

A. INTRODUCTION

South Africa like many countries is going through a very significant stage of socio-economic change, the Retirement Funds reform process. The Institute of Retirement Fund (IRF) is one of the leading role players in the industry and welcomes the long overdue process of retirement fund reform.

It is also significant to acknowledge and applaud the National Treasury's approach to the reform process. Unlike some countries, like the United Kingdom, South Africans have thus far been given an opportunity to express their views on the proposals made by National Treasury, in its Retirement Fund Reform Document.

To enhance the discussions on the National Treasury's document, IRF organized Indaba's on the entire rewrite of the Pension Funds Act. These Indaba's were intense discussions and open workshops and focused on the most pertinent issues highlighted in the reform document. The main purpose of these Indabas was to provide the entire industry with an opportunity to interact and comment on the reform document. A summary of the Indabas is contained in Part 1 of this Executive Summary. Full papers of all speakers from the Indaba's are available on the CD attached hereto.

Subsequent to the Indabas, IRF has collated in this executive summary and its annexures, written submissions from IRF Members in response to the National Treasury's proposal. The purpose of these submissions is to provide general views of our members on the reform document. These are contained in Part 2 of this Executive Summary.

The last part of this Executive Summary focuses on the most pertinent issues raised in the Indabas and submissions, and tries to provide IRF members

recommendations to the proposals made by the National Treasury in its reform document.

For ease reference, we have attached to this summary copies of presentations from the IRF Indaba's and submissions from members.

B. PART 1: IRF INDABA ON THE REWRITE OF PENSION

FUND ACT

B1. SOUTH AFRICAN RETIREMENT FUND LANDSCAPE: By: *Bruce Cameron*

As alluded in the above, most proposals made in the reform document have received great applause from the retirement industry. Bruce Cameron notes in particular, the National Savings Fund (NSF) which he regards as a major principle that provides solutions to some of the major gaps in retirement saving. However, Bruce Cameron notes the following factors as the most significant issues that the industry and document needs to address:

General Industry Improvements

Amongst other, the industry needs to improve certain issues such as trustee training, governance and professional trustees. In this respect, Cameron agrees with COSATU's view that it is superfluous to have professional trustees for a normal occupational fund if the industry has consultants. The issue of professional trustee is more suitable for umbrella funds or open umbrella funds.

South Africa, like the UK, also needs to improve retirement funds regulation by introducing severe penalties especially for late payment of benefits and inappropriate advices. Lastly, South Africa needs to improve funds reporting and disclosure requirements especially to its members. In this regard,

Cameron concludes that standardized codes of conduct for trustees and service providers and proper management of conflicts of interest needs to be introduced.

Compulsory Membership

Compulsory membership is advantageous and should be encouraged across the board. According to Cameron, compulsory membership contributes immensely to the wealth of individuals, families and the country. Most importantly, Cameron submits that compulsory membership alleviates the burden laid on social pension system.

Improved Member Rights

Cameron submits that because there are different kinds of funds, the rights of members in the proposed legislation need to be considered in the context of each of funds. Furthermore, he submits that pension funds members are the most vulnerable people in the entire retirement industry and the proposed legislation or the reform document must encourage formation or provide mechanism to set-up a national pension movement.

Broaden Access

Cameron views the issues of broadened access to retirement saving as a critical subject matter of pension reform and agrees with NTTT recommendations. The NSF according to Cameron is a proper vehicle to broaden access to retirement savings.

Leakage

The leakage issue according to Cameron is not only just about early withdrawals but it is about receiving lump sums instead of monthly pension. Another influence of leakage is poor investment. In this regard, he submits

that people chase the latest performer and thereby change funds on the basis of poor investment returns.

Investment Regulation

Taking into account the current Regulation 28 which has been breached continuously, Cameron submits that the reform document does not deal sufficiently enough with the policing of investments. Compounded to this problem, is the lack of trustee training and codes of ethics regulating issues such as conflict of interest. He submits that these problems need to be address in the proposed legislation or by the industry. Furthermore and on the issue of socially responsible investment, he concludes that member's choices need to be limited in certain instances.

B2. OVERVIEW OF RETIREMENT FUND REFORM DOCUMENT & REASONS FOR RETIREMENT REFORM: By: *Elias Masilela*

Masilela the leader of the NTTT on the retirement fund reform document under discussion seeks to provide in his presentation a clear exposition of the reform document and reasons for retirement reform. In the subject matter of his presentation, 'Key Themes in a Review of PFA 1956', we have noted the following factors:

Objectives Review

The most fundamental objective of the review process of PFA is to provide an effective and legally robust legislation. Through such legislation, Masilela submits will South Africans will be encouraged to provide adequately for their retirement, pension resources will be protected against erosion and standards of governance will be improved. He further notes that the objectives outlined in the reform document constitute the fundamental part of the entire reform document and without them; there is no purpose of reform or discussion.

Back-Drop

The National Treasury has taken cognizance of the continued piecemeal amendments of legislation and Masilela had submitted that the current reform process is no longer a mere legal process but a socio-economic challenge that takes into account issues of unemployment and their influence on South Africa's social security systems.

In relation to the above, Masilela justifies the review process and recommendations made NTTT under the following key themes:

Access

National Treasury considers the issue of broadening access to retirement savings as an important subject matter. In this regard, Masilela notes that access can be increased if South Africans can earn a stable income. However, this is one solution and other measures such as compulsion on the part of employers to provide a retirement vehicle need to be encouraged.

Benefits

Masilela concedes that the issue of benefits in general, is the most controversial subject matter that needs to be dealt with collectively. However, he notes in particular the issue of unclaimed benefits. The NTTT view in this regard is that unclaimed benefits must be paid to the state to assist in alleviation of burden on social grants.

B3. COST OF SAVING FOR RETIREMENT: By: *Rob Rusconi*

Through his intensive research on the issue of costs of saving for retirement, Rusconi has expounded the following issues and recommendations regarding this issue:

Costs

Rusconi's research shows that South Africa does not have a compulsory savings element as there are in other countries. On the international context, almost all systems have a common problem i.e. life expectancy. Rusconi highlighted that costs needs to be measured in two ways:

1. Reduction in yield – effective percentage reduction in annual return caused by the aggregate amount of charges.
2. Charge ratio – is a reduction in premium i.e. the percentage of premiums that have been eaten away by charges over a period of time.

It is recommended that the both remain in use.

Policy implications on the issue/s of costs

From Rusconi's research, the following policy issues were deduced:

- There needs to be transparency. This can be achieved from the implementation of minimum disclosure requirements. Even though transparency and competition alone does not reduce costs, it is nonetheless required.
- There should not be a closure of channels. For example the charge ceilings issue should be considered carefully as it has shown to be successful in other countries. However it is not suggested that charge ceilings must be implemented.
- A new class of products must be considered – which should be assessed in the context of SA's needs

Comments on Discussion paper

Rusconi is of the opinion that when the security of benefits are measured the poorest of poor are reasonably well taken care of by SOAP. The SA system is sound, the poor are in a good condition, and the wealthy are fine. However

those in the middle are where the major concerns arise. But, statistically SA has no record of how well those in the informal sector are in retirement.

Bearing this in mind it was submitted that that several issues emerge from the reform paper, namely:

- Security of retirement fund members are overstated. There is a concern about the lack of fiscal support for the National Savings Fund. Rusconi recommends that we need to have the numbers / statistics in preparing or planning for 2 or 3 generations ahead. For example how the costs for social security will change for the future is not discussed. There is no evidence of demographic modelling, AIDS pandemic considerations. We need to have some co-ordinated consolidated modelling.
- Costs have been under modelled in the research behind the Treasury document, especially for smaller funds. There's no modelling of career interruptions and currently we do not know how much SA is saving for retirement.
- The NSF may end up in the cold (not really a criticism but a caution). The concern is that the NSF is elegantly designed for the untaxed. It disincentivises the middle class and the wealthy, but it doesn't really encourage participation. If the taxed have been excluded, how does one encourage people to join in? Government supports the poor and the wealthy but doesn't appear to have concrete plans to support those in the middle. It is suggested that some sort of government-funded

bonus at retirement in order to incentivise membership all the way until retirement would suffice. A very simple order should be implemented to keep costs low, he suggests.

- Choice needs to be limited in order to keep costs down. For example the Thrift Savings Plan in USA offers only five investment options to the private sector in order to limit costs.
- In order to then determine whether access alone is sufficient to stave off dependence on the state in the old we need to ascertain how much that dependence is going to be, how much is it now and how much it would be in the future.

B4. ACCESS, PRESERVATION and INVESTMENTS UNDER THE NEW RETIREMENT LANDSCAPE: By: *Jeremy Andrew*

Jeremy Andrew states in his discussions that SA has a very curious part-compulsion part-voluntary system. Membership is compulsory if a new employee joins a firm and is eligible to belong to that particular firm's retirement fund or the retirement fund in which it participates in terms of the category definitions that have been laid down. Despite this, Andrew points out that high levels of coverage have been achieved in SA

South Africa's coverage contribution rates are also high. Therefore, Andrew's highlights that the major problem in SA is unemployment. Many other countries, like Chile, have managed to increase coverage by the simple method of compulsion. They compel membership of an occupational fund

and contribution of at least a minimum rate, and the intention behind that is that the resulting benefits will take some of the pressure off the state scheme and in order to make this appealing to people they provide generous tax incentives. But experience in these countries, Andrew states, indicate that compulsion can discourage entry into the formal sector – businesses that incur considerable costs, will have to belong to a retirement fund and then workers have to come on, and there are all sorts of costs associated with that and this can discourage one to enter the formal sector. Secondly, if a member remains in such a compulsory system for the minimum time, other alternative vehicles are being chosen such as investment in their own home to replace investment in the compulsory retirement system. Thirdly, the disadvantage with establishing a compulsion to contribute at least a minimum amount is that people will revert to that minimum.

The South African Position

Andrew is of the view that SA doesn't share many problems regarding compulsion. Our social-age pension is affordable and we have a successfully developed private retirement fund system.

Those people outside the retirement funding system (who fall partly in the informal and unemployed) need to be encouraged to save for retirement. The following was expounded by Andrew as the reasons this class falls outside the realms of the system:

- Occupational retirement funds almost only caters for people who are employed in the formal sector and more often than not it excludes the

informal and unemployed sectors. This is because of the high administration costs of bringing such people in for a short period of time and then paying a claim at the end of the period of employment (e.g. seasonal workers).

- If the contribution is small in rand terms, there are high administration costs relative to that contribution. Therefore if compulsion is not carefully considered – if those are the areas where people aren't in the system now, it could increase costs without significantly adding to the benefits to be enjoyed by the people who are currently outside the system.

Existing vehicles don't provide for irregular small contributions and access to savings in terms of life crises. Again administration costs are taking too large a portion of the amount available to be saved and we have two significant tax disincentives. Secondly, retirement fund tax penalises saving through a retirement fund compared to saving outside such fund for the informal sector and the unemployed. Thus a special savings vehicle is needed, like the NSF as recommended in the treasury document. The NSF should provide competitive returns – competitive with what a person could enjoy in other investment media. Jeremy Andrew's submits that it should be exempt from the means test in terms of the benefits that emerge.

Furthermore, the investment accumulation should be exempt from retirement fund tax so that the current tax disincentives in the retirement fund system for saving by the poor should be removed and we have to decide on cheap administration. There are two ways this can be done:

1. If we get enough people into the system it can be achieved by economies of scale; and
2. If other means were unsuccessful, then we could look for a government subsidy for administration costs and a simple uniform structure to try and keep costs down as much as possible.

Also, irregular contributions and withdrawals need to be allowed to meet life crisis needs. It was submitted that in SA we don't have the resources or time to investigate the reasons someone would want to withdraw their money. Currently, we have no tax means of encouraging people to save, because they don't pay tax anyway. Therefore Jeremy Andrew's suggests that we need to find more incentives outside of tax like a bonus on retirement, prizes etc – anything to encourage people to save their money and to keep it in there for retirement.

In his discussion Jeremy Andrew's alluded to statistics that indicate that the voluntary system that we now have achieved coverage and contribution rates are as good as most mandatory systems. Therefore we need to question the concept of compulsion and assess whether or not there is an alternative to compulsion.

- Firstly people should not be trapped into the formal sector system intended for people above the tax threshold (by means of an employment contract), if they would be better off in a vehicle for people below the tax threshold, like the NSF.

- If the employment contract is silent, the employer must offer educational training on the desirability of saving for a retirement and access to a retirement fund (occupational, individual for the NSF).
- Individual retirement funds are favoured if certain criteria is met ¹ and there is full disclosure of fees performance and individual members should be allowed to step out should they not be satisfied.

However, Andrew indicates that the primary retirement provision for the unemployed must be the social old-age pension. That is, for employees earning less than the tax threshold they should have, the social old-age pension but they should be able to supplement that with their savings from the NSF. Those employees earning more than the tax threshold should have a choice between occupational retirement funds and individual retirement funds. For the self-employed and individual contractors, they only have an individual arrangement to look for. In all cases, it is submitted; savings could be supplemented through banks, collective investment schemes, insurance policies and the NSF.

With regard to the issue of people having an inadequate benefit when they retire, two reasons are highlighted for this:

¹ Criterion: Individual retirement funds have no employer / employee relationship and they accept regular or irregular contributions. The contribution investment and benefit choice could be determined by the management board so that they may put together a desirable package. They should enjoy the same tax treatment as an occupational retirement fund and effectively there would be a contribution limit on the sum of member and employer contribution rates. Thus, transfer must be allowed at the request of the member. No inducement should be made to encourage the transfer and no penalties should be levied on members savings already accumulated in that fund if that member transfers.

1. Poor benefits on leaving service – This has been addressed by the Pension Fund Second Amendment Act through the imposition of minimum benefit levels. It is recommended that we need to ascertain how to encourage people to keep that benefit for their retirement. The National Treasury discussion paper suggests limited preservation²; and
2. Leakage.

Finally, on loss of employment, Andrew is of the view that, people need to be encouraged to draw on the Unemployment Insurance Fund and only once this Fund is exhausted, should they be able to draw on their retirement benefit.

B5. INVESTMENT UNDER THE NEW RETIREMENT LANDSCAPE: By:
Magda Wierzycka

Magda Wierzycka opines that the investment issues addressed in the treasury document have broad implications for the retirement industry in SA for many years to come.

Why should there be investment regulations within the retirement fund arena?

Wierzycka submits that Investment regulations and decisions are the most critical decisions that a board of trustees can take in the context of particularly

² This means that one should preserve benefits on a change of job and that would mean that you actually do retain employment one should transfer their benefits to a new fund or an individual fund or the National Savings Fund with no inducement payable on transfer and the benefit should only be payable in cash. The overriding principle is preservation of a fund's ability to guarantee a housing loan. If a Fund is guaranteeing a housing loan and the member agrees then there should be a claim against those benefits.

a defined contribution fund. However most trustees have limited knowledge and training regarding regulatory investment. In this environment therefore it is difficult for trustees to make objective investment decisions without a framework within which those investment decisions should be made and hence investment regulations are critical in terms of providing a framework for any investment decision-making, just from a safety perspective for everyone concerned.

Existing investment landscape

Retirement fund investments are governed by Regulation 28 of the Pensions Fund Act. Existing Regulation 28 was designed in an environment of defined benefit pension funds. Defined contribution investment pension funds only happened throughout the 1990's and Regulation 28 was never designed to address that and there are numerous problems with existing Regulation 28 viz;

1. Inadequate for defined contribution funds,
2. Inadequate for funds whose member investment choice has been introduced,
3. It doesn't recognise any fund specific needs or objectives,
4. It gives absolutely no guidance to boards of trustees in terms of an investment process that should be followed,
5. It doesn't adequately address many of the new investment instruments that have arrived on the horizon,
6. It doesn't allow for social responsible investments, and

7. All insurance policies with guarantees fall outside of Regulation 28³.

In recognition of the above shortfalls, the FSB together with National Treasury, convened to redraft Regulation 28. This resulted in the formation of, what has become known as, Draft Regulation 28.

Draft Regulation 28 has become a more process-oriented guidance document, to provide guidance to the trustees and was not intended as a framework of restrictions.⁴ However, some amendments were required for Draft Regulation 28 and the following limitations were highlighted by Wierzycka:

1. It was an expensive and onerous process to implement for many of the smaller funds which might not have access to specific investment advice and expertise;
2. It excluded all life insurance policies and unit trusts, collective investment schemes from being subject to the limits;
3. It had a problem in catering for smaller funds where essentially by virtue of their size, they are limited to investing in pooled portfolios which are available in the market, therefore it's virtually impossible to introduce a customised investment strategy if investments are so restricted;

³ Therefore some pension funds in South Africa have 100% of their assets invested offshore through structured-type policies with guarantees falling outside Regulation 28 and hence is now captured in the net of the regulation.

⁴ The few quantitative restrictions retained in Draft Regulation 28 had to do with diversification and protection from fraud, so there's no restriction which limits investments in individual shares to 7%,

4. No explicit encouragement of social responsible investments;
5. No mention of shareholder activism;
6. The 5% other investments was seen as both unclear in terms of how it would be applied in practice.

Wierzycka proposes that the new investments proposals therefore needed to take cognisance of the following:

1. It should provide guidance to trustees on appropriate investment strategies once they have taken into account the specific needs and objectives of their own funds;
2. That shareholder activism and socially responsible investments should be encouraged, given the economic and social needs of a developing economy such as South Africa;
3. That member investment choice, in particular, should be introduced only after careful consideration and should be made available to anyone.⁵

The **proposed framework** of the new investment regulation is highlighted by Wierzycka as follows:

1. It should be adopted into law subject to amendments,

simply to ensure that one's entire portfolio is not invested in one investment. Investment in sponsoring employer's are limited for obvious reasons and other investments were limited to 5%.

⁵ See below for further explanation of how member investment choice can be introduced and in under what framework.

2. A standard set of prudential limits for various assets classes be introduced for those funds which are unable to follow the process as defined in draft Regulation 28.⁶

The **process** to be followed in achieving this would be:

1. Trustees to formulate appropriate investment strategies for their funds.
2. To document that investment strategy and to communicate it clearly to all members of the fund.
3. Monitoring the success of that investment strategy on a regular basis, and an annual review of the strategy.

The above will be **policed** in the following manner so that it does have potential legal ramifications for the people involved in the process:

1. Trustees must consult investment experts in guiding them through this process;
2. Then an actuary / valuator must sign off, and verify the strategy as being consistent with the objectives and liabilities of the fund; and
3. The compliance of the fund with that investment strategy is reported to the regulators on an annual basis by an appointed official of the fund (compliance officer) ; and

⁶ Essentially this would mean that funds would, depending on their size, access to investment expertise, would decide whether they wish to comply with the set of standard prudential limits or whether they want to apply to the Regulator for exemption from those limits on the basis of having followed the due process as described in Draft Regulation 28.

4. The investment strategy and compliance is signed off by the chairperson of the fund concerned.

Some of the other requirements indicated by Wierzycka were:

- Disclosure of conflicts of interest (involves both trustees and product providers at individual and corporate level.
- Compliance officials can be any of the officials involved in the management of a retirement fund.

The implications of adopting Draft Regulation 28 would firstly include a positive impact on foreign investments.⁷ Secondly, there would be no limitation on any asset class if regulation 28 is followed and extends to unconventional asset classes like unlisted investments, property, hedge funds, derivatives and structured products. Therefore care must be taken. Thirdly, if a pension fund invests in a pooled portfolio and if that pooled portfolio does not comply with the standard prudential limits of any sort, in theory the asset manager would have the discretion to place the assets in anything they wish to, so that level disclosure from asset management industry would have to be there and scrutiny from trustees when investing in pooled portfolios. Fourthly, even though currently in SA the regulation applies to both direct investments and insurance policies, the loophole surrounding unit trusts have the potential of being exploited.

⁷ This means that any changes at the foreign exchange level will not affect retirement funds as they will still be limited to about 15% on the investment regulation. Thus foreign exchange controls could be scrapped without the fear of having a huge institutional outflow materialising.

Recommendations

Below is a list of recommendations Wierzycka points out.

Standard prudential limits – have to be complied with when the Draft Regulation 28 process is not followed. They were meant to encompass small pension funds that do not have the means of access to expertise in terms of implementing the proper investment process. However care must be taken that the standard prudential limits are not used by large pension funds. It is proposed that standard prudential limits should not be seen as a supplement to Regulation 28. Instead it should include some form of guidance on strategic asset allocations for smaller funds or for different risk profiles of membership in smaller funds and they should reflect a desire to encourage social responsible investments, and investments in broader asset classes. Furthermore standard prudential limits should be tight so as to prevent exploitation by product providers.

It is also proposed by Wierzycka that all funds that do not wish to follow standard prudential limits should be obliged to adopt Regulation 28, and apply to the regulator for exemption from that process by virtue of adopting standard prudential limits. This would give the regulators more control over which funds are actually not following a proper process. Alternatively, all funds should be obliged to follow both the process and the standard prudential limits unless they apply to the regulator to be exempt from following the standard prudential limits.

Member investment choice

Trustees introducing member investment choice

- Must ensure that members are trained and have ongoing access to suitable expert advice.
- Any portfolios that are offered should follow appropriate risk profile strategies.
- The performance of those products should be monitored by the board of trustees.

- Investment options should be limited to three to five choices.
- Default investment options must be made available.

Funds offering member investment choice

- more guidance is required on how this will apply to umbrella funds.⁸

Other additional recommendations

- Regulators should suggest performance benchmarks for monitoring of asset managers and trustees should then monitor achievement of those targets. It is suggested that it would be practical that investment regulations mention types of acceptable benchmarks without being too prescriptive.
- The treasury document does not provide sufficient guidance with regard to social responsible investments. It is proposed that social responsible investments should be defined. It also has to be discussed whether such investments should be prescribed, example by providing any limitations. Furthermore social responsible investments should have some tax incentives introduced into the system.

B6. BENEFITS, CONTRIBUTION RATES & MEMBER PROTECTION: By: *Rosemary Hunter*

Rosemary Hunter's presentation provides a discussion of significant issues raised in the pension fund reform document. In particular, her presentation centers around NTTT's proposals on the following issues:

⁸ Because in typical umbrella funds, the choices that are offered have seldom much to do with the boards of trustees joining the umbrella fund, they are standard offerings of that particular umbrella funds so its difficult to marry the fact one is buying into a standardised product .

Benefits

Under this subject matter, Hunter raises an important debate. The purpose of saving for retirement. She submits that more money is spent on non-retirement funding benefits such as death, disability and funeral benefits. In her debate, she argues that the non-retirement funding benefits reduce the money that was intended for retirement. However, in the context of AIDS pandemic she agrees with the NTTTT's proposals that payment of these benefits is more important than retirement funding.

Contribution Rates

Hunter concurs with the need to encourage people to save early for their retirement. However, she acknowledges the fact that for the majority of South African, saving early for retirement is practically impossible. In this regard, she submits that for some people there is simply nothing to save after payment of food bills, school fees and housing costs.

Member Protection

With respect to member protection, Hunter supports the recommendation made in the pension fund reform document. However, on the subject of pension increases, Rosemary Hunter submits that the proposed legislation should make it clear whether if the rules of the fund grants the employer the right to veto pension increase it can veto pension increases granted in terms of the pension increase policy.

In her conclusion, Hunter has concerns over the proposal that the wishes of the deceased member should be followed. In particular, she notes that some

members fail to elect beneficiaries of death benefits and some do not disclose their children born out wedlock or same sex partners. In this regard, the proposal of the NTTT makes these persons vulnerable in their claims of death benefits.

B7. BENEFITS, CONTRIBUTION RATES & MEMBER PROTECTION- A REGULATORY PERSPECTIVE: By: Mike Codron

This discussion by Mike Codron was made in the context of smaller funds which were termed the “20-man funds”.

Umbrella funds

Codron was in favour of umbrella funds only if they are properly run and he expressed a concern for people churning funds from one fund to one umbrella fund to another in order to generate additional fees for each other.

Furthermore in the context of smaller funds it would be difficult to educate members, member trustees and employer trustees due to limited finances.

This will therefore impact on the level of performance. Thus it was submitted that good governance is essential.

Regulation 28

He explains that it would be difficult to incorporate Regulation 28 into a 20-man fund. The default option is certainly one way of resolving the problem, but the cost of doing the job properly will basically erode all of the contributions.

Benefits

The conversions from DB to DC have mainly happened and the real issue according to him is whether they are fully funded if they still are DB funds?

SA is, as far as this aspect is concerned, way ahead of a lot of other regulators around the world.

Member choice

Clearly it would push up the cost of administering the fund. However if somebody does think he is competent, and does want to have some sort of choice, then he should pay for it. Why should the rest of the membership pay for it?

Longevity – Longevity of people in pensions funds have increased. Therefore costs are going to go up.

Transferability – He fully supports allowing people to transfer from funds especially individual funds if they so wish. There are however concerns regarding guarantee funds. When a person leaves what value does he get? Good governance is central to removing cross-subsidy between people which is an unfair cross-subsidy. This will in turn ensure smooth returns.

DB and DC funds – There is a need to maximise the investment returns, minimise expenses and maximise contributions. The reasonable split between retirement benefits and risk premiums is an important issue. Here again good governance is essential.

Leakages – the ordinary retirement funds do not make a lot of sense to those who are earning a very low salary. For them, it is worth their while to spend their pension money as soon as they can and not to keep it for retirement because even if they keep it for retirement, their retirement pension is not going to be that much different.

Contributions – With regard to unclaimed benefits, it should be for the benefit of the country as a whole. The incentive for a fund not to try and trace

unclaimed beneficiaries and to leave the money in the fund for the remaining members must be high and is therefore one of the reasons for non-support for it remaining in the fund.

Member protection – to achieve this, good governance is imperative. In some circumstances independent trustees can be more useful to a fund.

Good governance and educated trustees are important. But in the context of the 20-man fund, this will be difficult to achieve. From a good governance point of view, there is a need to have annual valuations so that costs may be cut down as much as possible. DC funds do not require reviews or evaluations. There should be a move towards at least annual reviews.

Investments – Trustees' duties to minimise fees and maximise investment returns.

SRI Investments are definitely required. However 2 requirements must be satisfied:

1. We need some kind of definition of what a SRI is; and
2. We need to make it compulsory to invest a percentage in SRI's (otherwise nobody will actually do it).

Conflict of interests – anybody who is in the pension industry should declare their personal interests.

Gifts and rewards – We have to be careful about excessive rewards and there needs to be a balance between being able to look after clients without getting something too excessive.

The Regulator – those duties where the regulator does not add any value to need to be removed from the regulator. It should be passed to other parties in the industry.

B8. REGULATION AND GOVERNANCE: By: Stella Seletse

According to Seletse, the policy objectives of the reform paper in assuring a sound regulatory framework is to cope with the risks that we have in retirement funds in SA. The paper talks of the powers of the regulator on issues like dispute resolution and touches on labour law. The current powers of the regulator are limited and all the regulator can do is take legal action to recover monies unlawfully removed from retirement funds. He can also seek replacement of a board of trustees. In limited circumstances, because he has to have this done via a court of law, he cannot sanction service providers. He also has the power to levy modest fines on funds which failed to lodge documents on time.

The reform paper proposes to that the Registrar will have the power to act against trustees, service and product providers by having the powers to fine, expel, suspend and even withdraw licences from service providers.

Seletse, is of the opinion that this could be dangerous because we've moved away from that autocratic type of dispensation into a democratic dispensation and what we're avoiding in South Africa and probably internationally is to have a one-man show, or to have a body that has autocratic powers. A more democratic process is needed if the registrar has powers to decide to remove a trustee or decide which service provider to expel or have licences withdrawn. If possible it should be left just the way it stands.

Institutional regulation vs Self-regulation

The registrar's office speaks of institutional regulation and not self-regulation in the industry. Internationally self-regulation has become a tool that has been used in the financial services industry and so should South Africa. Seletse alludes that we need to have a more synchronised industry whereby the service providers, product providers, the regulator and all other stakeholders in the industry co-exist. Some might argue that practically this is not feasible because there are many trustees and many fraudulent things happening in the industry. Unlike other industries, the retirement industry doesn't have a professional body that can ensure that self-regulation does take place. For example an institute like the Institute of Retirement Funds could enhance itself and become that professional body. This professional body can ensure that governance happens because it will have self-assessment mechanisms in place to ensure that the industry takes responsibility for regulation in the industry. There are various advantages of self-regulation. If we had a competent professional body which has all the expertise we would be able to elicit a lot of concern from trustees and the service providers who are being regulated.

With regard to umbrella funds there seems to be some contradiction in the reform paper. Umbrella funds are basically set up to ensure cost effectiveness. The National Treasury recommends that there be an audit of all sub funds in an umbrella fund. This is not cost effective. Therefore it is recommended that umbrella funds be audited just as a fund the way it has always been because after all the insurer who is in charge of this fund is going

to ensure that this audit has been completed and done within acceptable parameters.

The establishment of specialist tribunal regarding dispute resolution is commendable and can be done via the Pension Fund Adjudicator's office being further enhanced and given more powers to take on the duties of that special tribunal

B9. REGULATION & GOVERNANCE: By: *Prof. Dilip Garach*

The fact that we are moving from a DB to DC fund, the fact that people are living longer it is important from a policy objective point of view that the idea is to improve fund governance. This discussion focuses on the custodian (trustees and service providers) and beneficiaries (members).

Trustees have to be responsible and accountable. In comparison to directors of a company trustees lack provisions with regard to liability in the event of negligence of performance of duties.⁹

Delegation of authority and the extent you can delegate responsibility - It is important to understand that trustees have fiduciary duties to the fund. Unfortunately they believe that they represent either the union or the in service members or the pensioners or the employer. Therefore in order to move away from this, we need to encourage trustees knowledge and education. But how do we get that trustee knowledge is important. It has to

⁹ Section 424 of the Companies Act on the other hand deals with this aspect for directors of a company.

be discussed whether there is going to be a formal certification programme, whether short courses are available or do they just acquire those skills?

Another contentious issue is the *payment of remuneration to trustees*. Do you pay them? And if so do you pay them first? Do you pay them for attending meetings etc? These issues have to be re-visited.

C. Part 2: IRF MEMBERS SUBMISSION IN RESPONSE TO THE NTTTT

RETIREMENT FUND REFORM DOCUMENT

Introduction

This section constitutes a summary of submissions made by the Retirement Fund Industry to the IRF. In general the submissions received from the industry support the proposed reform as per the discussion paper of the National Treasury Task Team (NTT). However, the members wish to record the following submissions and recommendations for consideration in the proposed reform process.

Annexure 1: SA Retirement Fund Landscape

Members submitted that the increase in the threshold for deduction is supported however the position of the National Savings Fund (NSF) in the three pillar systems needs to be clarified.

Annexure 2: Access, compulsion, and preservation

South Africa's current retirement funding environment has been based on a system that contains an element of compulsion whereby employers are required to have all employees who fall into the defined category for membership to compulsorily become members as a condition of their employment.

National Treasury (NT) proposes to merely require those employers who do not provide retirement funding vehicles to provide payroll facilities and to inform their employees about their retirement funding options. The Institute of Retirement Funds (IRF) is concerned that such a less compulsory environment could undermine the successful levels of retirement savings as individuals opt to fall outside of existing occupational funds and choose not to contribute or to reduce, over time, their levels of contribution to individual retirement funds and/or the National Savings Fund, to the lowest minimums.

The voluntary savings ratios have been declining over the years and it is a grave concern that open voluntary participation in retirement funding vehicles will further undermine retirement provisions. This will further lead to the employer's occupational retirement fund suffering the loss of economies of scale as well as the benefits of cross-subsidisation of costs and ancillary benefits between low and higher paid employees, as employees choose to contribute elsewhere.

Generally members agreed with the compulsion system, however they recommended that the existing international models be investigated thoroughly with the objective of implementing a similar approach in SA.

Furthermore, members expressed that the disadvantage of compulsion has the potential to push people into the informal sector since compulsion is mostly applicable to the formal sector. As a result, the members recommend that the Regulator should encourage education on compulsion within the informal sector.

Preservation: In general members support preservation. However, they recommend that preservation must be compulsory.

The IRF supports the proposals of National Treasury to preserve exit benefits but also recognises the need to consider earlier access in times of life crisis.

Such earlier access and access to lump sums on retirement may be discouraged through the imposition of more penal tax rates which aim to claim back such portions of tax relief already granted to the individual. Minimum amounts available as cash lump sums may also be considered.

The opportunity for members to default on housing loans granted under guarantees of retirement benefits to gain access to retirement funding capital will also need to be considered. The provision of guarantees will also need to be considered in relation to retiring members ordinarily only entitled to gain access to no more than one-third of their benefit.

National Savings Fund:

The reform paper further suggests the setting up of a national Savings Fund (NSF) to provide access to individuals who have limited access to an adequate retirement fund vehicle. It is aimed at lower income earners and the informal sector and would allow irregular contributions on an ad hoc type basis to the Fund

The NSF would allow access to savings benefits for a life crisis need and may significantly undermine the levels of retirement funding for these categories of employees. Certain incentives in the form of tax exemption and bonuses for individuals who retain savings until retirement are proposed. The NSF would be exempt from the means test and members would also be entitled to receive State Old Age Pensions (SOAP). It will also be exempt from Retirement Fund Tax (currently 18 % on rental income and interest bearing investments).

The major concern from the industry on the NSF is that it is a savings fund as opposed to a retirement fund and no mention is made of any risk benefits for members in this fund.

Members generally accept the proposal on the formation of the NSF provided it is structured as a pure defined contribution arrangement.

However, members are of the opinion that it would be unfair to limit exemption from the means test exclusively to members of NSF. Thus, it is proposed that exemption from the means test should remain based on the level of income of the member and not on membership of any particular fund. This would

encourage retirement savings whilst at the same time provide for freedom of choice with regard to the retirement fund selected. Members are further of the view that the proposed NSF tax exemption should be extended to retirement funds in general, but only to those who are low-income earners.

With regard to bonuses paid to people who remain in the NSF until retirement, members are of the view that this may result in cross-subsidisation between people who are in the NSF for a short period of time and those who are with the NSF for longer. Further, members submit that it would be difficult to ensure members are not unfairly prejudiced by early withdrawals from the NSF.

Differentiation: Members welcomed the proposal to prohibit distinctions that amount to unfair discrimination but raised the following concerns regarding what can be deemed as unfair distinctions:

Restrictions on membership eligibility based on employment status;

Differences in benefit values based on age

Annexure 3: Benefits, Contribution Rates and Member Protection

Members expressed concern over the interpretation of the term “modest” as discussed.

Adequacy of Retirement Benefit – it was proposed that the possible increase in the maximum tax-deductible contribution levels for persons above 40 be investigated.

Loss of employment – Members recommended that where the termination of employment amounts to an involuntary loss of employment, an income benefit be provided, subject to certain benefits.

Annexure 4: Governance and Regulation

Members disagree with the transfer of regulatory functions from the Registrar of Pension Funds to “licensed Practitioners”. However the following concerns were raised:

- That these regulatory functions fall into the realm of administrative law, rather than functions that can be privatised.
- The role of such practitioners will further become a source of business for retirement fund administrators. This potentially opens the system for abuse especially if practitioners have whistle-blowing powers and ad hoc inspections;
- There are cost implications, as current fee structures are not feasible.

With regards to governance, members recommend an industry body for Fund Trustees should be established and this body should be required to draft a template of the code of conduct.

Members are also of the opinion that the limitation on the number of employers participating in one umbrella fund is superfluous and recommend that the control of administrators can be done by other means.

Preservation and portability

The IRF supports the proposals of NT to preserve exit benefits but also recognises the need to consider earlier access in times of life crisis.

Such earlier access and access to lump sums on retirement may be discouraged through the imposition of more penal tax rates which aim to claim back such portions of tax relief already granted to the individual. Minimum amounts available as cash lump sums may also be considered.

The opportunity for members to default on housing loans granted under guarantees of retirement benefits to gain access to retirement funding capital will also need to be considered. The provision of guarantees will also need to be considered in relation to retiring members ordinarily only entitled to gain access to no more than one – third of their benefit.

Pension versus Provident Fund Benefit

The NTTT recommends pension replacement rates of at least 75% for lower income earners and lower percentages for higher income earners. Retirement and death benefits should primarily be taken in the form of income for life as opposed to lump sums on retirement. However the consideration of a phasing-in period or granting those members who have saved for their retirement under a provident fund regime the retention of their vested right to take their benefits as lump sums, is critical.

Massive withdrawals from voluntary preservation funds are likely to take place should there not be vested rights or phase-in periods.

Trustee Training and activism

The effect of up-skilling of workers through voluntary participation in Sector Charter objectives and targets are recognised.

The IRF aspire to the implementation of minimum levels of education for trustees over time. The IRF is concerned with NT proposals to require that the standard for trustees be changed to one of the “prudent expert” as the current levels of trustees’ competency will cause most trustees to fall outside of these requirements.

The IRF are eager to work with NT to develop appropriate measures of mentorship whereby experienced trustees can mentor new trustees, as well means to ensure that the board at all times consists of knowledgeable and passionate trustees.

Furthermore trustees play a pivotal role in the retirement industry. They are responsible for making the accurate decisions for the fund and these in turn will have a serious impact in a members post retirement savings. However, the lack of meaningful participation from the people at the core of all fund activities – the trustees, is currently dismaying.

Fund members need to ensure that their own activism in their fund does not end after they have elected 'their' representative as experience is illustrating that not all trustees are actively involved and taking steps to improve their level of awareness and training in the interests of their constituents. Members need to ensure that their representatives constantly remain abreast of developments in the industry and are well equipped when representing their members' interests since this is not happening effectively at present.

The call for the termination of service provider domination in the industry has been long overdue.

As a start point all trustees owe it to their members to study the current Retirement Reform paper and pass their comments regarding the same.

In fairness, the lack of trustee activism seems to be not peculiarly specific to South Africa since as late as last year the Minister of Work and Pension in the United Kingdom questioned the lack of involvement of trustees in their own reform process.

Other Issues

The IRF supports the socially responsible investment proposals and notes that the right mindset to such investments is created through a more voluntary process such as the Financial Sector Charter.

Recommendations & Concerns Raised at the Indaba's

Pension funds vs Provident funds

The reform document should revisit the advantages of provident funds especially in light of life expectancy issues. The paper also does not explicitly recognise the need for a transition period if one is phasing out provident funds.

Death - It was highlighted that the rules of a pension fund provide that if you retire within the fund, one is entitled to a monthly pension and upon death a surviving spouse would get 50% of the income and the entire lump sum is lost altogether as opposed to being inherited by family etc. Thus the pension fund is benefiting all the time. This shortcoming needs to be addressed in the reform document.

Lack of day to day management – The retirement industry doesn't have a day to day manager and this duty is now being fostered onto the service provider. We can't rely on trustees to meet every quarter to do this.

There's a place in the industry for professional trustees who should have the necessary qualifications to do the job and be adequately paid for it. A system must have flexible parameters in it to enable change to take place and to be properly controlled.

Member apathy – We are targeting the industry and the players in the industry, but we also need to encourage people to take an interest in their retirement savings, instead of being paranoid of how they should invest it.

With the move from DB to DC pensioner investment choices needs to be expanded on.

In order to address the issue of costs of smaller funds, we should evaluate as an interim measure some equivalent to the US 401K plans where unit trusts (which is one of the best regulated financial sectors in our country) is used as

a pension fund with the proviso that there's no upfront management charges only management fees.

The issue of benchmarks being set by the regulator needs clarification. The regulation should set out a range of suitable benchmarks but at the same time should not be too prescriptive.

Pension on divorce – It would be a more workable solution that on divorce the benefit is clearly defined and it is then either transferred straight to the non-member's spouse's fund if she has one, otherwise to a preservation fund or retirement annuity. Here she will be able to decide if she wants the money to be invested or what underlying investment portfolio should be used for that

CONCLUSION

In summary, apart from the submissions above, members support the intentions of the draft discussion paper. However, there is a general consensus that the paper should have extended the ambit of its discussions to cover the taxation of pension funds and its application to bargaining councils and government sector funds.

The IRF cannot emphasize enough that the review of taxation, now long overdue, needs to urgently follow the progress made with regard to the reform discussions and proposals that have taken place so far.

Finally, it is our belief that the National Treasury structured consultation process on the reform document, when compared to the UK, has been a milestone in trying to achieve its objectives articulated in the discussion paper.

D. PART3: APPENDIX & MISCELLENEOUS

D1. TRANSCRIPTS FROM INDABA

D2. IRF MEMBER COMMENTS