

FEDUSA SUBMISSION ON THE RETIREMENT FUND REFORM: A DISCUSSION PAPER OF DECEMBER 2004.

A primary purpose of the Retirement Fund Reform Discussion Paper is to provide and encourage individuals to ensure proper guidelines and provision for retirement. In doing so FEDUSA support a review of the current retirement fund legislation. We have called for the review and specifically the tax review on retirement funds in our Budget submissions to the Parliamentary Portfolio Committee on Finance since 2000¹. The right of individuals to provide adequately for retirement is an important provision in public policy. However, the taxation on the retirement funds have a direct effect on the retirement capital of contributors and could add an additional burden on the state coffers if pensioners cannot live off secure pensions. It is imperative that the legislator also reviews income tax legislation during the process of the retirement fund review.

FEDUSA would like to submit that the taxation of pension funds requires further attention. When the tax on retirement funds was introduced in 1996, it was seen as a temporary measure pending the review of the retirement industry as a whole. Despite various suggestions from the Katz Commission, the review has still not taken place and we believe that this pension fund reform should have followed the tax reform and not visa versa. Absent from the discussion document is the tax treatment of retirement funds. The principles of the review imply a delay in this very important process.

Another key concern related to taxation on retirement funds is the possible impact, if retirement funds become subject to Capital Gains Tax. FEDUSA needs to caution Government and specifically the National Treasury on any proposals that could be to the detriment of individuals making provision for old age. The current tax policies on retirement funds acts as a disincentive for lower income earners to save towards their retirement. FEDUSA believes that the tax rate on rental and interest income should be scrapped in its entirety as it amounts to a double taxation of retirement funds, as pensioners' income is taxed in their hands. "Pension funds are finding it difficult to beat inflation in terms of performance and for the state to dip into workers benefits to the magnitude it is presently doing, adds insult to injury. Much of South Africa's labour and social legislation have been repealed and re-enacted in the post apartheid era. The current pension legislation dates back to the mid 50's and although amendments have been made to the Pension Fund Act to deal with issues such as the fiduciary duties of trustees, the introduction of the adjudicator, and surplus apportionments etc., it remains archaic legislation. The new legislation should take full cognisance of the rapidly changing environment within our country and the tax dispensation should be addressed as a matter of urgency.

In respect of governance issues, FEDUSA wishes to state that the new retirement legislation should also cater for the following:

Retirement fund trustees must be able to make separate appointments of consultants, actuaries, legal advisors, accountants and auditors, investment advisors, insurers and fund administrators.

Such a provision would prevent funds from being required, in terms of their rules, to use "closed" services, for example, the advisory and other professional services exclusively provided by a single fund administrator.

¹ FEDUSA Submission to the Parliamentary Portfolio Committee on Finance on the 2004/05 Budget: 18 February 2004 & FEDUSA Submission to the Parliamentary Portfolio Committee on Finance on the MTEF : 18 November 2003

All persons who give advice to retirement funds, including investment advice, who exercise any discretionary powers in relation to the management or administration of the fund or the control and investment of its assets and the disposition of its benefits are fund fiduciaries and must discharge their duties with care, skill and diligence. Fund fiduciaries, including fund trustees and consultants, should be required to give the advice and take the decisions that they believe to be in the best interests of the fund without regard to their own interests.

The disclosure of information in relation to decisions that the trustees of a fund make and the reasons for those decisions, should promote rationality in decision-making and a culture of accountability. Information that must be furnished to members should include a statement of investment policy principles; for defined contribution funds, the risk exposure details; for defined benefit funds, the level of financing of the accrued benefit; and on request, detailed and substantial information relating to benefits on retirement and withdrawal, and relating to the investment options and details on risk where the members bear the investment risk.

The regulatory body must have powers in relation to retirement funds, including the power of inspection, the power to substitute trustees (after proper legal processes) and the power to prohibit or restrict the activities of trustees if they fail to protect the interest of members.

FEDUSA would support the proposed legislation if it ultimately has the result of:

- Ensuring the effective protection of fund members;
- Reducing the costs associated with the administration of funds;
- Ensuring greater accountability of trustees, administrators and service providers;
- Ensuring that pensioners are not or do not become destitute;
- Adequate capacitation of trustees so that dependency on administrators and service providers can be reduced; and
- Ensuring effective protection of fund assets and investments.
- Addressing the tax dispensation of retirement funds.

With specific reference to the recommendations of the National Treasury Task Team, FEDUSA commented on the annexures as follows:

Annexure 1 The South African Retirement Fund Landscape:

FEDUSA agree with the principles of a retirement funding system and appears to be in agreement with the sentiments in the annexure.

Annexure 2 Access, Compulsion and Preservation:

With reference to Clause 1.6.1.1 and 1.6.1.2 (page 19):

These recommendations should be approached with caution. The debate regarding the status of pension benefits in relation to the contract of employment has been ongoing for some time now.

FEDUSA and our affiliates support the notion that retirement benefits be incorporated into the contract of employment but the legal obligations and consequences of this must be carefully considered and debated. Contributions are part of the pension promise that employees receive from their employer and such contributions are part of the remuneration package that an employee receives, albeit deferred to a future date. It must also be borne in mind that benefits are determined

actuarially in terms of fund rules and in the case of defined benefit funds actuaries determine contribution rates.

Pension benefits should never result in an employee having to protect vested rights by way of power play should an employer decide to unilaterally implement its position or even lock out its employees, after negotiations have failed.

With reference to Section 2: National Savings Fund (p.20):

The concept of a national savings fund is a new concept to Labour. It is proposed further that the labour federations be actively involved in the structure of such fund to act in the best interest of these workers and workers in general. The principles of the fund could be supported. This is not necessary if there is preservation. The national savings fund will result in a conflict between preservation and compulsory funds. The national savings fund has merit but there needs to be consensus on this point and the concept of a national savings fund needs to be consulted properly. Clause 2.5.1.2 with reference to sub – section (a – h), should form part of a participative public consultation process. The advantages which a national savings fund versus pension funds have should be placed into context properly. The principles of a national savings fund are supported.

With reference to the recommendations set out in Clause 3.5.3, it is submitted that such a proposal should be subject to a process of collectivity agreement to retirement funds, benefits and contribution rates.

With reference to Clause 4.2.1- 4.2.8 (page 26 & 27): FEDUSA and our affiliates support the proposal in relation to retirement options being created for the self – employed.

With reference to Clause 6.5.1 and 6.5.2 (pages 28 & 29): These recommendations are supported, provided that the proposal does not lead to unnecessary additional costs or the entrenchment of administrators.

FEDUSA hereby submit that Clause 6.5.1.3 provisions would prove to be very difficult to implement

Annexure 3: Benefits, Contribution Rates and Member Protection

Section 1: A new Clause 1.1.2.4 should be established and should read as follows: “Portion of the estate should be paid out (current section 37(c) of the Pension Funds Act)”. The trustees must investigate this benefit.

Section 2.4 (page 33)

FEDUSA supports these recommendations and wishes to add that the legislator should compel current retirement funds to deal with and conclude surplus apportionments within a defined time frame. It is also suggested that the registrar or legislator set criteria for the investment of assets in non insurer underwritten funds. Investments of this nature should not be of a risky or volatile nature.

Clause 3.4.1: In Clause 3.4.1.1.1 the word “*meaningful*” should be defined.

Section 3.5 (page 35)

FEDUSA believes that the minimum rates of contribution should be prescribed in legislation. The current provision of 3.5 makes a mockery of preservation. The provision should be linked to the aim or objective of the Fund as referred to in Clause 1.1.1 (page 30).

Section 3.6 (page 35)

In terms of Section 3.6.3 FEDUSA believes the wording should change as follows: “the word “vary” should be replaced with the word “*changed*”². The fund does not have the unnecessary variation when having a prescribed minimum. The intention of the legislator is to ensure adequate retirement benefits and if contributions by an employee are too flexible, then the purpose of the legislation will not be achieved. The FEDUSA local government affiliate, IMATU, avers that a contribution flexibility provision may lead to an increase in administration costs. Furthermore such flexibility should be allowed only to a limited extent. If a member of the fund has the option to continually reduce his / her contribution rate to 1%, for example, in order to have a bigger take home pay, it would lead to a circumvention of the purpose of the legislation.

Section 3.7 (page 36)

Clause 3.7.2 : the word “*modest*” should be defined to clarify what the intention is.

Clause 3.7.3 will lead to major opposition from employees who are currently members of provident funds. IMATU proposes that as an alternative to forcing such funds to change their rules, that these funds be ringfenced (i.e. no new members) and that the funds be phased out by natural attrition. Many employees have planned their retirements in line with provident fund principles and if the legislator is not prepared to allow for the ringfencing of such funds, it is proposed that the “reasonable period” should be at least 10 years.

Clause 3.8.4 (page 37)

Clause 3.8.4.2 : The pension fund should have the scope that the employee has a choice as to the options, where and when it should be paid to. One concern is the reference to “employer – nominated medical scheme”. The legislator promotes an employer – fund relationship, yet it appears that the employer could infringe on the employee’s freedom of association by dictating the medical scheme of choice for an employee.

Clause 3.11.3 (page 39)

FEDUSA reserves the right to comment on this issue once Treasury has finalized its policy stance on this subject matter.

Clause 3.12.3 (pages 39 and 40)

FEDUSA would support the principles but must emphasize that there is no value for a long term unemployed person in having his only probable financial asset caught up in a retirement fund in the long term. This may require the legislator to create an exception provision. New Clause

² The New Clause 3.6.3 to read as follows: The National Treasury task team recommend that, sub to the rules of the fund in which they participate, members may change their contribution rates, provided the limit on the tax deductible, contribution by member and employer combined is not bridged.

3.12.3.6(b) to read as follows: “*where the fund has guaranteed a members housing loan, and the member defaults, in which case the retirement fund must pay as much as possible of the outstanding loan (after the deduction of tax), and pay any residual amount (after the deduction of tax, if appropriate) to the national savings fund or to a fund nominated by an employee, on behalf of the member*”.

Clause 3.13.2 (page 40)

FEDUSA hereby proposes that a properly set – up interest – bearing account that bears fruit to the individual member should be set up. Replace the phrase “*interest – bearing account*” with a new phrase “*interest – bearing call account*”³.

Clause 3.14.3 (page 41)

In terms of Clause 3.14.3.2 FEDUSA officially disagrees with this clause. However, the proposal can be considered should proper management structures to such a Fund be set up that are feasible. that bears fruit to the individual member should be set up.

Clause 3.14.3.3 : replace the word “*may*” with the word “*must*”. New clause 3.14.3.3 to read “if the central fund is unsuccessful in tracing the former member or their dependants (*if the former member passed away*), *the central fund must release monies to the State in order to fund, for example, the social old age pension*”.

Clause 3.15.1.4 (page 42)

FEDUSA supports the stricter rules being applied to housing loans. Such loans are an effective way of securing funds for housing purposes and constitutes an acceptable return on investment. The granting of such loans must be strictly controlled to ensure that loans are in fact used for housing purposes.

Section 3.16 : Clause 3.16.2 should be aligned with Section 37(c) of the Pension Funds Act.

Clause 3.18.3 (page 47)

These recommendations are supported. It is also proposed that a dispute resolution procedure be introduced to deal with current section 37C⁴ type disputes, which procedure should be cost effective and efficient.

Furthermore it is suggested that the registrar issue guidelines to be used by trustees when expressing their opinion on whether compelling reasons exist for not adhering to the express wishes of a deceased member.

³ The New Clause reads: The National Treasury Task Team recommends that once a claim is admitted and the members interest in the fund is converted into cash. A management board should be required to invest this amount in an interest – bearing call account and pay the interest earned when the claim is settled.

⁴ Section 37C of the Pension Funds Act

ANNEXURE 4 - GOVERNANCE AND REGULATION

Section 3.4 (page 54)

FEDUSA supports this recommendation. It is also suggested that trustees and administrators be held accountable where an employee acts on disclosed information, which later appears to have been wrong or have inaccuracies, and the employee as a consequence thereof suffers damages.

Section 4.4 (page 55)

FEDUSA supports the principles. FEDUSA wishes to caution that the legislator should take extra caution when drafting the bill so that there is not a duplication of jurisdiction or confusion regarding the appropriate forum for disputes. In this regard the provisions of section 168 of the Constitution of the Republic of South Africa, Act 108 of 1996, read with sections 157 and 186(2)(a) of the Labour Relations Act, Act 66 of 1995 and section 30 of the Pension Fund Act, Act 24 of 1956 is a case in point of such jurisdictional uncertainties.

Section 5.6 (page 57)

It is strongly recommended that the legislator or registrar sets appropriate levels of trustee remuneration in consideration of the size of fund, its asset base and nature of a fund.

It is further recommended that the legislator spell out in more detail what is meant with the fiduciary duty and the duty of good faith of trustees.

IMATU also proposes that trustee training be compelled within certain time frames and that trustees be required to be examined and certificated, by a regulatory standard setting body. It is also proposed that refresher training be made compulsory, for example, every three years.

Section 6.5 (pages 62 and 63)

These recommendations are not supported by FEDUSA and we strongly object to the unilateral right, which the legislator wants to give to employers to change the nature of the pension funds to which employees belong. An employer can never have an unfettered right to determine the pension status of employees. Such a provision would be in breach of the employee's constitutional right to freedom of association and freedom of choice.

The proposal is a breach of contractual rights and gives employers, especially those within the State, the absolute power to renege on their contractual and common law obligations. At most the legislator should leave this matter to trustees and fund members to determine the status of their retirement funds and benefits.