MINISTRY: FINANCE
REPUBLIC OF SOUTH AFRICA
Private Bag x115, Pretoria, 0001 • Tel: +27 12 323 8911• Fax: +27 12 323 3262
PO Box 29, Cape Town, 8000 • Tel: +27 21 464 6100 • Fax: +27 21 461 2934

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

JABU MOLEKETI (MP), DEPUTY MINISTER OF FINANCE
24 MAY 2007

Introduction

The past year has been very eventful in terms of developments in the financial sector. Many successes have been registered, while we have also been confronted with certain challenges which again highlight the need for vigilance.

My input today will cover financial sector regulatory imperatives, reform of the retirement fund industry, bulking and secret profits, surplus fund apportionment, banks amendment bill, co-operative banks bill, financial sector charter, special pensions and the 2010 FIFA World Cup.

Financial Sector Regulatory Imperatives

One of our most important national assets is our strong, sophisticated and sound financial sector. The developmental benefits of a strong financial sector are considerable. A sophisticated financial system allows for an efficient allocation of economic capital, it provides an absorber against economic shocks and, if properly aligned and channeled, can make a significant contribution to breaking the cycle of poverty by facilitating access to affordable and appropriate banking, insurance, savings and credit facilities.

South Africa has benefited from a financial sector characterized by efficiency, innovation and strong growth. Increasingly, as witnessed by the Financial Sector Charter, we are also seeing a financial sector that is embracing transformation and reforming business models to extend services to low-income communities and finance broad-based economic development. This, in turn, has contributed to stronger, shared and sustainable economic performance.

We have seen a shift in regulatory practice from a traditional focus on prudential standards to one that balances and complements this approach through improved consumer protection measures, such as specific market conduct regulation and increased vigilance relating to matters affecting overall financial stability.

But ultimately, confidence in the South African financial sector is built on a foundation of trust. The vast majority of financial service providers cherish and respect the licence that is granted to them, which places them in a position of trust to manage the monies of others.

However, Chairperson, recently we have witnessed various instances where financial service providers have flouted the trust placed in them. The allegations leveled in respect of Fidentia are extremely worrisome and exceptions of this nature must not be allowed to undermine public and investor confidence in the South African financial services system.

In the wake of this transgression, we are obligated to ask how these events could have been avoided and what can be done to arrest this transgression. At the outset Chairperson I would like to state that we must recognise that this was in part a failure of collective responsibility.

The financial sector as a whole is placed in a position of trust and must be held to the highest levels of accountability. It is in the interests of the financial sector as a whole that confidence in the sector is maintained. This, in turn, implies a collective commitment and responsibility for ensuring that we maintain our prescribed standards of transparency, accountability and equity. In practical terms, this means that a number of financial services providers should be asking themselves hard questions about whether they had done enough to avert the Fidentia episode from occurring.

There was also a clear failure of proper governance on the part of trustees in exercising their fiduciary duties, especially when considering the allocation and method of payment of death benefits to beneficiaries. Collective action must also be considered to provide income support to those widows and orphans who may be left destitute by the actions of a handful of unscrupulous individuals. We therefore remain a strong advocate for educating trustees to execute their fiduciary duties in a responsible manner.

Closing the regulatory gaps that allow unscrupulous providers to operate will require a co-ordinated response across regulators, together with increased capacity to enforce the law substantially. The licensing process introduced by the Financial Advisory and Intermediary Services (FIAS) Act and steps to increase the enforcement powers of the Financial Services Board (FSB) are first steps in this regard.

All regulators and agencies involved in the financial sector, including the FSB, FAIS Ombud, the Financial Intelligence Centre and the South African Revenue Service (SARS), have a collective responsibility to ratchet-up their enforcement efforts.

With this in mind, the Ministry of Finance will be convening a process with all financial regulators to jointly identify potential financial regulatory gaps and to improve the effectiveness of licensing, monitoring and enforcement.

Furthermore, the Financial Institutions Amendment Bill to be tabled in Parliament later this year will seek to strengthen the FSB through the formation of an Enforcement Committee with the powers to apply administrative penalties.

Reform of the Retirement Fund Industry

The retirement fund industry more broadly has come under the spotlight in recent years in terms of various concerns relating to unfair practices, poor governance and high costs. This is largely a legacy of non-disclosure, opaque products, inappropriate sales techniques and a lack of effective competition – all exacerbated by poor financial literacy.

To address some of the most pressing inequities and inadequacies in the current system, various legislative and regulatory measures have been put in place to advance Government's social security and retirement reform. These include:

- the December 2005 Statement of Intent committing the life assurers to compensate for past inequities;
- the March 2006 *Discussion paper on contractual savings in the life industry;* and
- the Pension Funds Amendment Bill currently before Parliament.

Furthermore, the FSB has also released a draft Code of Conduct for pension fund trustees.

In the longer-term, however, improving the quality of private pension fund provision in South Africa, in terms of lowering costs and improving equity, will require more far-reaching reforms. These include facilitating effective competition, achieving economies of scale, protecting the value of retirement benefits, especially for the member's dependants after the member's death.

These areas of retirement fund industry reform are covered in the National Treasury's *Social Security and Retirement Reform: Second Discussion Paper*, published in February 2007. More detailed proposals in a number of these areas are currently being finalised as part of the work of the Inter-Departmental Committee on Social Security and Retirement Reform.

Bulking and Secret Profits

The Registrar of Pensions is investigating the extent of bulking and secret profits in the industry. In a survey in March 2006 eleven administrators reported that they bulk their clients' funds, but that the enhanced interest rate is passed on to their clients and/or that the prior approval of trustees were obtained for any benefit accruing to the administrator from this practice.

A handful of administrators declared that they had derived some benefit by way of practices such as undisclosed scrip lending fees and commission sharing arrangements with brokers. These administrators submitted proposals on how to deal with the benefits that they derived from these practices. The Registrar is monitoring the position with regard to these administrators. It is the Registrar's intention to refer all the responses received from administrators who admitted to making a secret profit to the National Director of Public Prosecutions for further investigation. Administrative action such as the withdrawal or suspension of licences will be considered by the Registrar once the full investigation and monitoring process in respect of the administrators have been completed.

Surplus Fund Apportionment

As at 22 May 2007, 661 schemes for surplus apportionment have been received by the Registrar. Of these, 312 have been approved, while 347 are pending or not yet completed. As at the same date, 15 214 "nil" returns have been submitted to the Registrar. Of these 13 965 (92%) have been approved, 22 rejected and 1 227 are pending or not yet completed. The relatively large number of pending schemes is due to the fact that many funds submitted close to 31 December 2006, which was a crucial cut-off date for the submission of a scheme.

Banks Amendment Bill

A further piece of financial sector legislation currently before Parliament is the Banks Amendment Bill, which largely aims to bring the South African banking sector in line with international risk management and capital standards published by the International Basel Committee – known as Basel II standards.

In summary, the Basel II amendments aim to create a sufficiently robust regulatory environment that will enable the Registrar to properly discharge supervisory responsibilities in respect of banks, controlling companies and banking groups on a solo, cross-border or consolidated basis.

The implementation of Basel II capital adequacy standards is scheduled for implementation on 1 January 2008 and is expected to further strengthen the soundness of the South African banking sector and its international competitiveness.

Co-operative Banks Bill

The purpose of the Co-operative Banks Bill is to create a development strategy and a regulatory environment for deposit-taking financial services co-operatives such as village banks and savings and credit co-operatives. Co-operative banks are member-based, deposit-taking financial services co-operatives which offer basic banking services such as deposit-taking, savings and issuing of loans to their members.

The draft Co-operative Banks Bill came about as a result of extensive consultations with relevant sector stakeholders with the intention to promote access to basic affordable financial services to all South Africans particularly those excluded by formal financial institutions. The Bill will ensure the sound and safe management of depositor money by financial services co-operatives and promote the development and growth of such co-operatives.
The draft Co-operative Banks Bill has been approved by Cabinet and it is expected to be tabled in Parliament in June 2007.

Update on the Financial Sector Charter

The first reporting cycle of the Financial Sector Charter took place in 2005, which reviewed performance of the institutions towards reaching the Charter targets. The purpose of this initial review was to establish the transformation status of the industry and to assess progress in implementing the Charter. Performance is assessed in terms of comprehensive reports submitted by each participating financial institution and is recorded on a scorecard.

The second Financial Sector Charter report will be released in July 2007. Chairperson I am glad to report that the financial sector is making good progress with regard to reaching the 2008 targets although there are some challenges.

Progress on meeting the 5-year targets is as follows:

- In 2005 the financial sector had virtually achieved its R50 billion target for funding major BEE transactions, set to be achieved only in 2008, and surpassed its R5 billion 2008 target for financing black small and medium enterprises (SME's).
- Financial institutions have provided over R100 billion to targeted investments in support of SME's, low-income housing, resource-poor farmers and developmental infrastructure.
- The number of Mzansi bank accounts for the period up to November 2006 is estimated to be in excess of 3 million.
- Over 73% of the approximately R16 billion of the sectors procurement was from BEE accredited suppliers.

Special Pensions

The Special Pensions Act of 1996 made provision for those persons who served the liberation struggle on a full-time basis for a period of 5 years and were therefore unable to provide for a pension. After ten years, 31 December 2006 marked the closing date for new applications under this Act. In terms of the Act, the Board and Review Board will be dissolved and any further adjudication and administration of benefits will become the direct responsibility of the National Treasury. We will ensure that adequate capacity is put in place to enable the speedy processing of the remaining applications.

During the last ten years we have paid R2.1 billion in benefits to approximately 16 500 beneficiaries. On a monthly basis the State pays an average of R23 million in pensions.

There are admittedly those who have served in the struggle who have not met **<u>all</u>** the criteria prescribed in the Act. We have received numerous submissions from affected parties which are currently under consideration. Resolutions have been passed in the National Assembly and we need to ensure that they are acted upon. Most pressing, in this regard, is the need to step up our commitment in training and skills development initiatives to assist younger men and women to take adequate advantage of opportunities associated with broad-based economic growth.

Chairperson it is unfortunate that fraudulent claims have been submitted to the Special Pensions Board in some instances. We will not allow the memories of our fallen heroes and heroines to be tarnished by such individuals. To this end we have requested the Special Investigating Unit to verify all applications. This is not a witch hunt. Those who truly served have nothing to fear. Instead it should be viewed as an integral part of Government's overall commitment to root out fraud and corruption.

2010 World Cup Soccer

Chairperson the awarding of the right to host the 2010 FIFA World Cup to South Africa was a great achievement in itself and the recently concluded 2006 FIFA World Cup held in Germany has proven that a well packaged and managed event can ensure immeasurable development in South Africa.

The hosting of the 2010 FIFA World Cup provides enormous opportunities to upgrade our sporting facilities and infrastructure and also to market the country to the rest of the world as a destination for investment, sport and leisure.

Government has set aside R17.4 billion direct investment in the 2010 FIFA World Cup which is integrated into a much larger spending programme between 2006 and 2010. During this period, the Government will be investing more than R415 billion in infrastructure. The 2010 FIFA World Cup investment is approximately 5 per cent of the R415 billion programme, although its significance as a catalyst for improved planning and infrastructure development extends well beyond these numbers.

The resources allocated to 2010 FIFA World Cup projects are significant and escalation of costs is an issue that must be addressed. A unit within the National Treasury has implemented checks and cost controls to track the escalation in costs of stadia and other infrastructure projects.

We are confident that construction of all stadia will be completed within the specified timelines. In some cases we are ahead of schedule and anticipate that R1.9 billion will have to be brought forward in the Adjustments Estimates Budget in October 2007, raising the expenditure in 2007/08 from R2.7 billion specified in February 2007 to an estimated R4.6 billion. All stadium facilitates will be ready by October 2009 to allow for the identification and allocation of seats and issuing of tickets.

Conclusion

In conclusion honourable Chairperson we need to be mindful of the wide-ranging reforms of our financial sector and social security arrangements that are currently underway. We have achieved far-reaching reforms to date, but it is clear that there is still room for improvement in tightening the monitoring and compliance framework, so as to protect the hard-won confidence in our financial system.

We will push ahead to process and finalise the new applications for Special Pensions in a timely manner to ensure that those who meet the criteria, or their dependents, receive the benefits due to them in this regard.

South Africa will take full advantage of the 2010 FIFA World Cup opportunity to attract inward investment and, new investment in stadia, transport, airports, communications, accommodation, broadcast & information technology and financial services. The 2010 FIFA World Cup projects will stimulate skills development and create the much needed jobs, develop football and its commercial base, and upgrade facilities to ensure South Africa is a competitive destination for major events.

In concluding, I would also like to thank the Minister of Finance for his stewardship in managing the Treasury, SARS and Stats SA, and to the management teams for maintaining the high standards of efficiency and competency.

I am proud to be part of this team.