The EY Financial Services Index

3rd quarter 2015

Building a better working world

Table of contents

Executive Summary

The EY Financial Services Confidence Index slows in line with weak GDP growth

- The EY FSI declined from 77 in the second quarter to 66 in the third quarter of 2015.
- A decline could be attributed to decreases in retail banking, asset management and life insurance confidence, which could not be countered by the increase in investment banking confidence.

Retail banking confidence slows on weak growth and rising credit losses

- Although income growth remained relatively strong in 15Q3, profits growth remained weak.
- Net interest income growth remained stable, but non-interest income weakened.
- South Africa's deteriorating economic outlook made banks more risk averse, taking a defensive position to minimise future credit losses.
- Operating expenses growth slowed, but remains nevertheless high.

Investment bank confidence rises despite weaker flows and slower profits

- Business activity retreated across all but one business line (Treasury & Specialised Finance).
- As a result, fee income dropped markedly.
- Investment banks reigned in costs, to some extent supported by a lower head count.
- Net profits growth slowed noticeably, on the back of weaker income growth.
- In comparison with long term averages, investment banks continue applying easy credit standards, albeit tighter than 15Q2.

Asset management confidence is knocked by global and local drivers

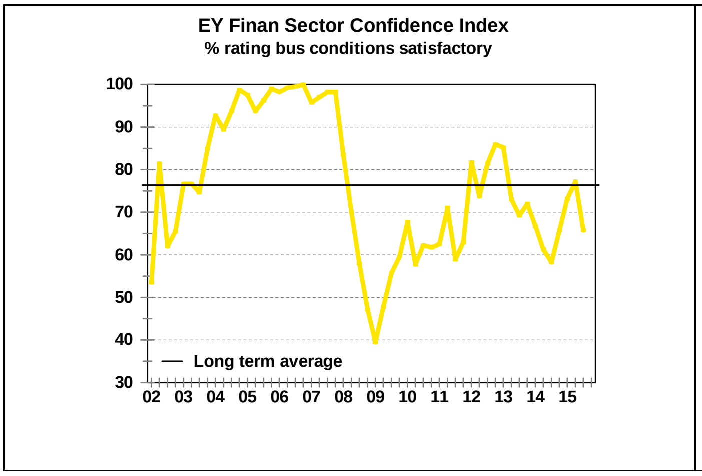
- Confidence was knocked by volatile markets.
- Net inflows slowed further due to dropping institutional and private client flows and sustained weak unit trust flows.
- Weaker net inflows and especially the fall in share prices knocked the growth in total income.
- Despite strong cost containment, weaker income knocked profits, which fell at their strongest pace since the GFC.

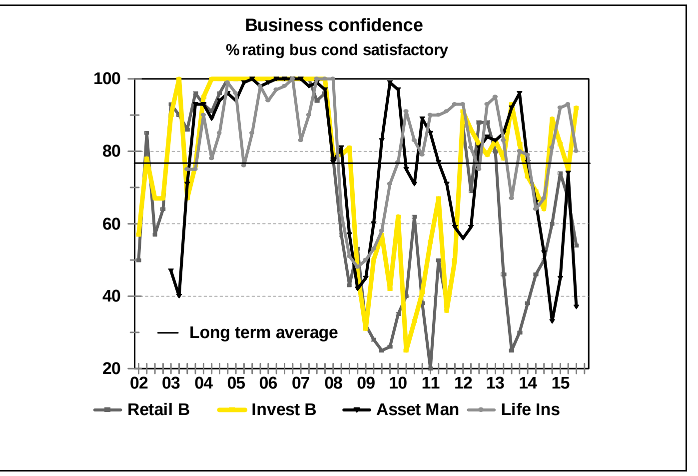
Life insurance confidence slips despite stronger profits

- Confidence was weaker in 15Q3, despite a strong recovery in premium and profits growth.
- Total premiums growth turned positive in 15Q3, driven by risk business.
- Investment premium growth deteriorated further.
- Investment income growth continued at a modest pace.
- Administration and marketing expenses continued rising, despite a lower headcount.

The EY Financial Services confidence index slows in line with weak GDP growth

The EY Financial Sector Confidence Index (EY FSI) declined from 77 in the second quarter to 66 in the third quarter of 2015[1,2]. Given the historical average of 76, the latest reading indicates that overall financial sector confidence has declined from a neutral to a relatively low level.





The percentage of respondents answering "satisfied" to the question "Are prevailing business conditions satisfactory or unsatisfactory?" is taken as the indicator of financial sector confidence.

The EY FSI reflects the unweighted average confidence of four segments of the financial sector, namely:

- retail banking,
- investment banking,
- asset management, and
- life insurance.

The third quarter decline in the EY FSI could be attributed to decreases in retail banking (from 67 to 54), asset management (from 74 to 37) and life insurance confidence (from 93 to 80), which could not be countered by the increase in investment banking confidence (from 75 to 92).

1 During the third quarter of 2015, respondents were asked to provide their views on the estimated developments for the period July to September 2015 and their expectations for the period October to December 2015. To improve the readability of the report, we refer to the first period as "estimation of the third quarter of 2015" (15Q3) and the second period as "expectations for the fourth quarter of 2015" (15Q4).

2 The Bureau for Economic Research (BER) at Stellenbosch University conducted the survey and processed the results on behalf of EY. The survey was conducted between 27 August and 16 September 2015. The results were processed on 17 September 2015. The number of responses processed was: retail banks (16), investment banks (8), asset managers (20) and life insurers (12).

Survey data

Survey data: Business confidence *	Retail banking	Investment banking and specialised finance	Asset management	Life insurance	EY Financial Sector Confidence Index **
06Q1	100	100	99	94	98
06Q2	100	100	100	97	99
06Q3	100	100	100	98	100
06Q4	100	100	100	100	100
07Q1	100	100	100	83	96
07Q2	100	100	98	90	97
07Q3	94	100	99	100	98
07Q4	96	100	97	100	98
08Q1	78	79	77	100	84
08Q2	57	79	81	63	70
08Q3	43	81	57	51	58
08Q4	53	46	42	48	47
09Q1	32	31	45	50	40
09Q2	28	50	60	53	48
09Q3	25	57	83	58	56
09Q4	26	42	99	71	60
10Q1	35	62	97	77	68
10Q2	40	25	75	91	58
10Q3	62	33	71	83	62
10Q4	38	41	89	79	62
11Q1	20	55	85	90	63
11Q2	50	67	77	90	71
11Q3	38	36	71	91	59
11Q4	50	50	59	93	63
12Q1	87	91	56	93	82
12Q2	69	86	59	81	74
12Q3	88	82	81	75	84
12Q4	88	79	84	93	86
13Q1	80	83##	83	95	85
13Q2	46	78	85	83	73
13Q3	25	93	92	67	69
13Q4	30##	82##	96	80	72
14Q1	38	73	77	79	67
14Q2	46	69	66	64	61
14Q3	50	64	52	67	58
14Q4	60##	89##	33	81	66
15Q1	74	82	45	92	73
15Q2	67	75	74	93	77
15Q3	54	92	37	80	66

* Percentage of respondents rating prevailing business conditions as satisfactory. 0 = extreme lack of confidence, 100 = extreme confidence

** The EY Financial Sector Confidence Index is calculated as the un-weighted arithmetic mean of the business confidence indices of retail banks, investment banks, asset managers and life insurers. The average for the period 2002 – 2013 is 77; a reading above 77 therefore indicates a relatively “high” confidence level and below 77 a relatively “low” confidence level.

A reliable result could not be calculated, as too few completed questionnaires were received by the cut-off date.

Lower than normal number of responses

The historical survey data can be downloaded in MS Excel format on www.ber.ac.za

Click the button named “Surveys” on the top banner and then select “Financial Services” on the banner along the left hand side.

Retail banking confidence declines on the back of weak growth and rising credit losses

The third quarter proved to be another difficult one for the South African economy. Data shows that growth turned negative in the 2nd quarter of the year, with emerging markets across the globe facing renewed pressure on the back of a sharply weakening Chinese economy in the third quarter. Equity markets, commodity prices, currencies and bond markets all experienced hikes in volatility, with emerging market currencies falling sharply, following weaker commodity prices. South Africa felt the impact of these difficulties.

The EY Financial Services index indicates that retail banking confidence is currently in line with long term average levels. It is neither particularly strong, nor weak. After falling to a low of 25 in 3Q13, retail banking confidence recovered to a high of 74 in 1Q15. Since then, confidence levels dropped to 67 in 2Q15 and still further to 54 in 3Q15. The decline in confidence can largely be attributed to the country's weak growth prospects. The deteriorating economic outlook has heightened risk aversion, making banks more risk averse and taking a defensive position in light of rising credit losses.

Although income expanded at a steady pace, in line with 2Q15 levels, retail banks expect this to slow noticeably in Q415. The steady growth in income growth in 3Q15 stemmed from stable net interest income. In contrast, non-interest income growth slowed, as lower transaction volumes resulted in slower fee income growth.

Growth in operating expenses slowed, and retail banks expect to keep costs contained in 4Q15. To some extent, slower cost growth will result from a shrinking headcount, with 3Q15 seeing a noticeable decline in employee numbers.

After unexpectedly falling sharply in 1Q15, credit losses resumed in 2Q15 and in 3Q15 the pace picked up, in line with 2013 and 2014 levels.

The deteriorating economic outlook and the resurgence of credit losses prompted retail banks to further tighten credit standards. Banks tightened their credit standards for both firms and households, but more drastically for households. This may well have been due to some extent, to the tighter affordability criteria following amendments to National Credit Regulations.

Survey data: Retail Banking [1]	2014				2015			
	Q1	Q2	Q3	Q4##	Q1	Q2	Q3	Q4*
1 Business confidence [2]	38	46	50	60	74	67	54	
2. Income								
a) total income [3, 4]	23	39	50	80	69	71	67	29
b) net interest income [3, 5]	39	61	75	90	82	72	65	
c) fee income [3, 6]	15	23	25	50	55	26	-6	
d) investment income [3, 7]	0	30	50	60	36	25	-8	
3. Expenditure								
a) total operating expenses (excluding cost of funding) [3, 4]	73	42	42	80	100	90	83	83
b) credit losses [3, 8]	62	39	25	30	-46	5	45	
c) total number of people employed [3]	-15	15	8	0	0	30	-5	
4. Efficiency and profitability								
a) cost-to-income ratio [3]	15	-8	-25	10	9	0	0	
b) net profit after tax [3]	54	84	83	70	55	10	11	
5. Credit standards for approving applications for loans [3, 9]								
a) total [3, 4]	23	8	17	30	-16	17	46	57
b) households [3]	42	15	33	25	0	19	61	
c) firms [3]	10	0	17	30	20	6	20	

Expected

Lower than normal number of responses.

1 Retail banking consists of regular retail banking, private banking, micro lending, commercial banking and corporate banking.

2 % satisfactory

3 Net balance (see Technical Note at the end of the report)

4 The total reflects the responses of participants. It is therefore not calculated as the average of the responses to the components. Each data series has to be considered on its own. Deviations between the total and components occur when participants reply “the same” given that the net balance statistic does not take “the same” responses into account. The fact that respondents only answer questions applicable to them and that missing items are not imputed also have an effect.

5 Interest income less interest expenses

6 Fees and commission

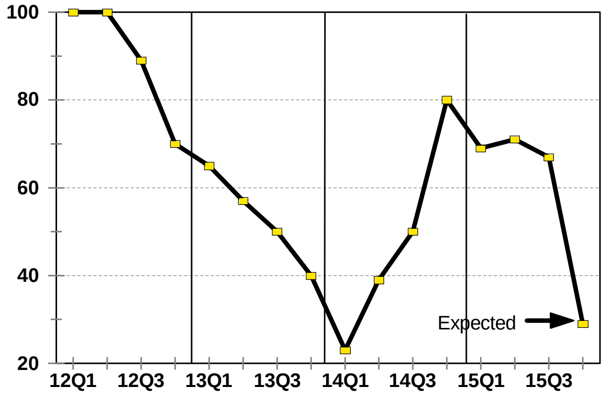
7 “Investment income” refers to all income from investments and not the investment return. It excludes deferred income and capital depreciation, but includes realised and unrealised capital gains and losses on investments.

8 Value of non-performing loans until 09Q2

9 Credit standards refer to the terms of the loans and credit lines, such as maximum size, spread of loan rates over bank’s cost of funds, premiums charged on riskier loans, collateral requirements etc.

Total income

Net balance: % up less % down

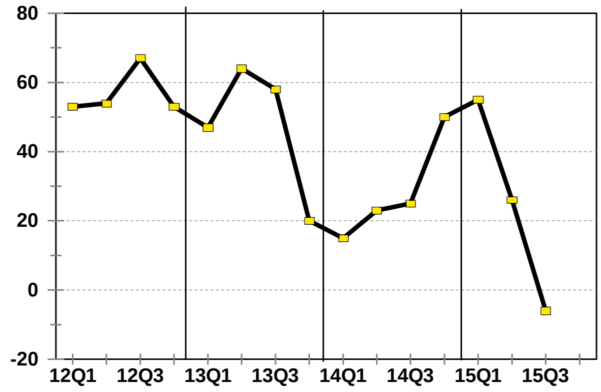


Net interest income

Net balance: % up less % down

Fee income

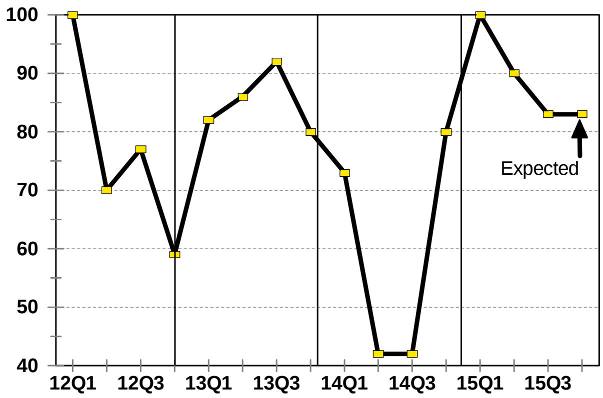
Net balance: % up less % down



Investment income

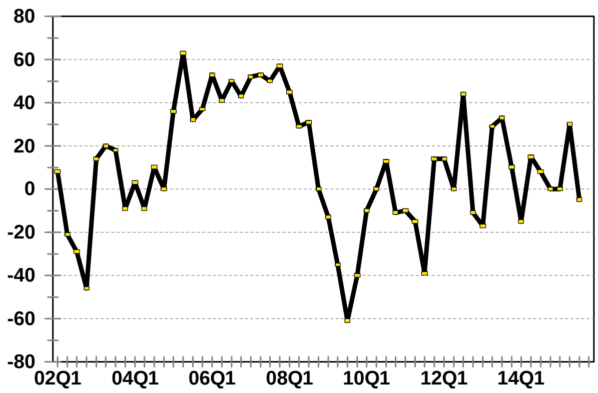
Net balance: % up less % down

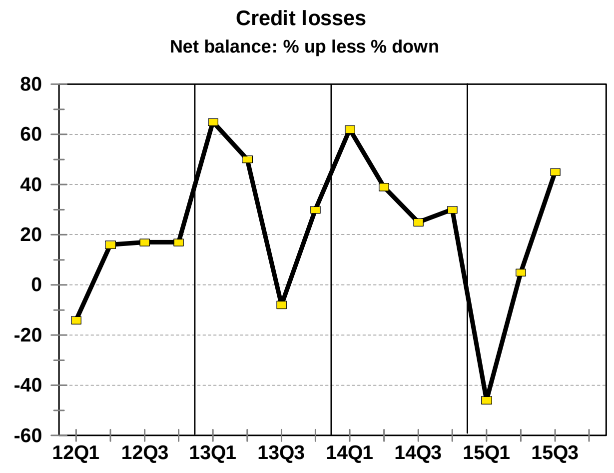
Total operating expenses (excl cost of funds), net balance: % up less % down

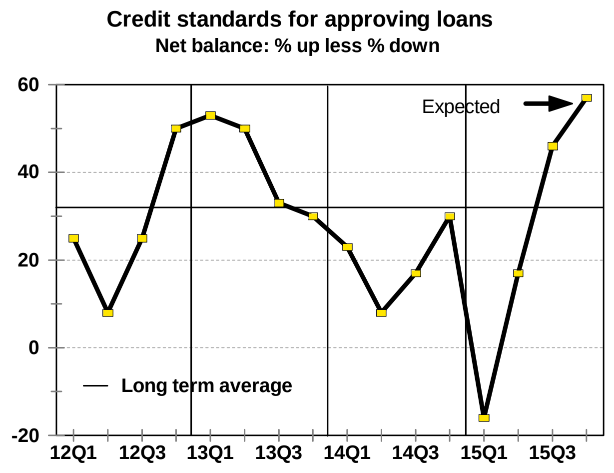


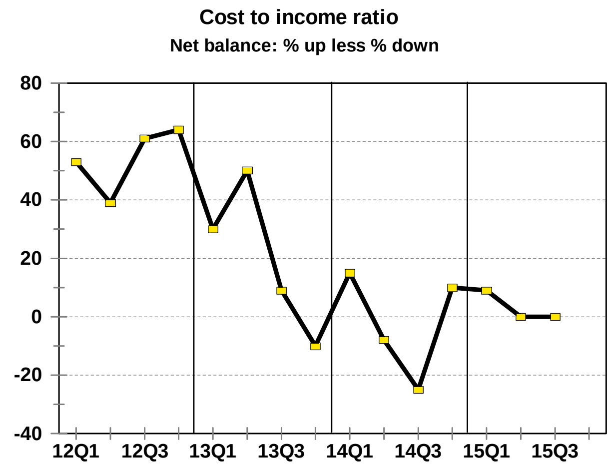
Number of people employed

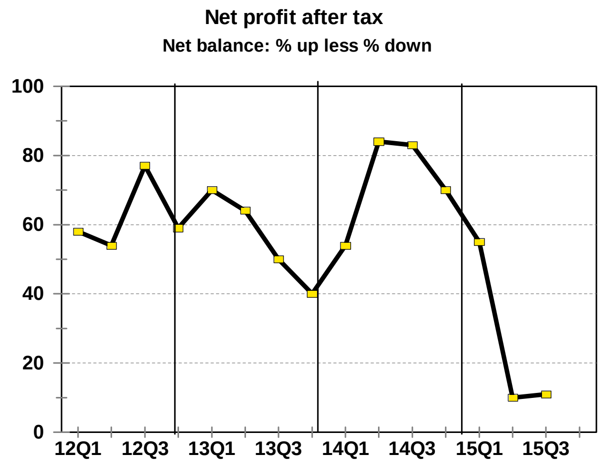
Net balance: % up less % down




Credit losses
Net balance: % up less % down
80
60
40
20
0
-20
-40
-60
12Q1
12Q3
13Q1
13Q3
14Q1
14Q3
15Q1
15Q3


Credit standards for approving loans
Net balance: % up less % down
Expected
Long term average
60
40
20
0
-20
12Q1
12Q3
13Q1
13Q3
14Q1
14Q3
15Q1
15Q3


Cost to income ratio
Net balance: % up less % down
80
60
40
20
0
-20
-40
12Q1
12Q3
13Q1
13Q3
14Q1
14Q3
15Q1
15Q3


Net profit after tax
Net balance: % up less % down
100
80
60
40
20
0
12Q1
12Q3
13Q1
13Q3
14Q1
14Q3
15Q1
15Q3

Investment bank confidence rises despite weaker flows and slower profits growth

Despite weak growth, investment banks recorded stronger confidence levels in the third quarter. After declining to 75 index points in 2Q15, confidence rebounded to 92 in 3Q15. This rebound and strong confidence is not in sync with the economic environment.
The strong confidence could be attributable to sustained albeit modest profits growth. Investment banks cut back costs amidst the weaker business volumes, supporting the modest profits growth.

Most factors were less supportive of stronger confidence, including falling activity levels, resultant weaker income growth, and sharply rising credit losses.

Business volumes shrunk across all bar one business line, (treasury & specialised finance being the exception).

The falloff in activity resulted in slower income growth. Fee income slowed sharply, although this was partially offset by stronger net interest and investment income streams. Respondents expect income to retreat further in 4Q15.

Investment banks moderated cost growth in the third quarter, aided by a lower head count.

Credit losses rose sharply, after a benign two year period during which credit losses were mostly shrinking. Indeed credit losses had remained well contained since the 2008 financial crisis. However, this quarter's reading may prove to be a one off (or outlier).

In comparison with long term averages, and considering the spike in credit losses during the quarter, investment banks applied neutral credit standards in 3Q15 (after easing in 2Q15). They expect to tighten credit standards in the last quarter of 2015, for the first time in a year.

Survey data: Investment banking [1]	2014				2015			
	Q1	Q2	Q3	Q4##	Q1	Q2	Q3	Q4*
1 Business confidence [2]	73	69	64	89	82	75	92	
2. Volume of business								
a) treasury and specialised finance [3, 4]	67	36	22	13	36	40	11	
b) private equity [3, 5]	27	0	-18	-44	18	0	-33	
c)corporate finance [3, 6]	13	-37	-22	12	18	30	-11	
d) project finance [3]	62	40	26	-13	9	10	-23	
e) stock broking [3]	16	44	0	-38	9	30	-11	
f)overall [3, 7]	37	17	2	-14	18	22	-13	
3. Income								
a) total income [3, 8]	18	-7	28	56	64	50	11	-22
b) net interest income [3, 9]	30	30	18	33	64	50	33	
c)fee income [3, 10]	20	0	-18	22	64	70	0	
d) investment income [3, 11]	27	15	18	33	64	70	44	
4. Expenditure								
a) total operating expenses (excluding cost of funding) [3, 8]	27	39	64	67	73	70	44	29
b) credit losses [3, 12]	-46	-39	-27	-34	-28	-30	56	
d) total number of people employed [3]	9	7	27	11	0	0	-22	
5. Efficiency and profitability								
a) cost-to-income ratio [3]	37	15	-18	0	18	10	0	
b) net profit after tax [3]	55	15	37	56	64	30	22	
6. Credit standards for approving applications for loans[3,13]	50	38	27	11	0	-34	0	25

* Expected

** A reliable result could not be calculated, as too few completed questionnaires were received by the cut-off date.

Lower than normal number of responses

1 Investment banking and specialised finance consists of corporate finance, private equity, project finance, treasury and specialised finance.

2 % satisfactory

3 Net balance (see Technical Note at the end of the report)

4 Treasury and specialised finance comprise structured finance, asset finance, acquisition finance, financial products, corporate treasury, debt restructuring, cash flow management, tax structuring and balance sheet management, as well as trading of commodities, foreign exchange and various financial instruments.

5 Private equity and direct investments comprise the active seek and selection of expansion and buy-out investments as principal in unlisted companies.

6 Corporate finance includes the provision of financial advisory services to listed companies related to mergers and acquisitions, divestitures, restructurings, spin-offs, joint ventures, capital raising and management buy-outs, as well as valuations, feasibility studies and due diligence reviews.

7 The unweighted average of treasury and specialised finance, private equity, corporate finance, project finance and stock broking.

8 The total reflects the responses of participants. It is therefore not calculated as the average of the responses to the components. Each data series has to be considered on its own. Deviations between the total and components occur when participants reply “the same” given that the net balance statistic does not take “the same” responses into account. The fact that respondents only answer questions applicable to them and that missing items are not imputed also have an effect.

9 Interest income less interest expenses

10 Fees and commission

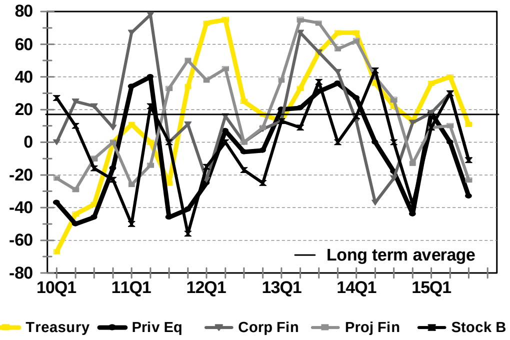
11 “Investment income” refers to all income from investments and not the investment return. It excludes deferred income and capital depreciation, but includes realised and unrealised capital gains and losses on investments.

12 Value of non-performing loans until 09Q2

13 Credit standards refer to the terms of the loans and credit lines, such as maximum size, spread of loan rates over bank’s cost of funds, premiums charged on riskier loans, collateral requirements etc.

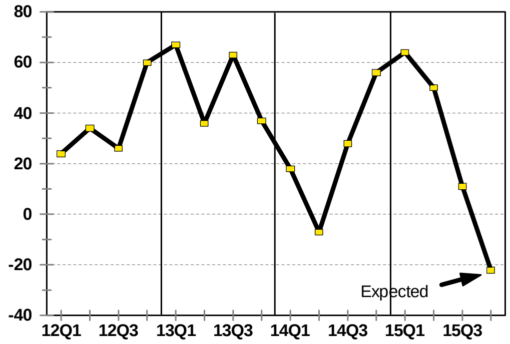
Business volumes

Net balance: % up less % down



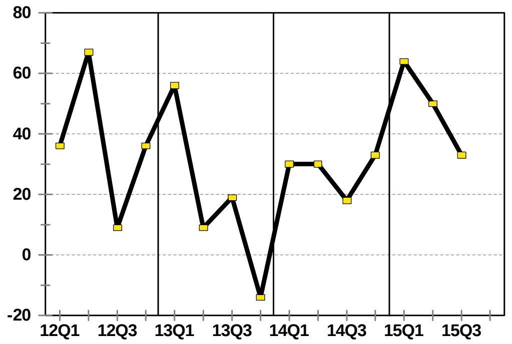
Total income

Net balance: % up less % down



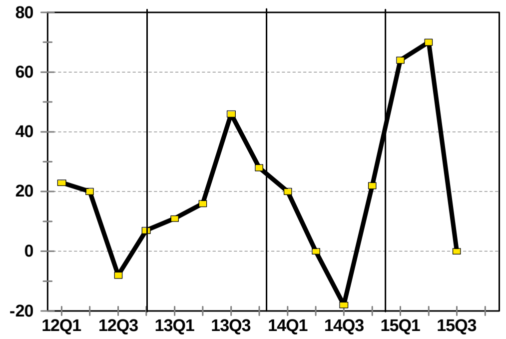
Net interest income

Net balance: % up less % down



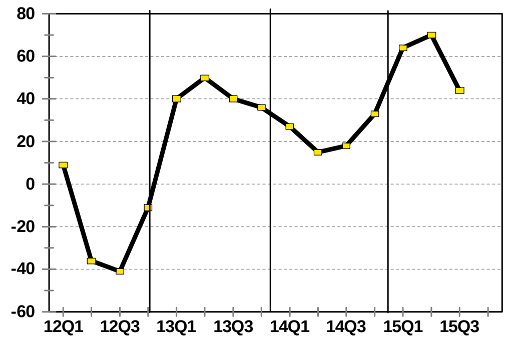
Fee income

Net balance: % up less % down

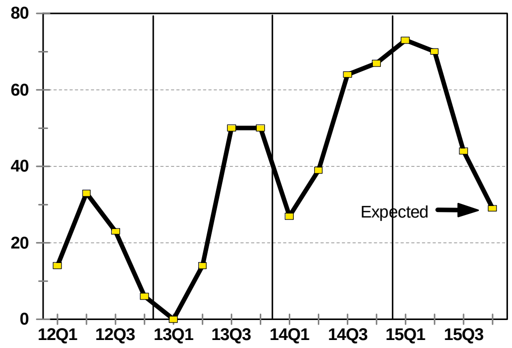


Investment income

Net balance: % up less % down

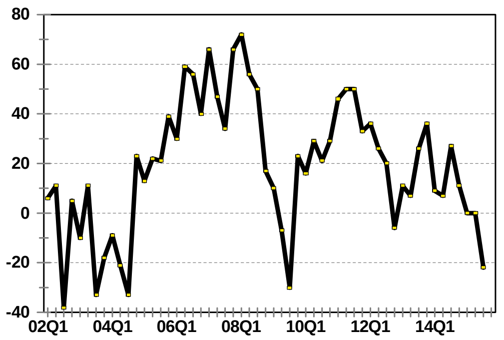


Total operating expenses (excl cost of funds), net balance: % up less % down



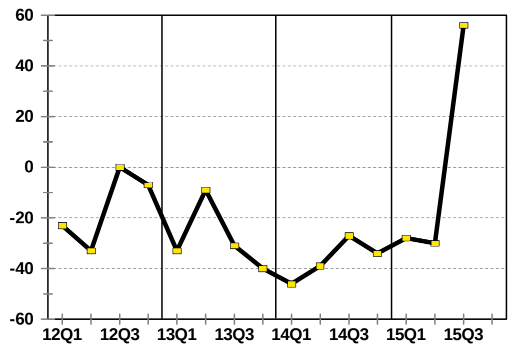
Number of people employed

Net balance: % up less % down

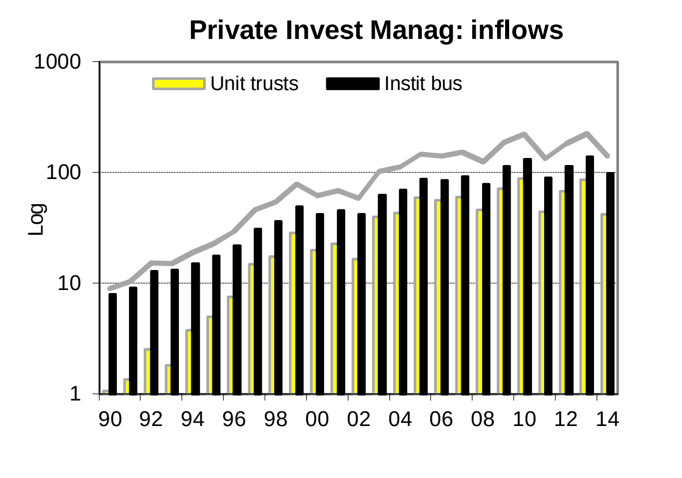


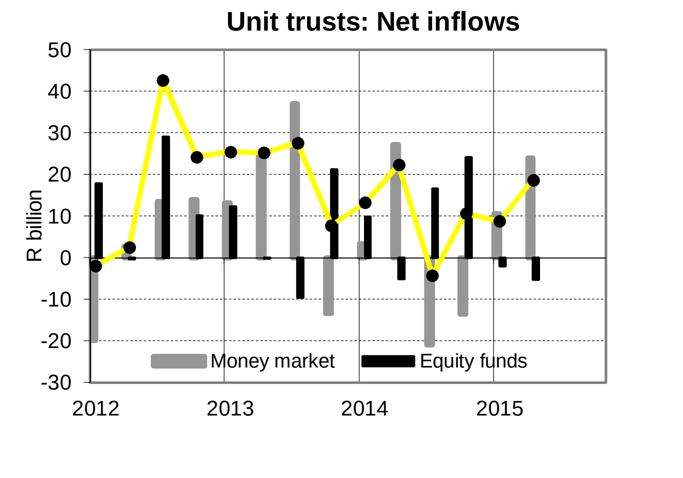
Credit losses

Net balance: % up less % down



Asset manager confidence is knocked by global and local drivers





SARB data show that the retail segment of the asset management industry struggled with weak inflows in the first half of 2015. Net inflows of money market funds made up for net outflows in the second half of 2014 (see the chart above). However, after strong net inflows of equity funds during the second half of 2014, the first half of 2015 saw net outflows. Even so, rising share prices until May 2015 benefitted assets under management and thereby boosted management fees.

Institutional funds (defined as net private pension fund inflows) remained static. Net inflows (defined as current income less current expenditure) have moved sideways since the GFC as a result of weak growth in private sector employment.

According to the BER / EY Financial Services Index, asset management confidence slipped sharply in 15Q3. A rebound in confidence in the second quarter proved to be temporary, with confidence down from 74 in 15Q2 to 37 in 15Q3. Asset manager confidence is lower than the beginning of the year (45), but higher than levels at the close of 2014 (33).

The decline in confidence is attributable to weaker net inflows, declining share prices (which reduced income from management fees) and another substantial weakening in profitability.

After rebounding strongly in 15Q1 on the back of resurging unit trust and continued strong private client net inflows, net inflows edged lower in 15Q2 on the back of unit trust inflows slowing once more. This continued In 15Q3, driven by a drop in institutional and private client inflows and sustained weak unit trust net inflows.

Weaker net inflows and share prices collectively hurt growth in total income.

Asset manager costs were contained, aided by a cut in headcount. However, asset managers expect to start hiring again before year end and therefore expect costs to edge up again in 15Q4.

Despite asset managers’ success in containing costs, the weak income took its toll on profits, which contracted at their sharpest pace since the GFC.

Survey data: Asset management – All	2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4*
1 Business confidence [1]	77	66	52	33	45	74	37	
2. Net inflows								
a) Total net inflows [2, 3]	12	-11	-12	-37	29	20	-5	1
b) Institutional net inflows [2, 4]	29	-6	9	-27	-19	-15	-41	
c) Unit trust net inflows: total [2, 3]	19	-9	8	-4	22	-6	-12	
i) Institutional [2, 4]	24	10	17	-26	14	-20	-52	
ii) Retail [2, 5]	27	-8	-5	45	46	-19	-22	
d) Private client net inflows [2]	22	-23	-20	0	10	1	-17	
3. Income								
a) Total income [2, 3]	81	74	42	42	26	18	-28	9
b) Average management fees charged [2]	30	22	4	8	-12	-27	-8	
4. Expenses								
a) Total expenses [2, 3]	77	94	68	61	19	32	23	39
b) number of people employed: total [2, 3]	53	33	15	-3	9	6	20	
c) back office costs [2]	71	66	53	38	23	15	23	
d) IT and systems costs [2]	73	65	69	67	3	10	29	
e) marketing costs [2]	41	61	50	23	-10	-13	-19	
f) other distribution costs [2]	50	58	57	57	58	47	36	
g) bonuses paid [2]	43	45	46	26	4	-30	-33	
5. Profitability								
Net profit after tax [2, 3]	80	57	45	20	6	1	-34	

*Expected

1 % satisfactory, weighted according to firm size

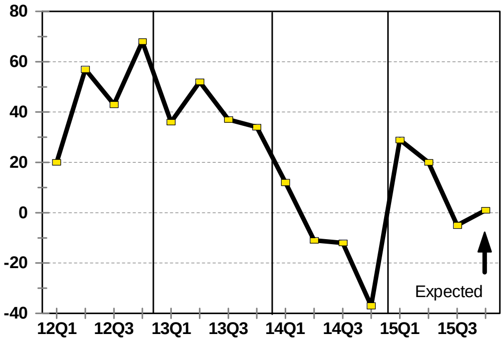
2 Net balance (see Technical Note at the end of the report), weighted according to firm size

3 The total reflects the responses of participants. It is therefore not calculated as the average of the responses to the components. Each data series has to be considered on its own. Deviations between the total and components occur when participants reply “the same” given that the net balance statistic does not take “the same” responses into account. The fact that respondents only answer questions applicable to them and that missing items are not imputed also have an effect.

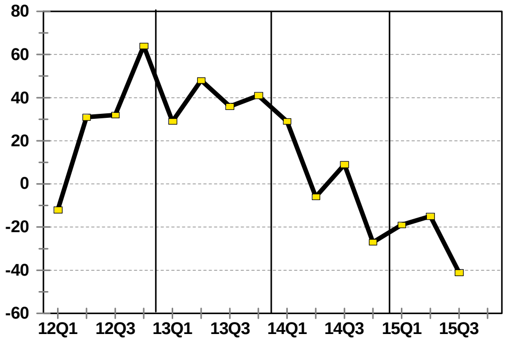
4 According to the Association of Collective Investments (ACI), an institutional fund is a fund in which an individual investor cannot invest. The units are held in the name of structures such as pension funds, provident funds, companies, endowment policies and structured funds.

5 According to the ACI, a retail fund is a fund in which individual investors can invest directly and indirectly and the investments are held in their names. Direct investments take place when individual investors deal directly with the management companies. Indirect investments take place when a reseller (LISP) or third party (e.g. a broker) acts as a go-between the individual investors and the management companies.

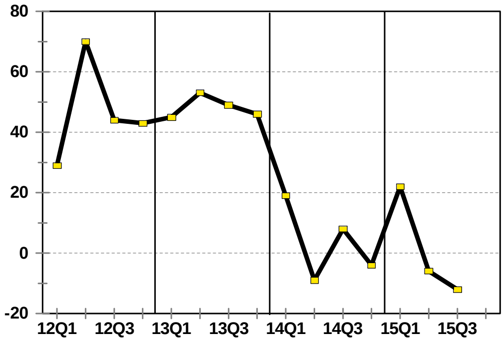
Total net inflows: All firms
Weighted,net balance: %up less %down



Institutional net inflows: All firms
Weighted,net balance: %up less %down

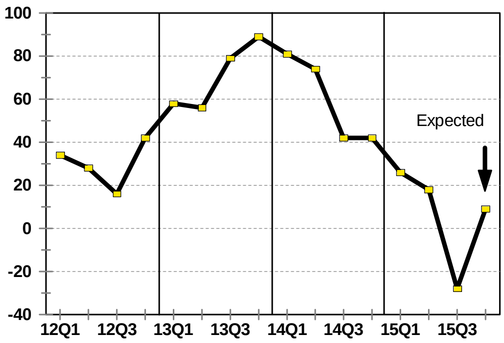


Unit trust net inflows: All firms
Weighted,net balance: %up less %down

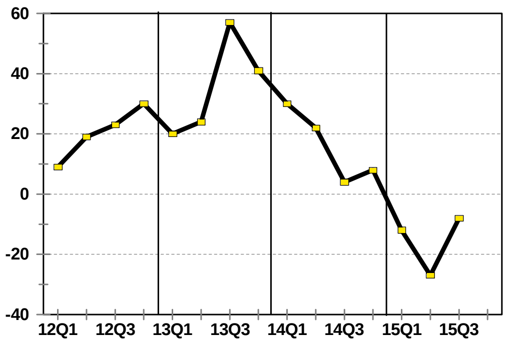


Private client net inflows: All firms
Weighted,net balance: %up less %down

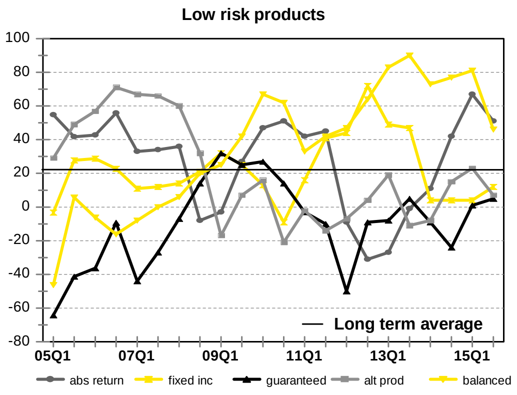
Total income: All firms
Weighted,net balance: %up less %down

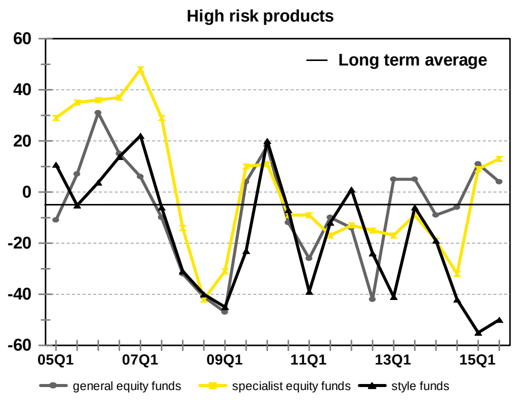


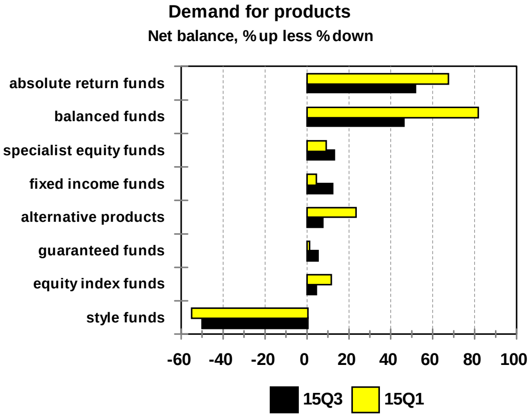
Avg management fees charged: All firms
Weighted,net balance: % up less % down



Survey data: All firms (continued)	2012		2013		2014		2015	
	Q1	Q3	Q1	Q3	Q1	Q3	Q1	Q3
Current situation								
6. Capital expenditure on ...								
a) domestic infrastructure development [1]	45	51	41	28	52	30	30	7
b) foreign infrastructure development [1]	3	1	19	26	9	13	0	19
7. Products								
a) Demand for								
i) general equity index / tracker funds [1]	-14	-42	5	5	-9	-6	11	4
ii) absolute return funds [1]	-9	-31	-27	-1	11	42	67	51
iii) fixed income funds [1]	44	72	49	47	4	4	4	12
iv) specialist equity funds [1]	-13	-15	-17	-9	-19	-32	9	13
v) style funds [1]	1	-24	-41	-6	-19	-42	-55	-50
vi) guaranteed funds [1]	-50	-9	-8	5	-9	-24	1	5
vii) alternative products (e.g. hedge funds) [1]	-7	4	19	-11	-8	15	23	7
viii) balanced funds [1]	47	64	83	90	73	77	81	46
b) Demand for foreign exposure [1]	52	27	45	55	77	87	72	62
c) Opportunities to introduce new funds [1]	10	28	64	6	5	14	-15	-44
8. Regulations								
Restrictions caused by the regulatory environment [1]	78	78	67	45	42	57	57	65

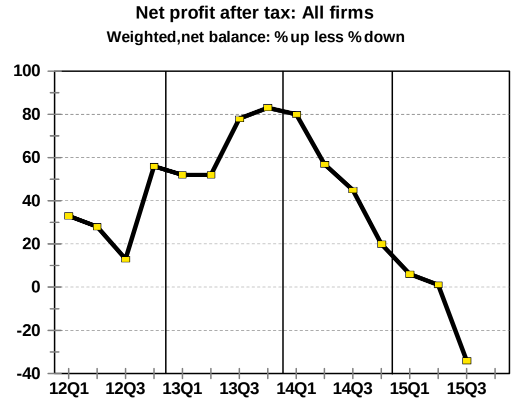

Low risk products
Long term average
abs return
fixed inc
guaranteed
alt prod
balanced


High risk products
Long term average
general equity funds
specialist equity funds
style funds


Demand for products
Net balance, % up less % down
absolute return funds
balanced funds
specialist equity funds
fixed income funds
alternative products
guaranteed funds
equity index funds
style funds
15Q3
15Q1


Total expenses: All firms
Weighted,net balance: % up less % down
Expected


No of people employed: All firms
Weighted,net balance: % up less % down


Net profit after tax: All firms
Weighted,net balance: % up less % down

Survey data: Asset management – Small Firms [1]	2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4*
1 Business confidence [2]	85	84	63	59	53	58	45	
2. Net inflows								
a) Total net inflows [3, 4]	60	31	4	14	41	-6	-5	35
b) Institutional net inflows [3, 5]	43	36	7	0	35	-21	-70	
c) Unit trust net inflows: total [3, 4]	64	68	79	38	23	25	25	
i) Institutional [3]	52	52	75	9	29	12	0	
ii) Retail [3]	64	44	58	62	35	44	31	
d) Private client net inflows [3]	50	34	46	60	67	73	56	
3. Income								
a) Total income [3, 4]	70	70	59	46	29	-11	-20	-30
b) Average management fees charged [3]	-7	35	11	0	0	0	-16	
4. Expenses								
a) Total expenses [3, 4]	87	96	75	76	71	78	80	40
b) number of people employed: total [3, 4]	69	88	45	50	53	42	70	
c) back office costs [3]	57	38	18	4	0	16	5	
d) IT and systems costs [3]	40	35	52	18	0	16	20	
e) marketing costs [3]	30	54	37	9	0	0	15	
f) other distribution costs [3]	44	14	23	23	24	21	5	
g) bonuses paid [3]	70	69	59	18	-35	-58	-15	
5. Profitability								
Net profit after tax:[3, 4]	55	59	58	46	12	-31	-12	

* Expected
1 Firms with funds under management of less than R40 billion in 2013.
2 % satisfactory
3 Net balance (see Technical Note at the end of the report), weighted according to firm size
4 The total reflects the responses of participants. It is therefore not calculated as the average of the responses to the components. Each data series has to be considered on its own. Deviations between the total and components occur when participants reply “the same” given that the net balance statistic does not take “the same” responses into account. The fact that respondents only answer questions applicable to them and that missing items are not imputed also have an effect.
5 Private pension funds, public pension funds managed on behalf of the Public Investment Commissioners (PIC), life funds, medical aid funds, etc.

Survey data: Asset management – Large firms [1]	2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4*
1 Business confidence [2]	74	60	48	21	42	79	34	
2. Net inflows								
a) Total net inflows [3, 4]	-2	-26	-19	-60	24	27	-6	-10
b) Institutional net inflows [3, 5]	24	-22	9	-40	-37	-13	-31	
c) Unit trust net inflows: total [3, 4]	8	-37	-27	-32	21	-12	-22	
i) Institutional [3]	17	-4	-5	-42	9	-28	-65	
ii) Retail [3]	19	-27	-30	37	50	-35	-36	
d) Private client net inflows [3]	15	-40	-47	-21	-8	-21	-40	
3. Income								
a) Total income [3, 4]	84	79	35	39	24	26	-31	20
b) Average management fees charged [3]	41	17	0	12	-17	-33	-5	
4. Expenses								
a) Total expenses [3, 4]	75	92	66	54	4	19	3	38
b) number of people employed: total [3, 4]	49	13	3	-27	-6	-5	4	
c) back office costs [3]	75	76	67	52	31	14	29	
d) IT and systems costs [3]	82	76	76	90	4	8	33	
e) marketing costs [3]	45	64	56	30	-15	-17	-31	
f) other distribution costs [3]	52	71	71	73	71	56	46	
g) bonuses paid [3]	35	36	40	30	19	-22	-39	
5. Profitability								
Net profit after tax [3, 4]	86	57	40	8	4	11	-40	

* Expected

1 Firms with funds under management in excess of R40 billion in 2013.

2 % satisfactory

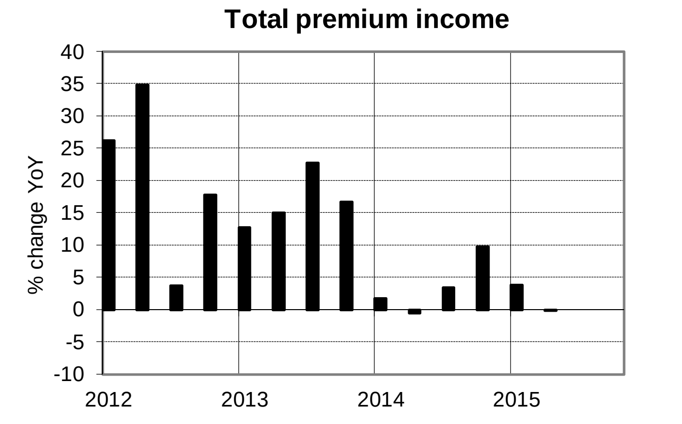
3 Net balance (see Technical Note at the end of the report), weighted according to firm size

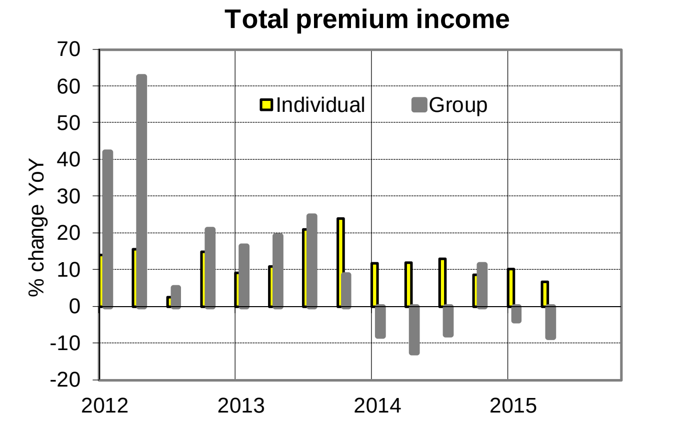
4 The total reflects the responses of participants. It is therefore not calculated as the average of the responses to the components. Each data series has to be considered on its own. Deviations between the total and components occur when participants reply "the same" given that the net balance statistic does not take "the same" responses into account. The fact that respondents only answer questions applicable to them and that missing items are not imputed also have an effect.

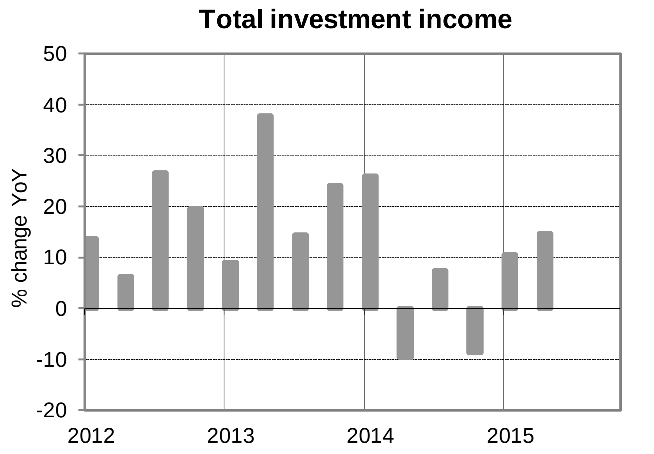
5 Private pension funds, public pension funds managed on behalf of the Public Investment Commissioners (PIC), life funds, medical aid funds, etc.

Life insurance confidence slips despite stronger profits

According to SA Reserve Bank data, life insurers faced more difficult prospects in 2014. Premium income growth slowed from 2012 and 2013 levels(see the chart below). While individual premium income (56% of the total) continued growing at comfortable levels, group premium income (44%) contracted in 2014 and into the first half of 2015.
Declining group premiums is attributed to a lack of growth in private sector employment since the GFC in 2008.







In addition to weak premium incomes (80% of inflows), a fall in investment income (20%) also impacted life insurers in 2014. After contracting sharply in 2009 and 2010 due to the recession, investment income began recovering in 2010 and registered the highest (year-on-year) growth in 2013. It contracted in 2014, partly due to the high base established in 2013, but also due to lower dividend yields, declining bond yields and little growth in real rentals. Rising bond yields lifted investment income during the first half of 2015.

After robust growth between 2012 and 2014, benefit payments moderated in the first half of 2015 (see the chart below). The slower growth is attributed to muted growth in lump sum payments (38% of the total) and to a lesser extent, weaker annuities (11%). In contrast, surrenders (52%) increased at an even faster rate than in 15Q1, in line with 2012 and 2014 levels.

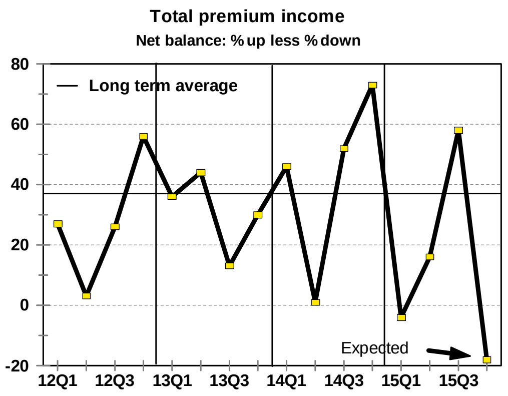
The BER EY Financial Services Index shows that life Insurer confidence fell in 3Q15, despite stronger income and profits growth. This was driven by stronger premium income growth after a weak first half. This growth was driven entirely by risk premiums, (with investment premiums deteriorating further).

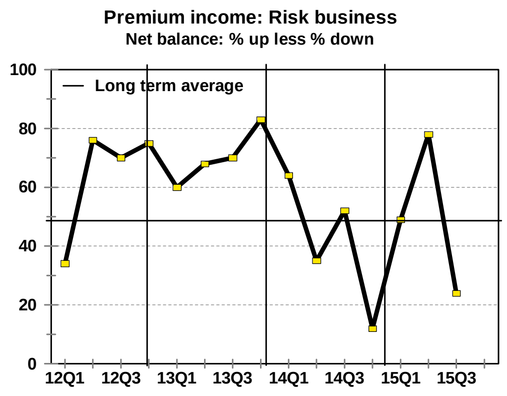
Respondents are not optimistic about 15Q4, expecting total premium to drop again. This is largely attributed to the weak economic outlook, which slows premium growth and raises surrenders. New business premiums were flat in 15Q3, prompting respondents to adopt cautionary expectations. However, these negative sentiments were countered by a continued decline in lapses.

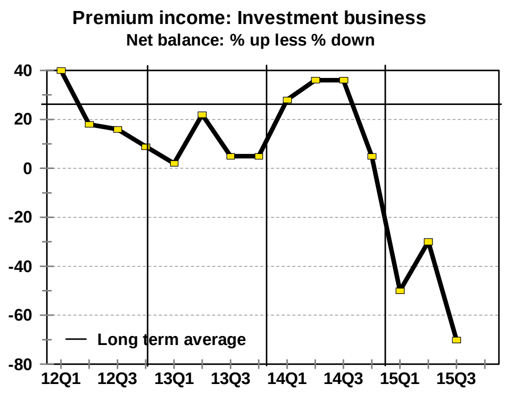
Investment income growth continued at a modest pace. Growth in benefits continued at 15Q2 levels. Surrenders surged in 15Q3, driven by pressured consumers cashing in policies prematurely. Administration and marketing expenses rose strongly, despite the full-time admin employee headcount shrinking. Stronger premium incomes and risk product profitability boosted net profits after tax growth.

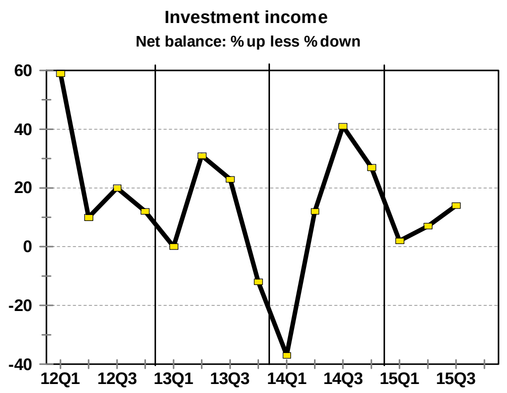
Survey data: Life Insurance [1]	2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4*
1 Business confidence [2]	79	64	67	81	92	93	80	
2. Inflow								
a) total inflow [3, 4]	46	47	50	64	-3	14	49	
b) total premium income [3, 5]	46	1	52	73	-4	16	58	-18
i) risk business / no of new contracts [3]	64	35	52	12	49	78	24	
ii) investment business (only individual business) [3]	28	36	36	5	-50	-30	-70	
c) new business premium income [3]	15	-2	49	78	89	76	40	
d) lapses / no of contracts terminated [3]	2	20	14	-20	-47	-25	-13	
e) investment income [3, 6]	-37	12	41	27	2	7	14	
3. Outflow								
a) total outflow [3, 7]	49	57	55	59	58	57		
b) benefits [3]	52	56	53	59	58	55	69	52
c) value of surrenders [3]	54	20	11	31	-13	2	46	
d) sales remuneration [3, 8]	88	93	89	53	68	80	72	
e) administration and marketing expenses [3]	19	63	75	61	53	75	71	
f) number of full-time admin employees [3, 9]	0	-5	41	53	14	-2	-7	
g) number of in-house agents [3]	42	61	33	-27	51	57	31	
4. Profitability								
a) net profit after tax [3]	20	56	70	39	-51	36	87	
b) profitability of risk business [3]	48	62	25	-30	-45	28	18	
c) administration expenses as % of premium income [3]	48	57	24	-10	69	41	16	
d) value of new business [3]	60	48	33	32	28	29	16	

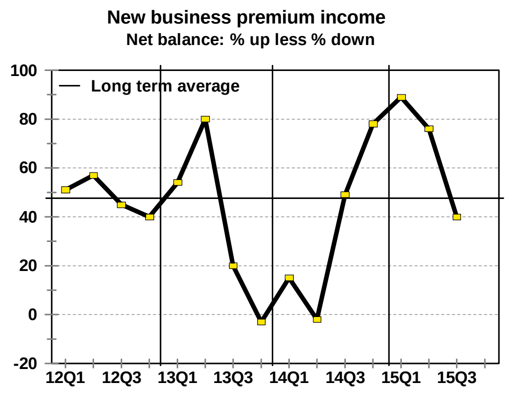
* Expected
1 Individual life and retirement annuities business plus group life and employee benefit business.
2 % satisfactory, weighted according to firm size
3 Net balance (see Technical Note at the end of the report), weighted according to firm size
4 Weighted net balance (80% total premium income + 20% investment income)
5 The total reflects the responses of participants. It is therefore not calculated as the average of the responses to the components. Each data series has to be considered on its own. Deviations between the total and components occur when participants reply “the same” given that the net balance statistic does not take “the same” responses into account. The fact that respondents only answer questions applicable to them and that missing items are not imputed also have an effect.
6 “Investment income” refers to all income from investments and not the investment return. It includes dividend, interest, rental and other non-capital investment income, as well as realised and unrealised capital gains and losses on investments.
7 Weighted net balance (90% benefits + 10% administration and marketing expenses)
8 Distribution costs and commissions.
9 Excluding field staff

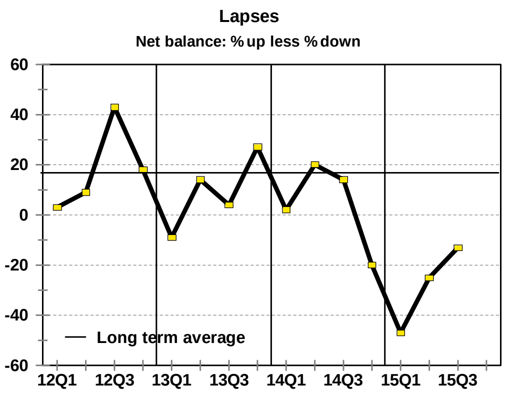

Total premium income
Net balance: % up less % down
Long term average
Expected
80
60
40
20
0
-20
12Q1 12Q3 13Q1 13Q3 14Q1 14Q3 15Q1 15Q3

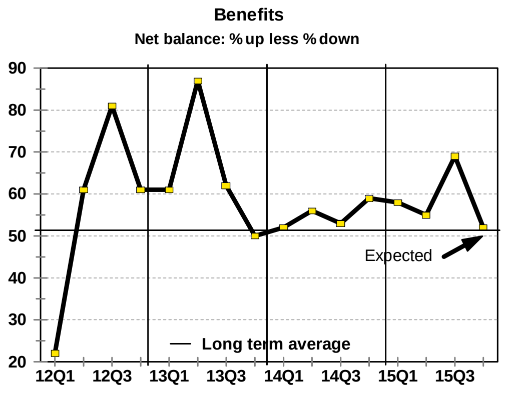

Premium income: Risk business
Net balance: % up less % down
Long term average
100
80
60
40
20
0
12Q1 12Q3 13Q1 13Q3 14Q1 14Q3 15Q1 15Q3

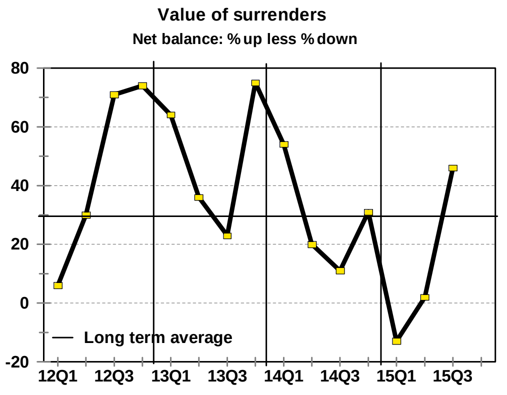

Premium income: Investment business
Net balance: % up less % down
Long term average
40
20
0
-20
-40
-60
-80
12Q1 12Q3 13Q1 13Q3 14Q1 14Q3 15Q1 15Q3

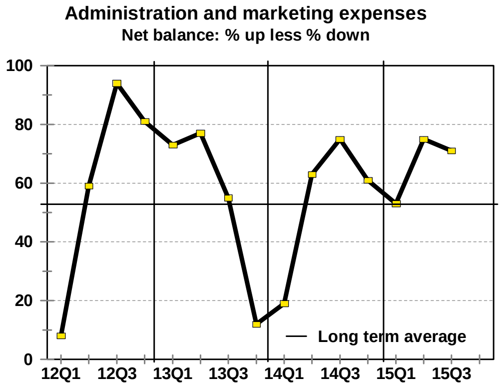

Investment income
Net balance: % up less % down
60
40
20
0
-20
-40
12Q1 12Q3 13Q1 13Q3 14Q1 14Q3 15Q1 15Q3

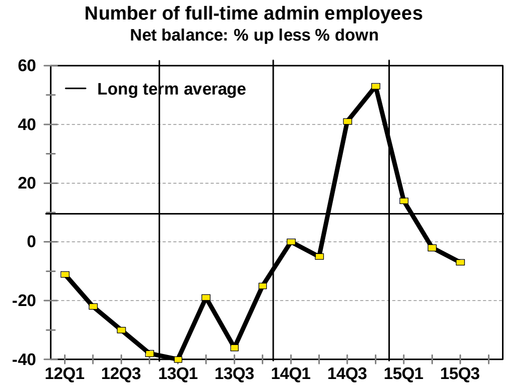

New business premium income
Net balance: % up less % down
Long term average
100
80
60
40
20
0
-20
12Q1 12Q3 13Q1 13Q3 14Q1 14Q3 15Q1 15Q3

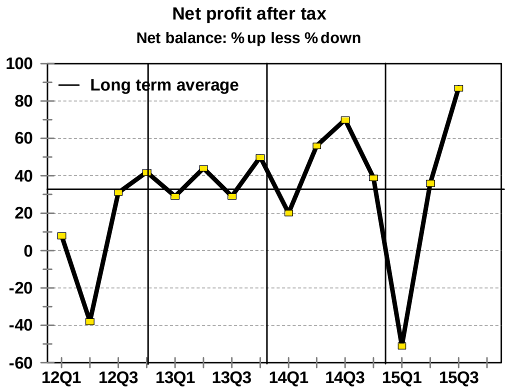

Lapses
Net balance: % up less % down
Long term average
60
40
20
0
-20
-40
-60
12Q1 12Q3 13Q1 13Q3 14Q1 14Q3 15Q1 15Q3

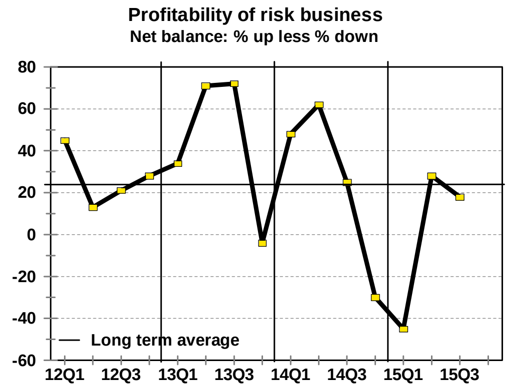

Benefits
Net balance: % up less % down
Expected
Long term average
90
80
70
60
50
40
30
20
12Q1 12Q3 13Q1 13Q3 14Q1 14Q3 15Q1 15Q3


Value of surrenders
Net balance: % up less % down
Long term average
80
60
40
20
0
-20
12Q1 12Q3 13Q1 13Q3 14Q1 14Q3 15Q1 15Q3


Administration and marketing expenses
Net balance: % up less % down
100
80
60
40
20
0
12Q1
12Q3
13Q1
13Q3
14Q1
14Q3
15Q1
15Q3
Long term average


Number of full-time admin employees
Net balance: % up less % down
60
40
20
0
-20
-40
Long term average
12Q1
12Q3
13Q1
13Q3
14Q1
14Q3
15Q1
15Q3


Net profit after tax
Net balance: % up less % down
100
80
60
40
20
0
-20
-40
-60
Long term average
12Q1
12Q3
13Q1
13Q3
14Q1
14Q3
15Q1
15Q3


Profitability of risk business
Net balance: % up less % down
80
60
40
20
0
-20
-40
-60
Long term average
12Q1
12Q3
13Q1
13Q3
14Q1
14Q3
15Q1
15Q3

Technical note

A document with more information on the survey method is available on www.ber.ac.za . Click the button named “Services” and then select “Surveys” and finally “Financial Services”. Alternatively, click on “EY Financial Survey” on the home page and then on “Financial Services” under Quick Links.

Survey method

The BER started conducting surveys amongst retail and investment banks in 2002. The scope of the survey was expanded to asset managers and life insurers in 2003.

EY, the international accounting and business advisory firm, not only supports the financial sector survey financially, but also made valuable inputs to the design and makes the overall results public. However, the BER conducts the survey and interprets the results. The BER treats the identities of participants and individual responses as confidential and does not reveal this information to any third party, including the sponsoring firm.

The division heads of all the major retail banks, investment banks, asset managers and life insurers operating in South Africa participate in the survey.

The survey results reveal current and expected changes in income, expenses and profitability for these firms’ South Africa operations only. Industry specific issues, such as banks’ credit standards and the demand for various products of asset managers, are covered during the first and third quarter surveys.

The surveys are conducted during March, June, September and December. The results reflect developments per calendar quarter, i.e. the first quarter reflect developments during January, February and March; the second quarter reflects April, May and June etc.

On occasion questionnaires reach us after the date on which the results of the current quarter are processed. Small revisions of the survey results of the previous quarter could occur when we process such questionnaires at a later stage.

The need for the financial services survey

South Africa has one of the most advanced financial sectors of all emerging market economies and its development is in many respects on par with those of industrialised countries – and yet its performance is not measured regularly and consistently. There is a general consensus on the need for a regular, consistent and impartial financial services survey, from managers in the financial sector to financial analysts.

The contribution of the financial sector to GDP has in-creased over the past decade and stood at 9.7% during 2011. The contribution of – for example – real estate (6.0%), transport (6.6%) and retail trade (7.2%) are all lower compared to that of the financial sector. However, the general government (16.5%), manufacturing (12.8%) and mining (10.2%) are bigger.

Despite its importance, current information on the performance of the financial sector lags behind:

Statistics SA publishes GDP and employment figures for the sector covering financial intermediation, insurance, real estate and business services with a lag of one quarter and no details about the sector’s financial performance.

The compulsory monthly BA 120 (DI 200 until 2007) returns of banks to and the Annual Report of the Bank Supervision Department of the Reserve Bank, the Quarterly Financial Stability Review of the Financial Stability Department of the Reserve Bank and the Annual Report of the Financial Services Board (FSB) provide detailed information about the performance of banks and other financial institutions, but the information is made public with a lag in time except for the BA 120 returns.

The interim and annual reports of listed financial companies provide information about their performance, but these reports appear at irregular intervals (their release dates depend on the financial year-ends of the different companies) and the results are not always comparable.

The periodic Price Waterhouse Coopers (PWC) Survey, although entirely relevant in relation to its intended target market and ultimate aim, differs fundamentally from the EY financial services survey. The EY survey measures the same performance criteria of financial institutions over time, appears quarterly and the results are obtained by means of short questionnaires.

The quarterly unit trust and bi-annual life insurance reviews of the Association for Savings and Investment SA (ASISA) are useful. However, the unit trust review does not provide information on the financial performance of management companies and the life insurance review is only published twice a year.

The investment performance and strategy of asset managers are measured regularly (e.g. Alexander Forbes and Plexus), but no regular, consistent measure of income and expenditure of asset managers exist.

The international standing of the financial sector survey

The UK, Poland and Switzerland have the longest experience in conducting financial services surveys. In the UK, the Confederation of British Industries (CBI) in London has been conducting comprehensive quarterly financial services surveys in partnership with Price Waterhouse Coopers (PWC) since December 1989. In Poland, the Research Institute for Economic Development (RIED) at the Warsaw School of Economics has been conducting a banking survey since 1999. The Swiss Business Cycle Institute (KOF) in Zurich has been conducting a quarterly banking and insurance survey since the beginning of 2000.

In the USA, the Federal Reserve Bank has been conducting a “Senior Loan Officer Opinion Survey on Bank Lending Practices” for many years, but unlike the UK, Polish and Swiss banking surveys, it focuses on bank lending practices and not the financial performance of the bank sector.

The South African financial services survey is modelled on those of the UK and Switzerland. However, the questionnaire has been adapted for South African conditions and needs. Furthermore, it also includes the questions on credit standards for approving applications for loans and credit lines out of the US “Senior Loan Officer Opinion Survey”.

Ensuring the reliability and accuracy of the financial sector survey

The questionnaire has been designed for maximum efficiency and minimum input time. Only multiple-answer type ticks are required. No figures are requested. For example, participants only have to tick if a particular activity (such as total income or number of people employed) is “up”, “the same” or “down” compared to the same period a year ago and with respect to their South African operations only.

Respondents are carefully selected and approached on the basis of their position in the financial world. The head of retail banking or the head of group life insurance is quizzed and not the chairperson of the board of directors of the group or holding company. Divisional heads tend to be best informed about their business units. The confidentiality of the responses adds to the honesty and candour of participants. Furthermore, respondent quality is monitored.

The same group of participants is surveyed from one quarter to the next. Changes in the results from one quarter to the next can therefore be attributed to an actual change in the performance yardstick in question and not because of the participation – or not – of particular banks, asset managers or life insurers.

South Africa has relatively few banks, asset managers and life insurers. For example, four banks dominate the retail and six the merchant and investment banking sector. Likewise, two companies dominate the life insurance industry. The number of potential participants in a financial sector survey is therefore relatively low in South Africa.

The degree of presentation of the panel of participants has an important impact on the reliability of a quantitative survey, i.e. when respondents have to indicate actual amounts for each activity and the rand value of the level and change are calculated. In contrast, the financial sector survey is a qualitative survey, i.e. the majority view of respondents on a particular activity is taken as an indication of the direction and strength of the trend in that activity. The degree of presentation of the panel of participants is less of a concern in the case of qualitative surveys. Furthermore, the participation – or not – of a particular respondent has less of an impact on the overall results in the case of qualitative surveys compared to quantitative ones, as the view of the majority is established and not the actual size.

The participating retail and investment banks accounted for 95% of total assets of registered banks in December 2007. The value of the total funds under management of the participating asset managers accounted for 63% of the total during the second quarter of 2007.

For reasons of focus, the following financial institutions are not covered, namely short-term insurers, public financial institutions (e.g. the Reserve Bank, Land Bank, Post Bank and official pension and provident funds), medical insurance savings schemes, the informal micro-lending and savings industry, retailers providing credit and individual insurance brokers/agents. The survey also only focuses on the supply of financial services and not on the demand for such services, which stems from government, businesses, households and the rest of the world.

The survey results reveal trends and not actual figures. The net balance statistic is used to interpret the survey results. (See next section for more details on the interpretation of the net balance statistic.) The net balance statistic is the percentage of respondents replying "up" less the percentage replying "down". The percentage of respondents replying "the same" is ignored. Over the years, the net balance statistic has proved to be the most reliable indicator of the direction and size of change in the trend of the respective activities surveyed. The net balance statistic is a qualitative yardstick of the direction and size of the year-on-year growth rate of a particular activity. A positive net balance implies positive year-on-year growth and vice versa. The higher the value of the net balance (positive / negative), the larger the rate of increase / decrease of the activity in question.

To aggregate the sector performance, individual responses are weighted according to their relative size. It makes sense that the response of a small participant has to count less compared to that of a large participant.

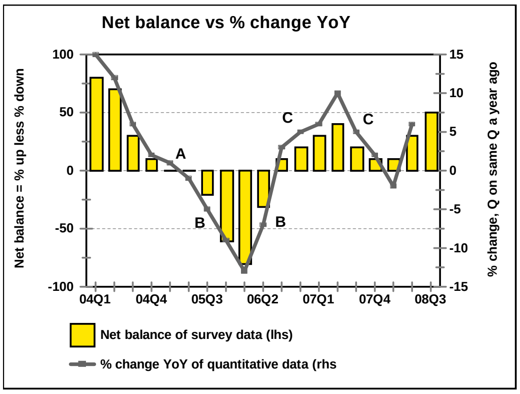
Results are published according to type of activity (e.g. retail banking, investment banking, life insurance and asset management) and not per institution (e.g. ABSA, Investec, Sanlam or Coronation).

How to interpret the net balance statistic

We base our interpretation of the survey results on the net balance statistic. Over the years, the net balance statistic has proved to be the most reliable indicator of the direction and size of change in the trend of the respective activities surveyed.
The net balance statistic is the percentage of respondents replying "up" less the percentage replying "down". The percentage of respondents replying "the same" is ignored. For example, if the percentage of respondents rating the volume of business higher / the same / lower compared to the same period a year ago is as follows:

Higher	Same	Lower	Net balance
70%	10%	20%	50%

Then we can conclude that the majority of participants experienced higher business volumes. A net majority (i.e. the percentage of respondents rating the volume of business higher less the percentage rating the volume lower) of 50% is registered in the above example.



The net balance statistic is an advanced qualitative yardstick / indicator of the direction (up, same or down) and size (small or large) of the year-on-year percentage change of the corresponding quantitative data (if available) of a particular activity. A net balance of zero tends to indicate no growth (marked "A" on the accompanying chart), between 0 and –100 a contraction (marked "B") and between 0 and 100 an expansion (marked "C") compared to the same quarter a year ago. A positive net balance, therefore, implies positive year-on-year growth and vice versa. The higher the value of the net balance (positive / negative), the larger the rate of increase / decrease of the activity in question tend to be.

Note that a net balance of –50%, for instance, is therefore not equivalent to a –50% decline (calculated year-on-year) in the quantitative data series. A net balance of –50% may correspond to –10% in the case of one set of quantitative data and –3% in another case. The net balance and corresponding percentage change in the quantitative data vary from one data set to the next and this relationship could only be established if many data points are available.

Published October 2015

Warning

This material has been prepared for general information purposes only and may not be relied upon as accounting, tax, or other professional advice. EY specifically renounces any liability for reliance on this material by either you or any third party to whom this material may be distributed. Please refer to your advisors for specific advice.

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.