ministry of finance

REPUBLIC OF SOUTH AFRICA

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ADDRESS TO THE NATIONAL ASSEMBLY DURING THE DEBATE ON BUDGET VOTE 8 – NATIONAL TREASURY (INCLUDING SARS) AND BUDGET VOTE 13 – STATISTICS SOUTH AFRICA

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Financial sector imperatives: equity and accountability

Stronger economic growth and investment, and the efficient allocation of investment funds, rest on the quality and depth of our financial markets. Over the past year we have seen an extraordinary performance in our capital markets, partly driven by robust global growth but also indicative of rising confidence in South Africa's growth outlook. For business in general, and certainly for the financial sector, conditions have never been so good.

But the sustainability of growth depends also on the quality and equity of economic performance, and this is perhaps especially true of the financial sector. At the heart of our broader economic development strategy are the key concepts of good governance, sustainability and equity. We have strived to do what is transparent; what will result in long-term success; and what is fair and right.

For business, this has resulted in a far more favourable environment than many envisaged. Whilst many in industry may originally have been sceptical about issues of empowerment, transformation and redistribution, increasingly

we are seeing the wisdom of such policies in that, not only were they the right things to do, but they have also contributed to stronger, shared and sustainable economic performance.

It is perhaps no surprise then, that questions of fairness have dominated the financial sector reform agenda during this past year of extraordinary growth and improved performance. The spotlight has fallen increasingly sharply on standards of good governance and equity, and the character of enlightened trusteeship at the helm of our financial ship.

Shortly after taking office in 1996, Minister Manuel stated that Government needed to have a greater say in the structure and the regulation of the financial services industry – that the industry could not "place itself above the law by defining its own regulation".

Ten years later we can see that those words were indeed prophetic. The situation inherited in 1996 was one of a financial sector that had developed within the context of an inward-looking policy environment, skewed investment opportunities and ownership by the few. Years of political and economic isolation meant that our regulatory structure had become progressively out of line with international standards. A highly concentrated financial sector meant that there was limited competition to bring down the costs to consumers or to spur innovation. A political dispensation that did not care for the majority of its people found its reflection in a financial sector that paid scant regard to the interests of ordinary consumers.

Over the past ten years, the pace of transformation in the financial sector has been remarkable. Legislation in most segments of the financial sector has been overhauled. Where traditionally regulation was focused on issues of prudential risk management, we have seen a range of new laws aimed at balancing this with improved consumer protection.

But legislation can only go so far. Bringing about true change is also about the enforcement of such legislation and the spirit and integrity with which financial sector participants take the message of this legislation to heart.

I am happy to say that though many challenges still exist in this regard, the last year has witnessed some heartening progress in giving effect to the principles of good governance, transparency, fairness and consumer protection.

Life products – early termination

In December 2005, the Minister of Finance and representatives of the life industry signed a Statement of Intent in which the industry committed itself to finding an effective solution to concerns highlighted by the Pension Funds Adjudicator relating to the lack of transparency in the fee structures of contractual savings products, in particular the costs of early termination.

While there was extensive debate about the obligations of insurers in terms of the relevant legislation and regulations, the life industry recognised that the reasonable expectations of consumers with respect to the net returns from retirement annuity fund member policies and other savings policies had not been met, particularly in the context of early premium cancellation.

As a result, the life industry agreed to a restitution package of close to R3 billion to reimburse effected policyholders.

The spirit that informed this agreement was that while certain practices may not have been formally illegal, they were plainly unfair and indefensible. In committing to doing the right thing, the industry has accepted that standards of transparency, sustainability and equity go beyond adherence to minimum legislative requirements.

The task of putting flesh on the bones of this agreement is currently underway, guided by a discussion paper on contractual savings in the life industry released by the National Treasury at the end of March 2006.

The premise of the proposed reforms is that a new business model which places the interests of the consumer at the heart of the way in which insurance companies operate will ultimately lead to a stronger and more sustainable industry for all.

This includes proposals on regulatory changes to provide more adequate consumer protection; measures to lower costs through improved transparency and competition; measures to better align the incentive structures of intermediaries with the interests of the client, including reforms to the structure of commissions; and lastly financial safety nets to provide a more equitable sharing of risks between the client, intermediary and the insurance company.

It is anticipated that these reforms will result in a significant improvement in consumer confidence in the value offered by the savings products of the insurance industry and provide a strong foundation for improving the culture of saving going forward.

Retirement fund management

A second example of the financial sector being held to the highest standards of transparency and accountability relates to the recent investigations into the practice of “bulking” by retirement fund administrators.

It has emerged that administrators were making undisclosed profits from bulking the funds under their administration and then negotiating a higher rate of interest to be paid on the funds, but taking some of this benefit for themselves without approval from the pension funds under administration. This is tantamount to taking away benefits from pension fund members without their knowledge or approval.

An agreement has been reached between the Financial Services Board and Alexander Forbes whereby Alexander Forbes will repay to retirement funds the total benefit received from bulking, as well as making a contribution of R12 million to the Financial Services Consumer Education Foundation, which amount will be used for the training of retirement fund trustees.

This sends a clear message to all retirement fund administrators, and other financial service providers acting as agents of retirement funds, that we will tolerate no less than the highest standards of accountability. Financial sector service providers are placed in a position of trust towards retirement funds and as such are under a legal duty to act in the best interest of their clients at all times. Receiving secret profits or undisclosed compensation from other parties is not acceptable practice.

Retirement fund administrators operate in terms of a license from the Registrar of Pension Funds, and as such must observe all the conditions and obligations that come with such a right to operate. It is imperative that all other administrators provide a full and frank disclosure of all practices that amount to undisclosed profits, as required by the Registrar of Pension Funds, and that similar steps be put in place to fully compensate retirement fund members and pensioners.

Surplus fund apportionment

I'd like the trustees of pension funds to take this message to heart as well.

In terms of the Pension Funds Second Amendment Act, 2001, all pension funds were required to submit pension fund surplus apportionment schemes to the FSB within two and a half years of their surplus apportionment date, but by 7 June 2006 at the very latest.

It is estimated that about 2000 pension funds will have surplus to apportion, but to date only about 10 per cent of this number – i.e. only 200 funds – have actually submitted surplus apportionment schemes.

In plain language, this means that there are hundreds of thousands of individuals who are not receiving their due surplus benefits. If this situation persists, we will see increasing numbers of people – especially pensioners – lose out on these benefits because they will not survive long enough for the process to be completed. This is entirely unsatisfactory.

The Chief Actuary of the FSB has been in ongoing communication with the largest pension funs administrators in an attempt to stress the imperative of adhering with these requirements.

Retirement fund members have a right to demand that the trustees of their funds take urgent action in the case of non-compliance. Ultimately, it is the retirement fund members and pensioners who are penalised by this inactivity. If no action is forthcoming, the trustees will have been derelict in their fiduciary duties and the fund will be required to appoint a tribunal to take over the duties of trustees in respect of complying with the surplus legislation. But ultimately this is an expensive and complex step that we do not want to take unless necessary – rather, we call upon all trustees and administrators to deal with this issue with the seriousness that it deserves and to submit surplus schemes in terms of an agreed timetable with the Chief Actuary of the FSB, but by no later than 31 December 2006.

I need to emphasise that the depth and soundness of our financial sector and the strength of the contractual savings industry are economic and social assets, but there are particular deficiencies that have to be addressed. The general message should be clear. Increasingly, the financial regulatory authorities are demonstrating that they do indeed have teeth, that the financial sector is under scrutiny, and financial institutions are expected to exhibit the highest standards of fiduciary integrity and trusteeship.

Financial sector transformation

It is not our intention that change in the financial sector should begin and end with what is prescribed in legislation.

The experience of the Financial Sector Charter is instructive in this regard.

Firstly, it is a model of constructive industry co-operation on a national scale – not in the form of collusion, but rather in the sense of the sharing of intellectual capital to find solutions to present day challenges.

Secondly, it breaks new ground in terms of an industry coming forward voluntarily to commit itself to doing things that go above and beyond what is required in terms of legislation. Certainly, legislation and regulations are important cornerstones in setting the framework within which firms must operate – and within which we must protect overall financial stability. However, the Charter has demonstrated the power of a shared vision – one that commits to transformation not only for moral reasons, but also because it will build the foundation on which we will all benefit in the future.

In a tangible sign of how sound partnerships can contribute towards transformation, the Mzansi bank account initiative continues to grow from strength to strength. Last year I was able to report that Mzansi had led to the creation of 1 million new bank account-holders within its first seven months. This figure has now grown to over 3,3 million new accounts. Mzansi will continue to evolve as new product features are added, but already it has taken significant strides in the challenge of improving access to banking services for all.

We are also seeing the development of similar initiatives in the insurance and collective investments industries.

Transformation and access to finance are also objectives of the proposed tiered-banking legislation, in the form of the Dedicated Banks and Cooperative Banks Bills.

The Cooperative Banks Bill seeks to provide community-based banks with legal standing and strengthened regulation, so as to afford its depositors the same safety and stability as enjoyed by the formal commercial bank's depositors. The Bill also provides for the creation of support organisations for the cooperative banks in order to ensure a continuous and sustainable capacity programme for the industry.

The first draft of the Co-operative Banks Bill has now been revised to reflect the numerous comments received, and will be tabled in NEDLAC within the next few days for further consultation prior to submitting to Cabinet later this year.

The Dedicated Banks Bill seeks to create new institutions that will provide core banking services, without having to conform to the traditional model of full-scale banks. Institutions that are envisaged to apply for these types of banking licenses would include telecommunication companies, large retail companies and micro lenders.

A revised draft of the Dedicated Banks Bill, integrating public comments that were received, will be submitted to Cabinet by August 2006 for consideration by Parliament before the end of the year.

It is my view that the promulgation of these two Bills will introduce significant opportunities for new entrants into the banking system, with the aim of increasing competition and access to finance.

Amnesty Unit

Turning to other organisations reporting to the Ministry of Finance, I am pleased to announce that the Amnesty Unit housed at the National Treasury, tasked with adjudicating the applications by South Africans wishing to voluntarily declare their foreign assets and to regularise their tax affairs, has completed its core work.

After undertaking a final audit of the files received, I can report that the Amnesty Unit has adjudicated all of the 42 679 applications it received since the announcement of the amnesty nearly three years ago. Of this number, 42 178 applications were approved. 937 applications of the total received applications (43 135 including duplicates) were withdrawn, deleted or voided, with 20 applications declined. The amnesty process has raised R2.9 billion in levies, and will soon transfer this amount to the National Revenue Fund.

It is worth noting that when the amnesty process was announced in 2003, it had four objectives: (i) to broaden the tax base and increase future revenue collection through disclosure of assets (both legal and illegal); (ii) to enable South Africans to regularise their affairs without being prosecuted; (iii) to provide the South African Revenue Service (SARS) and the Reserve Bank with details of foreign assets; (iv) and to facilitate repatriation of foreign assets to South Africa, without fear of recrimination.

I am pleased to announce that the amnesty process has successfully achieved all these objectives. A total of R68.6 billion worth of foreign assets have been disclosed. Approximately 70% of these disclosed assets were illegal, while about 30% were legal or legalised through the Reserve Bank. It is estimated that the income tax base has been increased by an estimated R1.4 billion, which is likely to increase the collection of personal income taxes by an estimated R400 million per annum. SARS and the Reserve Bank will also be able to fully update their records on the basis of the information disclosed.

The R2.9 billion of revenue raised through the levies is a further indication of the success of the amnesty process, and will be used for social development and community infrastructure.

The sanitisation of more than 41 000 applications, as required by law, was completed by May 2006. The Unit is on track to complete the remaining administrative functions by the end of July 2006. The applicant files will be stored with highly restricted access at central locations within the Reserve

Bank and SARS. These procedures will ensure that the objective of having enabled South Africans to regularise their affairs without fear of prosecution or recrimination is fully safeguarded.

I would like to take this opportunity to thank the Amnesty Unit for their sterling work. When the unit was initially announced, we did not anticipate the huge task that they would be faced with, both in the number of applications received and the associated logistics. It is through the exceptional efforts and meticulous approach of our Unit that other countries now seek to use our amnesty as an international benchmark. I wish to specifically thank the chairperson, Advocate Mbuyiseli Madlanga, who has led the Amnesty Unit impeccably and with great enthusiasm. I would also like to thank the Reserve Bank and SARS for their assistance in finalising the amnesty process.

Finally, my appreciation goes to Parliament and the public for the confidence they have show in this amnesty, which as stated above, has been a remarkable success.

The Financial Intelligence Centre

The Minister has made reference to the progress that has taken place with the implementation of the Financial Intelligence Centre (FIC) Act and the fruits that have already been borne of this. It is clear that many of the business institutions affected have been actively supportive. I wish to express on behalf of Government my appreciation of this and for the effort they have made in doing so.

However, the Minister has also indicated there are areas of compliance needing further enhancement. I have a comment to make on this - because I have personal experience of being FICA'd. I don't think it was ever the intention of the legislature, when it passed the FIC Act, to allow a situation to develop where the customer of a financial institution, for example a bank, would have to be FICA'd, would have to identify themselves, more than once.

However, what we have at the moment is a situation where every time a person who is already a client and who has already been FICA'd, wants a new product, lets say take out another home loan, or motor vehicle financing, she has to go through the motions of being FICA'd again and again. This is time-consuming, it is expensive. I believe it is the responsibility of a bank, or any other similar institution, to ensure that their internal systems enable them to have a single view of their customers. If they only have separate view, with each view only linking a particular client to a particular product, then how can they honestly state they have good customer relationship processes in place? How can they honestly say they have developed good risk management processes? Moreover it then becomes the excuse to pass the cost of complying on to the client.

Our banks and other financial institutions have world-leading IT systems. It seems to me that here is something that shouldn't be difficult to achieve. It also seems to me that in doing so they would not need to pass the costs to their clients, because the institution will soon recoup the costs through the better relationships they develop with their clients and with the many future others who will choose to come and bank with them.

In conclusion honourable Chairperson I would like to take this opportunity to thank the Minister of Finance for his leadership, and the management of Treasury and all the entities that are residing within its area of responsibility, and for maintaining the high standard of efficiency and competency. I must say today that I am proud to be part of this team. Thank you very much.