

## Policy changes that will shape our future

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July 2011

The investment environment in South Africa has been supported by a remarkably stable and consistent policy environment, both at macro and micro levels, over the past decade. This high level of policy predictability led to increased certainty which supported market confidence and created an environment in which it was possible for local capital markets to produce exceptional returns. However, most things are cyclical and periods of confidence and stability are inevitably followed by moments of change and increased uncertainty.

Due to a combination of global and local factors, many facets of historical policy decisions are currently under scrutiny. The primary rationale for a change in approach is the scars left by the global financial crisis in 2008. The impact of the crisis is pervasive, varying from lower economic growth and significant job losses in SA over the past three years to diminished trust in the global financial services industry and its regulators. Many of the new ideas and events that will shape our future has its roots in the global credit binge of the 2000s, the Armageddon moment in 2008 and the slow and painful deleveraging process we are living through at the moment.

The exploration of new policy directions will lead in some cases to fundamentally different approaches, which could impact the efficiency of the local economy in general and the operation of capital markets and its participants specifically. As a long-term focused investment business our interest in this process is to ensure that we can continue to deliver the best possible returns for our clients over time. We believe that reasonable outcomes are more likely to be achieved through constructive dialogue that focuses on identifying the best approach for SA while remaining mindful of balancing the costs and benefits of proposed market interventions. Coronation is actively participating in many of these debates on behalf of clients.

Some of the key areas currently under discussion are summarised below.

- The National Planning Commission (NPC) recently released its diagnostic report for discussion before finalising a development plan for SA through 2030.
  - Government released its New Growth Path (NGP) framework in November last year as a replacement for their previous economic frameworks AsgiSA and GEAR.
  - A National Health Insurance (NHI) scheme, which aims to extend healthcare delivered by a provider of choice to all citizens at no, or limited, cost to the user is intended to be implemented gradually over the next 14 years.
  - National Treasury released a discussion paper 'A safer financial sector to serve SA better' which deals with reforms and extends to the way in which financial sector activity will be regulated.
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- A further discussion paper on introducing a National Social Security Fund and reforming the retirement industry is expected later this year.
- Many aspects of the tax code relating, among others, to the taxation of dividends, interest, life insurance products, retirement savings and derivatives are either in the process of being changed or the subject of ongoing discussion.

### **Macro reforms**

Both the NPC and the NGP have identified the elimination of poverty and the reduction of inequality as key policy objectives, with reducing youth unemployment and improving educational outcomes as the key objectives. Achieving these objectives is imperative to the long-term wellbeing of SA. The NGP also envisages a greater level of investment by the formal savings industry in the infrastructure necessary to support economic growth into the future. If this policy objective is implemented well, it could lead to deeper and wider capital markets (increased liquidity and more investment instruments), offering more opportunities to investors to enhance their returns and/or reduce their risk. If implemented poorly, specifically in the form of prescribed investments not subject to market pricing, it could be viewed as a stealth tax on capital.

The proposed implementation of NHI is arguably the most ambitious entitlement programme launched in the democracy era. While the objective of enhancing health outcomes for all is laudable, the practical and cost implications are significant. Consulting firm Econex believes that this system will add around R100 billion to annual government expenditure, and take healthcare spend from 4% of GDP to 8.5% over the next 14 years. At least some of this additional cost will have to be funded through the tax system, most likely through an increase in personal income tax, and decreases in the tax incentives available to support private healthcare and pension savings. This initiative will cause a reversal of the reduction in personal income tax rates experienced over the last decade, which will force investors to save more to achieve the same after-tax outcomes.

### **Financial sector reforms**

The past focus of financial sector policy reform since the global financial crisis in 2008 has been on improving financial stability. This culminated in the Basel III and Solvency II processes aimed at strengthening the capital requirements applicable to banks and insurance companies respectively.

The current reform agenda is starting to focus more on changing the way in which the conduct of financial services providers is regulated. The key change in global thinking about regulating the financial services sector involves a move from a 'light-touch' to an 'intrusive' regulatory approach. The current 'light-touch' approach relies primarily on a disclosure and complaints driven approach, while a more intrusive approach will add more proactive regulatory interventions. While this more intrusive approach will enhance consumer protection, the risk is that its benefits may be outweighed by the additional costs incurred in policing the system.

The key market conduct initiative announced by Treasury is the implementation of a formal 'Treating Customers Fairly' (TCF) programme, which is intended to enhance market oversight. This programme, expected to be implemented formally from 2014, will be the first consistent consumer protection framework to apply to all types of financial products. The core principle underpinning TCF is to ensure that all companies operating in the financial services industry embrace a culture of putting customers first: by communicating relevantly and regularly, providing products specifically designed to meet client needs and explaining clearly what clients

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can reasonably expect from these products. As a client-centric organisation the equitable treatment of all clients has always been a key principle of how we conduct our business. In 2009 we decided to formalise our passion for clients in a public and open commitment that we have called the Coronation Client Charter (see inside front cover). The charter provides a clear indication of what you can expect from us and is closely aligned to many of the objectives of TCF.

### **Retirement reforms and social security**

SA has a well-developed retirement system, with an asset base that compares favourably to other countries at a similar stage of development. However, its design and architecture can be improved to better serve the needs of more South Africans. Learning from pension reform initiatives in many parts of the world, government has launched a formal retirement reform process to achieve the following objectives:

- Increase **coverage and access**, as only around 6 million of SA's 13 million employed labour force are currently members of retirement funds.
- Enhance **social solidarity** by enabling the needy to benefit from the protection of the majority.
- Improve **efficiency** through ensuring that benefits are not eroded by unnecessarily high fees.
- Ensure **sustainability** by keeping benefits affordable and simple enough to ensure that fund members understand the value thereof.
- Achieve **adequacy** through enhancing SA's saving culture and improving the level of retirement provision made by individuals.

Government's further discussion document on retirement and social security reform expected later this year this will give a clearer indication on how they believe the above objectives can best be achieved. For us, our focus remains on ensuring that pre-existing rights are protected in the event of significant changes to the existing system and that the implementation and transition risk of systemic changes are minimised.

As a member of Asisa (the Association for Savings and Investment South Africa), Coronation is supportive of a number of industry proposals designed to match government's objectives, industry's capacity and the needs of our clients. These proposals include:

#### **Coverage and access objective: implement a gap fund**

The creation of a gap fund that provides access to both formal and informal sector workers by using existing industry infrastructure to achieve cost efficiencies. The fund can be developed and implemented quickly and will require minimal legislative changes to achieve successful launch. The proposed fund design allows for significant policy flexibility and is loosely based on the successfully implemented Fundisa education savings scheme (a public-private partnership between industry and government). The gap fund presents a viable default option if a mandatory savings regime is implemented, somewhat similar to the National Employment Savings Trust scheme recently introduced in the UK. A key benefit of the fund is that it will achieve 'coverage and access' without major implementation risk as it will cause no significant disruptions in the

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existing pension system.

**Social solidarity objective: risk subsidy mechanism and standardised annuity**

Ensuring equalised, standard-rated minimum death and disability benefits for all workers is at the heart of achieving enhanced social solidarity. Considerable research has been done on the concept of a risk subsidy mechanism that can be used to equalise benefits across funds with different member risk profiles through transfers from lower risk to higher risk schemes. The design limits moral hazard by recommending technical rather than actual risk experience, to incentivise schemes and employers to actively manage risk through, for example safety and healthcare programmes. Equity in the system may be further enhanced through the introduction of a standardised annuity to provide better value for lower earners.

**Improve efficiency objective: ensure adequate economies of scale**

A comprehensive review of costs in the retirement industry confirms that the rapid consolidation in the industry - from more than 13 000 funds a few years ago to 3 200 at present - is driving increased economies of scale. It also shows that SA's large standalone pension funds and retirement annuity funds are very cost-effective by international standards. Large standalone funds on average incur costs of less than R38 per member per month. Inefficiencies are not only a factor of scale - complexities in the tax, benefit administration, contribution collection cycle, and fund rules all need to be addressed through policy intervention to enhance system efficiency.

It is clear that the scope of potential changes to the environment in which we invest on your behalf has broadened significantly, requiring us to engage more intensely with regulators and policymakers. While we will play an active role in protecting the 'commons' we all rely on, we remain convinced that by sticking resolutely to our philosophy of focusing on finding long-term value while ignoring the short-term noise, we will continue to deliver on our most important responsibility of producing superior investment returns for all our clients.

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