Update: South African retirement reform

Actuarial Society of South Africa Convention 2013

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Department:
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Overview of 2013 reforms

- Short- to medium-term reforms aimed at improving various aspects of the SA system
  - Creating a uniform approach to the taxation of retirement funds
  - Reforming the annuities market
  - Requiring preservation and portability
  - Measures to reduce the costs of retirement products
  - Introducing tax incentives to promote non-retirement savings
- Five policy papers were released over the period 2012-2013 (available at www.treasury.gov.za), series announced in the 2012 Budget speech
  - *Enabling a better income in retirement* (21 Sept 2012)
  - *Preservation, portability and uniform access to retirement savings* (21 Sept 2012)
  - *Incentivising non-retirement savings* (4 Oct 2012)
  - *Improving tax incentives for retirement savings* (4 Oct 2012)
  - *Charges in South African retirement funds* (11 July 2013)
- Policy announcements were made in the 2013 Budget speech, more to follow

Tax treatment of retirement contributions and pay-outs harmonised and simplified

- **Current situation**
  - 5 different bases used to calculate retirement contributions and related tax deductions, making system complex & increasing costs
  - "Provident fund" pay-outs not required to be annuitised
- **Reforms currently being implemented**
  - From T-day (1st March 2015), employer contributions to all types of retirement fund will be treated as a fringe benefit in the hands of employees
  - Employees will be able to deduct employer and employee contributions up to 27.5% of max(remuneration, taxable income), with a cap of R350 000 p.a.
  - "Provident fund" post-retirement pay-outs from post-T-day contributions subject to same annuitisation requirements as "pension funds"
  - Currently part of Tax Laws Amendment Bill 2013, before Parliament

Retirement funds to take greater role in providing post-retirement income

- **Current situation**
  - Provident fund balances not annuitised on retirement, means test provides further disincentive
  - Many retirement fund trustees view their job as complete when individuals retire, leaving individuals to retail market upon retirement
  - Intermediary bias toward drawdown products (complex, risky)
- **Reforms currently being considered**
  - Retail Distribution Review examining remuneration of intermediaries to address commission bias (currently underway)
  - All retirement funds must develop a default annuity strategy for retiring members, principles-based draft regulations to be released soon (simplicity, suitability, governance)
    - Members may opt out of fund-provided default
    - Bulk purchasing, implicit fund-provided financial advice
  - Remove means test on State Old-Age Grant by 2016
  - Make splitting retirement balance between types of annuities easier

Measures to increase the rate of pre-retirement preservation

- **Current situation**
  - Members of occupational schemes may take their entire retirement balance in cash when they change jobs
  - Practical default for most funds is to pay members out in cash, almost universal among lower-income, younger workers
- **Reforms currently being considered**
  - Full mandatory preservation viewed as undesirable in a voluntary system (Kenya)
  - Phased implementation:
    - 1: require all funds to develop a default preservation strategy for exiting members, principles-based draft regulations to be released soon (simplicity, suitability, governance)
      - Members may opt out of fund-provided default
      - Bulk purchasing, implicit fund-provided financial advice
    - 2: change tax rules to allow regular withdrawals of preserved funds, but of a limited amount, to apply to balance arising from post P-day contributions.

Introducing a TEE-type account for short- to medium-term savings

- **Current situation**
  - "Retirement" funds being used as short-term savings vehicles by many workers
  - Changes on preservation rules may deprive these workers of tax-protection for these savings
  - SA household savings currently very low, creating BoP problems and possibly constraining investment and hence future economic growth
- **Reforms currently being considered**
  - Introduce a tax-preferred savings account for short- to medium-term savings, TEE tax treatment
  - Contributions limited to R 30 000 p.a. with a lifetime limit of R500 000
  - No restrictions on withdrawal
  - Permitted investments must comply with principles on accessibility, simplicity, generality, transparency
  - Phased implementation, currently scheduled to commence in 2015

Measures to reduce retirement fund costs are still at draft policy stage

- **Current situation**
  - Parts of the SA retirement system (especially individual arrangements, 'commercial umbrella funds') are very expensive by international standards
  - Products can be exceptionally complex, especially when intermediated
  - Transfer pricing common ('charge shifting' from initial costs to recurring costs)
- **Reforms currently being considered**
  - Greater regulation of investment choice, including requiring all funds to develop a default investment strategy for members, principles-based draft regulations to be released soon (simplicity, suitability, governance)
- **Draft potential reforms still being discussed**
  - Improving governance, consolidating funds, increasing standardisation of fund rules and contracts
  - Simplifying products by standardising permitted charging structures
  - Requiring greater disclosure of charges (incl. special treatment of derivatives)
  - Moving towards mandatory savings, by creating a retirement fund exchange, to facilitate contributions by small businesses, possible contribution subsidy, strict rules for listing

THANK YOU

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