

LUASA

The Association of Professional Financial Planners

1 PRINCIPLES OF RETIREMENT FUND REFORM

- 1.1 LUASA, registered as a Section 21 Company in terms of the Companies Act, was founded in 1959 and is the oldest financial intermediary body in the country. Originally known as the Life Underwriters Association of South Africa (and hence the acronym LUASA), the by-line of the company was changed in 2002 to *The Association of Professional Financial Planners*, a more apt descriptor of the profession LUASA represents in the financial services sector.

Find attached the Vision, Mission and Philosophy of the Company.

- 1.2 LUASA supports the broad objectives of the Retirement Fund Reform Paper ("the Paper").
- 1.3 LUASA supports the re-drafting of the Pension Funds Act, 1956 in order to ensure consistency and rectify problems arising from piecemeal changes.
- 1.4 LUASA is of the view that tax reform should be dealt with at the same time as the reforms set out in the Paper. The tax structure relating to retirement funds is a vital aspect and may inform further changes. To leave it out at the beginning stage may well result in a non-cohesive system of reform.

2 ANNEXURE 1 – THE SOUTH AFRICAN RETIREMENT FUNDS LANDSCAPE

2.1 Paragraph 1 - Introduction

- 2.1.1 No comment.
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2.2 **Paragraph 2.1 – The “Three Pillars” of a Retirement Funding System**

2.2.1 No comment.

2.3 **Paragraph 2.2 – Employment and Coverage**

2.3.1 No comment.

2.4 **Paragraph 2.3 – Contribution Rates and Costs**

2.4.1 It is not clear how the contribution rates and costs can be compared to the range advocated by the World Bank in terms of taking into account the specific investment and inflation environment of South Africa.

2.4.2 LUASA supports full disclosure of all costs related to retirement funding products in the market.

2.4.3 LUASA supports full disclosure of all commissions and fees payable to service providers, including the requirement that they should be proportionate to the services rendered.

2.5 **Paragraph 2.4 - Replacement Rates**

2.5.1 No comment.

2.6 **Paragraph 2.5 – Leakage**

2.6.1 LUASA supports addressing the problem of leakage that remains in the system due to employees' not reinvesting their withdrawal benefits.

2.7 **Paragraph 2.6 - Interaction with the Social Old Age Pension**

2.7.1 No comment.

2.8 Paragraph 2.7 – Summary

2.8.1 Although most retirement funds are suitably regulated, there are instances of poor governance where retirement funds have “fallen between the cracks”.

2.8.2 Improved corporate governance should address these issues.

3 ANNEXURE 2 – ACCESS, COMPULSION, AND PRESERVATION

3.1 Paragraph 1 - Compulsion

3.1.1 Compulsion for an employer to set up/participate in a retirement fund would, in our view, be desirable in order to achieve even better savings rates for employees in the formal sector. Coupled with compulsory preservation, this would ensure that there are less people dependent on the low social grants.

3.1.2 The Paper does not support compulsion and mentions that certain measures to encourage participation should be set in place, i.e. that the determination of a retirement fund (if one is available) would form part of the conditions of service of employees and that, if an employer does not set up/participate in a retirement fund, the employer should make available payroll facilities to ensure that employees are able to contribute to individual retirement funds or the National Savings Fund (“NSF”). In our view this is not sufficient and tax incentives should be addressed in order to encourage employers to set up/participate in retirement funds.

3.2 Paragraph 2 – National Savings Fund

3.2.1 LUASA supports the establishment of the NSF.

3.2.2 More detail required on the NSF regarding access, preservation, migration from other retirement funds.

- 3.2.3 Tax details regarding the NSF would need to be addressed, e.g. the suggestion that it would be exempt from paying Retirement Fund Tax.
- 3.2.4 There seems to be no valid reason offered as to why all South Africans should not be encouraged to save within the NSF. It seems that contract workers etc. should also be encouraged to save and, if not afforded the opportunity of accessing the NSF, why individual retirement funds should not offer similar benefits and incentives.
- 3.2.5 The tax regime must be investigated in conjunction with investigating the NSF and perhaps the tax incentives not applied as a consequence of being a member of the NSF but rather that such incentives apply as a function of the actual income earned. The NSF should dovetail with other voluntary individual retirement funds.

3.3 **Paragraph 3 - Differentiation**

- 3.3.1 There should be no attempt to exclude differentiation necessary as a result of the funding method of the retirement fund in question.
 - 3.3.2 There should be no tax differentiation between employees who are members of occupational schemes and other persons who are members of individual retirement funds.
 - 3.3.3 The recommendation that the choice of fund may be negotiated as part of an employee's terms and conditions of employment could result in more costs to the employer (should it be required to participate in various retirement funds) and less inclination on the part of the employer to participate at all.
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- 3.3.4 LUASA supports only offering a variety of retirement funds in the event of a union-sponsored or bargaining council approved retirement fund being in place.
- 3.3.5 Restrictions based on salary level or employment grade are not necessarily unfair discrimination, particularly if the retirement fund to which the employee belongs forms part of the individual's terms and conditions of employment. In this respect such differentiation is no different to offering different employees, different salaries. Consequently the proposal to disallow such restrictions is not supported.
- 3.3.6 Funds should not be restricted from limiting risk cover in order to ensure the financial stability and viability of the retirement fund.
- 3.3.7 There appears to be support for the idea that not all employers need to ensure that the membership of a particular retirement fund is a condition of employment (see paragraph 3.5.3). This may create increased cost in providing retirement funds by employers. Mention is also made of employees below the tax threshold not being compelled to join an occupational and retirement fund but rather the NSF. Again, far more clarity on the NSF and how it dovetails with the other vehicles should be set out. In addition, the suggestion, as stated above is that the tax differences between the different vehicles should not be so stark as to encourage any kind of arbitrage. The tax consequences should rather be a function of the employee's salary and applicable tax rates.

3.4 **Paragraph 4 – Individual Retirement Funds**

- 3.4.1 Subject to what is set out below, LUASA supports the recommendations.
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- 3.4.2 The reasoning behind the proposed prohibition on paying commission or service fees to an intermediary for inducing a member to join an individual retirement fund is not clear. It would seem that there should be no difference between such an offering and any other financial services product in the market.

3.5 **Paragraph 5 – Resulting Environment**

- 3.5.1 No comment.

3.6 **Paragraph 6 – Ancillary benefits : insurance on death and disability, funeral benefits and post-retirement medical aid subsidy**

- 3.6.1 LUASA supports the recommendations.

4 **ANNEXURE 3 – BENEFITS, CONTRIBUTION RATES AND MEMBER PROTECTION**

4.1 **Paragraph 1 – Adequacy of Retirement Benefits**

- 4.1.1 No comment.

4.2 **Paragraph 2 – Pension Increases**

- 4.2.1 LUASA supports the recommendations.

4.3 **Paragraphs 3.1 to 3.4 – Benefits Available from a Retirement Fund**

- 4.3.1 Regarding the recommendation to disclose the exact contributions made to retirement savings, administration and/or risk benefits in the Rules, it should be noted that this may result in Rule Amendments having to be adopted on an annual basis – an additional administration cost. While the idea of full disclosure is supported, it is not always practical and cost effective to adopt Rule Amendments on a regular basis. It is proposed that the actual costs be set out in a separate document.
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4.3.2 The recommendation that death benefits are distributed in accordance with the member's nomination of beneficiary form *"...unless compelling reasons exist why this should not be followed..."*, could create the following problems:

4.3.2.1 Much legal argument and debate concerning what is meant by "compelling reasons";

4.3.2.2 This does not necessarily support the protection of the most vulnerable in our society, i.e. the nomination form may, for whatever reason, not reflect the name of the actual dependants of the deceased members.

It is thus proposed that the current provisions regarding the allocation of death benefits are retained. Although many boards of management do find the provisions difficult to implement, with the correct training and advice, the current provisions may easily be implemented by boards of management and ultimately serve the needs of the dependants better than requiring adherence to a nomination form.

4.4 **Paragraph 3.5 – Minimum Rates of Contributions**

4.4.1 In order to achieve a specific level of benefit, it may be preferable to introduce minimum rates of contribution.

4.5 **Paragraph 3.6 – Fluctuating Rates of Contribution**

4.5.1 The recommendation for variable contributions is strongly supported.

4.6 **Paragraph 3.7 – Form of Benefit Payment**

4.6.1 The recommendation is supported as long as members' existing benefits are not impacted negatively in any way, including as a result of changes in tax treatment.

4.7 **Paragraph 3.8 – Post Retirement Medical Funding**

4.7.1 LUASA supports the recommendation.

4.8 **Paragraph 3.9 - Leakage**

4.8.1 No actual recommendation is made in the Paper although it seems to imply that cash withdrawal benefits should be limited. This is supported.

4.9 **Paragraph 3.10 – Minimum Benefits**

4.9.1 No comment.

4.10 **Paragraph 3.11 – Loss of Employment**

4.10.1 Problems with compulsory preservation on loss of employment are acknowledged.

4.11 **Paragraph 3.12 – Preservation and Portability**

4.11.1 Subject to what is stated below, the recommendations are supported.

4.11.2 It is not clear what is meant by the statement “...*the transferor fund may not deduct any expenses from the member’s benefit...*” Clearly the transferor fund would not be able to operate in a financially viable way without deducting certain expenses. In fact if such expenses were not deducted from the transferring members’ benefits, this would prejudice the other members of the retirement fund if, for example, the transferor fund were the occupational fund set up by the transferring employees’ new employer.

- 4.11.3 Furthermore, the prohibition on rewarding a person for inducing the member to transfer the benefit may impose severe limitations on the provision of financial advice. Having said this, the principals of disclosure and transparency are supported.

4.12 **Interest on Late Payment of Benefits**

- 4.12.1 LUASA supports the recommendations.

4.13 **Unclaimed Benefits**

- 4.13.1 The concerted effort to trace members by the relevant retirement fund and the unclaimed benefits fund is supported.
- 4.13.2 The payment to the State after the elapse of a certain period of time is not supported. Other ways of supporting socially desirable projects (e.g. by way of investment) should be investigated.
- 4.13.3 Costs relating to tracing members should be deducted from the member's benefit.

4.14 **Paragraph 3.15 – Access to Retirement Savings During Employment**

4.14.1 **Paragraph 3.15.1 – Housing Loans and Guarantees**

- 4.14.1.1 The suggestion of only allowing housing guarantees is supported. The issue of what would constitute housing should be addressed in detail in order to clarify confusion in this regard. For example, would it include a loan for materials to build a dwelling in an informal settlement? Must the member own the land?
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4.14.2 **Paragraph 3.15.2 – Other Life Crisis needs**

4.14.2.1 The recommendation appears to only allow loans for life crisis needs from the NSF. What about members who are not members of the NSF by virtue of the fact that they are members of, say, a union sponsored arrangement?

4.14.2.2 This recommendation would result in differentiation between the NSF and other retirement funds which is not desirable as the NSF should be treated as any other fund and simply constitute a vehicle for individuals not in formal employment.

4.15 **Paragraph 3.16 – Deductions**

4.15.1 The recommendation that deductions in respect of damage caused to the employer by virtue of fraud etc. is not supported. Although it is recognised that retirement funds should be protected, it is consistent (rather than inconsistent as stated in the Paper) with the “package” approach that retirement moneys should be accessed in such circumstances. Indeed not to allow the employer access to such moneys in the case of damages caused to it, would act as a disincentive for an employer to set up an occupational retirement fund.

4.16 **Paragraph 3.17 - Divorce**

4.16.1 The recommendation that a member's minimum individual reserve should be deemed to form part of his/her assets in the case of divorce is supported.

4.16.2 However, the ex-spouse should be permitted to transfer the benefit to another retirement fund thereby alleviating additional administration problems inherent in deeming the ex-spouse to be a member of the member-spouse's retirement fund.

4.17 **Paragraph 3.18 – Payment of Benefits on Death**

4.17.1 Contrary to what is indicated in a previous paragraph of the Paper, it appears from this paragraph that the intention regarding the nomination of beneficiary form is that the member should provide sufficient information to the retirement fund regarding his/her dependants.

4.17.2 However, reliance on a beneficiary nomination form that does not necessarily include information about all dependants should be cautioned against as this would defeat the purpose of a retirement fund, i.e. to provide financially for members and their dependants.

4.18 **Paragraph 3.19 – Payment of Benefits on Disability**

4.18.1 LUASA supports this recommendation.

5 **ANNEXURE 4 – GOVERNANCE AND REGULATION**

5.1 **Paragraph 1 – Powers of the Registrar**

5.1.1 The Paper recommends fairly extensive expansion of the powers of the Registrar of Pension Funds and additional tasks to be performed by the Registrar.

5.1.2 These recommendations are broadly acceptable. However, the issues of costs must be raised.

5.1.3 Furthermore an investigation into the current performance of the Registrar's functions should take place in order to ascertain whether or not there are insufficient staff members or insufficient expertise at the Registrar's office.

5.1.4 The role of the Principal Officer in retirement funds should be addressed. This is a statutory appointment but the statutory duties are secretarial in nature. Despite this, many retirement funds require additional duties of the Principal Officer, i.e. both executive and/or compliance functions. It is envisaged that by clarifying this role and the responsibilities associated with it, regulation may be improved without imposing too many onerous new requirements on the Registrar's office.

5.1.5 Any codes of good practice to be formulated should be formulated in consultation with experts in the retirement fund industry to ensure applicability and/or practicality.

5.2 **Paragraph 2 – Statistical Reporting by Funds**

5.2.1 Although broadly supported, the issue of costs must be investigated.

5.3 **Paragraph 3 – Member Protection**

5.3.1 LUASA supports the recommendations, subject to what is said elsewhere in this document regarding the right of the employer to be paid any amount owing to it in respect of fraud etc.

5.4 **Paragraph 4 – Dispute Resolution**

5.4.1 The recommendation regarding a single dispute resolution tribunal is supported.

5.5 **Paragraph 5 – Governance and Trustee Conduct**

5.5.1 The recommendations regarding independent trustees where the members do not have the right to elect at least 50% of the members of the board of management are supported. However, the particular whistle-blowing obligations of such independent trustees must be clarified.

5.5.2 The recommendations regarding the codification of the duties of boards of management are supported, but it is noted that the current legislation read together with the common law does set out such duties comprehensively.

5.5.3 The recommendations regarding disclosure by service providers of their interest in the service or product offered is supported as is the prohibition or disclosure of any reward.

5.5.4 The recommendations regarding umbrella funds are broadly supported although it is not clear what the reason for a proposed limitation on the number of “sub-funds” participating in an umbrella fund is.

5.6 **Paragraph 6 – Intersection of Labour Law and Pensions Law**

5.6.1 LUASA supports the recommendations.

5.7 **Paragraph 7 – Investment Regulation**

5.7.1 LUASA supports the recommendations.

5.8 **Paragraph 8 – Funding and Calculation Techniques**

5.8.1 It is not clear whether or not the recommendations include the requirement that defined contribution funds be valued every three years and, if so, why. This would create an additional cost for such funds that is probably not necessary as there are no unfunded liabilities.

5.9 **Paragraph 9 – Winding Up**

5.9.1 LUASA supports the recommendations.

6 CONCLUSION

- 6.1 On the whole LUASA is of the opinion that the recommendations contained in the Paper are sound and will go a long way to clarifying current uncertainty and maintaining a strong retirement fund industry.
 - 6.2 As mentioned in the Introduction to these comments, the tax treatment of retirement funds is not dealt with and this is a key part of the entire industry. It should be dealt with at the same time as any reform in order to avoid unintended consequences.
 - 6.3 The issue of costs should be addressed as this will ultimately dictate whether or not an employer decides to set up/participate in an occupational retirement fund which is what the Paper seeks to encourage.
 - 6.4 Self-regulation should be encouraged where possible, for example the actuarial society in respect of actuarial issues rather than additional committees etc.
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LUASA

VISION

To become the leading intermediary service body of choice for financial service intermediaries.

MISSION

To raise the status and advance the profession of professional financial planners and to protect the rights and interests of the members and the public they serve

PHILOSOPHY

LUASA seeks to represent the rights and interests of its members and the public they serve, on a holistic basis, aimed at creating strength and stability through balanced representation that produces socially responsible financially beneficial outcomes for all the role players (within the financial services industry).

The philosophy is extended to the broader macro economic environment as LUASA is acutely aware of its integral role within the larger economic “eco” system and will act to serve the best interests of the country as a whole.
