A legal analysis of the preservation of pension benefits under the South African law.

By

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ABSTRACT

Preservation occurs when money saved for retirement through pension, provident and preservation funds remains in those funds until the person retires, or is rolled over into another similar retirement savings vehicle without incurring taxes or penalties when a person changes jobs. This research focuses on legislative framework, preservation of pension benefits and retirement reforms. In future, retirement funds will be required to identify appropriate preservation funds for exiting members, who will be encouraged to preserve when changing jobs.

DECLARATION BY SUPERVISOR

I, **Adv. Lufuno Tokyo Nevondwe**, hereby declare that this mini-dissertation by **Kaizer Khomotjo Makhweshang Maloka** for the degree of Master of Laws (LLM) in Development and Management Law be accepted for examination.

……………………………………………

Adv. Lufuno Tokyo Nevondwe

November 2013

DECLARATION BY STUDENT

I, **Kaizer Khomotjo Makhweshang Maloka** declare that this mini-dissertation submitted to the University of Limpopo (Turfloop Campus) for the degree of Masters of Laws (LLM) in Labour Law has not been previously submitted by me for a degree at this university or any other university, that it is my own work and in design and execution all material contain herein has been duly acknowledged.

……………………………………….

Kaizer Khomotjo Makhweshang Maloka

November 2013

DEDICATION

I dedicate this work to my late mother Maloka Raesetja Noriah who gave me an opportunity to further my studies

ACKNOWLEDGEMENTS

To Almighty God thank you for giving me strengths and wisdom to complete this mini-dissertation. I acknowledge the assistance and guidance of my supervisor Adv. Lufuno Tokyo Nevondwe for his assistance and editing of this work.

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LIST OF ABBREVIATIONS

FSB	: Financial Services Board
PFA	: Pension Funds Adjudicator
DB	: Defined Benefit
DC	: Defined Contributions
GEPF	: Government Employees Pension Fund
TPF	: Transnet Pension Fund
POPF	: Post Office Pension Fund
SOAP	: State Old Age Pension
SCA	: Supreme Court of Appeal

TABLE OF STATUTES

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Financial Service Board Act, 97 of 1990

Government Employees Pension Law, Proclamation No. 21 of 1996

Transnet Pension Fund Act No: 62 of 1990

Divorce Act, 70 of 1979

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Post and Telecommunication Related matter Act, 44 of 1958

Post Office Act

TABLE OF CASES

*Eskom Pension and Provident Fund v Krugel and Another [*2011] 4 All SA 1 (SCA).

Rossow v Reid and Another, unreported South Gauteng High Court Case No: 50730/2007.

Cockcroft v Mine Employees' Pension Fund [2007] 3 BPLR 296 (PFA).

Wiese v Government Employees Pension Fund and Others [2011] 4 All SA 280 (WCC).

National Tertiary Retirement Fund v Registrar of Pension Funds, [2009] ZASCA 41 (31 March 2009).

Mathilda Louisa Wiese v Government Employees Pension Fund and Others, [1] Case CCT 111/11 [2012] ZACC5.

Ngewu and Another v Post Office Retirement Fund and Others, 2013 (4) BCLR 421 (CC).

Alexander v Printing Industry Pension Fund, [2000] 8 BPLR 835 (PFA).

Seroto v Protektor Pension Fund, [2001] 3 BPLR 1789 (PFA).

Mgulwa and Another v First National Bank Group Pension Fund and Others [1999] 12 BPLR 379 (PFA).

Human v Protektor Pension Fund [2001] 9 BPLR 2462 (PFA) at para 10.

Mgulwa and Others v First National Bank Pension Fund and Others, [1999] 12 BPLR 379 (PFA).

Cloete v Sasol Pension Fund and Others [2000] 11 BPLR 1210 (PFA).

CHAPTER ONE: INTRODUCTION

1.1. Historical background to the study

Preservation funds were formed in the early 1990s to enable a member of an occupational retirement fund to preserve his or her benefits for retirement if he or she resigned from a fund before his or her retirement age. A Preservation fund can be either a Preservation pension fund or a Preservation provident fund. There were initially two benefits in transferring the resignation benefits to a Preservation fund: Firstly, a member of a Preservation fund was to take one withdrawal from the fund before he retires.[1] Secondly, before 1 October 2007 the taxpayer could preserve his or her period of membership of the fund from which the transfer took place for income tax purposes. Before 1 October 2007 the member's period of membership was taken into account in determining the tax free portion of the lump sum from the fund.

South Africa has moved from a largely defined benefit (DB) retirement system, to a largely defined contribution (DC) system over the last 25 years. By many measures, the retirement system is a great success.[2] However, most South Africans do not save adequately for retirement and only about half the country's workers belong to a retirement fund.[3] The South African Government is committed to increasing the financial security of all citizens. To realise this, wide-ranging proposals to reform social security and retirement funds are being considered.[4] In the premise legislation in respect of retirement planning has been subject to numerous changes also over the last

[1] RF1 of 1998
[2] National Treasury, Charges in the South African Retirement funds, 11 July 2013, Page 15.
[3] Cronjé M, Creating a savings culture for the black middle class in South Africa - policy guidelines and lessons from China and India, , research project at the University of Stellenbosch Business School (USB), December 2009.
[4] This includes the National Treasury's discussion document, "A safer financial sector to serve South Africa better, National Treasury, Preservation, portability and governance of retirement funds, 21 September 2012, National Treasury , charges in the South African Retirement funds, 11 July 2013

few years, which also comprised of various amendments where preservation funds are concerned.[5]

Preservation in retirement funds was introduced in the 2012 budget speech by the Finance Minister, Pravin Gordhan.[6] In essence, preservation is triggered when pension and provident fund members leave their funds by changing jobs. To effectively enable preservation, the 2012 Budget Speech proposed that portability of pension benefits be provided for. Portability allows employees changing jobs to transfer accumulated pension benefits to their prospective employer's plan or to a preservation fund, or to leave retirement savings with their former employer. In his 2013 Budget Speech, the Finance Minister announced that retirement funds will be required to identify appropriate preservation funds for exiting members, who will be encouraged to preserve when changing jobs.

1.2. Statement of the research problem

Many South African workers do not safe enough for retirement. This is also perpetuated by the fact that the South African economy is characterised by income inequality. The majority of the population has very little income. Much of their concern is immediate survival and they show a high propensity to consume rather than to save for the future.

In addition to the above, the Pension Funds Act[7] does not provide adequate measures to promote a culture of saving amongst South Africans. This is evident from the fact that the Act does not make preservation of pension benefits compulsory in South Africa

[5] Muller C, Preservation Funds: An Over view, Insurance and Tax Journal 2012.
[6] Nevondwe L, Preservation of pension benefits under the South African law, Insurance and Tax Journal, Vol 28 No.3, September 2013, p16.
[7] Act, 24 of 1956.

1.3. Literature review

The definition of preservation becomes necessary to this study as it would contribute significantly to its better understanding. The Oxford dictionary refers to the term 'preservation' as 'the act of keeping something in its original state or good condition'.[8] For the purpose of this study, preservation is the requirement that money saved for retirement through a pension fund or provident fund remains in such a fund until retirement, or is rolled over into another similar retirement savings vehicle without incurring taxes or penalties when a person changes jobs (that is, it has portability).[9] Other scholars do not differ much with this definition. According to Schreve, preservation funds serve as vehicles for preserving the retirement benefits of employees who resign, are retrenched or if their retirement funds are dissolved.[10]

According to Nevondwe preservation funds are erected to ensure that members who left their pension or provident funds by virtue of a dismissal, resignation or retrenchment prior to the age of 55 has access to an investment vehicle to preserve their withdrawal benefits until retirement date[11]. This preservation funds are regulated by rules which are registered with the Registrar of Pension Funds. In promoting a culture of saving, it has been said that Preservation keeps intact pension and other retirement savings.[12]

The then Pension Funds Adjudicator John Murphy held in the case of *Human v Protektor Pension Fund*[13] that the primary purpose for creating preservation pension funds was to ensure that members who left their pension or provident funds by virtue of a dismissal, resignation, retrenchment and etcetera prior to

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[8] Hornby AS, Oxford Advanced Learner's Dictionary (2005).
[9] National Treasury, Preservation, portability and governance for retirement funds (2012), p7.
[10] Schreve C, Preservation Funds: Summary Requirements of the South African Revenue Services**,** Retirement Planning Pensions World South Africa (2000).
[11] Nevondwe L, Pension Law Handbook, 2013, submitted for publication and it is at a review stage at Juta Law publishers.
[12] National Treasury, Preservation, portability and governance for retirement funds (2012), p7.
[13] *Human v Protektor Pension Fund* [2001] 9 BPLR 2462 (PFA).

age 55, had access to an investment vehicle to preserve their withdrawal benefits until retirement date, which was the main object of the pension or provident fund.[14]

Like any other pension or provident fund, the preservation fund is regulated by its rules as registered with the Registrar of Pension Funds. The South African Revenue Services periodically issues practice notes regarding preservation funds. The purpose of the practice notes is to lay down conditions under which the preservation funds will be approved for the purposes of the Income Tax Act.[15] Most preservation funds adapt their rules to comply with the practice notes issued by the South African Revenue Services. The practice note which was in operation before the coming into operation of SARS practice Note RF 1/93 is Inland Revenue Practice Note RF1/98 ("RF1/98"). RF1/98 expressly sets out formalities or requirements to be complied with by parties involved.[16]

According to Jeram and Gcelu, if a member withdraws from a pension fund (due to resignation, dismissal or retrenchment), and elects to transfer all or a portion of his withdrawal benefit ("translocation benefit") to a preservation fund, the translocation benefit is exempt from taxation. A preservation fund may not receive any member's contributions once the translocation benefit is received and it may only receive translocation benefits from other approved pension funds.[17] Practice note RF1/98 was replaced by the practice note RF1/2011[18]. The replacement started operating with effect from the 30th October 2010.

The Pension Funds Act provides adequate protection to the pension benefits against any cession, pledge or hypothec under judgement or order of

[14] *Human v Protektor Pension Fund* [2001] 9 BPLR 2462 (PFA) at para 10. See also Jeram N and Gcelu S, An introduction to Pensions Law (2005), p73 (unpublished).
[15] Act, 58 of 1962.
[16] Subsequently the Commissioner issued addendum A to clarify certain parts of RF1/98.
[17] Jeram N and Gcelu S, An introduction to Pensions Law (2005), p73 (unpublished).
[18] South African Revenue Service Retirement Fund Practice Note Rf1/2011.

court.[19] Furthermore section 37B of the Pension Fund Act protects the pension benefits of an insolvent employee. In terms of this Section the benefits due to the employee after the commencement of the Financial Institution Amendment Act[20] are deemed not to form part of the insolvent estate.

The above provision has the effect of preserving pension benefits under those given conditions. The courts and the Pension Fund Adjudications are often called upon to decide as to whether an employee is entitled to withdrawal of the preserved pension benefits.

In the case of *Eskom Pension and Provident Fund v Krugel and Another*[21]a non-member spouse referred her complaint to the pensions fund adjudicator and such complaint was upheld by the adjudicator.

Eskom pension fund and provident fund then appealed the decision to the High Court. The High Court dismissed the appeal by Eskom Pension and Provident Fund. The fund proceeded to appeal to the Supreme Court of Appeal. The Supreme Court of Appeal turned down the decision of the adjudicator and that of the High Court. The order of the pension fund adjudicator was replaced with an order dismissing the non-member's complaint.

In the case of *Rossow v Reid and Another*[22]the court confirmed the provision of the Income Tax Act to the effect that when the non-member spouse's portion accrues, the member spouse is liable to pay the Income Tax thereon, but with the right to recover the tax from the non-member spouse. What is of significant to note and also relevant to the topic under discussion here is that the legislation does not provide for any preservation of benefits for the non-member spouse after divorce. The non-member spouse has an option of

[19] Section 37B of the Act
[20] Act 101 of 1976
[21] 2011] 4 All SA 1 (SCA).
[22] Unreported South Gauteng High Court Case No: 50730/2007 decided on the 04th of February 2011.

taking the whole benefit due to her or him or to invest such benefits with another fund.

South African law allows individuals leaving pension and provident funds on job changes to access their entire retirement balances in cash, although tax is payable on the withdrawal of a lump sum benefit pre-retirement.[23] In addition, non-member spouses may receive cash payments in the case of divorce orders.[24]

According to Matotoka and Nevondwe the Pension Funds Amendment Act[25] read with Financial Services General Laws Amendment Act[26] has introduced amendments which allow a fund to deduct from the amount held by it in respect of a member's unaccrued benefit the share of the 'pension interest' allocated to the non-member spouse on the basis that, for the purposes of the Divorce Act[27], a benefit is deemed to accrue to the member on the date of divorce.[28] This position has been recently introduced in the public sector after it was successfully challenged in the matter of *Wiese v Government Employees Pension Fund and Others*[29].

The latter case the applicant was the former spouse of a member GEPF. The applicant argued that the differential treatment of a non-member spouse of a GEP Law member to that of a non-member spouse of a member of a pension fund governed by the Pension Funds Act violates section 9(1) of the Constitution, to the equal protection and benefit of the law. More particularly, it was contended that the applicant's right of access to social

[23] National Treasury, Preservation, portability and governance for retirement funds (2012), p10.
[24] ibid
[25] Act, 11 of 2007
[26] Act, 22 of 2008
[27] Act, 70 of 1979
[28] Matotoka and Nevondwe, Pension benefits payable to divorcees in the private and public sector, First International Conference on Development Finance and Economic Transformation, Conference Proceedings, 27-29 October 2013 at page 310. See also *Cockcroft v Mine Employees' Pension Fund* [2007] 3 BPLR 296 (PFA).
[29] *Wiese v Government Employees Pension Fund and Others* [2011] 4 All SA 280 (WCC).

security as entrenched in section 27 (1)(c) of the Constitution is violated.[30] The parties conceded that the applicant's right to enjoy protection and benefit of the law was infringed.[31]

These lump sum cash payouts are possible for both defined benefit and defined contribution funds. Such payouts cannot be considered life cycle savings if they are received before the retirement fund member reaches retirement age. 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 young.[32]

1.4. Aims and objectives of the study

The main aim of this study is to revisit the Pension Funds Act and determines whether the preservation of pension benefits provides adequate income security amongst South Africans. The study will also show how some of the applicable principles in our present pension law are real set back to the emancipation of the poor working class at the end of their carrier path.

The study will therefore benefit Managers, Directors, Executives, Legal Advices, Adjudicators and Presiding Officers who are employed by the National, Provincial or Local governments and those employed by private entities parastatals and non-governmental institutions, in their day to day work relating to pension law.

Shop stewards representing Labour Organisations and Lawyers representing the community at large will also benefit from this study as it will enhance their

[30] *Wiese v Government Employees Pension Fund and Others* [2011] 4 All SA 280 (WCC) at Para 11.
[31] See Matotoka and Nevondwe, op cit, page 313.
[32] National Treasury, Preservation, portability and governance for retirement funds (2012), p10.

skills used when representing their co-employees and clients on issues relating to pension laws.

This study will benefit students especially those who are studying pension law, labour law, social security law and actuarial science. This study will benefit legal practioners, pension lawyers, administrators of pension funds, trustees, pension fund to have an understanding of preservation of pension benefits. Lastly, this study will benefit young emerging academics who contend to do research on the same topic to bring insight on their programmes.

1.5. Research Methodology

The research method to be adopted in this study is qualitative. A combination of legal comparative and legal advisory methods based on jurisprudential analysis is employed. Legal comparative method will be applied to determine the development of the principle of preservation of pension benefits over the years.

The research is library based and reliance is placed on materials such as journals, textbooks, case law, conference papers, law reports, legislation, electronic sources, discussion documents and commission reports.

1.6. Scope and limitation of the study

This study consists of five chapters. Chapter one is the introductory chapter laying the foundation. Chapter two focuses on legislative framework. Chapter three deals with the preservation of pension benefits. Chapter four deals with the case law jurisprudence while chapter five deals with the conclusion drawn from the whole study and make some recommendations.

CHAPTER TWO: LEGISLATIVE FRAMEWORK

2.1. Introduction

The South African retirement industry is largely divided into private funds, which as discussed above, are regulated by the Pension Funds Act as well as Public pension funds which are regulated by different legislations. Public pension funds in South Africa include *inter alia*, the Government Employees Pension Fund (GEPF), Transnet Pension Fund (TPF), Post Office Pension Fund (POPF) and Telkom Pension Fund. This is not an exhaustive list.[33]

2.2. The Pension Funds Act 24 of 1956

The Pension Fund Act was passed in April 1956 and it is almost 57 years old. This Act came into operation during the apartheid system of government and it offers little relief to the majority of the retirees.[34] This legislation was enacted to provide for the registration, incorporation, regulation and dissolution of pension funds and for matters incidental thereto[35].

The Pension Fund Act applies to all pension fund established and registered in terms of Section 4 of that Act. Subject to Section 4A and any other law in terms of which a fund is established, the provisions of this Act apply to any pension fund including a pension fund established or continued in terms of a collective agreement concluded in a council in terms of the Labour Relations Act, 1995 and registered in terms of Section 4.

[33]Matotoka and Nevondwe, opcit, page 312.

[34] Nevondwe LT, South African Social Security and Retirement Reform: A long journey towards the redrafting of the new Pension Funds Act, pensions and International Journal, Palgrave Macmillan Publishers, UK, Volume 15, issue 4, March 2010, p287.

[35] The preamble to the Pension Funds Act, 24 of 1956.

The Pension Fund Act does not provide for serious preservation of pension fund at the present moment. However there are few provisions which have an effect of preservation though not an absolute preservation as required.

Section 37A[36] provides that safe to the extent permitted by this Act, the Income Tax Act No 58 of 1962 and the maintenance Act of 1998, no benefit provided for in the rules of a registered fund or right to such benefit, or right in respect of contributions made by or on behalf of a member shall, notwithstanding any-thing to the contrary contained in the rules of such fund, be capable of being reduced, transferred or ceded or of being pledged or hypothecated, or be liable to be attached or subjected to any form of execution under a judgment or order of a court of law ....[37]

In the case of *National Tertiary Retirement Fund v Registrar of Pension Funds*[38], the court applied the exception to the provisions of this section. The appeal before the court related to the Ruling of the Board of Appeal established in terms of the Financial Service Board Act[39], as well as the ruling of the High Court to the effect that, the rule of amendment was inconsistent with the Act because it reduces the benefits provided for contrary to the provisions of Section 37A and 14A. The court stressed the fact that the words "save as permitted by this Act" as contained in Section 37A qualified the provisions of that section.

This decision only point out that the preservation provided for by Section 37of Act is not rigid and can be waived in certain circumstances by provisions of that particular Act.

Section 37B of Act 24 of 1956 provides as follows:

[36] Section 37A (1) of Act 24 of 1956.
[37] 2009(5) SA 366 (SCA) Paragraph 14, 21, 22 and 23.
[38] [2009] ZASCA 41 (31 March 2009).
[39] Act 97 of 1990.

"If the estate of any person entitled to a benefit payable in terms of the rules of a registered fund is sequestrated or surrendered, such benefit or any part thereof which became payable after the commencement of the Financial Institutions Amendment Act 1d of 1976, shall, subject to the provisions of Section 37A (3) and 37D, not be deemed to form part of the assets in the insolvent estate of that person and may not in any way be attached or appropriated by the trustee in his insolvent estate or by his creditors, notwithstanding anything to the contrary in any law relating to insolvency."

The literal translation of this provision is that should an employee member of the pension fund become insolvent, his or her pension benefit will not be regarded as forming part of his estate for the purpose of insolvency.

To ~~me~~ this provision has the effect of preserving pension benefits only in case of insolvency against the employee member.

The preservation provided for by the provisions of Section 37A and 37B of the Pension Fund Act are limited and conditional. There are exceptional situations where such preservation does not find application.

The form of preservation provided by the above provisions does not held in solving the main problem encounter by the majority of workers in South Africa. This provision does not compel member employee, to preserve their benefits in case of dismissal or retrenchment.

2.3. Government employees pension law, Proclamation No. 21 of 1996

This law was passed to make provision for the payment of pensions and certain other benefits to person in the employment of the Government,

certain bodies and institutions, and to the dependants or nominees of such person, to repeal certain laws and to provide for matters incidental thereto[40].

The Government Employees Pension Law provides for the preservation of pension benefits in its Section 21 which reads as follows:

> *"(i) Subject to Section 24A, no benefits or right in respect of a benefit payable under this Act shall be capable of being assigned or transferred or otherwise ceded or of being pledged or hypothecates or, save as is provided in Section 26 and 40 of the maintenance Act of 1998 and Section 7(8) of the Divorce Act 70 of 1979, be liable to be attached or subjected to any form of execution under a judgment or order of a court of law".*

This provision has an element of preserving the pension funds held on behalf of a member employee. However subsection 2(e) provides that "The fund shall, within 45 days of the submission of the court order by the former spouse of a member, request the former spouse to elect whether the amount to be deducted must be –

(i) Paid directly to the former spouse, or

(ii) Transferred to an approved retirement fund on behalf of the former spouse".

Previously this law did not allow the immediate payment to the non-member spouse after divorce. The former Section 21[41] which is now amended provided that the non-member's pension would be identified, but only be paid when the member spouse's pension benefit have accrued or are due for payment. That would be when the member spouse retires or is retrenched

[40] Preamble

[41] Amended by Section 21 and Section 24A of the Government Employees Pension Amendment Act – No 19of 2011

or when he or she dies. The former Act did not allow what is referred to as the clean-break principle.

However the amended section in a form of Section 24A(e) has now two folds provisions subsection (e)(i) allows for a clean-break principle, in that the non-member spouse's benefits can immediately be paid.

Subsection (e)(ii) allows for preservation only with the consent of the non-member's spouse. In essence what this subsection provides is that if the non-member so elect, the pension benefits due to her or him will then be preserved.

The amendment to Section 21 and the inclusion of Section 24A to the Government Employees Pension Law was brought about by the decision of the constitutional court in the case of *Mathilda Louisa Wiese v Government Employees Pension Fund and Others*[42]. In this case the provision of Section 21 was declared unconstitutional..

Like many other pension laws the Government Employee Pension Law also does not provide for a compulsory preservation of pension benefits for employees who leave their employment before the actual time, or in case of divorce.

2.4. Transnet Pension Fund Act No: 62 of 1990

This Act was passed among others for the purpose of establish a pension fund for the employees of Transnet Limited and certain other companies, and for incidental matters[43].

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[42] Case CCT 111/11 [2012] ZACC5
[43] Preamble to the Act 62 of 1990

The preservation of pension benefits under this Act is premised on a number of section and among others Section 7 which provides as follows:

> *"No pension or lump sum from the Transport Pension Fund, or right to such benefit, or right in respect of contributions made by a member or on his or her behalf, shall be capable of being assigned or transferred or otherwise ceded or being pledged or hypothecated, or be liable, subject to Section 7 of the Divorce Act 70 of 1979, and the maintenance Act 99 of 1998, to be attached or subject to any form of execution under a judgment or order of a court of law ...."*

Section 8 further preserve the employee member's pension benefits in case of sequestration or insolvency. This section provides that the employee member's benefits would not be deemed to form part of the estate in such situations.

It should be noted that the Transnet Pension Fund Act was enacted among other things to disestablish the pension fund referred to in section 2 of the Railways and Harbours Pension Act of 1971 as well as that of the Railways and Harbours Pensions for non-whites Act of 1974.

The above provisions give an unconditional preservation of pension funds under the Transnet Pension Fund Act. However given the precedent set in the Wiese case referred to above as well as the Ngewu case still to be discussed it is evident that if this Act if challenged, it will not pass the constitutional master.

2.5. The Post Office Retirement Fund

The Post Office Retirement Fund is established by section 10 of the Post and Telecommunication Related matter Act 44 of 1958. The above section and

other subsequent provision did not allow for the clean-break principle, and that is the reason it was challenged in court.

In the case of *Ngewu and Another v Post Office Retirement Fund and Others*[44] the court stated the following:

> *"Section 10 to 10E of the Post Office Act, the relevant provisions dealing with the administrative and financial matters of the fund, are clearly unconstitutional because of the omission of the clean-break principle there is a difference between the payment of divorce spouse' interests regulated by the pension fund Act and the Government Employee Pension Law Amendment Act on one hand and the payment of divorced spouses' interest governed by the Post Office Act on the other. The differentiation is irrational as it has no basis...............[45]"*

The provisions of Section 10 to 10E were accordingly declared unconstitutional, on the 07th of March 2013 and the government was given eight months to cure the defect.

2.6. Income Tax Act[46].

From time to time the South African Revenue Services would issue practice notes which lays down the conditions under which the preservation of funds will be approved for purpose of the Income Tax Act. That Practice notes is the South African Revenue Service Retirement Fund Practice not RF1/2011. This practice notes replaced the inland Practice not RF1/98. These conditions are prescribes under the discretionary power granted to the commissioner for the

[44] 2013 (4) BCLR 421 (cc)
[45] Paragraph 17 of the *Ngewu and Another v Post Office Retirement Fund and Others* judgement.
[46] Act, 58 of 1962.

South African Revenue Services in terms of the definition of a "Pension Preservation Fund" in Section 1 of the Act.

There are two additional conditions which are the following:[47]

Benefits paid or transferred into a Pension Reservation Fund

Amounts or unclaimed benefits referred to in Paragraph (b) of the definition of a "Pension Preservation Fund" that are derived from a pension fund or pension preservation fund may not be paid or transferred in such a way that it is split between more than one pension preservation funds.

Benefits paid or transferred from a pension preservation fund.

Amounts or unclaimed benefits referred to in paragraph (b) of the definition of "Pension Preservation Fund" derived from a pension preservation fund may not be paid or transferred in such a way that it is split between more than one pension preservation fund or more than one retirement annuity funds or between more than one combination of one pension preservation fund and one retirement annuity fund. The aforementioned condition applies separately to each payment or transfer to the pension preservation fund from which the amount or unclaimed benefit is now denied.

Like all other legal provisions discussed above the practice notes only deals with pension benefits which are already preserved. They do not make preservation compulsory to those benefits not yet preserved.

The same can still be said here that, the problem of lack of saving and secured retirement is not fully addressed by our laws.

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[47] Condition for Pension Preservation Fund issued by legal and policy division of the South African Revenue Services

2.7. Discussion papers by the National Treasury.

The National Treasury has over some years issued a number of some discussion papers regarding the preservation of pension benefits. Each of the discussion paper would come up with its own recommendation on how the law relating to preservation of pension fund should be framed. Some of this discussion papers will be revisited and recommendations thereof be summarised.

2.7.1. The Discussion Papers

The main objective of the government's retirement policy with regard to preservation of fund is to encourage individuals to provide adequately for their own retirement and needs for their dependants. This objective is stermed on the fact that many people reach retirement age without adequate accumulated savings.[48]

With regard to preservation of pension benefits, this discussion paper recommended the following when an employee changes jobs and cease to be eligible to belong to his/her old retirement fund:[49]

> "that the benefit payable from the old retirement fund must not be available in cash but must be transferred to the employee's new occupational retirement fund, an individual retirement fund selected by the board of trustee of the old retirement fund, of the employee's choice, or the National Savings Fund, with the choice of transferee fund being made by the member".

If the member has not informed the old retirement fund of his/her election of receiving fund within a reasonable period, the old retirement fund may transfer the money to an individual retirement fund selected by the board of trustees of the old retirement fund and inform the member accordingly. The

[48] National Treasury, Retirement Fund Reform, A discussion paper (2004), p39.
[49] National Treasury, *ibid* at page 39.

member may move this money to other retirement fund if he/she so wish at any time.[50]

This recommendation aims at providing for total and compulsory preservation of pension benefit at the time the employee changes his/her job.

The same recommendations of the 2004 discussion paper were also proposed at the institute of Retirement Fund Indaba 1 of 3 March 2005 by the National Treasury as part of the pension reform.

Just like the 2004 paper, the 2005 paper also recommend that the should only be payment to the employee member if the retirement savings in the old fund are below a prescribed minimum or where the member has defaulted on his or her having loan from the fund in which case payment will be made to such fund.

The Financial Planning Institute of Southern Africa issued a discussion paper in November 2007 titled Social Security and Retirement Fund reform in South Africa.

With regard to the preservation of pension fund this document recommended that there should be compulsory preservation of retirement fund benefits, when member move between jobs. It is recommended that, that will be key to ensuring the success of a retirement fund reform programme.

According to the financial planning institute employee member of the fund should only be permitted to access portion of their retirement benefits under four conditions which are as follows:

[50] National Treasury, *ibid* at page 39.

- Cash benefits should be permitted where the member employee has a housing loan,
- Where the member employee fails to find employment and remains unemployed he/she should be allowed access to a limited portion,
- Where the member employee are too sick to continue working and do not have access to medical aid, they should be permitted to access cash payouts,
- In case of divorce the financial planning institute also recommended for a clean-break principle.

In May 2012 the National Treasury issued another discussion paper titled: Strengthening Retirement Savings. As far as preservation of pension benefits is concerned this document provide for the same recommendation as the 2004 and 2005 discussion paper as discussed above.

The recommendation of the discussion that have taken place throughout the years has now being consolidated into some proposals upon which the intended legislation would be based.

These proposals are wildly outlined in a reports by the National Treasury dated the 27th of February 2013, titled Retirement reform proposals.
The proposal is two legged, first it talks about the pre-retirement preservation and secondly the post-retirement preservation.

Under the former, the following is proposed that unemployment workers should be permitted some access to their retirement funds in case of need.

It is suggested that this should be the case only in situations where the member takes time to secure employment and need something for survival. It would be easy for skilled employees to secure employment quickly and it

might not be necessary or the need might not exist for such individuals to access their preserved benefits.

However, it would not be the case with unskilled employees. Taking into account our economic situation, this group of people does not access employment very easy. It is even worse when they are already old, because they would not be employable.

This is the main problem with this proposal because at the ultimate end the unskilled members would exhaust their benefit before their actual time of retirement, as it would not be easy for them to access employment.

It would certainly defeat the very same purpose of preservation in that, after exhausting their saving those employees will remain poor as if they had never been employed and end up resorting to government grant.

The other proposal is that, the vested rights of workers to access their retirement saving should be protected. This proposal has the effect making preservation optional rather than compulsory~~. I am saying~~ this because a member can decide to preserve his/her benefits today and after some few days or months, if not years, then decide to withdraw the preserved benefits using his/her vested rights.

If this situation happens in a majority of cases then it will be as good as making preservation optional other than compulsory.

It is further proposed that the administrative burden on providers and consequent cost on member should not be too high. The proposal does not highlight as to how this should be regulated.

CHAPTER FOUR: PRESERVATION OF PENSION BENEFITS

3.1. Introduction

Preservation occurs when money saved for retirement through pension, provident and preservation funds remains in those funds until the person retires, or is rolled over into another similar retirement savings vehicle without incurring taxes or penalties when a person changes jobs.[51] Preservation in retirement funds was introduced in the 2012 budget speech by the Finance Minister, Pravin Gordhan. In essence, preservation is triggered when pension and provident fund members leave their funds by changing jobs. To effectively enable preservation, the 2012 Budget Speech proposed that portability of pension benefits be provided for. Portability allows employees changing jobs to transfer accumulated pension benefits to their prospective employer's plan or to a preservation fund, or to leave retirement savings with their former employer.[52] In his 2013 budget speech, the Finance Minister announced that retirement funds will be required to identify appropriate preservation funds for exiting members, who will be encouraged to preserve when changing jobs.

3.2. What is a deferred benefit?

The rules of the fund may give a member an option to leave his withdrawal benefit in the fund on termination of employment. The benefit becomes payable on normal retirement in terms of the rules of the fund. Once the pension is deferred the member will not have access to his benefit until the retirement age stipulated in terms of the rules.

The rights which accrue to a member who defers his pension are defined in the rules of the fund. The member must make an election to defer his pension, and such an election must clearly be communicated to the fund. In

[51] National Treasury, Preservation, portability and governance of retirement funds, 21 September 2012, p 15.
[52] *Ibid,* 19.

Alexander v Printing Industry Pension Fund,[53] the complainant resigned from his employment in 1992. The rules of the fund provided for an option to defer the pension upon resignation from employment. The complainant elected to leave his benefit in the fund but did not inform the fund of his option. He was under the impression that when he resigned in 1992 he would automatically become entitled to a deferred pension.

Rule 12(9) of the fund provided that if on termination of service a member fails to inform the fund that he would prefer to leave his "fund credit" in the fund, he is deemed to have exercised the option to have his benefit paid out to him in cash. In 1995 he requested payment of his benefit in cash. The complainant argued that in terms of amendments made to the rules in July 1994 a member was entitled not to his own contributions, but also to the employer's contributions at withdrawal.

The Adjudicator ruled that because the complainant did not inform the fund of his choice, the fund had no option but to apply Rule 12(9). As a result, the complainant's active fund membership came to an end at the termination of service. The rule amendments that came into effect after that date did not apply to him.

Advantages

- When a member defers his or her benefit he remains a member of the fund and is entitled to some benefits enjoyed by the members of the fund such as disability and death cover.

- The deferred members may be entitled to share in the surplus and to extraordinary returns made by the fund, for example, demutualization benefits.

[53] [2000] 8 BPLR 835 (PFA).

- Where a member elects to defer pension, tax is deferred until date of retirement.

Disadvantage

- The disadvantage with a deferred pension is that one does not have access to the money before the normal retirement date.

In *Seroto v Protektor Pension Fund*[54], the complainant withdrew for the First National Bank Group Pension Fund on the 31 December 1996 at which date he transferred his withdrawal benefit amounting to R 168 217,66 to the Respondent, in terms of a formal application dated 29 November 1996. On 27 January 1997 he completed a withdrawal form in the amount of R36 859, 06 and this was paid to him by the Respondent.[55]

In June 1997 the Complainant applied to the Respondent for a further withdrawal and was refused on the grounds that he had already taken the one withdrawal permitted under its rules. The Complainant re-applied for a withdrawal on 16 April 1998 and was turned down on the 30 April 1998.[56]

The Complainant avers that at the time his benefit was transferred from the First National Bank Group Pension Fund and the initial withdrawal taken, he was not informed that he would be allowed only one withdrawal from the Respondent. Had the Rules been explained fully to him at the time he would most likely have applied the proceeds differently. The Complainant sought an order instructing the Respondent to allow the Complainant a further withdrawal up to the amount of the balance held on his behalf.[57]

[54] *Seroto v Protektor Pension Fund* [2001] 3 BPLR 1789 (PFA)
[55] *Seroto v Protektor Pension Fund* [2001] 3 BPLR 1789 (PFA) at 1790C.
[56] *Seroto v Protektor Pension Fund* [2001] 3 BPLR 1789 (PFA) at 1790D.
[57] *Seroto v Protektor Pension Fund* [2001] 3 BPLR 1789 (PFA) at 1790F-G.

The Adjudicator held that in refusing a second withdrawal the Respondent was acting in terms of its rules and in terms of South African Revenue Services Practice Note RF 1/93 which governed the operation of preservation funds at the time. The Adjudicator noted that in the case of *Mgulwa and Another v First National Bank Group Pension Fund and Others*[58], it had been held that the pension fund had exceeded its powers in restricting the amount the Complainant could withdraw in cash to the value of the member's refund only and ordered the preservation fund to allow a further withdrawal up to the balance retained, counting the double transaction as one withdrawal in satisfaction of SARS Practice Note RF 1/93.

The Adjudicator held that the deciding factor *in casu*, is whether a similar restriction had been applied by the First National Bank Group Pension Fund at the date of transfer to the Respondent forcing the complainant to take a lower cash withdrawal than he would otherwise have taken, or whether, regardless of any restriction imposed, the Complainant had been allowed to withdraw the amount of cash he chose. The Adjudicator was satisfied that the Complainant was entitled to withdraw his total benefit as a single withdrawal from the Respondent. The Respondent was directed to process the Complainants application for a withdrawal and to pay to him the full amount he wishes to withdraw within 14 days of receiving his application. For the purposes of SARS practice Note RF 1/93, the single withdrawal was taken to be the initial amount granted to the Complainant together with any amount paid pursuant the determination.[59]

3.3. Benefits paid from preservation funds

The then Pension Funds Adjudicator John Murphy held in the case of *Human v Protektor Pension Fund*[60] that the primary purpose for creating preservation

[58] *Mgulwa and Another v First National Bank Group Pension Fund and Others* [1999] 12 BPLR 379 (PFA).
[59] *Seroto v Protektor Pension Fund* [2001] 3 BPLR 1789 (PFA) at 1791D-E.
[60] *Human v Protektor Pension Fund* [2001] 9 BPLR 2462 (PFA).

pension funds was to ensure that members who left their pension or provident funds by virtue of a dismissal, resignation, retrenchment etc. prior to age 55, had access to an investment vehicle to preserve their withdrawal benefits until retirement date, which was the main object of the pension or provident fund.[61]

Like any other pension or provident fund, the preservation fund is regulated by its rules as registered with the Registrar of Pension Funds. The South African Revenue Services periodically issues practice notes regarding preservation funds. The purpose of the practice notes is to lay down conditions under which the preservation funds will be approved for the purposes of the Income Tax Act.[62] Most preservation funds adapt their rules to comply with the practice notes issued by the South African Revenue Services. The practice note currently regulating preservation funds is Inland Revenue Practice Note RF1/98 ("RF1/98"). RF1/98 expressly sets out formalities or requirements to be complied with by parties involved.[63]

If a member withdraws from a pension fund (due to resignation, dismissal or retrenchment), and elects to transfer all or a portion of his withdrawal benefit ("translocation benefit") to a preservation fund, the translocation benefit is exempt from taxation. A preservation fund may not receive any member's contributions once the translocation benefit is received and it may only receive translocation benefits from other approved pension funds.

In terms of RF1/98, the rules of the preservation fund should provide for a fixed date or ascertainable future date for payment of the benefit. This is usually the pensionable age in terms of the rules of the fund. Further, the practice note permits not more than one withdrawal benefit from a preservation fund prior to the retirement date. Any amount deducted from the translocation

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[61] *Human v Protektor Pension Fund* [2001] 9 BPLR 2462 (PFA) at para 10.
[62] Act 58 of 1962.
[63] Subsequently the Commissioner issued addendum A to clarify certain parts of RF1/98.

benefit is regarded as the member's first and final withdrawal benefit. A deduction in terms of section 37D from a benefit to be transferred to a preservation fund also constitutes a cash withdrawal from that preservation fund.[64] However, an amount transferred to a retirement annuity does not constitute a withdrawal benefit.[65]

A member may, however, withdraw the full amount of his benefit by means of one single withdrawal if the rules of the preservation fund do not impose a restriction. In *Mgulwa and Others v First National Bank Pension Fund and Others,*[66] the complainants sought to withdraw the full amount of their benefits from a preservation fund by means of a single withdrawal. The participating employer and the transferor fund opposed the withdrawal and contended that they were entitled to impose restrictions on withdrawals from the preservation fund. The Adjudicator held that should a pension fund seek to impose a restriction on a former member's right to a withdrawal benefit from a preservation fund to which he has transferred, it shall require the express or implied authority to do so in terms of its rules. In the absence of such authority, the term in the contract between the two funds imposing such a restriction shall be *ultra vires* and unenforceable.

3.4. Amendments to Preservation Funds

According to Muller legislation in respect of retirement planning has been subject to numerous changes over the last few years, which also comprised of various amendments where preservation funds are concerned. The most important changes with regards to preservation funds are the following: [67]

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[64] *Cloete v Sasol Pension Fund and Others(1)* [2000] 11 BPLR 1210 (PFA).

[65] In *Potter v Protea Life Preservation Provident Fund* it was stated that if a translocation benefit is to be transferred from a pension fund to a preservation fund, the whole amount of the benefit must be transferred. No cash withdrawal from the previous fund may be taken prior or coincident with the transfer. Any amount deducted from the translocation benefit during the transaction (other than an amount transferred to a retirement annuity fund) is regarded as the member's first and only withdrawal permitted from the preservation fund. [2001] 7 BPLR 2249 (PFA).

[66] [1999] 12 BPLR 379 (PFA).

[67] Muller C, Preservation funds- An overview, Insurance and Tax Journal Vol 27 No 2, June 2012, 18.

(i) the inclusion of a definition of a pension preservation fund and a provident preservation fund in the Income Tax Act;[68] and

[68] 'pension preservation fund' means a pension fund organisation which is registered under the Pensions Funds Act, 1956 and which is approved by the Commissioner in respect of the year of assessment in question: Provided that the Commissioner may approve a fund subject to such limitations and conditions as the Commissioner may determine, and shall not approve a fund in respect of any year of assessment unless the Commissioner is satisfied in respect of that year of assessment that the rules of the fund provide that—

(*a*)membership of the fund consists of—

(i) former members of a pension fund or provident fund whose membership of that fund has terminated due to—

(*aa*) resignation, retrenchment or dismissal from employment and who elected to have any lump sum benefit that is payable as a result of the termination transferred to that fund;

(*bb*) the winding up or partial winding up of that fund, if the member elects or is required in terms of the rules to transfer to this fund; or

(*cc*)a transfer of business from one employer to another in terms of section 197 of the Labour Relations Act, 1995 (Act No. 66 of 1995), and the employment of the employee with the transferor employer is transferred to the transferee employer, if the member elects or is required in terms of the rules to transfer to this fund;

(ii) former members of any other pension preservation fund or provident preservation fund—

(*aa*) if that fund was wound up, or partially wound up; or

(*bb*) if the member elected to have any lump sum benefit contemplated in paragraph 2(1)(*b*)(ii) of the Second Schedule transferred to this pension Preservation fund and who made this election while they were members of that other fund;

(iii) former members of a pension fund or nominees or dependants of that former member in respect of whom an "unclaimed benefit" as defined in the Pension Funds Act, 1956 (Act No. 24 of 1956), is due or payable by that fund; or

(iv) persons who have elected to transfer to that fund amounts awarded to those persons in terms of any court order contemplated in section 7(8) of the Divorce Act, 1979 (Act No. 70 of 1979), from any pension fund or pension preservation fund for the benefit of those persons;

(*b*) payments or transfers to the fund in respect of a member are limited to any amount contemplated in paragraph 2(1)(*a*)(ii) or (*b*) of the Second Schedule or any unclaimed benefit as defined in the Pension Funds Act, 1956 (Act No. 24 of 1956), that is paid or transferred to the fund by—

(i) a pension fund or any other pension preservation fund of which such member was previously a member; or

(ii) a pension fund or pension preservation fund of which such member's former spouse is or was previously a member and such payment or transfer was made pursuant to an election by such member in terms of section 37D(4)(*b*)(ii) of the Pension Funds Act, 1956 (Act No. 24 of 1956);

(*c*) with the exception of amounts transferred to any other pension fund, pension preservation fund or retirement annuity fund, not more than one amount contemplated in paragraph 2(1)(*b*)(ii) of the Second Schedule is allowed to be paid to the member during the period of membership of the fund or any other pension preservation fund. Provided that this paragraph applies separately to each payment or transfer to the fund contemplated in paragraph (*b*);

(*d*) a member, other than a member contemplated in paragraph (*a*)(iii) of this proviso, will become entitled to a benefit on his or her retirement date; and

(*e*) not more than one-third of the total value of the retirement interest may be commuted for a single payment and that the remainder must be paid in the form of an annuity (including a living

annuity) except where two-thirds of the total value does not exceed R50 000 or where the member is deceased .

'Provident preservation fund' means a pension fund organisation which is registered under the Pension Funds Act, 1956 (Act No. 24 of 1956), and which is approved by the Commissioner in respect of the year of assessment in question: Provided that the Commissioner may approve a fund subject to such limitations and conditions as the Commissioner may determine, and shall not approve a fund in respect of any year of assessment unless the Commissioner is satisfied in respect of that year of assessment that the rules of the fund provide that—

(*a*) membership of the fund consists of—

(i) former members of a provident fund whose membership of that fund has terminated due to—

(*aa*) resignation, retrenchment or dismissal from employment and who elected to have any lump sum benefit that is payable as a result of the termination transferred to that fund;

(*bb*) the winding up or partial winding up of that fund, if the members elected or are required in terms of the rules to transfer to this fund; or

(*cc*) a transfer of business from one employer to another in terms of section 197 of the Labour Relations Act, 1995 (Act No. 66 of 1995), and the employment of the employee with the transferor employer is transferred to the transferee employer, if the members elected or are required in terms of the rules to transfer to this fund;

(ii) former members of any other provident preservation fund—

(*aa*) if that fund was wound up or partially wound up; or

(*bb*) if the member elected to have any lump sum benefit contemplated in paragraph 2(1)(*b*)(ii) of the Second Schedule transferred to that fund and who made this election while they were members of that other fund;

(iii) former members of a provident fund or nominees or dependants of that former member in respect of whom an 'unclaimed benefit' as defined in the Pension Funds Act, 1956 (Act No. 24 of 1956), is due or payable by that fund;

(iv) a person who has elected to transfer an amount awarded to that person in terms of a court order contemplated in section 7(8) of the Divorce Act, 1979 (Act No. 70 of 1979), from a provident fund or provident preservation fund for the benefit of that person;

(*b*) Payments or transfers to the fund in respect of a member are limited to any amount contemplated in paragraph 2(1)(*a*)(ii) or (*b*) of the Second Schedule or any unclaimed benefit as defined in the Pension Funds Act, 1956 (Act No. 24 of 1956), that is paid or transferred to the fund by—

(i) a provident fund or any other provident preservation fund of which such member was previously a member; or

(ii) a provident fund or provident preservation fund of which such member's former spouse is or was previously a member and such payment or transfer was made pursuant to an election by such member in terms of section 37D(4)(*b*)(ii) of the Pension Funds Act, 1956 (Act No. 24 of 1956);

(*c*) with the exception of amounts transferred to any pension fund, pension preservation fund, other provident fund, provident preservation fund or retirement annuity fund,, not more than one amount contemplated in paragraph 2(1)(*b*)(ii) of the second Schedule is allowed to be paid to the member during the period of membership of the fund or any other provident preservation fund: Provided that this paragraph applies separately to each payment or transfer to the fund contemplated in paragraph (*b*); and

(*d*) a member, other than a member contemplated in paragraph (*a*) (iii) of this proviso, will become entitled to a benefit on his or her retirement date;"

(ii) the replacement of Retirement Fund Notice 1/98 with Retirement Fund Notice 1/2011 (RF 1/2011), dealing with Pension Preservation Funds, and effective from 30 September 2010;
(iii) the replacement of Retirement Fund Notice 1/2011 with Retirement Fund Notice 1/2012 (RF 1/2012), with effect from 1 November 2012.
(iv) the amendment of the Second Schedule of the Income Tax Act, with regards to the transfer of benefits between different funds.

3.5.1. South African Revenue Service: Retirement Fund Notice 1/2011

RF 1/2011 deals with additional requirements in respect of payments/transfers into or out of a pension preservation fund, namely;

(i) amounts paid/transferred out of a pension fund or pension preservation fund may not be paid/transferred in such a way that it is split between more than one pension preservation fund; and
(ii) amounts paid/transferred out of a pension preservation fund may not be paid/transferred in such a way that it is split between more than one pension preservation fund; or more than one retirement annuity fund; or more than one combination of one preservation fund and one retirement annuity fund. This condition applies separately in respect of each payment/transfer to the pension preservation fund.

According to Muller payments or transfers into a provident preservation fund from a provident fund or another provident preservation fund are limited to:[69]

(i) an amount assigned in terms of a divorce order to a non-member spouse and thus transferred from a provident or provident preservation fund of which the other spouse is a member; and
(ii) any amount transferred from a provident or provident preservation fund of which the person was previously a member;

[69] Muller C,*op cit*, p 21.

(iii) any other amount received by or accruing to a person by way of a lump sum as a result of membership of a provident or provident preservation fund;

(iv) the termination or loss of employment of such a person due to his/her employer ceasing (or intending to cease) carrying on the trade in respect of which the person was employed, or due to the person becoming redundant as a result of his/her employer effecting a general reduction in personnel or a reduction in personnel of a particular class,

and it does not include lump sum amounts received by or accruing to a person upon the retirement or death of such a person.

A person withdrawing from a pension/provident fund due to resignation or dismissal from employment, and then transferring/paying such funds into a pension or provident preservation fund may thus elect to take a portion of the benefit from the transferring fund (pension/provident fund) in cash, and transfer the balance into a pension preservation or provident preservation fund, provided that the rules of the transferring fund allows for this.[70]

A deduction in terms of section 37D of the Pension Funds Act will thus likewise not debar the person from transferring the balance of the benefit to a preservation fund. Where a person withdraws from the Government Employees Pension Fund (GEPF), such person will be allowed to do one of the following:[71]

(i) receive a gratuity (cash lump sum) calculated in terms of the rules of the GEPF; or

(ii) transfer a benefit to another approved retirement fund consisting of the gratuity mentioned in (i), plus the difference between the member's actual interest and the gratuity mentioned in (i).

[70] Muller C, *opcit*, p 21-22.

[71] Rule 14.4.1 of Schedule 1 to the Government Employees Pension Law, 1996. See also Muller C, *opcit*, p 22.

According to Muller a member withdrawing from the GEPF will thus only be allowed to take a cash gratuity or transfer the benefit mentioned in (ii) above to a preservation fund (or other approved retirement fund), and will not be able to take a portion in cash and transfer the balance to a preservation fund (or other approved retirement fund).[72]

A transfer from a retirement annuity fund into a preservation fund is not allowed as it is not included in the definition of a pension and provident preservation fund as defined in the Income Tax Act.[73]

It has been submitted that where an amount is transferred into a pension preservation fund from a pension fund, a provident fund, another pension preservation fund or a provident preservation fund (on withdrawal, resignation/dismissal or retrenchment), the amount so transferred is not taxed. The situation is treated the same where an amount is transferred from a pension preservation fund into a pension fund or retirement annuity fund.[74]

Where an amount is transferred into a provident preservation fund from a provident fund or another provident preservation fund on withdrawal, resignation/dismissal or retrenchment, the amount so transferred is not taxed. The situation is treated the same where an amount is transferred from a provident preservation fund into a pension preservation fund, provident fund or retirement annuity fund.[75]

Where a portion of a benefit from a pension or provident fund is taken as a cash withdrawal on resignation/dismissal, such amount will be taxed as per the table applicable to withdrawal.[76]

[72] Muller C, *opcit*, p 22.
[73] Muller C, *opcit*, p 22.
[74] Muller C, *opcit*, p 22.
[75] Muller C, *opcit*, p 22.
[76] Muller C, *opcit*, p 22.

Where a portion of a benefit from a pension or provident fund on retrenchment is taken as a cash withdrawal, such amount will be taxed as per the table applicable to retrenchment, retirement and death

3.6. Withdrawal from a preservation fund (before retirement or death)

After an amount has been transferred into a preservation fund one cash withdrawal from the fund (prior to retirement or death) during membership to this fund or any other preservation fund is allowed. According to Muller this, however, applies separately to each payment or transfer to the fund.[77] In this regard it must be borne in mind that where the member takes a portion of the benefit in cash before transferring it into the preservation fund, or an amount is deducted in terms of section 37D, this will not be regarded as the first withdrawal.[78]

According to Muller, a deduction for divorce purposes, whether before or after the transfer into the preservation fund is concerned, will not be regarded as the member's one withdrawal.[79] Where the benefit was transferred out of the Government Employees Pension Fund (GEPF) to another fund, the following should be borne in mind:

(i) The fund that the benefit is transferred to must contain a rule specifying that any lump sum payable by such fund will be limited to one third of the transfer benefit, plus interest.

(ii) The balance of the member's benefit (plus interest) shall, after deduction of the one third mentioned in (i) above, be used to purchase an annuity.[80]

The effect of this provision in the rules of the GEPF on transfer to a preservation fund is thus that the withdrawal benefit will be limited to one

[77] Muller C, *opcit*, p 23.
[78] Muller C, *opcit*, p 23.
[79] Muller C, *opcit*, p 23.
[80] Muller C, *opcit*, p 23.

third of the total benefit, and if such one third is withdrawn, the member will, on retirement, not be allowed any lump sum payments, and the total balance left in the fund will have to be used to purchase an annuity.[81]

As noted above, in the case of withdrawal from a pension preservation fund, the amount transferred to the following types of funds will be transferred tax free:

(i) another pension preservation fund;
(ii) a pension fund;
(iii) a retirement annuity fund.

The Second Schedule to the Income Tax Act provides that in the case of withdrawal from a provident preservation fund, the amount transferred to the following types of funds will be transferred tax free:[82]

(i) a pension preservation fund;
(ii) another provident preservation fund;
(iii) a provident fund;
(iv) a retirement annuity fund.

Where an amount is withdrawn from a preservation fund, the following will be allowed as deductions from the taxable amount (and will thus effectively be received tax free);[83]

(i) Any contributions made by a member to a provident or a pension fund before transfer of such benefits into a pension preservation or provident preservation fund, where such contributions were not allowed as a deduction for income tax purposes under the Income Tax Act;
(ii) Unclaimed benefits transferred to preservation funds and taxed prior to transfer;

[81] Muller C, *opcit*, p 23.
[82] Paragraph 6(1)(a) of the Second Schedule to the Income Tax Act 58 of 1962.
[83] Paragraph 6(1)(b) of the Second Schedule to the Income Tax Act 58 of 1962.

(iii) An amount transferred into a pension or provident preservation fund (or a previous fund that the member belonged to where a transfer took place into the current fund) in terms of an election made on a divorce order that had been taxed on such transfer;

(iv) An amount that had been transferred from a pension fund to a provident fund and such amount was taxed on the transfer;

(v) Pre-1 March 1998 portion of transfers from public sector funds or municipal funds.

3.7. South African Revenue Service: Retirement Fund Notice 1/2012

RF1/2012 introduces the following changes:

(i) It imposes additional conditions on the transfer of a benefit from a pension to a pension preservation fund and on a transfer out of a pension preservation fund;

(ii) clarifies when members may take cash on transferring their exit benefit to a preservation fund and

(iii) Clarifies how a transfer from preservation to a retirement fund is treated from a taxation perspective.

These changes are discussed more in detail below.

3.8. Translocation of benefits.

A member exiting their former occupational fund can now access a portion of their benefit in cash before transferring to the pension preservation fund or provident preservation fund.

Such a transfer is tax-neutral and does not preclude the member from accessing a further once off withdrawal benefits in the pension preservation fund or provident preservation fund.[84]

[84] SARS, RF1/2012.

3.8.1. Transfers to and from a pension preservation fund

When a benefit or unclaimed benefit is transferred from a pension to a pension preservation fund or to an unclaimed benefits fund, it may not be split between more than one preservation or unclaimed benefit fund (which is in fact another form of preservation fund). Should members wish to transfer out of their pension preservation fund, such transfer can only be made to:

- one pension fund; or
- one pension preservation fund; or
- one retirement annuity fund; or
- a combination of one pension preservation and one retirement annuity fund
- a combination of one pension and one pension preservation fund; or
- a combination of one pension and one retirement annuity fund.

This condition applies to each payment or transfer from the pension preservation fund.

3.8.2. Transfer from a preservation to a retirement annuity fund

The definitions of "pension preservation fund" and "provident preservation fund" currently provide that a benefit that is transferred from any preservation fund to a retirement annuity fund will be regarded as the member's once-off withdrawal.[85] The transfer of the benefit from the preservation fund to the retirement annuity fund is not prohibited in terms of the definitions. The transfer from a preservation fund to a retirement annuity fund will be allowed as a deduction in terms of paragraph 6 of the Second Schedule to the

[85] SARS, RF1/2012.

Income Tax Act when calculating the lump sum and is accordingly still a tax neutral event.[86]

The proposed amendment to both the definitions of "pension preservation fund" and "provident preservation fund" means that the member will be able to transfer such an amount to a retirement annuity fund without it being regarded as the member's once-off withdrawal.[87] It should be noted that if an amount is transferred before the promulgation of the Taxation Laws Amendment Bill of 2012, the transfer will be tax-neutral. However there is a risk that the benefit might be regarded as the member's once-off withdrawal if the legislation is not promulgated with retrospective effect.[88]

[86] *Ibid.*
[87] *Ibid.*
[88] *Ibid.*

CHAPTER FOUR: RETIREMENT REFORMS

4.1. Social security and retirement reforms proposals

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.

(a) State Old Age Pension

The Department of Social and Development offers various social assistance grants.[89] One of these grants is the State Old Age Pension (SOAP). SOAP is granted to the elderly, normally between the ages of 60 years or older, and it is funded by the government revenue. SOAP amounts to R1200, 00 as at July 2012, this amount changes annually.[90]

The payment of SOAP is subject to the means test, however it has long been recognised that this means test suffered from both design and implementation defects, and its reform needs to be considered alongside options for complementary contributory arrangements.[91] It is proposed that either the threshold for the deduction of independent income from the grant

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[89] Social assistance consists of old age pension, disability grant, child support gran etc.

[90] See State Pension, http://www.mywage.co.za/main/decent-work/state-pension , online accessed on 23 November 2012.

[91] National Treasury, Retirement Fund Reform, a discussion paper, December 2004, p 6.

be increased or the means test be scraped. We opine that the scrapping out of the means test is vital because it does not work effectively and it encourages dishonesty. In fact, the means test penalises the low-income earners for saving.

It is proposed that social assistance grants continue to be provided to the elderly, the disabled, children and care-givers. In the premise, 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.[92]

(b) Wage Subsidy

Wage subsidies may be seen as prominent features of the employment and social protection policies in many countries.[93] Accordingly, the South African government proposes to introduce an explicit wage subsidy and continuing minimum benefits through social assistance, rather than indirect cross-subsidisation.[94] 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.

The NT has proposed that the wages of all workers between the ages of 18 and 29 earning less than R60 000 a year – the current tax threshold – should be subsidised for a period of two years. Registered employers would receive the subsidy via credits on their PAYE account.[95] It is estimated that the programme would subsidise 423 000 workers. Of these, 245 000 jobs would be created in any case, and the remaining 178 000 would be created in

[92] 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, March 2010, p 291. See also paper presented by Rosemary Hunter titled "Social Security and Retirement Reform" at the Pension Lawyers Association Conference on 6 March 2009.
[93] Examples include the family credit system in the United Kingdom, the earned income tax credit in the United State, the tax credit for new job creation in Mexico and the subsidy for social security contributions of low-wage earners in the Netherlands.
[94] National Treasury, Social security and retirement reform second discussion paper, 23 February 2007, p 12.
[95] *Centre for Enterprise and Development, Jobs for Young People is the Wage Subsidy a good idea? 2011,* http://www.cde.org.za/article.php?a_id=401*, online accessed 23 November 2012.*

response to the subsidy. It is further estimated that some 45 000 workers would drop out of the labour force after having benefited from the programme, so the net result would be 133 000 more people employed by 2015, when the programme would end.[96]

The wage subsidy is intended to encourage employment creation and also to support a "living wage" in labour intensive sectors and low-wage occupations. 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.[97]

The question that perhaps needs to be answered is whether the wage subsidy proposal is the correct approach to create employment as it is intended. This question raised a lot of debate from concerned stakeholders. These stakeholders range from political parties and government, to trade unions and labour, business, civil society and the general public.[98]

The following are the arguments in support for the idea of introducing the youth wage subsidy.

- It is argued that the introduction of a youth subsidy will narrow the gap be-tween the costs employers incur when employing these workers and those workers' likely levels of productivity. This would make it an incentive for companies to employ more youth. It is further argued further that the youth subsidy has worked successfully in the United States, Belgium and Singapore. [99]

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[96] *Ibid*

[97] Nevondwe L, South African Social Security and Retirement Reform: A long journey towards the redrafting of the new Pension Funds Act, , Pensions, and International Journal, Palgrave Macmillan Publishers, UK, Vol. 15, issue 4, March 2010 , p 291.

[98] Introducing the Youth Wage Subsidy in SA: Arguments for and against it, 06 November 2012, http://www.polity.org.za/article/introducing-the-youth-wage-subsidy-in-sa-arguments-for-and-against-it-2012-11-05 , online accessed 23 November 2012.

[99] Thabani Mdlongwa, The youth wage subsidy: Is it a good idea or not ?http://www.ai.org.za/wp-content/uploads/downloads/2012/07/June-Vol-17-2012.pdf , online accessed 24 November 2012.

- It will lower the effective cost of employment and create hundreds of thousands of jobs without an adjustment of wages or conditions of employment. It acts as an incentive for on-the-job training and is a powerful remedy for reducing unemployment. Firms are re-warded for hiring, and they reward themselves by ensuring that those hired are also adequately skilled. This allows the market to take care of providing skills, rather than the state.[100]

The following are the arguments against introducing a youth wage subsidy.

- The main counter arguments made against the introduction of the youth wage subsidy are that it is costly and unsustainable in the long run, as it depends on how many workers the wage subsidy induces firms to employ.[101]
- It is also argued that the introduction of the youth wage subsidy may not have favour with employers who may feel that it is too risky to employ someone who is subsidised, and will not be able to dismiss them if they don't perform well due to South Africa's rigid labour laws.[102]
- It is argued further that the funds being contributed to the youth wage subsidy could be better spent elsewhere. According to COSATU, who are vehemently opposed to the introduction of the youth wage subsidy to reduce youth unemployment, the youth wage subsidy will be exploited by employers in the sense that an employer gets a tax break from employing anyone who is under 35 and currently unemployed. What then stops the employer from firing all the older workers and hiring only the under 35's to maximise their tax breaks?[103]

[100] *Ibid*.
[101] *Ibid*.
[102] *Ibid.*
[103] *Ibid*.

- It is argued that the older workers would be prejudiced as the younger employers might get paid more in order for the employee to get maximum tax benefits. It thus remains to be seen what will hap-pen to the idea of introducing the youth wage subsidy in South Africa.[104]

What is clear is that both arguments in support of and against the implementation of the youth wage subsidy, provide a compelling case and this is an area which will continue to garner heated debate within South Africa.[105]

(c) Mandatory participation in a national social security system for all.

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.[106]

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.[107]

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

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[104] *Ibid*.
[105] *Ibid.*
[106]Lufuno Nevondwe and Makhubalo Ndaba, South African social security and retirement reforms: Recent developments, Insurance and Tax, vol. 27 No 3 September 2012, p 23. See also 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, Vo15, issue 4, March 2010,p 291-292.
[107] *Ibid*.

proposed in the 2007 Second Discussion Paper that compulsory preservation would apply to compulsory contributions.[108]

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.[109]

For their contributions contributors will receive 'basic retirement funding' determined on a 'defined contribution' basis, unemployment insurance and life and disability cover. If social health insurance is thrown into the mix, the contribution rate would have to increase to between 20 per cent and 25 per cent of wages. Contributors could be allowed to make additional voluntary contributions to the scheme.[110]

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. [111]

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

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[108] *Ibid.*
[109] Nevondwe L and Ndaba M, *op cit* ,p 24.
[110]Nevondwe Land Ndaba M, *op cit* ,p 24
[111]Nevondwe L and Ndaba M, *op cit* ,p 24.

subsidy rather than the cross-subsidy by some contributors of the cost of providing benefits to others.[112]

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. 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.[113]

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. 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. [114]

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

[112]Nevondwe L and Ndaba M, *op cit* ,p 24.
[113]Nevondwe L and Ndaba M, *op cit*, p 24.
[114]Nevondwe L and Ndaba M, *op cit,* p 25.

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. 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.[115]

(d) Mandatory participation in private occupational or individual retirement funds

Many employees do recognises 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.[116] 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. This should allow individuals to save to provide for an adequate income replacement after retirement.[117] It is suggested that the

[115]Nevondwe L and Ndaba M, *op cit,* p 25.
[116] 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, March 2010, p 293.
[117] Nevondwe L and Ndaba M, *op cit*, p 25. See also 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, March 2010,p 292-293.

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.[118] 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, it cannot be foreseen that funds will want to make these transfers because it will reduce their economies of scale.[119]

(e) 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.[120]

(f) 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

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[118] *Ibid*

[119] *Ibid*

[120] Nevondwe L and Ndaba M, *op cit,* p 25-26. See also 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, 4, March 2010, p 293.See further a paper presented by Rosemary Hunter at the Pension Lawyers Association Conference on 6 March 2009, p7.

highlight a broader problem with fund governance that, if unchecked, will damage the trust underpinning the system.[121]

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.[122] 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.[123]

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.[124]

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.

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[121]National Treasury, Strengthening savings, an overview of the proposals announced in 2012 budget, 14 May 2012 , p 14.

[122]Nevondwe LT and Mhlaba MW, Judicial Activism and Socio-Economic Rights in South Africa (2012), p222.

[123] *Ibid*. See also Lufuno Nevondwe and Makhubalo Ndaba, *op cit* , p 26. See also Choma HJ and Nevondwe LT, Socio-Economic Rights and Financial Planning in South Africa (2010), p278-279.

[124] National Treasury, Strengthening savings, an overview of the proposals announced in 2012 budget, 14 May 2012, p 15.

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]

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."[126]

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;[127]

- 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;

[125] *Ibid*.
[126] Nevondwe L and Ndaba M, *op cit*, p 26-27. See also 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, March 2010, p 293-294.See also a paper presented by Rosemary Hunter at the Pension Lawyers Association Conference on 6 March 2009, p 7-11.
[127] *Ibid.*

- 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;[128]

- 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;[129]

- 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;[130]
- 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;[131]

- 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;

[128] *Ibid.*
[129] *Ibid*.
[130] *Ibid*.
[131] *Ibid.*

- 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.[132] 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.[133]

(g) 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

[132] *Ibid.*
[133] *Ibid.*

age and above. This will apply to both employer and employee contributions.[134]

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.[135]

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.[136]

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.[137]

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.[138]

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[134]National Treasury, Strengthening savings, an overview of the proposals announced in 2012 budget, 14 May 2012, p 13.See also Lufuno Nevondwe and Makhubalo Ndaba, *op cit* , p 29-30. See Nevondwe LT and Mhlaba MW, Judicial Activism and Socio-Economic Rights in South Africa (2012), p225.

[135]National Treasury, Strengthening savings, an overview of the proposals announced in 2012 budget, 14 May 2012, p 14.

[136] National Treasury, Strengthening savings, an overview of the proposals announced in 2012 budget, 14 May 2012, p 14.

[137] National Treasury, Strengthening savings, an overview of the proposals announced in 2012 budget, 14 May 2012, p 14.

[138] National Treasury, Strengthening savings, an overview of the proposals announced in 2012 budget, 14 May 2012,p 14.

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;[139]
- there are synergies between a robust pension environment and the development of financial markets that in themselves have further economic development benefits;[140] 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.[141]

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.[142]

Higher-income earners have benefited disproportionately from tax incentives in the past without this serving any particular public purpose, so it is likely that

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[139]A paper presented by Hunter R at the Pension Lawyers Association Conference on 6 March 2009, p 11. See also 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, March 2010, p 294-295.
[140]A paper presented by Hunter R at the Pension Lawyers Association Conference on 6 March 2009, p 12
[141] *Ibid.*
[142] *Ibid.*

there will be some form of monetary cap on tax relief on contributions to retirement funding vehicles.[143]

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. [144]

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.[145]

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.

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[143] *Ibid.*
[144] *Ibid.*
[145] A paper presented by Rosemary Hunter at the Pension Lawyers Association Conference on 6 March 2009, p 13.

CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS

4.1. Conclusion

According to Cronje in the context of developing countries and developing economies, one could argue that evidence of low gross savings and household savings rates is neither unexpected nor uncommon if one assumes that developing economies are characterised by low income growth that would inform low savings levels. [146]

The wide-range of proposals to reform social security and retirement fund is an indication that Government is committed in increasing the financial security of all citizens. The introduction of compulsory preservation of pension benefits 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.[147] 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.[148] 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 South African pension industry is one of the largest contributors to the country's economy and I submit 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

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[146] Cronje M, Creating a savings culture for the Black middle class in South Africa-policy guidelines and lessons from China and India, LLM mini-dissertation (2009), p106.
[147] National Treasury, Preservation, portability and governance for retirement funds, 21 September 2012, p 3.
[148] National Treasury, Strengthening savings, an overview of the proposals announced in 2012 budget, 14 May 2012, p 8.

introduce the statutory requirement that trustees be "fit and proper", with no criminal history.[149] 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.[150] It is also proposed that the trustees adhere to governance principles and continually undergo training to increase their knowledge and to equip them to carry out their duties more effectively.[151]

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 2013.[152] The time is right for bold new steps in improving income security of the poor and strengthening the fabric of social solidarity that binds all South Africans together.

From the discussions from the whole study, it is evident that South Africans do not save enough for retirement. According to the Retirement Fund Reform discussion paper "The organisation and financing of income security in retirement is amongst the most profound expressions of a nation's cohesion and values. It relies on confidence in the long-term continuity of institutions, it rests on trust in the law and sound financial and economic management, it embodies principles of solidarity, risk-sharing and prudential foresight".

The discussion paper further highlighted that "South African retirement fund industry has been heavily influenced by a racially divided past and the parallel existence of developed and emerging components of our economy. There is a large and well-established private contractual savings sector,

[149] National Treasury, Strengthening savings, an overview of the proposals announced in 2012 budget, 14 May 2012, p 15.
[150] National Treasury, Strengthening savings, an overview of the proposals announced in 2012 budget, 14 May 2012,p 15.
[151] National Treasury, Strengthening savings, an overview of the proposals announced in 2012 budget, 14 May 2012, p 27.
[152]Statistics South Africa, 2012 , The South Africa i know, the home i understand, http://www.statssa.gov.za/Census2011/Products/Census_2011_Pictorial.pdf online accessed on 25 November 2012.

government employees are provided for through a near-fully funded retirement arrangement, but approximately three-quarters of the population reach retirement age without a funded pension benefit and hence rely on a government social assistance grant programme. Though there are features of the structure and depth of the South African retirement funding environment that compare well with both developed and developing countries, there are also decidedly unsatisfactory aspects. Government seeks to build on the strengths of the established retirement funding environment, while progressively addressing its deficiencies".

4.2. Recommendations

I recommend that the Pension Funds Act need to be amended to cater for both public and private pensions. It must also have provisions on the compulsory preservation of pension benefits.

The Financial Services Board (FSB) as the regulator of pension benefits needs to be capacitated with professionals who have skills on pension benefits. The mandated of the FSB need to be broadened to include the public pension since the current regulator National Treasury cannot be the oversight and at the same time the regulator.

The retirement reforms proposed by National Treasury needs to be fast-tracked to close the gap of inequalities amongst the blacks, white, coloureds and Indians. There are different pension funds which are designed along racial lines.

I further recommended that the costs of administration of pension benefits needs to be looked since currently in many pension funds, it covers almost 40 percent of the entire benefits.

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