SA YEARBOOK 2007/08 | FINANCE

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

In support of government's Accelerated and Shared Growth Initiative for South Africa (AsgiSA), National Treasury's work on fiscal policy and budget reform focuses on strengthening infrastructure investment and maintenance, broadening participation in the economy and improving the quality of social services.

Improved budget planning, better documentation and greater transparency in public finances continue to be key priorities. National Treasury is expanding its capacity to provide technical support, particularly for infrastructure planning and project management.

The Constitution of the Republic of South Africa, 1996, lays down 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 also creates an independent auditor-general (AG) and an independent central bank, and sets out the principles governing financial accountability to Parliament, as well as the annual budget process.

Planning and budgeting challenges associated with the 2010 FIFA World Cup™ are being addressed through a dedicated unit, working closely with the Organising Committee and the Deputy Minister of Finance. Spending on stadium construction and transport systems for the 2010 World Cup will occur during the Medium Term Expenditure Framework (MTEF) period.

Fiscal policy framework

The Minister of Finance, Mr Trevor Manuel, presented the national Budget for 2007/08 in February 2007.

Spending changes for the next three years included:

- an additional R13,3 billion for the 2010 World Cup, bringing the total contribution from national government to R17,4 billion – R8,4 billion for stadiums and R9 billion for transport infrastructure
- the provincial equitable share was increased by R24,6 billion to improve the quality of and access to health, school education, welfare and economic services
- an additional R5 billion to the local government equitable share provides further support to municipalities for the delivery of free basic services
- an additional R4,6 billion for teacher bursaries and curriculum development and an increase in higher-education subsidies
- R11,6 billion for housing and community development
- R3,7 billion for the HIV and AIDS and STI Strategic Plan for South Africa and modernising hospitals and health facilities
- R2,4 billion for industrial development, science and technology
- R6,8 billion for justice and crime prevention, and improved access to justice services
- R4,7 billion for international relations and defence.

The main tax proposals included:

- net tax relief of R12,4 billion, replacing the secondary tax on companies with a dividend tax, and reducing the rate from 12,5% to 10%
- personal income tax relief for individuals amounting to R8,4 billion
- abolishing the tax on retirement funds
- reducing the withholding of tax on lump-sum pension and providend fund payments to zero for persons earning below R43 000 per year
- increases in excise duties on tobacco products and alcoholic beverages.

Debt management

Twelve years of prudent macroeconomic policy have contributed to a robust economy capable of both sustaining and accelerating the growth trajectory. The uniqueness of South Africa's economic landscape is reflected in the fact that government is increasing capital and socio-economic expenditure, even as it continues to enjoy a positive fiscal balance, and is reducing the amount of money it needs to borrow. As a result, government's net loan debt as a percentage of gross domestic product (GDP) decreased, from 48,1% in 1996/97 to 27,1% in 2006/07.

South Africa's public finances do not centre on servicing debt, but on the essential pillars of human development – poverty reduction, health, education and job creation. Interest costs measured as a percentage of revenue and GDP have fallen to historically low levels, as a result of a favourable interest-rate outlook and lower debt stock. A decade ago, government spent 18 cent of every rand on servicing debt. This decreased to 11 cent in 2007, and by 2009 the figure is expected to be around eight cent. Consequently, the debt burden on future generations continues to decline, releasing additional resources for economic development and poverty relief.

Government's debt-management strategy seeks to enhance liquidity in an environment of declining borrowing requirements. During 2007/08, liquidity was expected to be enhanced through continued issuance in existing benchmark bonds and the further diversification of the debt portfolio, by issuing a new inflation-linked bond and inflation-linked retail bonds. The foreign-debt-management strategy will focus on active debt management.

To reduce external vulnerability, government continues to work with the South African Reserve Bank (SARB) to improve the level of official reserves. Financial stability has contributed to the cost of capital remaining at historically low levels, and the sovereign risk premium continues to fall. As a result, the country's international credit ratings are improving, enabling government to borrow at more competitive rates in the global markets.

In December 2006, Rating and Investment Information of Japan upgraded South Africa's long-term sovereign debt credit rating from BBB+ to A-. Moody's Investors Service, Standard and Poor's and Fitch Ratings reaffirmed the country's BBB+ credit rating for 2006.

Government's initiatives to improve the financial performance and corporate governance of state-owned enterprises (SOEs) are paying off through increased infrastructure investment, contributing to further economic development. The major public entities plan to invest about R152 billion in infrastructure development over the three-year expenditure period. A lower borrowing requirement reduces government debt issuance in the market, providing the opportunity for SOEs and other companies to finance their operations at lower cost.

Risk management continues to focus on government-wide risk management, which includes identifying and quantifying risks to the fiscus.

Fitch Ratings has revised the outlook on South Africa's sovereign ratings from stable to positive, attributing the change to improved growth performance, increased investments and sound public finances.

South Africa's long- and short-term foreign currency issuer default ratings (IDRs) were affirmed at BBB+ and F3 respectively. The country's long-term local currency IDR was affirmed at A, as was the country ceiling.

Increased government savings and the use of fiscal surpluses to increase reserves have also reduced South Africa's external vulnerability.

South Africa's growth rate of 5% was sustained between 2004 and 2006 by strong consumer demand, while more recently, acceleration of capital investment reflected a massive infrastructure investment by the country's public corporations – both as part of the Government's general infrastructure programme and for infrastructure related to hosting the 2010 World Cup.

The agency said it expected consumer demand to remain firm despite rising interest rates, thanks to structural changes in the economy and a rise in employment and real income.

Fitch expected the country's growth rate to remain close to 5% in 2007 and predicted that potential growth would increase in the medium term. The agency also expected South Africa's current account deficit to remain between 6% and 7% of GDP.

Legislation

National Treasury tables a significant amount of legislation in Parliament annually. Legislation passed in 2006/07 included the:

- Appropriation Act, 2006 (Act 7 of 2006)
- Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006 (Act 9 of 2006)
- Second Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006 (Act 10 of 2006)
- Adjustments Appropriation Act, 2006 (Act 14 of 2006)
- Revenue Laws Amendment Act, 2006 (Act 20 of 2006)
- Revenue Laws Second Amendment Act, 2006 (Act 21 of 2006)
- Division of Revenue Act, 2007 (Act 1 of 2007)
- Finance Act, 2007 (Act 2 of 2007).

Legislation expected to be tabled in 2007/08 included the:

- Appropriation Bill
- Taxation Laws Amendment Bill
- Taxation Laws Second Amendment Bill
- Adjustments Appropriation Bill
- Revenue Laws Amendment Bill
- Second Revenue Laws Amendment Bill

Consolidated national, provincial and social-security fund expenditure: Functional classification[1]

	2006/07		2007/08		2008/09	
	Revised estimate	% of total	Budget estimate	% of total	Budget estimate	% of total
General government services and unallocable expenditure[2]	29 077,3	6,6%	34 796,1	6,9	38 076,9	6,8
Protection services:	77 638,3	17,6	86 993,4	17,3	94 202,8	16,9
Defence and intelligence	26 561,5	6,0	29 054,0	5,8	31 271,3	5,6
Police	34 256,7	7,8	37 969,7	7,6	41 309,7	7,4
Prisons	9 525,5	2,2	11 086,5	2,2	11 742,0	2,1
Justice	7 294,7	1,7	8 883,3	1,8	9879,7	1,8
Social services:	**264 925,5**	**59,9**	**296 630,8**	**59,0**	**331 833,2**	**59,8**
Education	94 979,1	21,5	104 672,0	20,8	117 176,7	21,0
Health	54 527,2	12,3	60 264,2	12,0	66 066,5	11,8
Social security and welfare	81 359,2	18,4	89 509,3	17,8	98 420,4	17,6
Housing	9 088,0	2,1	11 912,2	2,4	14 672,0	2,6
Community development[3]	24 972,0	5,6	30 273,0	6,0	35 497,6	6,4
Economic services:	**70 344,9**	**15,9**	**84 029,1**	**16,7**	**93 958,0**	**16,8**
Water schemes and related services	6 806,6	1,5	9 066,4	1,8	10 632,6	1,9
Fuel and energy	3 909,0	0,9	2 996,4	0,6	3 418,7	0,6
Agriculture, forestry and fishing	10 240,6	2,3	12 621,9	2,5	13 568,6	2,4
Mining, manufacturing and construction	3 027,9	0,7	3 504,1	0,7	2 460,3	0,4
Transport and communications	28 524,1	6,5	34 530,9	6,9	40 173,5	7,2
Other economic services[4]	17 836,7	4,0	21 309,4	4,2	23 704,4	4,2
Subtotal:						
Votes and statutory amounts	**441 986,0**	**100,0**	**502 449,5**	**100,0**	**558 071,0**	**100,0**
Plus contingency reserves	–	–	3 000,0	–	8 000,0	–
Total non-interest expenditure	441 986,0	–	505 449,5	–	566 071,0	–
Interest	52 178,0	–	52 916,0	–	52 967,0	–
Total consolidated expenditure	**494 164,0**	**–**	**558 365,5**	–	**619 038,0**	–

1) *These figures were estimated by National Treasury and may differ from data published by Statistics South Africa. The numbers in this table are not strictly comparable to those published in previous years, due to the allocation of some of the unallocable expenditure for previous years. Data for the previous years have been adjusted accordingly.*
2) *Mainly general administration, cost of raising loans and allocable capital expenditure.*
3) *Including cultural, recreational and sport services.*
4) *Including tourism, labour and multipurpose projects.*

Source: *2007 Budget Review*

- Municipal Fiscal Powers and Functions Bill
- Pension Funds Amendment Bill
- Banks Amendment Bill
- Diamonds Export Levy Bill
- General Finance Laws Amendment Bill
- Mineral and Petroleum Royalty Bill
- Western Cape Fuel Levy Bill
- Co-operative Banks Bill
- Financial Intelligence Centre (FIC) Amendment Bill
- Financial Institutions Amendment Bill.

A number of other pieces of draft legislation were under consideration and expected to be tabled in the short and medium term, pending the outcome of policy, drafting and consultation processes. These included the:

- Public Finance Management Amendment Bill, which will amend the Public Finance Management Act (PFMA), 1999 (Act 1 of 1999), to address, among other things:
  - practical difficulties encountered in implementing the PFMA, 1999
  - the incorporation of recent and intended budget-reform initiatives
  - improved financial regulation of public entities
  - the Direct Charges Bill, which will authorise certain withdrawals and payments from the National Revenue Fund as direct charges
- Regulation of Tax Practitioners Bill.

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.

Since then, there have been 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
- departments submitting monthly expenditure reports on actual expenditure incurred, and on projected expenditure for the remainder of the financial year
- risk-management processes, which are now being implemented by institutions
- establishing internal-audit functions and audit committees in all departments
- setting accounting standards in accordance with best accounting practices, both locally and internationally
- 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.

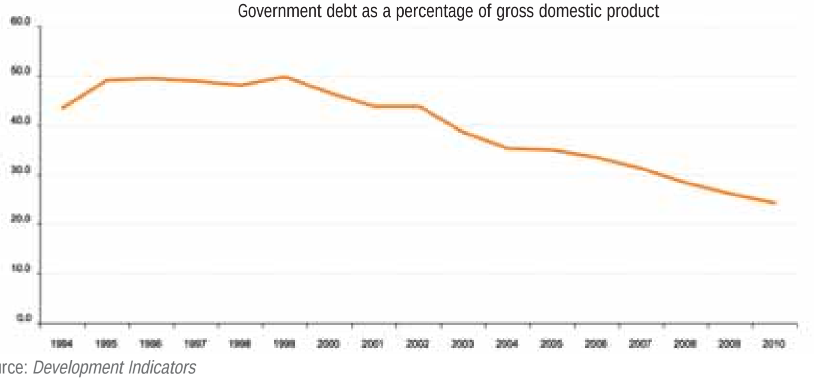
To further improve the financial-management skills of public-sector finance practitioners, the South African Management Development Institute has, in association with the National Treasury, developed the Financial Management Training Strategy.

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

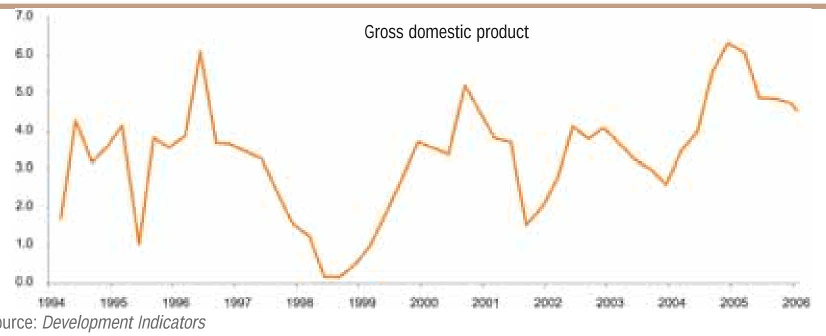
The MFMA, 2003 became effective on 1 July 2004. The Act aims to modernise budget and financial management by placing local-government finances on a sustainable footing to maximise capacity in municipalities to deliver services to all residents, customers, users and investors.

It also aims to implement a sound financial-governance framework, by clarifying and separating the roles and responsibilities of the

Government debt as a percentage of gross domestic product



Source: *Development Indicators*



Source: *Development Indicators*

mayor, executive and non-executive councillors, and officials.

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 the fiscal and financial affairs of municipalities and municipal entities
- managing their revenues, expenditures, assets and liabilities, and handling their financial dealings
- budgetary and financial-planning processes and co-ordinating processes of organs of state
- borrowing
- handling financial problems and other financial matters in municipalities.

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.

Financial Sector Charter

The Financial Sector Charter was signed in November 2003, signalling a key milestone in the transformation of the financial sector.

The charter seeks to ensure the broad-based transformation of the sector, based on the following elements: human-resource development (HRD), procurement and enterprise development, access to financial services, empowerment financing, ownership, control and corporate social investment.

National Treasury

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 AG's performance. It also assists Parliament, through the Standing Committee on Public Accounts (Scopa), with its recommendations and the formulation of corrective actions. National Treasury closely monitors the performance of state departments and is obliged to report any deviations to the AG.

National Treasury furthermore 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.

Exchange-control reforms

Further reforms were announced in the Febuary 2007 Budget Speech. Two of the reforms dealt with simplifying customer foreign-currency accounts and lowering the outward foreign direct investment (FDI) threshold for investments by South African entities outside of Africa, from controlling interest to at least 25%.

The JSE Securities Exchange Limited (JSE) was also, for the first time, given approval to establish a rand-currency futures market. A new framework, regulating authorised dealers in foreign exchange with limited authority, was approved by the Minister of Finance in 2007.

Amnesty Unit

A final audit in late 2006 confirmed that the Amnesty Unit had adjudicated all of the 42 679 applications it received since the announcement of the tax amnesty nearly three years earlier. Of this number, 42 178 applications were approved. Of the total received applications (43 135, including duplicates), 937 applications were withdrawn, deleted or voided, with 20 applications declined. The amnesty process raised at least R2,9 billion in levies.

The sanitisation of more than 41 000 applications, as required by law, was completed by May 2006. These files are in the safe custody of the National Treasury, the SARB and the South African Revenue Service (Sars), as per legislative requirements.

Retirement fund reform

On 23 February 2007, the Minister of Finance released a document titled *Social Security and Pension Reform: A Second Discussion Paper.* The document contains high-level proposals for the reform of the social-security system, including the establishment of a mandatory earnings-related contribution to a national fund. This attempts to bridge the gap between the pay-as-you-go social assistance and grant system, and tax-incentivised retirement savings. For very low-income earners, the introduction of a wage subsidy will seek to offset the social-security contribution for these workers, while simultaneously stimulating employment.

An inter-ministerial committee has been established, chaired by the Minister of Finance, which is tasked with further developing details around the proposals contained in the document.

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 treasury norms and standards aim at deregulating financial controls, by granting accounting officers of spending agencies more autonomy in financial decision-making within the ambits 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.

Early Warning System

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

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

Financial policies, systems and skills development

National Treasury is responsible for financial-management systems and the financial training of government officials.

It delivers services that support the following areas:

- financial systems, which consist of the Personnel and Salary System, Logistical Information System, Financial Management System, Basic Accounting System and Management Information System
- banking services and financial reporting for government
- developing financial management in national and provincial governments.

Procurement

The preferential procurement regulations give substance to the content of the Preferential Procurement Policy Framework Act, 2000 (Act 5 of 2000). This Act and its regulations apply to all three spheres of government.

Bids are evaluated according to a preference point system. A bidder can score a maximum of 80 or 90 points for price, while 10 to 20 points can be scored for contracting or subcontracting historically disadvantaged individuals (HDIs), and promoting or achieving specified Reconstruction and Development Programme (RDP) goals. A contract is awarded to the bidder who scores the highest total number of points.

The implementation of the regulations enhances the involvement of HDIs in the public bidding system and contributes to achieving RDP goals, including the promotion of small and medium enterprises (SMEs).

The Supply-Chain Management Framework replaces outdated procurement and provisioning systems in government with an integrated supply-chain management system, and an international best-practice process for appointing consultants.

Financial Intelligence Centre

Government has adopted a strong stance on eradicating money laundering and financing terrorism, in keeping with United Nations (UN) conventions and international standards.

South Africa's system of combating money laundering and the financing of terrorism is based on the interaction of three separate laws. In 1998, the Prevention of Organised Crime Act, 1998 (Act 121 of 1998), was passed, which criminalised money laundering. This was followed by the FIC Act (FICA), 2001 (Act 38 of 2001), which enabled the establishment of the FIC, and imposed reporting and administrative obligations on financial and other institutions.

The Protection of Constitutional Democracy Against Terrorist and Related Activities Act, 2004 (Act 33 of 2004), provides for the reporting of terrorism-financing activities.

The FIC started functioning in February 2003 as an autonomous government agency reporting to the Minister of Finance.

The centre is mandated to:

- identify the proceeds of crime and the financing of terrorism
- formulate and lead the implementation of policy regarding money laundering and the financing of terrorism
- advise the Minister of Finance about issues aimed at anti-money laundering and combating the financing of terrorism (AML/CFT)
- monitor the compliance of accountable institutions and supervisory bodies regarding their AML/CFT obligations
- prevent and reduce money laundering and terrorist-financing activities
- meet and uphold the international obligations and commitments required of the FIC and South Africa as a country.

The FICA, 2001 identifies a range of 19 different business sectors, which it defines as being accountable institutions and most vulnerable to abuse by criminals. These include banks, *bureaux de change*, life-insurance companies, stockbrokers, money remitters, casinos, lawyers, accountants, investment advisers, estate agents and motor dealers. These accountable institutions have certain reporting and administrative obligations, including record-keeping, appointing compliance officers and the training of staff.

The FIC analyses and stores reports made by the accountable institutions. It then makes disclosures or information packages available to law-enforcement agencies for investigation. It may also make this information available to similar bodies in other countries.

By May 2007, the centre had received in excess of 65 400 suspicious-transaction reports, of which 21 466 were made during 2006/07. In the first five months of 2007, the centre referred 549 reports of transactions totalling over R1 billion to law-enforcement agencies for investigation.

In 2002, South Africa joined the 14-member Eastern and Southern Africa AML Group. South Africa also became a member of the Financial Action Task Force, which is the international standards-setting body.

The FIC is a member of the Egmont Group of financial intelligence units, which facilitates the exchange of information, skills and technical assistance between financial intelligence units worldwide.

Financial and Fiscal Commission (FFC)

The FFC is a constitutional body established to give advice to Parliament, legislatures and organs of state on matters of intergovernmental finance. The commission, which came into operation in April 1994, is a statutory institution and permanent expert commission dealing with intergovernmental fiscal relations.

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, which are 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; and 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
- provincial and municipal loans
- the fiscal implications of the assignment of functions from one sphere of government to another.

Budget Council

The Budget Council consists of the Minister of Finance and the nine provincial members of the executive committees responsible for finance, while the Budget Forum is the Budget Council extended to include representatives of organised local government. The mission of the two forums is to ensure that there is cohesion between national policy priorities, the division of nationally raised revenues, and planning and budgeting at provincial and local spheres of government.

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

Public Investment Corporation (PIC)

The PIC, a corporate body governed in terms of the PIC Act, 2004 (Act 23 of 2004), was officially launched in April 2005, before which it was known as the Public Investment Commissioner. The PIC Act, 2004, which replaces the Public Investment Commissioners Act, 1984 (Act 45 of 1984), formalises the PIC as a legal entity and enables it to operate as a modern, professional and world-class investment manager.

The PIC invests funds on behalf of the South African public sector. By mid-2007, there were 40 entities or clients whose funds were being managed by the PIC. Assets managed by the PIC grew to over R719,8 billion in March 2007.

The PIC concluded the agreement for the establishment of a joint venture to create one of the largest socially responsible investment funds, the Community Property Fund. It is effectively self-funded and produces its own annual report, which is tabled in Parliament. The PIC reports to the Minister of Finance.

The PIC, a state-owned institution that manages public servants' pension funds, was corporatised under legislation that came into effect in April 2005. After its corporatisation, the PIC embarked on a gradual process of withdrawing funds placed with external portfolio managers.

The State remains the sole shareholder of the PIC, which reports to Parliament's Scopa, and whose controlling board is appointed by the Minister of Finance.

The biggest contributors to the PIC's assets are public servants through the Government Employees Pension Fund (92,3%). Other contributions come from the Compensation Commission, Associated Institution Pension Fund, Unemployment Insurance Fund, Guardian Fund and the Political Office Bearer's Pension Fund.

The PIC funds Black Economic Empowerment (BEE) borrowers. Since 2006, the PIC has exhibited keen interest in property investment.

Macroeconomic strategy

The economy continued to expand at a robust pace of 4,9% in 2006, generating new jobs, broadening the consumer base and providing the impetus for rapid growth in investment. Economic growth is projected to average just over 5% a year over the next three years. In 2007, a somewhat weaker growth in the world economy and the interest rate increases of the past year were expected to result in a growth rate of 4,8%.

In 2004, government set out the objectives of halving poverty and unemployment by 2014. A growth rate exceeding 5% a year on average between 2004 and 2014 is necessary to achieve these targets. In February 2006, government introduced AsgiSA with the objectives of growing the economy and improving the labour-absorbing capacity of the economy, leading to shared growth.

The methodology employed involves identifying the "binding constraints" to achieving growth objectives. AsgiSA has identified the following binding constraints:

- the relative volatility and level of the currency
- the cost, efficiency and capacity of the national logistics system
- the shortage of suitably skilled labour amplified

by the cost effects on labour of apartheid spatial patterns
- barriers to entry, limits to competition and limited new investment opportunities
- the regulatory environment and the burden on small and medium businesses
- deficiencies in state organisation, capacity and leadership.

A number of decisive interventions aimed at addressing these constraints and at allowing government to achieve its objectives more effectively include:
- Macroeconomic issues, including reducing the volatility of the Rand, improved estimation of revenue collections in the budgeting process and improved expenditure management.
- The rapid increase in infrastructure spending to improve the availability and reliability of infrastructure and to reduce the cost of doing business.
- Sector-investment strategies (or industrial strategies) to promote private-sector investment. The focus will be on rapidly growing labour-intensive sectors and sectors with BEE opportunities such as business-process outsourcing, tourism and biofuels.
- Skills and education initiatives to alleviate the pressing shortage of skills, including initiatives to improve skills in areas such as Science, Mathematics, engineering, management and information technology (IT).
- Second-economy interventions to bridge the gap between the First and Second Economy, including increased participation and broader access to opportunities and education.
- Public-administration issues, including the reduction of costly institutional interventions.

Government is committed to achieving the objectives set out in AsgiSA. Higher and shared economic growth will allow South Africa to achieve its social objectives of reducing inequality and virtually eliminating poverty.

South African Revenue Service

In accordance with the Sars Act, 1997 (Act 34 of 1997), the revenue service is an administratively autonomous organ of state. It aims to provide a world-class, transparent and client-orientated service, ensuring optimum and equitable revenue collection. Its main functions are to:
- collect and administer all national taxes, duties and levies
- collect 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
- facilitate trade
- provide protection against the illegal importation and exportation of goods
- advise the Minister of Trade and Industry on matters concerning control over the import, export, manufacture, movement, and storage or use of certain goods.

Tax system

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

In 2001, South Africa's source-based income tax system was replaced with a residence-based system. Residents are now taxed (subject to certain exclusions) on their worldwide income, irrespective of where their income was earned. Foreign taxes are credited against South African tax payable on foreign income. Foreign income and taxes are translated into the South African monetary unit, the Rand.

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 residence and source countries of international investors, double-taxation agreements provide a solid platform for growth in international trade and investment. South Africa has tax agreements with a wide range of countries.

Sources of revenue

Income tax

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

In South Africa, income tax is levied on South African residents' worldwide income, with appropriate relief to avoid double taxation. Non-residents are taxed on their income from a South African source. Tax is levied on taxable income, which, in essence, consists of gross income less allowable deductions as per the Act.

The income threshold below which no tax is payable by individuals under 65 years was raised to R43 000 for the tax year beginning March 2007, and for taxpayers over the age of 65 to R69 000 a year. The maximum marginal rate of tax remains at 40%, while the threshold was raised from R400 000 to R450 000.

The domestic interest and dividend exemption for taxpayers under the age of 65 was raised from R16 500 to R18 000. For senior citizens, the threshold increased from R24 500 to R26 000. The proportion of the exemption applicable to foreign-interest income and dividends was raised from R2 500 to R 3 000.

A revised tax regime for medical-scheme contributions and medical expenses was introduced in the 2005 Budget. It had the effect of raising the tax benefit for middle- and lower-income earners, while restricting the tax allowance for more expensive medical schemes.

Taxpayers under 65 are not taxed on, or may deduct, contributions to medical schemes up to R530 for each of the first two persons covered under a medical scheme (taxpayer and one dependant), and R320 for each additional dependant. In addition, they can claim a deduction for medical-scheme contributions above the caps and any other medical expenses, to the extent that the total exceeds 7,5% of taxable income. Taxpayers under 65 may claim all qualifying medical expenses where the taxpayer or the taxpayer's spouse or child is a handicapped person. Taxpayers who are 65 years and older continue to enjoy a full deduction of all medical expenses. These changes took effect on 1 March 2007.

Income-tax returns are issued annually to registered taxpayers after the end of each year of assessment. The year of assessment for individuals covers a period of 12 months, which generally commences on 1 March of a specific year, and ends on the last day of February the following year. Companies are permitted to have a tax year ending on a date that coincides with their financial year. Tax returns must be submitted to Sars within the specified period.

People who owe Sars tax are charged interest at a rate as published in the *Government Gazette* that is linked to the rate specified in accordance with the PFMA, 1999. Persons who derive income from sources other than remuneration, such as trade, profession or investments, and companies, are required to make two provisional tax payments during the course of the tax year and may opt for a third "topping-up" payment, six months after the end of the tax year.

Capital gains tax was introduced on 1 October 2001. It forms part of the income-tax system. Capital gains made upon the disposal of assets are included in taxable income.

Local governments levy rates on the value of fixed property to finance the cost of municipal services.

Value-added tax (VAT)

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% but certain supplies are zero-rated or are exempt from VAT.

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

Customs duty

South Africa is a signatory to the Southern African Customs Union (Sacu) Agreement, together with Botswana, Lesotho, Namibia and Swaziland (the BLNS countries).

The five member countries of Sacu apply the same customs and excise legislation, the same rates of customs and excise duties on imported and locally manufactured goods, and the same import duties on imported goods. The uniform application of tariffs and the standardisation of procedures simplify trade within the Sacu common-customs area.

Import duties, including anti-dumping and countervailing duties, are used as mechanisms to protect local industry.

The renegotiated Sacu Agreement is now in force and provides a new dispensation for calculating and affecting transfers based on customs, excise and a development component.

South Africa has entered into agreements on mutual administrative assistance with a wide range of customs administrations. These agreements cover all aspects of assistance, including the exchange of information, technical assistance, surveillance, investigations and visits by officials. Efforts continue to improve the effectiveness of custom control and trade facilitation.

Excise duty

Excise duty is levied on certain locally manufactured goods and their imported equivalents. This duty is levied as a specific duty on tobacco, liquor, and as an *ad valorem* duty on cosmetics, audiovisual equipment and motor cars.

Relief from excise duty is available where excisable products are exported. In addition, relief is also available for specific farming and forestry, and certain manufacturing activities.

Excise duties are imposed both as a means to generate revenue for the fiscus and to change consumer behaviour.

Transfer duty

Transfer duty is payable on the acquisition of property by individuals at progressive marginal rates between 0% and 8%. With effect from 1 March 2006, houses costing less than R500 000 attract no duty. A 5% rate applies at between R500 000 and R1 million, after which 8% applies. The 10% flat rate for companies and trusts was also reduced to 8%.

All transactions relating to a taxable supply of goods that are subject to VAT are exempt from transfer duty.

Estate duty

An estate consists of all property, including deemed property (e.g. life-insurance policies, payments from pension funds, etc.) of the deceased. The exempt threshold was increased to R3,5 million in 2007. The duty, at a rate of 20%, is calculated on the dutiable amount of the estate. Certain admissible deductions from the total value of the estate are allowed.

Stamp duty

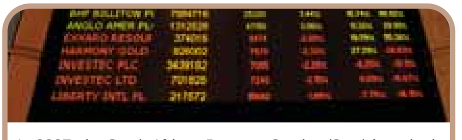
Stamp duty is levied on instruments such as leases of immovable property and unlisted marketable securities at different rates. It is also payable on leases' fixed property at a fixed rate of 0,5% on the quantifiable amount of the lease. It is proposed that the stamp duties on short-term leases (less than five years) should be abolished.

Uncertificated securities tax (UST)

UST at a rate of 0,25% is payable for the issue of, and change in beneficial ownership in, any securities which are listed on the JSE. In the case of unlisted securities, stamp duty is levied at the same rate of 0,25%. UST on the issue of securities was eliminated from 1 January 2006.

Skills-development levy

A skills-development levy was introduced on 1 April 2000. This is a compulsory levy scheme for the funding of education and training. Sars administers the collection thereof. The rate, as from 1 August 2005, is 1% for employers with an annual payroll in excess of R500 000.



In 2007, the South African Revenue Service (Sars) launched a simpler income tax return and filing process for individual and business taxpayers.

Individuals now receive their returns by mid-July and have until 31 October to submit them, while companies receive returns in September and have six to 12 months after the end of their financial year to submit the returns. Previously, the deadline for the submission of completed tax returns was early July.

Sars now pays money electronically into taxpayers' bank accounts and no longer issues cheques, unless taxpayers request otherwise.

The changes are, among other things, intended to ensure improved efficiency and faster turnaround times of Sars' internal processes.

Some of the benefits of the new system include e-filing, which allows taxpayers to file their tax returns via the Internet.

The system also allows Sars to use new statistical methods to identify risks, provide automated risk-profiling and validation, and enhance the ability to identify errant taxpayers.

Air-passenger departure tax

A tax of R120 per fee-paying passenger departing on international flights, and R60 per passenger departing to BLNS countries is payable.

Organisational performance

Sars collected R497,197 billion in taxes during the 2006/07 financial year, exceeding its revised target of R489,7 billion.

Sars continues to implement improvements in revenue collection to benefit the South African people, by enabling the fiscus to fund government's social-delivery programmes.

E-Filing

E-Filing *(www.efiling.gov.za)* is a secure service, enabling taxpayers to submit their tax returns online. It removes the risks and inconvenience of manual 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.

E-Filing in South Africa has been growing significantly since its inception, and has been delivering real benefits to both taxpayers and Sars.

Filing of Tax Returns Season

Filing Season is an extensive marketing and publicity venture to remind taxpayers of their responsibilities to submit their tax returns on time with the correct details.

The Taxpayer Education Campaign focuses on helping all eligible taxpayers to complete their tax returns correctly. The Filing Season Campaign has helped to increase the number of registered taxpayers from 4,8 million in 2003 to almost seven million in 2007.

Gambling

The National Gambling Board (NGB) was established in terms of the National Gambling Act, 1996 (Act 33 of 1996), which was repealed on 1 November 2004 by the National Gambling Act, 2004 (Act 7 of 2004). The Act provides for oversight of matters relating to casinos, gambling, betting and wagering, and promotes uniform norms and standards in relation to gambling throughout South Africa.

The vision of the board is to be a world-class organisation, providing a national regulatory framework in the gambling industry. The mission is to ensure uniformity, harmonisation and integrity of the gambling industry in South Africa, by enforcing compliance with the National Gambling Act, 2004 and ensuring compliance with other relevant legislation, such as the FICA, 2001, PFMA, 1999 and provincial gambling acts.

The NGB achieves this by:

- creating and establishing uniform norms and standards
- creating and establishing uniform rules and regulations
- conducting oversight evaluations of the performance of provincial licensing authorities (PLAs)
- evaluating the issuance of national licences by licensing authorities
- evaluating the compliance monitoring of licensees by PLAs
- assisting PLAs in ensuring that unlicensed gambling activities are detected

Main Budget: revenue

R million	2006/07 Revised estimate	2007/08 Before tax proposals	% change
Taxes on income and profits	274 300,0	326 500,0	13,8
Taxes on payroll and workforce	5 850,0	6 500,0	11,1
Taxes on property	10 345,0	11 000,0	6,3
Domestic taxes on goods and services	174 667,0	196 865,0	14,1
Taxes on international trade and transactions	23 900,0	27 485,0	15,0
Stamp duties and fees	600,0	612,0	-63,0
Total tax revenue (gross)	**489 662,0**	**568 962,0**	**13,7**

Source: *2007 Budget Review*

- monitoring socio-economic patterns of gambling activity
- conducting research on addictive or compulsive gambling and the socio-economic impact thereof.

Compliance

In December 2006, Cabinet approved the publication of the draft National Gambling Amendment Bill for broader consultation. The Bill established the legislative basis for gambling in South Africa. Owing to the borderless nature of interactive gambling, the board will provide licensing, monitoring and enforcement functions.

The Central Electronic Monitoring System was established in terms of the National Gambling Act, 2004 to:

- detect and monitor significant events associated with any gambling machines outside casinos, called limited-payout machines, which are made available for play
- analyse and report data in accordance with the prescribed requirements, as outlined in the service-level contract that the board had signed with the service-provider Zonke Monitoring Systems (Pty) Ltd.

The ongoing campaign against illegal gambling, spearheaded by the board, continues nationally with the collaboration and assistance of provinces.

In 2006/07, the NGB, as a supervisory body, conducted 33 compliance inspections at licensed casinos to ensure compliance with the FICA, 2001. The South African National Accreditation Standards (Sanas) ensures that all gambling laboratories that test gambling machines and devices are accredited to comply with the International Organisation for Standardisation (ISO)/IEC 17025 and ISO 9000, and technical competency in line with Sanas.

National gambling statistics

In an effort to provide comprehensive and user-friendly information about the gambling industry, the board developed the National Gambling Statistics Database, which focuses mainly on primary statistics such as turnover, gross gambling revenue (GGR) and gambling tax. PLAs are required to submit quarterly statistics to the board for analysis.

Based on the primary statistics received, the NGB then calculates the return-to-player percentage per gambling mode. The database comprises comparative statistics for the period 1 April 1999 to 31 March 2007. This information is vital for keeping the public and stakeholders informed of financial and operational gambling data in the country.

The results for 2006/07 continued to show a steady increase in gambling activities around the country. This is indicated mainly by the GGR, which increased by 18,6% as compared with 2005/06. In terms of gambling taxes and levies, an increase of 21,7% was recorded.

Responsible gambling

The National Responsible Gambling Programme (NRGP) integrates research and monitoring, public education and awareness, training, treatment and counselling. It is the only programme of its kind to be jointly controlled by a public/private-sector partnership, involving government regulators and the industry. The NRGP is supervised by the South African Responsible Gambling Trust, which was created by the South African Advisory Council on Responsible Gambling, an initiative of the board.

In 2006/07, the NRGP Counselling Line referred an average of 139 problem gamblers for treatment each month, and handled a further 180 problem gamblers per month who phoned the service in distress, but did not require referral.

On average, 10 problem gamblers per day benefited from the NRGP counselling services, which is consistent with the pattern of previous years.

Broad-Based Black Economic Empowerment (BBBEE) developments in the gambling industry

The NGB and other provincial gambling authorities have identified and advocated a need for an industry-specific BBBEE gambling charter. The aim is to uniformly and coherently achieve and implement the BBBEE objectives as set out in the BBBEE Act, 2003 (Act 53 of 2003), and gazetted Codes of Good Practice.

Regulators will enforce and implement the specific gambling charter.

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 large 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.

In September 2007, empowerment consortium Gidani was awarded the licence to operate the National Lottery. The lottery was suspended in March 2007 when the previous licence-holder's licence expired. It resumed in October 2007.

Auditor-General

The AG is South Africa's supreme audit institution. It was established in terms of Chapter 9 of the Constitution, and exists to strengthen the country's democracy, by enabling better accountability and governance in the public sector. Through the Constitution and the Public Audit Act, 2004 (Act 25 of 2004), the AG's mandate is to promote accountability and good governance within government.

The AG does this by providing world-class audits and reports on the accounts, financial statements and financial management of:

- all national and provincial state departments and administrations
- all municipalities
- any other institution or accounting entity required by national or provincial legislation to be audited by the AG.

The AG may also audit and report on the accounts, financial statements and financial management of:

- any institution funded from the national or a provincial revenue fund, or by a municipality
- any institution that is authorised in terms of any law to receive money for a public purpose.

Public-sector auditing involves investigating and evaluating government and related institutions' financial-management practices, performance and compliance with legal requirements.

Various business units provide auditing services, corporate services and specialised audit work, such as forensic and computer auditing, and audit research and development. The AG also boasts an international auditing complement.

Financial sector

South African Reserve Bank

The SARB and the Ministry of Finance form the monetary authority in South Africa. The SARB has been given a significant degree of autonomy in terms of the Constitution and must perform its functions independently.

However, the SARB must hold regular consultations with the Minister of Finance. Its management, powers and functions are governed by the SARB Act, 1989 (Act 90 of 1989).

The SARB formulates and implements monetary policy and regulates the supply of money by influencing its cost. Monetary policy is guided by the objectives of the SARB, which are formulated to ensure financial stability. Consistently combating inflation is the cornerstone of the bank's policy.

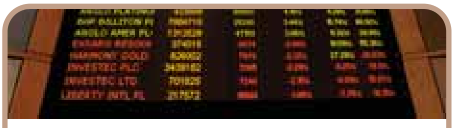
A formal inflation-targeting monetary-policy framework has been adopted since 2000. Monetary policy is set by the bank's Monetary Policy Committee (MPC).

The committee, consisting of the SARB's governors and other senior officials, usually meets every two months, after which the bank issues a statement indicating its assessment of the economy and policy changes, if any.

The SARB is responsible for:

- assisting government in formulating and implementing macroeconomic policy
- formulating and implementing monetary policy to achieve its primary goal in the interest of the community it serves
- ensuring that the South African money and banking system as a whole is sound, meets the community's requirements and keeps abreast of international finance developments
- informing the South African community, and all interested parties abroad about monetary policy, and the South African economic situation in general.

The SARB is managed by a board of 14 directors, seven of whom are elected by the shareholders of the bank and who represent commerce, finance, industry and agriculture. The President of South



The repo rate was left unchanged at 9% by the South African Reserve Bank's Monetary Policy Committee (MPC) in April 2007. In June 2007, the MPC decided to increase the repo rate by 50 basis points to 9,5% per year. In August 2007, the MPC increased the key repo rate by 50 basic points to 10%. The prime lending rate rose by 0,5 percentage points to 13,5%. October 2007 saw another increase of the repro rate to 10,5%. In December it rose to 11%.

Africa appoints the governor, three deputy governors and three directors.

The SARB acts as the central bank of South Africa and as a banker to other banking institutions. It provides accommodation to banks and is the custodian of the statutory cash reserves that all registered banks are required to maintain. It also provides facilities for clearing and settling interbank obligations.

The main instrument for managing liquidity in the money market is the repurchase transactions (repo) rate, which is the price at which the central bank lends cash to the banking system. The repo rate has become the most important indicator for short-term interest rates.

The repurchase agreements entered into between the SARB and other banks are conducted on the basis of an outright buy-and-sell transaction, with a full transfer of ownership of the underlying assets. The system also provides for a marginal lending facility, which replaces the previous discount window. This facility is available to banks at their initiative, to bridge overnight liquidity needs. The marginal lending facility forms an integrated part of the South African Multiple Option Settlement (Samos) System, which came into operation in March 1998.

This enables banks to electronically make payments to, and receive payments from, the SARB, through their settlement accounts held in the books of the Reserve Bank. Daily settlements of interbank exposures are effected through the Samos System.

Payments through the system can only be made if a bank has sufficient funds in its settlement account. Such funds can be obtained through interbank transfers, repurchase transactions, other types of liquidity-creating instruments of the SARB, or the marginal lending facility. The Samos System, however, allows banks to receive funds obtained in the interbank market directly in their settlement accounts in the SARB's books.

The SARB uses various instruments to achieve its objectives. These include changes in the repo-rate marginal-lending facility; open-market transactions, including selling its own debentures; changes in requirements regarding banking institutions' cash reserves; and controlling liquidity in the money market through repurchase transactions. The bank undertakes national and international transactions on behalf of the State, and acts for government in transactions with the International Monetary Fund.

The SARB is the custodian of the greater part of South Africa's gold and other foreign-exchange reserves. The SARB issues banknotes (printed by the South African Bank Note Company, a wholly owned subsidiary of the Reserve Bank) and controls the South African Mint Company.

Monetary policy

Growth in broad money supply (M3) continued to increase at a high rate throughout 2006 and early 2007, and fluctuated between a peak of 27,3% in March 2006 and 23% in February 2007. Banks' loans and advances to the domestic private sector remained relatively strong during 2006 and early 2007, registering average growth rates of 25% to 27%. Asset-backed credit (mortgage advances, leasing finance and instalment sale credit) constituted the bulk of the increase in banks' total loans and advances throughout 2006 and early 2007.

Growth in M3 and banks' total loans and advances was consistent with firm increases in nominal income, expenditure and wealth.

The banking industry

At the end of December 2006, 34 banks, including 14 branches of foreign banks and two mutual banks, were registered with the Office of the Registrar of Banks. Furthermore, 43 foreign banks had authorised representative offices in South Africa. By the end of December 2006, the banking institutions collectively employed 129 161 workers.

During 2006, the South African banking system remained stable and, in general, banks were sound. Banks continued to benefit from the favourable economic conditions that prevailed during 2006.

The banks were well capitalised above the minimum requirement of 10%, and the average risk-weighted capital-adequacy ratio for the banking sector was 12,3% at the end of December 2006 (December 2005: 12,7%).

The aggregated balance sheet of the banking sector continued to show strong growth during 2006. By the end of December 2006, the total assets of banks – comprising, among other things, money, loans and advances, investment and trading position and non-financial assets – had increased by 23,7% (measured over 12 months) to a level of R2 075,1 billion (December 2005: R1 677,5 billion). The five largest banks constituted 89,7% of the total banking sector's assets by the end of December 2006 (December 2005: 89,6%).

The profitability ratios improved throughout 2006. By the end of December 2006, an after-tax return of 18,3% on net qualifying capital and reserves (12-month smoothed average) was reported, compared with 15,2% in December 2005.

An after-tax return of 1,4% on assets (12-month smoothed average) was reported in December 2006 (December 2005: 1,2%). The efficiency ratio of the banking sector displayed a steady improvement throughout 2006, and by the end of December 2006, an efficiency ratio of 58,9% was reported (December 2005: 66,3%).

South African banks are regulated in terms of international best practice, for example, adherence to the Core Principles for Effective Banking Supervision and the planned transition to the Basel Capital Accord (Basel II) in January 2008.

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 on 1 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, which play a vital role in ensuring enforcement, promoting access to redress and adjudicating contraventions of the Act.

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 National Consumer Tribunal 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 NCR.

The Micro-Finance Regulator Council, mandated to regulate the microlending industry prior to the establishment of the NCR, had 2 056 registered entities with a gross loan book of R22,9 billion by February 2006.

Financial Services Board (FSB)

The FSB is an independent statutory body financed by levies imposed on regulated institutions and persons.

The FSB supervises institutions and services, in terms of several parliamentary Acts that entrust regulatory functions to the registrars of long-term insurance, short-term insurance, friendly societies, pension funds, collective investment schemes, financial services providers (FSPs), exchanges and financial markets.

The FSB also promotes programmes and initiatives by financial institutions and bodies representing the financial-services industry to inform and educate users of financial products and services.

Included in such functions is regulatory control over central securities depositories and depository institutions responsible for the safe custody of securities.

The FSB is also responsible for the financial supervision of the Road Accident Fund. Excluded from the FSB's responsibilities are certain areas involving listing requirements or public issues, take-overs and mergers.

The executive officer has the power to impose regulatory sanctions, including the cancellation of authorisation to supply financial services.

The executive officer has formal powers of investigation to which criminal sanctions attach in the event of obstruction.

The executive officer can, in certain circumstances, also petition for the winding up, or placing under judicial management or curatorship, of certain financial institutions such as insurers and pension funds.

Furthermore, the Inspection of Financial Institutions Act, 1998 (Act 80 of 1998), allows the FSB to obtain warrants for searching and questioning third parties who might have information about unregistered financial institutions, such as those providing insurance or investment services.

The FSB is assisted by an advisory board on financial markets, and by advisory committees on FSPs, long- and short-term insurance, pension funds and collective investment schemes. The Financial Services Consumer Advisory Panel advises the FSB and Registrar of Banks on consumer-protection issues falling within the regulators' jurisdiction.

The FSB maintains a close relationship with all existing industry associations. It liaises with overseas regulatory organisations, and is a member of the International Organisation of Security Commissions, the International Association of Insurance Supervisors, the African Association of Insurance Supervisors and the International Network of Pension Regulators and Supervisors.

Domestically, the FSB liaises with bodies such as the Independent Regulatory Board for Auditors, Consumer Affairs Committee and various government departments, as well as with prosecuting authorities such as the South African Police Service, the Directorate of Special Operations and the National Director of Public Prosecutions.

Insurance companies

Short-term (non-life) insurance is concerned primarily with risk management against the risk of a contingency loss in the short term. The contracts usually run from year to year and can be cancelled by either party.

These contracts apply to engineering, guarantee, liability, motor, business, accident and health, property, transportation and miscellaneous insurance. By 31 December 2007, 106 short-term insurers were registered with the FSB, of which 93 represented primary insurers and the remainder reinsurers. The total gross premiums of primary insurers grew by 12% between 2005 and 2006.

Long-term insurance business consists of life, assistance, sinking fund, health and disability insurance. By March 2007, the number of long-term insurers registered with the FSB totalled 81, of which 74 were insurers and the remainder were re-insurers. Net premium income for primary insurers increased from R165,1 billion in 2005 to R220,3 billion in 2006.

According to class of policies, life-insurance business forms the bulk of premiums of primary insurers and accounts for almost 50% of net premiums. Total assets of the long-term industry in South Africa increased by 19,9% to R1 302,1 billion as at December 2006.

Exchange rate of the Rand – percentage changes

	30 Sept 2006 to 29 Dec 2006	29 Dec 2006 to 31 March 2007	31 March 2007 to 29 June 2007	29 June 2007 to 31 Aug 2007
Weighted average*	7,7	- 4,4	1,8	- 1,5
Euro	6,2	- 50	1,3	- 1,6
US dollar	10,5	- 4,0	2,4	- 1,8
British pound	5,2	- 3,7	0,1	- 0,8
Japanese yen	11,3	- 4,7	7,0	- 6,0

*Against a basket of 13 currencies

Source: *Quarterly Bulletin,* South African Reserve Bank

Other financial institutions

Development Bank of Southern Africa (DBSA)

The DBSA Act, 1997 (Act 13 of 1997), stipulates that the main role of this development-finance institution (DFI) is to promote economic development and growth, HRD 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 bank operates within South Africa, in the other Southern African Development Community (SADC) countries, and increasingly as a development agent and knowledge partner in the wider region of Africa south of the Sahara. The mandate of the bank is mainly infrastructure development in the wider sense of the term.

Historically, the bank has covered economic, social and institutional development. This has been done both via loans of its own funds, and by acting as a catalyst for investments in partnership with the private sector and other DFIs, locally and internationally.

Funding and development impact

The bank is a self-funded institution and raises funding from domestic and international capital markets, bilateral and multilateral institutions, and internally generated resources. Credit lines have been established with reputable and highly rated international institutions, such as the African Development Bank, the European Investment Bank, bilateral sources such as the German *Kreditanstalt für Wiederaufbau* (KFW), the Japanese Overseas Economic Co-operation Fund and the *Agence Française de Développement*. The DBSA's capital and reserves at 31 March 2007 totalled R14 billion, including a callable capital facility of R4,8 billion from National Treasury.

The DBSA estimates the scale of the impact of its funding operations by using economic modelling techniques. Based on these, DBSA loan approvals in South Africa and the SADC – which are projected to be growing at a level of at least R6 billion per year by 2014 – will, when disbursed, have significant development impact.

Calculated from 2005 to 2014 in South Africa alone, a total of 127 000 jobs should be created; 2,4 million households connected to one or more basic services; and R22 billion contributed to the local economy. Over the period, the bank plans to invest over R46 billion (loans and equity finance) in infrastructure development, and well over R1 billion in technical assistance, capacity-building, knowledge development and development networking.

Strategy

The DBSA's strategy addresses five main themes:

- co-delivering social and economic infrastructure, with a focus on the public sector
- building human and institutional capacity, with a focus on municipalities
- promoting broad-based economic growth, job creation, co-operation, integration and prosperity, with a focus on identified sectors, geographical areas and projects
- serving as a centre of excellence for development financing and effectiveness
- engendering sustainability, both internally and externally.

Vision 2014

Vision 2014, which is guided by the bank's mandate, focuses on the following key goals within the Government's development agenda:

- reducing poverty by half through economic development, comprehensive social security, land reform and improved household and community assets
- reducing unemployment by half through new jobs, skills development, assistance to small businesses, opportunities for self-employment and sustainable community livelihoods
- massively reducing the incidence of tuberculosis, malaria, diabetes, malnutrition and maternal deaths, turning the tide against HIV and AIDS, and improving services to achieve a better national health profile and reduce preventable causes of death
- positioning South Africa strategically as an effective force in global relations, with vibrant and balanced trade with countries of both the South and the North
- providing the skills required by the economy, building capacity and providing resources across society to encourage self-employment.

Strategic initiatives

Key initiatives include leading Siyenza Manje, the municipal task force of engineers and project managers being implemented jointly with National Treasury, the Department of Provincial and Local Government, the South African Local Government Association and other government departments.

The Sustainable Communities Programme is also under way to turn dormitory townships and informal settlements into viable towns, with community centres, clinics, shops, sports facilities, etc. The Local Investment Agency has been established in the Eastern Cape to fast-track private-sector economic development in areas with natural potential. The bank is also heavily involved in supporting the host cities in their development of infrastructure for the 2010 World Cup.

The bank has positioned itself to provide strategic and financial support to the South African Football Association in its planning and co-ordination of infrastructure development around South Africa's hosting of the World Cup.

Vulindlela Academy

The bank has launched the Vulindlela Academy, a new specialised institutional training facility, dedicated to creating and upgrading the skills required for increased economic growth.

The DBSA Vulindlela Academy is supported by a local government resource centre and a wide area local government computer network, to connect municipalities to a wide range of resources and facilities.

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, co-operatives 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 Chapter 3: *Agriculture and land affairs*.)

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.

In recent years, the Land Bank's performance has been negatively affected by numerous factors.

Also key to new entrants in farming is access to finance and advisory support. Efforts are being made by the Land Bank to ensure it delivers on its mandate and remains sustainable.

Government has already injected R700 million and extended a R1,5-billion guarantee. The bank is also engaged with National Treasury to find an optimum funding model.

Collective investment schemes (CIS)

CIS in securities, property and participation bonds are supervised in terms of the Collective Investment Schemes Control Act, 2002 (Act 45 of 2002).

South African collective investment schemes in securities

There was a net increase of 136 funds during the 2005/06 financial year, driven mainly by the demand for third-party funds. By 31 March 2006, there were 33 managers with 718 FSB-approved funds available to the public for investment.

There was a net increase after fund closures of 121 funds during the year, which is slightly lower than the 136 experienced during the previous year. The increase remains attributable to the demand for third-party funds. By 31 March 2007, there were 34 managers with 765 FSB-approved funds available to the public for investment.

For the fourth consecutive year, the industry attracted record inflows. Net inflows in CIS portfolios reached a record R27,6 billion during the quarter ended 31 March 2007, as both retail and institutional unit-trust investment inflows soared.

At the end of the financial year, total assets under management stood at a record R596 billion (March 2006: R458 billion). In general, the industry produced excellent returns.

Foreign collective-investment schemes (FCIS) in securities

A healthy investor appetite for offshore collective-investment products saw net inflows of R34,7 billion into FCIS at year-end (2006), with the total assets under management standing at R105 billion at 31 March 2007. This represented a notable 49% increase, compared with the 33% increase recorded during the previous year. It also represented a doubling of the size of assets under management over a period of three years.

There has not been any significant change in movement in respect of foreign operators in the South African markets, as evidenced by the net decrease of two schemes and one portfolio during the year.

At year-end, 71 schemes were licensed to market 382 portfolios in South Africa.

Collective investment schemes in property

This sector continues to deliver positive returns, but not as spectacular as those recorded in the previous period. However, on a relative basis, the total return for the previous period was abnormal as a result of a re-rating of the sector.

This involved a reduction in yields during that period as a result of the decline in interest rates in the capital market. The reduction in yields in turn resulted in capital values appreciating. The total return for the 12-month period to March 2007 was 11,2%, constituted by an income return of 6,9% and capital growth of 4,3%.

This was achieved despite a significant downward correction in markets in general during the middle and second half of 2006, which resulted in a decline in stock market prices. Since then, CIS in the property market have substantially regained much of their losses.

It should be noted that the returns for 2006/07 were realistic when compared to long-term trends. Total participatory interests in issue at year-end stood at R2,7 billion, with a market capitalisation of R19,4 billion.

Collective investment schemes in participation bonds

The aggregate amount owing to 29 540 (2006: 35 542) participants at 31 March 2007 was R3,3 billion (March 2006: R3,4 billion). There were seven schemes in operation and 1 611 (2006: 1 671) registered participation bonds. It is evident that there is a steady decline of investment in this industry.

Regulatory developments

The FSB has performed compliance reviews on all the registered open-ended unit trust schemes. The reviews, designed to assess the key control areas in management companies, have been highly successful in the early identification of potential problem areas. Management companies have also expressed their approval of the process.

To ensure a smooth transition to risk-based supervision, the department created a separate supervision section, which is staffed by a manager and two analysts, with a specific mandate to develop and implement a risk-based supervisory model. It was envisaged that risk-based supervision would be in place by the second quarter of the 2007/08 financial year.

Stokvels

Stokvels are co-operative rotating saving schemes that mobilise funds among mostly black communities for a variety of purposes. Rotating saving schemes similar to stokvels are also found in countries such as South Korea, Jamaica, Egypt and Japan.

Estimates are that the total investment in stokvels and burial societies in South Africa has reached the R20-billion mark. According to a University of Cape Town Unilever Institute of Strategic Marketing research study, this sector touches every industry, either directly or indirectly.

The study shows that the average membership size of burial societies is 88, and that 29% of South African adults are members. This suggests a total of 89 000 burial societies. Figures gathered by the institute show that 2,5 million South African adults (9%) belong to eight million stokvels and that 14% of bank-account holders are stokvel members.

Stokvels and burial societies, according to the study, are based on group affinity and network marketing – selling to a group rather than to an individual.

Financial intermediaries and advisers

The purpose of the Financial Advisory and Intermediary Services (FAIS) Act, 2002 (Act 37 of 2002), is to regulate, in pursuance of consumer protection, the provision of advice and intermediary services to certain clients in respect of a range of financial products and services.

The FAIS at the FSB is responsible for the oversight and supervision of the industry, captured under the FAIS Act, 2002.

Recognised representative bodies

Section 6(3)(iii) of the Act provides for the Registrar of FSPs to delegate any of their 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 11 recognised representative bodies.

Advisory Committee on Financial Services Providers

The Advisory Committee on FSPs was appointed by the Minister of Finance to investigate and report or advise on any matter relating to FSPs. With the exception of the registrar, who is an *ex officio* member, committee members hold office for a period determined by the minister.

The second term of the committee ended on 30 November 2006. A new committee, which includes many of the previous committee members, was appointed in December 2006.

Licensing of financial service providers

In terms of the FAIS Act, 2002, the FSB approves and renders the ongoing supervision of three categories.

Category I consists of financial advisers and those intermediaries without discretionary mandates. Category II consists of individuals or entities that are involved in discretionary management of securities, loan stock and derivatives on behalf of both individual and institutional clients.

Category III represents investment managers specialising mainly in the bulking of collective investments on behalf of clients (linked investment services providers).

The total number of approved Category I, II and III FSPs at 31 March 2007 was 13 444, 511 and 23, respectively. Total assets under management by Category I and II exceeded R2 613 billion at 30 June 2006.

During the 2006/07 reporting period, the registrar authorised 1 377 FAIS licence applications as FSPs, bringing the total of approved FSPs to 113 978 on 31 March 2007.

Since 2004, 1 089 applications had been declined, 17 authorisations withdrawn and two had been suspended.

Intensified supervision

The FSB's FAIS has developed a customised risk-based supervision framework, which is vitally important for the successful supervision of FSPs. The diversity of the financial-services industry requires the department to concentrate its efforts on FSPs that call for greater supervisory oversight. It will also ensure a smooth transition from the previous compliance-based supervisory approach. For this purpose, a change-management process will be implemented to support the framework.

Inspections

Nine formal inspections were requested during the reporting period, mainly in respect of alleged contraventions of the provisions of the FAIS Act, 2002.

Retirement funds and friendly societies

By 31 March 2007, the FSB had supervised 13 020 registered retirement funds and by 31 December 2005, 98 registered friendly societies.

These funds exclude the official State funds, such as Transnet, Telkom and some bargaining-council funds, which are not registered in terms of the Pension Funds Act, 1956 (Act 24 of 1956).

The total membership of all retirement funds at the end of 2005 was 9 264 148, of which 8 119 860 were active members, and 1 144 288 were pensioners, deferred pensioners or dependants. These figures do not reflect the total number of individuals who were members of funds, because some were members of more than one fund.

The total contributions received increased by 3,2% from R72 826 million in 2004 to R75 131 million in 2005. Total contributions to the State, Transnet, Telkom and South African Post Office funds increased by 8,2%, while total contributions to self-administered, underwritten and bargaining funds in the private sector increased by 1,3%.

Benefits paid decreased by 0,3% from R86 195 million in 2004 to R85 937 million in 2005. Amounts paid in respect of pensions, lump sums on retirement or death and resignations were included. Total assets of the retirement-fund industry in South Africa increased by 17,1%, from R1 092 billion in 2004 to R1 284 billion in 2005.

The net assets of self-administered funds increased by 24,7% from R466 billion in 2004 to R581 billion in 2005.

To contribute to the build-up of retirement savings, the tax on retirement funds was abolished with effect from 1 March 2007.

Financial markets

Primary capital-market activity

Government bonds

Net redemption of fixed-interest securities by the national Government in the domestic primary bond market amounted to R0,3 billion in 2006/07, compared with R21,8 billion raised in 2005/06.

Strong tax revenue made it possible for the authorities to reduce the weekly supply of government paper made available on auction from an average of R750 million per week in 2005/06, to R650 million in 2006/07.

Two new fixed-income bonds were launched in 2006/07, namely the R208 and R209 bonds. The R209 bond was issued in July 2006 with a coupon rate of 6,25%, maturing in 2036. By March 2007, R5,0 billion had been issued. The R208 bond was launched in September 2006, carrying a coupon of 6,75% and maturing in 2021, and over R2 billion was raised in 2006/07.

The R007 – the first of the three tranches of the R194 government bond to be repaid – was redeemed on 28 February 2007. The capital redemption value of the bond amounted to R24,1 billion, and coupon payments on these and other outstanding government bonds put a further R10,1 billion in cash in the hands of investors. The remaining two tranches of the R194 bond, namely the R195 and the R196, mature in 2008 and 2009, respectively. The South African Government retail bonds were launched in May 2004 with maturities of two, three and five years.

Since inception to February 2007, government had raised a total of R2,2 billion through these bond issues. Priced off the yield curve, the interest rates on government retail bonds were 8,5% for the two-year bond, 8,75% for the three-year bond and 8% for the five-year bond in April 2007.

Private-sector bond issuance

The outstanding nominal value of private-sector bonds listed on the Bond Exchange of South Africa (Besa) increased by R77 billion in 2006, compared with an increase of R42,4 billion in 2005.

This included funds raised through asset-backed securities, collateral debt obligations and short-term commercial paper. Total issuance related to these securities amounted to R36 billion in 2006.

Contrary to the lower supply of government bonds, the issuance of private-sector bonds, whether through private corporate bonds, securitisations or private placements, has grown significantly in the past few years.

This can be attributed to more diverse instruments being used, declining interest rates, narrowing credit spreads indicating investor low-risk tolerance amid the search for high yield, and credit upgrades for a number of corporate institutions.

The South African private corporate bond market is expected to grow as new asset classes emerge and new issuers continue to enter the market.

Exchange control rulings were amended in October 2006 to provide for inward listings by foreign issuers on Besa. This allows foreign entities to raise capital in South Africa on the condition that only non-derivative debt instruments, denominated in rands, may be listed.

South African institutional investors may invest in these instruments within their permissible foreign portfolio investment allowances, while an additional 5% of total retail assets may be used for investing in African inward-listed instruments. Individuals are allowed to invest without restriction.

On 30 October 2006, a Mauritian bank became the first African entity outside the Common Monetary Area to issue rand-denominated debt on Besa.

Eurorand bonds

Abundant liquidity in the global financial markets led to increased activity in the Eurorand bond market. The Eurorand bond market expanded in 2005 and 2006 with gross issuance of R9,1 billion in 2006, which is 9% less than the R10,1 billion issued in 2005, excluding a R1-billion issue not regarded as a pure eurorand transaction. In 2006, R4,1 billion worth of eurorand bonds matured, resulting in a net issuance of R5 billion.

The interest in this market can also be attributed to positive sentiment towards the Rand and an overall positive performance in global fixed-income markets in 2005.

In the first three months of 2007, gross issuance amounted to R3,7 billion, while R1 billion matured, bringing net issues to R2,7 billion.

During 2006, Germany's KFW and the European Investment Bank dominated issuance in the Eurorand bond market, comprising 3,2% and 26% of total issuance respectively.

Other issuers include Rentenbank (9%), the Province of Ontario (7%), Rabobank Nederland (5%) and Eurofirma (5%). The rest were issued by new issuers such as *Caisse d'Amortissement de la Dette Sociale*, Toyota Motor Credit Corporation, Inter-American Development Bank and General Electric Capital Corporation.

The type of credit issued remained predominantly AAA-rated, and the maturity structure is concentrated in bonds maturing in nine years or less.

Uridashi bonds

In addition to the issuance of eurorand bonds, rand-denominated bonds were first issued by foreign borrowers in the Japanese uridashi market in July 2004 and sold by non-Japanese issuers to Japanese retail investors.

They generally offer a more attractive yield than those offered on similar bonds issued in Japanese yen. The total nominal value of issues amounted to R8,8 billion in 2005, followed by R4,8 billion in 2006 and R2,1 billion in the first three months of 2007.

Secondary capital-market activity

Domestic bonds

South African government bond yields increased considerably from the 36-year lows in February 2006 to September 2006, in response to the weaker exchange value of the Rand, the increases in the repurchase rate from June, and an upward movement in bond yields in the major international financial centres.

From the high in September 2006, bond yields reverted back to a declining trend up to February 2007, coinciding with, among other things, the strengthening in the exchange value of the Rand, the projections of lower supply of government bonds, and record-high net purchases of bonds by non-residents in November 2006. Thereafter, bond yields increased to March 2007.

Non-resident investors showed keen interest in the South African secondary bond market in 2006, after they had been predominantly net sellers of bonds since 2000. Non-residents' net sales of bonds of R10,7 billion in 2005 reverted to the highest-ever recorded annual net purchases of R34,1 billion in 2006, and included record-high monthly net purchases of R11,8 billion in July and R12,8 billion in November 2006. In the first quarter of 2007, net purchases of bonds amounted to R0,6 billion.

The value of trading activity in the domestic secondary bond market valued at consideration amounted to R13,6 trillion in 2006, which was 39% higher than the R9,8 trillion in 2005. In the first three months of 2007, the value of turnover on the bond exchange amounted to R4,1 trillion. The daily average turnover reached R67 billion in June 2006, before declining to R45 billion in December, but accelerated further to a high of R69 billion in February 2007.

Money-market activity

The South African money market is an over-the-counter market in which a fairly large number of banks and other institutions actively participate. The SARB implements its monetary policy in terms of a system based on creating a shortage in the money market. The bank refinances this shortage through weekly repurchase transactions with seven-day maturities at its policy rate, the repo rate. Thus, the bank influences other market interest rates. The daily liquidity requirement in the money market was maintained at close to R13 billion throughout 2005/06.

The SARB uses mainly four types of open-market operations to drain surplus liquidity from the money market, namely, issuing SARB debentures, conducting longer-term reverse repo transactions, foreign-exchange swaps, and outright sales or switches of government bonds. Furthermore, with the redemption of the R152 bond and coupon payments made to the SARB on various bonds during February 2005, the bank was able to permanently drain R3,1 billion worth of liquidity from the market.

Equity market

The total value of equity capital raised by companies listed on the JSE amounted to R82,2 billion in 2005 and subsequently increased to R87,8 billion in 2006. The amount raised was almost equally distributed between companies with primary listings on the JSE and companies with primary listings on foreign bourses and secondary listings on the JSE.

Equity financing amounted to R38,8 billion in the first quarter of 2007, mainly raised by companies with primary listings on the JSE. The number of new listings increased from 19 in 2005 to 37 in 2006, while the number of delistings declined from 35 in 2005 to 24 in 2006.

Seven new listings were recorded in the first three months of 2007. Some 1 047 securities were listed on the JSE at the end of 2006, compared with 984 at the end of 2005, increasing to 1 073 at the end of the first quarter of 2007.

Domestic share prices, as measured by the All Share Index (Alsi), increased to new highs during 2006 and the first months of 2007. From a low on 13 June 2006, the Alsi rose by 47% to 26 February 2007. The strong increase in share prices was led by the increase of 51% in industrial shares and 46% in resources shares (with platinum-mining shares increasing by 91% and gold-mining shares by 23%), while financial shares improved by 40% over the same period.

Factors that influenced the market during this period were the robust economic growth, prudent fiscal and monetary policies, higher commodity prices, expectations of continued higher corporate earnings, general optimism in global equity markets and strong demand from foreign and local investors.

However, this upward momentum was interrupted as share prices corrected and international commodity prices and share markets deteriorated, resulting in a decline of 7% recorded to 5 March 2007. Subsequently, the Alsi continued its upward trend, increasing by 14% to an all-time high of 28 507 on 17 April 2007 alongside renewed increases in commodity and global equity prices.

Turnover on the JSE, as measured in terms of the value of shares traded, reached R1 279 billion in 2005, and increased to a record-high of R2 122 billion in 2006. In the first quarter of 2007, turnover amounted to R657 billion. Annualised liquidity, measured as turnover as a percentage of market capitalisation, increased from 36% in 2005 to 42% in 2006, with market capitalisation increasing from R3 586,1 billion to R5 041,5 billion over the same period. Market capitalisation in US dollar terms increased by 29% from US$549,3 billion in 2005 to US$711,2 billion in 2006.

According to the World Federation of Exchanges, South Africa was in 20th position in the world league at the end of January 2007 in terms of market capitalisation, and in US dollar terms. Non-residents bought a record-high net amount of R73,7 billion worth of shares during 2006 and increased their holdings of domestic shares by a net amount of R20,6 billion during the first quarter of 2007.

The JSE's new interest-rate exchange, Yield-X, commenced trading on 28 February 2005. This interest-rate exchange is the JSE's fourth electronic clearing and settlement platform, alongside equities, financial futures and agricultural products. Yield-X aims to open up the interest-rate market to new players and new products, encouraging liquidity and market diversification.

In addition, Yield-X seeks to ensure proper price discovery for interest-rate products in South Africa. At the heart of the new exchange is an anonymous central order book, allowing for trading via a single platform with automated trade matching and guaranteed settlement.

The JSE expects Yield-X to emulate the success of its equities and futures trading systems over time, establishing a sophisticated interest-rate derivatives market for the country.

A major benefit of Yield-X is the elimination of bilateral counter-party risk. The JSE, through clearing-house Safcom, guarantees all trades and offer a cradle-to-grave audit trail. Yield-X operates in a fully regulated environment overseen by the JSE and the FSB.

Yield-X is targeting a range of investors, from large institutional investors, banks, corporate treasuries and intermediaries, to smaller financial institutions and retail investors who may have been previously excluded from the interest-rate market. The number of contracts traded on Yield-X totalled 21 413 in 2006, and 52% more than the 14 087 contracts traded in 2005. In the first three months of 2007, the number of contracts amounted to 4 423. In value terms, turnover of R32,1 billion in 2006 was 189% higher than the value of R11,1 billion recorded in 2005. Turnover amounted to R7,5 billion in the first three months of 2007.

Domestic currency market

The South African Rand appreciated by almost 20% against the US Dollar during 2004. Although part of this appreciation was due to general US dollar weakness over this period, which caused most emerging-market currencies to appreciate, the Rand was also supported by domestic economic conditions such as the decline in the inflation rate, positive economic growth, improved sentiment and an increase in official foreign-exchange reserves.

South Africa's official gross reserves increased from US$8,1 billion at the end of January 2004 to US$15,9 billion at the end of March 2005. Demand for the Rand was also fuelled by foreign portfolio investment, particularly during the last quarter of 2004. According to Bloomberg's annual ranking report, the Rand was the second-best performing currency against the US Dollar during 2004.

The analysis comprised 60 currencies from developed as well as emerging-market countries. The only currency to marginally outperform the Rand was the Polish Zloty. The Rand also appreciated against other major currencies. Against both the Euro and the Pound, the Rand appreciated by almost 10% and compared with the Yen, the Rand appreciated by 13%.

Volatility conditions, as reflected by the implied and historical volatility indicators, rose to as high as 25,6% and 28,4%, respectively, in January 2004, but declined significantly during the rest of the year. At the end of December 2004, the implied and historical volatility indicators were at 14,9% and 13,4% respectively, indicating that volatility in the Rand exchange rate had subsided.

The average turnover in the domestic currency market increased from US$92,9 billion for the 2003 year as a whole, to US$98,0 billion for 2004. The average net daily turnover increased from US$7,7 billion to US$8,2 billion over the same period. These increases occurred mainly in the foreign-exchange swap market, and were not out of line with global trends observed in the 2004 Bank for International Settlements survey of global foreign-exchange activity.

Domestic rand turnover comprises 0,42% of the global foreign exchange market. During the first quarter of 2005, the Rand depreciated by almost 10% against the US Dollar, mainly as a result of developments in international currency markets.

The main reason was the appreciation in the exchange rate of the US Dollar, which began early in January, caused by expectations that the Fed could increase interest rates at a faster pace than previously expected. This affected most emerging-market currencies. In addition, commodity prices declined to lower levels during 2005 with a subsequent effect on the Rand, given that it is a commodity currency.

Exchange control

Exchange control is administered by the SARB on behalf of the Minister of Finance. The bank is assisted in this task by a number of banking institutions that have been appointed by the Minister of Finance as authorised dealers in foreign exchange.

These institutions undertake foreign-exchange transactions for their own account with their clients, within limits, and subject to conditions laid down by the SARB.

The Government is committed to an open capital market and the gradual relaxation of exchange controls.

The following dispensations regarding exchange control are allowed:

Institutional investors

Part of the process of gradual exchange-control liberalisation and financial-sector strengthening is the shift to a system of prudential regulation governing the foreign portfolio investment of institutional investors, such as long-term insurers and pension funds.

Prudential regulations are applied internationally to protect policy-holders and pensioners from excessive risk, and typically include restrictions on foreign-asset holdings, set at a certain percentage of an institution's total assets or liabilities.

As an interim step towards prudential regulation, retirement funds, long-term insurers, collective investment-scheme management companies and investment managers are allowed to transfer funds from South Africa for investment abroad:

- Institutional investors will be allowed to invest, on approval, up to existing foreign-asset limits. These foreign-asset limits are 15% of total retail assets for retirement funds and long-term insurers. Investment managers registered as institutional investors for exchange-control purposes and CIS management companies are restricted to 25% of total assets under management.
- Institutional investors will, on application, be allowed to invest an additional 5% of their total retail assets by acquiring 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 Besa, respectively.

- 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 will be required to submit additional information when making an application for a foreign-investment allowance. The shift to prudential regulation requires improved data reporting on individual institutions' foreign investments and the foreign-diversification levels of the industry as a whole. The new regulation became operational on 1 May 2003, after National Treasury and the Exchange-Control Department of the SARB, in consultation with the FSB, reached agreement with the respective institutional investors.

South African corporates

The global expansion of South African firms holds significant benefits for the economy, including expanded access to markets, increased exports and improved competitiveness.

With effect from 26 October 2004, limits on FDI by South African corporates were abolished. Exchange-control approval is, however, required. Requests by corporations are considered in light of national interest, such as the benefit to South Africa's foreign reserves by, for example, generating exports of goods and services, etc.

The Exchange-Control Department of the SARB reserves the right to stagger capital outflows relating to very large foreign investments, to manage any potential impact on the foreign-exchange market.

Interest payments on loans raised abroad to finance or partly finance new approved foreign investments must be repaid from offshore resources.

As a further alternative mechanism of financing offshore investments or to repay existing offshore debt, applications by corporates to engage in corporate asset or share-swap transactions and requests for share placements offshore by locally listed companies will be considered.

The corporates that have existing approved subsidiaries abroad are allowed to expand such activities without prior approval, subject to certain conditions. Dividends declared by the offshore subsidiaries of South African corporates may, after 26 October 2004, be retained offshore and used for any purpose, without recourse to South Africa.

Authorised dealers may also extend foreign currency-denominated facilities to South African corporates for financing approved FDI.

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.

Emigrants' blocked assets in excess of the emigration allowance were placed in emigrants' blocked accounts to preserve foreign reserves. Reflecting the improved strength and resilience of the South African economy, these blocked assets are now being unwound.

The imminent elimination of the net open forward position, and an increasingly diversified and growing export sector, create an environment that is conducive to dealing with the foreign reserve problems of the past. As such, the following applies:

- Emigrants qualify for a foreign capital allowance of R2 million per individual or R4 million in respect of family units emigrating.
- Emigrant-blocked assets are being unwound. Amounts of up to R2 million, inclusive of amounts already exited, are eligible for exit without the 10% exit levy. Holders of blocked assets wishing to exit more than R2 million, inclusive of amounts already exited, must apply to the Exchange-Control Department of the SARB to do so. Approval is subject to an exiting schedule and an exit levy of 10% of the amount requested.
- New emigrants wishing to exit more than R2 million, inclusive of amounts already exited, can similarly apply to the Exchange-Control Department to do so, with approval subject to an exiting schedule and an exit levy of 10% of such additional amount.

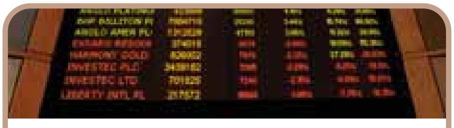
Private individuals resident in South Africa

Private individuals resident in South Africa qualify for a foreign-capital allowance of R2 million per private individual who is a taxpayer in good standing and over the age of 18 years, for investment purposes outside the common monetary area (i.e. Swaziland, Lesotho, Namibia and South Africa).

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, foreign companies or foreign-owned South African companies are permitted to make greater use of local finance.

With effect from 18 February 2004, foreign companies or foreign wholly owned subsidiaries



The JSE Securities Exchange Limited (JSE) recorded the highest number of trades and highest value of trades in its 120-year existence in August 2007.

In total, 80 268 equity trades were recorded to the value of R20,4 billion.

The records came on the heels of strong revenue growth recorded by the JSE for the interim six months to 30 June 2007, in which record volumes were recorded in the exchange's main three markets.

The previous record for volume was some 78 000 trades at the June 2007 futures close-out, and the previous record for value was achieved during June 2006.

can borrow locally up to 300% of the total shareholders' investment.

This ratio does not apply to emigrants, the acquisition of residential properties by non-residents or affected persons, and certain other financial transactions, such as portfolio investments by non-residents, securities lending, hedging, repurchase agreements, etc. In these cases, the 100% ratio still applies.

JSE Limited

Founded on 8 November 1887, the JSE is the sole licensed securities exchange in South Africa.

On 6 August 2001, the JSE acquired the business and assets of the South African Futures Exchange (Safex). Safex is now incorporated into the JSE in two divisions: the Financial Derivatives Division, which covers the equity and interest-rate futures and options markets; and the Agricultural Products Division, which covers commodities futures and options on maize, sunflower, soya beans and wheat.

In July 2005, after 118 years as a mutual association, the JSE celebrated its demutualisation and subsequently listed itself as a public company on 5 June 2006. The management and control of the JSE vests in the board, which has powers conferred to it by the Securities Services Act, 2004 (Act 36 of 2004), rules and the Constitution.

Regulation

As the frontline regulator of its primary and secondary markets, an independent regulatory authority, the FSB, supervises the exchange. The Issuer Services Division of the JSE, together with two independent bodies – the Generally Accepted Accounting Practice (GAAP) Monitoring Panel and the Securities Regulation Panel – enforces compliance with GAAP and the protection of minority shareholders, respectively.

The Insider Trading Directorate of the FSB operates a stringent enforcement programme, with the support of the JSE, in respect of the secondary market. In turn, the JSE regulates its listed companies and broking members by extensive rules and directives in line with the Securities Services Act, 2004.

In November 1995, the JSE permitted ownership by foreign and corporate members for the first time. The move, part of a broader deregulation package designed to entice local and international investors, parallels the London stock market's "Big Bang" of 1986, although changes were phased in over time. These included closing the open-outcry market floor in favour of automated electronic trading, the introduction of fully negotiable commission, and dual-trading capacity.

International involvement

The JSE is the largest securities exchange in Africa and has a market capitalisation of several times that of all the other African markets combined. It has the third-largest market for single stock futures in the world, the ninth-largest market for options and futures in the world, it accounts for over 75% of the equities market in Africa, and its reserves grew from US$31 million in 1999 to US$83 million in 2006.

The JSE is committed to promoting South Africa, both regionally and internationally. In this regard, it has led the process of harmonising the listings requirements of the members of the Committee of SADC Stock Exchanges (COSSE). The COSSE envisages an integrated real-time national network of securities markets in the region.

The JSE has offered its trading platform to these members, and the Namibian Stock Exchange has been trading on the JSE's trading platform for the past eight years.

In addition, the JSE has played an instrumental role in creating the globally prominent Code of

Corporate Practices and Conduct (referred to as King II), which is a follow-up to the King I Code. The listings requirements of the JSE now require that all companies provide a report in their annual financial statement on their level of compliance with King II, including progress on the novel stakeholder aspects of the code.

Consistent with the objectives of the New Partnership for Africa's Development and by virtue of the JSE's position in the southern African region, the JSE remains committed to the concept of a Pan-African board, and is involved in trying to raise money to assist neighbouring countries to participate in this initiative.

Foreign investors

Since 1994, South Africa has restructured its economic policies to attract foreign investment. The transition has led to a significant improvement in the quality and inclusiveness of institutions. Prudent social reform has been coupled with accountable political institutions and sound macroeconomic management.

The economic rating agencies' reports confirm the presence of high levels of political stability. The JSE Limited plays a vital role in the South African economy by putting capital-providers in touch with capital-seekers. Thus, cash resources are channelled into productive economic activity, building the economy while enhancing job opportunities and wealth creation.

Listing on the JSE enables capital to be raised for the financing of new and expanding business and creating new employment opportunities. In addition, it provides a secondary market for dealing in securities by bringing together buyers and sellers in a manner that ensures transparent price discovery.

In this way, new investment opportunities are created in the country.

During the February 2004 Budget Speech, the Minister of Finance announced the further relaxation of exchange controls by approving foreign companies seeking to issue securities on the JSE and Besa. In line with the approval, international investors have unfettered access to securities listed on the JSE:

- No exchange controls of any kind are imposed on foreign investors or any non-resident parties.
- There are no limits on the repatriation of capital or income on foreign shareholders.
- There are no withholding taxes or other penalties applied to the repatriation of capital, interest or dividends by foreign investors.
- There are no foreign-ownership limits on South African securities.
- There is no separate registration process for foreign investors. All shareholders are reflected in the dematerialised register. Purchases or sales of shares by foreign shareholders are reflected in its electronic share registry by insertion of a flag.
- South Africa has a free-floating exchange rate traded in all global financial centres. The currency is one of the most liquid among upper-middle-income countries, with currency equivalent to 24% of South Africa's annual GDP traded every day.

The currency is backed by an extremely liquid and deep sovereign bond exchange (not affiliated to the JSE) to which foreign investors similarly have unfettered access.

JSE member firms and central securities depository participants offer custodian services to foreign investors.

Product developments

The JSE launched the Social Responsibility Index (SRI) in May 2004 to focus on corporate social responsibility and sustainable business practices, and to encourage socially responsible investment in South Africa. The SRI measures the triple bottom line performance, in terms of environmental, economic and social sustainability of companies listed on the FTSE/JSE Alsi.

The SRI criteria are customised to the South African and African context, and could be an aspirational benchmark for all organisations, regarding best practice in the triple bottom line.

Driven by the quest to demystify the market and the desire to broaden the national retail investor base by encouraging a wider spread of knowledge of the financial market and the growth of an investment culture in South Africa, the JSE introduced the University Investment Challenge at the beginning of 2005.

This concept is rooted in the JSE/Liberty Investment Challenge, which is a simulated trading experience designed to encourage secondary-school learners to learn about the market by trading phantom portfolios. The challenge has been running for over 35 years.

New listing requirements became effective in September 2003. These stipulate that when listed entities wish to delist, they must make an offer to minorities and obtain a fair and reasonable statement.

Listed companies are required to comply with international financial reporting standards for all financial years, starting in 2005. The Alternative

Exchange, better known as AltX, was launched in October 2003 as a parallel market or alternative exchange for small-to-medium and growing companies. It is Africa's first alternative market for innovative companies and investors. AltX provides an attractive investment area for investors interested in the growth potential of smaller stocks. It is the sum of a partnership between the JSE and government through the Department of Trade and Industry.

In July 2006, the JSE launched the first Can-Do Options on the equity derivatives market. Hard on the heels of the launch of Can-o Options, the first structured transaction on Yield-X was listed in September. Yield-X is a single platform for the trading of interest-rate products on a yield basis. It is a single point of access and a one-stop shop.

The JSE Limited continually strives to run a low-cost, highly efficient market that offers a wide range of financial products to an ever-broadening investor community.

Bond Exchange of South Africa

Besa is an independent financial exchange operating under a licence granted annually by the country's securities-market regulator, the FSB. Besa is responsible for regulating the debt securities market in South Africa.

Operational developments

Government bonds are the backbone of the South African bond market. Some 85% of Besa turnover is in Republic of South Africa bonds, of which 22% is in standard trades, and 67% in repurchase agreements.

About 27% of Besa trade is concluded with non-residents and another 5% is traded offshore and settled through the South African settlement system. While bank lending remains the main source of corporate finance in most mature and emerging markets, the volume of corporate debt listed on Besa had steadily increased and topped 28,7% of listed debt as at 30 December 2006.

At the same time, Besa granted a listing to 725 debt securities issued by 91 borrowers with a total market nominal value of R725 billion (US$103 billion). More than 60% of this debt was issued by central government (corporate issues account for 29%). SOEs and local authorities account for 11%.

A number of other trade associations are being formed to facilitate trading, clearing and settlement of their product types.

Regulatory developments

Besa has been approved by the Exchange-Control Department of the SARB for the listing of foreign registered entities wanting to list their debt securities on Besa. The Bond Exchange Actuarial Society of South Africa's total return indices consist of an all-bond index made of 20 different bonds.

By 31 December 2006, some 95% nominal of listed debt securities had been immobilised or dematerialised in the Central Securities Depository.

The rules for derivate trading have been approved by the FSB and trading has commenced primarily in listed swaps and forward-rate agreements (FRAs) (currently unlisted and listed trading is reported to Besa).

Besa's listing disclosure requirements for high-yield bonds and exchange-traded funds have been formulated and approved by the Listings Technical Committee.

Besa continues to provide in-house training and education to foreign and local delegations, schools, and tertiary and postgraduate institutions.

Market performance

Bond turnover

Since market turnover reached its record level in 2002 at R11,7 trillion, annual bond turnover reported on Besa has ebbed, dropping to R8,1 trillion in 2005.

The R153 yield declined from 11,86% on 1 January 2002 to 7,31% as at 31 December 2005. At the beginning of 2006, Besa estimated that market turnover for the year ahead would be of the order of R7,8 trillion.

However, against all expectations, nominal turnover increased during 2006 by 41% to R11,4 trillion. The number of matched trades increased marginally by 4%, from 298 000 trades in 2005 to 311 000 in 2006.

Government bonds remained the most traded instruments, contributing 93% to the total nominal turnover. Monthly market turnover in 2006 was higher year on year, reaching a near-record level of R1,2 trillion in October 2006.

Where non-residents were net sellers (R5,5 billion) of South African bonds in 2005, they became net purchasers of bonds totalling R26,8 billion in 2006, while their participation in trading activity increased from 32% in 2005 to 38% of turnover during the year under review.

Listed and unlisted derivative trades reported on the Bond Exchange of South Africa

Besa launched a fixed income derivative platform (Intersec) in September 2005 to facilitate the capture and confirmation of plain vanilla FRAs and swaps traded over-the-counter (OTC).

Since 2005, OTC trades reported on Intersec had increased from a total of 627 trades with a value of R159 billion to 1 063 trades with a value of R589 billion in 2006.

Besa launched its FSB-approved listed fixed-income derivatives during the course of 2006 and established the Derivatives Traders' Association, which had 12 members by mid-2007. Listed derivative trading activity had been slower in uptake and at the end of 2006, swaps with a value of R2,5 billion were reported.

Listed bonds

The number of listings on Besa increased from a nominal value in issue of R637 billion at the end 2005 to R725 billion in 2006, with a market cap of R830 billion. The listed debt instruments totalled 725 issues by 91 issuers.

Most significant was the annual increase in corporate listings from 22% of the total nominal value in issue to 29% in 2006.

The nominal value of the corporate listings increased from R140 billion in 2005 to R208 billion in 2006.

In 2006, exchange-control regulations were relaxed, allowing foreign issuers to list ZAR-denominated bonds on Besa and allowing investment managers an increased investment allowance should these funds be deployed for development into Africa.

Besa listed its first such "inward listing" towards the end of 2006, when Mauritius Commercial Bank raised funding of R350 million in the South African market.

Strate Limited

Strate Limited, the central securities depository for equities, is responsible for equities and fixed-income securities. According to a report by Global Securities Consulting Services Benchmarks Limited, which is represented by 10 global participating custodians, Strate is rated sixth in the world in terms of settlement risk, and third in terms of custody risk. These benchmarks measure settlement, safekeeping and operational risk among central securities depositories in a range of major and emerging markets.

Financial-sector continuity planning

The South African financial sector collaborates extensively in contingency planning for systemic risks that may disrupt settlement, financial intermediation and possibly economic activity in general. The primary objective of this co-operative arrangement is to identify crisis events that may threaten the stability of the South African financial sector and to propose appropriate plans, mechanisms and structures to mitigate such threats.

This arrangement also facilitates co-operation between key financial-sector institutions and regulators in times of a significant catastrophic event, to have the best chance of protecting staff, facilitating recovery and sustaining both a stable financial market and consumer confidence.

Although individual firms are responsible for managing and mitigating risks to their respective operations, the broader collaborative effort is focused on risks that threaten the financial sector as a whole. Such risks range from the impact of global economic threats to potential causes of major operational disruption.

These risks are regularly analysed and appropriate response strategies devised. In 2006, a programme of financial-sector continuity testing was initiated to hone the responses of financial-sector authorities to systemic threats.

This programme of testing will be expanded as financial-sector authorities extend their co-operative relationships to promote greater vigilance, in an environment of growing complexity.

Acknowledgements

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