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SEPTEMBER 2015

A STUDY OF TAX-FREE SAVINGS ACCOUNT TAKEUP IN SOUTH AFRICA

A project by

intellidex

Researching Capital Markets & Financial Services

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KEY FIGURES

35 384

TFSA accounts have been opened by institutions in the four months to end-June 2015, excluding bank deposits

R284m

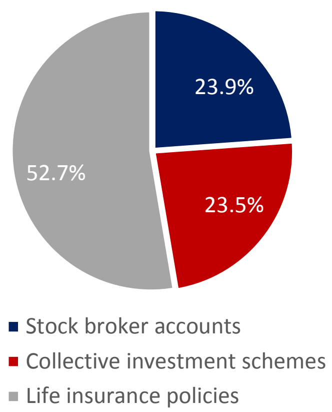
Of savings were held in these accounts as at 30 June 2015

32%

Of accounts opened are believed to be first-time savers

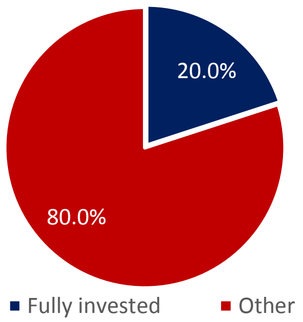
TYPES OF TFSAs ISSUED

(excluding bank deposits)

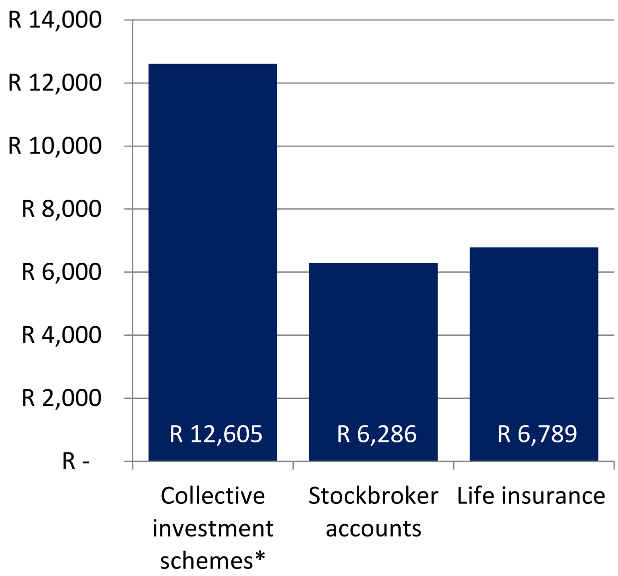


PROPORTION FULLY INVESTED ON OPENING

(full R30 000 limit invested)

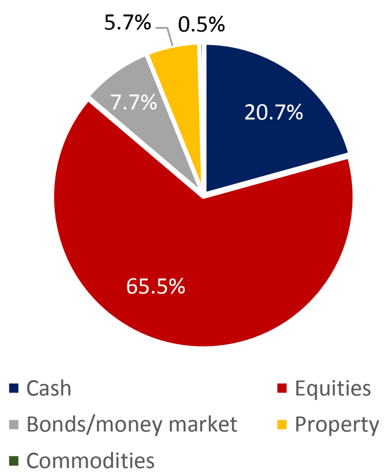


AVERAGE ACCOUNT NAV



ASSET CLASSES HELD

(all account types except bank deposits)



EXECUTIVE SUMMARY

- Our study focused on **non-bank TFSA providers**, including stockbrokers, asset managers and life insurers
- A total of 18 institutions responded to a questionnaire sent in July 2015. There is no way to accurately determine what proportion of the TFSA market this represents, but we estimate the sample includes over 90% of the universe by assets and the results are a reliable guide to total market activity
- We excluded banks because most refused to divulge information, citing competitive concerns
- Respondents reported that a total of 35 384 TFSAs have been opened by stockbrokers, asset managers and life insurers since the TFSA regime was launched on 1 March 2015 up until 30 June 2015
- Total assets in these accounts amount to R284.31m (as at 30 June 2015) implying an average account value of R8 035
- 7 092 clients (20%) invested the maximum annual limit of R30 000 on opening the account
- TFSA providers anticipate that another 14 730 (42%) of those who have opened accounts will have invested R30 000 by tax year-end
- 15 763 clients (45%) held existing accounts with their TFSA provider
- TFSA providers believe 11 374 (32%) clients are first-time savers
- TFSAs have attracted at least R86,3m in new assets to firms providing the accounts (some respondents did not provide figures for this measure, so it is incomplete)

WHY DID WE CONDUCT THIS SURVEY?

Tax-free savings accounts (TFSAs) were introduced in South Africa on 1 March 2015. The key objective of the regulatory space created for these accounts is to drive a change in savings behaviour by South Africans. At the same time we launched savetaxfree.co.za as a supplier-neutral information portal on TFSAs to assist the public in understanding the new regime and identifying potential providers.

We wanted to understand early trends in the use of TFSAs by the public. In order to do so we conducted a survey with providers, the results of which are presented in this document. We will continue to study development of the TFSA market and expect to do further research in future.

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RESEARCH METHOD

The information contained in this report is based on a survey of the universe of TFSA suppliers in South Africa. The universe consists of:

- All registered banks
- All collective investment scheme providers
- All linked product providers
- All registered life insurers
- All equity members of the JSE
- The SA government

Not all eligible institutions have introduced TFSAs to the market. We therefore conducted initial research to determine which institutions are marketing TFSA products, determined from various online searches and drawing from the mass media. Our website savetaxfree.co.za allows institutions to register as providers in order to use the portal to market to potential clients, which provided another mechanism for determining the eligible respondent universe. The respondents were the following, although not all respondents answered all questions:

- 22seven
- Absa Investment Management Services
- Absa Stockbrokers
- EasyEquities
- Element Investment Managers
- Emperor Asset Management
- ETFSA.co.za
- MMI
- Nedbank Private Wealth
- Old Mutual Investment Group
- Old Mutual Life Assurance
- PSG
- Sanlam
- Standard Bank Online Share Trading
- Stanlib
- Thebe Stockbrokers
- Vunani Fund Managers
- Vunani Securities

Questionnaires were drawn up in Excel format and sent to contacts at the relevant institutions. While most questions were quantitative, we also asked respondents a number of qualitative questions, responses to which we discuss below. In all cases we undertook that specific data provided by institutions would not be distributed, but that only aggregate results would be made public.

The questionnaires were sent out in early July 2015 and the final responses were received in mid-August 2015. Respondents were asked to give data as of 30 June 2015.

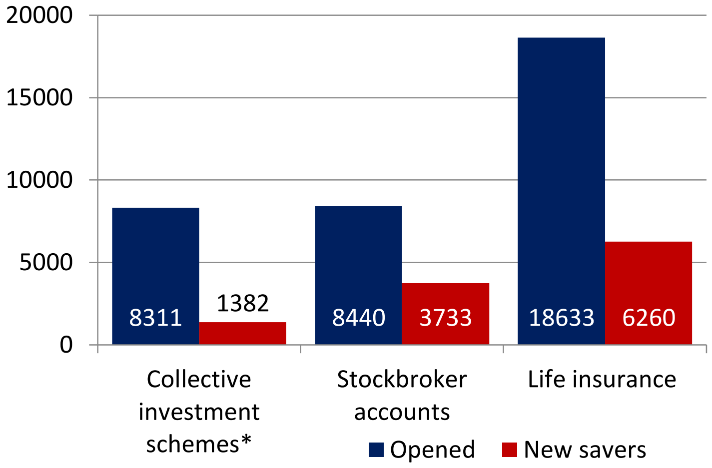
OVERALL FINDINGS

A sum total of 35 384 accounts have been opened by the firms who completed our questionnaire. Of these, about 20% had contributed the full R30 000 on opening. A further 55% of clients have set up monthly debit orders and are contributing monthly amounts in to the accounts. Our respondents believe that, based on monthly contributions, 42% of the accounts will reach the R30 000 limit by the end of the tax year.

Respondents report that 45% of TFSAs were opened by existing account holders. Respondents also believe that 32% of these account holders are first-time savers, usually because they had not held accounts beforehand. This implies that 32% of accounts opened represent new savers who have been induced into saving because of the TFSA account regime.

A total of R284.31m of assets is held in the accounts. This implies an average account balance of R8 035. Of the total assets under management, equities account for the largest slice, followed by cash. The relatively small allocation to cash should be seen in the context that our survey did not include the retail banks, all of whom have offered tax-free deposit accounts to clients that will have substantially increased the cash allocation with overall TFSA accounts.

In terms of account types, the following have been opened:



**LISP accounts were included as collective investment schemes*

WHY DID WE EXCLUDE BANKS?

Banks are important providers of tax-free savings accounts in South Africa, usually in the form of cash savings accounts such as fixed deposits. We did endeavour to include banks, however most of the banks we approached would not divulge any information so we were unable to provide meaningful figures regarding bank provision of TFSAs.

On the basis of the information we did receive we estimate that new account issuance has been low, with less than 10 000 new accounts opened.

In our view, cash-based TFSAs are relatively less attractive than other asset classes because of the generous interest exemptions that already exist outside of the TFSA environment. National Treasury has however indicated that these exemptions will be managed down in real terms, so cash TFSAs should become more competitive in future.

Different account types have different features such that we should expect different client behaviours. We consider characteristics of these types next.

STOCKBROKER TFSAs

A total of 8 440 clients have opened accounts with stockbrokers. Account holders are permitted to invest in certain portfolio products such as exchange-traded funds and discretionary managed portfolios of stockbrokers.

Stockbroker accounts provide a compelling tax strategy given that they are one of the only ways to avoid tax on dividends. Also, while capital gains exemptions are available outside TFSAs, for shareholders pursuing an aggressive growth strategy, a stockbroker TFSA is likely to provide tax relief in excess of the exemptions available outside of TFSAs. We expect Treasury will want to manage down these exemptions at least in real terms.

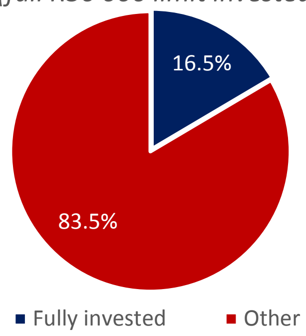
The total assets held by stockbrokers in TFSA accounts is R53m, implying an average account balance of R6 280.

Of the accounts opened, 1 396 (16.5%) invested the full R30 000 limit at the start. Brokers anticipate that another 3 607 accounts will have reached the limit by the end of the tax year.

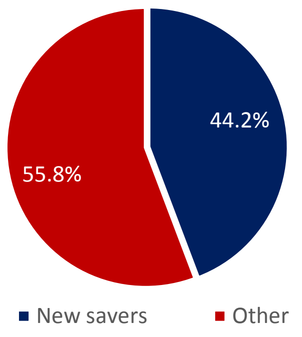
Of the accounts opened, brokers believe that 3 733 (44%) are new savers. More than half (4 659 or 55%) were opened by existing clients of the brokers.

STOCKBROKER ACCOUNTS: PROPORTION FULLY INVESTED ON OPENING

(full R30 000 limit invested)



STOCKBROKER ACCOUNTS: PROPORTION BELIEVED TO BE NEW SAVERS

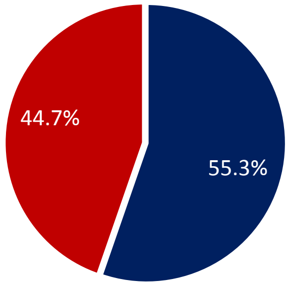


Qualitative feedback

The qualitative feedback provided by brokers indicates that most believe the TFSA regime will be positive for a savings culture in SA. Most (57%) thought it would “probably generate some savings” and 29% thought it would have a “very positive” impact on the savings culture in SA.

The R30 000 limit was not universally seen as a constraint on activity. Most stockbroker respondents believe that the limit is appropriate for the intended objective of promoting savings in low-income groups, although one stockbroker suggested doubling the limit. One respondent pointed out that given the average employed income is R15 000/month, the R2 500 monthly average limit of a TFSA implies 20% of monthly income can be saved, which is sufficient. There was also a feeling that the R500 000 lifetime limit was either unnecessary or counterproductive because it only affects younger savers, which should be the segment that the TFSA regime should aim to encourage most.

STOCKBROKER ACCOUNTS: PROPORTION NEW ACCOUNTS



The investment product range allowed in broker-based TFSAs did come in for some criticism. Brokers felt that the existing range should be expanded to include exchange-traded notes, which are not materially different to the currently allowed exchange-traded funds. Many brokers also felt that individual stocks should be allowed in the investment universe, particularly blue-chip stocks, such as those in the Top 40 index (one broker suggested the top 100 shares). One broker noted that TFSA accounts were carrying a higher cash balance than traditional broker accounts, which it surmised is because clients are less familiar with ETFs than normal equities so there is investment uncertainty.

Commentary

Brokers were some of the more aggressive marketers when TFSAs were launched, backed by a marketing campaign by the JSE of equity-based tax-free accounts.

The results show that these marketing efforts have been fairly successful in attracting new clients to the brokers. The proportion of accounts opened by first-time savers is roughly in line with other account types, though the tax advantages of broker accounts are arguably better. For wealthy savers who would use up interest and capital gains exemptions outside of the TFSA environment, a broker account would be an appropriate tool for a high-risk tranche of an overall portfolio where the tax shield on capital gains is likely to be most useful.

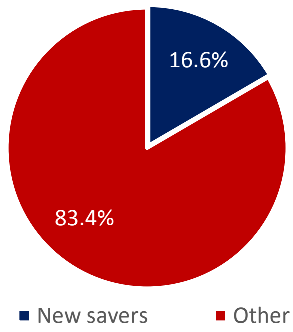
COLLECTIVE INVESTMENT SCHEMES TFSAs

A total of 8 311 TFSAs had been opened in collective investment schemes (often called unit trusts). This included both those opened directly with scheme providers and those opened via LISPs. Just over half of the accounts are funded by monthly debit orders (a significantly higher proportion than stockbrokers' but less than life insurers'). Of those opened, 1 941 (23%) invested the full R30 000 on opening. Account NAV averages R12 605, almost twice the average of stockbroker accounts and life insurance policies.

So far clients opening CIS TFSAs tend to be experienced savers with respondents reporting that they believe only 1 382 (17%) of new clients are new savers. However, just 1 645 (20%) of the total held existing accounts with providers so it is unclear why providers believe so few accounts are new savers.

Generally, schemes were mostly invested in equities (approximately two thirds), followed by bonds/money market instruments (20%), property and cash. Equity and balanced funds were the largest recipients.

CISs: PROPORTION BELIEVED TO BE NEW SAVERS



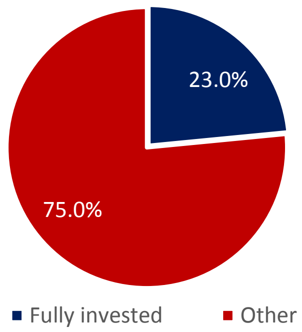
Qualitative feedback

Most (67%) respondents feel that TFSAs are likely to have a "noticeable impact" on the savings culture in South Africa with a balance of 33% saying they will "probably generate some savings".

Some respondents say they are not seeing significant take up of the accounts. One commented that "quite frankly, I do not think the advisors can make a lot of money out of it". Others commented that government should do more to educate consumers about TFSAs because financial service providers focus more on promoting their own products than on the general concept of tax-free savings.

CISs: PROPORTION FULLY INVESTED ON OPENING

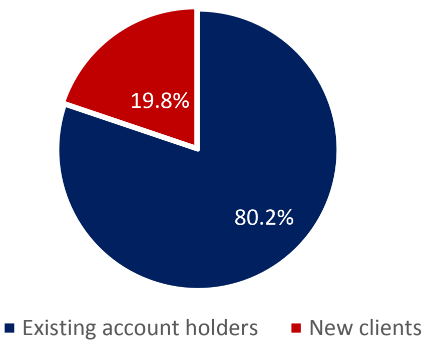
(full R30 000 limit invested)



A significant complaint was over the disallowance of smoothed bonus products. Such products act to limit volatility of returns, which may be preferred by risk-averse, less experienced investors. One institution said that TFSAs may well be preferred as a retirement savings product because of the accessibility of the accounts (i.e. savings are accessible at any time, not just retirement).

In contrast to stockbroker accounts, CIS providers were more negative about the R30 000 limit, arguing that it is particularly unhelpful for those aiming to use the accounts as a retirement vehicle in place of retirement policies. One suggested that Treasury should consider a higher limit for those over 65, which would allow retirees receiving a lump-sum payment to direct it into a TFSA.

CISs: PROPORTION NEW ACCOUNTS



Commentary

Historically the life and collective investment scheme industries have relied on financial advisors as their primary distribution network. TFSAs cannot easily follow this mechanism as the opportunity to pay commissions is limited. Therefore the collective investment scheme and retirement industries are less likely to be enthusiastic users.

However, managed funds offer important benefits for consumers, particularly in managing their risk exposures. Given that TFSAs should be a life-long investment home, we anticipate that consumers would prefer LISP platforms through which they can switch between managed funds or accumulate assets in a variety of funds in a single TFSA. This is consistent with the experience of other markets, particularly the UK, where fund supermarkets have become dominant operators. The business model for such supermarkets in South Africa is far from clear, however, given the unwillingness of product houses to support them.

Managed funds have to face up to the challenge that ETFs pose in the TFSA environment. Broking accounts provide consumers with some 40 ETFs to choose from and they can switch between them and accumulate a portfolio of them as they save. Managed funds need to be able to offer similar consumer choice and convenience.

LIFE INSURANCE POLICY TFSAs

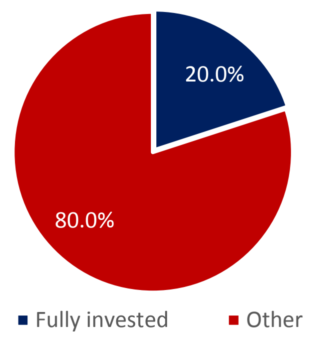
Life insurance policies have taken an early lead in TFSA volumes, responsible for more than half of all accounts (53%). In large part this reflects the distributional strength of the large life insurance companies. The vast majority of these accounts use monthly debit orders as a means to collect regular premiums rather than the once-off or occasional pattern of contributions in the case of stockbroker and collective investment scheme accounts.

A significant number of accounts opened were by existing account holders, although the exact figures are unreliable as one large life insurer would not disclose details on whether new accounts were to existing clients or not.

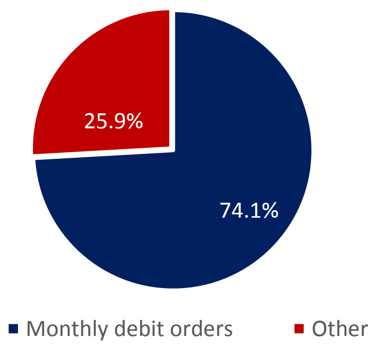
Life insurance TFSAs have unique features in that they provide for some protection from creditors in the event of insolvency and tax advantages in the event of death. Proceeds to named beneficiaries are excluded from the deceased estate for the purposes of estate duty. While life insurers tend to offer both unit trust and life-wrapper TFSAs, so far life wrappers have proved far more popular.

LIFE POLICIES: PROPORTION FULLY INVESTED ON OPENING

(full R30 000 limit invested)



LIFE POLICIES: PROPORTION WITH MONTHLY DEBIT ORDERS



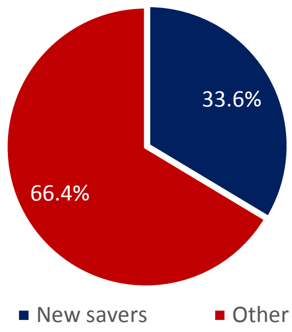
Qualitative feedback

Life insurers provided limited feedback. Most believe that the TFSA scheme will probably have a “noticeable impact” on the savings culture in South Africa but none believed it would be “very positive”. One argued for a significant increase in the contribution limit to R150 000.

Our comments

Life insurance TFSAs offer a competitive advantage for savers whose motive is to transfer assets to the next generation as they can be passed on in the event of death with minimal tax consequences, unlike other TFSAs which form part of the estate. Unlike traditional life products, life wrapper TFSAs still offer easy access to funds like any other TFSA. Life wrapped TFSAs tend to come with slightly higher fees, so they may not be preferred by savers interested in savings goals in their own lifetimes.

LIFE POLICIES: PROPORTION BELIEVED TO BE NEW SAVERS



The low limits for contributions mean there is limited scope for the traditional sales mechanisms for policies, specifically through financial advisors. The structure of TFSAs discourages commission structures although small ones are still possible. However, as a percentage of assets, the limit means commissions are inevitably small. Some insurers have creatively attempted to overcome this barrier with products that allow for multiple beneficiaries to be gathered into TFSAs administered through a single channel so the advisor benefits from larger asset balances.

Overall, the life-wrapped TFSA is clearly a competitive product in the market, as its market share testifies.

MORE INFORMATION

Intellidex undertakes commissioned research to assist financial service providers' strategies. Please contact Colin Anthony by email canthony@intellidex.co.za or call 010 072 0472 for more information