

FROM: Jacques Malan Consultants & Actuaries

We would like to take this opportunity to provide you with feedback on the proposals contained in the National Treasury's discussion paper on retirement reform issued in December 2004. We are an independent actuarial and consulting practice that operates in South Africa, Namibia and Botswana. We consult to retirement funds, smaller Insurers and medical schemes. We do not sell our own products and steer away from administration of funds so as to limit the potential for conflict when advising our clients. We have been in business since 1st July 1995.

OBSERVATIONS

- The tax treatment of retirement funds (by your own admission not considered in this document) is critical in the whole process. Without tax incentives the retirement fund industry and provision for retirement will probably die!
- The National Savings Fund (NSF) is an interesting concept, but you must be able to justify the "preferential treatment" given to members of this Fund relative to members in other pension funds i.e.:
 - exemption from RFT;
 - exemption from the means test.
- Further observations on the NSF:
 - Administration can be a nightmare (even if you keep the benefit structure simple). For this reason the membership should be limited to the category of members that are not accommodated in other funds. All attempts should be made to guard against misuse, fraud and a collapse in the service to the members.
 - By setting a maximum administration fee, it is likely that this fee would be insufficient and some form of subsidy will be necessary from taxpayers. Please be circumspect when setting the fee to limit the subsidy.
 - Should the proposals be implemented as is, you could find a migration of (eligible) members to the NSF due to the favourable tax treatment and exemption from the means test. This might not be welcomed by the management of the current funds.
 - Consider investment managers other than the PIC for this Fund. An alternative approach could be considered i.e. that investment returns could be subsidized or provided by the State by granting a fixed rate of interest e.g. inflation plus 2% for example. The assets then become part of Treasury's assets.
 - The NSF should **not** "permit withdrawal of savings for any purpose" since this will turn it into a casual savings scheme which would compete with the banks and the traditional Stokvel market. Limit withdrawals to clearly defined "life crises". The same conditions should apply to all funds including the NSF.
 - You are concerned about the possible abuse of the NSF, but you should also try to ensure that individuals at whom the NSF is aimed (inter alia people outside the retirement industry who are below the tax threshold) actually end up in the NSF. To transfer members out of an Industry, Private or Union Fund should not be promoted if the tax treatment and nature of the benefits are the same. You are proposing that these individuals (below tax threshold) should be entitled to membership of the NSF. The problems of giving such members

a choice will only lead to misunderstandings and they will lose the cross-subsidy from the higher-paid members of such funds. There should also be a proviso that they should be allowed to withdraw from the NSF should they become tax payers in the future, or transfer to another pension fund if they so wish.

- The introduction of the NSF and transfers to Individual Retirement Funds will place a huge burden on Employers with regard to advice, administration of contributions and benefits communication. We are also of the opinion that the transfer of retirement credits to Individual funds are promoted by parties who have a vested interest in building a business out of such advice to Treasury.

PROSOSALS WHICH WE DO SUPPORT

- We are very supportive of the following recommendations i.e.:
 - compulsory preservation, but the political will to implement this will be tested in the potential conflict with the existing situation;
 - making the retirement fund an effective vehicle to pre-fund the post retirement medical aid liability of an employer;
 - providing ancillary benefits via the retirement fund (in particular monthly disability income benefits). This does however present the problem of all declined disability claims ending up at the Adjudicator;
 - setting a minimum for contributions allocated towards retirement benefits. If the limit is set in Rands, then it will be impractical, and as a percentage of salaries will mean that a low savings rate could be implemented in a fund with external free-standing insurances for the risk benefits. The Task Team should also consider to call funds with contributions under this limit by another name e.g. Savings schemes and not Pension funds, because the name Pension fund has been abused in the past to let members think they are OK when they are not;
 - total transparency on all fees and communicating it to members;
 - targeting 75% of earnings as an appropriate retirement benefit and then also your proposals on inflation protection in the design;
 - higher tax deductibility for older people (age 40 onwards);
 - variable contribution rates;
 - to limit housing loans to the "collateral route" (and do away with direct housing loans made by Funds);
 - cleaning up the administration of divorce;
 - favouring pension benefits and limited cash lump sums (basically doing away with provident funds). Again, the conversion to a new basis may require some grandfathering for old funds.

PROPOSALS WHICH WE DO NOT SUPPORT (and our suggestions)

- The Proposal to pay death benefits according to nomination forms or an expression of wish. Section 37C should be retained because of the "valuable social service..." it provides to the dependants of deceased members. We are of the opinion that the advice to Treasury comes from parties that want to limit the problems related to fulfilling the desired (in our opinion) social function of looking after dependants in the first place.
- Nullifying the effect of the NSF by turning it into a saving scheme that allows withdrawals at the discretion of the individual. A tontine bonus will not stop people from making these withdrawals. Voluntary withdrawals can also negate "compulsory preservation". Our suggestion is that voluntary withdrawals should be limited to clearly defined life crises, and that this be the same for all funds (including the NSF). Life crises differ per individual and the pressure will be to relax it so that it could become a withdrawal on demand.
- Trying to over-regulate fees. Consumer awareness and general competition should keep fees in check if such fees are communicated to the buyer and therefore published as per the FAIS requirements. We do strongly support fee transparency.
- A central unclaimed benefits fund will not be well received. We are of the opinion that Funds will be more successful in tracing former members than a Government body (which can be open to abuse by tracing agents).

REGARDING THE INVESTMENT RELATED ISSUES

Regulation 28 – The previous proposed changes to draft regulation 28 have been widely debated and are generally accepted as the best approach. The main drawback of these proposals is that the cost implications of implementing the required process would be prohibitive for smaller funds. The current paper indicates that “limits” will still be applied but that Funds who go through the necessary process to set their own strategy will be able to obtain exemption from these limits. We view this as a positive step but the authorities need to understand that such default limits will, to a large extent continue to drive the market and considerable care and research must be put into developing suitable limits which move with the markets (i.e. will have to cover developments such as hedge fund investments).

SRI investing: The concept of supporting SRI investments but not at any cost is one which we support strongly. Too many suppliers regard the labelling of a product as SRI an excuse for providing below market returns. Correctly managed, SRI can form an important pillar of every fund’s investment strategy and one which provides superior returns in compensation for the higher risk and often lower liquidity restraints of such products. Trustees must, however, always consider the primary aim of providing real growth on assets. We would like to see a distinction between Social Responsible Investments and Social Development Investments. The first can include products which don’t invest in certain industries or do invest in companies which meet certain labour requirements. We think the emphasis should rather be on investing in products which help develop the broader social economic environment.

IMC – We support the concerns expressed regarding the introduction of Individual member choice (IMC), but would like to see this area regulated more – in particular, we think Trustees should have to explain to members the cost implication of the introduction of such a scheme prior to making a decision. The members who use the individual choice option should pay the extra cost. We also support the concept of restricting the choice to 3 or 5 risk profiled pools for most members. However, we think exceptions should be allowed. For top hat schemes or those catering for executives with access to financial advisors, there is a place for an open market option which would allow members to position their retirement fund investments correctly within their overall investment portfolio.

Benchmark – The concept of the Registrar providing a general benchmark for Trustees to compare their performance against seems to run contrary to the contents of the revised reg 28 which is based on the principle that each Fund must select a strategy (and benchmark) which is most suitable for their liabilities. With the provision of a general benchmark, care must be taken that this doesn't result in a continuation of the situation of herd like behaviour from asset managers.

CONCLUSION

The above comments were constructed with our experience of the RSA market. On balance we believe that the debate is healthy but that there is not enough focus on the empowerment of Trustees that has taken place since member Trustees have been introduced to all funds. Their training has led to an improvement of the understanding of investment markets and the social functions of such funds. The further development of this trend should not be diluted by attempts by certain industry players to nullify the power of member Trustees, for example in umbrella funds. Despite the problems of having member Trustees, they add value and must be supported for the interest of the membership. The concept to expect a higher level of operation than in the past is also not necessary in our opinion, since they should act within their talents and not be expected to suddenly become an 'expert'. Such elevated requirements are more suited to 1st world economies and will reduce the probability of the average member to become a Trustee. In the same vein, we have not been impressed with most independent Trustees who, because of their perceived expertise can become technically the only Trustee in a Board and effectively make all the decisions.

In addition, the NSF could be a monster that could devour well-run private sector funds, and limit the growth of the financial industry in RSA. We strongly suggest a more limited role for this fund. For example, we had a recent case of a farmworkers fund where the level of contribution is so low that a proper NSF could be an ideal product for them. Administration fees of R30 per month from the market are not attractive to members contributing R40 per month. Subsidization will be necessary to make it work.

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29 March 2005

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