National Treasury presentation on the Pension Funds Amendment Bill, 2020 [B30-2020]

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- FSCA colleagues also present

Retirement Reform Objectives in 2012

- Primary aim of the 2012 retirement savings proposals was to **encourage household savings** and ensure that individuals are not vulnerable to poverty, especially in retirement when they may be unable to work
    - South African households do not save much, and most household saving is contractual in nature
    - Gross saving in 2020 was 14.6% of GDP in 2020, with *household saving only* as 2.0% of GDP (SARB March 2021 Quarter Bulletin)
    - Structural and behavioural reasons for low savings culture
- Government committed to both **transformation and reform of the retirement industry, to ensure it serves members and country better**
    - Lowering of costs and consolidation of retirement funds (economies of scale)
    - Preservation and widening of coverage of retirement funds
    - Harmonisation and Simplification of Retirement Funds
    - Improving Governance over Retirement Funds
    - Encouraging annuitisation on retirement to ensure a regular post-retirement income
- Retirement reforms is for the **long term**
- Encouraging non-retirement savings

Significant but Limited Progress against 2012 Vision

- **Encourage preservation**
  - Default preservation regulation in place since March 2019
  - But loopholes remain and still need to be closed (withdrawal on resignation)
- **Enhance governance** of funds
  - Criminal and personal liability to employers in respect of **non-payment of retirement contributions** to a retirement fund
  - **Skills training** for trustees **compulsory** through trustee toolkit
- **Encourage annuitising** at the time of retirement
  - **Provident fund annuitisation** requirement effective as of March 2021
- **Simplify the taxation** of retirement contributions
  - **Tax deduction** same across all funds since March 2016
- **Encourage non-retirement saving** through tax free saving plans
  - Tax Free Savings Accounts since April 2015
- **Encourage good value retirement products and services** by reviewing cost
  - Regulations on default investment portfolio and annuity strategy since March 2019

Tax Harmonisation reforms already implemented

- Before 2016 there were three different tax regimes for contributions to pension funds, provident funds and retirement annuity funds, with differing tax treatments of employer and employee contributions
  - Similarly, there were different rules relating to annuitisation upon retirement
- The 2016 reforms created **one single tax regime for all funds**, a considerable simplification
  - The amendments also included employer contributions as a taxable fringe benefit for the first time and capped the deduction allowed for contributions to R350 000 to improve transparency and equity
- A major part of the reform, **compulsory annuitisation** at retirement for all contributions going forward, was delayed, but **has now been implemented from 1 March 2021**.
  - Even further simplification as now all funds can be treated the same at the time of contribution and at the retirement
  - This addition allows for tax free transfers between funds, which again makes it simpler and should encourage greater consolidation and a reduction in fees

Ongoing Reforms (2021 Budget and 2020 MTBPS)

- EXPANDING COVERAGE through auto-enrolment
- PRIORITISING PRESERVATION
- CONSOLIDATON, CONSOLIDATION, CONSOLIDATION
  - We need to pursue this objective more aggressively
  - Can we reduce to 10 or 100 or 200 or 300?
  - Such a road will make the path towards an NSSF easier, and less difficult?
  - Little point in saving for retirement if there is no preservation
  - Closing loopholes in current legislation
- IMPROVING GOVERNANCE (trustees, umbrella funds)
- REDUCING COSTS
- SIMPLIFYING TAXATION
- BETTER PRODUCT OFFERS (eg ANNUITIES)

RETIREMENT REFORMS AND NEDLAC

- **Retirement reform being undertaken under the auspices of Comprehensive Social Security and Retirement Reform at NEDLAC**
  - **Reducing the number** of retirement funds (economies of scale/consolidation)
  - **Reviewing the annuities market** to make it more suitable for the low income market
  - **Revising the social security paper** to release for public engagement
- **Early Access to Retirement Savings**
  - Consultations underway on LIMITED withdrawal option together with MANDATORY PRESERVATION
  - Nedlac considering speedy **introduction of auto enrolment** and **establishment of a default fund**
- **Consolidation and governance**
  - Enhance **governance** in umbrella funds
  - **Reduce** number of funds
- **Proposed Review of Regulation 28 (draft Gazette published for comment)**
  - Intention is to **make recognisable,** retirement funds **investment in infrastructure**
  - Proposed regulatory change seeks to ensure that retirement savings are not only invested in a prudent manner and earn good returns but also contribute in ways that support economic development and growth.

CoVID-19 Relief Measures Introduced

- A contribution suspension was enabled through a communique issued by the Financial Sector Conduct Authority ("FSCA") to retirement funds in late March 2020,
  - Employers and/or employees who are experiencing financial distress can consider using existing enabling rules to suspend or reduce retirement funds deductions and contributions, after engagement with the fund
  - Funds which do not have such rules can urgently apply for their registration with the FSCA, which has already put in place a mechanism to fast-track their processing
  - Members on zero salary during period of suspension continued to enjoy risk cover in the majority of cases, and preserved their fund credit and did not have to reduce or encash retirement savings
- Government provided temporary relief to living annuitants by allowing for draw down rates to be reduced to 0.5% (current minimum 2.5%) in order to protect underlying assets
- Living annuitants having living annuity as their only source of income were allowed a temporary increase to their draw down up to 20% (current maximum 17.5%)
- Further, the *de minimus* threshold for commutation of small living annuity capital values has been increased to R125 000 (previously R50 000 or R75 000)

Stated Purpose of Bill

- Bill proposes amendment to section 19 of the Pension Funds Act (PFA) to enable pension fund members to obtain a loan, secured by a guarantee from a registered pension fund
- Intention is to alleviate financial pressure during the COVID-19 emergency or any other emergency similar to COVID-19
- Proposed amendment would enable a fund to offer a guarantee to a member up to a maximum of 75% of their share in the value of the fund
- Claims to motivate the Bill:
  - That member access to a pension-backed loan would allow leverage of pension fund investment prior to a member's retirement date, without eroding their provision for eventual retirement
  - Lending institutions will be enabled to offer loans at competitive interest rates and over extended or deferred payment periods given that the loan is fully guaranteed
- No socio-economic or financial impact study provided to support the Bill and the claims to motivate the Bill

National Treasury Concerns with Bill

- National Treasury appreciates the objective of the Bill to provide relief to members of pension funds who are temporarily without income or are in serious financial difficulties as a result of the current COVID-19 emergency.
  - Bill has short-term objectives but has not taken into account the impact on MT and LT objectives
- Objectives of Bill are not clear, and even contradictory
  - COVID emergency to WITHDRAW funds (ST) vs Funding of housing (MT)
  - Funding of housing is not a COVID emergency, but a broader challenge
- Motivation for the Bill is also not supported evidence:
  - LEVERAGE: if a member ends up defaulting on the loan, it would substantially erode their retirement savings
  - COMPETITIVE INTEREST RATE: Not certain that a competitive interest rate would be granted, and the loan might still not be affordable for the pension fund member.
- BUT fund as a whole will be investing less if they do not have the funds (because of withdrawal or loan), and hence lower growth of entire fund
- Lowering the borrowing limit from 75% does not deal with the risks, and objection is to allowing any housing loan guarantees against retirement fund
  - Current system where a fund allows borrowing has a high level of abuse
- No SEIAS, so no study on impact on liquidity or how abuse (which happens currently in some funds) can be prevented

National Treasury Submission on the Bill

- Retirement funds are not easy to use for ST objectives like withdrawals
- It is critical that any measure to provide access to retirement fund benefits does not undermine long-term objectives
  - Members may wipe of all or most of their savings if (unlimited) withdrawals are allowed
  - Preservation cannot be achieved if there are no limits to withdrawals
- Discussions taking place within NEDLAC on how to enable LIMITED WITHDRAWALS without undermining broader objectives
- National Treasury has serious concerns regarding the Bill and is opposed to the Bill for reasons set out further on in the presentation

What is the impact of the Bill on SAVINGS?

- South Africans have an extremely low level of retirement savings, which has been highlighted in numerous surveys
- The recent 10X 2020 South African Retirement Realities Survey, for example, found that 49% of people surveyed say they do not have a retirement plan
- The number of South Africans who feel good or pretty good about their retirement plan remains very low at 30%. 69% of people surveyed said they had no retirement plan at all, or just a vague idea
- A mere 6% of South Africans surveyed said they were executing a retirement plan that they had properly thought through, which is similar to the National Treasury's estimates that only 6% of South Africans have sufficient savings for a reasonable retirement
- The proposal to enable access to up to 75% of retirement savings would erode the already extremely poor level of savings
- Statistics from ASISA show that at least 50% of members have less than R50 000 in capital in their funds
    - With the average benefit at retirement at approximately R350 000

Bill likely to increase Indebtedness

- The National Treasury does not support that pension fund benefits may used as a guarantee to obtain a loan, even if the guarantee is significantly less than the proposed 75% of the pension fund interest
- Most members are already overly indebted
  - Households debt is 77,1% of nominal disposable income in 2020, with household servicing of debt 8,5% of disposable income
- Incurring further debt could have a significant impact upon members' financial security over the long-term, including into their retirement years
- The actual rate of the loan is still subject to determinations by individual lending institutions, and can certainly not be definite or guaranteed
- Loans measure proposed in the Bill would be subject to the affordability requirements of the National Credit Act, 2005 (Act No. 34 of 2005)
- Members without sufficient income to meet affordability requirements, or who might be blacklisted would be precluded from accessing proposed relief, making relief measure inequitable
- Significant numbers of members who are in the greatest financial distress may not be able to access the envisaged relief
- Bill will effectively only benefit a few, and not the most vulnerable

Motivation does not detail how loan mechanism will work, and is RISKY

- No underlying operational details are provided in the motivation for the Bill
  - What problem is the Bill trying to solve?
- No proposal for oversight or requirements in relation to the use of the loan funds
- Members will be confused on why they allowed to incur debt for housing and not for other purposes
- Potential for abuse under section 19 amendment is high
- Bill is administratively onerous and costly for Funds, as their Boards would have to make a determination on a case by case basis
- Providing guarantees for loans would create potentially substantial contingent liabilities for pension funds
- If a guarantee is called upon, a pension fund would need to make a rapid sale of assets

Amendment to Section 19 not comprehensive

- The current restriction in section 19 of the Act on granting loans is based on the policy position that retirement benefits should be preserved for the member's retirement
- The exception of allowing a loan in relation to immovable property is viewed as being consistent with ensuring the long-term security of the member, as the ownership of immovable property also promotes financial security during retirement. Granting loans for any other purpose would be inconsistent with that objective
- Section 37A of the PFA protects a member's benefit from being reduced, ceded, transferred or attached by creditors as security for general debts
- Section 37D allows for certain deductions to be made from pension benefits, as permitted in terms of the Act
- The proposed amendment to sec 19 as contained in the Bill does not contemplate corresponding amendments to the aforementioned sections

Tax Implications are ignored in the Bill

- Retirement savings are linked to tax incentives on contribution and growth
- Early withdrawals open the tax incentive system to abuse
- The Bill will need to deal with amendments to the tax regime, which has to be doine via a separate Money Bill
- The current tax regime would require that any payouts from the fund that are made before retirement are taxed according to the withdrawal tax table
- Payouts from retirement funds are taxable since the contributions are made before tax is paid, otherwise the income could be received completely tax free
- The tax on withdrawals before retirement ranges from 18 per cent on amounts above R25,000 up to 36 per cent on withdrawn amounts above R990,000
- If a guarantee is called because the member can no longer service a loan, the retirement fund assets that are withdrawn to honour the guarantee would be subject to this tax. If the guarantee ensures that the post-tax amount of the loan is paid to the loan provider, there may be cases where more than the full amount of the available retirement fund assets is used to service the debt. This would leave nothing left in the fund for the member and may create an additional liability that cannot be serviced by the individual's assets

Treasury progress on **access to retirement savings AND PRESERVATION**

- 2020 MTBPS announcement
  - Limited withdrawals to be accompanied by mandatory preservation requirement,
  - Consultations underway with NEDLAC partners to introduce necessary legislative amendments this year or next
  - Proposals to alleviate the need for workers to resign to access retirement savings
- Many complexities related to withdrawals aside from preservation
  - TAX WITHDRAWALS
  - MAINTENANCE PAYMENTS
- Points to consider:
  - Access prone to abuse
  - Early withdrawals will severely reduce already low benefits at retirement
  - Early access changes the nature and structure of retirement savings
  - Will put a strain on administrators and funds, given that they are not geared to operate like banks
    - Administrators need system changes
    - Funds would have to amend their rules
    - Implications on SARS system

Treasury Response has limited itself given lack of details and SEIAS

- Treasury has not considered the implications from a FUNDs perspective or that of their service providers
- Treasury has not engaged with FUNDS or ASISA
- Treasury has not engaged with banks to assess how the loan mechanism may work
- Lack of OPERATIONAL details also makes it difficult to consider the full implications of the Bill

CONCLUSION

- BILL is NOT supported by Treasury, and brings great risk to members of retirement funds
- Allowing loans for housing or anything else is not supported, even if it is lowered from 75%
- Amending the Bill to deal with all the risks will be like doing a completely new bill – National Treasury is working on a more comprehensive bill
- Bill should be rejected to enable and await Bill from Government
- PRIORITY is Medium and long-term objectives of RETIREMENT REFORM
    - EXPANDING COVERAGE (auto-enrolment, vulnerable workers)
    - CONSOLIDATION, CONSOLIDATION, CONSOLIDATION
    - PRESERVATION, PRESERVATION, PRESERVATION
    - Lowering of costs and economies of scale
    - GOVERNANCE, GOVERNANCE, GOVERNANCE
        - Including for UMBRELLA FUNDS
    - Reforming and improvement of ANNUITY market
- Limited withdrawals with PRESERVATION will be introduced as a Bill AFTER agreement with NEDLAC partners