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Clarity & Strategy Through Economic Research

Fees and charges for financial services in Namibia and their effect on the access of the poor and the MSME to these services

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A report for the Ministry of Finance, The Bank of Namibia and NAMFISA

Concise Report

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1. CONCISE REPORT

1.1 Setting the scene

The Namibian Ministry of Finance has called for a study into the pricing and availability of financial services. Around half of the adult Namibian population has limited or no access to financial services. This report is the outcome of this request. The study involves a survey of fees charged by the suppliers of financial services and also includes interviews with providers, a consumer focus group exercise, a mystery shopping exercise, and desktop research.

Banking services are typically considered first-order financial services, as an ability to transact, receive funds and make payments in a convenient and affordable manner is key to economic participation. For low-income consumers other high priority issues include mechanisms not only to save, but also to pay for funeral costs and to provide protection for families in the event of death. Assistance in covering high, and unanticipated, medical costs, is also deemed important. Short-term asset insurance may be relevant to those with high value assets, or with items that are essential to their ability to earn income. Finance is also necessary to facilitate the acquisition of high value items such as houses and motor vehicles, or to fund irregular expenses, or to provide working capital for business activities.

Access problems may arise because of pricing considerations or because the services are inappropriate or inaccessible. The Namibian financial services sector is characterised as one that is highly developed, offering a range of services to businesses and middle and high-income consumers. The situation can be viewed as one of a sophisticated enclave surrounded by a sea of under-provision. This study also evaluates the role of market structures and regulations in perpetuating this disparity.

Authorities around the world generally agree that that financial exclusion worsens economic polarisation of communities. Access to such services can help to distribute economic opportunities more evenly, especially for poorer households and small businesses (Subbarao, 2009[1]).

Generally, access implies a composite of requirements regarding the *supply of and demand for* financial services – such as availability, affordability and appropriateness. While there may be supply and (notional) demand for financial

[1] Subbarao, D. 2009. *Financial inclusion: Challenges and opportunities*. Remarks by Dr. D Subbarao, Governor, Reserve Bank of India at the Bankers' Club in Kolkata on 9 December 2009.

services –it is only when they are consumed that we have usage. Hence usage refers to the actual consumption of such services, and can be seen to reflect effective demand (where the consumers are both willing and able to use financial services).

Many consumers who are excluded from financial services have low or inconsistent incomes - and for many of them this is the first and most important barrier to access. From the perspective of the consumer relative affordability of financial services is key. But even where prices are low, the price needs to be seen relative not only to the consumers' income, but alternative expenditures. Hence, people with low incomes may value a cell phone more than a bank account. But research also indicates that other barriers – apart from lack of affordability - such as poor physical accessibility, inappropriateness, complexity and discrimination (through language and other biases) also contribute to lack of access.

The provision of financial services is often through economically powerful firms that have met a number of regulatory entry requirements or barriers. The entry barriers do several things at once: they provide comfort to regulators that these firms have met fit and proper and prudential requirements; they confer privilege - such as access to the payments system; and they offer protection from the competitive forces of potential new entrants.

Namibia is a huge, sparsely populated country. These factors are additional constraints facing would-be green fields investors in conventional financial services.

Barriers to entry mean that the forces of competition cannot be relied upon to eliminate super profits. In this privileged and protected market, the impetus for firms to capture economies of scale through merger and acquisition leads to a concentrated landscape in the financial services industry. For these reasons, the financial sector comes under scrutiny from competition authorities - and those concerned about consumer protection - from time to time.

During South Africa's recent *Enquiry into Competition in the Banking Industry* (June 2008), the Enquiry Panel concluded that this was an oligopolistic market where competitors chose not to compete on price but on non-price determinants. The big four retail banks in South Africa have learnt that to undercut prices would spoil the market. Effectively, each bank follows the market leader in each of the sub-markets, spreading their overheads and an expected profit margin across all

transactions. One of the banks went so far as to say that when setting their prices, they compared their prices to those of their competitors, and adjusted them if they were out of line. Essentially the banks charge "what the market will bear", rather than base their charges on a detailed understanding on their costs per transaction. It is in this context that the question of regulation of pricing arises.

Price regulation is closely linked to what could be considered as reasonable prices. One of the aims of the banking enquiry in South Africa was to establish the relation between the cost of service provision and the charges for the consumer. Between August 2006 and June 2008, the enquiry received hundreds of submissions from banks and other stakeholders - many of them highly detailed – but it failed to establish any relation between the cost of service provision and the charges levied on consumers.

Whether or not it is possible to establish such a relation remains a moot point. However - the banks argued that:

- They never calculated such per transaction costs (clearly there has never been any need)
- They saw their overhead costs as "fixed" which meant they simply spread the burden of these costs (together with a "required" margin) across their activities.

For this reason, the Banking Enquiry did not see its way clear to recommend regulation of bank fees and charges, (except for penalty fees) although a number of key recommendations were made.

One of the concerns with regulation of prices (also known as substantive regulation) is that if the price is set too low, there will be lack of provision (or gaps in the market) or widespread lack of compliance. In contrast, if the regulated price is too high, it is simply ineffective and serves no purpose. Where authorities have regulated interest rates to moderate rates below market rates - such as in the US and South Africa – gaps have emerged in the market and providers have circumvented the caps on rates by charging additional fees to supplement their revenues (Feasibility, 2003). In the US, the outcome has been to generally move away from such caps (with some exceptions in certain states), while in South Africa, the authorities have responded with the National Credit Act (NCA) which caps not only interest rates, but also fees, on consumer credit loans.

However, even under the NCA, there are certain categories of fees that can be - and are - added to the total cost of credit.

Regulators around the world know that capping some fees or rates is like squeezing a balloon. Providers shift their margins to those areas that are not capped and in this way overcome the regulatory constraint on pricing. With substantive regulation therefore, comes an onerous regulatory burden of monitoring and supervision, without which there is likely to be widespread non-compliance. For example, in Namibia the annual percentage rate or total cost of credit charged by banks and micro lenders for term loans of up to N$50 000 exceeds the rate set by the Usury Exemption Notice. This may be because of lack of clarity of definition or lack of enforcement. The outcome is an uneven playing field that encourages non-compliance - as one provider quickly becomes aware of what another is getting away with.

This raises the question of what authorities in other countries have done to encourage lower pricing and improve access. This analysis is summarised in Section 1.5.

1.2 Overview of the sector

From a legislative and regulatory perspective, the Ministry of Finance has authority over financial firms, through the Bank of Namibia (BON), which regulates banks and the Namibian Financial Institutions Supervisory Authority (NAMFISA), which regulates the non-banks and credit provision to consumers. The firms under scrutiny are the banking, short-term insurance, life insurance and funeral policy, pension fund, micro-lending and medical aid financial services industries in Namibia.

There are four major **retail banks** in Namibia, Bank Windhoek, FNB, Nedbank and Standard Bank. They offer a range of banking services to individuals and businesses. This is a concentrated landscape, with the top 3 banks accounting for over 85% of the market share of assets.

In February 2010, the Fides Bank Namibia was granted a banking licence and became the first micro finance bank in Namibia. It offers services primarily to micro-entrepreneurs. The five banks under consideration are regulated through the Banking Institutions Acts, the Payments System Management Act and the Financial Intelligence Act. All of the banks, except for Bank Windhoek, have foreign majority shareholding.

Over and above this, the Post Bank division of NamPost - the Namibia Post Office - provides transmission and saving services to individual clients. It may take deposits and offer certain transmission services within its network. It is not entitled to make loans and is excluded from the Banking Institutions Act of 1998 and from participation in the payments system. It reports to the Department of Communication.

All together, the responses from the banks and Post Bank suggest that there are some 900 000 individual accounts in the system, with many banked Namibians having multiple accounts. Together, the commercial banks run some 218 branches, sub-branches and agencies, the bulk of which are in cities and towns. While Nampost serves smaller villages with its 127 branches, in a country like Namibia, where there is considerable distance between towns, the reality is that some areas remain poorly served. The use of technological innovation – such as mobile and internet banking - is the best hope for improved access and usage where there is low population density.

The Namibian commercial banks have achieved consistently high returns over many years. In the past four years, the average aggregated pre-tax return of the banks has been around 29% per annum. This puts them on a par with some of the most profitable banking sectors in the world. While 2008/9 was a tough year that generated a return of around 22%, this was a particularly weak year elsewhere too. In South Africa, the average return for 2008/2009 was 25%. While a full evaluation of profitability and market power falls beyond the brief of this report, the data are suggestive. Moreover, the sustained profitability of the Namibian banks suggests that the big four incumbents behave like oligopolists, each with some market power, but unwilling for the most part, to compete on prices.

The four commercial banks earn over half of their revenues from non-interest income, and incomes from fees and charges make up just over 30% of their income. This is in line with other countries like South Africa and reflects an international trend for banks to diversify income away from interest earnings.

In the case of the **life or long-term insurance** industry, there are 16 licences – with 8 firms licensed for all classes of life insurance, and 11 for funeral insurance. The life insurance industry is dominated by Old Mutual, Sanlam and Metropolitan, who collectively accounted for more than 87% of the total assets of the industry at the end of 2008. As far as these major players are concerned, majority

shareholding lies in the hands of South Africans, with cross holdings between banks and insurers evident. For example, Old Mutual has a majority shareholding of Nedbank. Capricorn Holdings – which owns the majority share of Bank Windhoek - owns a 30% share of Sanlam. Metropolitan's ownership is dominated by FNB. These cross-holdings tend to encourage bundling of products between related firms, which may not always benefit the consumer. Of the 16 licensed firms, the claims ratio (benefits paid expressed as a ratio of gross premium income) varies between 7.1% and 90.9%. The low claims ratios achieved by some firms warrants further examination by NAMFISA regarding possible unfair practices.

There are 14 licensed **short-term insurers** in Namibia, with Mutual & Federal, Santam and Hollard dominating the industry market share of premium income. The majority direct shareholding in the three largest insurers is South African. Old Mutual Plc has a 73% stake in Mutual & Federal Insurance Company Limited, which – in turn – owns 100% of Mutual & Federal Namibia. Sanlam Limited has a 56% stake in Santam Limited, which holds 60% of Santam Namibia. Hollard – South Africa's largest un-listed insurer – is thought to hold 100% of Hollard Namibia, but this has not been verified. A smaller short-term insurer – Legal Shield – is 100% owned by the Trustco Group, which is in turn owned by various Namibian interests.

There are around 249 registered **micro-lenders** in Namibia. They offer term loans and pay-day loans to formally employed individuals – if the latter are able to show a salary slip. Most of the lenders offer pay-day loans exclusively at a benchmark rate of 30% per month. The pay-day lenders are typically repaid in cash, and retention of the customer's card and pin is still a fairly common practice. The banks and other larger firms offer term loans under the auspices of the Exemption to the Usury Act. They are repaid preferentially through the payroll deduction system open to state employees and employees of big firms. More than one bank indicated they would consider offering pay-day loans in the future. The growth in the extension of micro-loans by some 25% per year between 2003 and 2007 suggests that these have become an increasingly familiar source of credit to those employed, and a profitable market for providers.

In term of **pension and provident funds**,the largest closed fund - in terms of numbers of members – is the Government Institutions Pension Fund, with some 72 000 members in 2007. Altogether private funds had some 152 000 members over and above this. The data suggest that while every public servant contributes to a pension fund, only 28% of those employed in the private sector contribute to

one of the registered funds. The relatively low-uptake of this service is not easy to evaluate. However, it may be that as in South Africa, the relative returns on such financial services are generally seen to be poor and where employees have discretion, they may be opting out of what is seen as offering little value.

In terms of **medical aid schemes and insurance**, the membership numbers provided by the registrar imply that in 2007 24% of all employed people in Namibia were principal members of a medical fund, and that only 14% of the total population at that time were covered by a medical fund. This implies that more than 80% of the population either fund their health care personally, or are dependent on the State.

The financial services sector in Namibia is an important economic sector, with some depth in terms of range and type of services to consumers. There is clearly a strong South African influence in terms of ownership, and possibly also operations. The cross-holdings of firms contribute to the fact that a few firms hold all the important cards.

The analysis of market structure was a challenge given that information that should be more readily available was not. The regulators need to assert their authority and insist on appropriate, timely information – especially from those considered to be important. Fines should be imposed for a failure to meet the required reporting standards – from both the perspective of time and the accuracy of information provided.

The discussion underlines the tendency of the financial services sector to favour employed individuals, with micro loans, insurance, pensions and medical aid contributions reserved for those with a current salary slip. This suggests a significant burden on the state for provision of social security benefits and medical care.

Although basic bank accounts can be opened by those without regular formal income, consumers do not always know this (as we shall see below).

1.3 Pricing and access

Regardless of the product or service, the financial services sector is not one that lends itself to easy price comparison. Where the price is readily given, such as in the case of short-term insurance, it does not contain all the necessary information for a consumer to make a rational judgement about the suitability of the product.

With this in mind, the data on pricing and access was obtained through a survey of firms, who were asked to submit product and pricing information along certain standard lines. The data from all the participating firms is presented so as to provide a sense of the comparative market prices in each case. In the case of simple, straightforward services (such as ATM transactions), the comparison is relatively robust and significant weight can be given to the veracity of the data. However, as the products become more complex, and such matters as exclusions come into play, it is more difficult to be sure that like is being compared with like. For example, the cheapest product with a high number of exclusions may not represent fair value to a customer - relative to a more expensive one that is more likely to pay out.

The firm data was checked through publicly available data and through mystery shopping, wherever possible. The data checking process revealed that a number of providers did not apply their minds to the completion of the survey and in some cases the initial submission was inaccurate in a number of key respects.

While some basic bank accounts may be opened without proof of income, most of them appear to require minimum income which ranges from N$200 to N$3 000 per month. Low-income individuals (defined as those earning N$3 500 or less) should, therefore, be able to open bank accounts. The four commercial banks all offer basic bank accounts, with an average monthly service fee for of N$4.00 and an average minimum required balance of N$37.50. A transaction account with a basic transaction profile[2] would cost between N$16.28 and N$108 per month, given the different options available from the different banks. It clearly pays to shop around.

It can be argued that the affordability of each service (in terms of share of income) is a more useful benchmark than the nominal price. In Namibia, the cheapest, simplest offerings for transaction bank accounts range between 0.5% and 3% of the gross monthly income of an individual earning N$3 500 and between 0.9% and 6% of one earning N$1 750. The comparative figures for South Africa are virtually identical – between 0.5% and 2.8% for a person earning R3 500 and between 0.91% and 5.6% for those earning R1 750. (In the Namibian comparison, eight accounts from four institutions were compared and in the South African example, 11 accounts from five institutions were compared.) In the past, studies have suggested a 1% or 2% share of income as a benchmark

[2] Based on the basic monthly transactions profile of: 2 cash deposits at own ATM (or alternatively at the counter), 2 cash withdrawals at own ATM, 2 electronic payments or purchases (using debit card), 2 balance enquiries at own ATM.

indicator of an acceptable cost of a basic transaction account. If the 2% rule is applied, then those with an income of N$3 500 are theoretically served with the current offerings – if we assume the profile of account usage reflects their transactions needs.

However for those earning N$1 750 or less, there is far lower access. In this respect, while it is conceivable they could open an account, they may well be inhibited in its use, which begs the question as to how useful such account ownership, truly is, and which may lead to high levels of dormancy.

Of course, the estimation of the cost of a bank account as a share of income would rocket out of range were the individual have even one rejected debit order due to insufficient funds in their account. Penalties for rejected debit orders on these basic bank accounts vary between N$49 and N$280. These are particularly punitive charges that came under the spotlight in the South African banking enquiry. At the time, those with basic bank accounts were twice as likely to experience debit order rejection fees and the revenue from rejections exceeded the fees for the successful processing of all debit orders[3]. When it was being investigated, the rejection fees on consumer accounts with the big four banks ranged from R28 to R105 per time. The Enquiry made the recommendation that such fees be capped to no more than R5 per rejection. Banks in South Africa responded in part, by reducing the penalty fees on Mzansi accounts. However, other entry-level accounts still have high penalty fees, with the variance on these accounts now between R5 and R115. The National Treasury of South Africa has recently put more pressure on banks to progress in this regard[4].

Since many of the low-income individuals canvassed in the consumer focus group discussions indicated they would like to have access to a range of financial services, a number of services have been evaluated in terms of the share of gross income they represent. Table 1 indicates the highest, lowest and average cost per month for a number of services and products that a 30-year old male with an average risk profile, earning N$3500 per month, could gain access to. Note that this represents the *maximum* monthly income used to define low-income individuals for the purposes of this study.

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[3] Banking Enquiry. 2008. *Report to the Competition Commissioner*, p 131. June

[4] *Business Day*, 2010. Treasury, banks agree to steps to lower costs. 2 June. P 1

Table 1: Price of financial services as a share of monthly income (N$3500)

	Basis of Price	Highest Price	Lowest Price	Average Price
N$100 000 of Life Cover	Monthly Price (N$)	250.00	27.90	125.97
	% of Monthly Income	7.1%	0.8%	3.6%
N$20 000 Funeral Policy	Monthly Price (N$)	156.00	55.00	105.50
	% of Monthly Income	4.5%	1.6%	3.0%
Most Basic Medical Aid	Monthly Price (N$)	711.00	229.00	414.71
	% of Monthly Income	20.3%	6.5%	11.8%
Vehicle Insurance on 2000 VW Polo valued at N$45000	Monthly Price (N$)	604.08	385.22	474.70
	% of Monthly Income	17.3%	11.0%	13.6%
N$100 000 Comprehensive Household Contents Cover	Monthly Price (N$)	321.60	145.00	218.39
	% of Monthly Income	9.2%	4.1%	6.2%
N$10 000 Personal Loan with 12 Month Term	Monthly Price (N$)	1351.6	390.68	895.47
	% of Monthly Income	38.6%	11.2%	25.6%
Mortgage for a property with a value of N$60 000 and a term of 240 months	Monthly Price (N$)	467.12	419.36	443.91
	% of Monthly Income	13.3%	12.0%	12.7%
Total for all the above financial products and services	Monthly Price (N$)	3969.60	1656.16	2727.32
	% of Monthly Income	113.4%	47.3%	77.9%

Source: Feasibility survey of providers

Table 1 reveals a number of issues. Clearly, there is benefit in shopping around, as the difference between the maximum and lowest price for a comparable service is considerable in many cases.

Second, while the lowest pricing suggests that some prices are potentially affordable, many services appear to be out of reach for low-income consumers. In particular, the price for vehicle asset insurance, at 11% and 17% of gross monthly income for the lowest and highest price respectively, may well be unaffordable. Similarly the price for a basic medical aid, between 6.5% and 20.3% of gross monthly income is likely to be seen as relatively expensive, given that there is public health care. The cost of loans (both a term personal loan and a mortgage) are slightly more difficult to evaluate in terms of perceived value as the consumer may have no choice but to take a personal loan and the mortgage allows the consumer to create wealth. Hence while affordability is a crucial mechanism by which to evaluate products for low-income individuals, the value assigned to any of the financial services remains highly subjective.

The consumer focus groups have made it clear that the perceived value of alternatives to financial services (such as cellular telephony) is crucial, with many financial services being seen as less important than other products and services. Moreover, there may be informal alternatives to formal services that allow the underserved consumers to get by. Hence preferences of consumers, and informal alternatives, clearly influence demand.

The limitation of using price as an indicator of access is apparent when looking at the details of certain products. For example, some legal aid products appear to be relatively affordable, but the claims ratios suggest that few people are able to make use of the protection the policy affords them. Similarly, some of the cheaper funeral policies offer too little cover to pay the full costs of a funeral. While the interest rate on a pension-backed loan appears to be relatively low - given that the pension offers such liquid security - the price can be considered high (at prime plus 1%) relative to a regular mortgage (where the security is less liquid). Moreover, the users of such facilities also do not always understand the implications of missed repayments for the value of their pension payouts.

The range of products available and the profile of income of consumers furnished by firms during interviews and in the survey revealed that financial provision in Namibia has, for the most part, been designed for wealthier and middle class consumers. Interviewees indicated that the total bankable population was around 600 000 people and for non-banking financial services, the potential market was around 350 000. Key to the thinking behind these numbers is the number of formally employed Namibians[5], with an implicit understanding from both providers and consumers that formal regular employment is a necessary condition for access to most financial services.

While this may suggest prudence on behalf of the providers, the requirement for formal income is only part of the barrier to usage. In particular, many products are simply not available unless the consumer works for the state or a large company where there is an option for the provider to collect premiums or repayments through the payroll deduction system. This was verified through the mystery shopping experience. The payroll deduction facility – to which only a select few providers have access - introduces a number of distortions to the market.

Firstly, it means that those who are unemployed or those that work for small firms (who do not have payroll facilities) are simply turned away. This has

[5] The latest Labour Force Survey suggests that around 51% of Namibians of working age are unemployed.

negative implications for access and the ability of consumers to shop around. Second, there is no evidence that the preferred collection procedure benefits the consumer in terms of lower rates or fees. So it simply provides a select few firms greatly reduced risks – with concomitant benefits to themselves and their shareholders. An uneven playing field is set with little justification.

Use of alternative collection mechanisms – such as bank debit order facilities, RealPay, or cash collection (even through the branches of NamPost) all have associated costs for both the provider and the consumer. In particular, the extreme penalty fees for dishonoured debit orders, when consumers often have little control as to when their salaries are paid, needs to be examined. These matters point to the need for improvement and development of improved electronic collection mechanisms.

There has been some innovation in product design for low-income consumers, as well as some experimentation with new channels of distribution. While a lower income group is being targeted, the requirement for formal income does not appear to be waived, except perhaps in a few banking products. The areas of innovation that emerged from interviews with providers include:

- Basic bank account offerings, with simpler services and fees.
- Adjustment of low-income life insurance products to the *Zimele* standards set in South Africa.
- Post Bank's biometric smart card - which can be used within a network of linked retailers - as well as Nampost branches.
- Development of a term-micro lending consolidator product which settles debts directly and allows for loan extensions to meet annual and monthly needs.
- Experimentation with new forms of distribution.
- In funeral policies, the introduction of a no-claim bonus
- Making use of telesales agents to sell products, with commission based on realised premiums.
- Medical aid schemes have introduced free ARV treatment for members, lower cost options with exclusions and lower ceilings, and mobile medical clinics that visit companies once every two weeks.

Specialised provision for small businesses was virtually non-existent, although banks do provide loans to formally registered entities with surety. Fides Bank Namibia is the only entity with a micro-entrepreneurial focus.

1.4 The consumer experience

Although consumers need to shop around, they face considerable difficulty in making comparisons, obtaining written quotes, and gaining insight into the exclusions from, and limitations to, the services. During the mystery shopping exercises conducted, written quotes were not provided in any instance. This together with the vagueness in marketing material makes it very difficult for the discerning customer to assess the quality of the service.

Weak disclosure means that consumers are not always able to play an effective market role in evaluating the products and services offered by the financial services industry. Part of the problem here is that financial service providers typically do not compete on price, but differentiate products in ways that effectively serve to shroud the price. The complexity of the products and services and the role of rewards programmes combine to make it difficult for consumers to switch providers when they are dissatisfied.

The mystery shopping experiences suggest that improved disclosure is a necessary - but not a sufficient - condition for the consumers to play their part in behaving responsibly. What is necessary over and above this, is improved expenditure to empower and educate consumers, together with enhanced regulatory powers to protect consumers. All of these elements are necessary and complementary.

In the consumer focus groups, it was apparent that people did not necessarily understand the role of, or benefits associated with, financial services. The response of the regulators should be two-fold. While education as to the role of financial services is important, it is also necessary to provide protection for previously unbanked and under-served consumers. This implies effective regulation – such as an evaluation of pertinent industry data which allows insight into particularly undesirable practices. This approach to examining such key risk indicators is generally familiar in the prudential area of regulation, but has been somewhat slow to develop in the area of market conduct regulation. An example of this would be to examine the claim ratios as a value of total premiums, in short term insurance, for example, or the lapse and surrender ratios in long term insurance.

Another general finding is that there appears to be room for improvement in terms of market conduct across the industry. Concerns around market conduct arise from:

- **Low claims ratios**. These need to be explored in terms of the experience of the customer: Are valid claims being refuted? Is the product too expensive, or are the terms of the contracts so stacked that it is difficult for consumers to successfully claim?
- **Marketing**. Incentives are being offered in order to sell the product – example include entry onto a TV show where prizes can be won. The provider should be tasked with showing to what extent this incentive encourages sales and to what extent there is value without it. It may be that this kind of marketing should be prohibited.
- **Weak educational initiatives**. At a recent micro-insurance forum, an industry leader acknowledged that putting an advert in a newspaper was not sustainable education.
- **Bundling of products** – such as "free" funeral insurance with a bank account. Ultimately the consumer will pay for such services. What are the claims ratios for such add-ons, and are these reported to a regulator?
- **Misleading advertising**. The provision of "free" life insurance together with the purchase of airtime should probably be more accurately billed as accident insurance.

1.5 International lessons

The difficulties associated with capping of prices has lead to alternate approaches – such as that in Mexico where guidelines are published on permissible fees and charges – rather than the capping of fees *per se.* In India, the Banking Association has been asked to recommend reasonable fees and charges and encourage voluntary commitment to such market guidelines. In South Africa, a mixture of disclosure and removing price floors set by the industry in the payments system is currently being attempted.

Clearly, many problems would be solved if new, innovative players could invest in the sector and undercut the prices of incumbents. As has been mentioned before, the geographic and demographic constraints in Namibia present a barrier to investment by new conventional entrants. However, recent experience in Kenya - with MPesa - and in the EU – where regulations are being adjusted to allow for non-traditional entrants to offer transaction capability – point to alternative solutions. In many developing countries micro-insurance offerings are being developed specifically with low-income consumers in mind, using alternative distribution channels. To facilitate IT firms providing non-conventional solutions in the financial services sector, regulators need to examine the necessity of

existing regulatory obstacles. in Brazil, the successful correspondent banking model with retail agents was facilitated by the development of a real-time settlement system for all retail transactions. This has greatly reduced risk in the system.

Many countries appear to have approached the problem from the perspective of financial inclusion, with a view to encouraging provision of financial services to those excluded. In India, for example, a recent directive from the Reserve Bank of India requires all banks to submit a financial inclusion plan so as to address widespread exclusion on the sub-continent. In a number of European countries, banks are required to offer a basic bank account to all comers. These requirements are typically for a no-frills account with certain requirements, such as low balance facilities and a requirement for no or low monthly fees. Apart from that, however, the fees for transactions and other services tend not to be capped.

The Indian approach is a longer-term one that combines regulation and moral suasion. Moral suasion works best where the regulated entities respect the authority of the regulator.

One of the concerns of the researchers of this project was the lack of respect displayed to the regulators. This included lack of respect shown to research conducted under their auspices. This may well have to do with clear lapses in monitoring and enforcement in the Namibian context. For example, the widespread disregard for the cap set by the Usury Notice Exemption - as regards term lending - is problematic. This may be because there is lack of clarity in terms of definition, or it may be it has been decided that the cap should not be enforced. Either way, the current outcomes appear to belie the intentions of the statute and this must be addressed. Similarly, the retention of card and pin by micro lenders has been outlawed but still continues, as it remains a practical method of collection in the absence of others. The regulators should be facilitating a better mechanism for collection that finally eliminates the need for such practices. In another case, the banks have been required since 1998[6] to submit their pricing to BON. Our information is that all that is collected in this regard are the pricing brochures available to the public (which are sometimes incomplete in terms of full listings of fees). This cannot have been the intention of the determination and suggests greater emphasis needs to be placed on effective implementation. The information potentially collected and analysed under the determination would be a hugely useful foundation for price disclosure in the

[6] Determination on the disclosure of bank charges, fees and commissions, 1998

industry. As regards payroll deduction arrangements, there appears to be widespread non-compliance with Section 12 of the Labour Fund Act of 2007, by the state and the private sector alike. This section of the Act clearly prohibits any salary deductions for third party arrangements such as term-loans or premiums. This matter needs to be addressed urgently.

International experience suggests that for regulators to be taken seriously by regulated entities, they need to monitor compliance with legislation and regulation and apply sanctions and enforcement for non-compliance.

1.6 Recommendations

There are a number of key areas of recommendation, each of which will contribute to better outcomes for consumers.

To assist stakeholders, recommendations in respect of key areas have been prioritised according to those issues which could be implemented relatively quickly, and those that will require further investigation, or which will take longer to implement.

Payment system innovations

i. BON has recently allowed for the possibility of regulating the costs in the payments system, through an amendment to the Payment System Management Act. The banking enquiry in South Africa suggested that the areas of concern in the payments system related to interchange fees agreed to by the incumbents, rather than say, the cost of the switching fee through the national retail switch, which tends to be relatively low. Access to the facilities of the payments system is also important in encouraging competition – particularly of non-conventional providers. The evaluation of the appropriateness of interchange fees for debit and credit card purchases and other electronic transactions when the customer of one bank pays the customer of another fall well outside the scope of this project. However, this is a hugely important area, and given that the BON now has the power to regulate, it should undertake a study of the influence of the costs on the national payments system on bank charges, as well as investigate the effect that the entrance of new players - including the Post Bank - would have on these charges. The possibility of technological change to facilitate new entrants or channels of distribution needs to be explored and prioritised.

ii. In a country as sparsely populated as Namibia, with ATMs relatively scarce, it would make sense to investigate ways to encourage the use of ATM and point-of-sale (POS) device cash withdrawal wherever they are available, rather than charge a surcharge for the use of an "other bank's" ATM. In South Africa recommendations to this effect have concentrated on implementing the direct charging model, where the consumer is informed of the price of using an ATM, prior to the transaction. This, together, with a prohibition on discrimination on customers holding cards issued by other firms, could help to improve fee disclosure to the customer and reduce costs. While the implications of off-us charging did emerge as a concern of consumers in the focus groups, this was clearly not a key focus of this report. It is recommended that this matter be further examined by the MoF.

Regulatory improvements

i. BON and NAMFISA need to evaluate areas of widespread non-compliance and need to consider whether there is a need for legislative or regulatory reform, or better monitoring and enforcement. The report has highlighted matters that must be addressed if the reputational risk of the regulators is not to suffer.

ii. Requirements for improved industry financial data disclosure should be set out by BON and NAMFISA. For example, annual reports of all large and medium registered providers should be available on the internet. Currently this is a constraint on evaluating the soundness and profitability of firms. Availability of such data would encourage more independent analysis by experts and journalists which would be of value to consumers and regulators alike. Insistence on publication of such data would break the hold companies (and in some cases, the regulators) have on the data.

iii. Linked to the point on data disclosure above, NAMFISA and BON need to go to greater lengths to improve the quality and consistency of the data collected, analysed and disclosed by them. Substantial variations in the values of data time series published by these regulators - due to factors such as the failure of registered entities to submit reports - undermines industry-wide analysis and policy-making.

iv. The MoF, together with NAMFISA and BON, should adopt a more visible approach to regulation, with inspection not only of head offices, but of branches. In addition, mystery shopping exercises to evaluate the

disclosure of fees and the marketing approaches should be implemented on a regular basis.

v. The MoF, together with NAMFISA and BON, need to consider the adoption of a risk-based approach to the regulation of both prudential matters and market conduct. This would require evaluation of effective regulation based on analysis of important indicators, such as claims ratios, profitability per segment etc.

vi. The authorities should conduct anaudit on the costs of medical providers and practitioners and consider alternatives to current costing and risk sharing model in the medical aid arena.

Collections

i. Once the matter relating to the Labour Fund Act is addressed, the MoF should even the playing fields, either by allowing all providers access to state payroll deduction facilities on the basis of objective criteria, or by announcing a date by which all such preferences will be removed.

ii. An improved electronic collection system, which collects payments from accounts – when they are funded by income - needs to be developed. In this regard there is considerable learning available from the AEDO and NAEDO payments stream established in recent years in South Africa.

iii. In parallel with the electronic collection mechanism being developed, the MoF should put pressure on all banks to allow RealPay and similar, competing solutions, for collection of one-month micro-loans. After a reasonable period of migration, the practice of retaining cards and pins should be targeted and non-compliance should be prosecuted.

iv. The MoF should put pressure on banks to reduce penalty fees for dishonoured debit orders. These fees are based on paper-based historical practices, with little justification in an electronic age. If the banks do not reduce these fees to acceptable levels, the MoF should consider capping them. Moreover, the implication of rejected debit order fees accumulating and "lying in wait" for when funds do accrue to consumer accounts needs to be investigated.

Disclosure, transparency and marketing

i. BON and NAMFISA should make it a requirement that the fees and conditions disclosure for *all* products should be available at all branches and on the internet. Where brochures on fees and charges are made available to the public at present, they are typically only for a subset of fees. Moreover, under their Determination, the BON should set further information requirements for the banks and publish a summary report on the outcomes of the analysis they conduct in this regard on an annual basis.

ii. The regulators should evaluate the marketing practices of certain product lines, particularly where incentives are in place. There should be a requirement for product line reporting on the claims ratios of all products that are bundled "free" with another service such as the "free" life cover on cell phone airtime and the "free" funeral cover on bank accounts. Given that these are "free" and given that there is such poor disclosure, it may be that that term does little more than seduce consumers to buy, while in reality it may be almost impossible to claim the benefits from them. It is recommended that the use of the term be prohibited, unless the provider can prove to the regulator that it is truly free. This would require the provision of considerable cost detail by the firm. Instead, firms should say that there is a charge for a specified bundle of goods.

iii. BON and NAMFISA should provide guidance notes for consumers on what to evaluate when examining the fee and condition data of providers. They should encourage independent evaluation of industry data, by placing the fee and condition data on their websites, if the industry associations cannot be persuaded to do so.

Consumer empowerment and education

i. A financial services ombud for all financial services needs to be established and funded. The remit of such an ombud should include unfair practices and overcharging, but should also embrace the concept of excessive pricing.

ii. The market conduct division of BON and NAMFISA need to be co-ordinated to commission education campaigns at several levels to train consumers and would-be consumers and students into the benefits of financial services, what they can expect from providers and what their rights are. Such education needs to be on-going and should also be included in education curricula. BON and NAMFISA should work together with

education authorities to develop effective and appropriate material for inclusion in school curricula.

iii. Regulation of appropriate disclosure of pricing, fees and practices is a key component of consumer empowerment and disclosure. Disclosure of fees at the time of transacting (ideally before the transaction is concluded) is a more effective means of empowering consumers and should be encouraged – and if necessary enforced – where possible.