KEY THEMES IN A REVIEW OF THE PENSION FUNDS ACT, 1956

NATIONAL TREASURY

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OBJECTIVES

- Plan for a regime that will be effective in the long term
- Improve efficiency, equity and fairness of system
- Enable and encourage South Africans to adequately provide for their retirement
- Ensure that all employees have affordable access to appropriate retirement funding vehicles
- Protect pension resources against corrosion (costs)
- Improve standards of fund governance
- Promote the adequacy of retirement fund provision

BACK-DROP

- Continued piecemeal amendments no longer desirable
- Worldwide paradigm shift from DB to DC has changed dynamics:
  - risk shifted to employee
  - education of trustees important
- South African retirement funding system broadly sound
- Growing consciousness for higher national savings
- Need to Take cognizance of recommendations of various commissions (eg. Taylor, Smith, Mouton, Katz)
- Reconsideration of taxation on pension funds

➢ We have opted for a systematic and holistic approach

LANDSCAPE

- Pillar 1: SOAP of R740 per month (means tested)
- Pillar 2: Large public sector DB funds, and mostly DC in private sector; hybrid funds; and umbrella funds
- Pillar 3: Private provision over and above Pillar 2 (eg. Retirement annuities)

➢ Is this an optimal structure for South Africa's conditions?

MACRO BACKGROUND

	1994	2000	2004
Unemployment rate (broad)	31.5%	35.5%	41.2%
Gross saving as % of GDP	16.9%	15.8%	14.8%
HH saving as % of disp inc	2.8%	1.2%	1.1%
Informal Sector (mln) **with agriculture** **without agriculture**		 3.33 1.82	 2.17 1.83
Employment (mln) **Formal** **Total**	 6.80 7.97	 7.43 11.88	 8.76 11.98
Social grants as % of GDP		2.00% (2.9mln)	2.50% (7.9mln)

COVERAGE

- In total, approx 9 million individual members across 15 000 funds
  - GEPF : 1.1 million
  - Gauteng Building Industry Fund : 407,000
  - Mineworkers provident Fund : 175 000
- Coverage in formal sector estimated between 66% and 84%. Even the lower estimate is internationally comparable
- Problem of high unemployment translates to poor provision in the aggregate, hence greater burden on the State

LEAKAGE

- Sanlam surveys suggest 10-12% (net) of earnings contribution for DC funds in 2004 for retirement, against a gross of 16.5%
- Costs seem to be increasing (problematic)
- World Bank recommends contribution rate of 10-13%
- Anecdotal evidence suggests leakage is a major problem
  - Increases future liability on State to provide SOAP for greater proportion of population

REPLACEMENT RATIO

- Leakage implies replacement ratio at retirement will be substantially reduced
- To give some idea: assuming a net 10% contribution, over 40 years with a real return of 3%, one would only achieve a replacement rate of approx 55%
- In other words, one cannot escape the numbers:
  - Staying invested (for a long period of time) is important
  - A culture of saving for retirement needs to be cultivated
  - Investment performance is crucial, particularly for DC funds
- Need to minimise leakage

ILLUSTRATION

Years of contribution	3% real return	4% real return
10	8,6%	9,0%
15	13,9%	15,0%
20	20,0%	22,1%
25	26,9%	30,6%
30	34,9%	40,8%
35	44,1%	53,0%
40	54,5%	67,7%
45	66,6%	85,3%

Assumptions: net of costs 10% of contribution goes to retirement

: R13,80 of capital buys R1 of pension at age 65

KEY THEMES AND PROPOSALS

ACCESS

- Basic question: What can be done to increase access?
- Compulsion on employer to provide a retirement vehicle or payroll facility
- Compulsory preservation on change of jobs
- Consider erratic employment (informal/seasonal)
  - National Savings Fund
- Costs in general are a concern and may inhibit access to retirement fund provision
  - Increase disclosure
  - Increase competition
  - Explicit regulation of costs

KEY BENEFITS

- Preference for limited lump-sums, with the purchase of an annuity on retirement
  - Challenge for provident funds
- Should pension fund offer ancillary benefits (eg. medical, disability)?
  - Consistent with SA conditions?
  - Benefits from scale economies for the individual?
  - Ring fencing?
- Housing: Only guarantees and not loans from funds
- Distribution of benefit upon death in accordance with nomination of beneficiary form, else his/her will, else intestate succession
  - Currently the nomination form only a guide
- Unclaimed benefits
  - Set up a central fund to trace beneficiaries/dependants
  - Unclaimed monies eventually revert to the State (SOAP)

CAUTIONARY

- Success of proposals dependant on good regulation
- Landscape will have to change notably
- Re-engineering of regulatory framework
- Give more powers to regulator
- Significantly increase capacity of regulator

GOVERNANCE AND REGULATION

- Recover monies removed from funds inappropriately
- Power to remove trustees
- Educate trustees
- Formulate codes of good practice and codes of conduct
- Better use of office of Adjudicator
- Retain minimum 50% rule for member elected trustees
- Deal with conflict of interest issues
- Deal with intersection of labour and pension laws
- Deal with umbrella funds
- Shareholder activism: Exercise voting rights
- Sanction investment managers, administrators etc.
- Disclosure requirements to members
- Permit trustees to be paid - at fund's discretion

CONCLUSION

- Many features of current legislation will remain
- Approach may conflict with profit maximisation motive
  - Balance and objectivity necessary
- Judge outputs on the basis of the objectives set out
- Engagements will have to emphasise sustainability of pension environment