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A financial sector that serves all South Africans

A transformative financial sector

South Africa's legacy of discrimination continues to exclude millions of people from meaningful participation in the economy, reinforcing unemployment, poverty and inequality. Although progress has been made in transforming the financial sector, more needs to be done to broaden access through more affordable financial services, improve market conduct, ensure employment equity at top management levels, provide procurement opportunities and transform ownership structures. The National Treasury will continue to work to ensure that the financial sector is not only transformed, but transformative. It will be engaging with the Financial Sector Charter Council, focusing on the four areas discussed below.

Access and inclusion

The introduction of the Financial Sector Charter in 2004 increased the focus on financial inclusion and led to the sector's renewed engagement with lower-income households. As a result, government and financial service providers steadily improved overall financial inclusion from 55 per cent in 2005 to 85 per cent in 2016, meaning that most adults in South Africa now have some form of financial product from a regulated financial institution.

However, this has not adequately translated into an improvement in the quality of lives of low-income households, nor into viable economic prospects for many small firms. Several products sold to the mass market are not appropriate, and customers are not always treated fairly. Many South Africans with a bank account withdraw their entire salary as soon as it is deposited, and many households are over-indebted.

Financial inclusion needs to be supported by strong market conduct and consumer protection regulation. Subject to the passage of the Financial Sector Regulation Bill, the Financial Sector Conduct Authority and Ombud Council will be established in 2017. These institutions will ensure a fairer and more effective financial sector. Further details on improved market conduct will be set out in the draft Conduct of Financial Institutions Bill and the financial literacy policy to be published in 2017.

The new market conduct regulator will continue the Financial Services Board's *Treating Customers Fairly* initiative. Information documents will be drafted and tested in 2017 to help customers compare the features and risks of financial products in a simple, easy-to-understand manner.

Employment equity

This is an area where meaningful transformation can be achieved most easily, yet financial institutions have been slow to improve their employment equity profiles, particularly at top management level. Black representation in top management was lower in 2015 than it was in 2013, although there have been improvements in black representation in middle and junior management. Some sectors, such as asset management, have changed less than others at senior levels.

Ownership transformation

Transforming ownership in the financial sector remains a significant challenge. Given the low level of domestic savings, the South African economy is reliant on foreign and institutional funding. The unencumbered capital needed to ensure banks can be recapitalised in a stressed situation has hindered the extension of direct ownership in the banking sector. To mitigate constraints to ownership transformation, the Financial Sector Charter proposed R100 billion in funding, based on commitments by members, to support black business growth. This would entail a combination of equity equivalents (estimated at R25 billion) and empowerment financing (estimated at R75 billion). These proposals were released for public comment in 2016. Each year, the National Treasury will publish an ownership monitor of listed companies to assess progress against ownership targets.

Procurement

The financial sector is performing better in relation to black economic empowerment (BEE) procurement, but stronger efforts are required to promote smaller black businesses. The National Treasury is engaging with the industry to develop insurance and banking market-development roadmaps, building on Financial Sector Charter procurement targets.

Other market conduct initiatives

Policyholder protection

The Policyholder Protection Rules, which have been issued for comment, aim to reduce unfair termination penalties on savings policies. This could save retail investors up to R1 billion over 12 years. The rules will also introduce strong requirements for how insurers must manage customer complaints.

Deposit insurance

The National Treasury and the Reserve Bank will soon publish a policy document on deposit insurance. It will complement proposals in the 2016 discussion document, *Strengthening South Africa's resolution framework for financial institutions*. Together, the resolution framework and the deposit insurance scheme will form a comprehensive regulatory framework to protect taxpayer funds and reduce the high social and economic cost caused by failing financial institutions. The main objectives of deposit insurance are to:

- Protect less financially sophisticated depositors against losses when banks fail
- Bolster the stability of the banking sector by reducing vulnerabilities to panic
- Foster financial market development and inclusion.

Financial markets review

To ensure that South Africa's regulatory framework remains at a high global standard, a comprehensive financial markets review will be undertaken in 2017, modelled on the *Fair and Effective Markets Review* in the United Kingdom. It will focus on competition and conduct practices, aiming to improve effectiveness to the benefit of market participants and customers. The review will begin in April 2017.

Indebtedness

Although household indebtedness remains high, modest progress has been made. The ratio of household debt to disposable income now stands at 74 per cent (September 2016), down from 78 per cent in 2014, and a peak of 86 per cent in 2008. This was achieved by:

- Introducing National Credit Act regulations to curb reckless lending by setting affordability criteria for retail credit providers.
- Setting norms and standards in the national payment system to prevent debit order abuse.

Forthcoming measures are expected to include:

- Limiting credit insurance through caps recently introduced by the Department of Trade and Industry.
- Legislative amendments to the debt collection regulatory framework to allow for action against unscrupulous legal firms.
- The Courts of Law Amendment Bill, tabled in Parliament in May 2016, which proposes amendments to the Magistrates Court Act (1944) to address abuses related to the issuing, structure and reporting of emolument attachment orders.

The systemic abuse of emolument attachment orders – also known as garnishee orders – has pushed many workers into an inescapable debt trap. These are court orders that oblige a debtor to repay a loan through instalments taken off their salary or wages. Government, as the largest employer in South Africa, has taken the lead against bad lending practices, investigating the legitimacy of 121 487 emolument attachment orders amounting to nearly R71.5 million issued against its employees. As at January 2017, government had reduced the number of emolument attachment order deductions by 35 800 and identified 7 450 orders as irregular.[1]

Government is also exploring debt relief for over-indebted households through voluntary mediation. Proposals will be announced in the first half of 2017. Debt-relief measures should balance the need to support lower-income households with a stable banking system, and ensure that they do not encourage reckless borrowing and spending in future.

Financial-sector development

Postbank banking licence

Postbank's application for a full banking licence has been submitted to the Reserve Bank. The appropriate holding company structure, as well as the additional capital that may be required to give effect to this structure, is under discussion.

Agricultural insurance

With the effects of climate change increasing the frequency and intensity of agricultural losses, the National Treasury and the Department of Agriculture, Forestry and Fisheries are considering the feasibility of agricultural insurance to soften economic shocks and protect the poorest farmers, who are hit hardest by natural disasters. A pilot project is expected to begin in the third quarter of 2017.

Green investment

The National Treasury plans to release a study examining how and to what extent investors and lenders currently finance green investment in South Africa. The study will analyse gaps in financing and identify potential financial policy innovations that can be used to increase such investment.

Cooperative Banks Development Agency

Ensuring a more inclusive economy will require the right regulatory framework to encourage the emergence of new small banks. The work of the Cooperative Banks Development Agency will be reviewed in 2017/18. The National Treasury has increased the agency's funding by 19.7 per cent between 2016/17 and 2017/18. To support cooperative financial institutions, the Cooperative Banks Development Agency is putting in place a national banking platform with administrative and support capabilities, an information and communications technology system, and access to the national payment system. Expanding this

[1] Emolument attachment orders identified as having irregularities (such as incorrect jurisdictions used, excessive legal fees charged or excessive interest charged) are either stopped or amended accordingly.

support across the financial sector would benefit other emerging financial institutions, like stokvels and funeral parlours.

Supporting small business

Credit infrastructure needs to be improved to support access to funding for small and medium-sized enterprises. The National Treasury will explore how to improve available credit information, establish viable risk-sharing schemes and extend the asset classes that can practically be used as collateral.

Standardised transparent and comparable securitisation

Through the diversification of credit intermediation beyond banks, securitisation can reduce the systemic dependence on banks, and foster competition while increasing credit in the economy. However, securitisation must be carefully regulated to ensure that the associated risks are disclosed. Insufficient disclosure and oversight can lead to systematic risk mispricing. The National Treasury and the Reserve Bank will introduce new regulations to ensure standardised, transparent and comparable securitisations for investors. This enhanced disclosure will allow greater simplicity for investors, which will provide more credit in key areas like mortgages.

Microinsurance

The Insurance Bill (2016) will give effect to the National Treasury's microinsurance policy, establishing a clear regulatory framework to facilitate the provision and distribution of good value, low-cost insurance products that meet the needs of low-income consumers. This is in line with government's objectives to increase access to financial services for the poor and provide a supportive regulatory environment for the implementation of the Financial Sector Code.

Retirement reforms

Default regulations to improve market conduct

The second revised draft of the default regulations were released for public comment in December 2016. The aim of the default strategies (investment, preservation and annuities) is to ensure that the retirement savings of members are better protected through lower charges and provide better value for money, especially to members who do not exercise any choice. The default annuity strategy section has been considerably simplified, given the difficulty of automatically defaulting members into annuity products that could be irreversible. While concerns on the blanket ban of performance fees and guaranteed products have been addressed, these may be reviewed in the final regulations published later this year. Further steps to lower charges will follow.

Pension Funds Act amendment

In 2017, amendments to the Pension Funds Act (1956) will be considered to introduce the concept of an umbrella fund, and to clarify the extent, purpose and interpretation of the powers of the Registrar of Retirement Funds to deal with funds that do not have properly constituted boards. The National Treasury will also engage with the Financial Services Board to find a sustainable policy solution to the challenge of unclaimed benefits.

Annuitisation for provident fund members

The Revenue Laws Amendment Act (2016) postponed the annuitisation of retirement benefits for provident funds to 1 March 2018 to allow for further consultation with the National Economic Development and Labour Council (NEDLAC) and others on retirement reforms. Discussions in the council and with other interested parties will continue, with the aim of reaching consensus on the need to annuitise at retirement. Should no agreement on annuitisation be reached, government will review the continuation of the tax deduction for funds that do not annuitise part of their retirement savings, to ensure the tax system is equitable across all retirement funds. The National Treasury will engage with the industry to provide appropriate annuity products that take better account of the needs of low- and middle-income members of retirement funds.

Automatic enrolment in retirement funds

South Africa has a well-developed occupational pension system, but there is limited coverage and a large number of funds. In November 2016, government tabled a discussion paper on social security reform at NEDLAC. While NEDLAC engagement is expected to take some time to conclude, a parallel process is expected to consider more urgent retirement reforms that can be implemented. For example, government is considering automatic enrolment as a key and urgent initiative to ensure more workers save for their retirement. This initiative would encourage or require employers to automatically enrol their workers into a retirement fund, which could be sponsored by the employer or sourced from a third party.

Complementary structural reforms to stimulate investment

The low level of domestic savings is one of the factors constraining investment. Savings have declined from an average of 26 per cent of GDP in the 1980s to an average of 16 per cent per year since 1990. To boost investment, higher savings – particularly for households – are needed. Several reforms have been implemented, including tax-free savings accounts, but reforms to stimulate investment are also required.

Removing red tape for investing

Government has prioritised investment. A dedicated one-stop shop, Invest SA, assists investors with the procedures required to start up and run a business. It provides streamlined and coordinated access to various registration processes and official authorisations, and helps to cut through red-tape.

To ensure that South Africa does not fall behind other countries in investment reforms, government aims to put in place policies that seek to improve entry conditions, reduce restrictions and facilitate foreign investment. According to the Investment Policy Monitor, the country's highest number of obstacles relates to the entry of investors and the establishment of businesses.

Financial regulatory proposals

Increased competition in financial markets

In response to growing interest in smaller exchanges and electronic trading platforms that cater for niche markets, the Financial Services Board has awarded new stock exchange licences to two operators (4 Africa Exchange and ZAR X) to broaden competition and market participation.

Financial technology

In 2015, South Africa's financial technology (fintech) industry received 53 per cent of total investments in this sector across the continent. Fintech hubs established in Cape Town and Johannesburg have begun to attract investor interest and funding. The fintech industry caters for changing consumer demands, such as mobile payments, and can promote financial inclusion. A fintech regulatory framework will form part of the Conduct of Financial Institutions Bill in 2017. This framework could include a "regulatory sandbox", to encourage innovation within a controlled environment while managing any potential risks.

Modernising capital flow management

Capital account management

During 2017, the National Treasury will undertake a review of its capital flows management framework. South Africa's framework will be reviewed against best practice in other developing economies, including Columbia, Mexico and Turkey, and fast-growing markets such as South Korea.

Inward-listing review

Inward listings are listings by foreign entities on South African exchanges. The National Treasury will begin consulting with interested parties on new inward listings, loops and trusts. The intention is to discourage tax inversion, a practice where companies relocate their legal domicile to lower tax jurisdictions while retaining material assets and operations in the country.

Intellectual property

Government proposes that companies and individuals no longer need the Reserve Bank's approval for standard intellectual property transactions. It is also proposed that the "loop structure" restriction for all intellectual property transactions be lifted, provided they are at arms-length and at a fair market price. Loop structure restrictions prohibit residents from holding any South African asset indirectly through a non-resident entity.

Exchange-traded funds referencing foreign assets

Government proposes that local collective investment scheme management companies registered with the Financial Services Board and regulated under the Collective Investment Scheme Control Act (2002) be allowed to list exchange-traded funds referencing foreign assets on South African exchanges. These funds will not be subject to macroprudential limits on amounts that may be invested offshore. South African institutional investors and authorised dealers will be allowed to invest in such funds, subject to their respective macroprudential limits. These funds will be classified as foreign assets for prudential purposes. The Reserve Bank has released circulars on these policy measures.