# Finance

SOUTH AFRICA
YEARBOOK
2011/12

The South African economy has averaged about 3% growth a year since 2009. Against the background of the slowdown in the global economy, real gross domestic product (GDP) growth is expected to fall to about 2,7% in 2012.

In the Budget Speech in February 2012, the Minister of Finance, Mr Pravin Gordhan, announced that government expected a recovery to 3,6% and 4,2% growth in 2013 and 2014. The deficit on the current account of the balance of payments is expected to widen from 3,3% in 2011 to 4,4% GDP in 2014.

National Treasury aims to promote economic development, good governance, social progress and rising living standards through accountable, economic, efficient, equitable and sustainable management of South Africa's public finances.

The department endeavours to advance economic growth, Broad-Based Black Economic Empowerment (BBBEE), progressive realisation of human rights and the elimination of poverty. It is responsible for preparing a sound and sustainable national budget and equitable division of resources among the three spheres of government. It strives to raise fiscal resources equitably and efficiently and manage government's financial assets and liabilities, promoting transparency and effective financial management.

The Constitution stipulates a framework for the division of responsibilities between national, provincial and local government. It prescribes an equitable division of revenue between the spheres of government, taking into account their respective functions.

It has also created an independent Auditor-General of South Africa (AGSA) and an independent central bank, the South African Reserve Bank (SARB), and sets out the principles governing financial accountability to Parliament, as well as the annual budget process.

## Financial expenditure

National Treasury plays a pivotal role in managing government expenditure.

It determines financial-management norms and standards, and sets reporting policy that guides the AGSA's performance. It also assists Parliament, through the Standing Committee on Public Accounts, with its recommendations and the formulation of corrective actions. National Treasury closely monitors the performance of national departments and is obliged to report any deviations to the AGSA.

The department maintains transparent and fair bidding processes, as well as accounting, logistic and personnel systems. It sets and maintains standards and norms for treasury and logistics, acts as a banker for national departments and oversees logistical control of stocks and assets.

National Treasury draws its mandate from Chapter Two of the Public Finance Management Act (PFMA), 1999 (Act 1 of 1999), based on Chapter 13 of the Constitution. It is mandated to:

- coordinate macroeconomic policy
- promote government's fiscal policy framework
- manage the budget preparation process
- coordinate intergovernmental financial relations
- facilitate the Division of Revenue Act, 2009 (Act 12 of 2009), which provides for equitable distribution of nationally raised revenue between national, provincial and local government
- monitor the implementation of provincial budgets
- create an enabling regulatory environment for the financial sector
- defend the integrity of the financial system
- ensure efficient and effective revenue collection
- oversee the programmes of development finance institutions (DFIs).

## Fiscal policy framework

Government's fiscal policy seeks to support structural reform of the South African economy consistent with long-run growth, employment creation and equitable distribution of income.

Fiscal policy seeks to:

- present a fuller picture of government finances and the effects of policy decisions
- ensure a sound and sustainable balance between government's spending, tax and borrowing requirements
- improve domestic savings to support a higher level of investment and reduce the need to borrow abroad
- keep government consumption spending at an affordable level
- contribute to lower inflation and a sustainable balance of payments
- support an export-friendly trade and industrial strategy to improve South Africa's competitiveness.

Owing to the changed economic outlook in 2008/09, the fiscal stance has become more expansionary. This enables government to con-

South Africa has improved its ranking and remains the highest-ranked African country in sub-Saharan Africa on the World Economic Forum's global competitiveness scale, released in September 2011.

The country moved up to number 50 on the list, and is also the second-highest ranked of the BRICS countries (Brazil, Russia, India, China and South Africa).

South Africa especially benefited from its economy – it ranked 25th in market size.

It also ranked fourth in financial market development, which was "particularly impressive" and showed "high confidence in South Africa's financial markets at a time when trust is returning only slowly in many other parts of the world," according to the *Global Competitiveness Report 2011 – 2012.*

tinue financing its priorities and support aggregate demand during the cyclical decline in revenue, supporting sustainable economic growth and social development.

Lower revenue and higher expenditure have resulted in an increase in the budget deficit, which will need to be financed. To ensure that a growing debt burden will not crowd out spending on developmental priorities, government will stabilise growth in interest costs through a careful and controlled reduction of the deficit.

The deficit will therefore be reduced to a sustainable level in a countercyclical manner.

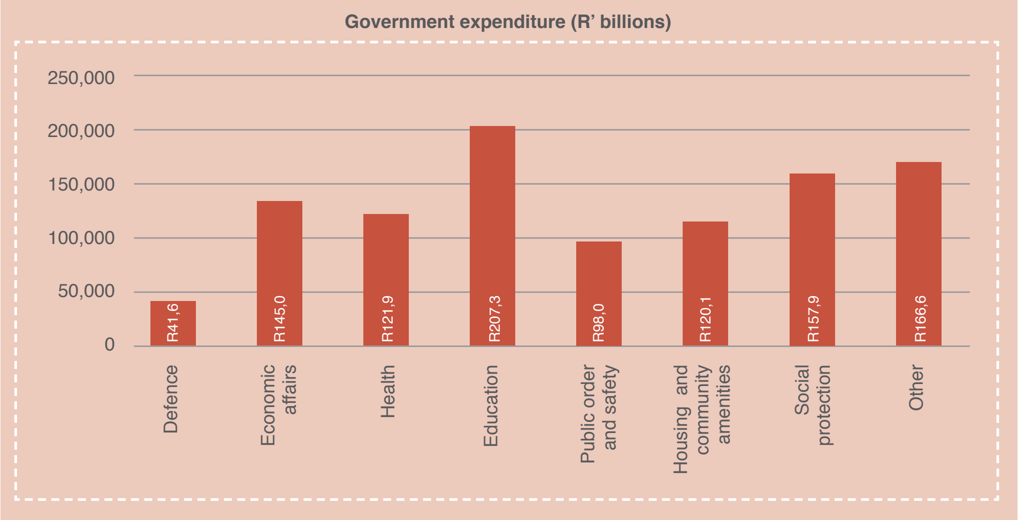
Growth in spending in the current context will stimulate economic growth and maintain spending on public services at a time when businesses and households require fiscal support the most.

## Economy and fiscal stance

Minister Gordhan presented the 2011/12 Budget in February 2011. It outlined several aspects of government's New Growth Path for South Africa:

- a concerted effort to reduce unemployment among young people
- support for labour-intensive industries through industrial policy interventions, skills development, public-employment programmes and a rural development strategy
- sustaining high levels of public and private investment and raising the savings level
- improving the performance and effectiveness of the State, especially the provision of quality education and training at all levels
- reforms to increase inclusion and participation in the labour market, alongside efforts to improve competition in product markets
- keeping inflation low, striving for a stable and competitive exchange rate and providing a buffer against global volatility
- raising productivity and competitiveness, opening up the economy to investment and trade opportunities that can boost exports.

The focus of the 2012/13 Budget, announced in February 2012, was on government's infrastructure development programme. It aims to grow the economy, create jobs and improve people's lives through massive investment in infrastructure. The State has chosen five major programmes for infrastructure development:




Source: National Treasury, *People's Guide to the Budget, 2012*

- Geographically strategic projects such as:
  - The development and integration of rail, road and water infrastructure around the Waterberg and Steelpoort areas in Limpopo to unlock the enormous mineral belt of coal, platinum, palladium, chrome and other minerals. Rail transport in Mpumalanga will be expanded, connecting coalfields to power stations. Parts of the North West will also benefit from the greater focus on infrastructure.
  - Improving the movement of goods and economic integration through a Durban-Free State-Gauteng logistics and industrial corridor. Transnet has developed the Market Demand Strategy, which entails an investment over the next seven years of R300 billion in capital projects. There are various improvements to the Durban-Gauteng Rail Corridor and the phased development of a new 16-million ton a year manganese export channel through the Port of Ngqura in Nelson Mandela Bay.
  - The development of a major new South Eastern node that will improve the industrial and agricultural development and export capacity of the Eastern Cape.
  - Expansion of water, roads, rail and electricity infrastructure in the North West. Ten priority roads will be upgraded.
  - Expansion of the iron-ore rail line between Sishen in Northern Cape and Saldanha Bay in the Western Cape, which will create large numbers of jobs and industrial activity in both provinces.
- Critical social infrastructure projects that will lay the basis for the National Health Insurance (NHI) system, such as the refurbishment of hospitals and nurses' homes.
- Building new universities in Mpumalanga and the Northern Cape. Some R300 million has been allocated for the preparatory work towards these facilities.
- South Africa's bid to host the Square Kilometre Array radio telescope in partnership with eight other African countries.
- The North-South Road and Rail Corridor, which South Africa champions and which is part of the African Union's New Partnership for Africa's Development Presidential Infrastructure Championing initiative.

## Macroeconomic strategy

The South African economy has demonstrated resilience in this environment. While global developments are likely to hold back higher growth over the short term, the domestic outlook remains positive. GDP growth is expected to slow from 3,1% in 2011 to 2,7% in 2012. As the world economy strengthens, GDP growth will accelerate to 3,6% in 2013 and 4,2% in 2014, led by robust household consumption, and stronger public- and private-sector investment.

Government will focus on capital investment in infrastructure projects and reduce the cost of doing business through targeted interventions, including lowering port charges and broadband costs.

Strengths in the domestic economy will help to sustain growth. Household spending remains robust, private-sector investment is gradually rising and interest rates are low.

There are encouraging signs of employment growth in the formal sector, with a net increase of 365 000 jobs reported over 2011/12.

South Africa's banks are well-capitalised. High levels of corporate saving are expected to enable increased investment spending as global uncertainty eases and business confidence strengthens.

Fiscal and monetary policies remain supportive of growth. Government will continue to monitor and adjust policy to changes in the domestic and global environment, while stabilising public debt at sustainable levels.

To reduce unemployment and poverty on a mass scale, the economy needs more rapid and broad-based growth. This requires policy reforms and actions by business and labour to reduce the cost of doing business, cut red tape, raise productivity, diversify exports, tap new markets for trade and take advantage of opportunities presented by enhanced regional integration.

Over the medium term and beyond, large-scale public-sector infrastructure investments will expand the capacity of the economy to grow more rapidly. Government is also implementing an economic support package to boost productivity, competitiveness, and research and development across the agriculture, mining, manufacturing and technology sectors.

Since the onset of the global financial crisis in 2008, the State has played a more prominent role in the economy. Sustained spending growth through the 2009 recession supported demand and allowed the public sector to serve as a key source of employment. More rapid and sustainable growth and job creation are reliant on increased private-sector activity. Government will play a supportive role over the medium term by providing high-quality, efficient and affordable network infrastructure, and creating a more favourable environment for business expansion and investment.

## Revenue trends and tax proposals

The 2012 tax proposals support a sustainable fiscal framework over the medium term, while facilitating economic growth and a more competitive economy. Reforms will improve the fairness of the tax system, ensuring that income from capital is taxed more appropriately.

Measures are proposed to encourage household savings. Financing options for the NHI as part of a strengthened public health system will be explored.

Meeting South Africa's development challenges requires sufficient revenue to fund key expenditure priorities, while ensuring that public debt and debt-service costs are contained, and avoiding overburdening taxpayers. Government is taking steps to improve the efficiency of public expenditure and root out corruption.

The revised estimated tax revenue for 2011/12 was R738,7 billion, R10,1 billion higher than the estimate at the time of the 2011 Medium Term Budget Policy Statement. This increase is mainly the result of higher corporate income-tax collections. The estimated gross tax revenue for the fiscal year 2012/13 is R826,4 billion, a nominal increase of 11,9%.

Audited results show that tax revenue for 2010/11 of R674,2 billion was R75,5 billion or 12,6% higher than actual tax revenue collected in 2009/10. Higher customs duties (36,1% higher than in 2009/10), value-added tax (VAT) (24,1%) and personal income tax (PIT) (10,6%) accounted for this increase.

The revised tax revenue estimate for 2011/12 of R738,7 billion is R64,6 billion or 9,6% higher than in 2010/11. This is the result of strong collections of customs duties (21,1%), corporate income tax (CIT) (14,4%) and PIT (10%).

The main tax proposals for 2012 include:

- personal income tax relief of R9,5 billion
- relief for micro and small businesses
- implementing the dividend withholding tax at 15%
- an increase in effective capital gains tax (CGT) rates
- reforms to the tax treatment of contributions to retirement savings
- further reforms of the tax treatment of medical-scheme contributions
- higher taxes on alcohol and tobacco products.

## Spending on public services

Poverty alleviation is at the heart of government's agenda. The social assistance programme is South Africa's most direct means of combating poverty. In 2012/13, R104,9 billion is allocated to social assistance, rising to R122,0 billion in 2014/15. The number of grant recipients will rise from about 15,6 million in 2011/12 to 16,1 million in 2012/13 and is set to rise to 16,8 million in 2014/15.

The Department of Social Development receives an additional R1,4 billion over the next three years, mainly to increase access to Early Childhood Development from 500 000 to 580 000 and to roll out an in-house and community-based childcare and protection programme, Isibindi.

The Isibindi Project will benefit 858 000 children and adolescents, with a focus on rural communities, orphans and child-headed households. About 10 000 youth workers will be employed in this programme.

The health sector is allocated an additional R2,8 billion over the next three years. Of this:

- The NHI Grant will be introduced in 2012/13, totalling R1 billion over the next three years. The grant will fund pilot projects for NHI and the increase in primary health visits.
- R450 million has been provided for the upgrading of approximately 30 nursing colleges.
- A further R426 million is allocated for the revitalisation of hospital infrastructure.

An additional R968 million is made available to accommodate provision of antiretroviral (ARV)

> In March 2011, South Africa's budgeting system was rated the most transparent in the world following the results of the International Budget Partnership's *Open Budget Survey 2010*.
>
> The study evaluates whether central governments give the public access to budget information and opportunities to participate in the budget process. The survey involved 94 countries and takes place every two years.

treatment at the CD4 threshold of 350. This will increase the number of ARV recipients from 1,5 million in 2011 to about three million by 2014/15.

Government spends more on education than any other non-interest item in the country's budget.

The 2012 Budget supports the goal of improving the quality of education at all levels, and reducing the skills shortages in the economy.

Over the next three years:

- the National Student Financial Aid Scheme receives R17,1 billion for loans and bursaries to improve poor students' access to universities and colleges
- a further R850 million is allocated to improve university infrastructure, including student accommodation.

Government plans to raise university enrolments to 962 000 by 2014/15 from 886 000 in 2011/12.

Enrolments in Further Education and Training colleges are expected to increase to 247 000 in 2014/15 from 211 000 in 2011/12. Adult education and training enrolments are expected to increase to 300 000 in 2014/15 from 215 000 in 2011/12.

To improve Literacy and Numeracy, an additional R235 million is allocated to the Department of Basic Education to extend assessments to Grade Nine and to strengthen the assessments at grades three and six. Learner and teacher workbooks in Literacy and Numeracy will be provided to all Grade One to Nine learners from 2012.

Other spending plans over the next three years include:

- R9,5 billion for the Economic Competitiveness and Support Package, including R2,3 billion for dedicated special economic zones
- R6,2 billion for job creation
- R3 billion for equalisation of subsidies to no-fee schools and expansion of access to Grade R
- R1 billion for the NHI Pilot Project
- R4 billion for the Passenger Rail Agency of South Africa for coaches, as the start of a programme to replace the current fleet
- R1 billion for signalling and depot infrastructure related to this new rail transport programme
- R4,7 billion for the electricity demand-side management grant: Eskom for the installation of solar water geysers
- R1,8 billion for municipal water infrastructure
- R3,9 billion for upgrading informal settlements.

## Debt management

South Africa's countercyclical response to the global economic crisis generated a significant national government borrowing requirement, which peaked at 6,8% of GDP in 2009/10. However, sound economic and fiscal policies, deep and liquid domestic capital markets, and the availability of international funding enabled government to finance the 2010/11 budget deficit for less than originally projected.

As a result, debt-service costs for 2010/11 were R4,8 billion lower than expected. Lower debt-service costs create more space to fund investment in economic infrastructure, which creates jobs, and to increase spending on social priorities such as education and health. While the gap between expenditure and revenue is projected to narrow in line with the economic recovery, national government borrowing in 2011 remained substantial at 5,4% of GDP, declining to 4,2% of GDP in 2013/14. Debt-service costs are expected to increase gradually to 2,9% of GDP in 2013/14.

## Treasury norms and standards

In terms of Section 216(1)(c) of the Constitution, National Treasury must prescribe measures to ensure both transparency and expenditure control in each sphere of government, by introducing uniform treasury norms and standards.

These aim at deregulating financial controls by granting spending agencies' accounting officers more autonomy in financial decision-making within the ambit of impending financial legislation.

## Budget evaluation

National Treasury plays an important role in supporting the economic policy to which government has committed itself. It determines the macrolimit on expenditure, which is then matched with requests from departments, in line with the affordability and sustainability of services.

Based on this limit, all national departments are requested to submit budget proposals annually to National Treasury for the following financial year.

## Budget Council

The Budget Council comprises the Minister of Finance and the nine provincial members of the executive councils responsible for finance.

The Budget Forum extends the Budget Council to include representatives of organised local government. These forums ensure cohesion between national policy priorities, the division of nationally raised revenues, and planning and budgeting in provincial and local spheres of government.

The forums also allow the leadership of the three spheres of government to evaluate government's execution of key national programmes and, where necessary, to agree on support initiatives that will ensure the attainment of national goals.

## Early Warning System

The Early Warning System was established in 1997. Any likely under- or overexpenditure is brought to the attention of Cabinet, so that the relevant Minister can ensure that appropriate action is taken.

The system assists in monitoring provincial departments' expenditure trends monthly, by having provincial treasuries report to National Treasury in a prescribed format. The information derived from early warning reports is used for advising the Minister of Finance, the Budget Council and Cabinet.

## Financial systems

National Treasury is responsible for the development, maintenance and support of financial management systems (Basic Accounting System or Bas, Persal, Logis and Vulindlela) that support:

- payment of government employees' salaries and service-providers
- financial reporting and management for government departments.

In 2005, Cabinet approved the development of the Integrated Financial Management System (IFMS). Two modules of the IFMS were put into use during 2010/11:

- the Asset Management Module was implemented at National Treasury and four Limpopo provincial departments
- the Human Resource Management Module was implemented in the Department of Public Service and Administration.

It was envisaged that the Procurement Management Module would be implemented during 2011/12 at National Treasury and the Department of Defence.

Other modules of the IFMS were envisaged to be completed by the end of 2011/12.

## Supply Chain Management (SCM)

SCM is an integral part of financial management. The SCM Framework, issued in terms of Section 76 of the PFMA, 1999, replaced outdated procurement and provisioning systems in government.

The Preferential Procurement Policy Framework Act (PPPFA), 2000 (Act 5 of 2000), and its related regulations are being aligned with the aims and strategies of the BBBEE Act, 2003 (Act 53 of 2003).

A phased approach is envisaged. The first phase will be alignment through the amendment of the current preferential procurement regulations as an interim measure.

The second phase will be the comprehensive review of primary procurement, namely the PPPFA, 1999. The current Act prescribes that tenders must be evaluated on a preference point system where 80 or 90 points are allocated for the price of the lowest acceptable tenderer, and a maximum of 10 or 20 points are allocated for ownership by historically disadvantaged individuals and for promoting specified Reconstruction and Development Programme goals. Cabinet has approved for promulgation, subject to legal refinement, the draft revised preferential procurement regulations, aligning the preferential procurement policy with the aims of the BBBEE Act, 2003.

Once promulgated, tenders will be evaluated in terms of the generic BEE Scorecard and where sectoral charters exist, evaluation will be done in terms of them. It is also proposed that local content be considered as an important element of the evaluation criteria.

During the Budget Speech in February 2012, Minister Gordhan announced that National Treasury would take the following steps to improve government's procurement capability:

- government will strengthen fragmentation in the system and strengthen the national procurement architecture
- National Treasury will appoint a chief procurement officer who will have overall responsibility for monitoring procurement across government
- it will review the competencies and capabilities required to perform the procurement function and there will be strict vetting of all the procurement officers to be appointed
- National Treasury plans to develop a national price reference system, to detect deviations from acceptable prices
- the tax clearance system will be strengthened to ensure that those who have defrauded the State cannot do business with the State

- steps will also be taken to improve the ability of departments to set bid specifications.

## Legislation

### Public Finance Management Act, 1999

Transforming public-sector financial management is one of National Treasury's key objectives. To this end, National Treasury has been implementing the PFMA, 1999 since 1 April 2000.

The Act changed the approach to the way in which public funds are managed by introducing a less rigid environment for financial management, with a stronger emphasis on the prudent use of state resources, improved reporting requirements and the use of management information to enhance accountability.

Since its introduction, the PFMA, 1999 has contributed towards measurable improvements in financial management in both the national and provincial spheres of government, which include, among other things:

- an improved linkage between planning and budgeting, whereby departments are required to compile and table strategic plans that are consistent with their budget envelope
- strategic plans and budget documentation containing improved information on measurable objectives expressed in terms of quantity, quality and timeliness
- the submission by departments of monthly expenditure reports on actual expenditure incurred, and on projected expenditure for the remainder of the financial year
- risk-management processes
- establishing internal-audit functions and audit committees in all departments
- setting accounting standards in accordance with best accounting practices
- finalising and submitting financial statements to the AG within two months of the end of the financial year
- tabling annual reports in the legislature within six months of the end of the financial year.

While it is recognised that the PFMA, 1999 has contributed positively towards the enhancement of public-sector financial management, it has been acknowledged that there should be an increased emphasis on capacity-building to further improve the quality of financial management. The Public Administration Leadership and Management Academy has, in association with National Treasury, developed the Financial Management Training Strategy for the roll-out of training programmes to improve the skills of public-sector finance practitioners.

### Municipal Finance Management Act, 2003 (Act 56 of 2003)

The Act applies to all municipalities and municipal entities, and national and provincial organs of state, to the extent of their financial dealings with municipalities.

The objective of the Act is to secure sound and sustainable management of the fiscal and financial affairs of municipalities and municipal entities by establishing norms, standards and other requirements for:

- ensuring transparency, accountability and appropriate lines of responsibility in their fiscal and financial affairs
- managing their revenues, expenditures, assets and liabilities, and handling their financial dealings
- budgetary and financial-planning processes and coordinating processes for borrowing by organs of state
- handling financial problems and other financial matters.

### Cooperative Banks Act, 2007 (Act 40 of 2007)

The Cooperative Banks Act, 2007 came into effect on 1 August 2008.

The Act aims to:

- promote and advance the social and economic welfare of all South Africans by improving access to banking services
- promote the development of sustainable and responsible cooperative banks
- establish an appropriate regulatory framework for cooperative banks that protects members of cooperative banks.

The Act provides for the establishment of the Cooperative Banks Development Agency as a public entity under the executive authority of the Minister of Finance.

## Financial institutions

### Financial Intelligence Centre (FIC)

The FIC is a national agency that develops and provides financial intelligence for law-enforce-

A 2011 report by the World Bank, the International Finance Corporation and accounting firm PricewaterhouseCoopers ranked South Africa's tax system as number one among emerging economies.

The system was ranked for its efficiency and for easing the compliance burden on taxpayers. The report found that South Africa took the lead as a result of first-world initiatives taken by the Government, such as e-filing.

ment authorities, the intelligence services and the South African Revenue Service (Sars). The FIC was established by the FIC Act, 2001 (Act 38 of 2001), which came into effect in February 2003. The FIC Act, 2001 is aimed at maintaining the integrity of South Africa's financial and economic system. The FIC reports directly to the Minister of Finance and to Parliament.

The FIC's mandate is to:

- monitor the compliance of designated businesses (accountable institutions) and supervisory bodies regarding their anti-money laundering and terror financing obligations
- receive and analyse transactional data from a range of businesses to identify the proceeds of crime, money laundering and the financing of terrorism
- provide financial intelligence reports to the law-enforcement authorities, intelligence agencies and Sars as a result of the analysis conducted
- formulate and lead the implementation of policy regarding money laundering and the financing of terrorism
- provide policy advice to the Minister of Finance
- uphold the international obligations and commitments required by the country in respect of anti-money laundering and combating financing of terrorism (AML/CFT).

The FIC Act, 2001 introduces a regulatory framework of measures that requires that certain categories of business take steps regarding client identification, record-keeping, reporting of information and internal compliance structures.

All businesses have to report various suspicious transactions to the FIC. The FIC also receives additional financial data from accountable and reporting institutions.

From October 2010, the FIC requires that all accountable and reporting institutions report on cash transactions exceeding R25 000.

In December 2010, amendments to the FIC Act, 2001 were promulgated, which required that all accountable and reporting institutions be registered with the FIC. Furthermore, the Act gave the FIC and supervisory bodies the authority to inspect and impose administrative penalties on non-compliant businesses. The Act also introduced an appeals process and appeals board.

South Africa is a member of the Financial Action Task Force, a body which sets international standards and policy on AML/CFT. It is also an affiliate of the 14-member Eastern and Southern Africa Anti-Money Laundering Group, which aims to help countries to implement the global AML/CFT standards.

The FIC is a member of the Egmont Group, consisting of the financial intelligence units of 126 countries, which aims to facilitate international cooperation, and the sharing of information and expertise among its members.

## Financial and Fiscal Commission (FFC)

The FFC is an independent, objective, impartial and unbiased constitutional advisory institution. It is a permanent expert commission with a constitutionally defined structure, a set of generic responsibilities and institutional processes.

The FFC submits recommendations and advice to all spheres of government, based on research and consultations on a range of intergovernmental fiscal issues.

The research includes:

- developing principles for intergovernmental fiscal relations, based on analysis of international best practice
- analysing local, provincial and national government budgets to understand revenue and expenditure trends
- identifying and measuring factors influencing provincial and local revenues and expenditures
- assessing fiscal policy instruments, such as conditional grants, equitable share transfers and taxes.

Government is required by the Constitution and other legislation to consult with the FFC on issues such as provincial and local government revenue sources, and provincial and municipal loans.

Consultation about the fiscal implications of assigning functions from one sphere of government to another is also required.

## Public Investment Corporation (PIC)

The PIC's clients are public-sector entities, most of which are pension, provident, social security, development and guardian funds. The PIC's role is to invest funds on behalf of these clients, based on investment mandates set by each client and approved by the Financial Services Board (FSB), with which it is registered as a financial services provider (FSP).

The PIC is wholly owned by the South African Government, with the Minister of Finance as the shareholder representative.

The PIC was established as a corporation on 1 April 2005 in accordance with the PIC Act, 2004 (Act 23 of 2004).

Corporatisation has enabled the PIC to structure its investment activities and operations in a manner comparable to that of private-sector investment managers.

Apart from pursuing FSB-compliant mandates, the PIC benchmarks its investment performance against market-driven indices, enabling clients and the shareholder to compare PIC's returns with those achieved in the marketplace.

## South African Revenue Service

In accordance with the Sars Act, 1997 (Act 34 of 1997), Sars is an administratively autonomous organ of state.

It aims to provide a world-class, transparent and taxpayer-centred service, ensuring optimum and equitable revenue collection.

Its main functions are:

- collecting and administering all national taxes, duties and levies
- collecting revenue that may be imposed under any other legislation, as agreed upon between Sars and an organ of state or institution entitled to the revenue
- advising the Minister of Finance on all matters concerning revenue and the exercise of any power or the performance of any function assigned to the Minister of Finance or any other functionary in the national executive in terms of the abovementioned legislation
- facilitating trade
- providing protection against the illegal importation and exportation of goods
- advising the Minister of Trade and Industry on matters concerning control over the import, export, manufacture, movement and storage or use of certain goods.

## Tax administration

National Treasury is responsible for advising the Minister of Finance on tax policy issues that arise in local, provincial and national government. As part of this role, the department must design tax instruments that can optimally fulfil their revenue-raising function, and that are aligned to the goals of government's economic and social policy. National Treasury and Sars cooperate in compiling tax policies.

Over the past few years, Sars has embarked on the successful Modernisation Programme, providing an electronic platform for taxpayers to interact with Sars across the major tax types, including PIT; Pay-As-You-Earn (PAYE); VAT; and customs. Individual taxpayers, employers, traders and VAT vendors can submit returns or declarations and pay Sars electronically.

The Modernisation Programme is based on:

- automating basic tax processes
- using the latest technology
- rethinking how better to use the Sars' pool of skills
- accessing third-party data and enhanced risk management.

The benefits for taxpayers include faster turnaround times for processing returns and the payment of refunds, and improved risk management. Sars is able to use third-party information obtained from other institutions to pre-populate many individuals' tax returns and verify information supplied by taxpayers. This has enabled Sars to adopt a much tougher stance against non-compliance.

### Tax Administration Bill

The Tax Administration Bill, 2011 seeks to provide a single body of law that outlines common procedures, rights and remedies and to achieve a balance between the rights and obligations of Sars and taxpayers in a transparent relationship. Once it becomes law, the Bill will establish a solid legal framework for Sars to continue modernising its systems and redesigning its process.

Some examples of the changes that can be expected are:

- the phased introduction of a single registration process whereby a taxpayer registers once for many tax types
- the extension of third-party information for reporting purposes
- a framework to support the modernisation of Sars' accounting system.

To further enhance taxpayers' rights, the Bill also provides for the Minister of Finance to appoint a tax ombudsman for a term of three years. The ombudsman's mandate is to review and address any complaint by a taxpayer regarding a service matter or a procedural or administrative matter arising from the application of the provisions of a tax Act by Sars, provided all other avenues for resolving the complaint have been exhausted.

## Tax system

South Africa has a residence-based tax system, which means residents are – subject to certain exclusions – taxed on their worldwide income, irrespective of where their income was earned. Non-residents are, however, taxed on their income from a South African source. Foreign taxes are credited against South African tax payable on foreign income.

Most of the State's income is derived from income tax (PIT and CIT), although nearly a third of total revenue from government taxes comes from indirect taxes, primarily VAT.

## Income tax (IT)

IT is government's main source of income and is levied in terms of the IT Act, 1962 (Act 58 of 1962).

Tax is levied on taxable income, which, in essence, consists of total income less exemptions and allowable deductions according to the Act. The remuneration received by or accrued to a person is subject to tax and the employer deducts employees' tax in the form of PAYE.

A person who receives income other than remuneration, such as income from trade, profession or investments, which is not subject to employees' tax, is required, under certain circumstances, to register as a provisional taxpayer and must pay provisional tax.

The primary rebate has been increased to R11 440 a year for all individuals. The secondary rebate, which applies to individuals aged 65 years and over, is increased to R6 390 a year.

The third rebate, which applies to individuals aged 75 years and over, is increased to R2 130 a year. The threshold below which individuals are not liable for PIT is increased to R63 556 of taxable income a year for those below the age of 65, R99 056 a year for those aged 65 to 74, and R110 889 for age 75 and over.

1 March 2012 introduced the tax credit for contributions to medical schemes, at a rate of R230 a month for the first two beneficiaries and R154 each for additional beneficiaries. Taxpayers 65 years and older and people with disabilities will be included in the second phase of this reform, which will be implemented in 2014. These reforms will significantly improve the fairness of the PIT system.

## Corporate income tax

Companies (other than gold-mining companies, small business corporations or micro businesses) pay tax on their taxable incomes at a flat rate. Companies, which are not "residents" of South Africa as defined in the IT Act, 1962, conducting trade within South Africa are taxed at a rate of 33% on income derived from a source within or deemed to be within South Africa.

The secondary tax on companies was terminated on 31 March 2012 and a withholding tax on dividends was implemented on 1 April 2012. This will align South Africa's tax treatment of dividends with that in most other countries. Pension funds will benefit from this transition as they will receive dividends tax free. The dividend tax was introduced at 15%.

## Value-added tax

VAT is levied on the supply of all goods and services rendered by registered vendors throughout the business cycle. Effectively, VAT is levied on the value added by an enterprise.

Vendors levy and pay over the tax included in their prices, resulting in VAT being paid by the final consumer. VAT is also levied on the importation of goods and services into South Africa. It is levied at the standard rate of 14%. Certain supplies are zero-rated or exempt from VAT.

The prices of goods and services must be quoted or displayed as inclusive, which means that VAT has to be included in prices on all products, price lists, advertisements and quotations.

## Excise duty

Excise duty is levied on certain locally manufactured goods and their imported equivalents, such as tobacco and liquor, and as an ad valorem duty on cosmetics, audio-visual equipment and motor cars.

Relief from excise duty is available where excisable products are exported, for example specific farming and forestry equipment, and certain manufacturing activities.

With effect from October 2012, an ad valorem excise duty at a rate of 7% will apply to small aeroplanes and helicopters with a mass below 5 000 kg. A duty of 10% will apply to motorboats and sailboats longer than 10 m.

## Transfer duty

Transfer duty is payable on the acquisition of property.

With effect from 23 February 2011, property costing less than R600 000 attracts no duty. A 3% rate applies to properties costing between R600 000 and R1 million.

In respect of property with a value between R1 million and R1,5 million, the duty is R12 000 plus 5% of the value above R1 million.

In respect of property above R1,5 million, the duty is R37 000 plus a rate of 8% of the value exceeding R1,5 million.

## Capital gains tax

The introduction of CGT in October 2001 was an important step in broadening the tax base.

To reduce the scope for tax arbitrage and broaden the tax base further, the CGT inclusion rate for individuals and special trusts was increased with effect from 1 March 2012 from 25% to 33,3% and for companies and other trusts from 50% to 66,6%. To mitigate the impact on middle-income earners, the various exclusion thresholds were increased.

## Estate duty

An estate consists of all the property – including life-insurance policies and payments from pension funds – of the deceased.

Certain admissible deductions are made from the total value of the estate to determine the net value. Some important deductions are allowable against the value of the estate such as:

- the value of property in the estate that accrues to the surviving spouse of the deceased
- all debts due by the deceased
- a R3,5-million general deduction.

The estate duty rate is 20% of the dutiable amount of the estate.

## Securities transfer tax (STT)

STT was introduced by the STT Act, 2007 (Act 25 of 2007), with effect from 1 July 2008 at a rate of 0,25% of the taxable amount.

It replaced stamp duty and uncertificated securities tax on marketable securities.

STT is levied on any transfer of a security (whether listed or unlisted) based on the taxable amount of the security. A "security" means any:

- share in a company
- member's interest in a close corporation
- right or entitlement to receive any distribution from a company or close corporation.

## Skills-development levy

This is a compulsory levy scheme for the funding of education and training. Sars administers the collection of the levy. The rate, as from 1 August 2005, is 1% for employers with an annual payroll in excess of R500 000.

## Unemployment Insurance Fund (UIF)

The UIF insures employees against the loss of earnings due to termination of employment, illness or maternity leave. A monthly contribution is collected from the employer, which consists of:

- a contribution made by the employee equal to 1% of the remuneration paid or payable by the employer to the employee during any month
- a contribution made by the employer equal to 1% of the remuneration paid or payable by the employer to that employee during any month.

## Air-passenger departure tax

From 1 October 2011, the air-passenger departure tax on flights to the Southern African Customs Union (Sacu) member states and other international destinations increased from R80 and R150 per passenger respectively to R100 and R190 per passenger.

## Rates on property

Municipalities levy rates based on the value of fixed property.

## Customs duty

The policy on tariffs applicable to importation into South Africa is set by the International Trade Administration Commission under the authority of the Department of Trade and Industry. The duties levied on imported goods can be separated mainly into customs duties, which include additional customs duties (ad valorem) on certain luxury or non-essential items, and anti-dumping and countervailing measures. In addition, VAT is also collected on goods imported and cleared for home consumption and certain other levies are imposed on specific products.

### Southern African Customs Union

South Africa, Botswana, Lesotho, Namibia and Swaziland are signatories to the Sacu agreement. They apply similar customs and excise legislation and the same rates of customs and excise duties on imported and locally manufactured goods.

The uniform application of tariffs and harmonisation of procedures simplify trade within the Sacu common customs area by enabling free movement of goods for customs purposes. However, all other national restrictive measures such as import and export control, sanitary and phytosanitary requirements and domestic taxes apply to goods moved between member states.

The 2002 Sacu Agreement is in force and provides a dispensation for calculating and effecting transfers based on customs, excise and a development component of the Revenue Sharing Formula.

At its meeting held in South Africa in March 2011, the Sacu Summit of Heads of State and Government endorsed an ambitious Sacu regional trade facilitation programme that is focused on creating common information-technology platforms to allow interconnectivity; harmonising enforcement strategies to curb illicit trade; improving border efficiencies to facilitate seamless trade; developing partnerships with traders through the establishment of a formalised Customs-Trader Forum; developing similar customs legislation; and establishing one-stop border posts. South Africa and all Sacu countries are working towards implementing the programme.

South Africa is automating most of its border processes, starting with customs and immigration, to bring the country in line with the international standards of the World Customs Organisation and world-class immigration processes and practices. The intention is to have a seamless process for compliant travellers and traders while making it difficult for illegitimate travellers and traders by employing the best technology solutions.

## International tax agreements for the avoidance of double taxation

International tax agreements are important for encouraging investment and trade flows between nations, by providing certainty about the tax framework. By reaching agreement on the allocation of taxing rights between international investors' residence and source countries, double-taxation agreements provide a solid platform for growth in international trade and investment. South Africa has tax agreements with over 60 countries.

## African Tax Administration Forum (ATAF)

In November 2009, the ATAF was launched in Kampala, Uganda, to give African tax administrations a platform to articulate African tax priorities, develop and share best practices and build capacity in African tax policy and administration. Sars Commissioner, Mr Oupa Magashula, was unanimously elected as the first chairperson of the ATAF at the inaugural conference and re-elected at the General Assembly held in Mauritius in July 2011. South Africa will also host the Secretariat of the African tax body.

## Organisational performance

In 2010/11, Sars collected R2 billion more than the targeted R672,2 billion, representing an increase over the previous financial year of R75,6 billion or 12,6%.

In 2010/11, government spent R891 billion of the budgeted R897 billion. The preliminary budget deficit was expected to be 5% of GDP.

The more than one million jobs lost during the recent recession limited the growth in revenue from PIT. While Sars' PIT revenue grew, it was 0,5% below the target.

VAT collection rose to R184,2 billion from R147 billion in 2010. Of the R674,2 billion collected, R226,3 billion came from individual taxpayers, while companies paid R133,4 billion.

The revenue collected from the fuel levy earned Sars R35 billion, which was 2,2% above target, and contributed 5,2% to the overall revenue collected. This increased from 4% in 2008/09 and 4,8% in 2009/10.

### e-Filing

Sars introduced e-Filing (*www.sarsefiling.co.za*) as an electronic gateway for taxpayers to interact with Sars, as well as a facility to file electronically at Sars branches. The e-Filing gateway is a secure and free service, enabling taxpayers to submit their tax returns online. It removes the risks and inconvenience of submitting paper tax returns. Not only can returns be submitted via the Internet, but users can also make secure tax payments online. There is also a facility to apply for tax directives, which can be obtained within 24 hours.

The e-Filing service is equal to international standards, being comparable with services offered in the United States of America (USA), Australia, Singapore, Ireland, Chile and France.

By November 2011, Sars had received more than three million returns since the start of the tax season in July 2011. This represented an increase of 15% compared to the 2009/10 tax season. Ninety-eight per cent of the returns were submitted via e-Filing.

It took 10 weeks for one million tax returns to be submitted via e-Filing, compared to 14 weeks in the 2009/10 season.

### Tax calendar

Sars has instituted three critical filing seasons in the tax year that runs from March to February. The first one is Tax Season for Employers, when employers file their annual PAYE reconciliations. This runs from April to May every year.

This is followed by Tax Season for Individuals, when individual taxpayers file their income tax returns. This runs from July to the end of November for non-provisional taxpayers who submit via e-Filing.

Employers then have an interim filing season when they file reconciliations for the first six months of the tax year, and this is in effect during September and October.

All three filing seasons are accompanied by innovative communication and marketing campaigns aimed at the relevant taxpayer segments, in line with Sars' segmentation approach. There has been a steady increase in taxpayer compliance as a result of the predictable filing seasons, combined with Sars' improved service offering and taxpayer education.

The Taxpayer Education Campaign focuses on helping all eligible taxpayers to complete their tax returns correctly, honestly and on time.

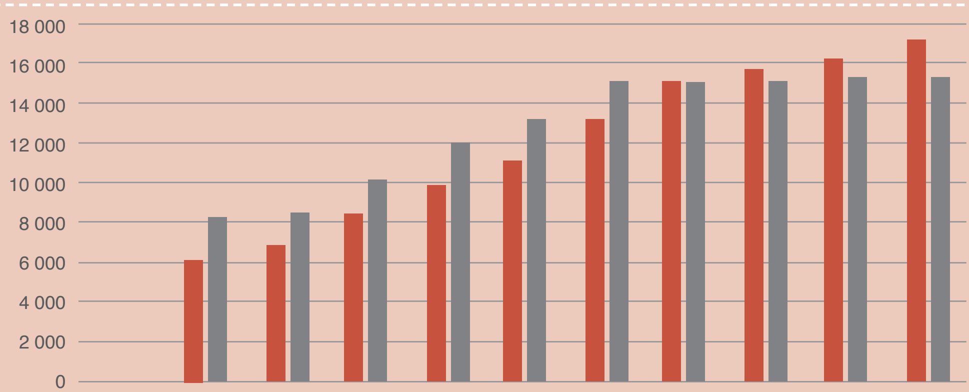
People who owe Sars tax are charged interest at a rate as published in the *Government Gazette.*

## National Gambling Board (NGB)

The NGB was established in terms of the National Gambling Act (NGA), 1996 (Act 33 of 1996), which was repealed on 1 November 2004 by the NGA, 2004 (Act 7 of 2004).

The vision of the board is to position South Africa as the pre-eminent jurisdiction with an effectively regulated industry. The NGB is com-

**Trends in gross gambling revenue (R' millions)**




| | FY 01/02 | FY 02/03 | FY 03/04 | FY 04/025 | FY 05/06 | FY 06/07 | FY 07/08 | FY 08/09 | FY 09/10 | FY 10/11 |
|---|---|---|---|---|---|---|---|---|---|---|
| At current prices | 6,227 | 6,954 | 8,240 | 9,918 | 11,400 | 13,520 | 15,618 | 15,921 | 16,268 | 17,140 |
| At constant prices | 8,108 | 8,429 | 10,148 | 12,022 | 13,365 | 14,956 | 15,618 | 14,866 | 14,603 | 14,814 |

Source: National Gambling Board

In May 2011, the Association for Savings and Investment South Africa announced that the size of the local unit trust industry was rapidly approaching the R1-trillion mark, with assets under management growing to R949 billion by the end of March 2011.

Statistics for the first quarter of 2011 showed that the industry's assets grew by R338 billion over the previous two years, from R611 billion at the end of March 2009.

mitted to effective regulation and supervision of the South African gambling industry by upholding internationally recognised standards of compliance.

Highlights of the NGB's achievements in 2011 included:

- Liaising with law-enforcement agencies to address illegal gambling activities and developing a working forum.
- Consulting with various gambling operators and strengthening stakeholder relations.
- Interacting with the South African Responsible Gambling Foundation to assess and contribute strategic input on how to use research and evolve a collaborative approach on the work of the National Responsible Gambling Programme (NRGP) to further inform communication and public awareness programmes.
- Refining legislation to simplify the implementation of self-exclusion registers.
- Completing the compliance strategy that will inform an automated compliance system by 2014.
- Monitoring treatment, counselling, public education and awareness and research initiatives implemented by the NRGP. It is the only programme of its kind in the world that is jointly controlled by a public-private-sector partnership, which involves government regulators and the gambling industry.
- Hosting the eighth Gaming Regulators Africa Forum in February 2011, the sixth Biennial Gambling Conference in April 2011 and the annual International Association of Gaming Regulators Conference in October 2011.
- Conducting comprehensive national research into the size and growth/non-growth of the gambling industry to eventually establish an integrated information portal or dashboard that will provide empirical data.

The emergence of illegal Internet gambling raises challenges to the regulatory regime concerning when, how and what the framework of interactive gambling will be, and what the challenges are. The NGB embarked on various actions to inform and create awareness of illegal modes of gambling to the South African public. Regarding curbing illegal gambling, the provincial licensing authorities conducted 86 raids and over 350 illegal gambling machines were destroyed.

## Statistics

The NGB maintains a national gambling database that contains information on primary statistics such as turnover, gross gambling revenue (GGR), gambling taxes and revenue, as well as return-to-punter/player. The results for 2010/11 showed an increase of GGR by 5,4% from R16 268 million to R17 140 million, whereas taxes/levies paid increased by 6% from R1 575 million to R1 670 million.

Gauteng is the biggest generator of GGR (41,3%) as well as taxes (39,3%). Apart from the seven operational casinos that generate income in Gauteng, the GGR in the province is also boosted by the presence of a high number of other gambling activities, such as racing and betting, the roll-out of limited pay-out machines, as well as bingo venues operating in Gauteng only.

## Gambling Review Commission (GRC)

The GRC was established to review the evolution of the gambling industry since 1996; and to assess its social and economic impact, specifically looking at:

- the demography of gambling participants
- the incidence of problem gambling and gambling addiction
- youth gambling
- the efficiency and effectiveness of current strategies to mitigate the negative effects of gambling
- assessing the proliferation of gambling in South Africa
- considering licensed and unlicensed activities and technological developments
- assessing the viability of new gambling activities
- considering the extent to which regulatory bodies have met their legislative objectives, to benchmark with international jurisdictions and to make policy recommendations regarding the gambling industry on the basis of its assessment.

The NGB's response to the GRC's final findings allowed the board to look critically at the regulatory space within which it operates. The findings resulted in the restructuring of the organisation and reviewing its strategic objectives.

The *Gambling Review Report* affirmed the success of a well-regulated industry and raised some challenges concerning the concurrent legislation. Notwithstanding the challenge, the NGB works efficiently with the provincial gambling boards to ensure effective coordination and monitoring of gambling regulations.

The NGB is addressing the need to ensure national oversight and monitoring of all legalised gambling activities and the closure of illegal gambling sites and activities with the aid of law-enforcement agencies.

## National Lotteries Board (NLB)

The NLB was established in October 1998 in terms of the Lotteries Act, 1997 (Act 57 of 1997).

The board's main activities are, among other things, to:

- advise the Minister of Trade and Industry on the issuing of the licence to conduct the National Lottery
- ensure that the National Lottery and sports pools are conducted with all due propriety
- ensure that the interests of every participant in the National Lottery are adequately protected
- ensure that the net proceeds of the National Lottery are as high as possible
- administer the National Lottery Distribution Trust Fund and hold it in trust
- advise the Minister on percentages of money to be allocated in terms of Section 26(3) of the Lotteries Act, 1997
- advise the Minister on establishing and implementing a social-responsibility programme in respect of lotteries
- administer and invest the money paid to the board in accordance with the Lotteries Act, 1997.

The National Lottery operator is Gidani, a 89,2% black-majority-owned private company.

Since inception, the National Lottery has raised more than R12,3 billion through ticket sales. With interest, the amount available for distribution to good causes increased to R16 billion, of which R11 billion has been paid out in the following proportions: R2,3 billion to 938 organisations in the arts, culture and national heritage sector; R2,7 billion to 3 564 organisations in the sports and recreation sector; and R5,8 billion to 4 051 organisations in the charities sector. Many beneficiary organisations were funded for more than one project, bringing the total number of grants to over 15 000.

The Department of Trade and Industry has launched a review of the Lotteries Policy Framework.

## Auditor-General of South Africa

The AGSA has a constitutional mandate. It strengthens South Africa's democracy by enabling oversight, accountability and governance in the public sector through auditing, thereby building public confidence.

The AGSA is one of the Chapter Nine institutions mandated by the Constitution to fulfil certain functions. These institutions are not part of government and do not have a duty to be part of the mechanisms of cooperative government. The independence of the AGSA is thus respected and strengthened.

As mandated by the Constitution and the Public Audit Act, 2004 (Act 25 of 2004), the AGSA is responsible for auditing national and provincial state departments and administrations, all municipalities and any other institution or accounting entity required by national and provincial legislation to be audited by the AGSA. Various business units provide auditing services, corporate services and specialised audit work, such as performance audits, information system audits and audit research and development. The AGSA also boasts an impressive international auditing complement.

In November 2010, the organisation hosted the 20th International Congress of Supreme Audit Institutions (XX INCOSAI). Over 150 countries attended the congress, which resulted in the adoption of the first international standards for public-sector auditing.

The AGSA was presented with the Jörg Kandutsch Award by its peers, in recognition of its efforts to enhance public auditing. The organisation has benefited from the shared experiences and knowledge gained as a member of several working groups, subcommittees and regional working groups of the International Organisation of Supreme Audit Institutions (INTOSAI).

In addition, the AGSA contributed directly to the development of the International Standards of Supreme Audit Institutions, which were officially re-launched as a whole during XX INCOSAI.

The Auditor-General of South Africa, Mr Terence Nombembe, was appointed chairperson of INTOSAI.

The AGSA celebrated its centenary in 2011.

## Financial sector

### South African Reserve Bank

The SARB is the central bank of South Africa. It was established in 1921 in terms of a special Act of Parliament, the Currency and Banking Act, 1920 (Act 10 of 1920), which was the direct result of abnormal monetary and financial conditions that had arisen during and in the period immediately following World War I. The SARB is governed by the SARB Act, 1989 (Act 90 of 1989). In terms of the Constitution, it has been given an important degree of autonomy in the execution of its duties. Since its establishment, the SARB has always been privately owned. It has more than 600 shareholders. Its shares are traded on the Over-the-Counter Share-Trading Facility managed by the SARB.

After allowing for certain provisions, payment of company tax on profits, transfers to reserves and dividend payments of not more than 10c per share per year to shareholders, the surplus of the SARB's earnings is paid to government. Its operations are motivated not by a drive to return profits, but to serve the best interests of all South Africans.

The Reserve Bank holds an ordinary general meeting of shareholders at its head office in Pretoria annually. This is the occasion where the Governor, as chairperson, delivers an annual address on the state of the economy and monetary policy, which is covered widely in the media.

The SARB has a board of 15 directors. Among them are the Governor and three deputy governors, who are appointed by the President, each for a five-year term. The President appoints four other directors for a period of three years. The remaining seven directors, of whom one represents agriculture, two industry, two commerce or finance, one mining and one labour, are elected by shareholders for a period of three years.

> The Discovery Invest Leadership Summit took place at the Sandton Convention Centre on 21 September 2011.
>
> The headline speaker was Al Gore, former United States Vice-President, Nobel Peace Prize winner and world-opinion leader on climate change.

The SARB has a staff of around 2 000. Management comprises the Governor, deputy governors and the heads of departments. It has branch offices in Bloemfontein, Cape Town, Durban, East London, Johannesburg, Port Elizabeth and Pretoria North.

The SARB must submit a monthly statement of its assets and liabilities to National Treasury and an annual report to Parliament. The Governor of the SARB holds regular discussions with the Minister of Finance and appears before the Parliamentary Portfolio and select committees on finance from time to time.

The Reserve Bank has a unique position in the economy, as it performs various functions and duties not normally carried out by commercial banks. Although the functions of the SARB have changed and expanded over time, the formulation and implementation of monetary policy has remained one of the cornerstones of its activities.

The SARB has used different monetary-policy frameworks over time, such as credit ceilings and credit controls in the 1970s, money-supply growth targets in the 1980s, money-supply growth guidelines in the early 1990s and an eclectic monetary policy with an informal inflation target from the mid-1990s.

In February 2000, an inflation target was specified for the first time, and the adoption of this target entrusted a single objective to the Reserve Bank: price stability. This target was set for the first achievement in 2002. The target is to keep the headline consumer price index (CPI) between 3% and 6% per year.

The framework was introduced because of certain perceived advantages, such as:

- making the objective of monetary policy clear, thereby improving planning in the private and public sectors
- forming part of a formalised coordinated effort to contain inflation and pursuit of the broader economic objective of sustainable high economic growth and employment creation
- helping to focus monetary policy and enhancing the accountability of the SARB to the public
- providing an anchor for expectations of future inflation, which should influence price and wage setting.

The Governor and the Minister of Finance consult on setting the inflation target. This approach implies that the Reserve Bank does not have goal independence (that is, the setting of the objective to be achieved), but has operational independence (such as the choice of instruments and the autonomy to adjust such instruments) in monetary-policy decisions aimed at achieving the target. The SARB publishes monetary-policy reviews, while regular regional monetary-policy forums are held to provide a platform for discussions of monetary policy with broader stakeholders from the community.

Data released by Statistics South Africa showed that the headline CPI for between February 2010 and March 2011 remained within the SARB's target range of between 3% and 6%. In the year to March 2011, it amounted to 4,1%.

## System of accommodation

The SARB's refinancing system is the main mechanism used to implement its monetary policy. Through its refinancing system, the Reserve Bank provides liquidity to banks, enabling them to meet their daily liquidity requirements.

"Liquidity" refers to the banks' balances at the central bank that are available to settle their transactions with one another, over and above the minimum statutory level of reserves that they have to hold.

The main instrument for managing liquidity in the money market is repo transactions. The refinancing system, based on repo transactions, was introduced in March 1998.

The repo rate is the price at which the SARB lends cash to the banking system and is the key operational variable in the monetary-policy implementation process. It represents the most important indicator for short-term interest rates. The refinancing system also provides for supplementary and standing facilities to bridge the banking sector's overnight liquidity needs, as well as a concession to banks to use their cash-reserve balances with the SARB to square off their daily positions.

## Creating a liquidity requirement

In terms of its monetary-policy implementation framework, the SARB has to compel banks to borrow a substantial amount (the liquidity requirement or the money-market shortage) from the Reserve Bank.

The SARB, therefore, creates a liquidity requirement (or shortage) in the money market, which it then refinances at the repo rate – a fixed interest rate determined by the Monetary Policy Committee (MPC), comprising the bank's governors and other senior officials. After each meeting, the MPC issues a statement indicating its assessment of the economy and announces policy changes, if necessary.

The SARB's repo rate influences the interest rates charged by banks, the general level of interest rates in the economy and therefore other economic aggregates such as money supply, bank-credit extension and, ultimately, the rate of inflation. The repo rate influences market rates in two ways: it directly influences the bank's marginal cost of funding and it reflects the bank's stance on monetary policy.

The SARB has to intervene regularly in the money market to create a shortage that would drain excess liquidity. In addition to the liquidity-management operations, the SARB uses other open-market operations (OMOs) to achieve its monetary-policy objectives.

The OMOs refer to the selling of SARB debentures, longer-term reverse repos, money-market swaps in foreign exchange and the movement of public-sector funds, for example, Corporation for Public Deposits and central government funds, as well as changes in the cash-reserve requirements for banks, which by mid-2009 amounted to 2,5% of banks' liabilities.

## Functions

The Reserve Bank performs a number of functions to achieve its objectives. Its current functions can be grouped into the following major areas of responsibility:

- Formulation and implementation of monetary policy (aimed at achieving the inflation target).
- Refinancing system and interest rates: The essence of the bank's monetary-policy implementation framework and the transmission of monetary policy is its influence on the level of interest rates through its refinancing system.
- OMOs: OMOs are conducted for two reasons: Firstly, to neutralise or smooth the influence of exogenous factors on the liquidity position in the money market. Secondly, to maintain an adequate liquidity requirement in the market, which has to be refinanced from the bank. Through this mechanism, the bank can exert influence over interest rates in the market.
- Service to government:
  - Gold and foreign-exchange reserves: The bank is the custodian of the country's official gold and foreign-exchange reserves. Sub-

sequent to the conversion of the negative net open foreign currency position in May 2003 into a positive position, foreign reserves have been growing.
  - Banker and adviser to government: The main services provided are administering the auctions of government bonds and National Treasury bills, participating in the joint standing committees between the bank and National Treasury, and managing the flow of funds between the Exchequer.
- Account and tax and loan accounts.
  - Administration of exchange control: The bank is responsible for the administration of government's exchange-control policy.
  - Provision of economic and statistical services: The bank collects, processes, interprets and publishes public information, economic statistics and other information, and uses this information in policy formulation.
- Bank supervision: The purpose is to achieve a sound and effective banking system in the interest of depositors of banks and the economy as a whole.
- The national payment system: The bank is responsible for overseeing the safety and soundness of the national payment system. The main aim is to reduce interbank settlement risk with the objective of reducing the potential of a systemic risk crisis emanating from settlement default by one or more of the settlement banks.
- Banker to other banks: The bank acts as custodian of the cash reserves that banks are legally required to hold or prefer to hold voluntarily with the bank.
- Banknotes and coin: The South African Mint Company, a subsidiary of the bank, mints all coin on behalf of the bank. The South African Bank Note Company, another subsidiary of the bank, prints all banknotes on behalf of the SARB. Currency is distributed through the bank's seven branches to commercial banks. It is the responsibility of the branches to ensure that there is an adequate supply of new notes available to meet the demand, and to replace unfit notes. The branches are responsible for the quality of banknotes in circulation in their respective regions.
- Lender of last resort: In terms of its "lender-of-last-resort" activities, the bank may, in certain circumstances, provide liquidity assistance to banks experiencing liquidity problems.
- Monitoring financial stability: In view of the interrelationship between price and financial-system stability, the bank monitors the macro-prudential aspects of the domestic financial system. The objective of financial stability is to prevent costly disruptions in the country's financial system.
- Provision of internal corporate support services and systems.

To ensure smooth operations and administration, the bank provides its own internal services, supported by information, communications and technology, and human resources.

The Cooperative Banks Act, 2007 (Act 40 of 2007), was promulgated in 2007. The Act seeks to enhance access to banking services and introduce more competition in the banking environment.

By October 2011, there were over 121 cooperative financial institutions with about 59 000 members and over R175 million in savings.

## Monetary policy

Domestic consumer price inflation continued to moderate during 2010, within an environment of relatively subdued local demand and an appreciation in the external value of the Rand throughout the year.

CPI accordingly slowed from an annual average of 7,1% in 2009 to 4,3% in 2010. Subdued inflationary pressures allowed the MPC to adopt an easier monetary-policy stance in the course of 2010, thereby supporting the recovery in domestic economic activity.

The repo rate was subsequently reduced three times during 2010. Alongside the lowest level of the repo rate in more than 30 years, other money-market rates continued to hover at historically low levels during the fourth quarter of 2010 and the first months of 2011.

The MPC maintained the repo rate at 5,5% at its meetings held in September and November 2011, extending the period during which the policy rate had been kept unchanged for almost a full year. The most recent period when the repo rate was kept on hold for almost such a long duration was between June 2005 and April 2006, when the MPC viewed the threats to the inflation outlook to be balanced enough not to require an adjustment to the policy stance.

In recent months, the inflation trajectory has risen, compounded on the upside by the volatility in the exchange rate of the Rand in addition to high fuel prices and accelerating food-price inflation. At the same time, growth in the domestic economy has remained fragile and uneven, partly affected by turbulence in global financial markets due to the European sovereign debt crisis. While a temporary breach of the upper limit of the inflation target range was foreseen by the MPC, this was balanced by the slack in the economy, the contained pace of underlying inflation and the projected return of headline inflation to within the target range from late in 2012.

## The banking industry

As at the end of December 2010, 33 banking institutions – 12 locally controlled, six foreign-controlled, 13 registered branches and two mutual banks – were reporting data to the Bank Supervision Department of the Reserve Bank. There were also 41 international banks with authorised representative offices in South Africa. The banking industry is characterised by a high degree of concentration, with four banks – ABSA Bank Ltd, Standard Bank of South Africa Ltd, FirstRand Bank Ltd and Nedbank Ltd – dominating the sector.

Although South Africa did not itself experience a financial crisis, it did not escape the effects of the resultant global credit squeeze and recession. As a result, the banking sector, in common with other sectors, experienced a difficult operating environment in the latter part of 2008 and for most of 2009. Most indicators, however, suggest that a nascent recovery in the sector began to take hold in 2010, although conditions remained difficult.

Total banking-sector assets amounted to R3 122 billion at the end of December 2010, compared to R2 963 billion at the end of December 2009 (and R3 167 billion at the end of December 2008), representing year-on-year growth of 5,4%. Total assets of the four largest banks accounted for 84,1% of total banking-sector assets (December 2008: 84,7%). Gross loans and advances increased by 2,5% from R2 253 billion at the end of December 2009 to R2 309 billion at the end of December 2010 (after a 2,6% decrease between December 2008 and December 2009).

Home loans remained the largest component of gross loans and advances, representing about 34%, followed by instalment debtors at 10,2% and commercial mortgages at 9,9%. At the end of December 2010, banking-sector total equity and liabilities amounted to R3 123 billion. Total deposits, amounting to R2 181 billion, represented 75,2% of the banking sector's liabilities of R2 902 billion at the end of December 2010 (December 2009: 75%).

Growth in loans and advances in the banking sector contracted sharply at the onset of the financial crisis. In 2008, gross loans and advances expanded at an average month-on-month rate of 0,9%. In 2009, this fell to -0,2%. However, in 2010 (to the end of July), average month-on-month growth began to recover, averaging 0,2%.

Deposits from corporate customers (including financial institutions) constituted 50,3% of total banking-sector deposits at the end of December 2010, followed by households and government (including parastatals), which accounted for 15,6% and 9,8% respectively. The total capital-adequacy ratio of the banking sector improved during 2010, increasing from 14,1% at the end of December 2009 to 14,9% at the end of December 2010.

As of December 2011, only 19% of total deposits were retail deposits and 80% of all deposits had a maturity of less than six months. Of total liabilities (comprising total deposits and borrowed funds – loans, borroings and other liabilities) on average, just under 60% had contractual maturities of less than one month.

The banking sector remained profitable throughout 2009 and 2010. However, the seven largest banks' return on equity and return-on-assets ratios deteriorated during 2010 to 17,9% and 2,5% respectively at the end of December 2010 (December 2009: 19,2% and 2,7% respectively).

The ratio of liquid assets to total assets held by the banking sector increased during 2010, rising from 11,7% in December 2009 to 12,3% in December 2010.

Credit ratios remained persistently high throughout 2010. Impaired advances in respect of which a specific credit impairment had been raised, were at 5,79% of gross loans and advances at the end of December 2010. It amounted to R134 billion at the end of that month or 5,9% of gross loans and advances.

Impaired advances to gross loans and advances have remained above 5% since April

2009, and above 5,7% since August that year. However, credit losses, having risen during the crisis, have fallen to near pre-crisis levels. Credit losses averaged 0,11% of gross loans and advances in 2008, 0,13% in 2009 (peaking at 0,14% in September 2009) and 0,10% in 2010.

## The microlending industry

The Department of Trade and Industry introduced the National Credit Act (NCA), 2005 (Act 34 of 2005), to allow the credit market to function in a robust and effective manner.

The NCA, 2005 replaced the Usury Act, 1968 (Act 73 of 1968), and the Credit Agreements Act, 1980 (Act 75 of 1980). The NCA, 2005, which became effective in June 2007, aims to regulate the granting of consumer credit by all credit-providers, including microlenders, banks and retailers.

It created the National Credit Regulator (NCR) and the National Consumer Tribunal (NCT), which play a vital role in ensuring enforcement, promoting access to redress and adjudicating contraventions of the Act.

Out of a population of 50,59 million, South Africa has just over 18 million credit-active consumers.

The NCR is responsible for regulating the South African credit industry. It carries out education, research and policy development; registers industry participants; investigates complaints; and ensures that the Act is enforced.

In terms of the Act, the NCR has to promote the development of an accessible credit market to meet the needs of people who were previously disadvantaged, earn a low income or live in remote, isolated or low-density communities.

The NCT adjudicates various applications and hears cases against those who contravene the Act.

The Act provides for the registration of debt counsellors to assist overindebted consumers. Debt counsellors are required to undergo training approved by the NCR through approved training service-providers appointed by the regulator.

## Other financial institutions

### Cooperative Banks for Development Agency

The Cooperative Banks for Development Agency was established in 2009 in terms of the Cooperative Banks Act, 2007. Its objectives are to provide for the registration of deposit-taking financial service cooperatives, savings and credit cooperatives, community banks and village banks, and their regulation and supervision. The agency also facilitates, promotes and funds the education and training of cooperative bank personnel.

The agency is responsible for, among other things:

- supervising and registering deposit-taking financial services cooperatives as cooperative banks
- capacitating, promoting and informing communities and groups about cooperative banking
- registering and regulating representative bodies and support organisations
- establishing the Deposit Insurance Fund for Cooperative Banks
- liquidity/solvency management through loans and grants
- formalising approaches to developing cooperative financial institutions.

Access to financial services is a precondition for economic development. As 37% of South Africans have no access to regulated financial services, National Treasury is committed to a range of initiatives to increase access.

Financial cooperatives are owned and controlled by members. The agency provides training and support to ensure that the members' savings and assets are properly managed, and not exposed to undue risk.

In line with government's responsibility for regulating banking and developments in the cooperative banking sector, the department developed appropriate legislation to supervise and support the sector.

South African banking group Nedbank has opened the first partially wind-powered bank branch on the continent.

The small informal settlement of Du Noon, just off Table Bay in the Western Cape, was considered windy enough to install a Kestel e300i 1kW small wind turbine, which produces up to 7,8 kWh – enough to power the branch's air conditioning, security systems and all computers.

It also produces energy for storage, which is fed to the branch during a power cut. The wind-generated energy is converted to three-phase electricity and then stored in an uninterruptable power supply.

Banking operations will continue even if the supply from power utility Eskom fails, and the only signs will be a dimming of the lights and temporary cessation of the air conditioner.

The branch derives as much as 35% of its energy requirements from the turbine, and it is expected that eventually it will be completely reliant on this clean, renewable energy source.

## Development Bank of Southern Africa (DBSA)

The DBSA Act, 1997 (Act 13 of 1997), stipulates that the main role of this DFI is to promote economic development and growth, human-resource development and institutional capacity-building. The bank achieves this by mobilising financial and other resources from the private and public sectors, both nationally and internationally, for sustainable development projects and programmes.

The DBSA's annual financial results for the year ended 31 March 2011 showed an enhanced contribution to development (loan and equity disbursements plus developmental initiatives) amounting to R8,9 billion. This was achieved despite the financial year being dominated again by economic and market conditions, characterised by lower short-term interest rates and increased long-term interest rates on investments.

During 2010/11, the DBSA spent R518,9 million (2009/10: R550,2 million) on developmental initiatives, representing 60,8% (2010: 66,9%) of its sustainable earnings.

The DBSA is an implementing agent of the Siyenza Manje Project, an initiative to build capacity and support programmes within local government by hiring experts and young professionals in areas where there are skills shortages.

## Land and Agricultural Development Bank (Land Bank)

The Land Bank operates as a DFI within the agricultural and agribusiness sectors, and is regulated by the Land and Agricultural Development Bank Act, 2002 (Act 15 of 2002). The Land Bank provides a range of financing products to a broad spectrum of clients within the agricultural industry. Financing products include wholesale and retail financing to commercial and developing farmers, cooperatives and other agriculture-related businesses.

The Land Bank's objectives are defined within its mandate, which requires that it should achieve:

- growth in the commercial market
- growth in the development market
- business efficiency
  - service delivery
  - resource management
- sustainability.

(See also Chapter 3: *Agriculture, forestry and fisheries*.)

The Land Bank is the sole shareholder in the Suid-Afrikaanse Verbandversekeringsmaatskappy Beperk, which provides insurance to people indebted to the bank through mortgage loans. A key recent achievement was the diversification of investors to fund the growing loan book.

In 2010/11, the bank launched the domestic medium-term note and secured additional loan capital of R1,1 billion, raised in bank bonds that are subscribed to by investors in the private sector.

## Financial Services Board

The FSB is a regulatory institution established in terms of the FSB Act, 1990 (Act 97 of 1990), to oversee the non-banking financial services industry in the public interest.

### Collective investment schemes (CIS)

CIS are investment structures whereby individual investor funds are pooled with those of other investors. Qualified asset managers regulated under the Financial Advisory and Intermediary Services (FAIS) Act, 2002 (Act 37 of 2002), invest these funds on behalf of the investor. Each investor owns units (participatory interest) in the total fund.

The South African CIS industry has recovered well after the global financial crisis. Total assets under management at the end of March 2011 increased to R962 billion, compared to R817 billion in March 2010, indicating growth of 18%.

CIS shares are generally considered a medium- to long-term investment and past performance is not necessarily a guide to the future.

### Financial advisers and intermediaries

The purpose of the FAIS Act, 2002 is to regulate, in pursuance of consumer protection, the provision of advice and intermediary services to

In July 2011, South Africa's Standard Bank Group was named Africa's top bank in *The Banker* magazine's 2011 rankings of the world's top banks by their Tier 1 capital.

It also rose from 106th to 94th place in the list of 1 000 top banks in the world. Standard Bank had increased its Tier 1 capital to US$12,06 billion, an increase of 26,15% from the previous year and almost twice as much as the second-ranked bank.

certain clients in respect of a range of financial products and services.

The FSB, through the FAIS Division, is responsible for the regulation of the rendering of financial advisory and intermediary services to clients by FSPs in respect of a wide range of financial products.

The provisions of the FAIS Act, 2002 became effective on 30 September 2004. In terms of this Act, before conducting any transaction, consumers should ensure that the FSP they are dealing with has obtained a licence from the FSB. Information on authorised FSPs can be obtained from the FSB website.

## Recognised representative bodies

Section 6(3)(iii) of the FAIS Act, 2002 provides for the Registrar of FSPs to delegate any of its powers in terms of the Act to anybody recognised by the Act. Two such functions, the consideration of applications for licences under Section 8 and the consideration of applications for approval of compliance officers under Section 17(2) of the Act, were delegated to two recognised representative bodies. As recognised examination bodies, another further four bodies are responsible for developing and delivering the regulatory examination.

## Advisory Committee on Financial Services Providers

The Minister of Finance appoints the Advisory Committee on FSPs, whose function it is to investigate and report or advise on any matter covered by the FAIS Act, 2002.

The advisory committee consists of a chairperson and other members, including a representative of the Council for Medical Schemes established by Section Three of the Medical Schemes Act, 1998 (Act 131 of 1998), and persons representative of product suppliers, FSPs and clients involved in the application of this Act, appointed by the Minister after consultation with the board.

The members of the advisory committee, except for the Registrar and Deputy Registrar, who are ex officio members, hold office for a period determined by the Minister.

## Licensing of financial services providers

The Registrar of FSPs authorises and renders ongoing supervision of five categories of FSPs. Category I consists of financial advisers and intermediaries who provide financial services without discretion. Category II FSPs offer discretionary intermediary services in terms of financial product choice, but without implementing bulking. Category IIA FSPs are hedge-fund managers. Category III FSPs are investment administrators specialising mainly in the bulking of collective investments on behalf of clients (linked investment services providers). Category IV FSPs represent assistance business administrators who render intermediary services in terms of the administration of assistance business (funeral policies) on behalf of an insurer to the extent agreed to in a written mandate between the two parties.

The total number of approved FSPs at 31 March 2011 was:

- Category I: 11 322
- Category II: 551
- Category IIA: 117
- Category III: 23
- Category IV: 38.

## Insurance companies

Insurance is divided into long- and short-term insurance. Insurance is an agreement between a policy holder and the insurance company. Under a short-term insurance policy, the insured is entitled to be compensated by the insurer for the loss of or damage to assets caused by the event against which they are insured.

The aim of short-term insurance is to put the insured in the same position they occupied immediately before the loss, depending on the terms and conditions of the policy contract. Examples of short-term insurance include motor-vehicle, household, theft and fire insurance.

By 31 March 2011, there were 108 short-term insurers in South Africa.

In 2011, National Treasury released a policy document entitled, *The South African Micro Insurance Regulatory Framework,* addressing issues such as promoting better access to affordable insurance products that meet relevant risks; better matching of insurance products to the needs of low-income consumers and strengthening consumer protection.

The framework also intends to provide opportunities for informal practitioners in the micro insurance field to enhance their credentials by becoming regulated entities within the sector.

Another objective of this policy is to outline ways in which consumer protection will be enhanced through business conduct regulation, improved enforcement regulations and consumer education interventions aimed at understanding insurance and its associated risks and benefits. It is envisaged that micro-insurance legislation will be tabled in Parliament in 2013.

Long-term insurance includes life and assistance policies that pay a benefit to dependants on the death of the insured person/s, endowment (savings) policies payable at a predetermined date, disability policies, pensions and retirement policies, or even a combination of these.

By 31 March 2011, there were 87 long-term insurers in South Africa.

In terms of the Long-Term Insurance Act, 1998 (Act 52 of 1998), and the Short-Term Insurance Act, 1998 (Act 53 of 1998), all insurance companies must be registered by the FSB and must comply with the provisions of these Acts.

The insurance industry has appointed a short- and long-term insurance ombudsman to mediate dispute resolution between insurers and policyholders.

### Market abuse

The Directorate: Market Abuse is an FSB committee responsible for combating market abuse in the financial markets in South Africa. The three forms of market abuse prohibited in South Africa are insider trading, price manipulation and publication of false or misleading statements.The members of the directorate are representative of the legal and accounting professions, financial markets, the banking industry, the fund managers' industry, the SARB and investors.

All three forms of market abuse are criminal contraventions. In addition, an offender may be referred to the FSB Enforcement Committee, which can impose unlimited penalties. In the case of insider trading contravention, such penalties are distributed to persons who were prejudiced by the offending transactions.

### Retirement funds

At 31 March 2011, there were 10 032 registered retirement funds supervised by the FSB. Of these, 3 160 funds were active, while the remainder comprised funds that are dormant, in orphan status (i.e. without boards of management), under curatorship, or being deregistered or liquidated.

The latest available statistics for the year ended 31 December 2009 are from the Government Employees Pension Fund, Transnet and Telkom funds, bargaining council funds not registered with the FSB and 75% of registered funds that submitted financial statements. The last-mentioned constitute about 94% of the assets of funds registered with the FSB.

Total membership of retirement funds in South Africa at 31 December 2009 was 11 679 959. Of this, 9 132 816 were active members and 2 547 143 pensioners, deferred pensioners and dependants.

Total contributions received by retirement funds in South Africa increased by 10,3% from R101,8 billion in 2008 to R112,3 billion in 2009. Total benefits paid by retirement funds in South Africa, which include pensions, lump sums on retirement, death and resignations, decreased by 4,2%, from R142,3 billion in 2008 to R136,2 billion in 2009.

### Enforcement

In November 2008, the FSB Enforcement Committee was established by an amendment to the Financial Institutions (Protection of Funds) Act, 2001 (Act 28 of 2001), replacing the Capital Markets Enforcement Committee. The committee is an administrative tribunal that has jurisdiction to impose penalties, compensation orders and cost orders against persons who contravene any FSB law. Its predecessor only had jurisdiction over market-abuse contraventions.

Since November 2008, the committee has adjudicated on a wide spectrum of contraventions of FSB legislation, and imposed substantial penalties. If a respondent defaults on the payment of a penalty, the High Court Registrar may issue a warrant of execution as if the committee determination was a High-Court order. Respondents have a right of appeal to the High Court of South Africa against a determination made by the committee.

## Financial markets

Global capital markets were characterised by high levels of capital inflows into emerging markets, the sovereign debt crisis in peripheral Europe, and the Dubai crisis, in the first half of 2010. Attractive returns in emerging debt markets coupled with higher growth prospects impelled investors around the globe to seek higher-yielding emerging market assets, particularly in the second half of the year.

The South African capital market had its fair share of capital inflows with a substantial amount finding its way to the local currency government bond market.

## Government bonds

### Retail bonds

Retail bonds can be purchased from National Treasury, the South African Post Office and Pick n Pay stores countrywide. Since the introduction of RSA fixed-rate retail savings bonds in May 2004 and inflation-linked retail bonds in April 2007, the cumulative amount reached R11,9 billion on 31 March 2011.

Government first issued these bonds to encourage South African citizens to save. These bonds are easily accessible through various distribution channels across the country. The number of investors has increased over the past six years.

Due to general familiarity with fixed deposits as made available by the commercial banks, investors in the RSA retail bonds are more inclined to invest in a predictable product such as fixed-rate investment. There has been increased investment in inflation-linked bonds, mainly due to the decline in stereotype associated with fixed-rate investments.

## Domestic capital market bonds

The strength of South Africa's macroeconomic indicators and higher global demand for emerging market debt has led to rising international interest in South African government bonds. Non-residents' purchases of domestic bonds more than doubled from a net R27 billion in 2009 to a net R56 billion in December 2010. In the first nine months of 2010, non-residents purchased a net of R73 billion worth of domestic bonds, with a historic high of R81 billion in September 2010. With investor sentiment changing, there was a sell-off, resulting in cumulative net purchases declining to R52 billion in March 2011. The sell-off has led to some weakness in government bond yields, which are moderate compared to the previous high level.

Among the most traded bonds in the market are the R157 (13%: 2015) and the R186 (10,5%: 2026).

The daily yields on the R157 government bond averaged 7,697% in 2011, after closing 2010 at the average of 7,736%, from a daily average of 8,181% in 2009.

The R186 government bond averaged 8,691% in 2011, after closing 2010 at the average of 8,612% as opposed to 8,698% in 2009.

The average spread between the R157 and the R186 widened to just below 100 basis points from 2010's average of about 88 basis points.

The break-even inflation rate – calculated as the differential between fixed-interest bond yields and the real yields of inflation-linked government bonds within the three-year maturity range – was at 5,82% in April 2010 and narrowed to 5,65% in April 2011. The long-term break-even inflation rate narrowed from 6,63% in April 2010 to 6,5% in April 2011, owing to stronger real yields being driven down by the demand for inflation-linked bonds.

## Primary market

Government funding in the domestic primary market is done through long-term market loans, which comprise fixed-income bonds, inflation-linked bonds, floating-rate notes and retail bonds. Fixed-income bond issuances constitute most of the total bond issuance, and were issued at a weighted average nominal yield of 8,3%, while inflation-linked bonds were issued at a weighted average real yield of 2,9% in the previous year.

Four new domestic bonds were issued in 2010 – the two new fixed-income bonds, R213

**Exchange rates of the Rand (percentage change)**

| | 30/09/10 – 31/12/10 | 31/12/10 – 31/03/11 | 31/03/11 – 30/06/11 | 30/06/11 – 31/08/11 |
|---|---|---|---|---|
| Weighted average | 5,4 | -5,0 | -1,5 | -4,0 |
| **Euro** | 7,3 | -8,2 | -2,0 | -3,1 |
| **US Dollar** | 5,1 | -2,4 | 0,0 | -3,5 |
| **Chinese Yuan** | 3,6 | -3,0 | -1,3 | -4,7 |
| **British Pound** | 7,8 | -6,2 | 0,8 | -5,1 |
| **Japanese Yen** | 2,8 | -0,7 | -2,8 | -8,0 |

* Against a basket of 15 currencies

Source: South African Reserve Bank, *Quarterly Bulletin*, September 2011.

(7%: 2031) and R214 (6,5%: 2041), and two new inflation-linked bonds, R211 (2,5%: 2017) and R212 (2,75%: 2022). All were well received by market participants and their volume has increased sufficiently to contribute to the improved market turnover.

## International bonds

For the first time ever, South Africa priced a US$750 million 30-year global bond in the international capital markets on 1 March 2011. The bond was priced at a yield of 6,292%, a coupon (interest) of 6,25% and a spread of 180 basis points above the 30-year US Treasury's benchmark bonds. The coupon (interest) of 6,25% compares favourably to the coupon of the 10-year global Dollar coupon issued in 2010 at 5,5%, with an increase of only 75 basis points.

South Africa's bond spreads traded below those of many of its peers towards the end on 2010. On 15 November 2010, the RSA global bond maturing in 2020 reached a spread of 95 basis points over the underlying US Treasury bond, and has since widened to 130 basis points, while the new 2041 narrowed to 158 basis points at end of April 2011.

Higher sovereign debt issuance in world markets and non-resident purchases of domestic bonds reduced demand for rand-denominated debt issued in Europe (EuroRand bonds) and in Japan (Uridashi bonds); with negative net issuances of R10,5 billion and R7 billion respectively in 2010.

## Secondary market

The local bond market continued to benefit from prudent macroeconomic policies, which saw the country through the global financial crisis in 2008. The turnover on the domestic bond market reached a record high of R19,2 trillion in 2008 before declining significantly to R13,4 trillion in 2009. In 2010, turnover increased to R17 trillion with support from non-residents.

Non-residents contributed about 36% to total turnover in March 2011, while local investors added the remaining 64%. The bond market capitalisation on the Johannesburg Stock Exchange (JSE) Ltd amounted to R1,3 trillion in March 2011, with government contributing the largest share of 59% to the total market capitalisation, followed by corporates at 19%. Plain vanilla bonds accounted for 71% of the total listing on the exchange in terms of instrument composition, while inflation-linked and floating rate contributed 14% and 10% respectively.

> In October 2011, government relaxed foreign exchange-control rules for individuals, making it easier for citizens to invest up to R5 million abroad a year, comprising an annual R4-million foreign investment allowance plus a R1-million single discretionary allowance.
>
> National Treasury also allows companies to top up capital in their offshore businesses, and has relaxed rules for corporations that want to invest outside their current business lines.
>
> Limits for individuals on alimony, wedding and travel allowances were done away with.

## Exchange rates

Subsequent to a decline of 5% in the first quarter of 2011, the nominal effective exchange rate of the Rand decreased by a further 1,5% from the end of March 2011 to the end of June 2011.

The Rand depreciated most notably against the Euro and the Japanese Yen, partly as a result of the rescue packages granted to certain European countries to avoid sovereign debt restructuring and to assist Japan in recovering from the natural disaster experienced earlier in 2011.

However, the exchange value of the Rand was cushioned by strong demand for high-yielding assets, elevated commodity prices, and a sizeable inward foreign direct investment (FDI) transaction in which a non-resident party acquired the majority equity stake in a domestic retail and wholesale group.

Elevated commodity prices and a weaker US dollar partly supported the external value of the Rand in April 2011. Following this, the nominal effective exchange rate of the Rand decreased in May 2011 before increasing in June, when it was affected by the depreciation of the Euro and the British Pound. During July and August 2011, the nominal effective exchange value of the Rand decreased by 4% as the Rand depreciated against all major currencies.

The real effective exchange rate of the Rand decreased by 0,7% in the year to June 2011 but increased by 1,3% on a month-to-month basis in the same month.

The average net daily turnover in the domestic market for foreign exchange decreased from US$23,3 billion in the first quarter of 2011 to US$22,6 billion in the second quarter. This decrease could largely be attributed to a decline in the value of non-resident swap transactions, which decreased from US$11,1 billion per day to US$9,5 billion per day over the period.

As a result, domestic banks' share (i.e. authorised dealers in foreign exchange) in the turnover in the domestic market for foreign exchange gained some ground.

## Exchange controls

Exchange-control regulations are administered by the SARB on behalf of the Minister of Finance. The Minister of Finance has also appointed certain banks to act as authorised dealers in foreign exchange, as well as authorised dealers with limited authority in foreign exchange, which gives them the right to buy and sell foreign exchange, subject to conditions and within limits prescribed by the Financial Surveillance Department (FSD) of the SARB. Authorised dealers are not agents of the FSD, but act on behalf of their customers.

Since 1994, South Africa has considerably reformed its exchange-control policies. The approach has been directed at the gradual liberalisation and relaxation of exchange controls, with the intention of replacing them with a strategy aligned to the broader macroprudential approach as part of the long-term exchange-control reform strategy.

There have been gradual exchange-control reforms concerning individuals, corporates and institutional investors. The liberalisation has been focused on progressively increasing the individual foreign capital allowance, increasing institutional investors' foreign exposure and allowing South African firms to raise capital and expand their operations offshore from a domestic base.

Since the drive to liberalise exchange controls in South Africa, in 2010 the Minister of Finance granted the following exchange control dispensations:

## Emigrants' blocked assets

A system of exchange control allowances for the export of blocked assets when persons emigrate has been in place in South Africa for a number of decades. In the past, emigrants qualified for a foreign capital allowance of R4 million and R8 million in respect of emigrating individuals and families respectively. Holders of blocked assets wishing to exit more than R4 million/R8 million had to seek approval from the FSD and approval was subject to an exiting schedule and an exit levy of 10% of the excess amount being requested. The R4 million/R8 million limits would be inclusive of the amounts already exited.

In 2010, permission was granted to release all emigrants' blocked assets without the application of the exit levy.

## Private individuals residing in South Africa

In 2010, the R4-million offshore capital investment allowance limit for individuals, which was a lifetime limit, was increased to an annual limit of R4 million, subject to compliance with tax legislation. In addition, the single discretionary allowance was increased from R750 000 to R1 million per calendar year, per resident over the age of 18 years, without the requirement that a tax clearance certificate be obtained, which may be apportioned for the purpose of:

- maintenance transfers to the father, mother, brother or sister of the applicant against the production of documentary evidence
- gifts and loans to non-resident individuals or to resident individuals who are overseas temporarily
- donations to missionaries, against production of a letter from an official or recognised religious body confirming that the beneficiary is a missionary
- travel allowance
- study allowance.

## Institutional investors

Exchange-control limits on foreign investment by institutional investors such as insurers, pension funds, CIS and investment managers have been liberalised gradually since 1996. Foreign diversification of investment portfolios, consistent with prudential limits, has largely been achieved.

In 2008, the Minister of Finance announced the removal of exchange controls on South African institutional investors and the implementation of prudential regulation of foreign exposures. The controls on foreign-currency transactions that had previously defined the exchange-control regime were replaced by a system of reporting and monitoring of foreign exposures, as part of a broader framework for risk-based financial regulation and supervision.

Retirement funds, long-term insurers, CIS management companies and investment managers are allowed to transfer funds from South Africa for investment abroad, for example:

- retirement funds and the underwritten policy business of long-term insurers may invest up to 30% of total retail assets; investment managers registered as institutional investors for exchange-control purposes, CIS management companies and investment-linked businesses of long-term insurers are restricted to 35% of total retail assets under management
- institutional investors are allowed to invest an additional 5% of their total retail assets by acquiring foreign-currency denominated portfolio assets in Africa through foreign-currency transfers from South Africa or by acquiring approved inward-listed instruments based on foreign reference assets or issued by foreign entities listed on the JSE Ltd
- foreign companies, governments and institutions may list instruments, including derivative instruments, based on foreign reference assets, on South Africa's bond and securities exchanges
- institutional investors are required to report quarterly on the allocation of assets according to the major asset classes and provide information from institutions in excess of the foreign-asset limit on proposed portfolio adjustments to bring foreign asset levels back in line.

South African institutional investors may invest in rand-denominated instruments issued abroad as well as instruments issued by South African corporates in the offshore market, on condition that the institutional investor remains within its applicable foreign-portfolio investment allowance.

Research was underway in 2011 to complete the move from control-based to principle-based prudential regulation of foreign exposure for institutional investors and to finalise the definition of foreign assets that capture the underlying risk.

## South African corporates

Mandated parastatals, as defined in Schedule 2 of the PFMA, 1999, private companies, public companies and listed companies wishing to make bona fide new outward FDIs into companies, branches and offices outside the Common Monetary Area (CMA), comprising South Africa, Namibia, Swaziland and Lesotho, where the total cost of such new investments does not exceed R500 million per company per calendar year, may do so without prior approval of the FSD. Where the total cost of such investments exceeds R500 million per investment, such transactions require prior approval from the FSD. However, no investment limit applies to corporates investing offshore.

The exchange-control requirement that a shareholding of at least 25% is obtained was replaced with the requirement that at least 10% of the foreign target entity's voting rights must be acquired. In addition, the prohibition of the South African Development Community loop structures has been abolished, while the policy regarding loop structures into the CMA remains extant.

Authorised dealers may also extend foreign currency-denominated facilities to South African corporates for financing approved FDI. To further enable South African companies, trusts, partnerships and banks to manage their foreign exposure, they were, with effect from February 2008, permitted to participate without restriction in the Rand Futures Market on the JSE Ltd. This dispensation was also extended to investment in inward listed (foreign) instruments on the JSE Ltd.

Corporates that had existing approved subsidiaries abroad were allowed to expand such activities without prior approval, subject to certain conditions. Dividends declared by the offshore subsidiaries of South African corporates may be retained offshore and used for any purpose, without recourse to South Africa.

The modernisation of the current exchange-control framework is inspired by the realisation that the existing exchange-control regime is outdated and that it may lead to a negative perception of the South African economy globally, which could impede on the country's ability to attract FDIs.

In this regard, National Treasury released a discussion document entitled *A Review Framework for Cross Border Direct Investment into South Africa*, with a view of developing a policy framework that would ensure consideration is given to public interest in inbound FDI into the country's strategic sectors in a more transparent manner.

In February 2011, the Johannesburg Stock Exchange (JSE) Ltd announced that it was getting a new trading system that would make equity market transactions 400 times faster. The migration was planned for the first half of 2012.

The JSE would move its equity market trading activity – the buying and selling of company shares – onto a system called Millennium Exchange. The new system will operate from Johannesburg, instead of London where it was based.

## Gateway to Africa

In support of government's broader strategy to make South Africa the gateway into Africa, exchange-control reforms to complement tax proposals for attracting international headquarter companies that wish to invest in the rest of Africa using South Africa as a base were announced in the 2010 Medium Term Budget Policy Statement.

The main criterion to comply with for the International Headquarter company (IHQ) to be approved for registration with the SARB, in line with the tax proposal, is that South African shareholders will have no more than a 20% shareholding in the headquarter company. The company will therefore remain a majority foreign-owned company and be treated as a foreign company for the purposes of exchange-control other than reporting. The shares and/or debt of the IHQ may not be listed on the JSE Ltd nor may the shares in the IHQ be directly or indirectly held by a shareholder with shares or debt listed on the JSE Ltd.

The transactions of South African firms with the IHQ company will be treated in the same way as any other transaction with a foreign entity. Since the IHQ company is foreign-owned with at least 80% of the assets consisting of foreign shares and foreign loans, the approach is to allow the company to play a major role in capital deployment in South Africa and the rest of Africa. The IHQ company is allowed to borrow freely from abroad and on-lend to foreign locations (mostly Africa) through South Africa.

In October 2011, the stock exchanges of the BRICS emerging market bloc – Brazil, Russia, India, China and South Africa – announced an initiative to cross-list benchmark equity index derivatives on each other's boards, in an effort to expose investors to opportunities in the world's leading developing markets.

The initiative was announced at the 51st annual general meeting of the World Federation of Exchanges in Johannesburg.

The initiative brings together the Bolsa de Valores, Mercadorias & Futuros de São Paulo from Brazil, Moscow Interbank Currency Exchange from Russia, Hong Kong Exchanges and Clearing Limited as the initial China representative, and South Africa's JSE Limited.

The National Stock Exchange of India and the BSE Limited (formerly known as Bombay Stock Exchange) have signed letters of support and will join the alliance after finalising outstanding requirements.

These seven exchanges represent a combined listed market capitalisation of US$9,02 trillion, equity market trading value per month of $422 billion and 9 481 companies listed. They also accounted for over 18% of all exchange-listed derivative contracts traded by volume worldwide, in June 2011.

Appropriately mandated private equity funds meeting certain criteria are also allowed to obtain upfront approval from FSD for investments into Africa.

## Active currency management

With effect from 15 April 2010, authorised dealers may provide active currency management facilities to their South African resident and non-resident clients (excluding transactions by private individuals trading on online platforms).

Authorised dealers may grant forward cover to their South African resident clients with an underlying foreign-exchange exposure, without the necessity to view suitable documentary evidence at the time of entering into the contract, provided that the duration of the exposure is less than six months.

## Local financial assistance to affected persons and non-residents

To improve access to domestic credit in financing FDI in South Africa or for domestic working capital requirements, since October 2009 foreign investors have been allowed to borrow domestically, without restriction, to finance FDIs. Affected persons and non-residents who will use the funds for financial transactions and/or to acquire residential property in South Africa will be restricted to the 1:1 ratio that applies to these transactions. Local financial assistance made available to emigrants remains subject to the 1:1 ratio.

## Customer foreign currency (CFC) accounts and foreign bank accounts

Effective from October 2009, South African entities (legal persons) operating CFC accounts are permitted to retain funds in their CFC accounts without the obligation to convert the funds into rand, with the current repatriation requirement remaining extant. South African companies are permitted to open and operate foreign bank accounts, without prior approval of Excon, for the accrual of funds in respect of transactions permissible in terms of the exchange-control rulings or a specific exchange-control authority.

## JSE Limited

As South Africa's only full-service securities exchange, the JSE Ltd connects buyers and sellers in different markets such as equities, which include a primary and secondary board; equity derivatives; agricultural derivatives; and interest-rate instruments. The JSE Ltd is one of the top 20 exchanges in the world in terms of market capitalisation.

The JSE Ltd is the market of choice for local and international investors looking to gain exposure to the leading capital markets in South Africa and the broader African continent. The JSE Ltd also provides companies with the opportunity to raise capital in a highly regulated environment through its markets: the Main Board and AltX, the Alternative Exchange. A respected brand associated with high market integrity, the JSE Ltd is regarded as a mature, efficient, secure market with world-class regulation, trading, clearing, settlement assurance and risk management.

The exchange has been part of that process, playing an instrumental role in creating the internationally prominent King II Code on Corporate Governance. The JSE Ltd's listing requirements demand that all companies adhere to key concepts of King II and all companies are required to report on their level of compliance with the code in their annual financial statements. Furthermore, the JSE Ltd has harmonised its listing requirements, disclosure and continuing obligations with those of the London Stock Exchange and offers superb investor protection.

The JSE Ltd renders a diversified range of products and services. It provides investors with the opportunity to trade a multitude of financial instruments, and at the heart of its diversified product offerings are single stock futures (SSFs). This area has grown substantially to become one of the five largest in the world.

SSFs are ideal for conservative investors seeking to hedge their share portfolios, or for sophisticated speculators seeking geared exposure to anticipated share price movements. This market also offers investors derivatives on indices, Kruger rands, dividend futures as well as can-do options, which give investors the advantage of listed derivatives with the flexibility of over-the-counter contracts.

The JSE Ltd's Agricultural Products Market reflects the commitment to providing versatility in the product offering.

It is a transparent electronic market used vigorously in the price-risk management of commodities through futures. This market continues to grow due to a greater understanding of its function and the development of a broader base of marketing strategies based on the derivative products. It is the first market in the world for trading both the cash spot bond (secondary trading) as well as the interest-rate derivative products on one trading platform.

The JSE Ltd provides total price transparency through its world-class information systems. The trading activity on the markets generates a wide range of data that assist market participants with make-or-break investment decisions.

The JSE Ltd has both domestic and global reach in terms of the provision of all its information, through data-providers, investment banks, other financial industry stakeholders and directly through the exchange.

JSE Ltd experienced a fair year in challenging conditions in 2010, driven by strong performances from the cash equity market, information product sales and commodity derivatives. Group revenues climbed by 9% to R1 255 million, up from R1 156 million in 2009, in a year of focus on operational projects and responding to changes in the global exchange industry.

JSE Ltd's operating costs before net finance income rose by 8% to R879 million, from R810 million in 2009, resulting in a net profit after tax of R378 million. Much of the cost increase can be attributed to costs related to JSE Ltd's large IT projects, which required increased staff numbers.

JSE Ltd had no borrowings in 2010, and R1 046 million in cash reserves, up from R921 million in 2009.

Revenue from the issuer services division rose to R86 million, mainly owing to the inclusion of 12 months of revenue from the interest rate market. In June 2009, JSE Ltd acquired the Bond Exchange South Africa (BESA). The JSE's issuer services division generates revenue from all listings, including companies, bonds and other instruments. The number of new company listings on the JSE rose from 10 to 14 in 2010, including one on AltX and one on the Africa Board.

Equities trading revenue again grew strongly, up 5% year-on-year, from R310 million in 2009 to R325 million in 2010, owing to growing trading volumes. The number of daily equity trades increased 13% year-on-year. A new equities billing model aimed at incentivising increased trade was implemented in March 2010.

In the equity derivatives market, the number of futures contracts traded rose in terms of value and number, but revenue fell slightly owing to a changed product mix. Trade in international derivatives grew particularly strongly. The team continues to bring new products to the market. To encourage a move to a central order book and to stimulate greater activity on the equity derivatives market, the JSE Ltd introduced the maker-taker billing model in July 2010.

Trade in currency derivatives for 2010 was slightly down from 2009 levels. In 2010, the JSE added contracts on the Swiss Franc and Chinese Yuan.

The commodities derivatives market performed well in 2010, with a 12% rise in commodity derivative contracts to 2,1 million. This is largely owing to a rise in volumes traded in its oldest product set – agricultural product derivatives – but also aided by the expansion of trade into new hard commodities products thanks to a licensing agreement with the CME Group.

Increased revenue from the interest rate market results from the inclusion of 12 months of revenue against six months the previous year, when it was acquired from the BESA. Revenue fell 10% to R35 million. Bond market volumes in 2010 were driven partly by foreigners entering the South African bond market, with net purchases valued at R58,6 billion. Interest rate derivatives volumes continued to grow off a low base. The JSE continues to discuss the model and ways forward with all market participants.

The Information Products Sales division's focus on previously untapped markets paid off. This is one of the reasons why revenue grew 7% to R117 million in 2010, from R109 million in 2009.

## Strate Limited

Since its inception over 10 years ago, Strate Ltd is the licensed Central Securities Depository for the electronic settlement of financial instruments in South Africa.

Strate Ltd's core purpose is to mitigate risk, bring efficiencies to the South African financial markets and improve its profile as an investment destination. Strate Ltd is aligned to international best practices and strives to ensure operational excellence and provide enhancements for the good of the southern African financial markets.

Strate Ltd handles the settlement of a number of securities, including equities and bonds for the JSE Ltd, as well as a range of derivative products such as warrants, exchange traded funds, retail notes and tracker funds. It has added the settlement of money-market securities to its portfolio of services.

## Acknowledgements

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*Budget 2012, People's Guide*, published by National Treasury
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