22 nd IIFA Annual Meetting - Montreal - Oct 2008

SOUTH AFRICA Member Report

1. Economic and financial background

GDP

After approximately four years of above-trend economic expansion in South Africa, growth in real gross domestic product (GDP) slowed to an annualised rate of only 2,1% in the first quarter of 2008. This was due to electricity rationing, weaker global demand, slower growth in incomes and high interest rates. In the second quarter growth rebounded to 4,9% mainly due to the recovery in mining and manufacturing after the power outages.

The World Bank has forecast 4.2% growth in 2008 with the large public infrastructure investment expected to offset the slower overall economy. Actual growth in 2007 was 5,1% against 5,4% in 2006.

Balance of Payments

Gold and foreign exchange reserves rose from US$33,0 billion at the end of December 2007 to US$34,9 billion at the end of June 2008 and comfortably cover some five months of imports.

Current account

South Africa's deficit on the current account of the balance of payments in the first quarter of 2008 widened to 9,0% of GDP - the highest level in 26 years due to surging imports and higher oil costs. It is forecast to narrow slightly over the year due to higher commodity export prices, slowing demand and a weaker currency. The current account deficit for the whole of 2007 was $20,5 billion.

Exchange Rate

During the first quarter of 2008 the rand declined by about 20%, partly due to increased risk aversion by international investors towards emerging markets and negative investor perceptions regarding growth prospects following electricity supply outages. During April and May 2008 the exchange rate of the rand strengthened, supported by the increase in domestic interest rates.

Inflation

Inflationary pressures continued to rise throughout 2007 and into 2008. This was due to soaring food prices, increasing petrol and domestic supply constraints in certain sectors. CPIX inflation jumped to a record 13,0% year-on-year in July which is expected to be the peak in this cycle. The Central Bank has been steadily increasing interest rates to combat surging inflation but at its last meeting kept rates unchanged due to weakening domestic demand. Rates are forecast to decline again from April next year.

Savings

Household debt has climbed to a record 78,2% of disposable income, well above the 50% level seen in 2002. The gross saving ratio of the *household sector* declined marginally from 1,3% in the fourth quarter of 2007 to 1,2% in the first quarter of 2008. The moderation in the household's consumption expenditure was more than offset by slower growth in the disposable income of households, inhibiting their ability to accumulate savings. The ratio of debt service costs to disposable income rose to about 11,3% in the first quarter from 10,5% in the last quarter of 2007.

2. Data on funds under management and portfolios

Statistics for 12 months to 30 June annually

	2000	2001	2002	2003	2004	2005	2006	2007	2008
TOTAL ASSETS (Rm)									
General Equity Funds	40,680	47,419	51,248	38,887	47,491	67,856	96,642	132,513	121,837
Specialist Equity Funds	23,024	20,253	22,274	19,660	24,423	39,743	50,206	62,438	60,293
Sub-total	**63,704**	**67,672**	**73,522**	**58,547**	**71,914**	**107,599**	**146,848**	**194,951**	**182,130**
Balanced/Mixed Funds	**6,996**	**9,027**	**16,881**	**17,905**	**32,190**	**52,468**	**91,494**	**153,046**	**167,055**
Property	**-**	**-**	**1,469**	**3,013**	**4,670**	**10,771**	**15,620**	**19,117**	**13,744**
Fixed Interest Funds									
Fixed Income Funds	4,088	5,413	5,595	6,252	8,241	9,743	12,347	8,790	11,890
Bond Funds	9,259	13,235	17,861	21,694	21,222	25,002	17,509	18,635	16,471
Money Market Funds	35,080	34,708	50,875	67,054	88,367	114,381	124,182	157,470	181,776
Other Sector	562	3,807	11,890	17,490	22,973	28,076	47,341	69,208	82,974
Sub-total	**48,989**	**57,163**	**86,221**	**112,490**	**140,803**	**177,202**	**201,379**	**254,103**	**293,111**
Fund of Funds	6,643	11,419	27,018	22,940	27,643	44,867	67,946	100,970	110,871
Grand Total	**119,689**	**133,862**	**178,093**	**191,955**	**249,577**	**348,040**	**455,341**	**621,217**	**656,040**
TOTAL NET FLOWS (Rm)									
General Equity Funds	3,624	4,619	-3,908	-3,966	1,789	2,494	2,786	467	-8,388
Specialist Equity Funds	3,076	-1,895	551	312	1,865	95	-2,980	-5,600	30
Sub-total	**6,700**	**2,724**	**-3,357**	**-3,654**	**3,654**	**2,589**	**-194**	**-5,133**	**-8,358**
Balanced/Mixed Funds	**-1,029**	**1,407**	**7,156**	**2,293**	**10,636**	**11,581**	**29,279**	**36,809**	**13,454**
Property	**-**	**-**	**81**	**1,172**	**1,450**	**3,610**	**2,483**	**-1,359**	**-589**
Fixed Interest Funds									
Fixed Income Funds	2,184	2,756	4,732	346	2,947	2,077	415	-1,117	-262
Bond Funds	762	966	340	2,386	586	1,655	-6,850	959	-2,220
Money Market Funds	12,285	1,263	17,243	15,989	21,030	25,174	3,687	29,617	23,534
Other Sector	389	3,108	8,029	5,627	4,641	4,739	21,438	18,762	14,651
Sub-total	**15,620**	**8,093**	**30,344**	**24,348**	**29,204**	**33,645**	**18,690**	**48,221**	**35,703**
Fund of Funds	3,622	4,379	12,552	412	1,590	6,017	12,147	17,944	10,173
Grand Total	**21,291**	**12,224**	**34,224**	**24,159**	**44,944**	**51,425**	**50,258**	**78,538**	**40,210**
NUMBER OF FUNDS									
General Equity Funds	72	88	109	115	110	113	112	127	141
Specialist Equity Funds	105	114	114	108	92	91	99	93	103
Sub-total	**177**	**202**	**223**	**223**	**202**	**204**	**211**	**220**	**244**
Balanced/Mixed Funds	**61**	**77**	**116**	**137**	**166**	**216**	**295**	**364**	**411**
Property	**-**	**-**	**4**	**6**	**11**	**19**	**24**	**26**	**28**

Fixed Interest Funds									
Fixed Income Funds	15	15	14	15	12	10	13	12	17
Bond Funds	25	32	38	39	41	41	45	41	39
Money Market Funds	21	24	24	28	25	26	27	27	31
Other sector	2	8	18	27	40	54	64	81	85
Sub-total	**63**	**79**	**94**	**109**	**118**	**131**	**149**	**161**	**172**
Fund of Funds	39	69	119	133	151	201	240	304	335
Grand Total	**301**	**358**	**437**	**475**	**497**	**570**	**679**	**771**	**855**
TOTAL NUMBER OF MANAGERS	**31**	**29**	**28**	**29**	**25**	**26**	**29**	**34**	**39**

3. Key trends in flows and assets under management

Like most jurisdictions, South African investors showed great cautiousness towards equity markets this year. This has been however a long standing trend since the turn of the century and despite a very strong and long bull market. This resistance to the equity sectors has been attributed to increased caution from financial advisers, who since the introduction of the Financial and Intermediary Services Act in 2003, have become a lot more accountable to the client for the advice that they give around portfolio construction. This has displayed itself in a move towards targeted return funds, stable/balanced funds and funds focussing on e.g. higher income yields as opposed to capital growth. The increased use of the collective investment vehicle as the underlying vehicle in pension products has also contributed to this more mature investment style.

Nearly all flows went into balanced, money market and specialist fixed interest funds during the past year.

4. Regulatory and self regulatory developments (including tax)

Retirement fund reform of the 50 year old legislation remains top of the policy makers list, however differing views between the Ministries of Finance, Social Welfare, Health and Labour have led to further delays in the issuing of a white paper. The reform will be part of a more robust and inclusive social security system.

The second consultation paper was issued at the beginning of 2007, and since then a number of discussion documents, mainly from the Social Development department have been issued, although none of them are official.

The proposals currently on the table are in line with the World Bank's five pillar model and include:

- Social assistance grants to provide a safety net against poverty in old age, as well as basic support to the disabled, children and caregivers. South Africa already holds the second position in the world in terms of numbers of grants paid each month.
- Mandatory participation in the National Social Security System, up to an agreed upon earnings threshold, providing basic retirement, unemployment, death and disability cover.
- Additional mandatory participation in individual retirement funds, for individuals earning above the threshold.
- Supplementary voluntary savings, allowing individuals to choose how they allocate income over their lifetime

A wage subsidy to offset the costs of social security contributions for low income earners and to encourage employment creation has been proposed. The ACI, backed up by the other industry associations, has recommended that a co-contribution model may be more appropriate, particularly taking into account the high level of informal employment in South Africa. In our view it will be more inclusive than a wage subsidy which will only benefit the formally employed.

Administration and tax reforms have also been suggested to streamline and simplify processes.

Latest indications are that the health system will also be included in the reform process making it highly unlikely that the previous target for implementation of a new system in 2010 is attainable.

A change in leadership in the ANC, the dominant political party in South Africa has led to amongst other things, a raft of bills, estimated over 60 in number, being set before parliament in an attempt for the current regime to finalise issues before potential changes in cabinet and ministries.

One of these bills allowed the CIS industry to lobby successfully against a previous move from the life industry which had blocked transfers between individual retirement funds.

The major regulatory developments in the CIS arena however are proposed changes to the legislation allowing for extended investment powers in line for example with UCITS legislation in Europe.

Most foreign collective investment schemes registered to do business in South Africa are also registered in Europe as their primary base, and mainly fall under UCITS legislation. Existing foreign schemes have been given permission to operate with the enhanced investment powers set out in UCITS III, as long as proof of the additional risk management processes is provided.

The next stage in the process is to level the playing fields between foreign collective investment schemes and local funds. Similar rules and risk management processes as to those found in the UK, Ireland and Luxembourg are being proposed. The regulator will then also allow new foreign funds into the market once the playing fields have been levelled.

This has brought the issue of hedge funds back on to the table as most of the concerns around offering regulated hedge fund products in South Africa have been around the use of some of the derivative and synthetic instruments, and the implications for the conduit principle for tax application on collective investment schemes. The ACI has engaged National Treasury and the regulator on this issue.

Other areas of regulatory activity include a proposal to bring venture capital into the CIS structure, to facilitate the development of small and medium size enterprises. There have also been proposals around how withholding tax is charged and a new Consumer Protection Bill, which all have impact on the industry.

5. Corporate governance - major developments*

No major developments this year.

6. Fund governance*

The introduction of TERs has been most successful, with policymaker, regulator and industry all aligned in seeing the benefit of a common platform to evaluate expenses.

7. Product developments

The major product development issue this year was the introduction of a collaborative industry scheme aimed at changing savings behaviour amongst ordinary South Africans.

We have spent considerable time attempting to find creative and effective ways to enable low income earners to access financial markets via collective investments. The result has been an appealing concept for low income earners and government alike, involving saving for further education through an education savings fund, to be known as the FundiSA Fund.

This education savings scheme represents an opportunity for incentivisation of a family to contribute to the cost of tertiary and higher education. After doing a review of incentive measures used abroad, we based our grant proposal on the Canadian Education Savings Grant (CESG) introduced by the Canadian government in 1998 - a reform to the Registered Education Savings Plans (RESP's) introduced in 1972. The South African grant matches investor contributions at 25% of contributions, subject to a contribution limit. Unlike the Canadian