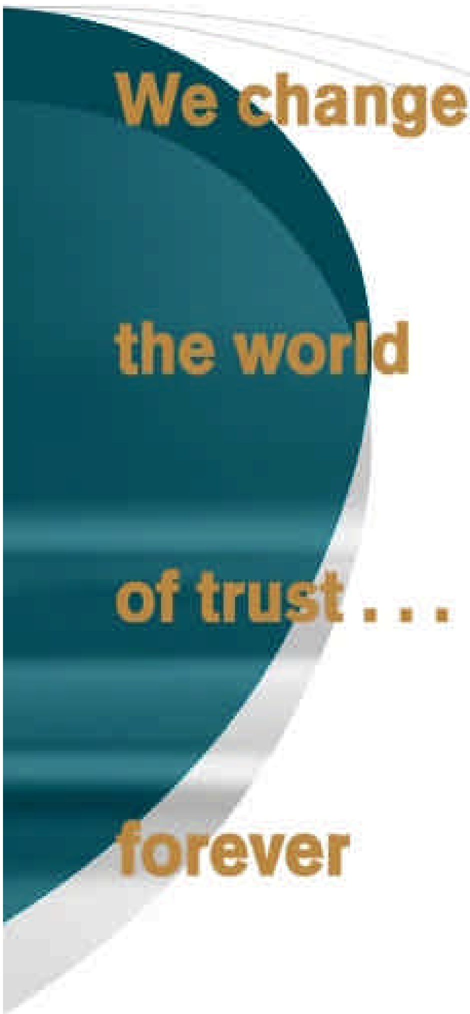
CORIS CAPITAL

Retirement Fund Reform Discussion Paper



INTRODUCTION

National Treasury's, Retirement Fund Reform Discussion paper has elicited widespread comments from most of the significant players in the industry. Thus far most of the important principles embodied in the paper has been welcomed although concerns were raised about the exclusion of the tax reform which the Minister of Finance requested be put aside until the structure of the future of the retirement funding system was finalised. We at Coris Capital however recognise that the tax considerations are inextricably linked to matters such as contributions and benefit calculations and will have a significant impact on the finalisation of the reform of our retirement funding system.

The comments below follow in the same sequence as the Discussion Paper. We have summarised the salient issues and added our comment were appropriate.

The broad objectives of the Discussion paper can be summarised as follows:

- Government seeks to:
  - Encourage individuals to provide adequately for the own retirement needs and the needs of their dependants,
  - Encourage employers and employees to provide for retirement funding as part of the remuneration contract,
  - Ensure that retirement funding arrangements are cost-efficient, prudently managed, transparent and fair,
  - Promote retention of purchasing power of pensions through protection against the effects of inflation, within the resource constraints of the fund,
  - Improve standards of governance, including trustee knowledge and conduct, protection of members' interest, accountability, and disclosure of material information to members and contributors, and
  - Provide, through social assistance, an assured basic income entitlement to elderly persons without means.

ANNEXURE 1: THE SOUTH AFRICAN RETIREMENT FUNDS LANDSCAPE

Summary:

Using the framework proposed by the World Bank, the Discussion Paper identifies three pillars of the South African retirement funding system viz.:

- The social old age pension (SOAP) grants funded from government revenue;

- The various occupational retirement funds in the formal sector fully/partially funded by employers and employees and
- The third pillar comprising voluntary retirement savings arrangements.

Recognition is given to the relatively good coverage for those employed in the formal sector. The challenge is to extend the coverage to those in the informal sector. Reference is made to the Sanlam Retirement Fund Survey findings on the average contributions rates for retirement savings of funds, which indicates that this is in line with the 10% to 13% advocated by the World Bank. Replacement ratios are used to access the efficiency of funds and highlighted the necessity for investing from an early age and to stay invested. Severe leakages make it impossible to obtain high replacement ratios.

We welcome the recognition given to the success in the formal sector and share the concerns raised in the paper with regards to the informal sector. We also share the concerns with regards to disclosure of cost and the increase in the cost of funding of risk benefits as a result of the impact of HIV/AIDS. Replacement rates is something we have long advocated be incorporated into the Defined Contribution Fund ideology and promote this thinking with our Trustees especially when formulating the Funds Investment Policy Statements and aligning of the investment strategy. The emphasis being on real returns nett of expenses.

ANNEXURE 2: ACCESS, COMPULSION AND PRESERVATION

Compulsion

The Discussion Paper takes the position that employers should at least provide access to retirement fund but will not make it a statutory requirement as the SOAP is set at a modest level and is sustainable. The minimum requirement being that employers provide payroll facilities and education on the desirability of retirement savings for employees who are not compelled to belong to an occupational fund.

Access

A National Savings Fund is to be introduced to provide access to individuals who have limited or no access to an adequate retirement fund vehicle. It would allow for flexible contributions on adhoc type basis, provide access to savings in a life crisis but where retention of savings to retirement is incentivised and is also exempt of the means test. Incentive may be in the form of tax exemptions and bonuses for individual who retain savings until retirement.

The new burden on employers may increase the cost to employ especially within the SME sector. We would like to see training material standardized and provide by the regulator. Another concern would be that compulsory occupational funds are not sufficiently encourage and we may find wide spread withdrawal from Funds in the formal sector to the National Savings Fund. We would also like to see harmonization of tax treatment of all funds to reduce risk of moving between funds for that reason.

Individual Retirement Fund & Ancillary Benefits

A new category of individual retirement funds is proposed which will replace existing retirement annuities and preservation funds. These funds would typically offer irregular contributions, a range of benefits, not require and employee / employer relationship and have all cost disclosed. The key seems to be the transparency and cost effectiveness. Further proposal are made that a retirement fund should offer temporary disability income benefits and post retirement medical aid funding and that a minimum percentage be prescribed for retirement savings.

Just one concern and that is that it will be difficult to be prescriptive on minimum savings percentage when retirement savings in itself are not being compelled.

ANNEXURE 3: BENEFITS, CONTRIBUTION RATES AND MEMBER PROTECTION

Adequacy of Retirement Benefits

It sets out Government's objectives for members to provide adequately for retirement. Replacement rates at retirement age of 65 of at least 75% for lower income earners and lower percentages for higher income earners are recommended. Retirement and death benefits should primarily be taken in the form of income for life and also provide for surviving dependants' income.

Providing income death benefits on an insured basis can be significantly more expensive. It is typical Defined Benefit fund offering and many funds have recently moved away from these types of benefits.

Pension Increases

Reference is made to the problematic implementation of the Second Amendment Act with a focus on pension increase policies that target a level of price inflation. Funds where pensioner liabilities are not insurer backed must invest assets separately from the rest of the assets and these investment returns should be utilised to for the increases in pensions.

Availability of Benefits

Treasury is clear that it prefers the "packaged" approach which covers early withdrawal, retirement, death and disability to just a pure savings approach for members provided that the savings portion is meaningful and separate from the ancillary benefits. This also allows members access to more competitive rates.

Preservation and Portability

Treasury proposes to compel preservation subject where the amount involved is lower than a minimum value set out by the regulator and where the fund has guaranteed the member's housing loan and the member defaults.

Interest on Late Payment

It is recommended that when members leave the fund the benefit is transferred to an interest bearing account and pay the interest earned when the claim is settled.

Unclaimed Benefits

The Paper recommends that Funds be compelled to trace beneficiaries and if unsuccessful the benefits be transferred to a central unclaimed benefits fund after a period of 2 years. Moneys unclaimed in the central fund would be released to the State.

Housing Loan Guarantees

Only Fund guaranteed loans should be permitted and which should be strictly controlled to prevent abuse. Treasury lists the following as the key reasons:

- Housing finance business is not consistent with the purpose of retirement funding,
- Not within the expertise of the trustees and may therefore pose inappropriate risk and application of resources.

These concerns are certainly valid and we also feel that direct housing loans may also be an inappropriate investment vehicle in the context of a funds overall investment strategy. The question however begs to be asked and that is whether banks are driving this to issue risk free loans to members and what is the benefit to the member.

Other Life Crisis needs

Funds will not be allowed to guarantee any other loans other than for housing and should not directly allow loans for another purpose. Insurers should be allowed to make accelerated payment of the death benefit to terminally ill members of a Fund.

Divorce

The Treasury recommends:

- The members minimum individual reserve value to form part of the assets available for splitting
- The court my determine a split between the parties
- The former spouse is to be deemed a member of the Fund iro of the portion awarded
- The former spouse should have the option to transfer their share to an alternative retirement savings vehicle.

We have concerns about including the former spouse as a member of the Fund as this may pose many difficulties to administrators. The issue of administrative costs in this regard would also need to be clarified. We do however support the recommendation that former spouses be allowed to transfer their share to an alternative vehicle.

Deductions

It is recommended that only deductions in respect of tax and housing loans or guarantees be permitted on exit of a member.

Death Benefits

Funds should require members to provide the identity of all their dependants and a beneficiary nomination form every 5 years. The distribution must follow these nomination forms unless compelling evidence to the contrary exists. Again income benefits should be preferred over lumpsum unless the value is too small. Trust should be established for those determined incapable of managing finances.

Distribution of Death benefits can be a time consuming exercise and following the nomination forms reduce difficulties. More clarity on the reasons not too, will have to be examined. The adequacy of handling of customary law marriages is also not handled adequately.

Disability Benefits

It is recommended that Funds be allowed to pay temporary and permanent disability income benefits as an approved fund for tax purposes. No minimum benefit is prescribed but should be negotiated.

ANNEXURE 4: REGULATION AND GOVERNANCE

Powers of the Regulator

Treasury recommends:

- The Registrar fall under the supervision of an appropriately constituted board that has decision-making powers in deadlock situation between stakeholders, which cannot be overturned.
- Some of the Registrars functioned should be performed by licensed practitioners who will have whistle-blowing rights
- Powers to enforce compliance should be extended.
- The Registrar should adopt a risk based approach, promote education of members and be empowered to formulate codes of good practice.

Licensing of practitioners should be prescribed to ensure consistency. We also have concerns of the cost that may arise from this arrangement. The leave to appeal the decisions should definitely be continued but should follow a clear process.

Dispute Resolution

The need to consolidate the plethora of forums available for dispute resolution is recognised. It is recommended that a specialist tribunal be established to deal with all funding disputes. The right to appeal determination is recognised.

Governance and Trustee Conduct

All funds should be required to have a board of trustees of which 50% should be elected by the members unless exempted by the Registrar. However, a condition of exemption is that the board must have 50% independent trustees certified as “fit and proper” and that they should constitute 50% of a quorum. These trustees must be paid only by the fund and be given special “whistle-blowing” obligations and be protected against victimisation. The focus is on Trustees and their obligation to act in the interest of stakeholders. There is an increase in disclosure requirements for trustees, service and product providers. One of the key proposals is that when trustees’ conduct is judged “the standard of a person who is familiar with the issues under consideration” be used. This confirms the higher level of knowledge required and further requires that the funds pay for trustee education. Employers are also required to give trustees reasonable paid time off work to attend to their duties and attend training sessions.

We support in full all the recommendation and already most of the funds we deal with comply with these requirements. We also support the idea of independent trustees as this will maintain the balance of power of the board.

Investment Regulation

A Prudential limit regime is proposed in line with draft Regulation 28 but which includes certain quantitative measures. However, exemption to limits can be applied for if the fund has adopted a properly formulated investment strategy. An interesting addition is that the regulator may specify which benchmarks asset class performance should be measured against. Funds will also be required to inform members in writing of plans to investment in socially desirable investment which are likely to yield lower than expected returns. Trustees will also be limited in the provision of investment portfolios offered to members as well as the number of portfolios offered.

The move to DC arrangements with member investment choice is acknowledged but we think that issues around life-stage compliance and new investment product offerings is not sufficiently addressed.

Funding and Calculation Requirements

It is recommended where appropriate that a fund must be actuarially valued at least once every three funds. Purely defined contribution funds will be exempt from this requirement however an annual comparison of assets and liabilities and an assessment of the adequacy of contribution rate is advised. Assets that back non-insured pensioner liabilities will have to be valued annually before pension increase can be awarded. The regulator will establish an actuarial review committee to determine standards, methods and provide guidance on actuarial matters if funds.

We welcome the regulators involvement and the harmonisation of the actuarial matters of funds. We do however have concerns that defined contribution funds requirements are only advised and not regulated. Again we have concerns about the inadvertent creation of additional cost through the creation of an actuarial committee.

Winding Up

Treasury recommends provisions to enable quick efficient and inexpensive partial or total winding up of funds. They further recommend that a task force be established to review the desirability of pension guarantee schemes to protect member of funds being wound up as a result of insolvency. If it is decided to continue with pension guarantee schemes, adequate fidelity and professional indemnity cover and strong funding must be a requirement.

General Remarks

- **The National Treasury Task Team should be applauded for a really comprehensive paper.**
- **Proposals were well thought through although cost consideration could be problematic.**
- **More consideration for Defined Contribution Funds investments should be given.**
- **Role of the Principal Officer and Compliance Office in processes should be addressed.**