

**Theoretical State Aid
To Raise New Student Funding for Higher
Education in South Africa**

An Asset Management & Common
Loan Vending Proposal Authored by
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INTRODUCTION

- The State President invited SA citizens and private sector in 2016, in September to come forward with proposals that can overcome the challenges and financial pressures, facing students at universities and technical colleges. Politicians were providing dubious statements of support for 'free education' without any roadmap of how it can be achieved.
- I am a Strategic Business Advisor with some knowledge of putting together BBEE transactions and working with trade union pension and investment companies. In my line of work you treat debt as an asset class and put an economic model to an idea.
- The trade unions in SA probably control about R 900 Billion-R1,2 Trillion in pension funds, directly or indirectly, through their investment companies and pension fund administrators. For the most part they are non-active investors, with a passive voice as to how to advance that economic power, for the national cause.

INTRODUCTION

- Some R 2,7 Trillion in SA is also invested in unit trusts and the two major stakeholders are pension funds and insurance companies.
- In addition, the **Public Investment Corporation** , which represent the pensions of about **1,2 million state employees**, administer assets of about ZA R **1,9 Trillion** worth of assets under management, on behalf of 1,2 million state employees.
- But those assets combined would be equal to all the assets held by commercial banks jointly, or 3 times the budget of the Republic of SA.
- Therein lies a potential roadmap, how you could ignite a platform to double our investment in higher education, using private sector capital. And you do not need a riot or burn any university building to achieve that.

INTRODUCTION

- Granted, collective savings, such as pension funds, are subjected to restrictions from the Financial Services Board, to avoid abusive behaviour that would be adversarial to the economic interest of the republic.
- But some financial engineering is needed to meet the serious challenges facing our society and there is an answer in the capacity illustrated above. That to me is a catalyst for proactive participation in developmental banking.

PREAMBLE

- The purpose of this proposal is to address the vacuum in student funding in a way, where it put less direct stress on the state and the tax payers, to fund higher education through '**theoretical state aid**'.
- Economists suggest broadly, free higher learning is only possible if VAT goes up, which will hurt the poor. Further PAYE and corporate tax will have to increase from 41% to 50%, which will have a domino effect on the capital and brain drain from this country. It would seem to be foolish to make 75% of the nation (about 40 Million people) who are stuck in a poverty trap, even poorer with higher taxation, in a panic reaction to appease the student population.

PREAMBLE

- **Theoretical state aid**, in my opinion is an appropriate response. The term was coined in Europe, when the EU economy almost went off track, in 2013. The EU faced colossal debt burden of US \$ **13 Trillion** in bad loans. The direct consequence was
 - Greece became the first country, in Post World War II, which became bankrupt.
 - Italy, Spain, Portugal and Ireland were potentially sliding in the same direction and also applied for varying degrees of financial assistance from the EU Central bank.
 - The European Central Bank jumped in with theoretical state aid or otherwise known as invisible state intervention.

PREAMBLE

- Banking liquidity rules changed to prevent the state from being the sole risk manager which introduced new asset classes known as TIER 3 within Basil III rules. This had an impact on the liquidity of banks, worldwide, including their subsidiaries in SA.
- It caused the beginning of disintegration of European unity, which caused Britain to break away from EU in 2016.

PREAMBLE

- The EU debt burden was a colossal economic and political crisis and was successfully reduced to a manageable problem through theoretical state aid, where private banks and governments held hands, in order to avert the most serious economic crisis in human history.
- The Europeans opted to rise up and the outcome was good. They expressed their political will through financial engineering, to address a crisis or market need, led by the private sector, where the strong arm of the state's fiscal capability only acts as a soft landing, to meet abnormal risks.

PREAMBLE

- But the part played by private sector market forces, was indispensable in the process. In other words, the EU governments did not say we will solve this problem. They said we will create the systems so that banks can solve the problem.
- Today in South Africa, I propose we only need the state as catalyst, to address abnormal risks, as opposed to being the sole funding wholesaler, retailer and insurer of higher education funding. What we need is **theoretical state aid**, as opposed to the present model, which has proven to be problematic, given other social and fiscal needs to combat poverty.

NATIONAL TREASURY AND GDP SPEND

- So I therefore wrote to the National Treasury on November 16th 2015. I received this response from National Treasury in the same month of November 2015.
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- Mr van Wyk:
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- “Thank you very much for your thoughtful contribution on this matter. One of the positive outcomes of the process has been the number of new ideas that have been generated. As you might imagine, we are very busy trying to respond to many issues including the financial structuring of student loans along the lines you suggest. Your email will also help us to think through some of the questions.” Best regards, **Mr. Mike Sachs**
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NATIONAL TREASURE AND GDP SPEND

- To my mind, the National Treasury we will deal with #FeesMustFall for the next 10 years, unless something dramatic happens in dealing with the core crisis. That crisis is that the percentage of investment that goes into Higher Learning (said to be about **0,71%** of GDP) must increase higher than the rate of real inflation. Increase per capita spending on university education must beat inflation (both visible and invisible)
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- This means that university fees cannot indefinitely and artificially be suppressed, without affecting the quality of education in the long run, anyway.
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- Secondly you have to deal with **student debt** as a **manageable risk**, like any other financial product. Part of the inflationary pressures is to tax current and future students, to subsidize historical debt of people that cannot pay or refuse to pay, for whatever reason. This is a core misunderstood backbone to the conflict.

NATIONAL TREASURY AND GDP SPEND

- Local universities seem to be stuck in a government hand-out mind set, from which it is unwilling to liberate itself. This paper shows how this mind-set can be changed.
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- Your problem in the National Treasury is that two conflicting voices which resonates upon the ministry. One voice from politicians say “borrow”, to appease the electorate and fund dysfunctional state owned enterprises. In 2002 state borrowing was at 27% of the GDP. Today it is approaching 51%. Greece borrowed up to 105% of their GDP and today it is a nation living on hand-outs from other EU states. The greatest export from Greece, a nation that can trace its history over 5,000 years, is human capital. Their young graduates and professional class are emigrating from Greece by the thousands and it is an unstoppable wave of human movement not seen since the Second World War.

NATIONAL TREASURY AND GDP SPEND

- Another voice resonating in National treasury says, let's get the fundamentals right so we can create wealth through economic growth.
- Our economic model is different to Europe and our Apartheid heritage created a legacy of poverty, which pose a threat to civil order. It may take about 15 years of GDP, at a minimum growth rate of 5% just to get the poverty trap balanced. It takes about 22 years to double the economic size of the country. This can only be shortened by increasing the annual growth rate of GDP.

NO SUCH THING AS FREE EDUCATION

- We need to create an enormous amount of wealth and the state cannot see to everything that must be “free”.
- There is an element of entitlement culture in student demands.
- I do not specifically wish to go into the race narrative, but this card is often overplayed to the point, where it insinuates an entitlement culture. Regrettably, the entitlement culture is at the heart of the students approach, how to solve their funding problems, but at whose expense?
- The deficit and shortcomings of a new economic order which has as its theme restorative justice, is one thing. Once it is accompanied by anger then fiscal prudence often falls out of the bus.
- In reality, there is no such thing as “free education” anywhere in the world! There are massively subsidized education in countries like Sweden, Norway and Germany, but it is not free. Let’s look at the invisible costs.

NO SUCH THING AS FREE EDUCATION

- Their citizens' tax burden is so high, to pay for educational subsidies, that every corporate with an income above \$ 100 million, creates offshore service companies in tax heavens like **Isle of Man, Luxembourg, Cyprus, Hong Kong** and The **Caribbean**, to escape their high tax regimes.
- There are about US \$ **15Trillion** invested in these tax havens. Most of this money, in turn, is borrowed to the US Treasury, through untraceable bonds and capital market instruments.
- This practice dilutes the originating nation's forex reserves and fiscal strength. In Europe today you have the real economy with hard assets, working parallel with a virtual economy, with invisible offshore cash. That in itself is one of the main causes of the European debt crisis.

NO SUCH THING AS FREE EDUCATION

- In addition, their most educated citizens, who are mainly young graduates, migrate between member states of the EU taking up job posts, where they have lesser taxation.

NO SUCH THING AS FREE EDUCATION

- So the cost of free education in some European nations is horrifically illustrated in the above scary scenario. Can SA go the same route as Europe with punitive taxes?
- In SA we cannot subsidize higher education 100% by simply increasing taxes. We will:
- Force our private and listed companies to set up head offices and service companies overseas, with the sole objective of extracting capital from their local subsidiaries, to escape punitive taxes, as is the case in Europe today.
- The brain drain from SA will exacerbate.
- FDI will decrease
- Offshore investment by local asset classes such as unit trust and other hedge funds will increase

NO SUCH THING AS FREE EDUCATION

- To jeopardize the SA economy in this way, to appease students, which represents **1,8%** of the population, would be a fundamental flaw.
- To achieve a growth rate of 5% our skills levels would need to double. For this reason the plight of the students cannot be dismissed and should never be weighted lightly. More people will have to be brought into the higher educational system, as opposed to constricting the system to those who can get loans and cash to pay for it. This is where theoretical state aid must step in.
- The private sector has about **R 2,5 trillion** to invest in the economy every year, if the political will existed. So there is no shortage of resources. What is lacking is an un-dubious government policy how student funding risks are mitigated.
- Once the state has the will to test this route, what would then be needed is a regime of financial engineering, which entice the private sector to come to the party, out of their own free will, because it would make economic sense.

NO SUCH THING AS FREE EDUCATION

- That is only possible if the negative connotation about market risk, is removed from the student lending market place.
- It is also very important to consider what impact so-called "free higher education" will have in terms of refugee flow into South Africa, to avoid future xenophobic incidents. In the primary and high school sector, scarcity of seats and availability of spaces are exacerbated by an influx of 'educational migrants'.
- These are citizens from neighbouring territories, with relatives or friends in the republic, who send their children here specifically to enter SA schooling systems. At the opening of schools in January 21% of school citizens in Gauteng were still floating from school to school to look for places. It causes immense pressure on the schooling system for the past 5 years. No regulatory framework exists to deal with this problem.

NATIONAL CREDIT ACT & THE CHALLENGE OF OVER INDEBTEDNESS

- This paper suggests, we have to institute that risk management system in the student loan market and we will solve the student fees crisis.
- Some may argue that it means that we will create a generation of indebted students.
- Does human capital investment constitute irresponsible lending, in terms of the National Credit Act? No. It is an investment in skilling the nation, like never before. Irresponsible lending is taking place in the non-asset consumer and agricultural markets by most listed financial institutions, even today, despite the NCA.

NATIONAL CREDIT ACT & CHALLENGE OF OVER INDEBTEDNESS

- It would also flush out grey area activities whereby collection agencies and wealthy law firms abuse students, by acting on behalf of loan vendors and universities. These collection agencies and law firms are exploiting confusion in the credit market around
 - The correct interpretation of section 103 (5) of the National Credit Act, in respect of conflicting interpretations of the statutory in duplum rule.
 - There are also abuses which ignores the Prescriptions Act in the student loan recovery system.
 - Universities are not registered Credit Providers, in terms of the **National Credit Act of 2008**. They must get out of the practise of providing student loans.
 - No university has registered as a bank with the Reserve Bank either, but their collection agencies calculate interest and admin charges as if they are banks.
 - An added problem is that most of that money from very poor ex-students, collected by collection agencies, does not end up with the university, but is gobbled up to pay administration, collection fees and commissions by wealthy lawyers and their collections agencies. What is the point then?

NATIONAL CREDIT ACT & CHALLENGE OF OVER INDEBTEDNESS

- The collection agencies use adverse credit bureaus data listing as a tool to enforce credit agreement compliance. This is also a problem in the student lending market. Adverse credit data can make it difficult for graduates to enter the job market. The credit history of job seekers, including graduates, is nowadays used as a yard stick to gain employment.
- Regulatory protection against adverse credit bureau listing against students may be necessary.
- The National Credit Regulator has not devoted significant attention to the student loan market. Obviously they only act on complaints from consumer society, but now that we are reviewing the matter of student finance, a case for engagement on the matter, with the regulator exists.

NATIONAL CREDIT ACT & CHALLENGE OF OVER INDEBTEDNESS

- My added proposal in regard to diffusing over indebtedness is this.
 - Employers will have to be given a tax incentive to buy up the student debt, as part of the recruitment package once graduates find employment. This is only applicable to people they recruit and provide employment in permanent job placements.
 - SARS, Department of Labour, National Treasury and trade unions will have to give some input here.
 - The Skills Levy Fund could ring-fence or reinsure the employer, should the worker terminate their employment or are fired.
- Both the middle income market and the low income market can be sufficiently catered for in this theoretical state aid system.

NATIONAL CREDIT ACT & CHALLENGE OF OVER INDEBTEDNESS

- The new asset management company can guarantee new loans (outside the bad bank debt)
 - The asset management company guarantee will be equalled with a NSFAS guarantee (on a 50/50 basis) which theoretically is state aid, only if and when required.
 - The credit line insurance from the asset management company and NSFAS, only becomes a last resort by banks and other vendors.
 - The loan vendor as registered financial institutions, would still require to apply risk management tools, policies and recovery procedure, before they can resort to the guarantee, as is the case with their other banking products.
 - The asset management company than buy out the loan at a discounted or insured rate and seek to realize the loan from the consumer/student.
 - Again the clear benefit is a clear loan recovery strategy so that financial institutions can enter the market energetically and with confidence.

PROVEN RECENT STATE EXPERIENCE IN THEORETICAL STATE AID

- Theoretical state aid only crystalize, as a last resort when the private sector has no other recourse.
- Student higher funding, however, is not a very unmanageable crisis. Lets give it some perspective:
 - Bad loans in the **agricultural sector** tops about **R 135 Billion**.
 - In the **non-asset loan** and consumer debt sector, bad loans tops over **R 350 Billion**.
 - At any point and time, delinquent and bad loans in the home-loan market (which are loans in arrears for more than 3 months) tops about **R 300 Billion**.
- Yet, bank share value is increasing and the banks are growing robustly, because they have risk management mechanisms in place to manage it.
- The latter, is still a hangover from the period 2002-2012, when about R 2,5 Trillion of non-asset and personal loans was borrowed by consumers from banks.

PROVEN RECENT STATE EXPERIENCE IN THEORETICAL STATE AID

- An illustration of the consumer lending crisis and a prime example of theoretical state aid was when **African Bank Limited's** share value was wiped out by jittery investors, overcome by fears that the bank's bad loan book will wipe out their investments.
- Their fears and adverse actions resulted in exactly that, when a run on the bank caused it to collapse in 2014.
- The state through the Reserve Bank, as the competent authority, jumped in and pumped **R 13 Billion** into the bank, on a Sunday morning when government offices were closed, before appointing a curator the following Monday morning.
- All that money has been paid back to the state in 2016. African Bank intends to relist on the JSE, under new management.
- Just imagine the state sat back, folded its arms and allowed the bank to be stripped to the bone. It would have had a domino effect on all other commercial banks through sheer panic by foreign investors.

BAD BANK FORMATION

- My proposal therefore is to create a **bad bank** to be ready to tackle current and future bad debt dilemmas in student funding, by way of a single **asset management** company to manage the debt.
- Universities, banks and NSFAS can transfer loans to this asset company in order to clean the bad loans slate. Slow paying loans and delinquent accounts may top about **R 24 Billion** in the NSFAS system, universities and bank sector, jointly.
- Banks are commercially self-insured through cell insurance companies for bad debt, so it does not concern them too much. Universities and NSFAS are not self-insured and have no soft landing cushion against loan delinquency.
- Because there is no hedge against this asset class, they are only reliant on government hand-outs and can for example not raise their own bonds or swap debt on the capital market.
- Credit default swap contracts are the preferred method of insurance favoured by investors, as bondholders.

BAD BANK FORMATION

- In that case it is a bottomless pit for the state and the tax payers.
- Once the current slate is cleaned, new funds can be advanced and raised for the student loan market, which can top R 150 Billion-R 250 Billion over 5 years.
- The benefits of a new single policy approach in the student loan vending system, would include universal clarity on theoretical state aid and potentially confusing different approaches in the private sector, about student loan products and recourse.
- A minimum target of R 150 Billion-R 250 Billion over 5 years can be set, at today's money, as new money coming into the student loan system. This money will be raised on special commercial terms from banks and other agencies mentioned above.
- Everybody should be included in the new system of theoretical state aid. The economy needs skills and race is often irrelevant in equipping the professionals, that must lead the country onto a higher trajectory of economic growth.

GOOD BANK

- I further propose the asset company should raise capital in the debt and bond market to invest in a good bank, which will be gradable corporate paper, or listed assets.
- The dividends thereof must both repay the principal bonds (debt) as well as infuse capital into a self-insured cell to underwrite the bad loan book (of the bad bank) until it is possible to sell portions of the loan book on the wholesale markets.
- The asset company will exchange and discount the loan books from subscribers (i.e. universities, NSFAS and commercial bank) at a predetermined discount rate, by way of exchanging shares in a good bank.
- The state must guarantee 50% of the discounted rate by way of loans, partnerships and bonds from any of the following developmental fiscal structures:

GOOD BANK

- the Reserve Bank
- Development Bank of SA
- Industrial Development Corporation
- BRICS Bank
- Public Investment Corporation
- Common Wealthy Development Bank
- Trade Union Pension Funds
- Commercial banks and other financial institutions
- Insurers and reinsurers
- Multilateral development agencies
- A sovereign instrument which can be constricted and pegged against BRICS member currencies only. This is an ideal new product which can be used as a source of funding for a state guarantee to NSFAS. NSFAS in turn can use the guarantee to raise billions of new money in the capital markets for student loans.

GOOD BANK

- The other 50% will be equity to be given to subscribers like NSFAS and universities, in the asset management company, which will manage the loan books.
- The asset management company will set up a new loan administration system or strip the capacity from NSFAS, or work in conjunction with their current debt recovery system to manage the loan books. The will to recover state aid may not reside in NSFAS at the current time. NSFAS philosophy is that of a developmental agency not as loan vending agency. This presents a problem in the loan recovery process.
- Proceeds from the loan book will go into paying back bonds and a cell insurance company to insure up to 50% of future loans.

GOOD BANK OPPORTUNITY

- There is an opportunity in the market place, which may enhance the good bank theory.
- The largest bank in Southern Africa, operates in 11 African countries and has a market valuation of about ZA **R 132 Billion**.
- This bank is part of a British banking group.
- The UK parent has publicly advertised that it wish to sell their **62,5%** stake in its local subsidiary in the first quarter of this year.
- About **12%** of this stake 62,5% stake was sold in March, 2016, at R 130 per share.
- The remaining **50,2%** is on offer and there are at least two consortia trying to buy that 50,2% stake from the British banking group.
- One consortium, based in London, is led by **Bob Diamond**, through his **Atlas Merchant Capital (AMC)** AMC has a market valuation of about US **\$ 2 Billion**, too small to buy the SA bank. They are relying on US Carlyle capital to do the deal.
- The second bid is led by the **Public Investment Corporation (PIC)** in SA together with consortia of other BBEE partners. Any bidder will need about **R 66 Billion** to buy the bank.

GOOD BANK OPPORTUNITY

- The PIC is the second largest investor in the bank with an **8%** stake. Trade union investment companies have a further 4% stake.
- It is conceivable, that the proposed asset management company which can initially be composed of universities, trade union investment companies and NSFAS, form a **Special Purpose Vehicle (SPV)** to buy a stake in the local subsidiary of the British Bank, as part of its “good bank” strategy.
- A state entity can act as a technical partner to warehouse the shares until the affected partners are able to convert them.
- To own more than 15% of any SA bank regulator approval is required from the Regulator (SA Reserve Bank)
- If the investor owns more than 50% of a local bank, the Minister of Finance needs to give his approval.
- BASIL III which came about after the European debt crisis. It requires new global banking rules affecting liquidity and the responsibility of shareholders. This will require a technical
- discussion that must take place with stakeholders and the SA Reserve Bank, i.t.o. local adaption of these rules, if and when applicable.

GOING FORWARD

- A **technical team** joined by National Treasury, Education Department, Reserve Bank, DTI and affected investors will require to be established on acquisition or establishment of a 'good bank' and bad bank.
- Thereafter a broader technical workshop must be held, with key governmental and private sector role players first, to define common ground on risk mitigation and how theoretical state aid can be shaped to achieve it, through the creation of a good and a bad bank, as contemplated by the technical committee as per 1, above. This may have to be a 2 days workshop and it should be restricted to no more than 100 participants from:
 - Dept of the Presidency
 - National Treasury
 - Department of Higher Education
 - Department of Trade & Industry
 - Department of Economic Development
 - Department of Labour

GOING FORWARD

- National Credit Regulator
- SA Reserve Bank
- Universities Councils
- SA Banking Council
- SA Development Bank
- BRICS Bank
- Trade Union Pension fund representatives
- Public Investment Corporation
- NSFAS
- SARS
- Credit Guarantee Corporation
- Lastly, a common general conference can be arranged for a larger private sector audience, which defines the universal approach to develop a new range of student loan vending products, procedures and policy frameworks. The audience will be expanded to about 1,000 delegates for a one day conference, aimed primarily at the financial, insurance and asset management sector with:

GOING FORWARD

- All of the above and
- Banks (local as well as corresponding office representatives of foreign banks)
- Student bodies
- Insurance companies
- Corporate community (Top 100)
- Industrial community (Top 40)
- Technical Universities
- Asset Management companies
- The PIC and the trade union pension community, together with unit trust managers can hold a stake holders meeting almost immediately to advance the above cause as and when the state is ready. The discussions are highly technical and encompass a variety of legislative frameworks to deal with. But the funding is there, once everyone is on the same page.

THE END

- **End of presentation by Anthony van Wyk**
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