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Legal update 6/2012

21 May 2012

## Strengthening Retirement Savings: Overview of the 2012 Budget proposals

National Treasury issued a document which provides an overview of the technical discussion papers that will be released this year. This will focus on the 2012 Budget proposals dealing with the promotion of retirement savings. In summary, the most important proposals are:

- Reducing retirement fund costs to encourage more participation in retirement funds.
- Reforming the annuities market by offering simple, standardised and low cost products.
- Phasing in a preservation model to ensure that employees are financially secure when they retire.
- Improving fund governance by imposing statutory requirements.
- Providing a uniform tax model for all retirement funds to simplify the system.
- Extending the application of the Pension Funds Act to public sector funds.
- Introducing a tax-free savings vehicle to encourage other savings apart from retirement savings.

These proposals are discussed in detail below.

### Household savings and retirement

Household savings in South Africa (SA) has decreased over time. To encourage people to save more, government is trying to ensure that lower income households now have access to formal savings instruments which includes retirement funds.

Government is therefore proposing various steps to strengthen retirement funding guided by the following principles:

- Greater protection for members.
- Improving efficiency and good governance.
- Using standardised products.
- Promoting financial inclusion for lower income households.

### Reducing retirement fund costs

Many employers do not want to set up retirement schemes for their employees due to the high retirement costs which tend to eat into retirement savings and reduce savings. Retirement annuity funds and umbrella funds have been identified as being particularly expensive.

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Government is currently in discussions with the industry to develop policy proposals which includes the following options:

- Standardising retirement products to increase competition based on price rather than product design.
- Exemption from the Financial Advisory and Intermediary Services (FAIS) Act for some standardised products.
- Regulating pricing structures to prevent negative impacts on small employers with lower paid employees.
- Standardising disclosure requirements across different products to ensure fair comparison.
- Encouraging passive investment management which is cheaper compared to active management.
- Ensuring that guaranteed and smoothed bonus funds are used appropriately.
- Discouraging direct payments from providers to intermediaries.
- Ensuring that fund trustees are aware of their responsibilities to members.
- Preventing cross subsidisation of services to the detriment of some members.

The technical discussion paper on *Retirement fund costs* should be released by October 2012.

### **Reforming the annuities market**

Compulsory annuity products, for example a living annuity or conventional life annuity, might involve complex choices, can include high charges, not offer value for money for lower income households and in the case of a living annuity there is no protection against members outliving their assets. Government believes that there is a need to structure the annuity market in such a way that members are encouraged to make good choices and are therefore considering the following options:

- Developing a simple, low cost retail bond based living annuity product.
- Developing standardised products in which retirement funds can place members without financial advice.
- Default members into new annuity products that share risks between providers and members.

The technical discussion paper on *Providing a retirement income* should be released by June 2012.

### **Preservation and portability**

One of the main reasons why South Africans are not financially prepared for retirement is because they do not preserve retirement fund benefits when they change or leave their jobs. Government wants to phase in a compulsory preservation model where members can only access a portion of their benefits in certain instances, for example where a person is unemployed and has exhausted their Unemployment Insurance Fund Benefit or where the money is required for a medical need.

The technical discussion paper on *Preservation, portability and uniform access to retirement savings* should be released by June 2012.

### **Improving fund governance and the role of trustees**

For any retirement fund, good governance is important. Funds must be managed in line with the law and always take into account the best interests of the members. Trustees must not only act independently but must have the relevant knowledge and expertise in managing a retirement fund. Government therefore proposes the following:

- PF Circular 130 (issued by the Registrar of Pension Funds) becomes legally enforceable.
- A statutory requirement that trustees be “fit and proper” with no criminal history.
- Professionalising the role of the Principal Officer.

The technical discussion paper on *Preservation, portability and uniform access to retirement savings* to be issued in June 2012 will set out these proposals in detail.

## Harmonising retirement fund taxation

Government propose a uniform tax treatment model for *all* retirement funds in respect of the funds' contributions and benefits. Their proposals include the following:

- Both employee and employer contributions will be taxed as a fringe benefit in the employees' hands with a deduction of up to 22.5% for individuals under 45 years and 27.5% for individuals over 45 years.
- The maximum permitted deduction will be between R20 000 and R250 000 for individuals under 45 years and up to R300 000 for individuals over 45 years.
- A special arrangement will be made for defined benefit funds and the Government Employees Pension Fund to prevent negative tax consequences for existing members.
- Annuitisation proposals will be phased in to help protect members from outliving their assets.

The technical discussion paper on *Uniform retirement contribution* model should be released by August 2012.

## Pension fund investments

The new Regulation 28 provides that trustees must invest assets in the best interests of members and must also consider the environmental and social factors underlying investments.

## Pension laws to be extended to all public funds

Many public sector funds for example the Government Employees Pension Fund, Transnet and Telkom are exempt from the provisions of the Pension Funds Act. Government is considering extending the provisions of the Pension Funds Act to public sector funds to offer more protection to those members.

## New tax-free savings instrument

Government proposes setting up a tax-preferred vehicle to encourage savings so that individuals do not use their retirement savings for short and medium term needs. Individuals will be able to save up to R30 000 per year with a lifetime limit of R500 000 and such amounts would be exempt from income tax and capital gains tax.

For lower income households, a similar scheme to Fundisa is being considered where for every rand that a household contributes, an additional amount will be contributed. Government will therefore have to focus on increased funding support for such an initiative.

The technical discussion paper on *Savings and fiscal incentives* should be released by August 2012.

## Comments by 31 July 2012

Comments on the Overview document can be submitted to [retirement.reform@treasury.gov.za](mailto:retirement.reform@treasury.gov.za) by 31 July 2012.

### Technical discussion papers to be issued in:

#### June 2012

- *Providing a retirement income* – reviews retirement income markets and measures to ensure cost effective & standardised products.
- *Preservation, portability and uniform access to retirement savings* – phasing in preservation and harmonising annuitisation.

#### August 2012

- *Uniform retirement contribution model* - harmonising tax treatment for contributions to simplify the retirement funds tax regime.
- *Savings and Fiscal incentives* – how short-term savings can be enhanced through tax-preferred individual savings.

#### October 2012

*Retirement fund costs* – review the costs of retirement funds and measure to reduce such costs.

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