Can agency banking improve financial inclusion in South Africa?

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Abstract

Financial inclusion, as measured by the percentage of consumers using one or more formal financial service, grew from 51% in 2006 to 63% in 2008. By 2011, the value was still 63%. In a bid to answer what could be done to improve financial inclusion in South Africa, the paper explores the role of agency banking.

The paper concludes that addressing the barriers to agency banking will be necessary, but not sufficient, to improve financial inclusion. Among the recommendations are regulatory engagement to address the barriers to agency banking and to evaluate the ways in which regulatory mandates are expanded to include financial inclusion; opening debate on an inclusive banking licence and monitoring and measuring financial inclusion more regularly and more comprehensively. The recommendations also have a bearing on advancing the adoption of mobile financial services

1. Introduction

Data on financial inclusion in South Africa show that since 2006, there has been a marked improvement in the number of South African adults (older than 16 years) with access to financial services. By 2008, some 63% of the population were using at least one formal financial product, compared to 51% in 2006 (see Table 1). The levels have remained relatively stable since then.

Table 1 Financial inclusion in South Africa

Finscope South Africa						
% of population	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Currently banked	51	60	63	60	63	63
Previously banked	12	10	8	9	4	4
Never banked	37	30	30	31	33	33

Source Finscope™ South Africa 2010 and 2011

In line with the numbers of financially included adults increasing, the numbers of unbanked (as expressed by the number of "never banked" and "previously banked") have fallen. In particular, those who are categorised as "previously banked" have fallen from 12% of the population to 4%. This suggests that there may well be improved service offerings from the industry, leading to lower levels of disillusionment and account abandonment, for example.

Primary research for the paper included interviews with bankers, regulators and policy makers. The list of interviewees is provided at the end of the paper. The secondary research included papers on agency and mobile banking and regulatory approaches in other countries

As a result of the Financial Services Charter and the availability of better information on the unbanked, the vast majority of financial providers have undertaken improvements and re-designed products and services in an attempt to provide more compelling offerings for under-served South African customers.

While these efforts by providers are noted and commended, the Finscope™ data suggests that the number of financially included have remained relatively steady since 2007, hovering between 60 and 63 per cent for the past five years. The Minister of Finance recently suggested that a more ambitious target of 70% could be achieved by 2013[1].

In a bid to answer what could be done to improve financial inclusion in South Africa, this paper explores experimentation with the agency model to date, the barriers to the success of the agency model and

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[1] As quoted in the Business Day, *Low income earners rush for bank accounts*. 1 September 2011

the institutional requirements for a flourishing model. The paper concludes with some recommendations on agency banking in particular and financial inclusion in general.

In Section 2, the discussion focuses on what is meant by agency and branchless banking, both internationally and locally. This sets the stage for the legislative review in Section 3. Section 4 sets out describes some of experimentation with the agency model in South Africa and Section 5 discusses the regulatory example offered by Pakistan and Kenya. Section 6 draws together the ways in which agency banking can address financial inclusion and Section 7 makes some recommendations.

2. Agency banking" and "branchless banking"

Internationally, the concepts of agency banking and branchless banking appear to be closely aligned or even synonymous. For example, CGAP discussions around banking correspondents in Brazil and India, M-PESA agents in Kenya or Smart Money branchless banking networks in Philippines appear to view the concepts interchangeably.

A useful distinction comes from within the regulatory arena, where branchless banking implies an innovative network – typically involving new payments technologies such as mobile financial services (MFS) – where the network encompasses agency arrangements. A good example of this is the State Bank of Pakistan's Branchless Banking Regulations 9 of 2008, where branchless banking regulations cover a range of possible relationships with banks and their agents[2]. For purposes of clarity, agency banking will be used in this report to refer to the specific arrangements between a bank and its agents and branchless banking is a broader concept referring to the network of agents and associated distribution channels.

The discussions in the interviews with local participants show that the definitions for agency banking vary whether or not a legal or distributional perspective is taken.

From a legal perspective, some interviewees saw "agency" as having explicit meaning in common law - where any dealings with an agent are as if dealing with the principle on whose behalf the agent is acting. In this view, branchless banking has no specific legal point of departure. The outsourcing provisions in the Bank Supervision Circular 6/2004 (discussed further below) do not distinguish between agency banking and branchless banking and have potential relevance to both the narrow and broader concepts.

[2] The State bank of Pakistan's regulations allow for a variety of one-to-many, or many-to-many arrangements between banks and agents. SBP, 2011 *Branchless banking News*

From a distributional perspective, “agent” was seen to imply a small branch – sometimes seen as “bricks and mortar”, whereas “branchless banking” was anything beyond the branch – and hence referred to people, rather than the structures itself. Branchless banking was seen to be facilitated by technology – particularly mobile technology. One set of interviewees said rather baldly; *Agency is not in our lexicon, we refer instead to our own channels and other partner arrangements – which would include retailers, and so on*.

A banking agent should be able to originate accounts, service them, sell associated financial services, such as funeral policies and loans – and allow for cash to be deposited and withdrawn

What does appear to be important in the discussion is the understanding that the services on offer in the agency or through the branchless channel must mimic that of the banks. There appears to be a lot of common ground from this perspective – as it was acknowledged that there were few – and short-lived – agency success stories – primarily because the ability to use agents and branchless networks to facilitate low-cost origination of sustainable accounts has remained elusive.

In the view of the interviewees, there is a significant distinction between an agent facilitating a transaction through a remote point-of-sale and an agent opening and servicing a bank account. In the final analysis, it appears that functionality dominates the definition of agency in South Africa, with most interviewees interpreting an agent to be a party that fulfils the functions of a bank – utilising the infrastructure of the agent. In general, most interviewees are not convinced that agents can do this sustainably, given the barriers identified in section 3.

3. Existing legislative overview

In this section, the relevant legislation that may impact on agency banking is reviewed, from the perspective of identifying potential legal barriers or impediments. The emphasis is on the Banks Act and its associated practice notes, and the Financial Intelligence Centre Act (FICA) and the Financial Advisory and Intermediary Services Act (FAIS).

Most of these matters were raised during the interviews conducted with providers and other experts. The discussion here is mostly practical rather than legal and does not amount to a full legal review, but is broadly indicative.

3.1. The Banks Act

The Banks Act (No 94 of 1990) is the overriding statute applicable to agency banking – as the notion implies a bank-led approach requiring a bank licence. Nevertheless the Act makes only a passing reference to the concept of agency.

In terms of the definitions of the Banks Act,

> ***"agency"****, in relation to a bank, means a right granted to a person by that bank to receive on its behalf from its clients any deposits, money due to it or applications for loans or advances, or to make payments to such clients on its behalf;*

Certainly there is no sense of prohibition in the Banks Act – as this is seen as an operational decision to be made by each bank[3].

However, Section 78(1)f reads:

> *A bank ...*
> *(f) shall not before provision has been made out of profits for the items referred to in paragraph (e) –*
> *(i) open any branch or agency or any further branch or agency; or*
> *(ii) pay out dividends on its shares;*

which makes it clear that banks are only entitled to open agents when any losses or debts have been provided for. Hence the only direct reference in the Banks Act has to do with the issue of soundness.

The Banks Act Circular 14/2004 provides some guidelines relating to specific concerns around outsourcing arrangements – which includes agency banking, but could also refer to treasury management, internal audit and compliance, amongst others. In the circular, the Bank Supervision Department highlights its concerns as to whether or not outsourced arrangements could have implications for the risk profile of banks. The circular sets out the need for on-going monitoring of external parties involved, the need for Service Level Agreements (SLAs), the need for contingency planning, the access of the Supervisor to necessary information and provision of information to other parties such as auditors.

These guidelines only apply where the outsourcing arrangements contemplated by the banks:

- Have a bearing on the risk profile of a bank.
- Affect the systems and controls of a bank.
- [May] be classified by the management of a bank as being of strategic importance.
- Have implications for the discharge of processes followed by the [Supervision Department][4].

[3] The Deputy Registrar confirmed this stance.

None of the interviewees saw the Banks Act, including the provisioning clause in Section 78, as an obstacle to agency banking. Of course, the interviewees, were for the most part registered Banks - already complying with the Banks Act. While several non-banks were approached, of whom some were willing to participate, the time of year made it impossible to secure interviews.

It is possible that if the views of non-banks had been obtained, there would have been more diverse views, given that the Banks Act is sometimes characterised seen as a significant regulatory barrier to entry for new entrants. The Deputy Registrar of Banks did point out that the Bank Supervision Department is under some pressure by cell phone companies to change the definition of a deposit and what is meant by banking so that more transactions could be facilitated at cell phone shops. However, the possible unintended consequence of such an amendment has made the department wary of such an action.

3.2. The Financial Intelligence Centre Act

Seven of the nine interviewees indicated that the Financial Intelligence Centre Act (No 38 of 2001) (FICA) was a significant barrier to low cost banking in general and agency banking in particular.

The FICA legislation has been in place since 2003 and requires transacting customers to have their identities and places of residence verified prior to conducting financial transactions. Verification of residence typically involves presentation of rates bills and so on. One interviewee pointed out that FICA insisted on the residential address component as, unlike many other countries, we cannot rely on the veracity of our ID documents. Another mentioned that a Home Affairs official had publicly stated that at least 25% of our IDs are fraudulent. Early on in the process, commentators pointed out that many South Africans neither receive nor are able to present rates bills. One of the key barriers to receipt of municipal bills is that both rural villages and informal urban settlements have not traditionally had physical addresses. The SA Post Office has been assigned the task of assigning rural villages addresses, however as has been pointed out, not all of these are geo-coded or verifiable[5]. Exemption 17 (of FICA) was put in place to deal with instances were potential (or existing customers) do not have verifiable addresses. Exemption 17 exempts banks from compliance with the standard residential address verification requirements of the FICA legislation. For a number of reasons, the initial exemption was deemed inadequate and a revised exemption was put in place in 2004. While some commentators have concluded that the new Exemption 17 facilitates account opening of under-served

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[4] Bank Supervision Department, 2004. *Outsourcing of functions within banks.* Circular 14/2004, p 2

[5] Coetzee, S and Cooper, A, 2007. What is an address in South Africa? *South African Journal of Science* **103** November/December, pp 449-458.

individuals – pointing specifically to the number of Mzansi accounts opened since 2004[6] - at least half of the interviewees in this study seem unconvinced.

Regarding the utility of Exemption 17, there appears to be a clear split in the views of interviewees. The primary cause for the sense of ambiguity is as one interviewee put it: *The way the regulations are written is subject to interpretation, depending on the risk profile of the bank. But this leads to unlevel playing fields*. In this view, one set of banks is approaching the regulations conservatively, perhaps even over-complying. For these banks there are significant operating and logistical costs associated with originating accounts and even facilitating certain transactions as a consequence. From this perspective, the exemption is effectively meaningless. Another set is viewing the regulations liberally and have decided the risks of being inspected and found non-compliant are small.

For example, from a conservative point of view, Exemption 17 is not relevant, as all the FICA documentation (including proof of residence) must be provided and physical photocopies of these must be made and stored. While digital copies (photos) can be taken using a cell phone in the field – there is some lack of clarity as to whether this is adequate. The liberal approach is to employ Exemption 17, i.e. ignore proof of residence, "verify" the ID (typically involving a process to ensure the ID number is valid) and if any digital copies are taken, to store these electronically.

One of the unnerving matters around FICA compliance for banks is that there is concern that what one compliance officer deems to be compliant today may not pass muster sometime in future. One interviewee spoke of how over 300 000 accounts for previously unbanked individuals - originated under the exemption (and hence which did not obtain proof of residential address) - were closed over a weekend as the compliance officer insisted that they be closed if no photo copy of the ID could be produced.

There is probably no single reason compliance officers have adopted such divergent approaches. Banks that utilise Exemption 17 are not protected against any money laundering, terror financing or fraud risk as the exemption was drafted and revised before South Africa's terrorist financing laws became effective[7]. Compliance officers may feel there is too much risk in accounts where the physical whereabouts of clients cannot be verified. It appears that the Financial Intelligence Centre has not specifically commented on this.

Indeed, in July 2009, the Banking Ombudsman and the Financial Intelligence Centre issued a joint statement affirming that photocopying is "the most prudent and practical manner to comply with" the

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[6] See for example, de Koker, 2008. Money laundering and terror financing risk management of low risk financial products and services in South Africa. Cenfri.

[7] De Koker, ibid.

recording obligation[8]. This appears to apply for both ID documentation and proof of residence. Adherence to this recommendation suggests that Exemption 17 does not preclude the need for photocopying to be done. Moreover, a 2008 amendment to FICA giving the Financial Intelligence Centre the right to levy personal penalties on bank compliance officers for violations of AML/CFT rules, may be all the incentive compliance officers need to take the conservative route.

Whatever the reasons, the consequence of this difference in interpretation and behaviour in the market means that one set of players goes to considerable effort and cost to be FICA compliant for all accounts, while the others effectively face lower costs to open an account for under-served South Africans where Exemption 17 is employed and electronic copies of IDs are taken.

That FICA compliance is seen as expensive is evident from the example given by interviewees that the Mzansi Money Transfer product was an outright failure as a consequence of pricing that had to cover costs associated with conservative FICA compliance on "both sides" of the transaction. This means that FICA documentation had to be produced both to remit and receive funds. By contrast, for example, the remittance through Capitec's Shoprite Checkers arrangement only requires FICA compliance (based on a liberal reading of Exemption 17) when funds are remitted, but not collected.

Since Exemption 17, the South African Reserve Bank has issued Circular 6 of 2006, which enables non-face-to-face account openings for accounts meeting the requirements of Exemption 17, but subject to an even lower transaction limit.

Even more recently, an amendment to the Regulation of Interception of Communications and Provision of Communication-related Information Act (RICA) requires operators and distributors of mobile phones to perform a full know your customer (KYC) procedure on any person to whom they provide a mobile phone or SIM card (including proof of residence). To the extent that financially inclusive offerings revolve around mobile phone technology, this effectively undermines Exemption 17 provisions.

3.3. The Financial Advisory and Intermediaries Act

The Financial Advisory and Intermediaries Act (No 37 of 2002) (FAIS) typically has reference to providing advice to consumers on financial products, and while banks do have to ensure accreditation of those staff members who perform advisory functions, FAIS is not typically associated with banking activities.

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[8] As referenced in CGAP 2010. *An update on branchless banking in South Africa*. January.

In spite of this, FAIS was mentioned as a barrier in several interviews. This has primarily to do with the reading that acceptance of a deposit[9] is regulated as a financial product in the Definitions of FAIS and that, a 3rd party in accepting a deposit could be deemed to constitute the "rendering of an intermediary service" being an act performed on behalf of an issuer of a financial product.

Accordingly, the impact is that an agent could be deemed to be accepting 'deposits' and since 'deposits' are defined as a 'financial service', the agent could be deemed to be an 'intermediary' for FAIS purposes.

In the view of those interviewees who perceive FAIS to be a barrier, compliance has been costly from a number of perspectives – primarily relating to the necessary training of agency staff so that they could offer advice. The comment from one interview was: *We understand that FAIS applies if a consumer opens a transaction account; some form of FAIS accreditation, is necessary. This is an overlay on everything else – we have to train each person who is opening accounts with this. The problem is that there is only one standard – the minimum requirements is the same for transactional accounts as for a life policy – same level of accreditation. So now we have to take 3700 front line people through entry-level exams. And then we will have to pay them more.*

In this matter – as in the case of the FICA issue – it is clear that there are diametrically opposed approaches within the industry. The difference in interpretation of the relevant legislation is leading to uneven playing fields – as will be further documented below.

When approached on this matter, the Financial Services Board (FSB)[10] argued that in their view, deposit meant "term deposit" and hence FAIS would only apply where a bank agent gave a consumer advice on the *length* of the term deposit. The FSB also indicated its willingness to review the matter if it was currently interpreted to be a barrier to inclusive banking. The suggestion was made by the FSB that if necessary, an exemption could provide temporary relief prior to an amendment of FAIS.

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[9] As defined in the Banks Act:

> ***"deposit"***, *when used as a noun, means an amount of money paid by one person to another person subject to an agreement in terms of which -*
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> *(a) an equal amount or any part thereof will be conditionally or unconditionally repaid, either by the person to whom the money has been so paid or by any other person, with or without a premium, on demand or at specified or unspecified dates or in circumstances agreed to by or on behalf of the person making the payment and the person receiving it; and*
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> *(b) no interest will be payable on the amount so paid or interest will be payable thereon at specified intervals or otherwise,*

[10] The matter was canvassed with Mr Gerry Anderson (COO) of the Financial Services Board

3.4. Conclusion

The research suggests that it is the FICA regulations, more than any other statute, which inhibits the origination of low-income accounts for certain players. This constraint applies whether an agent is used or not. The primarily cause is lack of clear statement from the Financial Intelligence Centre as to the minimum acceptable requirements for low-income accounts, and without these the disparate responses of providers is likely to persist.

4. Agencies and their use in South Africa

Interviewees mentioned few examples of successful agency arrangements. Mostly a string of disappointments were mentioned: Saambou's agency arrangements with loan originators, Standard Bank's MTN-banking arrangement and even Nedbank's Go-banking foray with Pick-'n-Pay. From the perspective of the interviewees, none of these were successful.

The successes that were mentioned were the African Bank arrangement with Ellerines furniture stores and Capitec's arrangement with Shoprite Checkers through its money market desks. But of course these are successes of a certain sort. Bank accounts with a range of services are not offered here. Instead, a rather a specific service of a micro-loan (in the case of African Bank-Ellerines) or a money remittance (in the case of Capitec-Shoprite Checkers) are offered.

In the opinion of the interviewees canvassed, agency banking had not been a success in South Africa as it was cumbersome to open bank accounts through agents.

A number of reasons were offered, prime among them being compliance with FICA. One party described FICA as *An absolute frame of reference for their compliance department and as a consequence we over-comply - You can't just open a bank account at a petrol station*.

Two of the major banks are taking a more liberal stance with FICA regulations, elements of which include:

- Opening bank accounts by taking digital pictures of an ID document with a cell phone (rather than taking a physical photocopy of the document)
- Transmitting and storing the ID image electronically, rather than in paper form
- Applying Exemption 17 (avoiding the need for proof of residence)
- Only applying FICA on one side of the transaction, e.g. when funds are deposited (e.g. for a remittance), not when they are collected

However, as has been discussed, other players are inhibited in their ability to originate low-income accounts. One interviewee said *While some big banks are choosing to take more risk on by ignoring regulations, we are on other extreme – we don't have regulatory risk, but the risk of being over compliant - which makes us relatively costly and means that we come under the political spotlight when we haven't got enough low-income accounts open.*

Of course FICA and its regulations are not the only identified barrier to more extensive agency banking in South Africa. It should be noted that while most interviewees explicitly differentiated between (pseudo) agents offering transaction services only and agents offering the full range of services including account opening, the reality is that the barriers to successful agency banking arise in both areas.

For example, one of the barriers is that in the South African payment system only intra-bank or "closed loop" transactions give a "real-time" confirmation. So if a consumer chooses to pay a shopkeeper and send proof of payment via SMS, this is only satisfactory if all the players, consumer, shopkeeper and cellular network bank with the same bank. If anyone of them has a different bank, the transaction will only be confirmed overnight. Merchants are reluctant to have consumers leave their stores carrying goods for which they do not have immediate proof of payment. While this is clearly a barrier to transactions, it also impacts on the sustainability of accounts – as one respondent put it *There's a really high attrition rate when consumers realise that they can't send money to all merchants from their cell phone, they are disappointed and stop using the account.* An informed commentator on the payment system pointed out that the real time clearing (RTC) payment clearing house – whose pricing typically restricts it to corporate and large personal transfers - has the mechanism to facilitate real-time clearing for smaller amounts too, but the pricing remains prohibitive.

Table 2 sets out some of the major inhibitors that the analysis has identified and juxtaposes this with international examples where it appears that the barrier has been overcome.

Table 2: Barriers to successful agency banking in South Africa

Barrier	South African barriers and international alternatives
Lack of clarity regarding the application of regulations	Both Pakistan[11] and India[12] have endeavoured to establish clear guidelines for branchless banking. In South Africa, two of the biggest institutions appear to be taking a liberal (and possibly correct) approach to FICA regulations, while others (both big and small) appear to be taking a highly conservative (and possibly correct) approach. Clarity is needed.
Lack of a mobile PCH[13] for small inter-bank transactions – and hence reliance of the Card PCHs[14]	There is no mobile payment clearing house (PCH) in South Africa. Hence mobile payments can be effected through closed loop systems ((where all players bank with the same bank) or via the card PCHs. The former as the disadvantage that if any of the players - consumer, shopkeeper or cellular network - banks with a different bank the transaction will only be confirmed overnight or the next day. While the Card PCHs are a convenient alternative – the convenience comes at a cost.SO mobile payments require the card infrastructure and membership requirements – all of which come at a cost. By contrast, in Brazil even the smallest interbank transactions 9inclusing mobile payments) are settled in real time at reasonable costs.
Dominance of major retail and banking groups	Brazil – more bank and retail competition, so hungrier to draw in more consumers. In South Africa, big banks and big retailers battle out relative shares of potential income.
Inability to incentivise agents effectively	In India, Brazil, Kenya, small merchants are keen to attract more customers into stores and service them. While there will be costs to this – such as having to maintain higher cash balances, visiting the bank more frequently, even having higher rentals, the benefits of drawing more custom into the store (or direct incentives) help outweigh the cost[15]. For example, in Kenya, M-PESA agents were remunerated upfront for each agent acquired[16]. In South Africa, labour agreements prohibit the possibility of exclusively offering incentives to the small group of store staff selling banking services. The outcome is that motivation to do the extra work is low, and initiatives in stores flounder.
Agency costs and scale	In other markets where correspondent banking is successful – such as Brazil, the model of agency management appears to be working successfully. In South Africa, an agency network is costly – in terms of management, monitoring and servicing by the bank and this is only likely to be cost effective if economies of scale can be reached where a single bank employee manages a substantial number of agents. In the view of some, agency scale has been undermined with the large number of interoperable ATMs and Points of Sale distributed throughout South Africa.
Cash handling costs high	Brazil – research into small merchants acting as banking correspondents suggest that cash handling is not a major cost to agents[17]. In South Africa, retailers have long complained about cash-handling costs[18], and interviewees suggested agents fall out of the system because they are now obliged to keep a certain float level or because agency banking arrangements mean they can no longer avoid cash handling costs.
Difficulties of identifying appropriate agents	While no one has specifically documented this, where community banking and correspondent banking is successful this barrier must presumably have been overcome. In South Africa, it is difficult to identify potential agents that have - or who will earn - sufficient trust from the community that they will be willing to deposit money with them. Moreover, many of the owners of spaza shops – and potential banking agents in the townships – are illegal foreigners. Since these foreigners don't have the prerequisite papers, they cannot open bank accounts. This means that employing them as agents is fraught with difficulty.

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[11] State Bank of Pakistan, 2011. Branchless Banking News Issue 1

[12] Through such guidance as the Regulations for Business correspondents published by the RBI.

[13] The Payment Clearing House refers the operational rules of the game for inter-bank payments, including the processing of such payments and ultimately their settlement between banks.

[14] There are two Card PCHs – one for debit card transaction and another for credit cards. In this view both debit and credit cards are payment instruments, but mobile devices such as cell phones are not.

[15] Krishnaswamy, K. 2010 Mobile banking in India: grass roots marketing and Rotman, S. 2010 *Branchless banking in Brazil* CGap Focus Note

[16] Mas, I. 2009. The economics of branchless banking. *Innovations,* vol 4 (2) p 62

[17] Rotman, S. 2010. *Branchless banking in Brazil: making it work for small merchants*. CGAP Focus Note

[18] See for example the Banking Enquiry, 2008. Even the biggest retail chains complained that cash handling costs are exorbitant.

The barriers listed in the table above include a range of matters including regulation, structural matters, market dominance, as well as costs and incentives.

Several players mentioned the matter of concentration in both the banking and retail markets. This "inhibits the appetite of the players" for agency arrangements – as the rewards were not attractive enough. One comment from an interview was: *Our partners think banking is an easy way to make money – but if you lend through a large furniture retailer you still run the risk of default, and if you deploy a mini-ATM in a spaza shop – there is reputational risk if the customer is cheated. We are the lender of last resort to the partner*. One interviewee intimated that banks are far more likely to attempt to deploy a "mini branch" in a container than bother with the agency arrangements necessary in outlying areas. The other side of this coin is the role of organised labour within these concentrated environments. One interviewee spoke of how a pilot agency arrangement had failed in a few stores as labour had refused to allow workers in only those participating stores to be incentivised. Another spoke of the difficulties of designing an incentive scheme that was deemed to be fair by organised labour. Yet another acknowledged the problem of adding additional tasks (such as providing financial services) to already-defined job descriptions.

Cash handling costs are high in South Africa, as a consequence of the costs of liquidity, bank charges on cash handling and security measures required to combat crime and fraud. Merchants – especially small merchants – try to avoid these in various ways. However, a banking agent may be required to hold a higher value float in tills, to improve security and face cash handling costs when supply of cash exceeds demand. This complicates the assessment of cost and benefit to the merchant (and ultimately the customer). In addition, agency banking is not costless to the bank involved as management, monitoring and servicing of agency can be time consuming. Without scale, the push for agents is not compelling and the pricing remains a deterrent for consumers. Customers may also be obliged to buy goods from the agent at the same time as making bank transactions[19], and where this is not be beneficial for the consumer, the result is attrition of such bank accounts.

Several interviewees raised the matter of identifying trustworthy agents in the community. This is a matter not only of identifying someone that meets the bank's criteria – but also provides comfort to the community. As one interviewee put it: *It's one thing to buy airtime from someone, and another to hand over your hard-earned cash to him*. Foreign-ownership of spaza shops in underserved areas relates to this barrier. Part of the problem is that many of these individuals do not have legal status and hence they cannot open a bank account themselves. It hence becomes highly problematic to incorporate them as agents. One interviewee estimated that as many as 75% of sole traders in certain areas informal

[19] See for example, Steyn, L, 2012. Stores score on pension payday, *Mail and Guardian* February 3 to 9, p 7.

areas are foreigners. Hence the foreigners don't pass muster in terms of the bank's requirements, even if they could earn the trust of the community.

Excluding those playing a regulatory role, all of the interviewees had ventured into agency banking in one form or another in the past. At the time of the interview, not one of the interviewees identified agency arrangements as key to their inclusive banking strategy, however, it was seen as something that could be valuable over time, should these barriers be overcome.

5. Enabling agency banking – regulatory examples

As the discussion above suggests, national differences make an inter-country comparison of limited value. However, there are regulatory approaches within different countries that may well have a bearing on encouraging financial inclusion[20].

In this section, the regulatory approaches of Pakistan and Kenya are briefly explored.

5.1. Pakistan

The State Bank of Pakistan (SBP) has attempted to encourage low cost services to the unbanked by promoting branchless banking for a number of years. In March 2008, it published regulations, which coincided with the proliferation of mobile phone services in the country. It recently revised these regulations by introducing the criteria for an entry-level account (called the "0" BB account) with higher transaction thresholds (meaning higher values could be transacted) and significantly lower KYC regulation (such as waiving the requirements for biometrics and digital records). The new regulations also make allowances for consumer protection. By September 2011, the two major branchless banking models – *Easypaisa* and *Omni* were generating transaction volumes of 175 000 per day[21].

Three key approaches of the SBP stand out:

1. It has provided early guidance for its bank-led model through regulations that set out varying agency models and permissible activities and channels. Moreover, it has played a constructive role in facilitating inclusive banking thereafter, leading to revised (and less onerous) regulations.
2. The SBP has co-operated with other government institutions in Pakistan and has been encouraged by the decision that G2P payments (to those affected by floods and social welfare recipients, among others), be facilitated by mobile phone and smart card.

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[20] A variety of other examples are given in the World Economic Forum's 2011 report, *Galvanizing Support: The role of Government in Advancing Adoption of Mobile Financial Services*

[21] State Bank of Pakistan, 2011. Branchless Banking News Issue 1

3. The SBP has monitored and published data on the Branchless Banking initiatives, including the number and type of agents, number and type of transactions, and so on. This significantly assists evaluation of the success of regulatory and other initiatives in encouraging financial inclusion through this method.

5.2. Kenya

The Kenya success differs from the Pakistan model in that, at least initially, a non-bank primarily drove the process of agency banking. It is something of a truism that technological innovation may run ahead of appropriate regulation, but it is also true that highly effective regulation can stifle innovation. In particular, licensing requirements for banks may form a significant barrier to both deposit-taking and payments services. This presents a significant challenge to central banks wanting to promote access while ensuring stability. The success of M-PESA in enhancing access to money transmission through mobile telephony, and in ultimately allowing for access to a number of essential financial services, has received widespread acclaim (e.g. The *Economist*, 2009). It is a story of harnessing technology successfully for the benefit of previously excluded individuals. But it is also a story of engaged and adaptable regulation.

The key approach involved:

1. The M-PESA success story reflects the willingness of the Central Bank of Kenya (CBK) to deal with non-banks in reaching its objective of improved financial regulation, effectively allowing innovation to run ahead of legislative change[22].
2. Allowing a monitored pilot phase during which the innovation by Safricom in conjunction with Vodafone[23], was assessed. It was determined that the product did not involve deposit-taking, as no intermediation was involved. Moreover, the amounts transferred were ring-fenced and not available for the operations of the firms involved. After a successful pilot, the CBK set out its reporting requirements and provided Safricom with a letter of no objection. The reporting requirements included monthly reporting of pre-determined metrics, but also regular meetings with key stakeholders[24]. While the risks of mobile phone banking include "fraudulent movement of funds, network hitches and mismatch of cash balances at the pay points"[25], the CBK was confident that the risks did not outweigh the benefits of the innovation under its oversight. Moreover, the CBK evaluated each product extension on a case-by-case basis[26].

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[22] Hawkins, P 2011. Financial Access: What has the crisis changed? A BIS publication for the African Central bank Governors: *Central banking in Africa*
[23] Business call to action, 2011. Vodafone: expanding access to financial services. www.BusinessCalltoAction.org
[24] Nyaoma, G, 2009 Presentation at *Global Policy Forum*, Regulating mobile money: the case of M-PESA. Nairobi. 16 September
[25] Kimenyi, M S and N S Nhung'u, Expanding the Financial services frontier: Lessons from Mobile phone banking in Kenya. *Brookings*. 16 October, p7.
[26] Nyaoma, G, *ibid*.

3. Subsequently, the CBK has made legislative amendments to bring mobile payments within the purview of the regulatory framework and to allow agents to take deposits on behalf of banks. It has also recently published e-money regulations[27]. Meanwhile M-PESA now offers an enhanced suite of financial services through its joint venture with Equity Bank and its M-KESHO offering. In this way, the M-PESA offering "evolved from the initial concept of transferring money from one individual to another to include other functions, such as payment of utility bills, loans, salaries and deposit mobilization"[28].

6. **Lessons from agency banking experiments**

During the course of the interviews, insights from agency banking experiments were canvassed.

6.1. Understanding the market

There have been lessons from some of the less successful forays into agency banking, and all of the interviewees were happy to share their insights displaying a greater understanding of the requirements of the market. So for example, Nedbank pointed out that its agency arrangement with Boxer stores had been more successful than with Pick-'n-Pay, as *customers like dealing with retail stores in the community*. Moreover, new approaches in under-served communities were being tried. This may involve other financial services partners, so that a range of services is explicitly offered – such as funeral policies, micro-lending – as well as banking. Pilot group saving and lending schemes are also being attempted.

Another interviewee pointed out that most transactions in spaza shops were less than R20 – and often children as young as three years were sent to buy goods. Ways of facilitating these micro-payments needed to be found – perhaps through a smart card, rather than through mobile channels where an SMS had to be sent. The matter of trust in cash was raised in this context. While a spaza shop would hardly risk cheating a three-year-old carrying R20 to buy a loaf of bread of the right change, a smart card is typically less transparent and could erode this trust[29].

It was also suggested that agency banking using spaza shops had required considerable adjustment on the part of the bank, given that there is often considerable competition between spaza shop owners.

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[27] Ndung'u, N. 2011. Strengthening regulatory frameworks in the finance industry – a key enabler for private sector development. Speech given at the *1st Annual Africa Banking and Finance Conference*, Nairobi, 21st February.
[28] Ndung'u, N. ibid
[29] The issue of trust in mobile payment services has also been highlighted in other countries as a barrier higher take-up, see Board of the Federal Reserve System, 2012, *Consumers and Mobile Financial Services*

Hence the owners inspect carefully any banking offering and its pricing – so that it serves to draw customers in rather than alienate them.

6.2. Managing expectations

Some of the interviewees pointed out that acceptance of new financial services were sometimes slow for those who had had no generational exposure to such services. For example, while debit cards had been introduced in 2000, and were widely used for cash withdrawal at an ATM, only 23% of low-income consumers ever presented their debit cards at the point-of-sale (POS)[30]. Another interview pointed out that credit growth (and the management of debt) was slowly improving in low-income communities – and that this was also financial inclusion. So education of both providers and consumers was necessary.

Another spoke of how the banks, their partners and consumers were beginning to come to terms with the technological innovations and how they could be effectively utilised to improve inclusion. In part, this technology could help reduce the costs of banking (not just fees but transport costs – and so on). Related to this was the awareness that for financially inclusive projects to be successful, it was necessary for bankers to realise that low-income consumers could not pay for regular transaction fees and that profits could only be realised through the on-selling of additional services such as funeral policies and loans. One interviewee pointed out that the return to the bank might only be long-term. Consumers of Standard Bank's Eplan product - an early initiative aimed at unbanked individuals, for example, - were mentioned in this regard. In its heyday, Eplan accounted for around 45% of the low-income market - and one interviewee asserted that: *It is from these ranks that the bank now gets its middle income account base*.

One interviewee spoke of an "expectation gap" – where things are improving, but maybe new accounts are not being opened at the expected pace.

7. **Recommendations**

7.1. Introduction – making financial inclusion an imperative

The analysis presented here suggests that bankers are indeed exploring ways to enhance their ability to service low-income consumers in a cost efficient way. This has resulted in experimentation with agency banking. There have been some improvements in understanding and a realisation that expectations may well need to be tempered. As one interviewee put it, *there have been some lessons*

[30] Although the pricing of many small debit card purchases may inhibit this activity too.

and the improvements have been gradual, but the banks remain complacent. New initiatives and players can stimulate competition and reduce complacency. For example, Capitec's capture of some of the middle banking market has resulted in responses from the big four banks. Regulatory change allowing new players may be the stimulus that is needed (see recommendation 7.2).

Perhaps a similar charge of complacency can be laid at the door of the regulators concerned. While the Banks Act does not prohibit agency banking, the lack of consistency between Circular 6 and FICA's Exemption 17 is a puzzle. The FICA exemption exists but has not been modified to capture the shift from provisions that dealt with anti-money laundering to include combating of financial terrorism. In the same way, the FSB is aware of the FAIS implications for origination of low-income bank accounts – but addressing this is not high on their agenda.

While agency banking can enable financial inclusion – there are a number of constraints to be overcome. The will to address them requires raising the imperative of financial inclusion for public and private sector players. This may mean including financial inclusion in the mandate of at least one significant regulator and enabling sufficient competition to undermine complacency in the banking industry. This points once more to the need for an inclusive banking license once mooted under the label of "dedicated banking". Regulatory co-ordination between regulators pursuing different mandates is crucial. As it stands, the FICA and RICA legislation seems ironically to have taken precedence in dominating financial inclusivity. Finally, the measurement of financial inclusion needs renewed energy – as technology allows for different payments methods – which need to be tracked.

The truth is that financial inclusion is not an explicit mandate for any financial sector regulator. This may well need to change if regulators are to consider the impact of their legislation, regulation and implementation on financial inclusion. Ideally, the wording of their Acts would include a clause that requires regulators to be mindful of the implications on financial inclusion, and that apparent trade-off would need to be discussed with fellow regulators and policy makers. (Recommendation 7.3 deals with this.)

Finally, measurement of financial inclusion needs to be more regular and more comprehensive than reliance on the annual Finscope™ survey. Recommendation 7.4 addresses this.

7.2. Inclusive banks licence

While the idea of a Dedicated Banks licence (as described in the Bill of the same name) has had some criticism, including the criticism that a window of opportunity has been missed, there was a surprising degree of support from interviewees for a bank licence for entities wishing to offer simple services to underserved consumers. Although the argument that such a simple licence may not offer as much reward as the full banking licence permits, the reality is that the current commercial licence is a substantial barrier to entry and as one interview put it: *We should open space for new banks*."

The possibility of would-be entrants simply becoming co-operative banks was rejected out of hand by interviewees, since a co-operative banking licence would not allow commercial innovation and that if a new licence were well designed, it would be taken up.

Two sets of interviewees pointed out how difficult it is for a large bank to have an inclusive unit, since the rewards are not apparent to the Board (of the bank). However, an entity with a simple licence would have a different frame of reference (and lower capital requirements). One interviewee said his inclusive unit existed only because he had obtained approval from the Board to continue as long as the rewards from the unit continue to exceed cash costs in the bank!

Related to the matter of a low-cost solution is the concern that the costs of access to Bankserv and the payments system (as well as the Card PCHs) be re-examined. As a response to the Competition Commission's Banking Enquiry (published at the end of 2008) – in which access to the payments system and its associated costs were examined - the National Payments System Department of the SARB is currently undertaking research into interchange (the interbank fees for payments). This is only part of the costs associated with interbank payments. Network infrastructure, use of the national switch, Bankserv, and membership of the different PCH's – especially the card PCHs – which requires membership of the card associations – VISA and MasterCard are other costs associated with being a member of the "payments club". One interviewee said that the costs of the payments system *nearly kills the small guys*".

From a regulatory point of view it was mentioned that an "inclusive banking" licence should not be Basel compliant and hence should not be part of the existing Banks Act.

7.3. Regulatory co-ordination

Most interviewees felt that financial inclusion was a key priority and that there was a considerable risk of "doing nothing" and "staying in the comfort zone." This applies to policy makers and regulators as well as industry players. The question was asked, *If we don't move now, how are we going to cope with 100 million South Africans in 2030*? One set of players suggested that certain regulators were "locked in a time warp" and did not take the risks of continued exclusion seriously. As has been mentioned above, this may well be because financial inclusion is omitted from the mandates of the financial sector regulators, and there is no useful co-ordinating mechanism for financial inclusion. Ironically, it can be argued that it is the FICA and RICA legislation that dominates financial inclusivity

The analysis presented here suggests that there is room for a series of regulatory discussions on the following:

- Clarity from FIC on Exemption 17 requirement, terrorism clauses, etc.
- Clarity from FSB on FAIS compliance.
- The need for an inclusive banking licence.
- Exploration as to whether the biometric check now being launched by Home Affairs (HANIS) offers a useful alternative to proof of residential address for those wanting to serve the un-banked. If so, moves have to be made to encourage the Financial Intelligence Centre to accept biometric information.
- Revisiting of costs of payments system – including interchange, Bankserv, etc.
- How the high value real-time payments system could be converted or modified to allow for small mobile payments. This would have to address, among others the pricing of the RTC payment stream.
- Evaluation of which regulatory entity should have financial inclusion within its mandates – and how.

7.4. Broader approach to measurement

In the same way that some of the South African providers may need to expand their notion of what it means to be served, it would be useful to find new and supplemental ways of tracking financial inclusion. As it stands, the FinScope™ Surveys are the only published indicator of financial inclusion in South Africa. Yet as the Pakistan example shows, data on money transfer or remittances may be a crucially important indicator of under-served individuals being effectively served through formal institutions. Our current statutory reporting from banks focuses almost exclusively on solvency, not on access.

Some possible statistics that could be useful if regularly monitored:

- Number of money transfers through agency arrangements.
- Take up (and servicing) of credit by lower income quartiles in South Africa.
- Number of active accounts that fall within the FICA Exemption 17 thresholds.
- Number of funeral polices sold (bundled and unbundled) and serviced by consumers.

During the course of the interviews, this matter was taken up with PASA. It was agreed that early in 2012, PASA would approach their member banks and request information on intra-bank transfers (such as Capitec's Shoprite Checkers arrangement) as well as the volume and value of small inter-bank transfers making use of agents. This could potentially be a joint publication between PASA and FMT. This would be an initial step to expanding measurement of financial inclusion.

Over time, however, these statistics should be gathered and monitored by the relevant regulator.

8. Conclusion

During the research, frequent reference to mobile financial services (MFS) was made. Indeed, the literature frequently merges discussion of agency, mobile payments, MFS and branchless banking. The agency banking model discussed here – bank-led in this case – requires both a mobile network and an agency network, and the business strategies are mutually dependent. For this reason, many of the constraints to successful agency banking and mechanisms to address them highlighted here have a bearing on unlocking the potential to mobile financial services in South Africa. Addressing these constraints would do much to push financial inclusion beyond the apparent ceiling.

9. Interview list

Sixteen people participated in nine interviews. Finmark Trust is most grateful for their time and insight.

Company	Name
Nedbank	Ciko Thomas, Managing Executive: Consumer Banking, Nedbank Retail, Anton De Wet and Brian Duguid
BASA	Cas Coovadia (CEO), Stuart Grobler & Fikile Kuhlase
Standard Bank	Leon Barnard, Head Inclusive Banking
FNB	Line Wiid, CEO (Smart Solutions) and Kim Dancey
SA Reserve Bank	Michael Blackbeard, Deputy Registrar
Capitec	Riaan Stassen, CEO
Wizzit	Brian Richardson (CEO) & Charles Rowlinson
PASA	Walter Volker, CEO
Post Bank	Shaheen Adam, Chief Operating Officer/Acting Chief Executive Officer& Nicola Dewar, Chief Financial Officer