

**Retirement reforms laws: A comparative study between  
South Africa and Chile.**

**BY**

**Michael Makebe Mamabolo**

**Mini Dissertation**

Submitted in fulfilment of the requirements for the degree of

**Masters of Laws (LLM)**

In the

**Faculty of Management & Law**

(School of Law)

**University of Limpopo**

(Turfloop Campus)

**Supervisor: Adv. LT Nevondwe**

**2015**

## **ABSTRACT**

This mini-dissertation discusses the retirement reforms laws. It analysis the comparative study between South Africa and Chile. South Africa had undergone the retirement reforms processes since 1992 when Mouton Commission of Inquiry was established and in 2002. Since then lot of discussion papers were finalised which mooted retirement reforms ranging from retirement reforms and social security, a safer financial sector to serve South Africa better, strengthening retirement savings, costs of retirement benefits. Chile is a country which is already ahead in their retirement reforms processes. This study seeks to evaluate the lessons which South Africa can learn from Chile so that they can fast-track their retirement reforms and re-write the new Pension Funds Act which incorporate both public and private sectors.

## DECLARATION BY SUPERVISOR

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

.....

**Adv. Lufuno Tokyo Nevondwe**

**March, 2015**

## DECLARATION BY STUDENT

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

.....

**Michael Makebe Mamabolo**

March, 2015

## DEDICATION

I dedicate this work to my late grandfather, Michael Mohlaume Mamabolo, and my family who encourage me in the compilation of this mini-dissertation.

## **ACKNOWLEDGEMENTS**

My work was made easier by the following persons:

My Supervisor Adv. Nevondwe who lectured me the basic principle of pension law, benefits, retirement and retrenchment

I wish to acknowledged Mr Obed Matlaila through his encouragement to pursue this mini-dissertation .Lastly to my wife and child in encouraging and helping at the time I was typing and producing this work i.e. Mpho (wife), child-Onthatile.

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1. Universal Declaration of Human Rights, 1948.
2. International Covenant on Economic, Social and Cultural Rights.
3. International Labour Organisation's Social Security (Minimum Standards) Convention No. 102 of 195
4. International Convention on the Elimination of All Forms of Racial Discrimination, 1979.
5. Convention on the Right of the Child.
6. The International Convention on the Protection of the Rights of all Migrant Workers and Members of their Families, 1990.
7. UN's Standard Rules on the Equalisation of Opportunities for Persons with Disabilities, 1993.
8. Convention Relating to the Status of Refugees, 1954.
9. Convention Relating to the Status of Stateless Persons (Stateless Persons Convention), 1967.
- 10.e African Charter on the Rights and Welfare of the Child, 1990.
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1. *Cockcroft v Mine Employees' Pension Fund'* [2007] 3 BPLR 296 (PFA *Robinson v Central Retirement Annuity Fund* [2001] 10 BPLR 2623 (PFA)).
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## CHAPTER ONE: INTRODUCTION

### 1.1. Historical background to the study

According to Olivier, Okpaluba, Smit and Thompson “the right to social protection is a fundamental human right in all modern states and an essential mainstay of society. There are many different social security systems, covering various social problems. Whatever their distinctions, all are intended to guarantee an income to those who are for one reason or other, are no longer able to earn a living, alleviate deprivation, or insure against adversity. Whatever the technique used, whether the emphasis is on insurance rather than on social assistance, social security is always based on solidarity”<sup>1</sup>

According to Olivier and Mpedi “social security is an umbrella concept, which from a South African perspective includes social assistance and social insurance. The South African Constitution, 1996 (the Constitution), seems to view social security as such an umbrella concept, encapsulating amongst other aspects, the notion of social assistance and, one could say, also social insurance”.<sup>2</sup>

Olivier opined that the human rights abuses characteristic of the previous political dispensation in South Africa have led to the adoption of two powerful conceptual approaches when the interim and eventually the final

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<sup>1</sup> Olivier, Okpaluba, Smit and Thompson *Social Security Law General Principles* Butterworths 1999

<sup>2</sup> Olivier MP and Mpedi LG *Understanding Social Security Law* Juta Law 2009.

Constitution were deliberated: constitutionalism and the entrenchment of fundamental rights. Based on a broad consensus amongst the constitutional drafters it was accepted that these approaches were necessary in order to avoid a repeat of and to redress past injustices, on the one hand, and to forge a new culture of accommodation, mutual respect, equality and freedom in South Africa, on the other <sup>3</sup> The Preamble to the final South African Constitution (the Constitution) bears clear testimony to this. And in one of its first judgments the Constitutional Court had this to say (*S v Mhlungu* <sup>4</sup>(para 111):

...the Constitution introduces democracy and equality for the first time in South Africa. It acknowledges a past of intense suffering and injustice, and promises a future of reconciliation and reconstruction...

Section 27(1) (c) of the South African Constitution, 1996 provides that everyone has the right to have access to social security. This section is the one which supported the right of everyone to have access and participate in retirement funding systems. Social security is divided into two parts, namely social assistance and social insurance. For the purposes of this research, focus is on the social insurance (retirement funding systems). Social insurance is a form of insurance which is contributory in nature.

For consideration for membership, there is a compulsory or mandatory contribution monthly which need to be made by the participants <sup>5</sup> The State has an obligation in terms of section 27(2) of the Constitution to develop policies and legislations which are aimed at realising the right of access to

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<sup>3</sup> Olivier M Constitutional perspectives on the enforcement of socio-economic rights: recent South African experiences 2002 Victoria University of Wellington Law Review Vol 33 117.

<sup>4</sup> 1995) (3) SA 867 (CC); (1995) (7) BCLR 793 (CC).

<sup>5</sup> Strydom Le Roux and Landman Essential Social Security Law Juta and Co Ltd 2005).

social security. This right is an important one and if realised it will go a long way to reduce poverty and old age people to rely on government grants <sup>6</sup>

Modern pension funds owe their existence largely to the industrial revolution and the social and technological advances that have since taken place. Although pensions had been paid in one form or another for hundreds of years prior to these advances, particularly in Europe, employees tended to work throughout their lives, and in infirmity were cared for by their extended family unit or by the local community <sup>7</sup> For example, retiring generals were often given gifts of land or cash by way of payment for loyal service, and the servants of landed gentry were often rewarded in a similar fashion when they were no longer able to carry out their duties effectively.<sup>8</sup>

The industrial revolution saw a major change in the nature of society and the start of mass urbanization. Industrial employers took over the role of work and sustenance provider, and the village and family unit was gradually broken down. As time went on, employers needed to strive for business efficiency and productivity which led to a shorter effective working life, and it was not too long before the more socially conscious employers recognized a need to make provision for those employees who had given them good service but had become too old to keep up with the physical pressures of work in a factory. <sup>9</sup>

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<sup>6</sup>Hanekom K and Marx GL *The Manual on South African Retirement Funds and other Employee Benefits* Lexis Nexis 2008.

<sup>7</sup> Jeram N *Introduction to South African Pension Law* 4 (Office of the Pension Funds Adjudicator 2005).

<sup>8</sup> *Ibid.*

<sup>9</sup> Nevondwe LT and Mhlaba MW *Judicial Activism and Socio-Economic Rights in South Africa* 212 (Lambert Academic Publishing Germany 2012).

Around the early 1920s, governments also saw the advantage of encouraging more formal arrangements as society became more dependent on savings made during employment as a means of survival in old age, rather than reliance on the family or community unit. They also realised, however, that some form of control over how pensions were being provided was necessary, and so, with the introduction of tax incentives to encourage the growth of savings for old age, they used their respective tax legislation to establish rules regulating retirement benefits. This resulted in a rapid increase in the number of employers providing properly funded and secure retirement benefits.<sup>10</sup>

The South African retirement funding system was formalised as early as the 1950's through the enactment of the *South African Pension Funds Act*, 24 of 1956. The Act came into operation during the apartheid era and offered little relief to the majority of the members of retirement, provident and pension funds and this automatically calls for a plethora of reforms in this regard<sup>11</sup>. According to Nevondwe it is almost 58 years since the Act was enacted and lot of changes have occurred in the post-apartheid South Africa since 1994 which necessitate the requirement to overhaul the retirement funding systems.<sup>12</sup>

The White Paper on South African Social Welfare Policy provides that social security covers a wide variety of public and private measures that provide

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<sup>10</sup> (Nevondwe LT and Mhlaba MW *Judicial Activism and Socio-Economic Rights in South Africa* 213 (Lambert Academic Publishing Germany 2012).

<sup>11</sup>Nevondwe L "South African Social security and retirement reform: a long journey towards the redrafting of the New Pension Funds Act" 2010 *Pension and International Journal* Vol 15(4) 287

<sup>12</sup> Nevondwe L "South African Social security and retirement reform: a long journey towards the redrafting of the New Pension Funds Act" 2010 *Pension and International Journal* Vol 15(4) 287.

cash or in kind benefits or both. The provision of these measures takes place, first, in the event of an individual's earning power permanently ceasing, being interrupted, never developing or being exercised only at unacceptable cost and such person being unable to avoid poverty.<sup>13</sup>

The White Paper defines the domains of social security as poverty prevention, poverty alleviation, social compensation and income distribution. The White Paper further defines social security as policies which ensure that all people have adequate economic and social protection during old age by means of contributory and non-contributory schemes for providing for their basic needs. At the International arena, the International Labour Organisation (ILO) Convention, Social Security (minimum standards) 102 of 1952 defines social security, as the protection which society provides for its members through a series of public measures against economic and social distress that would be caused by the stoppage or substantial reduction of earnings resulting from sickness, death and old age.

The Committee of Inquiry into a Comprehensive System of Social Security for South Africa – *Transforming the Present, Protecting the Future*, in its 2002 Report, provided a thorough review of strengths and shortcomings in the existing social protection arrangements. The so-called Taylor Report explicitly outlined recommendations for broadening social insurance and the implementation of a comprehensive and integrated medium- to long-term framework for income support.

In 2004, the National Treasury (NT) issued a first discussion paper titled "Retirement Reform" (hereinafter referred to as the "2004 paper"). The

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<sup>13</sup> The White paper was published in 1997.

objectives of the 2004 paper had been amongst others, (a) to encourage individuals to provide adequately for their own retirement and the needs of their dependants, (b) encourage employers and employees to provide for retirement funding as part of the remuneration contract, (c) to ensure that retirement funding arrangements would be cost-efficient, prudently managed, transparent and fair, (d) to promote the retention of purchasing power of pensions by ensuring adequate protection against the effects of inflation, within the resource constraints of the fund, (e) improve standards of fund governance, including trustee knowledge and conduct (f) protection of members' interest, (g) accountability, and disclosure of material information to members and contributors, and lastly but not least, (h) to provide, through social assistance, an assured basic income entitlement to elderly persons without means.<sup>14</sup>

In 2007, the NT issued a second discussion paper titled "Social Security and Retirement Reforms" (hereinafter referred to as the "2007 paper") which outlined seven proposals which amongst others included the governance of retirement funds, reform of the taxation system, establishment of a single fund for all South Africans called National Social Security Provident Fund, wage subsidy and the scrapping of the means test which was used for the old age grant. In South Africa social assistance is subject to means testing which implies that the South African Social Security Agency (SASSA) established in terms of the Social Assistance Act, 13 of 2004 evaluates the income and assets of the person applying for social assistance in order to determine whether the person's means are below a stipulated amount. The means test according to SASSA is a way of determining whether a person qualifies to receive a grant, as grants have been meant for those who most need them.

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<sup>14</sup> Retirement Reform discussion paper, 2004.

The means test varies from one grant to another. Other grants beside the old age grant include inter alia the child support grant and the disability grant.<sup>15</sup>

Since 2007, the NT has issued numerous papers which were aimed at encouraging the preservation of retirement benefits, portability and governance of retirement funds, strengthening retirement savings, twin peak model to overhaul the financial sector to serve South Africa better and reduction of the costs of retirement funding.

## **1.2. 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 favourable 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.

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<sup>15</sup> Social Security and Retirement Reform discussion paper, 2007.

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 behaviour 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 poor preservation of pension savings. Compulsory preservation principle needs to be introduced to encourage a culture of savings.

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 in retirement funds. This study will assist them to understand their rights and how the social security and retirement laws will be reformed to address their challenges.

### **1.3. Research question**

How can retirement funding systems in South Africa be improved through the retirement reforms?

#### 1.4. Literature Review

Retirement reforms come into existence as a result of pension funds and the role they play in the South African economy. Government encourages pension funds to provide members with cost-effective risk benefits; it views the main role of pension funds as making possible life cycle savings to support consumption in retirement.<sup>16</sup>

Preservation, portability and governance for retirement funds discussion paper further highlighted that this problem of leakage is a significant weakness in the retirement provision system and also has major negative implications for the country's long-term savings. Unfortunately it is also quite prevalent, especially among the youth.

Government intend to reduce retirement fund costs, improve efficiency and good governance through consolidation of private-sector retirement funds and address any gaps exposed by the global financial crisis, promoting financial inclusion and stability, and encouraging prudential activity that improves market conduct.<sup>17</sup>

Not only have there been a plethora of amendments to the Pension Funds Act, but a number of South African commissions have investigated the intricacies of retirement funding and provided their assessment. They include, with varying emphases: the Mouton Commission (1992), Katz Commission (1995), Smith Commission (1995), National Retirement Consultative Forum (1997), and the Taylor Committee (2002).The recommendations of these

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<sup>16</sup> National Treasury, Preservation, portability and governance for Retirement Funds discussion paper, 2012.

<sup>17</sup> National Treasury, Strengthening Retirement Savings, 2012

committees and commissions need to be taken into account when the new Bill is enacted in order to broaden the discussions on retirement reforms laws.

According to the 2007 paper, South Africa needs to introduce mandatory participation to retirement funds and compulsory preservation of retirement benefits to ensure that retirees can sustain themselves after retirement.<sup>18</sup>

The 2007 paper further indicated that a well-established case for the collective provision of basic insurance against catastrophic events, such as death, disability and unemployment, through a mandatory social security arrangement would need to be made. Mandatory, universal participation in a pooled social insurance arrangement recognises that those who are most vulnerable will tend to be excluded if participation is subject to choice or selection.

Preservation, portability and governance for retirement fund discussion paper further stipulates that the wide-range of proposals to reform retirement funding systems is an indication that government is committed in increasing the financial security of all citizens. The introduction of compulsory preservation of retirement benefits is a step in the right direction. A substantive number of South Africans reach retirement financially unprepared. Only half the country's workers belong to a retirement fund. Only a small fraction being ten percent (10%) of the country's workers is 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. Although the preservation requirement is not yet implemented, it is recommended that its implementation should be fast-

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<sup>18</sup> National Treasury, Social Security and Retirement Reforms, 2007.

tracked, but done correctly within a reasonable time frame and with thorough consultations with all stakeholders concerned.<sup>19</sup>

The South African retirement industry is one of the largest contributors to the country's economy and the writer opined that its proper governance is of paramount importance. The 2007 PF Circular 130 on good governance of retirement funds issued by the Financial Services Board is welcomed as it aims to strengthen fund governance. One of the features of the PF Circular 130 is to introduce the statutory requirement that trustees be "fit and proper", with no criminal history (National Treasury, (2012) Strengthening savings, an overview of the proposals announced in 2012 budget.<sup>15</sup> In this regard, the 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.

The population size of South Africa has increased noticeably from 40,5 million in 1996, to 44,8 million in 2001, and then to 51,8 million in 2011 (Statistics South Africa, (2012)The time is right for bold new steps to be taken in improving income security of the workers and strengthening the fabric of social solidarity that binds all South Africans together.

Nevondwe and Odeku has highlighted on how the Office of the Pension Funds Adjudicator (OPFA) must be transformed to expand its adjudication of complaints to the whole retirement industry.<sup>20</sup> The performance of OPFA in resolving disputes in the private sector so far should be commended even

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<sup>19</sup> National Treasury, Strengthening Retirement Savings, 2012.

<sup>20</sup> Nevondwe L and Odeku K "An analysis of the role of the Pension Funds Adjudicator in South Africa" 2013 East Asian Journal of Business Economics, Vol 13 825.

though there are delays in resolving complaints in some of the complaints.<sup>21</sup> It is evident that the OPFA is committed to resolving complaints in a procedurally fair, economical and expeditious manner. However, more still needs to be done especially to reduce delays in the processing of complaints, increasing the accessibility to and awareness of members of pensions fund about the services of the OPFA <sup>22</sup>

The role of the OPFA is critical in protecting members of the retirement funds. However an alarming concern relates to the fact that currently the Adjudicator has jurisdiction only in funds which are registered with the Registrar of Pension Funds in terms of the Pension Funds Act<sup>23</sup>. The Adjudicator lacks jurisdiction on the Government Employees Pension Fund (GEPF) which has more than 1, 16 million contributing members and 311 345 pensioners and beneficiaries, the Transnet Pension Fund and South Africa Post Office Retirement Fund<sup>24</sup>. This creates a concern since members of the above fund do not have recourse as they have to contact the fund directly if they are not satisfied with the benefits they have received<sup>25</sup>.

According to Marumoagae "section 7C(2) of the Pensions Fund Act outlines the general duties of the boards of retirement funds<sup>26</sup>. Over the years there

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<sup>21</sup> Nevondwe L and Odeku K "An analysis of the role of the Pension Funds Adjudicator in South Africa" 2013 East Asian Journal of Business Economics, Vol 13 825.

<sup>22</sup> Pension Funds Adjudicator (PFA) Annual Report 2011/12).

<sup>23</sup> Nevondwe L "The law regarding the division of the retirement savings of a retirement fund member on his or her divorce with specific reference to *Cockcroft v Mine Employees' Pension Fund*<sup>23</sup> [2007] 3 BPLR 296 (PFA)" 2009 Law, Democracy and Development Vol 13 2-3.

<sup>24</sup> Nevondwe L "The law regarding the division of the retirement savings of a retirement fund member on his or her divorce with specific reference to *Cockcroft v Mine Employees' Pension Fund* [2007] 3 BPLR 296 (PFA)" 2009 Law, Democracy and Development Vol 13 2-3.

<sup>25</sup> Nevondwe L "The law regarding the division of the retirement savings of a retirement fund member on his or her divorce with specific reference to *Cockcroft v Mine Employees' Pension Fund* [2007] 3 BPLR 296 (PFA)" 2009 Law, Democracy and Development Vol 13 2-3.

<sup>26</sup> (Marumoagae MC "Do boards of trustees of South African retirement funds owe fiduciary duties to both the funds and fund members? The debate continues" 2012 Potchefstroom Electronic Journal Vol 15 554.

has been much debate in the retirement fund industry as to whom the board, as the managing body of the retirement fund, is accountable<sup>27</sup>.

According to Nevondwe members of the pension funds contribute to pension, provident or retirement annuity funds and some people save enough in this way to be able to live adequately in retirement<sup>28</sup>. When the members have contributed in this way, the Pension Funds Act provides them with particular rights towards their specific fund, for example, members of the fund have the right to elect at least 50% of the members of the board of trustees. Whilst the rights of members exist, the boards of trustees, on the other hand, are entrusted with a duty to properly administer the pension funds on behalf of members. Trustees are expected to act in good faith and protect the interest of the members<sup>29</sup>.

According to Nevondwe, Odeku and Matotoka the trustees are confronted with many difficult decisions on a regular basis and required to have knowledge and understanding of the legal framework in which they operate under as well as the rights of the members under that particular legal framework<sup>30</sup>. At the core of the Pension Funds Act, lie the rights of the members and trustee duties, which are two fundamental aspects and play a significant role for the proper administration of the fund and protection of member's interest. Often these two aspects are in conflict with each other and thus become necessary, for the development of the pension law jurisprudence, to determine whether the trustees' duties supersede the

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<sup>27</sup> (Marumoagae MC "Do boards of trustees of South African retirement funds owe fiduciary duties to both the funds and fund members? The debate continues" 2012 Potchefstroom Electronic Journal Vol 15 554.

<sup>28</sup> (Nevondwe L "South African Social security and retirement reform: a long journey towards the redrafting of the New Pension Funds Act" 2010 Pension an International Journal Vol 15(4) 287).

<sup>29</sup> Nevondwe L "South African Social security and retirement reform: a long journey towards the redrafting of the New Pension Funds Act" 2010 Pension an International Journal Vol 15(4) 289.

<sup>30</sup> Nevondwe L, Odeku K and Matotoka M "The governance of the retirement funds in members rights and trustees duties in South Africa: A lesson learnt from USA, UK and Malawi" 2013 East Asian Journal of Business Economics Vol 3 56.

member's rights or whether member's rights supersede trustee's duties. It is evident that these two aspects complement each other, but the cardinal question that remains is that where should the emphasis be when these aspects are in conflict with each other<sup>31</sup>.

According to Nevondwe *et al* the question arises whether pension fund trustees in South Africa are sufficiently competent to safeguard all the moneys belonging to members<sup>32</sup>. According to Sigwadi this question is particularly compelling as there are cases in which trustees have been found not to be acting in the best interests of the members, but for their own personal gain and other ulterior motives<sup>33</sup>. It is therefore evident that trustees must be persons who are trustworthy and have the best interest of the members at heart.

It is recommended that the trustees must familiarize themselves with the provisions of the Act and rules of the fund in order to take informed decisions that protect the interest of the members. To become a trustee, it is not required by the Act that there should be qualifications or a particular experience. This is rather troubling as trustees are being asked to take crucial investment decisions, yet many lack resources and expertise<sup>34</sup>.

According to Nevondwe the primary object of a pension fund organisation as defined in the Pension Funds Act read with the Income Tax Act is to provide benefits to members of retirement funds when they retire from

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<sup>31</sup> (Nevondwe L, Odeku K and Matotoka M "The governance of the retirement funds in members rights and trustees duties in South Africa: A lesson learnt from USA, UK and Malawi" 2013 East Asian Journal of Business Economics Vol 3 56).

<sup>32</sup> Nevondwe L, Odeku K and Matotoka M "The governance of the retirement funds in members rights and trustees duties in South Africa: A lesson learnt from USA, UK and Malawi" 2013 East Asian Journal of Business Economics Vol 3 55-70.

<sup>33</sup> Sigwadi M "The personal liability of pension fund trustees for breach of fiduciary duties" 2008 SAMLJ Vol 20 33.

<sup>34</sup> Sigwadi M "The personal liability of pension fund trustees for breach of fiduciary duties" 2008 SAMLJ Vol 20 33.

employment upon reaching their retirement age<sup>35</sup>. The reality is that a member may die before he retires in which case the pension fund must pay the benefit to the member's dependants and nominees. Section 37C of the Pension Funds Act deals with the distribution and payment of the death benefits. Section 37C leaves the trustees with the discretion to distribute the benefit fairly and equitably. This raises concerns on what is fair and equitable.<sup>36</sup>

Recently in late 2013, the Financial Services Laws General Amendment Act<sup>37</sup>, was promulgated which also amends the Pension Funds Act. The amendments of the Act in piecemeal do not solve the retirement funding problems. These problems need to be addressed holistically and covers all the problems areas.

### **1.5. Primary and secondary research objectives**

The primary objective of this research is to determine to what extent the retirement funding systems can be improved by a retirement reform framework. In reaching the primary objective, the following secondary research objectives are to:

- (a) evaluate the literature on social insurance as part of social security;
- (b) evaluate literature on retirement reforms laws in SA;
- (c) review retirement legislations, regulations, guidelines and discussion papers;

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<sup>35</sup> (Nevondwe L "The distribution and payment of a death benefit in terms of section 37C of the South African Pension Funds Act, 24 of 1956" 2010 Pensions an International Journal Vol 15(1) 38-48.

<sup>36</sup> Nevondwe L "The distribution and payment of a death benefit in terms of section 37C of the South African Pension Funds Act, 24 of 1956" 2010 Pensions an International Journal Vol 15(1) 38-48.

<sup>37</sup> Act, 45 of 2013

- (d) compare and contrast South African and Chile retirement reforms and outlines good lessons learnt;
- (e) critique the current retirement funding systems and its challenges, particularly the fact that 50 percent of the workforce in SA are not part of the retirement funding and 10 percent of retirees are retired when they are financially prepared while 90 percent are financially unprepared; and
- (f) critique the idea of compulsory retirement savings when members change jobs or withdraw from the retirement fund prior reaching retirement age;
- (g) propose the new retirement legislation which incorporate both public and private and overhaul of the current retirement legislations;
- (h) evaluate the role played by relevant stakeholders including the NT, Financial Services Board (FSB), Department of Social Development (DSD) and South African Revenue Services (SARS) in terms of initiating the passing of laws which would be in favour of social protection and fiscal sustainability;
- (i) assist students from various fields with special focus being but not limited to social security law, tax law, actuarial science, pension law, labour law, insurance law and economics to add new literature in their studies;
- (j) benefit government through the NT, DSD, FSB, retirement funds industry members of the Pension Lawyers Association, Principal Officers Association, Institute for Retirement funds, insurance companies which offers retirement annuities, administrators of pension funds, trustees, advisors, civil society organizations and members of the public; and
- (k) assist young and emerging academics who intend to study, research and write further in this topic to bring insight into their future research endeavours.

## **1.6. Research methodology**

This research entails an analytical literature study of recent and relevant literature that is applied in a critical and integrated manner and presented as a well-integrated literature review. The research methodology used in this study is qualitative as opposed to quantitative. This research is library based and reliance is on library and online 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 the retirement reforms and the lessons which can be drawn from Chile which is ahead of South Africa on the provision of retirement funding. The study established the development of legal rules, the interaction between law and social justice, and proposed solutions or amendments to the existing law based on practical or empirical and historical facts. Concepts were analysed and arguments based on discourse analysis were developed.

## **1.7. Points of departure and assumptions**

### **Points of departure**

According to the 2004 paper, the retirement funding system has been in place for a long time, and has an established body of legislation governing it, principally codified in the Pension Funds Act. Over the course of the past 58 years there have been numerous amendments to the Act, which were made on an *ad hoc* manner. Some of the amendments introduced features such as member-elected trustees, the Pension Funds Adjudicator, minimum benefits, surplus apportionment, time-barring and prescription of pension funds complaints, beneficiary funds, and the clean-break principle. Therein however lays one of the reasons for a review of the current legislation, there is a need for careful review to ensure consistency and to resolve the problems

which have been worsened by the “piecemeal” addition of a variety of measures.

## **Assumptions**

Retirement legislations require an overhaul to ensure consistency in application and for it to be aligned with proper governance. It is evident that lessons can be learnt from the Department of Trade and Industry which overhauled the Companies Act of 1973 which was a vigorous exercise and a lengthy process. It is clear that the ideals of the 2004 paper and the 2007 paper were not in sync. The 2007 paper had anticipated that new legislation would be promulgated by 2010, however, the deadline has since passed and currently, four years later, it appears that the Bill has still not been initiated in parliament. A review of the Act should aim at consolidating and integrating retirement funding arrangements, while also contributing to a more consistent and coherent structure and regulation of the broader retirement funding system in South Africa.

### **1.8. Scope and limitations of the study**

The first chapter is the introduction which lays down the foundation of the study while the second chapter will discuss the right to social security. The third chapter will discuss the retirement reforms laws while fourth chapter will discuss the comparative study between South Africa and Chile. The last chapter will evaluate the conclusion drawn from the whole study and makes recommendations.

## CHAPTER TWO: THE RIGHT TO SOCIAL SECURITY

This chapter focuses on the right of everyone to have access to social security, including, if they are unable to support themselves and their dependents, appropriate social assistance.<sup>38</sup> It further focuses on policies and legislations which have been passed by parliament prior to 1994 and after. It also focuses on childrens' rights to social services<sup>39</sup> and international covenants which deal with the right of access to social security. This chapter will also highlight the achievement which has been made since 1994 by the government to address the right of everyone to have access to social security and the effects of corruption on social grants.

This chapter will also discuss social insurance, which includes among others, the pension fund schemes, retirement annuities and those pension schemes or provident fund which an individual elects so that it can assist him or her when he or she retires. The legislations which will be considered will be the Pension Funds Act<sup>40</sup>, Income Tax Act<sup>41</sup> and the Government Employees Pension Law.<sup>42</sup>

The term "social security" was first officially used in the title of the United States legislation-the Social Security Act of 1935. That Act initiated programmes to meet the risks of old age, death, disability and unemployment.<sup>43</sup>

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<sup>38</sup> Section 27 (1)(c) of the Constitution.

<sup>39</sup> Section 28 (1)(c) of the Constitution.

<sup>40</sup> Act, 24 of 1956.

<sup>41</sup> Act, 58 of 1962.

<sup>42</sup> Proclamation No. 21 of 1996.

<sup>43</sup> Okpalupa, MC, *Law and Contemporary South African Society* (2004), 187.

Social security is one of the important aspects of socio-economic rights. The Majority of poor South Africans are enjoying the benefits of this right.<sup>44</sup> During the apartheid era, social security benefited the majority of white people. After 1994, South Africa become a democratic State and adopted the Constitution<sup>45</sup>. There are three core values of our Constitution, which includes *inter alia*, equality, human dignity and freedom. <sup>46</sup>

Another important section of the Constitution which also protects the right to social security is the right to equality. Everyone is equal before the eyes of the law and all people are entitled to the equal benefit of the law.<sup>47</sup> No one may unfairly discriminate either directly or indirectly against anyone on the listed grounds of race, gender, sexual orientation, marital status, belief, political opinion, culture, language, birth, pregnancy, HIV / Aids status and etcetera.<sup>48</sup>

Section 9(1) has been operationalised by Promotion of Equality and Prevention of Unfair Discrimination Act (PEPUDA).<sup>49</sup> This piece of legislation was necessitated by section 9(4) of the Constitution.<sup>50</sup> This equality clause has changed the old system during the apartheid regime where the application of social security between the blacks and the whites were different. Whites were having too lucrative benefits as compared to the blacks.

The term “social security” appeared again in an Act passed in New Zealand in 1938 which brought together a number of existing and new social security benefits. It was used in 1941 in the wartime document known as the Atlantic

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<sup>44</sup> The ANC policies have pushed back the frontiers of poverty. In 1996, only 3 million people, had access to social grants. Today 12.5 million receive social grants. In 1996, only 34,000 children had access to social grants. Today nearly 8 million children younger than 14 years, receive social grants (ANC Election Manifesto, 2009).

<sup>45</sup> Act, 108 of 1996.

<sup>46</sup> Liebenberg, Poverty and Equality Hearings Social Security Themes (1983), 3.

<sup>47</sup> Section 9 (1) of the Constitution.

<sup>48</sup> Section 9 (3) of the Constitution.

<sup>49</sup> Act, 4 of 2000.

<sup>50</sup> Section 10 of the Constitution.

Charter.<sup>51</sup> The International Labour Organisation (ILO) was quick to adopt the term, “impressed by its value as a simple and arresting expression of one of the deepest and most widespread aspirations of people all around the world”.<sup>52</sup> The ILO Convention 102 is a landmark source in international social security legislation.<sup>53</sup> However none of the ILO Conventions that deal specifically with social security actually defines the term. The conventions focus rather on the various contingencies and on the benefits that must be provided in respect of these contingencies.<sup>54</sup>

The ILO has attempted to define social security as follows:

“the protection which society provides for its members, through a series of public measures, against the economic and social distress that otherwise would be caused by the stoppage or substantial reduction of earnings resulting from sickness, maternity, employment injury, unemployment, invalidity, old age and death, the provision of medical care, and the provision of subsidies for families with children”.<sup>55</sup>

Interestingly, none of the ILO Conventions that deal specifically with social security actually defines the term. The Conventions focus rather on the various contingencies and on the benefits that must be provided in respect of these contingencies.<sup>56</sup>

The omission was probably intentional, as it would have been extremely difficult to define social security in globally acceptable terms in these international instruments. Different historical factors, socio-economic and labour market policies have caused nations to deal differently with the various elements of social security. Accordingly, countries often differ on the

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<sup>51</sup> This Charter had been signed in 1941.

<sup>52</sup> ILO (Geneva) *Introduction to Social Security* (1989) 3.

<sup>53</sup> Blanpain, R *International Encyclopaedia of Laws: Social Security Law*, ILO 12.

<sup>54</sup> Strydom et al op cit 4.

<sup>55</sup> ILO (Geneva) *Introduction to Social Security Law* (1989) 3.

<sup>56</sup> Strydom, E M L, *Essential Social Security Law* (2006) 4.

specifics of social security such as the nature, size and duration of the benefits attached to these contingencies.<sup>57</sup>

There is no uniform definition of the concept 'social security' in South African law. Within the South African context the White Paper on Social Welfare<sup>58</sup> describes the concept and its aims as follows:

Social security covers a wide variety of public and private measures that provide cash or in-kind benefits or both, first, in the event of an individual's earnings power permanently ceasing, being interrupted, never developing, or being exercised only at unacceptable social cost and such person being unable to avoid poverty and secondly, in order to maintain children. The domains of social security are: poverty prevention, poverty alleviation, social compensation and income distribution.<sup>59</sup>

The White Paper defines social security as follows:

Policies which ensure that all people have adequate economic and social protection during unemployment, ill health, maternity, child rearing, widowhood, disability and old age, by means of contributory and non-contributory schemes for providing for their basic needs. State social assistance (grants) includes the following four categories of benefits: those associated with old age, disability, child and family care and relief for the poor. The term social security and social protection are used interchangeably. Social protection refers to income protection programmes.<sup>60</sup>

There is a variety of strands or categories of social security. Some of the strands are financed through taxes while others are financed through contributions. Some of the strands restrict benefits to those members of society that comply with a means test while others restrict benefits to employees. The various strands also provide assistance in respect of different contingencies. There are strands that cover contingencies linked to employment, such as employment or unemployment.

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<sup>57</sup> Strydom, E M L, op-cit at page 4.

<sup>58</sup> White Paper on Social Welfare (1997), Chapter 7: Social Security, 49 – 50.

<sup>59</sup> White Paper on Social Welfare, (1997), op-cit at page 49.

<sup>60</sup> GN 1108 in GG 18166 of 8 August 1997, Chapter 7.

Other strands cover contingencies that occur outside the workplace such as community crises caused by natural disasters or the hardships caused by governments. Social assistance and social insurance are the main strands of social security. Social assistance can be divided into two substrands, namely means-tested social assistance and national social assistance (also referred to as universal social assistance). There are other strands such as social relief, social compensation, social upliftment employer assistance and private's savings and insurance.

In general, the International community has been unable, because of lack of consensus, to take a position on whether a publicly funded health service should be extended free of charge only to particular groups, on the basis of need, or to everyone, as part of a comprehensive social security system.

The right to social security is enshrined in the Universal Declaration of Human Rights,<sup>61</sup> the International Covenant on Economic, Social and Cultural Rights<sup>62</sup> and in the International Labour Organisation's Social Security (Minimum Standards) Convention No. 102 of 1952, which has nine forms of social

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<sup>61</sup> Article 25, provides that everyone has the right to a standard of living adequate for the health and well-being of himself and of his family, including food, clothing, housing and necessary social services, and the right to security in the event of unemployment, sickness, disability, widowhood, old age or other lack of livelihood in circumstances beyond his control. Motherhood and childhood are entitled to special care and assistance. All children whether born in or out of wedlock, shall enjoy the same social protection.

<sup>62</sup> Article 9, states that the State Parties to the covenant shall recognise the right of everyone to social security, including social insurance. Article 10 also states that the State Parties to the covenant shall recognise that the widest possible protection and assistance should be accorded to the family, which is the natural and fundamental group unit of society, particularly for its establishment and while it is responsible for the care and education of dependent children. Marriage must be entered into with the free consent of the intending spouses. Special protection should be accorded to mothers during a reasonable period before and after childbirth. During such period working mothers should be accorded paid leave or leave with adequate social security benefits. Special measures of protection and assistance should be taken on behalf of all children and young persons without any discrimination for reasons of percentage or other conditions. Children and young persons should be protected from economic and social exploitation. Their employment in work harmful to their morals or health or dangerous to life or likely to hamper their normal development should be punishable by law. States should also set age limits below which the paid employment of child labour should be prohibited and punishable by law.

security: medical care; sickness benefit; unemployment benefit; old age benefit; employment injury benefit; family benefit; maternity benefit; invalidity benefit; and survivor's benefit.

The International Convention on the Elimination of All Forms of Racial Discrimination<sup>63</sup> requires social security to be guaranteed without discrimination, and the Convention on the Elimination of All Forms of Discrimination Against Women sets out the specific forms of social security which must, without discrimination, be provided to women. States Parties shall take all appropriate measures to eliminate discrimination against women in the field of employment in order to ensure, on a basis of equality of men and women, the same rights, in particular the right to social security, particularly in cases of retirement, unemployment, sickness, invalidity and old age and other incapacity to work, as well as the right to paid leave.<sup>64</sup>

Also binding on South Africa is the Convention on the Right of the Child, which obliges the State Parties to provide material assistance to support parents in their responsibilities towards children.<sup>65</sup> The International Convention on the Protection of the Rights of all Migrant Workers and Members of their Families, 1990, provides that migrant workers are entitled to receive equal treatment with nationals in social security and specific complementary rights.<sup>66</sup>

The UN's Standard Rules on the Equalisation of Opportunities for Persons with Disabilities, 1993 recommended that states should "ensure the provision of adequate income to persons with disabilities who, owing to their disabilities,

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<sup>63</sup> See article 5 (e) (iv).

<sup>64</sup> See article 11 (1) (e) of the Convention on the Elimination of All Forms of Discrimination against Women (CEDAW). On 18 December 1979, CEDAW was adopted by the United Nations General Assembly. It entered into force as an international treaty on 3 September 1981 after the twentieth country had ratified it. By the tenth anniversary of the Convention in 1989, almost one hundred nations have agreed to be bound by its provisions.

<sup>65</sup> See Article 27.

<sup>66</sup> See article 27, 45 and 54.

have temporarily lost or received a reduction in their income or have been denied employment opportunities”<sup>67</sup>

There are several treaties in the area of the protection of refugees. Some of these treaties deal with social security issues. These are the Convention Relating to the Status of Refugees,<sup>68</sup> the Protocol Relating to the Status of Refugees,<sup>69</sup> and the Convention Relating to the Status of Stateless Persons (Stateless Persons Convention).<sup>70</sup> These Conventions not only prohibit discrimination against refugees or other non-nationals on the basis of their status, but also require State parties to provide certain positive benefits to refugees on a par with nationals including social security.

There are also regional Covenants which provide for the right to social security. The African Charter on Human and Peoples’ Rights of 1981, omits the right to social security as a self-standing right, but includes, inter alia, facets of the right in the right to health, the rights of the aged and of those with disabilities to special measures of protection, and in the individual’s duty towards society.<sup>71</sup>

The African Charter on the Rights and Welfare of the Child (African Children’s Charter)<sup>72</sup> addresses various aspects of social security. The rights of the child which enjoy protection in terms of this instrument are the rights to survival, protection and development,<sup>73</sup> education,<sup>74</sup> health and health services and the right not to be exploited economically.<sup>75</sup> The Children’s Charter further

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<sup>67</sup> See rule 8 (1).

<sup>68</sup> 189 UNTS 150, entered into force on 22 April 1954 (South Africa acceded on 12 January 1996).

<sup>69</sup> 606 UNTS 267, entered into force 4 October 1967 (South Africa acceded on 12 January 1996).

<sup>70</sup> 360 UNTS 117, entered into force 6 June 1960. Not yet signed or acceded to.

<sup>71</sup> See articles 16, 18 (4) and 29.

<sup>72</sup> African Charter on the Rights and Welfare of the Child, 1990 OAU Doc CAB/LEG/ 24.9/ 49 (1990). South Africa ratified the Convention on 7 January 2000.

<sup>73</sup> Article 5.

<sup>74</sup> Article 11.

<sup>75</sup> Article 15.

contains a special provision regarding the social security rights of handicapped children.<sup>76</sup>

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<sup>76</sup> Article 13.

### CHAPTER THREE: RETIREMENT REFORMS

There are few scholars who wrote on retirement reforms and retirement fund law in general. There are a lot of policy documents which has been issued by National Treasury (NT) which will enrich the discussion. There are legislations and fund rules which critique the study. This research suggests the overhaul of the retirement funding system and the re-writing of the new Pension Funds Act which incorporate the public and private sector. The dilemma currently is that the public sector and private sector is regulated by different statutes which cause confusions. Some institutions which are public institutions are governed by the same law which governs the private sector. The case laws literature is enough to critique this topic.

Many institutional features of South African pension funds are designed to encourage individuals to save for retirement since majority of South Africans are not saving enough for retirement, they wait until they are nearer to retire. Pension fund membership is usually a condition of employment; the fund sets minimum contributions; contributions are deducted from gross salaries; and a board of trustees rather than individual fund members often make retirement fund investment decisions. According to the NT's, *Preservation, portability and governance for retirement funds* (2012:11) a glaring omission in law is that preserving retirement assets on change of job is not mandatory.

Nevondwe (2009) observes that retirement reform is a good sign and it proves that the government acknowledges the need to build better lives, alleviate poverty and implement a comprehensive social security system for the benefit of all South Africans. These critical steps by the government are necessary in building the nation.

There are seven proposals in the Social Security and Retirement Reform discussion paper and these proposals are based on the following two principal objectives of the government:

- to ensure a basic standard of living and to prevent destitution in old age or in circumstances of unemployment or incapacity partly or wholly through redistributive measures, and
- to encourage savings to provide for the replacement of income on retirement, disablement or death through long-term insurance arrangements.

### **State old age pension**

It is proposed that social assistance grants continue to be provided to the elderly, the disabled, children and care-givers. It is also proposed that either the threshold for the deduction of independent income from the grant be increased or the means test be scrapped. We opine that the scrapping out of the means test is vital because it does not work effectively and it encourages dishonesty. Nevondwe (2010:291) argues that the means test penalises the low-income earners for saving. It appears that South Africans will continue to receive SOAP when they retire, but it is not clear if they will also all get disability benefits or childcare grants if they have the means to survive without them. The SOAP amounts to R1260, 00 as at April 2013, this amount changes annually.

### **Wage subsidy**

Wage subsidies may be seen as prominent features of the employment and social protection policies in many countries. The government proposes to introduce an explicit wage subsidy and continuing minimum benefits through social assistance, rather than indirect cross-subsidisation. The wage subsidy

could take the form of a reimbursement to the employer in the form of a rebate or credit in the PAYE system.

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. 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. For 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.

The wage subsidy is intended to encourage employment creation and also to support a “living wage” in labour intensive sectors and low-wage occupations. According to Nevondwe (2010:291) 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.

### **Mandatory participation in a national social security system for all.**

According to Nevondwe & Ndaba (2012:23) this is the most controversial policy proposal and one that threatens the business of many providers of retirement funding products and services to the low-income, formally employed market.

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. It remains to be seen whether voluntary contributions by people employed in the informal sector will be feasible.

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. It is proposed in the 2007 Second Discussion Paper that compulsory preservation would apply to compulsory contributions.

According to Nevondwe & Ndaba (2012:24) the rate of contribution would be between 13 per cent and 18 per cent of after-tax wages (or between 11.5 per cent and 15 per cent of before-tax wages) up to a threshold of, say, R60 000 a year. If the percentage is 15 then, if you earn R70 000, you will be obliged to contribute 15 per cent 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.

Further according to Nevondwe & Ndaba (2012:24) the fact that the rate of compulsory contribution will depend on each contributor's rate of earnings means that the system will recognise the economic link between earned income and the affordability of benefits and will add both real and perceived value to the employment and remuneration contract.

If one earns less than the minimum taxable income (now R45 000 a year), his / her contributions to the social security fund would be paid by the state through the wage subsidy. This should mean that these new obligations do not increase the cost of the employment of low-income workers. This is one of the 'redistributive' elements of the overall proposal but entails an explicit subsidy rather than the cross-subsidy by some contributors of the cost of providing benefits to others.

South African Revenue Service (SARS) will need to undergo administrative reforms to enable it to maintain individual contributor records and ensure

efficient and reliable benefits administration although the latter could be conducted by the Social Security Agency. Nevondwe & Ndaba (2012:24) opines that the cost of this reform may, however, be offset 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.

And the reason for this proposal? The fact is that none of the South Africans save enough. South Africans underestimate the financial risks that they face and we put off making savings and investment decisions. Nevondwe & Ndaba observes that most of South Africans prefer default arrangements over those that require them to make a decision. The people who are most vulnerable will tend to be excluded if participation is subject to choice or selection. They are also the most vulnerable to the relatively high costs of private sector retirement funding arrangements, and therefore will benefit from the economies of scale that will be achieved.

For some reason, perhaps related to South Africans' national inferiority complex, South Africans seem to feel a little better if what is being proposed has been successfully tried out in other countries, especially western countries. In the light of this, many South Africans will take comfort from the fact that almost all members of the OECD, which comprises developed and middle-income countries, have some form of mandatory, earning-related provision, although there is variation in the measures used.

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 eight million tax-paying individuals and the Social Security Agency pays out nearly 12 million social security grants each month. According to Nevondwe & Ndaba, it is common cause that

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.

### **Mandatory participation in private occupational or individual retirement funds**

According to Nevondwe many employees do recognise the importance of retirement provision and state an intention to join a retirement plan or to increase their savings, however evidence shows that only a fraction do so in practice. They remain at the mercy of social assistance grants although there was an opportunity to make savings and prepare for an uncertain future.

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. Nevondwe & Ndaba opine that this should allow individuals to save to provide for an adequate income replacement after retirement. It is suggested that the individual's post-retirement saving should be reasonable in relation to their pre-retirement income.

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. 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. Unless this is made compulsory or at the election of individual members, Nevondwe & Ndaba opine that it

cannot be foreseen that funds will want to make these transfers because it will reduce their economies of scale.

### **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. Those tax incentives will not apply to contributions over a specified monetary cap.

### **Reform of the governance and regulation of the retirement funding industry**

Good governance and trust are the foundations of any sound retirement system. Members contribute in the present to save for the future. 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.

In 2007, the Financial Services Board 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 appraisal system for trustees. 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. Nevondwe & Ndaba welcomes the active support of both industry and union leaders to improve governance.

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.

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. 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.

According to Hunter 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. The high proportion of 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.”

To address these problems, the reform suggests a number of reforms such as –

- facilitating effective competition through increased transparency and disclosure, properly aligned incentive structures for intermediaries, removing regulatory barriers to the entry of a wider range of product providers and allowing transfers between funds and products without excessive penalty;
- achieving economies of scale by introducing accreditation standards that which should encourage, if not compel, the consolidation of smaller occupational retirement funds into “umbrella” or multi-employer funds;
- allowing a range of social security benefits to be provided by private retirement funds including short-term disability benefits, funeral benefits and post-retirement medical aid funding;
- protecting retirement savings from erosion by risk premium costs by setting minimum allocations of contributions to retirement savings, compulsory preservation and portability, regulated minimum early withdrawal benefits and restricted deductions;
- requiring the preservation of retirement savings on changes of employment through transfers to the employee’s new fund, an individual retirement fund or the national social security fund while possibly allowing withdrawals on loss of employment, possibly after the exhaustion of the unemployment insurance benefit;
- to the extent possible, ensuring continuing income during disablement and/or retirement and for the dependants of members after the death of those members, by requiring that a portion of the benefits be paid in the form of an annuity (although transitional provisions will be required to protect provident funds while they adapt) or that only so much as is not required to fund a multiple of the state old age pension be allowed to be withdrawn;

- improving the cost-effectiveness of annuity products by facilitating the wider provision of pensions by funds themselves, rather than by insurers, or by using an annuity provided by the national social security fund;
- protecting pensions from the ravages of inflation;
- achieving a better balance between the social service function provided by trustees in distributing death benefits and the need to ensure simplicity and speed in that distribution exercise;
- improving the security of dependants served by dependants' umbrella trusts through better oversight and possibly the establishment of dedicated "caretaker funds" regulated by the Financial Services Board;
- protecting unclaimed benefits through the establishment of a national Unclaimed Benefits Fund;
- regulating all retirement funds, including bargaining council funds and funds established in terms of specific statutes, in terms of a single Retirement Funds Act, extending the jurisdiction of the pension funds adjudicator to funds over which she does not now have jurisdiction and reforming the institution of the adjudicator's office. Currently the Adjudicator has jurisdiction only in funds which are registered with the Registrar of Pension Funds in terms of the Pension Funds Act 24 of 1956. The Adjudicator lacks jurisdiction on the Government Employees Pension Fund which has more than one million members, the Transnet Pension Fund and South Africa Post Office Retirement Fund. This creates a concern since members of the above fund do not have recourse since they have to deal with the fund directly if they are not satisfied with the benefits they have received.

## **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 deduction of up to 22.5% of their income if they are under 45 years of age and 27.5% if they are 45 years of age and above. According to Nevondwe and Ndaba (2012:29-30) this will apply to both employer and employee contributions.

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. The higher limits for older workers make allowance for those who did not save earlier in their lives.

According to the NT’s discussion paper on *strengthening savings* 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.

According to Hunter a number of inequities and complexities that need to be addressed in our tax system have been identified. At the same time the tax system needs to maintain sufficient incentives in place to encourage voluntary additional provision for retirement, particularly as

- the requirements and the costs of regulatory compliance by retirement funds is higher than the requirements and costs of such compliance by other savings vehicles;
- there are synergies between a robust pension environment and the development of financial markets that in themselves have further economic development benefits; and
- retirement savings institutions provide a stable long-term flow of funds, directed primarily to domestic investment, because funds seek to match their long-term liabilities with appropriate assets.

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. 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. Therefore, 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 and the national social security fund with such contributions being wholly or partially tax-deductible and, in the case of low-income workers, paid by means of the wage subsidy.

Higher-income earners have benefited disproportionately from tax incentives in the past without this serving any particular public purpose, so it is likely that there will be some form of monetary cap on tax relief on contributions to retirement funding vehicles.

There are a number of options in regard to the tax treatment of contributions that 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.

Hunter (2009:13) opines that a 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. 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.

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

The 2013 budget speech has indicated that the government intends to proceed with the implementation of tax-preferred savings and investment accounts. Accordingly, Tax-preferred savings and investment accounts will be introduced in 2015. The tax treatment of pension, provident and retirement annuity funds will be simplified and harmonized. However, with effect from 1 March 2013, tax-free interest-income annual thresholds has been increased from R33 000 to R34 500 for individuals 65 years and over, and from R22 800 to R23 800 for individuals below 65 years old.

## CHAPTER FOUR: COMPARATIVE STUDY BETWEEN SOUTH AFRICA AND CHILE

This study also focuses on the comparative study between South Africa and Chile since there are many lessons South Africa can learn from Chile. The paper chooses Chile because it has developed retirement funds legislations, experience, economic similarity and on-going retirement reforms which are at the implementation stage.

According to Nevondwe in his paper which was presented at a Law Week Conference, University of Limpopo titled "Social Security and Retirement Reforms" in 2009 retirement Reform is a good sign and it proves that the government acknowledges the need to build better lives, alleviate poverty and implement a comprehensive social security system for the benefit of all South Africans. These critical steps by the government are necessary in building the nation. Nevondwe and Ndaba suggests that retirement reforms continue to be a topical policy issue in most countries, including South Africa and Chile<sup>77</sup>. These reforms are necessitated by various factors associated with market imperfections, population dynamics, incomplete consumer information and literacy, low savings, investment risks, and the shortage of knowledgeable professional trustees.

The retirement reform is "one of the most difficult reforms in any economy". Chile, a country often used as a model for the South African social security system – is already in its fourth cycle of reform. The Chilean Pension Reform was introduced at the beginning of the 1980s 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. This is influenced by the fact that their populations are aging; and their systems

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<sup>77</sup> Nevondwe L and Ndaba M "South African social security and retirement reforms: recent developments" 2012 Insurance and Tax Vol 27 (4) 17).

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.

The Chilean reform includes the concept of individual capital accounts. This feature 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.<sup>78</sup>

South Africa should not aim to imitate international countries in its reform. Economies of each country differ tremendously and as a result each country should adopt reform features that are suitable to its own economy and standards. The real challenge for South Africa is to learn from these countries and adapt their best features in the construction of a solution for the very unique South African social, political and business landscape.

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 more than fifteen thousand registered pension funds in the country and each fund has its set of rules.

## **CHAPTER FIVE: CONCLUSIONS AND RECOMMENDATIONS**

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<sup>78</sup> Nevondwe L "South African Social security and retirement reform: a long journey towards the redrafting of the New Pension Funds Act" 2010 Pension an International Journal Vol 15(4) 290.

The wide-range of proposals to reform the retirement funds is an indication that Government is committed in increasing the financial security of all citizens. The introduction of compulsory preservations is a step in the right direction. A quite substantive number of South Africans reach retirement financially unprepared. Only half the country's workers belong to a retirement fund. Only a small fraction (10%) of the country's workers is 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. Although the preservation requirement is not yet implemented, it is recommended that its implementation should be fast-tracked, but done correctly within a reasonable time frame and thorough consultations.

The Second Discussion Paper titled Social Security and Retirement Reform which was published in 2007 provides that "these are reforms that will take several phases to be fully implemented. Their contribution to poverty reduction and income security will take time, their impact reinforced and magnified from one generation to the next. These are investments in social cohesion that will be felt long into the future, and we owe it therefore to our children to be vigorous and critical in our debate."

South Africa has a large and well-developed pension fund industry, which has grown in response to individuals' needs to save, to manage individual irrationality, and to provide a stable source of capital for domestic investment. However, the South African Government has become increasingly concerned about the low savings rate of South African households and their consequent lack of preparedness for retirement. To address these, effective policy must focus both on the preservation of accumulated pension savings to meet retirement needs, and the rate at which individuals access their funds at retirement. The low rate of savings and preservation of retirement benefits by retirees is a concern since majority of

retirees will have to rely on old-age grant for survival. The recent proposals made by the Minister of Finance, Pravin Gordhan in his Budget speech which suggests that old age grant will be available to all those who are 60 years of age or older and the means test will be scrapped off is not going to solve the problems of low savings. Considering the high inflation rate and the increases of prices every time, the old-age persons cannot sustain their lives with old-age grant since the amount attached to it is too little.

This study recommends that there is a need to reform the law of the retirement funding in South Africa since it does not reflect the aspirations of the new South Africa which is non-racial, non-sexism and have the supremacy of the Constitution and the rule of law. The retirement funding system does not cater the needs of the South Africans. The current retirement funding systems was relevant when the Pension Funds Act was promulgated in 1956 not now.

The study further recommends that the South African Parliament must consider introducing a new Bill which incorporate public and private pensions and abolish the status a quo which has different retirement funding systems for both public and private sector. This study further recommends to South African Government that these reforms are urgent since the retirement savings are not safe simply because the governance system of the retirement funds is weaker, taxation system is too high and the costs of retirement benefits is too high.

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