PENSION LAWYERS ASSOCIATION CONFERENCE

The State of Retirement Reforms in South Africa

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2 March 2015, Sandton City

Ladies and gentlemen, thank you for inviting the National Treasury to your conference. It is certainly a great honour to be in your presence.

Given that this is a lawyers' conference, I humbly appeal to all of you to approach our questions and answers session in a more measured way, and not treat it as a cross-examination of a gentle soul from the public sector.

Saving a challenge for South Africans

South Africa has a sophisticated and well developed retirement fund industry, together with an extensive social security system that caters for the needs of vulnerable children, the disabled and the elderly. If there is one area where Government intervention is justified and widely accepted internationally, is in its role to protect the most vulnerable members of its society. Of course, this protection must be done in a financially prudent and responsible way to ensure long-term sustainability.

Of equal importance, is to also ensure that South Africans who have been fortunate to work and earn a living, are able to also save for their retirement and be able to retire comfortably.

Unfortunately, South Africa has a worryingly low savings rate compared with other countries and its BRIC peers, with the problem more pronounced for households. The household gross savings rate was a meagre 1.7% of GDP in 2013.

It is widely reported that only around 6% of working South Africans who contribute to retirement funds will be able to retire comfortably; that is, around 6% of retirees will be able to receive, in their retirement, at least 75% of their pre-retirement income.

This disturbing low number can be attributed to a number of factors like high costs in certain products and services, lack of preservation when people change jobs and when they are in retirement, and poor discharge of fiduciary duties which result in some funds losing members' savings due to poor decisions or judgement.

The reform process

National Treasury resumed the retirement reform process in 2012 following an announcement of key reform proposals by the former Minister of Finance, Mr Pravin Gordhan.

Retirement reform seeks to address critical and urgent shortcomings in the system, and is not meant to replace the social security system, whether it be the current system or an enhanced future one.

The idea behind the retirement reform is to cultivate a culture of household saving in South Africa and ensure that individuals who have had an opportunity to be employed are not vulnerable to poverty in old-age.

The reforms seek to achieve the following objectives:

- **Firstly, encouraging preservation when workers change jobs.** Most workers cash-out their retirement savings when they resign and spend it or pay existing excessive debts. This means that they are not able to accumulate enough retirement savings and enable sufficient growth on those savings to provide for a decent retirement benefit when they retire.

- **Secondly, encouraging annuitisation at retirement.** This challenge is associated largely with provident funds, which by their nature pay out cash lump sum benefits in retirement. This has resulted in many retirees spending their retirement cash lump sum benefits too quickly and therefore being vulnerable to old-age poverty later in their retirement.

- **Thirdly, aligning the taxation of retirement contributions and benefits from retirement funds.** Different tax deduction rates apply to different retirement funds, with different "income" bases. Further, contributions from provident fund employees currently do not qualify for a tax deduction and are not required to be annuitised in retirement. The harmonisation of the tax system in relation to retirement contributions will mean that retirement annuity funds, pension and provident funds will be treated the same way from a tax and benefits perspective, thereby making the system easy to understand, administer and ensure the equitable treatment of contributions to all types of retirement funds. The Taxation Laws Amendment Act of 2013 is envisaged to bring into effect this change in 1 March 2016, and not 1 March 2015 as previously legislated. The postponement will allow for consultations between Government and NEDLAC, and an enhanced public communication.

The Taxation Laws Amendment Act of 2013, which outlined a uniform taxation of retirement contributions and treatment of benefits at retirement, inadvertently omitted some retirement funds from the latter reform. The National Treasury, as announced in the 2015 Budget, will soon propose technical amendments to correct this omission and thus harmonise the treatment of all retirement funds.

- **Fourthly, introducing individual tax free savings accounts.** The over-indebtedness of many South Africans signals that we are not saving at all. Also, when we do save, it is usually through our retirement funds, which we are then quick to access when we experience major shocks to our incomes and expenditure. We have also now realised that South Africans also tend to use retirement savings to pay for their excessive debts. This indebtedness, to a very large extent, explains the unfortunate premature resignations by some public sector employees to cash in their retirement savings. Our message to the public, especially Government employees, remains, you must not fear these retirement reforms since they are not about nationalising your retirement savings.

  The individual tax free savings accounts are meant to encourage discretionary or voluntary savings, and thereby supplement retirement savings by offering saving vehicles which will not attract any tax on interest, dividends or capital gains, or even at exit. The final Regulations in this regard were gazetted last week, and therefore this major dispensation will be available as of 1 March 2015.

- **Fifthly, encouraging good value retirement products and services by reviewing costs.** It does not help much to encourage and require South Africans to save if their savings are largely reduced by high costs and charges. Costs, in certain instances, can reduce returns on retirement savings by up to 40 per cent. The concerns around costs are global and will be addressed in South Africa through regular engagements with the industry. The recently released Retail Distribution Review and Market Conduct paper seek to also stimulate debate in this regard, and to ensure best outcomes to consumers of financial products and services.

The international debate continues to rage between active versus passive management of funds, with new middle grounds now coming up through what are called 'smart-beta' investments.

The Global Financial Crisis of 2008 resulted in low returns in many parts of the world, and there is a sense now that the pre 2008 returns will be hard to come by. In other parts of the world, yields on government bonds have trended to zero or even negative numbers. This new low return era poses challenges, as we see pension funds now scrambling for higher returns by using alternative investments like hedge funds, private equity, REITS, *et cetera*. It is, therefore, important that all forms of investments are regulated in South Africa. In this regard, we will soon be regulating hedge funds at a fund level to ensure investor protection, fund soundness and financial stability.

It remains, however, the role of trustees to understand the various investment options available to them and the related costs. Not all products and strategies cost the same, and not all of them yield the same result. Some products and strategies are more expensive, more complex and more risky, and require careful thought and due diligence.

- **Sixthly, enhancing governance of retirement funds:** South Africa relies on the system of trustees to manage and govern retirement funds, with assets worth over R 2 trillion as at 2013. It is, therefore, imperative that retirement funds are governed and run by sufficiently trained and skilled trustees, who are able to properly manage conflicts of interest, and take decisions which ultimately benefit the members of the funds.

  Major progress has been made in strengthening the governance of retirement funds. The amendment of the Pension Funds Act, done through the Financial Services Laws General Amendment Act Number 45 of 2013, included the following critical governance changes:

  - Whistle-blowing protection for board members, valuators, principal and deputy officers, and employees who disclose material information to the Registrar of pension funds.

- Requiring a fund board member to attain skills and training as prescribed by the Registrar, within six months of appointment.

- Extending personal liability to employers in respect of non-payment of pension contributions to a pension fund.

- Protection for board members from joint and several liability, if they act independently, honestly, and exercise their fiduciary obligations.

- Requiring pension funds to register or be provisionally registered prior to commencing the business of a pension fund.

  And lastly,

- Explicitly requiring trustees to exercise fiduciary duty towards both the members and the fund. Without the fund, there can be no retirement income for members. Without members, there can be no fund. The two are certainly mutually inclusive to the core.

The National Development Plan

The National Development Plan (NDP) also acknowledges the importance of higher savings and investments in promoting economic growth in the country. It also proposes an extension of Government social security to cover the informal sector in a mandatory contributory scheme. This proposal is in line with what the former Minister of Finance alluded to in his 2014 Budget Speech that measures need to be put in place to improve retirement coverage so that the excluded 6 million or so workers also enjoy access to an employer-sponsored retirement plan.

National Treasury together with other relevant Government departments is in consultation with NEDLAC on how best to extend retirement coverage to excluded workers.

The NDP further proposes that mandatory arrangements must provide for pension, death, disability and unemployment benefits supported by all workers earning above a minimum income threshold. The initiative to introduce a mandatory contribution system, or a cost-effective default fund remains under consideration, as mentioned in the 2015 Budget.

The Minister of Finance has also indicated in his 2015 Budget Speech that he has agreed with two of his fellow Ministers to release the long-awaited social security paper.

Default Regulations

The 2015 Budget announced that draft regulations on default preservation, investment strategy and annuities would be released for public comment in 2015. Drafting the regulations has taken longer than expected due to their complexity, but they are now projected to be released shortly. A journalist asked the Minister at the recent 2015 Budget engagement, what is meant by "shortly". Our answer is "sooner than later". On a serious note, hopefully by the end of June this year.

Defaults have proved, all over the world, to be a very powerful instrument in nudging people to make the right decisions and do the right thing, while also enabling them to exercise their individuality and right of choice by opting out of such defaults. This right to opt out, means that they do not interfere with vested rights.

Two measures were also announced in the 2015 Budget

- Firstly, allowing members to delay accessing their retirement money when they have reached retirement, and considering a cap on the duration of delaying such retirement savings commutation.
- Secondly, reviewing the possibility of allowing non-residents to withdraw from retirement annuity funds (RAs) when returning to their home countries.

Conclusion

Retirement reform is a complex, sensitive and on-going process which will take some time to complete, if ever. A gradual incremental approach is advisable.

Retirement reforms anywhere in the world are difficult and require hard engagements, patience and time. Mistakes can be very difficult to undo if wrong options are taken hastily, and the options are not always clear-cut.

The National Treasury remains committed to the retirement reform process. To quote the Minister of Finance in his 2015 Budget Speech, *"These reforms have one central objective: to maximise the long-term benefits to retirement fund members, so that they can retire comfortably"*. Nothing else is our aim.

Thank you