2013 Retirement reform proposals for further consultation

27 February 2013

Introduction

The Minister of Finance announced proposals in the 2013 Budget Speech to reform the retirement industry, with a focus on governance, preservation, annuitsation and harmonisation of retirement funds.

These proposals follow a series of technical discussion papers with *draft* proposals that were issued in 2012, after 2012 Budget announcements by the Minister of Finance. Over the course of 2012, both formal and informal consultations were held in respect of these papers with stakeholders, including unions, industry associations, product providers, intermediary associations, and members of the public. Following on from these consultations, the Government has developed *revised* policy proposals *for further consultation.*

Brief summaries of these proposals are contained in Chapters 4 and 6 of the Budget Review 2013. This note serves to describe in more detail the policy proposals already developed, and to initiate a further consultation period in respect of them, with a closing date of 31 May 2013 for written submissions. Draft legislation to give effect to these proposals will be introduced over the course of 2013 after the consultation process has been completed.

Executive summary

It is becoming ever clearer that employers which take greater responsibility for the overall financial well-being of their workers, including through the design of their retirement funds, reap the rewards of a more stable and happier work force.

The overall approach of these policy proposals is therefore to alter the defaults implicit in retirement fund design, where appropriate, to nudge, rather than force, individuals into making decisions which serve their long-run interests.

Taxation of retirement funds

- From an effective date, on or after 2015, called T-day, employer contributions to retirement funds will become a fringe benefit in the hands of employees for tax purposes. Individuals will be able to receive a tax deduction on employer and employee contributions to a pension fund, provident fund or retirement annuity fund up to 27.5% of the greater of remuneration and taxable income. A ceiling of R350 000 will apply. This proposal is described in more detail in Chapter 4 of the Budget Review.

Governance

- The duties of trustees to act independently, and free from conflicts of interest, will be strengthened by elevating PF Circular 130, which deals with the governance of retirement funds, to a Directive. A draft will be published for consultation later this year.
- The FSB is to monitor trustee appointments, including ensuring that trustees meet ‘fit and proper’ requirements.
- The current Trustee Toolkit may be elevated into a basic, independent, compulsory and free training kit for Trustees.

- The Financial Services Laws General Amendment Bill, 2012, which contains various provisions pertaining to governance, is currently in Parliament.
- The Minister is to convene a trustee conference, with a view to further strengthening the governance of retirement funds.

Preservation

- Full vested rights with respect to withdrawals from retirement funds will be protected. Amounts in retirement accounts at the date of implementation of the legislation, called P-day, and growth on these, can be taken in cash, but from a preservation fund, and subject to taxation as currently.
- After P-day, all retirement funds will be required to identify a preservation fund and transfer members' balances into that fund, or another preservation fund, when members withdraw from the fund before retirement.
- Existing rules on preservation funds will be relaxed to allow one withdrawal per year, but the amount of each withdrawal will be limited. Unused withdrawals in any year may be carried forward to future years. Withdrawal limits will account for vested rights as described above.
- Payments resulting from divorces will also need to be paid into preservation funds rather than being paid in cash.

Annuitisation

- The annuitisation requirements of provident funds and pension funds will be harmonised. However, the new annuitisation rules will only apply to new contributions made to provident funds after T-day[1], and growth on these contributions. Existing balances in provident funds, and growth on these, will not be subject to annuitisation.
- In addition, members of provident funds who are older than 55 on the date of implementation will not be required to annuitise any of their balance at retirement, provided they remain in the same provident fund until they retire.
- To lessen the impact on provident fund members, the means test for the old age grant will be phased out by 2016, and the *de minimis* requirement for annuitisation will be raised from R75 000 to R150 000.
- Trustees will be required to guide members through the retirement process, to identify a default retirement product in accordance with a prescribed set of principles, and to automatically shift members into that product when they retire, unless members request otherwise. The fund itself may provide the default product, or it may use an externally-provided product.
- Living annuities will be eligible for selection as the default product, provided certain design tests, including on charges, defaults, investment choice and drawdown rates, are met.
- Trustees that make commission-free financial advice available to members on retirement, paid for out of the fund on a salaried basis, will be given some legal protections in respect of the choice of the default. To increase competition, providers other than registered life offices will be allowed to sell living annuities.

Non-retirement savings

- Government intends to proceed with the implementation of tax-preferred savings and investment accounts. All returns accrued within these accounts and any withdrawals would be exempt from tax. The account would have an initial annual contribution limit of R30 000 and a lifetime limit of R500 000, to be increased regularly in line with inflation. The new accounts

[1] The initial version of the document, released on 27th February 2013, stated incorrectly here that these reforms would come into effect on P-day, although in the body of the document their effective date was correctly described as T-day. This version is a correction.

will be introduced by 2015, and will co-exist with the current tax-free interest income dispensation.

- With effect from 1 March 2013, tax-free interest-income annual thresholds will be increased from R33 000 to R34 500 for individuals 65 years and over, and from R22 800 to R23 800 for individuals below 65 years. These thresholds may not be adjusted for inflation in future years.

Broader reforms

- In addition to the proposals described above, Government is exploring ways to increase retirement fund coverage to all workers. This is a complex issue, given the large proportion of uncovered workers who earn below the tax threshold, who work for small employers, or who have a tenuous connection to the formal labour force, for instance because they work in construction or domestic service.
- A process is currently underway to bring public pension funds currently not governed under the Pension Funds Act, including the Government Employees Pension Fund (GEPF), Transnet, Telkom and Post Office retirement funds, into the purview of the Act.
- Any biases in retirement funds which may discourage individuals from working past the retirement age of their funds will be identified and removed.

Important dates

Date	Balance
31st May 2013	Formal consultation period on this document closes
Remainder of 2013	Legislation implementing these changes introduced
P-day	Preservation rules change for all retirement funds (expected to be on or after 2015)
T-day	Taxation rules and annuitisation requirement harmonised across all retirement funds (expected to be on or after 2015)

Taxation of retirement funds

Various issues regarding the proposal on the harmonisation of retirement fund taxation first made in Budget 2011 were presented in the paper *Improving the tax incentives of retirement savings*, released on 4 October 2012. The appropriateness of the caps in relation to individual savings patterns, the future role of the employer, the future of provident funds, the income base, and how the caps were to be applied to defined benefit schemes were discussed in the paper.

Responses to consultation

Virtually all comments received were supportive of the principle. However, responses differed on the appropriateness of the limits on tax deductions, whether risk benefits should be included or not, the income base to be used, and the timing and extent of the changes to annuitisation requirements for provident fund members.

Proposal

In formulating a policy, the following issues were taken account of:

- Administration should be easy for payroll administrators, individuals and retirement fund administrators.
- The permitted level of deductions should be sufficient to ensure that the vast majority of South Africans are able to retire with a reasonable level of savings should they use the permitted deductions.

- The system should be as simple as possible, to encourage individuals to understand and take responsibility for saving for their retirement.
- Defined benefit and defined contribution fund members should be treated as equally as possible to minimise the possibilities for tax arbitrage.

It is proposed that the rules on taxation of retirement fund contributions change on a particular day, to be called T-day. At this point, it is envisioned that T-day will occur on or after 2015.

The following are the main elements of the proposal:

- After T-day, employer contributions to all types of retirement funds will form part of an employee's taxable income, but a deduction up to specified limits will be granted in respect of employer and employee contributions for all types of retirement funds.
- The maximum deduction permitted will be equal to 27.5% of the greater of remuneration and taxable income. This will allow employers to determine an appropriate deduction without knowledge of their employees' tax affairs.
- The cost of risk benefits will be included in the deduction above.
- There will be a maximum deduction of R350 000 in any one tax year to ensure equity in the tax system.
- Unused deductions may be rolled over to assist those with volatile incomes.

Special arrangements will be made for defined benefit and hybrid funds, which are likely to be treated using the value of benefits approach described in the paper. Further consultations will be held to determine the details of the approach.

Pre-retirement preservation

The paper *Preservation, portability, and governance for retirement funds*, released on 21st September 2012, described the low rate of preservation of retirement savings, both pre- and post-retirement, and presented various options to increase it. It also addressed the issue of the portability of amounts between different retirement funds and described Government's attempts to improve the governance of retirement funds.

Responses to consultation

Most responses to the consultation, both formal and informal, agreed that the current system of paying cash withdrawal benefits virtually automatically when individuals leave employment is inappropriate. Yet few commentators supported the option of full preservation. Most responses to the consultation therefore supported one or other of the intermediate options that were presented.

Proposal

In formulating a policy proposal, Government has taken particular note of the following:

- Given the difficulties many workers currently have in finding and retaining full-time employment, unemployed workers should be permitted some access to their retirement funds in case of need.
- Imposing too great a requirement to preserve could inadvertently harm workers who were unable to access their retirement savings in times of great need.
- The vested rights of workers to access their retirement savings should be protected. This will ensure that workers who have made plans based on their retirement savings will be able to realise those plans, and would prevent disruption if workers rushed to 'cash in' their savings before any proposal came into effect.
- The administrative burden on providers and consequent costs on members should not be too high.

It is proposed that the rules on preservation will all change on a particular day, to be determined by legislation. This day will be called P-day. It is anticipated that P-day will occur on or after 2015.

The following are the main elements of the proposal:

- Vested rights will be protected on the balance that individuals have in their pension or provident fund on P-day, plus growth on that balance up to the date they leave that fund. Individuals will be able to access this amount, in cash, at any time after they leave their fund or join the preservation section of the fund.
- Pension funds and provident funds will be required to identify a default preservation option for their members. This fund could either be a section inside the fund, or a fund outside it. Trustees must abide by a set of principles in the selection or design of this fund, and will be given a degree of legal protection in respect of this choice, provided certain tests, including on design, charges, transparency, investment strategy and investment options are met.
- Trustees could be given some legal protections in respect of the choice of the default provided that certain conditions are met, including that members are given access to commission-free independent financial advice when they leave the fund, paid for by the fund on a salary or fee-for-time basis.
- From P-day, other than a *de minimis* provision, pension and provident funds will not be permitted to pay cash withdrawal benefits to any member who withdraws from the fund before retirement. Instead, all individuals must have their entire balance paid either into the default preservation fund or fund section, or into their new employer's fund, or into a preservation fund they have chosen. This requirement will apply to all benefits, including those to which vested rights apply. To prevent tax arbitrage, benefits may not be split, so the member's entire balance must be paid into a single fund.
- On P-day, the rules on preservation funds will change. The restriction on the maximum number of withdrawals will be removed. At any time, individuals will be able to withdraw, in cash, the portion of the initial deposit to which vested rights applied.
- To allow access to funds, preservation fund members will be able to withdraw each year the greater of the state old-age grant (OAG) or 10% of their initial deposit, excluding any portion to which vested rights apply. Any unused withdrawals may be carried forward, but to reduce administrative costs, individuals will be limited to one withdrawal per calendar year or part thereof.
- For individuals who are members of preservation funds on P-day, their initial deposit will be deemed to be equal to the value of their preservation fund on P-day, and vested rights will apply to this amount if they have not used their single withdrawal. If they have used their single withdrawal, vested rights will not apply.
- Consideration will be given to relaxing the preservation requirements of retirement annuity funds by allowing members of retirement annuity funds to transfer their balances to preservation funds, under some conditions to prevent tax arbitrage. These conditions may include preventing individuals who have transferred funds out of an RA fund from rejoining that fund, or alternatively from receiving a tax deduction in respect of any RA contributions, for a period. Consultation is invited on this point.

Examples

Existing member of a provident fund

Brian is a member of the United Workers Union provident fund. His balance on P-day is R400 000. The next day, he resigns from his job. His balance of R400 000 is transferred to the United Workers Union Preservation Fund (UWUPF).

New member after P-day

Themba graduates from high school after P-day. He starts working, and after 5 years, he has accumulated R100 000 in a provident fund. Because he started working after P-day, he has no vested rights.

He leaves his job, and transfers his fund to his new employer's fund. After three years, he has R200 000 in his new employer's fund. He leaves that job, too, and his R200 000 is transferred to the Life Company Preservation Fund (LCPF). At that point, the OAG equals R23 000 per year.

Box 1: Brian

Date	Balance*	Annual Old Age Grant*	Cumulative permitted maximum withdrawal	Actual withdrawal	Cumulative actual withdrawals	Unused withdrawals	Balance after withdrawal
P-day (leaves employment)	R400 000	R15 000	R415 000	R0	R0	R415 000	R400 000
+1 year	R450 000	R16 000	R431 000	R0	R0	R431 000	R450 000
+2 years	R500 000	R17 000	R448 000	R0	R0	R448 000	R500 000
+3 years	R500 000	R18 000	R466 000	R0	R0	R466 000	R500 000
+4 years	R600 000	R19 000	R485 000	R485 000	R485 000	R0	R115 000
+5 years	R140 000	R20 000	R505 000	R0	R485 000	R20 000	R140 000
+6 years	R160 000	R21 000	R526 000	R0	R485 000	R41 000	R160 000
+7 years	R150 000	R22 000	R548 000	R25 000	R510 000	R38 000	R125 000

* These values are illustrative and not intended to be indicative of future policy or market performance.

Since he has no vested rights, in the first year, he may withdraw the greater of R23 000 or 10% x R200 000, which is R20 000. He cannot find another job, so he withdraws R23 000 immediately. This leaves R177 000 in the LCPF.

A year later, this has grown to R190 000. The OAG is R24 000 per year. He withdraws R24 000, leaving R166 000 in his account.

A year later, this has grown to R185 000, and the OAG is R25 000 per year. He withdraws R25 000, leaving R160 000 in the account. He finds another job, and makes no further withdrawals until four years later, when he withdraws the maximum permitted R110 000.

Box 2: Themba

Date	Balance*	Annual Old Age Grant*	Cumulative permitted maximum withdrawal	Actual withdrawal	Cumulative actual withdrawals	Unused withdrawals	Balance after withdrawal
P-day (starts employment)	R0	R15 000	R0	R0	R0	R0	R0
+8 years	R200 000	R23 000	R23 000	R23 000	R23 000	R0	R177 000
+9 years	R190 000	R24 000	R47 000	R24 000	R47 000	R0	R166 000
+10 years	R185 000	R25 000	R72 000	R25 000	R72 000	R0	R160 000
+11 years	R158 000	R26 000	R98 000	R0	R72 000	R26 000	R158 000
+12 years	R170 000	R27 000	R125 000	R0	R72 000	R53 000	R170 000
+13 years	R190 000	R28 000	R153 000	R0	R72 000	R81 000	R190 000
+14 years	R200 000	R29 000	R182 000	R110 000	R182 000	R0	R90 000

* These values are illustrative and not intended to be indicative of future policy or market performance.

Existing member of an umbrella fund

Busisiwe is a member of the Consolidated Umbrella Fund. On P-day, her balance in the fund is R450 000. Two years after P-day, this balance has grown to R500 000. Contributions she made to the fund after P-day, and growth on these, are worth an extra R100 000. Her total balance is therefore R500 000, which represents her vested rights portion, plus R100 000, which equals R600 000.

At this point, she leaves employment. Her balance of R600 000 is transferred to the Consolidated Preservation Fund (CPF).

At any time, she may withdraw R500 000 from CPF. In addition, for each year she stays in CPF, she may withdraw the greater of the OAG, or 10% of R100 000. She chooses not to withdraw any money immediately.

After 5 years, the R600 000 deposit in CPF has grown to R1 000 000. At this point, the OAG equals R22 000 per year. She may now withdraw R500 000, plus the greater of 5 years x 10% x R100 000 or the sum of the OAG over the 5 years, which is R117 000.

She decides to take out R350 000. This leaves R650 000 in CPF.

Box 3: Busisiwe

Date	Balance*	Annual Old Age Grant*	Cumulative permitted maximum withdrawal	Actual withdrawal	Cumulative actual withdrawals	Unused withdrawals	Balance after withdrawal
P-day+2 years (leaves employment)	R600 000	R17 000	R517 000	R0	R0	R517 000	R600 000
+3 years	R580 000	R18 000	R535 000	R0	R0	R535 000	R580 000
+4 years	R690 000	R19 000	R554 000	R0	R0	R554 000	R690 000
+5 years	R750 000	R20 000	R574 000	R0	R0	R574 000	R750 000
+6 years	R920 000	R21 000	R595 000	R0	R0	R595 000	R920 000
+7 years	R1 000 000	R22 000	R617 000	R350 000	R350 000	R267 000	R650 000
+8 years	R700 000	R23 000	R640 000	R0	R350 000	R290 000	R700 000
+9 years	R900 000	R24 000	R664 000	R0	R350 000	R314 000	R900 000
+10 years	R850 000	R25 000	R689 000	R339 000	R689 000	R0	R511 000
+11 years	R550 000	R26 000	R715 000	R0	R689 000	R26 000	R550 000
+12 years	R600 000	R27 000	R742 000	R0	R689 000	R53 000	R600 000
+13 years	R700 000	R28 000	R760 000	R0	R689 000	R81 000	R700 000

* These values are illustrative and not intended to be indicative of future policy or market performance.

Three years later, this R650 000 has grown to R850 000. At this point, the OAG equals R25 000. Now, she may withdraw at most R500 000, plus the greater of 9 years x 10% x R100 000 or the cumulative sum of the OAG, less the R350 000 she has already taken out. This equals R339 000. She withdraws R339 000 to help pay for a new car. This leaves R511 000 in the fund.

Four years later, this R511 000 has grown to R700 000. At this point, the OAG equals R28 000. Now, she may withdraw at most R500 000, plus the greater of 14 years x 10% x R100 000 or the sum of the OAG, less the R689 000 she has already taken out. This equals R81 000. She elects to make no further withdrawals.

Post-retirement preservation

Different approaches to harmonising the annuitisation requirements of pension and provident funds were presented in the discussion paper. The options ranged from continuing to allow provident fund members to access cash lump sums at retirement, as currently, to a vesting scale requiring partial annuitisation, based on the years to retirement of the individual at the date of implementation of the legislation.

Responses to consultation

Most responses to the consultation, both formal and informal, agreed with the principle of harmonisation. However, responses differed on the timing and extent of the changes to annuitisation requirements for provident fund members.

Proposal

In formulating a policy, the following issues were taken account of:

- Requiring members of provident funds to annuitise their balances without altering the means test of the OAG would result in significant numbers of low-income workers facing implicit marginal tax rates on their retirement income equal to 40%. This is the same marginal tax rate currently paid by the highest income earners in South Africa.
- Many individuals near retirement age may be counting on receiving a large cash lump sum from their provident funds when they retire. Some of these workers would be adversely affected by annuitsation requirements which did not respect their vested rights.
- The importance of avoiding tax arbitrage between different types of retirement fund.
- Concurrent reforms to the market for retirement income products would be required to ensure that the market functions better than currently for low-income individuals.

It is proposed that the rules on annuitisation of retirement fund contributions will change on a particular day, to be determined by legislation. This day will be called T-day. The tax treatment of retirement fund contributions will also change on T-day.

The following are the main elements of the proposal:

- The means test of the OAG will be phased out by 2016. The secondary and tertiary rebates will be adjusted over the same period to preserve equity.
- Contributions made to provident funds after T-day, and the growth on these contributions, will be subject to the same annuitisation requirements that pension funds and retirement annuity funds will be subject to. This means that the individual's balance in provident funds at T-day, plus any growth on that amount after that time, will not be subject to annuitisation requirements.
- These annuitisation rules will be subject to two limitations. Firstly, individuals who are 55 years or older will not be subject to annuitisation requirements even on their new contributions. This is intended to ease the transition into retirement for those who are already eligible for early retirement. Secondly, the *de minimis* threshold, which currently states that retirement balances lower than R75 000 need not be annuitised, will be increased to R150 000.
- These provisions imply that those provident funds members whom the annuitisation requirements are likely to affect will, in most cases, have many years to plan for the change.

Examples

Provident fund member older than 55 on T-day

Thandi is a member of the United Workers Union provident fund. Her balance on T-day is R400 000. On that day, she is 56 years old.

She continues contributing to the provident fund, and retires aged 64. On that day, her provident fund balance is R750 000. She will be able to take the entire amount as a lump sum at retirement, as at present. Furthermore, she will not have her OAG reduced due to means testing, and so will also receive the full OAG, currently R1 260 per month for those under the age of 75.

Provident fund member younger than 55 on T-day

Willem is a member of the Open Provident Fund. On T-day, his balance in the fund is R450 000. He is 54 years old.

He continues contributing to the provident fund. Six years later, the R450 000 has grown to R600 000. Contributions he made to the fund after T-day, and growth on these, are worth an extra R100 000.

Vested rights apply to the R600 000, so he can take at least this amount as a cash lump sum. However, the additional R100 000, although formally subject to the annuitisation requirements, is below the new *de minimus* threshold of R150 000. He can therefore take the full R700 000 as a cash lump sum when he retires.

Furthermore, he will receive the full OAG, currently R1 260 per month for those under the age of 75.

Provident fund member who changes fund before retirement

Salman is a member of the Important Provident Fund. On T-day, his balance in the fund is R1 000 000. He is 29 years old.

He continues contributing to the provident fund. Six years later, he leaves his job. At this point, the R1 000 000 has grown to R2 000 000, and the new contributions he has made to the fund, and the growth on these, make up a further R500 000. He transfers his R2 500 000 balance to a preservation fund.

Many years later, when he turns 70, the R2 000 000 has grown to R10 000 000. The rest of his retirement funds are worth R50 000 000. He is eligible to take R10 000 000, plus one third of the R50 000 000, which is R18 333 333, as a cash lump sum. The rest of his retirement balances must be annuitized.

In addition to this, he will be eligible to receive the full OAG, currently R1 260 per month for those under the age of 75.

Governance

The paper *Preservation, portability, and governance for retirement funds* also discussed the governance of retirement funds. In particular, the paper emphasised the need for trustees to be sufficiently trained and knowledgeable to execute their responsibilities competently, independently and free of conflicts of interest.

Responses to consultation

The responses from the public were overwhelmingly in support of the areas of concern raised in the paper. There was support for mandatory training for trustees and elevating the current PF Circular 130 into a Directive, after appropriate revisions. Some of the comments even recommended that consideration should be given for having some trustee exams set up by the Financial Services Board.

Proposal

The complexity of retirement funds places a significant burden on the trustees, who are tasked with governing and managing them. Although trustees should seek expert advice and services where necessary, they are ultimately responsible for the decisions taken and the mandates given to service providers. Furthermore, they should always exercise their fiduciary duties free without fear and favour. Governance mechanisms to strengthen capacity within retirement fund boards, including peer review, will be explored in co-operation with the Financial Services Board.

To clarify the above responsibilities and duties, PF Circular 130, which deals with governance issues, will be revised and elevated to a Directive. A draft version will be published later this year for public comment. Consideration will also be given to elevating the current Trustee Toolkit into a basic, independent, compulsory and free training toolkit. The FSB should also be notified of any new trustee appointments or other changes to fund Boards. Later this year, the Minister will convene a conference of Trustees to discuss how the challenges of increasing governance standards can be met. The role of Principal Officers will also be reviewed to ensure that the highest standards of accountability, professionalism, compliance and independence are maintained at all times.

The Financial Services Laws General Amendment Bill, 2012, is currently in Parliament. The Bill has a provision which requires trustees to obtain training within six months of their appointment. The Bill also seeks to protect whistleblowing trustees from victimisation and liability. Lastly, but crucially, the Bill makes it an offence if employers fail to transfer pension contributions to a retirement fund.

Retirement income

The paper *Enabling a better income in retirement*, released on 21st September 2012, described the current market for retirement income products in South Africa. It detailed how most individuals appear to be left to the retail market by their retirement funds once they have retired. Here, they face a complex choice between conventional annuities, which guarantee individuals an income for as long as they are alive, and living annuities, in which individuals bear the risk of outliving their assets, as well as the risk that their investments will perform poorly. Most retirees currently appear to be choosing living annuities.

Responses to consultation

Most respondents pointed out that an important factor underlying the choice of annuity at retirement was the low level of accumulated funds in retirement plans, and that in many cases, unsustainably high levels of drawdown, or high levels of investment risk, were a response to this rather than other factors. After the implementation of the proposals on preservation, the level of assets at retirement should be higher for most people.

Most respondents also pointed out that because of the high heterogeneity of the South African working population, mandating a particular annuity product, or reducing the highest permitted drawdown levels in living annuities, could end up harming certain vulnerable groups.

Most respondents were in favour of reforming, rather than replacing, living annuities, although few were opposed to allowing companies other than life insurers to provide living annuities to increase competition.

Proposal

Important considerations underlying the policy proposals chosen were:

- Many of the difficulties associated with living annuities may be direct or indirect consequences of the ways in which intermediaries, including investment platforms, are remunerated. A process, led by the Financial Services Board, is already underway to investigate this issue. Changing the design of living annuities before the process has been completed may lead to unnecessary costs.
- A risk of allowing living annuity products to provide guarantees is that the resulting increase in product complexity leads to worse, rather than better, outcomes for consumers. Better outcomes may result if the rules on splitting annuity considerations between different products are eased, allowing retirees to choose different combinations of existing, relatively well-understood products.
- The current requirement for living annuity providers to be restricted to those with life licences is unnecessary. A broader range of providers may benefit consumers by increasing the degree of competition and reducing barriers to entry in this market.
- Requiring retirement plans to support their members into retirement, to choose appropriate defaults and to purchasing retirement income products in bulk on behalf of their members may lead to a significant improvement in the retirement outcomes of many members. It may also lead to the emergence of standardised retirement products.

The proposal has the following elements:

- As discussed above, the means test for the Old Age Grant will be phased out by 2016. All citizens over a designated age would be eligible for the grant, irrespective of income level. To ensure equity, adjustments to the secondary and tertiary rebates will be made to offset the costs of this change and retain broadly the same progressive tax structure. Also, the *de minimus* amount for which annuitisation is required will be raised from R75 000 to R150 000, and adjusted for inflation thereafter.

- Rules for splitting annuities will be reformed to allow easy splitting and to ensure that the *de minimis* provision only applies once. This will make it easier for individuals to purchase combinations of conventional and living annuities to suit their preferences.

- Although trustees' formal responsibilities may end at retirement, the primary purpose of a retirement fund is to provide income in retirement to members. It is therefore part of the responsibility of trustees to guide members through the process of converting their defined contribution lump sum accumulation into an income. An FSB directive will therefore be issued, outlining the minimum requirements that Trustees must meet in this regard.

- As part of this process, all retirement funds will be required to select a default retirement product for their members, and to automatically enrol members into this product unless they request otherwise. The default may be either inside or outside the fund. Individuals will be free to opt out of the default if they wish. Trustees should be guided by a set of principles in making this choice, including principles dealing with value-for-money and managing conflicts of interest, and a process will be set in motion to determine a suitable set of principles which could be adopted.

- Living annuities, whether within or outside the fund, will only be permissible for defaults if they meet strict conditions, including on design (default strategy, limited investment choices, limited drawdown rates), and costs.

- Trustees could be given some legal protections in respect of the choice of the default provided that certain conditions are met, including that members are given access to commission-free independent financial advice at retirement, paid for by the fund on a salary or fee-for-time basis.

- The living annuity market will be opened to more competition by allowing registered Collective investment Scheme (CIS) providers to create a CIS-like living annuity to compete alongside life insurers. CIS products will be eligible for defaults provided they meet the requirements applicable to living annuities. Retirement funds can already provide in-fund living annuities or conventional annuities to their retired members if they wish to.

- The FSB currently has two processes underway which may result in lower charges for living annuities. The Retail Distribution Review is investigating commissions on investment business, including on living annuities. Living annuities are also part of the scope of the Treating Customers Fairly initiative. An investigation of rebates paid for by investment platforms will be included in the Retail Distribution Review, and both processes will be strengthened with resources from National Treasury.

- To monitor the progress of these reforms, detailed reporting of annuity purchases by individuals retiring from funds, charges and asset mix on living annuity and CIS-type living annuity policies, and purchase prices and terms of conventional annuity policies will be required.

Non-retirement savings

The paper presented options for the design of tax-preferred individual savings and investment accounts. Based on the responses received, it was decided to proceed with the development of the accounts.

Proposal

In developing the proposals, particular attention has been paid to:

- Ensuring that the impact on older people who rely largely on accumulated savings to support themselves is not adversely impacted by transition arrangements.
- Not increasing administration costs unnecessarily.
- Ensuring that the thresholds are set at an appropriate level.
- Allowing a wide range of possible investments in the accounts to avoid undue distortionary effects on asset prices.

It is proposed that the current interest exemption threshold will be increased to R34 500 for those over the age of 65 and to R23 800 for those under the age of 65 with effect from 1 March 2013. These may not be adjusted for inflation in the future.

In addition to the interest exemption, further consideration will be given to developing the tax incentivised savings and investment product announced by the Minister in Budget 2012. This vehicle will function as a wrapper, exempting all investment returns from income, dividend and capital gains taxes. The contribution limits will be as indicated in the paper *Incentivising non-retirement savings,* i.e R30 000 p.a. and R500 000 in one's lifetime. These limits will be adjusted for inflation on a regular basis. The new accounts will be introduced by April 2015.

At this stage, two broad categories of products are proposed for inclusion in the tax incentivised savings product scheme, namely interest and non-interest bearing products. Possible products to be included under one or both of these categories are:

- Fixed deposit bank account
- Retail savings bonds
- CIS's (including Exchange Traded Funds)
- Property assets – Real Estate Investment Trusts (REITS), Property Listed Stocks (PLS) etc.

Broader reforms

In addition to the measures described above, Government is exploring ways to increase the number of workers who participate in retirement funds. Currently, only around half of formally-employed workers are members of an employer-sponsored retirement fund. Yet increasing coverage is more complex than it may first appear. Analysis based on the Quarterly Labour Force Survey of 2010, soon to be published by the Centre for Research into Economics and Finance in Southern Africa (CREFSA) indicates that 86% of workers without retirement funds earn less than the tax threshold, indicating that they receive no tax benefit for participating in retirement saving. Further, 73% of uncovered workers work for employers with fewer than 50 employees, and nearly 40% work in sectors such as construction, agriculture or domestic sevice, where their attachment to the formal labour force may be tenuous.

Increasing coverage will thus depend on reaching low-income workers, workers with a tenuous connection to the formal labour force, and workers who work for smaller employers. The issues involved are complex. Government is currently considering how to proceed as part of the process of broader social security reforms.

Consultation process

The public is invited to comment on the draft proposals contained in this discussion document by no later than **31 May 2013**. Comments may be submitted to:

Attention: Mr Olano Makhubela, Chief Director: Financial Investments and Savings, Private Bag X115, Pretoria, 0001. Or by fax to 012 315 5206; or by email to retirement.reform@treasury.gov.za.

Further consultations will be held during the legislative process. Consultative meetings will also be convened with trade unions, employers, retirement funds and other interested stakeholders.