BUSINESS UNITY SOUTH AFRICA

NATIONAL OFFICE
61 Katherine Street, Sandton, 2196
P.O. Box 652807, Benmore, 2010
www.busa.org.za
+27 11 784 8000

PARLIAMENTARY OFFICE
9 Church Square, 1st Floor Graaffs
Trust Building, Cape Town, CBD

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BUSINESS POSITION:
International Labour Organisation working papers

The International Labour Organisation ("ILO") has published the following two papers as part of their research mandate from the Department of Social Development[1]:

1. "Good governance in social security – Issues in the proposed comprehensive social security framework in South Africa"; and

2. "Tier-3 pensions in the comprehensive social security framework".

These two ILO papers were submitted to Nedlac's Comprehensive Social Security and Retirement Reform Task Team for comment by social partners. Set out below are the preliminary comments of Organised Business:

It is important to note, from the outset, that there are many areas within both ILO papers that have not addressed concerns raised at Nedlac by the Task Team. We therefore consider this to require a fair deal of additional engagement at Nedlac before any final proposal would be acceptable to Business.

1. Good governance in social security

a. Government has over the passage of some ten years, since a Social Security Oversight Department was first mooted by the IDTT, made no progress in consolidating existing social security responsibilities across government into a singular new department and ministry. It is questionable whether this is therefore pragmatic. The ILO alternative of a cross-ministerial policy coordinating council deserves consideration – certainly as an interim step.

[1] The papers refer in several places to a 2018 update of the 2012 discussion paper which is attached. This document has not been part of the Nedlac deliberations to date, but was released in response to a request from Business following the circulation of the ILO papers above. The paper seems not to include points made by constituencies during the Nedlac deliberations. It appears to mainly attempt an update on the 2012 version. Several updates appear to themselves be out of date indicating that the document was updated at more than one point in time.

b. The governance design proposals are all based on the merits of centralisation, without considering the systemic and concentration risks posed by such a solution. It does not speak to the hard experience gained through SASSA and PIC governance failures. For example, the Swedish system has four AP funds to ameliorate political risk. Other technological options might be available that will render an effective integration of the system, including health (which is largely ignored).

c. The principled points on the separation of powers in chapter 3 have not worked in practice in South Africa. Many of the proposed delineations are therefore theoretical rather than practical. No attempt is made to solve for these concerns in the new system. In Annex B various country examples are recorded that might be instructive. The Swedish system, for example, stipulates that the Board of Directors for funds AP1-4 have to be independent once appointed, "The institutions report annually to Government and Parliament on its business, but they do not and cannot take instructions or directions from Government or Parliament". Government, however, appoints the board members, 4 of whom are nominated by the social partners.

d. The document does not take into account the concerns raised in the Constitutional legal opinion that the merging of funds and their accrued benefits need to be carefully considered. These considerations are not clearly articulated.

e. Integration with NHI as part of social security is almost completely ignored, yet COID and the RAF are part of the future architecture of NHI.

f. Provision and governance related to informal workers is almost entirely ignored. The 2018 DSD document still envisages an ancillary solution to the NSSF for self-employed and informal workers, when Business has repeatedly made the point (now supported by Community and Labour) that we need an integrated solution.

g. Transversal policy and functionality across the tiers need to be better demonstrated. For example, the UIF as an existing social insurance fund could easily be extended to include a basic pension element.

h. The provision and governance of any guarantees from government is not articulated.

i. The governance document assumes certain policy outcomes, such as preservation as a prerequisite to adequacy. Preservation has been contentious because of structural inadequacies in household discretionary savings. Simply assuming that preservation can be used as a policy measure to solve for adequacy is simplistic. A net replacement rate of 75% is generally regarded as adequate in South Africa. The NSSF proposes to solve for adequacy with a target NRR of only 40% through enforcing preservation, while many retirement fund members use their retirement savings as precautionary savings. If preservation is to be successfully achieved, a shorter-term form of payroll-based saving needs to be included in payroll formulation as was done in the Netherlands.

j. Policy measures to improve governance around claims experience is not discussed. Neither is gender discrimination associated with benefit provision addressed.

2. **<u>Tier-3 pensions in the comprehensive social security framework</u>**

a. The paper does not demonstrate an understanding of policy integration across Tiers 2 and 3. The SA income distribution curve needs to be factored into an integrated policy perspective across the tiers.

b. The paper demonstrates inadequate understanding of the challenges that have manifested themselves in the existing system, and the impact of the proposed changes on the system and the economy:

i. It is not clear how existing pension funds will participate in Tier 3. Their structures (as prescribed by law) and their Board of Trustees' statutory responsibilities do not lend themselves to a Tier 3 as described.

ii. How death and disability benefits will be provided alongside the investment component is not explained. Integration of underwriting and investment provides a far more efficient outcome for retirement fund members.

iii. The paper demonstrates a lack of understanding of how the annuity market functions in South Africa. The large dispersion in longevity expectations is exactly why the proposed DB scheme will give poor value to lower paid workers. Comments that an annuity market needs to be developed is inaccurate. Furthermore, the paper states as a fact that annuity guarantees have little value for individuals. No supporting evidence is offered for this statement.

iv. Both papers emphasize the need for strong prudential requirements and supervision, which implies that this is currently lacking. No information is given to support this assumption.

v. Certain statements regarding the current regulatory environment are incorrect. For example, footnote 2 in the Pensions paper on underwritten funds being exempted from the requirements to appoint an auditor and valuator is outdated.

vi. Member choice is well developed in South Africa. Only a few sophisticated individuals select their own unique solution. For most members it is a function of term to retirement.

vii. Costs in the South African system are higher as a result of a lack of compulsion driving distribution costs. This has also led to a proliferation of benefit designs to differentiate between competitor offerings. This is not market failure, but a logical outcome of a policy choice.

viii. Much of the cost in the South African pension system is attributable to contribution collection and reconciliation between employers and administrators (where contributions have to be reconciled, assigned and invested within 7 days). It is not clear that by introducing a third party that this process will be improved. Much of this can be achieved digitally with minor amendments to the Income Tax Act.

c. The ability for fund members to choose the NSSF-default rather than their employer fund will dilute the cost-effectiveness and bargaining power of employer funds. It will add administrative complexity (acknowledged in the Pensions paper) which will add to the cost of administration. This can only dis-incentivise employers from continuing with their current funds or from setting up new funds.

d. The paper proposes abolishing pre-retirement withdrawal in Tier 2 and "tightly limiting" withdrawal in Tier 3. This without any consideration of the financial need of withdrawing members which is often the driver of the withdrawal as mentioned above. Financial Services Providers have always supported preservation of pension savings together with compulsory membership of retirement funds as being theoretically ideal. However, the social reality is that life cycle risks are not correctly matched to savings instruments.

e. The following regulatory and industry developments are not given a mention:

i. The Financial Sector Regulation Act, the various sections of which have been gradually made effective over the period 2018/2019, was promulgated to give effect to the Twin Peaks system of financial regulation. Amongst other provisions, the Act establishes the Financial Services Tribunal, which acts as an appeal body. If a party is aggrieved by a decision of the Pension Funds Adjudicator, it may apply to the Tribunal for a reconsideration of the decision. How will the offices of the Pension Funds Adjudicator and the Financial Services

Tribunal interlink with the Common Public Interface for Social Security and the Social Security Tribunal?

ii. The Conduct of Financial Institutions Bill, due for tabling in Parliament later this year/early 2020, provides for governance and conduct standards to be made in respect of pension funds, including public sector pension funds.

iii. The recently introduced "Default regulations" under the Pension Funds Act provide for significant changes both in governance and conduct responsibilities of the members of boards of trustees of pension funds, and also necessitated operational and systems changes for the funds' administrators.

iv. After many years of development, and with consultation and discussion with the FSCA, ASISA recently introduced the Retirement Savings Cost Disclosure Standard (effective 1 March 2019) and the Effective Annual Cost Standard for Individual Members (effective 1 October 2020). The former relates to the reflection of costs and charges in pension funds in a standardised manner so that employers and pension fund trustees can compare different fund options. The latter enables individual fund members to compare the effect of costs and charges across different funds, be they occupational or retail. Is the ILO even aware of these Standards?

Business will, at the next Task Team meeting at which these ILO documents will be discussed, further elaborate on its position and concerns.

End.