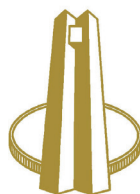


Cooperative Banks Annual Report 2017/18



South African Reserve Bank

Cooperative Banks Annual Report 2017/18



South African Reserve Bank

The page features a light green header and a large, faded background image on the left side. This image includes a geometric pattern of triangles and a portrait of a woman with short dark hair, wearing a patterned top. The text is positioned to the right of this image.

Mission

Promote the soundness of the cooperative banking sector through the effective regulation and supervision of cooperative banks in the interests of their members and the economy.

Regulatory philosophy

The Supervisor of Cooperative Banks (Supervisor) follows a coordinated approach with all stakeholders to ensure the consistent and fair application of the Cooperative Banks Act 40 of 2007.

The Supervisor's objective is to apply international regulatory and supervisory standards, where necessary, to cater for the unique needs of the domestic cooperative banking sector.

The Supervisor operates through a relationship of mutual trust and cooperation with all role players in an effort to promote and enhance the accessibility of sound financial services to all South Africans.

Cooperative Banks Annual Report 2017/18 for the financial year ended 31 March 2018 in terms of section 52 of the Cooperative Banks Act 40 of 2007

© South African Reserve Bank

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without fully acknowledging the *Cooperative Banks Annual Report* as the source. The contents of this publication are intended for general information only and are not intended to serve as financial or other advice. While every precaution is taken to ensure the accuracy of information, the South African Reserve Bank shall not be liable to any person for inaccurate information or opinions contained in this publication.

ISSN (print): 2223-9154
ISSN (online): 2223-9162

Available on www.resbank.co.za

Contents

| | |
|--|-----------|
| Chapter 1: Introduction and Supervisor’s overview | 1 |
| 1.1 Introduction..... | 1 |
| 1.2 Organisational developments | 2 |
| Chapter 2: Cooperative banking sector overview | 3 |
| 2.1 Introduction..... | 3 |
| 2.2 Membership and shareholding..... | 3 |
| 2.3 Balance sheet analysis..... | 3 |
| 2.4 Capital and capital adequacy | 5 |
| 2.5 Liquidity | 6 |
| 2.6 Asset quality | 6 |
| 2.7 Income statement analysis | 7 |
| 2.8 Performance rating..... | 8 |
| 2.9 Inherent risks..... | 8 |
| Chapter 3: Regulatory developments and interactions with stakeholders | 9 |
| 3.1 Introduction..... | 9 |
| 3.2 Regulatory developments..... | 9 |
| 3.3 Interaction | 9 |
| Figures | |
| 1 Registration of some deposit-taking institutions..... | 1 |
| 2 Structure of the Bank Supervision Department | 2 |
| 3 Composition of gross loans at 28 February 2018 | 4 |
| 4 Composition of deposits at 28 February 2018 | 5 |
| 5 Composition of capital in 2016/17 and 2017/18 | 6 |
| 6 Composition of delinquent loans at 28 February 2017 and 28 February 2018..... | 7 |
| Tables | |
| 1 Membership and share capital in 2016/17 and 2017/18..... | 3 |
| 2 Balance sheet growth during the period under review..... | 4 |
| 3 Change in the capital adequacy ratio during the period under review..... | 5 |
| 4 Risk classification of loans at 28 February 2017 and 28 February 2018 | 6 |
| 5 Provisions for total loans and delinquent loans at 28 February 2018..... | 7 |
| 6 Income and expenditure in 2016/17 and 2017/18..... | 8 |
| Abbreviations | 10 |

Chapter 1: Introduction and Supervisor’s overview

1.1 Introduction

The *Cooperative Banks Annual Report 2017/18* (Annual Report) begins with an overview of the organisational developments in the South African Reserve Bank (SARB). Chapter 2 provides data and an analysis of aggregated information of cooperative banks, while Chapter 3 outlines the regulatory developments during the past financial year and an overview of interactions with stakeholders.

Cooperative banks are registered in terms of the Cooperative Banks Act 40 of 2007 (Cooperative Banks Act) by the SARB, whereas the cooperative financial institutions (CFIs) are registered by the Cooperative Banks Development Agency (CBDA) in accordance with the Exemption Notice 620 of 2014, issued by the Registrar of Banks (see Figure 1).

Figure 1 Registration of some deposit-taking institutions



The year under review was momentous for the Cooperative Banks Supervision Division as a new cooperative banking license was issued and the department was preparing for the launch of the Prudential Authority on 1 April 2018. During the course of 2017, the Supervisor of Cooperative Banks granted an application for registration as a cooperative bank to Ziphakamise Savings and Credit Cooperative, submitted in terms of section 6 of the Cooperative Banks Act. The Ziphakamise Savings and Credit Cooperative financial institution was registered as a cooperative bank in terms of section 8 of the Cooperative Banks Act in the year under review.

The total assets of cooperative banks reached R154 million in the year under review. The performance of the combined results of the three registered cooperative banks has improved year on year.

The total income of the cooperative banking sector increased by 33.0%, from R14.3 million at the end of February 2017 to R19.1 million at the end of February 2018. Total assets increased by 26.6%, from R121 million to R154 million, which was mainly driven by growth in loans. Total capital also increased by 35.8%, from R16.1 million at 28 February 2017 to R21.8 million at 28 February 2018, which is attributed to increased retained earnings and reserves, while liabilities increased by 25.2%, mainly driven by the increase in members’ deposits. Profit before tax increased by 14.8%, primarily due to an increase of 39.6% in total net financial income, while operating expenses increased by 59.0%. The cooperative banking sector’s capital adequacy ratio increased from 11.9% at the end of February 2017 to 12.9% at the end of February 2018, which is well above the required 6%.

1.2 Organisational developments

1.2.1 Introduction

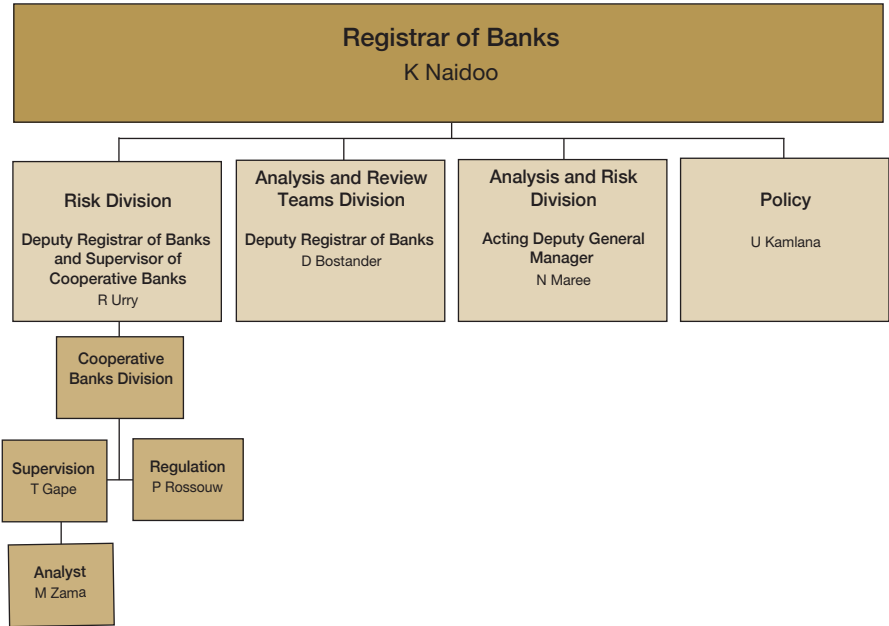
The previous staff member who was transferred temporarily to the Cooperative Banks Division of the Bank Supervision Department has since been withdrawn.

1.2.2 Structure of the Bank Supervision Department

The Supervisor of Cooperative Banks (Supervisor) has the authority to exercise the powers and perform the functions afforded by the Cooperative Banks Act. Mr R Urry is the Supervisor of Cooperative Banks and the Deputy Registrar of Banks in terms of the Banks Act 94 of 1990 (Banks Act). During the period under review, Mr Urry was assisted by Adv. P Rossouw, Dr T Gape and Mr M Zama, who were responsible for regulatory and supervisory responsibilities respectively.

There will be changes to the structure of the SARB's Cooperative Banks Supervision Department with the implementation of the Twin Peaks model of financial regulation in South Africa.

Figure 2 Structure of the Bank Supervision Department



Chapter 2: Cooperative banking sector overview

2.1 Introduction

This chapter provides an overview of the financial performance of the three cooperative banks in the cooperative banking sector for the financial year ended 28 February 2018. Increases and decreases indicate year-on-year fluctuations for the period under review, unless explicitly stated otherwise.

During the year under review, the cooperative banking sector experienced significant growth in its asset base, which was largely supported by the registration of the third cooperative bank and growth in deposits, the injection of capital and the retention of profits by the existing cooperative banks. On year-on-year basis, the cooperative banking sector's total assets increased by 26.6%, driven by an increase in loans, whereas liabilities increased by 25.2%, mainly driven by the increase in members' deposits. Profit before tax increased by 14.8%, primarily due to an additional 16.1% contributed by the newly registered institution, Ziphakamise Cooperative Bank, while operating expenses increased by 59.0%.

2.2 Membership and shareholding

In order to transact with a cooperative bank, customers must first become members by meeting the cooperative bank's eligibility criteria and purchasing membership shares in the cooperative bank. This results in members becoming both customers and owners of the cooperative bank.¹

Membership in the cooperative banking sector increased by 35.7%, from 2 392 at the end of February 2017 to 3 246 members at the end of February 2018.

Share capital amounted to R1 093 212 at the end of February 2018, which is an increase of 40.6% from R777 577 reported at the end of February 2017.

Table 1 Membership and share capital in 2016/17 and 2017/18

| | 2017/18 | 2016/17 | Percentage change (%) |
|-------------------------|------------|----------|-----------------------|
| Number of members | 3 246 | 2 392 | 35.7 |
| Share capital | R1 093 212 | R777 577 | 40.6 |

2.3 Balance sheet analysis

Year on year the cooperative banking sector recorded total assets growth of 26.6%, from R121.2 million to R153.5 million, mainly driven by growth in loans. Growth in liabilities was primarily due to increased member deposits, which accounted for 98% of total liabilities. Equity increased by 35.8% year on year, which was primarily comprised of retained earnings and reserves. Table 2 below provides further detail on the cooperative banking sector's balance sheet at 28 February 2018.

1 It should be noted that members of cooperative banks do not have a right to the cooperative bank's accumulated retained earnings and reserves, but each member's share value is paid back at nominal value when membership is terminated. It is also important to note that section 24(1) of the Cooperatives Act 14 of 2005 determines that, despite any provisions contained in its constitution, if a cooperative bank determines that the repayment of shares would adversely affect its financial well-being, it may direct that the repayment be deferred for a period not exceeding two years after the effective date of the notice of withdrawal.

Table 2 Balance sheet growth during the period under review

| | 28 February 2018 (R) | 28 February 2017 (R) | Percentage change (%) |
|--|-------------------------|-------------------------|--------------------------|
| Assets | | | |
| Loans | 114 914 400 | 84 552 050 | 35.9 |
| Liquid assets | 29 632 556 | 30 334 804 | -2.3 |
| Fixed assets | 3 041 132 | 2 158 652 | 40.9 |
| Investments | 2 972 998 | 2 094 258 | 42.0 |
| Other assets | 2 913 476 | 2 106 788 | 38.3 |
| Total assets | 153 506 380 | 121 246 552 | 26.6 |
| Liabilities and capital | | | |
| Liabilities | | | |
| Deposits | 128 812 551 | 103 994 839 | 23.9 |
| Other liabilities | 2 853 783 | 1 166 830 | 144.6 |
| Total liabilities | 131 666 333 | 105 161 669 | 25.2 |
| Capital | | | |
| Members' shares | 1 093 212 | 777 577 | 40.6 |
| Retained income | 15 154 082 | 10 966 267 | 38.2 |
| Reserves | 5 592 293 | 4 341 039 | 28.8 |
| Total capital | 21 839 588 | 16 084 883 | 35.8 |
| Total liabilities and capital | 153 506 380 | 121 246 552 | 26.6 |

At the end of February 2018, 74.9% of total assets comprised of loans, of which 85.2% were long-term loans, and 95.0% were secured by collateral in the form of deposits, mortgage bonds or guarantees.

Figure 3 Composition of gross loans at 28 February 2018

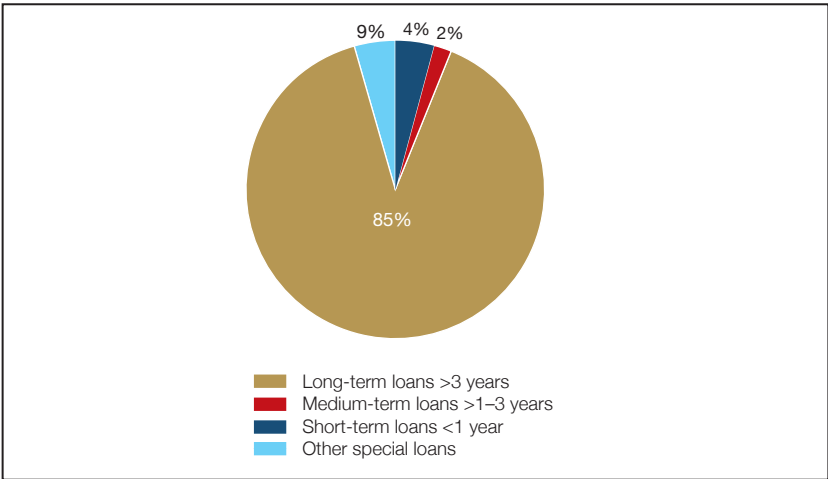
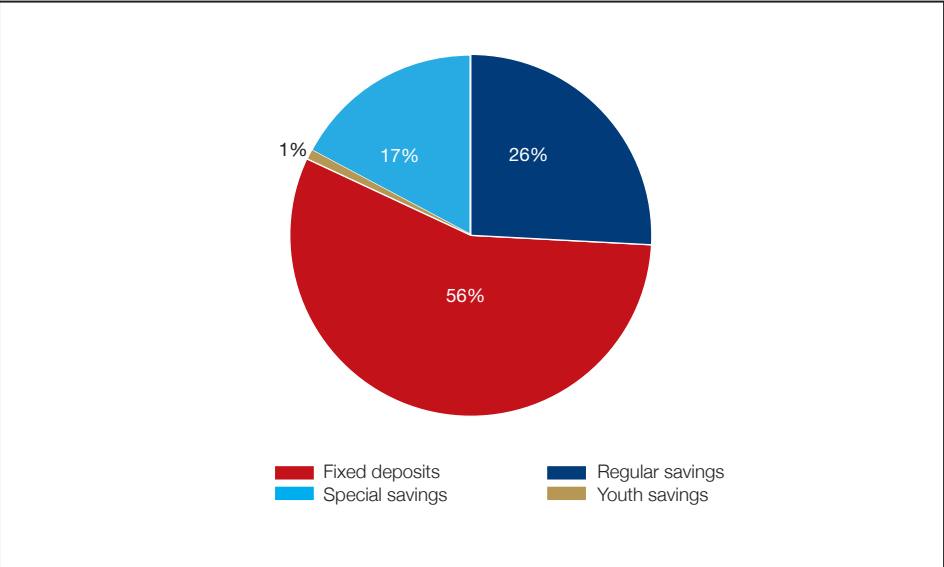


Figure 4 reflects the composition of the cooperative banking sector's deposits at 28 February 2018. Fixed deposits, which are deposits with maturity dates of up to six years, constituted 55.8% of members' deposits. Special savings, which are funds that are accumulated during the year for a particular purpose, such as school fees or seasonal expenses, accounted for 17.0%, and regular savings accounted for 26.2% deposits. Youth savings, which are savings of people under the age of 21, made up only a small fraction of the total savings in the cooperative banking sector.

Figure 4 Composition of deposits at 28 February 2018



2.4 Capital and capital adequacy

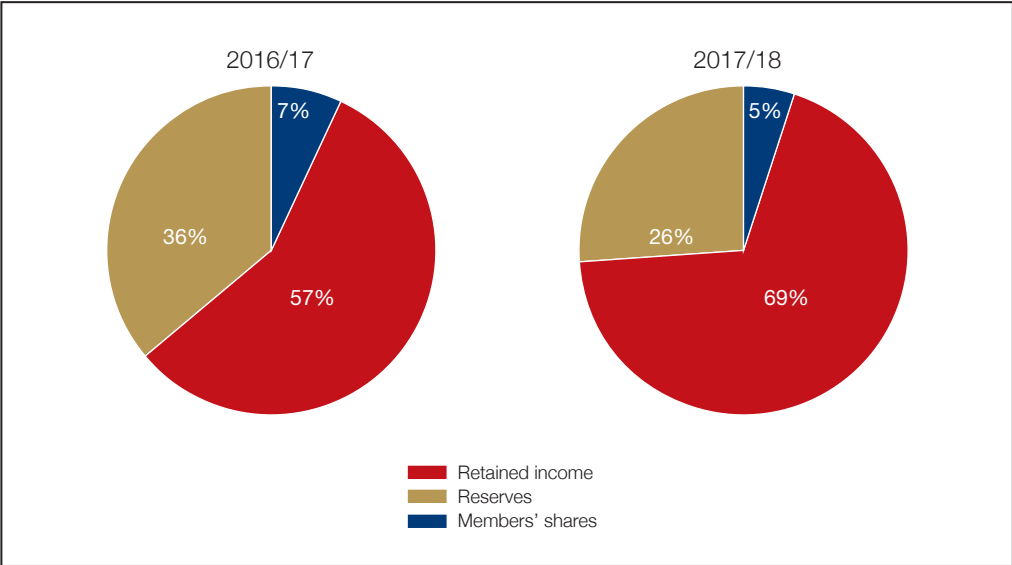
Total capital comprises of member share capital, retained earnings and reserves. Total capital increased by 35.8%, from R16.1 million at 28 February 2017 to R21.8 million at 28 February 2018. The significant growth is attributable to the registration of the third cooperative bank and increased reserves and retained earnings in the other two existing cooperative banks. The cooperative banking sector's capital adequacy ratio² increased from 11.9% at the end of February 2017 to 12.9% at the end of February 2018.

Table 3 Change in the capital adequacy ratio during the period under review

| | 28 February 2017 (%) | 28 February 2018 (%) | Percentage change (%) |
|---|----------------------|----------------------|-----------------------|
| Minimum required capital adequacy ratio | 6.0 | 6.0 | 0.0 |
| Actual capital adequacy ratio..... | 11.9 | 12.9 | 1.0 |

2 The capital adequacy ratio is calculated by subtracting the amount of provision made for delinquent accounts from the total capital and expressing it as a percentage of total assets. Regulation 4(2) of the Regulations relating to Cooperative Banks (Regulations) only allows members' shares, reserves held in terms of section (3)(1) (e) of the Cooperative Banks Act 40 of 2007, retained income (non-distributable reserves created or increased by appropriations of surpluses, but excluding loan-loss provisioning), and non-distributable reserves of a permanent nature, as approved by the Supervisor of Cooperative Banks in writing, to qualify as capital for purposes of calculating the capital adequacy ratio.

Figure 5 Composition of capital in 2016/17 and 2017/18



2.5 Liquidity

Liquidity is measured by the cash and other liquid financial assets that cooperative banks hold to meet their short-term commitments as and when they fall due. Effective liquidity management, which includes both quantitative and qualitative elements, is crucial for the continued viability of cooperative banks. The average liquidity ratio of the cooperative banking sector exceeded the minimum regulatory requirement of 10.0% of total deposits, amounting to 18.3% at the end of February 2018 (2017: 26.3%).

2.6 Asset quality

Delinquent loans accounted for 4.0% of the cooperative banking sector's gross loans at the end of February 2018, an increase from 3.7% in the previous financial year. The sector continued to provide sufficiently for potential losses in accordance with regulatory requirements during the review period.

Table 4 Risk classification of loans at 28 February 2017 and 28 February 2018

| | 29 February 2017 | | 28 February 2018 | |
|---|------------------|----------------|------------------|----------------|
| | Amount (R) | Percentage (%) | Amount (R) | Percentage (%) |
| Non-delinquent loans | 81 438 660 | 96.3 | 110 251 738 | 96.0 |
| Delinquent loans between 1 and 6 months..... | 2 637 694 | 3.1 | 3 498 698 | 3.0 |
| Delinquent loans between 6 and 12 months..... | 116 591 | 0.2 | 703 375 | 0.6 |
| Delinquent loans >12 months..... | 359 106 | 0.4 | 460 589 | 0.4 |
| Total loans | 84 552 050 | 100.0 | 114 914 400 | 100.0 |

Figure 6 Composition of delinquent loans at 28 February 2017 and 28 February 2018

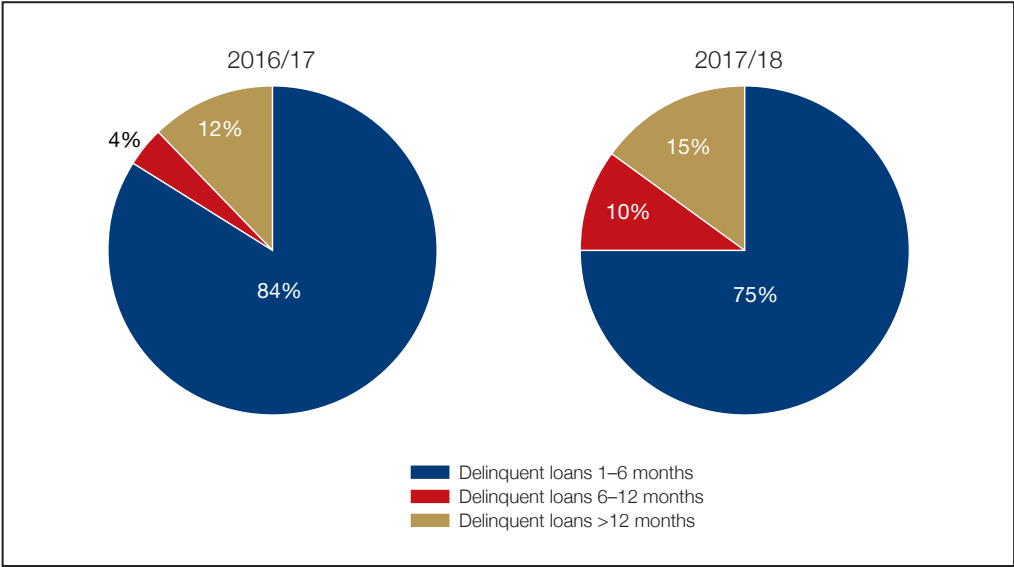


Table 5 Provisions for total loans and delinquent loans as at 28 February 2018

| | Loans (R) | Regulatory requirement (%) | Provision required (R) | Actual provision (R) |
|--|--------------|----------------------------------|------------------------------|----------------------------|
| Total loans..... | 114 914 400 | 2 | 2 298 288 | 2 298 288 |
| Delinquent loans between 1 and 6 months..... | 3 498 698 | 35 | 1 224 544 | 1 224 544 |
| Delinquent loans between 6 and 12 months..... | 703 375 | 50 | 351 688 | 351 688 |
| Delinquent loans >12 months..... | 460 589 | 100 | 460 589 | 460 589 |
| Total provisioning | | | 4 335 109 | 4 335 109 |

2.7 Income statement analysis

2.7.1 Profitability

The cooperative banking sector remained profitable in the year under review, with income before taxation increasing by 14.8%, from R4.2 million at the end of February 2017 to R4.8 million at the end of February 2018, which was driven significantly by increased interest income on loans.

The cooperative banking sector’s return on assets was 3.1% at the end of February 2018 compared to 3.5% at the end of February 2017, and return on equity was 22.1% at the end of February 2018 compared to 26.1% at the end of February 2017. The cost-to-income ratio increased to 44.9% at the end of February 2018 from 39.5% at the end of February 2017.

2.7.2 Income

The total income of the cooperative banking sector increased by 33.0% from R14.3 million at the end of February 2017 to R19.1 million at the end of February 2018. Income growth was primarily driven by a 40.0% increase in interest income, which accounted for 90.9% of the cooperative banking sector's total income for the 2017/18 financial year, up from the 88.6% recorded in 2016/17.

2.7.3 Expenses

Total expenses increased by 40.6%, from R10.1 million at the end of February 2017 to R14.2 million at the end of February 2018.

Table 6 Income and expenditure in 2016/17 and 2017/18

| | 2016/17 | | 2017/18 | |
|--|-------------------|--------------------------------|-------------------|--------------------------------|
| | Rand (R) | Percentage of total income (%) | Rand (R) | Percentage of total income (%) |
| Interest income..... | 12 703 732 | 88.6 | 17 346 685 | 90.9 |
| Non-interest revenue | 1 635 191 | 11.4 | 1 726 408 | 9.1 |
| Total income | 14 338 923 | | 19 073 093 | |
| Interest expenses | 6 932 887 | 48.4 | 8 737 443 | 45.8 |
| Operating income..... | 7 406 036 | | 10 335 650 | |
| Provision for loans..... | 278 380 | 1.9 | 861 921 | 4.5 |
| Operating expenses | 2 922 363 | 20.4 | 4 645 756 | 24.4 |
| Personnel | 1 747 422 | 12.2 | 2 711 057 | 14.2 |
| Governance..... | 404 203 | 2.8 | 666 319 | 3.5 |
| Marketing | 7 065 | 0.1 | 38 103 | 0.2 |
| Administration | 596 532 | 4.2 | 1 019 342 | 5.3 |
| Auditing | 143 989 | 1.0 | 176 261 | 0.9 |
| Depreciation | 23 152 | 0.2 | 34 674 | 0.2 |
| Total expenses | 10 133 630 | 70.7 | 14 245 120 | 74.7 |
| Operating profit/income before taxation | 4 205 292 | 29.3 | 4 827 973 | 25.3 |

2.8 Performance rating

The Supervisor applies the capital adequacy, asset quality, management quality, earnings and liquidity (CAMEL) rating system to assess the soundness of cooperative banks. At 28 February 2018, two banks were assigned an overall rating of '3', denoting 'fair', while the other bank was assigned a rating of '2', denoting 'satisfactory'.

2.9 Inherent risks

The inherent risks to the cooperative banking sector include credit risk, liquidity risk, interest rate risk, operational risk, legal and compliance risk, strategic risk and reputational risk. During the year under review, cooperative banks continued to improve in all risk areas, with adequate risk management policies and strategies in place to meet regulatory and reporting requirements.

Chapter 3: Regulatory developments and interactions with stakeholders

3.1 Introduction

This section of the Annual Report covers regulatory developments and interactions with stakeholders.

3.2 Regulatory developments

CFIs currently operate in terms of the Banks Act Exemption Notice 620 of 2014, and are subject to the supervision and regulation of the CBDA. In terms of the Financial Sector Regulation Act 9 of 2017, the registration, regulation and supervision of CFIs will become a function of the Prudential Authority (PA) on its establishment.

Section 40(A)(1) of Chapter VIIA of the Cooperative Banks Act 40 of 2007 was amended by the Financial Sector Regulation Act 9 of 2017 and it will come into operation on 1 October 2018. Therefore, a CFI that meets the requirements for registration must apply to the PA for registration within 12 months from the effective date. These registration requirements will be determined by the PA, taking into account the number of members, the value of membership shares and the total value of members' deposits held by the institution. Furthermore, the PA will also determine the general limit for holdings of members' deposits by any registered CFI.

3.3 Interaction

Apart from formal on-site visits to cooperative banks, the Supervisor is expected to participate in the activities of international bodies and authorities whose main purpose is to develop, advance and promote the sustainability of cooperative banks, and to cooperate with these international bodies and authorities in respect of matters relating to cooperative banks.³

A total of six on-site visits to the cooperative banks were undertaken during the period under review. The visits focused on ensuring compliance with regulatory standards. The reviews undertook to ensure that systems, processes and relevant risk frameworks were in place and functioning as they should. Other areas focused on during the visits included the Board of Directors and its effectiveness, the composition and functioning of subcommittees, and ensuring that policies were applied and up to date.

Between 12 and 14 July 2017, Dr Gape, a member of the supervisory team, attended the International Credit Union Regulators' Network (ICURN) Conference in Vancouver, Canada. The annual conference aims at addressing the challenges that exist in the regulation of CFIs across the globe. Emerging risks from different regions and ICURN guiding principles were explored. The regulators and supervisors of CFIs also dealt with topics such as financial technologies and new technology, assessing liquidity risks, corporate governance and guiding principles for effective financial cooperative supervision.

3 As prescribed by section 55(2) of the Cooperative Banks Act 40 of 2007.

Abbreviations

| | |
|-----------|---|
| Banks Act | Banks Act 94 of 1990 |
| CAMEL | capital adequacy, asset quality, management quality, earnings and liquidity |
| CBDA | Cooperative Banks Development Agency |
| CFI | cooperative financial institution |
| ICURN | International Credit Union Regulators' Network |
| PA | Prudential Authority |
| SARB | South African Reserve Bank |