Comment on the National Treasury Retirement Fund Reform Discussion Paper

Competition Commission South Africa, March 2005

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1. Introduction

In December 2004 a National Treasury task team released a thorough Retirement Fund Reform discussion paper and invited public comments to be submitted by the 31 March 2005.

The government's main objectives of retirement policy include to:

- Encourage individuals to provide adequately for their own retirement and the needs of their dependants.
- Encourage employers and employees to provide for retirement funding as part of the remuneration contract.
- Ensure that retirement funding arrangements are cost-efficient, prudently managed, transparent and fair.
- Promote the retention of purchasing power of pensions through protection against the effects of inflation, within the resource constraints of the fund.
- Improve standards of fund governance, including trustee knowledge and conduct, protection of members' interest, accountability, and disclosure of material information to members and contributors.
- Provide, through social assistance, an assured basic income entitlement to elderly persons without means.

In keeping with a framework that was proposed by the World Bank, the National Treasury task team bases its approach to retirement fund reform on a three "pillar" system:

- The first pillar is a public benefit programme, funded from general government revenue, which is aimed at redistribution (from the more well-off to the poor) in order to prevent poverty in old age. It comprises the social old age grant.
- The second pillar is typically privately managed, fully or partially funded, with mandatory participation, within which individuals save to provide themselves with an income during retirement. This pillar includes various pension and

provident fund arrangements associated with formal sector employment, in either the private or public sectors.

- The third pillar comprises voluntary savings, permitting individuals to choose how they allocate income over their lifetime. Pillar 3 represents voluntary saving.

2. Competition Commission comment

The Competition Commission ('Commission") supports the objectives of the retirement fund policy and especially the recommendation that a National Savings Fund (NSF) (annexure 2 section 2.5) be established for people with low incomes (particularly workers in the informal sector, part-time and seasonal employees, domestic and agricultural workers).

2.1. Recommendations supported

2.1.1. National Savings Fund (NSF) [annexure 2 section 2.5]

The Commission supports the recommendation of a NSF as this will stimulate competition among financial services companies. Just like the Mzansi account in the banking sector that stimulated competition for the low-income sector and forced banks to offer less costly banking products, the NSF will spur competition amongst financial services companies to offer simpler low cost retirement savings products.

The proposal to ensure that the NSF pays competitive investment returns (section 2.5.1.2.) is welcomed by the Commission.

2.1.2. Individual Retirement Funds (IRF) [annexure 2 section 4]

The Commission welcomes the recommendation by the National Treasury task team (in sections 4.2.3. to 4.2.6.) that IRFs:

- Enjoy the same tax treatment as occupational retirement funds;
- Allow transfer of retirement savings between funds at the request of the member, provided the fund to which the savings are transferred meets the conditions applicable to the first fund; and
- Disclose all fees charged to prospective and existing members and to the fund by its service providers; and, in order to encourage competition amongst such service providers, the regulator must publish the comparative fees of the funds on offer.

This will go a long way in solving the problem of opaqueness in the industry (especially with regard to asset management costs and commission paid to intermediaries) and will not prejudice individual funds against occupational funds.

2.2. Possible problems

2.2.1. National Savings Fund (NSF)

Since employees who earn low incomes will be entitled (and could be encouraged) to leave their occupational or union-based schemes to join the NSF, possible problems may arise.

- Firstly, since most occupational schemes are small, this will affect their economies of scale and they may be forced to close. They may not even benefit from pooling their assets together to share costs under umbrella funds.
- Secondly, the financial services industry may be prevented from administering the NSF. This may have negative impact on competition for fund administration. Some industry commentators have recommended that to solve this problem, private sector administrators may have to be given the chance to tender for the administration of the NSF.

2.2.2. Preservation

On page 7 the National Treasury task team acknowledges that the recent movement from defined benefit (pension) to defined contribution (provident) funds has encouraged members to be more vocal in the management of their retirement funds and has actually increased depth and competition in the industry.

However, the task team recommends in section 3.12.3.1:

“If an employee changes jobs or ceases to be a member of a fund, the benefit payable from the old retirement fund must not be available in cash but must be transferred to the employee’s new occupational retirement fund, an individual retirement fund of the employee’s choice, or the NSF”.

This recommendation effectively will do away with provident funds. However, the task team does not address the impact this recommendation will have on competition.

2.2.2. Taxation

The discussion paper has not addressed the issue of taxation of retirement funds[1]**.** It is hoped that there will be harmonization of tax for the different retirement savings vehicles.

Conclusion

In general, the Commission welcomes the broad aims of the retirement fund discussion paper. The aim of government to introduce transparency in the retirement savings

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[1] That will be discussed in a separate paper

industry is long overdue. It is hoped that the problems of payments of commission to brokers will once and for all be dealt with, especially the issue of up-front commission payments by the life industry.

Furthermore, National Treasury will have to address the possible elimination of competition in the fund administration industry once the NSF is introduced.