Five years of objective retirement reform advice for South Africa

2005 – 2010

A COMPENDIUM

by Elias Masilela
Time is against you if you don’t plan for what happens in retirement

End of recession saves industry from decline
In total the average contribution has dropped from 6% to 5.5%.

For every year that you spend your accumulated savings each time you change employment, people might see their pension fund as opposed to 25% can chop massive retirement benefits. Assuming 6% inflation), assets over time (a total return of 6% per year, says Cooper. Members of the basic public grant system to look after themselves at retirement and this makes deep financial system, through the improvement of the basic retirement savings – a contributory element to cover risks such as death, disability, and further fine tuning its proposals. This will be incentivised – which will be non-contributory and funded by the fiscus.

The underlying objective of undertaking the reform, by proposing the inclusion of broader social security related social security – which in turn are a result of putting in place a cost effective, basic individual account system. The biggest hurdles to participation, is cost. Social assistance – which will be given the option to opt out from this.

The health of income security is based on the provision of income security. The health of income security is based on the provision of income security for the collection of the proposal to establish an individual account system.
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South Africa has come a long way since the early fragile days of democratic government, more than 16 years ago. In the process we overcame obstacles that would have been impossible in many countries and, in doing so, we have won the admiration of the international community.

Furthermore, we are blessed, among other things, with a well developed financial services sector that proved its mettle during the worldwide credit crunch of the past two years. We were able to ride out the storm far better than most developed economies and in the process ensured that job losses in the entire economy were kept to a minimum.

However, as a nation we still have a number of critical challenges that require our focused attention. One of them is our lack of a savings culture. Apart from the more obvious implications, the resultant lack of adequate retirement provision has become a major headache for the government as well as for the financial industry. It is very clear that retirement provision must be reformed, not only to ensure less dependency on the state, but to eradicate poverty in retirement so that all South Africans can actually retire with dignity.

The fact that Sanlam has taken the lead over the past five years to keep this debate going and to educate the many role players on the whole concept of retirement reform is heartening. We are very much a business that must deliver the required return on investment to our shareholders but, as one of the largest custodians of our country's wealth, we also have a deep rooted responsibility to make financial independence a reality for all South Africans, especially in retirement. This compendium is evidence of our seriousness in this regard.

We will continue to lead the debate and to take action to ensure a prosperous future for all our people.

Johan van Zyl
Group Chief Executive
July 2010
Sanlam’s involvement within the retirement fund industry goes back many decades. Whether it is investment management, the provision of group risk services or retirement fund administration, Sanlam was always one of the main players and very much a leader in the industry.

It is therefore not surprising that Sanlam took the lead again, five years ago, when the strategic issue of retirement reform appeared on the national agenda. After all, as a client-centric business, we are aware that our clients often look to us for advice and direction, especially when it involves large-scale changes in the industry. And with our depth of talent and the quality of our people we are very often seen as the originators of new thought-provoking ideas and insights into industry issues.

The retirement reform debate is no exception. With an established platform like our annual Benchmark Symposium it was a logical decision to include the various aspects of the debate in the discussions and deliberations. And we went further. We also took the debate to the man on the street, in our efforts to educate retirement fund members. Hence the remarkable number of media articles from the pen of many a Sanlam staff member that has seen the light over the past number of years. That of course is not only a reflection of our own internal rigorous discussions but also of the important role of the media in keeping their readers informed about these issues. In a sense it is also part of our culture which encourages healthy debate in our endeavor to find the best solutions for all our stakeholders.

This compendium is testament to Sanlam’s continued leadership role within the retirement fund industry. It makes us proud.

Johan van der Merwe
Chief Executive
Sanlam Investments
July 2010
Long before retirement reform became a point of debate and discussion in the retirement fund industry in South Africa, Sanlam realised that it was just a matter of time before it would become an issue of national importance. It was abundantly clear at the time that the role played by industry in providing retirement benefits was sub-optimal. In particular, as a nation we were far off the goal of ensuring that all workers were making adequate provision for their retirement. This was the case even in the formal sector of the economy, let alone in the informal sector. There was no doubt therefore that the industry required a leader to establish the necessary platform for discussion and to move the debate along.

The government was already working on policy issues surrounding social security and retirement reform as early as 2004. Rather than waste effort in “reinventing the wheel” it seemed logical for Sanlam to tap directly into the pool of knowledge and experience already built up within the government. It was in this context Elias Masilela was approached to join Sanlam as a senior executive in 2005. At the time he was the acting deputy director general of economic policy within the National Treasury and led the government’s social security and retirement reform programme. His appointment at Sanlam was seen from the very beginning as the best means by which that public sector role could be extended even further.

In his appointment, Sanlam stood to benefit from his personal reputation as one of the leading advocates for retirement reform in South Africa. Furthermore, there was a clear recognition in those days that the government was running some way ahead of the industry in the retirement reform debate. Industry was therefore being called upon to step up its game in this regard. Bringing Elias Masilela on board was therefore entirely consistent with Sanlam’s commitment to being recognised as being at the forefront of the major financial services developments emerging within the South African economy.

Having been instrumental in Masilela’s appointment at Sanlam, I take personal pride in this compendium. It is therefore with a deep sense of achievement that I recommend it to you. I have no doubt at all that it provides a perfect platform for demonstrating Sanlam’s undisputed industry leadership position in this crucial national debate.

Thembu Gamedze
Previous CEO of Sanlam Employee Benefits
July 2010
The national debate on retirement reform and social security has been with us for a number of years. It has been discussed extensively on various platforms, in the media and in many private conversations.

However, although the retirement fund industry has made considerable progress in its endeavor to create a future where all fund members can look forward to retire with dignity, the stark reality is that only a small portion of pensioners are truly in a position of financial independence. This is clearly evident from all the available research data. At Sanlam we are even more aware of this and other disturbing facts due to the comprehensive market research that we are conducting on an annual basis. The trends are clearly visible. And we all know what the underlying causes are – those issues with which we as an industry are grappling with on a daily basis.

Issues, such as lack of a national savings culture, member education, governance, contribution rates, risk cover versus investments, and early withdrawal of funds, are the realities on the ground for which we need to find solutions – and fast – as poverty in retirement is widely regarded by many South Africans as a given, a trap from which they cannot escape.

This of course makes the retirement reform debate that much more crucial. As this compendium illustrates, Sanlam has been one of the leading voices in the debate over the past five years and we most definitely will continue to lead. But the time has also come to take the debate to a new level – one that is distinctly focused on the future and on the things that we (as an industry) and government need to do to get the reform process underway. We owe it to the members. We owe it to our country.

Paul Myeza
Chief Executive
Sanlam Employee Benefits
July 2010
Although South Africa’s retirement reform process has been driven by various stakeholders across the industry during the last couple of years, few would dispute the fact that Sanlam has played a major role in shaping the national debate. In fact, Sanlam, through many a spokesperson, has become a genuine thought leader on the whole issue of retirement reform.

This is due in no uncertain terms to the passion, commitment and hard work of Elias Masilela. Since joining the group five years ago, he has played a significant role in creating an ongoing internal debate to ensure that Sanlam has a clear position regarding retirement reform. An independent thinker himself, Elias has made it his job to get people to understand that business requirements and national interests must be aligned to ensure effective retirement reform that will be beneficial to all South Africans.

Initially appointed to the Employee Benefits division of the Sanlam Group, he quickly increased his sphere of influence to include the entire Group. His wealth of experience stemming from his days at the National Treasury, his present position as trustee member of the GEPF and, now, as a leading member of the National Planning Commission have introduced the Group to a whole new level of knowledge and insight, which we have regularly shared with all stakeholders across many platforms.

This compendium is therefore a true testimony to Elias’ inspiration and leadership since he joined Sanlam and also his passion for retirement reform that has become an integral part of our DNA ever since.

*Robert Roux*
Chief Operational Officer
Sanlam Investments
July 2010
Introduction

This compendium is a careful selection of articles that have been found to have influenced and inspired readers of Sanlam’s opinions in the retirement debate. It is an outcome of five years of intellectual freedom. It is a journey that came about as a result of many months of continual soul-searching, research and analysis of the various contexts of our economy, and a deep pondering of the role of business (in particular Sanlam’s) in the social life of the ordinary South African.

It can be said to be a collection of objective analyses and opinions (both published and unpublished), which have been produced over the years. I will forever be deeply indebted to Sanlam – leaders and colleagues – for allowing me the space to dream, research, opine and publish at will. Whilst I was doing this, I never fully appreciated the wealth that we were generating nor the vision that the institution had when investing in this work. All this could have easily been discounted as a waste of scarce resources.

This freedom proved to be essential to ensure absolute objectivity, which is what sets us apart.

Looking back, we concluded that it was important to gather these views together into one document. Firstly, it has historical value. Secondly, it allows for a reflection on how far we have come as a society in debating our future and how Sanlam, as an institution, has contributed. Thirdly, it preserves these now invaluable ideas.

Over the five years (July 2005 – June 2010), a lot has changed and a lot of clarity has resulted, even though we are still some way from the envisaged dispensation. One of the big, yet-to-be-acknowledged, outcomes is a significant level of convergence amongst the role-players in the retirement reform debate. However, the reader will be the best judge of this assertion.

This compendium can be used in the following ways:

- Source of reference
- To plot the developments in the policy debate, over the past five years
- Source of education
- To help the reader internalise the human element into the work of both the policymaker and regulator
- Influence service providers to endogenise the social complexity of the South African consumer into their delivery process
- Force a comprehensive integration of the objectives of economic agents (stakeholders) in the long-term savings, retirement and social security space

Whilst it does not provide solutions to all our problems, it does provide a sound framework within which various challenges can be approached in a systematic and consistent fashion. Enjoy the journey.

Elias Masilela
Policy Analysis
July 2010
Articles of interest from 2006
Sanlam was part of the SA National Defence Force Goodwill Parcel Mission that visited members of SANDF, deployed in Burundi and the DRC. What was its aim?

Originally, the programme was scheduled to include the Sudan, but owing to logistical constraints, that leg of the journey had to be cancelled at the last moment. This is an event organised by the SANDF and the Department of Defence, in partnership with South African corporates.

Sanlam has been an integral part of this project for the past four years, together with other corporates. The mission saw seven corporates participate in co-funding the project with Sanlam being one of the three primary sponsors. Three people from Sanlam participated in the visit, under the leadership of the Chairman of the Board, Mr Roy Andersen. Two of the Sanlammers (Wessie van der Westhuizen and I) travelled with our spouses.

The aim of the Goodwill Parcel Mission is multifaceted, namely to motivate South African soldiers at the front; to thank them for having made the commitment to represent the country under very difficult circumstances; to raise their morale and confidence that the people of South Africa are behind them; soften the potential negative psychological impact of not sharing their Christmas with their loved ones; and finally, celebrate an early Christmas with them as well share invaluable Christmas gifts, in a family atmosphere. Thus the deliberate idea of sending sponsors together with their spouses. Accordingly, it meant to be a family affair – by both look and feel.

The lunch

The mission left on military precision on the 11 December, from Waterkloof Air Force Base in Pretoria. It made its first stop at a small UN base, manned by the South Africans, Indians, Jordanians and Russians in Kamina, south east of the DRC. It is at this base that this article earned its title.

The procedure at every base carried the same (or at least similar) programme. It started with a welcoming, a special Christmas message and prayer by the Chaplain-General of the SANDF, followed by speeches, handing out of parcels and finally the celebratory Christmas meal. At all bases, it was truly a festive and momentous affair and an environment filled with joy as well as sadness. Every single member of the force was fully appreciative of the gesture. To crown it all, this year’s mission was graced by the presence of the Minister of Defence, Minister Mosiuoa Lekota, who gave a morale boosting speech at every base.

Three bases in all were visited, including Modderfontein (in Bujumbura) and Iveco (in Kinshasa). Both these names have interesting origins. Modderfontein because the camp is extremely muddy, and Iveco, because the UN converted an Iveco production plant into a base.

During the lunch in Kamina, we were each handed out crackers with surprise presents and messages within. The message that popped out of mine read, “What did the confused bee say? To bee or not to bee…” When I showed it to Roy, who was seated to my right, at the table, we instantly agreed on how close this represented South Africa’s economic policy. The rest is left to the reader’s imagination. However, for me, it had a more fundamental philosophical meaning. It is about the choices that we all have to make on a daily basis, some of which pose major challenges to our livelihoods. In this particular mission, each participant had had to make choices about its overall objective – ranging from volunteers, financiers, members of the military as well as government itself. In one way or another, each of these participants has to make a decision about how they wanted to get involved in this exercise as well as what risks they were willing to take. “To be or not to be … associated?” is the question.

This thinking coincided with the message from the Chaplain-General who paralleled the sacrifices by the deployed members to the difficult decisions that Mary Mother of Jesus had to take, when she took on the responsibility of bearing the child of God. Not only that, the decision of companies such as Sanlam to finance the Goodwill mission was also hailed as significant in the whole exercise of peacekeeping, at the seeming detriment of the policy-holdr and shareholder.

An economic case?

I have pondered this last prospect – very deeply. Is the funding of the mission really to the detriment of these interested parties? I have concluded that the answer is … No! No, because this is a classical process of “Thinking Ahead” and investing for the future. There is a compelling economic rationale in this seeming madness. Associating with the SANDF and government creates numerous opportunities for entities such as Sanlam. The whole initiative of peace building and peacekeeping as well as the maintenance of social cohesion in the countries where South Africa has troops deployed, potentially secures stable domestic economic markets and a strong potential for business. However, these opportunities will only come to fruition for those companies with the right vision and foresight. Clearly, the benefits of political and economic stability, the world over, will only benefit those that are willing to engage with markets on the ground.

With Sanlam already expanding on the continent, these opportunities are much more real for it than for companies that have not started engaging with the greater African economy.
Conclusion

The trip ended in true African style. As the convoy of six or so 4X4s and two buses approached the Kinshasa international airport, a fierce tropical storm started to gather. As if it was waiting for us to settle down, for, as we sat down in the aircraft, the skies suddenly opened up. A heavy downpour followed. As I was brought up to believe, this was an African blessing indeed. Of course, the blessing did not come without a cost. We experienced a 30-minute delay in our take-off as a direct consequence, which I considered a marginal sacrifice after all that had been committed...

“... To be or not to be a volunteer, peacemaker and pioneer of African stability and growth??” remains the question.

For me, this was truly an amazing experience, to which I have concluded: “It is a worthy course.” It allowed for one to take a personal reflection about what contribution he/she is making to society, and in particular the partnership for continental growth. Clearly, the pioneers of this initiative, such as Sanlam, will reap the fruit of the African economy’s success, when it ripens.

Insight: Galvanising partnership between the POA and Sanlam

On 21 June 2006, the Principal Officers Association (POA) held its inaugural conference at Gallagher Estate. As master of ceremonies at the conference, I provide feedback on the event...

The aims of the POA conference were to:
- Raise the profile of the principal officer in the retirement space in South Africa;
- Create an all-inclusive environment for all principal officers;
- Ensure the optimal skilling of principal officers;
- Empower boards of trustees by ensuring that principal officers are effective; and
- Relaunch the POA and find its right location in the industry.

To drive these objectives home, the POA used a train as the theme for the conference. This theme served as a metaphor for the South African retirement industry, where all players (ie, the regulator, savers/owners of retirement funds, service providers and intermediaries) are on board, but there is no clear captain driving this train. Conflicting objectives exist among the players – on the one hand, there are savers/owners of retirement funds aiming at maximising their benefits, while on the other hand there are service providers and intermediaries aiming at maximising their profits. This is unavoidable. Therefore, it is imperative that a mature level of leadership exists to manage the conflict and ensure a sustainable industry.

It was observed at the conference that such leadership could not only come from Government, but should also come from industry players. Each and every industry player ought to take it upon him- or herself to captain this train and uphold the health of this industry.

Herein lies Sanlam’s interest. Noting the importance of the role of a principal officer in the retirement environment, Sanlam has made a conscious effort to partner with the POA and assist it in equipping its members so that they can serve the boards of trustees optimally. Through Sanlam Employee Benefits (SEB), Sanlam Investment Management (SIM) and Sanlam Corporate Social Investment (CSI), there are ongoing consultations with the POA at various levels. The latest initiative Sanlam is assisting the POA with, is in the crafting of their development plan, led by CSI and SEB.

At the conference it was argued that savings are important for the sustainable growth of an economy. Given that the retirement industry is an essential vehicle for mobilising savings, it is imperative that the leadership of this industry is appropriately skilled.

Retirement’s real value

The retirement industry currently controls assets to the value of just below 80 percent of GDP. This represents the interests of just about nine million savers/owners of retirement funds (please note that there is potential for double counting in the calculation to arrive at this number). Considering the significance of the retirement industry, the role of the principal officer cannot be underestimated. The failure of the economy to mobilise sufficient savings for its investment demands can no longer be blamed on Government only. The industry has to account for a share of this failure – in particular the boards of trustees, and the principal officers, who are providing a key secretarial function as well as guidance to trustees and are a source of information.

For principal officers to serve on boards in South Africa, the body of principal officers needs to be professionalised. This means that:
- The intellectual independence of principal officers needs to be ensured;
- The roles of the principal officer and service providers need to be separated;
- The roles of the principal officer and the employer need to be separated; and
- Principal officers need to be able to provide objective decision-making information to boards.

To be able to undertake objective analyses of the environment they operate in, to attend to the needs of the saver/retirement fund member and to make independent decisions, principal officers need to be sufficiently trained. They need to have a clear vision
Role of financial sector in economic development

This speech was delivered to the University of Johannesburg in a conference at Sun City, 17th October 2006.

When I was invited to come and deliver this speech, I was at pains trying to decide what to say, given that I stood a very narrow chance of saying something that people in this room have not heard before. Once I settled on what I wanted to say, I did not know how to position it, given the intellectual debate that has already unfolded over the past day or two. I went ahead and crafted a framework, nonetheless. I sincerely hope that what I will share with you tonight will add value to the financial world, as well as to your deliberations in the next day.

I must say the theme for this conference is most appropriate. However, as a macro economist, I have opted to extend the objective you have set for yourselves. I look beyond adding value to the financial world.

After I had gotten over these two hurdles, I had to deal with my colleagues back at Sanlam, who wanted to know what cap I would be wearing tonight. They wanted to know whether I would be wearing a private-sector economist’s cap or would I be wearing that of a policy maker. I was tempted to give a cheeky response and say that I would be wearing a cap of an economist in transition. However, I held back my response. Similarly, I leave the judgement to you, as to what cap you think I am wearing, after my presentation today.

My talk is going to be an honest account of how I think we should position the financial sector to realise our broad societal objectives. We do not have to remind ourselves about the challenges of poverty, unemployment and inequality facing South Africa.

People may already be asking what has the financial sector got to do with this?

The underlying questions that I would like to see answered, include:
- Why are so many people and firms in South Africa excluded from full participation in the financial sector?
- Can we have a sector that identifies a social role as part and parcel of profit maximisation?
- Can we as a society successfully identify obstacles to financial inclusion and be able to deal with these appropriately, to everybody’s satisfaction?
- In short, what is the chance of having an altruistic financial sector, in South Africa?
- I am sensing silent murmurs and a response like … not a chance!
- I hope there is no one that is beginning to think, “There goes objectivity. There goes the credibility of our financial sector. What next?”

These questions are not at all unique to South Africa, even though we have spent quite a substantial part of the past twelve years trying to grapple with challenges of the financial sector. We will all recall the era of the Red October campaigns against the lending rules of banks. We presumably all remember how unsettling these campaigns were, both to confidence and certainty in the sector. This was the case until the successful conclusion of the Financial Sector Summit in August of 2002. Since the Summit, we have seen a series of partnerships and agreements between government and business, ranging from the GDS to ASGISA and JIPSA. Preceding all these agreements was the Jobs Summit of 1998.

Underlying the thinking and discussion throughout these stages was the desire to grow the economy, increase employment and eradicate poverty.

Within the same year, 2002, the Monterey Consensus explicitly recognised that microfinance and national savings schemes are important for enhancing the social and economic impact of the financial sector. This conclusion of Heads of State resulted in the year 2005 being declared the International Year of Microcredit, by the UN General Assembly. The aim of this declaration was to attempt an address of the constraints that exclude people from full participation in the financial sector.

In his speech of December 2003, following this adoption, Kofi Annan had this to say, “The stark reality is that, most poor people in the world, still lack access to sustainable financial services, whether it is savings, credit or insurance. The great challenge before us, is to address the constraints that exclude people from full participation in the financial sector… Together, we can and must build inclusive financial sectors that help people improve their lives.”

These concerns and questions are not being raised for the fun of
it. They are critical in the larger equation of economic productivity. The more people outside of the productivity net, the lower the chance of ridding ourselves of dependency and poverty.

I hope I have sufficiently dispelled any perception that could be sitting in our minds, that the questions I have posed are uniquely South African and therefore, not in line with international thinking and developments.

**Economic setting**

It is important to ponder the economic setting under which these questions are being asked and hopefully will be answered. What is the policy environment?

To gain a good understanding of financial sector policy we need to appreciate the role of the financial sector in an economy’s macroeconomic plan. We must also understand the vision and role of government in securing a development path for the country, as well as its relationship with the private sector. This is an important interplay.

Specifically, to what extent should government influence market outcomes? For many private sector actors, the ideal situation would be one where government does not influence outcomes. However, we all know how unrealistic this ideal is. Governments exist for very specific reason and we can never wish them away. The challenge is how do we engage with them, such that the decisions and actions they take, enhance rather than hinder our plans.

Over the past 10 years, the role of the state in the South African economy, as measured by the proportion of government expenditure to GDP, has hovered around 25 percent. Meanwhile, the financial sector has enjoyed a bold increase from 14.8 percent in 1990 to 19.5 percent in 2005. There is no doubt that these two sectors, to Gdp, has hovered around 25 percent. Meanwhile, the financial sector has enjoyed a bold increase from 14.8 percent in 1990 to 19.5 percent in 2005. There is no doubt that these two sectors, the financial sector has enjoyed a bold increase from 14.8 percent in 1990 to 19.5 percent in 2005. There is no doubt that these two sectors, significant and one cannot ignore the importance of the other.

As a direct consequence of these developments, any failure or success of the financial sector as is the case with the actions of government, will be felt across the entire length and breadth of the economy. In that regard, talking as one coming from the financial sector, it is imperative that as a sector, we behave and operate in a manner that raises, rather than decreases, the welfare of South Africans.

In that regard, we appreciate why the eyes of the regulatory authorities in South Africa have scrutinised this sector, to the extent they have, over the past few years. The increasing outrages over the lack of competition in the financial sector, and in particular the poor service delivery owing to inappropriate products in the retirement industry, as observed by the Pension Funds Adjudicator, highlight the importance attached towards the financial sector. We certainly do not think the financial sector is unduly being targeted.

This leads me directly to the topical issue of regulation.

**Regulation**

In any country, South Africa not excluded, the general approach to financial development is to a considerable extent, shaped by two fundamental factors, namely:

- The regulatory philosophy obtaining in that economy; and
- Levels of access to credit and safe deposit taking facilities, particularly in a savings constrained economy such as ours.

However, it is the latter that will be important in guiding the extent to which we take our creativity in developing solutions, in South Africa. Nonetheless, in our quest to realise our goals, we should avoid undermining financial stability, as this is the bedrock for all achievements. These are essential underpinnings that have helped South Africa achieve its positive economic record and also ensured that we survived many crises with little scathing.

As a matter of principle, the role of regulation should reflect the type of economic system that is appropriate for a particular country. Currently, industrial countries and many developing economies, rightly or wrongly, place a considerable premium on a market-oriented approach. This approach assumes that the working of the market mechanism will, in general, produce the best results in terms of efficiency as well as the allocation of financial resources. The efficient allocation of such resources would also imply an efficient allocation of physical resources. As a result, in most countries, the general philosophy is firmly anchored on the belief that market mechanisms produce optimal decisions and resource allocation. We may agree that this is not the case.

However, if we do not agree, we could pause right here; to ask the question ‘is this really the case in South Africa... Does the market mechanism always work better than the alternatives?’ Depending on the response, the policy and behavioural permutations and choices can be anything.

The specific problems of financial markets are at issue here. The question is whether they are conscious of the social obligations, facing policymakers. It is generally recognised, that financial markets have their own unique characteristics, and that participants in these markets differ from participants in other markets in so far as their activities often have a more widespread impact on economic activity. Accordingly, the working of financial markets, as a whole, should facilitate rather than impede the efficient operation of the financial system, and the ability to create wealth.

Regulation of these markets, therefore, has to be effective, efficient and responsive to the economic environment, both domestically and internationally. This is what should drive our thinking as a country, not what each individual business wants.

This necessarily, implies a responsibility for government to ensure that the financial sector delivers on its ostensible ‘mandate’ around savings, risk and payment issues. I can be bold to conclude that, the ultimate objective of regulation ought to be the achievement of a high degree of economic efficiency and consumer protection in the economy. This objective should be attained through:

- Securing systemic stability in the financial system;
- Ensuring institutional safety and soundness; and
- Promoting consumer protection.

As economic theory tells us, the financial sector is the oil of an economy, without it, the beloved economy would falter. We have, therefore, elected as a sector, that we will keep this engine, which is our economy, well oiled. This is not merely an act staged to please those in authority, we do so with the strong belief that, it is also essential to the health and growth of the financial sector.
Surely this has to be complemented by sound regulation.

However, in the light of this legislative dynamism, industry stakeholders are weary of a possible growing regulatory burden. As a direct consequence of this, debate has been simmering around whether regulatory structures should be consolidated, or move rather to increased harmonisation of principles of regulation and legalisation and its enforcement. Unfortunately, I will have to disappoint you, because I will not venture a view in this regard...

I will, however, venture to say that financial sector policy, including regulation, ought to be defined by a broader macro-economic strategy that determines the set of actions that government intends to take in reaching its growth, employment and redistribution objectives. This requires moulding the legislative and regulatory environment to give effect to prioritised outcomes consistent with a set of underlying socioeconomic principles, one of which is realising economic growth of 6 percent.

This objective can only be realized if we increase economic participation of all economic players, including the poor.

Interplay with conference

Given that I am presenting to a gathering of academics, it may be necessary to check if the basics of economics still feature in our day to day thinking, as opposed to the grandiose market analysis that we get bombarded with, every single minute of the day, through all forms of news media. As we answer the question, ‘What is the role of the financial sector in the economy?’ We need to stand back from the treadmill and sober our minds.

Part of this pondering would require understanding of what this animal called the financial sector actually is?

To describe the sector can be onerous, as it captures a widely diverse range of highly sophisticated products and services. Perhaps it is preferable to start with what an efficient financial sector does, namely one that:

- Encourages savings through the development and distribution of appropriate savings vehicles, and allocate these savings across suitable investment projects;
- Facilitates efficient intermediation, through lowest-cost capital and debt raising, for all market participants;
- Manages risk for companies, individuals and the country as a whole, through investment diversification, innovative structured product design, an insurance offerings; and
- Allows for a cost effective and quick payment delivery mechanism through the payment system.

Therefore, financial system development consists of developing our banking systems, capital markets, payments systems, insurance and contractual savings systems, and other financial institutions.

At this level of operation, the financial sector has the capability to combat poverty through:

- Spurring private sector-led growth, a critical driver of poverty reduction;
- Minimising the effect of unanticipated economy-wide risk; and
- Providing the poor with the tools for dealing with household vulnerability.

As is the case in South Africa, in most developing countries, the financial sector plays a major role in mobilising domestic resources and allocating them to deserving, and of course, sometimes undeserving investment projects. An ongoing debate is how much of these intermediated resources should be allocated to the private sector as opposed to the public sector. To a large extent, this will be informed by the behaviour of government, social needs and the development of fiscal balances. It has therefore, become imperative and an essential part of development economics to assess the potential role of improved financial intermediation in the process of economic development. To ensure sustained economic growth, the financial sector must mobilise domestic resources effectively, allocate them efficiently to finance new productive economic activities and at the same time maintain macro-economic stability.

The latter having been proudly realised and secured in South Africa, it is the other objectives that remain a critical thorn on our sides. This has forced us as a society to try and find consensus on what is meant by ‘effectively’ and ‘efficiently’.

Challenge for economics

Unlike other disciplines, economics is intimately intertwined with politics. On a daily basis we battle with answering three simple yet complex questions, namely, “Who gets: what, when and how?” In trying to answer these questions, it is always tempting to search for regularities in history and many economists have adopted a uni-directional view of development, in terms of some pattern of stages. There is also a huge temptation to utilise ideological bias to resolving societal problems.

Given the different approaches and potential contradictions, one has to draw on the wisdom of those who came before us.

Amongst the many thinkers to learn from, I would like to draw from the views of Professor Walt Rostow, who went out in search of alternative development paths to those spelt out by Karl Marx. Whilst the two thinkers could be found as having contrasting views, they did however, converge on the recognition that change has social, political and cultural origins and consequences. That is precisely where we find ourselves, as a society in South Africa.

Rostow finds, as we have in South Africa, that in terms of human motivation, many of the most profound economic changes must be viewed as the consequence of non-economic human motives and aspirations. Instead of reducing decision making to a simple act of maximisation, individuals engage in an ongoing act of balancing alternatives and often-conflicting human objectives, in the face of a range of choices open to them. It is upon these individual choices, that we have to see the manner in which society reaches and implements its decisions. One is tempted, to conclude that the philosophy carried by Marx, to the effect that a society’s decisions are merely a function of who owns property may not be entirely true and clearly not always true.

The simple conclusion here is that, the poor do not have a voice. This conclusion may be a subject of fierce debate in the South African context.

Rostow leaves us with a good sense of thought, when he says, “... Based on the convergence of motives of private profit in the
modern sectors with a new sense of affronted nationhood... other forces play their part as well. For example, the simple perception that children need not die so young or live their lives in illiteracy: a sense of enlarged human horizons, independent of both profit and national dignity. And when independence or modern nationhood is at last attained, there is no simple, automatic switch to a dominance of the profit motive and economic social progress. On the contrary, there is a searching choice and problem of balance among the three directions policy might go: i) external assertion; ii) the further concentration of power in the centre as opposed to the regions; and iii) economic growth."

All these are directions that have preoccupied public debate in South Africa, over the past while. We can bask in the comfort that, amongst the various schools of thought and emotions threatening our peace that it is for the same intention, namely, dealing with poverty and economic dichotomy.

Challenges

As South Africans, we have made ourselves globally great. Now we need to turn our strengths to work for the poor. We need to use technology to give more access to the poor, train for sound investment decision making at the level of the household, improve regulation and support thereof, to give greater access without compromising on the stability we have painfully earned over the years, increase competitiveness, not for the sake of it, but to increase affordability of products and solutions.

In a recent book by Prahalad, a globally recognised business consultant, with the University of Michigan Business School, in which he deals with eradicating poverty through profits, he identifies 12 principles of innovation to respond to market demands of the poor. Seven of these are pertinent for South Africa, and include:

- Focusing on price performance;
- Developing hybrid solutions that blend low-cost technology with rapidly evolving infrastructure;
- Solutions that are developed ought to be scalable, owing to the vast number and geographical distribution of the poor;
- Product development must start from a deep understanding of functionality, not just form, in order to meet needs of the consumer. We always here of consumer centrism, unfortunately this is only in speech and not in action;
- The design needs to take into account the level of skill and understanding of the low-income market. Currently, products generated by the financial sector are totally inaccessible to the poor, which extends their marginalisation. This needs to change;
- Education of clients on optimal product consumption is key; and
- Innovations must ensure optimal reach for the consumer, which means the financial needs to jack up its distribution structure quite significantly.

Conclusion

In conclusion, I would like to give comfort to those of us who are in service-provision. With the risk of sounding like a preacher, I have four things to leave with you. Do not despair:

- There is money in the poor;
- The poor are also brand conscious so if you deliver appropriate products this will have a meaningful effect to your bottom line;
- You can infinitely grow your business if you help to raise the capacity to consume for the low income earner; and
- The prerequisite for the success of such a business relationship is trust. Unfortunately, trust has reached its ebb in South Africa recently.

Of course it does require a fundamental change in business philosophy and only those that effect this change will reap the financial rewards. The pain of the change is worth the rewards. We also need to recognise that, like any benefits derived from R&D in other sectors, innovation in the financial sector can be quite energising and not only financially fulfilling but also professionally fulfilling.

I trust that this conference will spend time thinking about the issues raised, as we do in the financial sector, on an ongoing basis. Lastly, I beg your forgiveness for having successfully disappointed you by not dazzling you with financial market data that would keep us debating the whole night about whether our books or personal portfolios are performing as expected. This we can still do, but within the perspective of increasing the welfare of all, we ponder personal beneficiation and fulfilment. At this point I will leave you to judge, which cap I am wearing? I thank you.
Industry situation

The environment we are talking about is not friendly to the participation of the average South African, for a variety of reasons. One of these reasons has to do with information asymmetries, owing to the poor transparency and inappropriate communication obtaining in the sector.

The terminology and lingo in the insurance industry continues to baffle. The terminology used in contracts and communication to consumers is difficult and inaccessible to the average South African, owing to its level of density. I have also been amused by the level of disparateness of views on some of the key concepts among experts in the field. If this is the case, imagine the extent of bewilderment to the average person, on receiving correspondence from a service provider.

If, as an industry and the financial sector at large, we desire to increase access to financial services for the low-income earner, either as part of our charter commitments, or merely as responsible corporate citizens, we desperately need to do something about the way in which we communicate to consumers. Bear in mind, the low-income earner falls in the category of people less fortunate in terms of literacy. In that regard, the simpler the language, the more the low income earner is likely to understand and appreciate solutions being provided – and hopefully, this may influence them to increase their demand and control of services, where necessary.

This is particularly necessary if we believe that insurance products, unlike banking products, are supply rather than a demand-led. To convert the nature of insurance products to be demand-led as well, while this may take a long time, it is incumbent upon the service provider to render its products and solutions more transparent and better understood by the consumer. Drawing from this observation and belief, one is inclined to conclude that it is more imperative for the insurance industry to be more proactive in increasing the consumer’s level of understanding of its products.

However, not all is lost. There is still hope. This hope rests on this observation and belief, one is inclined to conclude that it is more imperative for the insurance industry to be more proactive in increasing the consumer’s level of understanding of its products.

Case for training

There are numerous arguments supporting the groundswell for training. Of particular concern, have been the conversions from DB to DC, which peaked in the late 1980s early 1990s. From a member perspective, the rationale for these conversions is three-fold, namely to:

- Give members more control over the management of funds;
- Secure more lucrative withdrawal benefits; and
- Secure upside benefits arising from good investment returns, for members. (It should be noted that the employers had a different set of motives for these conversions, in particular shifting risk and secure certainty in terms of contributions. Contributions for the member have become uncertain.)

However, with these benefits arising from the conversions a number of new responsibilities have emerged, since the risk associated with the fund’s investment strategy has effectively shifted away from the employer to the employee. As a result, members of boards of trustees must fully understand this consequence and be capable of managing this shift, in the interests of members. Needless to say, “the lower the level of expertise the higher is the risk to members.”

It is instructive to note that the rewrite of the Pension Funds Act is unlikely to result in a reversal of this trend, nor stop it. There is a plethora of other factors that point to the need for more training, including:

- Narrowing the knowledge gap between employer and employee appointed trustees;
- Ensuring an understanding by members of their rights under technical processes, such as the distribution of pension fund surplus;
- The achievement of greater trustee objectivity;
- The need to interpret accurately, manage and use advice from professionals and solution providers;
- Supporting the merits of the call for increased member representation on boards, above 50 percent, by developing a better skilled cadre of trustees;
- Empowering trustees to develop the capacity to decide on the amount of investment risk that is appropriate for the members;
- Ensuring that trustees are able to make decisions that will strike the optimum balance between the protection of member interests in the short term with issues of national interest and long-term interest, such as investment in Socially Responsible Investments (SRI); and
- Providing sound guidance for future conversions from DB to DC.

Who is the target audience?

In principle, everyone involved in the fund should be trained, including beneficiaries. Having said that, it is important that any training should be well targeted to maximise its impact on the operation of the fund and therefore be to the benefit of members.

At one level, training should definitely be targeted at trustees and shop stewards; at another level, it is becoming more and more important for general membership holders to be provided with at least a basic understanding of their fund. This makes communication between trustees and the general member easier and allows for greater participation from members in an informed manner; it also develops a wider pool from which trustees can later be sourced.

However, due to funding and other practical constraints, such as the availability of trainers and the logistics involved in broader communication, the scope of training for the wider membership needs to be considered carefully. Having said that, an investment in this broader scope for training does have a greater likelihood of better serving the nation and having a more sustainable positive impact on the economy.

Structure of training

Given this requirement for a stratified approach to training, curricula will have to be developed as a result of collaboration...
between a number of industry players. These should at the very least include government, the Insurance SETA, the Regulator, members of retirement funds, employers, existing trustees, as well as academic and technical institutions of learning.

Furthermore, it would be ideal if such training enjoyed accreditation by the Insurance SETA, as it would then be recognised within the industry and become marketable, as evidence of successful skills and knowledge transfer.

Who should provide the training?

There is a strongly held view within certain sections of organised labour that the provision of training by service providers does more harm than good.

One of the reasons for this view relates to the potential for the implicit conflict of interest to play itself out in trainers who may use their role as a platform to promote products and solutions developed by their employers. While this type of behaviour is very likely to have happened in the past (and possibly even in the present), our thinking at Sanlam is that it is possible to make use of trainers who are employed by service providers, as long as their contribution is targeted appropriately. Even if this proves in practice not to be possible, such providers may still be able to make a contribution to training, by assisting in the design of the curriculum, even if they are not necessarily involved in the delivery of the training itself.

There are in fact a number of models that can be considered for providing this training, in which the participation of the Insurance SETA, universities and technikons is obviously key.

Having said that, there is a need to consider the availability and cost of resources, particularly if the scope of training is to include all members, and therefore result in significantly larger programmes. The commercially neutral institutions listed above may not necessarily have the capacity to deliver on these programmes in reasonable time and at reasonable cost. Assuming therefore that the matter of the objectivity of service providers can be appropriately managed, there may still be a need to consider the participation of service providers in the training process in future.

Insurance isn’t law ... just a thought!

The aim here is to raise awareness about the appropriateness or otherwise of the way in which the financial sector communicates to consumers. Deliberately, the title is left to be sufficiently broad to allow for the widest understanding of the concept, where insurance is seen as any action that reduces vulnerability. In this regard, household savings, since they are aimed at reducing vulnerability of the household, could also be understood to constitute insurance. In the same vein, retirement plans ought to be seen as insurance.

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Insurance is first and foremost, an economic concept. However, because typically a third-party provides the cover by taking on the risk, contracts are raised. It is these contracts that become legal instruments. For some reason, it is the latter that has preoccupied the subject of insurance, much to the detriment of the poor. The description and delivery of these products has become liturgical rather than helpful.

Concern

The terminology and lingo in the insurance industry continues to baffle. The terminology used in contracts and communication to consumers is difficult and inaccessible to the average South African, owing to its level of density.

If, as an industry and the financial sector at large, we desire to increase access to financial services for the low-income earner, either as part of our charter commitments, or merely as responsible corporate citizens, we desperately need to do something about the way in which we communicate to consumers. Bear in mind, the low-income earner falls in the category of people less fortunate in terms of literacy. In that regard, the simpler the language, the more the low income earner is likely to understand and appreciate solutions being provided – and hopefully, this may influence them to increase their demand and control of services, where necessary.

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observation and belief, one is inclined to conclude that it is more imperative for the insurance industry to be more proactive in increasing the consumer’s level of understanding of its products.

**Recent mood**

Have you wondered why people have grown so weary of intermediaries recently? Part of the reason is the growing awareness of the inherent information and thus knowledge asymmetries in the market. The financial sector is characterised by glaring information imbalances, between the producer of services, on the one hand, and the consumer of these services, on the other. The providers have always enjoyed superior information, relative to the consumer. As such, they have been able to sell products without the consumer questioning the quality or relevance of the product. But with increasing knowledge on the part of the consumer and a growing realisation that the consumer could be dealt a raw deal, there has been growing questioning of the services being provided. This questioning has, even though not fully probing, led to a corrosion of trust between the service provider and the consumer. Consumers have started questioning the value for money from the goods they are purchasing.

The Pension Fund Adjudicator has contributed to this new level of knowledge among consumers, following the encouragement for shareholder activism from official quarters.

It has been argued that if the level of complexity could be reduced, the trust issue could be greatly resolved as consumers gain a better appreciation of what they are buying. They will now be in a position to evaluate the value for money more easily. This could also increase the ability to choose and consumers voting with their feet, which in its own right could contribute to encouraging competition.

Also, the massive structures that have been set up to deliver services would be grossly reduced, overheads would be lower, reducing the need for intermediaries at every point of decision-making by the consumer, which would ultimately increase demand for solutions.

**Other considerations**

The problem does not end there. While communication and complexity of language are important aspects for achieving higher access, there are other elements that need consideration even though these are slightly removed from communication. These include, the designing and development of low cost insurance products for the poor such as distribution, claim settlement, payment systems involved in collection and reimbursement of claims, alignment of policyholders/insurer’s incentives to combat fraud, and other similar considerations.

Finally, the manner in which we draft our legislations also has a strong bearing in increasing access to financial services. The less complex the wording in legislation the more painless it will be for the average South African to understand their rights and role in the financial sector. We hope that the re-write of the pension legislation and other laws to follow, will take this observation into account.

"The low-income earner falls [is] less fortunate in terms of literacy. In that regard, the simpler the language, the more the low income earner is likely to understand and appreciate solutions being provided."

**Finscope: True colours of the insurance industry ... or not?**

On the 5 December 2006, FinMark Trust launched its landmark survey, FinScope South Africa, which as always, provides interesting perspectives about South Africa’s financial sector. While this article may come long after the actual launch, the analysis and content remains relevant for our industry, as we think about how we re-invent and render ourselves more relevant to the consumer.

The article is also relevant, as it builds on the discussion we had in the December 2006 Insight Magazine. That issue, carries an article entitled “Insurance Isn’t Law”, where we spoke about the complexities in the financial sector, in particular the retirement industry. In that article, it is argued that the level of complexity obtaining in the industry is one of the key determinants for the poor access to financial services for consumers, more so, the poor and less educated.
Some of the findings

This latest FinScope corroborates the above observation, though notes an improvement at the sector level. It, however, painfully notes that the trajectory at the sector level is not matched by that obtaining at the level of the insurance industry.

Brief comparative indicators show that there has been an 11 percent increase in the number of people banked, from 14.3 million to 15.9 million in 2006. Inversely, the number of unbanked dropped, to account for 37.5 of the total population from 41.1 percent in 2005. The number of banked in LSM 1–5 has also increased from 32 percent in 2005 to 35 percent in 2006. This can be attributable to the establishment of uMzansi account, on the back of the coming into place of the Financial Sector Charter Council. It can be argued, something that is not explicitly done in the survey, that the intervention by uMzansi has singularly influenced the improvement in the financial penetration and financial access indices. In terms of penetration, FSM 1 – the category of people having the least engagement with the financial sector – has declined from 47 percent in 2005 to 34 percent in 2006, showing that there has been a significant increase in actual product usage by those in the lowest population tier. A similar reduction in the lowest tier for financial access, 42 percent down to 21 percent, shows that the physical barriers to financial access are being overcome.

Overall, the FSM 1 population segment has declined from 24.5 percent in 2004 to 16.9 percent in 2006, showing that the most disadvantaged in society are gradually becoming more sophisticated in their financial behaviour, with better access to the financial system and better financial control and discipline.

The same cannot be said for the insurance industry. The only notable increase in service provision and access is with regard to funeral policies sold. This may be explaining a redefinition of the product from a supply- to a demand-led commodity. Consumers may be viewing the death of relatives as the highest risk they are faced with, therefore, demanding this cover. The loss of a bread-

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“... In terms of penetration, FSM 1 has declined ... showing that there has been a significant increase in actual product usage by those in the lowest population tier.”

winner always has devastating effects to a household. If this assertion is true, which may have to be tested, it may be argued that the growth in funeral cover may not directly be a function of proactiveness on the part of service providers a growth in consciousness on the part of the consumer. If the reverse is true, then one may conclude that a notable change is taking place in the industry, with service providers responding appropriately to consumer needs. This would be a preferred scenario.

It is reported that a mere two percent of people in LSM 1–5 participate in short-term insurance. While there may be many reasons for this result, such as people in this category not having any notable assets worth insuring – the proportion seems woefully low.

While the numbers at the level of the sector are welcome, the index of “financial knowledge” seems to be displaying a worsening trend, with FSM 1 increasing from nine percent to 18 percent, between 2005 and 2006. The case for increased education and training is clearly made by these numbers.

Conclusion

The survey highlights several determinants for this poor showing of the insurance industry, ranging from affordability, to negative perceptions on costs and a low level of trust between consumers and service providers. In another article of last December’s Insight Magazine, entitled “Economic Development; The Role of the Financial Sector” a point is made that, “The prerequisite for the industry, with service providers responding appropriately to consumer needs. This would be a preferred scenario.

To put this into perspective, it has been found that for non-users of life insurance, only seven percent say life insurance providers can be trusted. However, this figure is much higher for existing users, recording 39 percent. What this may suggest is that people’s experience of life companies is generally reasonably positive. Although, with no doubt, one could argue quite strongly that 39 percent can be improved upon. At this point, people may be asking themselves, “What level of trust is desirable?” While it would be inappropriate (and difficult to justify) to propose an absolute level, it is perfectly justifiable that levels should compare reasonably with those obtaining in the banking sector and other key service sectors such as retail supermarkets.

Being in the industry and not only observing but also contributing to the change in culture, one remains upbeat about a turnaround in this regard. However, time will be the Judge.
Articles of interest from 2007
A sound National Savings Fund set up for South Africa

A growing sense of household vulnerability and the risk of future fiscal pressure has ushered in a pertinent debate on both the savings ability of South Africans and the appropriateness of various savings vehicles.

A concept that has been placed at the top of the national agenda is the possibility of establishing a national saving vehicle, to which every South African would have access. While this debate has emerged as a result of the retirement reform process, it is as important even when it is considered in its own right. The Sanlam 2006 Annual Survey has highlighted this issue of savings and savings vehicles as a major preoccupation not only locally, but also in several other countries, both in the developed and developing worlds.

This preoccupation has been necessarily brought about in all these jurisdictions, by a broader macroeconomic objective, namely that of raising domestic capital to meet domestic investment needs. This link is particularly important in the South African context given the need to raise the economy’s investment levels to address the unemployment challenge.

According to the thinking surrounding this debate, there are two main objectives for setting up such a vehicle for savings, namely:
- Providing a cost effective and convenient long-term savings vehicle for low income earners; and
- Accommodating the financial problems faced by people experiencing erratic/inconsistent income flows.

It has been argued that the traditional forms of saving instruments are inappropriately designed for our circumstances. If they are, they tend not to be affordable. Therefore, the operational phrases in the objectives are cost-effective, convenient and accommodative.

Traditional service providers, either banks or life assurance companies, have argued that the infrastructure to provide such savings across an entire economy is enormous and would push costs to levels that would be unsustainably high. In particular their concerns about broadening the geographical spread of these services have centred on these costs. Noting these, the National Treasury has responded by proposing a National Savings Fund, which is of a long-term nature. In that regard, it may be advisable to see it more as a national retirement fund rather, with people being locked-in for a notable period of time.

In terms of this idea, cost reduction will be achieved through scale and the pooling of resources, although given that a sizeable part of the labour market is informal, income streams are not always guaranteed. Traditional savings vehicles have not been accommodative to this feature of the South African economy and it still remains a challenge.

Conditions for a success of NSF

A promise to provide such a service to the South African public should be made only if, as a country, we are confident that we can deliver on that promise. This brings us to such issues as capacity, capability and efficiency. In thinking through the practical issues implicit in establishing a savings vehicle of the nature envisaged, there are numerous challenges to be surmounted which include, among others the requirement for:
- High levels of operational efficiency;
- User-friendliness at relatively low cost;
- Tax efficiency;
- Acceptable investment returns;
- Ease of access for the poor;
- Sound networks to ensure a solid footprint;
- A comprehensive central database;
- Efficient and reliable real-time reconciliations;
- The capability to deliver an effective mechanism for policing late and insufficient contributions across multiple employers and manage contribution infrequency;
- Access to bank accounts for contributors, probably linked to uMzansi;
- Simplified, accessible communication; and
- Limited flexibility to keep both complexity and costs down.

However, over and above these practical issues of administration, there are a number of policy questions that need to be considered. While there is some indication on the likely direction to be taken on some of these, many remain quite unclear.

The first issue relates to the tax treatment to be applied on the NSF. One is inclined to believe that the Treasury will pursue a route of neutrality across all retirement savings instruments, in this regard. Similarly, the issue of access ought to be given the same treatment. Therefore, tax and access issues ought to be top of the agenda.

An absence of neutrality would certainly lead to an unsustainable level of cannibalisation from existing traditional savings instruments. The question that we, therefore, need to ask ourselves as a country is whether or not we would want to see the disappearance of the existing savings industry. One is inclined to think that the answer to this question is: No. So far, there is no evidence of any country going along such a reckless path. This
question arises because of the potential negative effect the NSF could have on the financial services industry, as it exists today, even as an unintended consequence.

According to available data and based on the initially mooted income levels allowed to participate in the NSF, as many as 60 percent of members under administration by existing providers could migrate. This assumes that the NSF covers individuals under LSM 1-5. Such a situation can be expected to have significantly detrimental effects on remaining members, as this migration will necessarily force a repricing of the benefits for remaining members.

Another policy question is simply: Who will deliver on the NSF? This is a large operation, which will not only rely on systems, but also specific skills, expertise and experience. For the size of the operation, it is unclear whether one entity, would adequately meet all expectations in a seamless fashion. In that regard, one would be inclined to believe that the scale would dictate some form of a PPP arrangement. The principle of efficiency comes into this decision, yet again.

Caveat

After all has been said and done, there may be a need to shift the onus of ensuring that contributions made through the employer actually reach the NSF to the saver. This is an effective reordering of responsibilities. However, the administrator may be required to do the barest minimum, which is to flag a non-contribution in a particular month. An efficient electronic system, similar to the current cell phone system, to notify contributors, will definitely be necessary. In respect of the issue of infrequent contributions, there is not much more that the administrator can be expected to do, given that individuals will elect the frequency and consistency of contributions, as dictated by their respective circumstances.

Contributors would have to assume the responsibility to make requisite follow-ups and ensure that reconciliations are done. Without any doubt, this will prove quite onerous for many savers, as well as employers.

The way forward and key decisions points

If fashioned as envisaged, the NSF has the potential to form an extremely important component of the reform process and the sustainability of the industry that it will require a collaborative effort in finding an optimal working solution for its implementation. None of us can afford to sit on the sidelines. Every industry participant – savers, service providers as well as intermediaries, need to engage with these issues, to ensure a sustainable solution; one that will encourage higher savings for citizens and one that will benefit the economy as a whole by improving the saving/investment balance at the macro level.

Latest announcement by the President

In his latest State of the Nation address, the President announced “the introduction of an earnings-related social security system

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informed by the principle of social solidarity”. What this implies, is that while the government would be looking at a pre-funded scheme, this would not be based on an ability to pay basis, but rather rely on “cross-subsidisation”. While the details are not known, and we know that these will be subjected to a wider public debate once decided, we expect a progressive tax arrangement to fund the scheme if it proceeds as anticipated. Over and above this, there is talk of a removal of current tax benefits from retirement funding. If both these fiscal instruments are applied, this will make it increasingly unappealing to save for retirement.

We do not think that this will be a huge deviation from the original conception of the NSF. The saving element should remain the core of the proposal. The risk element would be an enhancement to the core. Another major extension to the NSF is that the latest proposal ushers in compulsion, which was not the defining characteristic of the NSF. The NSF emphasised voluntarism.

However, there are broad macroeconomic considerations that should inform the progression of this announcement, namely: Is it a good thing to do?

○ Yes. It is a fantastic idea, so long as it brings about broad based savings in the economy;
○ Any intervention that helps to raise savings ought to be commended, as it contributes to household vulnerability a very important part of insurance;
○ In this particular case, it smoothen the migration across pillars in the World Bank model; and
○ If it is contributory, it creates the right incentives and ownership, as well as reduce fiscal risk.

What should we worry about?

○ Affordability;
○ Efficiency of access. Ensure a good network on the ground;
○ Ensure good return for savers;
○ Consider value for money, in particular for the poor. Consumption today is better than consumption tomorrow; and

Competition with private providers?

○ Competition is always good. Certainly, private providers will not be obliterated. The retail bond did not do that to banks. This is unlikely to threaten the existence of long term saving providers;
○ However, fair treatment is expected, where this product is not given unfair tax treatment;
○ Success depends on:
  • The nature of the product or institution;
  • Who actually provides; and
  • Compulsion.
Towards a world of worker capitalists

This is one of a series of articles concerned with worker capitalists. It is concerned with the response to South Africa’s reform of pension and social security.

Why the term worker capitalist? The reform process in South Africa’s retirement and social security environment is entirely about empowering workers and to create long-term savers in particular. There is no one, even the most leftist of thinkers may question the need to make workers financially independent and self-sufficient. That is the basis for seeking and staying productively employed, whether in the formal or informal sectors of the economy. The reform proposals from government are a major step in this direction.

The title of this article draws from a piece of work, by an outstanding thinker and architect of pension reform, particularly relating to reforms leading to individual accounts. This is none other than José Piñera, of Chile. (Also see Lessons from Chile articles that follow.) In one of his seminal articles (2001), in which he opens with a fascinating statement that reads, “The world would be a better place if every worker were also an owner of capital. Workers would benefit from the appreciation of assets in the long term and feel more connected to the overall performance of the economy. The interests of the workers would be more in line with the interests of those who manage and control those assets, there would be less inequality of wealth, and workers would place a higher value on strong property rights and the rule of law. Above all, workers would find a new dimension of freedom and dignity in their lives.” How relevant!

People may be asking themselves, how relevant is this to the South African reform context. The shift from unfunded pay-as-you-go (PAYG) arrangements to an environment where workers can accumulate wealth in individual accounts can bring about a new paradigm, thus the concept of a world of worker-capitalists.

During a presentation I did to a COSATU gathering in March, this concept elicited a lot of debate as to whether this was consistent with the principles and philosophies of workers in South Africa. We had to go to basics and understand what a worker capitalist would actually mean, in the context. Thinking about the concept of “capitalist” this can be defined as “… an economic player operating in an economic and political system in which a country’s trade and industry are controlled by private individuals for individual profit maximisation, rather than by the state for purely societal profit”.

Clearly the recent set of proposals is pointing firmly in this direction. One of the key proposals in the second paper (2007) says: “… Mandatory participation in private occupational or individual retirement funds, for individuals with earnings above the threshold – ensuring that individuals at all earnings levels make appropriate provision for insurance coverage and income replacement in retirement.” (pg 4)

This is an argument that Piñera has been selling and he is seen as its most fervent proponent. It was on this philosophy that the Chilean system was reformed.

People have questioned the Chilean system. One of the frequently asked questions is whether the Chilean system has been successful? It is very difficult to make an absolute judgement as to whether or not these reforms were successful. This is mainly because, they were introduced as part of a much more comprehensive package. There was an appreciation, quite early in the process that pension reform on its own, is only a necessary dynamic, but not sufficient for dealing with poverty in a wholesome fashion. In that regard, pension reform was introduced and implemented only as a subset of a broader economic growth initiative.

It can be concluded that, as part of this wholesome programme, the Chilean economy was able to lift itself, by its bootstraps, from pedestrian growth rates to rates averaging seven percent for at least a decade, up until 2001. In the years 2004 and 2005, the...
Chilean economy grew at 62 percent and 6.3 percent, respectively. Since 2000 national savings have stayed comfortably above 20 percent, rising from 20.7 percent in 2000 to 23.6 percent in 2005. This good performance has been driven mainly by private sector savings, which have recorded 18.6 percent and 15.9 percent at the two points.

Piñera is quoted as saying that the average real rates of return on retirement accounts has averaged more than 10 percent since their inception in 1981, and pension assets under management have grown to be around 50 percent of GDP.

Fiscal restraint, prudent monetary policy in the context of inflation targeting and a freely floating exchange rate, a sound and deep financial system, and an outward-looking trade policy have provided Chile with enviably high rates of economic growth and low inflation. This has made retirement reform as successful as it has been recorded. The country has been able to realise deep social reform side by side with a one percent fiscal surplus rule. It is ironic that South Africa has decided to pursue its own social reengineering at a time it recorded its first surplus, at almost one percent.

Role of a healthy and robust economy

As the Treasury has always argued, a successful savings programme will always be a function of ones income. If one does not earn an income, that person will never be able to save. This is explained by basic economic theory which posits that saving is a function of disposable income. This can be represented as follows:

\[ S = a + Yd \]

Where:
- \( S \) denotes savings
- \( a \) denotes a minimum level of consumption, not related to one’s income
- \( Yd \) denotes disposable income

On the back of this thinking, the Treasury has yet again, in the second paper, emphasised the need to see this as an economic rather than a regulatory change. There is a strong precedence for this observation and position. If one looks at various reforms of a similar nature, that have taken place in other parts of the world, the key determinant the success of most if not all of them, was a healthy economy. A case in point is Australia and Singapore.

It is important to note that pension privatisation in Chile was introduced as part of a coherent set of radical free-market reforms, with the understanding that implementing such changes simultaneously was the best way to increase economic growth and get the most out of each reform. As a result, the growth rate of the Chilean economy doubled from its historical level to around seven percent a year for more than a decade. (The average real rates of return on retirement accounts has averaged more than 10 percent since their inception in 1981, and pension assets under management have grown to be around 50 percent of GDP.)
Don’t inequalities in society hamper the ability to save? It is accepted that one’s ability to save is a direct function of one’s income. The more low-income earners there are, the lower the economy’s propensity for saving will be. Understandably, people are concerned about the vigilance of organised labour and low-income earners regarding compulsion towards saving, but it is also accepted that if compulsion is part of a package, then it improves savings without compromising welfare.

I agree that one way of enhancing the ability of low-income earners to save is to introduce a wage subsidy as proposed by government. This will mitigate the impact of compulsion and, in addition, social security will be provided to increase the value for future consumption, in the minds of low-income earners.

In other words, any low-income earner who saves for retirement will be compensated up to a particular level. It may not necessarily be 100 percent of the amount set aside but it will be a significant amount that will lessen the negative impact of compulsion.

However, I must emphasise the importance of saving as an individual commitment, with or without fiscal incentives. This is essential to ensure the independence of individuals and households from state support, as well as purely preserving their dignity.

**Undergoing major transformation**

Focusing particularly on administration and risk provision, the public sector has indicated its intention to enter this space as a service provider, whilst there is no doubt about the concerns regarding the role of the private sector going forward.

In principle, the private sector consists of consumers and service providers who will each be affected differently. From a consumer’s perspective, there would be more benefits accruing to them than challenges, through increased competition and reduced costs, as well as better efficiency – theoretically. However, we caution that high-income earners are likely to be faced with a challenge of reduced tax benefits.

On the part of the service providers, there will be increased competition across the board, particularly at the low end of the market. Government’s entry and compulsory migration of members will mean that certain members will be lost to the national fund. Furthermore, risk and annuity business, particularly at the low end, will be lost to the government. What remains uncertain is the impact on asset management. But there is a strong enough indication that this is an area that will be least affected.

The implications are much more complex than presented in this article. These depend on the final configuration of the new dispensation, which is currently being speculated on.

**How to manage life-expectancy risk at retirement**

In the context of increasing longevity, a question was raised about whether immediate annuities were still appropriate. The importance of the concept of longevity is informed by people’s lifestyle and their welfare. With an increase in and enhancement of the position of low-income earners, we can expect a boost in life expectancy across income levels.

The annuities market does not take account of income-differentiated risks, and only deals with gender-differentiated risk. It is long overdue to start doing risk ratings by income groups, particularly since low-income earners have a lower life expectancy compared to higher income earners. It can be argued that by not taking this particular risk rating into account, insurers will tend to calculate longevity risk conservatively – causing a tendency where lower income earners subsidise higher income earners.

**How is double-dipping negative?**

This is a concept that explains the permissibility of earning an income in retirement, but at the same time being allowed to access and enjoy the benefits of the old age grant. Even though double dipping may increase the obligations of the state, it is not necessarily negative. If this proves unsustainable, the government may be forced to increase taxes in order to meet this obligation. Nevertheless, we do believe that a thorough sensitivity analysis has been undertaken to test the sustainability of the proposal.
Educating consumers about the NSSF

The education of consumers on this concept needs to be rolled out at household level amongst parents and children – ensuring that a culture of saving is promoted at the level of the household. It is critical that our children understand exactly what expenditures mean, when these should take place, and what the key distinction between needs and wants is. Saving for retirement ought to be seen as a need.

Putting trust in Government

When one puts money aside for retirement, one puts their trust in a system for almost 30 years or even longer. In this time frame anything can happen – governments can change, economic management can change, private sector entities can fold – the risks are numerous.

Therefore, it is important to remind ourselves that the record of the current government has been significantly superior compared to those of similar governments (globally) that have gone through similar reforms. In that regard, one is comforted that the policies and the institutions set up here have predominantly been aimed at enhancing welfare and safeguarding the interests of the individual and private enterprises. It is not only the responsibility of the government but also that of the public. We all have a responsibility to ensure sustained good economic governance, way into the future.

Why saving is important for the student

Now that the South African Savings Institute’s (SASI) Savings Month (July) has come and gone, it is essential that we take stock of the role of each economic agent. In this article we consider the role of the student in the savings debate (in South Africa) and why students should concern themselves with the process of saving.

One of the fundamental objectives of an economic practitioner is to educate and influence economic agents to save. An economic agent in this case, is anyone who is part of the economy either as a producer of goods and services or a consumer of goods and services, students inclusive. This craving is not merely an academic exploit for the practitioner, but a basic necessity for an economy to grow. I say necessity because; the growth of the economy will rely on much more than savings for its growth. Over and above the savings that an economy generates, one has to ensure that these savings are optimally intermediated for them to generate the desired growth. Thus, it may be rightly argued that savings are a necessary but not sufficient condition for growth.

In theory, it can be shown that there is a consistent (even though not always tight) link between savings and growth through investment. Increased savings in an economy means an increase in the supply of capital, for those who need it. If this occurs with a lagging demand for the capital, this would result in the reduction in the ‘price of money’ in an economy. The reduction in the price of money means a decline in interest rates or the cost of borrowing. Necessarily, if interest rates fall, a demand for investment is spurred, which should result in higher economic activity and thus employment.

This relationship is particularly pertinent for a student. Every forward-looking student will have one common desire, namely that of entering the job market after completion of ones education or setting up their own business, depending on ones entrepreneurial capabilities. Whichever one chooses, the ability to grow as a professional or ones ability to grow his business will be a function of the economy’s growth performance, which in turn is influenced by the interest rates obtaining at that point in time. As already argued, the interest rates will be affected by the economy’s savings performance. It is therefore, in the best interest of the student to save the little resources he/she commands and/or to encourage his/her household and colleagues to save. In this way, they will be having a direct contribution towards impacting on their future.

What do savings do?

Not only do savings influence us at the level of the macro-economy, they also influence us at the micro and household level. Savings for the individual are important to the extent that they are crucial
in the process of managing household vulnerabilities. A household that does not have money put aside for rainy days is most likely going to be negatively affected to a larger extent than one that has savings. This is typical if the household is hit by a large unanticipated occurrence. For instance, if there is a death in the family of a non-saving household, the family stands the risk of being thrown towards the verge of a poverty trap and an unending cycle of borrowing. Borrowing, in its own right is costly for a household as it can attract huge debt service costs, against meagre resources of a struggling household. A household that finds itself having to borrow for consumption purposes, can easily find itself in a debt trap which diverts resources from more deserving needs, such as education of the children and medical requirements.

This too, the observation at the household level, provides a solid case for why students need to be part of the saving culture and initiative in South Africa. A positive behaviour will have a beneficial effect to the individual member of society and the student included. The funding of tertiary education is always compromised by the inability of parents to save adequately. Therefore, it is essential that saving be part of the ongoing planning of every household and its members.

The South African savings institute is one of the bodies in the country that encourages savings across the board. It will be imperative that our future leaders take on the current leadership in growing the South African economy through higher savings and investment. This will safeguard the future of the students of today and build certainty for them to strive in later years.

Every forward-looking student will have one common desire, namely that of entering the job market after completion of ones education or setting up their own business, depending on ones entrepreneurial capabilities.

Business Day: Unemployment seen as snag to National Savings Scheme

Retirement fund industry professionals overwhelmingly agree that government should compel people in South Africa to save for retirement. The opinions of 720 trustees, service providers, principal officers and retirement fund intermediaries were elicited recently during the annual Sanlam Employee Benefits (SEB) symposium. They were reacting to research from SEB, which showed that contributions from both employers and employees to retirement were in steady decline.

By using an anonymous voting system participants at the symposium were able to air their views on the proposed national savings scheme and the issues raised an SEB industry-wide survey. We were able to make the symposium truly interactive as a result.

Commenting on the responses Masilela said that, while the industry supported the establishment of a national social security fund, most delegates believed that unemployment presented an obstacle to the realisation of significantly higher savings despite the implementation of mandatory contributions to the national fund.

He said that almost half of the participants at the SEB symposium felt that substantial progress on eliminating unemployment was required before they were comfortable about the proposals on national compulsory savings for retirement. However, almost a third of the participants agreed with the proposals and wanted to see them actioned as soon as possible.

A national social security fund would be best managed by private providers or under joint management by the private and public sector, said participants. Members would prefer to invest their money in private funds rather than a national fund if given a choice.

Most delegates believed that unemployment presented an obstacle to the realisation of significantly higher savings despite the implementation of mandatory contributions to the national fund.
life assurance, said more than 60 percent of respondents. Most agree the poor should be forced to save a minimum amount in the national social security fund only if everybody is compelled to contribute. If savings are mandatory, 25 percent of respondents would like to see the Social Old Age Grant Means Test abolished;

- Relating to investment issues, retirement fund money should finance social development in poverty stricken communities, said a small majority of participants. They strongly felt that investments should deliver equivalent returns;
- Investment in socially responsible investment (SRI) portfolios should, however, remain voluntary, said over 40 percent of participants. Those who favour a mandatory investment in SRI portfolios prefer less than five percent as their first choice and up to 10 percent as their second; and

- While the level and participation of retirement funds in SRIs remain woefully low, the public and private sectors have the appetite to address the problems of the poor, said most participants. The government’s envisioned national fund is expected to provide the requisite asset base and influence to invest in crucial infrastructure projects to drive further economic development and job creation.

View on retirement annuity space risk

One of the key proposals coming out of the National Treasury, with respect to retirement reform, is the entry of government in the delivery of services to the low end of the market. This piece is meant to provide a perspective with regard to the entry of the state in the annuities market.

Following is a quote from the Treasury paper on Social Security and Retirement Reform, 2007, which gives a good indication of what direction the state is likely to take in this regard:

**Annuities on Retirement**

113. In the context of the policy preference for the payment of benefits in the form of an income after retirement, it will be crucial to ensure that there is effective competition in the annuities market and that the costs of annuities are not excessive. 114. Generally, annuities on retirement are purchased from an insurer – either by a pension fund on behalf of the member or by the retiring member themselves. Some large pension funds provide pensions directly. Policy issues for consideration include whether regulation should facilitate the wider provision of annuities directly by pension funds, or whether an annuity provided by the proposed national social security fund could serve as a useful benchmark in this regard. (pg 25)

What this means is that government is likely to provide administration, risk and annuities, as part of the national savings fund package. At this stage, it is not clear to what extent the role of the state will be in the delivery of each of these services.

According to advice given to government on this market, there seems to be a thinking to the effect that the annuities space is one that the private sector cannot optimally provide insurance. The argument that has been made by one of the advisors to government, Nicolas Barr, is that with the uncertainty brought about by longevity today, it tends to shift the management of risk to such a high level that it becomes inefficient for the private sector to provide its own insurance. He argues that continued private sector provision necessarily causes the underwriter to take a highly conservative position when pricing for this risk.

Necessarily, therefore, given that the South African market does not risk rate by income differentials, the poor will most likely find themselves subsidising the rich. This conclusion is premised on the fact that low-income earners will tend to experience shorter life expectancies than high-income earners. Conservative pricing position will disfavour the poor.

The questions that we have to answer are:

- How large is the market we are talking about and how profitable is it?
- How is pricing undertaken in the annuities space?
- Is the pricing in this annuities space fair to annuitants across the income spectrum?
- Is there room to make the pricing fairer or more objective by introducing income risk rating? Why has the industry not considered this in the past?
- Does longevity bring about an insurmountable level of risk?
- Is there a case for the government to enter this space, to create competition, or are there ways of achieving the same objective?
- What are the ways of mitigating against conservative pricing, eg “with profit annuities”, “longevity bonds”?
- If government enters this space how flexible will it be in changing life expectancies and to what extent does this expose the taxpayer?
How other people perceive this issue

According to Jeremy Andrew (who was my mentor when I entered this area of policy debate way back in 1998), there seems to be an indication from the Actuarial Society that few insurers are making profits on their annuity portfolios because people are, in fact, living longer than expected.

Andrew adds that the pricing conservatism is to be expected in such circumstances. One approach to reducing the impact of this pricing conservatism is to allow “not for profit” institutions to compete with insurers: either government itself or retirement funds that permit new retirees to secure their pensions from the funds themselves on a “non-profit” basis.

A second approach (which is not mutually exclusive) is to ensure that retirees are able to buy “with profit” annuity policies: in such a policy, the amount of capital required to provide the initial pension is determined assuming a particular return will be earned on the underlying assets in future, and future pension increases are determined from investment profits earned on the underlying assets in excess of this particular return less any strains caused by people living longer than expected. This is exactly the approach that most pension funds that pay pensioners from the fund use. For example, a with profit annuity is priced assuming that a return of four percent per annum will be earned after retirement and pensioner longevity according to the PA(90) tables of annuitant mortality with an allowance for the improvement of mortality in future of, say, 0.5 percent per year (starting at 1990); if 10 percent is then earned on the assets backing the pensioner liabilities, the fund can afford to give an increase of approximately six percent (strictly 1.1 / 1.04 -1 expressed as a percentage) presuming there is no change in pensioner mortality. If profits or losses are experienced on pensioner mortality then these will either increase or decrease the capacity to give increases.

The issuing institution (either a retirement fund or an insurer) can then purchase a mix of investments appropriate to the envisaged rate of pension increase after retirement. For example, if the annuity is priced at the same yield as is earned on long-dated index linked bonds, and such bonds are purchased to match the expected outgo from the pension, then the institution has hedged its portfolio against future investment losses and is able to provide full inflationary pension increases.

Andrew goes on to say, the only difference here between either government or a retirement fund issuing such a policy and an insurer would be the profit margin included for the insurer, provided all were using the same mortality and investment yield assumptions. Provided there is competition in the marketplace, there is not information asymmetry amongst the pensioners purchasing annuity policies, and any financial advisor costs are neutral between the different options, the cost of using insurers as opposed to government or a retirement fund can be managed.

This same argument does not apply to annuity policies purchased with fixed rates of increase. Here it is likely that there will be conservatism and the lower income retiree or the retiree in poor health will be disadvantaged. It may be necessary to actively encourage through regulation the provision of impaired life annuities – that is, someone with lower expected future mortality is given a bigger pension for the same amount of capital than someone who has normal or good future mortality.

In order to help insurers get a more predictable return on their annuities (because they will be accepting lower risk), government could issue inflation linked and/or longevity bonds. This will pass much of the risk on to Government while still using the infrastructure of insurers, Andrew concludes.

UBS 10th Annual Financial Services Conference

At the UBS 10th Annual Financial Services Conference held in Cape Town, 16 and 17 October 2007, a number of issues were raised. Here is an excerpt of some of the most salient questions regarding the proposed National Social Security Scheme (NSSS), and their answers.

We would like to ensure that the presentations are focused on the theme of the conference, which is “Savings in Utopia”. Savings is defined as the broader field of savings products including off balance sheet fund management products and on balance sheet savings focused life products.

The intention was to maximise the value add for a well-informed audience of institutional investors and to keep the presentations as specific as possible. Essentially, we wanted to provide investors with new insights into the savings environment and your company’s strategy, opportunities, strengths and weaknesses.

**UBS** The first question is on the proposed NSSS. What role do you
This year’s Sanlam Symposium marked a departure from the past. Building on the research that Sanlam generates on an annual basis, a decision was made to internationalise the discussion around social security and retirement reform. As a key contribution towards addressing the ongoing national discord in South Africa, Sanlam brought José Piñera on board.

Piñera is internationally renowned for pioneering the successful Chilean pension reform, which numerous countries – both low- and high-income economies – have learnt from. To conclude the roadshow around the country, an exclusive workshop was held involving some key industry role-players, most of whom are expected to have critical inputs towards the discussions around government’s discussion paper on retirement reform, as well as being well positioned to influence decisions relating to social security and retirement reform. The workshop was held in Johannesburg on 29 June 2007, the last day of the Symposium.

Deliberations

During the workshop, a number of critical questions were raised, which sought to achieve two things:

- Firstly, to increase the participants’ understanding of the Chilean experience; and
- Secondly, to establish how implementable these would be for the South African environment.

Following an elaborate presentation by Piñera, a series of questions emerged, which formed the basis of the discussion.

“Clearly, with the need to increase individual responsibility and ownership, self-funding needs to be the character of the reform.”

Masilela

Believe government should be playing in retirement provision and how should this be funded?

Masilela

Certainly the position taken to compel people to save is the fundamental response to the challenge facing South Africa. You can never leave the decision to save to individuals and hope to realise your goal. Clearly, the values of savings is not the same across income levels. In particular, the low-income earners do not value future consumption as much as they value current consumption. In that regard, in order to enhance this perception of low-income earners, current welfare considerations are essential, thus our support for social security to be delivered side-by-side with retirement reform. So far, government is playing a role we fully support. Clearly, with the need to increase individual responsibility and ownership, self-funding needs to be the character of the reform. We support the move to individual accounts, as it cements this principle and more importantly divorces individual investment decisions from political decisions. Currently, DB promises are open to abuse, depending on the accountability of the government of the day.

UBS

Do you believe government can administer the NSSS as efficiently as the PVT sector?

Masilela

This is an empirical question. No one can absolutely argue that the private sector is more efficient than government. However, there are two likelihoods. The first is landing us with a SARS type institution, which would be argued to be efficient. The second is to land up with a Home Affairs type institution. This would certainly be destroying welfare. One cannot tell ex-ante what the outcome will be. However, whatever institution we end with, it has to result in lower delivery costs as well as increased efficiency and transparency.

UBS

Assuming they can, what is the likely impact on your businesses should government decide not to outsource any activities within the scheme?

Masilela

A rough estimate shows that if the migration threshold is at R60 000 per annum, we are likely to lose as much as 63 percent of admin business and as much as 52 percent of premium. However, from engagements, we do not expect any loss of asset management business, so long as we continue to perform.

UBS

Assuming they cannot, where can you extract more value than your competitors if Treasury do decide to outsource? What are your key competitive advantages here?

Masilela

This is not about whether they can or cannot, it is more about what is politically appealing. If the private sector can propose an alternative that is appealing, there would be no reason for government to do it itself.

Sanlam Symposium workshop report, 2007: Lessons from Chile

August
These ranged from social complexities to fundamental policy issues around the reform process. Issues that were prominent in the discussions included the following:

- The identification of a country’s social objective function as a critical factor in the design of any policy, whether in the area of retirement reform or any other aspect of economic policy, was seen as critical. This therefore implied that no matter what lessons we learnt from the Chilean case, or any other country for that matter, there was an underlying need to reinterpret these for South Africa’s circumstances. It could not be right that we would adopt these lessons as they were. Another factor relating to this observation was that, as we implement the principles from the Chilean experience, and given that some aspects of the Chilean model would not be transplanted, the resultant outcome ought not be expected to be the same. Whereas Chile realised huge economic benefits from the reform, we may find that these results are not necessarily observed in our case.

- The premise from which the discussion started was that the two countries (Chile and South Africa) are different; they are driven by different visions and wishes. One fundamental difference is that Chile started off with the inheritance of a badly managed, badly designed and poorly implemented pay-as-you-go (PAYG) system. Owing to growing corruption and demographics working against such a system, the country was forced to start off by reforming it. South Africa is fortunate that it does not carry such a legacy. Technically, it is starting from a position of health, given its system. Furthermore, Chile started off with:
  - A government that could not be trusted;
  - Absence of the private sector from the retirement industry;
  - An unsustainable fiscal performance; and
  - No financial market to talk about.

- In order to bring about a long-lasting solution to its problems, Chile had to create a system that links effort to return. This led to the development of the system of individual retirement accounts, effectively a defined contribution (DC) arrangement. That would form the defining characteristics of the Chilean system. However, what is clear is that this system came with its own pain and a lot of resistance from the labour unions. But once established, it has survived a series of governments, both right and left leaning. This is one feature of the system that proves its tenacity.

- Despite DC being the key pillar of the Chilean system, the government appreciated the fact that not all people would be able to benefit from this system from the outset. In that regard, it had to be supported by something else. With that in mind, the country ended up with a predominantly DC arrangement with a very strong social security underpin.

- Furthermore, this government recognised that retirement reform cannot and should not be undertaken in isolation of macro-economic reform. These were undertaken side by side, including extensive labour reform, with the aim of achieving optimal levels of labour market flexibility as an interim objective. The ultimate objective was to realise full employment. It was the belief of this government, and rightly so, that employment is the fundamental solution to effective, improved coverage and increased savings.

This view would later be a key source of debate, where participants queried the objective in the South African context. It was argued that coverage seems to be considered with no consideration being given to increased employment. If that is the case, then the whole reform system would be seen to be flawed.

- The concept of individual savings was driven like a religion in Chile. In order to make it tangible and to influence people psychologically, a savings book (Pension Retirement Passbook) system was developed, which allowed people to check their balances on an ongoing basis, and know exactly how much wealth they commanded at any point in time. This gave the average Chilean a sense of financial independence and personal dignity.

- In order to deal with one of the biggest contributors to leakage from the system, namely costs, Chile used the old-established instrument of competition amongst private sector providers to drive down costs, on the one hand, and increase returns, on the other.

- In the same vein, the relationship between the state and private enterprise was recognised as crucial in the rollout of the reform programme. In spite of the private sector being in the driving seat, the Chilean government remained instrumental in the development of the right environment for implementation. It was an essential player in its role for providing:
  - The right legislative environment within which the reform would take place;
  - Appropriate regulatory institutions and an environment against which players would be evaluated and monitored. It is interesting to note that, unlike in South Africa, the regulator reported to the Minister of Labour instead of the Minister of Finance. This is a very interesting distinction; and
  - A robust social security net, which was crucial for dealing with matters of unemployment, poverty and a skewed income distribution. This is a challenge faced by South Africa today.

- The result of this reform programme, which was implemented in an uninterrupted fashion for at least 20 years, is in an economy that enjoys healthy economic fundamentals, such as high economic growth rates (7%); low unemployment rates (2%); a healthy fiscal performance, enjoying surplus positions in excess of three percent; low inflation (3%); high real rates of returns on investment, approaching 10%; and much deeper financial markets, relative to the pre-reform period.

This background of the Chilean experience – which reads like a miracle but actually is the result of hard work, consistency of policy implementation and solid political support to the programme – resulted in a robust discussion. The discussion revolved around practical issues of implementation.

**Questions and answers**

The discussion included dealing with a wide range of questions, such as:

- Why are we undertaking this reform process in the first place?
- What would the role of the private sector be in the low-income
market after the reform exercise has been concluded, if it will have a role at all?

- What would the role of the private sector be in the annuities market?
- How does the government of Chile deal with a situation where an individual only at the time of retirement discovers that he has accumulated insufficient resources?
- How did Chile deal with the issue of the informal economy and high unemployment?
- How did they achieve labour market flexibility, given that the South African case is faced with a strong labour movement that resists this form of reform?
- How was the concept of individual accounts sold to the public, given that it is generally viewed as being capitalist in nature?
- How was the wage subsidy implemented, in light of the opt-out option?
- How did they deal with the lack of trust that existed between the government and the private sector?
- How did the country arrive at a set of objectives that were consistent across all constituencies, in light of the difficulty of finding similar convergence in the South African context?
- More fundamentally, once the design had been arrived at, how was the decision made, as to who should administer the system?

To a large extent, the answers to these questions (to get the detailed workshop discussions, visit www.sanlam.co.za) can be located in the philosophy and the manner in which the Chileans dealt with their reform programme. The response of the Chileans was driven by a strong belief in private enterprise, giving freedom of choice to the saver and sound economic policy management. The Chilean government was and continues to be a strong believer in growth and employment creation as a fundamental solution to poverty reduction and savings generation.

However, they also realised that the reform would result in inherent social and economic adjustment costs. In that regard they supported the reform by a robust social security system. All policy interventions were crafted purely to balance these objectives.

However, during the discussions, Piñera made it very clear that he was not giving advice to South Africa neither was he claiming to have solutions, because:

- Each country is unique;
- He did not know much about the South African environment; and
- Only the experts, namely South Africans in his interpretation, can come up with the right and hopefully lasting solutions to South Africa’s problems.

### Conclusion

On this score, it is essential that as we engage and consider different dispensations, we need to be cognisant of the fact that he final success of the reforms lies with South Africans.

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### Savings trends

While government and corporates are saving, individual South Africans are not and the trend appears to be getting worse each year. According to an indicator put out by the SASI (Savings Barometer) the environment for savings has improved over the past eight years.

The factors that should lead people to save more have been improving. Income levels have been rising, inflation has been coming down, interest rates are down considerably when compared to their highs, retirement fund taxes have been removed and income tax rates have been reduced over the years.

Therefore, the average household’s ability to save has been increasing. However, while there has been an improvement in the savings environment, actual savings have gone down.

The fundamental reason for this differential lies in consumer behaviour and a number of measures need to be adopted to develop a savings culture in this country. Education is a core strategy and campaigns have to be directed at helping people to understand the importance of savings. As to the emerging black middle class and why people in that demographic are not saving, the answer is that many of these consumers do not have any surplus income to save, owing to high dependency ratios.

Many members of the black middle class are the sole income earners in their households and they are supporting a number of family members which does not leave them with much left for savings. As more people move into gainful employment so families...
As more people move into gainful employment so families will begin to have more money that can be directed towards savings: job creation is seen by the government as a key vehicle for encouraging savings.

Implications for SA

The effect of a low savings rate on the economy as a whole can be interpreted in exactly the same way as the effect at the household level.

If a household is not savings enough to fund its needs, whether it is consumption or investment, it will have to borrow. The more you borrow, the less creditworthy you become and the higher the interest rate you have to pay. Exactly the same happens at the country level.

If South Africa relies on foreign savings, it will require that we justify their decision to invest their money in this country instead of another country. Therefore, for South Africa to be able to attract capital inflows we have to be able to offer offshore investors a good return and that means a higher interest rate and a higher cost to this country to borrow the capital.

The higher cost of capital results in higher costs of production making the country less competitive. However, if the cost at which South Africa borrows is lower than the rate of return that the country is able to generate then it can be beneficial. Borrowing is not bad in its own right, it is when it is unsustainable that it creates serious problems.

Consumer strategy

Saving is all about discipline and people spending less than they earn. If people are listening and learning then we will succeed in achieving our national goal to save. If not, we will be justified as society to compel. The proposals coming out of government are directed in precisely that direction, namely mandatory savings through a national pension fund scheme.

Similar programmes have worked in other countries and it will probably go a long way towards resolving the savings issue in South Africa. People will have to adjust their lifestyles and the manner in which they live so they can accommodate the redirection of income into a pension scheme.

After a few years people will get used to the idea and automatically discount their contribution to their pension savings. The adjustment happens all the time in companies that have their own in-house pension schemes and employee contributions are deducted before they are paid.

Insight: Sanlam Employee Benefits shares lessons from Chile

As thought leaders, Sanlam Employee Benefits (SEB) once again demonstrated its significant role in the retirement fund industry by initiating an exclusive workshop for some of the key role-players who will influence decisions relating to pension fund reform. Among the participants was José Piñera – internationally renowned for pioneering the successful Chilean pension reform. Read further to view highlights of the purpose of the workshop and its link to the second discussion paper on the retirement fund reform.

This year, SEB’s annual Symposium, which represents a comprehensive research study about the South African retirement fund industry, coincided with the launch of the second Discussion Paper on Retirement Fund Reform. The SEB illustrated its intention of playing a key role in the discussions on the reform process by expanding on the 2007 Symposium. In the process, SEB:

- Brought José Piñera on board. Piñera is the former labour and social security minister of Chile and the architect of the radical Chilean social security reform of the 1980s
- Implemented an exclusive workshop with a NEDLAC delegation made up of government officials, labour representatives and industry leaders in response to the government’s proposal
Why borrow from the Chilean model?

As a country of poor savers, South Africa can learn a lot from Chile's social reform strategy, which dramatically boosted retirement savings and economic growth in that country. The strategy helped shape Chile into a leading savings nation, driving economic growth up from 3.7 percent per annum in 1985 to about 7 percent in 1997.

The Chilean reform principles have been adopted in 30 countries, including Argentina, Hong Kong, India, Mexico, Nigeria and Poland. South Africa is currently undergoing a similar reform process, and the lessons from that part of the world are particularly pertinent.

What is the Chilean pension fund reform model all about?

Previously Chile's pension fund model was managed by the government and based on a pay-as-you-go system. In spite of the government charging every worker a huge payroll tax to finance the benefits of the elderly, there was no relationship between the contributions of the workers and the benefits that people received. As a result, everyone tried to minimise what they had to put in and maximise what they could get out. This eventually led to bankruptcy. Following Piñera's appointment as Minister of Labour and Social Security, the introduction of a system of individual retirement accounts followed. This meant that Chilean workers started to save 10 percent of their salary into a "pass book" to be accumulated for a period of up to 45 years with a compound rate of return. So when they reached their retirement age, pensioners will look at the last page of their passbook and see the total amount of their retirement savings.

The distinct difference

The distinct difference between the proposals is that Chile moved away from the public sector scenario, and more towards a private sector route. This was premised on the fact that Chileans had very little confidence on their government, both politically and in terms of their ability to run the system efficiently as well as meet future promised obligations. The same cannot be said for South Africa, but the reverse. In our case, and mainly due to high costs brought on by the absence of competition and poor transparency within a profit led industry of the private sector, government has found it appealing for South Africa to take the public sector route, as currently proposed in the 2007 discussion papers.

Where to from here?

Bringing in Piñera to South Africa contributed to the area of ideas generation and formulation – particularly with regard to a response to the proposals from government. We need to take from the Chilean experience what is relevant for us, and leave out what is not. Clearly, we can learn from both the best in the world and the worst.

Following the discussions at the workshop, it was agreed that the delegates would draft an understanding, using existing forums and drawing from the Chilean experience, in response to the government's proposal, with the aim of adding value to the outcomes. Furthermore, additional workshops will be held both inside and outside of Sanlam to finalise this understanding as part of the response to the government's proposal.

In an article from 2007, *South Africa Magazine* posed a series of questions and Elias Masilela answers them.

**SAM**: In February, during his State of the Nation Address, the South African President announced that a comprehensive social security reform policy would come into play this year. His mention was brief, and was seconded by the Finance Minister's small mention of social security tax in his annual budget speech. What exactly is social security, and how will it operate in the South African context?

**EM**: Social security is an institutional arrangement in a society, driven by the state to secure the welfare of members of society through securing a certain amount of minimum income, during their productive years and in retirement. It is a system that prevents destitution in the case of members of society faced with incapacity and unemployment. It is a highly distributive institution that relies...
Instead of establishing a national compulsory fund, an alternative could be to impose compulsory membership of any private pension fund that meets certain minimum requirements...

on the principle of solidarity among the income capable and the less income capable. The design of such system varies from society to society depending on the philosophies and circumstances influencing the design. The South African system, as envisioned in the current debate is contained in the social security and retirement reform second discussion paper.

So, very briefly, social security aims to provide an income after retirement that is sufficient to maintain a basic standard of living. Government hopes to achieve this by means of a compulsory contribution by all employees into a proposed national social security fund that will support retirement savings as well risk cover and annuities.

The actual design and implementation are yet to be worked out.

**SAM**: According to the policy discussion documents, mandatory earnings related social security tax of between 13 and 18 percent would be introduced on all employees in formal employment. Are there other ways of introducing social security reform? In your experience, have other countries done this differently?

**EM**: There are many ways in which social security can be introduced or reformed. To a large extent this is determined by the philosophy that drives a society. It is also driven by what funding options that society is comfortable with, which ranges from a fully funded option to pay-as-you-go (PAYG), which is driven by taxation. It can be a public driven initiative or private driven one. Instead of establishing a national compulsory fund, an alternative could be to impose compulsory membership of any private pension fund that meets certain minimum requirements, upon everyone in formal employment. So, yes, different countries have approached the same objective in different ways.

**SAM**: Will this be a contribution or is it a tax because the two are quite different.

**EM**: Technically, it is more a contribution rather than a tax. The key characteristic of a tax is a charge that is not linked to any particular benefit. But in this case, a substantial portion of the amount directed into social security will be a direct retirement benefit to an individual. It is expected that only a smaller portion will be directed at a pooled fund, defined by cross subsidisation of the poor by high income earners. In this regard, it cannot be said to be a tax.

**SAM**: According to the discussion papers, the tax will be managed by the South African Revenue Service, with all contributions listed as coming from whom and accruing to an individual rather than a pool of money to be used as a conventional tax. What are the implications of personalised contributions and accounts?

**EM**: SARS is expected to only be responsible for the collection of the contributions. But the benefit side will be managed by a different institution, yet to be determined. It is also expected that a portion of the contributions will accrue to an individual account, to be run on a defined contribution basis.

**SAM**: How does SA’s proposed policy compare to the 401(k) schemes in the US and to Australia’s investment friendly model?

**EM**: The proposed regime will compare very well with US and Australia’s individual models.

**SAM**: Eighteen percent is a large percentage of a salary – how will corporates be managed?

**EM**: It is not clear what this question requires. However, if it refers to RFT, this tax has been reduced to zero or scrapped effectively. If it refers to the contribution threshold of the new system, yes, 18 percent may be seen as being high, if one considers someone who remains invested for a minimum of 30 years, at healthy real rates of return of three percent. However, if the period of investment is shorter and the returns are lower, then 18 percent may be considered appropriate.

**SAM**: The discussion papers have introduced the concept of a wage subsidy to offset the social security contributions for the low income earners, but how will companies compensate for their loss in revenue, and on a larger scale, will this tax not negatively affect the local economy?

**EM**: The wage subsidy is meant to compensate the employer for resultant cost increases from compulsion if imposed on the employer. Given that wage elasticities for low-income earners are very high (–0.5 up to –1), any increase in cost of doing business would result in layoffs, which would be contrary to the underlying objective of government, namely, that of dealing with poverty through job creation. This is a fundamental principle, which shows that government fully appreciates the functioning of the labour market.

**SAM**: What are the impacts of such a scheme in relation to the South African dynamic – only a percentage of the SA population currently has pension schemes, not everyone has access to banking or financial services, many are uneducated, the industry is largely fragmented, and so on.

**EM**: The impact should be a positive one, in the sense that access to a retirement savings mechanism will be enhanced. The positive spin-offs at the macroeconomic level are conditional upon the savings being properly and appropriately managed and well invested, in the best interests of the employees concerned.

It is expected that insurance coverage will be increased, overall savings as a proportion of GDP for households will increase and the structure of industry will change significantly, converting what
was a supply led commodity into a demand led commodity. This is revolutionary yet conservative.

**SAM:** In your experience, what were the challenges faced by Chile in undergoing a similar pension revolution, and what were the lessons learnt?

**Masilela:** Many institutional problems faced Chile, brought about by inefficiencies, bad governance and inadequate financial system. These can be cited as:
- Design flaws;
- Lack of trust on politicians;
- Inability of state to administer;
- Low level of coverage;
- Inequitable benefits;
- Regressivity in income distribution;
- High admin costs; and
- Poor fund management.

The biggest outcome of the Chilean reforms is deepening of that country’s financial markets, increased savings rates and a sense of ownership, responsibility and dignity among the average Chilean. However, the system had its problems and shortcomings and that is why it is under review today.

Commenting on the results in general, attendees were in favour of government’s proposed reform but provisos were attached. One key concern which emerged was that lower income earners should not be forced to save for retirement if it means their standard of living in the short-term would suffer. So an approach that combines social security with retirement planning is imperative. This is important to ensure welfare is enhanced both pre and during retirement.

The underlying sentiment in the results indicated that delegates believed the proposed reforms would only succeed if government’s current excellent fiscal and economic management was preserved. This is premised on the need to meet the financial requirements originated by the proposal as well as the likelihood of the new regime providing individual accounts. “If this government changes in the future and the economic performance suffers, the positive stance would be tampered.”

Questioned about their perceptions on the options around the management of the National Savings Fund, 70 percent of delegates believed that a public-private partnership would be the best way to run the fund. This seems to me to indicate that there is a trust issue that arises between the state and private sector, with regard to the reform process. This issue will need to be resolved if the reform is to succeed and we need to be realistic about sentiment in this regard. For example, in Chile a lack of trust in the government led to that country choosing a private sector route as a key pillar to that country’s reform. However, what is clear in the South African context is that we are starting from a totally different premise, where it is the private sector that is under scrutiny.

In this country much of our lack of trust in the private sector centres around cost of service provision in the past and in the future. Whereas, with regard to government, people are concerned about efficiency issues. People ask the question, “Will government be able to successfully administer a fund of this size and complexity, in a seamless manner?” The answer from this group of interested parties is that government needs to cooperate with the private sector in order to minimise concentration risk.

**Results**

About 70 percent of delegates believed that South Africa’s poor should be forced to save a minimum amount in a National Fund. However, an interesting picture emerged when the audience was asked whether high-income earners should be incentivised if they are forced to contribute – nearly 60 percent believed they should...
One of the most pressing issues facing government is minimising over-dependency of the individual on the state and preserving their dignity. According to Leon Kok, this is the view of Elias Masilela, who is deeply engaged in the process of getting a viable pension system going.

FinFund: Both voluntary and statutory savings are not enough

There are numerous South African households that don’t save enough, which means that when they migrate from their productive years into their retirement years, they will not have enough resources set aside for retirement. That suggests that they will probably become a burden to the state.

It is paramount therefore that government makes people more conscious of their likely status at the point of retirement, and gets them to prepare for that event now rather than later. However, there is a second angle to this as well, he says. There are also people who are conscious of the need to save for retirement and willing to do so, but find it difficult and almost impossible to save. And the reason is the way the system has been structured.

Difficulties include products being too expensive, the corrosive effects of inflation, geographical and other forms of access, as well as complexity. “In many cases it is just too structurally difficult for people to access retirement funding, either because geographically they cannot access the facility, or if they do manage to access the facility, it is just too complex for them to comprehend,” says Masilela. “Therefore they choose to walk away from it. The underlying philosophy of the reform is ensuring that savings facilities are actually accessible, simple to understand, and affordable.”

Another spin is that because government has no confidence in the way that people are going to behave in the new dispensation, it is not going to leave it to chance. Originally the idea was to do just that. They must have had a rethink and decided they have to compel people to save, in the new dispensation. Individual savings in SA are less than two percent of gross domestic product (GDP).

“There is not only a problem at the household level, it is also a problem at the national level where savings amount to a mere 15 percent. We are looking to grow the economy at around five or six percent on a sustainable basis, we cannot hope to achieve that unless we raise national savings above 20% and closer to 25% of GDP.”

What’s ahead?

Now in terms of design going forward, he says: “We have a ‘proposed’ design from government. I’m saying proposed design because there is nothing firm on the table that describes...”
decisively what government is going to do. South Africa is waiting what I term a consensus document between the two key departments behind the reform, namely the National Treasury and the Department of Social Development. Until that happens, we will be speculating about the nature of the beast.”

The multi-faceted framework that government nevertheless has in mind comprises a non-contributory safety net funded out of government revenue to provide for old age retirement, disability grants and the like; a compulsory contribution to a national social security system up to an income threshold; and additional compulsory retirement contributions for all formally employed people, and supplementary voluntary savings by individuals with some tax incentives that are still to be defined within a certain cap.

The national social security fund is to be known as the “National Fund”, will be driven by the principle of solidarity where government will define certain benefits that will be distributed on a basis yet to be defined, but the contribution will be predominantly based on the ability-to-pay principle where high-income earners will subsidise low-income-earners. However, there is a likelihood that contributions will be capped at some reasonable level. What this level will be is not clear. This is just one of the many unknowns, with regard to the few thresholds in the system.

Another characteristic is that members currently in private sector employment but below a certain income threshold will be migrated from private retirement funds into the National Fund. People earning in excess of that threshold will have the option of investing in the National Fund, or investing elsewhere, in private sector funds.

The social security portion is considered to be a defined benefit, though at this stage it has not been decided what it will include and how it will be dispensed. One possibility is that it will fund risk benefits such as death, disability, annuity and unemployment benefits.

The final component, comprising those people above the income threshold, will be a defined contribution portion, where individuals will put money into accounts that directly reflect ownership of that money. Says Masilela: “When these people get to retirement, they will draw from the investment they put in, plus the returns they have gained during the period of the investment, less the costs associated with the management of the portfolio.

“Effectively, this shifts the risk away from the employer to the employee which means the owner of the fund would have to get more directly involved in the way the fund is invested.

“That in itself poses a huge challenge – if people have to be more involved, they need to understand what they are dealing with and make the right decisions, and if they don’t understand, somebody has to educate them. This will remain one of the biggest challenges of the new dispensation.”

Sanlam has formed a consultative forum to define the company’s response to the proposed National Social Security and Retirement Reform set out by the government. Here is a look at the impact of the proposals on the financial services industry.

How will the proposed retirement reform affect Sanlam and the industry?

The government has clearly indicated that it would not want to do something that will have a destabilising effect on the financial sector. The private sector is seen as an important foundation for the rollout of the reform. In that regard, the industry should assist government to realise its objectives without losing its role in the process.

There are many areas in which the industry can assist. One of the critical inputs, which may sound trivial but quite critical, is the providing and sharing of data. Although some of the data may be commercially sensitive, there are aspects of it that can be made public. It should be realised that the proposals that government put out are not quantified. Part of the reason is that the data that is required for that is locked up in our vaults. This input will be essential towards ensuring sustainable decisions and thresholds.

The industry can also help by evaluating the proposals.
and identifying which aspects are sustainable and which are unsustainable, not only from a business viewpoint but also an economic viewpoint. One fundamental area has to do with the thresholds that have been suggested. A critical threshold is that people below a certain level of income (at this stage an annual income of R60 000 has been suggested) will be migrated from the traditional savings (or retirement) environment to the new retirement environment, which will be the National Social Security Fund.

That means a number of members will be lost to the National Fund, which could have an estimated impact of 40 percent to 80 percent on the industry. The effective threshold could even be higher than the regulated number, by margins as much as R30 000. We will have to work out those margins. Part of the work of the internal consultative forum is to estimate price and cost elasticities, which would give a sense of these margins. This is going to be a lot of work.

Another aspect depends on the configuration of the proposals. If one of the configurations indicates that members and their accumulated interests are to be migrated, the reform will have a much bigger impact on the industry. But if only members are migrated, the impact will not be as far-reaching. We are pleased to note that the thinking is leaning to the latter option. As far as asset management is concerned, the government has yet to decide whether the Public Investment Corporation (PIC) or the private sector or a combination of the two will manage the funds that are generated for the new fund. Here too, the leaning seems to be towards avoiding over-concentration.

There are many decisions that still have to be made.

What are the responsibilities of the consultative forum that Sanlam has formed?

The ultimate objective is to be able to inform and influence the government in its decision-making. We can only do this if we know exactly what we want and what we can do for the reform. The forum is going to consolidate views from the business units, determine the risks associated with each business and work out how these can be quantified and how we are to respond to minimise negative impact.

Who will be affected most?

This is difficult to determine, but because the intervention is directed at the lower end of the market, every business unit that does business in this market will be affected. Umbrella funds will most likely be at the hurting edge together with the entry-level market.

What are the challenges that lie ahead?

Apart from the loss of business, it is making sure that we have the right data and are able to model the impact of the proposals. We need to model this not from a business case basis only, but also from an economic case basis. It is not about the industry protecting its book, but also about understanding the big picture and where the government is going. We should complement the process government has started rather than saying we think this will be bad for business and try to block it. The challenge lies in the potential for new business. Once government compels people to provide for their retirement, everybody who earns an income will be thrown into the net – there won’t be people inside and others outside the net. We need to determine how many people are currently outside the net who will be brought into the net, how much money they command and how much they are willing to put towards retirement. We need to work out the size of the new pie. Not only that, we need to be able to work out how much of this new pie we can capture. This is a huge task!

What is the anticipated time frame?

The government wants to start negotiating with NEDLAC stakeholders by July this year after they have received approval from Cabinet for negotiations and they will want to have concluded negotiations by the end of the year so that legislative drafting starts in 2008. We do not know whether these timeframes are feasible – many people are sceptical about them. The jury is out on this matter.

What is Sanlam’s view regarding the reforms?

The view from the industry is that we support the reforms. We see them as the right route to take, as they are the right things to do – from an economic perspective. They may have a detrimental effect on the business level, but on an economic level they are important. They also provide new opportunities, even though we cannot quantify these at this point.

First and foremost we are consumers and savers before we are employees of Sanlam. This means that when we think about the future, we need to think about the future in our individual capacity. We need to determine if we are saving enough to be able to retire comfortably, and if we are not saving enough, we will be affected in exactly the same way as everybody else.

That means, even at the level of the individual, we need to embrace the reforms, as they are consistent with the household aim of eradicating vulnerability. This is a major step in that direction.

By not saving enough, you shift your responsibility the state ... This necessarily worsens the tax impact on the average taxpayer. ...
Towards a world of worker capitalists

The world would be a better place if every worker were also an owner of retirement capital, according to José Piñera as far back as 2001.

Workers would benefit from the appreciation of assets in the long term and feel more connected to the overall performance of the economy. The interests of the workers would be more in line with the interests of those who manage and control those assets, there would be less inequality of wealth, and workers would place a higher value on strong property rights and the rule of law. Above all, workers would find a new dimension of freedom and dignity in their lives.

Karl Marx was right when he asserted that if workers could only sell their labour in the market, many of them would feel alienated from society. But he was terribly wrong in believing that collective ownership of property would give workers a sense of security and control over their lives. Liberating workers requires giving them access to individual ownership of capital in the context of a free market economy.

The worldwide pension crisis has created a great opportunity to empower workers without resorting to expropriations or violent revolutions. In most countries, workers are already compelled to contribute between 10 and 30 percent of their wages to pay-as-you-go retirement systems. The transformation of those unfunded systems into systems in which wealth is accumulated in individual accounts can bring about a new paradigm, a world of worker capitalists.

This was our guiding vision when we fully privatised the Chilean pension system 20 years ago. In a companion piece, “Empowering Workers: The Privatization of Social Security in Chile” (Cato Letter no 10, 1996), I explained the essence of that reform. Chile’s pension reform fully replaced the state-run pay-as-you-go retirement system with one of retirement savings accounts that are owned individually and managed by the private sector. It is important to note that pension privatisation in Chile was introduced as part of a coherent set of radical free-market reforms, with the understanding that implementing such changes simultaneously was the best way to increase economic growth and get the most out of each reform. As a result, the growth rate of the Chilean economy doubled from its historical level to around seven percent a year for more than a decade.

[1] The average real rates of return on retirement accounts has averaged more than 10 percent since their inception in 1981, and pension assets under management have grown to be around 50 percent of GDP.

However, the impact of pension reform in Chile has gone beyond impressive economic indicators. Pension privatisation led to a radical redistribution of power from the state to civil society and, by converting workers into individual owners of the country’s capital, has created a political and cultural atmosphere more consistent with free markets and a free society.

The Chilean pension model is a comprehensive alternative to the social collectivism initiated by German chancellor Otto von Bismarck at the end of the 19th century, which was the model for the welfare states of the 20th century. By cutting the link between individual contributions and benefits – that is, between effort and reward – and by entrusting governments not only with the responsibility but also with the management of these complex programmes, the Bismarckian pay-as-you-go pension system turned out to be the central pillar of the welfare state, in which the possibility of winning elections by buying votes with other people’s money – even with the money of other generations – led to an inflation of social entitlements, and thus to gigantic unfunded, and hidden, state liabilities. In Chile the same rationale that applies to the private pension system has already been extended, although imperfectly, to the areas of health and unemployment, with individual insurance (health) or accounts (unemployment) managed by the private sector.

In the 1990s seven other Latin American countries followed the path opened by Chile, and today some 40 million Latin American workers own financial wealth in their retirement savings accounts. The late 1990s saw another landmark when Hungary, Poland and Kazakhstan joined the reforming club, and now around 15 million workers have individual retirement accounts in those former communist countries.

In January 2001, Sweden, once a model welfare state, allowed its workers to put 2.5 percentage points worth of their 18.5 percentage payroll tax contribution into an individual account. The new programme, known as the Premium Pension System, passed the Swedish parliament with 85 percent approval.

A domino effect in Latin America

In the seven countries of the region that have implemented pension systems based on private retirement savings accounts, the structure of the private pension system closely follows the
Chilean scheme, and in all cases the private funds are surviving the difficult initial years and beginning to make a relevant contribution to the establishment of a free-market economy. Of course, the characteristics of the transition process have differed across countries because of the diverse economic, social, and political starting points of the reforms. [2]

Mexico, Bolivia and El Salvador have adopted two crucial features of the Chilean reform: (1) workers eligible for the private retirement savings account system do not contribute to the pay-as-you-go public pension system, and (2) new entrants to the labour force join the private pension system. Together, those features ensure that, after the transition is finished, the public pension system is extinguished, leaving only the private system for the vast majority of workers in the country (full privatisation). Peru has adopted (1) but not (2). In Colombia, Argentina, and Uruguay workers are in both state pension and private pension systems (partial privatisation).

**Mexico** – despite a long tradition of state paternalism – undertook in 1997 a major reform by completely eliminating the public pension system for private-sector workers and replacing it with a system of private retirement savings accounts managed by competing companies. All private-sector workers who were previously participating in the pay-as-you-go programme had to begin contributing 11.5 percent of their wages to their retirement accounts, to which the government also contributes. Regrettably, public-sector workers, including teachers, public health workers, and the civil service, were forced to stay in the government pension system. The private system now has 16 million participants, the most of any country in the region, and manages approximately $13 billion.

**Bolivia** – one of the poorest countries in the hemisphere – closed its public pension system in 1997 and replaced it with a privately administered system of retirement savings accounts. Bolivians now have 10 percent of their salaries placed in retirement accounts for the provision of old-age benefits. The pension fund companies now manage $575 million, representing about 10 percent of GDP, and there are half a million participants.

**El Salvador** – until recently a country torn by civil war – approved its pension reform in 1998, even with the votes of some former guerrilla commandants turned members of Congress. The features of the system are very similar to those of the Chilean system, with workers contributing 10 percent of their salaries to private retirement accounts. Assets under management total $213 million, and close to one million workers are enrolled in the private system.

**Peru** – the first country to follow the Chilean pension reform – established a private pension system in 1993. Peru gives workers the choice of moving to a private system managed by companies of their selection and provides recognition bonds for those who do. Peruvian workers place 10 percent of their wages into the retirement accounts and pay nothing to the state. But the pay-as-you-go pension programme has stayed in place for new entrants to the labour force, leaving open the door to an unfunded system that politicians may once again abuse. More than 2.5 million Peruvians have already moved into the new system, which has accumulated $2.5 billion.

**Colombia** – even under threat from Marxist guerrillas allied with drug cartels – introduced pension reform in 1994. It too allowed workers to opt for investing 10 percent of their wages in retirement savings accounts. A unique and most troublesome feature, however, allows workers to switch back and forth between the public and the private systems, giving rise to a permanent struggle between a state-run agency and the private system and perpetuating the pay-as-you-go system. Even so, the private system has attracted almost four million participants and has accumulated $3 billion in pension funds.

**Argentina** – under a government that engineered a partial break with the populism of the disastrous Perón era – set up a private retirement system in 1994. Argentine workers are given the choice of placing 11 percent of the salaries in their retirement accounts. However, the pay-as-you-go system was kept in place, providing all workers, including those in the public and private systems, a so-called “basic pension”. The law establishes that all workers put 16 percent of their salaries in the public pension programme. Those workers opting to stay in the public programme face a total of 27 percent of payroll taxes for pensions and receive benefits on top of the basic pension. By allowing the public pension scheme to continue, the Argentine government continues to add to its unfunded pension liability. Assets under management in the private pension system have grown to $20 billion and the number of participants to eight million people.

**Uruguay** – the Latin American country most influenced by the European social model – introduced a very limited reform in 1996, similar to the Argentine reform in that it keeps the pay-as-you-go system in place for all workers but allows for a portion of wages to be diverted into retirement savings accounts. As of this year, the pension fund companies are managing about $651 million in assets for half a million participants.

It must be emphasised that many of these reforms have important flaws that have to be eliminated before their full potential can be realised. But the basic structure of individual retirement accounts is firmly in place, and new constituencies of workers, entrepreneurs (including substantial foreign financial companies), and technical experts have emerged that will defend it in the future. So, with this new G8 of countries with private retirement systems, Latin America has become the world leader in structural pension reform. If Mexico and El Salvador are successful, pension reform will spread rapidly to the rest of Central America. The biggest laggard on the continent is Brazil. Even though some companies offer their workers private pensions, the largest country by size and population in Latin America suffers under the weight of an unfair and unaffordable pay-as-you-go public pension system, the deficit of which amounted...
to 4.6 percent of GDP in 1998. So far, the government has kept the social and economic problem from exploding by tinkering with the system, an approach that is reaching its limits.

From communism to property rights

In the late 1990s, Hungary, Poland and Kazakhstan, as part of the transition from a collectivist system to a market one, reformed their pay-as-you-go pension schemes and allowed workers to use payroll taxes to build their own retirement savings accounts. [3]

In 1998 Hungary became the first of the former communist countries in Europe to allow a portion of workers’ salaries to be invested in retirement savings accounts. Its pay-as-you-go public system was already experiencing deficits in the 1990s, while imposing 30 percent payroll taxes. With an already large elderly population, the country would have had to raise payroll taxes to an unfeasible 55 percent, and each pensioner would have been supported by one worker by 2035. Current workers were given the choice of staying in the public system or moving to the new one. New entrants into the labour force are required to enter into the new system. However, all workers still contribute to the public pension system. Twenty-four percent of the wages of those in the private system go to the pay-as-you-go system, and only six percent go to their own retirement savings accounts. The main shortcomings of Hungary’s system are similar to those of Argentina and Uruguay: high payroll taxes are used to maintain the public system, thereby discouraging job creation, and the system remains vulnerable to political manipulation. Hungary’s private pension scheme has so far generated $1 billion in assets under management and has 2 million participants.

Kazakhstan – an oil-rich former Soviet republic – opted in 1998 to reform its pension system by allowing workers to place 10 percent of their wages into retirement accounts managed by competing pension fund companies, while continuing to contribute 15 percent of wages to the state-run pay-as-you-go system. However, there is a dangerous requirement that a minimum of 40 percent of the funds be invested in government securities, and, in fact, 85 percent of the funds are now in government bonds, reflecting the infancy of the country’s domestic capital market and the turmoil in the region following the Russian default of 1998. As in Argentina and Mexico, there is a state-run pension fund company that competes unfairly with the private sector. Although in 1999 that company managed around 70 percent of the assets in the system, the share has now gone down to 42 percent, and the system may be privatized when its share of the market is further reduced to 25 percent. There are 3.2 million workers enrolled in the private pension system, and pension assets have grown to $700 million (4.2 percent of GDP).

Poland – the most successful of the former communist countries – introduced a pension reform in 1999. Workers between the ages of 30 and 50 at the time of the reform were given the choice of staying fully in the state-run old-age pension system – in which they have to pay a 19.52 percent payroll tax – or diverting 7.3 percent of their salary into their own retirement accounts and paying a 12.2 percent payroll tax to build “virtual” individual accounts in the state-run system. Younger workers must join the private pension system, while older workers must stay in the pay-as-you-go one. So far, 11.5 million workers (70 percent of those who could choose a retirement account, that is, people between the ages of 30 and 50) have enrolled in the retirement savings account system, and the funds have accumulated $1.5 billion.

As in Latin America, the example set by the pioneers is already generating followers in the region. Several countries, including Russia, are planning to introduce Chilean-style pension reform in the near future. [4] In another continent, China, the world’s most populous nation and still nominally a communist country, has been studying ways to solve its pension crisis by adopting a system of individual retirement accounts.

The coming crisis in Western Europe

Global demographic megatrends, such as longer life expectancy and reduced fertility rates, will accelerate the crisis of pay-as-you-go pension systems, especially in mature developed economies such as those of Europe, the United States and Japan. As former US Secretary of Commerce Pete Peterson has observed: “The costs of global ageing will be far beyond the means of even the world’s wealthiest nations – unless retirement benefit systems are radically reformed. Failure to do so, to prepare early and boldly enough, will spark economic crises that will dwarf the recent meltdowns in Asia and Russia. For this and other reasons, global ageing will become not just the transcendent economic issue of the 21st century, but the transcendent political issue as well.” [5] In stark contrast to some of their neighbours to the east and in Latin America, the political elites in western continental Europe have so far been unwilling to engage in structural pension reform. For Europeans, that political paralysis will be disastrous if it continues, since the region’s looming pension crisis is perhaps the most severe in the developed world.

According to the Organization for Economic Cooperation and Development, the unfunded liabilities in Europe are enormous – more than 200 percent of GDP in France and Italy and more than 150 percent of GDP in Germany, for example. [6] By 2025 nearly one-third of Europe’s population will qualify for public pensions. In 30 years, in Germany and Italy each retiree will be supported by one worker. Given those countries’ generous benefits and weak or nonexistent private savings for old age, drastic tax hikes or benefit cuts will be necessary just to keep the public pension schemes going. Italians, who already face 33 percent payroll taxes for pensions, could see those taxes increase to 48 percent, for example.
In a region that faces chronically high unemployment rates, such a move would only make job creation more difficult.

Yet even though continental European countries are spending up to 15 percent of GDP on public pension outlays – a figure that may rise to more than 18 percent within 40 years for some countries – they have so far implemented only expediency measures. Germany, for instance, has recently proposed raising payroll taxes and using state funds to encourage workers to put additional money into private accounts. Needless to say, such a move would hardly solve the coming crisis in a country whose pension system costs 11.5 percent of GDP – more than twice the US figure.

Spain’s pay-as-you-go public pension system, the most expensive programme in its federal budget, gives workers a minimal rate of return. Yet despite the facts that an economically feasible transition to a private system has already been identified and that the government is committed to economic liberalisation in other areas, political inertia has prevailed. [7]

In Italy – the country with the lowest fertility rate in the world – annual public pension outlays stand at around 14.5 percent of GDP. There is, moreover, blatant corruption in the system. In 1997 a Finance Ministry study discovered that the government had been paying disability pensions to 30,000 dead people. Spot checks of 15,000 recipients of disability pensions found that 5,000 of them had faked their handicaps (including a young woman who was collecting a pension for blindness while working as a chauffeur).

France’s pay-as-you-go system is also in deep trouble. The generous public pension system will go into deficit after 2010. Attempts by different governments to tinker with the system have been crushed by across the board opposition. The almost total lack of a parallel private pension system will make matters worse for future retirees.

As UK economist Tim Congdon observed in 1997, “Europe’s growth prospect is worse now than at any time since the start of the industrial revolution. If Europe’s governments cannot solve the problem of unfunded pensions, they will not be able to control their larger fiscal difficulties or to prevent rises in taxation which will wreck their economies.” [8]

The promise of America

Several developed countries have substantial private pension systems, especially the United States, Japan, the United Kingdom, the Netherlands, Switzerland and Canada. But those private systems coexist with important and flawed public pension systems.

Only two rich nations – the United Kingdom and Australia – have so far undertaken structural reform of their public pension systems. In 1986 the UK gave its workers the choice of opting out of the second tier of its public pension system and, with 4.6 percent of their wages, purchasing either defined-contribution or defined-benefit plans in the private sector. Two-thirds of British workers have opted out and contributed to the private funds. Currently, all workers contribute a percentage of their wages to the first pay-as-you-go tier and on retirement receive the basic state pension from the government. The UK’s public pension system still has an unfunded liability of around 40 percent of GNP. Australia’s previous system was a state-run operation funded by income taxes. In 1992 employers were required to establish superannuation accounts for all workers (9 percent of wages will be deposited by 2002), which will form the primary source of retirement income for most workers. But workers freedoms are unnecessarily curtailed by several restrictions, the main one being the obligation to contribute to the pension fund of their own sector.

There is the possibility of a breakthrough in the US, where the government-run pension system, at $400 billion, is the largest government programme in the world. Whatever its advantages to the first generation that has received its benefits, the way it was structured has prevented common workers from owning their retirement savings and has politiced decisions that should rightfully be made by individuals instead of politicians. Even though 40 percent of Americans have some sort of private retirement fund (IRA, 401[k], etc), another 60 percent do not. Yet all workers are still required to put one-eighth (12.4 percent) of their covered earnings in a system that does not give them ownership, market returns or security.

There are six key arguments for privatising Social Security in the US:

- **The Moral Argument:** A pay-as-you-go public pension system is a collectivist scheme that deprives individuals of freedom in organising their lives and planning for their futures. A mandatory private retirement account system keeps compulsion to a minimum (the mandatory savings), thus maximising the freedom to choose within a national retirement scheme.

- **The Rate of Return Argument:** Pay-as-you-go systems are, by their very nature, a good deal for the earliest recipients, but with time, what is essentially a financial pyramid scheme begins to expropriate younger workers. Today the implicit rate of return for current workers is less than two percent, and those born today will probably see negative returns. Mechanisms to postpone the public pension system’s insolvency, such as increasing payroll taxes or the retirement age, reduce the already minimal rates of return. In contrast, in the period from 1802 to 1997 in the US, the annual real rate of return has been seven percent for stocks and 3.5 percent for long-term government bonds. From 1802 to 1995, the average real rate of return for corporate bonds was 4.97 percent. [9] So a private retirement system can provide a higher rate of return, even if all the funds are invested in zero-risk government bonds.

- **The Fairness Argument:** Since the poor tend to start work earlier in their lives and have a shorter life expectancy than do the better off, the pay-as-you-go old-age retirement system is actually regressive for certain categories of workers. [10] Under a system of retirement savings accounts, poor workers would be accumulating savings in their accounts and therefore would be allowed to benefit from the rewards that markets are giving to wealth ownership, mitigating the recent increase in the “wealth
around the world. If the US institutes this reform, it would not only transform every American worker into an owner of capital, it would also encourage the rest of the world, especially continental Europe and Japan, to reform their systems. The benefits to workers and economies would be enormous. It would be a giant step toward liberating workers and the rest of the world, especially continental Europe and Japan, to reform their systems. The benefits to workers and economies would be enormous. It would be a giant step toward liberating workers around the world.

ENDNOTES: [1] According to economist Klaus Schmidt-Hebbel, the rate of growth of the Chilean economy went from an average of 3.7 percent per year, in the period from 1961 through 1974, to 7.1 percent per year in the period from 1990 through 1997, and of that extra growth of 3.4 percentage points per year, the pension reform would have contributed 0.9 percentage points per year, that is, more than a quarter of the total. Of the total increase of 12.2 percentage points in the rate of savings during those two periods, the pension reform contributed 3.8 percentage points, that is, 31 percent of the total increase. See Klaus Schmidt-Hebbel, “Does Pension Reform Really Spur Productivity, Saving and Growth?” Documentos de Trabajo del Banco Central (Chile) no 33, April 1998, pg 25, 29.


2008
Articles of interest from 2008
For the past two years Sanlam Employee Benefits (SEB) has proudly sponsored the Retirement Fund Focus – a definitive series about the retirement fund industry on channel 292 of DStv's Summit TV. According to viewers, the series proves to be hugely successful and informative, hence SEB’s decision to continue the sponsorship for 2008.

**Insight: What is in store for the retirement industry in 2008?**

This year, the New Retirement Thinking for 2008 series seeks to invite industry experts to share their unbiased opinions on topics tackling retirement, financial planning, pension funds, employee benefits and the national culture of savings. Since the retirement industry promises to be a busy one this year, presenter, Giulietta Talevi interviewed Elias Masilela to give us some idea of what to expect.

**Giulietta Talevi:** It strikes me that we started 2008 in a very different position to where we started 2007. We have high interest rates, higher inflation, a global economic uncertainty and also local political uncertainty. So what are the implications for the retirement fund industry this year given all these factors?

**Elias Masilela:** There are quite a number of implications but I think the main implication is what impact this is going to have on the potential saver or the consumer. The likelihood is that when there is a lot of uncertainty ... costs are going up, interest rates are going up, inflation is going up – there is a growing probability that the consumer or the saver is going to take a short-term view with regard to his/her finances, which goes against the objectives of retirement savings.

Regarding retirement savings we are looking at people taking a long-term view about their finances and I think this is a challenge we are going to be faced with as a society. I certainly hope that government is going to enter the fray and make sure that they change and manage the expectations accordingly.

**GT:** Typically, what's happened in periods of high interest rates and high inflation? Have you noticed that people are less diligent about saving? That they withdraw their savings to keep up with day-to-day living costs?

**EM:** Well, clearly for those people who are already in debt – when interest rates go up, it means there’s less and less cash flow to play around with and the likelihood is that they are going to go out and borrow more money in order to deal with their short-term expenses. Or, they may dip into their savings, including long-term savings and that is the big risk that we are faced with from a retirement perspective.

**GT:** So what does the industry do to mitigate these factors that will encourage people not to take the short-term approach and the shot gun approach as it were?

**EM:** I think it has strictly got to do with how you manage expectations. Government and industry players need to come into the equation and make sure that they change and inform people on how to behave from a savings point of view. What we saw last year when we entered 2007, was hype about the pension and retirement reform. People were looking forward to seeing developments in 2007 and participating in the reform process. Come 2008 we are still almost at the same position we were in 2007 because we have not moved significantly. As a result we are faced with this increasing uncertainty, while the reform process is expected to gather momentum in 2008, and will necessarily run ahead of people’s behaviour. While people are adjusting to short-term behaviour, the industry or the reform process is going to be trying to nudge people to think long-term.

**GT:** But now why hasn't the reform process moved ahead as quickly as we might have hoped it would, when the suggestions were first mooted in February last year?

**EM:** What has become very clear, particularly leading to the National Treasury and Department of Social Development Conference at the end of last year, is that the issues are much more complex than anyone had anticipated. And, given the complexity of issues, that has meant a lot of research has had to go into the engagement – meaning that there is no way of finalising positions before the research gives an indication of what needs to be done and what is sustainable. If you can think about the outstanding issues, you will easily appreciate that there is quite a host of them. But the one big issue that is outstanding relates to the thresholds that have been identified, who qualifies, how the contributions are actually effected, at what level of income, what the tax benefits are and over and above that is the funding programme behind the...
reform exercise and that funding programme also has to do with what the fiscus can afford and what the private sector can afford.

GT: So what are the indications at this stage? What can the fiscus afford?

EM: What we have seen so far is that some of the proposals, which have a fiscal implication, like your wage subsidy and extending the old age grant – those are the kinds of proposals that would seem like the fiscus is able to afford. But that depends on how the benefits are actually structured and defined. There are levels beyond which the fiscus will be unable to accommodate the reform. The big area of huge uncertainty is who actually protects the saver from longevity risk…

GT: Sorry, Elias, can you just explain longevity risk?

EM: Longevity risk has got to do with somebody entering retirement and working out how long he/she is going to live into retirement. To a large extent, a lot of people underestimate their life expectancy in retirement. They tend to invest for a shorter period than what they're going to live – and the remainder of the period beyond which they have not invested for, basically means that they are either poverty stricken or may have to rely on the State. It is that margin that we need to deal with and decide who actually picks it up.

GT: I imagine you've got a fair clutch of actuaries busy calculating those figures because that's quite a difficult area to pin down to concrete figures.

EM: It is very difficult because as you intervene from the welfare side as society, it basically means the life expectancy of people is improved, due to better health conditions. So all along people have been arguing that HIV/AIDS has a negative impact on life expectancy, but the interventions that have been put in place basically means they extend the life expectancy of the individual. And, if people are working on the basis that HIV/AIDS reduces your life, the interventions do exactly the opposite and we do not know what the actual result is going to be and that is where the risk is. Actuaries are going to use the data that we have seen over the years and are going to build in some assumptions based on how they understand the industry, or the behaviour in the household – and that relates to guesses as well. We may get it right, we may get it wrong.

GT: Elias, one of the other things that I imagine is going to be important in terms of retirement fund reform but also as private sector retirement funds, is managing expectations this year. I don't imagine that the investment returns for 2008 are going to be where they were in 2007, 2006 and a couple of years before that – so it must be probably one of the key factors that the retirement fund industry will be looking at this year?

EM: It is going to be an important issue. It is going to be a challenge as well, in the sense that with inflation being where it is, the likelihood is that equities are not going to perform as they were performing in the past. If that is the case and people have most of their investments in equities – the likelihood is that the returns are not going to be the same, in fact, they are going to be slightly lower than what we have seen in the past. Now we are faced with a dilemma here. If on the one side you are encouraging somebody who is not convinced that saving is a good idea and at the same time you are trying to convince that person the rate of return is worsening, the likelihood is that it is going to be a steeper battle to convince people to continue saving for the long term than it was in the past. But hopefully it is not going to be a permanent feature of the South African economy – we see this as a short-term phenomenon that is going to wash itself out in the next year or two.

GT: We will have to leave it there Elias, thanks very much for coming into the studio tonight. It will be an interesting year ahead.

Retiring in SA – concerns about costs and communication

The trend among South African employees and employers of contributing less to retirement continues. In total, the average contribution to retirement funds has declined from 11.5 percent in 2006 to 10.9 percent in 2008.

According to the retirement industry’s annual benchmark study from Sanlam Employee Benefits – involving principal officers and trustees from 200 South African funds – employer contributions have declined from 10.0 percent in 2006 to 9.5 percent in 2008, while employee contributions have dropped from 6.0 percent to 5.5 percent during the same period. If such contribution levels continue, the result will be a maximum average replacement ratio of only 30 percent for the majority of South Africans. In other words, a retiree’s income will be less than one third of that enjoyed during their productive years. By way of contrast, replacement ratios among OECD nations and North American countries are an average of 56 percent and 75 percent.
As far as communication is concerned, South Africa's retirement funds must address the fact that only 50 percent of employees understand more than half of the information provided to them.

respectively. Looking at South Africa's high levels of unemployment and poverty, it is clear that the majority of our citizens are not readying themselves adequately for a comfortable retirement.

Given this, South Africa's retirement fund industry has a crucial role to play in both the construction and implementation of the government's proposed national social security system – one that will require a functional public-private partnership. As part of this collaboration, at the top of the list is consumer communication regarding the importance of consistent savings and ensuring that costs to manage and administer funds are contained.

In terms of administration and operating costs, according to the Sanlam survey, overall fund costs are 1.1 percent of salary, down from 1.2 percent 2006. That being said, although the average costs per member per month has remained virtually unchanged among Member Choice Options (R33.08 in 2008 versus R33.80 in 2006), the cost of Standard Benefits Options has increased from R27.56 in 2006 to R32.47 in 2008.

As far as communication is concerned, beyond their annual benefit statement, South Africa's retirement funds, in conjunction with government, must address the fact that only 50 percent of employees understand more than half of the information provided to them. While the internet has been a useful tool to improve awareness and understanding among members – with 68 percent of fund members using such facilities to directly access fund information (up from 52 percent in 2006) – a more concerted effort with a wider variety of media needs to be utilised to further educate the general public about their retirement options, particularly as NSSS becomes a reality.

Cohesion and social development: NBI report back

September

Before one can deal with the concept of cohesion and social development, it is important to understand what this actually means, particularly within the context of achieving a sustainable democracy. There is no doubt that this will mean different things to different people. Here is an intervention that was given to the NBI annual report back on 21 Feb 2008 in Cape Town.

However, what we do know is that social development is unlikely to be realised, let alone sustainable, if the domestic economy does not function to deliver the basic needs to a society. It is from this premise that we need to try and understand what is facing us, with respect to this objective.

It is imperative; therefore, that whatever intervention is undertaken, either at the policy or service delivery level, a distinctive separation of the needs of the poor is performed.

More specifically, social development is about transforming societies by understanding the social context of the circumstances and the country these societies reside in, as well as the needs and wants of that society. It is also important to have a deep understanding of the way in which the society prioritises these needs and wants, differentiating between the rich and the poor.

Importing from the thinking of the World Bank, which further argues that "...people's priorities and experiences are affected by such variables as gender, social exclusion, intra-household allocation of resources, incidence of crime and violence, geographical location, access to networks of support, and relations with those in power. By capturing different dimensions of poverty, a multidisciplinary approach can deepen our understanding of poverty and the lives of the poor.

As such, social development aims to promote the transformation of subjects and beneficiaries by fostering an enabling, accessible, responsive, and accountable state. This requires:

- Policies that recognise and advance the universal rights and responsibilities of citizens, and strengthen the capacity of citizens to claim their rights;
- A recognition and celebration of multiculturalism as a source of strength for societies;
- Support for policies that accommodate diversity in the achievement of universal rights; and
- An understanding of the role of power relations, and the importance of creating institutional mechanisms that offer redress against power inequities.

The success of the objective of cohesion and social development can only be arrived at, in an optimal fashion, if it is undertaken
within the context of a well-defined social objective function. However, a social objective function in its own right is difficult to arrive at, particularly in a diverse and non-homogenous population, such as the one obtaining in South Africa. The more diverse the population the more difficult it would be, to find convergence in terms of interests. Herein lies the complexity of the subject we are dealing with tonight.

Commitment to the challenge

Complexities, notwithstanding, it is imperative that countries undertake ongoing assessments of how they perform with regard to these ideals, both in deed and intention. It is important to make this distinction, given that, to a large extent the promotion of social development will require extensive amounts of resources, which are strictly finite. In that regard, even if a country does not have an immediate tangible impact in the promotion of social development, due to stringent resource constraints, it may have a strong desire to do so over time. A country would, therefore, provide the requisite environment for its society to engage in social development. Underlying this intervention would include the establishment of robust private markets.

At the global level, this desire and commitment can be recorded through the alignment they have to various fora such as the World Summit on Social Development; commitment to reaching and realising the Millennium Development Goals and others. While these desires and signals may not directly translate into social development, they do focus the minds of society and force an alignment of energies as well as policies, influencing the manner in which business is undertaken.

Resource constraints have been and continue to be a real factor in the South African context. The manner in which this country has responded to these constraints is displayed in the manner in which economic adjustment has been undertaken, from the RDP and GEAR, to Job Summit and GDS among others. It is clear that as a society, we have notably converged in terms of our definition of what would constitute social development. This convergence has been underpinned by the numerous institutions that have been consciously set up to ensure the realisation of this objective – such as NEDLAC.

The success of the objective of cohesion and social development can only be arrived at, in an optimal fashion, if it is undertaken within the context of a well defined social objective function.

As a direct consequence, we have observed a conscious shift in resource allocation towards social expenditure over the years; ensuring increased participation of society in the economy, through the reform of the financial sector. Recently we have seen more energy exerted towards social security reform, more specifically. This will be the biggest policy initiative yet.

This focusing of resources is justifiable, given South Africa's historical background and societal differences that exist. In that regard, the concept of cohesion becomes a very important consideration, particularly in dealing with our challenges going into the future. However, the glue for all this has to be trust, transparency and accountability on the part of all economic players.

Why social security is important for South Africa

Social security reform is essential for dealing with the inequalities characterising South African society. Given the nature of this intervention, it can be seen as a key intervention for improving social development in South Africa.

But what does this mean? While there is no standard definition of social security, there are fundamental guiding principles of this concept and policy framework. In simple terms, social security can be seen as an institutional arrangement in a society, driven by the state to:

- Secure the welfare of members of society through securing a certain amount of minimum income, during their productive years and in retirement;
- Prevent destitution in the case of members of society faced with incapacity and unemployment; and
- Establish highly distributive institutions that rely on the principle of solidarity among the income capable and the less income capable.

The design of such system varies from society to society depending on the philosophies and circumstances influencing the design. The South African system, as envisioned in the current debate is contained in the social security and retirement reform second discussion paper. So, social security should be seen as aiming to provide an income after retirement that is sufficient to maintain a basic standard of living, among other goals. Government hopes to achieve this by means of a compulsory contribution by all employees into a proposed national social security fund that will support retirement savings as well as risk cover and annuities. However, welfare is also important ahead of retirement, thus a framework that proposes to secure a floor in peoples’ incomes as they go through life towards their retirement.

Questions for general reflection after the report back

- How can we deepen democracy?
- How do we tighten link between business and academia?
- Who cares for the poor?
- Technical political balance
- Reasons for failed balanced growth
- Role of CEOs in supporting skills in government
- Do you belong to government or private sector?
- Morality and development in business
- Inventive society.
Social development and macro-economic growth

At the heart of social development is fundamental economic growth, macro-economic stability, low and preferably stable inflation and the promotion of sectoral growth, in particular agriculture where the bulk of the poor are found. This ensures that the growth in the participation of members of society in the production processes of the economy – through investment, job creation, the provision of services as well as the creation of the requisite environment for people to make themselves productive. Linked to this is the need to develop people’s skills and deal with information asymmetries that often reduce the efficiency levels in an economy.

The extension of this consideration, to the macro-economy, needs to be underpinned by four key pillars, namely:
- Macroeconomic policies aimed at a stable macro environment;
- Structural policies aimed at a market based environment;
- Sound social policies, to include social safety nets; and
- Good governance of institutions of both the state and private sector.

If we are indeed concerned about balanced development, it will be important that we take heed of these key pillars for success. Nonetheless, it can be shown that while these conditions are known to many governments, the implementation of balanced development has been quite uneven across the world. There are numerous reasons for these results. The one key explanatory factor is the absence of a close link between technical decisions and political commitment to undertake difficult reforms. While financial constraints do play a role, it has been found that these are much easier to overcome, on a relative basis.

There is a growing appreciation that economic growth, for it to be beneficial to society, certain interventions are necessary, interventions that would ensure that people are sufficiently empowered to engage with the intricacies of a growing and ever adjusting economy. This can only be realised if and only if people are educated, information asymmetries are reduced, producers of goods and services are made to be more responsible in their delivery of these commodities, understanding that they have a responsibility to the consumer and finally, the consumer having the luxury of choice. The latter implies the existence of a market-based economy, one that allows for competition. Drawing once more from the thinking of the World Bank, this can be summarised as the need to create more inclusive, cohesive and accountable environments. This means:
- Inclusive institutions to the extent that they promote equal access to opportunities, enabling everyone to contribute to social and economic progress and share in its rewards;
- Cohesive societies that enable women and men to work together to address common needs, overcome constraints and consider diverse interests; and
- Accountable institutions that are transparent and respond to the ‘public interest’ in an effective, efficient and fair way.

Conclusion

In order to achieve sustainable and fully embracing social development, it is essential that this be underpinned by a healthy and robust economy, deep education and skills development in a free market economy with transparent, responsive and accountable institutions. Together, these factors will ensure increased participation of every economic player and characterise our society with inclusiveness.

That is the challenge facing us in South Africa and the world over. Our energies would be well spent if they were harnessed to deal with this complexity, in its totality.

National Social Security system will be stretched in helping the poor

Even though most of us dream of a comfortable retirement, the reality is that this is not always an eventuality, especially for low income earners. Government’s proposed National Social Security System (NSSS) aims to reduce people’s financial dependence on the state. This article delves into why the NSSS might struggle in helping the poor, in this regard.

The proposed national social security system is the government’s attempt to enable people to reduce their financial dependence on the state and even retire comfortably. However, these ideals may not be realised by the very people who are meant to receive the most assistance from the system.

People’s ability to save, which fundamentally depends on their ability to generate an income, needs to be improved if they are to engage meaningfully in the exercise of saving for their retirement. Until this is done, it is most likely that the majority of South Africans will live in dire circumstances throughout their
productive years and would have a short-term view to life. With the current changes in the country’s macro-economic conditions, with increasing inflation and resultant interest rate hikes, we will witness a declining economic performance and people may face job losses going forward. In this tougher economic climate, the purchasing power and ability to save is further compromised across all income groups. The increasing cost of food and other basic commodities in people’s expenditure basket will significantly squeeze the savings potential from their already stretched budgets. This scenario is notably worse for lower income earners, who already allocate a large percentage of their budget to consumption expenditure, meaning they are likely to save less and less over time. Clearly retirement saving cannot be paramount for this category of consumers.

The accumulation of saving from the stable contribution rates reported in the survey is threatened by these developments. Furthermore, low-income earners in South Africa generally have a low life expectancy and many may not reach retirement, which is key to reducing the preference for retirement saving in this group. Drawing from this observation, there is little justification in compelling low-income earners to save for retirement, contrary to the government’s well-intended proposal of compelling every income earner to save for retirement. However, an argument can be made for this group to save for other long-term considerations that are more meaningful to them, such as housing and children’s education.

The third issue that will affect low-income earners contributing to a national social security system is the fact that costs of service provision are not negligible. Not all of the money accumulated by a member will be available at retirement. Some of it is lost to inflation and to management costs. As the issue of costs has attracted a lot of attention and also is a key consideration in the reform process, higher efficiency will have to take centre stage. This is more important if the intention of the intervention is to assist the less abled.

A further factor in the consideration of reform issues relates to how assets are invested and the returns accrue to the individual investor. In an environment of choppy contributions – owing to employment contracts, premature withdrawals, and economic uncertainties – investment performance can be seen as the saving grace for effectively growing assets. A clear acknowledgement of this importance has been reflected in government’s decision to leave asset management in the private sector, to capitalise on skills residing there. Experience in other dispensations reveals that high investment returns has a statistically significant positive effect on voluntary savings. However, it is not clear that this will have any significant effect on the poor.

Given the disparate income conditions in South Africa, it is essential that the policy reforms should take account of these and design interventions that create the right incentives for the different income groups.

Setting the scenarios for a National Savings Fund

This year’s survey is being presented against a backdrop of turning fortunes in the South African economy. Inflation continues to surprise on the upside, necessitating monetary tightening, which is having a notably dampening effect on the economy. Johan van der Merwe, CEO of Sanlam Investments, discusses the issues with special emphasis on a National Savings Fund.

With a slowdown pointing to a worsening of the country’s savings propensity, people may ask whether the retirement industry reform is appropriate at this stage. The answer is a resounding yes. In fact, reform is appropriately timed. There is no better time to talk about saving and people’s expenditure behaviour, amid the growing concern among economic players as their wealth is being eroded, making the future uncertain. Undoubtedly, 2007 will go down in history as having provided the turning point for the economy, since 1994.

It should not be surprising that current macro-economic
If an individual determines that he has not saved adequately, he should have the option to work longer.

Imbalances are raising concerns across the board, and to some people, the retirement debate is seen to be adding to these concerns. As a result of this, it is important to educate against any potential panic. Rather, we need to deal with the concerns relating to the broader reform consideration in a proactive manner, to ensure that we maximise its gains. These considerations are numerous, but there are those that are of particular significance to this industry, such as:

- Suggested thresholds, in particular the contribution threshold;
- Migration to the national fund;
- Annuities;
- Retirement age; and
- Preservation.

In this article, we reflect on these issues, to aid the engagement in and response to these issues.

Contribution threshold

There are several concerns regarding the level of the contribution rate to be determined as well as who should participate in the national retirement fund. A high contribution rate will have a significantly reducing effect on people’s incomes and thus curtail consumption. For low-income earners, this may have the effect of compromising their welfare. However, it is intended that this risk be mitigated by the provision of a wage subsidy. But this, in itself, may impact negatively on the fiscus.

Meanwhile, adequacy of retirement savings will be directly influenced by the contribution level – the higher the level, the closer an individual will be to adequacy, and vice versa.

Another observation relates to the impact on the very low-income earner. This group’s perception towards retirement is very different, in that because they are already living on the borderline and their life expectancy is low, the will to save for retirement is low. This therefore, raises a question as to whether forcing this group to save is consistent with their circumstances.

Migration to the national fund

Concerns have been raised about the potential negative impact of the national fund and the migration of members from private sector funds to this fund. Based on a threshold of R65 000 per annum, it has been estimated that in excess of 60% of members could be lost to this fund.

The potential loss of business will be disproportionate to the determined threshold. If the private sector is to participate meaningfully in the retirement savings system in the future, it is important that the threshold is set at a level that allows for the private sector to still have a substantial role. Clearly, the investments and capabilities of the private sector, built up over the years, ought to be seen as an invaluable asset to the economy.

Provision of annuities

The government, rightly so, concerned about the pricing of annuities and particularly the likelihood of such pricing being driven by conservatism. The key concern is that such conservatism, if it exists, could result in a negative redistributive effect. Debate is unfolding as to how to deal with these likely imbalances, if they indeed exist. One possible solution is for the national fund to provide annuities. Such a response is likely to result in a huge risk to the fiscus and necessarily the taxpayer, as a result of longevity risk. If life expectancy at retirement is understated, the cost of the error may be too huge for the state. A complete overhaul of the system may be a costlier solution to the problem relative to improving the system in the private sector through a regulatory process. The latter option may also ensure the optimal utilisation of the skills in this part of the economy.

Retirement age

With the move to defined contributions and individual accounts, the concept of a regulated retirement age becomes increasingly irrelevant as each individual gets out of his retirement fund what he has put in. The decision when to retire becomes an individual choice. If an individual determines that he has not saved adequately, he should have the option to work longer.

However, people have been questioning the announcement of the decision to reduce the qualifying age for males to access the social old-age grant. This ought not be a source of concern, as in a DB environment regulating is necessary to ensure a fair distribution of benefits. There are other key economic considerations that informed this decision.

Preservation

Within the context of erratic and uncertain employment conditions, people should be encouraged to stay invested longer and not prematurely withdraw. Preservation of people’s savings is a fundamental solution. However, the implementation of this principle will pose one of the biggest policy challenges. Preservation depends largely on people’s intention to save – and most save for difficult times rather than retirement. These differential objectives will have to be taken into account when the final decision is made.

In conclusion, it is essential to deal with all likely scenarios of the reform and ensure that all concerned are on board. Currently there is growing speculation and misinformation circulating in the industry, resulting in people deliberately destroying their savings before the new dispensation comes into being. Good communication and effective expectations management are critical for the successful implementation of the changes, the macro-economic imbalances notwithstanding.
Johannesburg, 7 February 2008: The outlook for savings and the retirement industry in South Africa is significantly dimmer than it was a year ago. The main cause is the increasingly poor performance of South Africa's economy. Couple this with the delayed implementation of the proposed pension reform, and you have a country where individual and household savings are on the decline. In fact, many people have even begun to leave jobs purely to cash out retirement funds and gain access to cash. The long-term prospects for the savings of this country are currently seriously compromised by this situation.

The impact of economic performance on retirement funding

The fact is that the savings performance of an economy, both in terms household and individual savings, is fundamentally dependent on income generation. So job creation is a fundamental basis for success when an economy endeavours to increase national savings and improve the households' ability to deal with financial vulnerability. And all recent economic indicators in South Africa lead one to predict that the country's ability to save is going to continue to be significantly challenged.

Firstly, the economy has been threatened by rising inflation on the back of high levels of domestic consumer demand. In its own right, increased demand should attract investment to meet the new levels of consumption. However, this response is not always automatic, as has been observed in South Africa over the years. The consequence is that we now have a gap developing between what is produced and what is consumed. If consumption is higher than production, it tends to generate imports from the rest of the world, resulting in a wider current account balance. The sustainability of funding such deficits is increasingly becoming uncertain.

Not only that, these imbalances lead to higher domestic inflation. We have seen inflation ticking steadily above eight percent since December of 2007. It is clear that this inflationary tendency has not been driven by domestic conditions only. To a large extent, it was driven by imported inflation, as a result of higher crude oil prices. To tame this tendency, monetary policy has had to adjust to stem domestic demand, resulting in an environment of higher interest rates.

What does this mean?

Higher interest rates mean costlier money, thus lower investment and lower growth. These also have an overall dampening effect on aggregate demand, as domestic consumption responds, and cash is diverted from consumption to debt service obligations. These domestic conditions have occurred side by side with an observed global slowdown and rising world prices on the back of the sub-prime crisis and unprecedented oil prices. The combined result of these developments is slower economic growth, which declined from five percent in 2006 to 4.7 percent in the third quarter of 2007, with a steep declining tendency. We wait with bated breath to see what the latest official growth forecast will look like, when the Minister of Finance tables the National Budget on 20 February.

This continued slowdown of the economy certainly does not support the savings industry and retirement funding because it is likely to be followed by job losses and possible income declines in the near term. The power crisis that has engulfed the country will only precipitate the negative economic performance, thus raising the propensity for job losses further. As this occurs, people's ability to save will be significantly reduced.

It needs to be mentioned, however, that contractual savings will be less affected in the short term, relative to discretionary savings. Consumer behaviour is such that as soon as costs rise and incomes drop, people adjust by reducing or even stopping those savings that they have control over. This is a response to maintain consumption levels. On the other hand, contractual savings will only be affected negatively if the economy does indeed experience job shedding, as is highly probable.

Another key reason for worsening sentiment is the delay in the implementation of pension reform. This is also likely to contribute meaningfully to a decline in the country's savings performance. It has already been observed that people in the middle to low income brackets are cashing in their long term savings by resigning their jobs and getting re-employed elsewhere. By the time the new legislation kicks in, whether it is 2010 or 2015, we would be starting from a worse position, if this tendency is not curbed. The situation will only worsen if a direct intervention is not undertaken to try and influence expectations and minimise job losses.

South Africa has looked to the Chilean model for guidance in developing its thinking and the formulation of the proposed reforms. The circumstance under which we find ourselves in, are slightly different from those that Chile was faced with. In particular, when Chile introduced its wide-ranging and deep reform programme...
this coincided with a long economic upswing. For sustained periods of time, the economy enjoyed growth rates averaging seven percent, average real rates of return approaching 10 percent and savings rates reaching 24 percent. Our current climate seems to be in marked contrast. With likely declining returns, in both real and nominal terms, it will become increasingly difficult to convince people about the long-term benefits of saving.

Conclusion

It is imperative that South Africa acknowledges the slightly more difficult saving environment we will be going through as a country. In that regard, there is a need to double up on the efforts we have been exerting over the past few years, with respect to savings promotion. As stated in the State of the Nation Address (8 February 2008), the environment is ‘unusual’ and therefore, requires more concerted interventions and deeper determination towards building on South Africa’s ability to save and the consciousness to do so. All sectors of the economy need to take this responsibility and in particular government, in managing and influencing expectations, which is critical phenomenon for translating aims into actions.

Business Day: Ligotshwa Lisase Manzi!
Bend it while it is still moist

July is South Africa’s fifth annual savings month and focus this year is South Africa’s youth. The campaign is committed to instilling a culture of life-long financial saving early on in an individual’s life. In one key initiative, financial practitioners will voluntarily visit schools to teach learners about saving, budgeting, recognising needs from wants and the mechanics of interest.

In anticipation of this powerful project, which has had success in the US for many years, it is worth looking at where South Africa is currently in terms of savings and at how vital it is that the youth play their part in reversing an increasingly dire situation.

Savings in South Africa today

In July last year, savings month 2007, the national savings rate stood at 15.1 percent. In the first quarter of 2008, we record a savings rate of only 13.7 percent. This change is significant and is part of a long-term downward trend. In 1994, the economy recorded a savings rate of 16.9 percent. In 2001, when the South African Savings Institute (SASI) was born, the rate was 15.6 percent.

Many commentators, who are concerned about the turning economic fortunes, have asked, is it not time to give up the savings campaign and consider folding up SASI? Encouraging people to save seems to be a lost battle. The economic indicators, people’s ability to survive let alone save and the whole sentiment towards savings, are all working against your campaign. Why not give it up?

This represents a worrying change in sentiment from a few years ago when SASI was set up and greeted with much optimism and enthusiasm. It seems many are ready to give up the fight. It is easy to understand this sentiment particularly when one considers that low-income earners and the many other people are struggling to make ends meet. The rising cost of living is a reality that cannot be ignored.

Saving and the economic slowdown

But, under tough economic circumstances – and growing uncertainty – people need to increase their reliance on self-insurance rather than decrease it. This means, the more challenged we are and the more blurred the future, the greater the need to prepare and insure against unforeseen circumstances. One of the key pillars to this insurance is saving for these eventualities. So, the call for increased savings among those people who are able to save as well as the prioritisation of needs should gain even more importance now, than in the past. Doing anything different, would be working against the security of our people. As the saying goes, when you are in a hole, you stop digging.

The worsening savings environment is predominantly due to recent global developments that are largely beyond South Africa’s control. This trend was recorded side by side with a declining share of GDP accruing to individuals, which dropped from 55.9 percent in 1994 to 52.2 percent in 2001 and 46.5 percent in the first quarter of 2008. However, it can be argued that this is a declining proportion of a growing cake, given the improved economic performance post 1994.

There is no doubt that the campaign to promote savings will experience increasing difficulty, as more and more of people’s expenditure baskets become dominated by consumption. But should we be giving up? The answer is a resounding no!
Retirement worries

Another extremely concerning element in South Africa is people’s long-term savings and their lack of preparedness for retirement. Research done recently by Sanlam Employees Benefits, shows that the majority of South Africans will retire with insufficient resources. Many of us will experience a significant reduction in our welfare, to the extent of living close to the poverty line. This is indicated by the replacement ratios averaging less than 30 percent in South Africa, as compared to 56 percent in the OECD and 75 percent in North African states.

This is a direct function of a poor savings performance, unsustainable cost structures, early withdrawals and investment performance – over time. It can be shown that for people to be able to retire comfortably, they may have to save an extra 25 percent of their income, for this purpose. This is a huge gap.

The psychology of the savings campaign is made even more difficult by the intangible benefits and the attendant risks of not saving, which only become realised way in the distant future. If one compares this campaign to other campaigns which are more visible and affect individuals’ bottom lines and livelihoods almost immediately, such as HIV/AIDS and electricity, one can tell the significantly tougher challenge of convincing people to save, for a benefit they will only realise in 10 to 30 years later. Further still, the resources put behind these other campaigns are multi-fold, compared to what savings enjoys.

Getting in early

With this intention and fundamental belief in long-term savings, SASI and its many partners, are asking South Africa to embrace the theme “My Savings, My Future”. Our youth needs to understand that their future is in their own hands. They need to understand that their future will be far more secure if they are able to save more, and not live beyond their means and be ravaged by debt.

The Teach Children to Save Day, which has the endorsement of the Department of Education and is planned to become an annual event during savings month, aims to address this pressing problem of exceptionally low rate of savings, early on in the financial lifecycle. It aims to prepare the youth for when they start earning an income and facing up to the real world. We hope to get them to understand the value of saving and hopefully embrace it early enough in their lives.

The campaign draws its inspiration from an old-age Zulu proverb, that goes, Ligotshwa lisase manzi!, which means: “bend it while it is still moist.” If we can foster a culture of savings in our youth, certainly some of the hardest work will be done. Giving up is simply not an option.

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<thead>
<tr>
<th>Savings determinant indicators (in percentages)</th>
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<tr>
<td>Period</td>
<td>Gross saving/ GDP (%)</td>
<td>HH saving Y (%)</td>
<td>Share of GDP to employees (%)</td>
<td>Cons/ GDP (%)</td>
<td>Debt/ Disp. (%)</td>
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<td>18.6</td>
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<td>57.1</td>
<td>61.6</td>
<td>55.0</td>
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<td>1994</td>
<td>16.9</td>
<td>2.8</td>
<td>55.9</td>
<td>68.8</td>
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<td>3.2</td>
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<td>2001</td>
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<td>14.1</td>
<td>– 0.6</td>
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<td>2008 Q1</td>
<td>13.7</td>
<td>– 0.7</td>
<td>46.5</td>
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<td>78.2</td>
<td>2.1</td>
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Source: SARB

Symposium 2008 has come and gone

While the Symposium may have come and gone, its impact, relevance and uniqueness linger on. This article is meant to provide those of us, who were not fortunate enough to be part of this invaluable event on our almanac, with a brief summary of the deliberations and lessons. These will be instrumental in guiding the thinking of South Africans as the retirement reform discussions and engagements unfold.

The article is in two parts. The first is my own impression as a Sanlam employee and participant at the Symposium. The second is an independent view of two presentations made by Dr David McCarthy, who was invited by Sanlam to speak at the Symposium.

South African-born McCarthy is a senior lecturer in finance at the Tanaka Business School at Imperial College, London. While there, he designed – and currently runs – a world-leading MSc degree that is the first to harmonise financial economics and actuarial studies. He is also an actuary with a PhD in economics, which is a pretty rare combination. He began his academic career as research fellow at the Institute of Ageing at Oxford University. He currently consults to Mercer in London, and in the past has consulted to the UK’s Department for Work and Pensions, Watson Wyatt and the World Bank.
I am grateful to Johan Schreuder for his input to part 2. Schreuder is a member of the industry’s Joint Forum, which is an industry body that was formed in 2007. Its principal aim is to engage with government and other stakeholders in the retirement reform process, develop common positions on the proposals, learn from one another as well as influence the outcome to ensure sustainability. The members of the Joint Forum include the LOA, ACI, LISPA and IMASA, as well as the IRF and intermediary bodies.

Part I

A Sanlam view

The 2008 survey results clearly reveal that less and less resources of South Africans go towards retirement. The contributions of both employees and employers are on a downward trajectory. As contributions are declining, costs of financial services are growing, as reflected by costs of some risk benefits and costs of administering these resources.

Together, the above factors have a negative impact on people’s ability to retire comfortably. This is made even more acute by the worsening macroeconomic conditions in South Africa manifesting in poor economic indicators such as high inflation on the back of rising food and fuel prices, rising interest rates and a slowing economy. The likely impact of this will be job losses, rising dependency ratios and notable collapse of people’s marginal propensity to save. These indicators point towards a worsening environment for retirement savings and other financial services, as people may be forced to direct all their income towards consumables, as the cost of living rises.

Research, undertaken by Sanlam, reveals that the estimated replacement ratio in South Africa is barely in the region of 30 percent. What this means, is that the majority of South Africans will have to survive on significantly less than half their working income, when they reach retirement. This may require that the state provides assistance to a larger number of people. This goes contrary to the underlying aim of the reform process.

The Symposium has characterised this state of affairs as a structural constraint facing South Africa. As such, a structural approach to this problem was seen as fundamental. This would include interventions to improve macro-economic policy management, increase savings, delay retirement for many people – all of which may not necessarily be realised in the short term. It was recommended that, in the interim, investment performance could be seen as a possible saving grace to compensate for the poor contributions record. However, the right conditions for this to happen were emphasised as well as the right investment decisions on behalf of individuals.

Sobering thoughts

Over and above these observations, the guest speaker, Dr David McCarthy came with sobering thoughts about how to deal with the identified imbalances. Namely he argued that:

“ One could agree ... if the reason for South Africans cashing in their benefits was “discretionary spending”. But many believe that South Africans cash in their benefits because they’re desperate to pay off debt...”

- Not every South African can be forced to save for retirement, owing to the different life expectancies. In particular, the majority of the poor may not reach retirement, therefore it is inconsistent to force them to save for retirement. He supported a recent South African Savings Institute (SASI)/Finmark Trust study that arrived at the same conclusion
- Liquidity for this income group is rather crucial. Consumption today is more important than consumption in the future, a future which is unknown. More importantly, as observed in SASI/Finmark study, he noted the need for long-term savings for this group, such as saving for their housing and education of their children
- Dealing with leakages from the system is crucial. In particular dealing with charges for service provision;
- Whatever design we end up with, it ought to be one that incentivises the formalisation of the economy thus reducing the risk of implosion;
- While appreciating the role of providing risk benefits in the new dispensation, this ought to be driven by the cost of acquiring these, with the benefit being an outcome of the cost setting – and not the other way round;
- Prevention of savings corrosion by the cost of risk benefits needs to be guarded against;
- While appreciating the negative impact of leakage, he accepts the role of preservation with a pinch of salt. He argues that if it does not take account of individual circumstances, then it will defeat the whole objective of security and liquidity; and
- With respect to the proposed social security model for South Africa, he:
  - Welcomed the social assistance component;
  - Supported the DC idea, so long as it is well managed and in an environment where the private sector leads;
  - Welcomed that part of the contribution could be utilised to acquire risk benefits, so long as these are priced for properly and the structure is driven by affordability rather than by benefit design; and
  - Rejected the viability of a DB retirement component.

Conclusion

At Sanlam, we feel we have achieved one of our main objectives of hosting these symposia, namely that of extending the frontiers of our thinking by looking ahead as well as provide new insights to the debate. It is clear that the discussions have already started...
influencing policy thinking and permeating board rooms, across the country.

On the whole, the symposium provided a holistic picture of how individuals can improve their worth when they reach retirement as well how the envisaged system can positively contribute.

Part 2

An independent view

Sanlam Employee Benefits invited José Piñera to speak at the 2007 Sanlam EB Symposium. This year they invited Dr David McCarthy. He spoke at two Actuarial Society meetings (Johannesburg and Cape Town) as well as at the Sanlam EB Symposium (at various centres around the country). McCarthy presented an excellent critique of South Africa’s retirement reform proposals, and we hope that Government and other stakeholders also heard his views. We’ve tried to summarise them here.

What economic models of “need” say about pensions
(Presentation to the Actuarial Society – 26 June 2008)

Traditional actuarial models often ignore the human element, but economic models deal with human behaviour. For example, airlines use “yield management” for ticket prices, which relies on human behaviour. Economic man is driven only by “greed” and “fear”.

Economic man prefers certainty, which includes the certainty from spreading your income evenly over your lifetime. Interestingly, economic man is good at spreading income over a month, but not over his lifetime. Hence the need for retirement systems to encourage allocation over life-times, thereby increasing certainty.

How should people invest? Balanced? Life-stage? Target-dated?

Robert Merton (Nobel Laureate, Harvard University professor and former director of LTCM) proved in 1969 that people should invest in the same mix of asset classes, regardless of their age. The proviso is that you need to regard the present value of your wages as one of your assets, and this asset is more like bonds than equity. So it’s theoretically correct to start life with more equity than bonds, and end life with more bonds than equity.

From the above, McCarthy concludes that DC retirement systems are superior to DB retirement systems. Why? Because young people are already heavily invested in the present value of their wages (ie, bonds). So they need to invest in direct equity in order to diversify. A DB retirement system not only doesn’t allow for direct equity exposure, but it exposes the member to a DB asset that is directly related to wages. The member is left with 100 percent exposure to wage shocks. DB is also inferior because there’s undiversified default risk (think Enron) and DB generally re-distributes from poor to rich.

Based on the above, McCarthy seems to favour life-staged DC or target-dated DC. Importantly, in his ideal DC retirement system, there’s very little need for investment guarantees or smoothing. He regards investment guarantees as being “very expensive”.

Interestingly, McCarthy does not recommend “compulsory preservation” in the SA context. He says there’s just too much poverty and AIDS-related need to force poor people to preserve.

He says that, at most, contributions made by the government can be preserved, but members should be able to cash in their personal contributions. His alternative to “compulsory preservation” is “default preservation”. He says people underestimate the power of inertia and defaults, and that preservation rates are likely to be just as good with “default preservation” as with “compulsory preservation”.

One could agree with him if the reason for South Africans cashing in their benefits was “discretionary spending”. But many believe that South Africans cash in their benefits because they’re desperate to pay off debt. So, regardless of defaults, many believe that preservation rates will continue to be very low. An interesting alternative would be to allow all retirement funds (including preservation funds) to offer as much liquidity as a living annuity (ie, withdraw up to 17.5 percent per year under current circumstances). Yes, most people would cash in the maximum, but at least their benefits would be spread over a reasonable period, and there’s no incentive to cash-in just before annuitisation.

What is good for South Africans is good for South Africa
(Presentation at the Sanlam EB Symposium – 27 June 2008)

A recurring theme of this presentation was the power of “defaults”. Default contributions, default investment strategies, default preservation, default annuitisation. “The right thing to do should be the easiest thing to do.” Defaults rely on inertia, one of the strongest human behaviours. Defaults are also perceived as a very strong endorsement. As mentioned above, one can see the value of this idea for contributions, investment strategies and annuitisation, and its value for the preservation of existing benefits. But will default preservation be strong enough for the preservation of future benefits?

Regarding Compulsory contributions: McCarthy favours “default contributions”, and only for those who earn enough. “It would be very wrong to force low-earners to save formally. It would be especially wrong to force them to pay for formal life insurance! Low-earners save in many other ways, for example building or buying a home, paying for their children’s education, building and maintaining ties with the community.” Why defaults and not compulsion? “Compulsion will drive people away from formal employment.” McCarthy warned that in South America, where the level of human development is higher than in South Africa, there’s very little membership outside of the formal sector.

DB vs DC: McCarthy says rare risks (such as early death) should be pooled, but common risks (such as the retiring poor) should be saved for. That is, death benefits can be DB, but “DB retirement benefits are a terrible idea”. DB favours the rich, who generally start work later, live longer, and have steeper salary increases. There’s also a significant moral hazard in DB (and pooling in general) because “the disadvantaged will beg” and the system is open to greater corruption. DB social grants are good, but other retirement benefits should be DC. McCarthy believes that these DC accounts should be funded (that is, not paid from current contributions) and actively managed by the private sector.
After another successful Symposium, I share concerns raised by the audience at this year’s annual symposium and the important role that our clients play in highlighting these concerns.

Over the years, we have learnt a lot from engaging with clients. By no means has it been a one-way street. This mutual engagement has taught us to be nimble and flexible to the demands thrown at us. It has helped us better understand the needs, comforts, fears and preferences of consumers of financial services.

We have also discovered that we learn even more from our interactions at the Annual Sanlam Symposia. While we go there pretending we have the leading ideas and answers – this posture is merely meant to help trigger the inquisitiveness and unique knowledge of the participants. This provocation has worked. It has successfully led to the unearthing of masses of invaluable information from the questions and comments that follow.

Lesson from 2008

For the first time, after over 27 years, we have decided that this year we will share these experiences with you. This decision has been influenced by the depth of information enjoyed from every symposium, across the country and the SADC region. We have found it extremely valuable not only for what we do at Sanlam, but also for the wider national engagements in the unfolding debate on social security and retirement reform. This article aims to provide you with a flavour of the concerns raised, to wet your appetite.

Concern for the poor:
- What would be a useful investment option for low earners?
- As more people are illiterate and poor, how do offshore investments help them when they do not have anything to save?

Risk aversion and concerns about financial market volatility:
- Why are Latin funds heavily invested in bonds?
- How do we deal with investment timing risk in individual accounts and the intergenerational differences due to volatility in markets?

Equity:
- Is it correct that living annuities make more sense for those in poor health?

Cost efficiency and transparency:
- A 1% admin fee is more than 1% of assets when your pot is small. Please comment.
- Pure admin fees are not the problem; it’s the other add-ons that are erroneously bundled in to that fee. Please comment.

Security, fear of insufficient savings and adequacy:
- What about emergency access linked with compulsory preservation?
• Do you recommend retirement annuity (RA) or member contribution as a top up fund?

Historically, a total contribution of 15% of earnings was regarded as the norm to provide for retirement and personal insurance. What is the yardstick at this time?

- **Deep keenness to know about and understand the reform:**
  - What is the National Social Security System (NSSS)?
  - Will the NSSS work in South Africa?
  - What is the likely down side of the NSSS?

- **Scepticism about the ability to implement the reform efficiently and low confidence towards the state:**
  - Do you think that the current government is skilled enough to manage NSSS?
  - Is government using experts McCarthy* in developing the NSSS strategy? Would he consider returning to South Africa to work with national treasury on NSSS?
  - Should government be involved in the administration of NSSS?
  - Is this just another way for government to get their hands on “my” money?

- **Comfort that the principles have been well researched to avoid failure:**
  - Can we compare our NSSS to the UK?

- **Preservation of the rights of individuals and stemming leakages:**
  - How will NSSS affect those who already have a pension fund?
  - Will pre-existing rights of fund and retirement annuity members be protected?
  - If there is an umbrella fund in place, will the NSSS replace the umbrella fund? Will members be obliged to contribute to NSSS?
  - Currently employees can access their savings by requesting collateral loans. Will they able to do so in the NSSS?
  - What is the safeguard for the poor later in life if there is no form of forced preservation?
  - How do we protect against myopic non-preservation of higher Living Standards Measures?

- **The importance of partnerships and certainty:**
  - What role should the private sector play in the NSSS?
  - What do you think will happen to the SA retirement industry should government introduce the NSSS?

- **Confidence towards Sanlam:**
  - What role will Sanlam play in the NSSS?
  - Is the system as proposed by Sanlam the best solution for South Africa in your view?

It is instructive to note the extent and gravity of interest displayed towards reform issues, the level of consciousness and probably the fear in the minds and hearts of the participants. A total of 82 questions were asked across the country. This number is arrived at, after similar questions were consolidated. The original number of questions is in excess of 100. Out of the consolidated list, 55 of these were strictly on the social security and retirement reform process. These also accounted for many of the consolidated questions. This works out to a staggering 67% of questions posed and responded to, related to the reform process. That is a notable proportion. It is reflective of the level of interest people have on this national process. It is of little surprise, as this is congruent with the density of the initiative, as it has been hailed as the biggest reform since the country’s constitution, if not larger.

**Conclusion**

If these numbers are anything to go by and are seen as reflective of the sentiments of the South African population in general, it is imperative that between government and the private sector (particularly the Joint Forum) we need to improve the way in which we communicate to ensure effectiveness. It is also important to manage expectations and ensure a full buy-in from all economic players in South Africa.

Further, having gone through this learning curve, it gives us the encouragement to continue on this effort and even step up our investment in the contribution towards the development of our envisioned new dispensation.

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**The killer likes candy and the boss likes humour...**

Here, I pay homage to Themba Gamedze, who leaves his post after a successful stint at Sanlam.

It was both sad and exciting to hear that Themba Gamedze was leaving the Sanlam family. Sad, because of the loss. Exciting, because it gave me the opportunity to publish something I had banked since 2006. This is an article I had generated as a farewell recognition, when he left SEB. I strongly feel it is still relevant today...

My first encounter with Themba Gamedze was in 2004 at the Cape Town International airport. I was surprised by this guy I did not know, who walked past many empty seats in the SAA business lounge and chose to sit with me. All I observed was a face characterised by a permanent smile. Even before he could greet and request to sit with me, he was already beaming.

Little did I know that we had a lot in common, more particularly that we share a Swazi background. Worse still, little did I know that...
this friendly character, always laughing, would change my life – forever. When I finally made this discovery, my old hypothesis was yet again confirmed, namely that ‘Swaziland is dominating…!’

After spending 18 years in a policy environment, he, in a few meetings, convinced me to ‘cross the floor’ into the corporate world, a phenomenon that was pretty much in vogue in the South African political scene. Up to this day, I am still trying to work out whether the decision to cross was influenced by the wave of crossings at that time or some deeper consideration. I truly hope it was not the infectious smile!

Two years later, I found myself having to write about this person. How ironic?! Even more ironic is that what I wrote then remains ceaselessly relevant.

Among my colleagues in Sanlam Employee Benefit, I will least qualify as one who knows Themba. While I have known him for slightly more than four years, our history dates back to my university days in Swaziland, a fact we both did not know, but was revealed by our meeting in 2004.

In this short period, I have been exposed to Themba, I have learnt many things, not only about the engine room of the industry, but about people. The one big lesson I have emerged with from all this, is how human and humorous actuaries can be. Certainly, this is true with the few actuaries I have dealt with over the past couple of years. In my ‘previous life’, I found myself in some trouble with the fraternity, for having labelled them the ‘Dirty Dozen’. This was during a parliamentary hearing on the pension surplus legislation. My characterisation was purely on the basis of having observed how they presented themselves in what I viewed as a critical national process – resulting in my deep reservations about the profession. I had formed a negative view of the fraternity.

Without any contradiction, I can argue that Themba salvaged the profession in front of my eyes, by erasing the views I carried in my mind then, in this short space of time. The challenge is for the rest of his learned friends to keep me positive and hopeful about the interaction of the profession with the policy world, a world that concerns itself with the protection of the vulnerable. While this does not come naturally to the actuary, it defines the basis of doing work for the economist – which I am. That will certainly make it even more worthwhile, to having made the decision to cross.

In conclusion, I have observed a poetic parallel between Themba and the way I have always viewed life in South Africa. I am yet to see a decoupling of this parallel – and this is how it goes: In South Africa, when we are happy we sing; when we are upset we sing; when someone is born we sing; even when someone dies we sing. This somewhat inconsistency characterises Themba, who is always smiling and pleasantly humorous – under all manner of circumstances. Picturing him, he would probably not only smile under some of these circumstances, but would also dance. That is simply how good spirited he is about life.

My son, Rakgomo, who met him only once in his office, describes him as “… fun, funny, down to earth, not hard-nosed like most rich people and able to give advice generously”. I cannot comment about the rich part, but regarding the rest I would not be able to disagree with him. It is this human side of Themba that will be sorely missed.

I keenly wait to see someone taking over the baton!

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**Sandaba: NSSS**

**How is South Africa’s proposed social security programme progressing?**

Find out the key issues below.

Last year the government put forward a new set of proposals for a social security system and retirement reforms aimed at pulling all South Africans into a ‘new-breed social security net’ for the country – one which will emphasise long-term savings for retirement. This means the government wants to ensure that a certain minimum income will be available to secure the welfare of all South Africans during both their productive working years as well as in their retirement one day.
Sanlam, as an important member of the savings industry, is playing a key role in engaging with a range of stakeholders – including the government – in order to contribute and influence the thinking in relation to the development of the proposed social security system.

Sandaba asked Lizé Lambrechts (Chief Executive: Sanlam Personal Finance [SPF]) and Elias Masilela (Chief Strategist: Financial Sector Developments at Sanlam Employee Benefits) for an update on progress relating to the consultative process to establish the social security system.

Three processes

When one talks about the development leading to the establishment of the social security system, it is important to distinguish between three processes that are currently under way, says Masilela:

- Firstly, there is a policy-led process whereby government is casting a mental eye at the state of the social economy 20 or 30 years from now and how the fiscus should respond to the realisation of that state;
- The second process is one whereby government’s thinking is informed by its own global research – looking at the experience of other countries in order to apply the relevant experiences and designs to South Africa; and
- Finally, there is a process that ensures engagement with stakeholders in South Africa, such as organised labour, non-governmental organisations, service providers and employers, broadly to ensure a comprehensive and fully encompassing approach to social security.

“One has to remember that the reform is by no means just about retirement or social security. It is, indeed, also a labour market issue. That is why it is imperative for employers to be part of the engagements,” says Masilela.

Why social security is important to South Africa

According to Masilela, Sanlam and the industry support the proposed principles and objectives guiding the birth of a social security system and retirement environment, as there can be no doubt that the reforms will be good for the economy and for South Africa both at the micro- (household) and macro-economic level.

“It is at the macro level that we should be focusing our attention in designing this new dispensation.”

On a business case level the changes may be more challenging to the industry, he goes on to say, but there is general consensus that the proposed changes to include more South Africans in the retirement and savings net cannot be questioned. This notwithstanding the fact that major gains will arise from the reform. “From an industry perspective, one of the major positive aspects of social security is that a greater number of South Africans will be brought into the social security and retirement net. This will expand the market and will no doubt be good for business, will raise the welfare of South Africans in general, and create a more robust employment scenario.”

Masilela explains the proposals go beyond retirement provision to address the plight of South Africans whose life expectancy is such that, under the current scenario, they may never reach retirement and therefore have very little incentive to save for retirement. “From government’s point of view, social security is therefore also about dealing with the welfare of South Africans today, not just in retirement but also in terms of death benefits, funeral benefits, unemployment risk and matters related to running a household. The key is to ensure that low income earners benefit from the system by getting cover for risks that plague them today.”

Sanlam’s role

According to Lambrechts, Sanlam (as a leader in the financial services industry) believes the industry needs to accept its role in ensuring that financial services offered to the South African market are fair, equitable and sustainable. “As an industry we can assist government by providing our views and by indicating how we foresee implementation of the NSSS, as well as by offering them access to information and data that are uniquely available in our environment.”

She adds that Sanlam’s role in the process of engagement with government and the rest of the industry is both significant and instrumental. “Not only are we providing intellectual input to develop a position that will be fair to both the industry and the government, but we also consider our engagement as collaborative on an industry level.”

Sanlam is currently actively involved in discussions relating to the reforms with a range of stakeholders and role players, from the LOA to Nedlac and Business Unity South Africa (Busa).

The next step

The next step is for government to publish the so-called convergence paper, which will be the basis for negotiations and discussions on the national social security system from hereon, Lambrechts says. “This paper is expected sometime in June 2008. We therefore expect the process to pick up momentum in the second half of this year.

“It is important to realise, though, that the discussions and negotiations will take some time and that the process to establish the system is a long-term one,” she adds.
**Business Day: National budget 2008 set to help alleviate poverty in retirement years**

Cape Town, 14 April 2008: The impact and prevalence of poverty is notably high among the elderly of the South African population. There are a number of elements that emerged from the National Budget 2008 announced by Minister Trevor Manuel in February this year, that has directly or indirectly affected the elderly and their retirement.

Apart from dealing with matters of regulation, the Budget seemed to have focused more pointedly on dealing with social security and poverty reduction matters. With hindsight, this was most appropriate, noting the changing macro-economic conditions in the economy, with prices of basic necessities going beyond the reach of many, in particular the poor and the elderly. The general approach for government is to simplify every intervention with the public and find ways to prepare them adequately for retirement. The elderly are likely to benefit measurably in the long term.

### Simplification of the taxation formula for lump sums

The simplification of the formula to calculate taxation of lump sums makes it easier to anticipate the impact of the tax charged when accessing retirement savings. The industry and government have been engaged on debates about what the new dispensation should look like on social security and retirement in terms of whether annuities or a straight lump sum is the better option.

Although it is possible to do one’s own calculations without requiring expensive advice, not everyone uses money wisely and encouraging people to cash in a lump sum may be risky as potential misuse of the lump sum may result in insufficient funds for the rest of one’s retirement period. It has been observed in the past that it is not everybody who takes a lump sum invests it productively, stretching its benefit. Many use it all up in the early years of their retirement. In that regard, the lump sum route needs to be taken with a lot of caution.

He believes these recent tax changes don’t offer sufficient clarity as to whether government prefers lump sum or annuities. At this stage, it is not clear what signal the market should read from the recent changes.

### Qualifying age for pension

The qualifying age for old age pension was reduced from 65 to 60 for men, to equalise with women and to combat the problem of poverty among the elderly.

In the long term, this will alter the labour supply in the economy and partly deal with youth unemployment. More importantly though, it will deal with poverty in old age, as it has been observed that employment drops off significantly by the age of 50. Whilst this is positive at the level of the individual, it does bring about a new fiscal obligation by increasing the claimants of this grant.

### Reconfiguration of the means test

Another element is the reconsideration of the means test. Currently, the fact that one’s old age grant is negatively affected by income earned in retirement, results in the means test generating a disincentive to save. By abolishing it, government will remove the negative impact and encourage people to save over and above the flows they would enjoy from the grant. This is important especially for those earning an income above or around the grant amount. For people earning below the grant amount, it is actually unclear why they should save for retirement?

### Social security and child support

The National Budget, among other things, also aimed to put measures in place to alleviate poverty and offer social security, ultimately preparing individuals for retirement. Though these elements may not have a direct relationship with retirement, indirectly they play a great role in helping to improve the financial situation of impoverished families who would otherwise not have a chance to provide for their retirement.

The government made a decision that the social security grant will grow by inflation going forward. This year the increase on the social grant above inflation indicates government’s increased cautiousness in preserving welfare of people. A further element is the qualifying income for the child support grant. Households who did not previously qualify because of lower qualifying thresholds may now qualify.

I don’t believe that retirement funds and members would be affected drastically by changes in the budget since the government grants are non-contributory, while retirement annuities are self-funded. Having said this, the immense focus on poverty reduction and social security will inevitably have a long-term effect on the elderly and their retirement.
It is increasingly becoming a known fact that the savings performance of an economy, household as well as the individual is fundamentally a function of income generation. In this regard, job creation becomes the basis for the success of an economy in its endeavour to raise national savings and increase the households’ ability to deal with vulnerability.

Thoughts on the likely impact of economic performance on retirement funding

With the recent economic indicators in South Africa, one can predict that the country’s ability to save is going to be challenged quite significantly. Firstly, the economy has been threatened by rising inflation on the back of high levels of domestic demand. In its own right, increased aggregate demand should attract new investment to meet the new levels of consumption. However, this response is not always automatic, as has been observed in South Africa over the years. The consequence of this is that we have resulted with a gap developing between what is produced against what is consumed. If consumption is higher than production, it tends to generate imports from the rest of the world, resulting in a wider current account balance. Not only that, these imbalances lead to higher domestic inflation. We have seen inflation ticking steadily above eight percent in December of 2007.

It is clear that this inflationary tendency has not been driven by domestic conditions only. To a large extent, it was driven by imported inflation, as a result of higher crude oil prices. To tame this tendency, monetary policy has had to adjust to stem domestic demand, resulting in an environment of higher interest rates. Higher interest rates mean costlier money, thus lower investment, and lower growth. These also have an overall dampening effect on aggregate demand, as domestic consumption responds, and cash is diverted from consumption to debt service obligations. These domestic conditions have occurred side by side with an observed global slowdown and rising world prices on the back of the sub-prime crisis and unprecedented high oil prices.

Impact

The combined result of these developments is slower economic growth, which declined from five percent in 2006 to 4.7 percent in the third quarter of 2007, with a steep declining tendency. A continued slowing of the economy is certainly not supportive of the savings industry and retirement funding, as it is likely to be followed by job losses and possible income declines in the near term. The power crisis that has engulfed the country will only precipitate the negative economic performance, thus raising the propensity for job losses further. As this occurs, people’s ability to save will be significantly reduced.

Consumer behaviour is such that as soon as costs rise and incomes drop, people adjust by reducing or even stopping those savings that they have control over.

Short- to medium-term implications

It needs to be mentioned, however, that contractual savings will be less affected in the short term, relative to discretionary savings. Consumer behaviour is such that as soon as costs rise and incomes drop, people adjust by reducing or even stopping those savings that they have control over. This is a response to maintain consumption levels. On the other hand, contractual savings will only be affected negatively if the economy does indeed experience job shedding, as is highly probable.

South Africa may not be faced with the same fortunes as the Chileans did. When they introduced a wide-ranging and deep reform programme this coincided with a long economic upswing. For sustained periods of time, the economy enjoyed growth rates averaging seven percent, average real rates of return approaching 10 percent and savings rates reaching 24 percent.

It can also be argued that the delayed implementation in the reform process has the potential of contributing negatively to the country’s savings performance. The delays that have been recorded thus far extend uncertainty and anxiety among people who have been sceptical of the process in the first place. It has already been observed that people in the middle- to low-income brackets are cashing in on their long-term savings by resigning and getting re-employed elsewhere. By the time the legislation kicks in, we would be starting from a worse-off position, if this tendency is not curbed.

Conclusion

The outlook for savings and the retirement industry in South Africa is looking dimmer than it was a year ago. A worsening of the situation can be achieved through direct intervention to try to influence expectations as well as minimising job losses.
The Trevor factor

Here, I pay tribute to Trevor Manuel, who was one of the most respected finance ministers in the world. (Extracted from the *Times of Trevor*, a publication by the National Treasury.)

Rarely does one get the opportunity to deliver a personal tribute to a person to whom history has already bestowed greatness in his own lifetime. On this occasion of the celebration of the first 10 years of Trevor Manuel as Minister of Finance this honour has given to me. And I regard this as a rare honour – more than a golden opportunity for me – an opportunity that I will cherish for more than a lifetime. Better still, is the fortune of being able to address him on a first-name basis. That is merely a reflection of the personality behind the title. Definitely not the type of man described by Shakespeare as ‘a self-made man who admires his creator’.

My relationship with Trevor dates back to long before I walked through the doors of the Treasury. I met him when I was the Secretary of the Economics Association of Swaziland (ECAS). I hosted Trevor as a guest speaker in one of the key events of the Association, the ECAS Dinner, to help solve some of the problems of that tiny yet beautiful Kingdom of Swaziland. Little did I know that I was destined to become part of his team at the Treasury to deal with much bigger and more complex problems of not only South Africa, but also the SADC region and the African continent at large. The issues have been numerous and complex – not just technically challenging, but also politically delicate. Many of these problems could not be resolved without the strong leadership, political commitment and support that is the hallmark of Trevor’s approach to vexing problems that would have left lesser men wavering.

This background appropriately provides an apt prologue to my relationship with Trevor.

He is one of the very few politicians that I’ve met who doesn’t fit the description of Christopher Columbus, which goes: “When Columbus started out, he didn’t know where he was going. When he got there, he didn’t know where he was. When he got back, he didn’t know where he had been. And he did it all on other people’s money.”

What a politician Columbus would have been today!

**National Treasure**

Trevor is from a different mould altogether. Always modest, but straight to the point. He never winces when faced with difficult decisions.

Having joined the Treasury in 1998, I was really chucked in at the deep end. The first major national issue that was thrown my way was the reform of the Unemployment Insurance Fund (UIF), which had been in the red for a number of years. To this day, I cannot explain how Trevor decided on me to lead this process, given its policy and political importance. This would define his character, as a calculating task manager.

I was petrified because I was exposed to the actuarial profession – a mystical profession to me at that time – for the first time. With Trevor’s guidance I soon learnt that those guys, like lawyers, simply repackage ideas.

We set about this task with determination and resilience. Within a matter of a mere two years of the reform process the UIF was out of the red into black. The first lesson I learnt from Trevor was to differentiate between what was sustainable against what was not. This would guide the thinking and activities of the Treasury to this day.

The apportionment of Pension Fund surpluses in 2002 was the next big stumbling block I had to face with him. Here he had to deal with diametrically opposed interests – employers on the one hand and unions on the other, with an amount of R80 billion at stake. This was an interesting challenge – and the nation was watching.

It really needed the wisdom of Solomon, closely resembling the Biblical story of the two women who each claimed that a baby belonged to them.

There is a saying in politics: “Liberals call it share-the-wealth; conservatives call it soak-the-rich.” A delicate balance indeed to maintain.

But Trevor was committed to finding a lasting solution. Over a period of two years he chaired meetings between the chiefs of organised labour (unions) and organised business (private enterprise), meetings that often started at six in the evening and rarely ended before midnight. However, the next morning, Trevor was always first in the office dealing with many different matters, not allowing the slow progress of the previous night (which characterised this process) to worry him.

**A man for all seasons**

With the Pension Fund redistribution, he obviously couldn’t please everybody. The surpluses were ordered to be distributed in a well-balanced legislation, which continues to serve the country well today.

In cricket parlance they say a successful politician is one who plays both ends against the taxpayer. Not so for our Trevor. He bats for the poor all of the time, but not in such a way as to kill the goose that lays the golden egg.

Trevor’s policy eye is constantly on the poor and sees South African society as a whole. The interests of the poor are always
foremost in Trevor’s mind, but he realised that it was not good enough to only help them to get more income. He also had to preserve their purchasing power.

The pitfalls involved in striking a balance between social benefits and running a country’s budget is perhaps best illustrated by this saying: “Under some governments, the people receive free teeth but no meat to chew.”

In his passion for dealing with the problems of the poor, he instituted a programme of Inflation Targeting (IT) for the first time in South African financial history. During the process and debate around IT it became clear that IT did not only have to deal with financial markets, but was also an important political intervention to stabilise prices and to help the poor to preserve their assets, however meagre.

A common quote in the financial press in South Africa and on international fora is: “While the rich can hedge against inflation, the same cannot be said of the poor. In that regard IT can only be appropriate for South Africa.”

No academic or policymaker, anywhere, could fault this view. I am convinced that this view has rewritten economic theory. IT is regarded as a framework that formalises the stability of the economy as an explicit goal and in the application of IT, the policy maker is dynamically responding to the underlying structural challenges of an economy.

IT has led to unprecedented transparency and has made an enormous contribution to economic stability as well as an understanding of policy making by all economic players. IT has received a positive report card from all sectors of the South African economy.

And, as always, Trevor has explained IT in such a way that nobody could misunderstand it. More importantly though, is the boldness with which he took up the often-unsure critics of the framework.

The teacher

While Trevor had to deal with wide and diverse matters, he went out of his way to continually inform the financial sector of government’s intentions. He is always mindful of the fact that the financial sector is an important lubricant for the functioning of the economy. Every finance minister anywhere should have a particular interest in this sector and endeavour to obtain support for the fiscal goals of the Treasury.

Trevor extended this concept beyond the academic idea of stability. He used the financial sector as a major instrument of redistribution and empowerment of the poor. This is evident from the way in which regulation has shifted away from stability to regulating for access. This is a fundamental shift.

He always argued and convinced South Africa’s financial institutions that the poor are also bankable, that private sector institutions could do sustainable business and make money by engaging the poor.

A man of the world

There is virtual unanimity in South Africa about his abilities and his proud record in running the country’s financial affairs. In a way he seems to be removed from the political arena. And that is exactly what he has become in the eyes of all South Africans, and further afield in Africa – and the international arena. His legacy to South Africa is a stable and growing economy and a place in the global sun for the country he loves with absolute passion.

However, his passion is not limited to the South African economy, but extends way beyond, as is evident by his active engagement on issues affecting the poor on many forums. Critics may say he doesn’t stand alone in this commitment, and that may be vaguely true, but one characteristic sets him apart: his ability to always underlay his political engagements, thinking and philosophy with practical, implementable and sustainable economic programmes. This is revealed in SADC and on the continent of Africa.

NEPAD is an important institution that ensures a better functioning and equity enhancing economy. In SADC, Trevor has influenced a delicate balance between political cooperation at the level of states and convergence at the level of economies. While the SADC initiative has just entered its implementation stage, the engineering behind it is sound and Trevor’s political leadership unwavering.

Many of us have learnt a lot from his skills and wisdom. I would like to name him as the original realistic dreamer, because he has taught me that dreams can come true indeed, provided they can be implemented and sustained.
Finweek: The dynamics of being a retirement fund trustee

There has long been a legal requirement requiring at least 50 percent representation by employees on boards of trustees of retirement funds. However, this has not had the desired result of giving them 50 percent influence, because compared to employer-appointed trustees employee-appointed ones are less informed or prepared for the complex decisions and responsibilities they are expected to make.

For a long time, decisions have been to a large extent driven by employer-appointed trustees. This has been as result of the knowledge and information imbalance. But this is changing drastically.

This represents a polarisation that should never occur. One of the biggest sources of trustee error arises when they are first appointed to the board, in their election by either members or by the employer. Trustees frequently assume that because a certain constituency elects them, they're accountable to those interests.

The role of a trustee

Once a person is appointed as a trustee, they should have become independent and objective in the decisions they make. He is meant to look after the interest of the fund and its members. It should not be expected that the employer attempt to dictate to him what decisions he/she should be taking, or organised labour for that matter. But there’s always a confusion where an employee has a dual role.

It's typical of employers to appoint as trustees someone from the HR or finance departments, expecting them to understand and even look after the interests of the employer. If a decision has to be made having a potentially negative impact on the bottom line of the employer, the trustees appointed by the employer are expected to oppose the decision.

To the contrary, those trustees must make a decision with the sole interests of the beneficiaries in mind. This viewpoint is evolving, but it is still commonplace for the employer to think they’re in control of a trustee because they appointed him, and to exert influence. They also tend to see the fund and the entity as one.

Nothing demonstrates this more than the expectations that developed over pension fund surpluses, with both employers and labour believing they had the rights to the R80 billion (at the start of the debate in the 1990s) that had accumulated in pension funds.

After a process of arbitration it was established that neither party had a legal claim, but such surpluses had to be apportioned by a predetermined formula.

With such contradictions always likely to arise, it is imperative that trustees acquire optimal levels of skill, knowledge and education. Even if they appoint professional advisers, they still need to interpret the advice given. One of the key recommendations of the retirement fund reform paper of the National Treasury is to elevate the role of the principal officer.

Balancing act

Despite the often polarised relationship between employer- and member-appointed trustees, it is often on the shoulders of the principal officer that the sound day-to-day running of the fund and the board depends. He/she advises the board of trustees to make proper decisions. However, once again we find the bulk of principal officers are employer-appointed, and the mandate some principal officers are given is often to protect the employer's interests.

Among the interventions to empower principal officers, is the roll out of the work of the Principal Officers Association (POA), aimed at promoting objectivity and independence. The role of the principal officer needs to be elevated. It is observed that trustees often think about the fund in the period culminating to a board meeting, which is four times a year.

The principal officer thinks about it all the time, and his position should be elevated and protected. Currently, he can be fired from the board or by the employer, simply for acting purely in the interests of the fund or its beneficiaries. The debate has favoured the appointment of professional trustees (such as independent actuaries) to be appointed to boards, and while they may be expensive they may also work out cheaper than appointing professional advisers. The labour movement has resisted this as it argues most actuaries would still be employer-leaning. We are beginning to see more and more independent actuaries, and as to whether or not they act truly independently will only be proven out in time.
Finweek: Shrinking economy spells danger for industry

Most large companies have well entrenched employee benefit programmes, including pension and provident fund, medical schemes and risk cover such as death and disability benefits.

The issue for the employee benefits industry remains one of cost and efficiency, as well as government’s proposal to eventually establish a national social insurance fund. But much remains to be done among small and medium enterprises (SMEs) and this is where the bulk of the growth in employee benefits is taking place.

According to Seelan Gobalsamy, executive GM at Old Mutual Corporate, most employee benefit companies offer group schemes aimed at this segment. “Most businessmen running SMEs do not have the time or resources to set up in-house schemes. We offer umbrella retirement schemes with group life and disability, as well as open medical schemes.”

Liberty Life has made this business its area of specialisation, while Sanlam Employee Benefits is also active in this niche. Umbrella schemes give small business the advantage of scale: instead of being a 10-man fund, they become part of a 200 000-strong scheme, with the advantage of complete outsourcing of the administration.

Old Mutual’s Orion solution is simple in design, with easy interaction between client and insurer, as well as being simple to understand, says Gobalsamy. Among larger companies, the focus of employee benefits has become one of keeping a hawk-eye on cost inflation.

Elias Masilela says pension funds, especially labour-driven ones, are becoming increasingly aware of their rights and the issue of leakage. Behind this growing awareness, he says, is the issue of education. There are indications that the consumer has a higher level of understanding of the complexity of products that he or she had five years ago. “Given the complexity of products on the market, there is still a need for ongoing education, and we should aim for a level of education that has a steeper learning curve than the complexity of products,” he says.

Aiding this process is a better-defined segmentation of products that account for people’s circumstances. “Products for low-income earners do not have the same level of complexity as those for high-income earners. There also needs to be a seamless ramp-up, because people are rapidly climbing the ladder from low income, to medium and even high income, so the education process needs to be continual,” says Masilela.

The growing sophistication of consumers is being delivered on a number of fronts. Service providers are supplying clients with regular newsletters, while presentations to boards of trustees also helps. There has also been a concerted effort by representative organisations such as the Life Offices Association (LOA), LUASA, the Financial Sector Charter Council and many others, which are beginning to show results.

“A number of indicators point to better education existing,” says Masilela. “The best one is research undertaken by the SA Savings Institute, which engages at a local level with low income consumers. In the past there was little understanding of even the most basic concepts, such as the difference between paying from savings or paying on credit. But the level of questions from the same group today, suggests they are looking not just at the existence of various products, but have become sophisticated enough to differentiate between products and to undertake comparative considerations.

“They’re looking now at whether particular products suit their own circumstances, and this is a great advance from not even knowing what a product is,” says Masilela. However, it seems an equal education drive is necessary among higher-income groups.

“Despite the increase in income, overall decline in inflation and reduction in the tax burden, there is no corresponding increase in savings. This means the excess resources are going into consumption, not savings,” says Elias Masilela.

Despite the increase in income, overall decline in inflation and reduction in the tax burden, there is no corresponding increase in savings. This means the excess resources are going into consumption, not savings. Elias Masilela

This is a disturbing trend for the employee benefits industry, he says: “Whether one is looking at employee benefits or individual benefits, the fundamental solution to savings in any society is its ability to generate an income. If the economy is shrinking, the likelihood is that employment will decline and the employee benefits industry will shrink.

“That’s the challenge we face as an industry – to create cost-effective products and services that will grow the industry in spite of the economy,” says Masilela.
For classification purposes, size matters. But the Government Employees Pension Fund is being incorrectly classified as a sovereign fund. Implicitly, incorrect classification and understanding of the GEPF has a bearing on current policy debate.

I have always marvelled at ratings in world terms of the South African Government Employees Pension Fund (GEPF). This was until I read the latest Watson Wyatt Global Survey, published in September, on the world’s top pension funds.

Based on its recorded book assets of $103.6 billion (USD) the report ranks the GEPF as the world’s sixth largest pension fund. This position stands out in people’s minds. It is not the only significant metric for the GEPF, making it a world leader by asset size, but it is also the largest on the African continent in terms of membership; the GEPF has over one million contributing members.

However, it is not clear whether the PAYG view of the two social partners has been abandoned. The subject keeps emerging in current debate on social security and retirement-fund reform. Even more interesting, the Department of Social Development (DSD) seems to have jumped onto the bandwagon of the PAYG debate. Since the Job Summit debate, the GEPF has continued to enjoy a decent global rating.

Wrong classification

To my mind, the Watson Wyatt report has brought out a new conceptual conflict. It is that the GEPF makes it to the Top Six in the world by enjoying the highly debatable classification of a ‘sovereign fund’. This classification rings a note of inappropriateness.

The report has four categories of funds, namely:

- Sovereign funds: directly controlled by respective states;
- Public funds: covering public sector workers in provincial and state-sponsored plans;
- Private sector industry funds: covering workers in industry pension plans sponsored by private sector employers;
- Corporate funds: covering workers in company-sponsored plans.

The issue of ownership is critical where sovereign funds are seen as those in the hands of, and owned by, the state. By that definition, the GEPF is not a sovereign fund. One would have expected to see it classified as a public-sector fund, which it is.

Using a more appropriate classification of a public fund, the GEPF would rank (according to its official documents) as 21st in the world by asset size.

Let it be

On the basis of this analysis and my nationalistic ego, I would not protest the ranking given to the GEPF by the Watson Wyatt report. In order to continue enjoying this global position, as proposed by the report, the error of classification does not warrant a challenge. After all, many internationally established classifications remain questionable and sometimes subjective.
Social security is based on the prevention of destitution by securing a certain minimum income during productive years and in retirement. This means that social security can be highly redistributive with those capable of earning supporting those who earn low incomes or who are unemployed.

The design of a social security system can vary from society to society with greater or lesser emphasis on the redistribution of wealth. The objectives of retirement and social security reform must be to:

- Increase the number of people saving for retirement;
- Increase the total amount of money people save for retirement (long-term savings);
- Guarantee a minimum pension, that will increase with inflation, at retirement based on your final salary at retirement; and
- Complement the current redistributive (through taxation and expenditure) effect of the social grants programme (for example the social old-age grant) with other social security instruments, such as a death and disability insurance structure of which every employed person should be a member.

The reform process is based on four pillars but many of the details within each pillar must still be finalised.

The four pillars are:

1. **Social assistance**: This is the provision by the state of grants for such things as child support, disability and pensions for the destitute. The social old-age grant should be paid to everyone with the current means test being scrapped.

2. **Social security**: The current proposal is that there should be compulsory membership of a state retirement fund with risk (death and disability) benefits. Consideration is being given to a possible choice of full or partial opting out, but only from the retirement saving component. The fund would be aimed at including every employed person. The intention is the scheme would provide benefits to dependants on the death of the breadwinner, and/or an income on the disability of a breadwinner before retirement and/or a minimum inflation-linked pension at retirement. The affordability of benefits for the social security system could be based on various cross subsidy structures and subsidies, such as:

   - A wage subsidy for low-income employees to compensate them for contributions to the fund, which would necessarily reduce their consumption and thus welfare;
   - A defined minimum benefit structure or a defined contribution structure or a hybrid of both. With a defined contribution structure your pension benefits would be based solely on your contributions, whereas a defined benefit structure could be based on members receiving a universal minimum benefit and a further amount being based on your final income at retirement. The current proposal is that the state scheme should target a pension equal to a minimum of 40 percent of your final pensionable salary/wage, as will be defined later. A defined benefit scheme could either be fully funded by contributions; or by contributions from members as well as the current generation contributing to fund the pensions of people already retired (known as a pay-as-you-go scheme commonly used by most European countries); and
   - The wealthy contributing more than the poor. However in retirement there is a tendency for the poor to cross-subsidies the pensions of the wealthy as the wealthy live longer.

3. **Compulsory additional savings**: Additional retirement savings will be compulsory for people above a certain income bracket. These savings could be made through the state fund or any other registered retirement fund. The proposal is that these additional savings should be tax incentivised but the incentives should be capped at a fixed rand amount as well as a percentage of pensionable income. The non-state funds will have to be registered and meet strict standards of corporate governance to protect members.

4. **Voluntary savings**: These savings would be outside of the Pension Funds Act and would have no tax incentives. There were about 38 main proposals in the government’s second reform document and many of the issues are still being discussed in the government’s interdepartmental forum. Among the other issues still being discussed are:

The vast majority of employed South Africans will go into retirement without sufficient financial resources. Research undertaken by Sanlam shows that average contributions to retirement funds have been falling. In 2002 contributions averaged 12.4 percent of pensionable income. By this year they had dropped to 10.9 percent.

At the same time, costs have been edging up. This has resulted in dismal replacement ratios, averaging about 30 percent, compared to 56 to 58 percent in the OECD and 70 to 75 percent in developing economies.

There is an urgent need for you to save more, save for longer, retain your retirement savings until retirement while watching cost corrosion, if you are not to face destitution in retirement. Sound and responsible investing is also critical.
The state of the economy is inextricably linked to the success of retirement reform, and conversely retirement reform can also have a significant positive impact on the economy particularly on financial market deepening. If macro-economic conditions are not sound then retirement reform can fail, while successful retirement reform can contribute to the growth of the economy.

The main reason for potential failure of retirement reform is that people cannot afford to save under arduous economic conditions, particularly when employment levels drop. All the signs of people not being able to afford compulsory retirement fund membership are already evident against the background of a worsening economy.

He adds that among other things commodity prices are rising, pushing up inflation to its highest levels in five years and there is slowing economic growth with an increasing risk of a decline in employment numbers.

The impacts on individuals are:

- Average debt as a percentage of household income has soared from about 50 percent to almost 80 percent over the past five years. And with this has come higher interest rates, putting more pressure on household budgets; and
- Household savings has been steadily dropping, from 2.7 percent of disposable income (after tax income) to 0.8 percent in 2001 to a situation where savings are being withdrawn. In other words there is negative saving of 0.7 percent in the first three months of this year.

As it is South Africans, particularly in the low-income groups, do not place retirement savings high in their list of saving priorities. A 2007 survey done by the company Eighty20, on behalf of FinaMark Trust and the South African Savings Institute, showed that 43 percent of savings of families in the lower income groups is to set money aside for emergencies. The surveyed showed only 33 percent of people in low-income groups save and of these only five percent save for retirement.

People only really decide to save for retirement when they generate higher incomes and saving becomes affordable. One’s marginal propensity to save is positive related to income. That is the basis of a country’s savings performance and hopefully the current economic difficulties are a passing phase.

A lesson can be learnt from Chile where the first target was to improve the macro-economy and to address poverty. Retirement reform was not undertaken in isolation of the macro-economy. This was done by the government budgeting for a surplus, targeting inflation (three percent), having a floating exchange rate and more flexible labour markets. While we have boldly attempted the first three, in South Africa, we have been cautious on the labour market flexibility owing to our unique circumstances.

The result was a seven percent growth in the economy, an average real (after inflation) returns on savings of 10 percent a year and a savings rate of 24 percent of disposable household income, over a sustained period.

By its very nature, any reform is complex. South Africa’s retirement reform is especially so, says Elias Masilela. It has to deal with psychologies of society, real issues relating to empowerment and the ability to save – as well as institutional and policy behaviour to take account of the different abilities of people as well as different welfare levels.

One can better appreciate this complexity if we start off by defining what we mean by social security. Insert description: It I can be seen as “… an institutional arrangement, driven by the state to secure the welfare of members of society through securing a certain amount of minimum income, during their productive years and in retirement. It is a system that prevents destitution in the case of members of society faced with incapacity and unemployment. It is a highly distributive institution that relies on the principle of solidarity amongst the income capable and the less income capable…” The operative terms here are:

- Securing a certain amount of minimum income;
- Productive years and in retirement;
- Incapacity and unemployment; and
- Income capable and the less income capable.

That means any policy design should take account of these, for it to be seen as comprehensive, credible and sustainable.
However, the design of such a system varies from society to society depending on the underlying philosophies and circumstances.

This reform process is preceded by decades of debate, research and commissions of enquiry. All of which sought to meet the objectives as set out in the above description. I will not attempt to define the period that we have covered. It is sufficient to limit myself to the period since the most recent restart of this debate in August 2004. This period was marked by the issuance of the first discussion paper from the National Treasury. In that paper, many issues were raised. The extent of the number of issues and their complexity necessitated the Treasury to lay out a programme that would take about six years to conclude – thus the target of 2010 that we have come to make our reference. However it is instructive to mention that the paper set out to deal with a narrow set of reform issues, as we understand them today.

Government quickly realised that it was inadequate and inappropriate to confine this much desired reform to only retirement-related issues. This is inadequate and inappropriate because it confines itself to the employed and to the able person who saves for their retirement. A much broader approach had to be undertaken which resulted in the 2007 draft policy on social security and retirement reform. This swung open all the doors of the debate, as this form of policy would affect every sphere, sector and aspect of society. The research followed as an attempt to try and answer the many questions that were thrown up by the definition has resulted in an avalanche of new knowledge and sometimes misconstrued facts.

With the coming into being of the Joint Forum, an industry body set up to develop common positions, in the engagement with government, many of these issues are being tested from a private sector/service provider perspective. This is essential to ensure that the ultimate design is sufficiently balanced and preserves the value developed in the privates sector over decades.

**Whither South Africa?**

This avalanche is not new to South Africa. Neither is it unique. Several countries have gone down the same path. And all have gone through the process of trying to define an optimal social objective function for themselves. For each of these countries it took about a decade to arrive at what was seen as a social consensus. Reform for many of these, has become a way of life, where “reforms of the reforms” are an every year thing. The “global laboratory” of pension reform, Chile, is going through its fourth reform cycle, since its first attempt in 1924. The second wave was during the period 1970s until 1980. The third was from 1981. Each of these dealt with a different set of objectives. This, in itself is an indication that it is impossible to get it right the first time around. That is why careful thought is crucial.

Chile has changed several features of its system, ranging from:
- Investment rules;
- Worker choices;
- Basic solidarity principles and application;
- Gender equity; to
- Competition levels.

Just to name a few. Some of these changes may mean a reversal of policy as we have seen in Argentina. This country is rolling back some of the changes made towards DC and more towards pay-as-you-go – a system they initially reformed from. For political reasons and the need to ensure continued acceptability of the system, Chile is also investing a lot of resources to legitimise individual accounts.

South Africa is fortunate that it enters the reform at a time where the rest of the world has gone through a 27-year intense and unbroken learning curve. Learning from other countries’ mistakes will make it easier for South Africa to avoid the pitfalls. But, can we really learn from these mistakes? Are the circumstances the same? Are we reforming the same thing and in the same direction? These are interesting questions that can take a whole debate on their own.

The complexity not withstanding, the World Bank has assisted in excess of 80 countries to reform since 1994. Yet again, South Africa is unique, as it is doing it without any formal outside assistance.

In the Chilean case, which has been seen as the most successful to date, the circumstances were unique in the sense that not only did Chile have a dictatorship, under Pinochet, at the time the third wave went through; it was a benevolent dictatorship which operated under the best decisions for Chilean society. Simply because it was a dictatorship, little resistance was anticipated and observed. Despite that, the architect of the Chilean system, José Piñera, was very frequently on public for a – television, radio and other media – to communicate the reform and to educate the public, to ensure acceptance and guarantee smooth implementation. This was in a dictatorship. They could have chosen to ram these reforms through.

The South African context is significantly different to the Chilean one. Fundamentally we are one of the most robust of democracies in the world and we have a labour market that is highly unionised – thus we find ourselves having to operate in an environment that has evolved into a culture of optimal consultation. Guided by state and non-state institutions such as NEDLAC, the process of arriving at a socially objective function can be expected to be more complex, more painful and slower than we have seen elsewhere in the world. Even with the best intentions it is unlikely that South Africa will enjoy the same passage in terms of ease as that enjoyed by Chile. It will take a lot of doing to be ready to implement by 2010. In fat, I am confident to conclude that 2010 is no longer feasible – even to have legislation in place.

**What will it take us to be ready?**

Firstly, a convergence paper is expected from government, which will inform the negotiation process among social partners in NEDLAC, which in itself is a process that can take an average of six to nine months to negotiate a standard piece of legislation. That is before you have a set of principles and before you can envisage a legal drafting process. The legal drafting process together with the parliamentary process will take an additional substantive period.

It is hoped that the reader will have a better appreciation of the magnitude and complexity of the challenge facing us. We need to make sure that the first step taken is the right one. If not, it may be advisable to delay, or even undertake piecemeal interventions as we have seen happening over the past year and a half.
Why costs are important in our reform and financial sector development, in general

The rising cost of living in the South African economy, as displayed by rising inflation over the past year, should be made a key consideration in the planning process for retirement reform. Often, when the cost of living starts biting, discretionary savings are the first to suffer, as consumers re-prioritise. This, therefore, makes the world of costs very important when designing the proposed new national savings system.

If one thinks back to the origins of the current social security and retirement reform debate, one quickly arrives at a conclusion that these were triggered, to a large extent, by the issue of access or lack thereof. The sub-components of this can be identified as costs, complexity of product, transparency on the part of service providers as well as geography. Words that jump at me from the 2004 Treasury discussion paper are “… Government seeks to … ensure that retirement funding arrangements are cost-efficient, prudently managed, transparent and fair.”

Should we be concerned?

It is instructive to note that the sub-component that dominates the debate is cost. But a question that keeps emerging in debates I have with people, particularly those outside of the mainstream debate is: The private sector is very efficient and more efficient than government. Should we really be concerned about costs? If I were a theorist, I would have responded simply by agreeing with this thought. This is because only in Neoclassical thinking, do we have a situation of non-existent transaction costs. But we know that costs exist everywhere in the economic system. It is even more important to think about this variable, if there is any doubt that these could be high, to the detriment of the consumer. In this regard, these are critical and they will determine the optimality or otherwise of financial intermediation.

Under the circumstance of positive transaction costs, the role and design of institutions become extremely important towards making financial services more affordable. That is why the issue of costs in our retirement reform has ranked very high and will continue to do so even after the envisioned regime is in place. Costs will be one of the key variables to determine the success or otherwise of the system.

The bottom line, or key challenge for South Africa, is that we need to strive to design a system that allows the intermediation to occur under a minimum cost environment. However, it is not clear what minimum would mean. At the conceptual level, it will be that level of production that yields maximum efficiency. These efficiency levels would vary by regime, scale and technological usage. All these need to be tested in the South African context. It will not be good enough to respond by simply saying, “We cannot be more efficient than we are now.” This is particularly so, if the inability to improve cost efficiencies is a function of poor design and general inefficiencies of systems. The problem with this is that the cost of inefficiency is typically carried by the consumer – ‘The consumer always pays principle’ is pertinent here.

However, I must say that I have been impressed by the level of consciousness, particularly among admin providers, who are driven by the principle of efficiency and the aim of sharing the gains with the client. This breed of administrators has invested heavily in technology and the training of their staff in order to minimise errors, ensuring quick response times and direct access to personal information for the consumer. This is to be commended. But what I cannot comment on is how far we can go in increasing these efficiencies nor how low we take the costs of service delivery. This is an empirical question.

While having made the above observations, what if we do not realise the ideal efficiency levels, whatever this is? Some thinkers have responded to this question by proposing policy intervention, where the consumer gets subsidised from the fiscus, for these poor efficiencies. They argue that it is even more important in an environment of compulsion, which delivers to the service provider a captive market. They argue that often the consumer has little choice under these circumstances. That, to me, simply means, one solution to this problem is opening up the market as wide as possible and delivers to the consumer the much-desired choice.

Is there a case for subsidisation?

A lot has been said about how to compensate for inefficiencies of the system which, inefficiencies, raise the costs to the consumer. Among these, will include subsidisation by the state. Personally, I am very sceptical of this choice variable. In the ideal world, I would prefer a well functioning system that does not require state
intervention for its successful delivery to the consumer. Therefore, in its purest sense, one would expect a reform delivered without the need for subsidies, so long as we ensure maximum efficiency of the system. This ensures that the whole system is affordable to everyone – both high- and low-income taxpayers. The consumer pays principle returns to the stage here. Any subsidy that the state provides would have to be funded by someone and that someone happens to be the taxpayer. I can comfortably predict that it would not be the employer or the service provider. That cost would be simply passed on to the consumer.

So, there is a much stronger case for delivering on a self-cost reducing system, driven by competition, optimal production levels and disclosure. Any alternative will have inherent problems costly to the consumer and would be sub-optimal.

Likely efficiency measures

Various economists have researched this subject and have come up with various measures for efficiency. In his book, *Money, interest, banking in economic development*, Maxwell Fry identifies a number of these measures, including:

- Information arbitrage;
- Fundamental valuation;
- Full insurance;
- Functional efficiencies;
- Monetary policy;
- Allocative efficiencies; and
- Transactional efficiencies.

The two measures that stand out for our consideration, as part of the reform process are functional and transactional efficiencies. These relate to two key aspects of the financial sector, namely, administering the payments system and intermediating between savers and investors. These involve risk pooling, resource allocation, general insurance, administering the payments mechanism and mobilising savings for investment.

Fry proposes a few measures for assessing functional efficiency such as the:

- Soundness of appraisals measured by the level of arrears;
- Resources cost of specific operations;
- Quality and speed of delivery of services; and
- Amount of red tape involved, particularly in routine financial transactions, such as making a deposit into ones bank account or contributing to ones retirement.

As argued by Dimitri Vittas, financial ratios cannot be a substitute for a detailed understanding of local conditions and practices. This says volumes about cross country comparisons. As we engage on these, we ought not use the ratios emerging from other dispensations as absolute targets for what we can or cannot achieve in South Africa, as measures of efficiency.

From this analysis, it is clear that the consumer will be best served in the new dispensation if and only if we end up with a system that is efficient, transparent and delivers to the best interest of the consumer. These features of the system can be achieved in numerous ways, such as proper investment in technology, skilling of staff as well as simplicity. Reliance on state subsidies is an unpreferred second best.

The bottom line, or key challenge for South Africa, is that we need to strive to design a system that allows the intermediation to occur under a minimum cost environment.

Social security and retirement reform – The genisis

Hopefully with this information, people will be able to plan their financial management from an informed viewpoint and be able to optimally engage with the developments as they unfold.

The aim is to provide consumers and practitioners with information relating to the reform programme that started with a discussion paper, by the National Treasury in 2004, as well as the context. This is a significantly reduced version of the full set of proposals. As such, readers are advised to consult the National Treasury and Department of Social Development websites, for a more complete picture.

Background

In 2004, the National Treasury issued a discussion paper, proposing changes to the retirement system in South Africa. In February 2007, the National Treasury issued a revised discussion paper. This paper significantly extended the scope of the reform,
by proposing the inclusion of broader social security matters. The reason for the extension was informed by the need to deal with poverty, which is a major challenge for South Africa. It was an acknowledgement, and rightly so, that whilst retirement is an important consideration for policy and ones livelihood, it cannot be the only consideration. Given the high level of unemployment, social risks and high dependency ratios South Africans are faced with, it is clear that not everybody can afford to save for their retirement. In that regard, policy interventions had to be considered to deal with those people who are less able to look after themselves – thus social security. In September of 2007, the Department of Social Development issued a set of papers providing further elucidation on the scope of work and in particular, the importance of social security in this reform. During 2007, government established an inter-Ministerial and interdepartmental forum to coordinate work relating to the reform process and engage with the private sector, in this regard.

**Overarching aim of reform process**

The underlying objective of undertaking such a reform is to increase the participation of all South Africans in the financial system, through the improvement of coverage. This makes deep assumptions about people’s ability to set money aside so that they can be able to look after themselves at retirement and be less dependent on the state for their livelihood. The health of income replacement ratios are important in this regard, which in turn are a result of putting in place a cost effective, basic contributory social security system. It has been observed that one of the biggest hurdles to participation is cost. This is one of the principal considerations in the design of the new dispensation, to ensure affordability, by most South Africans. Such a system will go a long way in complementing the redistributive social grants programme. It will also empower the beneficiary through a more directly linked effort-benefit structure, within the context of the proposal to establish an individual account system. Finally, the key is to increase savings, which is best achieved through a prefunded system, such as the one being suggested, namely, establishing individual accounts. In the longer term, a better savings performance should translate into higher growth and hopefully lower unemployment. This provides the fundamental solution to the socio-economic imbalances obtaining in South Africa.

**Specific proposals for reform**

Building on the thinking carried in the 2004 and 2007 papers, towards the end of 2007, the Inter-departmental Task Team (IDTT) issued a paper providing the latest thinking in government and further fine-tuning its proposals. According to the latest set of proposals, four broad elements of the envisaged social security and retirement regime were unveiled. These included:

- **Social insurance** – a contributory element to cover risks such as unemployment, disability, injury and an element of retirement;
- **Mandatory supplementary retirement savings** – these will be additional private savings to ensure a healthy replacement ratio, at retirement. This will be incentivized up to an absolute level; and finally
- **Voluntary savings and insurance arrangements.**

It is expected that individuals earning below a certain threshold, yet to be determined, will be migrated to a national fund. Those earning above will be given the option to opt out from this fund.

**Principles underlying the proposals**

There are five principles guiding the success of the reform. These include:

- **Equity** – ensuring that people’s abilities are taken into account when designing the system;
- **Mandatory participation** – which is reflective of government not being convinced that leaving the decision to save, in the hands of the individual is optimal. Further, compelling people will increase the scale of the operation, thus aiding in bringing down the unit cost of providing the service. This will also ensure the coverage of both the formal and informal earners;
- **Efficiency of the system** – compulsion and scale will be significant in achieving these efficiencies, thus reducing costs. However, there is still consideration on how private sector and government capabilities can be harnessed, to maximise return; and
- **Solidarity** – noting the differential abilities of individuals to provide for themselves, reflected in income and poverty levels, it has been found to be appropriate in designing a system that allows for the poor to be subsidised by the rich.

**Ensuring that objectives are realised**

To ensure that the above objectives are realised and the conditions for success are aided, several matters of an administrative/regulatory nature are important. These are:

- **Adequacy** – in order to achieve this objective, the right contribution rates need to be determined, avoidance of leakage and good investment performance need to be realised;
- **Preservation** – the most important leakage relates to early withdrawals, especially when people change jobs. In order to minimise this and protect the savings of individuals, consideration is being given to how the principle of preservation can be implemented. This will ensure that people stay invested longer, than is the case currently;
- **Compensation for compulsion** – there is recognition that compulsion will have its own negative implications. One of ways of mitigating against these is the proposal to implement a wage subsidy. What this will do, is restore the income of low income earners; and finally
- **Sustainability** – this is directly related to the optimality of funding this programme, irrespective of whether it is funded.
by the private or public sector. It should be a system that can withstand the test of time and in particular, does not lead to job shedding. With this background in mind, we can envision a social security model that may result, if all the principles are put in place. This mental picture of the likely model is represented in the Venn diagram, at the end of this information sheet.

**Process of engagement**

When the President announced this process during last year’s State of the Nation Address, he hinted on the complexity of the initiative, its importance in dealing with inequities that exist in the economy. In that regard, and in order to ensure that whatever design we end up with, it should be one that is embraced by all. He emphasised the need for a thorough consultation amongst stakeholders. It was indicated that a significant part of this consultation would take place in the NEDLAC environment, where all citizens are represented, directly and indirectly.

**Role of the private sector**

In preparation for the NEDLAC process, the private sector, in particular the insurance industry, has established a Joint Forum with the task of developing an industry view on the proposals. The Forum agreed that industry’s response to the proposals should be driven by national interest, and what would ultimately be the optimal system for South Africa. The service provider side of the private sector operates through two levels. At the one level, industry bodies work closely in consultation with each other. Positions that are developed at these levels get escalated to the level of BUSA, which in turn represents the whole of organised business at NEDLAC.

NEDLAC discussions, albeit at an exploratory level, have started, where the nature of engagement, role of each stakeholder and raising the level of appreciation of the complexity of the task at hand constitute the agenda.

**Latest developments**

At the close of 2007, the IDTT hosted a workshop for stakeholders in the industry, academics as well as international researchers in the field. The main aim of the IDTT workshop was to “…contribute to the understanding of the challenges of social security and retirement reform and the refinement of reform options, and to provide a suitable forum for in-depth engagement on the main elements of the reform project.” A less formal, yet vital part of the rationale was to allow government the benefit of views from industry and academia, to help it finalise what we have termed the “convergence paper” from government. It was important that this consultation takes place ahead of the finalisation and distribution of such a paper, to achieve as much consensuses possible. What this means is that, if the process is optimally internalised into the final position of government, the negotiation process at NEDLAC will be as inclusive and as smooth as possible. This is a further commitment by Government to ensuring that no decisions will be taken without sufficient input from the South African public and ensuring that any potential negative implications of the new dispensation are minimised.

**Areas for further work and consideration**

- Fiscal affordability of lower qualifying age for SOAP;
- Application of affluence test;
- Contribution rate will depend on the benefits to be provided;
- Earnings ceiling for contributions;
- How much goes towards risk benefits;
- Review of UIF;
- Structure of annuity benefits;
- Defining qualifying earnings;
- Earnings floor and ceiling for contributions;
- Benefit determination;
- How to optimally provide protection from market and longevity risk;
- Tying contribution to the introduction of a minimum wage;
- Introducing medical scheme contribution protection;
- Possible introduction of a lower retirement age for national fund; and
- Funding options.

**Likely way forward**

It is expected that negotiations will start in NEDLAC during the second half of this year. This will be after government has made public, the convergence paper, which will provide a set of preferred positions from government as well as form the basis for the negotiations.

Whilst the original expectation, was to have the new dispensation coming into effect in 2010, owing to the delays in the process and the amount of research that has to go into the decisions, this timeline is no longer feasible. It is not clear how soon the negotiations will be concluded nor how quickly will the legislative process be finalised.
On Sanlam’s behalf, I thank COSATU for our ongoing partnership, which we value greatly. I am honoured and appreciative of this opportunity to show our gratitude and to highlight a key challenge as we move forward in building our nation.

Many of our elders are currently unable to provide for themselves or their families in retirement and have had to rely on handouts and charity in order to buy their basic needs, such as bread and milk. The shocking truth is that too many South Africans, young and old are facing that very same reality when they retire.

The reform process in South Africa’s retirement and social security environment is entirely about empowering workers and to create long-term savers in particular. The need to make workers financially independent and self-sufficient is the basis for seeking and staying productively employed, whether in the formal or informal sectors of the economy. The reform proposals from government are a major step in this direction.

I wish to quote an outstanding thinker and architect of pension reform, particularly relating to reforms leading to individual accounts. This is non-other than José Piñera, of Chile, who opened one of his seminal articles with a fascinating statement that reads, “The world would be a better place if every worker were also an owner of capital.

“Workers would benefit from the appreciation of assets in the long term and feel more connected to the overall performance of the economy. The interests of the workers would be more in line with the interests of those who manage and control those assets, there would be less inequality of wealth, and workers would place a higher value on strong property rights and the rule of law. Above all, workers would find a new dimension of freedom and dignity in their lives.”

The reform process is the means to achieve this as the shift from unfunded pay-as-you-go (PAYG) arrangements to an environment where workers can accumulate wealth in individual accounts, which can bring about a new paradigm, thus the concept of “a world of worker-capitalists”.

We have moved into an exciting period in our history in which we have the opportunity to make an incredible impact that will be felt for decades to come in the lives of our parents, brothers, sisters and children. The opportunity to take control of our financial well-being and live out our lives in dignity has come in the form of retirement reform. This we should fully embrace.

I thank you.
**ER:** Has your company noted an increase in pension fund withdrawals from group life policies which would indicate that employees may be resigning just to access their pension fund money?

**EM:** The picture of one company is grossly inadequate to be able to provide a representative picture of the economy. In that regard, providing the experience of Sanlam was found to be inappropriate – thus we provide a picture at the industry level.

Firstly, according to the latest data from ASISA, it is observed that between June 2008 and June 2009, total lapses have increased 23 percent, to 2 650 098. The number is 26 percent if one looks at total lapses first year.

Another picture, coming out of the latest Sanlam Benchmark Member Survey, shows that the number of people that have left retirement funds between 2007 and 2008 had increased five-fold. Ironically, at the same time, we observed a similar increase in the level of new entrants.

**ER:** What are the implications for employees who take such drastic measures? Whose responsibility is it to educate the employees regarding the consequences: the employer, the employer’s broker, the employee’s broker, the pension fund trustees or the insurer?

**EM:** The implications are numerous. It really depends on the intent of the action. The assumption we have made so far, interpreting the pattern, is that people resign their jobs to cash-in on their retirement savings and then find another job which gets them yet into another scheme. That is why the outflows seem to be mirrored so closely by new entrants.

If cashing-in results in paying down debt, so that people are debt free, this could be described as a positive phenomenon. However, it is very difficult to be too optimistic about this likelihood. This is because behavioural tendencies of South African consumers have never painted such a positive prospect. Firstly, it has been observed that when individuals are given an opportunity to pay down debt, it is only for a very short while, after which they go back into new debt. In many cases, people will cash-in to further increase their consumption expenditure. These are two phenomena merely with different levels of unsustainability. People need to be educated about this, in order to influence their behaviour in the long term.

The responsibility to educate consumers is that of all key players in the industry, starting with government, service providers, employee representatives as well as boards of retirement funds. The challenge is just too huge to be left in the hands of any one of these stakeholders. However, it is equally critical to ensure that when such education is undertaken, it is done in the most objective and relevant manner.

**ER:** What are the implications for the company pension fund?

**EM:** If the “mirror tendency” is sustained, there may be no significant impact on a fund, in terms of cash flow.

However, the impact would be negative in two respects. Firstly, is if the outflows outstrip the inflows. Secondly, is because as people leave and cash-in, those that re-enter do so with no lump sum assets to make up for those that have been withdrawn. The fund is always bleeding thus reducing the overall resource base. This would raise the unit costs of doing business, thus causing the fund to transfer these to the individual members. This has a long-term fundamental negative impact on the individual’s ability to retire comfortably, as their savings will be significantly corroded by the higher cost structure.

That means, it ought not to be so much a concern about the fund… rather it ought to be more a concern about the individual. That is why as a major part of the reform process, we are calling on consolidation of funds. Through scale, not only in terms of members but also (and if not more importantly) in terms of asset base, we are hoping that we could bring down the costs of delivering to the member over time.

Well of course, consolidation will also enable the regulator to better regulate for the benefit of all.

**ER:** What are the implications for the employer and the pension fund trustees?

**EM:** In the short term, these are not too obvious. But in the medium to long term, this may be an indictment on both. Both the employer and trustees ought to have a common objective and that is of ensuring that the members retire comfortably.

All systems and actions that are put in place are aligned to this objective.

Unfortunately, long after an employer is gone, the member who has not saved sufficiently shall be the responsibility of the state and the taxpayer.

**ER:** Should policies be implemented to deal with this issue? What are the solutions?

**EM:** Yes indeed. The key tactical (and also strategic) intervention is to implement preservation as soon as possible.

Of course, this consideration emerges with its own challenges. But we do believe that these are not insurmountable. If properly designed, this arrangement could minimise the leakage from the system, ensure continued savings and guarantee that people remain invested for long periods of time without any significant negative implications. There are numerous tools to mitigate against the latter. 

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This year, the Sanlam Employee Benefits Benchmark Symposium coincides with the worst and broadest economic slowdown in decades. Officially, it is at a time when South Africa experiences a rare recession. This is particularly evident if one looks at the extent to which every citizen has been impacted. As a result of this slowdown, South Africa is currently taking stock of whether the reforms we are considering will be sustainable or not. Whether they will be acceptable to the individual or not. Finally, whether they will be able to be delivered or not.

What is critical in any reform process is the level of confidence that society has in the process and the display of the benefits likely to accrue. With what has happened to the retirement savings of individuals over the past year, it is increasingly being argued that we are not ready for such a reform. Concern to this extent has been raised by the Harvard team, which was contracted by the National Treasury to do work on growth in this country. With this sentiment growing, it can only make it that much more difficult to convince people to save under the circumstances.

It is important that as we undertake the reform, we stay cognisant of the fact that the reform is about avoiding poverty at retirement. The concept of balancing opportunity with protection is very important in designing a vehicle that will deliver comfortably for retirement (which is the long-term target) but that it is, in a balanced way, able to look after the most vulnerable citizens in the short term (conservation of social security).

However, what the economic crisis also reveals to us is how critical the macro economy is to the success of any reform programme. We have tried to emphasise this in all our research including the work we did on the success of the Chilean reform, which clearly revealed the benefit of combining retirement with macroeconomic reform. This benefited that economy for a minimum of a straight 20 years of high real economic growth and real investment returns. This economic slowdown is just a confirmation of our concerns. The link between savings and investment is critical in this whole debate.

For people to be able to save, the economy should, in a sustainable fashion, generate jobs and incomes for households. In this situation, as incomes grow, the household’s ability to save increases. This is one of the biggest challenges that South Africa is faced with given the global slowdown. There are growing concerns about employment growth turning around, resulting in lower employment and lower aggregate incomes and thus lower savings.

We approached the slowdown with a healthy fiscal position where we enjoyed surpluses, a unique situation around the world. However, unlike other economies, South Africa finds itself in a relatively stronger position to deal with the economic slowdown. We approached the slowdown with a healthy fiscal position where we enjoyed surpluses, a unique situation around the world. This existed side-by-side with a low debt burden, a brisk and well-funded infrastructural programme as well as relatively higher interest rates, which provide for monetary policy space to stimulate economic growth. This puts us in a better position to respond in a counter-cyclical way, as an economy. However, a concern raised so far about the abilities of the economy to adjust, lies in the labour market. It is argued that the labour market may not be flexible enough. This is a matter that will be debated fully at this year’s Sanlam Benchmark Symposium.

What happens next cycle?

This observation has raised questions about the economy’s preparedness to ride the next economic upswing. We are in the same boat as a lot of developing economies with underlying weaknesses in their domestic economies, where the domestic economy is characterised by poor domestic saving, over reliance on foreign capital and high levels of unemployment. The potentially low level of flexibility in the labour market means we cannot quickly adjust to economic cycles on the down- or up-side, which means there is a risk of failing to capitalise on a future upswing. The impact on people’s ability to save and the perception about retirement dispensation are potentially negative.

Given all of the above factors, in particular the negative impact of the economy has potentially dampened the enthusiasm to save. Incidentally, this tendency has not only been observed domestically but also elsewhere in the world. According to the Employee Benefits Research Institute of Washington, retirement confidence stood at 27 percent in 2007 but dropped to 18 percent in 2008. Indications are that it will dip further in 2009. This trend
Balancing opportunity with protection
Part 2

This year's Benchmark Symposium coincided with not only the worst economic slowdown in history, but also the broadest given the extent of citizens' participation in the economy and in particular, the financial markets. The crisis settles once and for all the debate about the role of the financial sector, not only in the economy, but also more specifically in retirement funding. For a long time, people have thought that retirement reform is purely a legislative exercise. The latest experience dispels this notion.

Given the unique challenge that the economy is faced with, Sanlam used the Symposium not only to release its Benchmark Survey results, but also to step up efforts to better understand the complexity of the challenge as well as seek out far reaching responses and solutions for a forward looking, dynamic and sustainable social security and retirement regime. By this we mean a regime that takes account of economic cycles and ensures that both the well-placed and vulnerable citizens are fully catered for under any economic eventuality. Thus the theme, 'Balancing opportunity with protection'.

Social context

This is a theme borrowed from a year 2000 World Bank global study, which attempted to answer the question, whether policies that we put in place can take advantage of the economic conditions to improve the worth of the our people. At the same time, as we capitalise on these conditions, how do we ensure that those vulnerable and dependent on the state are not left out – instead, they should be sucked into the mainstream.

At the heart of all this effort and policy-making in general, is the desire to free the world of all poverty. That is what the reform in South Africa ought to be gearing itself towards and that is what the Sanlam Symposia help in catalysing.

We ought not look to the rest of the world for solutions, we have them right here. All that we need to do is increase the efficiency of our resource allocation, mitigate risk and keep expectations up.

The lesson for South Africa coming out of the recent global slowdown is that we need to ensure that the economy does not falter, at all costs. If we are to see a successful reform, we have to ensure that the economy gives confidence to the average individual to save and to adopt a long-term view about his or her savings. Further, as an economic downswing bites deeper on the poor, any design ought to take account of protecting the welfare of the poor.

Panel discussion

To deal with this challenge, this Symposium brought together a few of South Africa's thought leaders in the areas of micro- and macro-economic policy. This was set up to find a multi-faceted solution, given the broadness of the economic impact.

The panel consisted of Alan Hirsch of the Presidency, who dealt with the social response to the crisis; Johan van den Heever, who provided a deep insight into the role of monetary policy on long-term savings which is a critical piece of policy response; Haroon Bhorat
a labour economist, who dealt with the labour market impact of the crisis; as well as Jarred Glansbeek who provided insights into how investments should be performed across business cycles. Finally, I provided a macroeconomic interpretation of the economic slowdown as well as identifying the critical sectoral risks that the country has to brace itself up for.

Despite the diversity of the participants and the complexity of the problem, the panel shared a common view about the nature of the problem and the identification of the solutions. They agreed that:
- The solution to the long term saving problem lies in stemming the economic down-cycle and the promotion of jobs;
- Sectoral productivity was critical. This will be enhanced by a robust industrial policy;
- Increased flexibility of markets, in particular the labour market, was found critical in aiding a turnaround. Continued rigidity would hamper a recovery;
- Monetary policy cannot be seen as a silver bullet. Savings and growth cannot sustainably rely on interest rate policy;
- Maintenance of public sector investment was an important underpin and base from which the economy should take off. This has so far aided or made it possible for the government to run a sustainable counter-cyclical fiscal programme;
- Social intervention was found to be more important than an intervention to bail-out corporates. Where bailouts are considered, these ought to be targeted very specifically on corporates that have to be bailed out to minimise the incentivisation of bad management;
- From an investment perspective, things are not as bad as people think, not unless we see significantly higher retrenchments and higher company defaults. While there is a likelihood for these occurring, focused and systematic interventions would limit the negative impact; and
- Finally, when undertaking investments, it is important that one does not lose focus of his/her objectives. These can still be achieved even under the current economic conditions, so long as people stay focused.

Conclusion

There is no doubt that the panel discussion provided a sobering set of views for economic players in South Africa.

The key lesson was that we ought not panic, we ought not look to the rest of the world for solutions, we have them right here. All that we need to do is increase the efficiency of our resource allocation, mitigate risk and keep expectations up.

What we do now, will determine whether we capitalise on the upturn when it comes and whether we share the benefits equitably across society.

Flexible contributions

Bruce Cameron, author of Retire Right, reports that Elias Masilela and Sheshi Kaniki show that the number of South Africans with no pension plans have increased steadily since 2005. He also raises the importance of the correlation between economic performance and people’s ability to save, which makes macro stability critical, and in spite of one’s ability to pay – owing to education or lack there of and peer influence – high income earners find themselves delinquent.

I recently read a disturbing paper by Elias Masilela, the former senior National Treasury official who is the newly appointed head of Corporate Affairs and Retirement Reform at Sanlam, and Sheshi Kaniki, senior researcher at Momentum, based on the Labour Force Survey of September 2007 (published by StatsSA), which reveals that the number of South African workers aged 16 and above with no pension saving arrangement has increased steadily since 2005.

In September 2005, 56.15 percent of the nine million labour force contributed to a pension savings scheme, but by September 2007 this figure had dropped to 55.46 percent of 9.9 million. Granted this was for both the formal and informal sectors but the percentage of employees contributing to a fund in the formal sector has also dropped off, particularly at the lower income levels.

There is a problem even at income levels where it could be expected that there would be 100 percent coverage. For example only 83.4 percent of people earning more than R30 000 a month contribute to a pension scheme.

Masilela and Kaniki argue that this trend strengthens the case for the mandatory pension participation contained in Government’s retirement reform proposals.
I could not agree more. What worries me particularly is the formal sector, where employers could be expected to make retirement fund provisions for employees and make membership a condition of employment.

But against this there are many employers who do assist their employees to make provision for retirement and many senior executives of these companies spend hours of their time ensuring that the retirement funds that their companies sponsor are run efficiently and effectively.

One such company is First National Bank. Why I mention FNB is because it is in the process of changing its contribution structure, mainly to encourage its staff to save more for retirement.

A bit of background first. The taxman allows you to deduct up to 7.5 percent of your pensionable income (that normally means your basic pay without such things as car allowances and bonuses) from your taxable income. For example, if you are on the top marginal tax rate of 40 percent, you receive a 40 percent tax incentive in every rand to save for retirement.

But your employer also receives a tax incentive to help you save for retirement. Your employer can claim against taxable income any contributions (up to a maximum of 20 percent of your pensionable income) made to your retirement savings, and/or medical aid.

Your employer contributions to your retirement fund are in effect the additional pay that is not subject to income tax in your hands.

You will eventually pay tax on both your and your employer’s contributions, but only when you withdraw the money, either as a cash lump sum before retirement (not a wise thing to do) or at retirement, or as and when you receive pension payments in retirement. In the meantime your total contributions and those of your employer are receiving tax-free investment returns.

Case in point

Now to get back to FNB. Its retirement fund members contribute 7.5 percent of their pensionable salaries to retirement savings and until now FNB has matched the contribution. It pays an additional three percent of pensionable income of members for group life risk assurance (to cover members if they die or they are disabled before retirement) and for the administration of the fund.

What FNB is now doing is introducing optional employer contributions to fund members. This is good news for FNB employees, but there is a danger as well.

The FNB retirement fund members will now be able to opt for one of four employer contribution levels, namely five percent, 7.5 percent, 10 percent or 12.5 percent.

It is not that someone opting for the 12.5 percent will suddenly award themselves a quick salary increase. A staff member opting for the higher employer contribution will have to give up some monthly take home pay. In other words what is known as the “total cost to company” will remain the same, with the member sacrificing some take home pay.

In simple terms, say the member took home R1,000 a month but decided to increase the pension fund income by R50 a month, then take home pay becomes R950. But then the member receives a tax saving both in not paying tax on the R50 and on the investment build up on the R50.

The danger lies in some members reducing employer contributions to five percent. In my view any employer that offers a lower option should explain the dangers of the option, in that a member may not have sufficient money at retirement to have a financially secure retirement. (FNB is educating its members.)

What anyone, whose employer offers this contribution flexibility, needs to take into account in deciding what level to opt for is their required net replacement ratio (NRR). This ratio is simply the percentage of your final pay packet that you will receive as a pension.

So I did a few calculations on the new FNB employer structure. Firstly in these first examples I have assumed the fund member is earning R200,000 a year; the fund gave a real (actual growth less inflation) of five percent a year; and salary inflation (increases) was one percent above inflation.

In a best-case scenario, a member opting for an employer contribution of 12.5 percent and paying an employee contribution of 7.5 percent would receive after 40 years of membership a net replacement ratio of 197 percent.

In a worst case scenario, a member opting for an employer contribution of five percent and paying an employee contribution of 7.5 percent would receive after 40 years of membership a net replacement ratio of 123 percent.

Both are excellent outcomes. But let’s change the scenario somewhat by simply halving the real investment return to an after inflation 2.5 percent average a year for 40 years.

Then the NRR for the best-case scenario drops to 112 percent for the member receiving the 12.5 percent employer contribution; and to 70 percent for the person who opted for the five percent employer contribution.

But there is a bigger lurking danger than investment returns. The danger is the members themselves … When they change jobs they cash in their retirement savings and spend it.

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What the *Bible* says about saving

This article describes how I was inspired for my first Teach Children to Save (TCTS) campaign, which was held in Alexandra (on the outskirts of the Johannesburg), on 23 July 2009.

I was conscripted to give a keynote in my capacity as Chairman of the South African Savings Institute (SASI), on that freezing winter morning. This was at Ikage Primary School, where I was going to address Grade 6 students. *Ikage*, directly translated means, “build yourself”.

The school and name were just appropriate for the event and the aim of the initiative. Here we were, to share our little knowledge to a group of students and teachers who preach self-development, every minute of their lives. This is a philosophy carried in the name of this surprisingly wonderful institution. I will be honest to say that I never expected to find such an organised primary school in the middle of Alexandra. This is a school that puts many model C schools to shame.

Who were we to come and teach them something new? Therein started my predicament and there it lay until I was liberated by the *Bible*.

I had been thinking about my intervention for at least two weeks ahead of the event. To my dismay, for the first time in my professional life, I battled with what I wanted to communicate to my audience. For the first time, I fully appreciated how complex children can be. Given this difficulty, I decided to resort to the ‘Good Book’.

**What the *Bible* says**

While I knew that I was going to be sharing a podium with spiritual people, such as the Deputy Chair of SASI, Sheshi Kaniki, and the COO of SASI, Elizabeth Lwanga-Nanziri, I was rather concerned that I could have been taking a bad bet. Fortunately, the results proved completely different.

For the past few months, I have been forced by my wife to wake up at about 4am every morning. Without excusing herself, she would rudely switch on one of her favourite channels – TBN. Until July this year, I would not pay attention to what she would watch simply because I thought I was not a spiritual person. But this past month seems to have changed. I have been fascinated by how spiritual I can be, when the preacher blurted out a word that resonated with me and rang long and hard in my mind – Saving! I had never before listened to a sermon dedicated purely to debt management, financial management and sustainable saving – all in one sitting.

For the first time, I sat up and listened closely as if I have never heard about the concept of saving before. While fleetingly fascinated about what I was hearing, at the back of my mind I was

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**Whether this experience has made me spiritual or not, I do not really know. But what I do know is that something happened that morning.**
This is a perspective on key issues, based on Budget 2009, which lends itself to interpretation from a social security and retirement reform perspective, given the current economic climate.

For a while now, we have been arguing for the need to, on an ongoing basis, closely link the reform to the macro economy and its stability. The recent crisis has offered that quite well. It cannot be any clearer that the success of the reform is fundamentally dependent on the state of the economy, both at the micro and macro levels.

“The economic downturn highlights the importance of comprehensive social security, even as it underscores the necessity of a flexible and fiscally sustainable system. The social assistance safety net financed through the national budget has steadily expanded in recent years, providing income support targeted at the elderly, the disabled and children in need.”

(Budget Review, pg 87)

To do this, as well as promote the reader with an insight into the budget, we utilise a series of citations that provide the latest thinking from government and evidence, as carried in this year’s Budget Review.

Emphasis on themes

This time around, the Treasury has taken, and rightly so, a cautious approach in the manner in which it has communicated to the public. Unlike in previous occasions, they have dropped timelines with regard to delivery against the reform process. We think that this is important and the right thing to do, as it avoids raising expectations unnecessarily, which are finally not met, as has been the case over the past four years. Further, what this could mean is that the original timeline of 2010 is quietly being set aside. We think this is responsible and realistic.

Instead, they have focused more on content and providing more specificity with respect to positions they would be comfortable with.

“Government’s efforts to reform the retirement fund industry are focused on ensuring that low-income workers and those with periodic incomes have access to affordable retirement

March

Implications for social security and retirement reform – from Budget 2009

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insurance, while improving the governance and cost-effectiveness of retirement funds. The interdepartmental task team on social security and retirement reform will continue its work in 2009, with a view to developing a road map for introducing a national savings fund and broadening income protection for workers. The task team will also consider and provide advice on the insurance aspects of health care reform.” (BR, pg 16)

Many of the themes raised in the Budget support a lot of the thinking that obtains in the industry. However, two of these themes have not received sufficient debate within the private sector, namely health care and tax considerations. These themes are handled in turn, below.

**Growth and employment**

The underlying philosophy of a close link between the performance of the economy and a successful reform is sprinkled across the Budget documentation. This says volumes about the need to, among other responses:

- Improve the economy’s ability to absorb people into jobs, so as to generate the requisite income to save for their retirement;
- Improve the states capacity to provide support to the poor; and
- Ensure that the reform is not undertaken in isolation. It has to take place within a context of macro and micro economic reform, in particular to enhance competitiveness, productivity as well as commensurate flexibility in the labour market.

In this regard the Budget identifies broad areas of intervention, namely:

- Improvement of productivity and competitiveness, through continued capital expenditure and improving quality of spending;
- Emphasis on higher growth in the medium term through macro stability; and
- Job creation through public sector absorption and increased government efficiency.

**Unemployment risk**

One of the key considerations in the new dispensation is to deal with risk. In this economic climate, the risk that people would want to ardently manage is the risk of being unemployed.

As a result of the current economic climate the risk of growing unemployment is escalated. The above interventions are extremely critical in mitigating this risk. However, it is apparent that these interventions will only be effective in the medium to long term. In the short term, more specific labour market interventions are required.

One of these has been identified as the extensive employment benefits in the UIF, to deal with the placement of the unemployed in training or jobs, extending the current 35 weeks and possible revisions to the income replacement rate schedule.

“Research on a contributory social security arrangement will continue in 2009. Particular consideration is being given to options for improving and extending unemployment relief, while encouraging labour market participation. The design of a national savings scheme that would improve coverage of the retirement funding system and provide income protection in the event of death or disability of low income workers is under review.” (BR, pg 88)

**Adequacy of savings at retirement**

Adequacy of savings for retirement will remain the centre piece for any reform. We argued quite pointedly in the Sanlam Survey last year as well as during the Symposium that, for progress to be quantified and monitored over time, the replacement ratio would have to gain significant prominence in policymaking. This seems to be increasingly acknowledged by government. It is against this target that the reform will be judged directly or indirectly. What is clear to everybody is that when one reaches retirement the single most important question to answer is have I saved enough? Put differently, is my replacement ratio at the right level?

“The question of how much of their earnings workers can and should set aside for their old age is an important area of research. Initial modelling has suggested that a contribution rate of 12 to 15 percent of earnings can achieve an income replacement rate of 40 percent, based on about 30 years of contributions, but more work needs to be done in this area.

“In the context of South Africa’s unemployment challenge, compulsory participation by very low-income workers needs to be accompanied by contribution relief or subsidy arrangements to ensure that the social security system is affordable. One alternative under consideration is to base mandatory contributions on earnings above a set floor, possibly linked to the minimum wage.” (BR, pg 95)

What this statement implies is that government has elevated these key variables to securing adequate savings. This is also an acknowledgement that obtaining 30 percent replacement ratio in South Africa is grossly inadequate and we need to target a higher replacement ratio, thus the 40 percent. We have argued this is also inadequate. A target of 60 percent is closer to the ideal, for SA.

**Incentivisation of voluntary savings**

Government has kept to its continued support of rewarding good savings behaviour. While this is not purely linked to long term, it creates the right incentive structure for continued good behaviour.

Such incentive schemes will be extremely relevant in the debate around tax concessions for voluntary savings in the new dispensation. This leads to the next set of incentives, through the tax system. Part of this would involve the levelling of the playing fields between the private and public sector. Further will be the unification of pension and provident funds.
“Special attention has to be given to the rules governing withdrawals and compulsory annuitisation at retirement, with a view to achieving a reasonable balance between access to funds in the event of pressing needs and preservation of savings to secure an adequate income in old age.

“Although the tax-deductibility of contributions to retirement savings is important to encourage long-term savings, equity considerations suggest that favourable tax treatment should not be unlimited.” (BR, pg 96)

Necessity for income support

The acknowledgment of the fact that retirement savings alone cannot be appropriate in dealing with the challenges facing South Africa is made crystal clear in the budget. There is a significant number of people in society that cannot be independent, and as such are expected to be reliant on the state for their well-being. In this regard, income support and its efficient delivery are fundamental.

“Over the past five years, government’s social grants programme has grown steadily and now covers about 13 million beneficiaries. The social grants system is being expanded in three ways:

- Increasing the eligible age for the child support grant to children up to their 15th birthday;
- Revising the means test to cover a larger proportion of households; and
- Lowering the eligible age for men for the old age pension to 60.

The proposed extension of social grants is likely to bring an additional two million beneficiaries into the system.” (BR, pg 15)

With the income conditions obtaining in South Africa and the likely growth in unemployment, this will be an important part of the design in the short to medium term. This is well acknowledged in this year’s Budget:

“The economic downturn highlights the importance of comprehensive social security...” (BR, pg 87)

Acknowledgement of the power of partnership

One of the concerns that have been raised and keep coming up in every discussion around the reform, relates to concentration risk. That relates to the question as to who will manage the new institution and whether or not people will be forced into the envisioned national fund.

“The financial, structural and operational challenges associated with the current cash payment system for social grants suggest that the overall payment system requires review, focused on providing a more cost-effective and modern disbursement service.

...One of the key considerations in the new dispensation is to deal with risk. In this economic climate, the risk that people would want to ardently manage is the risk of being unemployed.”

Partnerships with other key government organisations (such as the Post Office), banks and private payment-service providers are being assessed.” (BR, pg 89)

“In some countries, the basic social security arrangement is a common, pooled fund to which all employed persons contribute. In others, accredited private funds are permitted alongside a statutory default arrangement for those without private or occupational cover. The central aim, whether realised through a single national fund or a variety of approved funds, is to ensure that all contributors have access to retirement savings and social insurance vehicles that provide income protection effectively and economically.” (BR, pg 95)

While this seems to be the direction to be taken, there is also a strong regulatory consideration to ensure that the basic objectives to protect the consumer are upheld, thus the identification of objective targets, namely ensuring:

- Access;
- Affordability;
- Minimum benefits; and
- Reasonable returns.

What also seems to be emerging from these statements, is the possibility of the product route gaining currency. For a while now, we have identified two key routes that the reform can take. One is the product model the other the institutional model. The product route is where the state sets minimum standards and contracts out to the private sector to deliver on its behalf, against these standards. The institutional route is where the state sets up an entirely new institution to deliver on social security and retirement services side by side with the private sector. Both of these arrive at the same objective, but with different risk and cost levels.

Lastly, government has recommitted to a unified legislative framework for the retirement industry. This is welcomed, as it provides much needed certainty for the policy design period.

Conclusion

Budget 2009 has provided valuable clarity about government preferences. What is comforting is that at the broad level of principle there is a high level of convergence with the thinking existing in the private sector. If this observation is anything to go by, one can safely predict productive and hassle free negotiations when these do take place. This notwithstanding, the devil is always in the detail.
Several years of strong growth and profitability for the employee benefits industry came to a sudden halt late last year, as the economic downswing hit harder than anyone had expected. The industry is beginning to see cancellations of policies on the individual side and to a lesser degree on the institutional side too.

While the international crisis has undoubtedly led to local financial services institutions taking a number of knocks in recent months, our country's financial institutions remain sound and investors should have full confidence in their credit quality.

Finweek: Employee Benefits: stalling economy spells danger for industry

This is a trend that inevitably occurs in an environment of job cuts. People’s ability to keep their contracts running is made difficulty by negative cash flows and unavoidable higher dependency ratios. If this continues into 2010, it may even begin to threaten the survival of some of the smaller service providers.

However, this scenario has a low likelihood given a recent financial sector assessment by the International Monetary Fund (IMF) which reported that the SA life industry was well capitalised and better prepared for difficult times than its counterparts in the rest of the world. In fact, the assessment painted an outstanding picture of the entire South African financial sector. This is a good rating for South Africa.

Nonetheless, be warned against complacency, noting that it is the larger banks that are hardest hit in the current global credit crisis. “I have always argued that just because you are large, does not mean you are safe. Size is not the safety factor – rather, it is a company’s level of capitalisation and the decision that gets made and implemented. Historically, we have found a strong correlation between this and regulation. This correlation is being played out in the current crisis.

Well-capitalised companies are better positioned to rise out a prolonged downturn. The key question facing the industry is how long will the slowdown last? This is particularly important where life companies write a lot of guaranteed business – they have to have sufficient reserves to pay bonuses in an environment where portfolios are declining.

South Africa has not seen the level of wealth destruction seen elsewhere, and if our economy turns around quicker than elsewhere we may yet miss real damage.

Steve Braudo, CEO of Insurance at Liberty Life, says the new level of new business is declining, with many employers that do not yet have employee benefit packages in place deferring their decision until next year. In such an environment, some of the smaller service providers might yet go out of business, and there may be some consolidation at the bottom end of the market.

This shows that when choosing a service provider, clients have to be careful. In a tough market, you need to get back to basics. However, as an industry it is safe, with more than 90 percent of all business being written by the larger five or six firms. “The financial sector is a key industry within the SA economy, and the life industry even more so: with assets under management equal to 80 percent of the country’s gross domestic product, the industry is key to socio-economic and financial stability.

The insurance penetration in SA is 16 percent, which compares with the best in the world. This demonstrates how significant the sector is and how damaging it could be should anything go wrong. Our saving grace is that we have a strong regulatory environment – the very thing that was criticized in the past proves to be the most beneficial today.

So I do not expect to see in South Africa such a big financial crisis as has been seen elsewhere in the world. However, for the employee, what has so far happened is bad enough. With the JSE losing 30 percent last year, and such a significant proportion of pension fund assets invested in equities, this means the industry’s asset base will fall by the same percentage.

This has obvious implications for the individual near to retirement – he will either have to retire with a smaller pot, or defer his retirement to rebuild his benefit. This prompts the question of whether South Africa should reconsider the issue of retirement age. In a defined contribution environment where the member takes all the investment risk, and people are living longer, members should have the option of whether or not to extend their productive life.

In its report, the IMF expressed grave concerns about the issue
Here are some simple tips that everyone needs in order to plan a budget.

The lack of savings is one of the biggest crises facing South Africa. South Africans are, on average, not managing to save. Our saving rate for 2008 was –0.4 percent, with many people dipping into their existing savings or borrowing money to make ends meet. This has a serious impact on economic growth, social development and improvement of living standards.

Savings cleverly, with the help of sound financial advice, can be empowering, as it will allow you to meet your short-, medium- and long-term goals.

Getting started with financial planning

Many people spend most of what they earn, but by drawing up a monthly budget and having a financial plan in place, you can avoid this trap and ensure that you have money left in your kitty for savings.

How do you fit your savings into your monthly budget? At this stage, however, you may say that you simply do not have any money left. But, while saving money may seem like an add-on, it is a necessity if you are going to improve your standard of living and afford the things you want and need.

And watching your money grow is truly exciting. A good start with short- and medium-term savings is to decide what goal you are saving for – whether it be for a car, house, university degree or new lounge suite. Once you know this, you can work with a professional to determine the best way of meeting your goal. You should also try to build up a nest egg for emergencies.

Deciding how much to save

In terms of emergency savings, it is recommended that you have at least a month-and-a-half worth of your salary (or if you are not on a salary, then one-and-a-half times your underlying monthly income) saved and available for emergencies. So, if you earn R10 000 a month, you should have a minimum of R15 000 saved at any given stage. This is the minimum though, and having six months’ worth of income saved should be your
ultimate goal. If you have a specific savings goal, consult an expert to work out how much you need to save to meet your needs and then draw up a plan to do so.

Choosing your savings products

This is often where it gets daunting for the man on the street. There is no getting away from the fact that the South African financial services industry has many providers and products, from unit trusts, endowments and money market funds, to bank savings products.

Internet research will help you get to know the product categories and then you can consult an expert for financial advice. Individuals are unique with their own needs and the products recommended will vary greatly from person to person. For example, a young person starting out in his or her career will be advised very differently from someone in their 50s or 60s and this advice will also be based on each individual’s specific needs.

Is South Africa’s financial sector robust?
Findings of the latest FSAP

With hindsight, one cannot help but conclude that South Africa’s Financial Sector Assessment Programme (FSAP) undertaken by a joint team of the IMF and World Bank could not have been better timed. This assessment was completed in August 2008 and published under the title, “Financial System Stability Assessment”.

This was exactly a year after the emergence of the sub-prime crisis that has resulted in the now insufferable economic meltdown. But what is an FSAP?

A financial sector assessment programme is a process to assess or evaluate the stability of the financial system in a country “... as a whole and not that of individual institutions. They have been developed to help countries identify and remedy weakness in their financial sector structure, thereby enhancing their resilience to macroeconomic shocks and cross border contagion. FSAP assessments do not cover risks that are specific to individual institutions such as asset quality, operational or legal risk or fraud.” (South Africa FSAP 2008, pg 1)

Countries elect to have this assessment undertaken and also have to elect whether or not the details of the report are shared with the rest of the world. South Africa was among the first, if not the first, developing country to have subjected itself to this exercise, and took the up-front decision to make the report public, as part of government’s comprehensive programme of deepening transparency.

In August 2008, the Joint FSAP team, concluded that South Africa’s financial sector is sound and seems to be weathering the storm: “South Africa’s sophisticated financial system is fundamentally sound and has so far weathered the global financial market turmoil without major pressures. Banks and insurance companies have enjoyed good profitability, capitalisation levels, and reserves.

“However, the system faces heightened macro-financial risks and financial institutions are bracing for a less benign environment ... Stress tests suggest that capital and reserve cushions at banks and insurance companies are sufficient to absorb large shocks.” (pg 1)

One of the key exercises undertaken by an FSAP team visiting any country, is to stress test the financial system. This is done through a modelling exercise, which is sometimes criticised for being too idealistic. With the advent of the sub-prime crisis, which gave birth to current economic weakness across the globe, there is no better stress test that one can ask for. Should the South African financial system show resilience under these circumstances, no one will remain in doubt about its robustness as well as regulatory regime.

However, the jury is still out. An assessment towards the end of 2010 would be more than appropriate.

Why is it of interest to the insurance and pension sector?

As rightly observed and stated in the FSAP report, “Insurance companies are major players in the South African financial sector... A key reason for the scale and significance of the life insurance sector is its large share of the retirement savings market”. (pg 26)

Given the strategic importance of this sub-sector it will always be the pace setter in the economy.

It is instructive to note that this is the second assessment to have been undertaken in South Africa. The first was undertaken in 2001. The key difference between the two is that the 2008 report is the first which, has delved into the insurance and pension sub-sector, having noted the importance of these areas to the economy. This was also triggered by the huge policy debate unfolding in the country, on social security and retirement reform. This process in itself is affected by what happens in the macro and micro economy.
According to the IMF, “Insurance penetration (in South Africa) – premiums in relation to GDP – is among the highest globally at 16 percent ...” (pg 26). It is common knowledge that life company assets are significant in South Africa, estimated at about 80 percent of annual GDP at the end of 2007. The strong correlation between the economy and the financial sector is well established. The recent economic upswing has benefited the financial sector, resulting in rising surpluses in excess of the relevant regulatory minima.

However, with the economic fortunes having turned, the outlook does not look as rosy, with high interest rates, slowing economic performance and subsequent reduction in employment – these factors combined, are forcing an increase in lapses and surrenders. There is no doubt that all insurers are singing a different tune with regard to the generation of new business. This may well be the case until sometime in 2010.

The interplay between the state of the economy and the financial sector will remain an important relationship to be watched over the next 18 months or so. Ironically, the FSAP report also raises the social security and retirement reform process as one of the key developments to be watched, “The government’s planned retirement and social security reforms, depending on their final shape, could lead to a drain of both retirement savings and protection business in favour of mandatory contributions to state insurance funds.” (pg 27). Mind you, this is not only in relation to developments in the financial sector.

These are concerns echoed by the private sector in South Africa. Clearly, there is a good case to watch these developments closely as they unfold. It is also interesting to note the unequivocal support from the FSAP team for:
- A shift from lump-sums to income;
- More stringent draw-down rules to deal with longevity risk;
- Preservation until retirement;
- Education and training, in particular of trustees to understand their fiduciary duties, to the extent of enforcing fit-and-proper requirements;
- Improvement in compliance and the general improvement of consumer protection;
- Consolidation of the industry for regulatory purposes; and
- Conversion of circular PF130 on good governance of retirement funds into a regulation that can be enforceable.

**Conclusion**

Clearly it can only be in the best interest of South Africa to ensure stability, robustness of the financial system as well as ensuring the deepening of trusted regulation and supervision. There is no doubt that we are reaping the benefits of a sound regulatory environment...

- Education and training, in particular of trustees to understand their fiduciary duties, to the extent of enforcing fit-and-proper requirements;
- Improvement in compliance and the general improvement of consumer protection;
- Consolidation of the industry for regulatory purposes; and
- Conversion of circular PF130 on good governance of retirement funds into a regulation that can be enforceable.

An outline of the impact of economic slowdown on retirement funding: What does it mean for SA’s retirement reform plan?

**The biggest intervention since 2004 has been the economy**
- Key argument for sound macroeconomic stability;
- This is the factor that has been ignored, the recession brought it to the fore; and
- Many lessons to learn from the OECD.

**Why the OECD?**
- Timing of the OECD Annual Economic conference was very timely;
- Significant global player;
- Originator of the financial and economic crisis;
- Important global body on thought leadership;
- Gloomiest conference in history of the new world; and
- Critical lessons for South Africa’s reform programme.

**What does the OECD find as the major impact of the economic slowdown on retirement funding?**
- Collapsed asset prices, by an average of 23 percent in 2008;
- Increase in unemployment;
- Reduction in people’s ability to save;
- Significant reduction in replacement ratios; and
- Changes in contracts.

This piece is based on my experience at this year’s Annual Economic Summit of the Organisation for Economic Cooperation and Development (OECD). Even though the focus for this year’s OECD Forum was driven by a series of concepts towards a stronger, cleaner and fairer global economy, it was the gloomiest and the most depressing conference I have ever attended.

The purpose of the OECD Forum is to provide a platform for governments of developed economies and partners, such as South Africa, to compare policy experiences, seek answers to common problems and identify good practices, as well as coordinate domestic and international policies.

On the back of the growing common concerns around a slow and sluggish recovery of the global economic crisis – the gathering concluded that the social and economic damage caused by this crisis will be devastatingly long-term. Crudely put, the tail will be long and the impact much deeper than we initially thought.

Summary state of OECD economy

Nevertheless, “a stronger, cleaner and fairer global economy” makes macroeconomic stability a key aspect of policy debate at the global level, which provides a number of opportunities for

How high has unemployment grown?
- In 2009, OECD is expecting an additional 11 million people to join the ranks of the unemployed; and
- Globally, the number is expected to be 50 million.

How are OECD countries responding?
- It is a mixed bag;
- Trade protectionism. As a result, trade will have declined more than 10 percent in 2009. Some people project 15 percent;
- Switching from DB to DC;
- Scaling down of promises or getting rid of them altogether; and
- Potential for a vicious circle to develop.

Has the economic slowdown been “all bad” and “no good” to the global economy?
- No. There is always a silver lining;
- Macroeconomic stability is firmly back on the global agenda;
- Regulatory soundness has become a major consideration, for each and every country, including the US;
- Urgency for sound reforms has been elevated; and
- Forcing a rethink on early retirement.

What impact is this likely to have on South Africa’s reform programme?
- Shift to short-termism;
- Reconsideration of the promises;
- Slowing down of the reform programme;
- South Africa is not unique in facing fiscal tightening; and
- However, social imbalances are much bigger in South Africa, therefore, we cannot afford all the adjustment luxuries seen in the OECD.

What’s been observed in SA’s long-term savings environment?
- Participation rates have dropped;
- Exits have increased five-fold in 2008 – so have entrants into retirement funds;
- 30 percent retire late, 28 percent in US;
- Voluntary savings continue = 2.1 percent, two to 10 percent in the OECD; and
- Confidence in our financial sector remains (58 percent).

What are the policy lessons?
- Bank crises have a deeper negative impact than non-bank crises;
- Increased market flexibility, in particular labour;
- From work first to skills first;
- Keep people in contact with labour market;
- Pay attention to youth;
- No early retirement;
- Increased moral suasion for higher voluntary savings; and
- Get rid of structural constraints to growth.

What are the prospects?
- Cautious and tentative;
- Economic and social damage to be deeper;
- High debt burden will weigh against a quick turnaround;
- Deep seated poverty;
- Dearth of long term capital; and
- Ironically, US recovery will be faster.
South Africa, particularly for those involved in the social security retirement arena since it:
- Puts macro economic stability back on the agenda;
- Increases the urgency of appropriate and sustainable reforms;
- Forces people to rethink about early retirement; and
- Elevates the importance of regulatory tools to achieving stability going forward.

Furthermore, one of the most alarming factors that were highlighted at the conference was the escalating numbers of people going unemployed. For instance unemployment for this year is expected to rise 2.2 percent from 5.6 percent in 2008 – resulting in an additional 11 million people going unemployed in the OECD. It is constructive to note that this number is equivalent of the full employment in South Africa today.

According to the OECD Economic Outlook, it is projected that unemployment will rise in 2010 by an additional 50 million people worldwide.

At the same time we have observed world trade decline by 30 percent, on the back of global assets collapsing by about 20 percent. In the OECD – on a weighted basis – the collapse in assets was recorded at 23 percent in 2008 and at 17.5 percent on an unweighted basis. The major drivers in terms of unemployment rates above OECD average are:
- Ireland (11.1 percent)
- Slovak Republic (11.1 percent)
- Hungary (9.6 percent)
- Canada (8 percent)
- Portugal (9.3 percent)
- France (8.9 percent)
- USA (8.9 percent)
- Sweden (8.5 percent)
- Spain (8.1 percent)

Then there’s the unemployment increases above OECD average, which are:
- Spain (8.1 percent)
- Ireland (5.9 percent)
- USA (3.9 percent)
- Sweden (2.8 percent)
- Denmark (2.4 percent)

As a result, the biggest implication will be felt on the labour market much later, as this sector is a lagging indicator. According to OECD studies this lag can take (on average) five years to turn around. For instance, in the US it could take up to four or five years, but in Finland it may take up to 18 years – a clear indication of the need for more labour market flexibility across the world.

Noting that the South African labour market is less flexible relatively to those in other parts of the world, it would not be misplaced to conclude that we are sitting with a much bigger problem compared to the rest of the world. There is a big need that we urgently shift our mindset from a “work first” to a “skills first” policy environment, given the relatively low level of skills and education that we are faced with.

South Africa will also need to elevate its active labour market interventions by keeping citizens in contact with the labour market even if they are unemployed. Interventions should include ways for them to have continuous access to information so that when the economic cycle turns we will enjoy a healthy and robust market clearing process.

However, the crisis should be managed in such a way that it does not strengthen a disability benefit culture. In response to this problem, the OECD member countries are currently using the following mechanisms:
- Skills;
- Growing the informal economy;
- Reducing information asymmetries;
- Guaranteeing work days for the poorest families; and
- Expanding a “green” economy (for example, France is expecting to create 400 000 additional jobs in terms of “green” economy investments).

In view of the economic performance, there is a growing concern that it is going to take a long time for the economy to turn around. The consensus is driven by underlying probabilities that we may see deeper devastation.

The OECD leading indicator also illustrates that the major economies such as Germany, the US, Canada, the UK, France and Italy are actually the leaders in pulling down the OECD economy. Moreover, the OECD Economic Outlook have for the first time included partner countries such as South Africa, Brazil, Russia, China and India – as further contributors to the broader OECD decline.

As described by Angel Gurria, OECD Secretary General: “…the global economy has not bottomed out. The OECD indicators suggest we are seeing an inflexion point, not a turning point … the recession seems to be slowing down, but it’s not yet over.”

In addition, the OECD Economic Outlook also highlights that signs of a recovery are not yet clearly visible in the euro zone.

As an export-led country, this is cause for alarm from a growth perspective for South Africa – as we are unable to grow internally if the rest of the world is slowing down. Reasons behind the OECD being cautious and tentative include:
- “…economic and social damage caused by the crisis will be long lasting”;
- “…corporations and consumers reducing their indebtedness will continue to hold back growth.” OECD Economic Outlook, 24 June 2009;
- Climate change;
- Crisis on back of food crisis;
- Deep-seated poverty (four billion people affected);
- Now we are faced with a multiple-crisis instead of just a financial sector crisis – which makes it a social crisis;
- Insufficient flexibility in markets; and
- Dearth of long-term capital.

However, it is interesting to note that the US is recovering faster than the rest of the OECD. This could be due to that economy being more transparent than Europe's, having more flexible markets (particularly on the labour side), or as a result…
of them having the biggest fiscal intervention among the OECD countries.

On the other hand, it could result in a deeper structural imbalance – particularly if the OECD ends up with a huge and unsustainable budget deficit that may result in a huge debt overhang going forward. If this happens, for the next 10 to 20 years they may find themselves undoing the negative impact of the intervention that was put in place.

Unquestionably, when posed with collapsing employment and income, savings can only be negatively affected for a substantial period of time.

What are the policy responses available at our disposal?

Macro responses include:
- Restoration of trust/confidence;
- Keep fiscal and monetary policies expansionary for longer;
- Avoid protectionism;
- Align short-term social protection with longer-term structural goals;
- Stronger labour force participation;
- Transparency and more responsible corporate governance;
- Sound incentive structures
- Maastricht-type institution to deal with crisis and retirement reform issues;
- More robust safety nets;
- Step-up education and financial literacy; and
- Implementable withdrawal strategies.

Financial sector responses:
- Problem caused by bad policy and supervision;
- Reform financial regulation and new instruments;
- Remove obstacles for micro credit; and
- Focused interventions (ie, guarantees, remove toxic assets, recapitalise and get out…).

There is also huge pressure on governments to tighten up policies within the financial sector. The response from other industries is that the financial sector is given preferential treatment. In other words, government policies do not respond to the financial sector the same way as it does to the rest of the economy (such as in the case of toxic assets).

They agree that, for example, if you were to produce toxic food in the manufacturing sector, the likelihood is that your company would be shut down and the chief executive placed behind bars.

Impact on retirement savings

Clearly retirement funding has been the first victim of the crisis as a result of asset collapse. And, since most people are exposed to retirement funds through the financial sector, it will directly impact on most people.

Secondly retirement funds are going to be affected by the sluggish growth, incomes and rising unemployment forcing an increase on retirement age.

At least six OECD countries have already increased their retirement ages above 65 years. Bearing in mind that over and above the crisis, longevity is also increasing (people are living longer).

What is the macro impact?

- Unsustainable public systems
  - Cost hover around 7.2 percent of GDP;
  - Costs growing 17 percent faster than national income;
  - Promises being reviewed;
  - Replacement ratios declining:
    - Korea 60.40 percent;
    - Switzerland to lower minimum benefit; and
    - Ireland introducing a levy.
- Difficult balance between financial and social sustainability.

Response to collapsed savings

The response to the collapsing of savings in OECD countries is to not only to encourage voluntary savings, but to also incentivise switching to private schemes (given that the public schemes are no longer sustainable as a result of declining tax incomes resulting in deficits):
- France, Hungary, Poland and Portugal introducing tax incentive;
- Norway mandated employers to contribute to private savings;
- Italy and Korea introducing various conversions;
- Automatic enrollment;
- Increasing coverage to part-time and low income workers; and
- Simplification of institutional arrangements.

Responding to the social pressures

We need to look at how we respond to social pressure that societies are faced with. These could include:
- Providing stronger social safety nets;
- Availing once-off payments as part of incentive packages;
- Providing early access to savings; and
- Encouraging workers to move to less risky assets.

In 2007, John Martin, OECD Director of Employment, Labour and Social Affairs said that most people, who receive a disability benefit for more than a year, would never work again. Not surprisingly then that 2.5 million more people received disability over unemployment benefits in 2007. Hence we need to take into account the following challenges that individuals are faced with:
- Live longer – work longer;
- Avoid early retirement and/or disability;
- Restoring confidence;
- Cultural and behavioural changes; and
- Education.

According to the latest Pensions at a Glance, the period of 2004 to 2009 has been one of evolution rather than revolution in pension systems. This is the OECD situation that is very much replicable in South Africa – as the risks that we currently see in South Africa are either slowing down of the reform programme, or significantly
Effective implementation of social security: some thoughts

Success in this area is a function of numerous interrelated factors that should work in perfect harmony. One of these is appropriate policy intervention at the right time. This is the South African context.

Before one considers the efficacy of implementation, an understanding of what is meant by social security is crucial. This is important to ensure that efforts are aligned to optimise the realisation of outputs and outcomes. It should be emphasised that social security reform is not undertaken for the sake of it. Ultimately, the aim is to improve the overall welfare of all in society. This is particularly pertinent for a society faced with huge income imbalances such as South Africa. The section following, deals with key definitional issues.

What does social security actually mean?

While there is no standard definition of social security, there are fundamental guiding principles of this concept and policy framework. Different literature and different intellectual bodies will define social security differently, depending on what they would like to emphasise and their leanings.

Social security is an institutional arrangement in a society, driven by the state to secure the welfare of members of society through securing a certain amount of minimum income, during their productive years and in retirement. It is a system that prevents destitution in the case of members of society faced with incapacity and unemployment. It is a highly distributive institution that relies on the principle of solidarity among the income capable and the less income capable. The design of such system varies from society to society depending on the philosophies and circumstances influencing the design. The

South African system, as envisioned in the current debate is contained in the social security and retirement reform second discussion paper.

So, very briefly, social security aims to provide an income after retirement that is sufficient to maintain a basic standard of living, among other goals. Government hopes to achieve this by means of a compulsory contribution by all employees into a proposed national social security fund that will support retirement savings as well as risk cover and annuities. However, welfare is also important ahead of retirement, thus a framework that proposes to secure a floor in peoples’ incomes as they go through life towards their retirement.

Why reform a social security system

There are numerous reasons why countries undergo reforms of the nature South Africa is going through at this point of its development trajectory. One of the key considerations is a need to deal with existing social imbalances in an economy, namely poverty, income inequalities and social risk. In the South African context the existence of an implicit poverty trap, brought about by a fragmented/porous social security net, necessitates the need for reform. Not only that, a host of other macroeconomic considerations have contributed to this decision.

These imbalances are located within the broader concern about savings performance at the economy level, as well as access to long-term savings vehicles for the low-income earners which, have

Crisis means that government’s attention is focused, more than ever, on the short term … long-term strategic planning … is set aside … governments may … backtrack on earlier reforms as labour market conditions worsen.”


The fundamental risk or deepening risks in the reform process in South Africa includes a shift to being “short-termist”, a deeper savings collapse and longer social impact – causing the long-term savings industry to suffer.

Conclusion

In conclusion, we cannot insulate ourselves – besides it being a long and gruelling road, we will have to face up to other burning issues, such as:

- Growing risk for protectionism;
- Labour market (generating the biggest pain);
- Retirement funding experiencing historic battering;
- Fiscus coming under sever strain; and
- A repeat of similar crises in the future.

Although South Africa is not an OECD member country, it has been given a form of ‘observer status’. South Africa has also been recognised amongst one of the most stable financial sectors in the world – according the most recent Financial Sector Assessment Programme (FSAP), of the IMF and World Bank.

“For more information, see “Is South Africa’s Financial Sector Robust – Findings of the latest FSAP”, in Insight Magazine, March 2009.
to have contributed to vulnerabilities at the household level. Other factors that have led to reform include:
- Cost of provision;
- Poor system efficiency and design flaws;
- Lack of competition;
- Poor coverage;
- Unsustainable fiscal exposure;
- Design flaws; and
- Lack of trust between private and sector and government.

**Considerations for social security in South Africa**

In this section we consider the factors necessary, not necessarily sufficient, for the optimal implementation of social security in South Africa.

### Effective implementation of social security, IRF intervention, 11 August 2007

**Background**

- Common understanding of social security is essential
  - Identify the different components of intervention
  - Identify the different role players and responsibilities
  - Objective framework for monitoring success
- There is no universal definition of Social Security, but common objectives;
- From definition we can come up with at least four distinct areas of intervention:
  - Securing a certain amount of minimum income:
    - Productive engagement in the economy; and
    - Employment growth and economic performance.
  - Productive years and in retirement:
    - Consciousness towards saving for retirement; and
    - Individual or societal decision.
  - Incapacity and unemployment:
    - Not everyone can be productively employed; and
    - Recognition of inherent dependency.
  - Income capable and the less income capable:
    - Cannot be the responsibility of government only;
    - Ability to pay kicks in implementing solidarity; and
    - Can solidarity work without government intervention?

**Conclusion**

- Cannot be implemented in isolation of macro considerations;
- It cannot be seen as a government only responsibility.

**Responses (Macro, micro and institutional)**

**Macroeconomic considerations**

Preservation of people’s purchasing power, which implies sound inflation management;
- Increasing people’s marginal propensity to save, which implies increased income levels. Economic growth is essential for the successful delivery of social security;
- Fiscal ability to support the initiative; and
- Labour market flexibility.

**Micro considerations**

- Risk sharing;
- Choice of DC versus DB structure;
- Deal with concerns about DC; and
- Moral hazard and adverse selection.

**Institutional considerations**

- Efficiency and trust towards the system;
- The choice between public and private sector provision:
  - Proposed DC with opt-out imply coexistence; and
  - Concerns about issues of investment returns.
- Efficiency across production line:
  - Collection;
  - Member data management;
  - Asset management; and
  - Benefit management.

**Success factors**

- Cost reducing effects of system;
- Poverty reduction;
- How does the shift to DC alter the security of social security?
- How well guaranteed is promise of benefit in DB arrangement?
  - Good political governance;
  - Good economic management; and
  - Increased transparency and accountability.
By its very nature, any reform is complex. South Africa’s retirement reform is especially so. It has to deal with psychologies of society, real issues relating to empowerment and the ability to save – as well as institutional and policy behaviour to take account of the different abilities of people as well as different welfare levels.

One can better appreciate this complexity if we start off by defining what we mean by social security. It can be seen as “… an institutional arrangement, driven by the state to secure the welfare of members of society through securing a certain amount of minimum income, during their productive years and in retirement. It is a system that prevents destitution in the case of members of society faced with incapacity and unemployment. It is a highly distributive institution that relies on the principle of solidarity.
amongst the income capable and the less income capable…”
The operative terms here are:
- Securing a certain amount of minimum income;
- Productive years and in retirement;
- Incapacity and unemployment; and
- Income capable and the less income capable.

That means any policy design should take account of these, for it to be seen as comprehensive, credible and sustainable. However, the design of such a system varies from society to society depending on the underlying philosophies and circumstances.

This reform process is preceded by decades of debate, research and commissions of enquiry. All of which sought to meet the objectives as set out in the above description. I will not attempt to define the period that we have covered. It is sufficient to limit myself to the period since the most recent restart of this debate in August 2004. This period was marked by the issuance of the first discussion paper from the National Treasury. In that paper, many issues were raised. The extent of the number of issues and their complexity necessitated the Treasury to lay out a programme that would take about six years to conclude – thus the target of 2010, which we have come to make our reference. However it is instructive to mention that the paper set out to deal with a narrow set of reform issues, as we understand them today.

Government quickly realised that it was inadequate and inappropriate to confine this much desired reform to only retirement-related issues. This is inadequate and inappropriate because it confines itself to the employed and to the able person who saves for their retirement. A much broader approach had to be undertaken which resulted in the 2007 draft policy on social security and retirement reform. This swung open all the doors of the debate, as this form of policy would affect every sphere, sector and aspect of society. The research followed as an attempt to try and answer the many questions that were thrown up by the definition which has resulted in an avalanche of new knowledge and sometimes misconstrued facts.

With the coming into being of the Joint Forum, an industry body set up to develop common positions, in the engagement with government, many of these issues are being tested from a private sector/service provider perspective. This is essential to ensure that the ultimate design is sufficiently balanced and preserves the value developed in the private sector over decades.

Whither South Africa?

This avalanche is not new to South Africa. Neither is it unique. Several countries have gone down the same path. And all have gone through the process of trying to define an optimal social objective function for themselves. For each of these countries it took about a decade to arrive at what was seen as a social consensus. Reform for many of these, has become a way of life, where “reforms of the reforms” are an every year thing. The “global laboratory” of pension reform, Chile, is going through its fourth reform cycle, since its first attempt in 1924. The second wave was during the period 1970s until 1980. The third was from 1981. Each of these dealt with a different set of objectives. This, in itself is an indication that it is impossible to get it right the first time around. That is why careful thought is crucial.

Chile has changed several features of its system, including:
- Investment rules;
- Worker choices;
- Basic solidarity principles and application;
- Gender equity; and
- Competition levels.

Just to name a few. Some of these changes may mean a reversal of policy as we have seen in Argentina. This country is rolling back some of the changes made towards DC and more towards pay-as-you-go – a system they initially reformed from. For political reasons and the need to ensure continued acceptability of the system, Chile is also investing a lot of resources to legitimise individual accounts.

South Africa is fortunate that it enters the reform at a time where the rest of the world has gone through a 27-year intense and unbroken learning curve. Learning from other countries’ mistakes will make it easier for South Africa to avoid the pitfalls. But, can we really learn from these mistakes? Are the circumstances the same? Are we reforming the same thing and in the same direction? These are interesting questions that can take a whole debate on their own.

In the Chilean case, which has been seen as the most successful to date, the circumstances were unique in the sense that not only did Chile have a dictatorship, under Pinochet, at the time the third wave went through; it was a benevolent dictatorship which operated under the best decisions for Chilean society. Simply because it was a dictatorship, little resistance was anticipated and observed. Despite that, the architect of the Chilean system, José Piñera, was very frequently in public – via television, radio and other media – to communicate the reform and to educate the public, to ensure acceptance and guarantee smooth implementation. This was in a dictatorship. They could have chosen to ram these reforms through.

The South African context is significantly different to the Chilean one. Fundamentally we are one of the most robust of democracies in the world and we have a labour market that is highly unionised – thus we find ourselves having to operate in an environment that has evolved into a culture of optimal consultation. Guided by state and non-state institutions, such as NEDLAC, the process of arriving at a socially objective function can be expected to be more complex, more painful and slower than we have seen elsewhere in the world. Even with the best intentions it is unlikely that South Africa will enjoy the same passage in terms of ease as that enjoyed by Chile. It will take a lot of doing to be ready to implement by 2010. In fact, I am confident to conclude that 2010 is no longer feasible – even to have legislation in place.

What will it take us to be ready?

Firstly, a convergence paper is expected from government, which will inform the negotiation process among social partners in
Financial Mail:
The state of savings in South Africa

It is instructive to start off with stating that the South African Savings Institute (SASI) fully supports the argument by the OECD that one of the key causes of the economic crisis is poor financial literacy. At this year’s OECD annual economic conference (OECD Forum 2009) this was identified as the key to undoing the ills of the US and getting the global economy permanently out of the morass it is in.

Needless to say, on the back of this observation, SASI feels even more energised to continue with its seven-year campaign of educating South African’s about the good virtues of saving. In the current crisis, education on savings is even more relevant, to help people navigate themselves out of trouble.

We were pleased with the increased support for the Savings Month campaign from many South African companies, government and semi-government entities.

Why is saving consistently so low in South Africa?

There are many reasons why South Africa is experiencing poor savings. These range from:

- Consumerism;
- Peer pressure;
- Competition;
- Financial liberation;
- Poor financial literacy;
- High unemployment levels;
- High dependency levels; and
- Absence of legislation to enforce saving.

It is the latter that we may want to examine further. If one compares South Africa similar economies, and more in particular, East Asian economies, one quickly realises that we lag these economies. While we enjoy a saving rate of (structurally) only 15 percent, these economies enjoy rates way in excess of 20 percent. The average among East Asian economies is the 30s.

One of the reasons for this disparity, is simply because these countries never left the discretion to the individual to save. Noting the underlying risk of to the fiscus of over dependency, the governments in these countries institutionalised and made it compulsory for people to save, in particular for their retirement. This has caused savings rates to rise, creating sufficient capital to fund domestic savings. In many of these, they actually enjoy surplus savings, which they export to the rest of the world.

As SASI we support the government’s indication to legislate for compulsory savings.

How SASI plans to increase the rate of savings?

While the impact of interventions on saving behaviour is complex, SASI hopes to complement the efforts put in place by government, through influencing consumer behaviour. Because of the integral role of financial literacy in saving, we intend to step up efforts of communicating, educating people as well as helping them manage down debt. The flagship interventions we have at our disposal currently are Savings Month and the festive season campaign.

These are augmented by efforts from SASI partners, such as the Banking Association, ASISA, National Treasury, Reserve Bank and corporates that assist, in particular, through their service provision. We are under no illusion. This is a very difficult task, as it involves changing the psyche of a nation. This cannot be achieved overnight. We see a big opportunity from the economic crisis. It is has brought financial literacy to the top of the global agenda. With South Africa’s level of education, paying attention to financial literacy is even more pertinent.

What is a healthy savings rate?

At the level of the economy, a healthy savings rate is in the region of 25 percent, to sustain a growth rate in the five to six percent level. However, at the household/individual level, it is more complex. It depends on the aim. These range from very short to long-term (retirement) savings. With the latter, one would have saved well if they are able to retire with a 60 percent
Macro-economic stability is fundamental for a sound reform – fact re-emerges

For sometime now, we have been softly arguing for a deeper and comprehensive link between the ongoing reform process and economic management. We have argued that this reform ought to be seen as a social compact. It cannot be about the private sector only or government only. The right macro-economic environment is critical. Unfortunately, such an environment is, in itself, a function of the partnership between the private and public sectors.

Issues of information asymmetry, policy certainty, job creation and economic growth, keep emerging, albeit peripherally, to the debate. Following the events of the past year, which have left the world poorer than it was in 2007 – and the previous five years – one can hope that this relationship will be taken even more seriously and dearly preserved by the reform stakeholders, in South Africa.

Reforming successfully

It has been displayed in other dispensations that social security and retirement reform needs to be undertaken within a broader macroeconomic reform framework, taking account of all aspects and sectors of the macro and micro economy. Chile has been a typical case in point here for many years, in particular, when one considers the third reform cycle, which started in 1981 and is quickly being followed by a fourth, as this document is being written.

One of the key considerations in such reforms relates to people saving adequately, for their retirement. Unfortunately, this consideration is driven, almost entirely by economic fundamentals, ranging from:
- Ability to earn an income;
- Ability to preserve the purchasing power of that income and savings; and
- To maximising returns that are earned, when this income is invested.

What incentives are there to save?

There are numerous incentives to save, ranging from tax incentives, investment returns etc. However, the most fundamental incentive is the need to insure against unforeseen circumstances and to retire comfortably. No amount of other incentive would surpass this one.

Insurance is important to both the household and the economy. Currently, South Africa is experiencing a huge outflow of capital as a result of foreign dividend payments. This has resulted in a ballooning current account deficit. Had we relied on our own savings to fund domestic investment, the bulk of profits made by corporate South Africa would be retained in the economy, through reinvestments to further spur growth and provide more jobs. This is not the case. The economy is paying a price.

January

Replacement ratio. This is driven by:
- One’s contribution rate;
- The period of contribution; and
- The net real return.
These will respectively be about 15 percent of one’s income, 30 to 40 years and three to four percent.

Clearly economic growth and job creation are critical in this equation. Linked to this will be financial market stability.

What we have seen over the past year, is a classical real economy-financial sector link and how closely intertwined these are. What started off as a localised banking imbalances scenario has resulted in the biggest economic crisis in history. This will now result in shrinking incomes, as investments collapse, employment declines and inflation getting out of control. Whilst we welcome the responses from various governments to this crisis, one shudders to think about the implications of the responses given the enthusiasm. There is a strong potential for longer-term structural worsening.

Retirement savings destroyed

Across the globe we have observed a collapse of pension assets, worsening returns, declining employment and slowing economies. According to The Economist (20 December 2008), the OECD economies have recorded 22 percent shrinkage of pension assets for the first 10 months of last year. This translates to a loss of $3.3 trillion. Of course, countries most exposed to equities led the shrinkage. The significance of this is the fact that notably more South Africans are exposed to the equity markets today, relative to any of the previous crises. This happens either directly through people engaging with the stock market or indirectly through their pension funds.
through people’s pension holdings. This will continue to be the case going forward. That means the social cost of a financial crisis gets increasingly more acute as people get exposed to the financial markets.

South African pension funds have not been spared the wrath of the economic crisis, which implies that the nest eggs of South Africans have shrunk over the year. It is estimated that pension assets could have shrunk by anything in the vicinity of R300 billion. With a slowing economy, declining returns as well as job shedding, it is expected that the replenishment of these assets will take a long time to be realised. This is a big challenge for the realisation of adequacy. In June 2008, we had estimated an average 30 percent replacement ratio for South Africans. With the base having shrunk to the extent it has as well as the negative factors towards capital growth, the replacement ratio ought to look much worse now.

According to the Employee Benefit Research Institute (EBRI) in Washington DC, retirement confidence in the US has dropped from 27 percent in 2007 to 18 percent in 2008. This is the biggest one-year drop in the 18-year history of its Retirement Confidence Survey. The survey measures the percentage of workers confident about retiring comfortably. ‘Confidence’ is defined to include amongst others, a number of variables, such as confidence that:
- One is saving sufficiently to meet retirement needs;
- One will have sufficient and consistent income to be able to save through his productive years;
- Employer will continue to contribute;
- Future benefits will be equal to today in value terms; and
- One will be able to pay for his/her health care in retirement.

This survey provides disaggregated data by gender, income levels as well as race groups. If the same survey could be done for South Africa, a gloomier picture would emerge.

It is a pity that the concept of adequacy has not caught on in South Africa. There are various reasons for this. One of these could be because the reform debate has not fully aligned itself with the longer-term objective of targeting an explicit replacement ratio and making this a policy objective. The reason for this could be to avoid raising expectations. Unfortunately, this will be a fundamental way of focusing people’s minds and influencing behaviour very early in the rollout of the reform. It has been my assertion, for sometime now, that the principle of the replacement ratio is critical in influencing attitudes and the behaviour of workers and retirees towards all aspects of saving, retirement and financial planning as well as long-term financial security.

**Conclusion**

The lesson for South Africa coming from the recent economic crisis is that, we need to ensure that the economy does not falter – at all costs – if we are to see a successful reform. Here we envision a reform that comes with more growth, more jobs as well as significant and sustainable real financial returns. More importantly, we need to ensure that financial stability is the bedrock of our macroeconomic and microeconomic programmes. Underlying this would be stable prices (low inflation), stable interest rates and a stable currency. As we all know, currency stability will be driven by various factors, both internal to the economy and external. It is the internal that is more important, which relies on economic fundamentals and is within our control.

In hot pursuit of the answer, we found ourselves at Emperors Palace, attending a series of presentations at the Financial Planning Institute of Southern Africa’s Annual Convention 2009. We had to wait until the second day of proceedings before Sanlam’s Elias Masilela took to the stage to entertain the audience with his Social Security and Retirement Reform Update. Imagine our surprise when Masilela opened with an observation on how little had emerged in terms of new thinking on the retirement reform issue. “Since the first paper put out by National Treasury in 2004, very little has happened,” said Masilela, briefly showing a graphical representation of the likely post-reform retirement industry structure.

**The vehicle is the same; but the environment is very different**

Instead of wading through what we already knew, Masilela changed tack. He chose to talk about the impact of the recent economic
downturn on the pension funds industry. And he addressed how the meltdown would affect the implementation of government’s proposed (though clearly delayed) retirement reforms. His one-liner on the topic is one of the best we’ve heard: “If the economy is not on your side any design will fail.”

The South African government – already hard pressed to find funds for various social objectives – will fail dismally if recession sets in. Masilela notes that even a simple 40% retirement replacement ratio would prove a step too far. “The impact of a slowdown in the economy is that it compromises your ability to save and it compromises the performance of your pension funds,” said Masilela. This is particularly worrying in a country like South Africa, where the small percentage of the population covered by retirement funding structures quickly dwindles. Between 2005 and 2008 South Africa has experienced a worrying decline in pension fund participation in the formal sector, from 61.73 percent to 56.63 percent.

This trend will accelerate due to the strong correlation between savings, investment and growth. Countries with better savings ratios grow faster and prove more resilient through economic downturns. Government is already adapting some of its policies for slower growth. If you look at the latest National Budget Review you will notice fewer targets and an absence of timeframes. These have been replaced with themes, the most dominant being that of growth and employment. Under these conditions the NSSS implementation is continuing behind the scenes, but Masilela says government will probably tackle its implementation gradually over time.

Will things get worse?

The domestic economy has already fallen hard. Masilela pointed out that “the current crisis is deeper than anything we’ve seen in the recent past”. The Organisation for Economic Cooperation and Development (OECD) leading economic indicator is deep in the red, while the South African Reserve Bank’s measure has fallen below its 1982/1983 level. And because this recession was triggered by a banking system failure, the recovery could take longer than we think. A study of factors causing economic downturns confirmed that, in all cases, bank-originated crises hit economies harder and for longer than other crises.

Proactive stakeholders can streamline a difficult process

Masilela pointed out that retirement reform was “one of the most difficult reforms in any economy”. Chile – a country often used as a model for the South African NSSS system – is already in its fourth cycle of reform. And the model of European efficiency, Sweden, is busy with its sixth iteration. Masilela says the real challenge for South Africa is to learn from these countries and consolidate decades’ worth of international experience in a three- to four-year implementation locally.

This will require buy-in from all stakeholders in the long-term savings environment. He observes that the reform process is a bit like a journey. We know where we want to go and we have a good idea what the state’s requirements are. It’s now up to industry to be proactive and begin implementing the changes that are certain to be legislated down the line. “If we are not proactive we are exposing ourselves to a government that’s going to say: ‘The industry doesn’t want to play ball, therefore I am going to make decisions, regulate and let them taste the poison!’ ” It sounds a bit harsh – but Masilela makes a good point. The private sector is better off building its own path to the inevitable outcome than following a path that government dictates to it.

“We don’t sell commodities – we sell trust,” said Masilela. Financial intermediaries sell a product that someone will consume 30 years from today. The entire industry is built around relationships – between clients, product providers and regulatory bodies. Retirement reform will be a great deal easier if implemented in the knowledge that each role player is fundamentally important.

Final thoughts

In our experience, private companies welcome change provided it doesn’t impact negatively on the bottom line. Although the industry has a good idea of the type of system government wants they also know the implementation will “cost” a fortune. Think about it, do you think the financial services industry will take significant steps towards retirement reform without government cracking the whip? □

Who said the financial system is vandal proof?

This article is a temporary and deliberate departure from classical thinking.

Over the past few months, I have been taken aback reading and hearing, commentator after commentator, lamenting the same thing. These are people, some of whom I really respect – not that I respect them any less now. They all lamented the current meltdown and – probably because of a lack of answers and solutions – questioned the efficiency or otherwise of the financial markets. The basis for this is because, in their opinion, they were not sufficiently protected by the system. Their assets
were exposed. They do not believe that the price adjustment was reflective of efficiency.

What all these commentators forget is that efficiency is not the same thing as vandal proof. The financial crisis, which ultimately led to the global economic recession, was a direct result of vandalism, either by lenders, consumers or regulators. The apportionment of this blame is even more interesting, but not a subject of this thought piece. Vandalism – that is what the financial system had to endure.

What efficiency should we expect from a system if it is battered by high levels of sustained ill responsibility? What result did we expect from such tendencies? Even the best of German technology, if it is exposed to sand rather than oil, it will falter and grind to a halt. Should we then turn around and blame the technology for the failure, or should we be blaming the vandals? Better still, do we blame the protectors of the system – the regulator?

Who dunnit?

As we critique what has happened to the global financial system, we should not forget the importance of human behaviour – or should I say misbehaviour. Mind you, this was the major ingredient in the functioning of this system.

Each time a question is posed about the source of the crisis, there is always a temptation to apportion blame. Given my craving for instant gratification, I will uncharacteristically spoil myself and half-wittingly suggest that “excess greed, poor risk management and poor regulation” are squarely to blame for all this mess. Not the inefficiency of the financial markets. The system may not be optimally efficient, but at the same time it does not always fail for any apparent reason. This time there was a definite reason and it had to fail.

However, on the contrary, one may argue that the system actually did not fail. It adjusted as it is expected to, in theory. It is unfortunate that in its adjustment process, it destroyed wealth and that is why people conclude that it failed. Well of course, because there is general consensus that we have experienced in the market, irrespective of its origination, government intervention has been accepted as the sole solution to the problem – which is right. Hopefully, the same acceptance will limit the actions that led to this failure in the first place. But because we do not learn as the global society, no one can guarantee us that there will never be a repeat of what we are going through.

True Love: Savings in South Africa

There are many reasons why people save. These are driven by their goals, which in turn are either short term or long term. In conjunction with the South African Savings Institute, I discuss the most common reasons as well as why it is important to do so.

In the short term people would save up for lumpy expenditures such as school fees, furnisher and such related transactions as well as unforeseen circumstances, such as a death in the family.

In the longer term, people save for investment purposes, such as purchasing a house, as well as putting enough money aside for retirement. The latter objective, seems to be the most elusive, as it is seen to be too distant by many consumers, as such, they are either unable to plan for it or do not believe that they will make it to that point of their life.

Fast growing economies have high saving rates – China (50 percent) and India (30 percent). These savings are essential for the fixed investment required for growth and improved living standards. Investment is one of the main components of economic growth and as such, employment creation. In the long run financial sustainability and wealth creation at the macro level or at the household level cannot be attained through excessive borrowing, but will require the discipline of saving.

In summary, therefore, at the household level, saving is essential to:

- Finance lumpy expenditures such as household furnisher, which saves people from higher purchase rates;
- Gives resources to fall back to when faced with unforeseen circumstances such as a death in the family;
- Provides cash in the hand, which gives the buyer bargaining power when engaging in trade and also the possibility of most valued discounts, as a result of cash sales; and
- Providing the opportunity to engage in investment decisions which otherwise consumers would not afford had they not saved.

How do I get started?

The starting point towards accumulating savings in a sustainable way requires:

- Understanding your purchasing power, which means what underlying income stream do you enjoy. Here the operative word is “underlying”. Bonuses and once-off sources of income are not to be counted;
○ Ensuring that you live within your means. That means, do not spend above your underlying income level, on average. Where you find yourself having to borrow money to bridge a gap, ensure that you can afford that debt – or find yourself in a debt trap;
○ Development of a budget;
○ Making a clear separation between needs and wants. The budget will help you arrive at this distinction if you are honest in your budgeting process; and
○ Develop a long-term financial plan that takes you to your less productive years – namely, retirement.

How can I save if I have so many other expenses?

The budgeting process and understanding the difference between needs and wants will help you adjust your expenditure basket accordingly, if it is already unsustainable. That you find yourself having so many expenses is because you were not disciplined in the first place and now need to go back to basics. This question is now prevalent given the economic meltdown we are observing across the globe.

For those who have lost their jobs during the downturn and very low-income earners, the answer at this stage is slightly different. For them, social assistance programmes from government will be critical for weathering the storm. Hopefully, the interventions government has proposed will help them get back into the labour market as quickly as possible. However, for those fortunate to still have their jobs it is the same as above.

Interest rates have fallen significantly since the beginning to the year. We have seen a drop in the year-on-year inflation rate. The year-on-year consumer price inflation rate for May was eight percent, the lowest level since the beginning of the year while the producer price inflation dropped from 16.4 percent in May last year to –3.0 percent in May this year, which means producer prices are actually falling. These developments increase the disposable income of households, giving the room to manoeuvre and hence increasing saving ability.

There is also a better institutional framework for personal financial management in the form of institutions such as the National Credit Regulator and the newly formed National Debt Mediation Association. Also, this is an excellent time to make a sober assessment of your expenses and see where you can cut down.

How much should I save – how much is enough?

There is no golden number. However, for the short term, it is advisable for one to have at least one and half times one’s underlying income in liquid assets, to deal with crises. For the long term, in particular when one is saving for their retirement, it is expected that one saves about 12 to 15 percent of their underlying income, consistently for 30 to 40 years, at an average real investment return of two to three percent – in order to achieve a 60 percent replacement ratio. A replacement ratio is that amount of income one earns in retirement as a proportion of the last income during their productive years. That simply means, after all this, one would live at 60 percent of the income they earned when they were productive. Put differently, one has to drop his/her standard of living by 40 percent.

If people want to maintain their standard of living, they would either have to save more for longer, as well as invest aggressively – or die sooner.

But the decision to save is not that of the individual or household only. It is also of concern to an economy. At the level of the economy, a healthy savings rate is in the region of 25 percent, to sustain a growth rate in the five to six percent range.

What are the best savings vehicles?

This does not exist. It depends on the objectives that individuals have set for themselves, their social objective functions as well as the investment outlook.

Unfortunately, at the South African Savings Institute (SASI) we do not talk about specific products. Instead, we believe in empowering consumers to understand the underlying principles of saving, debt management and financial management. These they can replicate across any product or circumstance in an objective and informed manner as well as being able to interpret their unique circumstances.

Why is saving consistently so low in South Africa?

There are many reasons why South Africa is experiencing poor savings. These range from
○ Consumerism;
○ Peer pressure;
○ Competition;
○ Financial liberation;
○ Poor financial literacy;
○ High unemployment levels;
○ High dependency levels; and
○ Absence of legislation to enforce saving.

It is the latter that we may want to examine further. If one compares South Africa to similar economies, and more in particular, East Asian economies, one quickly realises that we significantly lag these economies. While we enjoy a saving rate of (structurally) only 15 percent, these economies enjoy rates way in excess of 20 percent. The average among East Asian economies is the 30s. One of the reasons for this disparity, is simply because these countries never left the discretion to the individual to save. Noting the underlying risk to the fiscus of over dependency, the governments in these countries institutionalised and made it compulsory for people to save, in particular for their retirement. This has caused savings rates to rise, creating sufficient capital to fund domestic investments. In many of these, they actually enjoy surplus savings, which they export to the rest of the world.

As SASI we support the government’s indication to legislate for compulsory savings.
The importance of costs in our reform and financial sector development

Costs will be one of the key variables to determine the success (or otherwise) of the social security and retirement reform system. The origins of the current social security and retirement reform debate were triggered to a large extent by the issue of accessibility, with specific reference to costs, complexity of product offerings, service provider transparency as well as geography. The sub-component that dominates the debate is cost, because costs exist everywhere in the economic system and affordability is often a barrier to adequate retirement provision and discretionary saving.

With the rising cost of living, shifted consumer priorities have affected these savings – an additional consideration that greatly reinforces the importance of costs in designing a system. The role and design of institutions have become extremely important in making financial services more affordable. That is why the issue of costs in our retirement reform has ranked very highly and will continue to do so even after the envisioned regime is in place.

The key challenge for South Africa is to design a system that allows the intermediation to occur under a minimum cost environment. At the conceptual level, “minimum” refers to the level of production that yields maximum efficiency. The cost of inefficiency is typically carried by the consumer. Ultimately, to develop a consumer focus is key – no matter how cost-efficient systems are, there is always room to strive for greater efficiency.

There are many ways to compensate for inefficiencies of the system, which raise the costs to the consumer, one of which is subsidisation by the state. However, in an ideal world, I would prefer a well functioning system that does not require state intervention for its successful delivery to the consumer.

In its purest sense, one would expect a reform delivered without the need for subsidies, but that is able to ensure maximum efficiency of the system. This ensures that the whole system is affordable to everyone – both high and low-income taxpayers, because in this case, the cost is still carried by the consumer. So, there is a much stronger case for delivering on a self-cost reducing system, driven by competition, optimal production levels and disclosure. Any alternative will have inherent problems costly to the consumer and would be sub-optimal.

The Final Word?

Numerous economists through the years have researched the subject and have devised various measures for efficiency. These include information arbitrage, fundamental valuation, full insurance, functional, monetary policy, allocative and transactional efficiencies.

Ultimately, to develop a consumer focus is key – no matter how cost-efficient systems are, there is always room to strive for greater efficiency.

The two measures that stand out for our consideration, as part of the reform process are functional and transactional efficiencies. These relate to two key aspects of the financial sector, namely, administering the payments system and intermediating between savers and investors. These involve risk pooling, resource allocation, general insurance, administering the payments mechanism and mobilising savings for investment.

According to the late economist Professor Maxwell Fry, there are a few measures for assessing functional efficiency such as the soundness of appraisals measured by the level of arrears, resources cost of specific operations, quality and speed of delivery of services as well as the amount of red tape involved, particularly in routine financial transactions, such as making a deposit into ones bank account or contributing to ones retirement.

As argued by Dimitri Vittas, former senior advisor of the World Bank, financial ratios cannot be a substitute for a detailed understanding of local conditions and practices. This says volumes about cross-country comparisons. As we engage on these, we ought not use the ratios emerging from other dispensations as absolute targets for what we can or cannot achieve in South Africa, as measures of efficiency.

It is clear that the consumer will be best served in the new dispensation if and only if we end up with a system that is efficient, transparent and delivers to the best interest of the consumer. These features of the system can be achieved in numerous ways such as proper investment in technology, developing the skills of as well as simplicity.

Reliance on state subsidies is not the preferred second best.
Towards the end of 2008, COSATU made a very interesting yet interventionist statement, at the height of the power crisis in South Africa. At that stage, Eskom had indicated difficulty in raising affordable funding for its capitalisation programme. This continues to be the biggest challenge plaguing the power debate. In response, the leadership of COSATU, appreciating the negative impact costly finance would have on the economy and in particular the consumer, offered to assist by providing funding through its investment arm.

This response rang long and deep, in the ears of many; and generated ample expectation and anticipation. Whether COSATU can deliver on this, is an academic question.

In July 2009, yet again COSATU intervened positively, through pronouncements they made, in the doctors’ strike.

While these were statements that have the potential of surprising many, they ought not have surprised those close to the National Economic Development and Labour Council (NEDLAC) environment. These are statements that more importantly make a commitment that many people had been hoping for, since the establishment of the institution of NEDLAC in 1996.

The importance of the interventions, whether they get translated into real commitment or not, originate from the fundamental signalling that we may finally be edging ever closer to a social compact, in South Africa.

But what does this really mean?

One may not have an answer to this question, but global experience would come in handy here. It is global experience that has partly edged social partners in South Africa to craft an unprecedented social response to the crisis, during the course of 2009. This response has underpinned the counter-cyclical fiscal programme we have observed over the past while.

**Conceptual understanding**

The concept of a social contract is premised on an underlying understanding that the success of any government is rooted in its partnership with society and the upholding of the values and demands of society. John Locke, an English philosopher in support of this understanding, argues that, “…governments derive their authority from popular consent (regarded as a “contract”), so that a government may be rightly overthrown if it infringes such fundamental rights of the people as religious freedom.” Thomas Hobbes explains the same concept from the angle of absolutism, where he advocates for an “...absolutist government as the only means of ensuring order and security...” where he saw this deriving from the social contract.

Whether you think of it as a social compact, social contract or even a social accord, the principle remains intact. In principle, the modern understanding of social compacts is an attempt to address problems in the growth path that are best resolved through collective action and agreements between various interest groups. Chief among these are the tripartite social accords in the Netherlands, Ireland and Spain.

**Economic relevance**

During this time of a drastically slowing economy, rising unemployment, volatility in the currency markets on the back of growing sovereign risk among the emerging markets – coordination, consensus and the formulation of common agendas is critical. It is becoming very clear that some of the constraints that we are faced with as a country are not external to the economy. In fact, a few of these are a result of inappropriate decisions that we have taken and implemented in the past, sometimes right decisions that have not been well implemented. The example of the power crisis is pretty much a case in point here and that is why the response from COSATU was quite timely. Carrying forward of this leadership vision, on the part of organised labour is invaluable for South Africa.

But what are the lessons to be learned from the international experience of countries facing similar constraints? What lessons if any can be learned from countries which have managed to boost productivity and employment through a social compact among labour, business and state? Recently, we have observed very successful compacts in Europe directly responding to the crisis, with wage freezes, short-hours, re-skilling and such similar interventions. The same success has not been observed in our context.
For a social compact that involves all the role players to make a significant economic impact, the following conditions must hold:

- Preparedness by organised labour to make real concessions (income policies and labour-market reforms) in return for productivity-related benefits;
- Genuine commitment by employers to an accord process;
- Lending structural policy support to the accord process from the government, by ensuring timely and effective reforms in areas of labour, industrial, welfare and tax policy to aid part of the accord;
- Productivity growth succeeds in improving profitability, thus encouraging firms to increase their investments; and
- Discourage the persistence of insider/outsider imbalance and ensuring sustainability.

We can learn from some of the successful experiences of social pacts in other countries that are relevant to South Africa, such as the Netherlands, Spain and Ireland. It consistently seems like a commonly perceived crisis and recognition among all parties that concerted action is required to address the crisis, is a precondition for a social accord to be struck as we can learn from these countries.

**Conclusion**

In all countries that have dealt and implemented social accords, consistently all these processes were triggered by some form of a crisis. Hopefully, the domestically originated structural crisis, as well as the globally originated, will spur South Africa swiftly towards a more formal and virtuous compact. As the saying goes, “Every dark cloud has a silver lining.” The crisis is an important opportunity for us to think, plan and coordinate differently. Unfortunately, the biggest challenge remains the inherent low level of trust among stakeholders in South Africa.

At least we now have a test of our commitment, as a country, from the recent social response. Over time, we will be able to tell if we crafted these appropriately as well as whether we have put sufficient commitment behind the compact.

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**Implications for social security and retirement from Budget 2010**

The 2010 National Budget presented on 17 February was fairly balanced, providing positive economic prospects for most sectors of the economy. This article is meant to provide an interpretation of the likely impact of the Budget on the social security and retirement environment in South Africa, emphasising the role played by the health of the economy.

Many of the critical policy areas preoccupying the minds of South Africans received attention, albeit, with differential levels of emphasis. However, very little has come out in line with the industry’s expectations on social security and retirement reform. The waiting continues. Encouragingly though, subsequent to the presentation of the Budget, there has been a glimmer of hope.

The Minister of Social Development announced the existence of the much awaited convergence paper in government. But there have been quite pointed and deliberate announcements that will have a significant impact in the social security and retirement space, namely:

- Personal income tax relief;
- Increase in value of social grant;
- Merging of exemption value upon termination of service with retirement lump sum benefit system; and
- Allowing small retirement to be commuted into lump sum.

**Economic interpretation**

The economic implications of the announcements as well as some of the theory underpinning these announcements need to be investigated.

**Labour market**

Emerging starkly from the Budget is the observation that the bedrock of a successful social security and retirement system is being strengthened with the growing certainty in the turnaround of the economy. However, clear weaknesses have been identified arising out of the slower economy, in 2009. The vulnerability of the economy revealed itself in many variables published in the Budget Review. Two of these, which are crucial for social security consideration, include a notable rise in the number of people receiving social grants and unemployment benefits, which respectively grew by 6.8 percent and 26.6 percent in 2009/10.

Both these are a direct result of the economic slowdown and growing unemployment. They are representative of a number of indicators that have worsened as a result of the slowdown, across all sectors of the economy. This clearly displays the direct and inexplicable link between the economy and social stability or otherwise.
From the accompanying table, it can be seen that at the height of the economic cycle (2006–07), unemployment claimants actually declined. That is how important the economy is to our reform programme.

### Social Security Beneficiaries

<table>
<thead>
<tr>
<th></th>
<th>2006/07</th>
<th>2007/08</th>
<th>2008/09</th>
<th>2009/10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grants</td>
<td>11 983 141</td>
<td>12 374 770</td>
<td>13 066 118</td>
<td>13 958 894</td>
</tr>
<tr>
<td>Change</td>
<td>n/a</td>
<td>3.3%</td>
<td>5.6%</td>
<td>6.8%</td>
</tr>
<tr>
<td>UIF</td>
<td>154 546</td>
<td>140 086</td>
<td>164 301</td>
<td>207 967</td>
</tr>
<tr>
<td>Change</td>
<td>n/a</td>
<td>-9.4%</td>
<td>17.3%</td>
<td>26.6%</td>
</tr>
</tbody>
</table>

Source: Budget Review, 2010

During 2009, it is recorded that the economy lost 870 000 jobs. While this is a concern, more worrying is the nature of this growth in joblessness. The character of South Africa’s unemployment seems to be changing, structurally. Historically, the unskilled and low-income earners have dominated joblessness figures.

However, the latest observation shows that increasingly high-income earners are dominating this picture. This will have several notable implications for the long-term savings environment as well as the sustainability of the UIF finances, which had improved significantly since the last UIF reform in 2000.

To stave off these risks, it is imperative that we work on the labour absorptive capacity of the economy. That is the key and also a fundamental long-term solution to deal with the imbalances obtaining in the economy. As employment is and should always be seen as the key to any economic development, it has made the centrepiece for this year’s Budget. This was to be expected and is commendable. For any social re-engineering that a society wants to undertake, jobs will be paramount. In turn, economic performance will be the prerequisite. It is instructive to note that, for the first time, the Budget Review dedicates an entire chapter to employment and more specifically the wider labour market. This is an essential elevation of this policy area.

This is an area that we have emphasised over time as well as the growing need for flexibility in the labour market to be considered as one of the key policy considerations for turning the economy around. Indeed, some aspects of labour market flexibility are dealt with, in the Budget Review, namely:

- Aligning wage growth to productivity growth;
- Flexibility in wage and non-wage costs;
- Fair labour protection;
- Avoidance of discrimination; and
- Active labour market policies.

These are extremely important considerations, but on their own they are not sufficient to deal with the inflexibility obtaining in our labour market.

There is a need to deal with all aspects of labour market flexibility, to include:

- Focusing on factory-floor specific skills development, which is partly dealt with at different points of the Budget Review, but not necessarily as part of the underlying principle of flexibility;
- Reduction of information asymmetries; and
- Increasing the geographic and occupational mobility of labour.

Economic performance and impact

An indication of economic recovery and in particular, a better than expected growth for 2010, from 1.5 percent at the time of the MTBPS to 2.3 percent at the time of the Budget, is one of the most positive announcements coming out of the Budget. It is projected that growth will rise to 3.6 percent by 2012. This outcome provides better prospects for a reversal of the rising unemployment recorded in 2009 (from 22 percent in 2007 to 24.3 percent) and improved savings potential for the economy.

As significant part of this expected turnaround, is premised on a firmer global economic turnaround, a counter-cyclical fiscal programme in the domestic environment – characterised by a strong capital programme, firmer household consumption and a correction in the inflationary environment.

The Budget Review identifies eight key policy interventions, as canons for growth:

- Youth employment to prop up productivity, through a wage subsidy;
- Supporting labour intensive industries;
- Managing scarce resources;
- Improved energy maintenance;
- Increased productivity and competitiveness;
- Increased private investment;
- Raising saving and fiscal investment; and
- Reducing inflation.

These canons will be supported by various policy changes that will affect us both positively and negatively.

Financial sector

As a direct response to the source of the financial crisis, the Budget puts a lot of emphasis on regulation, as one of the instruments to turn the economy around. Resultantly, the following are seen as key considerations in the financial sector:

- Improved governance and accountability among financial regulatory agencies;
- Review of South Africa’s adherence to global regulatory standards by the IMF in March 2010;
- Review of South Africa’s crisis contingency framework by the World Bank within the first half of this year;
- As part of the global partnership, review the Basel II framework;
- Extending the scope of regulation to cover hedge funds and private equity;
- Monitoring the role of credit rating agencies in global investment, which will include the publication of a Credit Ratings Services Bill, soon;
- Reforming exchange controls, and in particular Regulation 28,
to modernise the flow of capital across the borders of the economy with an effective shift to prudential regulation; and
○ Providing certainty to markets with respect to monetary policy. Inflation targeting and the target range have been affirmed together with the independence of the Reserve Bank.

Fiscal sector
Fiscal leadership has been emphasised in the Budget, with policy stances underpinning the response to the economic conditions we find ourselves in. It is expected that this will result in a quick private sector crowding-in effect, to spur growth further. The following are worth highlighting:
○ A deliberate decision to keep the tax burden unchanged, allowing for a notable upward adjustment only in 2011/12, from 23.3 percent currently to 24.3 percent. This is critical to reduce the debt service burden;
○ Household tax relief to the tune of R6.5 billion to support aggregate consumption;
○ Determination to reduce the deficit in the medium term, to contribute towards confidence building, avoiding long-term structural imbalances as well as minimising inflationary contributions;
○ Sustain growth through an R845 billion capital programme, for the next three years. Capital expenditure is expected to be sustained above 2.5 percent of GDP. Projects to be funded cover energy, transport, water, housing as well as hospitals. These are the areas we have identified as desperately requiring attention;
○ Significantly larger allocations are made to municipalities, over the medium term to bolster their capital programmes. Municipal capital spending rises from R37.5 billion currently to R56 billion in the third year. This is very important to deal with efficiencies and risks in the economy;
○ Continued support for saving by increasing the tax allowance on interest income. Government needs to be commended for having kept its word in terms of consistently supporting this aspect of the economy;
○ Environmental tax to curb motor car emissions, with a proposal for a more comprehensive tax in the future; and
○ Significant downward adjustment to SACU distributions. The allocation is almost halved in the coming fiscal year, to only R15 billion and further to R11.2 billion in 2011/12. This will have a direct impact on aggregate demand as well as growth potential for the BLNS countries.

Social security and retirement-related issues
The one area that was not dealt with sufficiently enough relates to the much awaited social security reform, although this was touched upon in different parts of the Budget Review in relationship to other policy considerations, such as the UIF, Unemployment, NHI and health provision.

Following the SONA, expectations were high that better guidance will come out of the Budget. However, it can be said that some clarity has been provided, but it still leaves us waiting. As we have observed in the past, the Budget continues to extend gradual implementation, to improve the social security system as well as the functioning of the broad economy.

Retirement and health systems
Indeed, the link between retirement and health is being fully recognised in the Budget Review. The Review has a dedicated section that deals with these two policy issues as complimentary policies. This is pretty much in line with the views that we have espoused and we continue to do so.

In this section there is specific mention of the need for increased access for both retirement funding and health services, especially amongst the low-income earners. Work on both social security and the financial aspects of NHI will be dealt with by the Inter-Ministerial committee on reform.

With respect to retirement, these are the considerations:
○ The need to reconsider the means tested old age grant, given its potential negative impact on people’s preparedness to save for retirement;
○ The inefficiency of the voluntary savings system for retirement as well as high administration costs;
○ Need for consolidation of the retirement industry;
○ A proposal for a standard, basic retirement and income protection scheme; and
○ However, without being committal, the Budget Review indicates that the Inter-Ministerial committee will consider design standards this year. This leaves the timing of the issuance of the paper from government wide open.

With respect to health, these are the considerations:

What is labour market flexibility?
There is much debate and confusion about the concept of labour market flexibility, globally. This is particularly so in the South African context, as this concept has been conveniently utilised by different schools of thought, to support their respective view points and ideologies. As a result of very tense debates in the post 1994 period, this concept has been unfairly reduced to price flexibility, in particular wage flexibility. This has attracted a lot of unhappiness and discomfort from the labour union fraternity, and rightly so. But very few alternatives have emerged in the domestic discord.

However, the purest understanding of flexibility has to do with all variables that will render the labour market functioning efficiently. That means, allowing it to adjust swiftly to economic cycles. These factors would include, among others: wages, skills, costs of transport, information symmetry, etc.

All these factors need to support the optimal functioning of the labour market. It is, therefore, inappropriate to pick on only one of them, to define flexibility. The challenge for many countries, including South Africa, is that the more structural factors are much more difficult to put in place than the price of labour. That is why the debate tends to gravitate towards the easier variable, that being the price of labour.

Judging from the tone of the Budget Review, government is extending its hand for a more open and accommodative engagement on this important subject.
Private health provisioning/expenditure is consistently higher than public sector provisioning. In the current fiscal year, private sector accounts for 53 percent of total health expenditure; This is on the back of a shortage of staff and infrastructure backlogs, despite an assertion that the system services 40 million people; and Recognition that NHI cannot be implemented successfully without a sound and reliable health delivery capacity. At this stage, there does not seem to be a particular health insurance design, however, characteristics of the imminent model will be South African unique. This means, affordability, sustainability, recognising the role of the private sector through decentralisation of delivery as well as the incorporation of risk equalisation to improve the fairness of coverage – within a 10 point plan as proposed by the Minister of Health.

UIF

To improve the efficacy of the UIF:

○ Be involved in labour market interventions, such as the training layoff scheme agreed last year, as a response to the economic slowdown;

○ Improve and extend the benefits structure, to achieve, among other things, increasing the replacement ratio; and

○ Consider the extension of the system to cover public servants.

Conclusion

The lesson for South Africa, coming from the recent economic crisis, is that we need to ensure that the economy does not falter – at all costs – if we are to see a successful reform. Here we envision a reform that comes with more growth, more jobs as well as significant and sustainable real financial returns. More importantly, we need to ensure that financial stability is the bedrock of our macro- and micro-economic programmes. Underlying all this would be stable prices (low inflation), stable interest rates and a stable currency. The 2010 Budget is a significant attempt towards realising these objectives.

Proposals on a new regulation 28

The National Treasury has published for comment, the long-awaited revised Regulation 28. Finally, we can have a better sense of the principles that will guide the investment scope of retirement funds. This provides more clarity to what was an area of much speculation. Much of the proposals have been driven by the Regulators’ experience of the financial crisis.

The bulk of the proposals are pretty much welcome. Key features of the draft are:

○ Expanding the coverage of Regulation 28 as well as the introduction of new instruments, not previously covered;

○ Reconciling definitions with other pieces of legislation;

○ Subject member choice to Regulation 28;

○ Annuities are now brought into the ambit of Regulation 28;

○ Credit rating agencies now to be monitored under Regulation 28, with the Registrar responsible for determining which agencies may issue credit ratings, as well as defining credit risk bands;

○ Credit rating agencies are now to be monitored under Regulation 28, with the Registrar responsible for determining which agencies may issue credit ratings, as well as defining credit risk bands;

○ Introduction of Islamic compliant instruments;

○ Provide clarity on borrowing by increasing foreign exposure to 20 percent, to be in line with exchange control regulations, as well as allowing for an additional five percent for exposure into Africa;

○ Allowing for securities lending, to create an additional income-generating avenue for funds;

○ Permitting investments into derivatives, however, not for gearing and leverage;

○ Introducing the look-through principle for calculating exposures; and

○ Giving the Registrar the latitude to exempt a fund from any of the provisions of the regulation, subject to certain conditions.

FA News:

Time for innovation

Does the pension fund concept fit in with the expectations of the majority of our countries’ working population? We are applying First World pension constructions and retirement ages to an African problem. Time for some innovation?

When it comes to the notion of the pension fund, if we don’t address this from a developing world perspective, it will forever be regarded as a developed world concept. The fact is that at the end of the day, we all retire. On retirement we have, regardless of whether we are part of the First World or the developing world, the same needs facing us, with exactly the same timing. These are predominantly the need to live comfortably and access to decent healthcare and adequate supplies of food and clothing at
The economic, social and demographic situation in South Africa may present an obstacle for retirement reform, however South Africa's institutional and regulatory regime compares to some of the best in the world. Much larger unemployment problem, being almost three times that.

Any way you look at it, South Africa still has the issue of old age to consider. While we do offer old age grants as part of the social security system, taking into account the demographic structure of the country, the elderly tend to find themselves having to distribute that meagre grant across more than one mouth. This is due to the fact that upon reaching old age, pensioners typically inherit the liabilities of the youth. This is a direct result of the young in South Africa tending to bear children that they are not equipped to take care of, leading to these children having to be looked after by the elderly. Not only that, in the South African context we are also affected by the impact of HIV and AIDS. People of childbearing age often give birth to children and then die prematurely, leaving these children to be cared for and raised by the elderly. This means that the dependency ratio of the elderly in South Africa is much higher than that observed in the developed world.

The special case in South Africa

While retirement funding is a much more critical concept in South Africa than in the developed world, it is certainly a more challenging ideal to implement. This is due to a number of factors, namely: high levels of unemployment, high dependency ratios and the relatively low-income levels. This is in direct contrast to the developed world, where, despite retirement funding being less crucial, there are lower dependency ratios and higher income levels, as well as a sound functioning social security net. In addition the developed world's unemployment rate, on average, falls in the 10 percent region, at today's levels, while South Africa faces a much larger unemployment problem, being almost three times that.

The reason for this is multi-fold. Most importantly though, it is that the NHI programme has been elevated over and above all other social and economic policy considerations, owing to the political veil it has enjoyed. It is not clear to many people why that is the case. It is also not clear, how prepared we are for such an entity, mainly because not much is known about the technical rigour it has been subjected to – particularly understanding the fiscal implications side by side with South Africa's burden of disease.

While it happens everyday to have competing policies, it is rare to have competition among such significant policy matters. The
last such significant policy choice could have been that between the recapitalisation of Eskom and the arms deal, over a decade ago. The biggest source of concern among people, with respect to the current choice decision (particularly among participants in the long-term savings industry), is that this shift in focus may lead to a reduction in the importance and the impetus that had already been put behind the broader reform. This is important to them for the simple reason that the reform will be one of the most critical vehicles to the promotion of higher long-term savings in the country. In turn, this is crucial for the country’s investment and growth capacity, as well as the financial independence of households.

On the other hand, NHI will predominantly bring forth the inverse of this outcome, namely, higher consumption expenditure, overall. There is little doubt, therefore, why this policy refocus is resulting in a notable level of unease. Given the wide ripple effects it will have across the economy as well as the competition for dwindling resources, an integrated consideration of this two policy programmes is imperative.

This in no way should undermine the role health insurance has in a country. Based on empirical evidence, it may be argued that health is much more important than retirement policy because if people are not healthy, there is no point in talking about retirement. Poor health would reduce the likelihood of even getting close to that ideal point of retirement. While that may be true, it is not the case that health is the single most important imbalance in an economy.

It has to be considered in tandem with other policy challenges. As given by this definition of social security, “…an institutional arrangement, driven by the state to secure the welfare of members of society through securing a certain amount of minimum income/standard of living, during their productive years and in retirement. It is a system that prevents destitution in the case of members of society faced with incapacity and unemployment. It is a highly distributive institution that relies on the principle of solidarity among the income capable and the less income capable…” Health ought to be seen and treated as a subset of social security and it ought not to be dealt with in isolation of the broader social security and retirement reform.

In fact, if we consider that health dominates one’s expenditure basket in retirement, this makes a stronger case for dealing with these matters as a package. In studies that we have done, we displayed how expenditure patterns influence one’s replacement ratio. The costs of health are significant in this regard.

Linked to that is the fact that, in whichever direction we go and whichever policy we emphasise, each of these policies will attract (compete for) resources from the fiscus, and as such the taxpayer. That, to a large extent, may be the concern that people are having. It is not so much a concern that people do not appreciate the importance of health insurance. However, it has to be done within a broader context, ensuring sustainability.

In order to make sure that we achieve equity and optimality in our policy design as well as implementation, it is imperative that these considerations are undertaken as a package. It is not difficult to imagine that these processes may share platforms and human resources, for collecting contributions and distributing benefits. Further, even on design, there is a host of principle considerations that are yet to be considered in tandem. One of these is the cross-subsidisation principle expected to drive both social security and NHI. In that regard, therefore, it makes economic sense to deal with these together.

Reactions

There have been a few interesting yet distinct reactions from the private sector to proposals of the NHI rollout. One of the more interesting of reactions is one largely emerging from the health space, which predominantly sees the NHI as a new form of crowding out, likely to alter the obtaining market balance. This is despite comfort provided by the drivers of the initiative. While their concerns may seem valid, given the oligopolistic power enjoyed by health service providers, it can be argued that any system seeking to include the lowly paid and unemployed masses, as well as providing them with wider choice – can only be good for the consumer.

The first alteration of the existing balance would be to diminish the obtaining pricing power of private service providers, which has resulted in low coverage. According to the General Household Survey, coverage sits at a meagre 14 percent, which compares to 16 percent of the total population, by mid 2009. This low coverage can partly be explained by high costs of medical provisioning. In turn, a factor that underpins this state of affairs can be seen as the absence of a credible alternative to private health delivery. It can therefore, be concluded that the underlying problem is not insurance, but rather service provisioning, in particular, delivery by the public health sector. It has been argued that the under-resourcing of government institutions, in the form of skills and quality management, in a major way contributes to the current imbalance.

The perspective of the debate is that it is not insurance that people are in desperately need of but rather it is medical services. The reason that a lot of people do not have access to good medical services is because the public sector is not delivering sufficiently, which is what breeds the oligopoly power in the private space. As such, medical costs are rendered unaffordable to the sizeable number of South Africans. Instead of medical insurance, this school of thought calls for the stiff regulation of prices. However, there is a huge debate about the sustainability of this solution. This is particularly so, if we believe in and want to encourage private enterprise in the sector.

The long-term structural solution is to have an alternative health service or health delivery system that is not solely
dependent on the private sector, but one which is inclusive of both public and private sectors. Once a suitable healthcare delivery model has been identified or adopted, this will elicit an optimal pricing mechanism that can only bode well for the member or healthcare consumer, if not the public at large.

Currently if a member of society is faced with even a small ailment, such as a cold or flu, they consult a private practitioner and pay a sizeable consultation fee just for a prescription – a prescription that could also be obtained from a public environment for a much-reduced amount. However, many people simply do not have the time to wait in long queues to see a doctor so they opt to pay the more punishing private fees. According to data from Econex only 6.6 percent of people covered by medical schemes, ever visit a public health outlet. The rest of the 93.4 percent simply visit private outlets.

If government could improve service delivery it could accord people easy and yet affordable access to quality care beyond the currently dominant private medical services. That is where we need to be focusing our resources. The NHI can come in to complement the underlying intervention. It cannot be a solution in its own right.

In conclusion, it can be argued that the NHI is a necessary but insufficient intervention for the problem that we are facing as a country. Secondly, it ought to be seen as part and parcel of the broader aim of dealing with welfare, as such should form a part of a comprehensive social security plan for South Africa.

Patel’s 5% of pension funds tap for social spending – the facts

The call from the Minister of Economic Development, Ebrahim Patel, for the channelling of pension fund assets towards social investments has raised public concern over likely diminished returns for members. A recent endorsement from various quarters of this proposal has led to a dynamic debate across boards of trustees tasked with governing these funds on behalf of members. The proposal and debates are viewed with mixed feelings, which have prompted the inevitable question: Should we be concerned?

The announcement of such a proposal has raised fears that it could re-engineer the investment space, particularly given that it is now being presented as a policy plan. Whilst these fears may be understood in their own right, when considered in context the reality is different.

Ideally, this proposal needs to be viewed as the resuscitation of an old existing agreement and not a potentially harmful new initiative. The idea of targeting “5% of investable assets” is not new. It has its origins way back in the Growth and Development Summit agreement of 2003, reached among social partners at NEDLAC. The agreement, which all stakeholders agreed to and signed up for, was in response to organised labour and the SACP who, during the process of negotiating financial sector reforms (a year earlier, which culminated in the Financial Sector Summit, which in turn gave birth to the Financial Sector Charter), voiced their dissatisfaction with imbalanced investment in the economy.

This dissatisfaction led to a call for the return to the policy of prescribed assets if no other suitable alternative could be found. Despite the justifiable concerns of the SACP and organised labour, this particular solution did not augur well for both government and business stakeholders. The proposal was seen as a catalyst that would undo all the positive economic achievements recorded up until that point of time. As a result it became clear that the solution as proposed by the two social partners could not proceed and a compromise was reached with a proposal for a voluntary approach to socially responsible investment. This way, instead of government prescribing, it was agreed that a reasonable limit and definition for this type of investment be identified, while the decision as to where the investments be directed should lie with the investing entity.

The challenge

There were a number of issues that rendered this agreement challenging to implement. Firstly, it was the discord from originators of the debate over the narrow coverage, including only pension funds, which meant that trustees were responsible for the redirection of assets, to the exclusion of other social partners. The second issue facing the agreement was that the wording made it difficult to quantify and therefore monitor, with a lack of clarity surrounding...
March

Johannesburg, 4 March 2010: While the global economic crisis may have caused the mass devastation and disruption of markets worldwide, it also forced positive rethinking on economies and policies globally.

One of these is that macroeconomic stability has moved firmly back onto the global agenda. Not only that, regulatory soundness is now a major consideration for all countries, including the US. We are now in a position to take stock of the global economic crisis and take a look at the lessons we can learn from it. In particular, when it comes to South Africa’s retirement reform proposals, there are a number of important policy lessons we can learn from regarding the economic downturn. So, this cloud does have a silver lining.

One of the key conclusions that the economic downturn has highlighted is the fact that retirement and social reform cannot be successfully implemented in isolation of a sound economy. Fundamentally, the financial crisis has illustrated a need for South Africa’s policies to concentrate more on ridding the economy of structural constraints in order to promote more growth over the longer term. This should lead the way for increased focus on moral suasion for higher voluntary savings, despite the difficulty set upon us by the crisis, as well as serving as an encouragement for people less inclined towards the idea of early retirement. The urgency for dedicated social reform has moved up the scale and forced the reconsideration of early retirement.

What’s needed

The specific implications and lessons from the global situation for the reform process are considerable. Firstly, the impact is likely to lead to short-termism in policy planning. This comes down to the likelihood that, during a crisis, there tends to be an over-inflated focus on the design of policies – a short-term activity – with the focus on the longer term taking second priority. In relation to the issues we are facing as a country, particularly with regard to long-term savings shortages, I believe this is an approach that should be avoided.

Secondly, the crisis is likely to encourage a slowing down of the reform programme as the state becomes reluctant to commit to significant promises during this challenging fiscal period. It can be understood why a government may consider such a stance, having observed this happening among OECD countries, particularly in European countries. However, it ought not to be encouraged. We need to take a long-term view and ensure that our approach takes into account all likely business cycles. The longer the reform is delayed the more the country’s vulnerable citizens will be compromised. If it takes us 20 years to realise our social objectives, this is a delay keeping us 20 years away from our ideal.

It is instructive to note that this delay comes on the back of an already declining retirement contributions rate, in addition to an increasing exit rate from long-term saving, explained by the public’s current financial stress. The direct result of this state of affairs is a slump in the country’s average replacement ratio, from about 30 percent in 2008/2009. This in turn is leading to a surge in late retirees, with a 30 percent increase expected in South Africa and a 28 percent increase in the US.

We would like to believe that the world is now a wiser place. We have learnt that bank-originated crises have a deeper negative impact than non-banking crises. We have learnt that we need more flexibility in our markets to navigate a crisis effectively. This is particularly true for labour market flexibility, as this is the area directly linked with welfare of society. With such policy lessons kept at the forefront of our economic planning, South Africa has an opportunity to invest in the futures of its citizens and avoid the global mistakes of the past. All our planning should be inspired by these very lessons.