

# APPENDIX

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## **THE FINANCIAL SERVICES BLACK ECONOMIC EMPOWERMENT CHARTER**

### **PHILOSOPHY BEHIND THE FINANCIAL SECTOR CHARTER**

The challenge for the financial services sector was to develop a charter that balanced the transformational objectives of black economic empowerment and the exigencies of commercial reality. In interpreting the targets, it must be remembered that the spirit of the Charter and the whole Black Economic Empowerment ("BEE") initiative is to factor transformational goals for the sector to aspire towards. The industry set out to rise to the challenges of strengthening South Africa's democracy through broadening economic participation and creating opportunities for black South Africans. Achieving these objectives was never going to be an easy task given the gap between the need and the capacity of the sector to deliver within a sustainable framework. The sector has, however, accepted these challenges as well as the opportunities presented to it and has resolved to expend the necessary resources and energy to achieving their BEE objectives.

### **WHO IS SUBJECT TO THE FINANCIAL SERVICES CHARTER ("FSC")?**

The Charter was developed and adopted by the whole financial services sector. The signatories to the Charter were the Banking Council, the Life Offices Association, the South African Insurance Association, the Association of Black Securities and Investment Professionals, the Association of Collective Investments, the Investment Management Association of SA, the Foreign Bankers Association of SA, the South African Reinsurance Offices Association, the Bond Exchange of SA, the JSE Securities Exchange of SA, and the Institute of Retirement Funds. The Charter represents a voluntary commitment by the financial services sector to further black economic empowerment in the sector.

The FSC therefore applies to all companies in the financial services sector subject to certain exemptions detailed in clause 4 of the Charter. The intermediaries were not party to the negotiations, but had mandated the SAIA to represent them. The big brokerages have, or are in the process of, accepting the Charter and will opt in.

The brokers play a very significant role through advice to their clients to utilise BEE companies for certain services because they are the first point of reference for most policyholders. They will be able to make an important contribution to the procurement target by promoting the use of black suppliers for their goods and services. Short term insurers can also score for using black brokerage firms. Despite the fact that broker commission does not count for procurement targets, insurers will score for supporting and developing black brokerage firms under enterprise development or procurement.

## APPLICATION OF THE FSC

The targets of the Charter will come into effect on 1 January 2004. Although the Charter lists targets for 2008 and 2014, it is a living document and as such the commitment to the principles of the Charter will not subside after 2014. It is possible that after 2014 the need to set further targets will fall away. However, the Charter Council may decide to set adjusted targets for a determined period after 2014 if the market imbalances have not yet been corrected. There will be an initial review period in 2009 and the Charter Council will decide what adjustments need to be made for the Charter's second term.

Where a company is part of a group it will be measured and reported on as part of the group unless that company is a listed company or it decides to opt in. Some insurance companies are subsidiaries of banks and the Charter Council will include the insurance company's BEE credentials in evaluating the success of the holding company. At the sub-sectoral level, however the insurance company will have to report individually. All financial institutions have committed to ensuring that transformation takes place in their subsidiaries and divisions and these will also be measured.

## EXEMPTIONS FROM THE CHARTER

If a company has less than 50 employees it will be exempt from the human resource development provisions. However companies that have less than 50 employees may opt-in and will be bound.

Companies that have less than 10 million Rands in designated investments will be exempt from empowerment financing provisions unless they opt in.

An institution will therefore be exempt from all the provisions of the FSC if they have less than 50 staff members and have less than R 10 million in designated investments unless it opts to be so bound. If an institution is exempt from a provision of the Charter, it will not score at all on that particular provision. If, for example, an institution is exempted from HR targets it will score out of 80 as opposed to getting a zero for HR while pursuing a score out of 100.

## MAIN PRINCIPLES OF THE CHARTER

The targets set by the financial services sector relate to 6 main empowerment principles. 81% of the targets relate to broad based empowerment such as employment, training and development, access to financial services, targeted investments and procurement.

### 1. HUMAN RESOURCE DEVELOPMENT

To increase the participation of black South Africans at all levels of management.

#### Employment Equity

25% black representation at executive level by 2008 (4% black women)  
 20-25% black representation at senior level by 2008(4% black women)  
 30% black representation at middle level by 2008(10% black women)  
 40-50% black representation at junior level by 2008(15% black women)  
 33% representation at board level by 2008(11% black women)

The financial services sector will review the employment equity targets above before 2008 to decide on appropriate targets for 2014. However a 2014 target of 33% of the relevant total black representation at each level has been set for black women

#### Training and development

Each financial institution has committed to spending 1.5 % of total basic payroll per annum on training of black employees. This will be effective from 1 January 2003 and is a target for each company in the sector, not a sectoral target. Moreover this is over and above any skills levies that are payable in terms of other pieces of legislation.

### **Learnership Programme**

Each institution will employ, in registered learnerships, up to 4.5% of its total staff in the form of black matriculants (or NQF level four equivalent). All the expenditure that is not recovered from the SETAs or government will form part of the targets under training and development above.

### **Non-quantifiable Human Resource Issues**

Financial institutions have also committed to make reports on other human resource transformation objectives that do not have targets attached to them. These include reporting on their mentorship programmes, succession planning, cultural diversity and gender sensitivity programmes and training programmes

## **2. PROCUREMENT AND ENTERPRISE DEVELOPMENT**

To substantially increase the financial sector's procurement from black enterprises.

50% of the value of all procurement spend should be from BEE accredited companies by 2008 and 70% by 2014. These targets are conditional upon the implementation of transformation charters in the information and communications technology industry, the advertising industry, the automotive industry and the building sectors. Should the transformation charters not materialise, the targets will be reviewed. This all means that over the next decade insurers will need to focus on procuring services from accredited BEE companies.

The Short term insurance industry can play a significant role in BEE with regards to procurement since the sector spends over R17 billion a year on claims using a wide range of service providers. With regards to the motor insurance portfolio the industry spends over R5.2 billion on motor claims of which approximately R3.6 billion goes to repairing and replacing motor vehicles that have been involved in collisions.

A minimum of two thirds of the BEE procurement spend must be spent on BEE accredited companies as the primary vendor. One third may be spent via a vendor that is not a BEE company as long as it is ultimately channelled to a BEE vendor. Only the BEE portion of that expenditure will count towards the target. For the insurance sector, transformation in the motor industry will be critical if the industry is to achieve its targets. For the insurance sector, transformation in the motor industry will be critical if the industry is to achieve its targets. The Charter contains a clause that specifically recognises the peculiarity of short term insurers with regards to claims spend and states that the Charter Council will review the targets for claims procurement spend in the short term insurance sub-sector in 2005.

A commitment to enterprise development has also been made, which involves creating new and developing existing BEE companies. This can be done in various ways inter alia, the secondment of staff to accredited BEE companies, the provision of infrastructure support, technical and administrative assistance and financial support. Institutions may support the growth of BEE companies from whom they procure goods and services such as broking agencies, and may enter into joint ventures and equity investments in BEE companies.

Should a financial institution provide measurable financial support for the growth of a BEE company through which they acquire certain goods and services this will be measured under procurement in the scorecard. Should the institution provide measurable financial support in investing in equity in a BEE company this will be scored under targeted investments. By way of example, the Investec sale was by way of direct ownership. If Investec had financed the BEE deal themselves it would have recorded "Direct Ownership of 25% and the amount financed would go towards BEE transaction financing. The value of the black component of Andisa is measured as direct ownership. If Andisa is provided with infrastructure then the amount spent on infrastructure is measured as enterprise development.

### 3. ACCESS TO FINANCIAL SERVICES

#### Effective Access

To ensure that the majority of the people in the country have access to basic affordable financial services.

The financial sector commits itself to increasing access of people in LSM 1-5 to financial services. The commitment is that 80% of people in LSM 1-5 will have access to first order financial services by 2008. It was decided that all sub-sectors will contribute in this area but that only the big four banks will be able to earn maximum points in the scorecard. Short term Insurers will only be able to score a maximum of 8 points. The short term insurers have committed to ensuring that 6% of LSM 1-5 will have access to short term risk insurance products and services by 2008. The industry will decide in consultation with the Charter Council on how to divide the targets between the sub-sector and the individual insurance companies. As soon as insurers begin spending money on access to financial services, the expenditure will contribute towards the Access scoring. Therefore expenditure on research and development and workshops on access will be included in the calculations as well.

The industry will have to play an interventionist role in bringing relevant products to the poor in partnership with all stakeholders. By way of example, in partnership with the banking sector and the life insurance industry the short term insurance industry will be able to deliver a range of integrated products in low cost housing and taxi insurance. An opportunity also exists for private-public partnerships. For example, the Road Traffic Management Corporation Act seeks to promote public-private partnerships for the provision of road traffic management services. Another example is the provision of compulsory third party vehicle insurance.

#### Consumer Education

Each institution in the sector will invest 0.2% of post tax operating profit in consumer education. Educating the consumer on the products offered and the implications of acquiring them will contribute towards increasing the pool of consumers that can exercise their rights to effective access.

#### Commitment to non-discrimination

Although not a quantifiable principle, the sector has committed itself to ensuring that discrimination on any basis in the provision of financial services is not tolerated. This is a commitment that flows out of the Nedlac Transformation of the Financial Sector Summit committed to ensuring that their business practices are not discriminatory at the Nedlac Summit on the transformation of the financial sector. This is an area where insurers will have to pay particular attention to in view of the Promotion of Equality and Prevention of Unfair Discrimination Act.

### 4. EMPOWERMENT FINANCING

"Affected institutions" as defined in the FSC have made the commitment to empowerment financing. An affected institution is one that takes designated deposits and risk premiums have been included in the definition of designated investments. However short term insurers can only contribute to this target if regulatory changes are effected to allow short term insurers to invest their technical reserves for empowerment financing. The Financial Services Board will be approached to give the relevant clearance. Insurers may choose to use shareholder funds for BEE transaction financing but bearing in mind that the government is not prepared to lend risk mitigating support for BEE transactions financing insurers will be careful not to impair their capital growth. Over R 75 billion will be made available for empowerment financing. A third of this will be reserved for BEE transactions while the two thirds will be for targeted investments in low-income housing, transformational infrastructure, agriculture and black SMEs.

## 5. OWNERSHIP AND CONTROL

To increase the level of ownership and control of black South Africans in the sector

### Ownership

The companies of the financial services sector should be 25% black owned by 2010. A minimum of 10% must be direct ownership. Each institution shall individually set a target of 25% black ownership and this will be measured at holding company level.

Direct ownership must encompass one of the following; direct ownership in the financial institution as a result of an empowerment transaction, broad based ownership, disposal of any assets, businesses or subsidiaries by the institution to black people; direct shareholding or ownership with control at subsidiary level; or joint venture or partnership agreements.

It necessarily follows that indirect ownership has a maximum target of 15%. However a company may score under indirect ownership only if they have achieved the target of 10% direct ownership and if they can show that they have taken measures to increase the influence of black directors at Board level and to train shareholders and increase their knowledge and awareness through a planned shareholder activism approach. The measurement of indirect ownership is still to be determined and will be stipulated by the Charter Council.

Empowerment transactions that were concluded before the FSC Charter may be included in the calculation of direct ownership but only if they remain at the effective date. A question arises as to what happens if a company concludes a deal and that deal subsequently terminates. In those circumstances the direct ownership transaction must be referred to the Charter Council. If the Council finds that the transaction complied with the requisite for direct ownership transactions the deal will still be included for calculating direct ownership. If a financial institution is at least 25% owned by another financial institution it may take into account a portion of the direct black ownership in the holding company based on a percentage shareholding of the holding company. As an example if an insurance company owns 20% of an asset management company and it sells 50% of that asset Management Company to black people, the insurance company can record that it sold 50% of 20% to a BEE company. In other words it has effectively sold 10% to a BEE company.

These ownership targets do not mean that from the 1st of January 2004, all companies will have to sell 25% of their equity to black South Africans. It is a target that will take time to achieve and that will give a company maximum points in terms of the balanced scorecard. However companies can still gain points by achieving a BEE equity structure that suits them best. For those companies that find it impossible to score under ownership the balanced scorecard approach will give them the opportunity to score heavily elsewhere and make up for the poor ownership scoring.

### Control

33% black people on the board of directors by 2008  
 11% black women on the board of directors by 2008  
 25% black people at executive level by 2008  
 4% black women at executive level by 2008

## 6. CORPORATE SOCIAL INVESTMENT (CSI)

To promote investment by the sector in areas specific to the needs of the majority of South Africans.

0.5% per annum of post tax operating profits must be reserved for CSI. CSI projects include education, training, development programmes, environment, job creation, arts and culture, health, sport.

## THE SCORECARD

In determining the scoring the emphasis is on broad based empowerment and employment equity. 18 points have been allocated to the provision of access to financial services to the poor and 17 points allocated to targeted investments. Another 25 points have been allocated to employment equity, 15 points for procurement, 3 points for CSI.

This means 78% of the points are for broad based empowerment and only 12% are for ownership, while the remaining 10% are for BEE transactions. The scorecard approach substantiates the assertion that companies are not expected to achieve the targets set immediately and that the targets set in the Charter are indeed transformational. The scorecard is both a measure and an incentive to institutions to take such action as they deem necessary to ensure a reasonable achievement of the targets. The success of the Charter lies not so much in achieving a specific target but the interventions the sub-sector puts in place to achieve its transformational objectives. The biggest challenge for the industry is on deciding on and implementing the appropriate interventions and monitoring mechanisms.

The scorecard will be used by each financial institution in assessing its own BEE endeavour, by the Charter Council in evaluating progress in the sector and by the government in awarding tenders and by other private companies in evaluating the BEE compliant companies they wish to do business with.

Points will be scored once a financial institution reaches the threshold specified against each target. As an illustration, procurement has a threshold of 10% and institutions will only start scoring if they procure at least 10% of the total procurement spend from BEE companies. The scoring and the rating of companies will be a linear progression from the 2004 ratings to the 2008 ratings. Therefore if a target for 2008 is 20%, a company can start scoring after achieving 4% in the first year (20% divided by 5 years) There is no obligation to achieve 20% immediately. Therefore companies that have a base of 4% or more to work with will have a head start, as they will score immediately.

Interim scoring is still to be advised.

## IMPLEMENTATION AND MONITORING

The monitoring of the FSC will be vested in the Charter Council that will attend to receiving audits from all institutions and to confirm the ratings of financial institutions. The Council will also review the Charter process and prepare interim reports. However each institution and each sub-sector will have to conduct its own monitoring of progress in terms of the Charter. The SAIA will adopt a rating agency that is approved by the Charter Council to rate short term insurers and to advise companies on how best to achieve their BEE targets.

It is important to note that although SAIA is a signatory to the Charter and had certain obligations in terms of it, it is not a short term insurance Charter but a sector charter and as such the short term insurance industry has to contribute to the broader objectives of the financial services sector. The industry will have to workshop how some of the targets are going to be achieved. Is the implementation going to be at institutional level or at sectoral level. For example, consumer education may be pursued at sectoral level with the different sub-sectors contributing resources. Procurement will be pursued at institutional level on the one hand with each company monitoring its procurement spend but at the sub-sector level, the industry will have to apply pressure on the ITC and motor industry to transform their respective industries. It may be more efficient to implement the training mechanisms at institutional. All companies however small will have to make a contribution but the industry spreads the learnership target across the sector the smaller companies with less resources will be relieved of a great deal of pressure.

## REPORTING

All companies must report to the Charter Council on its progress in implementing the Charter. Reporting should be done at group level unless if the financial institution has opted in or is a listed company reports must be submitted by 31 March as at 31 December of each year. Companies will be required to conduct triple bottom line reporting.

## **MOTIVATION FOR OPTING IN TO FSC**

The companies that are exempted from the Charter or certain provisions of it will be motivated to opt in as it has now become clear that it is in a business imperative to do so. A company's BEE rating will become a competitive issue. The government will take into account BEE standing when adjudicating tenders for the provision of financial services and insurers will be no exception.

In order to improve their BEE rating, companies in other sectors will also make use of insurance companies with a good BEE contribution. Insurers comprise part of the supply chain for other sub-sectors and other industries and there will be pressure from those other sub-sectors to transform the insurance industry. Therefore the government itself may have less of an influence than the private sector because short term insurers do not rely on government tenders. Black economic empowerment has therefore become a business imperative and the FSC is a vehicle through which companies can measure that imperative and ride on the initiatives that are being embarked upon by the sector as a whole.

As an individual institution BEE will become an onerous task, but through this collective effort, the efficiencies of economies of scale will come to the fore.

## **OUTSTANDING ISSUES**

By the end of 2003, the Charter Council will be constituted. The details around the monitoring and implementation of the increasing access to the poor are still to be finalised.

The industry still needs to decide, together with the Charter Council, on how access will be monitored and how the targets will be divided between the individual institutions. It is possible though that access will be monitored from a sub-sectoral level.

The sector will engage further with government to assess the regulatory changes that are required for risk mitigation of empowerment financing. However empowerment financing details will have to be settled by 30 June 2004. The partnership between the sector and government in terms of creating a climate conducive for empowerment financing is paramount. This partnership's goal is to ensure that the current obstacles to financing into previously disadvantaged areas are removed and that the private sector can provide affordable finance in a commercially sustainable way. The potential economic ground swell created can be incredibly powerful and advantageous to all South Africans.

The government will publish a Code of Practice that will be binding on all tiers of Government when procuring financial services from financial institutions. This is presently lacking because currently, the basis on which financial institutions are rated for their black empowerment is arbitrary.

The government could also ensure that the Charter evens the basis for engagement between the financial sector and government.

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