

BUDGET VOTE SPEECH BY THE DEPUTY MINISTER OF FINANCE, 10 JUNE 2002

Madam Speaker

Honorable Members

The year that has passed has been one of the most momentous years. Apart from the dramatic events of Sept 11th, the world has suffered a series of spectacular corporate failures, not just the US. It has been proven once again that “credit addicted” countries like Argentina are not immune from bankruptcy, and all emerging markets have experienced some degree of instability in their markets.

Here in South Africa, we are quietly optimistic. Despite the sudden depreciation in the value of the Rand late last year and global market instability, our economy has managed to move from strength to strength. Our currency has shown resilience beyond anyone’s expectations, our capital markets have remained stable and robust throughout and we have managed to keep the interest rate from dampening our collective spirit. Business confidence has recently shown a marked increase which bodes well for our economic future.

FINANCIAL MARKETS

This is possibly the best time to reflect on the progress made since the last budget. I want to begin by talking about the developments that have taken place in our financial markets.

The link-up between the Johannesburg and London Stock Exchanges is on everyone’s mind in the financial world. A common trading system for both exchanges, which are located in the same timezone, is a significant development. There are so many options and possibilities to be explored and developed through the sharing of technology. The transaction is a first for the LSE and they have indicated that they will apply their experiences gained from the JSE venture to similar arrangements with other exchanges. Other exchanges have followed these developments with keen interest.

This is a very important moment for us, but I want to alert you to a less publicised, but equally important event that took place this year as well.

The “dematerialisation” of share certificates means putting all paper share certificates in the shredder and creating electronic “share certificates” instead. The process of dematerialisation began in 1998 with legislation to create STRATE (Share Transactions Totally Electronic), South Africa’s first Central Securities Depository (CSD) and ended just a couple of months ago.

The objective of dematerialisation is to reduce the risk of theft and the cost and time delays of exchanging vast amounts of paper. Trading in South African equities has just become significantly less risky, a lot more cost effective and now we are in a position to move towards compliance with the

very last international standards we have yet to comply with, namely settlement in three days after trade or T +3. I am very pleased about this.

Looking ahead for a moment, I am pleased to state that the Financial Services Board, in conjunction with the Treasury, have developed two new Bills, namely the Collective Investment Schemes Control Bill and the Security Services Bill. The State Law Adviser is currently certifying the Collective Investment Schemes Control Bill advisers.

The Security Services Bill will be Tabled in Parliament within the coming months and should be ready for promulgation by the end of this year. It will arguably be the most important piece of financial services legislation on the Portfolio Committee's agenda for the coming half year because it not only consolidates and codifies five pieces of existing legislation into one Act, it also represents a whole new, or modern policy approach to the institutional structure of our financial markets.

This Bill makes provision for an exchange to demutualise and for the Financial Services Board to assume any responsibility that is currently within the domain of an exchange, for example, the regulation of listings.

CONSUMER PROTECTION AND EDUCATION

Moving on to the other side of the spectrum, for the process of protecting and educating the users of financial services: the consumers, pensioners, workers, policyholders, investors; this year has been a year for concern and a year to rejoice.

Lets begin by rejoicing. We have almost finalised South Africa's first piece of legislation to regulate the conduct of financial advisors and intermediaries - the Financial Advisory and Intermediary Services Bill.

I am pleased to state to this House that the regulatory *impasse* experienced in relation to the Financial Advisory and Intermediary Services Bill, is over, and that it is anticipated that this Bill will be on the agenda of the Portfolio Committee for Finance, for its formal consideration and adoption, on 12 June 2002.

Preparations for the enactment of the Financial Advisory and Intermediary Services Bill, has largely given impetus to the establishment of a whole new Division within the Financial Services Board to deal with consumer education and the conduct of financial services providers, intermediaries and advisors. This step is testimony to our supervisory commitment to ensuring that consumers are not left penniless or vulnerable to unscrupulous brokers chasing commission at the expense of their financial clients needs.

There are numerous other legislative initiatives still in the pipeline. For example, the Financial Services Ombudsman Schemes Bill, which provides for the creation of ombuds for each category of financial services to provide recourse for aggrieved consumers. The implementation of the Bill is

anticipated after the enactment of the Financial Advisory and Intermediary Services Bill.

Protecting consumers through education and the regulation of the conduct of intermediaries and advisors is one approach to ensuring that people don't lose their money unnecessarily.

The other side of the equation is good corporate governance and the integrity of the auditing and accounting professions.

AUDITING AND ACCOUNTING

Whilst concern describes how I feel, I want to be constructive about the problems in the auditing and accounting professions.

It is no secret that globally the accounting and auditing professions are in the throes of a profound crisis. Confidence has been shattered. I wish to quote from a recent statement (May 2002) from Prof Arnold Schilder, Executive Director of the Netherlands Bank and Chairman of the Basel Committee Accounting Task Force, as follows:

"Enron has seriously shaken our confidence. This is a grave matter, because it means confidence has weakened in rules and regulations, in supervisory authorities and in the functioning of the financial system in general...The biggest shock is that no warnings were issued – and yet it happened. So the reputation of directors is at stake. The Enron executives are subject to public enquiries – but many other directors outside Enron suddenly face greater scepticism about their assurances. The slightest unclarity about financial statements may cause considerable confusion. Because it is no longer taken for granted that they can be trusted."

As government, we must be seen to act in the public interest– meaning in the interests of end users, depositors, policyholders, small investors and workers. There is a need for a more disciplined and realistic information feed to the public. This is the heart of the matter.

Michael Groom, head of the Institute for Chartered Accounts in England and Wales recently stated that the objective of any reform should be to:

"ensure high quality audit, strengthen accounting standards and codes of ethics and to introduce credible independent oversight – this is what defines commitment to the public interest".

There are two bills that are Government's primary tools for addressing the problems in the profession, namely the Financial Reporting Bill and the Accounting Professions Bill. Whilst the Accounting Profession Bill has been in the pipeline for a long time, the time is right for us to expedite the process to finalise the Bill such that it reflects a well thought-out response to the current problems facing the auditing and accounting professions.

In a speech to SAICA at the beginning of May 2002, the Minister of Finance highlighted the main policy issues government is concerned with that relate to the auditing and accounting professions. These issues require resolution before we can finalise the Accounting Professions Bill.

I want to briefly restate those issues so it becomes clear to the public and the profession that Government is thinking carefully about the best way to protect the public interest and ensure that the two professions continue to be well respected for the important role they play in the economy. We are moving forward on these issues and trying to find the best possible way to overcome the problems confronting the accounting and auditing professions.

The issues the Minister raised can be classified as those relating to the accountability of both professions, the standards and codes adopted, ethics and how accounting and auditing fit within the broader context of sound corporate governance.

In terms of accountability, there are three key issues. The first is to whom should auditors be accountable to? The relationship between a finance director and an auditor is fraught with problems. The second issue is audit costs and the liabilities of auditors who fail to properly disclose the financial status of their clients. We need clarity on what is affordable, on what is justifiable and on the detail of service level agreements. The third issue relates to the absence of term limits for auditors. All these issues relate to the oversight of the profession and the failure of self-regulation.

The appropriateness of accounting standards and disclosure rules, including the illusion of clarity on GAAP and the absence of standards to deal with new issues such as derivatives and other off-balance sheet holes are all issues that require immediate attention. We need new standards for a new era. These issues are to be dealt with within the ambit of the Financial Reporting Bill.

The ethics that accountants and auditors adhere to are the most fundamental to the notion of good corporate governance. The responsibilities of auditors and accountants are not confined to shareholders or investors, the failure of a badly managed company has much wider social ramifications and therefore directly affects the public interest. The absence of public remedies for both errant CEO's and auditors is an issue that undermines efforts to bolster the accountability of the profession.

Sound corporate governance is a prerequisite for sustainable economic growth and progress. South Africa has not been immune from corporate failures caused by gross mismanagement and silent auditors. We are dealing with this matter as best we can. Government is moving swiftly on these issues and next year I hope to report on what progress we have made.

FINANCIAL INTELLIGENCE CENTRE

The establishment of the Financial Intelligence Centre by the Financial Intelligence Centre Act of 2001 to counter money-laundering activities in our financial system, is moving ahead. The implementation process is underway and consultations have been held with the affected industry bodies on the regulations and other issues.

Government remains steadfast in its resolve to take the appropriate steps to ensure that our financial system is secure, efficient and consumer friendly. Honesty and market integrity in our financial system is undermined by efforts to launder money through our banks, brokers, insurers, etc.

It is worth restating that The Financial Intelligence Centre Act, 2001, introduces a comprehensive anti-money laundering regime in the Republic of South Africa which satisfies the major Financial Action Task Force (FATF) Recommendations.

The FATF, which is the de facto international coordinating body responsible for combating money laundering, consists of twenty-nine member countries and two regional bodies. The FATF has developed a set of Recommendations which set out the principles of the body and act as a global standard for the combating of money laundering and the financing of terrorism. These Recommendations have become known as the FATF 40+8.

However in terms of these 40+8 Recommendations, South Africa is required to become a member of the Eastern and Southern African Anti-Money Laundering Group (ESAAMLG). The ESAAMLG was established in November 1999 as the regional body of the FATF. The present members are Republics of Kenya, Malawi, Mauritius, Mozambique, Namibia, Seychelles, Uganda, the United Republic of Tanzania, and recently by the Kingdom of Swaziland.

Cabinet approval has been granted for South Africa to take its rightful place as a member of ESAAMLG, and our membership is important for South Africa for a number of related reasons:

- ?? Government has demonstrated that it is committed to combat organised crime and money laundering by passing the Prevention of Organised Crime Act, 1998 and the Financial Intelligence Centre Act, 2001. However, for South Africa to become fully compliant with the FATF requirements and to thereby gain international acceptance for its anti-money laundering stance it needs to become a member of the ESAAMLG.
- ?? Membership of regional bodies, such as ESAAMLG, is a requirement for membership of FATF, should South Africa wish to take up such membership.
- ?? Already South African business in the financial sector is increasingly faced with questions from international counterparts regarding the South

Africa's anti-money laundering stance and its membership of regional anti-money laundering bodies. It is anticipated that this pressure will grow in the period going forward.

- ?? Membership will also obviate pressure to place South Africa on the FATF list of Non-Cooperating Countries and Territories (NCCT), thereby effectively blacklisting the country.
- ?? The problem of money laundering cannot be dealt with in isolation by one country because of the ease with which money is able to flow across borders and requires coordination and mutual support between neighbouring countries.
- ?? This will further strengthen South Africa's anti-money laundering mechanisms.
- ?? Membership of the ESAAMLG will give the FIC easier access to other financial intelligence units on a continuous basis, thereby enabling it to share information and expertise.

PENSION FUNDS

Since our last report, we have passed The Pension Funds Second Amendment Act, 2001 which concerns the apportionment of actuarially determined surpluses and minimum benefits in private pension funds, registered under the Pension Funds Act, Act No 24 of 1956.

The National Treasury and the Financial Services Board is focussed on the implementation issues surrounding the Act and on ensuring that the Act in its present form is given practical effect through a process of speedy implementation. This is required in order that the Act may live up to its promise of equitably apportioning and distributing the surplus in pension funds to those entitled in the Act to receive them. Accordingly, the necessary regulations to effect to many of the provisions of this Act are in the process of completion.

PROCUREMENT

I now want to turn to matters of procurement. Pursuing from subsection 271(3) of the Constitution, the Preferential Procurement Policy Framework Act, No 5 of 2000, was promulgated during February 2002. The Preferential Procurement Policy Regulations, 2001, gave substance to the contents of the Preferential Procurement Policy Framework Act. The purpose of this act and regulations is to enhance the participation of Historically Disadvantaged Individuals (HDIs) and certain RDP goals such as the promotion of small medium and micro enterprises (SMMEs) through the public sector procurement system.

At the time of the promulgation of the Preferential Procurement Policy Framework Act, an undertaking was given by the Minister of Finance that

progress towards achieving government's procurement reform objectives would be monitored on an ongoing basis and that adjustments/amendments would be recommended as and when it becomes necessary. To this end, the Minister granted approval that a Joint Country Procurement Assessment Review (CPAR) be undertaken with the World Bank. A first draft report has recently become available and the recommendations contained in the draft report, is currently under consideration.

Based on the findings and recommendations in the draft report, current work in the National Treasury is focused in the following areas:

- ?? Enhancing uniformity in procurement practices at all organs of States
- ?? Promoting uniformity in interpreting government's preferential procurement policy
- ?? Refining the current Regulations to the Preferential Procurement Policy Framework Act

The current Regulations provide for a number of rules and prescripts that need to be followed. These rules are ambiguous and in some respects could be interpreted to being out of line with the letter and spirit of the PFMA. In addition to the preference points that could be allocated for HDI status, points could also be allocated for a number of RDP goals that are listed in the Regulations. Some of these goals are difficult to relate to contracts.

The remedy for the current deficiencies in the Regulations is seen to lie in the development of a well-formulated preferential procurement policy strategy. Such a strategy should outline clear policy themes, establish priorities where there is more than one theme and project-desired policy outcomes. Short and medium term targets (deliverables) should be established to give direction to implementing officials as to the targeting strategies that should be adopted for specific contracts.

Current work within the National Treasury focuses on the development of such a procurement policy strategy.

CONCLUSION

Madam Speaker, Honourable members, there are so many other issues and important matters that came to mind when deciding what to speak on today, but I believe I have captured those that are most significant.

What is left is for me to assure you that optimism in our markets is growing and confidence in our ability to harness international capital and put it to work in the most productive way in our economy must never be underestimated.

Thank You.