Reflecting resilience

South Africa – Major Banks Analysis

PwC analysis of major banks’ results for the reporting period ended 30 June 2021
About this publication

PwC’s Major Banks Analysis highlights key themes from the combined local currency results of Absa, FirstRand, Nedbank and Standard Bank, and incorporates common strategic themes from the other major banks, including Investec and Capitec.

About this publication

- This analysis has been prepared from publicly available information
- The data, charts and figures included are based on the banks’ published results, which are available on their respective websites
- Certain ratios have been recalculated to present comparable six-month results
- Where applicable, amounts and ratios are based on ‘Banking activities’, as published in the respective banks’ results

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SA’s major banks show signs of recovery as they focus on digitally-led strategies

Combined headline earnings of R40.6bn increased 177% against 1H20, combined ROE of 15.4% (5.4% at 1H20), net interest margin of 403 bps (392 bps at 1H20), credit loss ratio of 82 bps (232 bps at 1H20), cost-to-income ratio of 55.9% (55.1% at 1H20)

When the major banks released results at this time last year, it was in the context of unprecedented challenges triggered by the COVID-19 pandemic. Domestically, those challenges came against the backdrop of a laboured economy — one that entered the pandemic having experienced sustained weakness in growth and persistent structural challenges throughout the last decade.

Since then, the major banks have been determinedly focused on ensuring their operational and financial resilience and supporting customers, communities and colleagues. While operating conditions showed marginal improvement in the first half of 2021, the South African economy remains afflicted by several challenges, amplified by new waves of the pandemic, with unemployment having recently reached record highs amid expectations of continued uncertainty. Globally, financial markets were supported by fiscal stimulus and low interest rates over the period, while vaccination rollouts broadened beyond advanced economies.

Against a still challenging backdrop, the major banks delivered resilient results for the period as underlying business momentum and risk profiles performed better than expected. Armed with recent lessons learnt and emerging customer and workforce trends, management teams have focused attention towards reimaging overall bank strategies.

Central themes observed in the major banks’ results include:

- **After a considerable build in provisioning in FY20 and aided by a recovery in credit conditions in 1H21**, headline earnings benefited from sharply lower credit impairment charges across most lending portfolios and customer segments.
- **Record commodity prices supported South African corporate earnings across several key industries** and, in turn, loan performance within wholesale credit portfolios.
- **Regionally, commodity-led economies also benefited from favourable prices**, which aided the performance of the major banks’ subsidiaries in these territories. These gains were partially offset by volatility in exchange rates caused by a stronger rand and continued pressure in tourism-led economies, where significant economic challenges persist.
- **Key balance sheet metrics — including capital, liquidity and provisioning — continued to show resilience.** Together with improved underlying performance trends, we observed a return to double-digit ROE, although not yet at pre-pandemic levels, and dividend declarations by all of the major banks.
• Costs remained tightly managed below CPI growth for the period, benefiting from a stable inflation environment and lower travel and entertainment costs. Some of the major banks implemented property optimisation strategies as they rethink corporate and branch real estate resulting in savings on property costs. Overall, expenses increased moderately due to staff cost increases, bonuses and amortisation/depreciation charges on the back of continued technology investments, including digital offerings.

• Robust growth in banking revenues supported pre-provision operating profit, driven by a combination of heightened client activity, digital transaction volumes and credit demand, albeit off a low base comparatively. Revenue growth was offset by tighter interest margins and negative endowment effects given the low interest rate environment and challenging bancassurance earnings due to heightened mortality and retrenchment claims and higher reserving requirements.

• A client-focused digital banking strategy is now expected as a minimum. But what does it mean? The central challenge for banking in an increasingly competitive environment is increasing relevance to customers. While investments in IT architecture, digital platforms, data and automation continued, the major banks highlighted ambitions to capture learnings from the COVID-19 crisis and transform how they deliver products and services. Various operating models have begun to emerge — ranging from providing end-to-end services alongside underlying financial transactions to creating ecosystems by connecting customers with partners, fintechs and other providers through open architecture, and outsourcing some aspects of the delivery model to strategic delivery partners.

• Board, investor, customer and regulator perceptions of value and risk are changing, with environmental, social and governance (ESG) issues rising rapidly on the agenda. Thinking is moving beyond reporting of climate-related disclosures and ESG policies. The need for a convincing ESG strategy and appropriate performance measurement indicators is now front of mind. While these topics cross industries, the major banks are astutely aware of the shifting dynamics and importance of these areas.
The world is in the midst of an uneven economic recovery. Pandemic-induced aftershocks continued to play out divergently across advanced and emerging economies — and across industries — during 1H21.

Supported by extraordinary monetary policy, fiscal stimulus and relief measures, global economic conditions were generally supportive and made for buoyant equity markets over the period.

Unadjusted real GDP in South Africa for the first six months of 2021 grew 7.5% compared with the corresponding period, while quarter-on-quarter GDP grew 1.2% in Q2-21 following 1.0% growth in Q1-21.

The digitally-led platform journey

Our previous Major Banks Analysis noted that the future of banking will be centred on being purpose-led and platform driven. We observed that real digital transformation — applied toward a specific set of objectives, including rethinking the banking delivery model, boosting productivity, increasing employee engagement and creating a richer customer experience — will result in profound changes in the way banks will be organised and operated in the medium to long term.

These changes are firmly underway.

Accelerated by experiences from the pandemic, digitalisation has blurred lines and challenged traditional ideas of banking, leading to a convergence of industries and changed customer expectations around their relationship with financial services providers. This has triggered varying considerations for banks, customers and regulators.

For banks, this means:

- fostering deeper customer relationships through better understanding of evolving customer needs and behaviour, unlocked by leveraging data analytics across platforms and channels
- adapting the workforce in responding to this challenge is essential. Access to different skills — including engineers, data scientists and softer skills to help sharpen understanding of behavioural economics — is central to the ability to enrich customer experiences
- developing fit-for-purpose products powered through digital platforms and channels
- ultimately, increased customer relevance, deeper meaning in customers’ lives and larger shares of wallet.

All of this challenges existing banking delivery models, the traditional risk universe, organisational and cost structures and the composition of revenue pools.

In response, banks are reimagining how they do business, the products they develop – either by themselves, by co-creating with strategic partners or delivering services in collaboration with or through external providers – and the skills they will need.
Customers will experience:

- banks being able to fulfil a wider range of their evolving needs, far beyond traditional financial services
- customer needs being fulfilled through a combination of banks’ own products or through providing seamless access to services and providers via integrated digital platforms
- ultimately, enhanced customer service, convenience and a combination of the best of digital and human service delivery.

Regulators will need to:

- rethink the traditional risk universe and actively reflect on new and emerging risk types
- consider how banks identify, manage and mitigate existing and emerging risks associated with the evolving digital and platform economy
- develop a deep understanding of the relationships and risks brought about by new partnerships and third-party providers, and how these might impact the bank supervision model.
Major banks’ results highlights

- **Headline earnings**: Driven by a sharp decrease in the combined impairment charge, headline earnings grew 177% against 1H20. Looking beyond risk provisions, however, operating conditions remained challenging as operating income (net interest income and non-interest revenue) grew at a slightly slower rate (1.9%) compared to growth in operating expenses (3.7%).

- **Credit impairments**: Against better than expected credit conditions (including improved collections), the combined income statement impairment charge fell 65.4%, resulting in an improved credit loss ratio of 82 bps (232 bps in 1H20). Non-performing loans fell 1.2% against 2H20 and represented 3.7% of the major banks’ combined loan portfolios (3.8% at 2H20).

- **Revenue**: A clear theme across all of the major banks is that the number of digitally-active clients has further accelerated in all reporting periods since the onset of the pandemic due to a combination of lockdown restrictions and changing customer behaviour. Against 2H19, digitally-active clients have increased 25% on a combined basis, driving up digital transaction volumes. Non-interest revenue grew 0.8% while net interest income grew 2.6% within the context of a lower rate environment and negative endowment effects.

- **Costs**: Operating expenses grew 3.7%, below annual CPI growth of 4.9% in June 2021, largely driven by staff and technology costs. We continue to note the composition of technology spend evolving in line with the nature of the major banks’ increasing investments into cloud computing, data analytics capabilities and platforms to drive personalised customer experiences.

- **ROE and capital**: On the back of a resilient performance in headline earnings due to lower credit impairment charges, the major banks’ combined ROE moved back into double-digits and amounted to 15.4% (5.4% in 1H20), still lower than pre-pandemic levels (17.1% in 2H19). Supported by healthy growth in organic capital through increased profitability and successful Tier 2 placements in capital markets by some banks, the combined total capital adequacy ratio grew to 16.9% (14.5% in 1H20).

- **Liquidity and funding**: Deposits grew 1% supported by healthy growth in shorter-term deposit products, including current and savings accounts across the retail and corporate customer segments, while the combined loan-to-deposit ratio amounted to 87.1% (89.5% in 1H20).

The major banks’ results reflect their considerable efforts in maintaining financial and operational resilience through the COVID-19 crisis, and show positive signs of recovery. As they reflect on lessons learnt, including changing customer expectations in an increasingly competitive environment, the major banks are taking bold steps towards reimaging their strategic ambitions.

— Francois Prinsloo, PwC Africa’s Banking and Capital Markets Leader
Operating conditions are expected to remain challenging through to the end of 2021. Underlying consumer and business confidence levels will be affected by the continued presence of COVID-19, the level of broad-based vaccine take-up and the sharp spike in unemployment levels — which contributed to the sudden outbreak of rioting and looting that took place in parts of the country in July. While the financial effect of these events will be reported in the next results period, broader concerns range from their impact on already deteriorated consumer and investor confidence, the country risk premium and the solutions needed to address the underlying causes.

On a combined average basis, the major banks expect the South African economy to register 3.8% real GDP growth in 2021. Additionally, they are not expecting changes to policy rates for the rest of the year, barring any significant events.

Our economics team expects some pressure on the rate of recovery in Q3-21 due to a combination of adverse effects ranging from the unrest in early July together with the extended level 3 lockdown during that period. The severity of the mid-year pandemic wave and the accompanying strictness of associated lockdowns, will be the primary driver behind the nature and pace of the economic recovery, alongside the prospects of any further load-shedding.

Given this, our modeling points to a growth figure closer to 3.0%. The mediocre quarter-on-quarter real GDP growth seen in 1H21, coupled with the potential negative factors arising in Q3-21, does not encourage strong optimism about how quickly South Africa’s GDP will be back to pre-pandemic levels. Our baseline and downside assumptions also consider a likely fourth wave of infections during the summer holidays.

Regionally and globally, the macroeconomic outlook for 2021 remains mixed and subject to heightened forecast risk. The IMF expects sub-Saharan Africa to grow at 3.4%, weaker than the 6% projected for the rest of the world, amid limited policy space to support the crisis response and recovery in many sub-Saharan countries.

Against this backdrop, most of the major banks commented on their expectations for:

- A muted recovery in aggregate loan growth, while interest margins will continue to be impacted by the low rate environment.
- Non-interest revenue growth, particularly fee and commission income, will be supported by digital transactional volumes as strategic initiatives and digitalisation efforts are further embedded.
- A return of some discretionary spend and focus on implementing strategic ambitions will see expense growth, albeit in a continued context of tight cost control.
- Capital, liquidity and provisioning metrics, including regulatory required ratios, are expected to remain well managed.
More broadly, the determination to reimagine overall bank strategy is likely to be an area of intense management and board focus in coming months. Key themes that we see emerging include:

- The digital response to COVID-19 and level of acceleration in customer attitudes to how they engage with banks will prompt consideration of how best to maintain the rate of digital change and embed learnings.
- Finding an optimal workforce cadence and designing the ideal people and skills strategy as talent may become more global instead of local and regional.
- Articulating a clear purpose and where they stand on ESG issues is likely to be key, not just for the major banks external stakeholders, but also for a talent pool for whom these issues increasingly resonate.
- It is likely that those institutions that actively supported customers and communities over the worst phases of the pandemic enjoyed a trust premium. Finding ways to actively maintain this trust premium while balancing growth targets will also be a critical area of focus.

Navigating uncertainty with agility has emerged as a clear strength of the major banks. The trend towards embedding innovative, digitally-led banking delivery models holds promise for customers, and for financial services more broadly. Looking ahead, while forecast risk in a volatile environment will remain elevated, the major banks are focused on futuristic ambitions that seek to sustain and increase their relevance to customers.

—Rivaan Roopnarain, PwC Africa Banking Partner
Appendix A: Analysis of financial results

Figure 1: GDP and headline earnings growth

- On a rolling six-month basis, we continue to observe a strong directional relationship between the major banks’ combined headline earnings growth and South African GDP growth.
- Benefitting from sharply lower credit impairment charges, headline earnings grew 177% against 1H20, but remained below pre-pandemic levels.
Gross loans and advances growth was largely muted over the period, growing 0.8% against 2H20.

Credit portfolios that exhibited resilient growth were primarily related to corporate and investment banking, with retail portfolios showing muted growth across mortgages, vehicle and asset finance and credit cards (growing 0.5%, 0.9% and 1%, respectively).

The combined net interest margin grew to 403 bps (392 bps at 1H20; 383 at 2H20), offset by negative endowment effects given the lower interest rate environment.

Operating expenses grew 3.7% against 1H20, a lower rate than CPI growth for the period. The nature of spending is slowly moving away from in-house IT development and physical hardware towards cloud computing, AI, skills development and new ways of working.

Overall headcount remained relatively stable with slight reductions due to natural attrition, with employee-related expenses being directed towards equipping staff with the right skills to deliver on digitally-led business models.
FSR’s ROE reflects a six-month recalculated ratio.

Driven by strong earnings growth and relatively lower credit RWAs, the Common Equity Tier 1 ratio of the major banks improved to 13.2% (11.2% at 1H20 and 12.3% at 2H20), while the total capital adequacy ratio improved to 16.9% (14.5% at 1H20 and 15.3% at 2H20), well above regulatory required levels and at the middle-to-upper end of board targets.

A year ago, the major banks did not make any dividend payments due to a combination of regulatory guidance and a focus on capital preservation. This had the effect of supporting capital levels and creating further risk capacity throughout the period leading up to 1H21.
Figure 5: Stage 3 (NPL) Coverage

Source: PwC analysis

Figure 6: Performing portfolio coverage

Source: PwC analysis
The combined credit loss ratio declined to 82 bps from 232 bps at 1H20 (129 bps at 2H20). Declines in credit impairment charges are primarily due to an improvement in economic outlook, better than expected collections experience, less onerous lockdowns and a clearer understanding of industry-specific impacts as a result of the pandemic.

Digitally-active client numbers have been on a steady growth path, catalysed by evolving customer expectations, and grew 25% against 2H19. Client acquisition over the last 15–18 months has primarily been through digital channels, contributing to a higher proportion of digitally-active clients as a percentage of the overall client portfolio.
### Appendix B: Key banking statistics – 1H21

#### Key banking statistics – 1H21

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<th>SBK</th>
<th>Combined/Average</th>
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<td>Total assets</td>
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<td>1,525,964</td>
<td>1,560,996</td>
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<td>Gross loans and advances</td>
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<td>Total deposits</td>
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<td>Loan-to-deposit ratio</td>
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<td>Net interest income</td>
<td>25,585</td>
<td>24,718</td>
<td>24,072</td>
<td>23,639</td>
<td>32,494</td>
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<td>Non-interest revenue</td>
<td>15,625</td>
<td>16,586</td>
<td>16,006</td>
<td>17,251</td>
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<td>Operating income</td>
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<td>41,304</td>
<td>40,078</td>
<td>40,890</td>
<td>54,291</td>
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<td>Operating expenses</td>
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<td>-23,963</td>
<td>-21,613</td>
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<td>Pre-provision operating profit</td>
<td>18,605</td>
<td>17,341</td>
<td>18,465</td>
<td>17,522</td>
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<td>-14,661</td>
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<td>-912</td>
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<td>Return on equity (ROE)</td>
<td>15.3%</td>
<td>11.8%</td>
<td>2.6%</td>
<td>15.2%</td>
<td>21.2%</td>
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<td>Cost-to-income ratio</td>
<td>54.9%</td>
<td>58.1%</td>
<td>53.9%</td>
<td>59.3%</td>
<td>52.0%</td>
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<td>Credit loss ratio (CLR)</td>
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<td>1.1%</td>
<td>2.8%</td>
<td>0.8%</td>
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<td>Net interest margin (NIM)</td>
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<td>CET 1</td>
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<td>11.7%</td>
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<td>Tier 2</td>
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<td>2.8%</td>
<td>3.0%</td>
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<td>Total CAR</td>
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<td>15.0%</td>
<td>14.7%</td>
<td>15.6%</td>
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- Prior period restatements have not been adjusted for
- Ratios and income statement amounts have been recalculated in certain instances to reflect six-month periods
Appendix C: Our recent thought leadership

2020 Zambia Bank and Non-Bank Industry Survey: August 2021

This is our fifth edition of the survey and we are extremely excited to have been able to produce this report during a very difficult time for the industry.

Businesses in Zambia have faced unprecedented challenges over the last 18 months. The scale of difficulty brought about by the COVID-19 pandemic has tested the resilience of financial institutions unlike anything encountered in living memory.

This, coupled with an already weak domestic economy, has affected almost every aspect of business operations and exposed a plethora of risks — both old and new — for banks and non-bank organisations.

Despite these recent challenges, it is encouraging to see that financial institutions are increasingly positive in their outlook for the sector over the short, medium and long term.

This year, we have expanded our report to include insights from the chief executive officers of Zambia's commercial banks. Their valuable contribution supplements the responses of the banks’ chief financial officers and sits alongside those from non-bank financial institutions.

Payments 2025 & beyond: Navigating the payments matrix

The financial services industry is in the midst of a significant transformation, accelerated by the COVID-19 pandemic. Given the key role digitalisation plays in the financial lives of more and more of the world’s population, electronic payments are at the epicentre of this transformation.

Payments are becoming increasingly cashless and the industry’s role in fostering inclusion has become a significant priority. Payments are also supporting the development of digital economies and driving innovation — all while functioning as a stable backbone for our economies.

We are therefore delighted that the first report we are launching in our 2025 & Beyond series focuses on the payments industry and the key themes that are influencing it. How the industry responds to these trends will define how successful it is in the coming years and its impact on society overall.
IFRS 17: Transition Survey

All insurance companies reporting under the International Financial Reporting Standards (IFRS) will be impacted by the new IFRS 17 standard. IFRS 17 represents a fundamental change in the valuation of insurance obligations and will have major implications for existing financial reporting and operations.

PwC surveyed insurers in order to gain further insight into the current status of their IFRS 17 implementations. The focus was on technical accounting, financial impact, overall programme management and the effect on data and systems.

Eighteen insurance companies, including some of the largest insurers in the world, participated in the survey conducted between the end of April and the beginning of June 2021.

The future of advice and engagement in insurance

Many South African financial services organisations are focusing on improving their customer and intermediary experiences through the application of technology. To truly differentiate themselves and build the winning business of tomorrow, providers need to:

- define their purpose as part of the brand, clearly outline the measurable change they want to drive and the outcomes needed to improve
- develop a coherent customer and advice strategy using fit-for-purpose distribution and target-state architecture
- Reshape product propositions based on deep customer and behavioural insights and relevance
- Embrace more agile ways of work using new skills, new mindsets and co-creation with customers and brokers
- adopt a progressive approach to compliance by not only doing the right thing, but also through 'being seen to do the right thing' by those they are providing a service to.

Executive directors: Practices and remuneration trends report 2021

The effects of COVID-19 have dominated the headlines and conversations locally and globally. It is difficult to know what the future holds as organisations continue their journey to recovery and stabilisation and what effect COVID-19 and other megatrends will have on reward practices globally and in South Africa. While many see change coming, boards and management may not have started thinking about the opportunities presented by a post-pandemic environment and the corresponding actions they should be taking within the context of remuneration.

The report analyses executive pay during the period from 1 March 2020 to 28 February 2021, focusing primarily on executive remuneration among companies listed on the Johannesburg Stock Exchange (JSE). The report also includes high-level analyses of companies listed on seven selected sub-Saharan African stock exchanges.
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