2014 Budget update on retirement reforms

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National Treasury

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Introduction

We still seek improved coverage and preservation of retirement funds, and lower costs in the system. We are currently consulting within NEDLAC on measures to cover the 6 million employed South Africans who do not enjoy access to an employer-sponsored retirement plan. We intend to move progressively towards a mandatory system of retirement for all employed workers.

Agreement has been reached with the Association of Savings and Investment of South Africa on a way forward to reduce the level of charges for retirement savings products. Draft regulatory reforms will be published shortly". **2014 Budget Speech, Minister of Finance**

This paper provides more details on the retirement reform announcements by the Minister of Finance in his 2014 Budget Speech. A complementary paper provides more details on the non-retirement savings announcements. Both papers give effect to the savings and retirement reform process first announced by the Minister of Finance in the 2012 Budget, through the publication of the overview paper titled *Strengthening retirement savings: An overview of proposals announced in the 2012 Budget*.

The 2012 overview paper was followed by a series of technical discussion papers over 2012 and 2013 for public consultation. A major policy paper issued with the 2013 Budget initiated implementation of the first set of revised proposals, some of which have now been enacted as legislation. Many of the key reform proposals (on governance, preservation, annuitisation and the harmonisation of the tax treatment of retirement fund contributions and benefits) are in the paper titled *2013 Retirement reform proposals for further consultation* and are not repeated here, but only updated where necesary. This paper focuses on regulatory reforms to lower charges in the retirement industry, and hence completes the 2012 process to reform the retirement policy framework to be implemented over the next few years. Whilst significant progress is expected this year and next, given the long-term nature of retirement funds, it must be recognised that the entire process of reform will take longer to complete.

This paper (read with the 2013 paper) will form the basis for engaging with key stakeholders (trade unions, trustees, employers and industry) directly and/or through NEDLAC, to finalise the legislative framework for retirement reform. It will also facilitate consultations with ASISA in order to formalise the in-principle agreement to lower costs in the retirement industry.

Executive summary

This document summarises the process of retirement reform from 2011 until the present and lays out a future direction for the implementation of reforms over the next few years.

The broad policy goals of the intended reforms are:

- *Implementing mandation or auto-enrolment.* The voluntary nature of our retirement system is a significant factor underlying some micro structural inefficiencies in our retirement system. Mandating retirement provision, provided that the process is well managed and regulated, may resolve some of these issues, provided that adequate provision is made for low-income and vulnerable workers.
- *Improving preservation.* The lack of pre-retirement preservation significantly increases workers' financial vulnerability when they retire, and increases costs in the retirement system.
- *Improving fund disclosure.* Without a comprehensive and simple measure of charges in retirement funds, the market for retirement fund provision cannot be expected to function adequately. There is currently no prescribed charge disclosure methodology for retirement funds, and it is imperative that disclosure of charges be improved in the South African retirement industry as a whole.

- *Getting defaults right.* International experience suggests that one of the most powerful tools for improving retirement fund outcomes is to ensure that what happens when individuals fail to exercise choice – the default option – triggers the 'right' response in a cost-effective way.

- *Consolidating funds.* Consolidating funds, and increasing the degree of standardisation in the structure, investment and benefit offerings of funds is therefore an important driver of increased efficiency to ensure that funds achieve economies of scale and that these are passed on to members.

- *Simplifying retirement savings products and making them portable between providers.* Too many providers may be competing on the basis of complex product designs rather than on value-for-money for members. A retirement industry based on simpler, more portable products will increase market competition between providers and increase the rewards for market innovations which reduce costs.

- *Ensuring effective intermediation.* An important factor influencing product design in the retirement savings market is the way in which intermediaries who sell insurance policies, such as most retirement annuity policies, are remunerated. Intermediaries should be paid in a way which does not create conflicts between their own interests and their duties to their customers.

- *Providing tougher market conduct regulation and more effective supervision.* The government recognises that one of the key lessons from the 2008 Global Financial Crisis is the need for tougher and more intrusive and effective regulation. As is the case with recent global reforms to regulate the banking and insurance sectors more rigourously, the savings and retirement sector will need to be regulated more effectively, especially to protect members and improve market conduct practices.

A set of regulatory instruments, some to be preceded by policy papers for further consultation, has been designed to achieve these policy goals. A draft timeline for the publication of these regulatory instruments is shown in Table 1 below. In accordance with standard legislative processes, appropriate consultation, based on drafts where appropriate, will be held before each regulatory instrument is promulgated.

Consultation will take place once each draft regulatory instrument or further technical paper listed in this document is released, and during any subsequent legislative process. Consultative meetings will also be convened with trade unions, employers, retirement funds and other interested stakeholders where appropriate.

Whilst comments have already been taken on the issues raised in this paper, any new or further comments can be addressed to Ms Alvinah Thela, Director: Retirement Funds, Private Bag X115, Pretoria, 0001. Or by fax to 012 315 5206; or by email to retirement.reform@treasury.gov.za. Such comments should be submitted by 30 April 2014.

A brief summary of recent retirement reforms

The Minister of Finance first announced the savings and retirement reform process in the 2012 Budget with the aim of ensuring that the savings and retirement system serves the needs of South Africans better and more fairly than in the past, and as efficiently as possible, by providing more appropriate products. The broader aim of the announcement was to encourage South Africans to save in order to reduce their vulnerability, both before and after retirement.

The announcement was followed by the release of a series of technical discussion papers dealing with various aspects of the retirement system, to facilitate public consultation before finalising the policy framework. Each paper analysed a particular feature of the retirement system, identified shortcomings, suggested goals, and proposed various options for improving outcomes. Interested stakeholders and members of the public were invited to provide written comment. Four of the five technical discussion papers were released during 2012, and the fifth in 2013.

- *Enabling a better income in retirement*, released on 21 September 2012, analysed the annuities market and proposed reforms to ensure that retirement fund members received good value for money when converting their retirement savings into an income in retirement.
- *Preservation, portability and governance for retirement funds*, also released on 21 September 2012, discussed various policy measures to increase the rates at which individuals preserve their retirement savings when they change jobs, and how the governance of retirement funds could be improved.
- *Improving tax incentives for retirement savings*, released on 4 October 2012, presented details of the proposed uniform tax treatment of retirement contributions across pension funds, provident fund and retirement annuity funds, and possible options for the tax treatment of contributions to defined benefit (DB) pension funds.
- *Incentivising non-retirement savings*, also released on 4 October 2012, proposed the establishment of a tax-free account for short- and medium-term savings to encourage more discretionary savings by giving greater tax support to savers.
- *Charges in South African retirement funds,* was released on 11 July 2013. The paper described the various kinds and levels of charges in the South African retirement system, compared these to corresponding charges in retirement funds in other countries, outlined their impact on members' incomes in retirement, and suggested some possible reforms to lower costs.

Based on the feedback received in response to these papers, in the 2013 Budget Speech, the Minister of Finance announced draft proposals on governance, preservation, annuitsation and the harmonisation of the tax treatment of retirement fund contributions and benefits. Once again, comments on the draft proposals were invited and received from interested stakeholders. Comments on the 2013 charges paper were received towards the end of last year, and new proposals on lowering charges form part of this document.

Progress on implementation of retirement proposals in 2013

Some of these proposals were implemented during 2013 after consultation with industry stakeholders such as unions, employers and product and service providers. These proposals included amendments to the Pension Funds Act to strengthen the governance of retirement funds by allowing the Registrar to impose fit and proper requirements on fund trustees, to require trustee training, and by clarifying the fiduciary duty owed by trustees of a fund to its members and to the fund itself, as well as other technical changes. The non-payment of contributions to pension funds by employers has been criminalised, delinquent employers have been made personally liable for their non-payment of contributions and whistle-blowers are better protected. The Registrar of Pension Funds has been empowered to impose new standards for the governance of retirement funds and is expected to do so by notice in the near future.

Progress has also been made in implementing the tax reforms. From 1 March 2015, new contributions to any retirement fund will be subject to the same tax dispensation, and these contributions, and growth on them, will be subject to the same annuitisation requirements when members retire (that is, that no more than one-third may be taken in cash and the rest must be taken in the form of a pension). Vested rights have been protected, so members who have contributed to provident funds before 1 March 2015 will still be able to receive their benefits in respect of those contributions in the form of lump sums at retirement. Provident fund members over 55 on that date will be able to receive lump sum benefits in respect of contributions made to those funds after 1 March 2015. Further work, referred to in the *Budget Review 2014*, is required to clarify the tax treatment of contributions to DB funds. The *de minimus* threshold below which the capital value of a retirement fund benefit may be paid in full as a lump sum has been raised to R150 000.

These measures have been designed to protect vested rights to lump sum retirement fund benefits and ensure a gradual transition to the new annuitisation requirements. The first low-income retirees from provident funds will begin to be affected by the new rules in 2020 to 2025. The transition to the new

system will only be complete in around 2055, though it is hoped that members will voluntarily elect to purchase annuities with their retirement lump sums before then.

Furthermore, the Minister announced in his 2104 Budget Speech an increase in the tax-free lump-sum amount paid out of retirement funds at retirement from R315 000 to R500 000, benefiting especially lower income members who did not benefit from deductible contributions. This proposal has already taken effect from 1 March 2014. More details are available on this proposal in the 2014 Budget Review.

The FSB has been given a mandate to implement a stricter regulatory framework, to improve the enforcement of existing laws, to implement and supervise compliance with the retirement reforms and to design new regulatory measures in relation to retirement funds that are consistent with the approach to regulation contemplated in the Financial Sector Regulation Bill, 2013 (the 'Twin Peaks' Bill).

The 2013 charges paper

The main findings of the fifth paper, titled *Charges in South African Retirement Funds*, were:

- Issues related to the structure of the retirement industry – including the large number of retirement funds, the voluntary nature of the system (which has implications for design, cost and complexity), and the low rate of preservation in South Africa – are significant drivers of costs in the South African retirement system, which appears to be expensive by international standards.
- The required level of charge disclosure to members in both non-commercial retirement funds and commercial funds is low.
- Customers may be insensitive to the level of charges in their retirement funds, particularly to recurring charges which are netted off investment returns.
- There appears to be a broad tendency in all types of retirement funds to shift charges away from up-front charges based on contributions, to recurring charges expressed as a proportion of assets under management.
- Recurring charges may be shifted between investment-related fees, performance fees, guarantee charges, platform fees, administration fees and advisor fees in order to make the overall level of charges appear more palatable to consumers. Shifting may be implicit, or explicit, achieved through the payment of rebates, or through layered charging structures.
- The current system of financial intermediation has the unintended consequence of raising both the complexity of retirement fund designs and their cost. Further, the quality of financial advice may be adversely affected by conflicts between the duties of those advisors to their clients and their own interests. This is because remuneration structures are often designed to incentivise advisors to direct client business to providers which offer the advisors the greatest rewards rather than those that provide the best 'value for money' to their clients.
- Investment platforms, and the layered charging structures they create, add complexity as well as cost to retirement funds.

The paper on charges proposed a range of measures for lowering costs. These included measures intended to deal with the micro structural factors in the South African retirement system, such as encouraging fund consolidation, and increasing (and possibly mandating) retirement fund enrolment. Other proposals included incremental reforms to remedy shortcomings identified in the paper, such as increased disclosure, simplified plan design, stronger fund regulation and effective intermediation.

Response to submissions on the charges paper and broad outline of reforms to reduce costs

The paper generated over 30 submissions from a variety of stakeholders. In general, respondents were supportive of the intentions underlying the reforms. Most of the submissions acknowledged that

the industry had areas which required improvement, but support for the proposed policy interventions varied greatly between respondents. Many of the submissions, however, focused narrowly on those aspects of the paper that were relevant to their particular interests.

After considering the submissions to the charges document, the National Treasury accepts that costs in the retirement industry are driven by a combination of fundamental economic factors (high unemployment, low labour participation rates), the current structure of the retirement system (lack of preservation, voluntary participation in the system, multiplicity of funds) and poor market conduct practices (high product complexity, lack of transparency on charges, multiplicity of charges, and potential conflicts of interest in intermediary incentives).

This paper will not deal with the initiatives taken by government to deal with the fundamental economic factors to generate more jobs, higher economic growth and reduce inequality. Instead, it will focus only on the underlying structure of the retirement industry, and poor market conduct practices.

The National Treasury proposes to provide a clear outline of future policy goals to provide guidance on the reforms for the retirement industry and other stakeholders. The proposed goals will be achieved through various regulatory interventions over the next few years. Consultation will be held on all policy measures being considered for adoption.

Mandation or auto-enrolment

A particularly important principle in the context of South Africa is that of mandation: making retirement savings compulsory for all formally employed workers. In a voluntary system such as ours, individuals or companies must be persuaded to make retirement provision for themselves or for their employees. This is a significant factor underlying some micro structural inefficiencies in our retirement system, including the low rate of participation, high distribution costs and the high degree of complexity and product differentiation. Mandating retirement provision, provided that the process is well managed and regulated, may resolve some of these issues, provided that adequate provision is made for low-income and vulnerable workers.

Improving preservation

Even when workers do participate in the retirement system, too many withdraw their funds entirely every time they change jobs. This significantly increases their financial vulnerability when they retire. It also increases costs in the retirement system by lowering the amount of assets in the system and increasing the burden of administration on those that remain in the system.

Improving fund disclosure

Without a comprehensive and simple measure of charges in retirement funds, the market for retirement fund provision cannot be expected to function adequately. There is currently no prescribed charge disclosure methodology for retirement funds, although regulated charge disclosures have existed in Collective Investment Schemes (CIS's) and insurance policies (including most retirement annuity policies) for some time. As a consequence, parts of the market – particularly the commercial umbrella fund market, which is not subject to retail disclosure requirements – appear to downplay significant portions of charges such as investment management charges. The existing charge measures – the retrospective Total Expense Ratio (TER) for CIS's and the prospective Reduction in Yield (RiY) for insurance policies – also suffer from shortcomings which may significantly influence provider behaviour and product design. It is imperative that disclosure of charges be improved in the South African retirement industry as a whole.

A further weakness relates to non-disclosure of all grants and payments made to related parties, including to trustee conferences, and workshops arranged by stakeholders. Some of these practices may also need to be prohibited from a governance perspective to prevent conflicts of interest or dependence on key stakeholders.

Getting defaults right

Appropriate default arrangements can address many of the micro structural factors in our retirement system and improve the behaviour of industry and individual savers. International experience suggests that one of the most powerful tools for improving retirement fund outcomes is to ensure that what happens when individuals fail to exercise choice – the default option – triggers the 'right' response. Yet there are currently no regulations in South Africa that either require funds to create defaults or that lay out the requirements with which such defaults should comply.

While defaults are likely to be most effective where preferences are weak, or where the fund member is disengaged (for instance when the implications of a particular choice are felt in the future, rather than the present), there are advantages to requiring sensible defaults even when individuals are more likely to be active decision-makers. In particular, correct default policies could ensure that funds use their size and substantial bargaining power to provide better terms upon which individual members can access financial services (such as annuities) than if they purchased them unassisted in the retail market.

Fund consolidation

There are currently over 3 000 active retirement funds in South Africa. Most of these funds are small, and lack the economies of scale and strong governance required to operate efficiently. Consolidating funds, and increasing the degree of standardisation in the structure, investment and benefit offerings of funds is therefore an important driver of increased efficiency. However, for fund consolidation to be effective, well-governed multi-employer funds must be easily available even to small employers, and must be cost-effective for both fund members and their employers.

Furthermore, the high degree of diversity in fund design increases the difficulty and cost of transferring retirement savings between schemes, increases the need for financial advice (which must be paid for), and increases the ability of providers to compete on the basis of complex products rather than on service or price.

Simplifying retirement savings products and making them portable between providers

The charges paper emphasised the challenges of complex products. These products may improve welfare for some customers by meeting their needs more effectively, but they may also impose costs on others by increasing search costs and the cost of financial advice. They also make it more difficult for customers to evaluate how much they are being charged and whether the benefits of any particular additional design feature justify the costs. Too many providers may be competing on the basis of complex product designs rather than on value-for-money for members.

A well-functioning market also requires savings to be portable between different providers of retirement funding vehicles, and between different products offered by the same provider. Long-term retirement products which lock consumers into a particular product or provider may harm current consumers by preventing them from benefiting from increases in market efficiency and product innovation. Lack of portability also harms future consumers by retarding the development of cost-efficient financial markets by reducing the returns to providers of improved cost efficiency.

The National Treasury believes that there is a strong case for simpler and more portable products in relation to tax-incentivised retirement funding vehicles. One reason is the inability of retirement annuity fund members to access their retirement funds before the age of 55. Another is the positive public externalities of retirement fund saving, which motivate the substantial tax benefits associated with such contributions. It may therefore be appropriate to impose higher standards on portability and simplicity for tax-incentivised retirement savings vehicles and products than on other types of products, such as endowment policies. This would be particularly true once retirement savings has been made mandatory.

Ensuring effective intermediation

An important factor influencing product design in the retirement savings market is the way in which intermediaries who sell insurance policies, such as most retirement annuity policies, are remunerated. Insurers typically spread the high cost of initial commissions paid to intermediaries over the whole life of policies, and reclaim the unrecovered portion of these expenses from policyholders who surrender early by levying surrender penalties. Intermediary-driven demands for high upfront commissions increase the attractiveness to providers of complex policy designs which conceal charges and shift them around, harming consumers in the process.

High upfront commissions in investment products sold by life insurance companies may also create or exacerbate conflicts between the interests of financial advisors and those of their customers, increasing the risk of mis-selling.

Rebates paid by investment managers to providers of investment platforms are a form of commission that may adversely affect the choice of investment products and portfolios offered to consumers through their retirement funds by creating conflicts between investment platforms and their customers. They also complicate and conceal elements of the true costs of retirement fund investments.

Need for tougher market conduct regulation and more effective supervision

The government recognises that one of the key lessons from the 2008 Global Financial Crisis is the need for tougher and more intrusive and effective regulation. As is the case with recent global reforms to regulate the banking and insurance sectors more rigourously, the savings and retirement sector will need to be regulated more effectively, especially to protect members and improve market conduct practices. In this respect, the new market conduct regulator under the Twin Peaks system is expected to prioritise the regulation of the savings and retirement industry. This approach is borne out in many G20 countries, including the UK, where the the Financial Conduct Authority is currently also taking steps to reduce charges in the retirement industry.

High-profile losses that have been suffered by retirement funds and their members in recent years may indicate that stronger supervision of retirement funds and better enforcement of existing laws are required. Further, as part of the move to Twin Peaks financial regulation, the objectives behind the Financial Sector Regulation Bill and the Treating Customers Fairly principles in the *TCF Roadmap* (which can be found at www.fsb.co.za) will be applied to retirement funds, consistent with their application to other financial entities.

Timeline of reform

Given the interlocking nature of many of these reforms, they should be implemented in stages in a way which minimises disruption. Some reforms have already been implemented, whilst coming reforms are divided into short-term reforms, which will be completed before the end of the year, and medium- and long-term reforms which will take somewhat longer. A draft timeline for the publishing of specific draft regulatory instruments or technical papers is shown in the table below. Consultations will be held after such publication with stakeholders on each policy measure being considered.

Table 1

Time	Description	Agency
May 2014	Draft regulations on fund defaults for consultation	National Treasury
May 2014	Report on the Retail Distribution Review	Financial Services Board
Late 2014	Policy report on extending retirement system coverage with an emphasis on vulnerable workers	National Treasury
Late 2014	Draft regulatory instruments on trustee training, 'fit and proper' requirements, improved fund governance – particularly for multi-employer funds, unclaimed benefits funds and beneficiary funds - and consolidation and harmonisation of funds Draft regulatory instruments to improve legacy products	Financial Services Board
Early 2015	Draft regulations on charge disclosures for retirement funds	National Treasury
Early 2015	Draft amendments to Income Tax Act and Pension Funds Act to implement pre-retirement preservation proposals	National Treasury
Early 2015	Draft regulatory instruments to improve coverage of retirement system, with an emphasis on vulnerable workers	National Treasury
Late 2015	Draft regulatory instruments to improve product simplicity and portability Draft regulatory instruments to rationalise public pensions	National Treasury and Financial Services Board

Short-term reforms

Retail Distribution Review

Draft proposals regarding intermediary remuneration on investment products, including retirement annuity policies, and on rebates on investment platforms, will be published in May 2014 when the Financial Services Board (FSB) releases the report of the Retail Distribution Review (RDR). The National Treasury broadly supports the replacement of sales commission on insurance policies with investment components by transparent fees negotiated between intermediaries and their customers, and the phasing-out of rebates in investment platforms, whether paid to the platform or to other intermediaries. This will simplify the layered charging structures on investment platforms, which should have a significant impact on the market for living annuities and new-generation retirement annuities.

Other proposals for intermediary remuneration in short-term insurance and risk-only long-term insurance products will also be released as part of the RDR. These reforms are likely to be phased in, with remuneration practices and profit-sharing arrangements that give rise to clear conflicts of interest being addressed in the near future, while broader changes to intermediary remuneration structures and levels will be introduced over the next 18 to 24 months to allow for system changes and a smooth transition.

Retirement fund defaults

The National Treasury intends to release, by May 2014, a set of draft regulations on default strategies. The regulations will require funds to have default investment porfolios for the investment of retirement savings, default annuity products for members on their retirement, and default preservation rules for members on termination of membership before retirement, each to be chosen by fund boards subject to certain restrictions. The drafts will form the basis for a consultation process leading to final regulations.

Default investment and annuitisation strategies will be required to comply with both principles and rules designed to achieve appropriate outcomes. Products chosen for the purpose of default offerings must be simple, suitable for members, and chosen after a robust and transparent process so that members will have confidence that the defaults have been chosen with their best interests at heart and

will produce outcomes consistent with what they have been led to expect. Rules will give effect to these principles. Limited customisation of defaults will be permitted to allow the default arrangements to better meet the needs of defined categories of members who may have very different preferences for risk and reward.

Members whose retirement savings are automatically invested in default investment portfolios must be permitted to instruct their funds to disinvest some or all of those savings from those portfolios and to invest them in one or more alternative portfolios instead, without paying any implicit or explicit exit penalties other than reasonable administration charges. Recognising that the choice of annuity provider and product may be critical to a member's financial security in retirement, funds may be required to employ financial counsellors – who may not receive commission payments from service providers in respect of member choices – to guide members through the default annuity option and any other options they may be considering. Fund-provided financial counselling could also be considered when individuals leave their funds prior to retirement.

The required default preservation measures will be designed to ensure that individuals need to do very little to ensure that their retirement savings are preserved on termination of membership before retirement and will follow them from job to job (called 'savings follow member'). This requires a default for when individuals leave retirement funds before retirement age (the default rules will require that funds preserve individual benefits inside the fund), and when individuals join retirement funds (the default rules will require that funds ask members if they have any preserved benefits and transfer them automatically into the new fund). As with all defaults, members will be allowed to opt out of the default and select their own preservation provider, or withdraw the money from the fund after they have left the service of the employer, in line with current rules.

Disclosure of retirement fund charges

During 2014, the National Treasury and the FSB intend to continue consultation on how retirement fund charges should be quantified and disclosed with a view to releasing a draft regulation on this matter later this year or early next year. Any measure would need to make allowance for costs that are either incurred by funds directly or which are incorporated into investment products, including derivative instruments, investment portfolios or other vehicles in which funds may invest. To ensure fairness, it may also be necessary to include an allowance for the benefits to members of such features as guarantees or risk-insurance policies for which members are charged.

Stronger regulation and supervision

The Registrar of Pension Funds is preparing a number of draft regulatory instruments intended to implement new provisions in the Pension Funds Act relating to trustee training, "fit and proper requirements" for trustees, improving fund governance and promoting the harmonisation and consolidation of retirement funds.

At the same time, the Registrar is working with other FSB departments on proposals for new standards for the licensing, registration and operation of funds, including their administrators and those who provide other products and services to them. These proposed new standards will be formulated after careful and detailed analysis of the risks associated with the conduct of retirement fund business. This work is expected to take considerable time and effort. Stakeholders will be invited to submit representations for consideration while these standards are being formulated, both before the draft standards are published for comment and before they are finalised.

Medium- and long-term reforms

Retirement provision for low-income and vulnerable workers

Quarterly Labour Force Survey figures suggest that there may be as many as 6 million formally-employed South African workers who are not covered by employer-based retirement arrangements. The vast majority of these are low-income workers, most work for small employers, and many have a tenuous attachment to the labour force. Discussions with stakeholders have indicated that, partly due to high distribution costs, South Africa's existing voluntary model may not be capable of reaching

these workers in a cost-effective manner. The National Treasury, in consultation with labour unions, employer organisations and industry, will work towards estabishing good-value, convenient and standardised retirement funds for these workers.

One option to lower costs currently under consideration is a retirement fund exchange or clearing house integrated with the South African Revenue Service, which will collect retirement fund contributions directly from employers as part of their employee tax returns and pay them to highly standardised, qualifying funds listed on the exchange or clearing house.

A policy document laying out possible options for how coverage of the retirement system could be extended to include low-income and vulnerable workers will be released later in the year.

Member-level reporting to the exchange or clearing house

If a retirement fund exchange or clearing house were to be established, funds could be required to report member-level data to this entity on a regular basis. This would facilitate the transfer of members from one fund to another, make it easier to trace and pay beneficiaries of unclaimed benefits, and reduce the number of dormant accounts within funds by enabling a 'savings-follows-member' preservation rule without requiring input from members.

Mandation or auto-enrolment of retirement saving

It is a medium-term intention of the National Treasury to ensure that all formally-employed workers save for their retirement by making retirement savings mandatory. This will reduce vulnerability in retirement. However, some important criteria need to be met. These provide a joint challenge to industry, labour unions and government, who will need to work together to ensure that mandation can be achieved. These criteria include:

- *Efficiency.* Retirement fund provision for low-income and vulnerable workers must be provided in a cost-effective way which ensures that distribution and administration costs do not consume too much of the benefits of saving.

- *Convenience.* Employers should easily be able to make retirement provision for their workers without needing to employ financial advisors or incurring a heavy administrative burden for themselves or their workers. Any mandation of retirement provision should not lead to informalisation of labour, or retard job creation in the wider economy.

- *Access.* Low-income and vulnerable workers in particular may have erratic incomes and long spells of unemployment. Workers will therefore require assurance that saving for retirement is in their best interests. For this to happen, workers will require sufficient access to their savings to meet at least their basic needs during periods of unemployment or financial need. It is for this reason that the preservation proposal announced by the Minister of Finance in his 2013 Budget speech and currently under discussion at NEDLAC, proposes greater pre-retirement access to retirement savings for low-income workers. Additional measures may also be considered.

- *Incentives for workers and their employers.* The tax system currently provides significant support to higher-income workers who save through their retirement funds. For lower-income workers, less fiscal support is given. An important factor in facilitating retirement savings may be finding affordable ways of supporting the retirement savings of low-income workers.

Legacy products

While many of the reforms described in this document focus on improving value for money for future customers of savings products, it is important to extend similar standards of value and fairness to existing customers of legacy products.

In terms of the Treating Customers Fairly (TCF) approach to market conduct regulation and supervision adopted by the FSB, financial services firms may not continue to perpetuate practices

related to legacy products and services that have negative customer outcomes on the basis that these products and services were designed prior to the introduction of the TCF approach.

Firms will be expected to deliver TCF outcomes to all their customers – including holders of legacy products. Where it becomes apparent that products sold in the past are not meeting – or are no longer meeting – cutomers' reasonable expectations, firms will be expected to identify ways to improve outcomes for their customers. The FSB will also, as part of a pro-active market conduct supervisory approach, engage with the life insurance industry to find appropriate solutions to unfair outcomes arising from legacy contractual savings products and practices. In particular, early termination charges on legacy products should, over the next few years and in tandem with other reforms, be brought in line with standards of product simplicity and portability applied to new products.

Product simplicity and portability regulations

The National Treasury and the FSB will consult further on the issue of product simplicity and portability, with an initial focus on underwritten retirement annuity fund benefits and commercial umbrella funds. It is envisaged that the move away from upfront sales commission for investment products in the life insurance sector, as signalled by the RDR, will support significant further improvements in the simplicity and portability of these products. It is intended that these regulations will be introduced in tandem with the RDR, and the mandation of retirement saving, to prevent unnecessary disruption to the retirement savings market, particularly as it pertains to those in the lower-income segment.

Multi-employer schemes

It is not economical for every small employer to have their own employee fund. Rather, small employers and their employees should benefit by joining multi-employer schemes of one kind or another. To do so, they will need to be confident that the interests of members, who in most cases will have been enrolled into these schemes as a condition of employment, are protected. While some multi-employer schemes appear to be well run, the National Treasury is concerned about the governance of others and the consequences of poor governance for the outcomes experienced by members. Some of the governance challenges include the over-dependance of ill-trained board members on product and service providers for advice, and conflicts between loyalties to members and to those who elected or appointed the board members. The rules of some funds also constitute an impediment to sound fund governance, management and administration because they tie the funds to particular service providers. Some rules even compel members to remain enrolled in those funds when they, and their employers, are convinced that better value for money could be obtained elsewhere.

In response to these problems, the National Treasury and the FSB will initiate a consultation process with umbrella fund providers in order to improve the governance, design and benefit portability of these schemes in order to further protect the interests of members who are enrolled in them. Particular attention will be paid to underwritten schemes as part of this process.

Pre-retirement preservation

In his 2013 Budget speech, the Minister of Finance proposed a measure for the preservation of retirement savings which sought to balance the need of workers to access retirement savings before retirement with the need to promote a greater degree of preservation. The proposal was that workers would be permitted one withdrawal from a preservation fund each year, the amount of which would be limited to 10 per cent of the capital value of the retirement savings preserved, with a minimum value. Unused withdrawals would be permitted to be carried over so that members would not feel the need to withdraw the maximum amount each year to minimise potential financial strains in the future. In response to the submissions received on the proposal, the National Treasury consulted with unions and large fund administrators in the country in order to hear their views on the administrative aspects of the proposal and to refine it where necessary. In response to their feedback, the proposal has been amended in the following ways:

- A *de minimus* requirement has been introduced to remove the need for small sums to be preserved.
- The number of withdrawals will be limited to one withdrawal per taxpayer per year, rather than one withdrawal per preservation fund per year, to reduce the number of withdrawals.
- Under consideration is a review of the tax treatment of pre-retirement withdrawals to ensure fairness and to discourage withdrawals for frivolous reasons.
- Any withdrawals before retirement will serve to reduce the amount that can be paid by a pension fund in the form of a lump sum (one-third of the capital value if no prior withdrawals had been made) to minimise the erosion of retirement benefits by early access.

The amended proposal is currently under discussion with social partners at NEDLAC. Once discussions there have concluded, the proposal will be implemented following final consultations.

Public pension schemes

In tandem with reforms to the private pension system, it may also be appropriate to reform the provision of retirement benefits in the public sector. Emphasis will be placed on ensuring that public pension funds are large enough to provide economies of scale, are well governed, and have benefits which are sufficiently standardised to allow a high degree of portability within the public sector and between the public and private sectors. Appropriate protection of vested rights will be given in any reforms.