RESPONSE TO PORTFOLIO COMMITTEE ON TRADE AND INDUSTRY ON THE REGULATION OF THE BANKING SECTOR IN RELATION TO CREDIT PROVISION

PRESENTED BY:

Division:

Date: 22 Nov 2024

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

OUTLINE OF THE PRESENTATION

1. The pricing imposed by the banking sector on municipalities and its impact on service delivery - Intergovernmental Relations.

2. The disparity between credit regulation and regulation of financial conduct, among others – Financial Sector Policy Unit.

The pricing imposed by the banking sector on municipalities and its impact on service delivery

Municipal borrowing from private sector is fundamental to local infrastructure finance

- The Constitution of South Africa Sec 230
- The White Paper on Local Government
  - role of private capital markets in funding infrastructure
  - emphasises the need for municipalities to access private finance through demonstrating creditworthiness and sound financial management.
- Chapters 6 and 11 of the MFMA
- The Original Municipal Borrowing Policy Framework – adopted by Cabinet in 2000
- The Updated Municipal Borrowing Policy Framework – adopted by Cabinet in 2022

The 2022 Updated Municipal Borrowing Policy Framework

- Key principles of the policy framework
  - Creditworthy municipalities should ***borrow prudently*** to finance capital investment and fulfil their constitutional responsibilities
  - Municipal access to private capital, ***based on investors' evaluation of municipal creditworthiness***, is a *key to efficient local government* and fiscal discipline
  - Municipalities should ***borrow in the context of long-term financial strategies***, which reflect clear priorities and the useful life of assets
  - Neither national nor provincial government will ***underwrite or guarantee*** municipal borrowing

Process taken by municipalities

Municipalities undertake procurement processes In line with section 217 of the Constitution, Chapter 11 of the MFMA, the Supply Chain Management Regulations and the Municipal Supply Chain Management Policy.

- Advertise tenders
- Receive proposal
- Select the best proposal
- MFMA Section 46:
    - public consultation
    - notice to national and provincial treasuries
- Council Approval

NB: The amount to be borrowed must be appropriated in the municipal budget

How banks set Pricing

Interest on municipal loans varies, based on

- Banks’ own cost of funds (interest they pay in capital markets)
- Risk premium based on:
    - Municipality's credit rating
    - Municipality’s financial management (key ratios include debt/revenue, debt service to revenue, liquidity)
    - Revenue collection efficiency
    - Audit outcomes
    - Historical repayment performance
- Term of the loan
- Project being financed
- Security in terms of Section 48 of the MFMA
- Market conditions and competition with other lenders

Conclusion

- Banks must charge municipalities market interest rates to enable increased investment in public infrastructure and economic growth
- Good financial management means lower interest rates for municipalities
- Bad financial management means higher rates or no lending at all
- Municipalities that cannot afford loan repayments should not borrow
- In our engagements with municipalities, we have not experienced an indication that rates are too high and affect service delivery.

The disparity between credit regulation and regulation of financial conduct

The disparity between credit regulation and regulation of financial conduct

- The NCA is mainly rules-based in nature, and while well-intentioned this might be seen as prescriptive.
- To remedy this the CoFI Bill takes a principles-based approach which balances rules and principles to achieve the desired outcomes.
- The CoFI Bill seeks to establish a single, cross-sector conduct law, to give effect to the market conduct policy approach, to strengthen customer protection across the sector and to provide the Financial Sector Conduct Authority (FSCA) with better tools to support financial inclusion, transformation, innovation and competition.
- The reform of the financial sector regulation towards a Twin Peaks model strives to improve outcomes by placing equal and dedicated focus on managing key risks in the financial sector with a core focus on financial stability, prudential and market conduct regulation.

The CoFi Bill: Bridging the gap

Key features of the COFI Bill:

- **Activity-based regulation**: Regulates similar activities consistently across all financial institutions.

- **Outcomes-focused regulation**: Emphasises fair treatment and improved consumer experiences.

- **Risk-based and proportionate**: Prioritises resources where the risk of harm is greatest.

Co-operation and coordination between the NCR and FSCA

- The COFI Bill integrates culture and governance into its framework to foster cultural and governance practices within financial institutions which support the correct conduct outcomes being achieved, including a proper focus on customer interests.
- Concurrence and consultation amongst regulators are provided under the CoFi Bill arrangement.
- The FSCA and the NCR have entered into a Memorandum of Understanding (MoU) to strengthen and formalise their relationship through mutual co-operation, information sharing, and appropriate co-ordination of actions in terms of relevant financial sector laws and the NCA.
- The MoU also facilitates a common understanding between Parties on areas where their respective regulatory and supervisory objectives and responsibilities may overlap.

Conclusion

- The NCA and the CoFI Bill are both critical components of the regulatory framework for South Africa's financial sector and they both address credit regulation and regulation of financial conduct.

- Any existing gaps that have been identified are addressed in the COFI Bill to harmonise regulation across the credit sector by promoting collaboration, ensuring consistent standards, and prioritising consumer outcomes.

THANK YOU

ANNEXURE

Outstanding LG debt by different types of municipalities

Table 3: Outstanding long term debt as at 30 June 2023

Municipal Category	Municipality	Total debt Q4 2022/23 R'000	Share of total debt	Actual Revenue 2022/23 R'000*	Debt to revenue ratio
A	BUF	138 854	0,2%	7 806 270	2%
	NMA	1 272 215	2%	16 870 262	8%
	MAN	465 855	1%	8 377 698	6%
	EKU	9 881 230	14%	47 943 208	21%
	JHB	22 054 843	31%	70 513 631	31%
	TSH	9 492 185	13%	29 560 671	32%
	ETH	9 841 193	14%	47 638 510	21%
	CPT	7 462 407	11%	53 274 755	14%
	Total Metros	**60 608 782**	**86%**	**281 985 005**	**21%**
B	**B1 (19)**	6 880 567	10%	63 190 967	11%
	Other Municipalities	2 697 961	4%	99 051 340	3%
C	**Districts**	346 187	0%	26 111 180	1%
	Total all municipalities	**70 533 497**		**470 338 492**	**15%**

*excluding capital transfers

Source: National Treasury Database

Municipalities engaged in borrowing…

- About 86 percent (R60.6 billion) of municipal borrowing is undertaken by the metros
- The secondary cities account for about 10 percent (R6.9 billion) municipal borrowing
- 4 per cent (R2.7 billion) of municipal borrowing belongs to the rest of the local municipalities while only 1 percent (R346 million) belongs to district municipalities
- The metros are highly geared than the rest of the other municipalities with an aggregate debt to revenue ratio of 23 percent
- The secondary cities have an aggregated debt to revenue ratio of 11 percent while the rest of other locals have an aggregated debt to revenue ratio 2 per cent