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Microfinance Regulation and Supervision in South Africa

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ABOUT THE SERIES

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As South Africa made the transition to majority rule in the early to mid-1990s, it had to face up to the need for a parallel transition in its economic institutions. Since then, South Africa has made significant strides toward improving the national policy and legal environment for more equitable economic growth – including small-scale finance. As part of the process of deepening the financial sector, the Micro Finance Regulatory Council (MFRC) came into being in 1999, under an Exemption to the Usury Act. The MFRC's purpose is to supervise the operations of those institutions lending under its unrestricted interest rate window, and to provide for effective consumer protection and regularization of micro-lender operations in a growing market. Having served this role for over five years, the MFRC is soon to be absorbed into a larger regulatory structure, as part of a new generation of financial reforms. This essay examines the MFRC and its effectiveness within this setting, providing an overview of the reform processes leading up to the MFRC's establishment, as well as ongoing reforms.

1. This paper draws heavily on ECI Africa and IRIS, "The Evolution of the South African Microfinance Sector from 1992 to 2004: The role of the Microfinance Regulatory Council," report submitted to MFRC and USAID, March 2005; it also draws from Meagher, Patrick and Betty Wilkinson, "Filling the Gap in South Africa's Small and Micro Credit Market: An Analysis of Major Policy, Legal, and Regulatory Issues," report submitted to MFRC and USAID, September 2001.

Reforms leading to the MFRC

In South Africa, the financial sector has historically been unable to serve the majority of the population effectively. This is particularly true for lending to small businesses and micro-enterprises, for low-end housing, and for insurance and savings services at the lower end of the income range. Up to 60% of the population is excluded from formal financial services. The banking sector, although highly developed, is significantly concentrated, with limited competitive pressure to push services beyond the traditional client base. Banking and financial services legislation has been a major obstacle to the deepening of South Africa's financial market. Acceptance of deposits, broadly defined, is limited to banks, leaving a restricted role for the few mutuals and other non-banks. The banks also run the national payments system as a joint enterprise, setting rules that discourage non-bank access to the system. Consumer credit transactions as well as leasing and collateral lending are governed by separate legal regimes. The inefficiencies inherent in this fragmented approach, along with the outdated legislation in some of these areas, further constrain financing options for small firms and low-income households. Yet, South Africa has mostly trodden a path of intermittent and reactive financial sector reform.

An early step, as the apartheid government was nearing its end, was to create the Usury Act Exemption of 1992. The stated policy goal here was to spur growth in lending to micro, small, and medium sized enterprises (SMMEs). The Exemption allowed lenders to charge unregulated interest rates on loans under R6,000 (US $937)[1] and for a term of less than 36 months. What actually emerged was a booming micro-loan sector, dominated by payroll and cash-based lending mostly to formally employed, largely urban individuals. The Exemption essentially licensed micro-lenders to create a separate, largely unregulated, tier of

2. 1 USD = 6.4 ZAR (as of 17 May 2005)

credit provision to people on the fringes of the banking system. The Exemption did not have an immediate impact – but then, a few pioneering lenders started implementing a new approach that showed the potential of the 30-day cash loan market. Based on this demonstration effect, the market expanded rapidly.

By many accounts, the 1992 Exemption Notice created a "disaster" by dividing the market and thereby fencing lower income people off from the banking sector and formal credit options. Interest controls were removed without other constraints (such as debt recovery and capital access) being addressed. As a result, full conditions for the development of an efficient market (including regulatory oversight and consumer credit protections) did not exist at a time when the market was growing very quickly. A further problem, made worse by the Exemption, was the general legislative fragmentation created by the different rules applicable to each form of credit. The Exemption also did not address the restrictive framework that impeded entry of competitors into the banking sector. Last, this arrangement seemed to create a small universe of profitable and exploitative informal lending – which, in the absence of an incentive framework for developmental lending, seemed to discourage SMME (small, medium, and micro enterprise) financing.

By the mid-1990s, the advent of the first ANC government raised expectations and created increasing pressure for policies that would extend the benefits of credit liberalization to all – and create rules of conduct that would protect borrowers from sharp practices. The Minister of Trade and Industry observed that poor and low income South Africans were being charged unreasonably high rates of interest by the micro-lending industry, which targeted urban, employed individuals, especially those in the public sector, with little or no apparent increase in credit to SMMEs. On this basis, the Minister threatened to revoke the 1992 exemption. This sparked a five-year process of dialogue between the industry and government, which eventually led to the formation of the MFRC in 1999. On one side were the consumer and labor advocates calling for strong controls, if not shutdown. On the other side, the association of micro-enterprise lenders (now named the Micro Enterprise Alliance), along with the for-profit microlenders, called for an improved framework to regulate the microfinance sector and facilitate its growth.

Regarding SMME finance, the Government decided that the best approach would not be through changes in legislation and regulations (i.e. a market development approach), but rather through wholesale level intervention in the markets. An early response was to set up parastatal development finance wholesalers (Khula Trust and National Housing Finance Corporation or NHFC) to serve NGO-based microfinance institutions. This reflected the view that micro-lenders were inherently exploiting the poor and therefore could not be used as a tool to deliver finance to SMMEs. NGOs, on the other hand, were assumed to conduct their business in more socially and politically acceptable ways, including the notion that they charged low interest and treated their clients fairly. These institutions have not been a great success -- they have not proven sustainable, and have added cost to the system without improving access and efficiency.

Thus, the push to establish the MFRC came largely in response to widespread concern about high interest rates and abusive practices in the “cowboy” microlending market that boomed during the mid-1990s. There was a convergence of interest in creating a consumer credit regulator, among government, consumer advocates, and a number of financial institutions who were concerned about abuses as well as questions of sustainability in a market seemingly unconstrained by standards of good conduct. Banks were also concerned about the potentially negative reputation effects on the mainstream financial sector of this combined lack of conduct standards and development finance.

By 1999, the link between the Usury Act and SMME credit had waned in importance, as compared to concerns about exploitation. The key issues here were the very high interest rates being charged to poor and low income individuals, along with over-extension of credit and other alleged abuses (e.g., illegal collection methods, improper inducements, issuing credit before having signed documents, etc.). There was pressure to enhance access to finance for a large segment of the population, while still protecting individuals who were seen to be vulnerable to exploitative practices. One might have wished for thorough financial reform to put the industry on a solid footing. However, this proved infeasible at the time. The government had a mass of urgent policy priorities to address. Thus, as a “quick and dirty” approximation, the 1999 Exemption Notice, and with it the MFRC emerged.

The following table summarizes the main periods and decision points in the development of the microfinance sector:

Table 1: Main Periods and Decision Points in the Development of the Microfinance Sector

Time period / regulatory regime	**Issues and approaches**
Pre-1992 – Usury Act, etc.	Financial exclusion of majority, role of apartheid, distortions due to Usury Act
1992-1999 1st Exemption Notice	Micro-lending boom raises need for *consumer protection* – DTI New regime (1994) must address need for development finance (SMMEs, housing, education) – DFIs
1999-present, 2nd Exemption Notice, MFRC	*MFRC mandate:* Formalize micro-lending within Exemption; Consumer protection; Improve information & understanding
Usury Amendment Act 10 of 2003	Empowers MFRC to conduct inspections on both unregistered and registered lenders, using external inspectors. Provides for submitting questions to the High Court for declaratory order.
2005 into the future: Credit Regulator	*Unified credit law regime* Consumer protection: more solid legal foundation, more robust controls.

MFRC and the current regulatory system

The 1999 Exemption Notice made it a condition of micro-lender operations (i.e. extending credits up to a new maximum of R10,000 [US $1,562] at rates above the statutory interest rate cap) that each institution register with a new regulatory agency that would be established as a legal person. Thus, the MFRC came into being as a non-profit company carrying out delegated regulatory functions within the market niche carved out by the new Exemption. MFRC is a functional regulator – it focuses on a set of activities that it licenses and supervises, regardless of the organizational form or other financial license held by the lender. The key elements of MFRC's mandate boil down to these: (i) formalize the micro-lending sector, (ii) provide consumer protection, and (iii) improve information and understanding. Further, MFRC added to its mandate by expanding its focus in strategic ways to address glaring deficiencies in financial sector development, which may have strictly fallen outside of their explicit charge, but clearly either impeded or undermined their core responsibilities.

Formalization

In the area of formalization, the MFRC has used the leverage provided by the 1999 Exemption Notice to bring significant numbers of microlenders into formal registered status. The Accreditation and Compliance Department of MFRC handles this function. Upon MFRC's founding in 1999, it had to set up a specialised system of application, checking, and expediting registrations. For over three years, the MFRC struggled to carry out its mandate here, since it had at most only the implicit authority to require microlender registration. It had no statutory authority, and its efforts were resisted in the courts, until an amendment to the Usury Act was passed in 2003, enabling it to enforce the Act by delegation. Applications soared starting in mid-2004, evidently as a result of MFRC's campaigns against unregistered lenders. The key results of its efforts are as follows:

- Some 1,900 lenders have been registered (along with thousands of branches); MFRC argues that there has been a decrease in the ranks of unregistered lenders, but this is not firmly established.

- More than 200 Black South African micro-lenders have been registered. At the same time, there are indications that many more such lenders exist and have not registered, especially informal township based lenders.

Consumer protection

Consumer protection is the central, and least controversial, aspect of MFRC's mandate. The MFRC provides a platform for complaints resolution and a mechanism for borrowers to seek help. Even critics of the agency seem to agree that this is a breakthrough. MFRC also brings specialized resources to bear on the enforcement of consumer protection. The first consumer complaints related mostly to retention of bank cards, which became illegal along with the creation of the MFRC. Combating this and other illegal collection methods (e.g. the use of blank "process," or confession of judgment, forms) has proven difficult. Other consumer protection concerns included high rates, disclosure, abuses by agents and brokers, and reckless lending. As a result of MFRC introducing a prescribed loan summary in 2000 (comparable to "Truth in Lending" disclosure requirements in the U.S.), there has been a trend of increasing transparency in pricing. MFRC's change of rules in 2002 on "agents and brokers", requiring training by lenders and correct identification, appears to have resulted in a significant reduction in complaints related to non-compliance with MFRC rules. More recently, MFRC has focused a great deal on preventing over-indebtedness and reckless lending (see below).

In an effort to increase its efficiency and move closer to a risk-based, as opposed to rules-based regulatory approach, MFRC analyzed complaints concerning the largest of its member institutions, and worked with them to establish their own complaints departments. Now, some 20 lenders have such departments, which are required to meet standards and response times defined in service-level agreements with MFRC. In another strategic step, the agency has used compliance audits, in addition to its responses to complaints and pro-active investigations, to encourage good behavior. Compliance certification enables the lenders to report regulatory non-compliance before it is discovered by auditors, and thereby gain the opportunity to work out a compliance plan with MFRC (and reduce the possibility of eventual sanctions). MFRC statistics report that compliance has been improving.

Here are the key results in this area:

- MFRC has played a major role in "cleaning up" the industry, providing an avenue for clients to seek recourse, and fomenting major changes in microlender behavior towards more responsible lending practices. It has raised the bar in terms of ethical behavior by lenders.

- Rates and disclosures are standardized, and the procedures widely understood, if not followed universally.

- There has been a major influx of banks into the sector, driven in part by the reduction in reputational risk.

Information

MFRC's information role addresses both the financial literacy of consumers and policy-relevant knowledge of the microfinance sector. On the latter point, the MFRC is charged with reporting statistical returns and trends. It has gone beyond this narrow mandate, supporting, and in some cases leading, the review and development of new frameworks for reforming the financial services sector. With respect to financial literacy, this has long been recognized as a major problem in poor households and communities. MFRC has launched various financial education initiatives: a multimedia campaign aimed at informing consumers on their rights when borrowing money, the role of the MFRC in the protection of borrower rights, and prudent financial management; the training of educators and advisors of intermediary organizations which run educational programs amongst employees and in communities; and the launch of a debt relief program aimed at establishing a network of debt and financial counselors and mediators across the country.

Following are the major results in this area:

- MFRC has played a central role in the collection of sectoral data and the analysis of trends in the market. There are, at the same time, questions about the quality of MFRC's data -- although the data are clearly better than what had been available previously.

- MFRC has made strong efforts to inform and educate the public. Despite MFRC's public information campaigns and its efforts to ensure the use of standard contracts and disclosures, there are constant complaints that borrowers do not understand the terms of their loans.

- MFRC has produced critically important research, creating a much better standard of knowledge about the microfinance sector. It has used much of this research to press on major policy issues (e.g. credit law reform), injecting sound information and analysis into a political discourse that tends to be dominated by anecdote and polarizing rhetoric. As compared to the situation in 1999, much more is now known about the microfinance sector, and this is largely MFRC's doing. It has also used this research to improve its own regulatory function.

National Loans Register

The MFRC took a further step beyond its core mandate to establish the National Loans Register. MFRC understood that an implication of both the core consumer protection mandate and the industry development mandate was the need for much better credit information systems. Having these in place would enable the setting of over-indebtedness standards and help reduce the risks to lenders. Thus, MFRC stepped into the gap with its National Loans Register (NLR) initiative in 2002. Once this was in place, MFRC felt it had the information necessary to begin cracking down on reckless lending, i.e. credits that create over-indebtedness (defined as a percentage of household income).

The questions arose: Who would take the initiative to get it established, and what model would be used? Options included a voluntary, private sector model that set a requirement that loans must be registered in order for the creditor's interest to have legal priority over third parties. This is the essence of the system in the U.S. and other industrial countries. The model chosen, which requires checking the NLR as a condition of the enforceability of a loan agreement, takes a more directive approach. The South African approach is linked to specific features of the environment, notably the near-automatic repayment of payroll-based loans and the ability of banks to "jump the queue" and discriminate against microlenders in filling debit orders. Further, it was largely the threat posed by reckless lending investigations launched by MFRC, and the sanctions that adverse findings could bring, that pushed the industry towards compliance.

The requirement that lenders use the NLR was struck down in a court decision invalidating the 2002 revised MFRC rules. One of the more striking outcomes is the increase in NLR filings since then – indicating that lenders may have determined it to be in their continued self-interest to use the system. Thus, the kinds of commercial incentives discussed above appear to be coming into play in South Africa. This is partly due to the design of the system. Rather than set up a separate public credit registry, as a number of countries have done, MFRC chose a private sector model that links the two large credit reporting firms that serve the banks and larger micro-lenders (TransUnion ITC and Experian) to second-rung credit bureaus that deal with the smaller micro-lenders. MFRC has access to this information, and monitors activity and reports aggregate statistics.

Outcomes

What have been the outcomes of the system just described? MFRC has played an important role in the emergence of a R17 billion market (from less than R1 billion [US $156.3 million] in 1992, and around R10 billion [US $1.6 billion] in 1999, at the time of MFRC's inception). There is evidence that nearly 30% of this consumer credit has gone towards developmental purposes (i.e. enterprise, housing, and education). Other evidence suggests that the MFRC has helped create access for an estimated three million people who did not have access to formal finance before. These other broad impacts are apparent:

- Major changes in micro-lender behaviour towards more responsible lending practices and concern for lenders' reputation.

- The influx of banks into the sector, which appears to be driven in part by the reduction in reputational risk.

- A quantum leap in information and understanding with respect to the sector.

Some have suggested that MFRC's efforts encouraged consolidation, since the more marginal players were unable to meet all the regulatory requirements. Indeed, the microlending market features severe concentration, with the commercial banks constituting 0.5% of the registered lenders with the MFRC, but holding 47.8% of the gross loans and 38% of the clients. Once the banks decided to enter the sector, they were very quick to aggressively grow their market share, taking advantage of their preferential access to the payment system. This has led some to complain that MFRC in fact had an anti-competitive effect on the market, and in particular that compliance costs may have discouraged more black micro-lenders from entering the market. Further, microfinance bank failures in 2001-2 helped reinforce the division of the market between very large lenders, mainly banks and very small ones – with little middle ground. Again, much of this results from secular trends that were only tangentially related to MFRC.

One clear outcome of these experiences has been the testing of an innovative model for microfinance regulation. The MFRC is an example of hybrid or delegated regulation. Here, political influences are counterbalanced by the pressures inherent in all forms of self-regulation. At the far extreme of self-regulation, i.e. voluntary industry codes of conduct, the government is kept at arm's length and the industry determines the mode of policing, which may be more or less robust depending on the outside pressure that the industry faces. The other end of the self-regulation spectrum is closer to classic governmental regulation, but with some public-private division of labor. Here, there are a few variants. The form typically associated with the professions is for legislated standards to be enforced by industry associations, and for certification procedures to reinforce professional standards and public confidence. Another variant, involving greater involvement by government, is used in some stock exchanges. The exchanges police member behavior according to well-established industry rules, under continuous oversight by government regulatory, investigative, and judicial authorities. MFRC combines aspects of these models.

Several microfinance industry representatives in South Africa have complained about the MFRC's intrusiveness, and the fact that it does not behave the way a member-based industry promotion organization should. On the other hand, consumer advocates have complained that it has been too lenient with the industry on rates, disclosure, and over-indebtedness. It is precisely because the MFRC was set up as a hybrid, not an arm of government, that it has been able to encourage voluntary compliance by the industry, as a self-regulatory body, at the same time as it wielded investigatory powers and official sanctions. Its position outside the government hierarchy (along with astute appointments), has enabled MFRC to resist political pressures to become a draconian enforcer.

Future of the Sector and Its Regulation

Looking forward, as the situation develops in South Africa, a number of critical issues remain to be addressed.

- The need for a more unified, less fragmented, structure for credit regulation
- Incentives to expand development finance: top-down (banks), bottom-up (MFIs)
- The efficiency of commercial credit transactions and information infrastructures, such as title and collateral registries.
- The need for savings, insurance, other vehicles
- The heavy burden of “red tape” on SMMEs
- The need to expand credit access, and especially to develop the embryonic township and moderate-income housing markets.

Responses to several of these issues have been formulated and are being discussed. The key initiatives are described below. However, there has not yet been an adequate response to the question of developmental, or SMME, finance. The market for small and micro enterprise finance has developed only modestly since the early 1990s. It is hard to make a profit in it, hence the massive entry into consumer credit, which now relies almost exclusively on either bank account deduction (debit order based) or, to a lesser extent, payroll-based repayment mechanisms, neither of which are available to enterprise lenders. The development of financial products (particularly, credit) has, to date, appeared to have largely been dictated by the collection mechanisms available to lenders, as only a handful of NGO MFIs make loans to non-salaried people, even though some financial institutions, including at least one bank, have begun to develop and pilot products that would better serve this market.

A complex array of problems, unrelated to the governance of the financial sector per se, weigh down the development finance market. Labor regulation and land titling are at the top of many lists of complaints. The former appears to have a severe dampening effect on the growth of small firms, hence the demand for SME credit. A regulatory impact study estimated the overall costs of inappropriate regulation in South Africa at R 89 billion (US $13.9 billion). The land titling makes it extremely difficult for lenders to efficiently leverage collateral in the form of real property. Apparently, title registries in low-income areas such as townships cannot keep up-to-date records of transfers, because so many of these happen informally. Related to this is a lack of supportive economic infrastructure in the townships, which government is now trying to address. This has led many to the conclusion that there is as yet no real moderate-income housing market in South Africa.

Consumer Credit Bill, National Credit Regulator

The centerpiece of South Africa's current strategy for enhancing credit access is the Consumer Credit Bill. In brief, the Bill creates a unified credit law applicable (with a few exceptions) to those loans extended to natural persons. It replaces the dual system of Usury Act and Exemption Notice, and the further division of transactions by form (e.g. bank loans versus retail credit agreements), with a single set of norms. By setting up the National Credit Regulator (NCR) under a legislative act, the Bill eliminates those questions that arose about the *ultra vires* nature of MFRC actions with respect to the Exemption Notice and the Usury Act. All NCR powers are on a firm legislative footing.

The Bill creates a set of protections, including a standard of over-indebtedness and a prohibition on reckless lending, as well as interest rate caps to be determined by DTI. This approach has evoked lots of commentary, as in many areas, with different sides of the question taking strongly contradictory positions. The lenders suggest that the Bill goes overboard in its level of protection, and that the compliance costs will cause a contraction and consolidation in the credit market. Some go farther, claiming that the Bill undermines the voluntary Financial Sector Charter (see below) by imposing interest rate controls, costly and intrusive reckless lending rules (based on a definition of income that ignores informal earnings), flawed disclosure rules – and all without a serious regulatory impact assessment. All credit facilities will have to be reviewed in light of the reckless lending rules. Some interpret the Bill as imposing requirements that will make revolving credit lines impossible, due to the required processes of giving quotes, and giving a cooling off period between replenishments. It is also feared that it will discourage mortgage lending due to over-indebtedness provisions.

To what extent does the Credit Bill reflect the lessons of MFRC's experiences, and build on its successes? Clearly, the provisions on the NCR resemble those of the 1999 Exemption Notice. The responsibilities of the two agencies are quite similar. There is, however, a potentially important difference. The MFRC reflected more of a self-regulatory approach to the sector, while the NCR is to a greater extent a creature of government – hence more of a classic public sector regulator. Whereas the MFRC was required to have equal representation of the industry and of consumers on its Board, the NCR is to have a Board appointed entirely by DTI and other interested ministries. In addition, the Exemption Notice stipulated that the MFRC's revenue would come in large part from regulatory fees – a provision that, along with the Board representation and the trends leading to its founding, meant that MFRC's incentives were to a great extent aligned with the industry's. A more politically responsive regulator – one more closely tied to DTI and government, and less sympathetic to the industry – would likely find it difficult to resist crackdowns in response to outcries about particular problems or abuses. The political economy of credit in South Africa is such that the enforcement of protections could easily become uneconomical, and so restrict the very access to affordable credit that policies in this area seek. The full extent of the change here has yet to be decided, since the enabling language of the Bill has not yet been translated into regulations.

Dedicated Banks Bill

The bill addresses the issue of financial sector tiering and competition. It provides new windows for financial services: the savings bank, and savings and loan bank (S&L). The Bill's provisions create an institutional license category that could be filled by non-bank companies with the capital and outreach to compete with the banks in offering basic savings, transfer, and credit facilities. Some have questioned how much this will change things. It is unlikely to attract a large influx of new entrants. Its success in mobilizing savings on a safe and sound basis will likely depend on the establishment of some form of deposit insurance, which to date has been resisted by the banks. However, there may well be sufficient interest by companies with client bases – e.g. large retailers and cellphone companies – to make possible the entry of a few key competitors.

Several provisions in the Dedicated Banks Bill are likely to discourage any potential interest from those wishing to establish a savings and loan (second tier) bank. First, an S&L's ability to intermediate savings is limited. It can extend unsecured loans only up to the amount of its qualifying capital and reserves, and it can extend secured loans up to a percentage – to be prescribed – of the value of the security (Art. 4(1)). Unless borrowers can put up valuable collateral, an S&L will be limited – as all non-banks are currently under the Banks Act – to its own capital as a source of loan funds. (Contrast this with banks, which can extend unsecured credit subject to risk-based capital adequacy and provisioning rules.) Secured loans, of course, can potentially be a highly valuable source of small enterprise finance. But this assumes the kind of efficient and flexible system of secured transactions available in a few of the developed industrial countries, but not (yet) in South Africa. So also with mortgaging systems, which have proven thus far unequal to the task of supporting investments in housing for the average South African – above all in the townships. Furthermore, the R 50 million (US $7.8 million) minimum capital for an S&L (Art. 66) may be difficult to raise. Restrictions on ownership of dedicated banks by non-financial companies (Arts 33, 38) may create a disincentive for potential investors such as cellphone companies and retailers. Last, the liquid reserve levels are to be determined – it is not entirely clear how viable the second and third tier banking windows will be until this is defined.

These concerns apply to the second-tier bank category. This is the tier that, in principle, holds the greatest promise of bringing serious competition into the banking industry. The third-tier savings bank category appears more straightforward and raises fewer concerns. This suggests that mobilizing savings is a key motivation behind the Bill, and is the most likely benefit to materialize. A more binding constraint in the Bill is the lack of access to the payment system for dedicated banks. Since the payment system is essentially a common enterprise of the largest banks, it is very unlikely that prospective competitors will be offered equal access – short of some robust government intervention. This and other limitations in the Bill correspond well with the longer-term scenario of the banking industry fending off potential sources of competition, e.g. in creating the Mutual Banks Act, which has attracted little interest due to the inadequate incentives offered to potential entrants.

Financial Sector Charter

The banking industry has focused its response to popular pressure for expanded services and "black empowerment" on the Financial Sector Charter. The Charter embodies an agreement among the major players in the financial sector – banks, insurance companies, brokers and exchanges – on a set of service provision and empowerment targets in such areas as banking services to low income populations, black employment and ownership in the financial sector, and support for black entrepreneurship. Financial services companies are expected to pursue these targets, to report periodically on their progress to a monitoring body set up under the Charter, and to be graded on their performance in the form of a public "scorecard." The mechanism here is one of self-regulation on the basis of a voluntary code – but with the threat of Community Reinvestment Act (CRA) -type legislation hanging in the background should the sector not perform satisfactorily.

The Charter is frequently cited as transformative, something that will supply the missing dynamism and outreach to the sector. It is certainly possible that it will bring significant improvements in service provision. However, it is a pale substitute for real competition – and it is the specter of competition that the sector appears to have headed off by means of the weak provisions of the Dedicated Banks Bill and other relevant legislation.

It is also not clear what the cost will be of meeting the Charter targets. In the U.S., while the CRA has forced some service extension and empowerment activities, some analyses see it as anti-competitive. The costs of compliance have been more easily borne by large banks than by their prospective competitors in the relevant neighborhoods – with the result that actual financial services to these communities have in many cases suffered. Similarly with the Charter, the dominant players in the sector will be best able to afford to comply. Again, this may bring benefits in terms of outreach and black representation, but the Charter is also likely to be anti-competitive (despite exemptions for very small institutions).