

## **Retirement Fund Reform discussion paper: Comment**

### **General**

Sanlam Personal Portfolios Pty Ltd (SP<sup>2</sup>) supports the objectives of Government's retirement funding policy in principle. However, we are concerned about the impact these proposals might have on the existing retirement fund industry as a whole. All proposals should thus be considered carefully in order not to erode the strengths of the existing system.

### **Tax**

We take note of Treasury's view, to address the tax implications of the proposals only once the objectives have been finalised. However, tax implications play such an important role in the retirement funds industry that any proposals to reshape the retirement funds industry should not be considered without taking tax implications into consideration at the same time.

### **National Savings Fund – Annexure 1**

We support the concept of a National Savings Fund (NSF). Currently the proposals are that the NSF benefits should be accessible to members in life crisis events. It will be impossible for an administrator to determine whether an application to withdraw money is indeed in respect of a life crisis event. Members of the NSF might thus misuse the accessibility of funds in the NSF.

It is Government's objective to ensure that retirement benefits are available to workers in the lower income and informal sector. We propose that

- the accessibility to NSF benefits should be restricted, and/or
- requirements for a minimum amount to remain in the NSF until retirement be implemented, in order to realise these objectives.

It is proposed that members of funds in the formal sector should have the option to transfer to the NSF. Accessibility to fund benefits in the formal sector will be more restrictive than in the NSF. These members can transfer to the NSF in order to access their fund benefits. This may result in an increased dependency on the State at retirement clearly defeating one of Government's major objectives.

Members belonging to employer occupational schemes might also transfer to the NSF in order to obtain tax benefits.

### **Access, Compulsion and Preservation –Annexure 2**

#### **Compulsion –paragraph 1**

We support the recommendation not to compel every employee to belong to a retirement fund or to pay compulsory minimum contributions towards retirement funding. Such compulsion might encourage employees to move into the informal sector or remain in the informal sector. As recommended in the discussion paper, participation should be encouraged as part of the conditions of employment. We do not support the recommendation that

- the employer should be obligated to provide education on the desirability of retirement savings and

- compulsion on the offering of payroll facilities to the employee to belong to a retirement fund of his/her choice for the following reasons:
- The employer might not have the necessary expertise in order to educate the employees on the available retirement savings products and options. Should it be mandatory for the employer to provide such information, it can become extremely costly for the employer to provide such expertise. As an alternative we propose that government provides standard information. The obligation could then be placed on the employer to distribute the relevant information to the new employee.
- Providing payroll facilities to enable employees to join any individual retirement fund will result in increased payroll administration costs as every employee can elect to become a member of a different individual retirement fund. We recommend that the employer should only be obliged to offer payroll facilities in respect of the employer's own scheme and the NSF. Contributions to other individual retirement funds could be deducted from the employee's bank account as banks are currently geared to provide this service. The employee could then provide the employer with the necessary proof of contributions to a retirement fund in order to enable the employer to deduct any contributions from taxable income, if applicable.
- Providing education and payroll facilities will be especially burdensome for small enterprises and will be contrary to government's stated intention to reduce the administrative burden on small businesses. Mandatory provision of education and payroll facilities may even be a factor that will hamper the transfer of enterprises from the informal to the formal sector.

### **NSF – paragraph 2**

Currently members in the formal sector earning below the tax threshold, belonging to an occupational retirement fund, enjoys affordable risk and disability cover as a result of cross subsidisation. In respect of risk benefits, one might argue, that the more affluent members subsidise the risk premiums of the lower income members. The objective of the NSF is to provide for retirement savings and not risk cover. Should these members be allowed to transfer their fund benefits to the NSF, these members might not be able to afford risk cover or disability cover on an individual basis or enjoy cover at favourable rates.

As mentioned earlier these employees may also move to the NSF because the accessibility of fund benefits in the NSF. We propose that the rules on accessibility of fund benefits be aligned in respect of members belonging to the NSF and those employees in the formal sector earning below the tax threshold belonging to occupational retirement funds.

Accessibility of fund benefits should be limited. The fact that some sort of bonus is contemplated, should the member remain in the NSF until retirement, will not sufficiently encourage members to remain in the fund. For the administrator to determine whether a life crisis event occurred will be virtually impossible. We propose that only a portion of the money should be available in life crisis events. The remainder should only be withdrawn at retirement.

### **Differentiation –paragraph 3**

We strongly support the recommendation that the taxation of all types of retirement funds should be harmonised.

### **Paragraph 3.5.2.2**

The paragraph is unclear. Should the intention be to prohibit a top up scheme for senior employees within an existing scheme, we do not support the recommendation.

### **Paragraph 3.5.2.3 (c)**

This proposal is not clear. If this means that funds will be compelled to offer memberships to all members irrespective of risk profile, employers may decide not to offer the occupational scheme.

### **Paragraph 3.5.1**

We agree with the recommendation that the employee should have the option to choose whether he/she should join the occupational retirement fund in which the employer participates or any other individual retirement fund.

### **Individual retirement funds – paragraph 4**

We agree that all retirement funds should enjoy similar tax treatment and that the relationships should be between the member and the fund, i.e. employer/employee relationship should not be a requirement for membership of a fund.

Legislation and not practice notes to be issued by the authorities should govern requirements in respect of membership of these funds.

We agree that transfers between retirement funds should be allowed. Such transfers are not necessarily in the interest of members and often result in the duplication of administration costs. We propose that transfers between funds should be limited to specific occurrences. e.g. termination of service.

### **Intermediary fees on joining an individual retirement fund - paragraph 4.2.8**

We do not agree with the recommendation that no commission or service fees may be payable to intermediaries for inducing a member to join the fund. A substantial number of members who join funds have little financial education and may therefore purchase inappropriate financial products and are most likely to make inappropriate investment choices if not assisted by a financial intermediary. Experience indicates that retirement funds are bought and not sold. In terms of the Financial Intermediary Services Act (FAIS), financial intermediaries must disclose all fees and costs. Should there be no incentive for financial intermediaries to assist prospective members, the wide percentage coverage in the voluntary sector might drop significantly. Members do rely on financial intermediaries for advice. It is therefore important that financial intermediaries should be allowed to receive a service fee and/or commission.

It must also be noted that new financial advisers entering the industry are more dependent on initial fees and commissions, than established advisers who have already built up significant assets under advice. The abolishment of initial fees/commissions related to a member joining a fund, will therefore have the unintended consequence of making it more difficult for even well-qualified persons to enter the industry. This can in turn slow down the transformation of the racial profile of financial advisers.

### **Benefits, Contribution rates and Member Protection – Annexure 3**

We agree with the proposal that the deduction of fund contributions should be age related.

### **Benefits - paragraph 3**

#### **Paragraph 3.4.1.4**

Creates uncertainty. Distribution of fund benefits is one of the major factors causing increased administration costs. It is recommended that the fund trustees should be obligated to distribute members' benefits in accordance with members' nomination of beneficiary forms. Members should also take responsibility for ensuring that their beneficiary nominations are up to date. Where no beneficiary is appointed, the trustees should be compelled to pay the benefits into the estate of the deceased. However, the trustees should be obligated to communicate on a regular basis the importance of appointing beneficiaries and nominees to fund members.

The recommendation that legislation may describe the type of annuity must be clarified. Only broad principles should be regulated. The type of annuity should be determined by the trustees who will take into account the profile and financial sophistication of members before offering specific types of annuities in terms of the fund rules.

#### **Paragraph 3.5**

We fully support the recommendation that no minimum rate of contribution should be prescribed in legislation.

#### **Paragraph 3.6.1**

We support the recommendation that fluctuating rates of contribution should be allowed.

#### **Form of Benefit Payment - paragraph 3.7**

We support the recommendation that the form of the benefit payment should be aligned in respect of all funds. However, the accessibility of fund benefits prior to member retirement should also be aligned in order to prevent members from transferring to another fund in order to withdraw from the fund. Pensioners should be able to access the underlying fund capital in the event of life threatening events, e.g. medical care.

#### **Preservation and Portability- paragraph 3.12**

We agree with Treasury's recommendation that fund benefits should be preserved on a change of jobs, but the member should have the choice to select the fund to which he or she wishes to transfer. As the member will also have the option to transfer to the NSF, this option may defeat the objective of preservation of retirement fund benefits, as currently the funds in the NSF will be accessible. Members may transfer fund benefits to the NSF in order to access fund benefits prior to retirement. The requirements in respect of accessibility of fund benefits should therefore be aligned.

It is proposed the fund benefits may not be reduced to recover any expenses from the member's benefit. The proposal should be carefully considered and clarified. In certain instances the administrator of the fund or the product provider does not charge any initial administration costs with the intention to recover the initial administration cost over a period while the funds remain under the administrator's administration. Should the transferor fund not be allowed to recover unrecouped administration costs, annual administration fees will be increased, or an upfront fee will be charged, which may not be in the interest of members staying in the fund for a long time.

As mentioned earlier, a significant number of members of funds have insufficient financial education and expertise and rely on financial intermediaries in order to

purchase the appropriate product. Should intermediaries not be allowed to receive service fees or commission, financial intermediaries might not be willing to assist individual members when transferring benefits, which may result in incorrect investment and other choices inappropriate for the specific member's circumstances.

#### **Unclaimed benefits fund –paragraph 3.14**

The actions to be taken by the unclaimed benefit fund in order to locate members and/or dependants should be regulated. Should these prescribed steps not be followed, the unclaimed benefits fund should be prohibited to release the money to the State. Where any former member or relative of the deceased member is located, the central fund should be compelled to distribute benefits to these members or dependants.

#### **Other life crisis needs –paragraph 3.15.2.3(b)**

Allowing withdrawals from the NSF for "any purpose" is too wide and is likely to erode the retirement benefits to such an extent that the stated objectives may not be met. We propose that a limit be placed on the amounts that can be withdrawn. Also see our comments under "Par 2: NSF"

#### **Deductions- paragraph 3.16**

Were a member is terminally ill, the insurer should be permitted to accelerate payment of the death benefit in all circumstances.

#### **Paragraph 3.16.5**

Payment in respect of maintenance orders should be deductible.

#### **Governance and regulation – Annexure 4**

It is important that the cost efficiency of regulation be borne in mind. The cost of regulation and compliance should not result in the reduced offering of retirement fund benefits to employees.

SP<sup>2</sup> supports the formulation of Codes of good practice. These codes should never obtain regulatory powers. If so, such action will create uncertainty in the retirement fund industry.

Stakeholder input should also be obtained when drafting the codes.

#### **Statistical reporting by funds –paragraph 2**

Any additional reporting should be evaluated on a cost benefit analysis.

#### **Dispute resolution –paragraph 4**

We strongly support the recommendation that a member and/or fund should have the right of appeal against a determination by the tribunal to the High Court or the specialist FSB Appeal Board.

#### **Governance and Trustee Conduct –paragraph 5**

All fees paid to service providers and product providers should be disclosed in terms of FAIS. Should an administrator obtain any benefit as a result of the bulking of the fund assets, the administrator should be able to retain the benefit, provided that this has been negotiated with the fund's trustees and is fully disclosed. Should the administrator not be allowed to negotiate this rebates with members an increase in administration charges will be inevitable.

### **Board of trustees - paragraph 5.6**

- It should not be a requirement in respect of individual retirement funds, where employer-employee relationships do not exist, that 50% of the board should consist of member elected trustees. In the absence of employer infrastructure this requirement will be unnecessarily costly and will not necessarily meet the objective, as the members will not know each other. A requirement that individual retirement funds should be compelled to appoint 50% independent trustees will be more effective.
- It is proposed that the trustees should enact a rule agreed to by the employer and employee provided such rule amendment is not inconsistent with any law. This recommendation is not clear. The trustees owe a fiduciary duty to the fund and all stakeholders. The trustees should only implement rule amendments, which are not in breach of this duty.
- We propose that any trustee should disclose any interest in any service or product, which is been promoted to the fund. Once such interest has been disclosed, the trustee should be allowed to take part in the decisions by the fund.
- The requirement that separate annual financial statements are to be submitted for each sub fund, should not be required for individual retirement funds.
- A limit should also not be placed on the number of sub funds, which can form part of an umbrella fund. The reasoning for placing such a limit is not understood.
- When a member elects to exercise his/her cooling off right, the fund should be allowed to recover any market movements from the value of any refunds payable by the fund.
- On the transfer of fund benefits, the transferor should be allowed to set of certain unrecouped cost from the transfer value e.g. unrecouped product costs and the cost of effecting the transfer.

### **Investment regulation –paragraph 7**

Socially desirable investments (SDI's) should be clearly defined. It is proposed that direct and indirect investments, e.g. products with underlying assets in SDI's, should also qualify.

Should funds be compelled to invest in SDI's similar to the prescribed assets requirements of the 80's, employees will be discouraged to belong to retirement funds.

We assume that the intention is not to restrict member choice in the case of individual retirement funds. This should be clarified. Individual retirement funds should be allowed to allow unlimited member investment choice to individual members who have the necessary expertise or access to the necessary expertise. Retirement funds offering unlimited investment choice could be compelled to:

- monitor the investment performance of asset managers;
- communicate and provide information on the underlying funds;
- educate members;

- issue health warnings to members, e.g. that members should only invest in portfolios that meet his or her risk profile;
- insist that members consult with financial intermediaries; and
- ensure that individual member investment must comply with regulation 28.

If this is done there is not adequate reason to restrict member choice in respect of occupational funds to 3 to 5 choices. This proposed limit is unnecessarily restrictive.