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Financial sector update

This annexure provides an update on regulatory changes in the financial sector, including changes announced in the 2019 *Medium Term Budget Policy Statement* to promote investment and reduce burdensome regulation.

Fighting financial crime and corruption

South Africa's financial intelligence system is undergoing a mutual evaluation by an assessment team from the Financial Action Task Force (FATF). This review, which takes place regularly in all FATF member countries, evaluates national systems to prevent money laundering, terror financing and financing of the proliferation of weapons of mass destruction. The review will conclude in September 2020, at which time the review team will provide an evaluation and recommendations to the South African authorities.

Concurrently, government is preparing legislative and regulatory proposals to combat sophisticated financial crimes, unexplained wealth and suspicious financial flows. These may include expanding the scope of suspicious transaction reporting, facilitating greater cooperation and information sharing between relevant authorities, and expanding capacity in the areas of analysis, enforcement and investigation. These proposals will complement the recommendations emerging from the FATF review.

Simplifying cross-border trade and financial flows

In 2019, South Africa was one of 54 countries that signed up to an African free-trade area encompassing 1.2 billion people and more than US$3 trillion in output. African countries have agreed to cut tariffs to zero on 90 per cent of goods, which, alongside other trade-facilitating measures, is expected to increase intra-continental commerce by more than 50 per cent over four years, according to the United Nations Economic Commission for Africa. The free-trade area presents an opportunity to speed up development on the continent, and represents a potentially large market for South African goods and services.

In this context, the National Treasury proposes modernising the foreign-exchange system. Since 1933, South Africa has operated a "negative list" system. By default, foreign-currency transactions are prohibited, except for those listed in the *Currency and Exchanges Manual*. As a result, even small individual transactions – such as for travel – require onerous approval processes. This regime constrains trade and cross-border flows, particularly in relation to fast-growing African economies.

Over the next 12 months, a new capital flow management system will be put in place. All foreign-currency transactions will be allowed, except for a risk-based list of capital flow measures summarised in the box overleaf. This change will increase transparency, reduce burdensome and unnecessary administrative approvals, and promote certainty. The capital flow measures take account of the Organisation for Economic Co-operation and Development best-practice *Code of Liberalisation of Capital Movements*[1] and

[1] Available online at http://www.oecd.org/daf/inv/investment-policy/Code-capital-movements-EN.pdf

are aligned with similar approaches in other developing countries. The detailed list of remaining capital flow measures will be published on the Reserve Bank website.

Remaining capital flow and macroprudential measures

To ensure financial stability, some macroprudential and capital management measures will remain. These include:

- South African corporates will not be allowed to shift their primary domicile, except under exceptional circumstances approved by the Minister of Finance.
- Approval conditions granted by the Minister of Finance for corporates with a primary listing offshore, including dual-listed structures, will be aligned to the current foreign direct investment criteria and/or conditions to level the playing field.
- Cross-border foreign-exchange activities will continue to be conducted through dealers authorised and regulated by the Reserve Bank.
- Prudential limits on South African banks and institutional investors will remain, but the limits will be reviewed regularly.
- Banks' unhedged foreign-currency exposures will remain limited to 10 per cent of liabilities (known as the net open foreign exchange position) and will remain regulated by the Prudential Authority of the Reserve Bank.
- The domestic treasury management company policy, which allows South African companies to establish one subsidiary as a holding company for African and offshore operations without being subject to exchange control restrictions, will remain in place, as will the international headquarter company regime.
- The export of intellectual property for fair value to non-related parties will not be subject to approval.
- The current policy of certain loop structures, which relates to the acquisition by private individuals of equity and/or voting rights in a foreign company, will remain until tax amendments are implemented to address the risks.

The foreign-exchange treatment of individuals will be aligned to the tax treatment, which is discussed below and in Annexure C.

Tax and exchange control treatment of individuals

Following reforms to the income tax treatment of South African tax residents who receive remuneration outside the country, government proposes to remove the exchange control treatment for individuals, while strengthening the tax treatment. The intention is to allow individuals who work abroad more flexibility, provided funds are legitimately sourced and the individual is in good standing with the South African Revenue Service. Individuals who transfer more than R10 million offshore will be subjected to a more stringent verification process. Such transfers will also trigger a risk management test that will include certification of tax status and the source of funds, and assurance that the individual complies with anti-money laundering and countering terror financing requirements prescribed in the Financial Intelligence Centre Act (2001). This will be phased in by 1 March 2021.

Under the new system, natural person emigrants and natural person residents will be treated identically. Additional restrictions on emigrants – such as the restrictions on emigrants being allowed to invest, and the requirement to only operate blocked accounts, have bank accounts and borrow in South Africa – have been repealed. The concept of emigration as recognised by the Reserve Bank will be phased out, to be replaced by a verification process based on the requirements above. Tax residency for individuals will continue to be determined by the ordinarily resident and physically present tests as set out in the Income Tax Act (1962). Under existing international standards, South Africa participates in the automatic sharing of information between tax authorities on individuals' financial accounts and investments. These cooperative practices will remain in place to ensure that South African tax residents who have offshore income and investments pay the appropriate level of tax.

Other reforms

State bank

In 2019, Parliament passed legislation to allow state-owned companies to apply for banking licences. Postbank is in the process of applying for such a licence. The decision to grant a licence is ultimately the prerogative of the Prudential Authority, which will assess each applicant on its merits. The design of any state bank will protect the fiscus in the event of poor governance, non-performing loans or shortages in capital funding.

Sovereign wealth fund

The National Treasury is conducting a feasibility study for a sovereign wealth fund, possibly from the proceeds from the allocation of spectrum and the sale of non-core assets to capitalise such a fund. In addition, a fiscal rule that saves fiscal surpluses in the fund could help to manage volatile revenues.

Alignment with Basel Committee on Banking Supervision principles

In line with the Basel Committee on Banking Supervision's core principles on corporate governance, South Africa has strengthened the regulatory framework by enforcing stricter independence requirements for directors on bank boards. In 2019, government updated banking regulations relating to a securitisation framework, total loss-absorbing capacity holdings, capital requirements for equity investments in funds, capital requirements for bank exposures to central counterparties and the standardised approach for measuring counterparty credit-risk exposures. In addition, consultation with the banking industry has started on the *Fundamental Review of the Trading Book*, a comprehensive set of capital rules applied to a bank's wholesale trading activities. The economic effects of implementing these rules will be comprehensively assessed.

Third-party cell captive insurance

In December 2019, the Financial Sector Conduct Authority published a position paper[2] to address concerns about third-party cell captive insurance, in which insurance is provided through cells, rather than directly to a client. Improving its regulation and supervision will protect consumers by ensuring that a financial advisor can no longer earn commission and share in the profits of the cell captive arrangement.

Deposit insurance for financial institutions

Following extensive consultation, the Minister of Finance has submitted final legislation to introduce a comprehensive deposit insurance scheme that protects depositors when banks fail. This safety net will also support the growth of smaller banks. In addition, systemically significant payment systems, as defined in the National Payment System Act (1998), will be considered. The Corporation for Deposit Insurance, which will be located at the Reserve Bank, is being created to manage and administer the deposit insurance fund. Further details of the tax treatment of this fund are contained in Annexure C.

The Conduct of Financial Institutions Bill and retail distribution review

In 2018, the Conduct of Financial Institutions Bill was published for public consultation. Public workshops were held during 2019. Over 800 pages of comments were received, including feedback on governance requirements, retirement funds, payment services, financial markets and wholesale banking. A revised draft of the bill will be published for public comment and tabled in Parliament in 2020.

The Financial Sector Conduct Authority published an update of its retail distribution review in December 2019.[3] The report indicates significant progress in implementation, which establishes requirements for product sales and ongoing support to the consumer, and ends "sign-on" bonuses.

Financial markets legislation

In the context of rapidly evolving financial markets, South Africa needs to update its legislative and regulatory framework. An extensive review of the Financial Markets Act (2012) highlighted gaps in the

[2] Available at https://www.fsca.co.za/Regulatory%20Frameworks/Pages/Position%20Policy%20Papers.aspx
[3] Available at https://www.fsca.co.za/Regulatory%20Frameworks/Temp/RDR%20General%20Status%20Update%20December%202019.pdf

current framework and proposed changes. The National Treasury has consulted with market participants, the Prudential Authority and the Financial Sector Conduct Authority. A consultation paper will be published on the National Treasury website, and legislation will be drafted for public comment and tabled in Parliament by 2021.

The framework for regulating over-the-counter derivative markets has been finalised, in line with South Africa's commitment to the Group of Twenty. The final joint standard on margin requirements will take effect on 1 October 2020.

Levies

The Financial Sector Levies Bill, to be submitted to Parliament during 2020, will propose the collection of levies to ensure that the Prudential Authority, the Financial Sector Conduct Authority and ombuds are sufficiently resourced to carry out their duties and functions.

Transformation and financial inclusion

The Financial Sector Transformation Council has established eight subcommittees to review the targets in the Financial Sector Code to strengthen transformation of the financial sector. To date, the committees have developed targets for management control, skills development, socioeconomic development, consumer education and retirement funds.

A paper to establish a policy framework for financial inclusion in South Africa will be published for public comment in 2020.

Innovation hub

The Intergovernmental Fintech Working Group is introducing an online fintech portal with an innovation hub, which will clarify the applicability of financial services regulation and support the testing of new products and services.

Unclaimed benefits

Retirement funds and the Guardian's Fund are sometimes unable to trace beneficiaries, resulting in the money remaining unclaimed. The money is invested in government bonds and other instruments. These investments are being considered in the mobilisation of funding for infrastructure. Government will introduce legislation later this year to centralise such funds and establish a central registry of all members of retirement funds.

Retirement fund reform

Government and the National Economic Development and Labour Council have agreed to proceed with retirement reform related to the harmonisation of all retirement benefits, including provident funds. Government will take steps to ensure the development of annuity products more suitable for the low-income market. Further reforms will include improving oversight and governance of commercial umbrella funds, fund consolidation and auto-enrolment.