STRENGTHENING RETIREMENT SAVINGS

Standing Committee on Finance | Mr Ismail Momoniat | National Treasury

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national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Background: Twin Peaks Reform after the Great Financial Crisis

Global Financial Crisis has resulted in a fundamental rethink on approach to regulation

- The 2008 financial crisis necessitates legislative changes as outlined in the National Treasury's policy paper "*A safer financial sector to serve South Africa better.*"
- Key lessons from the crisis:
  - Shift from light-touch to more intrusive regulation and supervision
  - Stricter prudent regulation to improve financial soundness (eg higher capital reserves Basel 3)
  - Market conduct regulation to improve customer protection
  - "Macro-prudential" or system-wide approach to deal with systemic risks
    - Swift action to prevent contagion
- SA response to set up TWIN PEAKS system of regulation
  - Prudential regulator in the SARB, Mkt Conduct regulator ("new" FSB)
  - Fin Stability Oversight Committee and role of SARB in fin stability

In South Africa, we are shifting to tougher Macro-prudential and Twin Peaks reforms circumstances

Financial Stability

- Reserve Bank to lead
- Establish a Financial Stability Oversight Committee

Consumer protection

- Financial Services Board and National Credit Regulator to lead
- New market conduct regulator for banking services in the Financial Services Board

Access to financial services

- Treasury to lead
- Further support to co-operative and dedicated banks, including Postbank
- Treasury to introduce a microinsurance framework

Combating financial crime

- Enforcement agencies to lead
- Investigating and prosecuting abuses
- Continued work with international partners

Council of Financial Regulators

Ensures coordination where necessary

Implications for Financial Regulators and Institutions

- Making financial regulators/supervisors like Fin Services Board (FSB) and Banking Supervision Dept. much STRONGER, more INTRUSIVE and much TOUGHER
- Re-organisation to the Prudential Regulatory Authority in the SARB and transforming the FSB into a new MARKET CONDUCT REGULATION
- Regulators will need to be protected from legal liability when they act (e.g. FIDENTIA)
- Financial Institutions will be held to HIGHER standards on CONSUMER PROTECTION, Market Conduct, Capital Reserves, Liquidity etc.
- Financial Institutions will also have to continue to meet with ACCESS targets, as agreed in the Financial Sector Charter
- Financial Inclusions targets must also continue to apply

Strengthening Retirement Savings Draft Proposals

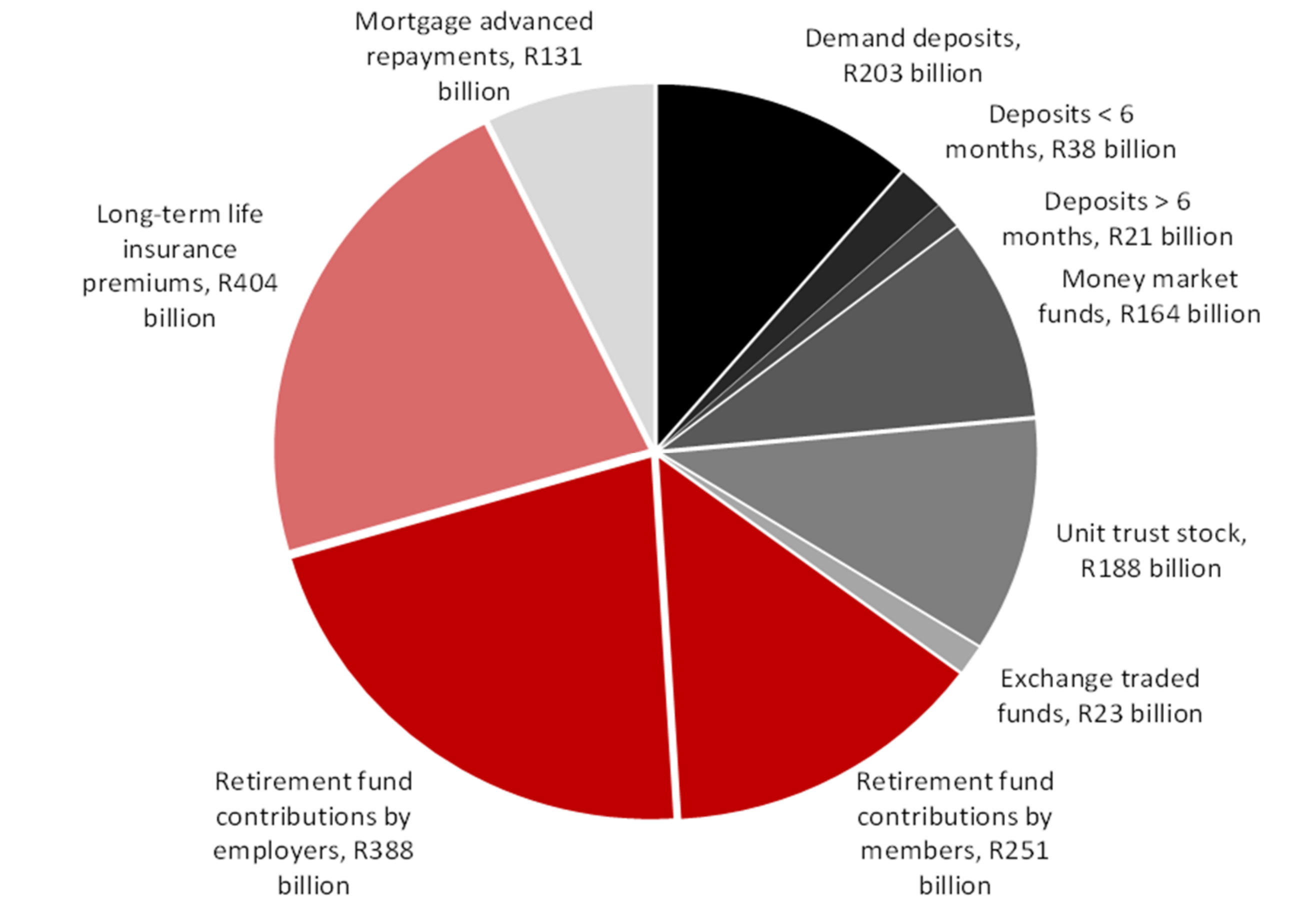
2012 Budget Retirement saving proposals: Overview Paper

- These are an URGENT set of proposals, some more urgent than others
  - Announced as part of 2012 Budget, but some proposals (e.g. on taxation of retirement funds) also made in 2011 Budget
- These are DRAFT proposals for strengthening the CURRENT policy framework for retirement savings
- Minister requested preliminary consultations with key stakeholders, including letters on Budget Day to union federations
  - Min very keen to ensure that vested rights protected, and no unintended consequences (e.g. people rushing to cash pensions)
- Minister has committed to extensive consultations over next few months
- BROADER PROPOSALS ON SOCIAL SECURITY REFORMS WILL BE RELEASED FOR PUBLIC DISCUSSION ONCE CABINET PROCESSES HAVE BEEN COMPLETED
  - Retirement proposals complementary, and required whether or not social security reform takes place or not

Strengthening retirement savings in SA

- **"STRENGTHENING RETIREMENT SAVINGS: Overview of the 2012 Budget proposals"**
  - paper released on 14 May 2012
- The proposals for improving retirement savings arise from the 2012 Budget announcements and seek to address the following concerns:
  - Inadequate retirement savings
  - Low levels of preservation and portability
  - High fees and charges
  - Low levels of annuitisation
- Currently, retirement funds (which manage around R2.4 trillion) are the destination of more than half of household savings

Household savings flows, 1999 to 2010



Source: Association for Savings and Investment South Africa, South African Reserve Bank, JSE

Strengthening retirement savings in SA

- Proposed urgent short- to medium-term reforms include:
  - Requiring preservation and portability
  - Improving fund governance and the role of trustees
  - Extending existing pension laws to all public pension funds
  - Reforming the annuities market
  - Creating a uniform approach to the taxation of retirement funds
  - Measures to reduce the costs of retirement products
  - Introducing tax incentives to promote retirement and other investment products
- A series of technical discussion papers will be released over 2012 in the above areas
- Longer-term reforms will be dealt with through Social Security Reforms

Preservation and portability

- Preservation seeks to address pre-retirement leakage caused by payments to:
  - members leaving pension and provident funds upon job changes and retrenchment
  - non-members in cases of divorce order settlements
- Preservation is the requirement that:
  - money saved for retirement through a pension fund or provident fund, should remain in such a fund until the person retires, or
  - should be rolled over into another similar retirement savings vehicle when a person changes jobs or receives a divorce order settlement (without incurring taxes or penalties)
- While the stated intention is to protect retirement funding through preservation and portability, there might be a need to allow access to the retirement benefits in some limited instances
  - Withdrawals to be allowed for individuals who are <u>temporarily unemployed</u> or need to undergo <u>life-saving operations</u>, up to a 1/3rd of accumulated benefits
- Proposal to be phased in given consideration to **<u>protecting vested rights</u>**
- Paper due to be released by **September 2012**

Improving fund governance

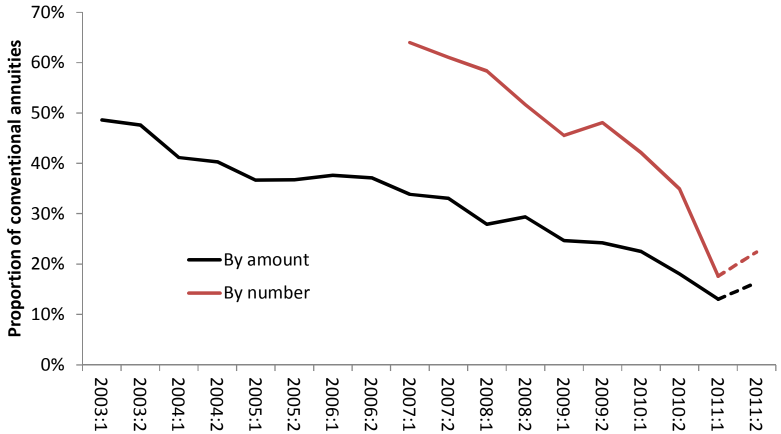
- Pension fund governance problems emerge from weaknesses in governing boards of trustees
  - No relevant experience and skills
  - Conflicts of interest
  - But this is a tough job!
- Proposal
  - Application of “fit and proper” standards
  - Put in place mechanisms and legal requirement to achieve proper training (e.g. trustee toolkit training a requirement)
  - Strengthen governance by elevating PF Circular 130 to a Directive
  - Empower and legally protect trustees (“whistle-blowers”) to act independently without fear or favour
  - Professionalise the role of principal officer
- Part of the preservation and portability discussion paper to be released by **September 2012**

Extending pension laws to public funds

- GEPF, local government and other official pension funds characterised by rules and regulations fragmented from private sector funds
- PFA rules and developments not incorporated into public sector pension funds
  - Clean break policy (currently being implemented for GEPF)
  - Members access to Pension Funds Adjudicator
  - Minimum benefits
- Proposals
  - All public sector pension funds to register under PFA and be supervised by the FSB
  - Design a uniform public sector pension funds act consolidating all funds not supervised under the PFA

Reform of annuities market

- Annuitisation crucial in dealing with post-retirement **leakage**; **investment** & **longevity** risk
- **Living annuities** in particular are a complex product, requiring financial advice and regular reviews, people may not be managing them effectively yet more are being sold



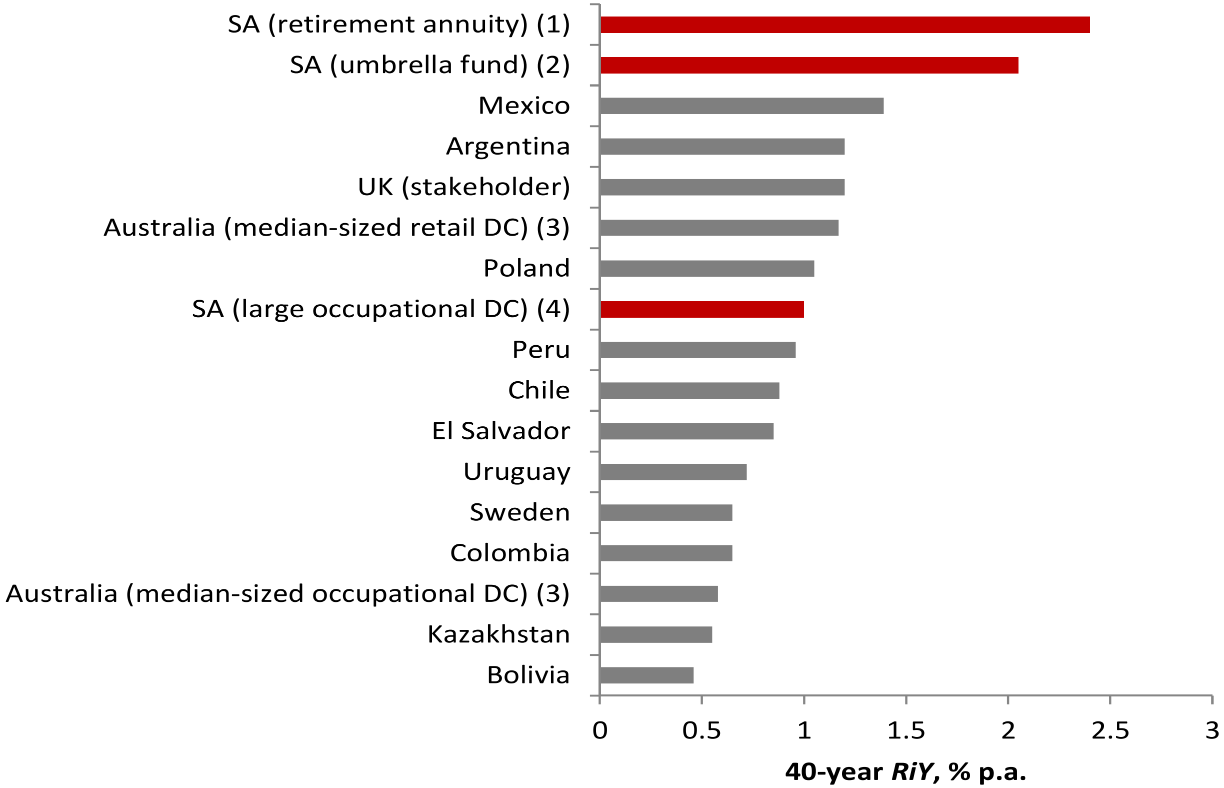
- **Conventional life annuities** protect against longevity and investment risk but are not accurately rated, so are more expensive for the poor
- Looking into conventional annuities or a life-living annuity combination as a default product
- Review paper to be released by **September 2012**

Reducing retirement fund costs

- Reducing costs to reasonable/fair levels is important
- Standardising disclosure and transparency
- Further consolidation of pension funds would aid effective supervision and provide for economies of scale
- Consideration for standardising products
  - Encourage competition on prices and not product type
- Final review to be released by **October 2012**

40-year RiY for selected international retirement systems

- South African retirement funds of all kinds appear expensive relative to international benchmarks



Source: Whitehouse (2000) unless otherwise indicated. Figures refer to mandatory national retirement systems, unless otherwise indicated.

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Introduce a tax-free savings vehicle

- Nature of tax incentivised product
  - Similar to many accounts in OECD countries (e.g. Canadian RESP, UK ISA)
  - Can be invested in savings accounts, Treasury Retail Bonds, money market instruments, Collective Investment Schemes (CIS)
- Nature of tax incentive
  - Tax free capital growth, income and exit (T-E-E)
- Administration
  - Limits are legislated and promoters of products are required to run them within the legislated parameters
  - SARS makes an assessment on documented accounts of conduct
- Ideal take-up (target) market
  - Middle to high income households
- Contribution caps
  - Yearly contribution limit (e.g. R30 000)
  - Lifetime contribution limit (e.g. R500 000)

Harmonising retirement fund taxation

- Uniform retirement contribution model:
  - Proposes harmonising the tax treatment of contributions to and benefits from pension and provident funds (and retirement annuity funds)
  - Will substantially reduce the complexity of our current retirement system
  - Achieve greater equity in the tax system by rationing tax exemptions
- Treatment of contributions:
  - Employer contributions treated as a fringe benefit and therefore taxable in the hands of employee, if above the caps
  - Exemption for employer & employee contributions, up to a percentage ceiling (22.5% of income, 27.5% for over-45's), and up to a rand amount (R250 000 and R300 000, latter for over-45's)
- Treatment of benefits:
  - Proposal to phase in annuitisation of 2/3rds of provident fund benefits, similar to pension and retirement annuity fund
  - **NB** : alignment will lead to tax benefit for provident funds employee contributions
  - Proposal to be phased in given consideration to **protecting vested rights**
  - Consider raising *de minimus* annuitisation requirement from R75 000
- Paper to be released with the tax proposals by **September 2012**

Technical discussion papers to be released for consultation during 2012

- ***Providing a retirement income*** – Reviews retirement income markets and measures to ensure that cost-effective, standardised and easily accessible products are available to the public. Paper due to be released by September 2012
- ***Preservation, portability and uniform access to retirement savings*** – Gives consideration to phasing in preservation on job changes and divorce settlement orders, and harmonising annuitisation requirements. The aim is to strengthen retirement provisioning, long-term savings and fund governance. Paper due to be released by September 2012
- ***Savings and fiscal incentives*** – Discusses how short- to medium-term savings can be enhanced, and dependency on excessive credit reduced, through tax-preferred individual savings and investment accounts. It also discusses the design of incentives to encourage savings in lower-income households. Paper due to be released by September 2012
- ***Uniform retirement contribution model*** – Proposes harmonising tax treatment for contributions to retirement funds to simplify the tax regime around retirement fund contributions. Paper due to be released by September 2012
- ***Retirement fund costs*** – Reviews the costs of retirement funds and measures proposed to reduce them. Paper due to be released by October 2012

Process of Consultations for Retirement Savings proposals

- Broad consultations and public comment on Overview Paper
- Specific and more detailed consultations over coming technical discussion papers
  - Some papers require less consultations (e.g. over lowering costs) than others (e.g. preservation)
  - Appropriate consultation processes for different papers
  - Meetings will be convened with key stakeholders, including trade unions, employers, businesses and industry
- Additional consultations when any proposals put in the form of legislation
  - Two periods of public comment with bills
  - First period is after bill is approved by government, but before it is tabled in Parliament
  - Second period is after bill is tabled in Parliament
- Further consultations on requests – we always open to consultations

THANK YOU

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