

The Interdependence Between Financial Stability and Financial Inclusion: A South African Perspective

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SUMMARY

Financial stability and financial inclusion are important goals, and both are promoted in the Financial Sector Regulation Act of 2017. This contribution considers whether there exists a possible tension between the South African Reserve Bank (with its financial stability mandate) and the Prudential Authority and Financial Sector Conduct Authority (with their mandates to promote financial inclusion). Selected definitions of the concepts of financial stability and financial inclusion are analysed. Academic contributions addressing the nexus between financial stability and financial inclusion, and empirical studies on this nexus, are explored. An analysis of the Financial Sector Regulation Act considers the financial-stability and -inclusion mandates implemented by the Act and how these measures can work with or against each other. The findings are analysed in a discussion on the connection between financial stability and financial inclusion. Recommendations are made to ensure that financial regulators and institutions simultaneously pursue the goals of financial stability and financial inclusion.

KEYWORDS: Financial Sector Regulation Act, financial stability, financial inclusion

1 INTRODUCTION

Financial stability and financial inclusion are nationally important goals for consideration by legislatures, policymakers and financial institutions. Internationally, both are key priorities. The G20 acknowledged the importance of financial inclusion at the Seoul Summit in 2010 and supported it through the Maya Declaration and the Global Partnership for Financial Inclusion.¹ The G20

¹ Global Partnership for Financial Inclusion “G20 Financial Inclusion Action Plan 2014” (2014) <https://dwg20.org/app/uploads/2021/09/2014-g20-financial-inclusion-action-plan.pdf> (accessed 2024-01-18) 2; Aizawa, Bradlow and Wachenfeld “International Financial Regulatory Standards and Human Rights: Connecting the Dots” 2018 15 *Manchester Journal of International Economic Law* 2 40; Alliance for Financial Inclusion “Maya Declaration” (2011) <https://www.aifi-global.org/global-voice/maya-declaration/> (accessed 2024-02-24) 6; Global Partnership for

also supports financial stability through the Global Partnership for Financial Inclusion and the Financial Stability Board.² Because of the interconnectedness of financial inclusion on the one side and financial and monetary stability on the other side, central banks and financial regulators have the authority to create the legal environment necessary to achieve these goals.³

A study by economists from the World Bank and the International Monetary Fund analysed the nexus between financial stability and financial inclusion from an economic perspective.⁴ The Financial Sector Regulation Act (FSR Act)⁵ legislated financial inclusion for the first time in South Africa and gave an explicit financial-stability mandate to the central bank. This contribution analyses whether the FSR Act has created tension between the central bank (the South African Reserve Bank (SARB)) and the Prudential Authority (PA) and Financial Sector Conduct Authority (FSCA) in pursuing financial stability and financial inclusion. It also explores how these objectives could be achieved by complementing each other. The discussion commences with introductory remarks on financial inclusion and financial stability.

1 1 Financial stability

The key challenge is that “financial stability” appears notoriously hard to define precisely or comprehensively. Allen points out that although many international financial instruments mention the concept of financial stability, they neglect to define this concept.⁶ She, therefore, proposes that the term “financial stability” should mean a state of affairs wherein (i) financial institutions and markets can facilitate capital intermediation, risk management, and payment services in a way that enables sustainable economic growth; (ii) there is no disruption to the

Financial Inclusion “2023 GPF I Progress Report to the G20 Leaders” (2023) <https://www.gpfi.org/sites/default/files/News D%29 - 2023 GPF I - 2023 Progress Report to G20 Leaders.pdf> (accessed 2024-01-24) 2; Financial Stability Board “Promoting Global Financial Stability – 2023 FSB Annual Report” <https://www.fsb.org/wp-content/uploads/P111023.pdf> (accessed 2024-02-04) 30; Wang and Luo “How Does Financial Inclusion Affect Bank Stability in Emerging Economies?” 2022 51 *Emerging Markets Review* 1; Čihák, Melecký and Mare “The Nexus of Financial Inclusion and Financial Stability: A Study of Trade-offs and Synergies” 2016 *World Bank Policy Research Working Paper* 7722 2; Alliance for Financial Inclusion “Global Policy Leadership Alliance” (2022) <https://www.afi-global.org/about/> (accessed 2024-02-5) 36. The Alliance for Financial Inclusion is a member-owned network of central banks and financial regulatory institutions that works to advance financial inclusion. By the end of 2022, member institutions of the Alliance for Financial Inclusion from 76 countries committed to achieving their nation’s financial inclusion agenda by committing to the Maya Declaration. See Bolzani “Leading the Way in Payments: How Central Banks Are Using Innovation to Promote Financial Inclusion and Reshape Competition” 2022 41 *Journal of Law and Commerce* 103 117.

² Global Partnership for Financial Inclusion <https://www.gpfi.org/sites/default/files/News D%29 - 2023 GPF I - 2023 Progress Report to G20 Leaders.pdf> 2; Financial Stability Board <https://www.fsb.org/wp-content/uploads/P111023.pdf> 30; Wang and Luo 2022 *Emerging Markets Review* 3; Čihák et al 2016 *World Bank Policy Research Working Paper* 7722 2.

³ Bolzani 2022 *Journal of Law and Commerce* 117.

⁴ Wang and Luo 2022 *Emerging Markets Review* 3; Čihák et al 2016 *World Bank Policy Research Working Paper* 7722 1–43.

⁵ 9 of 2017.

⁶ Allen “What Is ‘Financial Stability’? The Need for Some Common Language in International Financial Regulation” 2014 45 *Georgetown Journal of International Law* 929 932.

ability of financial institutions or markets (to carry out such functions) that might cause harm to persons (wherever they may be resident) who are not customers or counterparties of those financial institutions, nor participants in those financial markets; and (iii) financial institutions and markets can withstand economic shocks (such as the failure of other markets and institutions, or a chain of significant losses at financial institutions), so that there will be no disruption to the performance of the functions outlined in (i) and no harm caused to the persons outlined in (ii).⁷

Čihák, Melecký and Mare define financial stability in a broad sense, capturing (i) the resilience of the financial system, indicated in the way future shock can be withstood by the system; (ii) volatility in key segments of the financial markets; and (iii) negative, low-probability extreme events associated with financial crises when the financial sector fails to perform its core functions.⁸

SARB described financial stability in 2018 as “a financial system that is resilient to systemic shocks, facilitates efficient financial intermediation, and mitigates the macroeconomic costs of disruptions in such a way that confidence in the system is maintained”.⁹ In 2024, it paraphrased its description of financial stability, referring to a financial system that is resilient to systemic risks and shocks and that can efficiently intermediate funds, even in adverse conditions, thereby bolstering confidence in the financial system and financial institutions.¹⁰

The European Central Bank defined financial stability as a condition in which the financial system, comprising financial intermediaries, markets and market infrastructures, is capable of withstanding shocks and the unravelling of financial imbalances, mitigating the prospect of disruptions in the financial intermediation process that are severe enough to impact real economic activity adversely.¹¹

Houben, Kakes and Schinasi’s notion of a stable financial system is one that enhances economic performance and wealth accumulation while it also being able to prevent economic disturbances arising from an inordinately disruptive event.¹² They further indicate that because finance is a dynamic concept, involving inter-temporal transactions and innovations, financial stability may be

⁷ Allen 2014 *Georgetown Journal of International Law* 932.

⁸ Wang and Luo 2022 *Emerging Markets Review* 3; Čihák *et al* 2016 *World Bank Policy Research Working Paper* 7722 26-27.

⁹ South African Reserve Bank “Financial Stability Review 2018 First Edition” (2018) <https://www.resbank.co.za/en/home/publications/publication-detail-pages/reviews/finstab-review/2018/8420> (accessed 2024-07-08).

¹⁰ South African Reserve Bank “Financial Stability Review First Edition 2024” (2024) <https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2024/financial-stability-review/First%20Edition%202024%20Financial%20Stability%20Review.pdf> (accessed 2024-07-08).

¹¹ European Central Bank “Financial Stability” (undated) <https://www.ecb.europa.eu/pub/financial-stability/html/index.en.html> (accessed 2024-02-04).

¹² Houben, Kakes and Schinasi “Toward a Framework for Safeguarding Financial Stability” (June 2004) *IMF Working Paper No WP/04/10* 10.

seen as “occurring along a continuum, changeable over time and consistent with manifold combinations of its constituent elements”.¹³

1 2 Financial inclusion

Financial inclusion has been recognised as an important tool for the relief of poverty and inequality since 2000.¹⁴ The groups of individuals most excluded financially are the poor, people living in rural areas, females, and young people.¹⁵ In developing countries like South Africa, financial inclusion is even more important than in advanced economies because many people in developing countries remain unbanked.¹⁶ In South Africa, surveys by the Finmark Trust indicate that 80 per cent of people 16 years and older owned bank accounts in 2018 and 85 per cent in 2021.¹⁷ The Finmark Trust surveys in 2018 indicated that only 60 per cent of banked people used their bank accounts regularly. Thus, only 48 per cent of adults in South Africa (60 per cent of 80 per cent of people with a bank account) could be considered properly banked.¹⁸ Although owning a bank account is considered the first step towards financial inclusion, full use of the account is essential, because only with regular use do people fully benefit from having an account.¹⁹ Financial inclusion must lead to more than access to a bank account. It should include the use of accounts for payments, savings and credit, specifically appropriate financial products and services, at affordable prices, since that holds many benefits beyond convenience for the owners of such accounts.²⁰

¹³ *Ibid.* See Appendix II of their working paper for an overview of many proposed definitions of financial stability.

¹⁴ Demirgüç-Kunt, Klapper, Singer and Ansar *The Global Findex Database 2021: Financial Inclusion, Digital Payments, and Resilience in the Age of COVID-19* (2022) 9; Wang and Luo 2022 *Emerging Markets Review* 1; Beck, Demirgüç-Kunt and Peria “Reaching Out: Access to and Use of Banking Services Across Countries” 2007 85 *Journal of Financial Economics* 11; Chitimira “Historical Aspects of the Statutory Regulation of Financial Inclusion for the Poor and Low-Income Earners in South Africa” 2020 16 *Acta Universitatis Danubius* 269.

¹⁵ Allen, Demirgüç-Kunt, Klapper and Peria “The Foundations of Financial Inclusion: Understanding Ownership and Use of Formal Accounts” 2016 27 *Journal of Financial Intermediation* 13.

¹⁶ Demirgüç-Kunt, Klapper, Singer, Ansar and Hess “The Global Findex Database 2017: Measuring Financial Inclusion and Opportunities to Expand Access to and Use of Financial Services” 2020 34 *The World Bank Economic Review* S4; Wang and Luo 2022 *Emerging Markets Review* 2.

¹⁷ FinMark Trust “FinScope SA 2018 Fact Sheet” (undated) https://finmark.org.za/system/documents/files/000/000/196/original/FMT_Finscope_factsheet.pdf?1601972787 (accessed 2023-12-15) 2; Demirgüç-Kunt *et al* *The Global Findex Database 2021* 178.

¹⁸ Van Niekerk “Appraisal of Financial Inclusion in South Africa: Proposing the Agent Banking Model Implemented in Malaysia” 2021 33 *SAMLJ* 447 462. When people use bank accounts as mailboxes where the money is withdrawn as soon as it comes into the account, many benefits of having an account are not available to the owner of the account.

¹⁹ Van Niekerk 2021 *SAMLJ* 2021 462; Pearson, Stoop and Kelly-Louw “Balancing Responsibilities – Financial Literacy” 2017 20 *PER/PELJ* 1 37; Demirgüç-Kunt, Klapper, Singer and Van Oudheusden “The Global Findex Database 2014: Measuring Financial Inclusion Around the World” 2015 *World Bank Policy Research Working Paper* 72552 1 49.

²⁰ Demirgüç-Kunt *et al* *The Global Findex Database 2021* 955; Van Niekerk 2021 *SAMLJ* 2021 462.

The Financial Action Task Force Guidance on Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion confirmed their definition for financial inclusion in 2025:

“In general terms, financial inclusion refers to access to and usage of an adequate suite of appropriate, safe, convenient and affordable financial services and products by all individuals (including households) and entities that would benefit from such services. ‘Appropriate’ means that the product is suited to the needs of the customer and offered in a fair and transparent manner. The concept of financial inclusion has evolved, from access to regulated financial services to also include appropriate usage of those services and products and financial literacy.”²¹

A definition of the multidimensional nature of financial inclusion, derived from the widely recognised elucidations of the concept, is when individuals and entities that would benefit from financial products and services have access to and can use these products and services suited to their needs in safe, convenient and affordable ways.²²

Advantages of financial inclusion include increased investments, increased savings, empowered female employment and entrepreneurship and achieving sustainable growth.²³ It was found that there is a significant correlation between financial inclusion and economic growth.²⁴ Her Majesty Queen Maxima of the Netherlands²⁵ lauded the dataset in the Global Findex Database 2017 as the tool with the greatest value to advance financial inclusion.²⁶ The key findings

²¹ The Financial Action Task Force (FATF) “Guidance on Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion” (2025) <https://www.fatf-gafi.org/en/publications/Financialinclusionandnpoissues/aml-cft-financial-inclusion-public-consultation-february-2025.html> (accessed 2025-04-15) 6.

²² Wang and Luo 2022 *Emerging Markets Review* 1 and 3; Čihák *et al* 2016 *World Bank Policy Research Working Paper* 7722 4; Beck *et al* *Journal of Financial Economics* 11; Demirgüç-Kunt and Klapper “Measuring Financial Inclusion. The Global Findex Database” 2012 *World Bank Policy Research Working Paper* 6025 3; Allen *et al* 2016 *Journal of Financial Intermediation* 2; Demirgüç-Kunt, Klapper, Singer and Ansar *The Global Findex Database 2017: Measuring Financial Inclusion and the Fintech Revolution* (2018) 1 55; Demirgüç-Kunt *et al* *The Global Findex Database 2021* 49; Aduda and Kalunda “Financial Inclusion and Financial Sector Stability With Reference to Kenya: A Review of Literature” 2012 2 *Journal of Applied Finance and Banking* 95 100; Hannig and Jansen “Financial Inclusion and Financial Stability: Current Policy Issues” 2010 *ADB Working Paper No 259* Asian Development Bank Institute (ADB) Tokyo 22; Thorat “Financial Inclusion and Millennium Development Goals” 2006 50 *RBI Bulletin* 239 241; FATF 2025 <https://www.fatf-gafi.org/en/publications/Financialinclusionandnpoissues/aml-cft-financial-inclusion-public-consultation-february-2025.html> 6.

²³ Wang and Luo 2022 *Emerging Markets Review* 1.

²⁴ Digdowiseiso, Setiawan and Saputra “Increasing Financial Inclusion Towards Reducing Poverty Levels in Indonesia: A Literature Review” 2023 3 *International Journal of Economics, Management, Business, and Social Science* 1052.

²⁵ UN Secretary-General’s Special Advocate for Inclusive Finance for Development and Honorary Patron of the G-20’s Global Partnership for Financial Inclusion.

²⁶ Demirgüç-Kunt *et al* *The World Bank Economic Review* xi–xv; Demirgüç-Kunt *et al* *The Global Findex Database 2021* xv: The Global Findex database is the world’s most comprehensive data set on how adults save, borrow, make payments and manage risk. The initial survey was done in 2011, followed by surveys in 2014, 2017 and 2021. Gallup Inc. collected the data based on interviews with between 128 000 and 150 000 randomly selected adults in between 123 and 140 economies; Allen *et al* 2016 *Journal of Financial Intermediation* 2.

and detailed insight in this report underlined the potential benefits that could follow from financial inclusion – for example, improving people’s income-earning capacity and enabling households to increase savings, thereby reducing poverty.²⁷

The unbanked members of a community must use cash to make payments, which can lead to financial and personal risks, as funds can be stolen without any recourse.²⁸ Unbanked individuals are excluded from the asset building that can be facilitated by having a bank account, leaving them unprotected from shocks and from a safe retirement.²⁹ Various examples are found across the world where financial inclusion has led to a better life and where having a bank account has empowered women.³⁰ In Kenya, it was found that women-headed households could increase their savings because of financial inclusion, which allowed many to develop business and retail activities and reduce poverty among them.³¹ Financial inclusion through digital financial services assisted people in Kenya in managing financial risk by enabling them to collect money through remittances from distant relatives or friends during difficult times.³² Having a savings account enabled market vendors in Kenya, primarily women, to save and invest such savings in their businesses.³³ In Nepal, women-headed households had a high demand for savings accounts and could spend more on nutritious food and education because of access to free savings accounts.³⁴ Increasing the scope of banking services thus has the potential to lead to high returns in the long run.³⁵

This contribution explores academic literature addressing the nexus between financial stability and financial inclusion, as well as empirical studies on this nexus. An analysis of the Financial Sector Regulation Act follows, considering the financial-stability and financial-inclusion mandates implemented in the Act, as well as how these measures can work with or against each other. The

²⁷ Demirgüç-Kunt *et al* *The World Bank Economic Review* S1; Allen *et al* 2016 *Journal of Financial Intermediation* 2.

²⁸ Gross and Schmeiser “Use of Financial Services by the Unbanked and Underbanked and the Potential for Mobile Financial Services Adoption” 2012 98 *Federal Reserve Bulletin* 4; Hawkins “Financial Access and Financial Stability” (2006) <https://www.bis.org/events/cbcd06e.pdf> (accessed 2024-10-15).

²⁹ Rhine and Greene “The Determinants of Being Unbanked for US Immigrants” 2006 40 *Journal of Consumer Affairs* 21.

³⁰ Ashraf, Karlan and Yin “Female Empowerment: Impact of a Commitment Savings Product in the Philippines” 2010 38 *World Development* 333 340.

³¹ Jack and Suri “Risk Sharing and Transactions Costs: Evidence from Kenya’s Mobile Money Revolution” 2014 104 *American Economic Review* 183 192 in Demirgüç-Kunt *et al* *The World Bank Economic Review* S1.

³² Jack and Suri 2014 *American Economic Review* 220 in Demirgüç-Kunt *et al* *The World Bank Economic Review* S1.

³³ Dupas and Robinson “Savings Constraints and Microenterprise Development: Evidence From a Field Experiment in Kenya” 2013 5 *American Economic Journal: Applied Economics* 163 179 in Demirgüç-Kunt *et al* *The World Bank Economic Review* S4.

³⁴ Prina “Banking the Poor via Savings Accounts: Evidence From a Field Experiment” 2015 115 *Journal of Development Economics* 16 23 in Demirgüç-Kunt *et al* *The World Bank Economic Review* S2.

³⁵ Prina 2015 *Journal of Development Economics* 24.

findings are analysed in a discussion on the connection between financial stability and financial inclusion. Recommendations and a conclusion follow.

2 LITERATURE ON THE NEXUS BETWEEN FINANCIAL STABILITY AND FINANCIAL INCLUSION

Financial inclusion and financial stability usually complement each other and have a positive effect on each other.³⁶ In 2016, García referred to various works that addressed the relationship between financial stability and financial inclusion by referring to articles and working documents on the subject.³⁷ Several authors opined that financial stability and financial inclusion have a positive effect on each other,³⁸ and others only that they do affect each other, but that the results are mixed and that policymakers and financial-sector regulators should follow a holistic approach to ensure that the relationship is a positive one.³⁹ In this literature review, the author will refer to the works mentioned by García but will also incorporate the more recent literature on the topic.

Musau referred to various theories that explain the effect of financial inclusion on financial stability.⁴⁰ The finance growth theory explains that financial inclusion creates an environment where economic growth can take place, and that the level of financial inclusion and stability in financial institutions affects the success of economic growth.⁴¹ Financial development, when effectively supervised and regulated, compels economic growth and reduces income inequality.⁴² The financial intermediation theory observes that since banks are intermediaries between borrowers and savers, they provide access to financial diversification and usage, and that without banks, investors are unable to transform their investments, being illiquid assets, into liquid liabilities.⁴³ The financial asymmetry theory explains information asymmetry, where one party in

³⁶ Hannig and Jansen 2010 *ADB Working Paper No 259 22*; Khan "Financial Inclusion and Financial Stability: Are They Two Sides of the Same Coin?" Address by Shri H R Khan, Deputy Governor of the Reserve Bank of India, at BANCON 2011, organized by the Indian Bankers Association and Indian Overseas Bank, Chennai, (4 November 2011) <https://www.bis.org/review/r111229f.pdf> (accessed 2024-07-08) 2; Al-Smadi "The Role of Financial Inclusion in Financial Stability: Lessons from Jordan" 2018 13 *Banks and Bank Systems* 31.

³⁶ Feghali, Mora and Nassif "Financial Inclusion, Bank Market Structure, and Financial Stability: International Evidence" 2021 80 *The Quarterly Review of Economics and Finance* 236.

³⁷ García 2016 *Economic Issues* 86.

³⁸ Hannig and Jansen 2010 *ADB Working Paper No 259 22*; Khan <https://www.bis.org/review/r111229f.pdf> 2; Cull, Demirgüç-Kunt and Lyman "Financial Inclusion and Stability: What Does Research Show?" 2012 *The Consultative Group to Assist the Poor Brief* 11; Rahman "Ethics in Banking: Interfacing Financial Inclusion for Socially Responsible Development" 2014 *Bank Parikrama* 18 23.

³⁹ Jima and Makoni "Causality Between Financial Inclusion, Financial Stability and Economic Growth in Sub-Saharan Africa" 2023 15 *Sustainability* 1155 1152; García 2016 *Economic Issues* 94; Mehrotra and Yetman "Financial Inclusion Issues for Central Banks" 2015 *BIS Quarterly Review* 83.

⁴⁰ Musau "Deepening Financial Inclusion and Stability of Commercial Banks in Kenya: Synergies and Trade-Offs" 2022 3 *International Academic Journal of Economics and Finance* 143.

⁴¹ Musau 2022 *International Academic Journal of Economics and Finance* 147.

⁴² Cull *et al* 2012 *CGAP Brief* 1.

⁴³ Musau 2022 *International Academic Journal of Economics and Finance* 147.

a debt contract has more and better information than the other party, making it difficult to distinguish between good and bad borrowers.⁴⁴ This can contribute to non-performing loans when new customers become financially included in the formal financial sector, since it might be difficult for financial institutions to determine whether a customer is a good risk, and too many risky transactions may threaten financial stability.⁴⁵

Hawkins considered whether increased financial inclusion could jeopardise financial stability and is of the view that the promotion of financial access will enhance financial stability.⁴⁶ She identified regulatory interventions that the central bank can use to promote financial inclusion and reinforce financial stability.⁴⁷ One of these is to create several tiers of banks, wherein the services offered would be different in the various tiers.⁴⁸ That would have the effect that a bank offering fewer services would be licensed more easily, allowing more banks to be licensed.⁴⁹ She contended that the ease of entry and exit of banks in the market could enhance the competition between banks, making it more difficult for banks to have monopoly powers because other banks could easily enter the market.⁵⁰ She recommended that a deposit insurance scheme be implemented to promote confidence and stability in the financial system.⁵¹ Broader access by people to bank accounts means more people being financially included, which can positively influence financial stability because the increased number of bank accounts can lower transaction costs, and capital can be dispersed in other areas of the economy.⁵²

Aduda and Kalunda studied the relationship between financial inclusion and financial stability and found that they could be complementary, supplementary or contrary to each other.⁵³ They proposed that Hawkins's approach does not take into account that risks for financial stability come not only from within the financial system but can also emanate outside the financial system; therefore, the interconnectedness of the financial markets and systems should be taken into account.⁵⁴ Although banks agree that financial inclusion has many benefits, it has cost implications that could negatively impact their profits, bringing a

⁴⁴ *Ibid.*

⁴⁵ Musau 2022 *International Academic Journal of Economics and Finance* 148.

⁴⁶ Hawkins <https://www.bis.org/events/cbcd06e.pdf> 68; Aduda and Kalunda 2012 *Journal of Applied Finance and Banking* 109; Havard "Doin' Banks" 2020 5 *University of Pennsylvania Journal of Law & Public Affairs* 317 374.

⁴⁷ Hawkins <https://www.bis.org/events/cbcd06e.pdf> 68; Aduda and Kalunda 2012 *Journal of Applied Finance and Banking* 109.

⁴⁸ *Ibid.*

⁴⁹ Hawkins <https://www.bis.org/events/cbcd06e.pdf> 71.

⁵⁰ *Ibid.*

⁵¹ *Ibid.*

⁵² Havard 2020 *University of Pennsylvania Journal of Law & Public Affairs* 321; Han and Melecky "Financial Inclusion for Financial Stability: Access to Bank Deposits and the Growth of Deposits in the Global Financial Crisis" 2013 *World Bank Policy Research Working Paper No 6577* 1 16–17.

⁵³ Aduda and Kalunda 2012 *Journal of Applied Finance and Banking* 99.

⁵⁴ Aduda and Kalunda 2012 *Journal of Applied Finance and Banking* 110.

financial instability risk; therefore, banks should implement low-cost methods to reach out to the poor.⁵⁵

The objectives of financial inclusion and financial stability may be mutually reinforcing, but for successful implementation, the central bank and government should be aware that they need to express these sentiments with one voice to the public and the financial sector.⁵⁶ In the South African Twin Peaks model of financial regulation, where the central bank has an express financial stability mandate, the SARB may take shocks outside the financial system into account when evaluating financial stability.⁵⁷

According to Cull, Demirgüç-Kunt and Lyman, financial inclusion can influence financial stability on the micro- and macro-levels; for example, savings by individuals and households strengthen their financial stability; greater access to credit positively affects the stability of financial institutions; and, at a country level, financial inclusion through domestic savings can lead to sound savings and investment cycles, and thereby to greater stability.⁵⁸ Financial inclusion can lead to financial stability, but when credit is expanded and borrowers are not creditworthy, their financial inclusion may be risky, endangering financial stability.⁵⁹

Allen, Demirgüç-Kunt, Klapper and Peria recommended that the universal use of credit services should not necessarily be set as a policy goal that would also serve as a financial stability goal, as was seen in the US subprime crisis in 2008.⁶⁰ They found that the effectiveness of policies to promote inclusion would vary depending on the characteristics of the individuals considered.⁶¹

Central bank digital currency (CBDC) has the potential to include more people financially, especially in remote areas. Therefore, many countries are considering implementing CBDC to bring about greater financial inclusion.⁶² The biggest concern for government-backed cryptocurrencies is the potential instability that they could bring about in the global economy.⁶³ Goldsmith believes that government-backed cryptocurrencies pose a greater threat to financial stability than private cryptocurrencies.⁶⁴ The cross-border reach of cryptocurrencies can pose a threat to financial stability, since

⁵⁵ Aduda and Kalunda 2012 *Journal of Applied Finance and Banking* 109.

⁵⁶ Hawkins <https://www.bis.org/events/cbcd06e.pdf> 77.

⁵⁷ South African Reserve Bank "Financial Stability Review: Second Edition 2023" (2023) <https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2023/financial-stability-review/second-edition-2023-financial-stability-review/Second%20Edition%202023%20Financial%20Stability%20Review1.pdf> (accessed 2024-07-08); Ss 11 and 12 of the FSR Act.

⁵⁸ Cull *et al* 2012 *CGAP Brief* 2; Prasad "Financial Sector Regulation and Reforms in Emerging Markets: An Overview" 2010 *IZA Discussion Paper Number* 5233.

⁵⁹ Feghali *et al* 2021 *The Quarterly Review of Economics and Finance* 236.

⁶⁰ Allen *et al* 2016 *Journal of Financial Intermediation* 3.

⁶¹ Allen *et al* 2016 *Journal of Financial Intermediation* 29.

⁶² Goldsmith "The IMF Must Develop Best Practices Before Government-Backed Cryptocurrencies Destabilize the International Monetary System" 2020 34 *Emory International Law Review* 595 603.

⁶³ Goldsmith 2020 *Emory International Law Review* 598.

⁶⁴ *Ibid.*

“the actions of one country that buys and sells cryptocurrency to control its availability could have a destabilising effect on other economies that also widely use that cryptocurrency; in this way, one country’s approach to cryptocurrency could undermine price stability or exacerbate recessions or overheating in another country.”⁶⁵

Since CBDCs could destabilise the monetary system, best practices should be developed, before they are introduced, to protect the international monetary systems proactively; governments should not just be persuaded to rush into creating CBDCs by the positive goal of financial inclusion.⁶⁶

These studies show that financial inclusion and financial stability are connected and should be managed well, since a lack of any of them might cause systemic crises.⁶⁷

3 EMPIRICAL STUDIES ON THE LINK BETWEEN FINANCIAL STABILITY AND FINANCIAL INCLUSION

Under the previous heading, studies were analysed on the nexus between financial stability and financial inclusion. The analysis above did not refer to studies using empirical data. Such studies are now analysed under this heading in order of publication date.

Han and Melecky did an empirical study on 95 countries, analysing bank deposit year-on-year growth rates between 2006 and 2010, and included indicators for deposit insurance, bank stability, bank liquidity, loan-to-deposit ratios, and others to explore the link between greater access to deposits and greater financial stability.⁶⁸ They found that broader access to and use of bank accounts can significantly mitigate bank deposit withdrawals or growth slowdowns in times of financial stress.⁶⁹ They contend that since the savings of individuals contribute to the financial stability of financial institutions involved, increasing the amount of savings of bank customers could thus potentially support the stability of the financial system as well.⁷⁰ During a financial crisis, as was seen in 2008 with the global financial crisis, stable retail sources of funding can enhance the soundness and resilience of financial institutions, as opposed

⁶⁵ Perkins “Cryptocurrency: The Economics of Money and Selected Policy Issues” (7 December 2018) <https://fas.org/sqp/crs/misc/R45427.pdf> (accessed 2024-01-18) 23; Goldsmith 2020 *Emory International Law Review* 604; See Reddy and Lawack (“An Overview of the Regulatory Developments in South Africa Regarding the Use of Cryptocurrencies” 2019 31 *SA Mercantile Law Journal* 1 26) on the risk of instability that cryptocurrencies currently pose.

⁶⁶ Goldsmith 2020 *Emory International Law Review* 598.

⁶⁷ Wang and Luo 2022 *Emerging Markets Review* 2; Ahamed and Mallick “Is Financial Inclusion Good for Bank Stability? International Evidence” 2019 157 *Journal of Economic Behavior & Organization* 403 419; Le, Chuc and Taghizadeh-Hesary “Financial Inclusion and Its Impact on Financial Efficiency and Sustainability: Empirical Evidence From Asia” 2019 19 *Borsa Istanbul Review* 310 321; Wang and Luo 2022 *Emerging Markets Review* 3; Čihák *et al* 2016 *World Bank Policy Research Working Paper* 7722 33.

⁶⁸ Han and Melecky 2013 *World Bank Policy Research Working Paper No 6577* 1.

⁶⁹ Han and Melecky 2013 *World Bank Policy Research Working Paper No 6577* 4.

⁷⁰ *Ibid.*

to relying on borrowed funds.⁷¹ They stated that their findings show that policymakers should focus on the synergy between promoting financial development and financial stability by promoting broader use of bank deposits to improve the resilience of bank funding, enhancing overall system financial stability, and complementing mainstream macroprudential policies to bring about financial stability.⁷²

Jima and Makoni refer to three empirical studies that confirm that financial inclusion drives financial stability, and three such studies that show that financial stability drives financial inclusion.⁷³ They mention that, globally, opposing evidence is found about the relationship between financial stability, financial inclusion and economic growth.⁷⁴ They analysed the relationship between these three concepts in sub-Saharan Africa and found that the expansion of financial services increases the financial stability of the formal financial sector.⁷⁵

Amatus and Alireza conducted an empirical study in 35 countries in sub-Saharan Africa from 2004 to 2011 on the link between financial stability and financial inclusion.⁷⁶ They used outstanding loans from commercial banks to their clients, and found that greater lending by commercial banks leads to financial stability.⁷⁷ On the other hand, they also found that higher outstanding deposits of clients at commercial banks may hurt financial stability, the reason being that in sub-Saharan Africa the number of depositors is low and not diversified and during periods of financial stress, depositors are inclined to withdraw their deposits, giving rise to financial instability.⁷⁸

A study by economists Čihák, Mare and Melecký estimated empirically the association between financial inclusion and stability by selecting a range of empirical indicators that measure the two concepts and then using correlations

⁷¹ *Ibid.*

⁷² Han and Melecký 2013 *World Bank Policy Research Working Paper No 6577* 16.

⁷³ Jima and Makoni 2023 *Sustainability* 1155. Studies indicating that financial inclusion drives financial stability are: Siddik and Kabiraj "Does Financial Inclusion Induce Financial Stability? Evidence From Cross-Country Analysis" 2018 12 *Australasian Accounting, Business and Finance Journal* 34; Tran and Nguyen "Financial Development, Business Cycle and Bank Risk in Southeast Asian Countries" 2020 7 *The Journal of Asian Finance, Economics and Business* 127; and Boachie, Aawaar and Domeher "Relationship Between Financial Inclusion, Banking Stability and Economic Growth: A Dynamic Panel Approach" 2021 *Journal of Economic and Administrative Sciences* (ahead of print). Studies indicating that financial stability drives financial inclusion are: Robinson *The Rate of Interest and Other Essays* (1952); Stern "The Economics of Development: A Survey" 1989 99 *The Economic Journal* 597; and Ismail, Wahab and Ibrahim "Measuring Financial Inclusion in Egypt" 2018 2 *Scientific Conference* 7.

⁷⁴ Jima and Makoni 2023 *Sustainability* 1153.

⁷⁵ Jima and Makoni 2023 *Sustainability* 1163.

⁷⁶ Amatus and Alireza "Financial Inclusion and Financial Stability in Sub-Saharan Africa (SSA)" 2015 36 *The International Journal of Social Sciences* 39 40. In sub-Saharan Africa, the financial system is dominated by the banking sector. It is still undeveloped compared to the rest of the world and at the time of their study, only 24% of adults possessed a bank account at a formal financial institution.

⁷⁷ Amatus and Alireza 2015 *The International Journal of Social Sciences* 45.

⁷⁸ *Ibid.*

to study the dependence between them.⁷⁹ It was found that there are macroeconomic linkages between financial inclusion and financial stability that should be considered by policymakers who design policies for the inclusion of individuals.⁸⁰ Importantly, it was found by these authors that greater financial inclusion is associated with greater financial stability.⁸¹ During financial crises, when individuals borrow extensively, financial inclusion may lead to financial instability, though.⁸² When the authors studied country-specific scenarios, it was found that low tax rates (which stimulate precautionary savings owing to smaller social safety nets), education (which improves financial literacy and responsible financial inclusion) and the depth of credit information systems (which improves screening of creditworthy financial customers and new users of credit) positively influenced financial inclusion and stability.⁸³ Policies that promote the use of savings instruments could positively affect financial inclusion and financial stability.⁸⁴ Financial openness could lead to less financial stability, but it could be mitigated by policies that deepen credit information systems.⁸⁵ The authors recommend that their findings be considered for policymaking.⁸⁶

Le *et al* conducted a study from 2004 to 2006 on 31 Asian economies, and found that financial inclusion and financial stability are mutually reinforcing and that they complement each other.⁸⁷

A significant study by Ahamed and Mallick on 2 635 banks globally in 86 countries from 2004 to 2012 found that a system with inclusive financial services reinforces banking stability.⁸⁸ Greater financial inclusion of customers

⁷⁹ Čihák *et al* 2016 *World Bank Policy Research Working Paper* 7722 2; Wang and Luo 2022 *Emerging Markets Review* 3.

⁸⁰ Čihák *et al* 2016 *World Bank Policy Research Working Paper* 7722 14; Wang and Luo 2022 *Emerging Markets Review* 3. The authors of this paper are authoritative leaders in their fields. At the time of writing the paper, Martin Čihák was Advisor and Unit Chief at the International Monetary Fund; Davide S Mare was a visiting researcher at the World Bank and Assistant Professor at the University of Edinburgh; Martin Melecký was Lead Economist at the World Bank.

⁸¹ Čihák *et al* 2016 *World Bank Policy Research Working Paper* 7722 12 and 17; Wang and Luo 2022 *Emerging Markets Review* 3.

⁸² Čihák *et al* 2016 *World Bank Policy Research Working Paper* 7722 12 and 17; Wang and Luo 2022 *Emerging Markets Review* 3; Note that financial inclusion for individuals can also complement stability. Therefore, appropriate policies, such as greater use of saving instruments, could yield progress in both inclusion and stability. See Han and Melecký 2013 *World Bank Policy Research Working Paper* No 6577 4.

⁸³ Čihák *et al* 2016 *World Bank Policy Research Working Paper* 7722 17; Wang and Luo 2022 *Emerging Markets Review* 3.

⁸⁴ Čihák *et al* 2016 *World Bank Policy Research Working Paper* 7722 12 and 17; Wang and Luo 2022 *Emerging Markets Review* 3; Han and Melecký 2013 *World Bank Policy Research Working Paper* No 6577 4.

⁸⁵ Čihák *et al* 2016 *World Bank Policy Research Working Paper* 7722 17; Wang and Luo 2022 *Emerging Markets Review* 3.

⁸⁶ Čihák *et al* 2016 *World Bank Policy Research Working Paper* 7722 17; Wang and Luo 2022 *Emerging Markets Review* 3. One important tool for formulating high-level policy for the financial sector is that the financial-sector strategy should pay attention to trade-offs.

⁸⁷ Le *et al* 2019 *Borsa Istanbul Review* 321; Wang and Luo 2022 *Emerging Markets Review* 4.

⁸⁸ Ahamed and Mallick 2019 *Journal of Economic Behavior & Organization* 413.

mitigates excessive risk-taking by individual banks, improving bank stability.⁸⁹ They found that when banks strive to include more people financially, they use the mechanism of financial inclusion to obtain cheap retail deposits, reducing costly money-market funding.⁹⁰ Focusing on financial inclusion, banks also reduce the marginal cost of producing outputs, which contributes to greater pricing power of banks and adds to their stability.⁹¹ Their results emphasise the importance of banks setting, as a priority, an inclusive financial system not just as a development goal, but also to ensure their stability.⁹²

Machdar found in an empirical study in Indonesia that the effect of financial inclusion is markedly positive on financial-system stability, and that the more financial inclusion there is, the greater the stability of the financial system.⁹³ A possible reason for this is that as the number of people who save grows, the stability deposits increase, which reduces banks' dependence on non-main financing, which is not stable during a financial crisis.⁹⁴ Furthermore, it was contended that greater financial inclusion can contribute to better monetary-policy transmission, which could result in financial-system stability.⁹⁵

Wang and Luo, in a study on the effect of financial inclusion on bank stability in 36 emerging economies in Latin America, Asia and Central and Eastern Europe from 2004 to 2018, refer to the World Bank and mention that "there is limited empirical work exploring the specific relation between financial inclusion and financial stability".⁹⁶ One of the reasons for this claim is the scarcity and inconsistency of time-series data on financial inclusion across countries.⁹⁷ They found that bank stability is strengthened when financial inclusion is enhanced in a booming economy where sound financial and other policies are in place.⁹⁸ The opposite scenario of a loose monetary environment with strong governmental power promotes more risk-taking and lowers bank stability and financial-inclusion processes.⁹⁹ They found that in emerging economies, improvement in financial inclusion positively affects bank stability and, from this, they draw the conclusion that an inclusive financial sector should be regarded as crucial for the financial stability of the entire economy in a country.¹⁰⁰ Wang and Luo also suggest in their research that measures should be taken to ensure that banks do not take unnecessary risks to ensure financial inclusion¹⁰¹ – for

⁸⁹ Ahamed and Mallick 2019 *Journal of Economic Behavior & Organization* 413 and 422; Wang and Luo 2022 *Emerging Markets Review* 3.

⁹⁰ Ahamed and Mallick 2019 *Journal of Economic Behavior & Organization* 413.

⁹¹ *Ibid.*

⁹² *Ibid.*

⁹³ Machdar "Financial Inclusion, Financial Stability and Sustainability in the Banking Sector: The Case of Indonesia" 2020 1 *International Journal of Economics and Business Administration* 193 199.

⁹⁴ *Ibid.*

⁹⁵ *Ibid.*; Hannig and Jansen 2010 *ADB Working Paper No 259* 22.

⁹⁶ Wang and Luo 2022 *Emerging Markets Review* 3; Cull *et al* 2012 *CPAG Brief* 1.

⁹⁷ Wang and Luo 2022 *Emerging Markets Review* 3.

⁹⁸ Wang and Luo 2022 *Emerging Markets Review* 2.

⁹⁹ Wang and Luo 2022 *Emerging Markets Review* 19.

¹⁰⁰ Wang and Luo 2022 *Emerging Markets Review* 20.

¹⁰¹ Wang and Luo 2022 *Emerging Markets Review* 19.

example, by extending credit to customers who would not be able to repay the credit. Increasing credit to previously financially excluded financial customers should be monitored and prudentially supervised to ensure that financial inclusion takes place in a responsible manner and that financial stability is not jeopardised.¹⁰²

In a study in Kenya, Musau analysed the effect of financial inclusion on the financial stability of 42 commercial banks, and found that financial inclusion had a statistically significant effect on the stability of these banks.¹⁰³ She focused on the effect of branch networks, automatic teller machines, agents and mobile banking and found that these increased owing to the increased deposits and access to credit, which supported financial stability.¹⁰⁴ She recommended increasing the number of banking customers by advancing affordable and accessible banking services to disadvantaged groups in Kenya through increasing branches and automatic teller machines, and the adoption of mobile money technologies such as mobile and agency banking.¹⁰⁵ She further recommended that commercial banks should ensure that banks are financially stable while the deepening of financial inclusion takes place, and suggested that reforms in the financial sector should focus on digital finance because of its affordability.¹⁰⁶ This will lead to a financially stable economy over time.¹⁰⁷ Kenya is an emerging market in Africa, as is South Africa, and therefore, much can be learned from the latter for application in South Africa.

4 THE FINANCIAL SECTOR REGULATION ACT

The key reforms set out by the National Treasury in 2011 for a new financial regulation framework for South Africa were structured into four policy objectives, two of which are addressed in this contribution, namely financial stability led by the SARB through enhanced supervision of the financial sector, and financial inclusion, being expanded access to financial services for the poor, the vulnerable and those living in rural areas.¹⁰⁸ The Twin Peaks model of financial regulation was envisioned to bring about these policy objectives, and was implemented by the Financial Sector Regulation Act of 2017.¹⁰⁹

¹⁰² Wang and Luo 2022 *Emerging Markets Review* 3; Čihák *et al* 2016 *World Bank Policy Research Working Paper* 7722 15.

¹⁰³ Musau 2022 *International Academic Journal of Economics and Finance* 143–155.

¹⁰⁴ Musau 2022 *International Academic Journal of Economics and Finance* 150.

¹⁰⁵ Musau 2022 *International Academic Journal of Economics and Finance* 152.

¹⁰⁶ *Ibid.*

¹⁰⁷ *Ibid.*

¹⁰⁸ National Treasury “A Safer Financial Sector to Serve South Africa Better” (23 February 2011) <https://www.treasury.gov.za/twinpeaks/20131211%20-%20item%202%20a%20safer%20financial%20sector%20to%20serve%20south%20africa%20better.pdf> (accessed 2023-03-15) 4–8. The other policy objectives set out by the National Treasury are, thirdly, consumer protection and regulation of market conduct through creating a retail banking services market conduct regulator, and the implementation of a comprehensive treating-customers-fairly initiative, and fourthly, combating financial crime.

¹⁰⁹ 9 of 2017.

The basic feature of the FSR Act is that, first, the SARB is given an express overall financial-stability mandate, making it responsible for the macroprudential supervision of financial institutions.¹¹⁰ Secondly, the Act established the Prudential Authority (PA) as a separate juristic person within the SARB and under its administration, and responsible for the prudential supervision of financial institutions.¹¹¹ Thirdly, the Act established a second separate juristic person as the market-conduct authority, namely the Financial Sector Conduct Authority (FSCA), responsible for protecting consumers of financial services and promoting confidence in the South African financial system by regulating and supervising the market conduct of financial-services providers.¹¹² The central bank must focus on financial stability, while prudential regulation of financial institutions is taken care of by the PA to ensure the soundness of these institutions, and the FSCA assures that the conduct of financial institutions is regulated, ensuring the fair treatment of their customers. Effective regulation of the economy is necessary to obtain financial stability in the economy.¹¹³

4 1 Financial-stability mandate in terms of the FSR Act

Before the FSR Act was enacted, the SARB did not have an explicit financial-stability mandate. The primary objective of the SARB, as determined in the South African Reserve Bank Act (SARB Act),¹¹⁴ is the protection of the value of the currency of the Republic in the interest of balanced and sustainable economic growth in the Republic.¹¹⁵ The Constitution later confirmed this as the primary mandate of the SARB.¹¹⁶ The SARB thus had the responsibility for implementing monetary policy aimed at price stability.¹¹⁷ The other functions of the SARB were: making banknotes and other functions set out in section 10 of the SARB Act; acting as the supervisor of banks;¹¹⁸ acting as supervisor of the payment system;¹¹⁹ and acting as a lender of last resort.¹²⁰

With the drafting of the FSR Act and the introduction of the Twin Peaks system of financial regulation, the focus of financial regulation by the SARB

¹¹⁰ S 11(1) of the FSR Act. See also Van Niekerk *A Comparative Analysis of the Role of the Central Bank in Promoting and Maintaining Financial Stability in South Africa* (doctoral thesis, University of Pretoria) 2018 109 on the expanded financial stability mandate of the SARB.

¹¹¹ S 32(1) of the FSR Act. Prudential supervision is the supervision of the safety and soundness of financial institutions.

¹¹² S 56(1) of the FSR Act.

¹¹³ Hawkins <https://www.bis.org/events/cbcd06e.pdf> 67.

¹¹⁴ 90 of 1989.

¹¹⁵ S 3(1) of the SARB Act.

¹¹⁶ S 224 of the Constitution of the Republic of South Africa, 1996.

¹¹⁷ Mboweni "The Role of the South African Reserve Bank in the Economy" (14 March 2000) <https://www.bis.org/review/r000321a.pdf> (accessed 2024-05-31). See also De Jager "The South African Reserve Bank: An Evaluation of the Origin, Evolution and Status of a Central Bank (Part 2)" 2006 *SA Mercantile Law Journal* 274; De Jager "The South African Reserve Bank: Blowing Winds of Change (Part 1)" 2013 *SA Mercantile Law Journal* 342 344 and 357.

¹¹⁸ S 90 of the Banks Act 94 of 1990.

¹¹⁹ S 10(1)(c)(i) of the SARB Act, read together with the National Payment System Act 78 of 1998.

¹²⁰ De Jager "Central Bank, Lender of Last Resort Assistance: An Elusive Concept?" 2010 43 *De Jure* 228 236; De Jager "The South African Reserve Bank: Blowing Winds of Change (Part 2)" 2013 *SA Mercantile Law Journal* 492.

moved from microprudential supervision of individual financial institutions to macroprudential system-wide supervision, focusing on financial stability.¹²¹ The importance of macroprudential regulation and supervision was highlighted by the FSR Act when an overall financial-stability mandate was assigned to the central bank in South Africa.¹²² The SARB Act was amended to describe not only the primary mandate of the SARB¹²³ but also the statutory mandate of being responsible for protecting and maintaining financial stability as envisaged in the FSR Act.¹²⁴

Financial stability is described in the FSR Act to mean that financial institutions are able to provide financial products and services, and market infrastructures are able to perform their functions and duties in terms of financial sector laws without interruption, despite changes in economic circumstances, and that there is general confidence in this ability of financial institutions and market infrastructures.¹²⁵ Various powers and functions entrenched in this framework legislation require the SARB to monitor the financial system closely and to act pre-emptively to prevent disruption of financial stability – for example, by the determination of systemic events,¹²⁶ and if such disruption occurs despite the SARB's efforts to prevent it, then to manage such a situation to eventually restore financial stability.¹²⁷ Furthermore, the Act brought in special measures to prevent systemically important financial institutions from disrupting the whole financial system because of their size and systemic interconnectedness.¹²⁸ In terms of the FSR Act, the SARB is required, at least every six months, to make an assessment of the stability of the financial system in a financial stability review.¹²⁹ In the first edition of the Financial Stability Review in 2024, the Review highlighted that the South African financial system remains resilient, as evidenced by financial institutions' ability to provide financial services uninterrupted, and this resilience is expected to be sustained over the forecast period to May 2025.¹³⁰

¹²¹ See also National Treasury <https://www.treasury.gov.za/twinpeaks/20131211%20-%20item%202%20a%20safer%20financial%20sector%20to%20serve%20south%20africa%20better.pdf> 4 and 12.

¹²² S 11 of the FSR Act; South African Reserve Bank <https://www.resbank.co.za/en/home/publications/publication-detail-pages/reviews/finstab-review/2018/8420>.

¹²³ S 3(1) of the SARB Act: protection of the value of the currency of the Republic in the interest of balanced and sustainable economic growth in the Republic.

¹²⁴ S 3(2) of the SARB Act.

¹²⁵ S 4(1)(a), (b) and (c) of the FSR Act.

¹²⁶ S 12 of the FSR Act.

¹²⁷ S 14(1)(a) of the FSR Act; Van Niekerk *Financial Stability* 101.

¹²⁸ S 29(1)(a) of the FSR Act.

¹²⁹ S 13 of the FSR Act.

¹³⁰ South African Reserve Bank <https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2024/financial-stability-review/First%20Edition%202024%20Financial%20Stability%20Review.pdf>.

4 2 Financial-inclusion mandate in terms of the FSR Act

One of the objects of the FSR Act is to establish, in conjunction with the other financial-sector laws, a regulatory and supervisory framework that promotes financial inclusion.¹³¹ Financial inclusion is explicitly legislated for the first time in South Africa.¹³² Financial inclusion is defined in the FSR Act as all persons having timely and fair access to appropriate, fair and affordable financial products and services.¹³³ The financial regulators established by the FSR Act (the PA and the FSCA) have to use their powers to enforce the provisions of the Act to increase the financial inclusion of all people in this country. Financial inclusion should be supported by the PA, and the FSCA should promote financial inclusion.¹³⁴ The FSR Act does not give explicit guidelines on how the PA could support financial inclusion in South Africa.¹³⁵ The PA must support but not actively engage in facilitating financial inclusion. This would mean that the PA should at least consider whether some of the prudential requirements it imposes on financial institutions may compromise access to financial products and services by consumers.¹³⁶ The FSCA is also obliged to promote financial inclusion by developing and implementing strategies for the promotion of financial education of all persons in South Africa.¹³⁷

To enhance the framework for cooperation and collaboration between the financial-sector regulators, the FSR Act established the Financial System Council of Regulators (FSCR) as a coordinating body. The FSCR founded a financial-inclusion working group to promote greater intra-governmental coordination and information-sharing regarding financial inclusion.¹³⁸

The empirical studies referred to above indicate that improving the financial system's stability can increase financial inclusion.¹³⁹ Financial regulators anticipate that more financial inclusion of people will lead to a more stable financial system with fewer risks for financial instability, but they also know that greater financial access may increase financial instability because expansion of the financial system may be unregulated.¹⁴⁰

¹³¹ S 7(1)(f) of the FSR Act.

¹³² Van Niekerk 2021 *SAMLJ* 2021 461.

¹³³ S 1(1) of the FSR Act.

¹³⁴ Ss 34(1)(e) and 58(1)(e) of the FSR Act.

¹³⁵ Chitimira and Ncube "The Role of Regulatory Bodies and Other Role-Players in the Promotion of Financial Inclusion in South Africa" 2020 1 *Acta Universitatis Danubius Juridica* 7 11; Ss 32–55 of the FSR Act.

¹³⁶ Van Niekerk *Financial Stability* 129.

¹³⁷ Ss 58(1)(e) and (j) of the FSR Act.

¹³⁸ S 81 of the FSR Act; Financial Sector Conduct Authority (undated) "Financial Inclusion Strategy" <https://www.fsca.co.za/Documents/FSCA%20Financial%20Inclusion%20Strategy.pdf> (accessed 2024-07-12).

¹³⁹ Amatus and Alireza 2025 *The International Journal of Social Sciences* 46.

¹⁴⁰ García 2016 *Economic Issues* 95.

5 DISCUSSION OF THE CONNECTION BETWEEN FINANCIAL STABILITY AND FINANCIAL INCLUSION

Risks to financial stability could arise from new financial institutions and instruments, and broader access to the financial system could improve the financial stability of the system. On the one hand, measures to improve financial stability must consider the potential financial-exclusion effect they may bring about.¹⁴¹ On the other hand, prudential regulation should ensure that when basic financial services are provided to financially excluded people, these services do not become a source of risk or fraud.¹⁴²

When new institutions and instruments, such as mobile banking, are brought into the financial system to enhance financial inclusion, there is a possible impact on financial stability because of contagion and bank panic.¹⁴³ To mitigate the potential risks of such financial additions, the financial-sector regulators should use traditional measures in financial regulation, like deposit guarantee funds, minimum capital requirements, and *in situ* supervision.¹⁴⁴ New financial instruments, such as electronic payments and transactions on mobile telephones, can be instrumental in improving financial inclusion, but if they are not properly regulated, financial stability could be endangered.¹⁴⁵ Non-bank digital-payment providers should be supervised to prevent systemic financial instability.¹⁴⁶

The findings by Wang and Luo and by Čihák, Mare and Melecký referred to above prominently consider whether the financial-stability mandate of the SARB and the financial-inclusion mandates of the PA and FSCA could work against each other. For the most part, these objects would not work against each other. The objects put more emphasis on the roles of the PA and FSCA going to greater lengths to ensure financial inclusion in order to enhance financial stability. More financial inclusion and a stable financial system would lead to economic growth, which South Africa greatly needs. However, one has to consider other findings referred to in the study, namely that expansionary monetary policy and a better investment environment and country intensity, gauged by bank regulation measures and strict deposit insurance schemes, might weaken the link between financial inclusion and financial stability.¹⁴⁷ This could be balanced, as shown in the study, by comprehensive law enforcement and a policy setting regarded as sympathetic without strong interference by political powers.¹⁴⁸

The specific question that must be answered is whether the measures that banks and other bodies take to enhance financial inclusion can lead to bank risks. Various authors have argued that the institutional risks of this segment of

¹⁴¹ Khan <https://www.bis.org/review/r111229f.pdf> 12; García 2016 *Economic Issues* 98.

¹⁴² Khan <https://www.bis.org/review/r111229f.pdf> 8.

¹⁴³ García 2016 *Economic Issues* 88.

¹⁴⁴ García 2016 *Economic Issues* 97.

¹⁴⁵ *Ibid.*

¹⁴⁶ *Ibid.*

¹⁴⁷ Wang and Luo 2022 *Emerging Markets Review* 19.

¹⁴⁸ *Ibid.*

the population (vulnerable clients who have limited salaries and carry out small transactions) may be treated with supervisory and prudential tools that are already in use, underlining the importance of policies for consumer protection and financial education.¹⁴⁹

There exist trade-offs and synergies between financial stability and financial inclusion.¹⁵⁰ As can be seen by the studies referred to above, financial inclusion can weaken financial stability, but the opposite is also true: synergies exist when more people use financial services, assisting financial institutions to broaden their services, hence promoting financial stability.

The author referred to a 2022 study by Wang and Luo that focused on emerging economies, where it was unequivocally found that bank stability is strengthened when financial inclusion is enhanced in a booming economy where sound financial and other policies are in place.¹⁵¹ They found that in emerging economies, an improvement in financial inclusion positively affects bank stability and, from this, they draw the conclusion that an inclusive financial sector should be regarded as crucial for the financial stability of the entire economy in a country.

The author agrees with studies that the important factors for ensuring greater financial inclusion without endangering financial stability are sufficient regulation of the latest financial-inclusion instruments and institutions, as well as adequate financial consumer-protection policies and programmes for financial education.¹⁵²

6 RECOMMENDATIONS

For policies to be in place for financial inclusion and financial stability, multiple agencies will have to work together. Policymakers who design policies for financial inclusion and financial stability should consider that these multiple agencies, namely the SARB, the PA and the FSCA, will have to work together to be successful. The policies should emphasise that the PA and FSCA must go to greater lengths to ensure financial inclusion to enhance financial stability and that more financial inclusion would lead to a stable financial system in South Africa. The regulators should create a regulatory milieu where greater financial inclusion and financial stability can be achieved, exploiting the “two sides of the coin”, as Khan says:

“The twin objectives of financial stability and financial inclusion are arguably two sides of a coin but it is imperative that a robust risk-mitigating framework which exploits their complementarities while minimising the conflicts is adopted to ensure that they do not work at cross purposes.”¹⁵³

¹⁴⁹ García 2016 *Economic Issues* 86; Hannig and Jansen 2010 *ADB Working Paper No 259* 25; Khan <https://www.bis.org/review/r111229f.pdf> 9; Cull *et al* 2012 *CGAP Brief* 5; Rahman 2014 *Bank Parikrama* 23.

¹⁵⁰ Musau 2022 *International Academic Journal of Economics and Finance* 144.

¹⁵¹ Wang and Luo 2022 *Emerging Markets Review* 2.

¹⁵² García 2016 *Economic Issues* 94.

¹⁵³ Khan <https://www.bis.org/review/r111229f.pdf> 12.

From this study, the following recommendations can be made for financial institutions and financial regulators to pursue simultaneously the goals of financial stability and financial inclusion. The SARB, FSCA and PA could implement most of the recommendations suggested below through both policies and financial regulation measures that would force financial institutions to implement proposed changes.

6 1 Access to financial data

When customers have access to their deposits, investments, loans and other data, it implies their ownership of the account hosting the data.¹⁵⁴ If customers are exploited because they are uninformed about risk management and appropriately priced savings and credit opportunities, their financial inclusion is limited.¹⁵⁵ Access to data should be available to all financial customers, and expanding access to financial data should therefore be a key public-policy intervention.¹⁵⁶ Financial institutions should develop specific technical solutions to overcome a lack of access to financial data.¹⁵⁷

6 2 Diversification of financial products and financial education

The findings require that financial regulators and financial institutions should work together to increase financial inclusion and encourage financial stability. Policies should be implemented that promote financial inclusion and the broader use of bank deposits, as this can enhance financial stability in the economy. Financial institutions should focus their strategies on low-income customers and potential customers and should aim to ensure that the transaction costs involved are low, using new technology to achieve that. Policymakers should encourage diversification of deposits and credit, easy access to open accounts and affordability of financial products.¹⁵⁸ Financial education should be emphasised to enhance financial literacy to reach groups who are financially illiterate.¹⁵⁹ The regulatory environment should promote new lines of business where the risk profile of the business is relatively low.¹⁶⁰

6 3 Increased digital finance

To mitigate financial exclusion, regulators should adopt policies that encourage financial institutions to focus on increasing digital finance since this is a cost-

¹⁵⁴ Kokkinis and Miglionico "Open Banking and Libra: A New Frontier of Financial Inclusion for Payment Systems?" 2020 2 *Singapore Journal of Legal Studies* 601 605.

¹⁵⁵ Kokkinis and Miglionico 2020 *Singapore Journal of Legal Studies* 629.

¹⁵⁶ Kokkinis and Miglionico 2020 *Singapore Journal of Legal Studies* 605.

¹⁵⁷ Kokkinis and Miglionico 2020 *Singapore Journal of Legal Studies* 629.

¹⁵⁸ Machdar 2020 *International Journal of Economics and Business Administration* 201.

¹⁵⁹ Khan <https://www.bis.org/review/r111229f.pdf> 12; Machdar 2020 *International Journal of Economics and Business Administration* 201.

¹⁶⁰ Khan <https://www.bis.org/review/r111229f.pdf> 12.

effective measure and could ensure financial stability over the long term. An example is the increased use of mobile banking.

6 4 Policies to encourage higher use of savings accounts

Allen *et al* found that account ownership and the use of bank accounts depend on the costs of the accounts as well as the proximity to branches; high costs of accounts are a perceived barrier to financial inclusion.¹⁶¹ Since it was found that financial inclusion for individuals can complement stability, and suggested that the greater use of savings accounts could add to financial inclusion and financial stability, policies should be put in place to stimulate the greater use of savings accounts.¹⁶² Financial customers and people who are not yet financial customers should be encouraged to use bank accounts more broadly, especially to use bank accounts as savings accounts.

6 5 Addressing trade-offs and synergies between financial inclusion and financial stability

Policies on financial inclusion and financial stability in South Africa would involve the PA, FSCA and the SARB, since the PA and FSCA have financial-inclusion mandates, and the SARB has a financial-stability mandate. Čihák, Mare and Melecký highlight that the trade-offs and synergies between financial inclusion and financial stability are significant, and they suggest that they should be addressed in policymaking.¹⁶³ Khan shows that the synergies between financial inclusion and financial stability should be exploited to ensure affordable financial services to the financially excluded without compromising the level of financial stability.¹⁶⁴ Therefore, policies should emphasise that the PA, FSCA and SARB agree on a give-and-take approach to find the middle ground in exploiting these synergies.

6 6 Central Bank to promote financial inclusion through payment structures

The Central Bank of Brazil fulfilled its mandate to promote financial inclusion by developing innovative policies in the payment industry so that payment services are more accessible.¹⁶⁵ The Bank licensed payment institutions to offer payment accounts to individuals and businesses, without enabling such payment institutions to make loans like banks, thus lowering the risks of the

¹⁶¹ Allen *et al* 2016 *Journal of Financial Intermediation* 19 and 29.

¹⁶² Wang and Luo 2022 *Emerging Markets Review* 3; Čihák *et al* 2016 *World Bank Policy Research Working Paper* 7722 12 and 17; Han and Melecký 2013 *World Bank Policy Research Working Paper* No 6577 4.

¹⁶³ Wang and Luo 2022 *Emerging Markets Review* 3; Čihák *et al* 2016 *World Bank Policy Research Working Paper* 7722 18.

¹⁶⁴ Khan <https://www.bis.org/review/r111229f.pdf> 12.

¹⁶⁵ Bolzani 2022 *Journal of Law and Commerce* 120.

payment institutions.¹⁶⁶ This was done through the Brazilian Pix Payment System, an instant payment scheme empowered by the Brazilian central bank, which brought in new market solutions and advanced financial inclusion.¹⁶⁷

Central banks are globally more and more considering their role in advancing financial inclusion because of their contribution to financial stability.¹⁶⁸ Future research should explore whether it would be legally possible and viable in South Africa for the SARB to be involved in financial innovations that would create new structures and services in the payment system.¹⁶⁹

6 7 Enhancing consumer protection and financial literacy

To meet the goal of financial inclusion while promoting financial stability in a regulatory environment, an effective consumer-protection policy framework is a critical component.¹⁷⁰ Measures should be considered to ensure that banks do not take unnecessary risks to ensure financial inclusion – such as extending credit to customers who would not be able to repay the credit. Increasing credit to previously financially excluded financial customers should be monitored and prudentially supervised to ensure that financial inclusion takes place in a responsible manner and that financial stability is not jeopardised. For the entire framework to be effective, greater financial literacy and awareness would remain very critical.¹⁷¹

7 CONCLUSION

Financial stability and financial inclusion are both important outcomes for financial policymakers. Still, the nexus between financial stability and financial inclusion is more complicated and involved and less straightforward than was believed in the past. For example, the danger of focusing strongly on financial stability may lead to the protection of financial customers against over-indebtedness, which can hurt financial inclusion. For the optimal policy rules for these two variables, a policy model is needed that considers a policy tool that affects financial stability and another that drives inclusion, and then finds the optimal point for the two policy tools.¹⁷²

¹⁶⁶ Bolzani 2022 *Journal of Law and Commerce* 121.

¹⁶⁷ Bolzani 2022 *Journal of Law and Commerce* 172.

¹⁶⁸ Bolzani 2022 *Journal of Law and Commerce* 116; Hannig and Jansen 2010 *ADB Working Paper No 259* 22; García 2016 *Economic Issues* 95; Hawkins <https://www.bis.org/events/cbcd06e.pdf> 67.

¹⁶⁹ Bolzani 2022 *Journal of Law and Commerce* 120 and 172.

¹⁷⁰ Khan <https://www.bis.org/review/r111229f.pdf> 12; Comparato “The Rationales of Financial Inclusion in the Changing European Private Law” 2015 11 *European Review of Contract Law* 22 38.

¹⁷¹ Khan <https://www.bis.org/review/r111229f.pdf> 12; Amatus and Alireza 2025 *The International Journal of Social Sciences* 46.

¹⁷² Wang and Luo 2022 *Emerging Markets Review* 3; Čihák *et al* 2016 *World Bank Policy Research Working Paper 7722* 7.

Empirical studies referred to above provide wide-ranging evidence that greater financial inclusion adds to the financial stability of an economy. Various avenues for how financial inclusion affects financial stability are identified – for example, banks using financial inclusion to obtain cheap retail deposits, not relying on costly money-market funding, or reducing the marginal costs of products.¹⁷³

Scholarship has highlighted that policies should address financial inclusion of people who do not have access to formal financial services in South Africa. Policy implications from the findings are that banking services should be expanded to people without bank accounts or who do not use their accounts sufficiently. The Act emphasises the importance of the PA and FSCA going to greater lengths to ensure financial inclusion so as to enhance financial stability.

These findings show that the financial-stability mandate of the SARB and the financial-inclusion mandates of the FSCA and PA would mostly not work against each other and would complement each other if managed well.

¹⁷³ Ahamed and Mallick 2019 *Journal of Economic Behavior & Organization* 423.