

Retirement Reform in South Africa

2013 PENSION LAWYERS ASSOCIATION CONFERENCE

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national treasury

Department:
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REPUBLIC OF SOUTH AFRICA

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Background

- Four papers on retirement proposals released in 2012, as announced in Budget 2012, dealing with:
 - Options to **encourage preservation**, especially during job changes
 - Options to **encourage annuitising** at retirement
 - **Simplifying the taxation** of retirement contributions
 - Introducing **individual tax incentivised saving plans** to encourage short to medium term saving
- The above retirement reform proposals were initiated by the policy document: “**A Safer Financial Sector to Serve South Africa Better**”, released and endorsed by Cabinet in 2011
- The primary aim of these proposals is to encourage household savings and ensure that individuals are not vulnerable to poverty, especially in retirement
- These are urgent proposals to address major challenges in the current retirement system, especially member protection
- Reforms meant to complement social security proposals and support Twin Peaks

Consultation Processes

- Extensive and open consultations have taken place
- Current proposals are firmer proposals, after publishing of DRAFT proposals
- Further consultations on these proposals will take place before legislation is prepared later this year
- Closing date is 31 May 2013

Encouraging preservation before retirement

➤ **Current situation**

- Employees are allowed to cash in their retirement savings upon job changes, and therefore not preserve

➤ **Key factors taken into account**

- Protection of vested rights
- Workers should be permitted access in case of need
- Preservation requirements should not deter workers from participating in the system
- Administrative burden should not be too high
- Defaults should be the 'right' defaults

Pre-retirement preservation proposals

➤ Key proposals for Budget 2013

- Protect vested rights: retirement savings accumulated up to the date of the new rules coming into effect, including growth on these accumulated savings, will not be affected by the new rules
- Default: upon leaving an employer, accumulated retirement savings will be automatically transferred to a preservation fund, of the employee's choice or a default chosen by the employer
- New contributions after the date of legislation/new rules will be subject to new rules:
 - workers can withdraw annually an amount equal to the greater of the old age grant and 10% of the initial deposit into a preservation fund
 - unused withdrawals can be carried forward

Post-retirement preservation

➤ Current situation

- Members of provident members are not compelled to annuitise at retirement;
- So they can take entire money as cash lump sum; many spend it quickly
- Members reluctant to annuitise since they lose old age grant if annuity larger than the grant (problem of means-test)

➤ Key factors taken into account

- Means test on state old-age grant is an implicit tax on annuitisation
- Vested rights crucial, especially for those near retirement
- Reforms needed to make annuities market function better for low-income workers
- Standard annuity rules required as part of tax harmonisation

Post-retirement preservation proposals

➤ Key proposals for Budget 2013

- Phase out the means-test for the old age grant by 2016;
 - It discourages saving for retirement and annuitising
- Raise *de minimis* requirement on annuitisation to R150 000
- Protect vested rights: employees can still take all accumulated savings on date of implementation, and growth on them as a cash lump sum in retirement (i.e. not annuitise)
- Existing members above 55 years not to be required to annuitise, to avoid disrupting their retirement plans
- Members below 55 years required to annuitise new contributions and growth on them after date of the new rules
- Provident fund members to enjoy same tax benefits as pension fund members

Improving annuities market

➤ **Current situation**

- Two types of annuities; living and life
- Living annuity can be complex to manage, costly and might not protect against longevity risk (ie risk of outliving your retirement savings) because of high draw down rates and market volatility
- Life annuity protects against longevity risk, but can be opaque (since they are an insurance product) and some make it hard to bequeath
- More people opting for living annuities

➤ **Key considerations taken into account**

- Many flaws in retirement income market caused by lack of preservation, addressed above, and problems with intermediation, being addressed by the FSB
- High levels of heterogeneity means specifying a particular default difficult
- Simpler products to be preferred to more complex ones

Retirement income proposals

➤ Budget 2013 proposals

- Trustees of funds must guide the member during contribution phase until the annuitising phase, and not only during contribution phase
- All retirement funds to identify and have suitable default annuity products they can automatically put their members into
 - Living annuities to be permitted as default, but “suitability” to be guided by principles and rules (e.g., limited investment choice, simplicity, transparency, cost effective and limited draw down levels)
- Splitting annuities to be made easier
- Retail Distribution Review of FSB to be supported
- Opening living annuity market to more competition

Simplifying the taxation of retirement contributions and also incentivising non-retirement savings

➤ Current situation

- Different bases used to calculate retirement contributions and related tax deductions, making system complex & increasing costs
- Limited tax equity as some individuals and employers contribute more than is sufficient, and thereby excessively benefiting
- Pension and provident funds contributions taxed differently; members of provident funds not eligible for a tax deduction, only the employer
- Limited incentives on non-retirement savings might be contributing also to low household savings

➤ Budget 2013 proposals

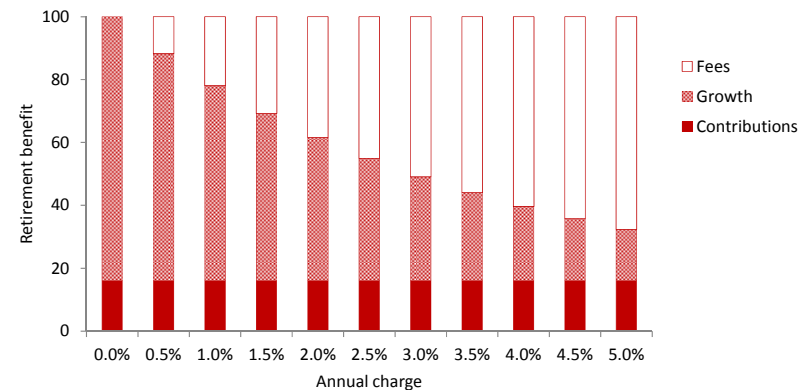
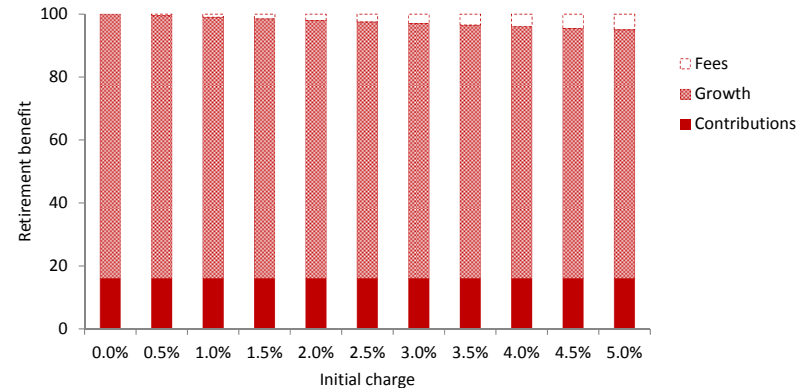
- Base will be the greater of remuneration or taxable income
- New contribution rate of 27.5%, with annual rand cap of R350 000
- Provide same tax dispensation for provident and pension funds; *i.e.* provident funds members to directly receive tax benefit for their contributions
- Proceed with previously announced tax incentivised individual saving accounts, in addition to the current tax-free interest allowance

Paper A: Charges in SA retirement schemes

- Paper promised before the end of 2012
- Slightly delayed, but will be released shortly
- Paper is a first attempt to discuss charges in SA retirement system based on the information available to us
- Intended to facilitate further engagement with industry and other stakeholders
- Detailed proposals to reduce charges, where required, will follow this engagement
- All proposals will be subject to extensive formal and informal consultation, as well as Parliamentary processes, if necessary

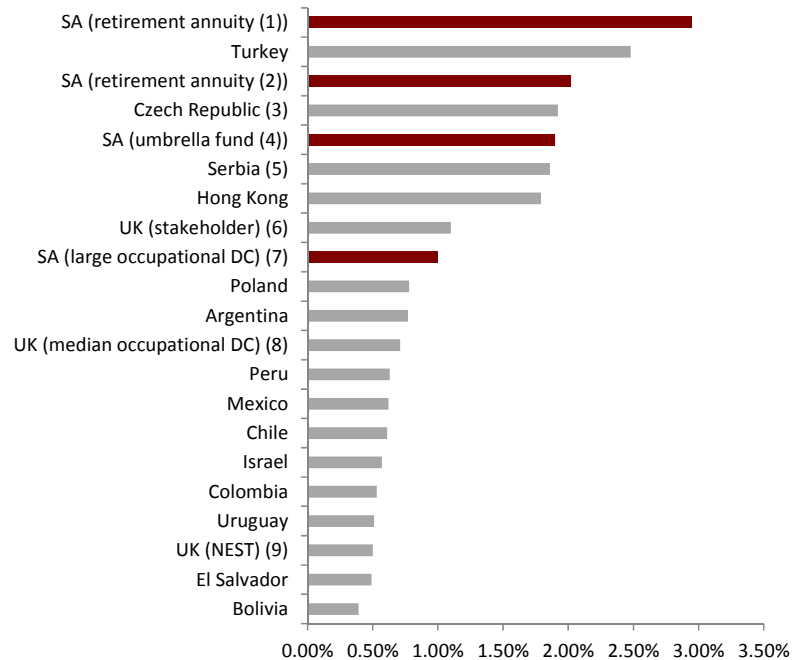
Charges have very different effects on retirement benefits

- Charges, especially recurring charges, significantly reduce benefits
- Initial charges (possibly) shared between employers and employees; employees bear all recurring charges in the form of lower benefits



SA retirement system looks expensive

- The SA retirement system appears expensive, especially given its relative maturity, but comparisons are difficult for many reasons
- With some exceptions, SA relies almost entirely on market mechanisms to determine type and level of charges



Complexity, disclosure, intermediation and charges are all related

- Required levels of disclosure are low
- Commercial products can be exceptionally complex, making product comparisons difficult
- Intermediaries serve to raise product complexity, as well as costs
- Market mechanism may create a tendency to shift charges from initial charges (based on contributions) to recurring charges (based on assets), and between types of recurring charges
- Preference for active investment management raises charges above the lowest attainable levels
- Remuneration of intermediaries, including investment platforms, creates conflicts of interest which raise charges
- (Weaknesses in governance need to be addressed)

Conclusions

- Paper contains broad suggestions of measures to reduce charges
- Approach likely to be similar to 2013 Budget proposals
- Detailed proposals to reduce charges will follow the closure of the consultation process related to the paper
- All proposals will be subject to extensive formal and informal consultation, as well as Parliamentary processes, if these are necessary

- Our current consultation closes on 31^{May} 2013
- Please send any comments to retirement.reform@treasury.gov.za