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Speaker : DEPUTY MINISTER GILL MARCUS

SPEECH BY MS GILL MARCUS, DEPUTY MINISTER OF FINANCE, AT THE LAUNCH OF OASIS ASSET MANAGEMENT, 6 AUGUST 1997

Mr Ebrahim,

Distinguished Guests,

Allow me, at the outset, to apologise on behalf of Minister Trevor Manuel, who is unable to be here this evening. Unfortunately, the Cabinet meeting was set for a full day, and he was not able to return to Cape Town in time.

It is indeed a pleasure to be here, and participate in the launch of Oasis. The fact that Oasis has come into existence is itself testimony to the tremendous changes taking place within our society, providing new and exciting opportunities for all South Africans.

Tonight, I would like to address the question of the rapidly changing environment that you, as a new asset management company, will operate in.

The normalisation of South Africa's international financial relations, globalisation, the removal of restrictions on international capital movements and the linking of financial systems and markets, pose new challenges to the financial markets in South Africa. To maintain and indeed improve the well-developed and sophisticated financial system we have, and to ensure an investor-friendly environment, it is essential to enhance both transparency and liquidity in the financial markets, as well as reduce risk.

A number of structural changes have been made, or are in the process of being implemented. Ongoing liaison between the Department of Finance and the South African Reserve Bank, as well as the other role players in the South African financial markets, ensures a constant evaluation of such changes.

Considerable progress has already been made to ensure South Africa is more investor friendly. This includes the phasing out of exchange control restrictions, including the removal of all restrictions on the inward and outward movement of capital by non-residents.

Various tax changes, in addition to the rate reduction in STC and MST, that will affect institutional investors and therefore also the financial markets in South Africa, have been introduced or are under consideration. The following principles have been accepted by government:

- consistent tax treatment of private and public funds;
- tax neutrality between different forms of retirement provision;

- minimisation of opportunities for arbitrage arising from taxation;
- an incentive in favour of lifetime annuities; and
- taxation of retirement fund income as it arises, rather than when it is paid out.

Furthermore, significant operational and regulatory changes have been, or are in the process of being implemented in the domestic market. This will contribute to improved competitiveness as well as compliance with international standards. These changes include:

- the termination of trading on the gilt floor of the Johannesburg Stock Exchange in November 1995. Bond trading shifted to the Bond Market Association, which since its inception in 1989 had operated an informal screen and telephone trading system with the Universal Exchange Corporation Ltd. (Unexcor) as its clearing house;
- the approval of the Rulebook and underlying principles of the official bond market in March 1996 and the licensing, on 15 May 1996, of the Bond Exchange of South Africa to trade. Certain operational and regulatory changes are still in the process of being implemented, namely the establishment of a surveillance department and a reporting system for trade in bond options. The implementation of the recommendations of the Group of thirty concerning a T + 3 rolling bond settlement, is scheduled for November 1997. The advantages of this are the reduction in credit, counter-party and settlement risks, apart from achieving conformity with international standards.
- all exchanges, in line with international standards, have been orienting towards electronic scrip depositories and clearing and settlement procedures. In the JSE and the Bond Exchange of South Africa, this involves a movement away from paper based markets. This move has necessitated the development of electronic scrip depositories. The restructuring of the financial markets will favour the development of a single umbrella electronic scrip depository, and clearing and settlement procedures. This will lead to improved security and enhanced efficiency. The Bond Exchange is also developing a risk management system to risk manage all the spot, forward and option positions on the exchange. The system aims to measure all significant risks in bonds and options.
- the introduction of operational and regulatory changes on the Johannesburg Stock Exchange.

The promulgation of the Stock Exchange Control Amendment Act of 1995, facilitated the following important changes:

- corporate membership, with the option of limited liability;
- the opening of membership to non-residents (subsidiaries of foreign banks and security firms) and domestic financial institutions;
- the establishment of the South African Institute of Stockbrokers;
- the introduction of new capital adequacy requirements based on European Union Standards, with real-time electronic surveillance;
- the revision of the Johannesburg Stock Exchange Guarantee fund rules;
- the phasing-in as from March 1996 of the Johannesburg Equities Trading System, with dual capacity trading and fully negotiated brokerage. This replaces the open outcry floor trading system, which enhances security, speed of trading, efficiency and liquidity;

- the implementation of new listing requirements to improve investor protection and to contribute to access to the market by emerging entrepreneurs and companies;
- the revising of the Johannesburg Stock Exchange market indices and the introduction of a new indices to address the needs of portfolio managers and derivative traders;
- the introduction of the concept of host broker as part of capital requirements; and
- initiatives aimed at the extensive of the automated trading system and the implementation of an electronic scrip registry and rolling settlements.

Important initiatives are also under way in the area of the marketing of government bonds. The South African Reserve Bank currently acts both as an autonomous monetary authority and as government's agent for the marketing of its debt instruments. Due to the inherent conflict of interest in pursuing its own policy objectives as monetary authority and at the same time also needing to be conscious of government's policy objectives regarding public debt management, government now has full authority over all policy matters pertaining to the management of public debt. A two-phased implementation strategy is being followed.

Firstly, all funding activities that are being performed by the Bank on behalf of government have been ring-fenced from the Bank's monetary management activities. The Bank is directly accountable to the Department of Finance in respect of all matters concerning debt management. A risk management framework has been adopted by government, which provides for reference points against which compliance by the Bank to government's philosophies and principles of debt management can be monitored.

Secondly, interaction with market participants has been initiated, with a view to appointing a panel of primary dealers in government bonds. Once primary dealers have been appointed, it is the intention that the functions of market-making and the selling of government bonds that are currently being performed by the Bank be shifted to the primary dealers for their own risk. As a pre-requisite to the appointment of primary dealers, it will be necessary to reform the present tap system of marketing government debt, and establish a tender or auction system.

The intended appointment of primary dealers should be viewed as an important element of a longer term initiative to further contribute to the development of the South African financial markets. In the process, the focus will be on the establishment of the State's name as a fair and efficient competitor in the domestic and international financial markets.

Once primary dealers have been appointed, a stronger focus will be placed on the marketing of rand-denominated instruments in the international financial markets. This will have the benefit of attracting much needed foreign capital and also contribute to liquidity in domestic government debt instruments.

As part of the broader initiative to contribute to the development of the South African financial markets, the role of the Reserve Bank (as agent of government), as provider of forward cover, is in the process of being phased out. At the request of government, the Bank has already stopped providing any new long dated forward cover contracts.

The various structural changes in the South African financial markets that have been or will be effected no doubt contributes significantly to improving South Africa's international competitive position. This is can be seen by:

- the strong demand in the Euro-rand market, particularly since the beginning of 1997;
- the strong interest by major international financial institutions to become primary dealers in the marketing of rand denominated debt instruments; and
- the opening of branch offices by international financial institutions in South Africa.

The changes also greatly contribute to the development of derivative instruments. This is particularly important in that it provides for much needed hedging opportunities in an international integrating environment.

In addition, the increasing presence in the South African market of foreign financial institutions as a result of the opening-up of our markets, contributes to the development of our region as a whole. Not only do foreign institutions use South Africa as a base for investment in other countries in our region, but also by operating branches and subsidiaries in other countries a significant contribution is being made in the broader development of financial markets.

The changing environment does, however, pose important challenges for all of us, both in government and for organisations such as yourselves. These include:

- the need to improve our ability to effectively deal with the increased volatility in our markets;
- the need for South African institutions to properly position themselves to effectively compete with foreign players in our markets;
- the need for the South African Reserve Bank to ensure, on an ongoing basis, the effective management of the money market. In this respect it is interesting to note that many other central banks operating in sophisticated financial markets now influence short-term interest rates more directly with their operations in the markets. Instead of overnight loans being provided at the discount window, they enter into repurchase transactions with banking institutions. This provides the added advantage that it can be coupled with a tender system for central bank money, and a variable Bank rate;
- the need for better co-operation between the regulators of the role players in the South African financial markets; and
- the further development of a framework of incentives that will induce market discipline on all public sector borrowers.

All of the above indicates the ongoing need to evaluate policy objectives of regulation against the rapid changes in the operating environment, not least the way in which technological advances constantly impact on existing regulations. We need to ensure appropriate prudential requirements with appropriate compliance supervision, especially of conglomerates given the trends towards concentration and conglomeration of the industry.

We also need to eliminate the gaps in regulation, and ensure domestic regulation meets international standards. Above all, we need to provide adequate protection from unscrupulous operators. This requires a long-term strategic approach to the regulatory framework, taking account of the need for both functional and institutional regulation for both corporate and financial institutions. Our imperative must be the education and protection of the consumer.

What all of the above indicates is that we are operating in a rapidly changing environment. The very nature of the South African economy dictates that we embrace the challenges of globalisation. But we need to recognise that globalisation has certain disciplines. Companies faced with the choice of investing anywhere in the world compare the price and efficiency of the fixed factors of production, and we need to ensure that we are competitive.

Investors also want to know, with a degree of certainty, that the prices of today are the prices that will prevail in the future. Thus there is a comparison of macro-economic management across countries.

With the emergency of companies like Oasis, companies committed to the development of South Africa and all its people, we can together build the skills, competitiveness and excellence that will make our country a winning nation.

I wish you every success in your endeavours. Harnessing your combined skills, talent and energy into a company like Oasis, committed to the highest ethical standards, should be good for all of you, for your clients, and for the country.