



**IMPERATIVES , CHALLENGES AND**  
**STATUS OF SOUTH AFRICA'S**  
**PENSION REFORM**

8<sup>th</sup> Annual IIEF Pension Policy Conference  
and  
IIEF Regional Pension Policy Roundtable '08  
1 May 2008

Presented by  
**Shantha Padayachee**  
**Specialist Pensions Law Consultant**

01/05/2008

1

# INTRODUCTION



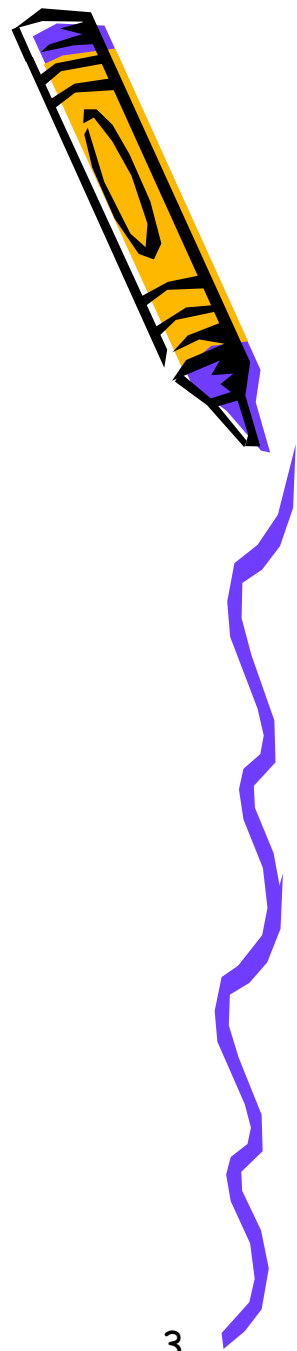
- The topic unpacked:-
- Pension Reform in South Africa
- February 2007 proposals encapsulated in the "Social Security and Retirement Reform - Second Discussion Paper" published by National Treasury (Ministry of Finance )
- **"Imperatives"** : creating a contributory earnings related social security arrangement based on the principles of social solidarity and risk-sharing
- **"Challenges"** : attacking poverty to reduce income vulnerability while supporting employment creation
- **"Status"** : a medium to long term framework for income support



01/05/2008

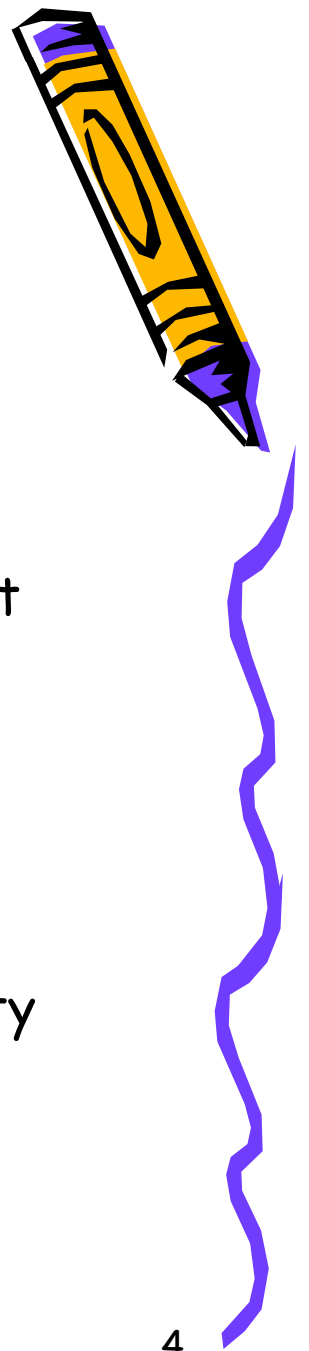
# STRUCTURE OF PRESENTATION

- Background
- Key proposals
- Implications
- Social security design options
- Industry and regulatory reforms
- Tax framework for retirement savings



01/05/2008

# BACKGROUND - SECOND DISCUSSION PAPER

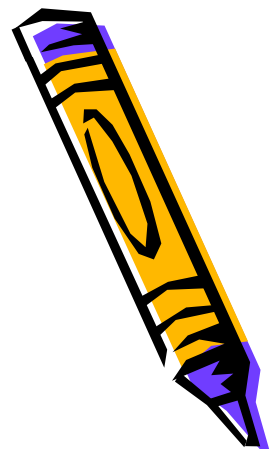


- Second Discussion Paper (SDP) was preceded by:
  - 2002 Taylor Report - Committee of Inquiry into a Comprehensive System of Social Security for SA
  - 2004 National Treasury Discussion Paper on Retirement Reform
- Reform essentially divided into two separate parts:
  1. Overhaul of private pensions provisions and amendment of pre-existing legislative and regulatory framework
  2. Creation of a comprehensive national social security system



01/05/2008

# BACKGROUND: RETIREMENT SAVINGS



- Two-thirds of population reach retirement age and depend on the social old age pension (SOAP);
- Basic poverty relief in old age, quasi-mandatory occupational funds and private retirement savings
- Disjuncture exists between poverty relief "pay-as-you-go" system and tax incentivised retirement funds benefits
- Lack of governance and high cost issues of funds
  - 80% of funds had less than 100 members
  - +/-13 500 funds reduced to about 8000
  - Conflicts of interest for both trustees and service providers; cost overruns



01/05/2008

# BACKGROUND: MACRO-ECONOMIC LEVEL

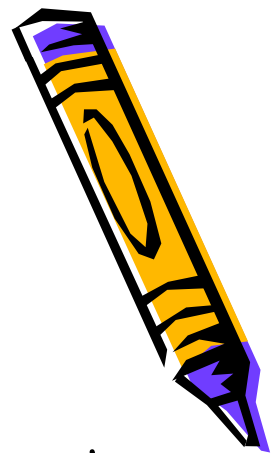


- Stronger growth and surplus fiscal position created space for broadening and consolidating social security benefits
- SA lacks integrated "2<sup>nd</sup> pillar" earnings-related savings and social benefits system
- Existing arrangements fragmented & incomplete -
  - UIF, workman's compensation funds, social grants, Road Accident Fund and various retirement vehicles
  - Requires consolidation
  - Private savings industry is a source of financial & institutional strength, but does not efficiently pool risks for low income earners or preserve savings



01/05/2008

# KEY PROPOSALS



- Social old age grants to remain
- However amend or abolish "means test" to eliminate poverty trap
- Establishment of national social security fund
- Collective social security contributions as payroll tax
- To finance basic retirement savings, disability and death benefits, improve unemployment insurance & social security administration
- Broad-based wage subsidy for very low income workers, to be implemented as reimbursement to Employers from State
- Collective administration and investment of benefits by State to result in low costs and high returns

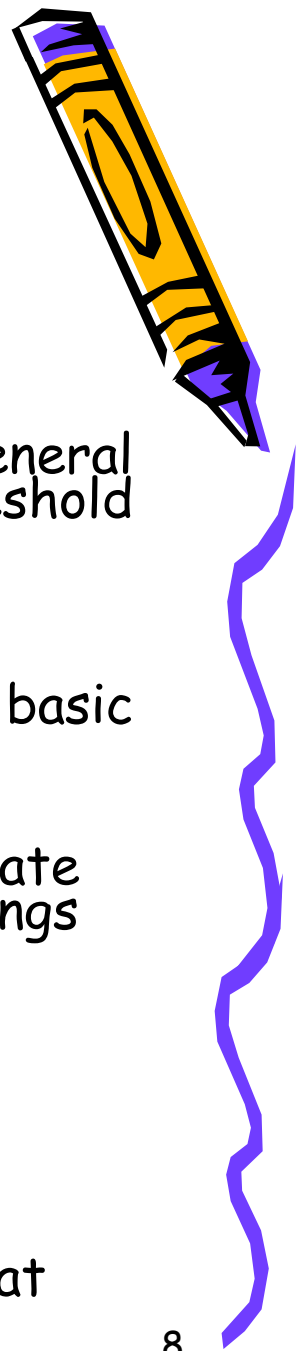


01/05/2008

# PROPOSED STRUCTURE OF RETIREMENT FUNDING

- **Pillar 0:** Social old age grant providing safety net against poverty in old age. Funded from general revenue, with means test removed or threshold increased.
- **Pillar 1:** Mandatory participation in national social security fund, up to threshold, providing basic retirement and risk benefits.
- **Pillar 2:** Additional mandatory participation in private pension funds, for individuals above earnings threshold, to ensure adequate income replacement
- **Pillar 3:** Supplementary voluntary savings, tax-incentivised up to a capped maximum
- **Pillar 4:** Community and state non-cash support that enhances the well-being of the elderly

01/05/2008



# BROAD IMPLICATIONS



- Reforms are significant and will have to be coordinated, widely consulted on and phased-in
  - Discussions with constituencies at the National Economic Development and Labour Association Council (NEDLAC)
  - Interactions with international experts
  - Will impact on labour market, SARS, SASSA and retirement industry
- Impact on government, the tax system and institutions
  - Interdepartmental task teams working on host of processes continually



01/05/2008

# LABOUR MARKET IMPLICATIONS



- imperative that SA encourage job creation
- social security reform must avoid raising labour costs
- Hence wage subsidy proposal
- Well-designed social security can support formalisation of employment & reduce dependence on welfare assistance
- Mandatory contributory savings & preservation of retirement benefits requires improved unemployment and risk (death, disability) benefits
- "Poverty trap" can be overcome by earnings-related bridge between social assistance programmes & tax-privileged retirement, risk and medical scheme benefits



# IMPLICATIONS FOR TAX SYSTEM



- Present payroll taxes (UIF, skills levy) to be integrated with social security contribution
  - Public service must be included
  - Coverage issues to be considered: agricultural workers, self-employed, household employees
- Offsetting wage subsidy and possible changes to the personal income tax structure
- Further reform of retirement fund & medical scheme tax deductibility to cap benefits & improve equity

Revenue administrative systems capacity to manage individual contribution records

01/05/2008



# IMPLICATIONS FOR SOCIAL SERVICES



- **Consolidation of benefits administration**
  - Social grants via SASSA, UIF, Workman's Compensation funds, National savings account payments
- **Reform and rationalisation of risk benefits**
  - Unemployment, disability, compensation, survivor benefits
  - Means test standards to be reviewed
- **Social health insurance opportunities**
  - Low income medical scheme to be created as supplementary benefit
  - Collective funding of post-retirement medical assistance
- **Improved standards of service delivery**
  - Alignment of public and private sector arrangements



01/05/2008

# ORGANISATIONAL CHALLENGES

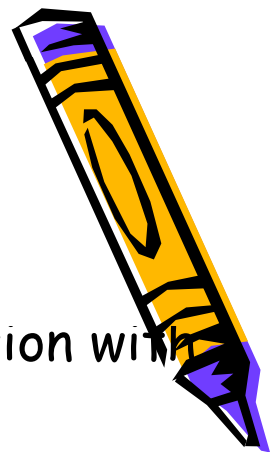


- Social security reform involves detailed coordination of financing, tax, administration and benefits arrangements
- Various institutional reform challenges
  - Public sector: National Treasury, SARS, Labour, Social Development, Health; service delivery challenges also for provincial health & social development departments
  - Employers and organised labour: restructuring of remuneration arrangements
  - Retirement fund industry: market structure to adapt to complementary collective schemes
- Planning & phasing-in of reforms requires detailed strategy and improved inter-departmental coordination



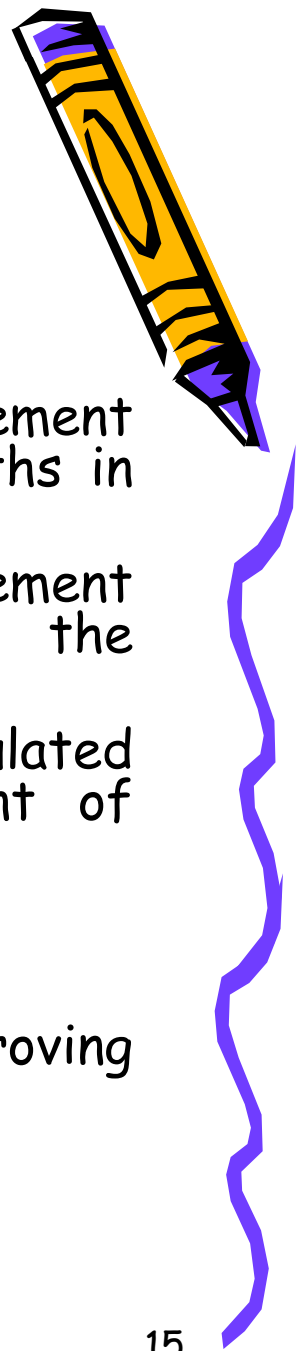
# SOCIAL SECURITY DESIGN

- Initial proposals require further modeling and discussion with stakeholders during 2008/9/10/11
- **Coverage:**
  - Universal: household, agricultural and self-employed to be phased-in
- **Contributions:**
  - Depends on what benefits are to be financed
  - International practice suggests about 15 % of wage
  - Up to a contribution ceiling (e.g. earnings level of R60,000), but provision for voluntary supplementary contributions
- **Funding:**
  - Retirement savings in individual accounts (funded, DC)
- **Administration and fund management:**
  - Options: administration and fund management undertaken by government agency or contracted-out to private sector with accreditation criteria



# RETIREMENT FUND INDUSTRY REFORMS

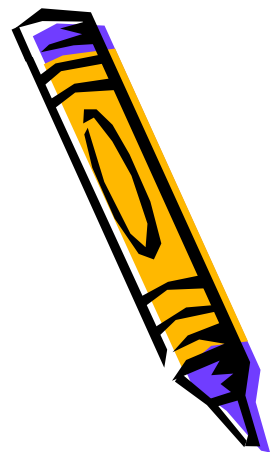
- Seeking structural reform of current retirement funding system, while building on current strengths in the private retirement fund sector.
  - Retirement industry would continue to supplement basic retirement benefits provided through the social security fund
  - Ensuring a strong, cost-effective and well-regulated private pensions sector is a critical element of overall retirement funding strategy.
  - Product and service fees may be regulated
- Regulatory and tax reforms are aimed at improving equity, efficiency and adequacy.

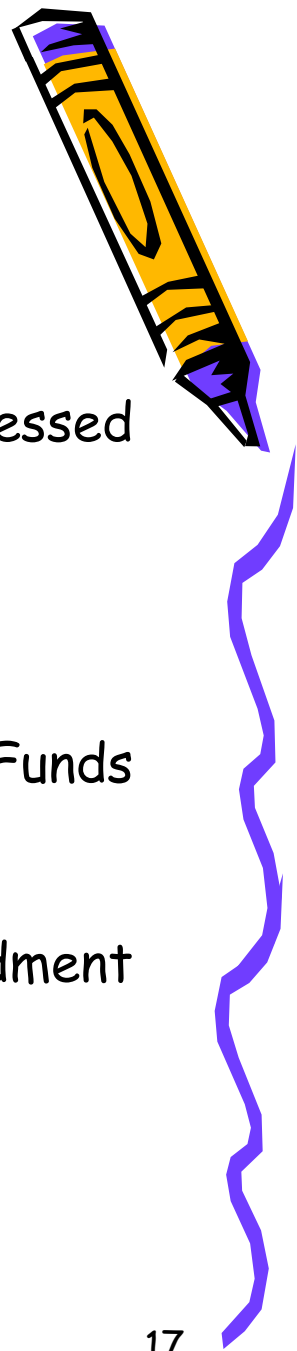


# REGULATORY CHALLENGES

Lowering costs and improving security and equity:

- Facilitating competition through improved disclosure and transferability
- Encouraging economies of scale
- Protecting member benefits: minimum benefits, compulsory preservation, portability
- Ensuring an annuity income after retirement, death, disability - but integrated with social security benefits
- Improved oversight of payments to beneficiaries (e.g. widows and orphans)
- Improved standards of fund governance: trustee training, code of conduct; conflicts of interest; umbrella funds
- Stronger supervision and regulatory powers
- Consolidating retirement fund legislation over time





# REGULATORY CHALLENGES cont.

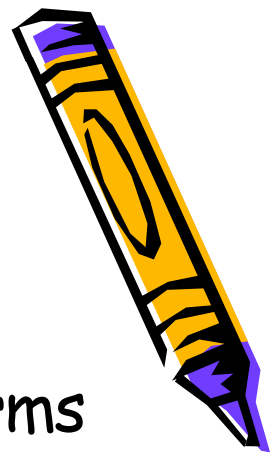
- Pension Funds Amendment Bill before Parliament addressed the ffg issues:
  - technical issues relating to surplus apportionment
  - powers of the Registrar
  - Re-iterates what is expected from Administrators
  - Clarifies jurisdiction and operation of the Pension Funds Adjudicator
- Broader reform will require re-write of Act in entirety
- 21 April 2008 General Financial Services Laws Amendment Bill published for comments



01/05/2008

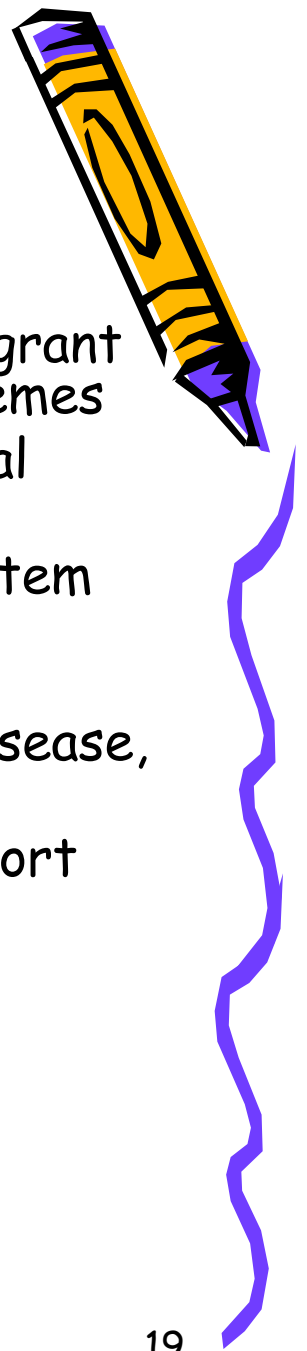
# TAX FRAMEWORK FOR RETIREMENT SAVINGS

- Tax regime to complement regulatory reforms
- Tax reforms seek to maintain sufficient incentive to save, while addressing inequities and complexity in the system
  - Tax encouragement of mandatory contributions to a basic savings fund
  - Some tax encouragement of supplementary savings
  - No special tax treatment above a certain ceiling
- Simplification of formula applied to tax-free lump sum benefits



# CONCLUSION

- Reform to address disjuncture between "means-tested" grant programmes and tax incentivised retirement savings schemes
- Intention is to create fiscal support for savings and social insurance
- Development of an earnings-related social protection system that is complete and co-ordinated
- Wider reach of social security to protect against income vulnerability, compensation for occupational injury and disease, road accident benefits and health insurance
- Requires transitional arrangements and institutional support
- Reforms may be phased-in
- Long term view has to be adopted.



01/05/2008

Thank you for your kind attention.

Questions?



01/05/2008