NATIONAL REPORT FOR SOUTH AFRICA
H P MITCHLEY

Politics

The political miracle of the success of the 1994 elections and the hand-over of power to the Government of National Unity has been followed by a period of consolidation.

The Reconstruction and Development Program which aims to raise the standard of living of the poorer population, particularly in housing, heath and education, is progressing slowly - there is a considerable backlog in the provision of these essential services that will take many years to overcome.

Elections for local government were held in November 1994 (except in some areas where municipal boundaries had not been agreed). They were accompanied by a restructuring of local councils in the major metropolitan areas. The division of powers between provincial councils, metropolitan councils and the sub-councils is still undecided in many areas with consequent uncertainty of how effective the new structures will be.

Economics

In spite of improving economic figures - the Gross Domestic Product increased by 2,3% in 1994 and 3,3% in 1995 - employment in the formal sector has not increased and unemployment remains a major problem. The inflation rate was 9,9% in 1994 and declined to 6,9% in 1995 - the lowest figure since 1972.

The exchange rate of the Rand against the US dollar has been in the narrow range of R3-50 to R3-65 to the Dollar. For almost ten years a dual exchange rate system applied - a Commercial Rand, which applied to trade and current transactions, and a Financial Rand, which applied to capital investment transactions. The Financial Rand traded at a discount to Commercial Rand which at times was a high as 30%, but a significant improvement in the second half of 1994 and early 1995 enabled the Finance Minister to abolish the Financial Rand in March 1995.

Business confidence levels have improved in recent months and the best summer rains in many years have boosted the outlook for the agricultural sector.

Capital investment which will create employment opportunities is still at a low level and remains the major concern for economic growth.

The Profession

The number of members of the Consulting Actuaries Society of South Africa has increased from 55 in 1994 to 61 in 1996.

Life assurance companies have been making a concerted effort to widen their sphere of services and are becoming more direct competition for consulting actuaries. Some life companies have established consulting actuarial companies in an attempt to project a degree of independence.

Retirement Funds

Two major commissions have reported on retirement funds in 1995 - the Katz Commission of Enquiry into Taxation Matters and the Smith Committee on the Strategy and Policy Review of Retirement Provision.

The Katz Commission, which has undertaken a holistic review of the entire tax structure, has made some radical proposals in relation to taxation of retirement funds.

Broadly the present system is -

(a) Contributions deductible in determining taxable income (limits 7,5% by employee and 20% by employer).

(b) Investment income of retirement funds totally exempt from tax.

(c) Lump sum benefits taxed at average rates in year of receipt.

(d) Pensions and annuities taxed as normal income in year of receipt.

Manipulation of taxable income in the year of retirement, with a consequent reduction in the average rate of tax, has led to inequities in the proportion of tax payable on lump sum benefits compared with that payable on pensions with a similar capital value.

As an interim measure the average rate is now based on higher of the income in the year of retirement or the income in the preceding year and one of the main loopholes for reducing the taxable income has been closed.

The major proposals of the Katz Commission are -

(a) Contributions deductible as before (but employer's limit reduced to 15%).

(b) Interest and rental income to be taxed at 30% (which is the same rate as that payable by life assurance companies) - dividend income and capital gains are not taxable for individual taxpayers, or life assurance companies.

(c) Where there is a lump sum benefit only it will be taxed on a sliding scale so that the proportion payable as tax will be similar to that that would have been payable if the lump sum were converted to an annuity that was fully taxable.

(d) The capital value of a pension or annuity to be combined with any lump sum benefit and the total will be taxed at the date of retirement on the same sliding scale as a lump sum benefit (with adjustments to a certain tax-free amount to encourage pensions) and the net pension or annuity to be tax free.

In addition it is proposed that the tax-free lump sum privileges of public sector employees be phased out. It is also proposed that defined benefit funds should have a limit on the level of benefits.

The major objection to the proposals is the taxation of interest and rental income at a rate higher than that that would be payable by the majority of individual members of funds on their own private savings, which will result in a disincentive for such members to participate in retirement funds.

The main recommendations of the Smith Committee for the retirement provision system are -

(a) The present old age assistance system be retained on an unfunded basis, but that personal provision should continue to be encouraged by tax incentives so that the cost of old age assistance can be maintained at an affordable level.

(b) The administration of the present assistance system be improved to reduce the opportunities for fraud and corruption.

(c) A technical committee be established to monitor the long term costs of old age assistance.

(d) Financial discipline of old age assistance costs be maintained by linking it to a percentage of GDP.

(e) Occupational provision and open retirement funds be encouraged, without compulsory provision at this stage, and special funds, with incentives, be developed for the informal sector.

(f) Funds be required to offer full transfer values for members leaving service so as to encourage preservation of benefits.

(g) Incentives be developed to encourage pensions rather than lump sum benefits by means of suitable tax structuring and subsidies.

(h) Funds be permitted to provide "lifetime benefits" by way of loans for housing, education and major medical costs.

(i) A National Retirement Provision Forum be established at which a draft policy document be tabled for consultation and negotiation.

The recommendations for pension benefits for civil servants are -

(a) Retirement arrangements be formally recognised as part of remuneration.

(b) Clarify the present situation, particularly in relation to the benefit promise and large deficit in the government fund.

(c) Because the current benefits are some 20% more valuable than the norm in the private sector, renegotiate the benefits which are out of line.

(d) Reassess the current funding policy.

(e) Separate the management of the government fund from the State.

(f) The related funds for local government and semi-government organisations be treated similarly to the government fund.

There are obvious conflicts between the recommendations of the two commissions, which will have to be resolved to maintain an orderly advancement of retirement provision.

Investment issues

In spite of the correction in equity prices triggered by the Mexico crises in January 1995 the equity market performed well over the two years 1994 and 1995, the exception being the mining sector which was affected by increasing production costs and labour problems.

Long term interest rates increased sharply by about 4% in the middle of 1994 and then moved in a relatively narrow band through to the middle of 1995. With the decline in the rate of inflation in the second half of 1995 rates fell by about 3%.

Investment returns have continued to beat inflation by a considerable margin. Average investment returns on assets of retirement funds over five-year period compared with average inflation rates over the same periods have been as follows:

Five years ended	Average investment return	Average inflation rate
1993	22,5%	13,0%
1994	18,9	11,9
1995	20,7	10,4

Life insurance companies and retirement funds are now permitted to invest a portion of their assets overseas by means of asset swops (the limit set by the Reserve Bank is 5% of total assets but the Registrar of Financial Institutions has set a lower limit of 2,5%). Further relaxation of exchange controls which would permit direct investment in other countries is expected in due course.

Entry into the global market is the latest challenge facing investment managers and several institutions have established joint ventures with international organisations to facilitate international investment.

Life insurance

Over the past few years the actuarial profession, working closely with the supervisory authorities, have developed a number of professional guidance notes to assist the actuary in fulfilling his duties. There are currently five guidance notes.

AIDS remains a significant issue for companies transacting life assurance in the Southern African market. Two of the guidance notes deal with the AIDS issue. The industry has adopted various measures to reduce the impact, including stricter underwriting, exclusion clauses etc. Recently products have been introduced that require regular HIV tests for cover to continue.

The three other guidance notes deal mainly with the financial reporting of life assurance companies. The first of the three deals with the financial soundness valuation basis (a basis intended to give a prudently realistic picture of the overall financial position of the assurer). The next deals with the "Report by the Valuator in Financial Statements". This is based on the financial soundness valuation. The third is related and deals with the "Maximum Dividend that may be declared". Further issues such as profit reporting are now receiving attention.

Healthcare

Although no drastic changes took place during the past two years in the healthcare scene in South Africa, tremendous changes are expected in the near future. Plans are tabled for a National Health policy that will provide primary health care benefits to all South African citizens not participating in a Medical Aid Scheme. Employers will have to take larger responsibility in providing medical aid benefits, at least at the level of that provided under the National Health Scheme in respect of all employees. The proposal is for the National Health Scheme to be funded by means of contributions levied as a percentage of payroll of employed persons. The balance will have to be funded by means of tax revenue.

There are no legal requirements for actuaries to be involved in the funding of medical aid benefits, but actuaries are becoming increasingly more involved in rating, reserving and investment policies for medical aid schemes.

The calculation of liabilities in respect of medical subsidies after retirement is attracting more interest, particularly as the South African Institute of Chartered Accountants has laid down guidelines for accounting with regard to the disclosure in the financial statements of any liability in respect of subsidies after retirement. The prefunding of these liabilities is also being addressed. At the end of 1995 the Actuarial Society of South Africa produced a set of guidelines for the valuation of these liabilities.