

Social Security and Retirement Reform

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“It’s the biggest reform of economic policy since 1994.”

Financial Mail, 2 March 2007

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“How ordinary people’s income security beyond their working years is provided for is a primary expression of society’s long-term institutional stability, integrity and social solidarity.”

Second Discussion Paper at para 23.

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Government Objectives

- ❑ Ensure basic standard of living for the old, unemployed or disabled through redistributive measures.
- ❑ Encourage savings for income replacement in these circumstances through long-term insurance arrangements.

Proposal 1: SOAP for all

- ❑ Continuation of government-funded grants for the elderly, disabled, children and care-givers.
- ❑ Modification or elimination of the means test.

Proposal 2: Wage subsidy

- ❑ Graduated wage subsidy for employers of low-income employees.

Proposal 3: National social security fund

- Compulsory contributions by all formal sector employees.
- Contributions of between 11.5% and 15% of pre-tax wages up to threshold of R60 000 p.a. Wage subsidy to fund contributions for those earning less than R43 000.
- Benefits:
 - basic retirement funding;
 - Unemployment and disability insurance;
 - Road accident and workplace compensation.

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Proposal 4: Compulsory contributions to occupational or individual retirement fund

- These contributions should allow members to save for post-retirement income at a rate that is reasonable in relation to their pre-retirement income.
- Government does recognise the value of the retirement funding industry.
- But it wants funds to allow transfers to the new national social security fund.

Proposal 5: Additional voluntary contributions to occupational or individual retirement funds

- These contributions will be tax-incentivised up to a monetary cap.

Proposal 6: Reform of the governance and regulation of the retirement funding industry

- To facilitate effective competition***
 - Increased transparency and disclosure;
 - Intermediary incentives to be aligned with interests of client;
 - Regulatory barriers to entry of new players to be removed;
 - Transfers to be allowed without excessive penalties.

Proposal 6: Reform of the governance and regulation of the retirement funding industry

To achieve economies of scale

- Introduction of accreditation standards to encourage or compel consolidation;

To improve social security

- Funds to be allowed to provide –
 - Funeral benefits;
 - Short-term disability cover;
 - Post-retirement medical aid funding.

Proposal 6: Reform of the governance and regulation of the retirement funding industry

- To protect retirement savings –***
 - Regulation of amount of contributions which must be allocated to retirement savings;
 - Compulsory preservation on change of employment;
 - Portability;
 - Regulated minimum withdrawal benefits;
 - Restricted deductions.

Proposal 6: Reform of the governance and regulation of the retirement funding industry

To minimise leakage –

- Compulsory preservation on change of employment;
- Possibly some withdrawals to be permitted on change of employment, after exhaustion of unemployment insurance;

To avoid dissipation –

- Requiring that all funds pay at least some of the benefit on retirement, disablement or death in the form of an annuity;

Proposal 6: Reform of the governance and regulation of the retirement funding industry

To improve value of annuities –

- Making it easier for funds to pay pensions themselves rather than outsource those liabilities;
- Using the national social security fund as a benchmark and competitor;
- Inflation-linking pension increases;
- Simplifying the distribution of death benefits (without undermining social value of trustee distribution)

Proposal 6: Reform of the governance and regulation of the retirement funding industry

- ❑ ***To protect members and dependants –***
 - ❑ Regulation of death benefits trusts, possibly establishment of “caretaker funds” regulated by FSB;
 - ❑ Establishment of unclaimed benefits fund;
 - ❑ Regulating all funds in terms of single Retirement Funds Act;
 - ❑ Reforming the institution of the adjudicator’s tribunal;

Proposal 6: Reform of the governance and regulation of the retirement funding industry

□ To improve standards of fund governance –

- Improving trustee knowledge and standards of conduct;
- More systematic approach to trustee training;
- Introducing role for compliance officer;
- Addressing conflicts of interest;
- Adopting special measures for umbrella and retirement annuity funds and one-stop-shops;
- Setting disclosure standards.

Proposal 6: Reform of the governance and regulation of the retirement funding industry

Improving financial regulation –

- Better regulation of funding, valuations and winding up;
- Pension guarantee fund ?;
- Combining “prudent expert” guidelines and quantitative limits in prescribed investment regulations;
- Regulating member investment choice;

Proposal 6: Reform of the governance and regulation of the retirement funding industry

Improving financial regulation –

- Defining “socially responsible investments” and determining how it should be encouraged;
- Determining scope for shareholder activism by funds;
- Improving supervision to –
 - Address fraud and conflicts of interest;
 - Reduce exposure of members to excessive risk.

Proposal 7: Tax reform

Importance of tax incentives:

- To encourage voluntary additional savings;
- To off-set costs of retirement fund regulation;
- To promote development of financial markets;
- To promote stable long-term flow of funds into domestic investment.

Proposal 7: Tax reform

- ❑ ***Proposed approach to tax reform –***
 - ❑ EET but some tax relief on lump sums paid on retirement;
 - ❑ No taxation of benefits for those earning less than R43000 per year;
 - ❑ Accommodation of those with volatile incomes, with periods of unemployment, with contributions commencing late in career.

The Way Forward

- ❑ Inter-Ministerial Committee;
- ❑ Consultation with Labour, Business and other stakeholders during 2007;
- ❑ Release of further “technical papers” this month;
- ❑ Release of tax paper later this year;
- ❑ Establishment of technical committees to investigate and make proposals on specific issues;
- ❑ Drafting Retirement Funds Bill;
- ❑ Implementation over next 3 years.

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The Way Forward

“These are reforms that will take several phases to be implemented. Their contribution to poverty reduction and income security will take time, their impact reinforced and magnified from one generation to the next. These are investments in social cohesion that will be felt long into the future, and we owe it therefore to our children to be vigorous and critical in our debate.”

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