

HR *Quarterly*

October 2015

*A quarterly journal
published by PwC South
Africa, providing
informed commentary
on local and
international
developments in the
Reward arena.*



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Managing talent – food for thought

Finding and retaining the right talent, and simultaneously managing costs, is a perennial challenge for businesses of every size in every sector worldwide. The competition for talent is as fierce as ever, as the global population ages, the nature of work changes and companies look for the skills they need to grow.

Many organisations also lack the sort of information they require to make informed plans and decisions – e.g., information about returns on investment in human capital, staff productivity and employees' views.

What does this mean for your business?

Tackling such issues successfully involves adopting a more strategic approach, based on a powerful employer brand. With better information, companies can also identify the kinds of skills they need, and where they need those skills, to realise their short- and long-term plans.

One key step is to embed and integrate workforce planning into business planning from the start, rather than treating talent as an afterthought. This demands strong board support on talent sourcing and management, and close on-going collaboration between HR and the business.

Put simply, managing and capitalising on talent is no longer a role that can – or should – be left to the HR function alone. Talent strategy and business strategy must go hand in hand. Otherwise, there's likely to be a big gap between what you aim to do and your ability to do it.



How does this impact reward?

Over the last decade there has been increased focus on aligning the reward strategy of the organisation with the longer term business strategy. Most organisations have documented their strategic reward objectives and in some cases communicated this effectively with line managers and employees. The reward strategy provides a best practice context and framework, a set of principles, and a number of guidelines, all of which will guide

HR and reward professionals in the finalisation of a coherent and cohesive set of reward policies within the organisation. It also contributes to good governance and is a pre-requisite for a comprehensive remuneration report.

The question that is often not answered is the measurement of success against the key goals and principles of a reward strategy. More often than not companies are faced with many challenges outside of their control which impacts their ability to achieve the reward strategy objectives. It becomes increasingly difficult to be innovative in the reward arena, more so in a very lacklustre economic climate, but the key to success remains the alignment of employees to the business strategy.

The PwC Reward Team

“Your work is going to fill a large part of your life, and the only way to be truly satisfied is to do what you believe is great work. And the only way to do great work is to love what you do. If you haven't found it yet, keep looking. Don't settle. As with all matters of the heart, you'll know when you find it.” Steve Jobs

Increases and the current economic climate – the never-ending challenge

Are employees out of pocket despite increases being higher than inflation?

In the September 2015 publication of the REMchannel® internet based survey, the average increases anticipated over the next 12 month period are expected to range between 6.3% and 7.5% on basic salary, 5.7% and 7% on flexible package, and 6.5% and 6.9% on total package. However, as can be seen from PwC's September 2015 Salary and Wage Movement report the maximum basic salary increases are in the double digits for a number of the employee categories.

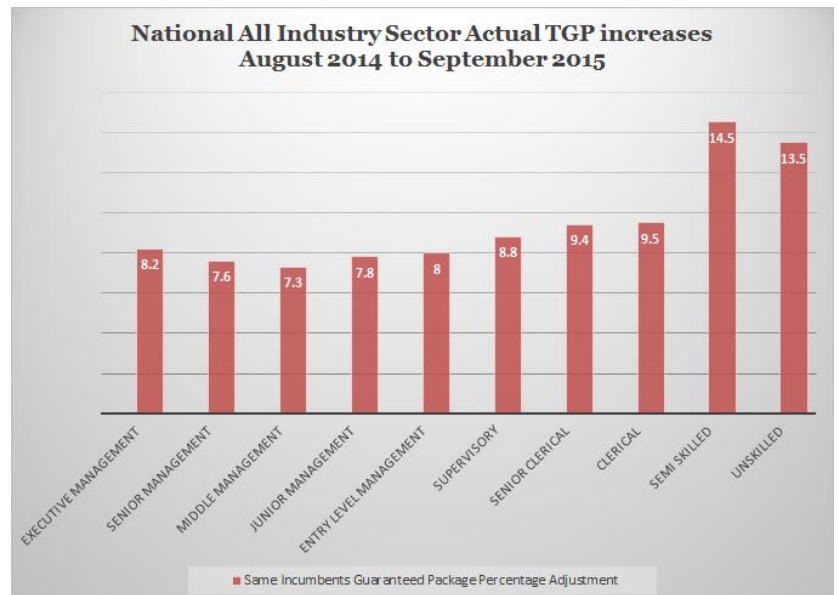
Of real concern is the escalation in the year on year total guaranteed packages of same incumbents as extracted from the REMchannel® internet based survey and demonstrated below. This phenomenon can be attributed to the fact that salary negotiations on basic salary are often in line with anticipated increases but various other benefits are negotiated separately. This is normally at a much higher rate than the negotiated basic salary increase.

Increased salary bills inevitably increases the price of services, production, commodities and ultimately translates into higher inflation rates. On the flip side employees are constantly faced with financial constraints due to the continued decrease in disposable income. This creates an environment where the retention of key talent becomes increasingly difficult as employees will leave for greener pastures if it simply provides them with the ability to sustain their current life-style. It is clear that the implications for talent management are profound. Skills shortages are once again keeping CEO's awake at night and the economic climate is likely to make the

problem worse. This is no time for tinkering at the edges of talent management; the magnitude of the changes underway mean that a fundamental rethink is needed. As reward professionals we know that there are serious talent management challenges ahead. 93% of CEOs say that they recognise the need to change their strategy for attracting and retaining talent. But an enormous 61% have not yet taken the first step. CEOs are well aware that something needs to be done, but are less sure of exactly what that is. The most successful organisations will be those that learn quickly how to harness the opportunities and minimise the risks of South Africa's economic climate.

PwC's bi-annual Salary and Wage Movement survey has been published which will provide organisations with insight into the anticipated increases for the next 12 months. It also covers starting rates of pay for graduates and labour turnover statistics. If you would like to obtain a copy of the latest publication contact

Margie Manners at margie.manners@za.pwc.com or Theresa Kite at theresa.kite@za.pwc.com.



Workforce analytics - business outcomes are inextricably linked to people decisions

Business executives need deeper insight to make better decisions about their people and respond to market challenges.

Forward thinking leaders are increasing the sophistication of their workforce analytics practices to obtain this crucial insight and respond to market and people challenges. Leaders need to understand what drives business results, what will likely happen going forward and how they should respond. This involves moving from standard metrics, reports and benchmarking to advanced analytics solutions.

Workforce analytics can help you to:

- Align and motivate workers to achieve your business strategy
- Structure the workforce/ management to achieve a competitive advantage
- Proactively lead your business and continuously improve the way you work
- Solve complex business issues and seize new opportunities.

For most businesses, people are the largest source of cost and of potential growth and innovation.

Effectively using people analytics to understand the workforce you have, the workforce you need and what will drive your people to perform can provide significant commercial advantage.

As the digital age gets into its stride, increasing volumes of data are available; the challenge is being able to trust, analyse and drive insight from it, in a manageable, repeatable way. This means developing capabilities that have not traditionally existed in the area of people management.

No one has all the answers yet but market leaders are increasingly using data-driven analytics to provide new insights, to build cases for change and to earn HR a valuable seat at the business leadership table.

How are companies responding?

Increasing understanding of workforce composition and alignment to business strategy by conducting data-driven, diagnostic analytic projects

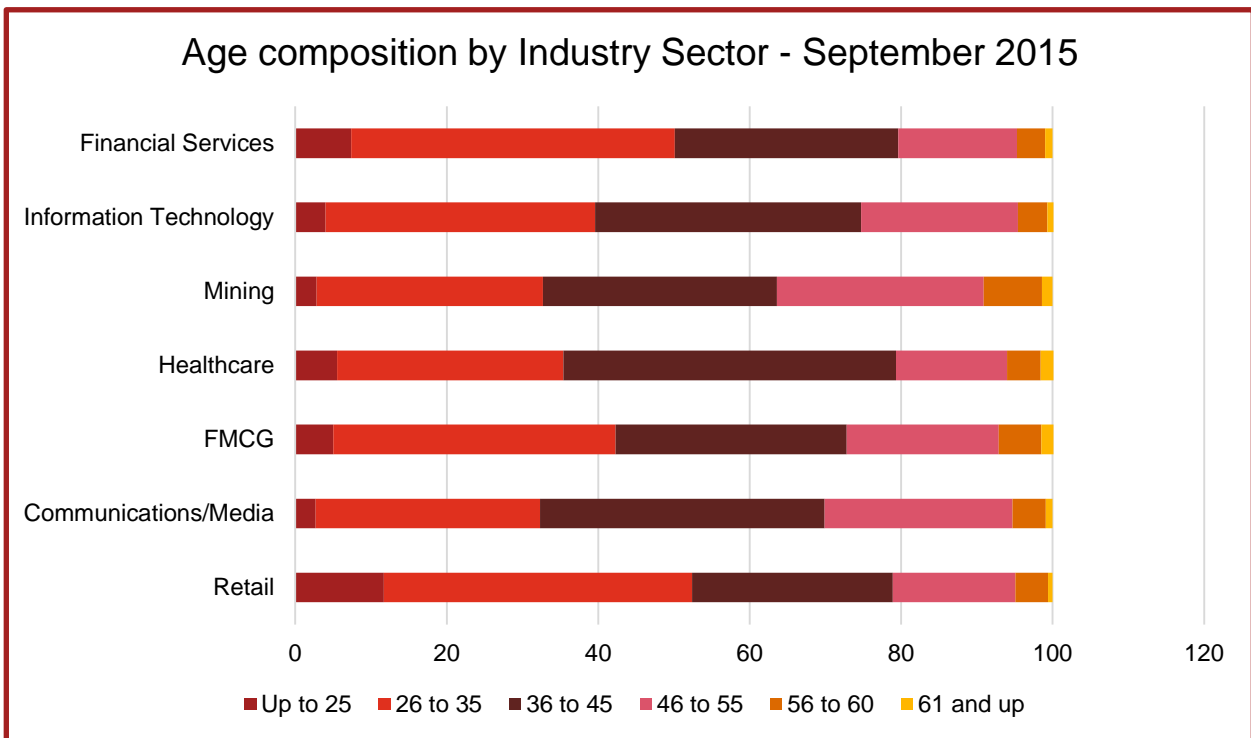
- Improving ability to assess and report on key people issues by determining specific people measures to monitor via interactive dashboards
- Increasing compliance and reducing risk by enhancing the clarity, classification and governance of people data
- Improving data integrity, by implementing consistent people data models and systems architecture
- Increasing understanding of internal data by benchmarking key people metrics between divisions and against external peers
- Improving their ability to coordinate, consolidate and drive value from analytics and reporting by developing people analytics centres of excellence
- Increasing their ability to anticipate people issues that will affect the business and enable mitigating actions to be taken by utilising predictive analytics and strategic workforce planning.



Workforce analytics - business outcomes are inextricably linked to people decisions (cont)

Understanding the age composition of your workforce will form a key part of your decision making process. This specifically relates to how your employee value proposition is structured and ultimately your reward strategy and policies.

The graphical illustration below provides an overview of the age composition for various industry sectors in South Africa as extracted from the REMchannel® on line salary survey as at September 2015.



From this it can be seen that on average 50% of the workforce in the Financial Services, Retail and Fast Moving Consumer Goods industry sectors are up to 35 years of age whilst Mining, Communications/ Media and Healthcare industry sector’s employees are between 36 and 55 years of age.

Employers’ biggest challenge is that employees are increasingly diverse with very different needs and values. We recently surveyed over 2,000 individuals of working age across the UK to gain insight into their views on current and potential employee benefits. The results highlighted a number of differences that should be considered by employers when constructing reward packages. Men and

women perceive benefits differently; views change based on the sector in which we work, and the value we assign to benefits changes as we go through the employment cycle. In short, we all seek different things from our jobs - and reward needs to adapt to that challenge.

The world of work is changing - and while it is more important than ever to have the tools to attract and retain talent, companies are faced with continued pressure on costs and the need to justify their spend on reward. It is a fine balance but rewarding employees appropriately is crucial to enhancing engagement and driving productivity and discretionary effort from employees.

Draft retirement default regulations – understanding the implications for funds in South Africa

On 22 July 2015 National Treasury published the long awaited draft regulations on defaults. These regulations will apply to employer-sponsored retirement funds, umbrella funds and retirement annuity funds. The public consultation period ran until 30 September 2015 after which final regulations will be released.

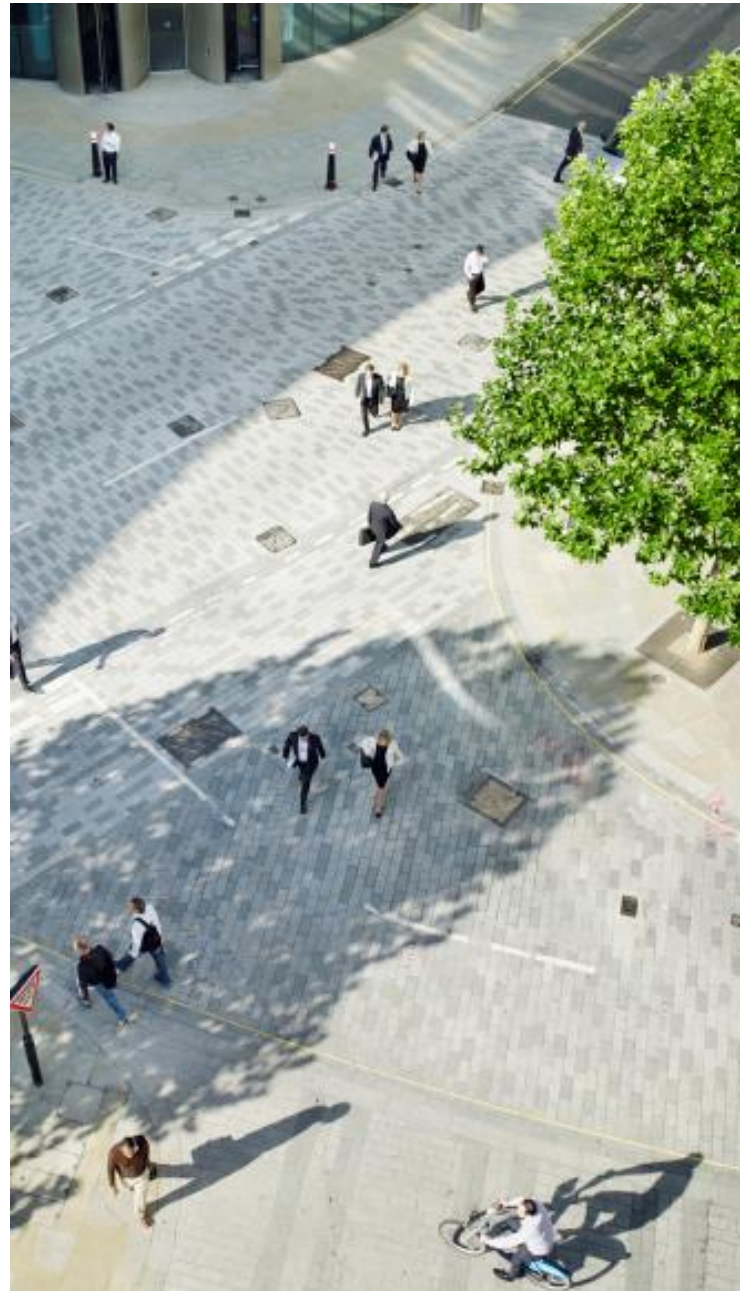
The draft regulations address default investment portfolios, default preservation and portability and default annuity strategies. Importantly, the details of these arrangements must be included in the rules of the funds.

The aims of the default options include:

- Encourage members to make appropriate financial decisions by providing default options that are appropriate for them.
- Reduce the charges in the retirement fund system by removing performance fees and exit penalties on default options.
- Improve confidence in the retirement system by ensuring that the default options are appropriate for the intended membership and increasing the transparency of the options in terms of operation and costs.

Background

The 1990's saw a big shift from defined benefit to defined contribution retirement funds. Today, the vast majority of open retirement funds are defined contribution and to allow members more flexibility to structure their retirement savings plans based on their personal circumstances, individual options such as a selection of investment strategies and portfolios and different contribution rates are offered. As a result, members of retirement funds are faced with several important decisions related to their retirement savings:



Draft retirement default regulations (cont)

- How much to contribute to the retirement fund.
- How to invest these savings.
- What to do with the benefits when changing employment.
- How to invest the savings at retirement in order to provide an adequate lifetime pension.
- Loyalty bonuses, penalties or fees on exit and risk benefits (for example death benefits) may not be included as part of the investment portfolio. The benefit may also not depend on the reason for exit.
- In order to improve transparency and competition, the objective, composition, performance and fees of different investment options must be communicated to members.

However, retirement fund members (and owners of retirement annuities) often lack the necessary financial expertise to make these life-changing decisions.

The published draft regulations aim to address these issues through the implementation of default options. While members may still exercise their own decisions, the defaults will provide an option which is appropriate for them based on their circumstances. It does however require careful consideration from boards of funds on what the defaults for their members should be. Likewise, product providers will have to review the features of their products to meet the requirements.

Default investment portfolios

Members not selecting an investment portfolio will be automatically invested in the default investment portfolio. Most occupational retirement funds (including umbrella funds) already have such a default portfolio in place, but the regulations formalize the specific requirements of these defaults:

- The default must be appropriate for the members who will be enrolled in it, based on the member's preference for risk and return, likely future term in the retirement system, level of financial sophistication and ability to access financial advice.
- The investment fees must be reasonable and competitive, simple (making it easy to understand and compare), performance fees are not allowed and the board must consider a passive investment strategy.

The usual regulatory requirements – compliance with Regulation 28 and regular review of the portfolio – continue to apply to the default.

Default preservation and portability

Currently very few retirement funds made provision for in-fund paid-up members. When leaving a fund before retirement, members usually have to choose whether they want to receive their benefit in cash, transfer it to a preservation fund or to the retirement fund of the new employer (if available). Most members choose to take their benefit in cash.

The new regulations will require retirement funds to set up a paid-up membership section and withdrawing members will be transferred into this section by default. These members will receive a paid-up membership certificate which they can use to transfer their savings to the fund of their new employer. Importantly, all retirement funds will have to accept such transfers for new members.

Retirement funds will also have to provide financial council explaining the default preservation option to these members before they may take their benefits in cash (or transfer the savings to the fund of the new employer).

The benefit of a paid-up defined contribution member must be invested in the default investment portfolio (unless the member selected a different portfolio) and additional requirements apply to paid-up benefits that are defined benefit in nature.

Draft retirement default regulations (cont)

Default annuity strategies

The new regulations are the first indication to the industry of the types of default annuity arrangements that will be allowed and which not. Importantly, trustees need to ensure that the default annuities are appropriate for the members who will automatically be enrolled, based on certain considerations. Some of these considerations may require funds to record more information on their members, for example other retirement savings outside the fund and details of the dependents of the member. It is also likely that different groups of members will require different default annuities and accordingly multiple default annuity structures be put in place.

Similarly to the pre-retirement withdrawal, retirees must be provided with financial counsel before they make their retirement decision. While the counsel is only required to include an explanation of the default annuity, comprehensive personal financial advice is often viewed as the most effective way of ensuring that retirees invest their savings in a product or solution that is appropriate given their particular personal circumstances.

As with the pre-retirement withdrawal, retirees must be provided with financial counsel before they make their retirement decision.

Living annuities

Where funds wish to use living annuities as a default, only in-fund living annuities may be used and retail living annuities are not allowed. Further requirements are set out in the draft regulations.

The relative inflexibility of the in-fund living annuity compared to a retail living annuity (in terms of draw down limits and investment portfolios) may result in retirees preferring retail annuities instead of the in-fund living annuity. On the other hand, the likely lower cost of an in-fund living annuity will make it an attractive option.

In-fund guaranteed annuities

Retirement fund may offer the traditional in-fund pension to retirees, similar to a retail with-profit annuity. These pensions bring a defined benefit element to a fund which may be undesirable for a defined contribution fund.



The second type of pension – introduced in the draft regulations – involves a ring-fenced pool of assets for the pensioners and the level of the pension is based on the amount of assets available. As a result, pensions can increase or decrease on an annual basis as a result of mortality and investment profits or losses.

The introduction of guaranteed pensions on a defined contribution fund may introduce an immediate defined benefit obligation in the balance sheet of the sponsoring employer (depending on the exact arrangement). It is therefore important that the introduction of any form of guaranteed annuity be discussed with the employer.

Draft retirement default regulations (cont)

Retail guaranteed annuities

Guaranteed annuities provided by an insurer may be used as a default annuity on condition that the pension increases are linked to a formula that can be verified independently of the insurer. Inflation-linked annuities meet this requirement but may be expensive compared to with-profit alternatives.

A big concern with the use of retail annuities is the automatic investment of a member's retirement savings in a product which cannot be sold or exchanged for a different benefit or annuity. A fund can negotiate with the insurers to offer a surrender option on the annuities (possibly for a limited period) to allow members sufficient time to make a decision.

Recommendations

While the default investment portfolios are really just a refinement of current investment strategies, default preservation and default annuities will require careful consideration by boards of funds and significant changes to fund administration, rules and member communication. Product providers will also have to evaluate their solutions in light of the requirements.

But the regulations are currently in draft format. In order to prepare for the coming regulations, boards of retirement funds should analyse their membership to enhance their understanding of their members' financial situation and needs.

The default regulations may be the most revolutionary pension fund legislation in South Africa since surplus legislation in the early 2000's and if successful, will go a long way to improve the outcomes of employees at retirement.

Should you require additional information pertaining to the draft regulations contact Niel Gerryts, Associate Director at +27 (21) 529 2189 or +27 (82) 437 8000.

2015 PwC Global Equity Incentive Survey and its application to the South African market

For this year's Global Equity Incentive Survey (GEIS), PwC US teamed up with the National Association of Stock Plan Professionals, to compile the 9th GEIS covering the design and administration of equity incentives for multinational companies. This is one of the most comprehensive surveys available on equity incentives.



This year, approximately 245 companies, headquartered in 12 countries with employees in more than 75 countries, participated in the GEIS. Although the survey focuses on multinational companies that are predominantly headquartered in the US, there are a number of themes that would also be of interest to South African companies and South African multinational companies.

Participation by African subsidiaries

The majority of companies surveyed continue to grant equity-based remuneration to subsidiaries outside of the USs and compared to the 2012 GEIS, there has been an 11% increase in companies offering equity-based remuneration to their foreign

affiliates. This suggests that there is a continuing trend in companies expanding their global equity plans to provide consistent worldwide benefits. The majority of respondents focus their equity grants to employees in North America, Europe and the Asia Pacific region. Looking at Africa, almost 100% of the respondents include only between 0% and 10% of their African subsidiaries in equity plans. This suggests that the granting of equity in Africa is far from an established principle amongst foreign multinational companies.

This practice amongst US multinational companies differs somewhat from PwC South Africa's observations of grant practices amongst South African multinationals: looking at major JSE listed

2015 PwC Global Equity Incentive Survey (cont)

companies, our observation is that approximately 60% of companies extend automatic participation in the equity-based plans to all employees of African subsidiaries who are on eligible grades, regardless of region. The remaining 40% of companies restrict participation based on a combination of either: region, individual performance and/or grade (for example: a number of companies only extend participation in the equity incentives to the most senior employees in a particular subsidiary).

The conclusion that can be drawn is that eligibility is one of the key design considerations, particularly in a region where equity-based plans are not commonly offered.

Performance conditions

As many countries, particularly in the EU, have or are introducing corporate governance legislation similar to the Dodd-Frank Act in the US (i.e. legislation intended to reduce risks and promote corporate transparency), nearly 100% of the respondents in the 2015 GEIS indicated that performance conditions do not differ for US and non-US participants. These practices accord with our observation of performance conditions used by South African companies: Based on our review of the performance conditions attached to equity awards for the top 40 companies listed on the JSE, only 4 out of the top 40 JSE listed companies (10%) make use of business unit measures, either alone or in conjunction with group performance conditions, whereas the remainder only use group performance conditions.

The most challenging tax compliance countries in the GEIS were noted to be the UK, China, France, Australia and India.

Looking more closely at the nature of performance conditions: The GEIS indicates a notable number of companies moving to earnings per share (“EPS”), share price targets, and other return measures, over revenue and other earnings targets (EBIT and EBITDA). The most commonly used measures

historically used (based on the 2012 and 2011 GEIS) have been revenue/growth, followed by EPS, return (e.g. ROE, ROA, ROIC, RONA), and TSR. In 2015, a continuing trend is observed regarding the use of EPS, followed by TSR (absolute), followed by return and relative share price or TSR growth.

As similar decline is not observed in South Africa, where HEPS remains the most popular measure, followed by TSR and return measures.

Tax compliance & recharge arrangements

Achieving global compliance is not without its hurdles in certain countries. The most challenging tax compliance countries in the GEIS were noted to be the UK, China, France, Australia and India. Looking at South African multinational companies, the most common challenges facing these companies with African operations are exchange control restrictions and untested or no legislation governing equity incentives.



2015 PwC Global Equity Incentive Survey (cont)

“sell to cover” method (net share settlement where enough shares are sold to cover the taxes and the remainder is delivered to the employee).

A cost recharge is an arrangement between the headquarter company and its foreign subsidiaries, where the headquarter company charges back the costs associated with equity-based incentives to its foreign subsidiaries. 59% of the GEIS participants indicated that they charge back the cost of equity awards. For companies that chargeback, the reasons include to achieve cash savings (32%), mitigate accounting expense (13%) or to accomplish both (53%). The most common reasons for not charging back (41% are not charging back) are administrative burdens (37%), low headcount where costs are recharged (33%) and that charging back only provides limited tax advantages (32%).

Due to current exchange control restrictions imposed by the South African Reserve Bank (“SARB”), South African employees participating in share plans offered by foreign headquartered companies, will not be allowed to participate if there is a recharge agreement in place. Looking at South African multinational companies - approval must also be sought from the SARB before shares can be offered to employees in foreign subsidiaries and approval for such participation will only be granted if the foreign subsidiary bears the cost (i.e. there should be a corresponding in-flow of cash into South Africa in exchange for the externalisation of a South African asset).

Due to the complexity of equity plans, employees often do not value awards and coupled with a lack of proper communication, this could lead to these plans not serving the intended purpose of retaining and motivating employees.

Administration and communications

The use of a third party administrator is an increasing trend amongst global multinational companies. Currently 75% of companies with equity participants outside the US outsource their plan administration. These outcomes correspond with PwC South Africa’s observations of the trend in South Africa.

Communications are a key consideration if an equity plan is perceived as valuable for employees and successful for a company. The results from the GEIS are as follows: 74% of the participants communicate at every grant date whilst 69% have information always available (intranet website, administer tool etc.). Surprisingly only 35% of companies communicate at vesting. 35% of the participants communicate annually with the total reward package, whilst only 29% of participants communicate at the time of the first grant.

Due to the complexity of equity plans, employees often do not value awards and coupled with a lack of proper communication, this could lead to these plans not serving the intended purpose of retaining and motivating employees. The lack of providing communications drives the belief of the majority of companies (66%) that there is not a strong understanding of plan benefits and further, 67% believe there is not a strong understanding of the mechanics of how to reap benefits outside the US.

Looking at South Africa, we observe a similar trend and the importance of simple and regular communications should not be overlooked.

For further information on the content of the GEIS or in order to obtain an executive summary of the full results or to share insights on share plan design, please contact Karen Crous at karen.crous@za.pwc.com or +27 11 797 4616.

Current and forthcoming attractions

The following thought leadership and survey publications have been released or will be released in the next few months. Should you wish to download a copy of any thought leadership publication, please go to our website www.pwc.co.za and select the “Publications” tab. For enquiries regarding survey publications, please contact Theresa Kite at theresa.kite@za.pwc.com or Margie Manners at margie.manners@za.pwc.com.

Thought Leadership

Annual South African non-executive Director’s Survey: January 2016

Surveys

South African Employee Benefits Guide: December 2015

Salary and Wage Movement Survey: September 2015

Salary and Wage Movement Survey: March 2016



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