FICA and RICA, and other requirements.
<p>PILLAR TWO - EXTENDING ACCESS TO FINANCIAL SERVICES FOR SMMEs</p>	
<p>Priority 9: Improve access to credit by building credit infrastructure for small businesses</p>	<ul style="list-style-type: none"> • Improve credit information sharing for the SMME credit market, by including payments data in the shared information available to credit information services and credit providers. All service providers should be able to use this information to enable credit providers to assess the financial situation of all types of SMMEs. • Take steps to improve the effectiveness and take-up of support provided by the SEFA credit guarantee scheme; perform an assessment of what is functioning well and what is not in the current system, and to what extent the scheme meets the needs of the SMME credit market. The <i>Diagnostic Assessment of the Khula Credit Guarantee Scheme</i> study that was undertaken by the World Bank and the scheme's subsequent proposed business plan should form the basis of this intervention. • Consider reforming the secured transactions law as it pertains to SMMEs, especially security interest for movable assets and the establishment of a movable assets' registry. • Build business knowledge and financial literacy by improving synergies between SEDA and lending institutions and promoting the financial education of entrepreneurs through South Africa's financial education policy.

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Priority	Proposed projects for development
Priority 10: Broaden the range of financing instruments available to SMMEs	<ul style="list-style-type: none"> Investigate the potential for capital markets to finance SMMEs in South Africa in order to propose specific instruments that meet their financing needs at different stages of the business development cycle. Evaluate the venture capital tax scheme for its effectiveness and make recommendations for improvements that could increase its take-up and reach.
Priority 11: Use of transaction accounts and payment services by SMMEs	<ul style="list-style-type: none"> Investigate whether mobile payment capabilities can be extended to take explicit account of the needs of SMMEs to make, receive and track payments. The capabilities should also allow for the use of payment information as part of the credit worthiness data that is used to base credit assessments on.
Priority 12: Suitable insurance for SMMEs	<ul style="list-style-type: none"> Conduct demand-side research to understand SMMEs' needs and use the findings to develop minimum product standards that can inform a review of the targets in the Financial Sector Code. Explore the need and potential for specific agricultural insurance in South Africa, including weather index insurance.
PILLAR THREE - LEVERAGING A MORE DIVERSIFIED PROVIDER AND DISTRIBUTION BASE	
Priority 13: Strengthening financial co-operatives and the developmental microfinance sector	<ul style="list-style-type: none"> Promote the sustainable development of cooperative banks and cooperative financial institutions and support their graduation from informal entities to formal ones, and then to competing against large banks. Introduce a tiered licensing framework for banking and or deposit-taking institutions to allow for new entrants to the financial sector and propose solutions to increase market diversification and support the growth of smaller financial institutions. Consider conducting an in-depth assessment on the role and function of the cooperative banks and CFIs currently operating in South Africa and identify options for growth. Review the mandate of the Cooperatives Banks Development Agency (CBDA) to align it better to the microfinance sector's needs. One option is to extend the mandate of the CBDA to become a cross-sector development agency for all informal or smaller financial institutions – including cooperatives and financial sector SMMEs - that want to formalise and grow (also see Priority 14 in this regard). This assessment should consider existing DFI support programmes as a way to promote efficiencies and avoid duplication. Introduce deposit insurance to safeguard individual depositors who might lack the knowledge to assess the risks that exist between different financial institutions. Explore ways in which developmental microfinance institutions can be supported.
Priority 14: Explore the role of the state in supporting sustainable financial inclusion	<ul style="list-style-type: none"> As part of National Treasury's financial sector development agenda, consider research to evaluate the opportunities, risks and effectiveness of state-owned banks and DFIs. Design the research to take into account South Africa's financial inclusion needs and objectives.

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Priority	Proposed projects for development
<p>Priority 15: Enable a broad base of agents in the provision of financial services</p>	<ul style="list-style-type: none"> • Take steps to improve the access point network, especially through strengthening the agency model in South Africa by: <ul style="list-style-type: none"> • Getting representative survey data on incentives/disincentives for retailers to act as agents. • Developing a suitable regulatory framework to promote shared usage of widespread branch networks, like SAPO; support the potential role of CFIs and smaller retailers in reaching the under-served market; support partnerships between banks and retailers; and move closed-loop systems⁴ into the interoperable environment as part of the interoperability strategy).
<p>Priority 16: Leveraging fintech disruptors to promote and support financial inclusion</p>	<ul style="list-style-type: none"> • Develop a fintech policy informed by financial inclusion with the latter as one of the key objectives of that policy. At the core of such a policy should be an assessment of the effect of fintech on the SA financial consumer from a usage cost and access perspective. • Enable regulatory “sandboxing” for new ideas and business models, that enable service providers bring innovative financial products and services to the un- and under-served market.

⁴ A closed loop system is a platform that doesn't integrate well with the systems of other parties.

1 INTRODUCTION

South Africa has a well-developed and well-regulated financial sector, with a wide range of financial products and services, typically offered and supported through a national network of an increasing range of access points of service. This provides a solid base for sustainably and beneficially extending financial inclusion. Over the past two decades the financial services sector has developed in line with the changing domestic and international environment and it remains a key contributor and enabler in the South African economy. The regulatory structures, aimed at improving the stability, safety, efficiency and integrity of the financial sector, have been developed and strengthened to meet international standards and to serve South Africans better. South Africa's financial sector was able to weather the 2007/8 global financial crisis better than many other countries', particularly some developed nations', and it is viewed as a key and able partner in taking financial inclusion forward in the country.

South Africa's implementation of the rigorous Twin Peaks system of financial regulation entrenches financial inclusion as a core priority for Government and the sector regulators. Besides taking a tougher and more intrusive approach to market conduct, prudential and stability risks, the regulators are required to support and promote financial inclusion through their respective regulatory and supervisory frameworks. While financial inclusion has been on the policy agenda for some time, the Twin Peaks reform provides for a more strategic and deliberate response.

This policy document outlines Government's policy to shape regulatory approaches, the evolving Financial Sector Code, and sector market practices in general. The introduction defines financial inclusion and its role in transforming the country's financial landscape. Chapter 2 then outlines the range of South Africa's population that is most directly in need of financial services, and provides context on the current state of financial inclusion in the country. Chapter 3 provides background on the evolution of financial inclusion in the global environment and considers regulatory developments and interventions relevant to financial inclusion in South Africa. In Chapter 4 the three policy pillars that support financial inclusion are discussed. Chapters 5 and 6 provide a plan for implementing the policy and a guide on how progress towards meeting the policy objectives will be measured. Finally, Chapter 7 maps the immediate next steps that should be taken to start the adoption and implementation of the policy.

1.1. What is financial inclusion and why is it important?

Financial inclusion is the provision and use of affordable and appropriate financial services by those segments of society where financial services are needed but not provided, or they are inadequately delivered. It is an important tool in the economic development of a country, just as financial exclusion is a significant constraint to economic and societal development.⁵

In recent years, financial inclusion has gained increased international recognition and prominence. During the last 10 years, globally the number of financially excluded adults has decreased from approximately 2.5 billion to 1.7 billion,⁶ a figure that is still concerningly high. Those who are financially excluded may not have transactional or savings accounts, they may not receive credit from formal credit providers, and they may not have any type of insurance. They rarely make or receive payments through formal financial institutions, which further increases their financial vulnerability. Their exclusion exacerbates poverty and contributes to continuing income inequality and slower economic growth.

5 Numerable studies support the link between financial inclusion and economic inclusion and development. For example: In Malawi access to accounts increased savings among farmers which translated into greater agricultural output and household spending whilst digitising social transfer payments in Niger significantly reduced travel and wait times for recipients receiving the funds and also lowered the government's administrative costs.

6 World Bank's Global Findex Report, 2017.

1 INTRODUCTION

Financially excluded people and businesses rely on the cash economy and consequently on less efficient, inadequate and higher-risk financial services. Appropriate access to financial services can empower individuals and entrepreneurs – particularly those with a lower income such as Natalie and Rolphy in Box 1 – to better integrate into the economy, actively engage in their own development and protect themselves against economic shocks.

Box 1: The un- and under-served market⁷



Natalie

Natalie (41) is a grandmother of 11. Her husband and three of her children passed away a few years ago leaving her with six orphans. She has a part-time cleaning job which pays her R1,500 per month and is also entitled to foster care grants for the six orphans.

With a monthly household expenditure of around R3,500, Natalie's income hardly covers her living expenses. To make ends meet, Natalie started borrowing from banks and has since been borrowing from different institutions. One of her largest loans (R14,000) was used to buy a water tank and to put electricity in the house and another recent one was used for a burial. Natalie now looks for smaller institutions to borrow from as she believes they are the least concerned about her credit history. Natalie is paying just over R1,200 per month to service her loans. She recently borrowed R400 from a loan shark that lives in her village to feed her family.

⁷ Stories were extracted from "The personalities of the underbanked: A point of view on financial inclusion in South Africa", FINMARK TRUST and FROG, November 2012.

1 INTRODUCTION

Box 1: The un- and under-served market



Rolphy

Rolphy is a 31-year-old entrepreneur from Blood River in KwaZulu Natal Province. He established his tombstone business with a group of friends five years ago and sells headstones mainly to customers living in his neighbourhood. The sustainability of his business has not been easy, given how competitive the funeral business has become with many new players in recent years. In addition, his customer base is shrinking – most of his customers are older. When he receives his income, Rolphy pays for all the expenses and banks the remaining amount. Rolphy keeps a record of his business activities in a book that he keeps at his home, and he has one financial product: a transactional account with a bank in a town near his place of business. His largest business spend is buying material for the tombstones and paying for electricity for his business premises.

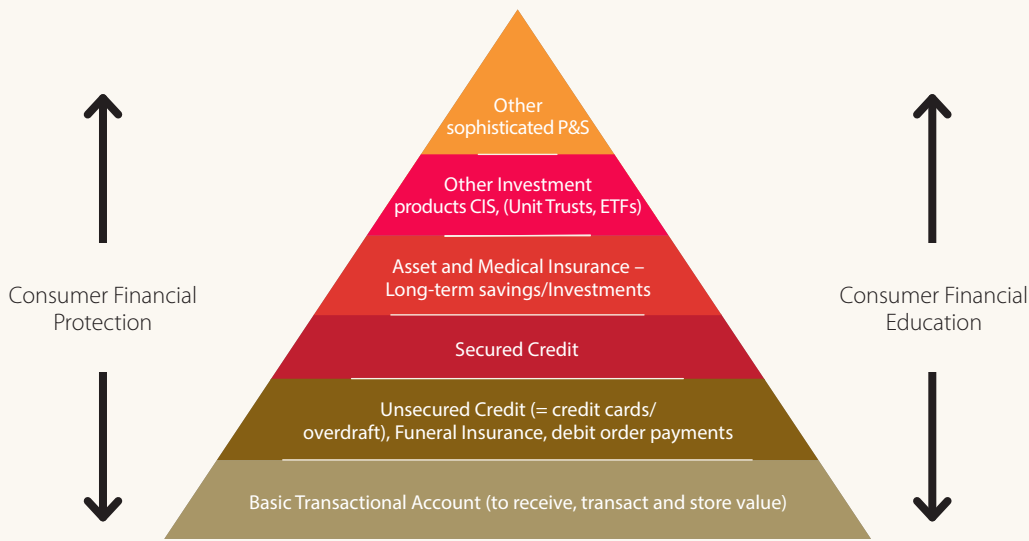
Rolphy is worried that one day he will not be able to continue his business and believes the only way to get out of this predicament is to expand into other funeral parlour services and obtain new customers. He has considered borrowing from banks to expand his business, but he thinks they will not lend to him. Rolphy is also worried that he will not be able to make payments on time should he get funding. Currently he borrows from his friends to sustain the business.

The Centre for Financial Inclusion, an independent global think tank, defines full financial inclusion as a “state in which everyone who can use them has access to a full suite of quality financial services, provided at affordable prices, in a convenient manner, with respect and dignity”. The path to financial inclusion differs according to individual circumstances, but it mostly begins with the acquisition of a basic transactional account.

1 INTRODUCTION

Box 2: Pathway to full inclusion

Figure 1: Financial inclusion pathways



In South Africa the pathway to full financial inclusion begins with the acquisition of a basic bank account and is generally followed by credit, insurance (e.g. medical) and long-term savings in the form of retirement. The pathways, however, are different for those employed, unemployed or self-employed. For example, employed individuals may access medical insurance and retirement whereas the unemployed and self-employed may have difficulty in accessing these – hence their preference for informal products and services. Products such as collective investment schemes and other sophisticated products remain out of reach, mainly because of their complexity and a lack of financial education among most people.

It is important that financial inclusion be supported by relevant and continuous consumer financial education and consumer protection at all levels of the financial inclusion pyramid.

Financial inclusion is definitely not an end in itself. However, it is deemed a key enabler in improving the quality of life of households and individuals, and increasing the productive capacity of SMMEs, thereby reducing poverty and inequality, especially for disenfranchised groups. The policy statements and policy implementation approach in this document should be seen against this wider developmental agenda, in support of Government’s National Development Plan 2030.

1 INTRODUCTION

1.2 Policy objectives and scope

1.2.1. Objectives

Government acknowledges that the nature and extent of financial exclusion in South Africa poses a significant social and economic challenge and warrants a dedicated policy response. The objectives of this policy are:

- To promote improved and sustainable access to, and the use of, appropriate and affordable financial services.
- To ensure that greater financial inclusion delivers measurable socio-economic benefits in improving the quality of life for all South Africans, particularly that of low-income earners, and that the economic prospects of SMMEs and the communities in which they operate improve.
- To improve the coordination of and support for financial inclusion policies and initiatives.
- To transform the financial sector in a way that supports the responsible delivery of financial services to low-income earners and SMMEs (with an emphasis on promoting black-owned and operated businesses).
- To improve cooperation and coordination amongst stakeholders with the aim of promoting financial inclusion.
- To improve the measurement and monitoring of financial inclusion.

Achieving financial inclusion requires both the widening and deepening of the engagement of individuals and SMMEs with financial services and products compared to current levels. Widening implies both the inclusion of new providers in the marketplace and more people and enterprises using the services. Deepening implies greater beneficial usage of a variety of products and services by a wider spectrum of users over time. By widening and deepening its reach and provision, financial inclusion also serves an important transformative role. Transformation is thus a fundamental and complementary objective of financial inclusion.

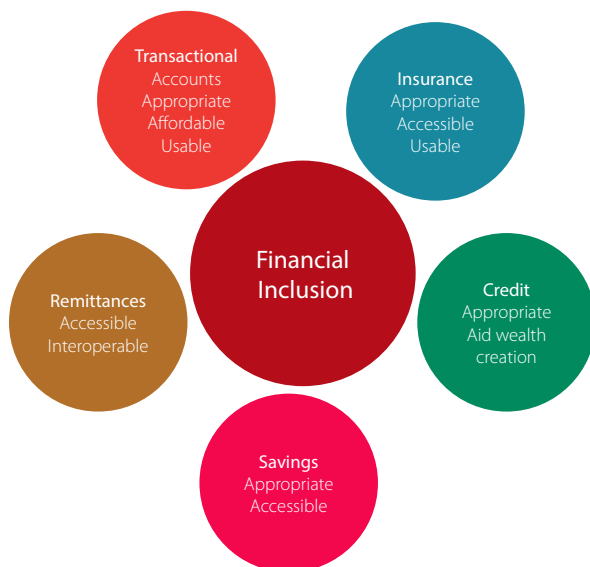
1.2.2. Scope

This policy document focuses on access and usage of financial services by the South African adult population, defined as people who are 16 years old and above and living in South Africa, with an emphasis on lower-income individuals and SMMEs. The document will therefore deal with the financial services landscape, the financial infrastructure and the classes of financial services as they pertain to the un- and under-served.

The classes of financial services include the following five product categories that meet South Africa's basic financial needs:

1 INTRODUCTION

Figure 2: Product categories



- **Transactional accounts** have become the anchor product for participating fully in the economic and social life of a modern society. The key enabler in engaging with financial services is to have and use a transactional account. It is therefore critical for the banking sector to provide needs-oriented and affordable transactional accounts with full-service capabilities to the financially excluded.
- **Credit** is critical for individuals and SMMEs in financing productive capacity and smoothing consumption. The key policy objective is to ensure that there is responsible access to credit to ensure economic development by ensuring the sustainability and growth of SMMEs and improving the quality of lives of individuals and households.
- **Insurance** provides a cushion against costly and unforeseen life events and, as a result, is particularly important for low-income and other vulnerable segments of the population.
- **Savings products** are important, as they allow a person to spread their income over lean earning periods, as well as for the accumulation of wealth for the future acquisition of services and goods.
- **Remittances**, both domestic and cross-border, are crucial mechanisms for channelling funds to low-income and vulnerable households, including immigrants working in South Africa and people in rural areas. It is often the first use of financial services by individuals and the entry point for the use of additional financial services.

2 SOUTH AFRICA'S SOCIO-ECONOMIC AND FINANCIAL INCLUSION CONTEXT

2.1. Socio-economic context

South Africa has a population of over 55 million.⁸ Although South Africa's poverty levels have improved since democracy, a combination of international and domestic factors such as low economic growth, continuing high unemployment levels, higher consumer prices and greater household dependency on credit has seen the financial health of South African households decline over recent years. More than half of South Africans were poor in 2015 with the poverty headcount increasing to 55 per cent from 53 per cent in 2011.⁹

In the fight against poverty, Government's main priority is job creation. South Africa's unemployment rate stands at over 30 per cent with youth unemployment estimated at 43 per cent in the first quarter of 2020.¹⁰ Based on the Gini index¹¹ estimates from the World Bank, South Africa has the highest inequality in the world.¹² This is reflected through its dual economy where the richest have incomes comparable to the Organization for Economic Co-operation and Development (OECD) countries and the poorest nearer levels observed across Sub-Saharan Africa.¹³ Redistribution taking place through the tax and social grant systems and the B-BBEE framework is a necessary and important "balancer". However, current domestic production and income constraints mean that a significantly raised employment level is the most sustainable and meaningful way to bring South Africans out of poverty, eliminate inequality and empower individuals to determine their own futures, thereby taking pressure off the state as a safety net. Consider for example that in 2017 over 17 million grant beneficiaries were paid over R150 billion, representing almost 10 per cent of the national budget. This amount has increased by 26 per cent over the past five years, straining a declining tax base and escalating the budget deficit and debt-to-GDP ratio.

South Africa will need to grow at 5 per cent per annum if it is to generate sufficient jobs to absorb new entrants to the job market every year. This will require an increased investment rate of over 30 per cent, compared to the current 19.5 per cent. But South Africa also falls short in domestic savings, with the savings rate¹⁴ at around 16 per cent, significantly below the 30 per cent required to support higher levels of investment.¹⁵ What is worrying is the observed low savings rate at the household level, meaning that households are not only poorer today, but will most likely not be able to escape the poverty trap in future.¹⁶

Structural realities outside and within the financial sector also impact South Africa's potential to grow the economy and thereby increase jobs and reduce inequality. Firstly, South Africa's dual economy is a major factor in this context. It manifests in the financial sector in the sophisticated and well-established formal sector operating in parallel to an underdeveloped and largely informal "township or rural" economy. Cash remains the dominant means of payment for a significant percentage of the country's population, even for those that already have transactional accounts.¹⁷ Despite a 80 per cent banked population, 52 per cent of the total value of all consumer transactions in South Africa were conducted in cash in 2018.¹⁸ Secondly, the

8 Community Survey, Statistics South Africa, 2016.

9 Poverty trends in South Africa: An examination of absolute poverty between 2006 and 2015, Statistics South Africa, 2017.

10 Quarterly Labour Force Survey, Statistics South Africa, Q1 2020.

11 The Gini index or Gini coefficient is defined as a statistical measure of distribution often used as a gauge of economic inequality, measuring income distribution or wealth distribution among a population: <https://www.investopedia.com/terms/g/gini-index.asp>

12 The "Poverty trends in South Africa: An examination of absolute poverty between 2006 and 2015" report released by Statistics South Africa in August 2017 indicates that South Africa's Gini-coefficient ratio based on per capita income is 0.68.

13 South Africa Country Report No. 17/189, ARTICLE IV, Annex II - Financial Inclusion, IMF, 2017.

14 The savings rate refers to the amount of money, expressed as a percentage or ratio, that a person deducts from his disposable personal income to set aside and save through formal institutions.

15 Inclusive economic growth: Key stylised facts on capital, investments and savings, National Treasury, 2017.

16 The household savings rate in South Africa was at 0.20 per cent in the third-quarter of 2017, <https://tradingeconomics.com/south-africa/personal-savings>.

17 Individuals and microenterprises operating under conditions of informality rely exclusively or almost exclusively on cash for receiving and making payments.

18 Consumer cost of cash in South Africa, Genesis, 2016.

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economy in general and the financial sector in particular is highly concentrated, with the top four banks¹⁹ holding over 80 per cent of banking assets. The top five insurers²⁰ account for over 70 per cent of the long-term insurance market, and the seventh largest fund managers²¹ control 60 per cent of unit trust assets. Thirdly, as a critical contributor towards economic growth and employment, the SMME sector is underdeveloped relative to peers. In OECD countries formal SMMEs account for 55 per cent of GDP and 60-70 per cent of employment, while in emerging markets these enterprises account for 40 per cent of GDP and 80 per cent of new jobs²². South Africa's performance is fairly below these levels with SMME contribution towards GDP estimated at 36 per cent²³, and contribution towards employment at 47 per cent, with owners comprising 14 per cent of the said employment²⁴.

Given South Africa's socio-economic make-up, this Financial Inclusion Policy is geared towards enabling job creation and balanced wealth generation. To achieve this, Government interventions should foster entrepreneurship and enterprise development. Improvements to the structural make-up of the financial sector – bringing together the formal and informal sectors, reducing reliance on cash, and supporting small business and black-owned business – can reduce the concentration of asset ownership that exists in the financial sector and promote competition, in turn supporting better value and more appropriate financial products and services.

2.2. South Africa's financial sector²⁵

South Africa's financial sector is large and sophisticated, consisting of banking and non-banking financial institutions (NBFIs).²⁶ It contributed 22.39 per cent of GDP in 2018 and had total assets of R5.14-trillion. The sector remains highly concentrated with the five largest banks holding 91 per cent of total assets as of December 31st, 2017. The banking landscape is changing rapidly as banks face increasing competition from technology-based financial services, newly-established banks and growing credit granting from other credit providers. This is forcing the big four banks to place increasing emphasis on growing customer numbers with innovative product offerings to attract lower-income earners. Competition from newly established banks – i.e. Discovery Bank, Bank Zero and TymeDigital – aims to disrupt the sector and it is forcing big banks to intensify their efforts to modernise technology platforms to satisfy customers' demand.

NBFIs in South Africa comprise about two-thirds of financial assets, which is large for emerging markets. Of these, pension fund assets comprise 110 per cent of GDP. Long-term insurers (mostly life) hold most of the insurance sector assets, which comprise 64 per cent of GDP. Short-term insurers hold a significantly low proportion of this. Unit trusts or collective investment schemes (CISs), the fastest growing segment in the financial sector, hold assets to the value of 42 per cent of GDP.

19 Standard Bank, FirstRand, Barclays Africa (Absa) and Nedbank.

20 Old Mutual, Sanlam, Liberty, Momentum Group (MMI), Discovery Life.

21 Public Investment Corporation, OMIGSA, Stanlib, Allan Gray, Sanlam Investment Management, Investec, Coronation.

22 Small business, Job creation, and Growth: Facts, Obstacles and Best Practices, OECD, 2009.

23 Global Entrepreneurship Monitor, 2016/2017.

24 The Small, Medium, and Micro Enterprise Sector of South Africa, Bureau for Economic Research (BER) of behalf of SEDA, 2016.

25 South Africa Financial System Stability Assessment: Country Report No. 14/340; IMF, 2014.

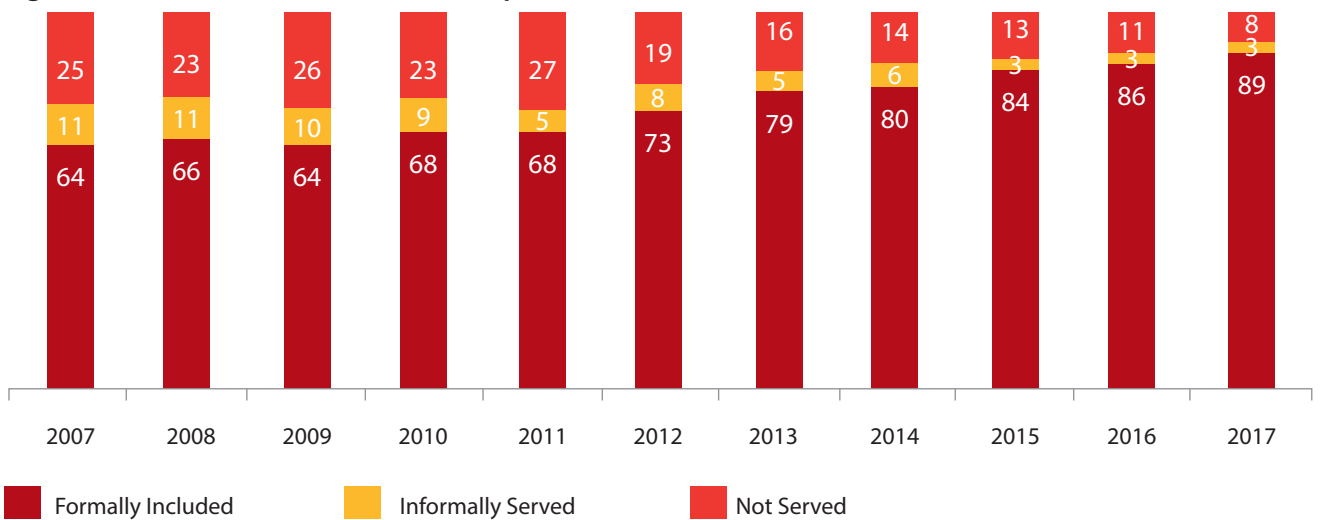
26 Non-banking institutions are defined as institutions that do not have a full banking licence and are not supervised by a national or international banking regulatory body. These include institutions that provide insurance, securities, pension and provident funds.

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2.3. The evolution and current state of financial inclusion

Financial inclusion has improved considerably over the past decade, with more than 34 million (89 per cent) adult South Africans using some form of formal financial service or product in 2017, compared to just over 20 million (64 per cent) adults in 2007 (see Figure 3).

Figure 3: The financial inclusion landscape in South Africa



Source: FinScope SA surveys (2007-2017)

Factors that have contributed to this improvement include:

- the introduction of the Mzansi²⁷ bank account in 2004 (see Box 4) and the subsequent improvement of appropriate and affordable products by financial services providers;
- the existence of a well-established formal banking footprint and a financial services network infrastructure in South Africa;
- technological innovation in the provision of financial services;
- a focus on consumer literacy; and
- a new system of distributing social grants to beneficiaries that moves from using pure cash to transferring money to bank accounts.

When taking stock of progress, it is important to look not only at access to financial services, but also the take-up and usage of these services by both individuals and SMMEs. This involves an assessment of the quality of financial services available. Box 2 below explains the assessment method.

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Box 2: Assessment approach

Assessment and monitoring of financial inclusion is typically done in three dimensions, namely access, usage of, and the quality of financial service provisioning.

- **Access** refers to the capacity that financial institutions have in place or are using to provide financial services and products to satisfy the needs of the market, which translates to the ease with which consumers can obtain financial services. It includes both the physical and electronic reach of service provisioning, as well as the affordability of financial services.
- **Usage** refers to the uptake of appropriate products and services, as well as how they are used after acquisition.
- **Quality** refers to the way in which financial service provisioning takes place. It includes consumer financial literacy and capability and market conduct issues.

Indicators for the measurement of access, usage and quality calculate the direct effect of financial inclusion policies and initiatives and are reasonably well established, both locally and internationally. However, these indicators do not provide a measure of the practical impact of financial services on end-users. The methodology for the impact assessment should be further developed and strengthened.

An analysis of the headline indicators points to the following main challenges:

- The use of an entry-level banking account is frequently reduced to a simple monthly cash distribution service, where the account behaves more like a “mailbox” (cash-in/cash-out).
- The national payment network is underutilised.
- There are too many instances of unproductive credit extensions to consumers.
- Individuals' propensity to save is low.
- The use of insurance products by individuals points to a relative over-reliance on funeral plans and a lack of appropriate asset-insurance products for the low-income market.
- SMMEs are underserved and business owners are compelled to over-rely on their access to financial services in their individual capacity.²⁸

Affordability and product design may be the main drivers of weak uptake and usage, and poor market conduct practices may further compromise the positive effects of financial inclusion. Overall, South African SMMEs significantly lag individuals in terms of their access and take-up of financial services. These features are examined in detail below.

2.3.1. Access to financial services

Access to financial services refers to the capacity that financial institutions have in place – or are using to provide financial services and products – to satisfy the needs of their market. Access indicators reflect the depth of reach of financial services, the diversification of its providers, as well as the cost of financial services and products to the users. Improving access also requires the continual assessment and removal where possible of potential barriers to bringing services to the low-income market.

²⁸ There is a very blurred line between the business and the business owner. For example, sole proprietorships are owned and run by one natural person and there may not be any distinction between the owner and the business entity. Micro- or “survivalist” entities, discussed under Pillar II, may be informal but nonetheless may have financial services' needs that are different from those of the people who run them, especially in respect of credit.

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Providers of financial services in South Africa. A diversified financial sector usually bodes well for the provision of market-oriented financial services. Table 2 gives an industry breakdown of financial services providers in South Africa since 2012. While the fundamentally sound and sophisticated banking sector provides a solid platform for the provision of financial services, the market remains highly concentrated. The number of banks has been stable over the past five years, with the four big ones dominating the market with more than 90 per cent of market share in terms of both assets and retail deposits, according to the South African Reserve Bank (SARB). These banks have branch distribution across the country but mainly in urban and semi-urban areas.

Table 2 - Number of financial services providers

Financial service providers	2012	2013	2014	2015	2016	2017	2018
Banks	16	17	17	17	17	19	19
Mutual banks	3	3	3	3	3	3	4
Co-operative banks	2	2	2	2	2	3	4
Registered co-operative financial institutions	106	24	24	28	28	28	22
Non-life insurers	106	99	97	92	89	88	86
Life insurers	87	77	74	75	74	72	73
Credit providers	5,450	5,450	5,724	4,577	4,569	5,591	6,191

Source: SARB Banking Supervision Reports (2013 – 2017), Prudential Authority Annual Report (2018) FSB Annual Report (2013 – 2017), NCR Annual Reports (2013 – 2018) and CBDA Annual Reports (2013 – 2017)

The number of registered mutual banks had remained static between the period 2012-2018 with only one additional bank, Bank Zero, registered in 2018. However, in the same year the number of mutual banks decreased by one back to three when on November 13th, 2018, the North Gauteng High Court issued VBS Mutual Bank a final order to liquidate in the interests of the public. Only one additional co-operative bank, the Young Women in Business Network Cooperative Financial Institution, was registered in 2018. The number of registered co-operative financial institutions (CFIs) however, declined significantly in 2013, as a result of the introduction of a new regulatory framework that led to fewer CFIs meeting the registration requirements. Due to the dominant position of the major commercial service providers in South Africa and the relative lack of capacity of CFIs, the latter institutions' penetration is not at the same level that is witnessed in other African countries, such as Kenya (175)²⁹ and Malawi(153)³⁰. In most other countries CFIs have support from Government in the form of being permitted payroll deductions as well as having a tax-free status. The role of these member-based organisations in South Africa should, however, not be discounted. Prominent significant banks that were launched in 2018 were Discovery Bank, Tyme Digital Bank, African Bank, African Bank which steadily built up its deposits following a well- documented curatorship, and Postbank, which is the Post Office's foray into full-service banking.

South Africa's formal insurance sector, on the other hand, is relatively large and diverse, with 86 non-life insurers and 73 life insurers registered as of the end of 2018. They offer a variety of products including funeral policies, endowment policies, savings products, life insurance policies and short-term insurance products, such as household insurance and motor vehicle insurance.

The number of registered credit providers in South Africa (6,191) is much higher in relation to other financial services providers, as it is easier to register as a credit provider compared to acquiring a banking or insurance licence. However, in terms of the

29 World Council of Credit Unions, https://www.woccu.org/newsroom/covid19_resources?post_id=1811

30 Makiyoni, K, file:///C:/Users/6849/Documents/ditc-ted-21112019-Malawi-CDF.pdf

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overall gross debtor's book, the credit market in South Africa is still dominated by the banking sector, which holds just over 79 per cent share of the total book. Of concern is the high prevalence of unregistered credit providers, or "mashonisas", who serve the most economically vulnerable South Africans, often with harmful lending and debt collection practices.

The role of physical versus digital infrastructure. The achievement of financial inclusion is directly linked to the physical presence and geographic penetration of financial institutions and the availability of technology. Physical and digital access to financial services has improved significantly over the last decade. However, the rate of expansion in the physical "main street" branches has slowed, with only limited use of non-traditional infrastructure, for example offering financial services through the branch networks of retailers.

Looking at different markets, the South African banking services infrastructure has a well-developed services network and makes extensive use of technology to enable and extend the service reach. Since 2010 more than 90 per cent of households had access to physical points of presence within a 10 kilometre radius (according to the Banking Association of South Africa). Physical points of presence consist of bank branches, ATMs³¹ and point-of-sale (POS) payment devices. The focus on access in the financial sector codes³² has led to both an increase in the number of points of service as well as in the geographic distribution of services. Each of the 278 municipalities in South Africa has at least some transactional points of service from a regulated service provider.

Banks offer a variety of electronic or direct channels to access financial services through the growth and development of technology. This complements the traditional branch distribution model. The increase in the transactional capabilities of POS³³ payment devices in stores, enabled by both banks and retailers, is particularly relevant for low-income earners. These devices enable consumers to make payments for goods and some third-party services as well as cash withdrawals.

Although the physical reach and use of technology have improved financial access in South Africa, there is still much scope for improvement compared to other developing countries, as can be deduced from Table 3 (Australia has been included as a developed economy for reference purposes only).

Table 3 - International comparison of physical banking infrastructure

Access Indicator	South Africa	Brazil	India	Mexico	Australia
Commercial bank branches per 100,000 adults	10.96	46.33	12.8	14.74	29.07
ATMs per 100,000 adults	66.32	126.54	17.8	48.45	159.95
POS terminals per 100,000 adults	1,200 ³⁴	2,247.4	67.1	592.14	4,039.64

Source: G20 Financial Inclusion Indicators 2014; CGAP and World Bank Financial Access 2010 (For POS only)

31 Automated teller machine that dispenses cash or performs other banking services when an account holder inserts a bank card.

32 Previously Financial Sector Charter

33 A point of sale (POS) is the point where sales are made. On a micro level, retailers consider a POS to be the area where a customer completes a transaction, such as a checkout counter. It is also known as a point of purchase.

34 This figure was estimated by National Treasury using the number of POS devices data from various sources including the Reserve Bank.

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The relatively deep physical reach achieved in Brazil is arguably attributed to the success of its banking agency model in promoting financial inclusion. While purchasing banking products and services in South Africa is predominately done through traditional bank branches, most transactions are executed through direct electronic transfers, ATMs, POS, cellular phones and online services. To further extend financial inclusion, greater use of other distribution models is required to provide support for the low-income segment.

The affordability of financial services. Affordability of financial services, especially the on-going costs of using such services, is one of the key indicators of financial service accessibility. If services are easily available through physical and electronic means, but the cost to the end-user is unaffordable, then the services cannot be deemed accessible. A World Bank diagnostic into the market conduct of South Africa's retail banks, conducted on behalf of the National Treasury, found that accounts became prohibitively expensive for low-income earners the more they used the physical rather than digital infrastructure, as banks try to promote increased usage of digital transaction streams.³⁵

Remittance services in South Africa, which are a dominant way to transfer funds to loved ones for low-income earners, are deemed the most expensive amongst G20 peers, with fees at an average of 17.78 per cent. This is well above the global average of 7.45 per cent.³⁶

2.3.2. Take-up and usage of financial services

While South Africa compares favourably to other major emerging economies like Brazil, Russia, India and China and other countries, in terms of overall product take-up (see Figure 4), its level of financial inclusion relative to financial development is comparatively low. Inequalities in financial inclusion are significant considering, for example, that about 80 per cent of the highest quintile have bank accounts compared to about 60 per cent in the lowest quintile, reflecting South Africa's dual economy.³⁷

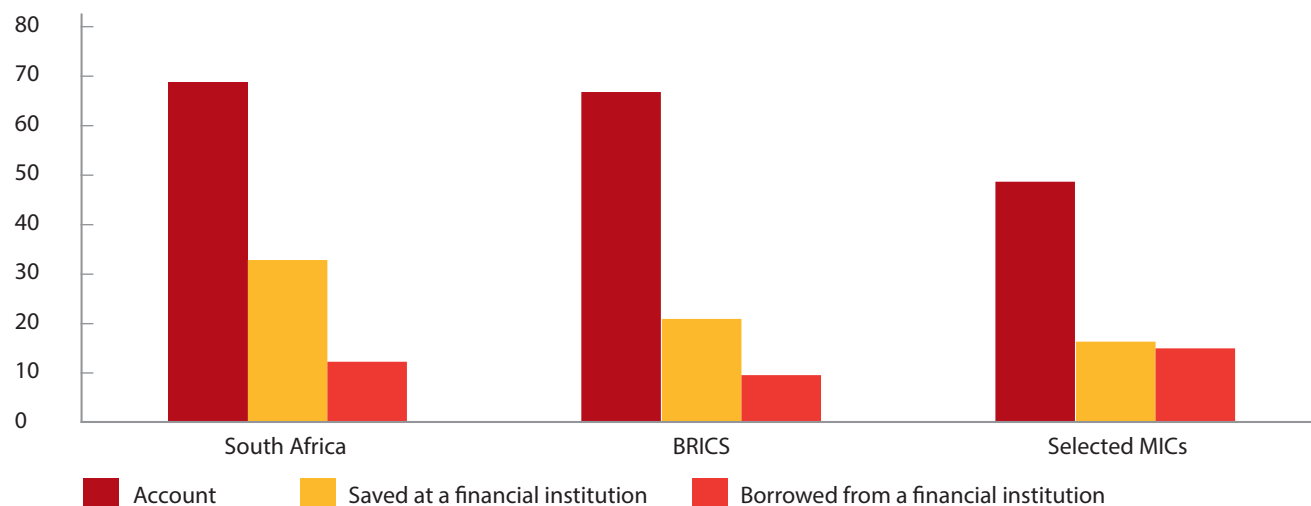
35 South Africa, Retail Banking Diagnostic, Treating customers fairly in relation to transactional accounts and fixed deposits, World Bank, 2018.

36 RPW monitors remittance prices across all geographic regions of the world. It is used as a reference for measuring progress towards global cost reduction objectives, including the G20 commitment to reduce the global average cost to 5 per cent. Remittance Prices Worldwide (RPW) Report, World Bank, 2017.

37 South Africa Country Report No. 17/189, ARTICLE IV, Annex II - Financial Inclusion, IMF, 2017.

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Figure 4: Comparative access to financial services across BRICS and selected MICs³⁸



Source: South Africa Country Report No. 17/189 ARTICLE IV 2017

The uptake levels of financial products and services in Figure 4 reflect the extent to which South Africans acquire different financial products and services.

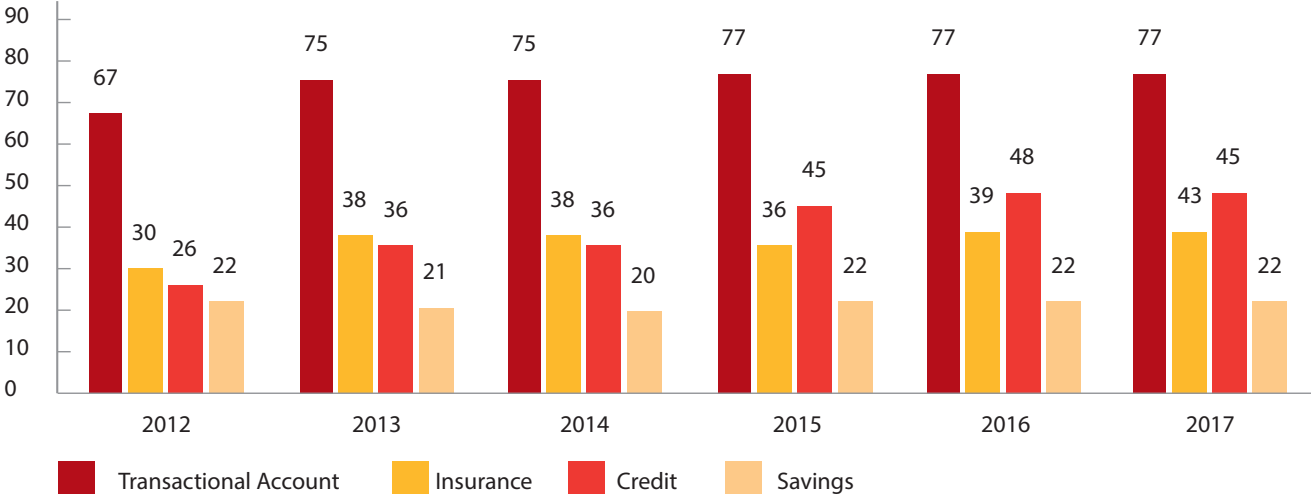
Transactional accounts

The proportion of South Africans who hold a transactional account has increased from 67 per cent in 2012 to 77 per cent in 2017 and is well above the acquisition of all other financial products. The take-up of transactional accounts bodes well for financial inclusion. It can facilitate the use of a range of other financial products and can thus be seen as a gateway to other financial services or products. In South Africa, however, the use of an entry-level banking account is frequently reduced to a simple monthly cash distribution service (cash-in/cash-out).

³⁸ Per centage of Population (age 15 & above): With an Account at a financial institution, South Africa Country Report No. 17/189 Article IV Consultation, Annex II. Financial Inclusion, IMF, 2017

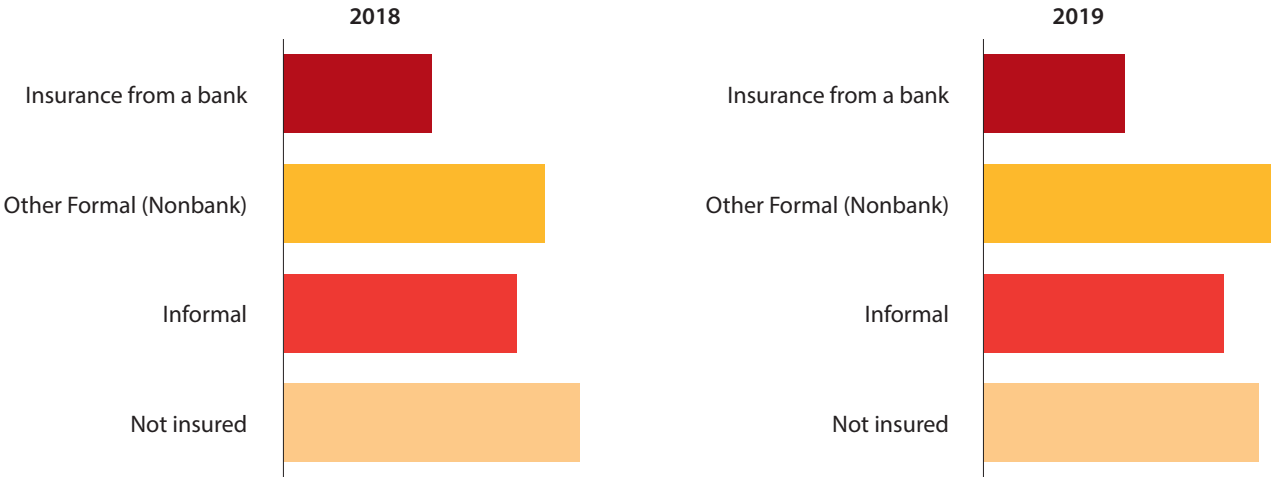
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Figure 5: Financial product uptake levels



Source: FinScope Survey (2012 to 2019)

Insurance



Source: Finscope, 2019

Finscope data shows that 42 per cent of the South African adult population does not have an insurance product, an increase from 39 per cent in 2018. In total 33 per cent have informal insurance through community groups. The proportion of the uninsured population is likely to increase as consumer household income decreases.

Furthermore, funeral insurance cover (79 per cent of the adult population is covered) uptake continues to grow in South Africa with non-funeral insurance (21 per cent) uptake remaining almost static.³⁹

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Credit

As of October 2019, there were 25 million (61 per cent) formal credit active consumers and more than 10 million of these were behind on their payments.⁴⁰

Table 4 - Credit granted by credit type

Agreements	2018-Q3 R000	2018-Q4 R000	2019-Q1 R000	2019-Q2 R000	2019- Q3 R000	2019-Q3% Distribution	% Change (Q3/Q2)	% Change (Y/Y)
Mortgages	39,792,621	41,987,504	35,239,545	40,184,436	43,160,531	30.18%	7.41%	8.46%
Secured credit	41,989,883	45,412,106	39,850,388	41,203,406	43,333,966	30.30%	5.17%	3.20%
Credit facilities	18,844,672	21,670,829	20,263,914	21,108,047	22,572,414	15.78%	6.94%	19.78%
Unsecured credit	28,524,241	31,131,005	28,245,060	28,637,233	30,067,134	21.03%	4.99%	5.41%
Short-term credit	3,060,046	3,211,484	2,447,528	2,366,709	2,342,794	1.64%	-1.01%	-23.44%
Developmental credit	1,425,040	1,244,072	1,809,717	1,210,990	1,526,675	1.07%	26.07%	7.13%
Total	133,636,503	144,657,000	127,856,152	134,710,821	143,003,514	100.00%	6.16%	7.01%

Source: NCR Consumer Credit Market Report, September 2019

As indicated in Table 4, the unsecured credit share of total credit granted increased from R28.64 billion for the quarter ended June 2019 to R30.07 billion for the quarter ended September 2019. The increase in the take-up of credit over the years mirrors the decline in savings. Most of the adult population that saves in the formal market falls into the higher Living Standards Measure (LSM) categories (6-10), implying that the savings rate for lower LSMs (1-5) in formal financial institutions is well below the average. However, if the size of the stokvel market as depicted in Box 3 is taken into consideration, then it is clear South Africans do save, just not through traditional formal institutions.

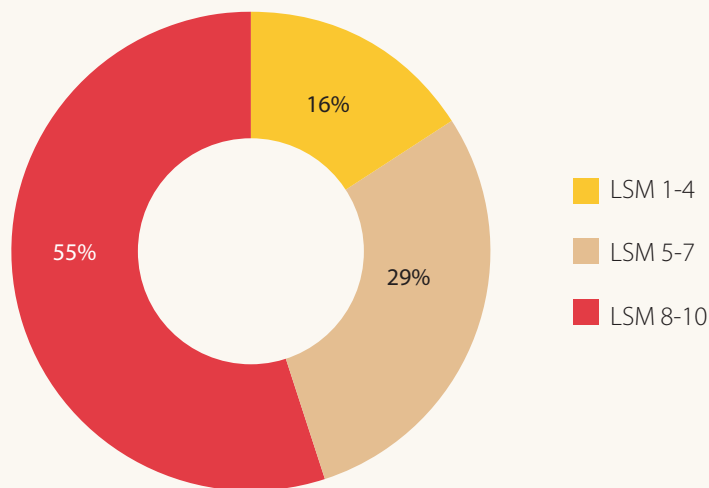
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Savings

Box 3: Savings Stokvels in South Africa

The word "stokvel" is often used to refer to various "groups" such as social clubs, informal savings groups, burial societies, syndicates, mogodisano, mgalelo, makgotla and gooi-gooi. Contrary to the general belief that stokvels are a financial structure only for the poor, data indicate that stokvel membership is distributed amongst all LSM categories (see Figure 6) with those in LSM 5-7 making up the largest share of the stokvel market.⁴¹

Figure 5 - National Distribution of Stokvel Members⁴²



Source: NASASA, 2017

Stokvels are joined for the purpose of fund pooling with a primary mandate to either save for a particular goal, or to help one another, especially where individual financial means fall short, or are unbudgeted for, as in the case of an emergency. As of the end of 2017 there were 810,000 registered stokvels with 11.5 million individual members distributed across all nine South African provinces, with approximately R49 billion in savings.

Remittances

In South Africa, there is significant use of remittances, both domestically (transferring funds within the country), as well as cross-border (transferring money outside the country). The 2018 FinScope Survey indicated that more people were using a combination of formal and informal channels to send money. Of those who use remittance services, 46 per cent are remitting via banks, 42 per cent via retailers and 48 per cent via informal channels.⁴³ South Africa, a destination country for many in the SADC region looking for better opportunities, has an estimated three-million immigrants.

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42 National Distribution of Stokvel Members, 2017, NASASA

43 Cross-border remittances, 2016, A FinMark Trust report prepared by Eighty20, available at <http://www.finmark.org.za/wp-content/uploads/2016/11/cross-border-remittances-2016.pdf>

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Data from the OECD⁴⁴ shows that South Africa contributed more than 51 per cent to the GDP of the 16-member SADC region. South Africa, a destination country for many in the SADC looking for better opportunities, continues to be the largest recipient of migrant labour in the region with an estimated four-million immigrants residing in the country. As such, South Africa has a significant amount of remittances, both domestically as well as cross-border. Of those who use remittance services, 21 per cent are remitted through banking channels, 27 per cent via other formal channels and 18 per cent are remitted via informal channels only.⁴⁵

Box 4: Financial Inclusion of Refugees

A refugee in South Africa is entitled to all rights, except the right to vote. However, refugees continue to face challenges when accessing formal financial services.³⁸ South Africa currently hosts 273,488 persons of concern whose cases are active with the Department of Home Affairs. Of these 89,285 are refugees and 184,205 asylum seekers (UNHCR). A significant barrier is presented by the lack of familiarity that financial services providers (FSPs) have with this market segment. Providers lack information on livelihood opportunities for refugees, the business case for serving them, their rights and their credit risk. Many enterprises that are run or owned by refugees need access to microcredit loans in order to expand their activities. These loans are very limited and almost non-existent in South Africa. In addition, there is a demand for other types of financial services to the refugee population, such as access to savings accounts, payment or remittance services and insurance.

Fintech

Though still nascent, fintech development in South Africa has already been catalysed by consumers and businesses seeking novel financial services to make payments, save and borrow and insure against daily risks. To date, Government has embraced a pro-innovation stance, working across agencies to develop harmonised approaches to fintech and clarifying the regulatory stance on emerging technologies and products, with the goal of benefiting all South Africans. An inter-governmental fintech working group (IFWG) was formed in 2016, comprising representatives from the National Treasury, South African Reserve Bank, Financial Sector Conduct Authority, National Credit Regulator, South African Revenue Service and Financial Intelligence Centre. Moreover, the Conduct of Financial Institutions (COFI) Bill's priority will be to manage consumer risks in digital financial services, ensuring continued trust in the financial sector. Flexibility exists within the COFI Bill, with provisions for a supportive and proportionate approach to fintech entrants even while prioritising fair customer treatment.

2.3.3 Quality of financial service provisioning

The quality dimension of financial service provisioning relates to the experience of the consumer, both when acquiring and during the use of financial services. In this context, quality includes issues around financial literacy, market conduct and the appropriateness and utility of the product or service. Although these aspects apply to all users (or potential users) of financial services, the focus is particularly on the low-income market segment, given its vulnerability. In the South African context, this focus is particularly relevant because of the historical imbalances that exist in the exposure to, and use of, financial services.

44 OECD, Economic Survey, 2017. <https://www.oecd-ilibrary.org/economics/oecd-economic-surveys-south-africa-2017>

45 FinScope 2019

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Consumer financial education

Financial education is the process by which financial consumers/investors improve their understanding of financial products, concepts and risk. Through information, instruction and objective advice, they develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being.⁴⁶

Financial literacy is – as a combination of financial awareness, knowledge, skills, attitude and behaviours – necessary to make sound financial decisions and ultimately achieve financial well-being.⁴⁷ Financial literacy can be described through several stages depending on the individual/household, financial, economic and social contexts. Financial literacy often involves intimate knowledge of financial concepts like compound interest, financial planning, the mechanics of credit, advantageous savings methods, consumer rights, and the time value of money to make sound financial decisions and ultimately achieve individual financial well-being. Financial literacy is the outcome of financial education.

Financial education is a key factor in ensuring sustainable and effective financial inclusion, as it provides individuals and entrepreneurs with knowledge, understanding, skills and confidence to make financial decisions and take actions which are appropriate to their circumstances. Therefore, increased financial literacy levels are a prerequisite to both improving usage of existing users and of extending financial inclusion to currently un- or under-served people. A considerable number of South Africans still display very low levels of financial literacy and their financial participation lacks depth, partly due to gaps in financial knowledge. A significant divide between different population groups and income levels with regard to financial literacy is still evident.

The 2015 South African Social Attitudes Survey (SASAS),⁴⁸ which measures financial control, planning, knowledge and product choice, showed an average overall financial literacy score of 55 per cent. This implies that only half of the decisions made about the use of financial services in South Africa are well-informed.

2.3.4. SMME financial inclusion

Relative to individuals, SMMEs are poorly served, with most of their financial needs served outside of the formal sector, particularly for micro and informal enterprises. According to the FinScope 2010 survey and the South Africa Small Business Survey (FinScope SBS), only 45 per cent of SMMEs have a transaction product⁴⁹, while only 53 per cent of the banked business owners reported depositing cash at a bank. In 2007, the World Bank's Enterprise Survey found that almost all formal South African SMMEs (97.9 per cent) had a transactional account, which means the lack of this facility is more prevalent among informal enterprises.

Access to formal credit, which is one of the primary drivers of this segment's growth, is even lower, although improving, with 9 per cent of SMMEs having some form of a line of credit from formal financial institutions in 2016 – up from only 3 per cent in

46 OECD, 2005a, https://www.oecd.org/finance/financial-education/G20_OECD_NSFinancialEducation.pdf

47 OECD/INFE, 2012, https://www.oecd.org/finance/financial-education/G20_OECD_NSFinancialEducation.pdf

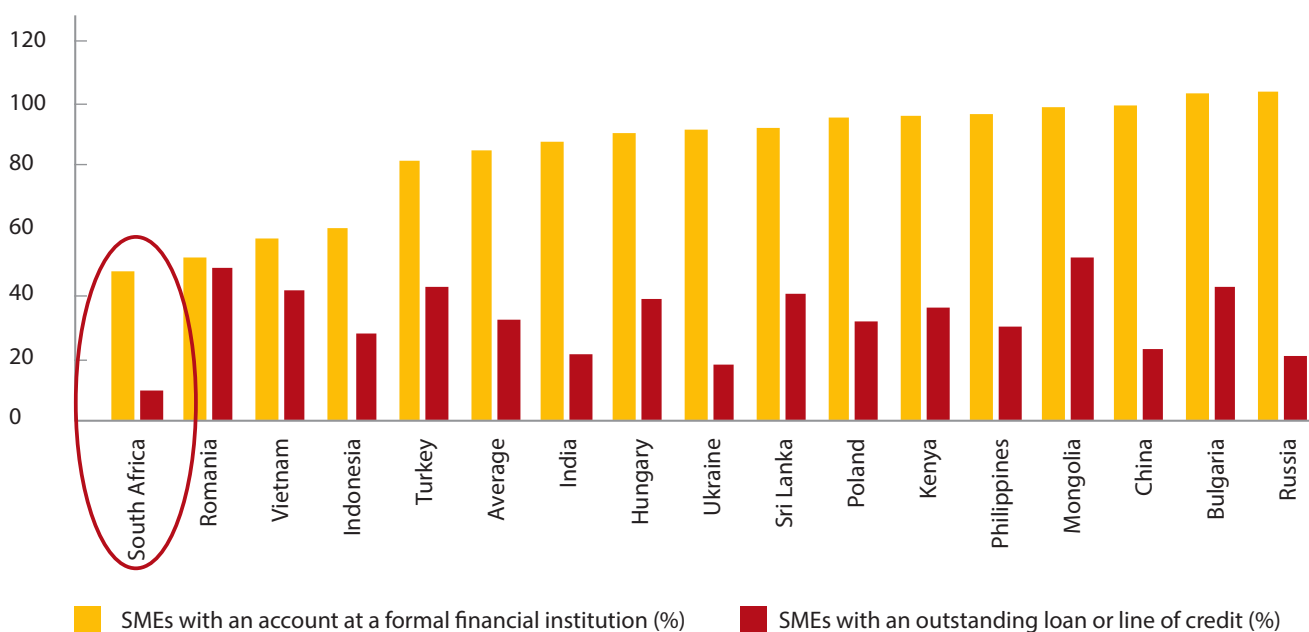
48 The SASAS is part of the ongoing study of financial education in South Africa and its objective is to provide the Financial Sector Conduct Authority (FSCA) with information about the financial knowledge, attitudes, skills and behaviour of adult (aged 16 and older) South Africans.

49 A transaction account, checking account, current account or demand deposit account is a deposit account held at a bank or other financial institution. It is available to the account owner "on demand" and is available for frequent and immediate access by the account owner or to others as the account owner may direct.

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2010. This places South Africa significantly behind many emerging market peers (Figure 7).⁵⁰ The total exposure of the major retail banks to small business lending made up about 11 per cent of their total loan book in March 2018.⁵¹ According to the 2010 World Bank Survey on access to finance for SMMEs in South Africa, 80 per cent of banks perceive SMMEs to be riskier and less profitable. The International Monetary Fund (IMF) has observed that the sophisticated nature of banking operations in South Africa lends itself to servicing the wealthier.⁵²

Figure 7: SMME credit access



Source: South Africa Country Report No. 17/189 ARTICLE IV 2017

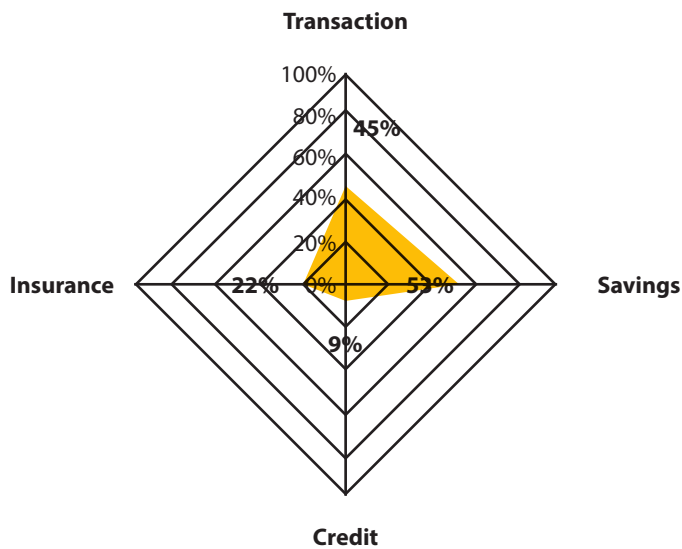
Savings uptake is higher among business owners, with 53 per cent of them having some form of savings product through banks (82 per cent) and informal societies. Only one in five business owners have an insurance product that could be used for business purposes. Overall, penetration among businesses was dominated by funeral cover (73 per cent). Although funeral cover can be a beneficial product, it provides no asset risk management for the enterprise.

The majority of SMME business transactions still take place outside the formal bank networks. This necessitates an understanding of the needs of this market and the development of appropriate products to serve them. Figure 8 below shows the main financial services used by SMMEs.

50 South Africa Country Report No. 17/189 Article IV Consultation, Annex II. Financial Inclusion, IMF, 2017.
 51 BA200, SARB, March 2016.
 52 South Africa Country Report No. 17/189 Article IV Consultation, Annex II. Financial Inclusion, IMF, 2017.

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Figure 8: SMME financial inclusion landscape



Source: FinScope South Africa Small Business Survey 2010

A number of development financial institutions and support agencies have been created to try and address the lack of financial services for SMMEs, by providing finance where there is a funding gap and developmental support to aid their growth and sustainability. However, many SMMEs do not know about the services available. The 2010 FinScope survey showed that 76 per cent of business owners were unable to name any organisation that provides help and advice to small businesses while 94 per cent have never used any support.

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3.1. Policy and regulatory developments and interventions relevant for financial inclusion in South Africa

Policy and regulatory developments across South Africa's socio-economic landscape that are relevant to financial inclusion and should be taken into account are:

3.1.1. The National Development Plan

In 2012 Government developed and published the National Development Plan (NDP) with the aim of eliminating poverty, reducing inequality, and achieving full employment, decent work and sustainable livelihoods for all. The NDP acknowledges financial inclusion as one of the important tools that will contribute towards the realisation of its goals. The NDP goals are therefore key objectives in the framework of the collaborative effort to take financial inclusion forward.

The NDP includes a target of 90 per cent of the population achieving banked status by 2030. However, financial inclusion goes beyond being just banked, it also includes the use of financial products. For instance, in South Africa 81 per cent of all adults have a bank account. However, if the social grant beneficiaries are excluded, only 68 per cent of its adults are currently banked.⁵³

The focus of this policy is to ensure, as far as possible, that financial inclusion interventions are designed and executed to meet the NDP's target. This should be done in such a way that the quality of life of financially included households, and economic opportunities for SMMEs, improve.

3.1.2. Financial Sector Charter and the subsequent Codes⁵⁴

The Financial Sector Transformation Council (FSTC)⁵⁵ is a unique forum in which the financial sector, Government, organised labour and community representatives collaborate to set transformation targets for the sector through the Financial Sector Charter (FSC). Areas on which the FSC focuses include ownership in the financial services sector, management and employment equity, infrastructure investment, empowerment financing and enterprise development. Recognising the transformative impact of the sector, access to financial services and empowerment financing are also a key component of the FSC, as the sector can be leveraged to change the way black South Africans participate in the economy in general, thereby contributing to the transformative objective of the FSC.

⁵³ Finscope, 2019

⁵⁴ The Financial Sector Charter was a voluntary Charter from 2004 to 2008 which was then replaced in 2012 by the Financial Sector Code (the Code) and revised to be aligned with the B-BBEE generic codes in 2017. This Code was renegotiated, gazetted and structured in accordance with the B-BBEE Act, and is legally binding.

⁵⁵ Previously known as the Financial Sector Charter Council.

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Box 4: The Mzansi account

In 2004 the Mzansi account was jointly developed by South Africa's four major banks and the South African Post Office's Postbank, as a basic bank account intended for the low-income segment of the economy. The development of this basic account was a result of the banking sector's commitment to the Financial Sector Charter.⁵⁶

Each bank developed its own pricing and product features for the Mzansi account based on the following agreed principles:

1. Prominent use of the Mzansi brand;
2. The account had to have an associated debit card, with normal debit card functionality and operational ability in the fully interoperable South African payment environment;
3. No "penalty" was imposed for using other banks' infrastructure;
4. It would have a defined basket of transactions not exceeding an agreed amount that was deemed affordable by the target market. This upper limit was significantly lower than the cost for typical bank products;
5. No monthly or management fees were charged;
6. There would be one free cash deposit per month;
7. Withdrawals and basic enquiries could be done at all Post Office branches, irrespective of the bank involved in issuing the account; and
8. Exemption 17⁵⁷ of the AML/CTF legislation was incorporated into the opening procedure of all Mzansi accounts.

The Mzansi account had a major impact on attracting low-income earners, many of whom were non-bank clients, into the banking system. However, critics of the Mzansi account argued that the fixed and inflexible product features and the reputation the account acquired of being "an account for the poor" rendered it inappropriate in the longer term. In addition, they believed that the needs of the market would not necessarily be served by a "one-size-fits-all" product. The industry subsequently opted for a principle approach by developing access to qualifying products for low-income earners as defined in the FSC.⁵⁸

Interventions undertaken because of the FSC have contributed meaningfully towards financial inclusion in South Africa, especially for transactional banking (see the Mzansi account experience in Box 4).

Much less progress has been made in relation to insurance with the exception of funeral and credit insurance.

The close relationship between transformation and financial inclusion means it is imperative that these policies are aligned and designed to be mutually reinforcing, though noting that transformation may not necessarily result in financial inclusion. Future revisions of the FSC should consider this policy and be leveraged to promote financial inclusion, particularly in lagging areas.

⁵⁶ The Financial Sector Charter (the Charter) came into effect in January 2004 as a result of a voluntary offer to develop an industry transformation Charter by the financial sector at the National Economic Development and Labour Council (Nedlac) Financial Sector Summit.

⁵⁷ Exemption 17 of the FIC Act exempts designated accountable institutions from compliance with certain client identification and verification obligations required by the FIC Act.

⁵⁸ Financial Sector Codes Product Access Standards were adopted in 2005 and are defined in terms of physical access, appropriateness, affordability, simplicity and understandability for the target market. AQP are savings and transactional products. Each bank has a single target for Access Qualifying Products (AQP), which may include any combination of transactional products, savings products and hybrid products (which are both transactional and savings products). In other words, each bank can decide whether to focus on one or two or all three types of AQP to meet their product access targets, based on their individual strategy and product design.

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Notwithstanding the criticism of the Mzansi intervention in 2006, 60 per cent of adults who opened a Mzansi account claim they have never had a bank account and approximately six-million Mzansi accounts were opened by 2008. This translated into South Africa's banked population increasing from 46 per cent in 2004 to 63 per cent in 2008.⁵⁹

Lessons learned from the Mzansi account initiative⁶⁰

- Among lower segments of the population there is an unquestionable strong demand for basic transactional products with features like a low minimum balance and no fixed fees.
- Although some account holders had a desire to save, the interest rate structure and balance limits on the Mzansi accounts did not incentivise the accumulation of funds. The lesson here is product design and features are important for low-income earners.
- The banks demonstrated that it was possible to collaborate, develop and roll out a major initiative that added lots of lower-income earners to the banking sector.

3.1.3. Treating customers fairly framework⁶¹

In 2010 the Financial Services Board (FSB) – it is now called the Financial Sector Conduct Authority (FSCA) – introduced the treating customers fairly (TCF) framework. This framework focuses on an outcomes-based approach, requiring financial service organisations to incorporate the fair treatment of customers throughout a product's lifecycle, including the design, marketing, advice, point-of-sale and after-sale stages. Given additional, legal backing by the Financial Sector Regulation Act and the anticipated Conduct of Financial Institutions Bill, the framework should support more-optimal outcomes from the perspective of regulators, consumers and financial services providers. The framework is a key element in driving the expansion of sustainable financial inclusion.

3.1.4. Financial Sector Regulation Act

In 2011 Government announced a shift to the Twin Peaks model of financial regulation. Since then, two regulators have been established under this model with strong powers to monitor emerging risks and take action to manage them,⁶² as provided for in the Financial Sector Regulation Act 2017. The Prudential Authority is focused on prudential oversight, while the Financial Sector Conduct Authority is focused on market conduct.

National Treasury's document *"A safer financial sector to serve South Africa better"* outlined South Africa's approach to the Twin Peaks model and identified the primary aims of the country's policy pertaining to the financial sector, which are financial stability, consumer protection, access to financial services and the combating of financial crime.

The Twin Peaks model is being implemented in such a way as to strengthen, amongst other things, financial inclusion. The two authorities established under the model are required to support and promote financial inclusion in the performance of their respective functions. This means that the effects of their respective activities on financial inclusion should be routinely considered as well as efforts to support and promote inclusion identified in each authority's regulatory strategy. The Ombud Council – established to strengthen the ombuds' system and ensure that financial customers have access to and are able to use affordable, effective, independent and fair alternative dispute resolution processes – will also be required to support financial inclusion in carrying out its functions.

59 The Mzansi Account Initiative in South Africa, FinMark Trust, 2009.

60 The Mzansi bank account initiative in South Africa, FinMark Trust, 2009.

61 For a comprehensive list of the TCF outcomes see link: <https://www.fscaconsumered.co.za/Consumer/Pages/Treating-Customers-Fairly.aspx>.

62 The Financial Sector Conduct Authority will operate alongside the NCR to protect financial consumers.

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The Financial System Council of Regulators will establish a workgroup to focus on financial inclusion matters relevant across Government. However, given the wide range of stakeholders involved in the planning and implementation of national financial inclusion strategies, the National Treasury, through the envisaged Financial Inclusion Task Force and the Financial Inclusion Forum (see Chapter 5), will remain the lead organisation responsible for financial inclusion.

3.1.5. Parliamentary enquiry into transformation of the financial sector

Scrutiny of financial sector transformation intensified during the review of the Financial Sector Regulation Act (FSR Act) by the Standing Committee on Finance of parliament's National Assembly. Most committee members expressed concern over the apparent lack of meaningful transformation across the sector, and they asked how the FSR Act would take steps to address this. Although it was recognised that the FSR Act could not be the main instrument to effect transformation, the Act was strengthened to entrench the principle of transformation, by:

- making transformation an object of the Act;
- referring to the Financial Sector Code in the Act; and
- requiring that a transformation working group or subcommittee be established in terms of structures for coordination between the various regulators and national departments responsible for regulating the financial sector.

The Standing Committee on Finance and the Portfolio Committee on Trade and Industry at the National Council of Provinces held public hearings on transformation. These were designed to get a deeper understanding of, and stimulate debate around the state of transformation in the financial sector, the main barriers to transformation, and the options that are available to drive improved transformation. Three public hearings took place between March and May 2017 in which 53 submissions were heard from Government, its agencies and regulators, bodies for constituency negotiation and agreement, political parties and associations, civil society, financial sector providers and industry representative bodies. The first report on the Transformation of the Financial Sector⁶³ by the Standing Committee on Finance and the Portfolio Committee on Trade and Industry makes recommendations relating to:

- Reporting on transformation in the financial sector;
- The Financial Sector Transformation Council's visibility to stakeholders and capacity to perform its duties;
- Transformation targets;
- The role of the Broad-Based Black Economic Empowerment Commission⁶⁴ in ensuring transformation in the financial sector;
- Market concentration and ownership patterns in the financial sector;
- Accessibility of non-banks to the national payments system;
- Financial inclusion;
- The conduct of financial institutions;
- Support for smaller and other black businesses, with a particular focus on new entrants, into the financial sector; and
- The financial education of financial customers and the public in general.

⁶³ 1st Report on the Transformation of the Financial Sector, Standing Committee on Finance and the Portfolio Committee on Trade and Industry, 2017.

⁶⁴ The B-BBEE Commission became operational in 2016 and was established by Section 13B of the B-BBEE Act 46 of 2013 to oversee, supervise and promote adherence to the Act in the interest of the public.

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As the line department responsible for the financial sector, the National Treasury played an important role in supporting the Committee on Finance and the Portfolio Committee on Trade and Industry in these deliberations. The transformation debate will potentially impact all future policy developments in the financial sector. For financial inclusion it speaks to the sustainable provision of financial products and services to all South Africans by a diversified financial sector that should reasonably represent the demographics of South Africa in terms of ownership, control, management and employment. It also implies structural reform of the sector to enhance competition and broad-based participation by black South Africans in the sector.

3.1.6. The Financial Intelligence Centre Act

The Financial Intelligence Centre Act (FIC Act) has been strengthened by introducing a risk-based approach to customer due diligence. The Act embraces a more customer-friendly and cost-efficient approach to the implementation of anti-money laundering and combating the financing of terrorism (AML/CTF) in line with the Treating Customers Fairly Initiative. The application of a risk-based approach to customer due diligence can support financial inclusion objectives. This allows for a more flexible application of customer due diligence measures to certain categories of financial products or customers, who might otherwise struggle to meet rigid identification and verification requirements. The FIC Amendment Act further places an obligation on accountable institutions to develop, document, maintain and implement a risk management and compliance programme that will enable them to be more innovative and use new technology to apply simplified due diligence in cases of lower risk exposure.

National Treasury's *"A New Approach to Combat Money Laundering and Terrorist Financing"* document provides a set of principles to guide the implementation of the risk-based approach. It emphasises the need to ensure that customers are not burdened unnecessarily with a bureaucratic or tick-box approach to compliance, and are not excluded from the financial system solely because the customer is unable to produce a particular document that may not be readily available or easily accessible.

3.1.7. Insurance Act

In 2011, National Treasury issued a policy document *"The South African Microinsurance Regulatory Framework"* that made provision for the introduction of a proportionate and appropriate regulatory and supervisory framework for micro-insurers. The policy framework was developed in response to a discussion paper issued in 2008: *"The future of Microinsurance in South Africa,"* which was developed to try address the low penetration levels of insurance products among low-income earners in South Africa. The policy framework was intended to achieve the following objectives:

- Extend access to a variety of good-value formal insurance products appropriate to the needs of low-income households.
- Facilitate the provision of formalised insurance by currently informal providers and, in the process, promote the formation of regulated and well-capitalised insurance providers and small business development.
- Lower barriers to entry, which should encourage broader participation in the market and promote competition amongst providers.
- Enhance consumer protection within this market segment through appropriate prudential and business conduct regulation.
- Improve the enforcement of regulatory transgressions and multiply consumer education interventions that are targeted at understanding insurance and its associated risks and benefits.
- Facilitate effective supervision and enforcement, supporting the integrity of the insurance market as a whole.

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The Insurance Act, No.18 of 2017, subsequently introduced a risk-based legal framework for micro-insurers through appropriate prudential and market conduct regulations. The Insurance Act introduces micro-insurance⁶⁵ as a class of insurance business in South Africa that forms part of the broader insurance market. However, it is distinguished by its particular focus on the low-income market, which translates into a distinct means of product design and distribution channels that aim to increase insurance penetration levels in its target market.

3.1.8. Review of banking and payment methods in distributing social grants

South Africa's social security system is one of the largest social welfare transfer systems in the developing world,⁶⁶ transferring over R150 billion in social assistance to over 17 million grant beneficiaries (about 12 million people).⁶⁷ It is likely the single largest impact on how the poorest South Africans interact with the financial sector. In line with findings by the constitutional court, the South Africa Social Security Agency (SASSA) introduced a new solution for the payment of grants. The previous payment model, which took place through a single dedicated service provider (Net1), was phased out and replaced by a "hybrid model" where social grant payments are now paid through the South African Post Office and the existing bank network. It is important that any solution adopted for the payment of social grants maintains and builds on the financial inclusion of beneficiaries achieved thus far, and encourages more beneficial use of bank accounts and other appropriate financial services.

3.1.9. Other interventions

Other interventions undertaken are set out below.

- The FSCA's review of retail distribution to improve transparency and accountability of financial services providers and intermediaries, for example by improving disclosure and confronting conflicts of interest.
- A retail banking diagnostic conducted by the World Bank for National Treasury to understand market conduct practices in the retail banking sector and make recommendations for improvements.
- Introducing comprehensive conduct of business returns for insurers, for the FSCA to better understand and monitor their market conduct practices and emerging conduct risk.
- The development of a regulatory framework for financial institutions to manage complaints. This is currently at various stages of implementation across market segments, and it will be standardised through the Conduct of Financial Institutions Bill.

3.2. Global trends towards coordinated financial inclusion policy

The Leaders of the G20 are promoting reforms in support of an inclusive financial sector, endorsing a financial inclusion action plan (FIAP)⁶⁸ and establishing the Global Partnership for Financial Inclusion (GPII) as a global coordinating platform. The GPII is the main implementing mechanism of the action plan and the G20 Principles for Innovative Financial Inclusion. (A summary of the evolving FIAP is given in Box 5.)

65 The National Treasury's South African Microinsurance Regulatory Framework issued in 2011 defines microinsurance as insurance that is accessed by the low-income population (also known as the mass market), provided by a variety of different providers and managed in accordance with generally accepted insurance practice.

66 A 2009 report from CGAP estimates that 170 million people receive regular G2P payments globally, this makes the South African grant distribution scheme comparatively significant.

67 <http://www.sassa.gov.za/phocadownload/december%202017.pdf>; the number of beneficiaries exceeds the number of grant recipients as many receive multiple grants.

68 http://www.gpii.org/sites/default/files/documents/2014_g20_financial_inclusion_action_plan

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Box 5: Financial inclusion action plan (FIAP)

In 2010 the G20 developed a financial inclusion action plan for improving the level of financial inclusion among its member and non-member countries. The plan provides the main areas of focus, with objectives and outcomes and the specific activities required by the G20 to support and promote financial inclusion globally. The plan is revised every three-to-five years to keep it up to date, as such an approach allows for the incorporation of new financial inclusion developments.

1. Main steps to implement the plan:

Establish a global partnership for financial inclusion (GPFI) to serve as an inclusive partnership mechanism. The objective of this step is to take the G20's work on financial inclusion forward by facilitating efficient and effective coordination, monitoring progress over time and ensuring continuity on financial inclusion in global discussions.

Mobilise funding for financial inclusion by leveraging existing funding mechanisms and establishing an SMME trust fund and possibly a structured investment fund.

2. Key action items:

Commitment to implement G20 Principles for Innovative Financial Inclusion under a shared vision of universal access.

Further encourage standard setting bodies (SSBs) to support and catalyse SSBs' progress on financial inclusion within the context of their respective mandates and to share the information with each other and other stakeholders.

Work with the private sector to harness public and private sector cooperation on efforts aimed at increasing the delivery of financial services to households and SMMEs.

Improve data to contribute to, and strengthen, the global dialogue to measure progress in creating the GPFI.

Support capacity building and training to enhance the skills and knowledge of policymakers and financial sector institutions in the development of financial inclusion policy (including issues such as consumer protection and financial literacy) and its implementation.

Improve national, regional and international coordination to strengthen coordination and collaboration between relevant national, regional and international stakeholders relevant to financial inclusion – recognising the complementarity between financial stability, integrity and inclusion – and advance progress towards universal financial inclusion through the implementation of the G20 Principles for Innovative Financial Inclusion.

Integrate financial inclusion into all types of financial system assessments by incorporating robust financial inclusion components that yield high-quality analysis and actionable recommendations in all financial sector assessments, including the national financial system or sector assessments and those of other international bodies.

In 2014 a review of the progress in implementing the original FIAP was conducted and a revised FIAP was adopted for the ensuing five years. The revised key action areas for the GPFI were:

1. Small, medium and micro-sized enterprise (SMME) finance

- Accelerate and replicate successful policy reforms that facilitate the expansion of financial services to SMMEs.
- Establish the SMME Finance Forum as global centre for good practice knowledge exchange and promotion.
- Improve financial access through the SMME Finance Compact, SMME Finance Initiative, and key development achievements.

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2. Regulations and standard setting bodies

- Mainstream financial inclusion in the work of the standard setting bodies and other relevant global organisations and increase their understanding of the interdependence of financial inclusion, stability, integrity and consumer protection.
- Encourage effective and consistent incorporation of financial inclusion in financial sector assessments.

3. Financial consumer protection and financial literacy

- Improve the capacity of public authorities and other relevant stakeholders to develop and implement financial literacy and consumer protection measures.
- Promote consumer protection and financial education best practices for digitally delivered financial products and services.

4. Markets and payment systems

- Help to analyse and consider ways to address money transfer operators bank account closure issues.
- Reduce the cost of sending remittances.
- Expand opportunities for innovative technologies to grow responsible financial inclusion.

In 2017 a review of the 2010 and 2014 editions of the FIAP reaffirmed the G20 leaders' commitment to advancing financial inclusion for the benefit of all countries, focusing in particular on under-served groups (such as the poor, women, youth and people living in remote rural areas) and vulnerable groups (which include elderly people, migrants and forcibly displaced people). The GPMI has also identified the following four key trends that will set the stage for continued progress in achieving financial inclusion over the coming years:

- Align the work of the GPMI with the 2030 Agenda for Sustainable Development as the overarching framework for financial inclusion.
- Digitisation through financial products and services and identity systems to accelerate financial inclusion.
- Increase attention on the importance of responsible access to, and usage of, financial services by the poor while also strengthening the focus on the G20's financial inclusion priorities for under-served and vulnerable groups.
- Mainstream financial inclusion goals alongside the other financial sector development goals of stability, integrity and consumer protection. In addition, reinforce the notion that financial inclusion and other financial sector goals can be mutually supportive.

Under the GPMI umbrella exist various implementing partners, like the Consultative Group to Assist the Poor (CGAP),⁶⁹ the Alliance for Financial Inclusion (AFI),⁷⁰ the World Bank,⁷¹ International Finance Corporation and the OECD.

On a country level, increased focus on financial inclusion has had varying degrees of success. The GPMI and implementing partners have therefore been key to monitoring experiences of what has worked and what has not, distilling these experiences into the overarching principles, the FIAP and country-case studies. It is worthwhile to note that the starting point for more

⁶⁹ CGAP provides practical support across a range of inclusion initiatives, from good practice in micro-finance to the role of mobile payments in extending financial services.

⁷⁰ AFI is an organisation that offers a platform for financial inclusion policymakers to address issues of common interest and to share the experiences of financial inclusion policies and interventions. Organisations from more than 100 developing countries are members of AFI.

⁷¹ The World Bank as part of this focus gives technical assistance to many countries including South Africa, with funding from the Swiss government through its agency the State Secretariat for Economic Affairs (SECO).

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successful countries like Brazil, Malaysia, India, and Kenya was the development of a multi-stakeholder financial inclusion strategy, with high-level political buy-in, and strong monitoring and evaluation strategies to track implementation effects.

No single model or blueprint will satisfy the needs of all countries. The reality of different stages of development and infrastructure, differing economic and political priorities, and the relative maturity and strength of the financial services sectors, demand that each country decide on its own financial inclusion strategy and means of implementation. This must take into account, but not be prescribed by, learning from international experience. But this learning is important, and we therefore reflect on relevant country experiences and case studies in this document to inform the proposed policy pillars and prioritised projects.

3.3. International principles localised and made relevant for South Africa

Through this policy, Government is making an explicit commitment to improve financial inclusion by promoting greater access to, and sustainable use of, appropriate financial services to all who need and will benefit from them. Taking into account the current state of financial inclusion, the development agenda in the country, the evolving G20 FIAP (Box 5) and the G20 Principles for Innovative Financial Inclusion adopted in 2010 (Box 6), National Treasury has identified the following principles or policy building blocks to help implement the Financial Inclusion Policy:

Box 6: G20 Principles for Innovative Financial Inclusion

- Leadership: Cultivate a broad-based Government commitment to financial inclusion to help alleviate poverty.
- Diversity: Implement policy approaches that promote competition and provide market-based incentives to deliver sustainable financial access and use of a broad range of affordable services (savings, credit, payments and transfers, insurance) as well as a diverse group of service providers.
- Innovation: Promote technological and institutional innovation as a way to expand access to and usage of financial systems. This will include addressing infrastructure weaknesses.
- Protection: Encourage a comprehensive approach to consumer protection that recognises the roles of Government, providers and consumers.
- Empowerment: Develop financial literacy and financial capability.
- Cooperation: Create an institutional environment with clear lines of accountability and coordination within Government; and encourage partnerships and direct consultation across Government, business and other stakeholders.
- Knowledge: Utilise improved data to make evidence-based policy, measure progress and consider an incremental “test and learn” approach that is acceptable to both regulator and service providers.
- Proportionality: Build a policy and regulatory framework that is proportionate to the risks and benefits involved in such innovative products and services, and based on an understanding of the gaps and barriers in existing regulations.
- Framework: Consider the following in the regulatory framework, international standards, national circumstances and support for a competitive landscape: an appropriate, flexible, risk-based anti-money laundering regime that also combats the financing of terrorism (AML/CFT); conditions for the use of agents as a customer interface; a clear regulatory regime that reflects electronically stored value; and market-based incentives to achieve the long-term goal of broad interoperability and interconnection.

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Principle 1: Access for all, and responsible use of financial services according to the user's need

Financial inclusion requires that unreasonable or unfair barriers to access are removed, so that a variety of financial services are available to all. However, it is equally important that financial services are used in responsible, appropriate and beneficial ways, based on the actual needs of the users of the services. The effectiveness of financial inclusion therefore depends on the financial and economic viability of services provided by the financial sector, as well as the productive and responsible use of those financial products and services by consumers. This should be achieved through a strong market conduct regulatory framework and improved consumer financial literacy. (See Principle 3.)

Principle 2: Promote competition and market-based solutions, encouraging diversity in service providers

In South Africa, the range of products offered to low-income households and the reach of distribution mechanisms (bank branches, ATMs and point of sale payment devices) have increased over the years, which has made financial services more accessible. (see Section 2.3.1 for a closer examination of these developments.) But there is still scope for improvement, especially in underdeveloped urban centres ("townships") and rural areas where financial products are not adequately provided, and the presence of financial services infrastructure is limited.

A transformed financial sector which reflects a diversity of providers and products is important to promote competition and encourage market-based solutions to financial inclusion. A provider who understands a local community is likely to be better positioned to understand and respond to its financial services' needs. The more black industrialists and SMMEs who participate in the supply of financial products and services, the more financial sector gains are retained in black communities.

In 2014 the IMF's Financial Sector Assessment Programme observed the South African financial sector is highly concentrated and interconnected. This gives the major financial institutions significantly more market-pricing power than is observed in other more competitive economies. The IMF recommended the adoption of a more transparent entry and exit framework and the reduction of capital requirements to allow smaller and more specialised players to access the system.

Regulations in the financial sector should embrace both institutional and product diversity, enabling large universal financial institutions and small-scale community institutions to co-exist. This should lead to greater diversity in the provision of financial products to meet the broader range of customer needs. The licensing and regulatory requirements imposed on these providers should be proportionate to the risks they individually bring to consumers and the system, and they should not pose unreasonable and prohibitive barriers to entry.

Principle 3: The drive for financial inclusion is balanced with and supported by the objectives of financial stability, integrity and market conduct

The approach to financial inclusion extends beyond just access and usage. It should also consider the other critical financial sector policy objectives of promoting financial stability, consumer protection and financial integrity. For example, bringing more South Africans into the formal banking sector has brought access to a wider range of financial products. But at the same time it has exposed customers to abusive lending and debit order practices in the form of reckless lending, excessive fees or even fraudulent deductions. Unfettered access to credit has led to half of all borrowers showing signs of financial distress.⁷²

72 The NCR's Q3, 2017 Credit Bureau Monitor reported that only 49,2 per cent of credit active consumer had a current credit standing, the remainder were either 1-3

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The market conduct framework for the sector must therefore ensure that users of financial services are provided with the information they need to assess the services on offer, as well as analyse and sanction collusive or other abusive behaviour by financial institutions. Furthermore, improved financial literacy and capabilities through education, as a component under the market conduct framework, are essential to broadening awareness among consumers and SMMEs of the need for financial services. It also helps an individual or SMME to select appropriate products and services. Market conduct regulation and consumer financial education are core functions of the new FSCA. Regulatory requirements should protect consumers while not unduly excluding potential suppliers.

Similarly, the prudential and integrity frameworks should not be compromised by recklessly bringing customers into the system in ways that threaten financial institutions' balance sheets or prevent them from performing effective due diligence under AML/CFT obligations. On the other hand, these frameworks should at the same time support financial inclusion. For prudential regulation, this means that licensing and regulatory requirements should accommodate a wider range of providers than has traditionally been the case. For integrity, the application of AML/CFT requirements by financial institutions should not lead to overly onerous requirements placed on the un- and under-served, which prevents them from accessing a bank account and related services.

The pursuit of these objectives and any resulting trade-offs must be balanced and proportionate, an approach referred to as I-SIP.⁷³ The pursuit of the balanced (or I-SIP) approach encapsulated in this principle highlights that financial inclusion efforts should not be to the detriment of the other components (and vice versa). Quite often it is possible to find a point in this conceptual framework where a mutually beneficial (or at least neutral) intervention can be crafted. It can also be used to, a priori, identify aspects that could have a negative effect on one or more components.

Principle 4: The informal sector⁷⁴ is an important transformation and empowerment tool in facilitating the transition to formality

The informal financial sector, for example burial societies and stokvels as well as financial co-operatives,⁷⁵ provide financial services to many South Africans in townships⁷⁶ and rural areas, especially low-income earners and the formally excluded. While it is important to ensure that financial services providers are all appropriately licensed and regulated, Government recognises the important role played by the informal sector in the lives of financially excluded South Africans.

Stokvels have over the years provided crucial savings mechanisms for millions of households (there are an estimated 850,000 stokvels in South Africa supporting 11 million members), while burial societies and funeral parlours have also played an important role in those households by securing a dignified burial for their loved ones. National Treasury acknowledges the transformation and empowerment potential in financial sector SMMEs (i.e. SMMEs as financial services providers) and informal community-

months in arrears, had adverse listings or judgements on the bureau.

73 I-SIP stands for inclusion, stability, integrity and protection. It refers to a proportionate approach to any financial inclusion measure (and specifically to its regulatory and supervisory design and implementation) that optimises the I-SIP linkages, maximising synergies and minimising trade-offs and other negative outcomes. Inclusion, Stability, Integrity and Protection: Observations and lessons for the I-SIP methodology from Pakistan, CGAP, 2014.

74 The informal sector, informal economy, or grey economy is the part of an economy that is neither taxed nor monitored by any form of government. Unlike the formal economy, activities of the informal economy are not included in the gross national product (GNP) and gross domestic product (GDP) of a country, https://en.m.wikipedia.org/wiki/Informal_sector.

75 Co-operative Financial Institution (CFI) refers to member-based deposit-taking financial co-operatives, owned and controlled by their members who have a common bond and whose members choose to call themselves either a Credit Union, Savings and Credit Co-operative (SACCO), Financial Services Co-operative (FSC) or Financial Co-operative (FC), CFI start-up guide, www.treasury.gov.za/coopbank.

76 Townships in the South African context refer to the often underdeveloped segregated urban areas, <https://en.m.wikipedia.org/wiki/Township>.

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based financial service groups, and will approach the informal sector with a view to growing and supporting these financial sector SMMEs to enable them transition to formal service providers. Such an intervention requires proportionate regulatory frameworks to ensure that consumers are protected against any illegal activities and abusive market practices by such providers.

Principle 5: Promote technological and institutional innovation in support of financial system access and usage, addressing infrastructure weakness

The use of software and digital platforms to deliver financial services to consumers has the potential to provide them with greater universality, speed, accountability, and efficiency, and is a powerful driver of effective competition. Technology and innovation in the financial sector have the potential to make financial products and services more accessible and affordable. While technology is creating benefits and increasing consumer convenience, it is important to note the challenges it brings to the way in which individuals engage with the financial system. Financial education will thus play a critical role in enhancing consumer protection, improving awareness and information about digital finance, and strengthening overall consumer trust and confidence in digital financial services.

Regulation will need to balance the risks and benefits that innovations can bring. Regulators responsible for prudential management, financial stability and market conduct should take a collaborative approach to developing a framework that promotes innovation, but also balances the associated benefits and risks that may be introduced (consistent with I-SIP).

Principle 6: Promote proportionality in regulation and supervision

Regulation and supervision should be proportionate to the risks posed by a financial institution. The Twin Peaks reforms recognise that the traditional 'one-size-fits-all' approach to regulation can create an unnecessary regulatory burden, while still not achieving intended outcomes. The reforms aim to provide legislation that can be proportionately applied.

Large financial institutions with a commensurately large customer base can pose a high risk because their conduct or prudential failings could impact many people. They are likely to also be more connected to the rest of the financial sector and economy more broadly, causing a domino effect of poor outcomes. More stringent requirements should be placed on such institutions, and greater supervisory resources dedicated to monitoring compliance. Smaller institutions pose different risks. While conduct and prudential failings will have less impact in absolute terms, their customer base may include vulnerable customers in need of more protection. On the other hand, the product offering of a small financial institution could also be simple and straightforward, posing relatively little risk to the customers served. Small institutions would have less resources to dedicate to regulatory compliance than larger institutions, and they could be negatively affected by burdensome regulatory requirements.

Regulation and supervision should therefore be proportionately applied in terms of the risks posed. This includes the risk to the development of the financial sector, which would suffer if firms exited due to overly burdensome regulatory requirements that made their operation unprofitable and onerous.

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Principle 7: Encourage coordination across stakeholders with clear lines of responsibility and accountability

A financial sector that is inclusive of all South Africans cannot be achieved without the collaborative participation of all stakeholders. A multi-stakeholder approach should therefore be adopted to ensure that financial inclusion does not only increase access but also increases economic opportunities and quality of life for the poor and low-income earners. The cooperation of Government departments and agencies, regulators, financial institutions, representative bodies and relevant development partners is necessary to achieve financial inclusion objectives.

Principle 8: Improve data to make evidence-based policy and measure impact, applying a “test and learn” approach

Policy implementation requires that appropriate and reliable data be available to support the policy’s design and supervision, and the measurement of its impact over time. The availability and quality of data, to measure the impact of the financial inclusion policy and drive the strategies to improve it, cannot be the sole responsibility of policymakers. It requires regulators and service providers to play a role in the collection, analysis and dissemination of the data.

The lack of available data should not delay or deter the introduction of interventions aimed at improving financial inclusion. Rather, an incremental “test and learn” approach by both regulators and service providers can be adopted to mitigate any risks posed by the introduction of a new service or business model. It can also ensure that the service provider provides a stream of data that can be used to monitor, assess and refine regulatory policy.

When, in 2005, the first mobile network operator (Safaricom) requested permission from the Central Bank of Kenya to launch mobile money services, there was no certainty it would be workable or beneficial. But the regulator allowed the operator to provide the service with conditions for the operator to follow. Over time this fed into Kenya’s e-money regulations that better reflect an understanding of the market, risks and opportunities that mobile money provides. (See Box 7 for the full case study.)

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South Africa compares well with similar developing countries on its overall rate of financial inclusion. However, the high concentration of banks in the financial sector combined with the legacy of apartheid may go some way to explaining the inadequate attention low-income individuals and small enterprises have received. Low levels of financial literacy and capabilities in the country exacerbate these effects, often leading to poor financial decisions and worsening economic conditions for those who can least afford it.

As we have seen, success in the overall financial inclusion rate tends to obscure the fact that there are significant issues that need to be dealt with. **For individuals**, the level and composition of take-up and usage is suboptimal and has not led to a positive and sustainable impact for either service users or the providers. Examples of this phenomenon are the negative impact of the overuse of credit, resulting in over-indebtedness, and the unproductive use of newly opened transactional accounts. Ownership of a bank account has not sufficiently translated into greater savings or insurance coverage. The lack of beneficial effects of acquired financial services points to the need to deepen financial inclusion.

SMMEs are even more constrained, with access to appropriate products and services the primary challenge. This minimal use of financial services by SMMEs constrains development. The NDP emphasises the role of SMMEs in achieving South Africa's future economic growth and employment targets. In fact, the NDP foresees that as much as 90 per cent of new employment will be created in small and expanding firms by 2030. However, indications are that we are falling short of these targets and that, if anything, the percentage of employed adults in South Africa had decreased at the time of writing this document. According to the Stats SA Labour Force Surveys, SMMEs are maintaining employment levels far better than corporates do, although there is no real growth in relative terms. It is therefore critical to optimise the role that appropriate financial services can play in developing the SMME sector.

A carefully considered holistic response will need to consider the dynamics explained in this chapter. In addition, steps must be taken to address the structural deficiencies noted, especially as they relate to the high concentration of the financial sector, within which black South Africans are under-represented. Government intends to address these issues in conjunction with the sector's stakeholders, via three core policy pillars:

- **Pillar One – Deepen financial inclusion for individuals.** Improve the beneficial use of financial services for the newly included, the payment infrastructure for mass use of new payment methods and the take-up of savings, insurance and productive credit.
- **Pillar Two – Extend access to financial services for SMMEs.** This includes improving the credit infrastructure for SMMEs, leveraging off a broader payment system and incentivising the provision of asset insurance.
- **Pillar Three – Leverage a more diversified provider and distribution base.** Support competition and diversification of the supply base by strengthening the co-operatives sector, developing a more proportionate regulatory environment to ease compliance costs, allowing for and empowering the use of agents in financial service distribution and leveraging fintech disruptors.

The sections that follow highlight the main concerns under each pillar, and in turn, they identify different priorities and potential projects to address them. These priorities will be continually evaluated for relevance and impact, and they will be followed by more detailed specialist policy notes.

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Pillar One – Deepen financial inclusion for individuals

Section 2.3 shows that most individuals in South Africa are already financially served, primarily through the uptake of a bank account (or in many other instances a funeral, credit or legal insurance policy) but this does not necessarily reflect the appropriateness of products acquired and the extent to which the products are actively used. For instance, nearly half of bank account holders (42 per cent)⁷⁷ withdraw all their money as soon as it is deposited, illustrating that many people do not make full use of their *bank accounts* but rather use them purely as a substitute for cash distribution. This may be attributed to a lack of knowledge of the benefits of a transactional account, inappropriate (to the low-income market) payment and transactional capabilities, and the high costs associated with ATM withdrawals (which incentivises a single withdrawal).

The take-up of both *savings and insurance products*, with the exception of funeral policies, is significantly low. This is a result of the traditional distribution models used by financial institutions (i.e. agents or brokers and technology-based solutions), and the availability of products that are affordable and meet client needs. As with transactional accounts, where products are acquired, the use thereof does not translate into meaningful or appropriate usage.

Retail *credit* advanced to the low-income segment of the population, although high, is primarily for consumption, rather than productive purposes or wealth-accumulation, such as buying a house or starting a business.⁷⁸ Credit bureau data indicates that the most open accounts are for retail apparel, with unsecured loans, credit cards with retail accounts and unsecured credit the most common amongst low-income earners. More concerning is that almost half (47 per cent) of low-income earners have at least one account that is three months or more in arrears, in comparison to only 20 per cent of those earning more than R15,000.⁷⁹

The continuous and productive use of products is necessary to ensure beneficial financial inclusion. The imperative thus shifts towards the use of a broader portfolio of financial services and the quality of its use and provisioning, rather than access to a single bank account. The development of product standards aimed at improving the quality of service provision, rather than setting fixed features through regulation – taking into consideration international approaches, for example in Canada and the European Union – points towards minimum standards that do not only offer protection, but that can also be enhanced by providers.

Quality thus shifts to whether the financial take-up is meeting people's underlying financial needs. This includes efficiency (for example, where interoperability in the payments space brings down costs and improves functionality) and value (for example, whether a person overpays for a service, or earns adequate returns, or is able to claim). It also refers to market development whereby the country as a whole may benefit, for example the impact on inclusive growth of increasing mortgage lending to traditionally black areas and townships.

A major challenge for effective financial inclusion thus remains the lack of available, appropriate and affordable financial products and the lack of, or limited knowledge about, financial services and products for a significant portion of the South African population. Gaps in market coverage and development will need to be addressed through this policy and supporting

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78 It is estimated that over half (56 per cent) of credit active consumers earn less than R7,500.

79 Understanding heavily indebted consumers in South Africa, Eighty20 on behalf of National Treasury, 2018.

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Government processes, such as:

- The evolving financial sector codes;
- Reform of the national payments system spearheaded by the South African Reserve Bank;
- The implementation of the Insurance Act of 2018 (this accommodates microinsurance as a licence category) alongside a market development roadmap for the insurance sector;
- The implementation of recommendations made by the retail banking diagnostic conducted by the World Bank for National Treasury; and
- The development of a national financial education policy to provide a consistent framework for financial literacy in South Africa.

The following, based on the current state of financial inclusion and the manner in which financial services and products are used, can be summed up as the current prominent constraints to financial inclusion for individuals:

- Inadequate usage of bank accounts;
- Underdeveloped payment options;
- Low levels of use of formal or regulated remittances (as opposed to informal remittance services);
- Low savings rates in the traditional formal sector;
- Low take-up of insurance products, with the exception of funeral, credit and legal ones;
- Over-indebtedness relating to excessive take-up of unsecured (unproductive) credit and, on the other hand, frustrated access to housing finance;
- Inadequate leveraging of opportunities for inclusion arising from social grants; and
- Low levels of client on-boarding due to perceived onerous regulatory requirements.

These constraints inform the eight policy priorities under this pillar. Project proposals are made in support of each priority.

Priority 1: Promote the beneficial use of transactional accounts

Seen as the “gateway” to financial inclusion, more effective transactional accounts are in fact its starting point. They serve as the platform for extending the range of products that are available and taken up. However, as previously highlighted, many South African bank account holders use their account solely as a tool for cash distribution. This is a concerning trend, since the store-of-value aspect of the bank account is removed along with the holders’ ability to make and receive payments electronically. Users falling into this category, if they have no other products from financial services providers, are arguably not financially included, as there is little difference in their quality of life compared to receiving the money in cash. Apart from the obvious need for improved financial education in this regard, improving the value proposition of bank account services will be important to changing the scenario of underused bank accounts.

Although efforts are underway to promote a cash-lite society (Priority 2 explains the associated benefits), South Africa’s substantial informal sector and the underdeveloped payment ecosystem means cash remains prevalent. Ignoring this reality will exclude billions of rand of capital (and the holders of this capital) from the formal banking system. This reality must be acknowledged and understood. With retail and other network participation in the payment system, payment services and withdrawal options have improved considerably, but too often they are operated on a closed-loop system outside of the national payment system, with many innovations favouring middle- and high-income clients (for example, relying on smart phone apps). Getting cash into your account remains expensive, while high and opaque penalty charges foster mistrust.

Promoting the beneficial use of transactional accounts and payment services is key to Government proposals. This means improving customer benefits and cutting frictional problems or other product failures that impede usage. In turn, this means

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building more diversified, efficient and effective payment options, developing store-of-value accounts as an alternative to traditional bank accounts, and improving the value proposition of a bank account.

The following research activities are therefore proposed:

- **Demand-side research** to understand blockages and impediments to account usage; and
- Coordinating a stakeholder workshop to explore **affordable and effective cash-in options**, considering especially the potential benefits to improved cash-in facilities, current blockages and market experiences.

Priority 2: Build appropriate payment options to drive usage

Payment systems play an important role in providing financial services by facilitating the flow of payments and value between parties. The interoperable⁸⁰ capability of the payment system has the potential to increase access to financial services by increasing shared access points, convenience, and reducing the cost of financial services for the user.

To operationalise the convenience and increased access, local points of payment, particularly in township and rural retailers, must be enabled. It is generally recognised⁸¹ that the acceptance of digital payments – and hence the active use of transactional accounts – requires a functional ecosystem at all levels. It serves little purpose to ensure that most people have a transactional account but there are few practical places where it can be used for day-to-day purchases. Creating local ecosystems holds immediate benefits for the small retailer as well, in that the enterprise can participate in digital payments in general, over and above the efficiencies being introduced through reduced cash handling and holding. This in turn enables the small merchant to pay suppliers and service providers digitally. If this payment information is then used as alternative data in credit assessment, it opens up the possibility of the small retailer being in a much better position to access credit when necessary.

In a global context, the World Bank – CPPI *Payment Aspects of Financial Inclusion* (PAFI) report – lists guiding principles that are relevant to payments, and specifically transaction accounts. The World Bank has undertaken an assessment of the South African payment system. The resulting report *Achieving effective financial inclusion in South Africa: A Payments Perspective* was published in August 2018, and informs the various proposals made in this document as relating to the payment system.

Advancing mobile payments.⁸² The vast majority of South Africans (more than 90 per cent of adults) use a mobile (cell) phone. This reality has spurred some service providers, including but not limited to banks, to offer an array of mobile-based financial services over the last 15 years. Notably, the use of mobile payments in South Africa is unlike that of other African countries, where mobile payments followed by other mobile financial services enjoyed quick acceptance and rapid growth – a summary of the M-Pesa experience is given in Box 7. This is because South Africa is inherently a cash-driven economy, where despite the growing penetration of mobile phones, consumers continue to use cash to pay for day-to-day needs.

More can and should be done to reverse this trend.

80 Interoperability is the ability of a payment system to conclude transactions across multiple payment service providers.

81 See for example the GPFI Guidance Note on Building Inclusive Digital Payment Systems 2017. <https://www.gpfi.org/publications/gpfi-guidance-note-building-inclusive-digital-payments-ecosystems>

82 Mobile payment (also referred to as mobile money, mobile money transfer, and mobile wallet) refers to payment services operated under financial regulation and performed from or via a mobile device.

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Box 7: Development of the M-Pesa mobile product in Kenya from concept inception to December 2008⁸³

In 2005, Safaricom⁸⁴ – a mobile operator in Kenya – requested permission from the Central Bank of Kenya (CBK) to launch the first mobile money service, M-Pesa. It started as a pilot project with support from a UK Department of International Development (DFID) grant. The concept was initially positioned as a microfinance institution (MFI) where locals would be able to borrow money. However, early pilots proved too difficult to integrate easily with the MFI systems. The M-Pesa team persevered, given the potential of the mobile device to enable Kenyans to send money home from those who worked in urban areas to family members in rural areas. The broadening of the vision beyond MFIs was the basis for the engagement between the M-Pesa project team and the CBK.

The CBK isolated some areas of potential concern in relation to introducing M-Pesa. These ranged from legal, regulatory and money laundering risks to operational risks and prompted the authorities to ask questions relating to M-Pesa's business model. In response to the concerns raised, a review of the M-Pesa concept was undertaken by the CBK with the M-Pesa team to better understand the nature of the product and the associated risks, and to address or mitigate them.

Legal

CBK's legal counsel indicated that M-Pesa was not doing banking business as defined by the Kenya Banking Law, but that the service provider would still need to acquire authorisation to operate a money transfer service.

Anti-money laundering

The M-Pesa technology team developed the product with explicit anti-money laundering (AML) measures in mind, such as suspicious transaction monitoring and electronic audit trails. The team ensured that M-Pesa complied with AML standards set by the Kenyan anti-money laundering legislation as well as those set by Vodafone and the Financial Action Task Force (FATF).

Operational Risk

The entire M-Pesa IT platform was examined with a particular view to ensuring that it could operate safely in the Kenyan market. For example, the end-to-end encryption of the SIM card functionality – which held all of the confidential customer data – was tested and the business processes, security, risk management and reporting were checked to ensure they are appropriate.

Customer experience

In September 2008 CBK through the FSD Kenya commissioned a survey of over 3,000 M-Pesa customers that revealed more than 80 per cent of users were happy with the service. The majority of customers used the service for domestic remittances, with buying pre-paid airtime and saving as the next most regularly used functionality.

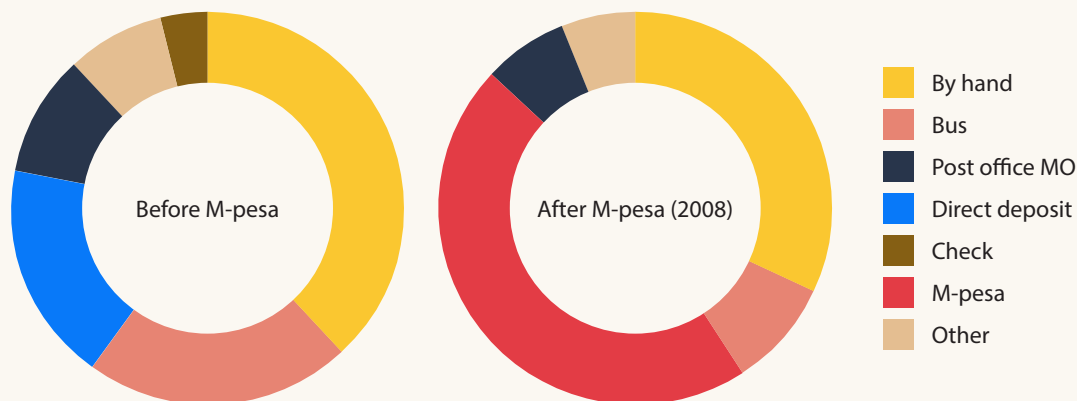
The survey also indicated that M-Pesa had substantially changed the market for domestic transfers, almost eliminating the role of bus companies and the post office, and reducing the percentage of people using hand transfers, as depicted in Figure 8 below.

⁸³ Enabling mobile money transfer: The Central Bank of Kenya's treatment of M-Pesa, AFI, 2010.

⁸⁴ Safaricom is a mobile network operator in Kenya and a member of the Vodafone Group.

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Figure 8: Customer usage of M-Pesa compared to other money transfer products



Source: AFI, 2010

The review demonstrated that it was viable to operate the system in Kenya and that it was designed for the Kenyan market (specifically the AML/CFT systems) and was further capable of handling the demand imposed on it. CBK, wishing to enhance financial inclusion, decided that, even though it had no clear authority over non-bank fund transfers, M-Pesa could operate and allowed Safaricom to launch the product in March 2007, provided certain basic conditions were met. These include that:

- Appropriate measures are put in place to safeguard the integrity of the system in order to protect customers against fraud, loss of money, privacy and quality of service.
- The system provides adequate measures to guard against money laundering.
- Proper records are kept and made available to regulatory authorities in formats that may be required from time to time.
- M-Pesa observes all existing laws governing its relationship with its agents and customers.
- All agents who offer M-Pesa service needed to pre-deposit a sum of money (“float”) in a bank account, from which the electronic value was used to guarantee all customer deposits and withdrawals.

The Kenyan parliament questioned the possible implications of allowing unregulated money transfer services. After identifying a gap in the payment services regulatory framework, the Kenyan Ministry of Finance publicly requested the CBK to conduct a risk assessment audit of the service and to determine how it fits into their existing regulatory framework. As a result of the audit, the CBK issued a press statement on its review prior to the launch of M-Pesa, and further incorporated additional, evidence-based, areas of relevance into the standard supervisory practice. It also developed a more robust system of monitoring M-Pesa as it continues to grow.

M-Pesa has grown to over 16 million customers, served by over 12,000 agents throughout Kenya. M-Pesa services have expanded to include bill payments, group salary payments and school fee payments. Furthermore, Safaricom continues to work with the CBK to develop creative new products for the service.

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Interoperability. A major barrier to mobile payment services being offered is where the payments are not truly interoperable. In other words, the payment recipient has to be part of the same platform to be identifiable, and thus to receive the payment and products that tend to operate in a series of closed-loop⁸⁵ systems. This means that households must pre-allocate sufficient funds for each of the services they intend using. This is cumbersome and has a negative effect on cash flow, particularly of low-income families. This, plus the non-standard way in which such payments are initiated and executed, has led to the relatively low adoption of mobile payments. Without the advantage of being able to execute payments to all users of regulated service providers and across all mobile networks, the potential of mobile payment schemes will always be limited. Similarly, without adequate market preparation and appropriate financial literacy intervention, any new initiatives are unlikely to achieve their full potential. Although fully interoperable mobile payments will benefit the entire market, the relative impact on low-income individuals and SMMEs will be proportionally higher, given that those segments have limited access to affordable payment services.

It is in South Africa's interest to create options for non-account, small-value digital payments, or a cash-light economy. To try and realise this, Government is promoting cashless payment methods for low-value payments, particularly in the mass-transit industry such as the Rea Vaya bus rapid transit system. The payment industry has responded positively to this by introducing low-value payment cards. These payment cards allow the customers to "tap and go" instead of the traditional way of paying cash. A distinguishing attribute of low-value payment systems is that such payments are similar to cash, in that additional authentication is not required at the point of payment – the card is simply presented and authenticated. This increases convenience, but also increases risk. Risk is mitigated by restricting either the value on the cards or the transaction amount, or both.

Mass-transit systems are promising entry points for the acceptance of digital payments, as the experience can easily be extended into other environments. However, currently there is limited interoperability for these systems and clients have to maintain multiple payment cards. It is therefore important to pursue interoperability through the already agreed standard.

Unlocking the potential of e-money.⁸⁶ E-money is defined as an electronic store of monetary value on a technical device in the consumer's possession. It is generally used for making payments to entities other than the e-money issuer. The device acts as a prepaid bearer instrument which does not necessarily involve bank accounts in transactions. Unlike in some other countries, in South Africa e-money business is considered as deposit taking and can only be performed by banks. Although this has resulted in sound deposit protection, it has constrained access to e-money by limiting entry into the market by non-bank payment service providers.

The absence of a national strategy as to what form e-money should take in South Africa has led to numerous closed-loop e-money products and services that are not interoperable. As a result, e-money has not been as effective in achieving financial inclusion objectives as was anticipated. However, if well accepted by merchants and consumers, e-money has the potential to reduce the "reach" problem and promote financial inclusion.

85 A closed-loop system is a system where the issuer of a payment service is the only one that can process the payment to the recipient, no other provider can process the payment.

86 E-money, or electronic money is an electronic store of monetary value on a technical device that may be widely used for making payments to entities other than the e-money issuer. The device acts as a prepaid bearer instrument which does not necessarily involve bank accounts in transactions.

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The following are proposed for project development:

- **Develop a payment ecosystem that is accessible and serves all users of financial services**, covering transactional accounts, mobile payments, small-value payments and remittances services (both domestic and cross-border).
- **Develop innovative ways in which small merchants can be assisted to acquire affordable payment devices**, to enable a variety of interoperable point-of-payment channels.
- **Provide non-banks access to the payment and settlement system** in order for these entities to directly provide payment services.
- **Develop a national strategy for interoperability**, identifying a national vision and steps required to get there. This could focus on the critical levers highlighted, including leveraging off large-scale payments like transit and implementing the national standard.
- **Explicitly allow for e-money** to be enabled and regulated by the South African Reserve Bank and cater for wallets and other purely digital forms of value stores.

Priority 3: Position remittances as springboard for further financial inclusion

In today's global society it is common for people to migrate to other countries or areas in search of a better life. This phenomenon can often have a positive effect on the economy of the destination country or area, while also benefitting the place of origin through the transfer of surplus income to family members residing there. This transfer of money to migrants' countries of origin is referred to as "cross-border remittance", while transfers to areas in the same country are termed "domestic remittance". Globally, remittances are an important and stable source of income for low-income households, particularly in developing countries. The World Bank estimates that remittances totalled \$613 billion in 2017, \$466 billion of which went to developing countries, involving some 258 million migrants (including refugees). In some countries, the value of remittances is often on par with, or even exceeds, foreign direct investment and overseas development assistance. Studies from CGAP and other development agencies have shown that remittances promote financial inclusion and contribute to poverty reduction in home countries, hence the increasing international focus on this issue.

Remittances are often the first touch point in the use of financial services and, as such, provide a springboard for further financial inclusion. Both domestic and cross-border remittances are widely used in South Africa. However, many of the current remittance flows, especially cross-border remittances, go through the informal sector. This is concerning from the perspective of consumer protection as well as the integrity of the financial system, while it also does not provide the desired financial inclusion on-ramp. Government intends to develop this market with a view to achieving both greater formalisation and efficiency.

Creating an interoperable domestic remittance system. Numerous services are offered by financial services providers in South Africa in the domestic remittance market. These include the use of the networks of non-financial services providers, e.g. retailers and retail mobile resellers, which has extended the reach of formal remittance service providers. These services are typically closed-loop, in the sense that the recipient must find a point-of-representation associated with the originating service provider. This is true even where the pay-out can occur at an ATM, as the recipient must find an ATM operated by the original service provider. This may prove to be a logistical problem and precludes the effect of competition on services being provided to recipients. An additional issue is that remittance senders are typically treated as having a once-off interaction with the service provider, so that the remitter must undergo the full AML/CTF process or elements of it every time the service is requested.

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Expanding low-cost, accessible cross-border remittance options. The high cost of South African remittances may be driven by the dual and related effects of stifled competition as a result of regulatory barriers to entry, on the one hand, and the way in which financial institutions give effect to these regulatory requirements, on the other. The international regulatory standards that have a bearing on cross-border transfers from South Africa are:⁸⁷

- The standards set by the Financial Action Task Force (FATF⁸⁸) for controlling money laundering and combating the financing of terrorism;
- SWIFT messaging standards;
- Guidance provided by the Basel Committee on Banking Supervision, notably on cover payment messages; and
- The General Principles for International Remittances Services released by the Bank for International Settlements (BIS) and the World Bank.

On the national level, South African remittance entities must comply with:

- South Africa's exchange control regulations;
- Anti-money laundering rules and the Financial Intelligence Centre Act;
- Immigration laws; and
- E-money regulation and directives.

Locally, financial institutions have tended towards a risk-averse and “blunt” approach to AML/CFT regulatory requirements, not considering the individual and the low risk of particular transactions, especially in respect of the second and third regulations listed above. Immigration laws pertaining to the ability of a migrant to open a bank account are also generally considered to be more restrictive than in other markets, limiting migrants' ability to leverage low-cost digital channels. As a result, undocumented immigrants face great difficulties in accessing formal financial systems. Low-income immigrants also struggle with the affordability of, and hence the accessibility to, the financial system. Informal services are often less costly than regulated ones and, as a result, most cross-border remittances to SADC countries are made using informal means. This has two major implications – the integrity of the remittance system is severely undermined, while particularly low-income immigrants face the high risk of using informal means of remitting funds. In addition, informally transferred remittances represent a loss in terms of economies of scale that would be achieved by the regulated market if it were used for remittances. In other words, higher volumes could lower the cost of regulated services which could, in turn, lead to increased use of regulated channels.

Regulatory changes intended to foster competition and exert downward pressure on the cost of remittances in South Africa include:

- The FIC Amendment Act, as explained in section 3.1.6; and
- Lifting ownership restrictions on foreign participation in authorised dealers with limited authority (ADLAs⁸⁹) and creating an additional category for money transfer operators so that these entities can participate in the market on a standalone basis.

It will be important under the FIC Amendment Act to instil a risk-based approach to identifying remittance customers, setting threshold amounts for remittances below which anyone sending amounts must be identified without the need to have their

⁸⁷ Guiding Principle 7 of the World Bank-CPMI Payment Aspects of Financial Inclusion is also relevant, from a financial inclusion perspective.

⁸⁸ The Financial Action Task Force (on Money Laundering) (FATF), also known by its French name, Groupe d'action financière (GAFI), is an intergovernmental organisation founded in 1989 on the initiative of the G7 to develop policies to combat money laundering. In 2001 the purpose expanded to act on terrorism financing.

⁸⁹ Authorised dealers in foreign exchange with limited authority, including bureaux de change, are authorised by the National Treasury to deal in foreign exchange for the sole purpose of facilitating travel-related transactions.

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identity verified. Specifically, remitters' immigration status should not be a hurdle to using formal remittance services below the agreed threshold.

Expanding on the CENFRI 2012⁹⁰ research, it will be important to improve the collection of data on remittance flows for monitoring purposes, to include estimates of transfers through regulated and unregulated channels. These could be widely disseminated to raise service providers' awareness of the potential of the market.

The following are proposed for project development:

- **Investigate the feasibility of an interoperable domestic remittance system**, including allowing non-banks to provide domestic remittances without the backing of a bank (as is currently required). Interoperability in this context does not imply a single system, but rather that money can flow seamlessly between different platforms and service providers.
- Support the **establishment of an interoperable person-to-person money transfer system in the SADC region**. Such a system should leverage existing infrastructure to the extent possible,⁹¹ taking into account all stores-of-value and making full use of mobile technology capabilities. It should also embed a proportionate and risk-based approach to applicable international standards, ensuring that the implementation of these standards by regulators and financial institutions does not have unintended consequences on financial inclusion. The Department of Home Affairs should be brought into the solution.
- Undertake a **risk assessment to set thresholds and requirements for different types of transactions**, ensuring their alignment with projects undertaken in pursuance of Priority 8.
- **Prioritise the collection of data on remittance flows**, including estimates of transfers through unregulated channels, published as remittance indicators as part of the Financial Inclusion Monitor proposed in Chapter 6.
- **Identify customer education on safe and efficient ways of sending and receiving money** as part of the National Financial Education Strategy.

Priority 4: Supporting increased formal savings for low-income earners

The 16 per cent savings rate among South Africans is undesirably low. The reasons for the low savings rate in the country are manifold, including its level of poverty, the low incentive to save and the lack of sufficient engagement by formal institutions in the low-income market. Add to these the cost of savings, particularly saving small amounts, and it becomes apparent why the situation remains as it is. It is also clear that the problem is complex and will not be resolved by a single initiative in the short and medium term. However, this does not mean that no intervention is required. At the very least the environment should be changed to make it easy and worthwhile to save, particularly for people with low incomes.

The retail savings bond⁹² is one product that already addresses some of the savings needs of many South Africans. However, it requires a significant initial investment of R1,000 (from the perspective of low-income savers) and a fixed long-term commitment, although the rate of return is very attractive.

To further improve the low rate of savings while also helping to maximise tax relief, in 2015 the new tax-free savings accounts for individuals was introduced by banks. This account allows for all proceeds, including interest income, capital gains and dividends

90 The South Africa–SADC remittance channel, Cenfri, 2012

91 This in recognition that SADC's regional cross-border settlement system, SIRESS, is live and other SADC integration initiatives are ongoing.

92 An RSA Retail Saving Bond is an investment with the government that earns fixed interest for the term of the investment. It offers guaranteed returns, and carries no commission, agency or service fees.

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from these accounts to be tax free. This reduces a person's tax burden, increases returns and hence makes saving more attractive. Nevertheless, additional products are required to mobilise savings and instil a wider savings culture across the country.

Although saving in the traditional sense entails putting away money into savings channels such as bank accounts, policies and investments, it is imperative that saving is also understood from the perspective of consumers of financial services and products like Thato in Box 8 below.

Box 8: Understanding savings

Thato (40) is a single mom of two children aged nine and seven. She started working at the age of 25 in Pretoria city but she continued to stay with her parents in Mamelodi so that she could try and save up for her own house. However, due to unreliable transport services Thato reverted to buying herself a small car to get around. This eroded the little money she had intended to save. Ten years ago, after paying off her car, Thato moved out of her parents' home and eventually purchased her own house.

Thato is still not saving, as most of her income goes towards her monthly living expenses. Anything that is left over from Thato's monthly budget is transferred to her mortgage account. Thato's main financial goal is to be debt free by the time her first-born child goes to university.

The high prevalence of informal saving in South Africa through stokvels points to the potential in building on and expanding savings patterns. The National Stokvel Association of South Africa estimates that R49 billion is held in savings by stokvels. These funds, with the potential to create wealth, are mainly held in bank accounts earning low interest, highlighting the need for more innovative products to service stokvels. The introduction of a stock exchange for stokvels in recent times, affording them the opportunity to invest in the stock market, is one such initiative towards better servicing this market. It is, however, not without risk and appropriate financial education needs to be developed to afford stokvels the ability to interact with this service appropriately and meaningfully. More of such initiatives will need to be developed.

Box 9: Savings products in India

The Indian Government offers a multitude of savings schemes that are easy to enrol in through both the public and private banking systems. These range from high-value to low-value schemes and include products such as:

- The **Public Provident Fund (PPF)** is a savings-cum-tax-saving instrument introduced by the National Savings Institute of the Ministry of Finance in 1968. The aim of the scheme is to mobilise small savings by offering an investment with reasonable returns combined with income tax benefits. The scheme is fully guaranteed by the Government. The balance in a PPF account is not subject to attachment under any order or decree by a court.
- **Kisan Vikas Patra (KVP)** is a savings certificate scheme that was first launched in 1988 by India Post. KVP certificates are available in denominations of Rs1,000, Rs5,000, Rs10,000 and Rs50,000. The minimum amount that can be invested is Rs1,000. However, there is no upper limit on the purchase of KVPs.
- **Sukanya Samridhi Account** (literally Girl Child Prosperity Account) is a Government-backed saving scheme targeted at the parents of girl children. The scheme encourages parents to build a fund for the future education and marriage expenses of their female offspring. The account can be opened at any post office with a minimum opening balance of Rs1,000.

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The following is proposed for project development:

- With the aim of **tapping the massive informal savings pool in South Africa**, perform a **diagnostic on available savings mechanisms** that considers market failures, including those relating to product design and distribution. Make recommendations for possible savings models (like those applied in India), the design of savings products (that includes the support of regular small-value savings), and an extended product range for stokvels and distribution improvements.

Priority 5: Promote appropriate credit by promoting credit for assets and investment over consumption

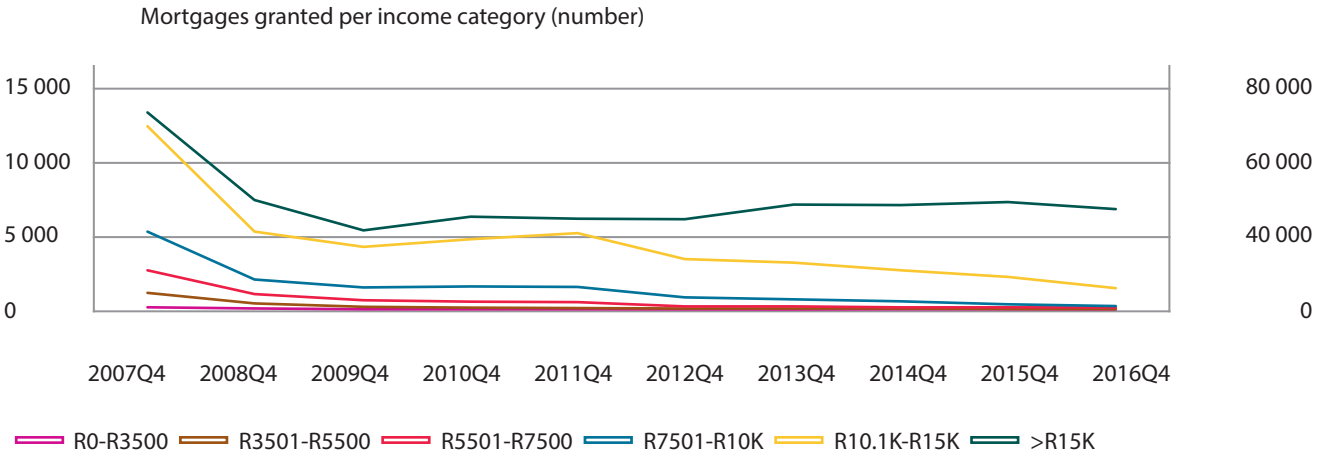
Many South Africans have access to some form of formal credit. However, there are underlying problems in its access and usage. For low-income people the predominant vehicle through which credit is accessed is unsecured credit, mainly for consumption purposes and often leading to an increased and unsustainable credit dependency. In the period up to mid-2014, the growth in unsecured credit (which outstripped the growth of any other form of consumer credit) was mainly driven by extending more credit to the same market, rather than extending credit to new markets. To relieve over-indebtedness pressures on households, the minister of trade and industry and the minister of finance, acting under the direction of cabinet, took measures to reduce reckless lending and egregious debt collection practices, improve the functioning of the credit insurance market and limit debit order abuse.

In response to the partly worsening economic conditions and a tightening regulatory environment, credit extension has slowed. The ratio of household debt to disposable income declined to 74 per cent in 2016, down from an all-time high of 86 per cent in 2008. Despite this, the number of registered credit providers continues to increase year-on-year, and there are now more access points at which a South African can borrow money than deposit it (see Table 2). Not in itself the cause of the problem, this does reflect the underlying structural challenge – South Africans are net borrowers and prefer to spend on consumption rather than investment. In line with South Africa's developmental agenda and the National Development Plan, poverty relief and reduced inequality requires ordinary South Africans to shift from consumption to investment spending. This requires in parallel a shift from credit to savings, and consumption credit to productive credit. In short, this means more credit should be issued for home improvements, vehicles and education over clothes, appliances, furniture and general day-to-day expenses. Of these, homes and education are identified as critical.

The social imperative of providing safe and secure housing for South Africans warrants focus on the availability of home loans, i.e. mortgages. Middle-income earners, with or without Government subsidy, remain under-served because their earnings are above the qualification threshold of R3,500, but generally insufficient to qualify for a mortgage loan at a financial institution. There are two main challenges to the extension of mortgage credit: a lack of suitable housing stock and mortgage lenders' appetite for risk. While the former lies outside the scope of this study, the issues are difficult to separate. As a result, certain South African banks have indicated that they are looking to partner with property developers in support of this objective. Figure 10 below shows the significant decline in mortgage lending to lower income segments. Of concern is the dramatic decline of lending to the R10,100–R15,000 income category, which had tracked the higher income categories until 2011.

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Figure 9: Mortgages granted per income category (number), 2007-2016



Source: National Treasury analysis, based on NCR data

Funding tertiary education is currently under considerable scrutiny. While options are being considered to make education free for those in need, not all students will be accommodated, and there will likely remain a funding gap. Box 10 explores some of the realities and challenges faced by students and the knock-on impact on society.

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Box 10: #FeesMustFall – Funding failures spark protests

In October 2015 disgruntled students protested against university fee hikes that were above the inflation rate. The protests started at the University of Witwatersrand and spread rapidly to other universities across the country. The announcement by Government that there would be no tuition fee increases for 2016 saw the end of the 2015 protests, but this was short lived. The protests were activated again in 2016 when the South African minister of higher education announced there would be fee increases capped at 8 per cent for 2017; with each institution given the freedom to decide by how much their tuition fees would increase. Although the focus of the protests was on a rise in fees, other factors may be contributing towards the discontentment of students.

High cost of tuition

South African universities are unaffordable to many. In 2015 BusinessTech looked at tuition fees for the first year of study at those universities featured in the top 100 universities in the Brics nations and emerging countries. Costs ranged from R25,000 to R60,000 per academic year with accommodation ranging from an additional R17,000 to R50,000 per student per year.⁹³ On average a first-year student will therefore pay R72,172 per annum for tuition and accommodation, excluding all other expenses such as study material and meals. In contrast, BankservAfrica's Disposable Salary Index shows monthly "take home" salary for South Africans in the formal sector average well under R15,000.

Funding through the National Student Financial Aid Scheme (NSFAS)

The funding of tuition and accommodation fees can take place through various means, such as full bursaries (students are fully funded by the bursar and do not need to co-pay), partial bursaries (students need to co-pay some of the expenses), financial aid by Government's NSFAS or alternatively self-funded (includes cash payments or study loan).

The NSFAS facilitates loans to students in financial need. The loans are paid back by the recipient upon completion of their studies and attainment of employment, provided that the respective loan recipient's salary is R30,000 or more per year. To qualify for the loan a student is subject to a "means test" to rank how financially needy they are. The formula used to rank financial neediness considers household income, the number of dependants in the household, and the family's cost of living. Usually, students with an annual household income of R160,000 or less will be eligible to apply.

For households earning above R160,000 that do not qualify for financial aid or need to co-pay, the cost for university translates to approximately 45 per cent of household income for those earning over R160,000.

Although South Africa has a thriving credit market the same cannot be said for developmental credit – defined as a credit agreement which is entered into between a credit provider and a consumer for the following purposes:

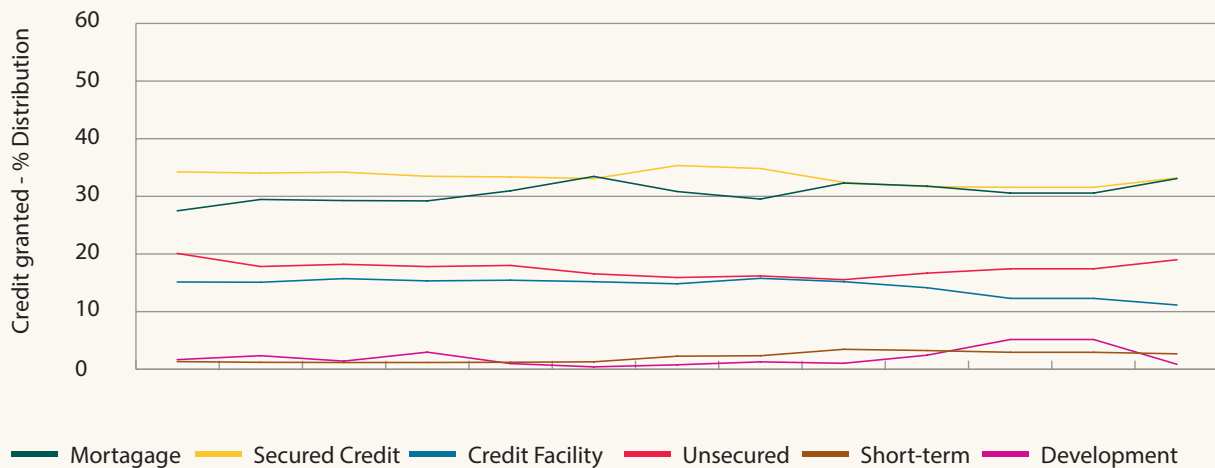
- an educational loan;
- development of a small business; and
- the acquisition, rehabilitation, building or expansion of low-income housing.

Developmental credit has over the years made up the lowest share of the gross debtors' book (see Figure 11).

93 It costs R17 360 for a double room at the North-West University and R50 100 per student per year for a single room at the University of Cape Town.

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Figure 11 – Credit granted per credit category



Source: NCR, 2013-2016

While Government may be stepping in to fully fund tertiary education in line with commitments made by the ANC, this case study nonetheless highlights the gap in credit for productive and developmental purposes.

The following activities are proposed for project development:

- Coordinate a stakeholder workshop between Government, DFIs and industry to unpack the issues, hear experiences of market participants and international counterparts, and explore options for addressing these issues, with the aim of reaching concrete recommendations.
- The new Financial Sector Conduct Authority set up under the Twin Peaks model – in support of the National Credit Regulator – will proactively and pre-emptively monitor credit providers for conduct risk and respond to poor conduct practices before they become systemic.
- Review the Financial Sector Code to set access to finance targets⁹⁴ for specified developmental loans. Loans needed for students from low-income families should be informed by Government's approach to improve funding for tertiary education. The following approaches should be considered:
 - Reduce the credit risk for lenders by setting up a facility where Government shares the loss on defaults. This in effect is a partial credit guarantee (PCG) scheme for education loans similar to what is proposed in more detail under Pillar Two's Priority 9.
 - For student loans, use the student's future income generation capability as the primary way of assessing if it is affordable for them, rather than the current approach which looks at the ability of another party, typically a parent or guardian, to repay the amount owed.
- In support of wealth creation among the currently un- or under-served while also increasing the level of home ownership in South Africa, explore the feasibility of using other types of security – such as a permission to occupy (PTO) – to grant home loans or mortgages.

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Priority 6: Promote appropriate, affordable and quality insurance

The relatively low-level use of insurance products by the low-income market (see section 2.3.2) is concerning, as it reflects the reality that the most vulnerable people in society are not adequately protected against day-to-day financial threats. There is little take-up of asset insurance and basic life insurance and an over-reliance on funeral insurance. The decline in the use of formal insurance products in periods of financial stress also points strongly to issues of inadequate financial education and possibly the inappropriate sale of insurance products by providers, as is the case in Karabo's situation in Box 11.

Box 11: Funeral cover vs life insurance

Karabo's parents passed on when he was still young, and he and his sister were left in the care of their grandmother. Karabo recently started working and took out funeral cover for his family (himself, his grandmother and sister). He covered his sister and grandmother for R20,000 each, as he believes that is how much it will cost to have a decent funeral.

Karabo explained to the consultant assisting him with the cover that he wanted to safeguard his sister's future. Thus, he said he needed more money to be available should he die as his family relied on him now that he was working. He was then informed that funeral cover can now go up to a maximum of R100,000, so for himself he took out the maximum cover for which he pays R195 per month as he wants his sister to still be able to go to school should he die.

Karabo can get life cover for the same amount and pay less than R100, but he does not know this.

Affordability also plays a role, but this is materially a function of the distribution (or delivery) model adopted by insurance providers, historically aimed at supporting the middle and upper market segments. In combination, these factors lead to a situation in which the most vulnerable section of society is the most ill-equipped to deal with issues of unexpected loss. Governments, NGOs and private companies have partnered with self-help groups in India and Kenya to reach a wider customer base, as explained above. South Africa's distribution model for insurance products in turn needs revisiting.

To sustainably improve the usage of insurance products is to ensure that what is offered addresses the needs of the targeted customer segment: i.e. the products need to effectively and affordably deal with risk management in the low-income market and the claims process should be efficient and easy to administer. Fintech disruptors provide an opportunity in this regard (as discussed in more detail in Priority 17). Consider the example of Lemonade in Box 12.

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Box 12: Lemonade

Lemonade is an insurance company offering homeowners, renters and home sharers property and liability or cautory insurance in New York, USA.

The company uses artificial intelligence in the form of chatbots and machine learning to provide insurance policies and handle claims in the place of brokers, call centres and paperwork traditionally associated with the process.

Lemonade uses behavioural economics research to displace fraud and conflict, while aligning interests to remove the motivation for not paying claims and keeping the inclination to defraud an insurer in check. Integration of these principles is found in Lemonade's policy documents and claims processes, with policyholders signing their names on a digital pledge of honesty at the start of the claims process, rather than the end, and speaking into a camera to file a claim rather than using forms.

Product uptake and claims process

A client or potential policyholder accesses Lemonade services through a mobile app or web interface. To take out insurance the potential policyholder will answer a few underwriting questions on the chatbot, e.g. location for insurance and personal details. An artificial intelligence programme will respond by drafting an individually risk-based policy document that can be accepted or amended via the app or web interface. The process is on demand, paperless, available anytime and quick. Claims are handled in a similar manner via the app or web interface.

Twenty per cent of premiums received are retained by Lemonade as a fixed fee, utilised for all running expenditure. The remaining 80 per cent is utilised for paying claims. Lemonade does not benefit from the underwriting profits. If the full 80 per cent is not used to pay claims, the remaining unclaimed premiums amount is used for social good by means of "Giveback". Giveback is a charity component of the business model that is also an attempt to mitigate fraudulent insurance claims. Upon signing up for Lemonade, policyholders select a non-profit organisation or charity that will receive a pay-out on an annual basis from the unclaimed premiums or underwriting profit.

Lemonade underwrites its own policies and is reinsured at Lloyd's of London for approximately 20 per cent of the premium income.

How did the company fare at inception?

Within the first 48 hours of launching in New York in 2016, Lemonade reported that 36,000 people visited their site, of which 140 purchased policies equating to \$14,300 in gross written premiums. By June 2017, 14,315 customers had signed up for a Lemonade insurance policy, the majority of whom were first-time insurance buyers.

The following activities are proposed for project development:

- **Demand-side research** to understand blockages and impediments to take-up and usage of insurance, which may relate to, amongst other factors, product suitability, distribution channels and overall affordability.
- Develop **minimum product standards for a simplified product** that meets the needs of low-income South Africans and can be provided under the new Insurance Act's microinsurance framework. This product should

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inform FSC targets and be supported by consumer protection measures like standardised point-of-sale disclosure documents.⁹⁵

Priority 7: Increase the financial inclusion impact of social grant distribution

About 30 per cent of adults in South Africa receive a social grant, as compared to an average of less than 5 per cent globally. This high percentage and the resultant role that social grants play in society's economic life must be leveraged. While it is paramount that the social grants improve the lives of the recipients, it is also crucial that they are managed in such a way that the beneficial effect to society as a whole is optimised, both in terms of the grants made and used, and the way in which they are paid (i.e. the distribution channel). The restricted use of bank accounts previously used, required that funds be withdrawn within three months of their receipt. For those that are transferred out to other accounts, the funds are nonetheless usually withdrawn in full immediately.

At present the scheme distributes over R10 billion per month via more than 17 million grants to more than 12 million people. The *Banking the Poor via G2P Payments* report from CGAP estimates that 170 million people receive regular G2P⁹⁶ payments globally. Even accounting for the intervening years, this makes the South African grant distribution scheme probably the largest in the world by a sizeable margin. The size of the scheme makes it imperative that maximum and lasting benefit is derived from it. As mentioned earlier, the use of a bank account in the current scheme to simply withdraw the full amount of the grant the moment it is available does not constitute meaningful financial inclusion, nor does it actually benefit the recipient.

The social grants network provides an opportunity for Government to optimally use both the payment and national identification infrastructure, thereby advancing financial inclusion. Optimal use will allow for the provision of other appropriate financial services to this market in an effective and responsible manner, as well as the extension of the payments infrastructure to the benefit of both grant recipients and other users of the payment services.

95 Key information documents prepared by the Financial Services Conduct Authority are currently undergoing consumer testing for effectiveness ahead of implementation.

96 Government-to-person (G2P) payments include social transfers as well as wage and pension payments. With appropriate experimentation, these payments have the potential to become a vehicle for extending financial inclusion and improving the welfare of poor people.

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Box 13: Principles for the distribution of social grants⁹⁷

- A recipient should receive the grant in a dignified and convenient manner.
- A recipient should be able to use the grant for their benefit or that of their family.
- A recipient should receive appropriate financial consumer protection.
- Full use should be made of the existing national infrastructure, both from an informational and payment perspective:
 - The Department of Home Affairs (DoH) has the mandate for identity management in the country, including the life status of all South African residents. Information of this kind can be used to assess applications and oversee grant distributions. Physical verification should therefore align with existing capabilities.
 - The South African National Payment System has enabled a nationwide set of interoperable payment capabilities that can be leveraged to drive down per-transaction costs (resulting from high volumes).
- Cost of distribution and the potential incidence of fraud must be minimised. In particular:
 - Life stage identification should be linked to the DoH repository for each distribution.
 - There should be no duplicate identity payment created.

The following activities are proposed for project development:

- Support the Department of Social Development to **explore a long-term and sustainable solution for grant payments in support of financial inclusion**. In doing so, conduct research to consider the appropriate role of banks (state and commercial), other payment service providers and transactional accounts in the payment distribution chain, in order to:
 - **Utilise existing infrastructure as far as possible**, particularly that which relates to payments and identification;
 - Encourage the **extension of that infrastructure for the benefit of all**;
 - Take a systemic approach to grant distribution and encourage the **development of beneficial ecosystems**, particularly around the distribution aspect of the process, and small enterprises within communities where grant recipients reside; and
 - Enable access to, and use of, **appropriate other financial services** in a fair and competitive environment.

Priority 8: Improve efficiencies in the on-boarding of financial services clients

The effect of the FICA has been touted by financial services providers as a major hindrance to efficiently on-boarding clients, particularly in the low-income segments where the required documentation may not be easily available. Similarly, potential clients viewed the requirements of FICA as onerous and it was offered as one reason for not acquiring formal financial services. In many financial institutions, a client may be subjected to multiple FICA processes for different products that are taken up. This is not a regulatory requirement, but rather the result of customer-unfriendly internal processes.

National Treasury challenges “accountable” institutions to ensure that any new systems they put in place should not expose the customer to higher costs, because of duplication in verification and other processes. Besides the improved systems that will be required of financial and other accountable institutions, the potential utilities that can provide centralised access to information for verification purposes in a safe and secure way could make compliance with the new requirements more efficient and reliable. As “single-view” imaging of financial customers is prioritised from resolution, stability and consumer protection perspectives, it seems timely that a solution is developed that concurrently deals with challenges relating to legacy systems that cannot offer a consolidated customer view on a dynamic basis.

97 Social protection payment delivery mechanisms, inter-agency social assessment protection, <https://ispatools.org/>

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The following activities are proposed for project development:

- Explore the impediments to **client validation services and establish a centralised client information** validation service. This system will explore the use of the national identity system (Department of Home Affairs) and consider a customer's ID as their unique identifier in the payment system to reduce the potential for fraud and to support other consumer protection measures like switching across product suppliers;
- Explore the potential to **synchronise FICA and RICA requirements**; and
- Financial institutions should be required under the new market conduct framework to **develop a single validation process within the organisation** to further reduce duplication. This should be aligned to the "single-customer" view processes underway, and its resulting system development.

Pillar Two – Extending access to financial services for SMMEs

Of the estimated 2.2 million SMMEs in South Africa, about 700,000 are considered formal and 1.5 million as informal. Of the total SMMEs, 34 per cent are black-owned and 7 per cent are operated by those earning less than R30,000 per year. They include individuals who have identified a business opportunity as well as those conducting some sort of business because of necessity, and for whom no alternative sources of income are available. Two out of three small business owners run their own enterprises and do not have any employees, while 32 per cent provide between one and 10 jobs. Rural areas generally have a higher proportion of informal SMMEs due to a high number of hawkers and informal traders. While growth in the number of SMMEs over the 2010 to 2015 period was substantially lower than economic growth, the contribution by these SMMEs towards South Africa's gross value-added (which is equal to GDP before taxes and subsidies) increased from 18 per cent to 22 per cent.⁹⁸

But South African entrepreneurs are struggling. An estimated 40 per cent of new business ventures fail in their first year, 60 per cent by the second year and 90 per cent within the first 10 years of existence.⁹⁹ In recent research, entrepreneurial intentions are shown to have dropped by one-third since 2013 and have halved since 2010.¹⁰⁰ The regional average is four times higher than South Africa's. The rate of established SMME ownership among adult South Africans is low at only 2.6 per cent, a decline of 26 per cent since 2015 and the lowest rate recorded since 2011.¹⁰¹ South Africa performed especially poorly in this indicator across all participating economies, ranking 61st of 65 economies. The regional average for SMME ownership is almost five times higher. Global Competitive Report rankings for 2016/17 show South Africa is slowly improving overall (it climbed two places to 47th position out 138 countries).¹⁰²

SMMEs are not homogenous and thus do not all have the same financial service needs. Entry-level enterprises typically consist of informal sole proprietor operations where there is no distinction between business and personal financial needs (the so-called "survivalist" enterprises). These micro enterprises usually lack formality in terms of registration and include "spaza" shops, minibus taxis and household industries. They typically employ no more than five people and the business turnover is less than the VAT registration limit. The predominant financial services need for these micro enterprises is for short-

98 Figures from this paragraph are derived from the Small, Medium and Micro Enterprise Sector of South Africa, Research Note 2016 No 1, commissioned by SEDA.

99 The DTI's annual review of small business in South Africa 2005-2007, which cites Radipere & Van Scheers, 2005.

100 These statistics relating to the state of entrepreneurship in South Africa are by Global Entrepreneurship Monitor (GEM) South Africa Report for 2015/16.

101 The GEM determines the established business ownership rate as a percentage of the adult population between the ages of 18 and 64 who are currently an owner-manager of an established business. The latter means owning and managing a functional business that has paid salaries, wages, or any other payments to the owners for more than 42 months.

102 Indicators here include: Public trust in politicians (88 in 2013/2014 to 109 in 2016/17), irregular payments and bribes (47 to 53), and favoritism in the decisions of government officials (110 to 115).

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term access to working capital and access to payment services. An SMME that is not formalised is not bankable. As a result, informal enterprises must rely on the business owner's bankability and finance worthiness rather than the business's. Formal SMMEs are more structured and better resourced, with more sophisticated financial needs that are determined by their scope of operations. Across the spectrum of SMMEs exist different permutations of arrangements relating to institutional form, tax status, size as relates to income and number of employees and ownership. In developing a work programme for the priorities identified, it will be necessary to take these differences and the heterogeneity of SMMEs into account – different solutions will be required for different types of SMMEs. This reveals an inherent challenge in developing financial products and services for the SMME market, which is to cater for unique business needs on the one hand while still obtaining sufficient economies of scale for the product providers on the other.

The core financial services needed by SMMEs are:

- Access to funding;
- A basic bank account as a store-of-value;
- Appropriate payment services, both to receive and make payments; and
- Appropriate insurance products to mitigate risks pertaining to the enterprise.

Of these, both access to funding and credit are considered the most poorly served and the highest priority. Credit is critical to establish and grow a business, and relying on personal credit lines (linked to a personal transactional account) is generally not recommended: it commingles consumer and commercial credit, making one type of credit indistinguishable from the other; risks violations of company law and accounting standards, which require the separation of the personal income, financing and expenses of business owners from the commercial income, financing and expenses of the business enterprise; reduces your ability to borrow in support of your personal life, e.g. to finance a house; affects your credit profile, which is risky for a start-up or early-stages business; products may not be suitable as they are designed with a different purpose and need in mind; it is more challenging to keep strong financial records to build up a credit history; and it distorts needed commercial bookkeeping and accounting standards with personal information. There is an additional risk that SMME loans may further amplify personal indebtedness, especially given South Africa's weak insolvency framework.¹⁰³

The IMF recommended the following activities to improve financial inclusion in relation to SMMEs:

- Exploit credit information technology; and
- Develop a separate framework for "Tier II" banks that service SMMEs.

In looking at improving access to funding specifically, the Global Entrepreneurship Monitor (GEM) South Africa report for 2015/2016 makes the following recommendations:

- Strengthen seed funding for market research, product development and proof of concept, especially through increased state support for research and coordination. For example, this can be done through collaborative funding models between commercial banks and DFIs (recognising that commercial banks may not feel comfortable in their assessment of SMME risk, may have a risk threshold above other formal businesses, and are not necessarily geared to provide technical support to these SMMEs).
- Focus on micro-funding models, to combine with training and mentoring especially through the first year of operation. This could also be used to improve access to funding for youth businesses.
- Consider expanding subsidies and other grants to all entrepreneurs and not just black entrepreneurs, given the social benefits that result from the growth of the SMME sector.

¹⁰³ The Insolvency Act of 1936 requires significant modernisation, a process being led by the Department of Justice and Constitutional Development.

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- Improve transparency and good governance practices in DFIs.
- Improve the turnaround time for loan approvals.
- Strengthen incentives for lending to SMMEs below a certain threshold, e.g. tax benefits to “angel investors”.
- Simplify the legal and regulatory framework for SMMEs, including BEE and labour law requirements.
- Explore alternative support mechanisms like establishing a database of funders and replicating initiatives like the Western Cape Funding Fair.¹⁰⁴
- Encourage the private sector to develop additional credit products for SMMEs, which are profitable and sustainable on their own, without the need for Government or development bank subsidies or guarantees.

It is unlikely that the level of funding for SMMEs will improve without considering other factors crucial to ensuring their success and sustainability, including market access, business and management skills, and financial education. This is a point that has been largely communicated by South Africa’s banking sector, and it implies that a package of broader developmental support should be considered, especially to support the formalisation of informal SMMEs.

Looking past an SMME’s funding needs, improved payment services facilitate the ready transaction capability of “sales” and are therefore also a high priority. A final challenge relates to transactional accounts as a store of value. While start-ups tend to rely on the owner’s bank account when setting up, combining personal and business accounts brings risks to the SMME owner, especially for budget and cash-flow management. Moreover, the payment services suitable for SMMEs are likely different from those for personal use. Although insurance is a secondary need that can generally follow once the business is operational, the anticipated review of the FSC in support of transformation presents an opportunity to raise SMME insurance to the agenda. These dynamics inform the four policy priorities under this pillar. As with Pillar One, project proposals are made in support of each priority:

- Priority 9: Improve access to credit by building credit infrastructure for small businesses.
- Priority 10: Broaden the range of financing instruments that are available for SMMEs.
- Priority 11: Improve the use of transaction accounts and payment services by SMMEs.
- Priority 12: Develop suitable insurance for SMMEs.

Interventions should consider SMMEs of different sizes, geographical footprint and stages of business development and growth, as these have differing financial service needs. Where steps are taken to increase product availability and usage, this should be done within the consumer protection framework provided by the Financial Sector Regulation Act (FSR Act), existing financial sector laws and the impending Conduct of Financial Institutions Act.

An SMME development policy, based on current realities and objectives, is crucial to the growth of the sector. This is not a financial inclusion matter *per se*, but National Treasury should play a major role in the development of such a policy and assist the Department of Small Business Development in this regard. Not only will such a policy give purpose to inter-governmental cooperation in the SMME space, it will also inform Government and private sector engagement on the matter. From a financial services perspective, it is essential that the role of the state and the private sector is addressed in the policy and that the approach to the informal-formal “divide” is dealt with, to the extent that the provision of financial services can be undertaken

¹⁰⁴ This is a partnership between Deloitte and the Western Cape Department of Economic Development and Tourism (DEDAT). It facilitates face-to-face contact between project promoters, entrepreneurs and other funding institutions within the region, seeking to educate and empower the former two to turn ideas into bankable business plans and provide funders with single-point access to projects seeking finance. Expert workshops, presentations and an exhibition support knowledge-sharing and the transfer of skills.

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with greater certainty. In the South African context, it is unrealistic to expect that enterprises will simply move from informal to formal. At the same time, financial service provisioning requires that the entity being served is clearly identifiable. However, this can be achieved in different ways along a “path to formality”, not only through a single step.

Priority 9: Improve access to credit by building credit infrastructure¹⁰⁵ for small businesses

A lack of access to appropriate credit products is a major inhibitor of SMME development. A recent study by FinMark Trust confirmed that access to formal credit by SMMEs constituted as sole proprietorships has a positive relationship with firm size as measured by the number of employees.¹⁰⁶ Yet GEM has found that for the past 15 years almost 60 per cent of experts surveyed identified access to finance as a constraint,¹⁰⁷ especially for those wanting to start a business or a business that is in its early stages of existence. Financial institutions generally require property or securities as collateral in addition to formal business records, which many SMMEs do not have. Entrepreneurs tend to raise the start-up capital from their own or family savings rather than approaching formal institutions or agencies. This means that young South Africans, women and people in rural areas are likely to be particularly disadvantaged in their attempts to start small businesses.

The main reasons for the lack of formal finance products that are available to SMMEs include absence of readily available credit information, the perceived riskiness of SMME finance, high costs of administration, inadequate record-keeping by SMMEs, and a lack of appropriate assets available to SMMEs to serve as collateral.¹⁰⁸ These issues reduce the availability and increase the cost of credit for SMMEs. These inefficiencies in the SMME credit market have a direct bearing on the sustainability and growth of SMMEs.

In trying to address SMME access to responsible financing and assist in the development of this market, Government has created development financial institutions (DFIs¹⁰⁹) at national and provincial level as well as other support agencies, such as the Small Enterprises Finance Agency (SEFA), the Small Enterprise Development Agency (SEDA), the National Empowerment Fund (NEF), the National Youth Development Agency and the Gauteng Enterprise Propeller. These DFIs and agencies offer products and services that include wholesale and retail financing, credit guarantees and other ancillary services, such as business development services and the implementation of special sector schemes for specific industries, for example small agricultural development. The funding agencies have seen some success. Over the five-year-period from 2013 to 2017 SEFA financed 241,537 businesses through disbursements valued at R4.3 billion.¹¹⁰ Nearly 56,000 jobs were facilitated in 2017. The NEF in 2016 dispersed R819 million to support 4,938 job opportunities.¹¹¹ However, the problem of inadequate infrastructure, the lack of appropriate skills, governance challenges and operational inefficiencies have to date limited the impact of these DFIs and agencies on the development of SMMEs.

In order for the formal credit market to be made more accessible to SMMEs, it is necessary to address the structural issues in the market. Viable SMMEs must be able to access credit priced according to their specific risk profile. By further developing

¹⁰⁵ Credit infrastructure is the set of laws and institutions that enables efficient and effective access to finance, financial stability, and socially responsible economic growth through credit reporting, secured transactions and collateral registries; and insolvency and debt resolution, <https://www.worldbank.org/en/topic/creditinfrastructure>

¹⁰⁶ Financial Access and SME Size in South Africa, FinMark Trust, 2016.

¹⁰⁷ Access to finance is identified as a constraint alongside government policies on education and training – see Pillar Three to follow.

¹⁰⁸ South Africa Country Report No. 17/189, ARTICLE IV, IMF, 2017

¹⁰⁹ A development finance institution is an alternative financial institution aimed at capacitating the market and includes microfinance institutions and community development financial institutions.

¹¹⁰ SEFA annual report, 2017.

¹¹¹ NEF annual report, 2016.

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financial infrastructure to support the provision of credit to SMMEs, credit providers will be in a better position to advance credit to viable enterprises at risk-appropriate prices if there is improved credit information, structured risk-sharing and risk-reduction mechanisms. Acknowledging that many SMMEs and especially informal providers blur the line between the business and the individual, alternative lending models should be developed to support personal lending for business purposes. Over time these businesses can become more “business” focused.

Improving access to appropriate finance products is not a silver bullet to maximise the growth in this sector in general, but it is a key enabler for many SMMEs to realise their potential growth.

Credit information sharing. Credit information services for retail clients are well-established and highly developed in South Africa. The corporate sector, including larger micro, small and medium-sized manufacturing enterprise, is also well-served through a range of credit and risk assessment tools. In both cases, albeit on very different scales and levels of complexity, credit assessment is a well-informed and efficient process, generally leading to rational credit decisions and appropriately priced credit. This is not the case for SMMEs, as there is a dearth of readily available information on which to base credit decisions. This requires potential credit providers to obtain information from enterprises seeking access to credit in each instance, leading to significant costs to simply gather information on which to base credit decisions. This leads to a reluctance to engage this market and an increase in the cost of credit where such engagements do happen. A sound, efficient and easily accessible credit information infrastructure will assist in responsible credit provisioning. Government will focus on expanding and strengthening this infrastructure, with specific focus on improving SMME access to finance.

PCG schemes. In South Africa, as is the case globally, SMMEs have a high rate of business mortality in their infancy. Over and above the lack of credit information discussed above, this high failure rate, coupled with the prudential burden placed on the main credit providers through adherence to the international banking regulatory accord Basel III, results in the main credit providers being very cautious in extending credit to the SMME market. While this has a positive impact on the stability and international reputation of South Africa’s financial sector, it has severe negative implications for the state’s ability to support and grow the SMME sector. This situation is a very good example of where a balanced I-SIP approach, rather than a focus on stability only, is the preferred option.

To start addressing the issue of reducing the risk of enterprise failure, particularly but not exclusively related to start-ups, many countries have introduced the concept of risk-sharing through PCG schemes. In such a scheme the risk of default is shared between the credit provider and the provider of the credit guarantee, typically the state. This does not take the form of a guarantee for the full default amount, but rather an agreed portion of the default amount.¹¹² If the scheme works well, it has the effect of reducing the expected cost of default on a loan for the lender, thereby changing the credit provider’s overall credit assessment. This in turn reduces the cost of credit for viable SMMEs and increases the amount of funding that is made available to those enterprises. Such schemes played a significantly beneficial role in south-east Asian countries after the global financial crises. Evidence suggests that the overall outcome of the schemes played a role in maintaining the healthy GDP growth rates in that region, despite the global slow-down (see Box 14).

112 To further decrease the risk of irresponsible lending practices due to the reduction in risk to the credit provider, further conditions could be imposed on the scheme.

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Box 14: Loan guarantee schemes for SMMEs – Malaysia

The Credit Guarantee Corporation (CGC) in Malaysia was established in 1972 as a result of the unavailability of funding for SMMEs by formal institutions. Many small firms had to resort to non-institutional sources of finance whose cost of funding was exorbitant. This situation still prevailed in the 1980s, despite the efforts of the CGC and other government bodies to promote SMME financing. The CGC was subsequently restructured and strengthened. The CGC primarily facilitates SMME access to financing through its guarantee schemes. Initially it provided guarantee cover for credit facilities extended to SMMEs in three broad sectors: general business (including, wholesale and retail outlets, small-scale construction firms and hawkers and petty traders), agriculture and manufacturing. As the Malaysian economy expanded and diversified over the years, the demand for CGC's guarantee services also grew and this led CGC to expand its range of products and services to cater for larger credit facilities required by medium-sized SMMEs.

Today, the CGC's support for SMMEs is not only confined to the provision of loan guarantee and financing facilities but also advisory services such as financial and business development, credit information and credit rating services in collaboration with SMME Corp and Credit Bureau Malaysia.

In recent years, CGC has forged strategic alliances with fellow banking partners to offer innovative financing options and delivery channels that are cost-effective and efficient to enhance SMME access to financing.

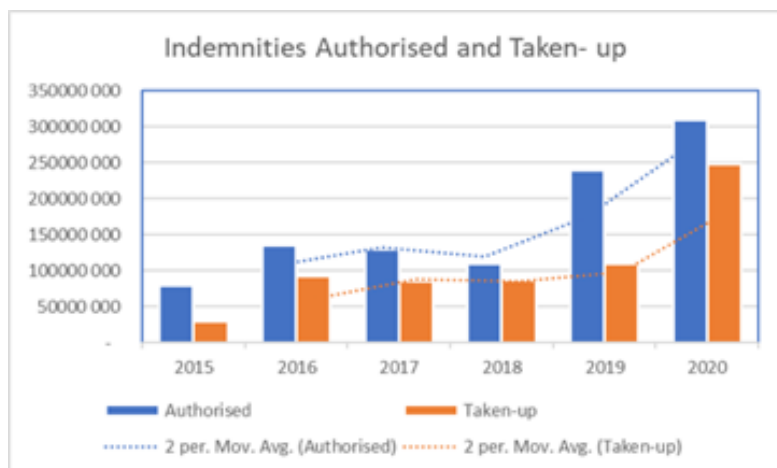
- The current shareholders of CGC are Bank Negara Malaysia (the Central Bank of Malaysia) and commercial banks licensed in Malaysia.
- CGC has assisted SMMEs by providing guarantees to over 445,217 financing facilities to SMMEs valued over RM63.7 billion since its establishment.

The uptake of SEFA's Khula Credit Guarantee product by commercial lenders has been increasing steadily, as is evidenced in Figure 12. Currently the scheme supports loans totalling about R250 million. Some of the reasons cited for this improved performance includes a diagnostic assessment of the scheme that was undertaken by The World Bank in 2015, where it recommended a major re-engineering of Khula's institutional structure, regulatory status, business model, product offering, guarantee approval process, claim pay-out, and monitoring and reporting. Since then SEFA has managed to implement some of the recommendations from the assessment.

The high failure rate of SMMEs has a significant adverse effect on the ability of viable enterprises in this category to access start-up funding. It may be worthwhile to explore mechanisms by which viable start-ups can be distinguished from riskier ones. This has been explored in a few countries, notably Italy. If such a distinction is possible, it will reduce the risk of moral hazard.¹¹³

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Figure 12: Usage of SEFA Credit Guarantee Scheme



Source: SEFA, 2020

Asset-based finance. SMMEs often encounter difficulties in securing credit from formal credit providers due to not having adequate assets to offer as surety. These difficulties arise partially from most formal credit providers accepting only fixed assets as appropriate collateral for loans. However, SMME capital in South Africa is mostly in the form of movable assets such as livestock, inventory, raw material and equipment. It is often necessary for the owner of the business to raise the required loan capital in their private capacity, which is undesirable. By way of an alternative, asset-based funding is obtained by an SMME based on the value of its available assets, including accounts receivables, inventory, machinery, equipment and real estate, rather than on its own credit standing. These are known as “movable assets”. Accepting movable assets as collateral gives much more flexibility to SMMEs, serving the needs of young and small firms that have difficulties in accessing traditional lending. Many SMMEs in OECD countries, and increasingly in emerging economies, use asset-based finance for working capital, supporting domestic and international trade and investment purposes. (Despite the global financial crisis, in Europe asset-based lending is approximately equal to that delivered by traditional banks.)

Secured transactions ¹¹⁴ laws and registries support asset-based finance by providing:

- Greater flexibility in the loan transaction and the property that can be used as collateral;
- Greater uniformity in the registry system and notice provided to third parties;
- More certainty and transparency about the priority of creditors (including insolvency proceedings) and rights of third parties; and
- Greater agility in the enforcement of a security interest in the case of default.

By operating electronically, a modern collateral registry system is accessible to all users, including lenders, borrowers and third parties.

Modernised secured transactions systems have been shown to increase the credit capital available in a local economy, creating a virtuous legal and economic environment through the existence of increased legal certainty and reducing the risk

¹¹⁴ A diagnostic on secured transactions that was undertaken by the World Bank on behalf of National Treasury is published as a supporting document to this policy. It should be seen as an input supporting the policy debate, and unless specified as such, the recommendations of the report (which go wider than financial inclusion), should not be assumed to be the recommendations of this policy.

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of a loan and the cost of credit. This in turn facilitates greater access to finance and increased competitiveness among local financial institutions. Countries with positive experiences in this regard include China, Mexico, Ghana and Columbia.¹¹⁵

However, credit providers in South Africa generally do not accept movable assets as collateral as these cannot easily be attached should the debtor default. It is problematic for the lenders to ascertain whether the same asset has already been used as collateral by the applicant with another credit provider, which makes it difficult to execute a legal claim on such assets. A diagnostic conducted by the World Bank on behalf of National Treasury into secured transactions collateral registries found that existing security options – including pledges, notarial bonds, cessions, hire purchase agreements and retentions of title – do not provide sufficient legal certainty or an economic or operational framework for lending against movable assets. This can cause disagreements and uncertainty with respect to the way notice is provided to third parties and the way creditor priorities are determined. Registry and enforcement frameworks are reported as being complex and outdated in various respects, adding time and costs to operations.

The diagnostic makes the following recommendations:

- Reform the law related to secured transactions, to introduce a modern, simplified legal framework governing security interests in movable property¹¹⁶;
- Create a registry for security interests in movable assets;
- Raise awareness amongst lenders and borrowers of the opportunities created and how to take advantage of reform; and
- Monitor and evaluate the results and impact of the reform project over time, especially to identify those SMME segments that the movable asset register supports best versus those that are not as well supported.

The law reform and establishment of a movable asset register may facilitate SMMEs to put up these assets as traceable and legitimate forms of collateral, without having to rely on any fixed private assets of the business owner. This could in turn lower the risk of lending to these SMMEs, increasing access and reducing the cost of credit. However, the wide reach of the recommendations is recognised to go considerably beyond the scope of financial inclusion for SMMEs, and reform may need to be narrowed to focus on this aspect, at least as a first step.

Technical support for SMME entrepreneurs, including building business knowledge and financial literacy. While not part of the credit infrastructure *per se*, the level of business and financial knowledge of business owners is fundamental to ensuring sustainable SMMEs, thereby increasing the likelihood that an SMME borrower can pay back its loan, in turn substantively reducing its credit risk. Conversely, improvements to the credit infrastructure in isolation will assist credit providers in more accurate risk assessments on the one hand, and provide opportunities to better share the risk of default on the other (through risk-sharing schemes or extending asset classes that can be used as collateral). However, it does not actually bring down the risk of default. To reduce the risk of business failure, and therefore better leverage the credit infrastructure available, there is a need to focus on building technical expertise within SMMEs. In recognition of this, Government established the SEDA, which provides a range of business support services to SMMEs. Some financial institutions are creating support platforms for prospective SMME business owners that look to build skills and financial literacy and may even explore how to support market access challenges.

115 The World Bank diagnostic of STC registries describes case studies of Columbia, Mexico, Ghana and China.

116 The diagnostic advises further that the law be tailored to the local legal system taking into account international best practices and standards developed by UNCITRAL.

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The following activities are proposed for project development:

- **Improve credit information sharing for the SMME credit market**, by including payments data in the shared information available to credit information services and credit providers. All service providers should be able to use this information to enable credit providers to assess the financial situation of all types of SMMEs.
- Take steps to **improve the effectiveness and take-up of support provided by the SEFA credit guarantee scheme**. Perform an assessment of what is functioning well and what is not in the current system and to what extent the scheme meets the needs of the SMME credit market. The study, *Diagnostic Assessment of the Khula Credit Guarantee Scheme*, undertaken by the World Bank and the subsequent proposed business plan for this scheme should form the basis for this intervention.
- **Reform secured transactions law pertaining to SMMEs**, especially security interest in movable assets.
- **Build business knowledge and financial literacy of SMMEs** by improving synergies between SEDA and lending institutions and promoting the financial education of entrepreneurs (through South Africa's financial education policy).

Priority 10: Broaden the range of financing instruments available to SMMEs

Bank lending remains the most common source of financing for SMMEs and entrepreneurs. However, despite the envisaged efforts to support improved credit extension (Priority 9), it may ultimately not meet the full demand that exist. Also, capital gaps will likely remain for transitioning enterprises, like those undergoing ownership and control changes, and those looking to deleverage and improve their capital structures.¹¹⁷ Indeed, the high degree of leverage observed in SMMEs may in itself be a contributing factor towards their weak success rates. The "New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Instruments" study conducted by the OECD in 2015 considers a wider range of financing instruments for SMMEs and entrepreneurs, to bring in a much stronger role for the capital markets, including:

- Alternative forms of debt like corporate bonds, debt securitisation and covered bonds;
- Equity finance for companies looking for long-term corporate investment, which is relevant for companies that have a high risk-return profile, such as new, innovative and high growth firms; and
- Hybrid instruments, which combine debt and equity features into a single financing vehicle, suitable for firms that are already highly geared but do not want to necessarily dilute their ownership.

Private equity investments are also considered to include venture capital funds and business angels, as well as crowdfunding. They differ from the other instruments insofar as they finance a specific project rather than the enterprise as a whole. Of these, to date only venture capital placements have been promoted by Government, through a tax incentive scheme.

These interventions will be particularly sensitive to the stage of an SMME's development, as well as its size and degree of business capability.

The following activities are proposed for project development:

- **Investigate the potential for capital markets in financing SMMEs** in South Africa, to propose specific instruments that, in particular, meet financing their needs at different stages of the business development cycle; and
- **Evaluate the venture capital tax scheme** for effectiveness and make recommendations for improvements that could increase its take-up and reach.

117 New approaches to SME and entrepreneurship financing: Broadening the range of instruments, OECD, 2015.

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Priority 11: Use of transaction accounts and payment services by SMMEs

By and large SMMEs have the choice of a basic bank account often at reasonably attractive costs. Most formal SMMEs have a bank account, but micro and other informal businesses often rely on the personal account of their owner. The relatively low level of uptake is as much an issue of the banks' inadequate focus on this market as it is of enterprise owners using their personal accounts to effect business transactions. This issue needs to be addressed through ongoing financial capability improvements in the sector.

The take-up and use of accounts for an enterprise will be enhanced if appropriately priced and easy-to-use payment services are made available. These services need to include the ability of the enterprise to both make and receive payments. Receiving payments for low-value traders should get special attention if South Africa is to reduce its reliance on cash in the informal markets. Access to mobile services is well-established among SMMEs, and the utilisation of enhanced mobile payment capabilities should directly assist the efficiency of such enterprises, as illustrated by the example of a new point of sale (POS) in South Africa in Box 15.

Box 15: A new point of sale device and app¹¹⁸

A new device which offers a secure cloud-based solution that backs up continuously and syncs automatically across all your devices, enabling off-site store management, has recently been launched in South Africa. It is designed to enable payments to be made and received more easily, including by working offline, using shortcuts to speed up check-out. It provides for a user-friendly payment experience for customers by enabling easy refunding and discount options and interfacing with other payment apps. The support team is said to be available 11 hours of the day and support is proactive, i.e. support contacts you when a possible problem is detected.

This app has been designed to support small and emerging enterprises with tools to enhance their business. In addition to its standard POS offering, an extended package allows businesses to also organise stock, ring up sales, do cash-ups, recons and monitor their sales performance in real time.

The example of Anzole farming in Box 16 highlights the benefit of related value-added services to payments, and the potential benefit of aggregating businesses to leverage economies of scale.

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Box 16: Payment solutions make payments easier for SMMEs¹¹⁹

Anzole Farming, a group of small businesses run from Tzaneen in Limpopo, South Africa, has streamlined its payments, accounting and payroll processes by replacing its old business system with an innovative payment solution. The tight integration between this solution's payment portal, accounting services and its payroll services has enabled Anzole Farming to reduce its costs while improving efficiency.

Before the implementation of the solution for the group, paying creditors meant printing out the creditors list from the bank, searching for each account in the banking app, and then re-entering each amount to be paid. Not only was this time consuming, but it also left room for error. Now, they can export payments from the solution's accounting module and its payroll service to pay creditors and employees.

The following activity is proposed for project development:

- **Extend mobile payments capabilities** to take explicit account of the needs of SMMEs to make, receive and track payments. The capabilities should also **allow for the use of payment information as part of credit information** on which to base credit assessments.

Priority 12: Suitable insurance for SMMEs

FinScope SBS 2010 identified the main sources of risks to SMMEs, in order of importance, as flood, fire or natural disasters, illness or death of owner, and theft. Yet according to FinScope 2016, 23 per cent of individuals whose main source of income is from SMMEs have no form of insurance. The most prominent response for not having insurance is affordability, followed by uncertainty over the value of having an insurance cover – respondents felt that they do not believe in insurance. These reasons point to areas where industry can alter current approaches.

Products currently offered might be incorporating benefits that do not meet the needs of the SMME market. A mismatch in a product offering and its needs may inflate prices and drive unaffordability further.

The fact that respondents said they do not have insurance cover because they do not see its benefit points to poor or lacking consumer education in the market and, to an extent, poor product design. Insurance policies are used to hedging against the risk of financial losses, both big and small, that may result from damage to the insured or their property, or from liability for damage or injury caused to a third party. If SMMEs feel that products offer little value, an investment or savings component added to the insurance's core offering might change consumer's perspective and increase penetration rates.

From a supplier perspective, problems with selling insurance may relate to a lack of information about what products are needed to meet the observed risks identified, combined with heterogeneity of the market that makes selling a generic low-cost product challenging.

Given the importance of land ownership and food security in South Africa, National Treasury has also been working with the International Finance Corporation, a member of the World Bank Group, to explore the case for weather index insurance for smallholder farmers in South Africa. Box 17 reflects on the rationale for and potential benefits of weather index insurance applied across Africa.

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Box 17: Evidence of weather index insurance in Africa¹²⁰

Weather index insurance refers to a contract between an insurer and a farmer where compensation is paid if an observable and public index falls below a predetermined threshold, which could for example be linked to rainfall or regional production. It can help rural households mitigate the risk that they will lose income from a poor crop due to extreme weather events – like drought, flood, tidal waves and hurricanes – increasing due to global climatic changes. For example, in a household survey conducted by Giné, Menand and Townsend in Andhra Pradesh, India, 89 per cent of surveyed rural landowners cite drought as the most important single risk faced by the household. Closer to home, Malawi is a very rural country, with over 80 per cent of its people engaged in farming, and primarily smallholders cultivating areas of 1 ha or less. The main crops are maize, tobacco and groundnut, with over 90 per cent of crop production rain-fed, taking place during a single rainy season lasting from December to April.¹²¹

Weather shocks tend to affect all households in a local region, meaning that seeking help from nearby family, friends and neighbours is relatively less effective. Also, the risk of drought is a major productivity constraint, since even in good years farmers are wary of using inputs such as improved seeds and fertilisers for fear of losing their investment. Weather index insurance is being implemented worldwide for low-income farmers.

Recent drought in parts of Africa has triggered the largest insurance pay-out to date for vulnerable farmers, under an innovative climate risk management scheme known as the R4 Rural Resilience Initiative (R4). Farmers participating in R4, launched by the United Nations World Food Programme and Oxfam America in 2011, will receive insurance payments totalling \$1.5 million to compensate for weather-related crop losses in Ethiopia, Kenya, Malawi, Senegal and Zambia.

The pay-out enables nearly 30,000 farming households to cover immediate needs including the purchase of food and payment of children's school fees. Many smallholders also invest a portion of the pay-out in seeds or fertilisers, or in starting small-scale family businesses.

Insurance payments in the R4 programme are based on an index of rainfall, vegetation or yield estimates determining the extent of the loss incurred by participating farmers.

R4 combines four inter-linked risk strategies: improved natural resource management (risk reduction), insurance (risk transfer), the promotion of investment including better access to micro-credit (prudent risk-taking) and savings (risk reserves). The initiative reaches over 57,000 farmers in Africa who are vulnerable to climate risk.

120 Sarris, Karfakis and Christiaensen, 2006 FAO Commodity And Trade Policy Research Working Paper No. 18, "Producer demand and welfare benefits of rainfall insurance in Tanzania"; World Food Programme <http://www1.wfp.org/r4-rural-resilience-initiative>; Giné (World Bank), Menand (Federal Reserve Bank of New York), Townsend (MIT Economics Department) and Vickery (Federal Reserve Bank of New York), "Microinsurance: A Case Study of the Indian Rainfall Index Insurance Market."

121 Case Study, Drought Insurance in Malawi, https://www.fanrpan.org/archive/documents/d00255/3-Climate-risk_Africa_2007e.pdf;

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Since 2011, more than \$2.4 million has been distributed in pay-outs to R4 participants in Ethiopia, Senegal, Kenya, Zambia and Malawi as compensation for weather-related losses. The programme will be expanding to Zimbabwe this year.

However, demand for this insurance remains a challenge and take-up will not necessarily stimulate greater input usage and yields. A study of Ethiopian farmers in this regard found that improving access to credit alongside the insurance offering can assist.¹²²

The following activities are proposed for project development:

- **Conduct demand-side research** to understand micro, small and medium-sized enterprise needs and use the findings to develop minimum product standards that can inform a review of the targets in the Financial Sector Code.
- **Explore the need and potential for specific agricultural insurance in South Africa**, including weather index insurance.

Pillar Three – Leverage a more diversified provider and distribution base

The high level of concentration in the provision of financial services is concerning not only from a market structure perspective, but also from a financial inclusion one. A competitive and market-focused financial services landscape has the potential to develop more appropriate products and services, lower costs-to-users and increase market penetration, thereby improving the levels and sustainability of financial inclusion.

A transformed financial sector that diversifies and strengthens the provider and distribution base for financial services will further support financial inclusion. The major bank and insurance groups currently dominating the sector have traditionally concentrated on the middle- and upper-income segments, as well as medium and large enterprises. Their level of complexity implies relatively high compliance requirements, technology investments and operational costs. These institutions may as a result not always be best placed to engage either the low-income or SMME markets, but through structures such as a cell captive arrangement in insurance may have the potential to serve this un- or under-served market (see Box 18).

122 2017, Ahmed (Food and Agriculture Organization of the United Nations, Italy), McIntosh (University of California, USA), Sarris (National and Kapodistrian University of Athens, Greece) "The impact of commercial rainfall index insurance: experimental evidence from Ethiopia"

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Box 18: Cell captives and financial inclusion

Cell captives, created by an agreement (a participation agreement or shareholder's participation agreement or SPA) between a cell owner (s) and a licensed cell captive insurer (known as the "promoter") are a unique South African construct that emerged in the early 1990s as a way for entrepreneurs or organisations with an insurance business concept to participate in the insurance market without obtaining an insurance licence of their own.

Under this arrangement, a cell captive account is created on the books of the "promoter" and a cell owner buys a special class of shares in the cell captive insurer to capitalise that cell. This ownership allows the cell owner rights that will be stipulated in the SPA, such as: drawing dividends on the proceeds of the cell, obtaining underwriting from the cell captive insurer and benefiting from other services provided by the "promoter".

The cell structure, as opposed to a pure distribution relationship, allows the cell owner the independence to tailor its product offering to suit their vision and customer-base needs, as well as the ability to innovate in an agile structure that sits outside of the corporate culture and legacy systems of "traditional" corporate insurers.

A cell captive can be arranged in terms of four different models, namely:

- **Model A: The cell owner as underwriting manager.** Under this model the cell owner also acts as the "promoter's" binder holder and an underwriting manager.
- **Model B: The cell as affinity.** Under this model the cell owner has an existing relationship with an identifiable customer base which is regarded as an "affinity group" and provides products for this market.
- **Model C: The cell owner as non-mandated intermediary.** Under this model, the cell owner has a specific distribution platform or IT solution and a value proposition and distribution model to market products to an identified market.
- **Model D: The silent partner cell owner.** Under this model the cell owner does not perform any services directly related to insurance provision under the cell structure, but rather just capitalises the cell and is responsible for ensuring its continued solvency.

The independence of the cell owner to tailor its product offering, the agility of a cell structure as well as the lean regulatory and capital requirements relative to traditional insurers mean that cell captives provide a good base to implement product and process innovations. These create value for clients and have the potential to serve the un-served, particularly in the low-income segment. For instance, those with pre-existing affinities can tailor-make products to better serve their customers because of the relationship they have already established. Those with specific distribution platforms or IT solutions can use these technology-based platforms to reduce distribution costs to the un- or under-served market.

In many developing countries, the SMME market is served by specialised financial service organisations, in particular deposit-takers and credit providers with otherwise limited service offerings. The reasons for this include their ability to structure their operational models and risk-mitigating structures specifically to this market. A number of international "franchise" organisations have emerged in this niche of the micro-finance market, which is also referred to as the micro-banking market. This enables lessons from other developed countries to be deployed correctly, as well as the sharing of technology investments, thereby further reducing the costs of such operations. In many instances, these organisations have been able to adapt to serve the

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low-income individual market, as the two markets (individual and SMME) are intertwined in the same communities. In short, the incumbent large financial institutions have struggled to meet the financial needs of lower-income and rural-based South Africans and SMMEs. This is evidenced, for example, by the persistent high cash preference for making payments, proliferation of legitimate and illegal micro-lenders, low insurance penetration rates (except for funerals and credit cover) and the lack of products that meet the needs of SMMEs. Many smaller and alternative financial institutions have moved into this space, with the potential to improve awareness and trust in financial services and, in the case of co-operatives and SMMEs, provide direct ownership and generate gains for members in the communities in which they operate.

These institutions currently fall into five broad categories:

- Financial co-operatives,¹²³ in which members, besides obtaining the financial services on offer, share in its ownership, management and, potentially, profits if services are offered to non-members, and provided that the main motive of the arrangement remains the benefit of members.
- Non-bank lenders i.e. Micro-finance institutions, or micro-lenders.
- Funeral parlours offering funeral insurance and services.
- Alternative financial institutions, being non-traditional providers of financial products and services that can operate in competition to traditional financial institutions like banks, insurers and asset managers. Often, the financial sector activity is not its core business, but rather has been deployed in support of it. Currently in South Africa the main alternative financial institutions are telecommunications companies and food retailers (for payment services), clothing retailers (for credit and insurance) and motor dealers (for asset insurance).
- Informal or semi-formal, member-based arrangements like stokvels,¹²⁴ friendly societies¹²⁵ and burial societies.¹²⁶

Steps should be taken to support the growth and development of these entities in a way which improves access and take-up of good-value financial services, improves consumer protection and supports wealth creation. Recognition is also given to the role of these and other entities acting as intermediaries, therefore significantly broadening the potential access points for South Africans to meet their financial service needs. Lastly, the rapid pace of technological developments in the provision of financial products and services – loosely termed “fintech” – is expected to increasingly bring in new players and new distribution channels in competition with traditional models.

The following therefore constitute the priorities for this pillar:

- Priority 13: Strengthen the financial co-operatives and developmental microfinance sector;
- Priority 14: Explore the role of the state in supporting sustainable financial inclusion;
- Priority 15: Enable a broad base of agents in the provision of financial services; and
- Priority 16: Leverage fintech disruptors to promote and support financial inclusion.

Priority 13: Strengthen the financial co-operatives and developmental micro-finance sector

Financial co-operatives provide a platform for communities to participate in the ownership and management of their own financial institutions. These institutions can be geared to their members' specific financial service needs. In the process they can support empowerment and development through offering a range of products like a low-cost, safe savings channel; the ability to make and receive payments in competition to large corporate banks; and the provision of productive credit to the community for home improvements, education and SMME financing. Currently South Africa has only deposit-taking co-operatives, provided for under the Co-operatives Banks Act and authorised as either a co-operative bank or co-operative

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financial institution (CFI).¹²⁷ From a financial inclusion perspective, the sector has not yet made a meaningful impact in serving the financially excluded section of the population. As of 2017, there were only three co-operative banks and 28 co-operative financial institutions registered in the country, collectively serving just under 30,000 members.

The most prominent areas of weaknesses in the sector include:

- Inadequate credit management practices;
- Weak governance structures;
- Weak operational capability, especially the lack of accounting expertise and poor management information systems, e.g. using manual accounting and management information systems; and
- A shortage of skills at all levels, including the board of directors, senior management and staff.

A 2014 assessment by FinMark Trust into financial co-operatives¹²⁸ found that while the regulatory environment in South Africa is generally enabling, additional support may be required, noting:

- Past grant-based programmes did not operate long enough to ensure that managers and communities were sufficiently upskilled to run CFIs, and the resulting poor performance of these institutions compromised trust in the sector.
- Inadequate development programmes for CFI start-ups that do not achieve the thresholds for registration.
- Inadequate Government resources dedicated to support CFIs.
- Low levels of financial literacy among CFI members, which means society does not fully understand the benefits of being a member of a CFI.
- Public sector payroll deductions were disallowed.
- No deposit insurance scheme exists in South Africa at the moment. Such a scheme would cover members' deposits should a CFI fail.

Role of the Co-operative Banks Development Agency. The Co-operative Banks Act provides a developmental framework for CFIs, including through the establishment of the Co-operative Banks Development Agency (CBDA). At the core of the CBDA's objectives is the promotion of sustainable co-operative banking that will contribute towards providing South Africans with access to affordable financial services. Yet, as noted, the impact of the co-operative financial sector has been far more muted than was foreseen when the Act was passed, and many financial co-operatives have proved to be non-viable.

Responding to some of the observed constraints faced by CFIs and co-operatives, the CBDA is establishing a national banking platform with administrative and support capabilities, an ICT system and access to the national payment system. This should allow CFIs to keep appropriate records, produce management and regulatory information and offer a wider range of services to its members, including payment services. As part of the long-term objective of developing the financial services landscape, responsibly increasing competition and enhancing access to banking services, Government will expand the regulatory framework to include additional classes of specific and focused financial services providers.

Recognising informal co-operative arrangements. Development of the sector also needs to look at informal mutual and co-operative arrangements, especially stokvels and burial societies. Government acknowledges the role that these institutions play and will ensure they receive the necessary support to formalise as co-operatives.

¹²⁷ A co-operative financial institution (CFI) is a member-based deposit-taking financial co-operative with a common bond among its members. A co-operative bank is any CFI registered as a bank, but the term applies automatically to any CFI that has 200 members or more and holds deposits of such members in excess of R1 million.

¹²⁸ "Understanding financial cooperatives in South Africa, Malawi and Swaziland," FinMark Trust, April 2014.

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In South Africa, stokvels are one of the most prevalent forms of savings groups or mechanisms. A stokvel has an informal structure and enables a particular group of people to save, while also affording them a chance to receive all the pooled money at a particular draw. Membership of a stokvel is thus based on the “common bond”¹²⁹ principle. In pursuit of formalising the stokvel industry, a national umbrella body, the National Stokvel Association of South Africa (NASASA), was established in 1988. NASASA is a self-regulatory organisation authorised by the South African Reserve Bank. Its members do not have to be registered formally unless such a stokvel has more than 20 members who operate on a commercial basis.

Friendly societies are defined as not-for-profit organisations or associations of people established to provide relief or maintenance in case of a variety of events for members or people related to members. The relief could take any form or nature, including: payment of a sum of money upon the birth of a child or upon death of a member, for the insurance of tools used in a trade, for unemployment benefits, or for the education or training of members or their children.

Friendly societies play a risk-mitigating role in communities by insuring life events that may occur. As of the end of 2015 there were approximately 201 registered friendly societies in South Africa with R850 million worth of assets¹³⁰.

As mentioned, the developmental microfinance sector in South Africa is immature, with only two institutions having achieved any scale by servicing more than 2,000 clients. Successful development microfinancing has the advantage that its business model incorporates a business development focus, directly or through a group. In South Africa this speaks directly to the major needs in the market, as there is a requirement for basic business support, for access to finance and for monitoring the use of such finance. By their nature these microfinance institutions take a considerable time to reach sustainability, so they require direct support and development. This is a crucial aspect of developing access to the finance market, particularly for micro-enterprises.

Allied to this is the absence of global development microfinance institutions in South Africa. This is primarily due to the cost and licensing requirements for such institutions, since the only practical way in which they could maintain their business model (taking deposits, providing payment services and providing access to finance) is by applying for a full banking licence. This is deemed too onerous, given the limited scope of their activities. Such institutions have and do play a major role in other developing countries to support SMMEs and it is envisaged that the tiered licensing framework that National Treasury is currently drafting will assist in allowing development microfinance institutions as well as state banks, innovative banks (including fintech banks) and others to be licensed, regulated and supervised in line with the FSR Act and Twin Peaks implementation.

The following activities are proposed for project development:

- **Promote the sustainable development of financial co-operatives**, including banks and non-banks, and **provide for their graduation** from informal to formal entities to compete against large banks.¹³¹ The first steps towards achieving this include **enabling insurance co-operatives** under the Insurance Act, as part of National Treasury’s banking development

¹²⁹ The bond of association or common bond is the social connection among the members of co-operative financial institutions (CFIs). Common bonds substitute for collateral in the early stages of the financial system’s development. The common bond is also sometimes referred to as the chain of trust among members. In modern financial co-operative systems, common bonds remain a key building block, especially for the strategic networks that underpin many of Europe’s co-operative banks.

¹³⁰ Out of the 201 registered friendly societies, 11 were in the process of liquidation, 158 were excluded in the data reported due to either exemptions or failure to submit financial returns on time. The size of the assets is thus based on the value held by 32 friendly societies only. Registrar of Friendly Societies Annual Report, 2016.

¹³¹ A developmental plan for co-operatives will need to consider at least: current barriers; how to create an enabling environment for CFIs to be sustainable; access to the payment system – the current review of the NPS Act is exploring options to facilitate “safe” access for non-banks; demand-side pressures pertaining to how CFIs can better serve member needs; and access to South Africa’s deposit insurance scheme by co-operative banks and CFIs to foster growth and trust.

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agenda, and conducting an **in-depth assessment of the role and effectiveness of the co-operative banks and CFIs** currently operating in South Africa.

- The **mandate of the CBDA should be reviewed** to align better to sector needs. One option is to extend its mandate to become a cross-sector development agency for all informal or smaller financial institutions – including cooperatives and financial sector SMMEs – that want to formalise and grow (also see Priority 14 in this regard). This assessment should **consider existing DFI support programmes**, in order to promote efficiencies and avoid duplication.
- **Introduce deposit insurance** to safeguard individual depositors who might lack the knowledge to assess risks between different financial institutions.¹³²
- **Directly support developmental microfinance institutions**, through funding and skills development, to establish sustainable enterprises at scale.
- Investigate the broadening of the regulatory framework to **enable global developmental microfinance institutions to enter the South African market** and to allow domestic microfinance institutions to extend their scope of services to include deposit-taking.

Priority 14: Explore role of the state in supporting sustainable financial inclusion

Where possible this policy looks to private sector solutions for financial inclusion. However, in certain instances the state may be well placed to bring competitive products and services to the market, especially where there are market gaps or failures as in the case of lending to SMMEs (for which there is an estimated R759 billion funding gap).

South Africa already has some niche or specialist state-owned financial institutions, such as the Land Bank. Consistent with the parliamentary recommendations on transformation, Postbank also has a role to play given its branch network. Less than 2 per cent of the banked population hold an account with Postbank, and it holds less than 1 per cent of deposits, presenting an opportunity for growth. However, the issuing of its licence – as with any other prospective bank – should be subject to it satisfying any licensing conditions set by the Banks Act as overseen by the Prudential Authority.

The role of state-owned development financial institutions. The main purpose of the DFI model is to provide finance or capital in areas of the private sector that would otherwise not have access to it, as well as ensuring that the catalytic impact is high and sustainable. Internationally, DFIs do not only focus on providing access to capital but are premised on the notion that financial and developmental success go hand in hand, therefore viewing the growth of the private sector as one of the keys to sustainable development. South Africa has witnessed the establishment of a number of DFIs to address different developmental challenges, including private sector growth and job creation, poverty reduction, improved health, education and environmental sustainability and social change. These DFIs include the IDC and SEFA. The role, scope and funding of all DFIs should be examined and optimised in terms of what is the desired impact and investment requirement to develop the SMME sector. This sector provides funding for SMMEs through grants and financing. The outstanding direct Government loans to SMMEs at the end of 2016 was R8.7 billion, which accounts for 1.4 per cent of extended SMME loans.

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The following activities are proposed for project development:

- As part of National Treasury's financial sector development agenda, **consider research to evaluate the opportunities, risks and effectiveness of state-owned banks and DFIs**, to make recommendations about how these institutions could be rationalised and restructured to deliver on South Africa's socio-economic objectives. This research should be **designed to take into account South Africa's financial inclusion needs and objectives**.

Priority 15: Enable a broad base of agents in the provision of financial services

Success in improving access to financial services depends to a large extent on the geographic penetration of financial institutions' physical presence and the availability of technological infrastructure. The South African financial services sector, particularly the banking sector, has established a well-developed financial services network, including making extensive use of technology. According to the Banking Association of South Africa (2010), more than 90 per cent of all households have access to a physical point of presence within a 10 km radius. Physical points of presence comprise bank branches, ATMs and point-of-sale payment devices. The number of branches has been stagnant over the last few years, presumably due to the high cost of setting up a traditional bank branch.

To complement the traditional branch distribution model, banks offer a variety of electronic or direct channels to access financial services through the growth and development of technology. Financial services are accessible via on-line services (typically internet enabled) and mobile-enabled services, typically using mobile devices (cell phones). Particularly relevant for low-income people is the increase in the number and transactional capabilities of merchant POS payment devices in stores, enabled by both banks and retailers. These devices enable card-owning consumers to purchase goods, make payments and get cash, without having to go to a branch or ATM.

Although the physical reach and the use of technology have improved financial access in South Africa, there is still much scope for improvement, particularly in rural areas where the presence of financial services infrastructure is limited. For example, according to the FinScope survey 2015, the median time for adults in South Africa who live in rural areas to get to a bank branch is 54 minutes and 48 minutes to get to an ATM, as opposed to 26 minutes and 20 minutes respectively in urban areas.

To further extend financial inclusion, especially to enable customers to use accounts in a more convenient way and thereby deepen inclusion, greater use of alternative, low-cost distribution models is needed to enable low-income users to perform basic transactions on their accounts. Branchless banking reduces the costs of financial intermediation and reduces reliance on expensive physical infrastructure. It combines existing banking technology with local information and proximity to deliver financial services to the under-served, especially in rural areas. In the correspondent – or agency – banking model, banks partner with non-banks like grocery stores, retail outlets, post offices and pharmacies to sell financial services and transact on their behalf.

Banks have three main incentives to support correspondent banking.

- Correspondents allow banks to reach new customer segments, especially low-income and rural ones, that are too costly to serve with bank branches due to the fixed costs involved. Also, in the case of areas already covered by bank branches, transferring some activities to correspondents allows banks to cut costs and concentrate employee attention on more value-added activities, while also decongesting bank branches and increasing convenience for customers.
- The model is also attractive to correspondents, who are paid a commission per transaction, improving their revenues. On the cost side, initial investment is set by contracting financial institution and the existing personnel that can handle the

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extra work, without the need to hire additional staff. When the customer cashes out, they may decide to spend part of their income at the retail store, increasing sales. In local communities, retailers hold valuable knowledge on the shopping and payment habits of their customers. If they become bank correspondents, such knowledge can be used in loan applications, which helps to mitigate asymmetric information problems.

- Correspondents usually have longer opening hours than bank branches, reducing the need for customers to take time off work to do their banking.

Brazil and Kenya have both successfully adopted the agency banking model in support of financial inclusion, as described in Box 19. Consumers use the retail outlets to acquire a basic product, such as a transactional account, deposit and withdraw funds, pay their bills, transact and make basic information enquiries. Countries in Latin America that have followed Brazil include Mexico, Peru, Colombia, Ecuador, Venezuela, Argentina, and Bolivia. Other countries around the world include Pakistan, Philippines, Uganda and India.

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Box 19: Leveraging correspondent banking in Brazil and Kenya

Brazil

Brazil's economy is the largest in Latin America, with a GDP (in current US dollars) of about \$1.8 trillion as of 2016. With 200 million people living across an area of 8.515 million square kilometres, Brazil has a very uneven population distribution, ranging from two people per kilometre in areas around the Amazon to more than 400 people in cities. In 1999, 29.8 per cent of Brazilian municipalities lacked access to standard distribution channels of financial services. The poorest states in the northeast and north of the country were worse, with the proportion of unassisted municipalities reaching 45.6 per cent and 60.3 per cent, respectively. These states contain a larger proportion of the poor.

Without reasonable access to branches, customers had to travel long distances to reach a branch and spend time traveling and queuing up to use financial services. A customer survey carried out by the Brazilian bank Caixa Econômica Federal (CEF) found that prior to the opening of its Caixa Aqui outlets, 51 per cent of respondent clients had to travel more than an hour to get to a bank branch, and 55 per cent had to spend from R\$5-R\$15 in travel expenses.

In response the Banco Central do Brasil in 2000 introduced regulatory changes that supported an agency banking model, where banking correspondents act as agents on behalf of partner banks to supply financial services. This enabled banks like CEF to expand their existing partnership with the national chain of lottery shops to broaden the range of services offered in those locations. The number of agents in Brazil is currently around 160,000, with 253 agents per 100,000 Brazilians (this ranks the country third in the world in number behind Bangladesh, which has 530 agents per 100,000 people and Columbia with 275 agents). Agent banks now cover more than 99 per cent of the municipalities.

Bank correspondents in Brazil are permitted to perform extensive services on behalf of registered banks, including receiving deposits, payments as well as loan and credit card applications.

Brazil achieved the highest ranking of any Latin American country on the 2015 Brookings Financial and Digital Inclusion Project Report, coming third overall with a score of 78 per cent. The report finds that 68 per cent of the adult population has a financial account (among women this figure stands at 65 per cent).

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Kenya

Kenya's banking sector experienced a slowdown in bank expansion from the 1990s, and it had a limited reach. Most of the under-banked and un-banked Kenyans were not inclined to access banking services, as they perceived them to be too "elitist", targeting the more sophisticated and employed segments of the population. The Central Bank of Kenya (CBK) thus sought to develop more customer-friendly, convenient and lower-cost delivery channels for Kenyan consumers.

In October 2009, CBK, together with the Kenya Bankers Association (KBA) and the National Treasury, conducted a knowledge exchange tour of Brazil and Colombia to gain in-depth and hands-on learning experience of agent banking. This exchange led to the development of Agent Banking Guidelines for commercial and microfinance banks in 2010 and 2012, respectively. The model is envisaged to enable banks to leverage on additional cost-effective distribution channels in order to offer financial services.

For this model to be realisable, the Banking Act was amended to permit banks to contract third parties to provide specified banking services on their behalf. The guidelines to facilitate rolling out the agency banking model were issued by the central bank and took effect in May 2010.

The agent banking model has enabled commercial and microfinance banks to expand into areas they would otherwise not have reached, due to such limitations as the viability of establishing a bricks and mortar branch, establishment costs and lack of infrastructure. Agency banking also tailors banking services to the convenience of consumers who can now save on transport costs and time taken to visit bank outlets.

Since the rollout of agency banking in May 2010, 18 commercial banks and five microfinance banks (MFBs) have contracted 53,833 and 2,068 agents respectively. These agents have managed over 322 million transactions cumulatively from 2010 to December 2016, which was worth over Ksh1.9 trillion (USD 18.65 billion) over that period.

Equity Bank is one of the banks in Kenya that adopted the agency banking model and it offers its clients the following range of banking services through an agent: cash deposit and withdrawal, payments including remittances, airtime top-up, account opening, origination and balance enquiries.

Currently a few banks in South Africa have entered into partnerships with retailers and mobile network providers so they can use that infrastructure to extend financial services to their customers, as well as deepening the use of already acquired products. However, the current use of the agency banking model by financial institutions in South Africa is very limited. Its contribution to the improvement of financial inclusion through increased access to financial services is therefore not yet meaningful.

In a study undertaken by FinMark Trust,¹³³ a main reason cited for the limited use of the agency banking model in South Africa was the perceived (or real) regulatory implications. There is a perceived lack of clear guidance from the regulatory authorities on the route that agency banking should take in South Africa. The industry has therefore followed a cautious interpretation of the regulations that has an implicit bearing on agency banking. While there is nothing in the Banks Act that stops banks from making use of agents to further their products and services delivery agenda, FICA and the FAIS Act were perceived to be restrictive in terms of functionality. The study recommended, among other things, an inclusive banking licence to foster

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agency banking, improved regulatory coordination across regulators including the FIC, and the improved measurement of financial inclusion indicators to support policymakers.

The following activities are proposed for project development:

- Take steps to **improve the access point network, especially through strengthening the agency model in South Africa** by:
 - Getting **representative survey data** on incentives and disincentives for retailers to act as agents; and
 - Developing a **suitable regulatory framework** to promote shared use of widespread branch networks like SAPO, support the potential role of CFIs and smaller retailers in reaching the underserved market, support partnerships between banks and retailers, and move closed-loop systems into an interoperable environment (as part of the interoperability strategy).

Priority 16: Leveraging fintech disruptors to promote and support financial inclusion

The G20 Financial Stability Board has defined fintech as technologically enabled financial innovation that can result in new business models, applications, processes and (financial) products or services with an associated material effect on financial markets and institutions. Fintech can be applied to a wide range of areas, including electronic payments, automated advice, delivery channels, cyber security and peer-to-peer lending.

These innovations present a challenge to policymakers and regulators, who need to understand how to approach fintech matters so that innovations do not create an un-level playing field, or negatively affect competition. Importantly, consideration needs to be given to how customers – particularly the vulnerable groups – understand and interact with innovative financial products and platforms, and what customer protection principles do and should apply in these circumstances.

However, fintech can deliver benefits for consumers through improved access to financial products and services, greater flexibility, increased speed of delivery and competitive prices. Regulators therefore need to carefully balance the risks and benefits that innovations can bring and ensure that the benefits are leveraged.

The G20 recognises digital financial inclusion as an important feature of economic growth. Leveraging the opportunities that technology offers to reduce costs, expand access to financial products and services and extend their reach is vital to the success of achieving universal financial inclusion. The G20 High-Level Principles for Digital Financial Inclusion¹³⁴ included in Box 20 provide guidance on country-level actions needed to harness digital financial services and delivery mechanisms to safely expand access and the usage of financial services for under-served market segments.

¹³⁴ The 2016 High-Level Principles for Digital Financial Inclusion build on the success of the 2010 G20 Principles for Innovative Financial Inclusion which spurred initial efforts by providing a basis for country action plans reflecting country context and national circumstances to leverage the potential offered by digital technologies (<https://www.gpfi.org/publications/g20-high-level-principles-digital-financial-inclusion>)

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Box 20: GPMI High-Level Principles for Digital Financial Inclusion

Principle 1: Promote digital financial services as a priority to drive the development of inclusive financial systems, including through coordinated, monitored and evaluated national strategies and action plans.

Principle 2: Balance promoting innovation to achieve digital financial inclusion with identifying, assessing, monitoring and managing new risks.

Principle 3: Provide an enabling and proportionate legal and regulatory framework for digital financial inclusion, taking into account relevant G20 and international standards and guidance.

Principle 4: Expand the digital financial services ecosystem, including financial and information and communications technology infrastructure, for the safe, reliable and low-cost provision of digital financial services to all relevant geographical areas, especially under-served rural areas.

Principle 5: Establish a comprehensive approach to consumer and data protection that focuses on issues of specific relevance to digital financial services.

Principle 6: Strengthen digital and financial literacy and awareness support and evaluate programmes that enhance digital and financial literacy, in light of the unique characteristics, advantages and risks of digital financial services and channels.

Principle 7: Facilitate access to digital financial services by developing or encouraging the development of customer identity systems, products and services that are accessible, affordable, and verifiable, and accommodate multiple needs and risk levels for a risk-based approach to customer due diligence.

Principle 8: Track progress on digital financial inclusion through a comprehensive and robust data measurement and evaluation system. This system should leverage new sources of digital data and enable stakeholders to analyse and monitor the supply of, and demand for, digital financial services, as well as assess the impact of key programmes and reforms.

The South African authorities have established a fintech working group to coordinate efforts in developing the country's approach to fintech. The working group represents a collaborative approach among the National Treasury, South African Reserve Bank, Financial Sector Conduct Authority, South African Revenue Service, National Credit Regulator and the Financial Intelligence Centre. Through the intergovernmental fintech working group (IFWG), financial sector regulators work together to demystify the regulatory landscape, provide a space for safe experimentation and actively advance innovation. The IFWG has recently published the Fintech Vision Document, which outlines the following vision statements for fintech: (i) Addressing the needs of underserved and marginalised segments, (ii) encouraging expanded investment in South African fintechs, (iii) enhancing the legal and regulatory environment to promote innovation and competition, and (iv) building South Africa's talent base.¹³⁵

4 POLICY PILLARS OF FINANCIAL INCLUSION

The following areas, which are expected to evolve over time, were identified:

- peer-to-peer lending, online marketplace lending, or “loan-based crowdfunding”;
- non-bank payment services including digital wallets;
- regulatory technology, including the use of big data;
- robo-advice; and
- data management, including offshoring and cloud computing.

Malaysia has been at the forefront of fostering fintech for financial inclusion; Box 21 shows how sandboxes are being used to drive technological enhancements in support of reaching the final inclusion “frontier” and supporting take-up and effective usage.

Box 21: An approach to sandboxes – Malaysia¹³⁶

Malaysia is a middle-income country where 92 per cent of the adult population had an active deposit account at a financial institution by 2016, and an estimated 70 per cent of working Malaysians invested in unit trusts. Households have access to a wide range of conventional and Islamic financial products and services.

An identified challenge is to reach the remaining segments of the population, which have limited or no access to financial services. These are generally people with low levels of formal education, living in low-income households and rural areas. An additional challenge is usability. Many Malaysians are not fully deriving the developmental benefits from the financial services currently available. These people are, however, rapidly gaining access to financial services through innovative financial products, such as mobile phone applications and agent banking, which can leverage technology and enable financial institutions to reach out to customers in remote areas in a secure and cost-effective manner.

Recognising the potential of technology to transform the financial sector, Malaysia has taken proactive steps to facilitate innovation and the growth of its fintech industry. In September 2016, Bank Negara Malaysia, the Central Bank of Malaysia, issued the Regulatory Sandbox for new companies to test their products in a safe regulatory environment. The “sandbox” enables new companies in the financial sector to develop and test their products under a more flexible regulatory regime, for a period of up to six months. It is intended to protect consumers and contain risks, as some products and fintech companies will not be able to survive in the marketplace. In particular, the sandbox framework:

- Adopts an open application programme interface to enable data-sharing with third parties without compromising data privacy and security.
- Creates a common know-your-customer (KYC) utility for financial institutions to facilitate a more effective and efficient approach to managing compliance obligations, while also aiming to reduce fraud and improve the delivery of personalised financial services.
- Develops guidelines for cloud computing to harness operational efficiencies while protecting data integrity.
- Examines applications of distributed ledger technology to evolve new infrastructure, arrangements, and processes that will transform the way financial services are delivered.
- Takes steps to enhance cybersecurity resilience within the financial sector.

4 POLICY PILLARS OF FINANCIAL INCLUSION

The following activities are proposed for project development:

- **Financial inclusion should inform fintech policy development** and be one of its key objectives. At the core of such policy should be an assessment of fintech on the South African financial consumer from a usage-cost and access perspective.
- **Enable regulatory “sandboxing”** of new ideas and business models for providers bringing innovative financial products and services to the un- and under-served market.

5 FROM POLICY TO ACTION: A COORDINATED APPROACH

Government acknowledges that the successful implementation of this policy requires strong coordination among its departments and agencies, regulators, financial institutions and their representative bodies, the private sector (i.e. mobile network operators, technology companies and SMME associations), relevant civil society organisations as well as the informal sector. To achieve this, two bodies are proposed:

- An intra-government financial inclusion sub-working group established under the Council of Financial Regulators (as provided for in the FSR Act); and
- A financial inclusion forum (FI forum) for industry and other non-governmental stakeholders to engage policymakers and regulators on strategic priorities.

Chaired by the National Treasury, the purpose of the financial inclusion sub-working group is to:¹³⁷

- Act as a platform for intra-governmental coordination on matters of financial inclusion.¹³⁸
- Develop an financial inclusion implementation strategy derived from this policy document and, in doing so, determine the projects to be housed under each broad theme.
- Provide the basis for more stringent and in-depth analysis to inform the project priorities, and to allocate responsibilities for how these must be implemented and coordinated.¹³⁹
- Oversee the implementation of the various projects identified.
- Monitor the main objectives to be achieved, including the assessment of the socio-economic impact of financial inclusion.

Additionally, the FI forum will coordinate interactions with regional and international bodies engaged in the promotion of financial inclusion and deliberate on key regulatory and enforcement changes required to actively balance stability, market conduct and integrity issues with the objective of responsibly and sustainably expanding financial inclusion.¹⁴⁰

The financial inclusion sub-working group will be supported by the FI forum. The purpose of this forum is to encourage greater openness and collaboration and to transcend entrenched interests. It also provides a platform for regulators and service providers to deal with concerns in terms of compliance matters that impact on financial inclusion. At times industry and other stakeholders may be best placed to lead or actively participate in technical work, so working groups will be set up to facilitate this as required.

The FI sub-working group should have as permanent members:

- National Treasury (as the proposed executive lead and secretariat);
- The Prudential Authority, the Financial Services Conduct Authority, the National Credit Regulator and the Co-operative

¹³⁷ A few leading practices are emerging in the international financial inclusion world; with the establishment of a national, broad-based financial inclusion focus or task group one of the most promising. Mexico, during its presidency of the G20 in 2012, was a firm proponent of this approach and embedded it in its contribution to the development work of the G20. Several other countries have established such a national platform as well, notably Brazil, Malaysia, the Philippines and Nigeria.

¹³⁸ The FIT will map the financial inclusion landscape not only in terms of the demand-side needs, but also in terms of governmental bodies contributing to the agenda with different focus areas. Particularly in terms of the SMME sector, priorities and projects supported by development agencies and DFIs (e.g. mandates, value add, synergies) should be considered.

¹³⁹ Since the co-ordination of development efforts in the SME world is crucial to maximise impact, the forum should ensure that adequate structures are in place to achieve this level of impact. The forum will also play a key role in identifying and promoting beneficial innovations, specifically balancing the potential benefit of the innovation with the risks it introduces.

¹⁴⁰ The forum will seek to foster consistency in regulatory and enforcement approaches, with regard to conduct issues impacting on financial inclusion – from both a consumer and an industry perspective – particularly between the Financial Services Conduct Authority and the National Credit Regulator. This may additionally be addressed by the abovementioned MoUs. While input from other stakeholders is important and the policy objectives are paramount, the actual regulatory changes are the responsibility of the regulators.

5 FROM POLICY TO ACTION: A COORDINATED APPROACH

Banks Development Agency and the National Payment System Department of the Reserve Bank as regulators;

- The Department of Small Business Development, the Economic Development Department, the Department of Trade and Industry, the Department of Social Development and other critical Government role players; and
- The Financial Sector Transformation Council as the coordinating body for the Financial Sector Code.

The consultative FI forum should have as permanent members all financial inclusion sub-working group members as well as:

- Financial service industry representatives (BASA, SAIA, ASISA, ABSIP, FIA, BIOA, BIAC and others);
- Mobile money network operators and technology companies;
- The Payments Association of South Africa;
- Agencies representing civil society and other relevant interests as invited by the National Treasury; and
- Independent financial inclusion experts as may be determined by the financial inclusion sub-working group.

Consumer representative organisations, SMME representative organisations, state-owned enterprises involved in the provision of financial services (Post Office/Postbank, SEFA and others), Statistics South Africa, the National Consumer Commission, Nedlac, human rights advocacy groups and specific industry players, as relevant on a topic-by-topic basis, could be co-opted on an ad hoc basis over time.

6 MEASURING PROGRESS AND IMPACT

Monitoring and evaluation play a critical role in the financial inclusion policy-making process and in ensuring that the design of initiatives and setting of priorities for actions are informed. Many international organisations and agencies have developed robust indicators to help participating member countries assess their state of financial inclusion.

In South Africa, the collection of relevant data to allow for a comprehensive assessment of the state of financial inclusion should be prioritised. Measurement and monitoring should cover the three dimensions of financial inclusion, which are: access, usage and the quality of financial services. These indicators can be used to assess on a dynamic basis the current state of financial inclusion, areas of shortcomings and the effect of implemented policies. This is a necessary feedback loop to learn what interventions are effective and to serve as a catalyst for the future design of new financial products and services.

It is also necessary to assess the impact of financial inclusion policies on the quality of life and the financial well-being of financial services users. To this end, emphasis will also be on the development of appropriate indicators to assess the socio-economic impact of the financial inclusion policy.

It is expected that financial sector regulators will play a major role in data collection in financial service provisioning, as they are best suited to obtain data from the institutions or aspects that they supervise. In addition, appropriate use will be made of survey data to measure the demand side of financial service provisioning.

We have good quality data available currently to assess the state of financial inclusion in South Africa from both local organisations like FinMark Trust and international organisations like the World Bank Group, International Monetary Fund and Bank for International Settlements. However, there are still shortcomings in both the quality and the scope of the available data. For example, the number of account holders (in contrast to the number of accounts) is not known at a national level, the use of services specifically by low-income users can quite often only be deduced and significant portions of transactional infrastructure is not reported or only partially reported. Information on the use of financial services by SMMEs is sparse and, in most cases, dated. This erodes the grounds on which evidence-based financial inclusion policies should be based.

The following activities are proposed for project development:

- Develop **appropriate indicators** to assess the state of financial inclusion and the impact of its policies on the quality of life of individuals and on the financial well-being of SMMEs. Such indicators should be in line with international reporting standards i.e. IMF Financial Access Surveys, G20 Basic Set of Financial Inclusion Indicators, Global Findex as well as include the mapping of financial access points.
- It is necessary that the usage indicators should include gender and age as attributes, to allow for the necessary disaggregation for these groups.
- Build a **qualitative demand-side survey** to understand the financial services needs of lower-income South Africans, asking questions like: Why is there a perceived preference for favoured products like funeral insurance over other life cover? What is preventing the take-up and usage of a wider range of financial products and services? What explains the usage patterns of bank accounts?
- Expand the financial inclusion surveys to include needs-based data.
- Introduce an annual SMME survey that assesses SMMEs from both a supply-side and demand-side perspective.
- Publish an annual financial inclusion monitor that summarises data and survey findings.

7 NEXT STEPS

This document presents South Africa's draft Financial Inclusion Policy and proposes an approach to the implementation of the policy objectives. It is published for public comment and consultation.

The FI working group and FI forum will be established in 2020.

A National Financial Inclusion Strategy will be developed in the year 2021.

A Financial Inclusion Monitoring and Evaluation framework (i.e. financial inclusion monitor) will be developed in the year 2021.

This policy will be supported by additional research papers that focus on the identified priority areas.

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The Impact of Covid-19 and the Future of Financial Inclusion

In the fourth-quarter of 2019 the South African economy slipped into a recession and was already struggling when it confronted the coronavirus pandemic in March 2020. COVID-19 resulted in the South African Government declaring a state of national disaster and led to an introduction of regulations aimed at curbing the spread of the virus. This was followed by the implementation of a strict 21-day nationwide lockdown that became effective on March 27th, 2020. During the lockdown many businesses, SMMEs and informal enterprises were prohibited from operating and only a few essential businesses could function, albeit under strict health and safety protocols, including other restrictions like social distancing. This reduced consumer demand for most goods, which forced businesses around the country to lay-off employees, cut salaries, restructure their debt, downsize or shut down. After the initial hard lockdown was lifted many businesses still remained in a state of partial or full lockdown, particularly those in the tourism, hospitality, beverages and entertainment sectors. This exacerbated South Africa's high unemployment rate, estimated by Statistics South Africa to be at 30.1 per cent in the first quarter of 2020.

This annexure will complement and propose additional considerations and proposals for further development in support of the financial inclusion agenda. Each of the considerations below will be in support of, or additional to, the current policy pillars and priorities that have already been covered in this policy paper. The pillars are:

- Pillar 1: Deepening financial inclusion for individuals;
- Pillar 2: Extending access to financial services for SMMEs; and
- Pillar 3: Leveraging a more diversified provider and distribution base.

To mitigate the impact of the coronavirus pandemic on financial inclusion in South Africa some key challenging aspects have been identified, and the following special and urgent areas are proposed as additional priority areas to be considered and explored.

Pillar One: Deepening financial inclusion for individuals

Additional Priority: Build an appropriate digital and payments ecosystem to drive the use of digital financial services

To support Priority 1 promote the beneficial use of transactional accounts. For Priority 2, build appropriate payment options to drive usage. For Priority 7, increase the financial inclusion impact of social grant distribution.

The pandemic has impacted on the way consumers in South Africa interact with financial products and services, particularly with the closure of some post office branches and reduced opening hours as a result of the lockdown. This has heightened the importance of digital transactions, including online, mobile and contactless payments and point-of-sale devices in the country.

South Africa has not yet introduced convenient and affordable digital payment mechanisms for low-income and rural markets, as seen in countries like Kenya and Rwanda. A majority of transactions are still conducted in cash (i.e. 52 per cent), which is perpetuated by its convenience, the absence of bank branches and financial service outlets outside of urban locations and a lack of trust in the banking system. The perceived lack of fees also makes transacting in cash very attractive for the majority of low-income individuals. In recent years, the rise of fintechs have played a role in addressing the gaps in digital financial service innovations, but the country still has a long way to go in ensuring that its citizens have access to and are comfortable with using digital financial services. Moreover, banks have closed some of their branches and pushed clients to use digital platforms (i.e. banking apps and online banking) to conduct their transactional banking activities. They have

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also been discouraging cash deposits at teller counters and pushing clients to withdraw and deposit funds at ATMs. Some rural areas do not have ATMs, especially those with deposit functionality, and queues at the cash withdrawal points that are available can be very long (DMA,2020).

Moreover, the Government also administers one of the most extensive social security grant systems in the world. This programme directly assists more than 11 million people and benefits more than 40 per cent of South African households. Currently, all grant recipients utilise some bank account, while the majority use Postbank. However, very few of the recipients use these accounts in a beneficial manner as a store-of-value from which they can make payments as needed, and, if possible, access other financial services. About 300,000 recipients receive their funds at cash distribution points provided by the South African Post Office, while most of the other recipients withdraw all their funds once they are available. The consequence of this reality is that the benefits of the grants, both to the recipient and to the communities in which they reside, is limited to the use of the cash (Finmark, 2020).

Many countries are providing COVID-19-related social grants to assist with the widespread negative impacts of the crisis on consumers' livelihoods. In light of this, the importance of a robust digital payments infrastructure that can quickly get money to those in need, as well as the development of an ecosystem to enable digital financial services that aid merchants -- particularly in the informal sector -- to accept electronic and contactless payments, should not be understated. The South African government's COVID-19 unemployment grant of R350 has demonstrated the importance of digital payments for a crisis response. Currently the COVID-19 Social Relief of Distress grant is being established and implemented during the COVID-19 crisis and under strict social distancing guidelines. The programme has clear eligibility criteria. Individuals can only receive the grant if they are a) unemployed; b) not receiving any income, social grant, unemployment insurance benefit, or a stipend to study (NSFAS); (c) do not qualify for the Unemployment Insurance Fund benefits (UIF); and d) are not a resident in a Government-funded or subsidised institution. To ensure compliance, the applicant's information must be cross-checked against a myriad of national databases, including at SASSA, the Department of Home Affairs, SARS, NSFAS and the UIF. These systems are not interoperable and do not feed into a centralised system. It is unclear if they easily link to South African ID numbers. Additionally, there is legal red tape regarding consumer protection and privacy legislation with regards to accessing all these data sources, creating an additional layer of complexity. The clients have asked for commercial bank's support to overcome these challenges.

While digital payments have played a significant role in ensuring social distancing and facilitated consumers' ability to make payments without the need for physical contact, the risk of scams and cybersecurity issues have also emerged. Scammers are targeting financial sector consumers and institutions to exploit the uncertainty created by the pandemic, particularly with senior citizens who are not comfortable with digital transactions. There is the risk that these scams could undermine confidence and trust in digital technologies. To this end, it is important that the promotion of digital payments be complemented with improving consumer digital capability and literacy to ensure that digitisation does not unintentionally become an access barrier for consumers who are not technologically savvy.

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Key considerations and proposals for project development

Digital payment mechanisms for low-income and rural markets

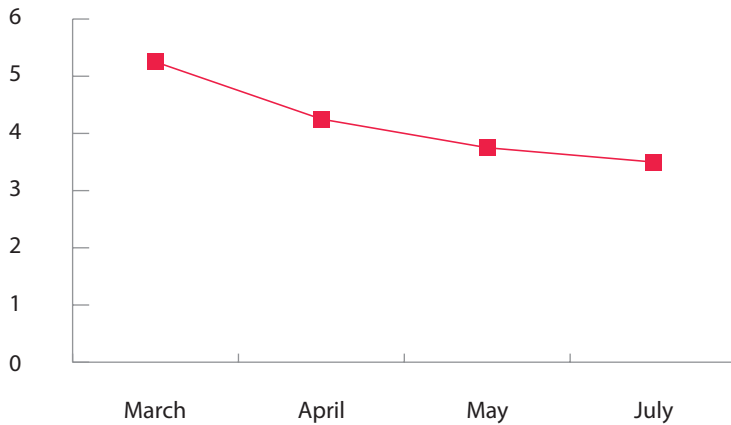
- Design a pilot to incubate the development of a transformational digital financial services ecosystem in South Africa. Would this consider: beneficiary targeting and registration? Digitising payments and creating an enabling financial sector ecosystem? Financial management systems? Interoperability? Cashing out? There could be an opportunity to support the distribution of the social relief grants effectively, and specifically the interoperability of Government databases through a master social security register which would support the targeting and registration of beneficiaries. This pilot project could target clients of development microfinance institutions and or SASSA grant recipients.
- Any move towards digitisation would have to take into context the reality of South Africa's rural communities: i.e. many rural villages and townships have weak foundations to support robust digital finance. As the Government and private sector seek to push for digitisation, they should develop a comprehensive response that might have to look into enabling areas. These include the availability of telecommunications infrastructure, cellphone data, and the digital capability (i.e. literacy) of individuals. Banks may have little incentive to serve these communities, but other types of companies (telecommunications or cable companies, for instance) that utilise agent networks may be a better channel to deliver digital finance services.
- Engaging the extensive network of spaza shops and other informal vendors in the digital payments' ecosystem is an enormous opportunity to overcome the last mile challenges while supporting commerce in poor neighborhoods. There is a resounding gap in SASSA's vendor model and in South Africa's ecosystem for digital payments more broadly. Spaza shops and informal vendors in townships and rural zones are largely outside the digital payments ecosystem. Perhaps there could be an initiative to engage these players.
- Given the increasingly digital environment for financial products and services and the potential for digitisation to support greater financial inclusion and inclusive growth, the need for effective financial consumer protection is more important than ever. Digitisation has the potential to increase customer vulnerability to criminal activity, including fraud and scams like phishing schemes and data theft.

Additional Priority: Credit and consumer financial vulnerability to support Priority 5 promote appropriate credit by promoting credit for assets and investments over consumption.

From as early as 2012 debt servicing costs as a percentage of disposable income had been increasing in South Africa, showing that consumers were struggling financially and becoming more indebted in an economy that was not showing signs of growing. The South African Reserve Bank estimated household debt-to-disposable-income ratio to amount to 72.7 per cent at the end of 2018 i.e. almost 70 per cent of households' available funds are spent on debt.

Households' ability to continue meeting their financial obligations has now been further put under immense pressure by the COVID-19 crisis, as it has led to increased unemployment and decreased incomes. This has resulted in many consumers being unable to service their debt, which has further exacerbated the credit crunch.

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Source: South African Reserve Bank

Although the SARB has provided some relief through repurchase rate (repo rate) reductions since the start of 2020 to support the debt repayment capacity of borrowers, increases in non-performing loans (NPLs) are expected over the coming months. In addition, the absence of adequate safety nets, including savings and insurance, are also anticipated to add to consumer vulnerability and this situation could potentially force affected consumers to rely on coping strategies, such as accessing informal loans at very high interest rates.

With unemployment figures expected to surge and the pandemic affecting many households, borrowing from the informal support network of family and friends is less likely to be possible.

In an effort to assist consumers, some of the major South African banks and more established non-bank financial services providers have granted clients who are in good standing a reprieve, through payment holidays and the restructuring of debt repayments. The objective of a payment holiday is to give financially distressed consumers immediate payment relief on loans without adversely impacting their credit record. The downside to the payment holiday is that loans will continue to attract interest, which will be capitalised and the repayment terms adjusted. Customers were also encouraged to establish if they had credit life insurance (CLI), which covers an individual for a stated period in the event they lose their job, before applying for a payment holiday.

Furthermore, credit providers were also able to invoke provisions of the National Credit Act (NCA) in terms of emergency loans as provided for in Section 1 of the NCA, and thereby extend credit to consumers affected by COVID-19. The extension of such credit is exempt from affordability assessments and reckless lending provisions.

Financial services providers have been required to intensify their consumer education initiatives by providing information on their websites and using other electronic modes to ensure the information reaches the consumers. However, many consumers, particularly the elderly and those in low-income groups, are largely unable to interact with their financial services providers through these electronic modes: either because they have low digital capabilities or data costs are too high for them.

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Moreover, in the year ending December 2019, many banks had already noted an increase in bad debts on their books.¹⁴¹ NPLs continue to increase for all banks, reaching 4.59 per cent in May 2020 versus 3.83 per cent in May 2019 amid weak economic growth. NPLs are likely to rise significantly as a result of the COVID-19 crisis, however, this impact will likely be delayed as loans are restructured.

Key considerations proposals for project development

Alternative credit scoring models

- While financial institutions have relied on traditional credit scores from credit bureaus to assess the risks of loans, these methods could exclude a major portion of individuals and SMMEs. Many people have had drastic salary cuts and challenges in paying loans will result in the impairment of many consumers' credit profiles.
- Policymakers could explore policies aimed at enabling and regulating the use of alternative credit scoring in the long term. This will enable lenders who are flexible to collect more information and gain a larger picture of a borrower's financial history, and thus extend credit to these individuals.

Disclosure and transparency

- Consumers must be provided with key information relating to the fundamental benefits, risks and terms and conditions of financial products and services.
- The disclosure standards should also address the potential lack of consumer awareness, which may give rise to poor consumer outcomes.
- It is important to strike a balance when considering initiatives to assist consumers to ensure they are not unintentionally over-indebted, which increases their vulnerability.

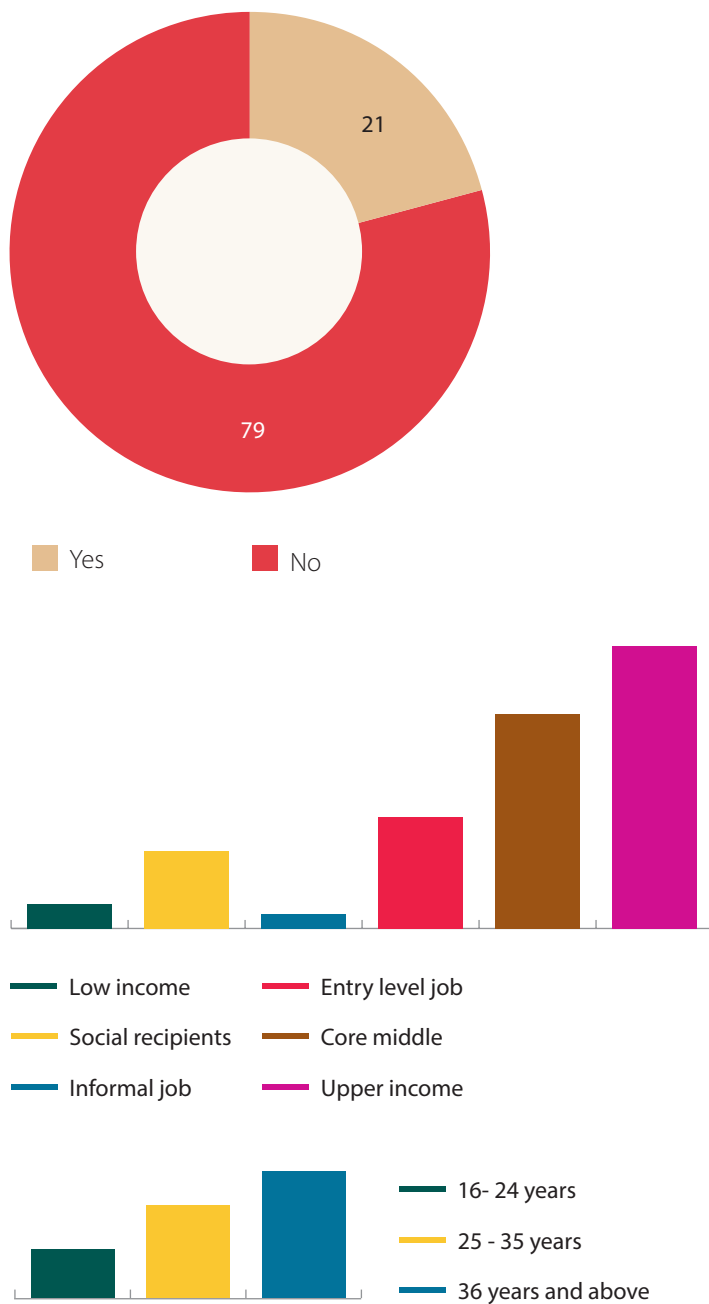
Financial literacy and awareness campaigns

- Targeted financial education programmes can play a major role in empowering consumers to take responsibility for their debt/financial management, which would improve consumers' ability to make sound and informed financial decisions related to their unique needs.

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Additional Priority: Short-term and long-term savings to support Priority 4 promote increased formal saving for low-income earners

Figure 2: Incidence of “rainy day” funds



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Finscope, 2019

According to Finscope 2019, only 21 per cent of individuals have three-months' savings set aside as an emergency fund. With the pandemic, many employers may find themselves unable to pay workers while others may only be able to make partial payment of salaries and wages.

Businesses are likely to close or reduce their number of workers. The retirement fund industry and the insurance sector will be affected as workers who lose their jobs are likely to withdraw their retirement savings or surrender their long-term insurance savings policies early.

While withdrawals from retirement savings and surrendering long-term savings policies before maturity date may not be advisable, for some these savings are the only source of funds available to them during this uncertain and difficult period.

Enabling early access to pension funds could be explored, but this would require legislative amendments because the current law and policy prohibits any pre-retirement access to these savings unless an employee resigns or is retrenched.

South Africa's worryingly low formal savings rate and people's current dependence on retirement savings necessitates that an awareness drive be put in place to ensure South Africans save more in the future, once the experience of this global pandemic has passed.

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Measures already in place

Contribution suspension and holiday enabled

- To ease the impact of COVID-19 on employers and employees, the FSCA has issued a communique (FSCA Communication 11 of 2020 (RF)) in late March 2020 to the retirement funds industry informing it that employers experiencing financial distress can consider using existing enabling rules to suspend or reduce retirement fund deductions and contributions, after engagement with the fund. Funds which do not have such rules can urgently apply to register them with the FSCA, which has already put in place a mechanism to fast-track their processing.

Expansion of access to living annuities

- Government has provided temporary relief to living annuitants by allowing for draw down rates to be reduced to 0.5 per cent (the current minimum is 2.5 per cent) in order to protect underlying assets. However, for people whose living annuity is their only source of income, Government has allowed for a temporary increase in their draw down capabilities, by up to 20 per cent (the current maximum is 17.5 per cent). Furthermore, the Government expanded access to living annuities to amounts up to R125,000, from R50,000 and R75,000 bar that it was previously set at.

Key considerations and proposals for project development

Restructure the retirement system – long-term measure

- Create a savings vehicle for fund members that will be accessible for tuition, housing, medical emergencies by taking advantage of the effectiveness of savings through the retirement system.
- Restructure the retirement system to cater for and withstand another potential state of disaster in the future.

Consumer awareness and education: Customers should receive clear information about the consequences and implications of withdrawing long-term savings. This is particularly important for those whose actions may be driven more by market uncertainty than the need to access funds.

Additional Priority: Investments and fund managers

Prior to the pandemic, ratings agency Moody's downgraded South Africa's credit rating to sub investment grade, which culminated in the country's exclusion from the FTSE World Government Bond Index.¹⁴² Barclays and Citigroup estimated that Moody's downgrade could lead to \$6 billion and \$6.6 billion of outflows respectively due to their forced bond selling.

R2.2 trillion (ASISA: 2020) in assets held in collective investment schemes (CISs) are predominantly invested in equities, fixed-income instruments (e.g. bonds) and real estate vehicles in South Africa. The majority of low-to-middle income South Africans are investors in CISs in the form of unit trusts, given their affordability and easy accessibility. According to media company Moneyweb (March 23), 23 of South Africa's top 40 companies lost more than 30 per cent of their value as result of the impact of COVID-19, and these losses have been transmitted to the investment savings of millions of South Africans.

¹⁴² The FTSE World Government Bond Index (WGBI) measures the performance of fixed-rate, local currency, investment-grade sovereign bonds. The WGBI is a widely used benchmark that currently includes sovereign debt from over 20 countries, denominated in a variety of currencies. The WGBI provides a broad benchmark for the global sovereign fixed income market. Sub-indexes are available in any combination of currency, maturity, or rating.

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The equities and bond markets have come under severe stress that is characterised by high degrees of volatility and illiquidity, and the expertise of investment managers is critical to salvaging the remaining investment values and savings.

To counteract the impact of decreased bond portfolios, the SARB purchased Government bonds in the secondary market to manage liquidity in the financial markets.

Key considerations

- The initial lockdown forced sell-offs, significantly of depressed bond portfolio values, but inevitably the overall assets under the management of the industry. However, these have been slowly recovering and international investors' interest in them has been slowly increasing.

Proposal for project development

- Going forward, Government and the investment management industry should work together to rebuild investment values and discourage panic withdrawals through consumer education.

Additional Priority: Increase access to Insurance to support Priority 6 promote appropriate, affordable and quality insurance

Markets have been in turmoil and this has significantly impacted on insurers' investment portfolios. Additionally, interest revenue streams may quickly dry up as interest rates continue to drop. Despite the impact on liquidity, insurance companies are expected to remain solvent in order to pay claims now and in the future.

In South Africa, credit life insurance¹⁴³ regulations came into effect on August 10th, 2017. Credit life insurance (CLI) provides for loss of income and most credit providers require that consumers take this cover. Despite many consumers having CLI as part of their loan agreements, a lot of them were unaware that they already had this insurance in place, and that they could lodge claims against it in this regard. Of the customers who were offered payment relief, 60 per cent had credit life, and this boosted claim numbers. It is, however, hard to determine the exact period the benefits will be paid for, as the insurance industry did not anticipate a pandemic of this nature and it is unclear how long the lockdown will be required. This will further exacerbates the multiple challenges faced by the insurance industry.

Key considerations

- Inclusive insurance should form a part of the financial inclusion strategy, focusing on well-designed insurance products that provide households with the means to protect themselves against the consequences of different kinds of shocks.
- Explore the need and mechanics for having "business interruption" insurance to cover SMMEs whose businesses are disrupted during extraordinary events like pandemics.
- Ensure that consumers are protected to ensure their fair treatment when dealing with health insurers and others in a pandemic crisis.

143 Credit life insurance is insurance that provides security should you be unable to repay your debt due to retrenchment, disability or death.

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Pillar Two: Extending access to financial services for smmes

Additional Priority: Enable the transition of SMMEs from the informal to formal businesses To support Pillar 2 extending access to financial services for SMMEs

There are an estimated 2.3-2.8 million SMMEs in South Africa according to the IFC report, *The Unseen Sector – A report on the MSME opportunity for South Africa* 2018. The study also says that SMMEs account for 34 per cent of GDP in South Africa and provide 50-60 per cent of the country's employment. Protecting the sector during a crisis is particularly important given that South Africa already has one of the highest unemployment rates in the world, sitting at 30.1 per cent at the end of the first quarter of 2020. Although SMMEs are a core part of the economy, they are particularly vulnerable to a host of adverse effects arising from the COVID-19 pandemic. For instance, demand for their products and services has reduced, their supply of inputs has been disrupted, while the provision of credit has tightened amid an environment of rising uncertainty. In the short term, it is imperative that SMMEs can access liquidity in order to manage cash-flow shortages and reduced demand, and to limit firm closures, bankruptcies and prevent widespread lay-offs. To avoid persistent negative effects on economies and workers, it is critical that viable SMMEs survive, and that financial institutions continue to provide access to credit and working capital for businesses in a sustainable way.

The coronavirus pandemic led to the implementation of measures to support SMMEs. For SMMEs to access debt relief from the Department of Small Business, some qualifying criteria was put in place. These conditions include that a business must have been registered with the Companies and Intellectual Property Commission (CIPC) and it must be registered and compliant with SARS and UIF. This situation resulted in the re-emergence of the issue of formality vs informality in the South African context.¹⁴⁴ According to the World Bank (2019) only 14 per cent of SMMEs are formalised in South Africa.

The SARB/NT launched the SME loan guarantee scheme of R200 billion in partnership with all South African banks (i.e. Absa, Bidvest Bank, First National Bank (FirstRand), Grindrod Bank, Investec, Mercantile Bank, Nedbank, SASFIN Bank and Standard Bank). To date, the banks have also approved just over R10.6 billion in concessionary loans for 7,496 qualifying small businesses, in terms of the COVID-19 Loan Guarantee Scheme, which was launched in mid-May. A total of 33,965 applications had been received by July 31st, 2020.

The Department of Small Business Development (DSBD) launched a debt relief fund for SMMEs negatively impacted directly, or indirectly, by the COVID-19 pandemic. The debt relief finance provides preferential financing (at interest rates of prime less 5 per cent) for salaries, rent and municipal accounts. SMMEs can access the resources after registering on the national SMME database and they must have also been registered with the CIPC by the end of February 2020 in order to qualify. Companies must be 100 per cent South African-owned and registered and complainant with SARS and UIF. SMMEs can register and apply online. As of May 12th R513 million had been approved for the SMME Debt Relief Funding Scheme, 1,501 SMMEs had benefitted from the scheme and about 18,000 jobs had been saved, according to the DSBD. The fund has since been closed.

144 SMME Debt Relief Finance Finance Scheme, Department of Small Business Development (https://www.gov.za/sites/default/files/gcis_documents/SMME%20Debt%20Relief%20Scheme.pdf)

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The DSBD had launched the Township and Rural Entrepreneurship Programme (TREP) offering R740 million in loans and grants targeted at informal businesses and formal microenterprises operating in townships and villages in the following sectors: (a) bakeries and confectionaries, (b) clothing and textiles, (c) automotive afterparts support, (d) fruit and vegetable traders, and (e) spaza shops.

Key Considerations and proposals for project development

- Policymakers must work in close collaboration with banks and actively support entities like the Small Enterprise Development Agency to encourage those informal businesses that display formality characteristics to formalise.
- Leverage DSBD's Township and Rural Entrepreneurship Programme (TREP) and explore regulations to motivate businesses to formalise.
- Reduce regulatory red tape to improve the operating environment for SMMEs.
- Rollout one-stop shops and technology-enabled business registration to grow the bankable SMME market segment.¹⁴⁵
- Minimize onerous tax administration processes.
- Develop projects to improve the COVID-19 response. i.e. improve the uptake of the COVID-19 loan guarantees and improve loan and grant disbursements through DSBD.

Additional Priority: Promote appropriate affordable and quality insurance for SMME to support Priority 12 facilitate suitable insurance for SMMEs

Pandemics are generally excluded from insurance policy coverage. This has led to coverage disputes particularly when it comes to business interruption cover. The tourism and hospitality sector, particularly its smaller SMMEs, has been severely impacted by this. Coverage, relative to various policy wordings against potential COVID-19-related losses and liabilities, is restrictive, whereby many insurance companies do not provide cover when the national lockdown is the cause of the interruption or interference to the business. There is still uncertainty in this area of insurance regarding coverage disputes.

The full or partial closing of businesses coupled with social distancing has also led to a decreased demand and premium volumes for insurance, as fewer people are buying houses, cars, and other insurable products.

Key considerations

- Understand SMME needs and use the findings to develop minimum product standards.

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Priorities in the future world of promoting and enhancing financial inclusion

Enhanced focus on consumer protection

The emergence of a lot of new fintechs and digital platforms in the financial services sector is expected after the pandemic has subsided. This would place the work of the FSCA – i.e. the importance of consumer protection – high on the national agenda.

Furthermore, there is likely to be an increase in the number risky investments, like ‘get-rich-quick’ schemes. Depressed economic conditions may make more customers susceptible to engaging in risky investments, and more likely to fall prey to fraudulent schemes such as ponzi or pyramid schemes, as they seek to make returns on limited capital.

Key considerations

- Finalise the COFI Bill and fast-track its full implementation.
- Strengthen the financial sector ombuds system to protect poor and vulnerable financial customers.

Enhanced focus on consumer financial education

As consumers continue to grapple with the impact of COVID-19 on their livelihoods, it is important that financial consumers are provided with information on how to manage their personal finances. They must be helped to adapt to their evolving circumstances and where applicable given assistance on how to access available relief measures as well as their rights and shown what protection measures are available to them in the event of abuse.

For instance, relief measures have already been initiated by various stakeholders to assist consumers and small businesses experiencing financial difficulties. There were concerted efforts to publicise information about the measures as widely as possible. Although there was communication, there were challenges with regards to effective engagement and ensuring that the messages reached the relevant communities, especially those who could not access electronic material that was largely published on websites.

Moreover, apart from South Africans failing to save, taking on debt and making poor spending decisions, consumers who are not financially savvy are also highly vulnerable to scams. Any move to digitisation will require a ‘bottom up’ approach where the digital capability (literacy) of individuals is considered. In light of this, the National Consumer Financial Education Committee (NCFEC)¹⁴⁶ facilitated coordination and collaboration on the communication of topical COVID-19-related financial information to the public to ensure the effective reach and use of available resources.

The NCFEC is also planning to produce a regular newsletter under the Money Smart Week South Africa 2020¹⁴⁷ (MSWSA) campaign banner where it will share relevant COVID-19 financial education or information. This is will be used as advocacy for the MSWSA which has been postponed to March 2021.

¹⁴⁶ The NCFEC is a multi-stakeholder which was established in 2012 to secure the active involvement, collaboration and coordination of a range of stakeholders in consumer financial education. The committee comprises of representatives of the financial sector industry associations, government agencies, academia, and other civil society organisations and under normal circumstances, meets quarterly.

¹⁴⁷ MSWSA is a flagship financial literacy campaign of the NCFEC that is aimed at motivating and empowering South Africans to become more educated about their finances. Given the accelerated spread of COVID-19 in South Africa, the Money Smart Week South Africa 2020 event was postponed to March 2021.

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Key considerations and proposals for project development

- The high cost of data makes digital financial education material inaccessible to low-income consumers. Explore zero-rated websites¹⁴⁸ for financial literacy content.
- Inclusive consumer awareness campaigns are crucial to ensure consumers can make informed financial decisions that are suitable for their personal circumstance. As long as people have relatively low levels of financial education, they will not be able to meaningfully participate in the financial sector.
- As a supplement to financial inclusion and financial consumer protection, financial education is also important to restore confidence and trust in financial markets, and it can also support financial stability¹⁴⁹.

Proposed Research Agenda

The pandemic has exposed the plight of low-income households and small businesses, but it remains unclear how the future will develop. Human behavioral research might be required to fully understand the impact of COVID-19 on financial inclusion as it relates to households and SMMEs.

Key considerations

Research survey (preliminary questions)

- How was life (financial status) before the pandemic with regard to access and usage of financial services? How is it now?
- Which firms (especially SMMEs) have or are exiting the financial services market i.e. the basic characteristics of those SMMEs?
- Those firms that survived how are they keeping their doors open and how long can they survive?
- Are communities comfortable with going digital? if not, what would make it easier for them to adopt technology?
- Are households making ends meet? Are they food secure? If not, how can they be further assisted?

¹⁴⁸ Zero-rated websites provide internet access without financial cost under certain conditions, such as by permitting access to only certain websites, by subsidizing the service or by exempting certain websites from the data allowance. In the context of Covid-19 it means that financial education/ awareness material could be posted to these website to enable all citizens to improve their financial literacy levels.

¹⁴⁹ Advancing National Strategies for Financial Education: A joint publication by Russia's G20 Presidency and the OECD (2013); and Seminar on Financial Education, Financial Stability Board, 2016.

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CONCLUSION

We do not yet know the medium- to long-term implications of the coronavirus pandemic on financial inclusion. What we know is that “our new economy must be founded on fairness, empowerment, justice and equality. It must use every resource, every capability and every innovation we have in the service of the people of this country. Our new economy must open new horizons and offer new opportunities.”¹⁵⁰

One thing the pandemic has taught the Government of South Africa is to be agile and move quickly – consumers were forced to learn and move quickly to tighten their budgets and adjust household spending and priorities as their incomes were reduced; policymakers had to move quickly to implement policies in support of hard-hit consumers; financial services providers were forced to be innovative and agile, to quickly design and deliver products that offer relief and support to their customers; and regulators had to come to the party and ease the regulatory compliance burden on the providers of financial services. With financial literacy and consumer financial education is also a long-standing issue in South Africa, COVID-19 has placed the finalisation of work around the development a National Consumer Financial Education Strategy high on Government’s agenda. Access to finance for small business also needs to be tackled at a hastened pace and more creatively than it was in the past. Initiatives like the formalisation of small business, the development of a credit information system for SMMEs as well as the development of an immovable collateral registry for SMMEs, remain pressing matters for South Africa. The pandemic has also further emphasised the digital divide and the need for Government to develop and roll out short-, medium- and long-term strategies in collaboration with the private sector to mitigate and narrow it. The crisis has also revealed the need for the efficient management of market conduct risks, especially during a pandemic. In addition, incidences of market abuse have further highlighted the need for the finalisation of the COFI Bill and the strengthening of the ombud system.

The lessons from the crisis will afford policymakers an opportunity to build a “new economy” and set a new agenda for financial inclusion for the whole country.

150 President CM Ramaphosa Statement, 21 April 2020, <https://sacoronavirus.co.za/2020/04/21/extraordinary-budget-for-coronavirus-response/>

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