# South African banking landscape: Introduction & Background

Bank Enquiry Public Hearings

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First session

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F E A S i b i l i t Y

Financial Economic Analysis Strategy

*This document provides an outline of a presentation and is incomplete without the accompanying oral commentary and discussion.*



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# Agenda

- Importance of competition in banking
- Overview of SA banking industry
- Competition in SA Banking report (2004)
- Task team report recommendations
- National payment system and competition in banking report (2006)

# Importance of Competition in Banking

- Spur to efficiency, innovation, consumer choice, quality of goods and services, and low prices.
- Banking system provides a payments and settlement system, mechanisms for borrowing and lending, pooling and allocation of funds, and plays a central role in the economy, and in the financial sector.
- The impact of weak competition will affect:
  - the cost of financial intermediation.
  - Incentives to save and invest.
  - Allocation of resources (under or over pricing risk)
  - Ability to earn a wide margin between borrowing and lending which may leave potentially viable projects under-funded.

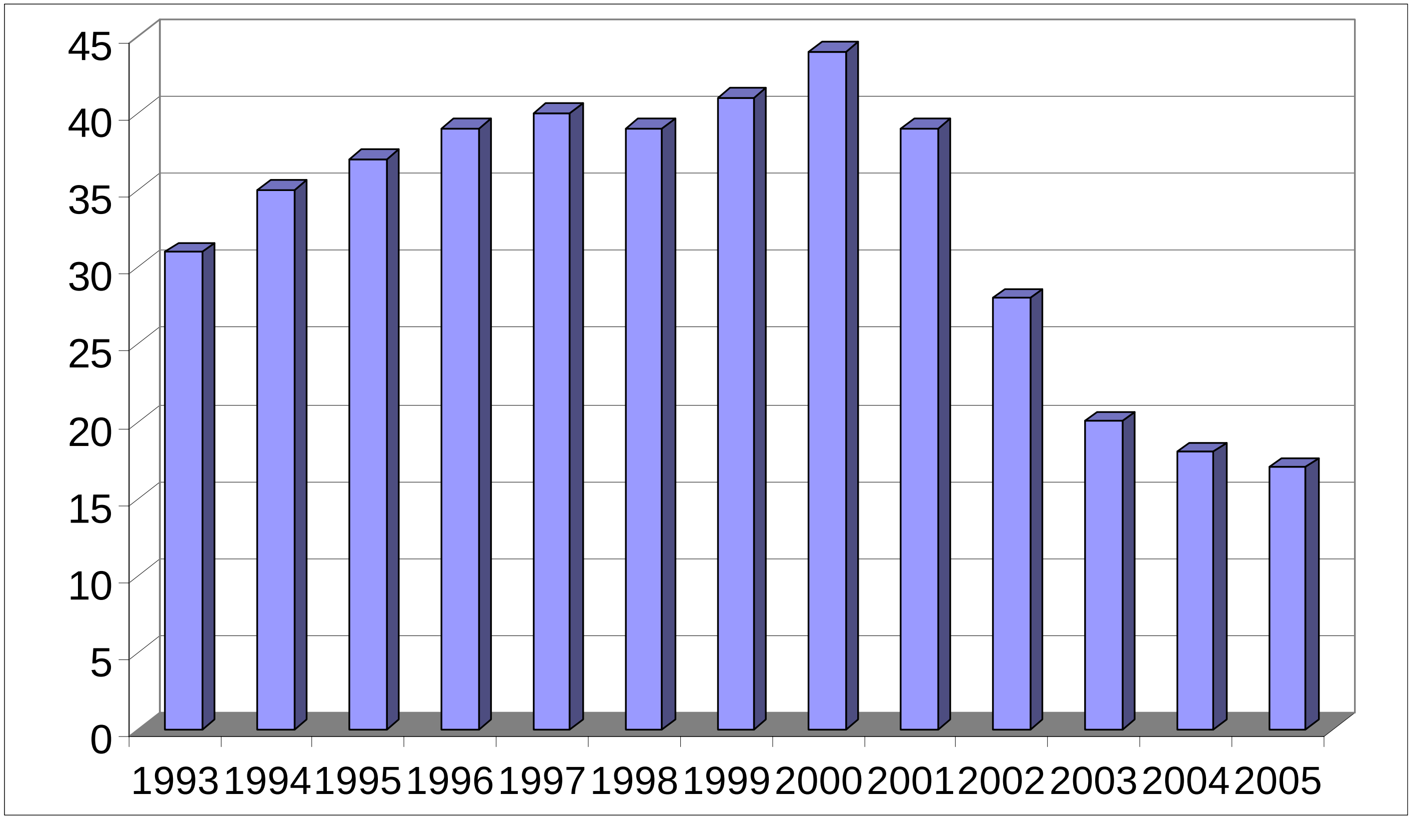
# Importance of Competition in Banking

- Without competition, a transfer of welfare from consumers to producers of goods and services and shareholders in these firms may take place.
- Differential access to financial services has important distributional effects.
- The efficiency of the financial system has both growth and distributional dimensions in the economy.

# The South African Banking Industry - Overview

- 17 registered commercial banks (down from 44 in 2000)
- 15 local branches of foreign banks
- 2 mutual banks
- Big 4 banks account for 84% of the industry's assets
- ...with Investec, Big 5, they make up 90% of the industry's assets.

# Number of South African Registered Commercial Banks




**(Excludes mutual banks and branches of foreign banks)**

*(Source: Bank Supervision Department)*

# Brief historical overview

- During the 1980s, legislation allowed for the blurring of lines between banks and building societies and, by 1994, building societies were no more.
- The Mutual Banks Act of 1993 allowed for mutual banks to fulfil the role of building societies. There has been little uptake and there are only two mutual banks.

# Brief historical overview

- Following deregulation in 1994, there was an influx of niche and foreign banks, so that by 2000, 44 banks were registered
- The failure of two small banks (Saambou and Unifer) led to the demise of the smaller banks and one of the larger banks, BOE. By 2003, there were only 20 registered commercial banks ,(now 17).

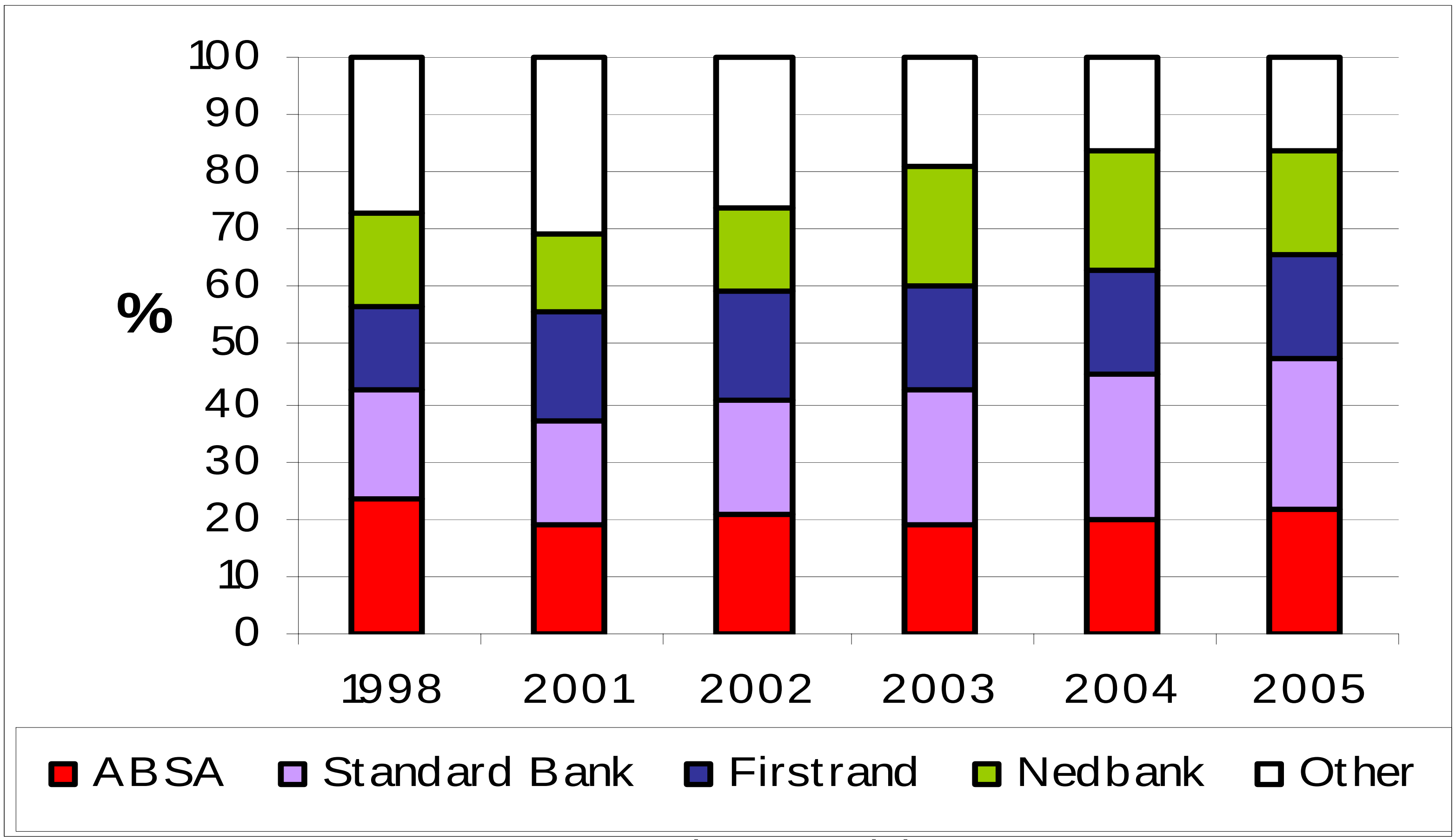
# Competition in South African Banking (2004)

- Task team report chaired by Dr. Hans Falkena
- Commissioned by SA Reserve Bank and the National Treasury
- Outcomes of concentration in the sector are:
  - high profitability (especially in retail segments),
  - ability to impose higher fees and
  - an incidence of cost that disadvantages low-income consumers and small businesses.

# Competition analysis

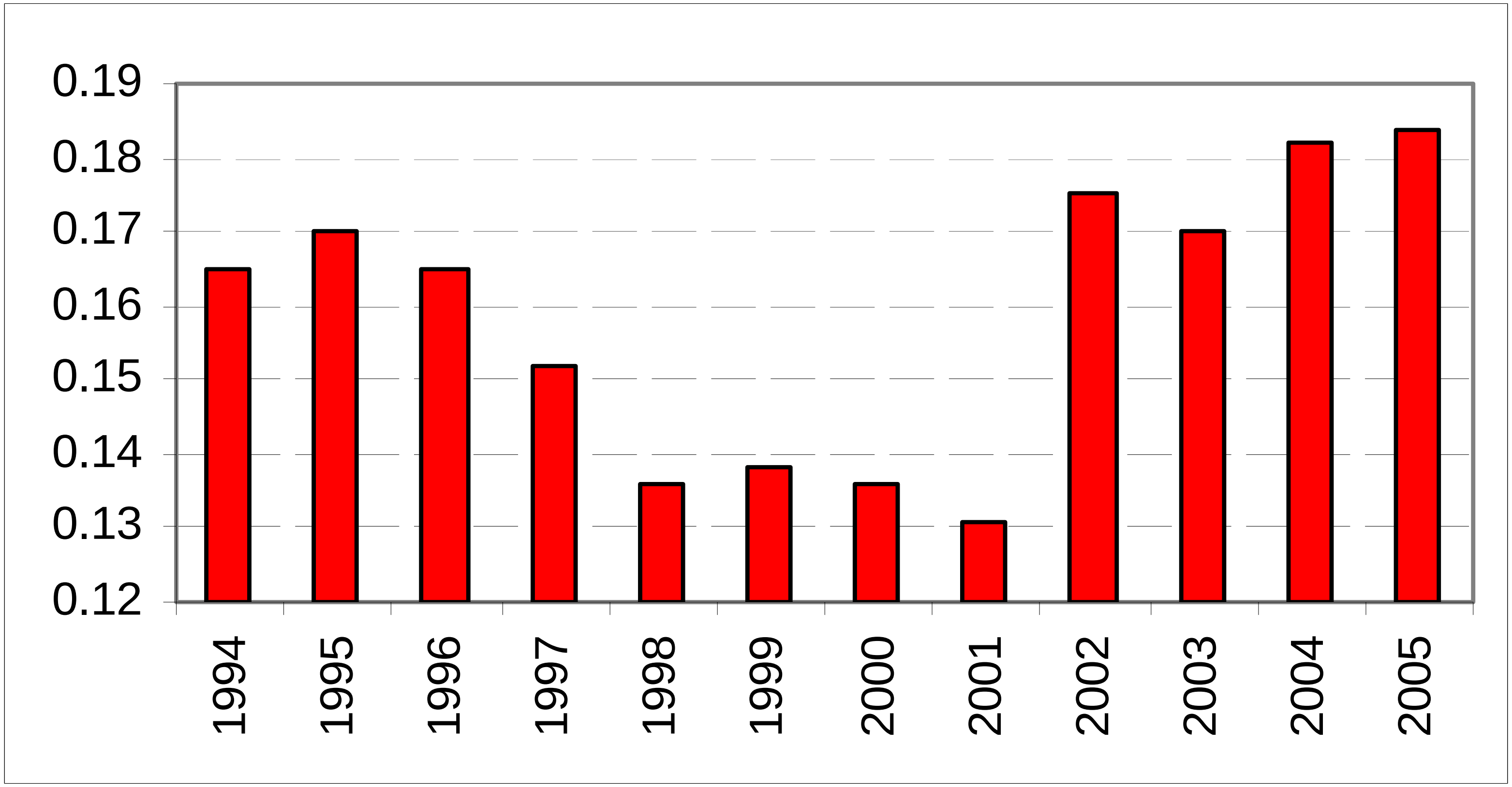
- Competition in the industry
  (Structure, Herfindal-Hirschman Index)
- Contestability of markets
  (Entry and exit barriers and threat of entry)
- Effective competition
  (Consumers able to make rational choices and able to exercise them)

# Market share of Assets of Big Four




*Source: Bank Supervision Department*

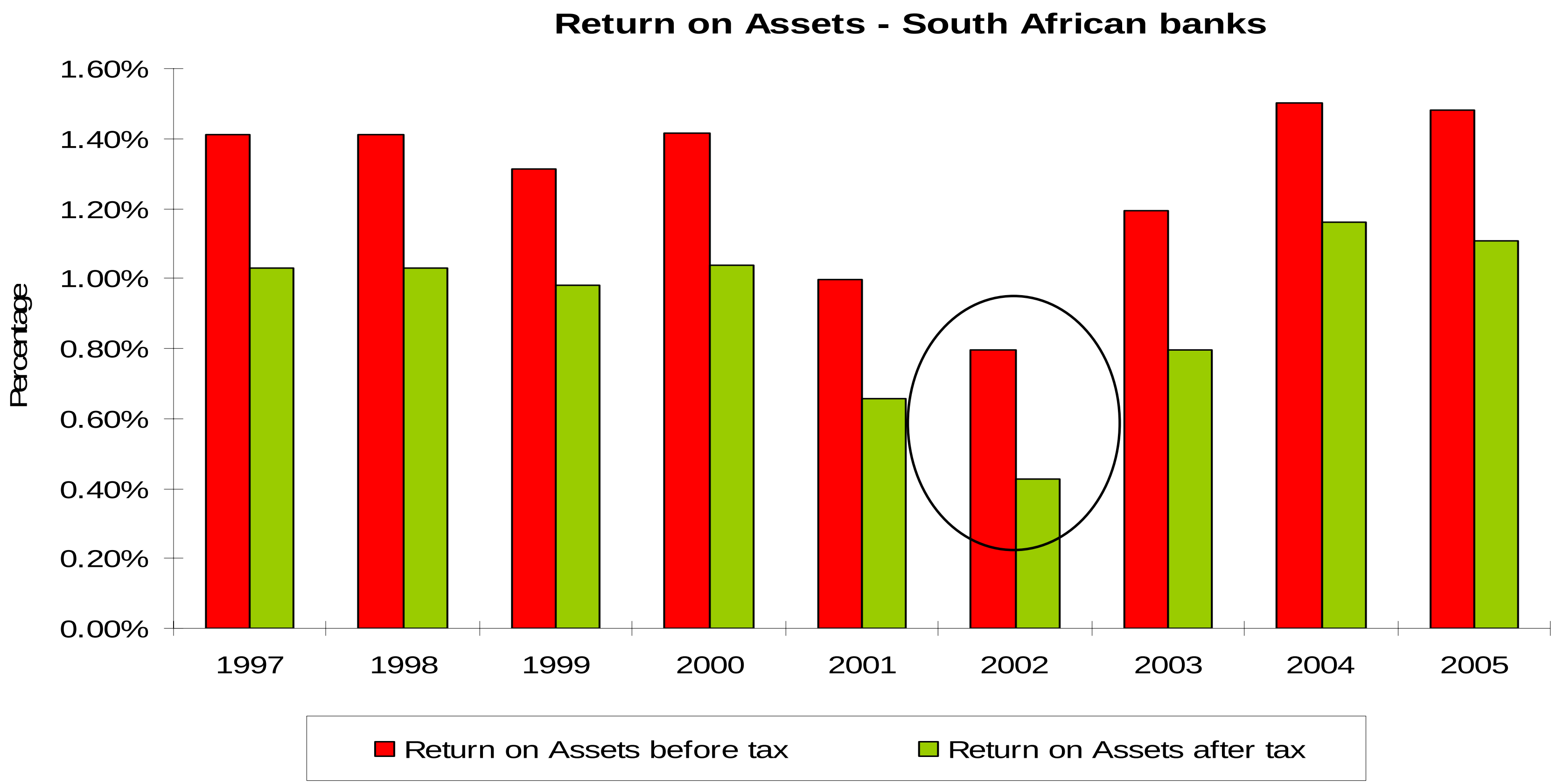
# Herfindal-Hirschman Index (HHI) of the banking sector




**(Sum of the squares of the market share of each bank)**

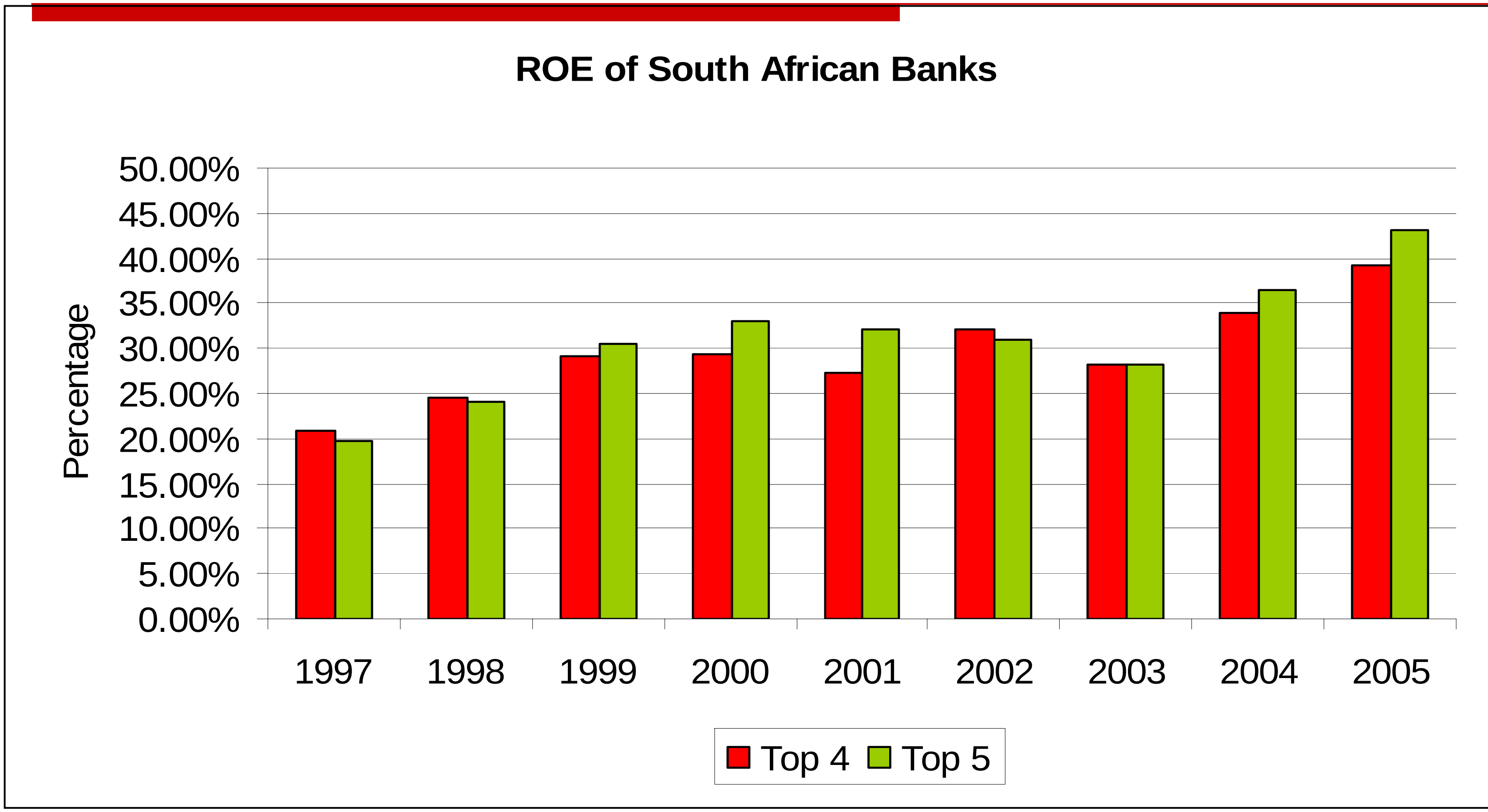
*(Source: Banking Supervision Department derived figures)*

# Return on Assets for South African banks




*Source: Bank Supervision*

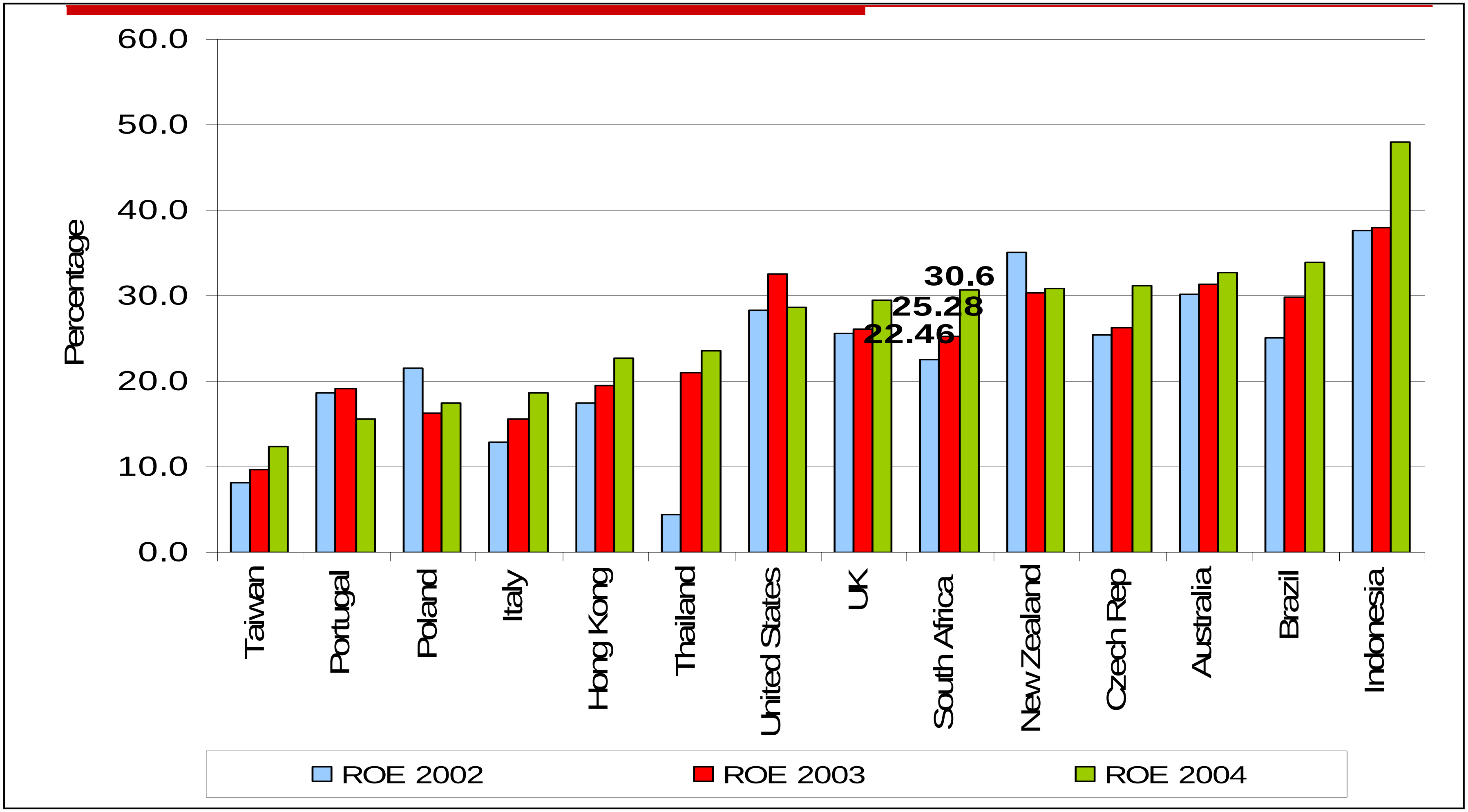
# Return on equity of SA Banks




*Source: The Banker, INet Bridge*

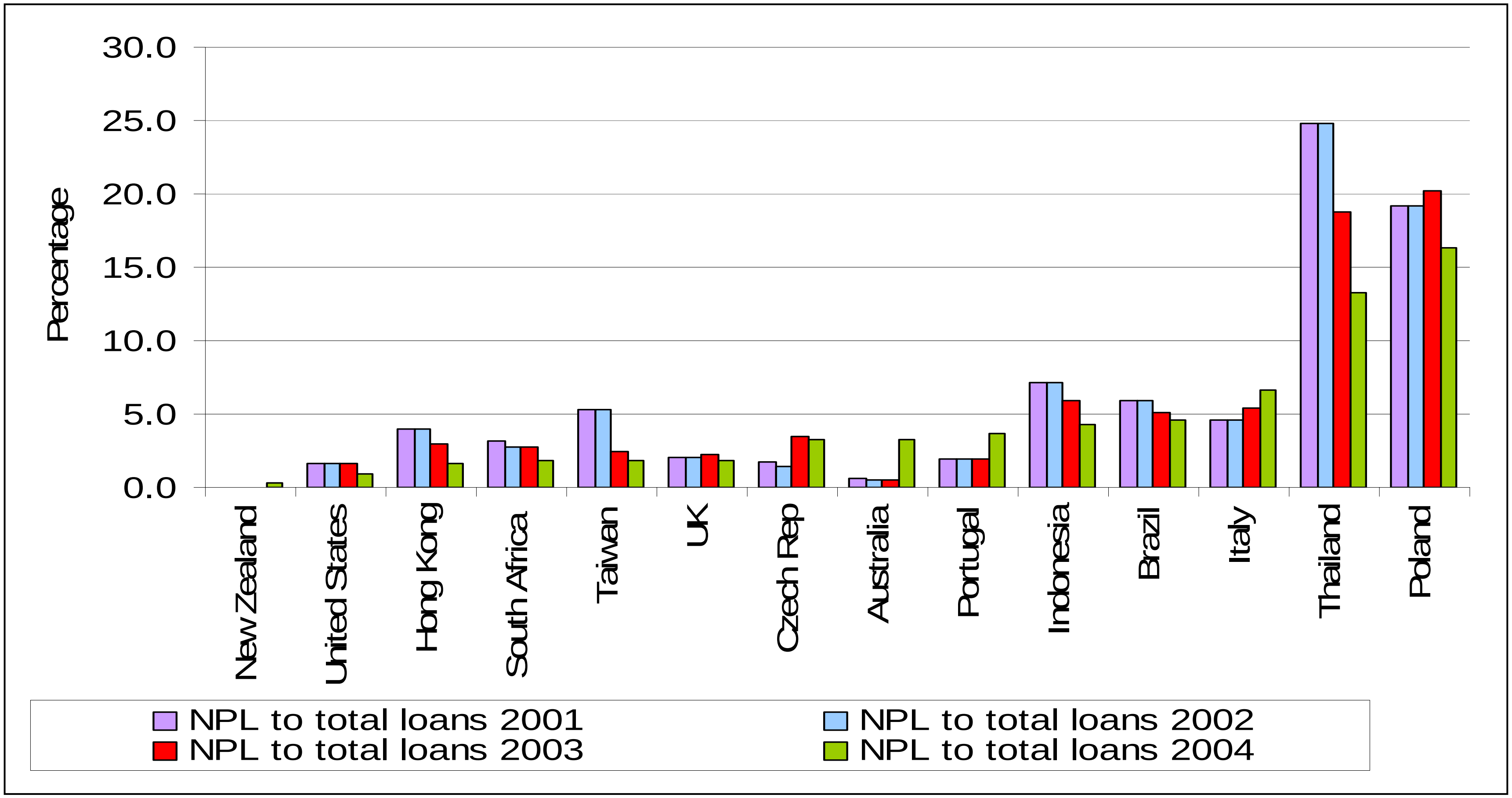
# Return on equity:

*Source: The Banker July 2006*



# Non-performing loans (as a % of total loans) 2005

*Source: The Banker July 2006*



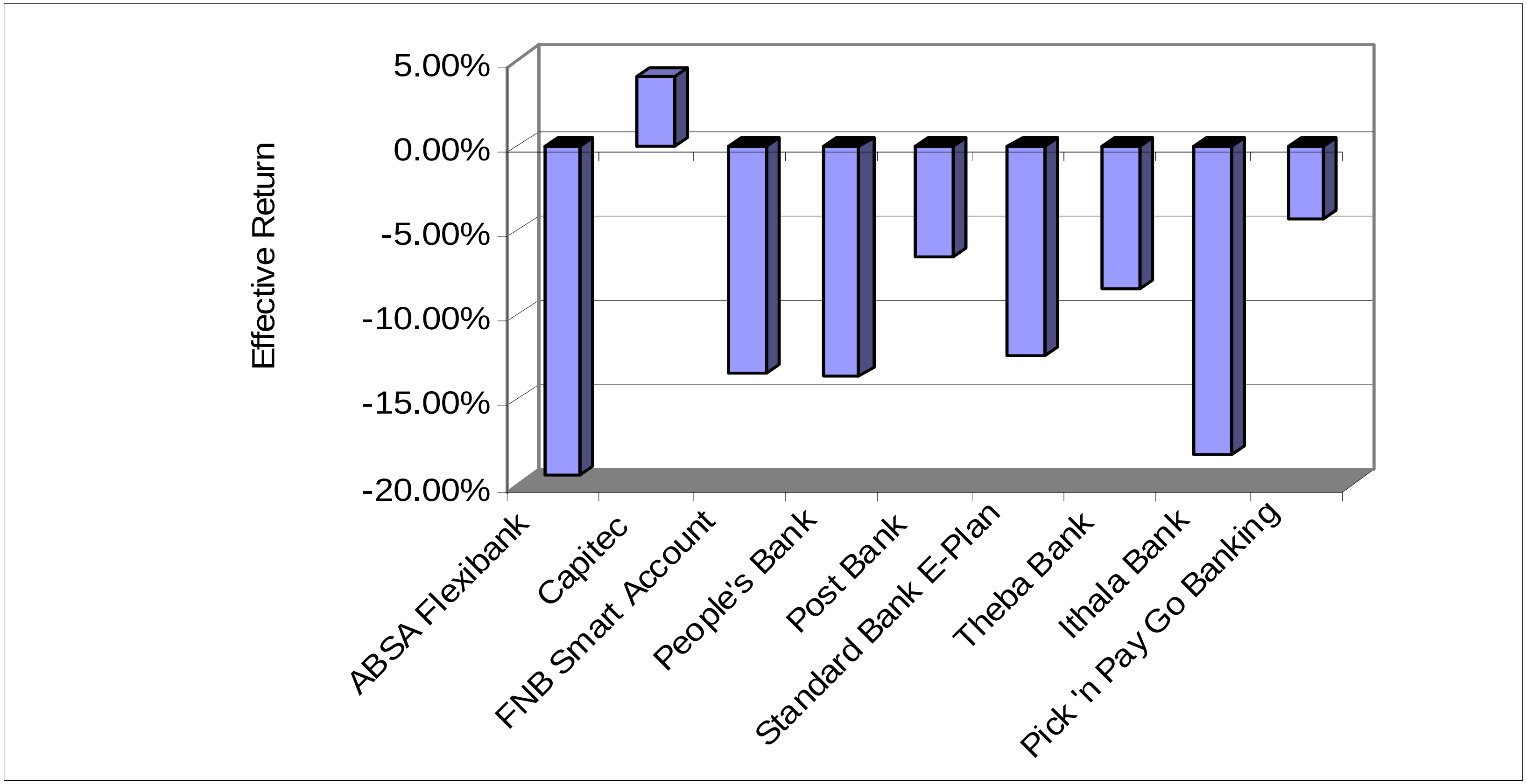
# Incidence of Costs: Task Team Report, 2004

Falls on those marginally banked: Lack of access stultifying for communities. Premium for being being unbanked

| Unbanked | | Partially Banked or Banked | | | | | |
|---|---|---|---|---|---|---|---|
| No bank account | | No bank account - use of Post Office | | Bank account - branch use | | Bank account - ATM use | |
| Receive cash | R 0.00 | Receive cash | R 0.00 | Assume salary paid in | R 0.00 | Salary paid in | R 0.00 |
| Transfer using services of Taxidriver | R 25.00 | Transfer using postal order (excludingtravel) | R 17.80 | Transfer using postal order (excluding travel) | R 17.80 | Transfer (in branch) | R 6.90 |
| | | | | 2 Withdrawals in branch | R 34.60 | 2 ATM "on us" withdrawals | R 8.60 |
| Total | R 25.00 | Total | R 17.80 | Total | R 52.40 | Total | R 15.50 |

# Incidence of Costs: Task Team report, 2004

**Returns on entry level savings accounts, prior to Mzansi account**



# Profitability of retail banking

**Returns on retail and mass market segments, 2003**

| Bank segment | ABSA Retail | ABSA Flexibank | Nedcor Retail | Nedcor Peoples |
|---|---|---|---|---|
| Return on Average Equity | 46.6% | 151.8% | 8% (11.1%) | 11% (26.9%) |
| Cost-to-income ratio | 83.4.% | 65.2% | 76.6% | 51.1% |

*Task team report, 2004. ABSA And Nedcor Annual reports*

*Source: ABSA Group and Nedcor Annual Reports, 2005*

# Profitability of retail banking

| | Bank segment | | | | |
|---|---|---|---|---|---|
| ABSA | Return on Average Equity | | | Cost-to-income ratio | |
| Group year ends March | Retail Banking | Flexi Banking Services | Retail Banking Services | Retail | Flexibank |
| 2003 | 46.6% | 113.0% | 83.4% | 83.4% | 65.2% |
| 2004 | 31.9% | 240.4% | 80.2% | 80.2% | 81.8% |
| 2005 | 40.0% | 202.9% | 78.8% | 78.8% | 77.7% |
| Nedcor Group | Nedbank Retail | | | Nedbank Retail | |
| Group year ends December | | | | | |
| 2003 | 9.7% | | | 78.7% | |
| 2004 | 12.8% | | | 76.9% | |
| end June 2005 | 18.3% | | | 73.2% | |

# Profitability by segment 2003

| Profitability | Profitability of segment in the last year (ranked by those active in the segment) | | |
|---|---|---|---|
| | Moderate 10-20% | High 20 - 30% | Extreme 30%+) |
| Retail banking | | 60% | 20% |
| Corporate banking | 50% | 25% | 6% |
| Merchant banking | 47% | 24% | 6% |
| Private banking | 18% | 18% | 27% |
| Internet banking | 43% | | |
| Credit cards | 50% | | 17% |
| Micro-lending | | 25% | |

*Source: PWC Banking Survey 2003*

*Source: PWC, Banking Survey, 2005*

# Profitability by segment: 2005

| Profitability | Profitability of segment in the last year (ranked by those active in the segment) | | | | |
|---|---|---|---|---|---|
| | Loss <0% | Marginal 0-10% | Profitable 10 - 20% | Very profitable 20-30% | Extreme >30% |
| Retail banking | | 50% | | | 50% |
| Home loans | | 20% | 20% | 60% | |
| Vehicle financing | | 33% | 50% | 17% | |
| Credit cards | 28% | | 14% | 14% | 43% |
| Corporate | | 28% | 44% | 22% | 5% |
| Merchant | | | 30% | 35% | 35% |
| Private banking | | 42% | 12.50% | 12.50% | 12.50% |
| Internet banking | 17% | 17% | 33% | 17% | 17% |
| Micro-lending | | 17% | 17% | 50% | 17% |

# Incidence of Costs: SME's

## Charges for SMEs and for individual current account holders (2003)

| Scenario: SME Current account usage | | |
|---|---|---|
| Description | Charge as SME | Charge as individual* |
| 10 cheques a month average R2000 | R 251.00 | R 225.00 |
| R80000 cash deposited into account (in R5000 tranches) | R 729.60 | R 720.00 |
| R20000 received by cheque | R 0.00 | R 0.00 |
| Payment of 15 accounts electronically ave. R2000 | R 196.50 | R 187.50 |
| Exceeds overdraft limit once | R 90.00 | R 0.00 |
| Overdraft fee for overdrawn balances | R 25.00 | R 0.00 |
| Withdrawal Own ATM R5000 | R 45.50 | R 45.00 |
| Withdrawal other ATM R5000 | R 51.00 | R 51.50 |
| TOTAL CHARGES FOR MONTH | R 1,469.85 | R 1,285.25 |
| Difference | | 14.36% |

# Conclusion of the Task team report, 2004

- Profitability of the industry indicates stability and potential for change.

- Stimulation of competition inhibited by:
  - Weak and incomplete disclosure (to industry & consumers).
  - Possible complex monopoly of essential infrastructure (Payments system).
  - Monolithic licensing /registration structure.

# Task team, 2004 Recommendations, inter alia:

- Enabling legislation for second and third tier banks needs to be put in place
- Access by second tier banks to the payment system on competitive terms should be facilitated
- Interoperability in the payment system and transparency of access requirements should be extended
- Penalty fees should be on a cost-plus basis and open to regulatory oversight

# Task team, 2004 Recommendations, inter alia:

- Introduce improved disclosure requirements on banking services.
- Introduce legislation that would compel banks to offer existing and potential customers unbundled service and pricing options.
- Government should prohibit any preferential processing mechanism for payments
- The Commission should investigate the NPS as a complex monopoly

# Following Task team report...

- Dedicated Banks and Co-operative banks bills published for comment, 2004
- Barclays PLC buys a majority stake in ABSA
- Termination clauses for preferential payments arrangements in National Credit Act
- Announcement of credit card alliances between Edgars and Standard Bank, Metropolitan and Mercantile Bank, Kulula and FNB and Virgin and ABSA and Voyager and Nedbank have been announced.
- Competition Commission study into the National Payments System launched in 2005

# National Payments System and Competition in banking, 2006

- FEASibility (Pty) Ltd
  - Provide a technical description of how NPS operates, the operators and ownership structures of the payment system
  - Provide an understanding of the regulation of the system and current and pending changes to the regulations
  - Provide an analysis of possible anti-competitive outcomes of the system
  - Focus on retail payment system
- Prof Olu Akinboade (UNISA)
  - International review