JSE SECURITIES EXCHANGE

SOUTH AFRICA

DISCUSSION PAPER ON RETIREMENT FUND REFORM

A Representation On The Role The JSE Securities Exchange (JSE) Can Play In Promoting Effective Retirement Savings

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1. BACKGROUND

For some time now, the low level of retirement savings by the general population has been of considerable concern to the Government of South Africa. Insufficient saving by private individuals places huge strain on the fiscus of the country, in that those with insufficient means to support themselves in retirement make use of the government social assistance grant programme.

In response to this, the government plans to institute several reforms to retirement savings legislation and in this way provide a more accessible, cost efficient and transparent industry.

The "Retirement Fund Reform Discussion Paper" ("the Paper") refers to several objectives. Among these objectives are that the government seeks to:

i. encourage individuals to provide adequately for their own retirement and the needs of their dependants; and
ii. ensure that retirement funding arrangements are cost-efficient, prudently managed, transparent and fair.

It is regarding these two objectives in particular, that the JSE believes it can provide a valuable service to retirement savings reform. The specific proposals of the JSE will be more fully explored later in this paper.

2. REFORM OBJECTIVES

Based on the Paper and the Institute of Retirement Funds Indaba held on the Paper, it appears that included in the intention to make retirement saving accessible to more people, the government also intends to open up the range of products available to savers.

Historically, the government has supported specific products such as retirement annuities and pension funds by granting tax incentives for people to invest in them. While these incentives do encourage people to save for their retirement, the tax benefit gained is largely eroded by the cost involved with investing in these types of instruments. Many cost-efficient savings vehicles fall outside of the definition of pension fund or retirement annuity, and investors therefore don't qualify for the tax incentives for retirement saving.

This is clearly not to the benefit of these investors and, in effect, disincentivises them from using these low cost investment alternatives.

Another area of concern is the inability of investors to manage their own funds rather than pay investment professionals to do same. While we understand Government's concerns with allowing the average person in the street to manage a portfolio of investment products, we do believe that retirement savings that are supplementary to pension funds could be left more to the investors' discretion.

3. JSE PROPOSALS

The JSE therefore wishes to make two proposals regarding retirement fund reform.

1. **The Government should consider providing tax incentives for all approved retirement saving products**

Many well regulated, cost-efficient and transparent products currently do not qualify for tax incentives for retirement savings. While the JSE does not favour throwing the market open to all savings and investment vehicles, we do believe that the current offering of tax incentivised products could be expanded upon. Collective Investment Schemes and Exchange Traded Funds are amongst the most cost efficient savings vehicles available on the market, but investors are not incentivised to purchase them for retirement provision. We are aware that not all CIS's and ETF's can be categorised as cost-efficient, and the JSE would therefore propose that a cost ceiling be placed on these instruments in order to qualify for approval as a retirement savings vehicle.

The issuer of these products would also have to demonstrate to Government that they have adequate controls in place to ensure that investors cannot withdraw funds from these products unless in accordance with the conditions laid down by the product provider. Any such withdrawal should, as with pension funds, be subject to the normal tax consequences which will prevent investors from using the product to speculate or to save for other purposes.

Similarly, these instruments should not be used for estate planning or non-retirement fund purposes, and it may be worthwhile to consider a stipulated age or ages at which an investor is compelled to purchase an annuity with the proceeds of the investment.

This proposal also includes self-managed individual pension funds managed on the JSE. Many investors wish to take more responsibility for their retirement savings and should not be denied tax incentives for doing so. It is essential for the development of our country that we encourage a deeper level of financial literacy and competence. Encouraging people to manage a portion of their retirement saving would actively build their literacy and competence. While we do not propose that investors cancel their pension funds and invest all of the cash themselves, we do propose that investors who wish to self-manage their supplementary retirement savings be able to do just that.

We propose that all purchases for these Self-managed funds should be made through a professional stockbroker, who would also be responsible for ensuring that the individual retirement fund accounts are Regulation 28 compliant, as well as provide investment research and recommendations. In this way the Government can take comfort from the fact that the investor has received professional advice before making his/ her investment choice.

The Government would also be at liberty to set investment guidelines, or prudential limits, for these individual funds, and this would ensure that individuals are not over-exposed to derivatives and other sophisticated instruments.

2. The Government should consider using listed Collective Investment Schemes, such as Satrix, for the equity portion of the National Savings Fund (NSF) and Individual Retirement Funds (IRFs)

Satrix Collective Investment Scheme is an investment vehicle that tracks the benchmark indices of the JSE. It currently comprises three funds; Satrix40 that tracks the Top40 index, SatrixFini that tracks the Fini15 index, and SatrixIndi that tracks the Indi25 index. Satrix differs from other Collective Investment Schemes in that the participatory interests are listed and traded on the JSE.

Listed Collective Investment Schemes have several advantages over their unlisted equivalents. These advantages are:

Intra-day Trading

The price of an Exchange Traded Fund is dynamic and changes intra-day. Investors can therefore take advantage of intra-day price movements.

Cost

Exchange Traded Funds are extremely cost-efficient. There are no up-front fees payable for purchases in the secondary market, and the invested capital of an investor is never reduced to cover costs because these running costs are off-set against income in the fund.

Disclosure

Investors are aware, on a daily basis, of what the basket of shares represented by an ETF comprises. This allows investors to accurately price their participatory interest, as well as take advantage of any arbitrage opportunities.

Regulation

ETF's are well regulated. In addition to falling under the Collective Investment Schemes Control Act, listed products are also regulated by the JSE Listings Requirements and the Securities Services Act.

4. SUMMARY

The JSE agrees with the rationale to reform retirement savings legislation and supports the current initiative by Government.

As the primary source of equity investment and trading in South Africa, the JSE feels that we have an active role to play in the formulation of new policies and guidelines for retirement saving, and would welcome any opportunity to make a contribution to the process.

Our proposals encourage cost-efficiency and transparency; areas fundamental to the success of the financial market of which the retirement savings industry is a major part.