KEEPING AN EYE ON REGULATORY DEVELOPMENTS IN SOUTH AFRICA

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As 2024 dawns, we cannot help but feel that the world is considerably different to the way it was 10 years ago. Globally, economies must now contend with a simultaneous multiplicity of risks which are proving to be quite dauting. In a 2023 speech, whilst visiting South Africa, the First Deputy MD of the International Monetary Fund, Gita Gopinath, highlighted three conditions which have transformed the economic landscape and made the world more volatile and uncertain: a) global financial conditions have become tougher, (b) geoeconomic fragmentation is rising, and (c) climate change is inflicting growing costs on economies[1].

This year, over 2 billion people – or approximately 25% of the world's population – will have national elections, the biggest election year in history, giving rise to its moniker the super election year, so we can expect a year of growing risks and uncertainties. Some nations may see a change in leadership and policy direction while in other countries more of the same is likely to prevail. One implication of having new leaders at the helm, is that it not only affects domestic issues but it could have far-reaching ramifications for important global matters such as trade and security, climate change action and immigration policies.

South Africa is one of those countries heading to the polls this year, for what promises to be the most contentious national elections in its democratic history. Many election surveys and pundits predict that the governing party, the African National Congress will, for the first time, receive less than 50% of the national vote. This implies that an opportunity for some form of a coalition government at national government will open, something that has become more common at lower levels of government. In this scenario, the longer-term implication is a policy and legislative environment that is more polarised and combative than ever.

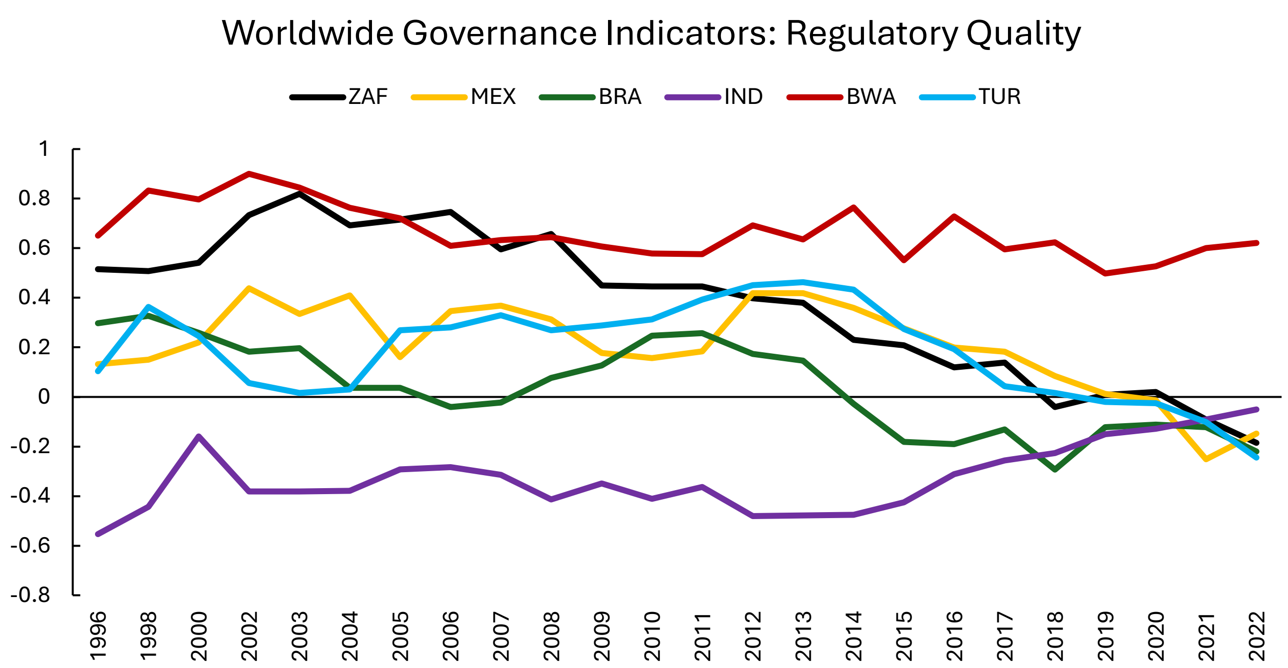
Given this environment, this article will focus on three pieces of legislation, which are at different phases of development, adoption and implementation, which can have a material impact on a company's operating model and ultimately its financial performance. The careful monitoring and

[1] Gopinath, Gita. "Charting a Course through Rough Seas: How Emerging Markets Can Navigate Tougher External Conditions". Keynote Address at the SARB Biennial Conference, September 1, 2023.

consideration of the legislative environment in South Africa and globally, is something that we at Matrix consider to be an integral part of our investment process. Regulatory developments and changes can have a material impact on individual companies, specific sectors and even the wider domestic economy and, as such, it is something that we continuously monitor.

A useful starting point in our analysis is to consider data from Worldwide Governance Index (WGI) collated by the World Bank which provide an insightful overview of the governance landscape trends of countries over time. The WGI aggregates six governance indicators over time from countries across the world, namely: (1) Voice and Accountability, (2) Political Stability, (3) Government Effectiveness, (4) Regulatory Quality, (5) Rule of Law and (6) Control of Corruption. For this article, we will focus only on the Regulatory Quality indicator, which captures perceptions of the ability of the government to formulate and implement sound policies and regulations.

Figure 1: WGI - Regulatory Quality for selected countries.



Source: The World Bank

Figure 1 shows that South Africa's perceived regulatory quality has been in a continuous decline since the early 2000s, following a period of slight improvement under the new democratic dispensation. But, as the chart shows, this deterioration in regulatory quality has also taken place across other selected developing countries. It is only Botswana, where the score has been largely unchanged over this time period, and India, where the score has improved meaningfully over the last decade, that reflect a different overall pattern of the perception of regulatory quality.

Three Bills investors should monitor closely

1. Tobacco Products and Electronic Delivery Systems Control Bill

This Bill was introduced to Parliament in 2022 by the Department of Health (DOH), with previous iterations of the Bill being introduced in earlier years. Some of the key objectives of the Bill include:

i. to regulate smoking;
ii. to regulate the sale and advertising of tobacco products and electronic delivery systems, and
iii. to prohibit the sale of tobacco products and electronic delivery systems to children.

The Bill aims to address some of the socio-economic problems caused by tobacco-related illnesses: in 2016 alone, South Africa had 25,708 smoking-attributable deaths and over 200,000 people admitted to hospital. This imposes significant economic, health, social and environmental burden on the country[2]. According to the DOH, some of the proposals of the Bill include the prohibition of smoking in any enclosed public place or enclosed workplace, the banning of cigarette sales through vending machines and the ban on display at point-of-sale.

The World Health Organisation has shown support for the Bill and argues that it is a highly comprehensive piece of tobacco control legislation, and that the proposals are in line with tobacco control best practice to protect bystanders and children from exposure to harmful second-hand tobacco product emissions[3].

From a business perspective, the prohibition of smoking in public areas, both indoors and outdoors, can have a significant impact on firms that require mass foot traffic – including malls, hotels, restaurants, theme parks, casinos and night clubs. Sun International considers that this Bill will have a deleterious impact on the group's casino income. Tsogo Sun Group further adds that banning of

[2] Department of Health. (2020). Socio-economic Impact Assessment System. Final Impact Assessment Template
[3] World Health Organisation. (2018). WHO supports South Africa's draft bill to control Tobacco Products and Electronic Delivery Systems.

smoking will shift gambling from casinos to either illegal or online operators which, in turn, will result in significant loss of employment and a reduction in capital investment across the casino industry.

The Bill is currently under consideration by the National Assembly.

2. The National Health Insurance Bill

The National Health Insurance (NHI) Bill arguably represents one of the most contested pieces of legislature in the country at present, given the seismic structural change it will likely bring to the domestic healthcare system. The current version of the Bill was introduced into the National Assembly in 2019 by the Health Ministry. The NHI Bill seeks to provide for universal access to health care services in the country in accordance with the National Health Insurance White Paper and the Constitution of South Africa. The key objective of the Bill relates to the establishment of an NHI Fund which aims to achieve sustainable and affordable universal access to quality health care services by serving as a single purchaser of health care services in the country. Once fully implemented, medical schemes may only offer complimentary cover to services not reimbursable by the NHI Fund.

The Bill was passed by both houses of Parliament – the National Assembly in June 2023 and the National Council of Provinces (NCOP) in December of 2023 – and has been submitted to the President for assent. The President now has two options before him:

i. Sign the Bill into law – which will make it an Act of Parliament, or
ii. Return the Bill to the National Assembly should he have reservations about the constitutionality of the Bill.

Various stakeholders have had strong opposing views about the Bill. Following the Bill being approved by the NCOP, COSATU, the largest trade union federation in South Africa, applauded its being finally adopted by Parliament. The trade union believes that the myriad of healthcare crises requires the creation of a NHI[4]. Conversely, the South African Medical Association, a non-statutory body representing medical professionals, notes that while it principally supports universal healthcare coverage, it has concerns about several aspects of the Bill, including that (i) the current healthcare

[4] COSATU. (2023). COSATU applauds Parliament's finalisation and adoption of the long delayed National Health Insurance Bill. https://mediadon.co.za/2023/12/07/cosatu-applauds-parliaments-finalisation-and-adoption-of-the-long-delayed-national-health-insurance-bill/

system is not ready for the implementation of the NHI; (ii) there is a risk of an exodus of healthcare professionals from the workforce, given that their contributions have been excluded from practical aspects of the Bill and (iii) the proposed funding mechanism, relying on greater public taxation may cause added financial hardship to the general public[5].

Various listed companies, whose business operations will be affected by the NHI legislature have similarly expressed their views on the Bill. Life Healthcare notes that, while the immediate impact of the Bill being signed into law may be small, there is uncertainty regarding various parts of the legislation, including how the NHI will be financed and administered. It further points out that in order to overcome the significant challenges in the healthcare sector, they can only be overcome by addressing the chronic shortage of nurses, doctors and capable hospital managers.

According to the Discovery Group's Risk Management Framework, the NHI Bill represents the second biggest risk for the Group, behind the global rising cost of living crisis. A central issue for the Discovery Group relates to Section 33 of the Bill, where medical schemes will not be able to cover services included in the NHI. While it does not expect the NHI to be fully implemented in the near future, it is concerned that the legislature introduces a short-term risk of negative sentiment amongst medical professionals which could lead to a skills gap in an already constrained healthcare system.

3. Climate Change Bill

Under the purview of the Department of Forestry, Fisheries and the Environment, the Climate Change Bill was tabled in Parliament in February 2022. The overarching objective of this Bill is to enable the development of an effective climate change response and a long-term, just transition to a low-carbon and climate-resilient economy and society for South Africa, in the context of sustainable development. Through the Bill, it will

i. develop a National Adaptation Strategy and Plan which will provide a strategic and policy directive for adaptation to the impacts of climate change;
ii. set out the country's national greenhouse gas emission trajectory; and
iii. set out sectoral greenhouse gas emission targets.

[5] SAMA. (2023). Statement on the NHI Bill By The South African Medical Association. https://www.samedical.org/cmsuploader/viewArticle/2344

Importantly, the Bill will require provinces and district municipalities to develop a climate change needs and response assessment for their respective regions that will, amongst others, identify and spatially map vulnerabilities, areas, ecosystems and communities that will arise, or that are vulnerable to the impacts of climate change. The Bill has been passed by the National Assembly and is now under consideration by the NCOP.

While the Climate Change Bill will be the key legislative instrument towards enabling a climate change response in South Africa, other key policies and measures to support the country's GHG reduction ambitions include the Integrated Energy Plan, Integrated Resources Plan, National Energy Efficiency Strategy, Green Transport Strategy, Waste Management Strategy, the National Forests Act and the Carbon Tax Act[6].

The Carbon Tax Act, in particular, is an important legislative development to encourage emitting entities to change practices to reduce fossil fuel emissions. Signed into law in 2019, the Act gives effect to the polluter-pays principle for large emitters and helps to ensure that firms and consumers take the negative adverse costs (externalities) into account in their future production, consumption and investment decisions[7]. The implementation of the Act has two distinctive phases:

i. Phase 1: Caters for significant tax-free allowances of between 60% to 95%. Additionally, the first phase will not impact on the price of electricity.
ii. Phase 2: Before introduction of the second phase a review of the impact of the tax will be conducted and future changes to rates and tax-free thresholds in the Carbon Tax will follow after the review.

In the 2022 Budget, the first phase of the carbon tax was extended by three years from 1 January 2023 to 31 December 2025. In the 2023 Budget, it was announced that the carbon tax would increase by 16% from R159 to R190 per tonne of carbon dioxide equivalent (CO_2e). Additionally, National Treasury will release a discussion paper later in the year that will outline the second phase of the Carbon Tax Act for public comment.

Sasol, the largest emitter listed on the JSE, accounted for about 14% of the country's total annual emission in 2018[8]. In its latest CDP report, Sasol notes that phase two of South Africa's implementation

[6] Department of Forestry, Fisheries and the Environment. (2023). South Africa's 5th Biennial Update Report to the UNFCCC.
[7] International Energy Agency. (2023). Carbon Tax Act (Act No. 15/2019). https://www.iea.org/policies/3041-carbon-tax-act-act-no-152019
[8] Centre for Environmental Rights. (2019). Full Discolosure 5 Report. https://fulldisclosure.cer.org.za/2019/ emitters/emitters-and-emissions

of the Carbon Tax Act will result in a significantly higher financial liability as carbon taxes rise and allowances fall away. Additionally, Sasol notes that non-compliance to emerging regulation in the Climate Change Bill, could result in fines, penalties or even result in the loss of its operating licenses within the country.

Sibanye Stillwater has noted that changes in carbon pricing instruments in the country present regulatory risks. It adds that higher carbon tax rates will increase costs in key upstream products such as cement, lime, explosives, and electricity. Impala Platinum further adds that both its South African and Canadian operations are currently exposed to carbon taxes, which are expected to rise in line with global carbon prices. In a study it commissioned, Implats projects that in 2030 carbon price could rise to up to US$100/tonne CO_2e for developed countries and US$50/tonne CO_2e in developing countries.

The road ahead?

As the date for national elections rapidly nears and millions of South Africans head to the poll, it is important to point out that these votes will determine who represents South Africans in Parliament. Members of Parliament have an enormous responsibility of being the voice of the people in Parliament, developing the laws of the country and providing oversight to the actions of the executive and of various state institutions.

The 7th Parliament, which will be constituted after the upcoming elections, will have the responsibility of promulgating the regulations that supplement the above-mentioned Bills. It is thus important to keep a watchful eye on the outcome of the elections and even members who make up the different sub-committees within the two houses of Parliament, as they have a significant influence on the formulating and passing of laws in the country.

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Thato is responsible for anchoring the ESG functions across the different business units at Matrix Fund Managers, taking up the role from April 2022. Prior to this, he worked as an economist and fixed income analyst and fund accountant at Matrix. Before joining the business in February 2018, Thato worked as a Pension Fund Accountant at a multinational bank. Thato has an M Com in Accounting from UCT.