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The Road from Polokwane

The pillars of retirement savings reform that Rob Rusconi's tabled for discussion at the ANC's Polokwane conference in 2007 in South Africa included the following key elements:

Preservation of savings, Portability of benefits, Universal coverage, Adequate Benefits, Administrative efficiency and Governance and regulations.

Preservation of savings

We firstly unpack Preservation of Savings, which means "implementing measures to prevent individuals from withdrawing their retirement savings before retirement, which was a common practice that left many without adequate funds in old age".

The problem faced was that employers could choose to set up either pension or provident funds. Provident funds became more attractive as it allowed employees to take all their savings in a cash lump sum on retirement whereas pension funds only allowed employees to take one third in cash at retirement.

Legislation was introduced in 2016 to align the taxation of contributions to pension and provident funds. The Taxation Laws Amendment Act of 2015 introduced harmonised tax treatment for contributions to different types of retirement funds. With effect from 1 March 2016 all retirement savings instruments, including pension and provident funds enjoyed the same tax deductibility of a maximum of 27,5% of all taxable income.

Preservation of savings was not effectively addressed as members of pension and provident funds could still take their money in a cash lump sum at withdrawal.

The COVID pandemic highlighted a real need for financially distressed members to have early access to their retirement savings. The two-pot system introduced a solution to provide early access to members while also introducing compulsory preservation at the same time.

As from 1 September 2024 two thirds of future contributions will only be allowed to be accessed on retirement or death.

The new legislation will now lead to preserved savings and more importantly will increase member's retirement benefits in future.

The long term effect is that the burden of old age pensions will be reduced as fewer members will be reliant on the government for old age grants.

Portability of benefits

Portability of Benefits means "Allowing workers to retain their retirement savings when they change jobs, ensuring that their savings remain intact and continue to grow regardless of employment changes".

When an employee changes their job, they can either preserve their savings in a preservation fund or transfer it to their new employer's retirement fund. Their retirement savings must be moved between two different legal entities in terms of the Second Schedule of the Income Tax Act, 58 of 1962.

The problem is that the entities administratively cannot transfer the underlaying script between each other, and members are obliged to encash their savings before the transfer can be affected.

Members who transfers from one fund to another when the market is depressed will effectively lock in their loss in the transfer process during a down turned or depressed market.

This unfair practice was dealt with when the default investment regulations for retirement funds in South Africa were introduced. These regulations were implemented by the Financial Sector Conduct Authority (FSCA) and came into effect on 1 March 2019.

The regulation introduced a category called "Paid Up" member. Members can now opt to leave their savings with the administration company as a paid-up member. Their current investments are maintained however no new contributions can be made and the member is no longer linked to their previous employer.

Universal Coverage

Universal Coverage refers to the "aim to ensure that all South Africans have access to some form of retirement savings, addressing the problem of many citisens, particularly those in informal employment, having no retirement savings plan".

South Africa has one of the lowest savings rates in the world at just 0.5% of GDP in 2023. The low savings rate in South Africa is a long-standing issue, with the rate steadily declining over the past 20 years. This is largely attributed to a combination of factors, including high unemployment, lack of trust in financial products, and poor household savings habits.

To improve the savings culture the regulators needed to implement policies that either incentivize or compel greater savings by individuals.

Tax-free savings accounts (TFSAs) were introduced in March 2015 as an incentive to encourage household savings and reduce household indebtedness. This however only benefits the middle to upper classes that have additional disposable income to invest.

While two-pot legislation addresses the preservation aspect of coverage, there are many members both in the formal and informal sector who do not contribute to any form of savings, leaving them financially vulnerable at retirement.

While membership of employer owned retirement fund policies is compulsory for eligible categories of employees, employers are still under no obligation to institute a retirement fund for their employees.

There has been mention that once the two-pot legislation is implemented on 1 September 2024, Treasury will be looking at compelling all qualifying companies in South Africa to offer their employees some form of compulsory savings solution. It is currently envisioned that an alternative government fund would be instituted for those companies that fail to comply.

Adequate Benefits

Adequate Benefits means "Ensuring that retirement savings are sufficient to provide a reasonable standard of living in retirement. This includes reforms to increase contributions and ensure benefits are substantial enough to prevent poverty among retirees".

Members need to be making meaningful contributions if they wish to be able to comfortably retire. The Sanlam Benchmark Survey 2022 provides insights into retirement savings and contributions in South Africa. The key points regarding the contribution rates are that the 5 year average contribution rate for employees is 7% and the employer contribution rate is 9.4%. A meaningful total contribution rate, which would allow a member to retire without a drastic change in his lifestyle is believed to be between 15% and 16%.

The Taxation Laws Amendment Bill (TLAB) and Tax Administration Laws Amendment Bill (TALAB) was implemented on 1 March 2016 and Act introduced a 27.5% tax deduction up to a maximum of R350 000 per annum. This meant that members could contribute up to 27.5% of all their income tax free. The maximum of R350 000 was introduced to ensure that the higher income earners do not exploit the system.

Members are effectively enjoying the compounding effect on the tax that is only due on retirement and they should be educated to save as much as is legally allowed.

Members should also be encouraged to make voluntary contributions.

Administrative Efficiency

Administrative Efficiency means "Reducing the administrative costs associated with retirement funds to ensure that more of the contributions go towards the savings rather than administrative fees".

Rusconi analysed the impact of current practices on the retirement outcomes of individuals. He highlighted that high costs and fees can significantly erode the retirement savings of individuals, leading to inadequate retirement income. The two biggest costs that were highlighted were the cost of administrating members accounts and the cost of managing members investments.

The Association for Savings and Investment South Africa (ASISA) introduced the Total Expense Ratio (TER) and Transaction Costs (TC) measures in 2019. The ASISA Standard: Calculation and Disclosure of Total Expense Ratios and Transaction Costs was published on 28 May 2019. The standard ensured that all the costs of managing an investment portfolio were comprehensively disclosed. This has led to better transparency and the ability for employee benefit consultants to compare the various Regulation 28 portfolios offered under the different commercial umbrella funds.

Technology has facilitated a reduction in the cost of the members administration. Commercial umbrella administrators have and are in the process of transferring to paperless methods of communication and administration. The introduction of artificial intelligence into the administrative process flows have also facilitated additional efficiencies and transactional security with the cost savings being passed to members.

Governance and Regulation

Governance and Regulation refers to the "Strengthening of the governance and regulatory framework to protect members' interests, improve transparency, and ensure the sustainability of retirement funds".

In South Africa, the primary legislation introduced to protect fund members is the Pension Funds Act of 1956. This act regulates the establishment, management, and administration of pension funds, ensuring that the interests of fund members are safeguarded. Since inception the Pension Funds Act of 1956 has been amended to keep pace with changes in the retirement savings space. The default investment strategy introduced in 2019 discussed under Portability of Benefits above and the implementation of the Two Pot System are examples of these amendments.

One of the main provisions of the Pension Fund Act includes provisions for the protection of members' benefits. The Protection of Personal Information Act (POPIA) in South Africa came into full effect on July 1, 2020. POPIA aims to protect personal information processed by public and private bodies, this included retirement funds.

Know Your Customer (KYC) regulations were formally introduced in South Africa in 2001 with the enactment of the Financial Intelligence Centre Act (FICA). The legislation was introduced to combat money laundering and terrorist financing, requiring financial institutions to verify the identity of their clients and report suspicious transactions to the Financial Intelligence Centre (FIC).

It was a setback when South Africa was grey listed by the Financial Action Task Force (FATF) in February 2023. The grey listing indicates that although we have regulations that deal with anti-money laundering and counter-terrorism financing measures, TAFT is of the opinion that there are deficiencies in adhering to these regulations.

In response to TAFT's grey listing, there have been several legislative changes especially around getting to know who the beneficial owners are of policies and accounts. Other initiatives introduced are the strengthening of financial institutions, enhanced monitoring and reporting, training so staff understand the regulations FICA introduced and increased cooperation between SA and international organisations to improve the transfer of information in the fight against money laundering and terrorist financing.

It has been a long and winding road from Polokwane, and it continues.