SOUTH AFRICA

BANKING

SUMMARY

As of December 31, 1997, banking in South Africa was conducted by 56 fully licensed institutions and 59 representative offices of foreign banks. The industry is dominated by four large banks whose combined assets account for almost 80 percent of total bank assets. Foreign banks are estimated to hold about 6.7 percent of total bank assets. There is significant cross-shareholding among banks, industrial companies, and insurance and other financial services organizations. None of the banks are state-owned. Despite high interest margins and a return on assets of 1.2 percent (equal to that of U.S. banks), South African banks are hampered by high cost ratios and a relatively low return on equity of 12.1 percent.

The Bank Supervision Department, a part of the South African Reserve Bank, is responsible for regulating banks, mutual banks and mutual building societies. The Financial Services Board is responsible for other financial institutions that operate on an agency and/or principal basis.

There is currently only one U.S. bank (Citibank) with a full commercial banking license, which operates through a branch focusing on corporate business. Four other U.S. banks have representative offices.

Beginning in May 1995, foreign banks were permitted to establish in branch form in South Africa. However, several restrictions are placed on their foreign branches. Foreign bank branches can only accept deposits provided the initial deposit is more than US$200,000 and this balance is maintained at all times. A foreign bank that wants to establish a branch or acquire a locally incorporated bank must maintain at least US$1 billion in net assets (total assets less total liabilities) at all times, and at least 18 months prior to its application. A foreign branch must also maintain its own endowment capital (unencumbered assets less liabilities) of not less than the greater of US$10 million or 8 percent of the amount of risk weighted assets and other contingent liabilities. The local capital of the branch rather than the consolidated capital of the parent bank is also used to compute the branch's risk weighted capital ratio, legal lending limit, and other capital driven thresholds – in effect, eliminating many of the benefits of establishing in branch form. Foreign branch management must include at least two persons residing in South Africa, one of whom is the Chief Executive Officer. The clearing system is owned and controlled by the four largest locally-incorporated banks; all other banks must clear through the big four. Locally-incorporated commercial banks are also favored over foreign commercial banking operations in bidding on government contracts.

DESCRIPTION OF THE MARKET

Structure of the Market

As of December 31, 1997, South African banks had total assets of approximately US$109.8 billion of which US$94.6 billion consisted of outstanding loans. Of the 56 commercial banks, four have assets in excess of US$18 billion, five "medium sized" banks have assets in excess of US$1 billion and remaining "small" banks have assets of less than US$600 million. In addition, there are four mutual banks, 10 subsidiaries of foreign banks, 12 direct branches of foreign banks, and 59 registered representative offices of foreign banks.

The banking system is dominated by the four largest locally-incorporated banks (the "big four"), Standard Bank, ABSA, First National, and Nedcor. All four have operations internationally although only Standard Bank appears to have a strategy of expansion abroad, especially in other African states. Between them, these banks control about 80 percent of total South African banking assets and a similar percentage of outstanding loans. In recent months, mergers between large banks, insurance companies, and merchant banks have been consummated as local firms try to achieve the scale necessary to compete with the international competitors coming into their market. South African commercial banks provide a full range of corporate banking services to all sectors of the retail and corporate markets. However, in general they will not make loans (other than overdrafts) of less than US$2,000. The retail sector of the market is serviced mainly by nonbank lenders.

Mutual banks conduct the same business as commercial banks, with the main difference being shareholding; mutual banks are not equity banks and their depositors are regarded as their shareholders. Capital adequacy requirements are lower for mutual banks.

Foreign banks from the UK, Germany, France, the Netherlands, Taiwan, Greece, and Cyprus operate either through subsidiaries or as investors in local operations. Citibank, the only U.S. bank with a full banking license in South Africa, has established one branch. Bankers Trust, Chase, First Union, and Bank of America have representative offices. The overbanked and relatively sophisticated nature of the market have mitigated against many foreign banks joining the South African banking market.

At year end 1997 the average BIS capital adequacy ratio of local banks was 10 percent against the 8 percent required by regulation. Total nonperforming loans totaled US$3.2 billion, or 3.2 percent of total loans outstanding. Nonperforming loans are defined as "overdue loans" in South Africa. Although no specific definition exists for overdue loans, banks are expected to report on overdue loans from four months (and longer) in arrears. Of nonperforming loans, 43 percent were related to housing, 12 percent to installment loans, and 45 percent overdrafts and other. Bankers say that the huge upsurge in mortgages and other facilities granted to the previously disadvantaged (and unbanked) population and a recent trend to provide mortgagees for a higher percentage of the mortgaged property, have contributed to the majority of nonperforming loans. Banks have established specific reserves equivalent to 45 percent of total nonperforming loans. Loans to municipal and provincial governments and authorities have also contributed to nonperforming loans. In recognition of the risk associated with these loans, the regulators have increased the capital requirement on all such loans from 0.8 percent to 8 percent.

Aggregate revenues of all banks amounted to US$6.6 billion in 1997. In recent years the percentage of total income attributable to interest margin has been declining steadily as fee income becomes more important. Meanwhile, bank cost ratios are high by international standards (65 percent of operating income versus 62 percent in the United States). This is attributable to the large branch networks, investment in new technology, lack of economies of scale, massive security costs because of the high crime rate, and low productivity. In an effort to deal with this problem, banks are investing heavily in technology, closing branches, and laying off employees.

Aggregate pretax bank income for 1997 was US$1.52 billion. After deducting a tax charge of US$420 million (27.6 percent), net profit was US$1.1 billion. With expenses totaling US$5.7 billion and net interest and transaction fee income totaling US$4.86 billion, South African banks as a group were able to turn a profit based only on their trading and investment income and not from their core operations. Banks attribute this to competition, the high cost of personnel, and the cost of imported technology.

Regulatory Structure

The South African regulatory framework has evolved around the need to regulate specific financial activities and is based on institutional rather than functional lines. The function of deposit-taking, however, is regulated in terms of the Banks Act, 1990, and supervised by the bank Supervision Department of the Reserve Bank. Regulation applies whether the business is structured as a separate subsidiary company or as a branch of a foreign banking company. Once a South African banking institution is authorized, all its activities are subject to Bank Supervision Department prudential supervision, even if some of its activities are also regulated by another regulator. With the advent of universal banking, and the fact that all nonbank supervision is under the Financial Services Board (part of the Department of Finance), a system of "lead regulator" has been in effect. This does not exempt an institution entirely from any one regulator's requirements, but it does prevent double regulation in certain areas. New legislation has been introduced before a Parliament to further clarify South African banking regulations and to bring them into line with international "best business" standards.

There is currently no deposit insurance or deposit guarantee program in place in South Africa.

U.S. PRESENCE IN THE MARKET

Foreign banks operated in South Africa through 12 direct branches and 10 subsidiary banks as of year-end 1997. (Foreign banks operated through six bank subsidiaries as of year-end 1993.) They have been allowed to establish in branch form only since May 1, 1995.

Citibank is the only U.S. bank with a full commercial banking license. Citibank has a fully licensed branch in South Africa and a marketing office in Durban. Four other U.S. banks have representative offices; none are presently considering upgrading their status.

Foreign banks focus on providing differentiation of corporate banking products and quality service. Their retail banking activities are limited, in large part due to the minimum deposit requirement placed on their foreign branches, and the fact that the retail market is in general considered overbanked in the middle and upper income categories. They specialize in such areas as privatization and project finance, international treasury and cross-border transactions, and access to international debt and equity markets. But these operations face stiff competition from a small group of local players whose focus has narrowed to corporate work for South African blue chips expanding abroad.

TREATMENT OF U.S. FINANCIAL INSTITUTIONS

Foreign banks may establish bank subsidiaries, branches, or representative offices in South Africa. A foreign bank approved by the registrar of banks may also acquire up to 100 percent of the shares of a local bank or hold 100 percent of the capital of a nonbank subsidiary established in South Africa. (Locally incorporated banks do not establish subsidiary banks.) Foreign subsidiary banks are treated in precisely the same manner as any other South African bank and are not limited as to the scope of their activities or regulated differently from other local institutions.

Foreign banks with at least US$1 billion in net assets (total assets less total liabilities) may establish branches in South Africa or acquire full ownership of local banks upon approval of the registrar of banks. The following licensing requirements must be met in order for a foreign bank to establish a branch in South Africa:

- The foreign institution on its own, or a foreign institution and the banking group of which such foreign institution forms a part, shall hold net assets, as certified by auditors and reflected in the audited annual financial statements, of a value of at least US$1 billion, while foreign institution itself shall hold net assets of at least US$400 million. This level of assets must also have been held for at least 18 months prior to the submission to establish a branch. Intangible and "not readily marketable" assets must be excluded from total assets.

- The foreign institution should have a long-term investment grade debt rating from an internationally recognized rating agency.

- Management must comprise at least two persons residing in South Africa, one of whom is the Chief Executive Officer.

- The business operations must at all times be covered and supported by a letter of comfort and undertaking issued from the parent company.

- The branch must have its own capital of not less than the greater of US$10 million or 8 percent of the amount of risk weighted assets and other contingent liabilities. The capital adequacy ratio is based in the local capital of the branch rather than the consolidated capital of the parent bank.

For prudential and regulation purposes, the local capital of the branch is used to compute the legal lending limit and other capital driven thresholds, effectively removing much of the advantage of establishing a branch. Moreover, foreign bank branches are limited in their business by being able to accept deposits only from corporations or other "juristic persons," or from individuals provided the initial deposit is more than US$200,000 and this balance is maintained at all times. Foreign branches are not able to have a net open position in foreign currencies of more than 15 percent of net capital and reserves.

The clearing system in South Africa is owned and controlled by the four largest locally-incorporated banks; all other banks must clear through the big four. Citibank and the small domestic banks are negotiating with the Reserve Bank, so far unsuccessfully, to obtain membership. Locally-incorporated commercial banks are favored over foreign commercial banking operations in the bidding on government contracts. This is true only in the commercial banking sector, not the investment banking sector.

1996 Key Statistics for Leading South African Banks

	Return on Assets	Return on Capital	Capital/ Tier I Assets	Charges for Bad Debts/ Avg. Balances	Cost Ratio
ABSA	0.96	15.36	6.5	0.60	70.47
Boland	1.42	15.00	6.3	1.37	58.33
First National	1.17	21.34	7.3	0.94	62.49
Nedcor	1.44	21.89	8.4	0.52	61.38
Standard Bank	1.38	21.12	8.6	0.55	65.48