

**ANNEX 1:  
INTRODUCTION TO ABSA  
AND THE BANKING  
ENVIRONMENT**

## 1. Introduction

1.1 This document has been prepared by Absa Bank Limited ("**Absa**") in response to the issues raised in the Commission's terms of reference and also provides answers to a number of questions posed by the technical task team of the Commission. On 4 August 2006, the terms of reference of the enquiry were published. In short, the Commission is tasked with investigating "*the level and structure of charges made by banks*" (and matters related thereto), the "*feasibility of improving access by non-banks and would-be-banks to the National Payment System infrastructure...*", as well as "*any other aspect relating to the payment system or the abovementioned charges which could be regarded as anti-competitive*".

1.2 In this introductory section to Absa's response, we set out below:

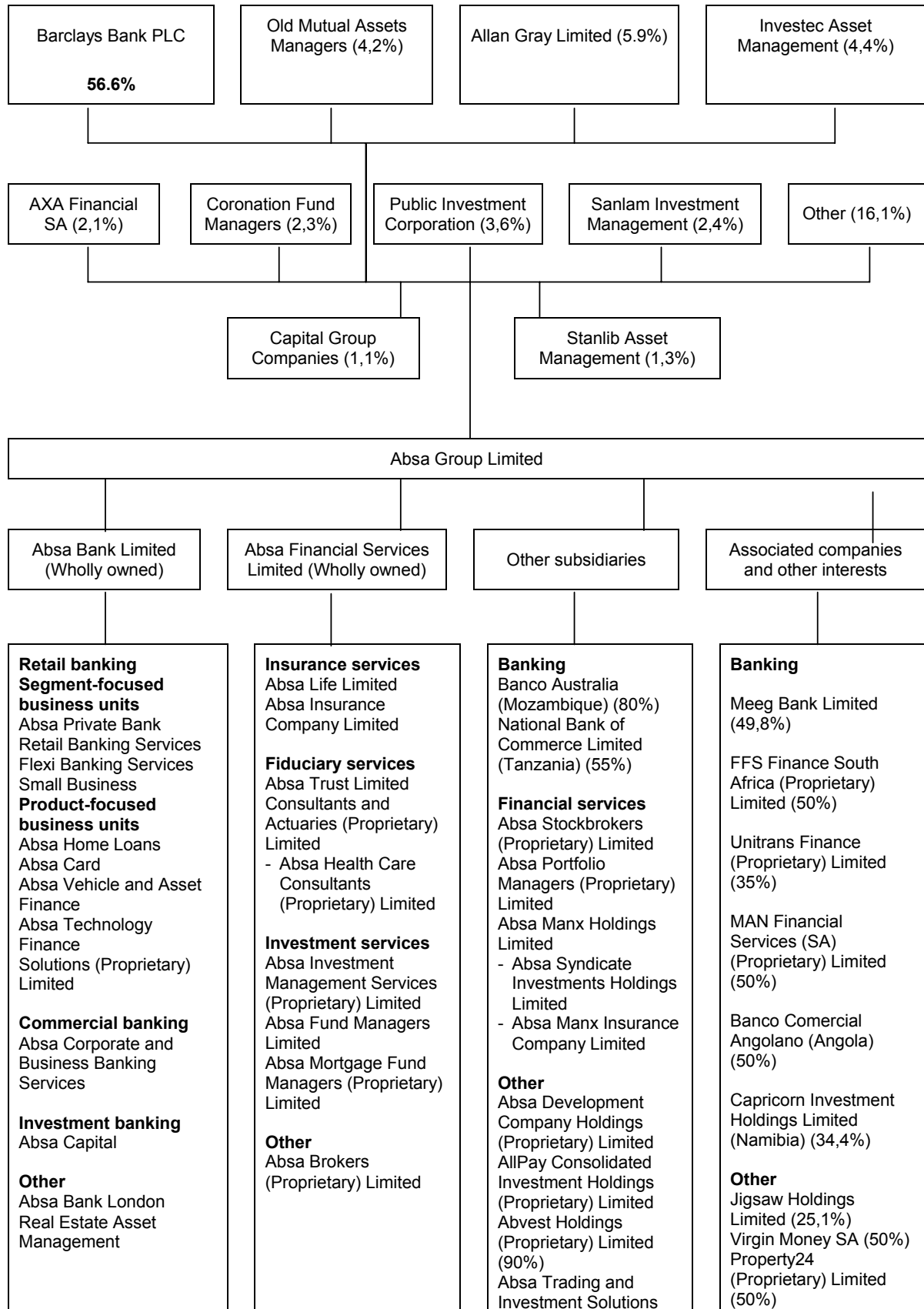
- 1.2.1 a brief description of Absa and its underlying operations;
- 1.2.2 an overview of the South African banking sector;
- 1.2.3 a summary of the regulatory landscape governing the banking sector;
- 1.2.4 providing banking services to the unbanked; and
- 1.2.5 the structure of Absa's document.

## 2. Absa

### 2.1 History of the Group

2.1.1 Absa had its origins in the merger of UBS Holdings, Allied and the Volkskas Group, together with certain interests of the Sage Group in 1991. In 1992, Absa acquired the entire shareholding of the Bankcorp Group (which included Trust Bank, Senbank and Bankfin). In 1997 the name of the holding company, Amalgamated Banks of South Africa Limited was changed to Absa Group Limited. In 1998 the United, Volkskas, Allied and Trust Bank brands were consolidated into a single brand and Absa adopted its new corporate identity.

- 2.1.2 On 27 July 2005 Absa became a subsidiary of Barclays Bank PLC ("**Barclays**"), when Barclays acquired a controlling stake in the Absa Group. Barclays is an international financial services group engaged in retail and commercial banking, credit card issuing, investment banking, wealth management and investment management services.
- 2.1.3 The structure of the Absa Group, including its principal shareholders and operating divisions is set out in the diagram below:





Holdings Limited

Sanlam Home Loans  
(Proprietary) Limited  
(50%)

## 2.2 **General information**

2.2.1 **This paragraph is confidential in its entirety.**

2.2.2 The Absa Group is listed on the Johannesburg Securities Exchange in the Financial Services sector and is South Africa's second largest banking group.

2.2.3 Absa's board of directors consists of 18 directors, of whom 11 are independent directors.

2.2.4 Absa operates primarily in South Africa. Only 3.3% of its earnings for the year ended December 2005 emanated from outside of the country.

## 2.3 **Black economic empowerment and Absa's support for the Financial Services Charter**

2.3.1 Absa regards itself as a responsible, committed and contributory member of the South African business community. As such Absa is cognisant of its obligations in playing a relevant role in the South Africa of the future by ensuring compliance not only with all legal and regulatory requirements, but also with the need to reverse the previous inequalities arising from apartheid. An example of this is Absa's commitment to achieving the objectives set out in the Financial Sector Charter which was signed on 17 October 2003. The Financial Sector Charter is a voluntary initiative designed to address the issue of Black Economic Empowerment in the financial services industry.

2.3.2 Absa has already made significant strides designed to achieving the minimum target of 25% Black ownership by 2010. On 1 July 2004 Absa concluded a Broad-based BEE transaction with the Batho Bonke Consortium and Absa's Employee Share Ownership Programme. As a result of the transaction, 11% of the enlarged issued share capital of Absa is held by the two groups, of which 10% was issued to the Batho Bonke Consortium and 1% was issued to the Employee Share Ownership Programme. In addition, Absa has also set up the Absa Foundation, which is Absa's primary vehicle for corporate social investment. The Absa Foundation currently receives 0.5% of after-tax

operating profit, which is used to facilitate a number of community investments.

- 2.3.3 Moreover, employment equity at Absa is both a strategic focus area and a business imperative. Absa has actively sought to meet employment equity targets and the percentage of historically disadvantaged employees in the Group has increased from 47.8% (31 March 2005) to 52.1% (31 December 2005).

## 2.4 **Absa as a responsible corporate citizen**

- 2.4.1 **This paragraph is confidential in its entirety.**

- 2.4.2 As far as Absa's Small Business Division is concerned it has made significant efforts to support small business development.

- 2.4.3 Absa is also a significant employer within South Africa and has a well developed corporate social investment programme. Absa has also played a significant role in facilitating the funding of low cost housing in support of the Government's objectives in this regard. As discussed in detail below, Absa has played a large role in facilitating access to the payment system for new entrants through sponsorship and through access agreements for non-banks.

## 3. **Overview of the South African banking sector**

- 3.1 A perception appears to exist that the South African banking sector has been a relatively stagnant sector, characterised by low levels of competition. An assessment of the developments within the banking industry over the last 10-15 years points to the contrary. It is suggested that the banking environment over this period has been characterised by dynamic change. The last decade has been a particularly turbulent and eventful chapter in the history of the South African banking sector. Notwithstanding these changes, the South African banking sector has also won a number of plaudits and has been recognised as a significant strength in the South African economy.

- 3.2 In the early '90s, there was an initial period of consolidation arising from the mergers of various banks, including Allied, United and Volkskas to form Absa in 1991. Subsequently, however, the promulgation of the Banks Act in 1990

led to a proliferation of banking licences being issued. In the Commission's Report to the Reserve Bank in relation to the proposed merger between Nedcor and Stanbic, it was stated that "*Post 1994, however, has seen the entry of a number of foreign controlled banks and their representatives*". There was also the hostile bid by Nedcor for control over Stanbic, which ultimately failed, but had a major impact on the corporate strategies of the two groups. Many others acquired banking licences in the years that followed, so that by 2002, there were 43 registered banks. The flurry of new banking entrants came to an abrupt halt in 2001/2002, with the announcement of Saambou's financial difficulties and its subsequent demise.<sup>1</sup> This led to a "run" on BOE<sup>2</sup> and other smaller banks. As a result of the "*Saambou crisis*", a number of institutions decided not to renew their banking licences (such as Cadiz, Corpcapital, Brait and Syfrets) and other smaller banks, such as Mercantile Bank, sought assistance from foreign shareholders (Caixa Geral de Depositos SA assumed majority control of Mercantile in 2002). At the same time Regal Bank was in financial difficulties and, ultimately, was placed in curatorship.

- 3.3 Throughout this period a number of foreign banks established a presence in South Africa, including Citigroup, Standard Chartered (which acquired the 20Twenty division of Saambou) and Barclays, which resumed banking operations in South Africa - albeit on a limited basis. In more recent times, Barclays acquired a controlling shareholding in Absa and other new entrants, such as Virgin Banking, have established a presence in South Africa. There have also been persistent market rumours that other large foreign banks will establish a firm presence in South Africa in respect of retail banking services.
- 3.4 Accordingly, the banking sector has undergone a period of substantial change and volatility over the last few years and seems destined to attract ever greater levels of competition in the years ahead. This new competition is being provided by small banks (such as African Bank, Capitec and the Bank of Athens) and the Postbank, all of which are targeting previously unbanked

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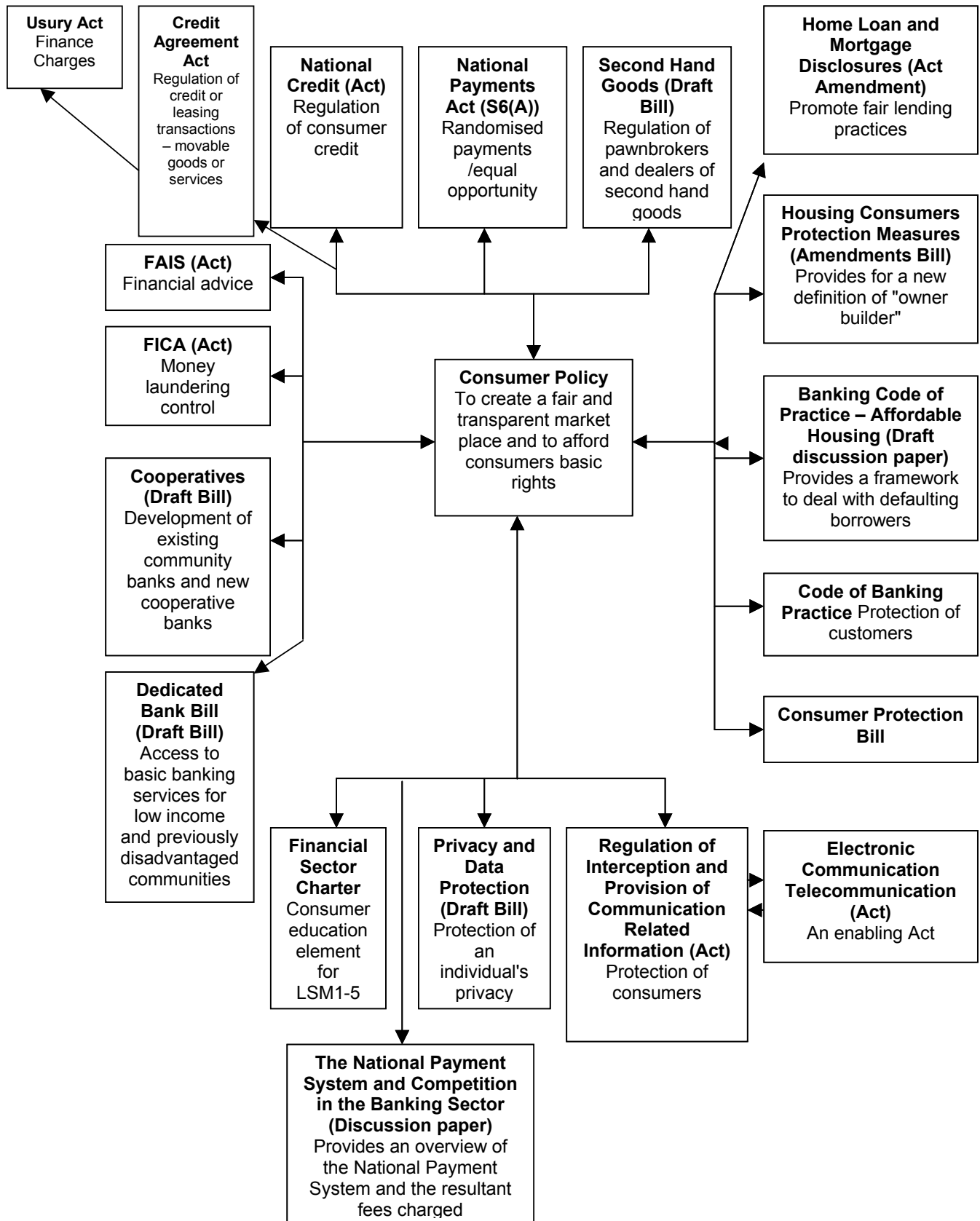
<sup>1</sup> Saambou's failure is the largest failure experienced by the South African Banking system. Saambou was listed on the JSE, employed over 2,500 people and had approximately 52 branches throughout the country. A run commenced on the bank, which may still at this stage have been solvent. Notwithstanding some involvement by the Reserve Bank, the large withdrawals led to the bank becoming insolvent and being placed into curatorship.

<sup>2</sup> In early 2002, a run commencement on BOE's deposits. The Reserve Bank intervened, but BOE eventually amalgamated with Nedbank.

and underbanked communities. (New competition is also coming from non-banks such as retailers, cellphone companies and insurance companies which are increasingly offering financial services that in the past were provided exclusively by banks.)

#### 4. **The South African regulatory environment**

- 4.1 The South African banking sector is one of the most heavily regulated industries in South Africa. The existing regulatory framework is soon to be amplified through a proliferation of new statutory measures designed to ensure even greater regulatory oversight over South African banking operations. These include the Financial Intelligence Centre Act ("**FICA**"), the Financial Intermediary and Advisory Services Act ("**FAIS**"), the National Credit Act and the Consumer Protection Bill.
- 4.2 The National Credit Act and the Consumer Protection Bill, in particular, have been designed to secure increased protection for consumers in relation to a variety of banking products, including home loans and personal loans, as well as regulating disclosure of information, pricing practices and regulating certain marketing practices. The following diagram sets out a number of recent regulatory interventions that have been – or will be – promulgated.



- 4.3 In addition to the wave of consumer-driven legislation, Absa also has to comply with both local and international measures designed to achieve greater corporate governance. These include the Code of Corporate Practices and Conduct set out in the King Report on Corporate Governance ("**King II**") and the revised Basel Capital Accord ("**Basel II**"), which relates to financial reporting standards. As part of the Barclays Group, Absa is subject to certain external compliance regimes, including those of the United States' Reserve Bank Sarbanes Oxley Act of 2002. In terms of section 404 of that Act, the Securities and Exchange Commission requires that SEC-registered companies' annual reports be prepared under US generally accepted accounting practices.
- 4.4 Banks are subject to the oversight of both the Registrar of Banks and the Financial Services Board ("**FSB**"). The Registrar of Banks is an official of the Reserve Bank and heads the Office of Banks. The Registrar must perform the functions assigned to him under both the Banks Act and the Mutual Banks Act and he must do this under the control of the Reserve Bank and in accordance with directions issued by it. The Registrar may also provide banks with guidelines by means of circulars on the interpretation and application of the Act. In addition to the powers conferred by the Banks Act, the Registrar has the powers conferred by the Inspection of Financial Institutions Act.
- 4.5 There are also a number of ombudsmen, who have been appointed to oversee the financial services sector in order to achieve quick and effective dispute resolution. Absa is a subscribing member of the Office of the Ombudsman for Banking Services. The mission of the Ombudsman is to provide banks and their customers with a quick and efficient dispute resolution service in a fair, impartial and confidential manner. In addition, the FAIS is a statutory ombudsman established in terms of the FAIS Act. The objective of the FAIS is to deal with complaints in a procedurally fair, informal and expeditious manner. Its jurisdiction is to hear FAIS-related complaints that have arisen out of financial prejudice that the customer is alleged to have suffered. This financial prejudice could have arisen by either a contravention or a failure to comply with FAIS or where a financial service (advice or intermediary service) has been rendered negligently, or where the customer

has been treated unfairly by an authorised financial services provider. The FAIS ombud is independently appointed by the FSB and his or her jurisdiction extends over the entire spectrum of financial service providers, including product suppliers, independent intermediaries and corporate brokers.

- 4.6 Moreover, a range of new legislation is in the offing to facilitate greater access to the banking sector and the national payment system in particular. This legislation includes the Co-operative Banks Bill and the Dedicated Banks Bill.
- 4.7 A detailed assessment of the South African regulatory environment in relation to banks is contained in ANNEX 2 of these submissions.
- 4.8 The net result of the significantly enhanced regulatory framework is that it has resulted (or will result) in significant changes to the competitive dynamics of the relevant markets. In addition, banks such as Absa are incurring significantly greater costs and employ larger numbers of people to ensure regulatory compliance. Interestingly, the Monitor report finds that, "*Regulatory costs in South Africa are higher than in many other developed countries.*"<sup>3</sup> Absa must also ensure compliance with the Financial Sector Charter ("**the FSC**") and other aligned initiatives. It stands to reason that any Commission of Enquiry into the banking sector needs to take careful account of the range of recent regulatory interventions and the impact which they will have in protecting consumer rights and on the competitive dynamics with the relevant markets.

## 5. Investigations into the banking industry

- 5.1 Over the last few years there have been a number of investigations worldwide into various national banking sectors, which have led to the publication of reports such as the Wallis Report in Australia, the Cruikshank Report in the United Kingdom, the recent sectoral enquiry into the banking industry by the European Commission, and the publication of the Falkena III and Feasibility reports in South Africa. What is notable about most of these investigations is the limited nature of the recommendations which have been made and the recognition of the importance of the banking sector to the entire economy. It should also be borne in mind, as discussed in the Cruikshank Report, that

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<sup>3</sup> Countries for comparison were Australia, Brazil, Canada and the UK. See page 99 of the Monitor Report.

international comparisons are of limited assistance owing to the fact that the banking sector is highly regulated throughout the world and, therefore, the competitive dynamics will differ significantly from country to country.

- 5.2 A number of the recommendations made by the Falkena III Report have already been implemented by the banking sector in South Africa. The conclusions and recommendations of the Falkena and Feasibility reports in particular are dealt with in ANNEX 6 of this report. It should be borne in mind that a number of the recommendations made by the Falkena Report have already been implemented by Absa and by the banking sector in South Africa.

## 6. Providing Banking Services to the unbanked

- 6.1 **This paragraph is confidential in its entirety.**
- 6.2 Absa expects that a range of new banking products will shortly be introduced through telephone banking and that this will ensure greater access to banking services in the same way as Internet banking has achieved similar objectives in relation to more affluent consumers. Indeed, it is evident that the banking sector is experiencing entry by a host of new competitors in the form of non-traditional players, such as MTN, Pick 'n Pay, Shoprite and Vodacom. Moreover, the last few years have witnessed a surge in the number of micro-lenders and these include companies such as Capitec and African Bank. Capitec, in particular, has started to move outside the realms of traditional micro-lending and is, increasingly, playing an active part in the sphere of savings and transactional accounts.
- 6.3 **This paragraph is confidential in its entirety.**
- 6.4 The role of technology and innovation in the banking sector will be dealt with more fully in ANNEX 4 of the report. **THIS ANNEX HAS HOWEVER BEEN REMOVED AS IT IS CONFIDENTIAL IN IT'S ENTIRETY.**