MINISTRY OF FINANCE
REPUBLIC OF SOUTH AFRICA

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SPEECH BY DEPUTY MINISTER OF FINANCE

THE ANNUAL NEDGROUP INVESTMENTS TREASURERS' CONFERENCE
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Good morning, ladies and gentlemen,

It gives me great pleasure to join you today for this annual Newgroups Investments Treasurers' Conference.

It is an honour to deliver the opening keynote address to this influential Treasurer grouping.

The money market industry
As I read through the conference program, I realized that this is a conference of influential investment professionals, with a footprint in the money market industry. This is one of the most important subsectors of the wider money management industry.

The money market industry provides liquidity to various sectors of our economy, thus facilitating economic activities and investment opportunities.

According to ASISA, the assets under management in local money market funds, exceeded R400BN, as of 30 June 2024. This translates to approximately 6% of South Africa's nominal GDP of R6.7 trillion. This signifies the importance of this sector and the broader asset management industry.

The coming into effect of the two-pot system from 1 September 2024 will certainly trigger liquidity pressures on the investment portfolio. Unlike long-term illiquid investments, we expect the money market industry to play a role in providing liquidity to meet redemptions.

During rising global risk and market uncertainty, business models and solutions that deliver capital preservation and liquidity outcomes for investors are encouraged and desirable.

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I am indeed delighted to be interacting with investment professionals who are working with the government, regulatory authorities, and clients to promote the stability and liquidity of our financial system. This important work should continue, as we strive to make South Africa the preferred investment destination.

While we recognize the short-term investment horizon of money market funds, we continue to invite the investment management industry to consider infrastructure asset classes that meet the investment mandates of clients.

Research is also now showing that Environment, Social, and Governance (ESG), and Impact Investing can provide better returns than standard investments if done properly and carefully.

The key function of entities like banks and institutional investors like retirement funds, insurance companies, and asset managers is to receive savings from households and corporates. Savings are the most important source of investible funds in any economy. Empirical studies have shown a direct correlation between the two.

This makes sense because institutions that receive savings should pay some rate of return to savers and for that reason, they must invest these savings. The challenge is how to encourage these savings to go into the real economy in the form of start-ups, renewable energy, broad infrastructure, and industrialization, instead of being concentrated in listed securities like companies listed on the JSE.

There are pros and cons of investing in listed companies, as listings provide price discovery, liquidity, and transparency, but investments might not always feed into the real economy in the form of funding new and more risky companies or major projects.

The unlisted space, which has grown recently in the form of peer-to-peer lending and private equity, as examples, by nature tends to invest more directly into the real economy by funding new types of business and projects that are consistent with ESG and Impact investing.

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It is important therefore for retirement funds, including asset managers, to rethink how they have done business in the past, and see how they can assist the economy and society in achieving the right levels of growth and development.

Investments are arguably the most powerful channel to grow any economy, particularly an emerging economy like South Africa. Investments are about building and improving infrastructure like roads, renewable and green energy, telecommunications, and industrialization.

South Africa is a country with low household savings rates, hovering around zero percent as a percentage of GDP in the last couple of years. With low domestic savings, and or when available savings is not channelled towards assisting the economy in its quest for increase in infrastructure investment, South Africa must rely excessively on international investors. This has its challenges in the form of volatile currencies and decisions of rating agencies. However, in the absence of sufficient domestic savings (and growing fiscal deficit), the country has limited options but to borrow from abroad.

But this can also be reversed if South Africans were to take savings more seriously, which would include not accessing their retirement savings when changing jobs; and saving for income shocks, like what Covid-19 had presented to us.

Economic Growth and Structural Reforms

It is our view that investment in our country's infrastructure and industrialisation will boost the productive capacity of the economy, thus providing a bedrock for sustainable economic growth and development.

To accelerate economic growth, we have been undertaking structural reforms through Operation Vulindlela to make the South African economy competitive by, amongst others, reducing the cost of doing business in South Africa.

We have been working hard to reduce the cost of energy, telecommunication, and freight logistics and make it easy to source skilled labour through VISA reforms.

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The logic of these reforms is straightforward. Greater efficiency in energy and logistics decreases the cost of doing business, which enables local production to expand and jobs to be created.

Higher production and exports, as well as the additional jobs created, in turn, increase consumer spending and boost our tax revenues. As confidence in the economy grows, so does investment, creating jobs and supporting demand – a virtuous cycle that leads to higher growth on a sustained basis.

As households and businesses generate more income, they will also save in different asset classes, including money market instruments.

We continue to invite the private sector, in particular, money managers to partner with the government in mobilizing capital towards growth-enhancing and bankable projects that offer real returns for asset owners.

The best example of how we can work together to finance infrastructure on sound commercial terms is the Water Partnership Office (WPO) under the Water Affairs housed at DBSA. Through the WPO, municipalities can partner with funders to finance water maintenance, including leaks.

In addition, the liberalization of the energy sector has led to a new need for transmission infrastructure. Transmission infrastructure is emerging as a significant bottleneck to the ability of the grid to incorporate additional renewable energy generation into the country’s energy supply.

The investment community can play a crucial role in this space at the back of the reforms that the National Treasury is championing to crowd in the private sector in the funding framework for the grid. The two prominent initiatives are the introduction of an Independent Power Transmission model and the establishment of a Credit Guarantee Vehicle to derisk projects.

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Retirement Funds and Regulation 28
Retirement funds, as asset owners and through trustees, have the power to influence how savings are channeled and invested.

There is no government intention to interfere with the investment mandates and discretionary powers of the investment managers. Money owners must provide mandates to money managers, who must in turn generate good returns for clients and positively impact the socio-economic transformation.

The government respects the investment mandates of pension plans, the fiduciary duties of trustees, and their desire to maximize portfolio returns within acceptable risk tolerance levels.

Workers are represented by pension fund trustees, therefore they can mandate trustees to invest more in infrastructure. This should not be at the detriment of members if done correctly through proper due diligence, it could enhance member returns, enabling also retirees to retire in a stable society with good infrastructure.

Regulatory instruments such as Regulation 28 provide prudential guidelines and an enabling framework to facilitate investments in infrastructure that complement the long-term investment horizons of retirement funds.

The retirement funds, already hold about 62% of government bonds. The support of alternative clean energy shows that retirement funds are keen to invest in projects where they can earn a fair return, where projects are well managed, where products and services are provided affordably and competitively, where management is competent and accountable, and where there is no corruption.

What the Minister of Finance may announce in October 2024 during the Medium-Term Budget Policy Statement (MTBPS or 2025/6 Budget, may make the calls for the asset prescription less necessary.

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But before anyone can decide on asset prescription, they will have to determine the percentage of retirement funds' assets to be allocated to certain government-approved instruments. What will these instruments be? Who will issue such instruments? Will they be a sovereign, provincial, municipal, bonds, bills, or IOUs? Will the prescription be a one-off or a permanent feature requiring retirement funds investment? What will be the duration of the prescribed instruments, short, medium, or long term?

The potential problem with prescription is that recipients of the prescribed funds may be incentivized not to manage the entities e.g. SOEs, municipalities, etc. effectively and efficiently as they would be guaranteed to get funds regardless of how they are managed. If these entities were to continue to be ineffective and inefficient they would be boosted by prescription in the short-term but would fail in the medium to the long term and fail to give any return and fail to repay the retirement funds which will in turn lead to the failure of the retirement funds.

Poorly performing projects and organizations will receive capital that they would not have received if retirement funds managers evaluated them in terms of good business principles, thus rewarding their poor performance and providing no real incentive to improve.

If the prescribed investments offer below-market returns, this will reduce the ability of retirement funds to meet their liabilities and the ability to pay benefits in the medium to long term.

The sponsors of defined benefit funds, i.e. companies in the case of private funds and the government in the case of the GEPF will have to increase their contributions. For defined contribution funds, the accumulation of member accounts will be reduced leading to smaller lump sums at the time of benefit claims.

As retirement funds are voluntary, new retirement funds may not be established exposing workers to not having retirement benefits. Existing retirement funds may scale down their benefits, offering or closing down over time exposing workers to reduced retirement benefits.

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Overall capital markets operations, effectiveness, and efficiency would decline, both the intermediation of the listed equities and the bond market, with share prices declining the yield curve being distorted and transaction costs of all debt increasing.

Foreign investor confidence in the efficiency of South African capital markets would be undermined, further reducing the available savings pool.

FATF and the Business Operating Environment
Businesses are not only constrained by logistics but are subjected to greater scrutiny in their domestic and international transactions due to South Africa's greylisting by the Financial Action Task Force (FATF) in February 2023.

Some jurisdictions like the EU and UK have already taken unilateral steps requiring enhanced due diligence over transactions with grey-listed countries like South Africa.
The European Commission designated South Africa as a high-risk, third country on 6 July 2023.

South Africa has until January/February 2025 to address the 14 outstanding items identified by FATFF.

The need to address the action items is also consistent with the national strategy on AML/CFT which was adopted by Cabinet in November 2022 and will help strengthen the fight against financial crimes in the country and assist in preserving the integrity of the country's financial system.

Conclusion
In conclusion, the South African government recognizes that it has a huge financing gap for its infrastructure portfolio and industrialisation.

We need to find the right incentives and structures to encourage investment in infrastructure, industrial and economic growth.

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We need to work together on project preparations to determine how to structure commercially viable projects.

Regarding the FATF Grey List, the National Treasury notes that whilst South Africa is on track to address all the outstanding Action Items, it remains a tough challenge to address all 14 of the remaining Action Items by February 2025.

However, all relevant agencies and authorities will need to continue to demonstrate significant improvements, and that such improvements are being sustained and are effective.

Thank you!