CFA Society South Africa

2nd Annual Retirement Reform Workshop in collaboration with IRFA and SAVCA

Executive Report

May 2023

Index

1.0 Terms of reference

1.1 The 2nd Annual Retirement Reform Workshop

The Mercer CFA Institute Global Pension Index 2022 compares 44 retirement income systems and compares each system in terms of **adequacy, sustainability and integrity i.e.: -**

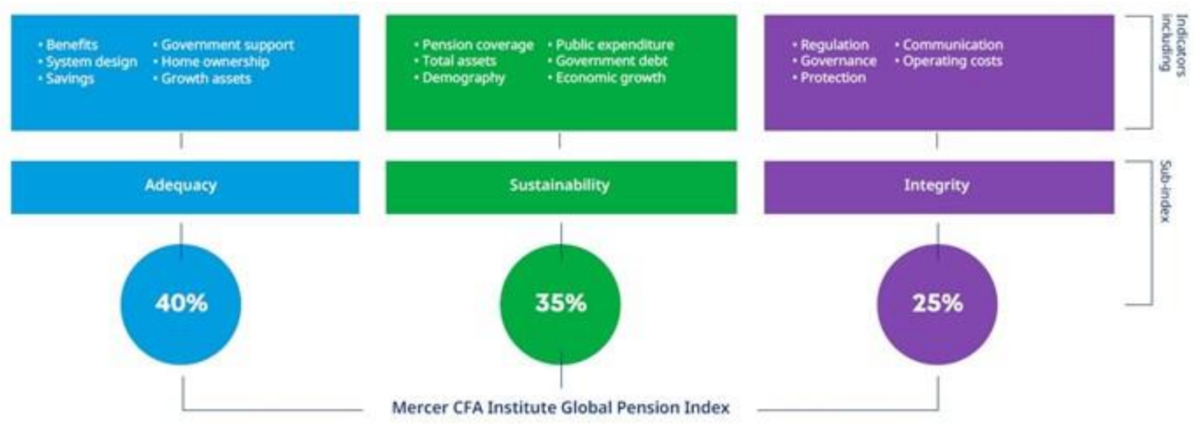
- What benefits are future retirees likely to receive?
- Can the existing systems continue to deliver, notwithstanding the demographic and financial challenges?
- Are the private pensions plans regulated in a manner that encourages long-term community confidence? Some existing pension arrangements are either providing very limited benefits or may not be sustainable over the longer term.

The primary objective of the research is to benchmark each retirement income system using more than 50 indicators.

CFA Global Institute is the primary sponsor of this research. The CFA Society of South African hosts an annual workshop in collaboration with IRFA and SAVCA, facilitated by CFA Board Member Raazia Ganie. The aim of the workshop is to use the Mercer CFA Global Pensions index as a framework and to identify steps that could be taken to improve South Africa's overall ranking in the Mercer Index and in doing so to improve retirement outcomes for members overall.

1.2 Some information on the Global Pensions Index

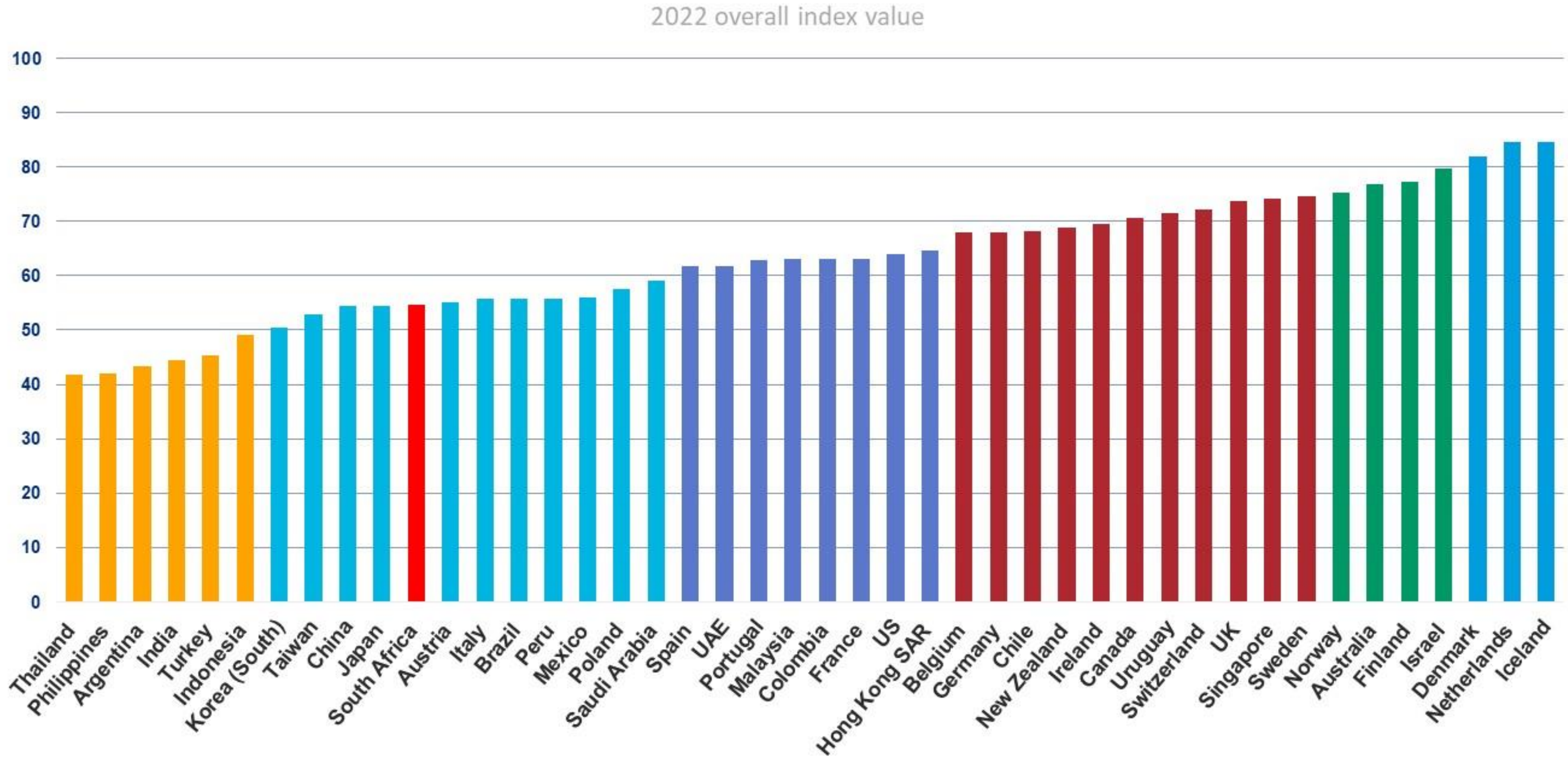
The Mercer CFA Institute Global Pension Index uses three sub-indices/critical dimensions, **those of adequacy, sustainability and integrity,** to measure each retirement income system against more than 50 indicators, defined and weighted as follows: -



Overall classification across all variables is in categories A-E as follows: -

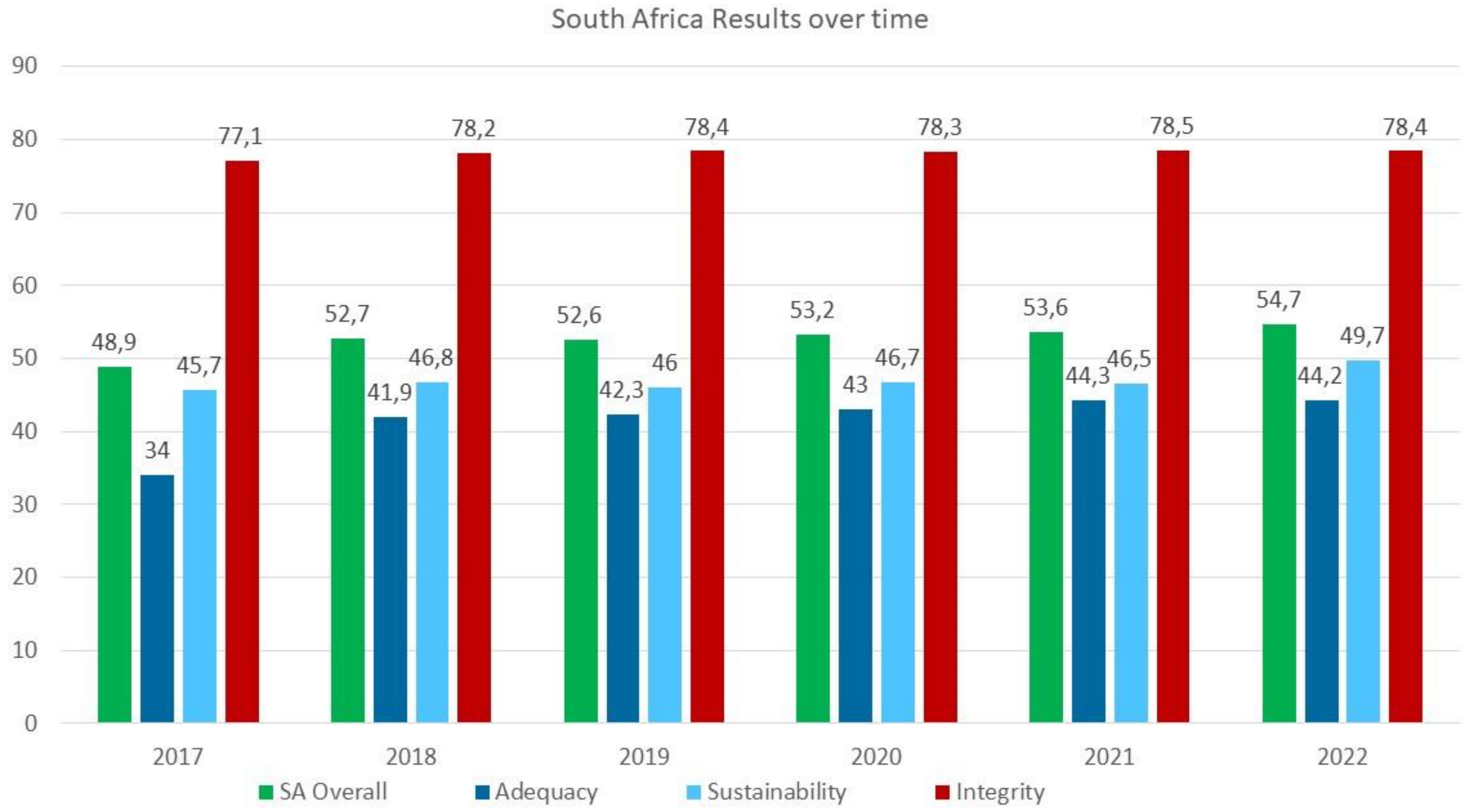
- **A (Score of 80 and above):** A first class and robust retirement income system that delivers good benefits, is sustainable and has a high level of integrity.
- **B (Score of 65-80): A** system that has a sound structure, with many good features, but has some areas for improvement that differentiates it from an A-grade system.
- **C (Score of 50-64):** A system that has some good features, but also has major risks and/or shortcomings that should be addressed. Without these improvements, its efficacy and/or long-term sustainability can be questioned.
- **D (Score of 35-49):** A system that has some desirable features, but also has major weaknesses and/or omissions that need to be addressed. Without these improvements, its efficacy and sustainability are in doubt.
- **E (Score less than 35):** A poor system that may be in the early stages of development or non-existent

South Africa is classified in the "C" category and ranked 34^{th} out of 44 systems (a marginal improvement on 2021 findings where the country was ranked 31^{st} out of 43 systems) as follows: -



Since inclusion in 2018 South Africa has moved from a D grade to a C grade system and has maintained this rating.

In terms of the critical dimensions of **adequacy, sustainability and integrity** South Africa scores as follows: -


South Africa Results over time
90
80
70
60
50
40
30
20
10
0
48,9
34
45,7
77,1
52,7
41,9
46,8
78,2
52,6
42,3
46
78,4
53,2
43
46,7
78,3
53,6
44,3
46,5
78,5
54,7
44,2
49,7
78,4
2017
2018
2019
2020
2021
2022
SA Overall
Adequacy
Sustainability
Integrity

- **Overall recommendations from the Mercer study, with those pertaining to South Africa highlighted in grey.**

    - Increase the coverage of employees (including non- standard workers) and the self-employed in the private pension system, recognising that many individuals will not save for the future without an element of compulsion or automatic enrolment
    - Increase the state pension age and/or retirement age to reflect increasing life expectancy, both now and into the future, thereby reducing the costs of publicly financed pension benefits
    - Promote higher labour force participation at older ages, which will increase the savings available for retirement and limit the continuing increase in the length of retirement
    - Encourage or require higher levels of private saving, both within and beyond the pension system, to reduce the future dependence on the public pension while also adjusting the expectations of many workers
    - Introduce measures to reduce the gender gap and those that exist for minority groups in many retirement income systems
    - Reduce the leakage from the retirement savings system prior to retirement thereby ensuring that the funds saved, often with associated taxation support, are used for the provision of retirement income
    - Improve the governance of private pension plans and introduce greater transparency to improve the confidence of plan members
    - Increasing the minimum level of support for the poorest aged individuals
    - Introducing a minimum level of mandatory contributions into a retirement savings fund

1.3 A summary of the South African Pension Landscape (Wayne Hiller van Rensburg)

To set the stage, IRFA Executive Officer Wayne Hiller van Rensburg provided an overview of current and planned industry reform. Wayne noted that the current pension fund landscape was “complicated” albeit entrenched in Section 27 of the South African Constitution. He also noted that we do have a well-established formal retirement sector and that the years 2012 to 2019 have seen a complex reform process which is still underway.

In citing significant advances Hiller van Rensburg listed the default preservation regulation of March 2019 set in place to encourage pre-retirement preservation. He also listed regulations which ensure personal and criminal liability to employers who do not pay retirement contributions to a retirement fund, and lauded current initiatives boosting the skills and knowledge of trustees of retirement fund management boards.

On legislation with regard to provident funds Hiller van Rensburg noted the encouragement of annuitisation at the time of retirement (March 2021) and the simplification of taxation on retirement contributions, standardised since March 2016. Welcoming the introduction of tax free saving accounts since April 2015 and regulations which have been put in place to ensure good value retirement products and services (including default investment portfolios and annuity strategy regulations) Hiller van Rensburg observed that consolidation and coverage were high on the agenda of the National Treasury, boding well for the retiring workforce of the future.

Hiller van Rensburg also promoted the concept of investment in real assets to generate economic growth. The idea being that pension assets can provide appropriate returns to members of retirement funds and play a catalytic role and economic growth which promotes increased labour participation through infrastructure development or employment opportunities.

1.4 Overview of the 2022 Mercer CFA Institute Global Pension Index Report as it impacts the South African retirement sector (Raazia Ganie)

Raazia Ganie told delegates that "we have unique circumstances which we need to find positive ways to deal with and improve on so we can compete globally."

Noting that South Africa ranked 34 out of 44 countries on the collaborative Mercer and CFA Global Pensions Index, an annual study based on the World Bank Model whose primary objective is to ensure older citizens maintain a decent standard of living and a comprehensive review of global pension systems,

Ganie drew attention to the critical dimensions of the study, those of adequacy, sustainability and integrity.

"In other words, she said, "what do you get on retirement and how much will it be relative to your current salary (adequacy), can your pension keep delivering (sustainability) and what are the regulations surrounding your pensions and the costs pertaining thereto (integrity.)

On adequacy South Africa scored at 44,2 (out of a potential 100) translating to a D rating. The highest-ranking countries on this indice are Iceland (85,8), Portugal (84,9) and the Netherlands (84,9). Lowest rankings on this scale are Indonesia and India.

Contributing variables are minimum (or base) pension, net replacement rate (weighted), system design features, household savings/debt and level of growth (assets.)

Contributing variables to sustainability are coverage of funded pension plans, level of pension assets as a percentage of GDP, demographic variables, mandatory contributions with funding, labour force participation at older ages, public pension costs/net government debt and real economic growth. South Africa's score rose by

3,4 points to 49,7 on this dimension in 2022. Ganie says that only 16 of the 44 systems considered in the study have coverage rates above 64%.

Moving on to integrity which focuses on the regulation of private pension plans, as well as governance requirements, protection of member benefits, communication to members and costs of the system, this is an area where South Africa has a high score of 78,4%, due, according to Ganie, “to sound regulations and relatively good governance within the retirement fund system .”

Clearly says Ganie, the local retirement sector and regulators need to look at improvements to adequacy and sustainability as defined by the study, where development is indicated. She concludes “we can make significant improvements on our scores with the right focus.”

2.0 Core insights from the three working groups

2.1 On boosting the adequacy dimension

The adequacy of a retirement system for any country is a function of how well that country has addressed its other obligations around social capital. SA contributes more than any other African nation to education, healthcare and security- and yet all of these areas fall short (when compared to other African countries) due to corruption and incompetent administration.

The group tabled the following suggestions: -

- **Proposed structural changes:** The industry needs to develop solutions for those without retirement cover (i.e., low income market, informal sector). This demands government participation.
- Providing solutions to members that allow for **funding for affordable housing at a much earlier stage in their life cycle.**
- **Review and revision of the unclaimed benefits issue. S**pecific legislation to govern the management of these without disadvantaging members may be required.
- Ensuring a savings culture through **financial education** and communication
- **Lowering of costs to retirement by** reducing post-retirement medical costs, upgrading of public healthcare system, providing affordable healthcare and reducing administrative fees
- **Enhancing liquidity of private market investments through** education and development of a credible secondary market

2.2 On boosting the sustainability dimension

The working group noted that the three streams; adequacy, integrity and sustainability, all come together into problem management of pension funds.

The group concurred that there was a benefit in that formally employed people are able to contribute to retirement funds but cautioned that there are no legal requirements in South Africa for an employer to provide retirement benefits to employees and that not everyone has retirement savings.

The group also noted that South Africa is one of the few countries to have an established private retirement system. A large proportion of the country's GDP is made of these retirement fund assets. While in comparison, most other countries provide social security benefits for all citizens.

Key takeouts from this session to boost this dimension were as follows:

- **Increasing coverage:** The informal traders, contracted workers, are not able to contribute to retirement funding hence a solution for the informal and formal divide needs to be found. As a first step ensuring that employed individuals participate in a retirement system.
- **Finding ways to make it affordable to contribute with regard to auto enrollment** by including auto escalation of contribution for employers and/ or employees will help to improve the wellbeing of contributors; and improving cost efficiencies by building scale.
- **Education** on sustainable investments, developing financial acumen amongst the youth and developing skills to improve access to employment and therefore access to "social security" retirement.
- **Infrastructure and community development by** promoting investment into infrastructure development/ SME and promoting community upliftment by creating jobs. Access to social security retirement is also critical in this regard (more people participating in the growth of the SA economy).
- **Labour participation is vital to enhancing this dimension,** financial education and upskilling are important in this regard.
- Phased retirement is seen as a solution to skills transfer and mentorship. In addition, it allows for retirees to upskill to so as to build a potential second career and income source post-retirement
- **Simplification of the system by** reducing costs and ensuring sustainability

  Contributing to real economic growth by implementing a trusted system which can address issues such as liquidity concerns, unitization, due diligence demands and comprehensive and continuous governance oversight.

2.3 On boosting the integrity dimension

This working group noted that the current B ranking on the Global Pensions Index was a good score but there was still room for improvement. It was agreed that governance played an important role in sustaining this ranking and that the retirement sector were not always proactive in providing suggestions on regulatory requirements.

Key conclusions reached and proposed by this group include:

- While there may be excellent laws in place, the problem in SA is that there may be minimal consequences when a problem arises. There should be a push to improve the **supervisory and boost the enforcement** and

protection of members from fraud/mismanagement of benefits and predatory/unethical behaviour from all pension industry stakeholders who are able to take advantage of members.

- While SA is moving towards consolidation of funds, to ensure that the integrity of these funds (i.e., providing members with the best value) there needs to be more competition. We believe that South Africa should explore the model followed by Australia where they have Superannuation funds that are either provided by the financial services industry or represent Mutual Benefit Umbrella Funds.
- **On the regulation and governance of private pension plans** the group noted that these were being driven by current reforms (such as the Two Pot system). However, in truth, to create a viable and inclusive system demands that government comes to the party in a meaningful manner. i.e., there needs to be a government under-pin that applies to all citizens, rather a means tested methodology.
- **Holistic education on financial competence is required** for a complex system such as the two-pot system to work effectively.
- **Timely and relevant communication** with members, so as to enable informed decisions was also raised in this regard.

3.0 Recommended next steps

Based on the feedback from each working group, the following recommendations featured strongly across the three pillars:

- Government must be part of the solution to ensure it does not fail
- Social trust and community confidence needs to be built up for the system to be successful
- Education and financial competence must be a focus area to ensure that citizens understand the solutions on offer and the risks
- Credible solutions with a focus on costs (at all times) must be created for the informal and contracted market.