SOCIAL SECURITY AND RETIREMENT REFORMS IN SOUTH AFRICA: PROSPECTS AND CHALLENGES.

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A MINI-DISSERTATION SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTERS OF LAWS (LLM) IN DEVELOPMENT AND MANAGEMENT LAW IN THE SCHOOL OF LAW, FACULTY OF MANAGEMENT & LAW, UNIVERSITY OF LIMPOPO (TURFLOOP CAMPUS)

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2013.

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ABSTRACT

This mini-dissertation discusses South African social security and retirement reforms that will be used as guidelines towards promulgation of the new Pension Funds Act which will incorporate both private and public pensions. These proposals have been highlighted in the Retirement Reform Discussion Paper issued by National Treasury in 2004 and the Social Security and Retirement Reform paper, issued by both National Treasury and Department of Social Development, 2007. Further, the recent discussion papers entitled 'Strengthening Retirement Savings and a Safer Financial Sector to Serve South Africa Better' published in 2011 and 2012 respectively have strengthened social security and retirement reforms debate in South Africa. This mini-dissertation will incorporate both social security and retirement reforms.

DECLARATION BY SUPERVISOR

I, Adv. Lufuno Tokyo Nevondwe, hereby declare that this mini-dissertation by Itumeleng Peter Kgatla for the degree of Masters of Laws (LLM) in Development and Management Law be accepted for examination.

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Adv. Lufuno Tokyo Nevondwe

January 2013

DECLARATION BY STUDENT

I, Itumeleng Peter Kgatla declare that this mini-dissertation for the degree of Masters of Laws in Development and Management Law at the University of Limpopo (Turfloop Campus) hereby submitted, has not been previously submitted by me for a degree at this or any other university, this is my own work in design and execution and all material contained herein has been duly acknowledged.

………………………………

Mr. Itumeleng Peter Kgatla

January 2013

DEDICATION

To my brother Marcus Ngaletsani Kgatla for being such a wonderful person to me and for supporting me since childhood, with love and gratitude.

ACKNOWLEDGEMENT

Thanks are due foremost to my supervisor, Adv. Lufuno Tokyo Nevondwe, without whose careful guidance, astute comments, patience and kind words, the completion of my mini-dissertation would have been far more difficult.

I would like to acknowledge my mother, Moyahabo Mashala who through her love and support I managed to soldier on and to my sister Asnath, Rachel, my brother George and Marcus who stood by me through trials and tribulations.

My special token of appreciation goes to Cde Solly Africa Mapaila for making it possible for me financially to be part of the Masters programme.

LIST OF ABBREVIATIONS

1. AFP-*Administrados de Fondos pensiones*
2. ANC-African National Congress
3. BIG-Basic Income Grant
4. COSATU-Congress of South African Trade Unions
5. DA-Democratic Alliance
6. DB-Defined Benefit
7. DC-Defined Contribution
8. EAC-East African Community
9. FEDUSA-Federation of Unions of South Africa
10. FSB-Financial Services Board
11. GDI-Gross Domestic Income
12. GDP-Gross Domestic Products
13. GEPF-Government Employees Pension Fund
14. NPA-National Planning Commission
15. NSSF-National Social Security Fund
16. NT-National Treasury
17. NYDA-National Youth Development Agency
18. PAYE-Pay as you earn
19. PAYG-Pay as you go
20. PFA-Pension Funds Act

20. SACP-South African Communist Party
21. SARS-South African Revenue Services
22. SASSA-South African Social Security Agency
23. SOAP-State Old Age Pension
24. UK-United Kingdom
25. USA-United States of America
26. YCLSA-Young Communist League of South Africa

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1. Eskom Pension and Provident Fund v Krugel 2011 (4) All SA (SCA)
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5. Pension Funds Act, 24 of 1956
6. Senior Citizens Freedom to Work Act, 2000.
7. Social Security Act, 1938.
8. Social Assistance Act, 13 of 2004.
9. Social Assistance Act, 59 of 1992
10. The Interim Constitution of South Africa Act, 200 of 1993
11. The Unemployment Act, 1930

CHAPTER ONE: INTRODUCTION

1. 1. Historical background to the study

The South African social insurance system was formalized as early as the 1950 through the enactment of the South African Pension Funds Act 24 of 1956. The Act came into operation during the apartheid government and offers little relief to the majority of retirees and this automatically calls for a plethora of reforms in that regard.[1]

Currently there are more than 13 500 private pension funds which include occupational pension and retirement annuity or personal plan retirement funds.[2] There are about 9 million members of retirement funds and coverage rate for formal sector employees is 60%.

The retirement reform process aimed at "*Transforming the present, protecting the future*" was finalized in 2002.[3] The report provided a thorough review on the strength and shortcomings of the present social protection arrangement. The committee as part of the recommendations proposed the broadening of social insurance and the implementation of a comprehensive and integrated medium to long term framework for income support which include the relationship between the private and public health sector.

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[1] Nevondwe L, South African Social security and retirement reform a long journey towards the redrafting of the New Pension Funds Act**,** Pensions, an International Journal, Palgrave Macmillan Publishers, UK, Vol 15, issue 4, November 2010.p.3.
[2] National Treasury, Social security and Retirement Reform second Discussion paper, 2007, para 98 at page 22.
[3] Taylor V, Report of the committee of inquiry into ccomprehensive system of social security for South Africa, 2002.

In 2004, the National Treasury (NT) released a discussion paper[4] on retirement reform and research was undertaken on behalf of the Forum of South African Directors Generals Social sector cluster task team on social security. This discussion paper was followed by the second discussion paper titled Social security and retirement reform released by NT on 23 March 2007.

The discussion paper sets out the main proposals for a broad-based contributory Social security system and improvements to the South African retirement fund industry.[5] The redistributive social assistance minimum benefits floor will remain in place, funded through the budget. A basic social security arrangement is proposed to complement this, as a mandatory, pooled, contributory, administratively simple social protection system. A wage subsidy will be introduced to offset the costs to low-wage earners of the social security contribution and to encourage employment creation.

Above an agreed threshold, retirement savings will continue to be mandatory, but will mainly be provided by occupational and individual schemes within a regulated industry. Voluntary retirement savings will continue to be tax-encouraged; but, above a certain percentage of earnings or monetary cap, the tax incentive will fall away and savings and investment decisions will be driven less by tax considerations.[6]

The wider social security framework is not just about protection against income vulnerability, but it includes compensation for occupational injury and disease, road

[4] National Treasury,Social security and Retirement Reform:Second discussion paper,2007
[5] Para. 174 at Page 38.Ibid.
[6] Para.177 at Page 38.Ibid.

accident benefits and health insurance arrangements. These go beyond the scope of this discussion paper, but it is recognised that progress towards a basic contributory income protection system may provide a platform on which other reforms can be built. For the period ahead, however, there is a great deal of further work to do in developing the details of the proposed social security system and associated retirement industry reforms.[7]

1.2. The statement of the research problem.

Despite the fact that, the South African social security system is intact, well established and comparable with other developed and developing countries, the retirement system has some unsatisfactory features in that the system suffers from a serious fracture which has divided the first and the second economy along racial lines making the system inevitably beneficial to one group and detriment to the other especially the historically disadvantaged black majority.

The major problem with the existing system is the modes of funding, the gap between social old age grant for the poor and the tax incentivized private pension sector that is favorable to high income earning individuals as opposed to low income individuals in that, the current means test applied by government is not consistent and as a result present a double edged sword to the poor for the little that they save preclude them from accessing the government grant and diminishes as their income rises while the tax incentive for the rich rises in value as lifetime income increases.

[7]National Treasury,Social security and Retirement Reform:Second discussion paper,2007. Para.178.Page.38.

It therefore discourages the poor from saving during their working age in that, the little that they save will not be enough to replace income on retirement and on the other hand make them fail the means test thus disqualifying them to receive the old age grant, by implication, they will be too rich to qualify for the government grant, yet too poor for self sustainability.

Secondly, the fiscus cannot accommodate a high number of poor retirees due to the social security funding model which is not contributory in nature and thus not sustainable. This model is responsible partly for the irresponsible financial behavior of young people in the formal sector who defer financial security decisions with the intention to rely on the old age grant on retirement.

The flexibility principle currently practiced by social insurance funds which allow members to withdraw their savings before actual retirement encourages financial misbehavior which in the end put constraints on the fiscus. Compulsory preservation principle needs to be introduced to cover this social security gap.

The problems and challenges faced by retirees is that they are not aware of their pension law rights and how their benefits are being invested. This study will assist them to understand their rights and how the social security and retirement law will be reformed to address their challenges.

1.3. Literature Review

Discussion documents, legislations, policies and academic analysis through conference presentations and recommendations by commissions of inquiries suggest that there is enough literature for review to make reform and recommendations to achieve the aim and objective of the study. The evolution of the past regimes including the pre and post-apartheid era on social security and retirement systems will be analyzed to draw good lessons. The prospects and shortfalls of the current social security system under the government of the day will be closely looked at. The experience and policy formulation and implementation by specific countries[8] both developed and developing countries will be discussed in the comparative study to draw lessons and learn from their successes.

In terms of the Taylor Commission of Inquiry Report on Social Security[9] which the aim was to build a better tomorrow by fixing and modifying the current system under the theme *"Transforming the present, preserving the future".* The social security system must be broadened and there is a need to implement a comprehensive and integrated medium to long term framework for income support which includes an improved partnership between the private and the public health sector for instance.

This in essence speaks to the introduction of additional direct cash transfer measures to vulnerable groups such as the working age youth as a way of directly tackling poverty and also assisting them in job seeking while having a means of survival and not destitute. This broadened system will also ease the burden on the state funded social security system if it is funded through a mandatory contributory system for all those who are earning a taxable income whether in the form of a salary or a wage, from formal or

[8] The social security policies of China, Malaysia, Sweden, the United Kingdom, the United States of America and Nigeria will be analysed.
[9] Taylor V, Report of the committee of inquiry into ccomprehensive system of social security for South Africa, 2002.

informal employment so as to have an alternative revenue generation mechanism apart from the general income tax.

The report[10] further recommends the review of the institutions and organizational framework governing the social security system. It speaks to the establishment of structures responsible for policy determination, organizational framework for social security and protection, governance structures for social insurance funds, private sector regulation and enforcement.

Such a reviewed structure will ensure the separation of powers and clarify duties to avoid an overlap of duties and powers between structures leading to the blocking of services due to unnecessary bureaucratic processes. This speaks to the establishment of the Social Security Board reporting directly to the Minister of Social Development established alongside the South African Social Security Agency (SASSA) reporting directly to the board.

It is for this reason that the current social assistance system is doing well in some areas owed to the fact that it is accountable to an independent board of directors which then advices the Minister accordingly. The current structure can do well if maintained as is with the additional and strict requirements for nominees for membership of the board, the issue of skills; abilities and high level of education must be specific to avoid a well formulated structure being under the leadership of people who are not fit and proper for the role.

[10] Taylor V, Report of the committee of inquiry into ccomprehensive system of social security for South Africa, 2002

In terms of the 2004 NT discussion paper[11] on retirement reform, there is an urgent need for the reviewing of the existing retirement legislation[12] with the intention to improve the structure and evolution of the South African retirement funding system. There is also a need to adopt new regulations and tax measures comparable to international standards and developed countries. This speaks to South Africa having to draw lessons from other countries with an improved social insurance system that is more contributory than the one that is entirely dependent of the national fiscal to avoid budgetary challenges.

The objective of the paper amongst others is to encourage individuals to save enough for their own retirement and the needs of their dependants. Encourage employers and employees to provide for retirement funding as part of remuneration contract and provide a thorough social assistance and an assured basic income entitlement for the elderly without a means test.

This objective however cannot be realized if government does not put measures in place to make it mandatory in as much as they encourage people to save enough for retirement based on the observation that salary earners like deferring long term financial decisions until it is too late. The provision of social assistance for the elderly without a means test remain a pipe dream unless the national saving fund is set up for contribution by all income earners to save for their own without means test old age pension administered by the government. This is informed by the fact that, the without

[11] National Treasury:Retirement fund reform,A discussion paper,2004.
[12] The Pension Funds Act 24 of 1956 with its promulgations through the Pension Funds Amendment Act, 11 of 2007.

means test pension must co-exist with an alternative revenue collection to supplement the government nationally budgeted grant.

According to the 2007 discussion paper[13], which represent a fundamental re-think of the role to be played by government, private sector and individuals to insure financial sustainability in the case of old age or any other factor which may lead to destitution if precautionary measures are not taken to prevent such calamities in the case of lack of income or death of the breadwinner.

The objective of the paper's re-think is to ensure a basic standard of living and prevent destitution in old age or any circumstance including unemployment or disability, wholly or in part through redistribution measures. It also aims to encourage saving during working age to provide for the replacement of income on retirement through long term insurance arrangement. This fundamental re-think as proposed by the paper is correct in a sense that, it crushes the dependency theory by the people on the state, a situation whereby individuals just splash their earnings during working age or lump sum payouts with their hope being put on the state old age grant.

The government must ease the burden on the national fiscal to make it compulsory for individuals to save by regulating the role of the private, public and individual behavior and the uniformisation of the funding and saving modes into one national saving scheme.

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[13] National Treasury,Social security and Retirement Reform:Second discussion paper,2007

According to Nevondwe[14], the social security reform processes must move towards bridging the gap between poverty relief measures which most of low income earners rely on and the tax incetivised long term insurance and saving measures that are not friendly to low income and irregular workers.[15]

The delay on the part of the NT and the Department of Social Development to implement the 2007 paper proposals will further delay the promulgation of the legislation that will replace the Pensions Funds Act (PFA). The new Act will regulate both public and private pensions' funds[16] because this variety of legislations creates a lot of confusion as they bring contradictory and parallel policy positions on withdrawals and regulation of pension benefits.

The typical example is the "*clean break principle"* arising from the PFA through the promulgations of the Pension Funds Amendment Act[17] and the Financial Services Laws General Law Amendment Act[18] which allows non-member spouses to withdraw their pension benefits on the date of the divorce order being granted as opposed to the date

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[14] Nevondwe L, South African Social security and retirement reform a long journey towards the redrafting of the New Pension Funds Act**,** Pensions, an International Journal, Palgrave Macmillan Publishers, UK, Vol 15, issue 4, November 2010.
[15]Ibid.
[16] This speaks to, The government Employees Pension law of 1996 which regulate government employees pension fund, the Transnet pension fund act 62 of 1990,the South African post office act and the Special pension act 69 of 1996.
[17] Pension Funds Amendment Act 11 of 2007, Section 37D.
[18] Finacial Services Laws General Law Amendmend Bill,2012.The bill aims to amend and update: The Pension Funds Act, 1956, the Reserve Bank, 1989, the Financial Services Board Act, 1990, the Long-term Insurance Act, 1998, the Short-term Insurance Act, 1998, the Inspections of Financial Institutions Act, 1998, the Financial Institutions (Protection of Funds) Act, 2001, the Financial Advisory and Intermediary Services Act, 2002, the Collective Investmen Schemes Control Act, 2002, the Co-operative Banks Act, 2007, and the Financial Services Laws General Amendment Act, 2008, in order to close regulatory gaps, to effect improvements to certain provisions, to provide for increased supervisory capabilities, to rationalise and align the supervisory functions afforded to the Registrar and to align the aforementioned Acts with the Companies Act, 2008; to amend the National Payment System Act, 1998, the Medical Schemes Act, 1998 and the Co-operatives Act, 2005, to the extent that such laws impact on the stability of the financial services sector and impede on a holistic regulatory approach and effective supervision; and to provide for matters connected thereto.

when the member spouse exit the fund upon resignation, death, dismissal, retrenchment, disability or retirement.

The Government Employees Pension Law[19] was amended with effect from 12 January 2012. Under current law, the “clean-break” principle has been introduced in public sector funds. The Government Employees Pension Fund (GEPF) has already introduced the “clean-break” principle for the division of pension benefits, and it is expected that other public sector funds will soon follow. Given the regulatory changes, the tax regime as from 1 March 2012 will effectively place all public sector fund members on equal footing with private sector fund members as regards to the application of the “clean-break” principle.[20]

In the case of *Wiese V Government Employees pension Fund.*[21]

The court held that, the non member ex spouse is entitled to the portion of the pension interest upon the granting of the court order and prior to the actual exit from the fund by the member ex spouse.

In the case of: *Eskom Pension and Provident Fund v Krugel*[22]*,* the husband had resigned long before the divorce and became a deferred pensioner. Upon divorce, he agreed as part of the divorce settlement that his wife be entitled to 25% his pension interest in the fund payable when the member become entitled to his pension benefit. The wife sought a court order as the fund refused to register endorsement. The court held that, the divorce act is not applicable because the husband had no pension interest

[19] Government Employees Pension Law Amendment Act 19 of 2011.Section 24 A which is also similar to section 37D of the Pension Fund Amendment Act 11 of 2007.
[20] National Budget Review, 2012: Taxation of Divorce order related Retirement benefits published 13 march 2012.
[21] Wiese V Government Employees pension Fund[21](CCT 111/11 (2012) ZACC 5
[22] Eskom Pension and Provident Fund v Krugel[22] 2011 (4) All SA (SCA)

as per the definition on the basis that, the pension interest was deferred before divorce. The court however emphasized that; the wife still had a valid claim against her husband for her share when the husband's deferred pension become payable.

The South African social security and retirement reform will shift from defined contribution (DC) which normally used in the private sector to defined benefit (DB) which is normally used in the public sector, for example the GEPF.DC refers to pension arrangements in terms of which the funds contributed by both the employer and the employee are fully invested in normal business ventures and as a result, the retirement benefit is not guaranteed because the investment may either prosper or entirely go wrong depending on the type of business in which the money is invested, economic and political conditions.[23]

On the one hand, DB refers to pension funds arrangements which are also known as final salary or fixed benefit funds in that, the benefit is determined by a criteria which considers a number of factors which include, the salary of the member at the time of retirement, the duration of the membership, the total contribution which is determined by the number of years and the amount contributed in percentages against the salary. This is a sure return saving since the money is not subjected to investments in normal business ventures and the benefit is not dependant on the economic or political conditions.

[23] www.pension.co.za/prod4.asp

1.4. Aims and objectives of the study

This dissertation is aimed at conducting a concrete analysis of the current laws, policies, regulations and guidelines dealing with social security and retirement reform in South Africa, the structural framework and funding model of the South African social security system. The prospects of the system as a poverty alleviation mechanism and challenges thereof.The role played by relevant stakeholders including the Department of Social development, NT, Financial Services Board (FSB) and South African Revenue Services (SARS)[24] in terms of initiating the passing of laws which are in favor of social protection and fiscal sustainability.

This dissertation will through the critical analysis of the current legal situation determine if there is a need to develop new policies, laws and regulations dealing with social security and retirement.

This dissertation aims to assist the students from various fields of study with the focus being but not limited to social security law, pension law, labour law, insurance law and economics. It will also be beneficial to government through the Department of Social Development, NT, social security agencies like SASSA, the National Planning Commission (NPC),FSB,the retirement industry, civil society organizations and members of the communities affected negatively by the current set up of the social security and retirement system with regard to accessibility, eligibility and affordability.

[24] South African Revenue Services.

1.5. Research Methodology.

The research methodology used in this study is qualitative as opposed to quantitative. This research is library based and reliance is on library materials such as textbooks, reports, legislations, regulations, case laws and articles. Consequently, a combination of legal comparative and legal historical methods, based on jurisprudential analysis was employed. A legal comparative method was applied to find solutions, especially an investigation on the way forward for social security and retirement reforms. The study established the development of legal rules, the interaction between law and social justice, and proposed solutions or amendments to the existing law or constitutional arrangement, based on practical or empirical and historical facts. Concepts were analysed and arguments based on discourse analysis were developed. A literature and case law survey of the constitutional prescriptions and interpretation of statutes were done.

1.6. Scope and limitations of the Study.

This mini-dissertation consists of five interrelated chapters. Chapter one is the introductory chapter laying down the foundation. Chapter two deals with social security and retirement reforms proposals while chapter three deals with strengthening retirement savings. Chapters four deals with comparative study . Chapter five deals with conclusions drawn from the whole study and makes recommendations.

CHAPTER TWO: SOCIAL SECURITY AND RETIREMENT REFORMS

2.1. Introduction

The social security policy in South Africa has long existed making provision for the vulnerable groups in the society to make a living but was not sufficient to create better and decent living for all in that it provided social assistance allocated along racial lines and consequently favoured and perpetuated white supremacy at the expense of the oppressed black majority. Both the 1993 Constitution[25] and the 1996 Constitution[26] ushered a new era of constitutional order which expressed constitutionally backed social security rights and such a constitutional backing gave rise to a plethora of policy formulation and implementation in favour of decent lives for all at the cost of the state.

The constitutional provision however dictates that the social assistance policy and legislation be updated and expanded on the basis that, the wording and the spirit of the social assistance legislation[27] currently in operation was formulated under the guidance and inspiration of the apartheid era legislation[28] which is out of touch with the reality of the new constitutional order and represented the direct opposite.

A more inclusive social security policy is needed since only the poor chidren, older people and the people with disabilities are protected by the safety net but there are

[25] The interim Constitution of South Africa Act, 200 of 1993
[26] Constitution of the Republic of South Africa Act, 108 of 1996.
[27] The Social Assistance Act, 13 of 2004.
[28] The Social Assistance Act, 59 of 1992

many people who are still living below the poverty line, with specific reference to the structurally unemployed workers without skill, single parent households and others.[29]

A considerable number of policy options have been considered by the NT, the social security department, international law office[30] and other stakeholders dealing with social security and retirement reform in South Africa and at an international level.

2.2. Proposal One: State Old Age Pensions (SOAP) for all.

The social assistance grants are perpetually granted narrowly in that they are provided to the elderly, the disabled, children and care-givers, thus not creating a required safety net for the poor and vulnerable in the country.[31] The proposal on the table offers two policy options, with the first one being the increase of the threshold for the deduction of independent income from the grant. The second option is the total scraping of the means test or modification which is highly unlikely.[32]

The cost of administering the means test can be higher than the savings made; the cost will arise from the application of the policy to disqualify certain categories.[33]The universalisation of the state old age pension policy option appears viable but it is not

[29] National Treasury, Social security and Retirement Reform: Second discussion paper, 2007.
[30]Consultation report, observations on social security reform in South Africa, Social Security Department, International Labour Office, July 2008.
[31] Hunter R, Social Security and Retirement Reform, presentation at Pension Lawyers Association, 2007.
[32] *Ibid*. See also para. 13 and para.63.Nevondwe and Mhlaba,Opcit.
[33] Para.1, page 7.

clear whether the disability grants given to the disabled will also be awarded on the one size fits all approach.[34]

However, the fiscal consequences connected to the scrapping of the means test for old age would be unfavourable in that, in 2011, the South African government spent 3.5% of the Gross Domestic Income on the seven major social assistance with the old age grant as the second biggest with 2, 2 million beneficiaries.[35]This is to illustrate the point that, once the means test is scrapped, the number of beneficiaries is likely to skyrocket and the national budget might not be able to deliver on such ambitious promises.

2.3. Proposal Two: A wage subsidy.

Government proposes to introduce an explicit wage subsidy[36] which could take the form of a reimbursement to the employer in the form of a rebate or credit in the PAYE system.[37]It would only be paid in respect of employees earning below a specified level of wages, such as R43 000 and will be greater in value, the less that the employee earns.[38]The details of the proposal are scant and government recognises that there are numerous design issues that will have to be carefully considered and addressed.[39] For

[34] Nevondwe LT and Mhlaba MW, Judicial Activism and Socio-Economic Rights in South Africa, Lambert Academic Publishing, Germany, published on 31 May 2012, this book is available online.
[35] Stephen Devereux and Colette Solomon, Can Social Protection Deliver Social Justice for Farmwomen in South Africa? Institute of Development Studies, April 2011.
[36] National Treasury,Social security and retirement refoform,second discussion paper,2007.Para. 51. See also Nevondwe and Mhlaba, opcit.
[37]*Ibid*.Para. 54. See also Hunter R, Social Security and Retirement Reform, presentation at Pension Lawyers Association, 2007.
[38]Para. 54.
[39] Para. 56.

example, it considers that it may be that it would be more cost-effective to subsidise workers in particular sectors, or only first-time entrants to the labour department.[40]

Either way, it is thought that the wage subsidy is more likely to protect the living standards of working people than is regulation of labour relations. It is also more likely to promote, rather than inhibit, economic activity.[41]

It is possible that this wage subsidy will encourage employers and employees to place their relationships on a more "formal" footing so that they can take advantage of the subsidy. Certainly it is hoped that it will contribute towards job creation because it will lower the cost of jobs.[42]

2.4. Proposal Three: Mandatory participation in a national social security system for all.

This is the most controversial policy proposal and one which threatens the business of many providers of retirement funding products and services to the low income, formally employed market.[43]

[40]Para.56.
[41] Paragraph 56.
[42] Paragraph 57.
[43] Nevondwe L and Ndaba M, South African social security and retirement reforms: recent developments, Insurance and Tax Journal, Vol. 27, No. 3, September 2012, pages 16-33.

The proposal is that all employed in the formal sector will all be obliged to contribute to a National Social Security Fund. Compulsory contributions by domestic workers and the self-employed would be phased in over time.[44] It remains to be seen whether voluntary contributions by people employed in the informal sector will be feasible.[45]

Investigations will also have to be done to determine whether it would be feasible to implement the proposals in the 2004 *Discussion Paper* that contributors be allowed to withdraw amounts from the scheme to deal with life crises with due consideration for the need to encourage preservation.[46] It is proposed in the 2007 *Second Discussion Paper* that compulsory preservation would apply to compulsory contributions.[47]

The rate of contribution would be between 13 and 18 percent of after-tax wages (or between 11.5 and 15 percent of before-tax wages)[48] up to a threshold of, say, R60 000 a year.[49]If the percentage is 15% then, if you earn R70 000, you will be obliged to contribute 15% of R60 000, that is R9000 a year or R750 a month. The cost of the contribution payable by a low-income worker should be covered by his or her wage subsidy.[50]

For their contributions contributors will receive "basic retirement funding" determined on

[44]National Treasury,Social security and retirement refoform,second discussion paper,2007 Para. 60.
[45]Para. 62. See also Nevondwe and Mhlaba, opcit.
[46]Para.62.
[47]Para.73.
[48]Para.67.
[49] Para.70.
[50]Para.61.

a "defined contribution" basis[51], unemployment insurance and life and disability cover.[52] If social health insurance is thrown into the mix, the contribution rate would have to increase to between 20 and 25 percent of wages.[53] Contributors could be allowed to make additional voluntary contributions to the scheme.[54]

SARS will need to undergo administrative reforms to enable it to maintain individual contributor records and ensure efficient and reliable benefits administration[55] although the latter could be conducted by the South African Social Security Agency (SASSA). The cost of this reform may, however, be off-set by the savings and efficiencies that will result from the consolidation of the social security arrangements that are now in place to finance unemployment insurance, maternity benefits, compensation for illnesses contracted at work and injuries sustained at the workplace or on the road.[56]

The fact is that South Africans do not save enough for retirement. They underestimate the financial risks that they face and they put off making savings and investment decisions.[57] Most of people prefer default arrangements over those which require you to make a decision.[58] The people who are most vulnerable will tend to be excluded if participation is subject to choice or selection.[59] They are also the most vulnerable to the

[51]Para.72.
[52]Para.67.
[53]Para.68.
[54]Para.71. See also Hunter R, Social Security and Retirement Reform, presentation at Pension Lawyers Association, 2007.
[55]Paragraph 14.
[56]Para.75.
[57]Para.35.
[58]Para.36.
[59]Para.34.

relatively high costs of private sector retirement funding arrangements[60] and so will benefit from the economies of scale that will be achieved.[61]

Many people have expressed doubt about whether government is capable of running such a large scheme. They forget that SARS manages to collect tax “contributions” from approximately 8 million tax paying individuals and the SASSA pays out nearly 12 million social security grants each month.[62] Yes, there are instances of fraud in relation to social grants but corruption is not an element of the product or delivery design as it has arguably been in the case of some private sector retirement funding products. Nonetheless government intends to research and consult over the possibility of “outsourcing” some of the management of the scheme, even considering the “contracting out” options adopted by some overseas jurisdictions.[63]

This initiative is admirable as is sustainable and not fiscal reliant and will instil a sense of responsibility on the part of the contributors come beneficiaries. It will crush the dependency syndrome on the part of the South African citizens and eliminate a link leading to a welfare state. This initiative in comparable to the Chinese Housing Fund whereby the employee contributes 15% of his or her salary and the employer contributes 25% of the employee’s salary as an insurance for housing ,thus easing a burden on the state.

[60] Para.38.
[61] Para.37.
[62] See Nevondwe and Mhlaba, opcit.
[63] Para.74.

2.5. Proposal Four: Mandatory participation in private occupational or individual retirement funds

It is proposed that people employed in the formal sector be obliged to make additional contributions to occupational retirement funds or individual retirement funds out of their earnings above the earnings ceiling, up to a monetary cap. This should allow individuals to save to provide for an adequate income replacement after retirement. [64]

It may come as a relief to providers in the private sector that government recognises the benefits of the capacity, innovation and competition evident in the private sector.[65]
It is also proposed that funds be allowed to make transfers to the new National Social Security Fund for the credit of individual members and then continue to collect contributions as "top up" occupational or individual retirement funds.[66] Unless this is made compulsory or at the election of individual members, I cannot see funds wanting to make these transfers because it will reduce their economies of scale.[67]

Many countries that have relied predominantly on mandatory sate run funding and administration in the past have sought to encourage parallel or supplementary private saving and insurance markets. This was due to lack of sustainability and affordability attributed to ageing populations and rising costs of health and social security services.[68]

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[64] National Treasury,Social security and retirement refoform,second discussion paper,2007Para.64.
[65] Para.30.
[66] Para.66.
[67] Nevondwe L, South African Social security and retirement reform a long journey towards the redrafting of the New Pension Funds Act**,** Pensions, an International Journal, Palgrave Macmillan Publishers, UK, Vol 15, issue 4, November 2010, pages 292-293. This article is available online.
[68] Para.25.

2.6. Proposal Five: Voluntary additional contributions to occupational or individual retirement funds

It is proposed that additional voluntary contributions to private occupational or individual retirement funds be encouraged by means of tax incentives.[69] Those tax incentives will not apply to contributions over a specified monetary cap.[70]

2.7. Proposal Six: Reform of the governance and regulation of the retirement funding industry

Good governance and trust are the foundation of any sound retirement system. Members contribute in the present to save for the future.[71] They have a right to expect that their funds will be managed prudently, in their best interests and in accordance with the law. Several recent high profile lapses highlight a broader problem with fund governance that, if unchecked, will damage the trust underpinning the system. [72]

In 2007, the FSB issued PF Circular 130 on good governance of retirement funds. The circular recommends that trustees put in place a documented code of conduct, an investment statement, a communication strategy for members and a performance

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[69] Para.83.

[70] Para.159. See also Choma and Nevondwe, opcit at page 277. See also Hunter R, Social Security and Retirement Reform, presentation at Pension Lawyers Association, 2007, p7.See also National Treasury discussion paper tittle social security and retirement reform, second discussion paper, published on February 2007,page 35 paragraph 162.

[71] Nevondwe L and Ndaba M, South African social security and retirement reforms: recent developments, Insurance and Tax Journal, Vol. 27, No. 3, September 2012, pages 16-33.

[72] National Treasury discussion document titled strengthening savings, published on 14 May 2012, page 15.

appraisal system for trustees.[73] The circular also places an obligation on board members to receive training. The Financial Services Board has launched an online education programme, known as the trustee toolkit, to develop and educate retirement fund trustees. Currently, both PF Circular 130 and the use of the trustee toolkit are voluntary. The active support of both industry and union leaders to improve governance is welcomed.[74]

The industry recognises that practices like surplus stripping (where employers obtain surplus assets from a fund illegally) and bulking (where administrators pool the assets of many funds to obtain higher deposit rates, but keep the interest for themselves) undermine the entire industry.[75] Improving fund governance also requires dealing with conflicts of interest. The current system of 50:50 representations requires both employers and workers to take joint responsibility for managing such funds.[76]

Under this system, trustees do not represent the constituency that appointed them; rather, whether appointed by employers or unions, trustees must act independently and without fear or favour in exercising their fiduciary duties to promote the interests of all members of the fund. To ensure this is achieved, it could become a statutory requirement that trustees have relevant qualifications and expertise in the management of pension funds, with training completed within a set period after appointment.[77]

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[73] *Ibid.*
[74] National Treasury discussion document titled strengthening savings, published on 14 May 2012
[75] *Ibid.*
[76] *Ibid.*
[77] *Ibid.*

The Second Discussion Paper on Social Security and Retirement Reforms stipulates that “a frank assessment of the current South African retirement savings landscape suggests that while many people in formal sector jobs contribute to retirement funds, the vast majority start too late in their careers to save enough for retirement, or cash in their retirement savings when they change jobs.

Rates of contribution appear reasonable on average, but are increasingly being eroded by rising administration costs and risk premiums.[78] The high proportion of Defined Contributions (DC) retirement funds in the private sector means that the risk of governance failures, expense inflation and inadequate benefit protection fall on the individual member, who is often the least equipped to manage or withstand the loss.”[79]

2.7. Proposal Seven: Reform of the tax system.

To simplify the retirement system, government proposes a uniform retirement contribution model, under which all contributions to retirement funds – including annuities, pension and provident funds and all benefits from these funds will be subject to the same tax treatment. Employer contributions to all types of funds will be included in an employee’s remuneration as a fringe benefit, but individuals will be permitted a

[78] Hunter R, Social Security and Retirement Reform, presentation at Pension Lawyers Association, 2007, P7.
[79] Paragraph 93.

deduction of up to 22.5 per cent of their income if they are under 45 and 27.5 per cent if they are 45 and above.[80] This will apply to both employer and employee contributions.[81]

To cater for the self-employed and partially self-employed, and to ease administration, the income base upon which this deduction is calculated will be changed to the greater of remuneration and taxable income. To improve equity in the tax system, and to enable lower-income individuals and those with variable incomes to contribute more, it is proposed that the maximum permitted deduction will be greater than R20 000 and less than R250 000 (R300 000 for those of 45 and above), regardless of income.[82]

The higher limits for older workers make allowance for those who did not save earlier in their lives. A special arrangement will be made for defined benefit funds that still exist, including the Government Employees Pension Fund, to prevent excess contributions regarding current fund surpluses or deficits, or complications caused by ageing schemes, to have negative tax consequences for current members. These changes are unlikely to affect the tax liabilities of the vast majority of taxpayers. By increasing pension contributions, such liabilities could even be reduced.[83]

Given that retirement savings are part of household savings, any changes to the regulation of retirement funds must take into account the effect on the savings.

[80] Nevondwe L, Social security and retirement reforms: recent developments, Social Security Law Colloquium, UNISA, 4 August 2012. See also Nevondwe L, Recent developments with regard to social security and retirement reforms, Society of Law Teachers of Southern Africa, Nelson Mandela Metropolitan University, 12 July 2012.

[81] National Treasury discussion document titled strengthening savings, published on 14 May 2012, page 13, and See also Nevondwe and Ndaba**,** South African Social security and retirement reforms: recent developments.

[82] *Ibid*.

[83] *Ibid*.

Proposals to enhance short- and medium-term savings are under consideration. The current regulatory framework allows individuals to use their retirement assets to fill short- and medium-term consumptions living needs. Low rates of preservation indicate that this function is important for many people.[84]

Individuals will be able to save up to R30 000 per year into this account, with a lifetime limit of R500 000. These caps ensure that the wealthy do not benefit excessively from the incentives on offer. Holdings in the account will be exempt from income and capital gains taxes. A broad variety of assets will be permitted, including bank deposits, shares, RSA retail bonds and collective investment schemes. Changes to the existing tax-free thresholds on interest income are considered as part of this reform, and will be phased in to ensure that existing savers are not prejudiced.[85]

International evidence indicates that front-loaded tax benefits – that is, the favourable tax treatment of contributions to retirement funding vehicles – is the most effective way of stimulating savings.[86]This treatment is available to members of pension funds, is not available to members of provident funds, and is available on a restricted basis to members of retirement annuity funds. So it is likely that the reform of retirement funding taxing arrangements will see more equitable tax treatment of contributions towards pension, provident and retirement annuity funds[87] and the national social security fund[88]

[84]National Treasury discussion document titled strengthening savings, published on 14 May 2012, page 13, and See also Nevondwe and Ndaba**,** South African Social security and retirement reforms: recent developments.
[85] *Ibid.*
[86] National Treasury,social security and retirement reform, second discussion paper, published on February 2007,Para.151.
[87]*Ibid*.Para.157.
[88]*Ibid*.Para.158.

with such contributions being wholly or partially tax-deductible and, in the case of low-income workers, paid by means of the wage subsidy.[89] Higher income earners have benefited disproportionately from tax incentives in the past[90] without this serving any particular public purpose[91] so it is likely that there will be some form of monetary cap on tax relief on contributions to retirement funding vehicles.[92]

There are a number of options in regard to the tax treatment of contributions which could be considered. These include granting full or partial tax deductibility at marginal rates, or a tax credit system. The tax credit system is roughly equivalent to allowing a tax deduction at a standard rate.[93]Special consideration will have to be given to the tax treatment of contributions of those with volatile incomes or periods of unemployment and those who have started contributing to a retirement fund late in life[94].

The tax on certain forms of retirement fund investment income has been scrapped to enhance the adequacy of funds available in retirement, to simplify the tax treatment of retirement savings and to minimise tax-driven investment decisions.[95]

Finally it is proposed that some tax relief on lump sums paid on retirement be retained but the basis for determining it this will have to be simplified. Withholding tax on

[89] *Ibid*.Para.161.
[90] *Ibid*.Para.165.
[91] *Ibid*.Para.160.
[92] *Ibid*.Para.159.
[93] National Treasury, Social security and retirement reform, second discussion paper, published on February 2007,Para. 163.
[94] Para.167.
[95] Para.169.

benefits paid to persons with taxable income of less than R43 000 a year will be abolished.[96]

[96]Para.172.See also Nevondwe L, Social security and retirement reforms: recent developments, Social Security Law Colloquium, UNISA, 4 August 2012. See also Nevondwe L, Recent developments with regard to social security and retirement reforms, Society of Law Teachers of Southern Africa, Nelson Mandela Metropolitan University, 12 July 2012.

CHAPTER THREE: STRENGTHENING RETIREMENT SAVINGS

3.1. Introduction

The need for the reform of the South African retirement industry in immediate informed by a plethora of reasons which if left unattended, defeats the intended purpose of the retirement savings initiative. Despite high participation rate, high contribution rates and significant assets under management, only 10% of South Africans are able to maintain pre-retirement level of consumption after they have stopped working but before the actual retirement.[97]

This is normally influenced by the premature withdrawal of retirement benefits which in turn prevent people from retiring comfortably, adversely affecting the growth of pension funds and resulting in poor savings.[98]The overall appreciation of in the value of assets under management is due to the general rise of assets prices.

There are several reasons for the low levels of preservation including early withdrawal of benefits especially by younger and low paid employees to carry out immediate financial responsibilities.[99]In South Africa, there is an uneven treatment of the various retirement savings products due to lack of compulsory preservation for occupational pension funds, there are reported cases on individuals who resigning from their jobs just to gain access to their pension benefits.[100]

[97]National Treasury, Strengthening retirement savings, an overview of the proposals announced in the 2012 Budget.
[98] National Treasury, A safer financial sector to serve South Africa better, 23 February 2011.
[99] *Ibid.*
[100] *Ibid.*

Because the government is committed to increase financial security for all citizens, wide ranging proposals to reform social security and retirement arrangements have been lined up and are to be discussed in detail hereunder. The proposals are guided by the principles of inadequate lifetime savings, low levels of preservation and portability, high fees and charges and low level of annuitisation:

"… a balanced and honest attempt to identify inefficiencies in the system and take bold steps to address them. Many of the proposals require behavioral changes, not only on the part of the members but also on part of service providers. Many of these can only be brought about by legislative change - compulsory preservation being the best example."[101]

Government is proposing several incremental steps to strengthen retirement funding, guided by the following principles:

- Enhancing protections for individual savers, ensuring that their retirement assets are invested in their best interests, and that such protection is of a higher standard than required by consumers of other goods and services.
- Improving efficiency and good governance through consolidation of private-sector retirement funds.
- Encouraging the use of standardized products, promoting competition to benefit lower- and middle-income households.
- Ensuring that changes are consistent with broader social security reform and government objectives.

[101] Retirement reform proposals, Simeka Cconsultants, May 2012.

- Addressing any gaps exposed by the global financial crisis, promoting financial inclusion and stability, and

3.2. Reducing retirement fund costs

Although the South African retirement industry is successful in many ways, high costs relative to international benchmarks are a concern. A high cost structure erodes retirement benefits, reduces saving returns and discourages participation in the voluntary system. Over the long term, high costs may threaten the industry's structure.[102]

NT believes that they can improve efficiency and good governance through further consolidation of private retirement funds. The number of registered standalone funds is down to 2 700. Umbrella funds remain the only alternative, even though they are still considered too expensive. The establishment of a market conduct supervisor is however expected to improve transparency, making the retirement industry more competitive and lowering its cost structure.[103]

3.3. Reforming the annuities market

The current system guards policyholders when they contribute, but the quality of protection mechanisms declines when members retire. Most defined contribution funds,

[102] National Treasury, Strengthening retirement savings, an overview of the proposals announced in the 2012 Budget.
[103] *Ibid.*

after automating the savings and investment choices of members over their working lives, leave them to the retail market when they retire.[104]

Members of pension funds and holders of retirement annuities are required to purchase either a living annuity or a conventional life annuity with two-thirds of their accumulated balance.[105]If members of retirement funds are to be required to annuitise their retirement assets, the annuity market must be structured in a way that encourages members to make good choices.[106]A living annuity with an underlying investment in South African Retail Bonds is being developed to provide an additional simple, low-cost product to meet retirement income needs.[107]

Policy position under exploration with the retirement industry include developing standardized products into which retirement funds can automatically place members when they retire, without requiring financial advice.[108]These products will have to meet design, access and cost conditions. Another option is to allow funds to default members into new types of annuity products that share risks between providers and members, making annuity provision more cost effective and attractive.

Higher-income retirees will continue to make their own choices about additional retirement savings.[109]Members when they retire, without requiring financial advice.

[104] *Ibid*.
[105] *Ibid*.
[106] *Ibid*.
[107] *Ibid*.
[108] Retirement reform proposal, Simeka Cconsultants, May 2012, page 4.
[109] *Ibid*.

These products will have to meet design, access and cost conditions. Another option is to allow funds to default members into new types of annuity products that share risks between providers and members, making annuity provision more cost effective and attractive. Higher-income retirees will continue to make their own choices about additional retirement savings.

3.4. Preservation and portability.

Despite high participation and contribution rates, most South Africans reach retirement financially unprepared. Only about 10 per cent of South Africans are able to maintain their pre-retirement level of consumption after retirement, largely because of a lack of preservation of retirement fund assets when members leave their jobs.[110]

Government proposes to phase in, over time, a preservation requirement. When employees change jobs, their balances can remain in their employer's fund, or be transferred to a preservation fund or to their new employer's fund, rather than be withdrawn in cash.[111]

Preservation is the requirement that money saved for retirement through a pension, provident or retirement annuity fund should remain in such a fund or be rolled over into another similar savings vehicle without incurring taxes or penalties until the person

[110] *Ibid.*
[111] *Ibid.*

retires in the normal course of his or her career, reaches the age of 55 or retires on grounds of permanent disability.[112]

In terms of Regulation 28 which the aim of pension fund investment regulation is to ensure that the saving South Africans contribute towards their retirement is invested in a prudent manner that not only protects the pension fund member, but is channeled in ways that support economic development and growth.[113]

The proposal to preserve may be partially waived to allow those who are unemployed and have exhausted their Unemployment Insurance Fund benefits to access a maximum of one-third of their accumulated funds. Access will also be allowed in cases of demonstrated medical need.[114]This measure will be phased in over a number of years, following thorough consultation. Protection will be given to vested rights to prevent any short-term disruption to retirement savings, and to minimize the impact on current workers who may view their retirement savings as precautionary or medium-term consumption smoothing.[115]

3.5. Harmonizing retirement fund taxation

To simplify the retirement system, government proposes a uniform retirement contribution model, under which all contributions to retirement funds – including

[112] National Treasury, A safer financial sector to serve South Africa better, 23 February 2011, p50.See also National Treasury, Preservation, portability and governance for retirement funds, 21 September, 2012.
[113] The Pension Funds Act, 24 of 1956
[114] *Ibid.*
[115] Retirement reform proposal, Simeka Cconsultants, May 2012.

annuities, pension and provident funds – and all benefits from these funds will be subject to the same tax treatment.[116]

Employer contributions to all types of funds will be included in an employee's remuneration as a fringe benefit, but individuals will be permitted a deduction of up to 22.5 per cent of their income if they are under 45 and 27.5 per cent if they are 45 and above. This will apply to both employer and employee contributions.[117]

To cater for the self-employed and partially self-employed, and to ease administration, the income base upon which this deduction is calculated will be changed to the greater of remuneration and taxable income.[118]
To improve equity in the tax system, and to enable lower-income individuals and those with variable incomes to contribute more, it is proposed that the maximum permitted deduction will be greater than R20 000 and less than R250 000 (R300 000 for those of 45 and above), regardless of income. The higher limits for older workers make allowance for those who did not save earlier in their lives.[119]

A special arrangement will be made for defined benefit funds that still exist, including the GEPF, to prevent excess contributions regarding current fund surpluses or deficits,

[116]National Treasury, Strengthening retirement savings, an overview of the proposals announced in the 2012 Budget Speech.
[117] Retirement reform proposal, Simeka Cconsultants, May 2012.
[118] *Ibid.*
[119] National Treasury, Strengthening retirement savings, an overview of the proposals announced in the 2012 Budget Speech.

or complications caused by ageing schemes, to have negative tax consequences for current members.[120]

Harmonizing the annuitisation requirements of all retirement funds will help protect members from the risk of outliving their assets. To reduce the consequences of this change for older and lower-income workers, it is proposed that this shift be phased in for the over-50s, with a possible increase in the minimum annuitisation requirement from its current level of R75 000. This change will not affect most low-income retirement fund members who are nearing retirement.[121]

3.6. Improving fund governance and the role of trustees.

Good governance and trust are the foundation of any sound retirement system. Members contribute in the present to save for the future.[122]They have a right to expect that their funds will be managed prudently, in their best interests and in accordance with the law. Several recent high-profile lapses highlight a broader problem with fund governance that, if unchecked, will damage the trust underpinning the system.[123]

In 2007, the Financial Services Board issued PF Circular 130 on good governance of retirement funds.[124]The circular recommends that trustees put in place a documented code of conduct, an investment statement, a communication strategy for members and

[120] *Ibid*
[121] *Ibid*
[122] *Ibid.*
[123] Retirement reform proposal, Simeka Cconsultants, May 2012.
[124] *Ibid.*

a performance appraisal system for trustees.[125]The circular also places an obligation on board members to receive training. The Financial Services Board has launched an online education program, known as the trustee toolkit, to develop and educate retirement fund trustees. Currently, both PF Circular 130 and the use of the trustee toolkit are voluntary.[126]

The active support of both industry and union leaders to improve governance is welcomed. The industry recognises that practices like surplus stripping (where employers obtain surplus assets from a fund illegally) and bulking (where administrators pool the assets of many funds to obtain higher deposit rates, but keep the interest for themselves) undermine the entire industry.[127]

Improving fund governance also requires dealing with conflicts of interest. The current system of 50:50 representations requires both employers and workers to take joint responsibility for managing such funds.[128]Under this system, trustees do not represent the constituency that appointed them; rather, whether appointed by employers or unions, trustees must act independently and without fear or favour in exercising their fiduciary duties to promote the interests of all members of the fund. To ensure this is achieved, it could become a statutory requirement that trustees have relevant qualifications and expertise in the management of pension funds, with training completed within a set period after appointment.

[125] *Ibid.*
[126] Strengthening retirement savings, an overview of the proposals announced in the 2012 Budget Speech, p14.
[127] Cameron B, Renewed efforts at retirement reform, 15 April 2012, Personal Finance, online.
[128] *Ibid*.

To strengthen fund governance, PF Circular 130 will become legally enforceable by the Registrar of Pension Funds. In line with this approach, government will consider a statutory requirement that trustees be “fit and proper”, with no criminal history. Trustees will be declared prohibited persons by the regulator if they are found to have been involved in past transgressions of good pension fund governance.[129]Government and the industry are also considering professionalizing the role of principal officer and are evaluating different methods to strengthen the enforcement of laws.[130]

3.7. Pension fund investments

Government reissued Regulation 28 in 2011, which sets out the prudential framework under which retirement funds must invest their assets.[131]The regulation establishes principles by which trustees are required to determine their investment policies, and sets maximum permissible limits for investment by asset class and by issuer to ensure that funds are adequately diversified.[132]

Trustees are required to invest assets in the best interests of the members of the fund. In addition, they are now required to consider the environmental and social factors

[129] Cameron B, Renewed efforts at retirement reform, 15 April 2012, personal Finance, online.
[130]*Ibid.* See also strengthening retirement savings, an overview of the proposals announced in the 2012 Budget, p15.
[131] The public sector fund accounts for R820 billion rands worth of investment through the Public Investment Cooperation including the its stake in the Implants Platinum sector.
[132] *Ibid.*

underlying investments.[133]This gives trustees the opportunity, where they deem it in the best interests of their members, to align their investment policies more consistently with national goals, such as contributing to infrastructure development.

3.8. Pension laws to be extended to all public funds

Pension fund legislation is not uniform across the retirement industry. Several public-sector funds, including funds from Transnet, Telkom, the Post Office, the Associated Institutions Pension Fund, the Temporary Employees Pension Fund and the Government Employees Pension Fund, are exempt from the provisions of the Pension Funds Act.[134]While most of these funds are defined benefit funds, and the frameworks applying to these funds and defined contribution funds will differ, the same principles of member protection and good governance apply.[135]

Extending the provisions of the Pension Funds Act to give members of public-sector funds the same protections offered to members of private-sector funds is being considered. Where there are exemptions, they will be transparent and subject to review on a regular basis.[136]

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[133] This assertion is in line with the South African Communist Party Perspective (SACP) which dismisses the proposal by a mining sector analyst, Duma Gqubule that the state must use the public retirement funds of R820 billion to realize quick nationalization of mines in south Africa.

[134] Nevondwe L, South African Social security and retirement reform a long journey towards the redrafting of the New Pension Funds Act**,** Pensions, an International Journal, Palgrave Macmillan Publishers, UK, Vol 15, issue 4, November 2010,p.3.

[135]*Ibid.*

[136] *Ibid*.

CHAPTER FOUR: COMPARATIVE STUDY

4.1. Introduction.

The reform of social security and the pension industry is "one of the most difficult reforms in any economy." Chile is a country often used as a model for the South African social security and retirement system as is already in its fourth cycle of reform. The Chilean Pension Reform was introduced at the beginning of the 1980's as the successor to the old state run system, which went bankrupt.

Like Chile, many countries, including the United States, are facing the insolvency of their social security system. That is because their populations are aging, and their systems must pay a high level of benefits compared with a low level of revenues. Chile's experience is relevant for every country that is trying to make its system solvent again.[137]Other countries to be looked at for the purpose of drawing a comparative perspective include, the People's Republic of China, the United States of America, the New Zealand and some selected countries on the African continent.

4.2. The Chilean experience on social security and pension reform.

Chile initiated sweeping retirement reforms in 1981 that replaced a state-run, pay-as-you-go defined benefit retirement system with a private, mandatory system of individual retirement accounts where benefits are dependent on the account balance. As a

[137] Mitchell O, Chile's Pension Reform, An inspiration to others, online, visit also www.wharton.universia.net.

pioneer of individual retirement accounts, Chile has become a case study of pension reform around the world.[138]

Pension reforms have contributed to the rapid growth in the Chilean economy over the past two decades and returns on pension fund investments have been greater than expected. Administrative costs, however, have been high and participation rates have been modest at best. There is concern that the system does not cover the entire labor force and provides inadequate benefits to low income workers.[139]

The Chilean reform includes the concept of individual capital accounts. This future appeals to many people who believe that governments are often unable to maintain sufficient assets to finance a retirement system. Individual accounts can be better protected against political risks. Its retirement reform incorporates a security network in the form of minimum pensions and old-age benefits guaranteed by the government.[140]

Chile has privatized its social security system more extensively than any other country to date. Because few dispute that social security privatization has been accompanied by a revived economy and widespread public support, interest in Chilean social security reform has spread to other Latin American countries; to transition economies in Eurasia; and to developed nations, including the United States. Since 1993, Peru, Columbia,

[138] Tamborini C, Social Security: The Chilean approach on retirement, Congressional Research Service,17 may 2007.
[139] Tamborini Social Security: The Chilean approach on retirement, Congressional research Service,17 may 2007.
[140] Nevondwe L, South African Social security and retirement reform a long journey towards the redrafting of the New Pension Funds Act**,** Pensions, Palgrave Macmillan Publishers, UK, Vol 15, issue 4, November 2010, page 290. This article is available online.

Argentina, Uruguay, and Mexico have implemented privatized social security reforms that resemble Chile's system.[141]

Over the years, the system has undergone some major changes, including broadening the allowable investments and introducing a choice of several types of pension funds with varying degrees of risk levels**.**[142]The new system carried with it significant advantages, first it enabled the workers to make contribution to the new defined contribution account to the tune of at least 10 percent and not more than 20 percent of their earnings, secondly, the system mandated employers to raise the earnings of both old and new members of the labour force by 18 percent. The system has both portability and preservation features as it put the workers at liberty to migrate to the new system or remain with the old for a specified period of time.[143]

Over the years, Chile made some major changes to its capitalization system, such as liberalizing investment rules and increasing the type and number of pension funds that a pension fund management company (AFP) must offer its account holders.[144]However, despite these and other changes, a number of policy challenges remain unresolved including large groups of workers who are not covered and irregular worker participation rates, both of which could lead to inadequate retirement benefits.[145]Also, according to

[141] Salisbury D.L,Chilean social Security reform as a prototype for other nations, Employee Benefit Research Institute, August 1997,Vol.18, No.8.
[142] B.E Kritzer, Chile's next generation pension reform, Social security Bulletin, Vol.68.No.2,2008.
[143] Salisbury D.L, Chilean social Security reform as a prototype for other nations, Employee benefit research institute, August 1997, Vol.18, No.8.
[144] *Ibid.*
[145] *Ibid.*

international standards, the administrative fees the AFPs are charging account holders are high and could significantly decrease the size of a worker's pension.[146]

Two and half decades later, the country's new pension reform law provides the most comprehensive overhaul of the individual account system since its inception. The International Monetary Fund supports these changes because they strive to retain the basic features of the individual account system and, at the same time, address its major shortcomings.[147]The reform expands coverage and creates a basic benefit for many Chileans who would not otherwise qualify for a pension. Other measures will improve gender equity, encourage competition in the pension fund industry, and lower costs to help raise the net rate of return for account holders; thus, providing higher pensions.[148]

4.3. Lessons from African Countries on retirement and social security.

Coming to Africa, there are some lessons to be learnt. As South Africa continues to pursue social security and retirement reform, drawing on the experience of other African countries can provide some useful insights. Three members of the East African Community (EAC) - Kenya, Tanzania and Uganda – have operated National Social Security Fund (NSSF) and retirement arrangements for several decades.[149]

Although South Africa is in many ways more economically advanced than these countries, it can nevertheless benefit from the experience with NSSF arrangements that

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[146] Salisbury D.L,Chilean social Security reform as a prototype for other nations, Employee Benefit Research Institute, August 1997,Vol.18, No.8.

[147] B.E Kritzer, Chile's next generation pension reform, Social security Bulletin,Vol.68.No.2,2008.

[148] *Ibid.*

[149] Momentum online, lessons to be learned from national security funds in East Africa, see also http://www.momentum.co.za

they have adopted. Moreover, in many ways it is more appropriate to compare South Africa with other African countries than with advanced economies. For example, the understanding of contributory social security and retirement schemes among low income South Africans is likely to be closer to East Africa than the United Kingdom or the United States. Furthermore, institutional challenges facing public institutions in East Africa are of relevance to South Africa.[150]

The primary objective of social security and retirement reform in South Africa is to extend coverage, particularly to low income earners. Social security coverage in Kenya, Tanzania and Uganda is approximately 15%, 5% and 5.4% of the labor force respectively.[151] Low coverage rates are because NSSF arrangements cater predominantly for those in formal sector employment, while the majority of workers in these countries are in the informal sector. At approximately 15% of the employed, the informal sector in South Africa is smaller than in East Africa.

However, it still accounts for a significant proportion of South African workers. At some stage, it will be necessary to introduce specialized arrangements aimed specifically at the informal sector.[152] These arrangements could include relatively low contribution rates, co-contributions by the government, flexible contributions that cater for irregular income streams and some provision for early withdrawals. It would also be important to undertake a pension literacy campaign aimed at both the formal and informal sector.

[150] Momentum online, lessons to be learned from national security funds in East Africa, see also http://www.momentum.co.za.
[151] *Ibid*.
[152] *Ibid*.

Expanding coverage to low income earners will require a much better understanding of the necessity of saving for retirement, than is currently the case.[153]

The real challenge for South Africa is to learn from these countries and consolidate decades' worth of international experience in a three to four year implementation locally.[154] This will require buy-in from all stakeholders in the long-term savings environment. The reform is like a journey and a long one, but it needs the government and the private sector to assist each other to have a reform which will rectify the injustices of the past and create an environment wherein they will be consistent in the industry or the standard uniform.

Currently there are many registered pension funds both in the public and private sector in the country and each fund has its set of rules. The lessons to be learn from other countries will be merge all the funds and establish a single fund a proposal already suggested in the social security and retirement reform.[155]

4.4. Social security and retirement system of the people's Republic of China.

China has a pension system in place to ensure maintenance of its citizens after retirement in which both the employer and the employee contribute on monthly basis. The portion contributed by the employee goes to a personal fund and can be withdrawn by the contributor after retirement. The portion contributed by the employer goes into a social pool and such funds are then distributed to all citizens who have contributed

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[153] Masilela E, paper at the Financial Planning Institute of Southern Africa's Annual Convention 2009 titled "*Social Security & Retirement Reform Update*"
[154] *Ibid*.
[155] *Ibid.*

during their working life, these benefits are payable on monthly basis and the aim is to protect those who might have squandered their personal lump sums.[156]

Comparatively, this set up is a bit similar with the South African pension system where there is a personal lump sum and retirement annuity contributions paid to augment the pension payable to the retiree.However,the notable difference is that with south Africa, retirement annuity is not directly administered by government and is not mandatory.

On employment insurance, China has a system in place whereby, employers and employees are obliged to contribute into a fund which then caters for members in the case of temporary unemployment. The benefits are given to members who have contributed for at least one year and can be received for a maximum period of 24 months.[157]

Comparatively, this system is basically identical to the south African unemployment insurance fund, the only notable difference however is that with China, the benefits need not comply with the salary or the accumulation made through member contribution as is the case in South Africa whereby the more you have contributed, the higher the benefits and the longer the receiving period. The Chinese system is commendable in communist state given its quest to create an egalitarian society.

In the case of maternity, contributions to the insurance fund are only made by the employer for the benefit of the employee. The employee is entitled to a lump sum to cover children birth costs, the fund is oblige to pay the employee a salary calculated at

[156] Livermore A, Understanding China's Social Security System, China Briefing, Magazine and daily news services, 14 September 2010.See also.www.china.briefing.com.
[157] *Ibid.*

an average salary of the region within which the employee is located, this means that the insurance fund will not pay the personal salary at a consideration of what the employer was earning.[158]However, in most cases, the employer is responsible for the remaining portion of the salary to insure that the employee receives the same salary as during normal working period for the duration of the maternity.

China has a unique system forming part of the social security and retirement arrangements called the housing fund. In terms of the housing fund, both the employer and the employee are obliged to contribute to the housing fund whereby the benefits will accrue directly to the employee. The aim of the fund is to encourage the employee to save enough to buy a house or apply for a low rate mortgage loan. The employee's contribution to the fund is fixed at 15% of the gross salary while that of the employer is fixed at 25% of the employee's gross salary.[159]

These contributions are the symptoms of the real meaning and business of the social security and retirement system in China as opposed to south Africa whereby there is no housing fund and the only system available is the low cost housing provided by the state from the national budget and the housing allowance paid by the employer which is not even enough for many employees to pay for an average house. The Chinese system, notably seeks to ease the burden of the part of the state by ensuring that people with the assistance of the employee are forced to purchase houses of their own. This kind of obligation on the part of the employer creates a problem whereby the employer will be reluctant to create more jobs to hire more people.

[158] Livermore A, Understanding China's Social Security System, China Briefing, Magazine and daily news services.14 September 2010. See also.www.china.briefing.com
[159]*Ibid.*

CHAPTER FIVE: CONCLUSIONS AND RECOMENDATIONS

5.1. Conclusion

In line with the broader package of social security and retirement reforms and the shift towards a twin peaks model of regulation, government is making a number of proposals to strengthen retirement funding and savings now and in the future. To address the high rate of leakage out of the retirement system, and to ensure that more workers are financially secure when they reach retirement, government is proposing to phase in preservation of retirement fund balances.[160]

The South African social security and retirement system has always from its historical existence been used as a poverty alleviation tool. The structure, policies, legislation and political will on social security issues are not well consolidated in south Africa from its inception, though the initiatives have long existed, not enough is done to realise the ultimate goal of the social security system which is the total alleviation of poverty like other developed and middle income countries have done to move people out of the poverty trap.

Many progressive policy proposals and recommendations on social security have been ignored by governments of the days, both in the pre and post 1994 democratic breakthrough, lack of political will and insufficient understanding of policy positions by political heads seems to be the major predicament to implementation of progressive policies recommended by experts in this area of focus.

[160] National Treasury discussion document titled strengthening savings, published on 14 May 2012, page 17.

The social security system in is narrowly focused and myopic, the positioning and structuring favors one group or the other at the huge expense of the next which in the ultimate end creates an impression that, the aim of the policy in place is not to fight poverty but to do favors to selected groups.

The social security on the social assistance side is fiscal reliant with its revenue base coming from the national government through the general income tax. This makes the system less sustainable given the high intake and the possible expansion to accommodate more beneficiaries who will supplement the current beneficiation criteria which is only focused on age and incapacity.

We have found these proposals to be energising and invigorating. Many people have become jaded by disputes over the interpretation of the surplus legislation, by arguments over the powers of the regulator and by increasingly appalling abuses of retirement funds by stakeholders from all quarters including employers, service providers, members, unions and others.

These proposals will help us to look forward to a future in which retirement funding arrangements will do effectively what they are intended to do, that is to provide retirement savings and related benefits to members in a cost-efficient way.[161] Finally the proposals will go the long way to encourage a culture of savings among South Africans for retirement. It will also strengthen the regulation and incorporated all retirement legislations to a single legislation for a uniform standard in the retirement industry.

[161] Nevondwe L, South African Social security and retirement reform a long journey towards the redrafting of the New Pension Funds Act**,**Pensions, an International Journal, Palgrave Macmillan Publishers, UK, Vol 15, issue 4, November 2010, pages 295- 296. This article is available online

5.2. Proposals and recommendations.

Based on the concrete analyses above and lessons drawn from other countries discussed in chapter four. This mini dissertation proposes and recommends as follows:

- The introduction of uniform tax treatment for retirement fund contributions and benefits will simplify the retirement system.
- Several initiatives to reform the annuities market, lower retirement fund costs and strengthen fund governance must be seriously considered.
- Annuitisation requirements for all types of retirement funds should be harmonised to limit the effect on low-income households, the *de minimus*[162] annuitisation requirement will also be raised in tandem with the reform.[163]
- These are investments in social cohesion that will be felt long into the future, and therefore the government and relevant stakeholders must prioritise these reforms by allocating all the necessary resources both in terms of personnel and finances to effect these proposed overhaul.
- More revenue collection method need to be established such as focused funds to collect revenue to assist the vulnerable in areas of focus such as disability fund, old age and children fund, war veterans fund, deserted or widowed women fund, health insurance fund, education fund, National Youth Development fund, Housing fund etc.

[162] The requirement to annuitise assets is currently waived if the rand value of the portfolio is below R75 000.
[163] *Ibid.*

- The collection of such revenue would be the responsibility of the South African Revenue Service and should be collected from all tax threshold income earners both in the formal and inform sector, both local and foreign nationals generating income or conducting business in the country. This recommendation is inspired by the Chinese system in revenue collection and the New Zealand social assistance beneficiation system respectively.
- On social assistance offered and administered by the South African social security agency, the main policy problem is that the focus is on age and incapacity in that, the assistance is availed to the young in terms of the child support grant, the elderly in terms of the old age grant and the disabled in terms of the disability grant. This policy initiative leaves the vast majority of the poor and unemployed under the poverty line.
- The policy on social insurance be radically reviewed to include household, unemployment and other benefits to move towards a comprehensive social security system which allows for an expanded poverty net. This recommendation is informed by the New Zealand lessons where, the social security system covers all the vulnerable groups including single parents and deserted mother and unemployed working age youth.
- The road accident fund must be integrated into the comprehensive social security system to make provision for a comfort zone to all the disabled people or accident victims by looking at the poverty generated by the disability and not the generation of the disability.

- The judicial commission of inquiry must be established to deal with the beneficiaries' identification criteria or strengthen the special pension fund to speed up the establishment of the war veteran database before paying out the benefits in the new veterans act. The further recommendation is that, the benefits should be paid in a sustainable manner which preferably should be in monthly amounts as opposed to lump sums which can be easily wasted. In case of the deceased, the dependants should be given educational funding and survival means as opposed to business opportunities which will translate to tenders which are not advisable for school going age youth.
- On the clean break principle which allows for the spouse of the member of a pension fund to withdraw his or her benefits upon the granting of decree of divorce. The dissertation views this newly court endorsed position as the wrong policy position which encourages matrimonial opportunism and the commercialisation of marriages, this is informed by the possibility of the member who has been contributing to pension for many years and about to retire getting married to an opportunist who intend to divorce him or her within a year solely to access pension benefits.
- The dissertation therefore recommends that, the clean break principle be reviewed to allow the immediate withdrawal of benefits upon divorce provided the spouse has been married to the member for a period of at least ten years. This proposal is informed by the spousal benefits on pension in the United States of America and is in the interest of low divorce rate.

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