

Regulating South Africa's retirement funds: the case for clearer objectives

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ABSTRACT

The rationale for regulating financial markets rests on a combination of their considerable complexity and their critical importance to the economic players that they serve. Retirement funds are worthy of special regulatory attention because of the substantial role that they play in the lives of individuals and in society more broadly. This provides, in turn, strong rationale for the requirement that the system under which retirement funds are regulated is underpinned by a transparent, publicly-stated set of objectives. This study builds the position that the objectives underpinning the regulation of South Africa's retirement funds are stated with inadequate clarity. This reduces the transparency and potentially the effectiveness with which this regulation is undertaken. This is not helped by opaque government policy regarding the contribution of privately-managed retirement funds to broader social protection objectives. The regulatory authority nevertheless has the mandate to make a considerable difference to the effectiveness with which the interests of retirement-fund members are protected by the trustees of these funds and their service providers. Meeting this mandate could be considerably assisted by the research of actuaries and others focused on improving the outcomes achieved by the members of these funds.

KEYWORDS

Retirement funds, financial markets, regulatory objectives, social protection, government policy

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1. INTRODUCTION

1.1 Financial markets form a critical part of an economy of any size. Financial markets are fragile, however, justifying the existence of regulation to protect the participants in such markets inadequately able to protect themselves. This is particularly pertinent to retirement funding entities, substantial customers of and participants in financial markets. These entities safeguard the interests of large numbers of members who are typically not able look after their interests with the skills required of a soundly-functioning market.

1.2 The rationale for the regulation of financial markets may be clear but the role of the regulatory authorities tasked with overseeing these markets is typically not. One of the most appropriate ways to clarify this role is to expand the mandate granted to the authority by legislation into a clear set of objectives. These objectives should be focused on mitigating the potential for the market to fail in achieving its ultimate purpose, which is to bring together providers and customers in a manner that efficiently meets the needs of these customers. If the objectives could be framed around these possible failures and if they are supported by an unbiased set of measurable outcomes, the regulator would be in a sound position to demonstrate the success with which it achieves the underlying reason for its existence.

1.3 The paper describes the rationale for regulating financial markets in general and applies this to retirement funding vehicles in particular (Section 2). It explores the manner in which regulatory objectives over such marketplaces in seven countries have been defined (Section 3). It then turns to South Africa's regulatory objectives, describing the market and identifying some of the challenges of regulation (Section 4), and looks at how regulatory objectives covering the retirement fund market are defined in practice (Section 5). Recommendations for consideration (Section 6) and thoughts for further research (Section 7) follow.

1.4 Terminology can be confusing. In some parts of the world, vehicles for providing income in old age are referred to as 'pension funds.' The term in South Africa has a specific meaning that distinguishes it from alternative vehicles called 'provident funds.' The general preference in this paper is for the term 'retirement fund', but the term 'pension' is used from time to time where appropriate to a particular market or to distinguish the pension market or pension system from the entities participating in them. A distinction is made between 'regulation', the practice of drafting and passing laws, and 'supervision', the corresponding practice of ensuring that licensed entities adhere to these laws. In some instances, the overseeing entity is a supervisor and in some a regulator. Finally, the term 'policy' is used to describe the process of developing and implementing the underlying strategic direction of government.

2. RATIONALE FOR REGULATING FINANCIAL MARKETS

The discussion that follows establishes the rationale for regulating financial markets and then applies this rationale to retirement funds, which play a substantial role in and alongside these markets. The section closes with consideration of the benefits to this regulatory process of a set of transparently-stated objectives.

2.1 The nature and significance of financial markets

2.1.1 Financial markets play an enormously important role in supporting the interactions of participants in economies of all sizes, from remote communities to the global village. Robert Merton describes the fundamental role of these markets as “to facilitate the allocation and deployment of economic resources, both spatially and temporally, in an uncertain environment” (Merton, 1995:23). The interactions between these participants are numerous, widespread and diverse. They include, to name a few, compensation for physical goods or for services, the pricing, pooling and management of risk, and the transfer of consumption over time (Fohlin, 2014; Merton, 1995; OECD, 2010; World Bank, 2012), the last of which is particularly relevant to pension saving.

2.1.2 Markets have become highly complex. For example, they are characterised by an enormous diversity of participants: banks, non-bank deposit-takers, insurers, credit institutions, foreign-exchange merchants of various types, stock- and bond exchanges, custodians, providers of payment services and derivative providers of various types (ECB, 2012; CFRNZ, undated; Merton, 1995; Tagoe, 2016). Many of these entities participate in some way in pension markets, creating complex chains of service. With increasing integration and globalisation (OECD, 2010) come signs of elevated complexity (Erskine, 2014).

2.1.3 Retirement funds, critical elements of a broader system of old-age provision, both participate in and utilise financial markets. Income security in old age depends on two types of operation: a process of deferred consumption and a mechanism for insurance (Barr & Diamond, 2006). Both of these services are available through financial markets. Both operate imperfectly, as discussed in Section 2.2, failing to meet customer needs with precision at the best of times and occasionally collapsing spectacularly, leaving large numbers of participants devastated. To the international example of the 2008–09 financial crash may be added isolated but surely more pertinent South African examples of Fedsure, Fidentia, Steinhoff and VBS, all of them market failures with significant and widespread consequences.

2.2 Financial market failure and the role of regulation

2.2.1 As critical as they are to the operation of the global economy and all of its component parts, financial markets exhibit remarkable fragility, much like a growing pile of sand.¹ While the global financial crisis of 2008–09 may provide the most recent significant

1 Halland, D (2012). ‘Complexity Theory, Sand Piles and Financial Crises, Casey Research, 24 Feb 2012, [www.financialsense.com/contributors/dav`id-galland/complexity-theory-sand-piles-financial-crises](http://www.financialsense.com/contributors/dav`id-galland/complexity-theory-sand-piles-financial-crises); Lazaroff, P (2017). ‘Thinking About Markets Like Piles of Sand’, Peter Lazaroff, 11 September, <https://peterlazaroff.com/thinking-about-markets-like-piles-of-sand/>, Mauldin, J (2018). ‘The Growing

global evidence of this fragility, it was by no means a unique event (Reinhart & Rogoff, 2008 and 2011). It is clear from a walk through the pages of economic history that the damage caused by the failure of financial markets, intractably unquantifiable (Coates, 2015; Cochrane, 2014; Posner & Weyl, 2013b) is not only frequently severe but often extends well beyond the participants of those markets themselves.

2.2.2 While economists appear at odds on how to classify these failures, or what to call them (Brunnermeier et al., 2009; CFRNZ, undated; De la Dehesa, 2010; FCA, 2013; OECD, 2010; Parker, 2002), it is clear that markets do not always deliver what their participants expect of them. Perhaps the most significant of market failures are those that cause widespread damage not only to market participants but, through what are known as spillovers or externalities, to the wider economy (Brunnermeier et al., 2009; Carvajal et al., 2009; IMF, 2013, 2014a and 2018; Grochulski & Morrison, 2014; refer to the South African examples cited in § 2.1.3).

2.2.3 Spectacular as those might be, perhaps they are less dangerous than the veiled market distortions that undermine the effectiveness of financial markets. The impacts of these distortions, which include information inequity (Healy & Palepu, 2001; Barr & Diamond, 2006), market-power imbalances (Khwaja & Mian, 2011) and principal-agency conflict (CFRNZ, undated; Laffont & Martimort, 2002; NTSA, 2012a and 2013a) can also have significant adverse impacts on participants, often those in the poorest position to defend against these impacts.²

2.2.4 This propensity for distortions in financial markets and the potentially damaging impacts of widespread failure are typically utilised as the rationale for regulation of these markets (Falkena et al., 2001; Llewellyn, 1999; OECD, 2010; NTSA, 2011a; Schwarcz, 2019). Such a basis for regulation may be logical, but it is also risky, for it requires a sound understanding of the manner in which markets fail and confidence that intervention in the operation of these markets has a meaningful prospect of success (OECD, 2010). This is complicated by the difficulties of determining whether the benefits of such intervention indeed exceed the cost³ and by the very real problem that regulation itself can contribute to the problems that it seeks to solve (Acharya et al., 2011; Australian Government, 2014; Bisias et al., 2012; Cochrane, 2014; Falkena et al., 2001; FCA, 2013; Gillingham and Sweeney, 2010;

Economic Sandpile', Mauldin Economics, 31 August 2018, <https://www.mauldineconomics.com/frontlinethoughts/the-growing-economic-sandpile>; Ritchey, B (2017), 'Sand Piles and Markets', K2 Advisors, 20 April 2017, <https://us.beyondbullsandbears.com/2017/04/20/sand-piles-and-markets/>, all accessed 2 June 2020

2 This paper asks questions, for example, of the dramatic shift of retirement saving in South Africa from arrangements of the defined benefit type to those structured on a defined contribution framework. The broad inability of members of these funds to manage the risk that has been passed on to them may be considered a type of market failure, particularly in the context of the rent seeking by various entities that this facilitates.

3 A wide range of publications are available to readers interested in regulatory impact assessment and its tricky application to financial-sector regulation (Adelle et al., 2015 and 2016; Arthur & Booth, 2010; Bartlett, 2014; BDI, 2016; Coates, 2015; Cochrane, 2014; Gordon, 2014; OECD, 2009a; Parker, 2002; Posner & Weyl, 2013a and 2015; Radaelli, 2005; Revesz, 2016; Rose & Walker, 2013; Sunstein, 2015; Zilgavis, 2014).

Parker, 2002; Whitehead, 2012; Winston, 2006) or introduce moral hazard into markets (Kim, 2011; Ötoker-Robe et al., 2011).

2.2.5 The rationale for regulating financial markets rests, in summary, on the combination of their importance to society and their considerable complexity. Both of these contribute to their potential to cause great harm not only to market participants but to households and other economic units well outside of the directly-affected markets. Regulation itself, finally, may contribute to the potential for market failure.

2.3 Application to retirement funds

2.3.1 Retirement fund vehicles are worthy of special regulatory attention, for a number of reasons. These are considered in turn in the discussion that follows.

2.3.2 Retirement funds utilise financial markets and participate in them to an enormous extent. Despite falling in value over the course of the year, global assets in retirement funds at the end of 2018 amounted to well over USD40 000 billion in value (OECD, 2019; Thinking Ahead Institute, 2020⁴). This amounts to a substantial proportion of global Gross Domestic Product (GDP), depending on how it is defined, but over half on some measures.⁵ Retirement funds are, individually and collectively, the largest customers of the entities, insurers, asset managers, advisors and custodians, for example, operating in financial markets. They also have substantial potential to influence, for better or for worse, the operation of these markets.

2.3.3 The existence of these funds generates income for a substantial community of providers operating both within and alongside these financial markets. The need to buy, sell and invest the assets of retirement funds occupies substantial resources, yet this is only a part of the operation of a retirement funding arrangement.⁶ As key customers of the entities operating along this value chain, retirement funds have the power to define the characteristics of a substantial ecosystem.

2.3.4 Their allocation of assets can make a substantial difference to the nature of the economies within which they are located. The impacts of retirement funds on the economies that they support are widely debated (Apilado, 1972; Davis & Hu, 2008; Holzmann, 1997; Impavido et al., 2003; Moleko, 2019; Stewart et al., 2017; Thomas & Spataro, 2016;

4 The OECD (2019) cites end-2018 assets of USD44 100 billion across a set of 88 countries. The Thinking Ahead Institute (2020) gives a figure of USD46 734 billion for 22 markets at the end of 2019 and estimates an additional USD3 000 to USD4 000 billion outside of these countries. Assets are not evenly spread. Some 92% of the assets in the 22 jurisdictions studied by the Thinking Ahead Institution (2020) are limited to only seven of these and 62% of these assets are in the United States.

5 The Thinking Ahead Institute (2020) estimates that end-2019 assets for the 22 countries included amount to 68.8% of the corresponding total GDP of these countries, but rough estimates of global GDP appear to vary from USD86 000 to USD126 000 billion depending on whether purchasing power parity is taken into account (World Bank data, <https://data.worldbank.org/indicator/NY.GDP.MKTP.CD>, accessed 4 June 2020).

6 Price (2018) describes the stages of the pension value chain as including membership and payment channels, recordkeeping and accounting management, governance and the investment of assets, the management of assets and the pay-out phase. He draws a connection between the length of the value chain and the ultimate costs to members and other sponsors.

Vittas, 1998). With the size of the investable assets in mind, however, there is little argument that they indeed have an impact. Retirement funds are in a position to define or at least substantially influence the characteristics of the capital markets of a country.

2.3.5 Retirement funds provide a vital contribution to government policy on social protection, government effectively outsourcing part of its social responsibility to the private sector (Benish et al., 2017; Kalusopa et al., 2012; NPCSA, 2012; NTSA, 2007; CoISA, 2002; Stewart & Yermo, 2009; World Bank, 2001). The policy framework for retirement funds often has objectives beyond the deferred consumption and insurance mentioned in Section 2.1.3. Government typically, in addition, seeks a contribution to the objectives of poverty relief and income redistribution (Barr & Diamond, 2006) and may also be looking for other benefits like development and economic growth. The attitude of policymakers to retirement funds is strongly defined by the extent to which these funds contribute to or detract from the policy of government regarding social protection.

2.3.6 They typically attract a considerable share of government expenditure (more precisely, income foregone) in the form of tax incentives of various kinds (Cymrot, 1980; Disney et al., 2010; OECD, 2018; Saez, 2009; Van Soest & Vonkova, 2014). This means that the government, that is the taxpayers, of a country have a financial interest in the effectiveness of retirement funds and the extent to which they meet stated or perceived objectives.⁷

2.3.7 Retirement fund membership often includes a high proportion of the working- and elderly residents of a country. In some jurisdictions, close to all of the working age population is covered in funded, private retirement plans but, across countries, levels of coverage vary significantly (OECD, 2019).⁸ Furthermore, membership of a retirement arrangement does not necessarily translate into consistent contributions and a prosperous retirement.⁹ Notwithstanding the challenges of promoting and maintaining participation in these entities, it is clear that the citizens of a country also have a substantial stake in the effective operation of its retirement funds.

2.3.8 Retirement funds play a significant role in labour dynamics and employment practices, representing deferred income to workers, typically more effectively and efficiently provided than would be possible by the workers on their own.

2.3.9 This list builds on earlier arguments underpinning the need for sound regulation of financial markets. Not only are these markets of critical importance to the effective functioning of the economy, yet enormously complex and prone to fragility, but retirement funds play a substantial role in and alongside these markets. What the list aims to emphasise, however, is the complexity of the policy framework within which this

7 The point should be completed by acknowledging that the expenditure through tax incentives is offset, at least partly, by social grants not paid by virtue of the private provision for retirement.

8 Patchy coverage of private-sector workers characterises South Africa's retirement funds as well (NTSA, 2013b).

9 This is evident from the experience of Chile. High membership of pension arrangements is not equivalent to consistent contributions and widespread prosperity in retirement (Arenas de Mesa et al., 2001; Iglesias-Palau, 2009; Mesa-Lago and Bertranou, 2016; Sojo, 2014). The same conclusions have frequently drawn upon observation of the South African system (DSDSA, 2006; NTSA, 2012b)

critical market finds itself. This complexity renders the role of the authority responsible for supervising retirement funds significantly more difficult to describe, let alone summarise into a concise set of objectives.

2.4 The benefit of regulatory objectives

2.4.1 The discussion that follows considers why it might be considered appropriate to regulate on the basis of a set of stated objectives. The three reasons proposed are: objectives promote accountability, they provide the benchmark against which progress may be assessed, and they establish the rationale for regulatory intervention in the market.

2.4.2 Public, transparent accountability is critical to the effectiveness of governance in a democratic framework (Brandsma & Schillemans, 2012; Gyong, 2011; Sarker, 2009). Accountability by government for its actions is best underpinned by a pre-defined set of objectives (CFRNZ, undated) supported by an objective set of measurable outcomes (OECD, 2010). Poor perceptions of transparency in South Africa are well known.¹⁰ A commitment to policy accountability is nevertheless evident in a number of the explanatory papers that policymakers have issued over the last few years.¹¹ South Africa has also been consistently rated among the top few in the openness of its budgeting process.¹² If objectives are to promote transparency, they need to be clearly stated and supported by measurable outcomes. Reporting on these outcomes and the responses to them would also need to be an established part of regulatory practice (see the next paragraph).

2.4.3 Objectives provide the means to track progress. It is typically straightforward for an observer to provide evidence of failure by a regulator but much more difficult to provide the corresponding evidence for success. Tangible objectives help. While the laws that establish and empower regulatory authorities, along with the laws that these regulators enforce, may include objectives, these are typically written at a rather high level, making it difficult to provide evidence of success (Black, 2012). For regulatory objectives to provide the means to monitor progress, therefore, regulatory or supervisory authorities should translate these high-level objectives into more tangible goals, supported by a set of measurable outcomes

10 South Africa's score on perceptions of transparency, at 44, puts it in position 70 out of 180 rated countries, according to the 2019 rating by Transparency International (<https://www.transparency.org/en/cpi/2019/results/table>, accessed on 8 June 2020).

11 Examples include papers on the development of regulatory policy (NTSA, 2011b) and structure (NTSA, 2013c), explanatory material concerning legislation under consideration by Parliament (NTSA, 2011a and 2014a), a review of South Africa's financial markets (NTSA, 2018), early thinking regarding market-conduct supervision (Feasibility, 2010), along with the plan for roll-out (FSB, 2011), a comprehensive discussion paper regarding the distribution of financial products (FSB, 2014) and subsequent updates (FSB, 2015a and 2016a) and the intended roll-out of risk-based supervision (FSB, 2010), which also was supported by a number of updates (FSB, 2012, 2015b and 2017b).

12 Fin24, 2018: <https://www.news24.com/fin24/Economy/sa-wins-high-score-for-budget-transparency-survey-20180201>, and CNBC Africa, 2020: <https://www.cnbc.com/news/2020/05/04/sa-takes-first-place-in-2019-open-budget-index-survey/#:~:text=The%20global%20average%20transparency%20score,is%2014%20out%20of%20100.&text=The%20OBI%20survey%20provides%20a%20comprehensive%20review%20of%20South%20Africa's%20budget%20process,both%20accessed%20on%208%20June%202020>, both accessed on 8 June 2020.

(Knot, 2014; Baldwin & Black, 2016),¹³ not easy in the context of retirement funding (see Section 4.3).

2.4.4 Describing the objectives underpinning a regulatory initiative, along with measures for assessing the extent to which these objectives are met, helps to support the stated rationale for regulatory intervention. In order to be effective and credible, the objectives should achieve one or both of two criteria. They should mitigate the risk of specified market failures (OECD, 2010; NTSA, 2011a; Cochrane, 2014). They should aim to achieve a set of outcomes that are socially or economically desirable and consistent with government policy (OECD, 2010). The comprehensive policy- and discussion papers issued by South Africa's policymakers (Feasibility, 2010; FSB, 2010 and 2014; NTSA, 2011b and 2013c) aim to achieve these goals.

3. SUPERVISORY OBJECTIVES IN OTHER JURISDICTIONS

In the discussion that follows, the publicly-stated objectives of the respective regulatory authorities overseeing retirement funds in a number of countries is presented. The sample includes three advanced retirement funding markets in developed economies, two emerging Latin American systems and two African markets. Country descriptions are drawn from the OECD (2019) supported by the analytical content in another OECD (2009b) source.

3.1 Australia

3.1.1 In Australia, retirement arrangements, which are referred to as superannuation funds, are dominated by defined contribution schemes, which had accumulated assets by 2018 of over 140% of national GDP. Superannuation funds are overseen (IOPS, 2019) by the Australian Prudential Regulation Authority (APRA), which expresses its regulatory goals in a publication dedicated to the purpose (APRA, 2019a). Notwithstanding a system highly rated by international observers (ACFS & Mercer, 2017), Australia's retirement framework is imperfect in a number of ways. Beset by the highly-publicised consequences of skewed incentives (Australian Government, 2014), it has also been criticised for inadequately providing explicitly for income in retirement (Asher, 2018 and 2020; Asher et al., 2017).

3.1.2 The authority states its key objectives as the financial security of the entities under its remit and the stability of the financial system as a whole. It recognises four second-tier considerations—efficiency, competition, contestability and competitive neutrality—that typically reinforce each other but sometimes conflict with one another (APRA, 2019a).

3.1.3 APRA expands on its objectives by preparing and releasing, every year, a corporate plan that extends four years into the future (APRA, 2019b). This identifies focal areas for the near future and establishes a number of performance measures through which it seeks to achieve its objectives. Each year, it reports progress in meeting its strategic objectives within the constraints of these measures (APRA, 2019c).

13 The South African Reserve Bank, for example, places heavy emphasis, in its reports, on the evidence available to demonstrate the extent to which it has met the objectives that it has set for itself (SARB, 2017).

3.1.4 Reforms are underway that aim to improve on the outcomes to members. Among the changes legislated in 2019 and being implemented in 2020 is the requirement on trustees to develop and approve strategic objectives towards the achievement of a set of targeted member outcomes (IOPS, 2019). APRA also reports annually the results of a survey of stakeholder views (APRA, 2019c).

3.1.5 In summary, while the system is by no means perfect, the Australian regulator of retirement funds has established comprehensive objectives with a well-defined set of supporting measures and a strategic approach to its priorities that are reviewed every year. It utilises a detailed reporting framework to describe its progress. This framework includes a full assessment of stakeholder views. APRA also demonstrates a willingness to involve itself in the process of addressing flawed market dynamics in the interest of improved member outcomes. It will be interesting to see what types of actions are taken to support the focus on member outcomes and to address imperfect incentives, particularly in retail markets.

3.2 United Kingdom

3.2.1 Pension schemes in the United Kingdom form part of a complex public-private system of old-age provision (OECD, 2015). Private-sector arrangements consist of both defined benefit and defined contribution arrangements, tilting over the last number of years towards the latter (Baker & Adams, 2019). Total assets in funded private-sector arrangements in 2018 amounted to just under 105% of GDP. The Pensions Regulator (TPR) is responsible for overseeing what it calls workplace pensions in the United Kingdom.

3.2.2 TPR works under six statutory objectives, which it expands into four outcomes and eight outcome indicators. The outcomes are expressed in terms of participation levels, the protection of members, accountability of regulated entities and public confidence in the system. Every year it reviews its plans, resolving six corporate priorities and 18 key performance indicators (TPR, 2019a), three indicators to each priority. The annual report of the TPR sets out a thorough assessment of progress against its performance indicators (TPR, 2019b).

3.2.3 The priorities most recently expressed are as follows (TPR, 2019a: 17–22, paraphrased):

- extending regulatory reach with a wider range of proactive and targeted regulatory interventions,
- promoting and enforcing high standards of trusteeship, governance and administration,
- ensuring that defined benefit schemes are properly funded,¹⁴

¹⁴ This is evidently proving difficult. A Parliamentary briefing (Thurley, 2020) reports that “almost all [defined benefit] schemes currently have a funding deficit” (page 6) but that the situation is not irretrievable as “many employers could clear their pension deficit if required” (page 6). PWC reports (2019) that some 80% of schemes sampled were in deficit. See also UKDWP (2017), more detailed but a little dated.

- ensuring, through automatic enrolment, that staff have the opportunity to save into a qualifying workplace pension,
- enabling pension schemes to deliver promised benefits to members notwithstanding significant environmental changes, including Brexit, and
- building a regulator capable of meeting future challenges.

3.2.4 The performance indicators pertinent to the second of these priorities, by way of example, are expressed as follows (TPR, 2019a: 26, quoted):

- Schemes have provided their scheme returns to us in line with requirements.
- We will establish our content strategy and framework for all our publications.
- We will support development of and design our approach to deliver the required data standards for the pensions dashboards.

3.2.5 On its website TPR prominently sets out five areas of responsibility¹⁵ and backs this up with the six priorities for the period 2019–2022, which it describes in more detail in its corporate plan (TPR, 2019a). The five areas of responsibility include ensuring employer remit of contributions, protecting the savings of members, improving the manner in which pension arrangements are run, reducing the risk of these funds failing and ensuring that employers balance the needs of their defined benefit pensions scheme with the goal of growing their business.¹⁶

3.2.6 Like its Australian counterpart, the United Kingdom pension system is not perfect. Limits exist, for example, to the extent to which the regulator can address underfunding of defined benefit arrangements. The Pension Regulator nevertheless has established objectives that are ambitious and far-reaching. This is supported by a detailed and transparent methodology for tracking progress.

3.3 Netherlands

3.3.1 The pension system of the Netherlands is substantial, arranged largely to cover the workers of entire industries, and quasi-mandatory in the sense that membership is a condition of employment in these industries (Hassel et al., 2019). It nevertheless includes as well a few hundred single-employer arrangements and many insurer-operated schemes (Beetsma et al., 2015; Broeders & Ponds, 2012). Individual saving is also possible.¹⁷ The system is dominated by defined benefit plans, though these schemes have been changing over the last few years under funding pressure and concerns over sustainability (Beetsma et al., 2015; Bovenberg & Gradus, 2015; Broeders & Ponds, 2012), in the process reducing some

15 <https://www.thepensionsregulator.gov.uk/en/about-us/what-tpr-does-and-who-we-are>, accessed 15 June 2020.

16 TPR also lists all contracts awarded, sending older versions of these lists to the National Archive, an indication of its commitment to good governance.

17 De Nederlandsche Bank, <https://www.dnb.nl/en/about-dnb/dnb-pension-system/index.jsp>, website accessed 18 June 2020.

elements of the solidarity characteristic of defined benefit arrangements (De Deken, 2018). One of the largest pension systems in the world, assets in 2018 amounted to 173% of GDP, having reached 184% the year before.

3.3.2 The system is overseen by a directorate at the central bank, De Nederlandsche Bank (DNB), supported by a number of cross-cutting specialised units at the same institution (IOPS, 2012a). The DNB does not appear to disclose the objectives underpinning its regulatory process. An impressive annual report (DNB, 2019) includes a special discussion on reforming the pension system but does not set out regulatory objectives in a systematic manner. The supervisory strategy for 2018–2022 (DNB, undated) focuses on the priorities of responding to technological innovation, fostering a forward-looking and sustainable sector and taking a hard stance on financial and economic crime, but also does not include a systematic approach to regulatory objectives.

3.4 Chile

3.4.1 Chile famously led the way in converting a large part of its liability to citizens under public retirement arrangements into a mandatory system of individual accounts established on a defined contribution basis (OECD, 1997; Queisser, 1998; World Bank, 1994). Assets in Chile's individual accounts exceeded 70% of GDP in 2017 and 2018, but the system has not been without its challenges, particularly in achieving acceptable levels of coverage and of active participation (Rofman, 2005; Rofman & Oliveri, 2012). A number of reforms have followed to improve the redistributive effectiveness of the underlying social security system, without materially affecting the individual-accounts framework (OECD, 2013; Robles Farías, 2013).

3.4.2 The pensions superintendent (La Superintendencia de Pensiones, SP) has been responsible for overseeing the (relatively few) entities registered to manage pension savings under the individual-account system since 2008, when it replaced the original superintendent.¹⁸ The nature of oversight in Chile is quite different to the corresponding approach in countries, like South Africa and the UK, in which large numbers of retirement entities are regulated. In Chile, as in other countries with mandatory individual-account systems, a proactive approach is used. Few entities are licensed but they are regulated pre-emptively and intensively, in a way more akin to banking supervision (Rocha et al., 1999). It is suggested in this paper (§ 6.5.4) that some parts of the South African retirement fund market may benefit from this type of approach.

3.4.3 The SP describes its mission¹⁹ as improving the quality of lives of the population by:

- safeguarding the interests of users of the system,
- ensuring regulatory compliance by the entities that it oversees,

¹⁸ Material in this paragraph is drawn directly from the SP website, <https://www.spensiones.cl/portal/institucional/594/w3-propertyvalue-5990.html>, accessed on 15 June 2020.

¹⁹ Both lists that follow are paraphrased from SP material, using author translation from the Spanish.

- proposing continuous improvements, and
- advising and educating the population.

3.4.4 It expands this into a set of four strategic objectives, which it states as:

- developing an organisation that delivers quality care to the users of the system,
- contributing to the process of perfecting the pension system by subjecting regulated entities to enhanced standards of oversight,
- improving the quality of decisions taken by users by providing clear and timely information along with education on social security topics, and
- contributing to effective operation of the system by generating sound and reliable information.

3.4.5 The SP publishes a formal description of priorities to its line ministry (SPC, 2019a). This includes a report along the lines of a number of strategic objectives that do not appear to coincide precisely with those described on the SP website (see previous paragraph). It also provides a summary of strategic intent for the period 2019–2022. In addition, the SP publishes annual summaries, written for broader public consumption (SPC, 2018 and 2019b). These do not include performance against objectives but provide benchmarks against what the SP terms ‘measures of efficiency’ and includes feedback on customer satisfaction.

3.4.6 The SP is an influential organisation, as was its predecessor (see the book, SAFP, 2003, for example), in Chile and beyond, presiding over an important and world-leading marketplace. Its objectives are clearly expressed and ambitious, but limited to the operation of the market over which it presides. It does not venture into wider policy areas like expanding levels of participation in pension markets.

3.5 Mexico

3.5.1 Mexico launched a mandatory individual-account system, similar to its Chilean counterpart in 1997, following an initial attempt in 1992 (Grandolini & Cerda, 1998; Queisser, 1998; Sales-Sarrapy et al., 1998). Assets forming part of the privately-managed system are relatively small, amounting in 2018 and for the four years before that to between 16% and 17% of GDP. The pension fund management companies, as in Chile relatively few in number, are overseen by the regulatory authority, CONSAR (Comisión Nacional del Sistema de Ahorro para el Retiro, the national commission of the system of savings for retirement).

3.5.2 CONSAR does not appear to have adopted a set of supervisory objectives. It has developed a statement of its vision, however, in which it accepts responsibility:

- for guaranteeing adequate administration of saving for retirement,
- for contributing to the development of financial markets, and
- for promoting a retirement culture.

3.5.3 This amounts essentially to a set of objectives. These are supported by a mission statement in which it defines its responsibilities as protecting the retirement savings

of workers and developing a competitive environment to the end of adequate pensions for workers (IOPS, 2012b). An annual report does not appear to be available.

3.5.4 In summary, CONSAR indeed sets objectives, but at a relatively high level. It appears to have some way to go to translating these into measurable outcomes and to reporting its progress in achieving these outcomes.

3.6 Kenya

3.6.1 Kenya has an unfunded Civil Service Scheme, a funded National Social Security Fund, occupational schemes, both defined benefit and defined contribution, and individual schemes available to members of the public (IOPS, 2012c). The assets in privately-managed arrangements amounted in 2018 to some USD11.5 billion, approximately 13% of GDP. All funded arrangements (IOPS, 2012c) are regulated by the Retirement Benefits Authority (RBA), whose mandate includes expansion of pension saving to the informal sector (Kwena & Turner, 2013).²⁰

3.6.2 The RBA describes its mandate in broad terms as protecting the interests of members and sponsors of the retirement benefits sector, and regulating and supervising retirement benefit schemes. It also states itself as responsible for:

- promoting the development of the sector,
- advising the policymaker on national policy pertinent to retirement benefits, and
- implementing all government policies concerning the industry.²¹

3.6.3 The RBA continues this bold and broad approach in its statements of objectives, articulating its overarching goal as “achieving 30% pension coverage with an asset base of 2.4 trillion Kenyan shillings by 2024.” (RBA website)²²

3.6.4 The RBA discloses clear objectives in its strategic plan for the period 2019–2024 (RBAK, 2019). It sets out three strategic themes of establishing operational excellence, formulating and overseeing a strong policy- and regulatory framework and enhancing coverage in the informal sector. These are translated into a set of strategic objectives, which are described as improving or enhancing (paraphrased from RBAK, 2019: xi):

- access to the services of the RBA,
- governance of the retirement benefits sector,
- customer experience,
- confidence in the retirement benefits sector,

20 Government recently announced the launch of a contributory fund for public-sector workers in an effort to reduce the growing financial pressure on government in respect of its obligations to retirees (Source: Reuters, [https://af.reuters.com/article/kenyaNews/idAFL8N2F75OJ#:~:text=Faced%20with%20pensions%20time%20bomb%2C%20Kenya%20asks%20government%20workers%20to%20pay%20up,-2%20Min%20Read&text=NAIROBI%2C%20Aug%205%20\(Reuters\),finances%20from%20growing%20retirement%20obligations.,](https://af.reuters.com/article/kenyaNews/idAFL8N2F75OJ#:~:text=Faced%20with%20pensions%20time%20bomb%2C%20Kenya%20asks%20government%20workers%20to%20pay%20up,-2%20Min%20Read&text=NAIROBI%2C%20Aug%205%20(Reuters),finances%20from%20growing%20retirement%20obligations.,) accessed 11 August 2020.)

21 RBA website, <https://www.rba.go.ke/our-mandate/>, accessed 16 June 2020.

22 RBA website, <https://www.rba.go.ke/vision-mission-core-values/>, accessed 16 June 2020. The amount cited is approximately equivalent to R383 billion or approximately one quarter of 2019 GDP.

- pension coverage among both formal- and informal-sector workers,
- the asset base of Kenyan pension funds, and
- the contribution of the retirement benefits sector to the so-called 'Big 4 agenda.'

3.6.5 The Big 4 agenda forms part of Kenya Vision 2030, the so-called Medium-Term Plan III, prioritising affordable housing, universal healthcare, food security and manufacturing (RBAK, 2019; NTPK, 2018). The purpose of the focus on pension saving, notwithstanding its location outside of these four themes, is to assist in financing investment in these national priorities.

3.6.6 The RBA strategic plan also includes descriptions of the stakeholders of the RBA, the key risks that it faces and appetite for each of these risks, and the monitoring and evaluation framework of the authority. The front page of the document makes clear its focus on integrating informal-sector workers into the retirement saving framework. The annual report of the regulator (RBAK, 2018) mentions the strategic intentions of the authority, but does not expand on progress over the year under review.

3.6.7 The RBA appears to have taken an extraordinarily ambitious approach to its responsibility. Not content with regulating the market and supervising participating entities, it expresses itself intent on influencing government policy and expanding retirement saving by residents, even those working in the informal economy. It appears to have strong support from policymakers for the pursuit of this broad set of objectives. Yet to be seen is how transparently it reports its progress against these goals.

3.7 Nigeria

3.7.1 Nigeria established a mandatory defined contribution arrangement in 2004, replacing the deeply troubled defined benefit scheme that preceded it (Binuomoyo, 2010; Fapuhunda, 2013; Idowu & Olanike, 2010; Ubhenin, 2013). The individual account system is overseen by a dedicated regulator, the National Pension Commission (Pencom).

3.7.2 Rapid growth of the industry brought assets under management to approximately 6.7% of GDP in 2018, up from 2.8% in 2008. It appears nevertheless that improvements could be made to the system of governance and to efforts to cover informal-economy workers (Idowu & Olanike, 2010; Ubhenin, 2013). Questions have also been asked about the quality of the administrative infrastructure across the industry (Fapuhunda, 2013) and the effectiveness with which the arrangement improves the welfare of its participants (Idowu & Olanike, 2010).

3.7.3 Pencom reports that efforts to expand coverage were supported by the Pension Reform Act in 2014, which expanded coverage of the scheme to the self-employed and to micro-enterprises. It states that this forms part of strategic efforts to raise participation in the scheme to 30% of the working population by 2024.²³ The Pencom statement of mission focuses on the benefits of sound regulation to workers covered under the system, but the

23 Pencom website, <https://www.pencom.gov.ng/micro-pension/>, accessed 17 June 2020.

vision states the aspiration, by 2020, for 20 million contributors and a measurable impact on the Nigerian economy.²⁴

3.7.4 Pencom states its objectives²⁵ in terms of:

- protecting member interests in the scheme,
- assisting individuals by fostering saving,
- protecting pensioners from cumbersome pension-payment processes,
- ensuring uniformity of regulations and standards for retirement benefits, and
- reducing the problem of outstanding pension liabilities.

3.7.5 These objectives present a mix of high-level aspiration concerning the size of the scheme and a determination to address pressing operational challenges. The annual report (NPCN, 2018) does not reiterate these objectives or provide information on progress made.

3.7.6 In summary, the Nigerian regulator appears to blend the wide-ranging goal of expanding the retirement industry with an acknowledgement that work is required to improve the quality of the operational infrastructure of the industry.

3.8 Concluding comments

3.8.1 What may be gathered from this brief study of the approaches taken by the authorities in seven different countries? First, a number of different approaches are evident. The meticulous methodology of the Anglo-Saxon model in the United Kingdom and Australia is echoed in the ambitious and wide-ranging strategic goals expressed in Kenya. Chile's approach is clear but a little understated. Nigeria has goals but a number of practical problems to overcome as well. The objectives of the respective authorities in the Netherlands and Mexico are not as clearly expressed as elsewhere.

3.8.2 Second, having a dedicated pension supervisor appears to be helpful to the definition of goals because they represent the entire ambition of that organisation. This is particularly clear in the United Kingdom and Kenya, and to a somewhat lesser extent in Chile. Of course, supervisory structure alone is not sufficient where practical challenges abound, as in Nigeria, but the supervisory authority in that country still makes an effort at publicly-stated objectives. Finally, the Australian instance shows that having a dedicated pensions supervisor is not a precondition for establishing and reporting on a clear set of generic objectives that are greatly relevant to the retirement funds industry.

3.8.3 Third, though an improved knowledge of the respective political economies would assist in the understanding, policy support appears to matter. The mandates of the authorities in the United Kingdom, Australia, Chile and Kenya appear to benefit from a coherent framework and adequate support from their respective policymakers in government. These nevertheless do not guarantee widespread success across the pension framework, as illustrated by shortcomings in all of these systems.

²⁴ Pencom website, <https://www.pencom.gov.ng/about-us/>, accessed 17 June 2020.

²⁵ Pencom website, <https://www.pencom.gov.ng/about-us/>, accessed 17 June 2020.

3.8.4 Finally, in practice few hindrances appear to exist to any supervisory authority, with the support of policymakers and within the constraints of its legal mandate, from adopting a strong and transparent set of objectives supported by a measurable set of outcomes.

4. THE SOUTH AFRICAN RETIREMENT FUND MARKET

Section 2 aims to establish the rationale for regulating financial markets with the support of transparently-stated objectives and Section 3 reflects on the approaches taken in seven different markets. Section 5 considers the extent to which such objectives are used by the regulator of South Africa's retirement fund market and the manner in which this might be improved. The discussion that follows prepares for that assessment by describing this market and contextualising it within the broader policy framework of social protection.

4.1 Regulatory framework

4.1.1 Until recently, South Africa regulated its banks from the central bank, the South African Reserve Bank (SARB) and all other financial-market participants through the non-bank regulator, the Financial Services Board (FSB). Following the patterns established by a number of other countries, Australia and New Zealand for example, regulation of all financial-market entities has been split between two specialist organisations. Prudential regulation now falls to the newly-established Prudential Authority (PA), which is located at the SARB.²⁶ Market-conduct regulation is the responsibility of the Financial Sector Conduct Authority (FSCA), based at the offices of the defunct FSB and utilising some of the infrastructure established by the FSB.

4.1.2 Retirement funds fall into a special category of entities whose prudential oversight falls under the responsibility of the FSCA rather than the PA. Indications are that this may be temporary, but the strategy paper of the FSCA merely indicates the expected transitional nature of FSCA accountability for the prudential supervision of retirement funds (FSCA, 2018:28) without reporting where this process is going. The PA, in contrast, confirms that it is expected to take responsibility for the prudential oversight of retirement funds from 1 April 2021 (PASA, 2020).

4.2 The significance of South Africa's retirement funds

4.2.1 South Africa's retirement fund industry is large by any standards. The IMF (2014b) reports the total assets of South African retirement funds in 2013 at 109.9% of GDP.²⁷ The corresponding ratio reported by the OECD (2019) for 2018 is 95.1%. These percentages

26 Questions have been raised about the potential for conflicts of interest where the prudential regulator is based at the central bank, as in New Zealand (Godwin & Schmulow, 2015). The model may be preferred on cost grounds against the alternative under which another entity, separate from the central bank, is established to undertake prudential regulation, as in Australia.

27 This percentage, higher than the others cited, perhaps double counts some of those instances in which the assets of retirement funds are held by insurers in policies.

are high by international standards, particularly against other developing countries, where South Africa is amongst the highest. An OECD (2019) assessment covering 52 countries outside of the OECD puts South African privately-managed retirement assets in 2016 at second in dollar terms, behind only Brazil and, relative to GDP, first.

4.2.2 Industry statistics are available from the FSCA, which regulates retirement funds as an extension of its brief to oversee market conduct across the financial sector. The most recent available regulatory report dates back to the FSCA predecessor, the Financial Services Board (FSB), specifically to the Registrar of Pension Funds, the person legally responsible for supervising retirement funds (FSB, 2018) under the previous dispensation (see Section 4.1). As South Africa's retirement funds do not all fall under the oversight of the FSCA, gathering industry statistics can be difficult. The most recent report (FSB, 2018) is helpful in this regard, citing total assets across all fund types of R4 262 billion.²⁸ This amounts to 89.3% of the end-2017 value of GDP indicated by the South African Reserve Bank of R4 772 billion.²⁹

4.2.3 Membership of these funds is more difficult to determine with certainty. The FSB (2018) reports total membership of all funds as 16.9 million at the end of 2017. This is, at face value, impressive. It compares with an end-2017 labour force of 22.1 million and total employed of 16.2 million (StatsSA statistics).³⁰ In fact, only 11.2 million of the members are reported by the FSB as contributing to their retirement funds. Some 950 000 are pensioners³¹ and a remarkable 4.5 million are eligible for unclaimed benefits. Furthermore, it is reasonable to assume significant double-counting of these 11.2 million contributing members, particularly across the 6.3 million in privately-administered funds and 3.6 million active members of underwritten funds.

4.2.4 Concern has been expressed regarding the quality of protection provided by this system. These are not recent concerns and neither are they limited to those representing a particular ideological position. From the Taylor Committee (CoISA, 2002), the Department of Social Development (DSDSA, 2006 and 2007), the Presidency (NPCSA, 2012) and numerous papers and recommendations by National Treasury (NTSA, 2004, 2007, 2012a, 2012b, 2012c, 2013a, 2014b, 2015 and 2016, to mention a few), it is widely agreed that the system of private provision for retirement in South Africa suffers major flaws and does not, by and large, achieve its primary objective of providing effectively for the retirement needs of workers (see Section 4.3).

28 Of this total, some R1 937 billion is in privately-administered funds, R520 billion is in funds underwritten by insurers, R1 705 billion is in the Government Employees Pension Fund for public-sector employees (consistent with end-March totals published by the GEPE, 2019) and just under R100 billion is in other entities.

29 Accessed at <http://www.resbank.co.za/webindicators/SDDSDetail.aspx?DataItem=NRI6006L> on 8 June 2020.

30 Figures are from quarterly labour force surveys, available at http://www.statssa.gov.za/?page_id=1866&PPN=P0211&SCH=7622.

31 This most likely includes only pensioners registered with retirement funds, not those who purchased annuities from insurance companies to meet post-retirement income needs.

4.2.5 Preserving retirement savings is not compulsory, notwithstanding broad agreement on the principle and repeated efforts by policymakers to render it so. The outflow from retirement funds significantly exceeds the corresponding inflow.³² Despite the fact that government forgoes large amounts in tax revenue to encourage South African workers to save for retirement, they do not appear to be doing so consistently, begging the question of whether this constitutes as effective use of government resources.³³

4.2.6 The membership of retirement funds appears to be broadly healthy, but it is in fact very poor in some industry sectors and income bands (NTSA, 2013b).³⁴ Concerns have been raised about the conflicts of interest that characterise the offerings of insurers to the employees of small companies, typically bundled into multi-employer arrangements called umbrella funds. The durability of accumulated saving after retirement is also being brought into question, given the investment risks carried by members in their defined contribution arrangements and evidence of high rates of drawdown in retirement in preference to purchasing an annuity guaranteed for life (NTSA, 2012a).

4.2.7 A mixed picture emerges. On the one hand, South Africa's privately-managed retirement funds are large by any standard and have a number of important roles to play in the manner in which they invest their extensive assets. The case for sound regulation of these entities appears strong. On the other hand, for a number of reasons, the benefits of this industry are felt unevenly. These retirement funds do not appear to contribute effectively to the goal of establishing the financial security of a large proportion of South Africa's elderly. One of the questions asked by this paper is whether this failure lies at the door of the regulatory authority or elsewhere. In the discussion that follows, the broader policy within which these funds fall is considered, expanding on the existence of a number of failures in this framework.

4.3 Policy context

4.3.1 A casual glance at the assets in South Africa's retirement funds might lead to the conclusion that the country has high rates of household saving in these tax-effective vehicles. This is not the case. Gross nominal household saving amounted to 1.3% of GDP throughout 2019 (seasonally adjusted, SARB, 2020). This is marginally higher than over the previous decade, but low by international standards. The OECD cites South Africa's household saving rate at 0.26% of household disposable income in 2017, the first year since 2005 with

32 Total contributions received by privately-administered and underwritten retirement funds in 2017 amounted to R168 billion. Outflows from these funds totalled R216 billion, well in excess of what might be expected from retirements based on the demographic distribution of members. Some R78 billion was paid in resignations and terminations alone.

33 Government gave up R73 billion in tax revenue through the incentives provided on retirement saving in the 2016/17 tax year (NTSA, 2019).

34 Some 32% of workers earning below the tax threshold, 36% of workers in companies with fewer than 50 employees and 12% of workers in agriculture, domestic service or construction are members of occupational retirement funds (NTSA, 2013b: 93).

a positive value.³⁵ That figure for 2017 puts the country in position 27 out of 34 jurisdictions included, mostly industrialised countries.

4.3.2 Syden (2012) suggests that household saving has been on a downward trend since 1983 and argues that poor levels of saving in general detract from economic growth because the resources needed to contribute to economic growth must be found elsewhere, notably on international securities markets. The significant net outflow from retirement funds (see ¶4.2.4) paints a picture of decline, not growth.

4.3.3 If savings rates are low and participation in retirement funds inconsistent, one might ask why South Africa's retirement fund industry is so large by international standards. The answer lies in the design of the system of old age provision as a whole. South Africa is rare among developed or upper-middle-income developing countries in that it offers no national-level retirement savings vehicle to which contributions are mandatory or strongly encouraged.

4.3.4 This is inconsistent with both the World Bank multi-pillar model that emphasises a shared approach to old-age provision across a number of variables and the corresponding framework of the International Labour Organisation that focuses on the role of the state as primary provider of social protection (Bloom & McKinnon, 2013; Holzmann, 1998 and 2012; Holzmann et al., 2005 and 2008; ILO, 2014a, 2014b and 2017; ISSA, 2019; James, 1995; Willmore, 2000; World Bank, 1994, not including an array of country- or region-specific papers). While South Africa does provide near-universal old-age income to a large proportion of its elderly citizens (Case & Deaton, 1998; Duflo, 2003; Devereux, 2007; Guven & Leite, 2016), this is not designed to meet the needs of its low-income workers, many of whom are effectively excluded from the system of retirement saving.

4.3.5 South Africa's unusual approach to social protection for the elderly has been acknowledged and discussed by policymakers for some time (see ¶4.2.4). The primary concerns of those representing the working poor and the unemployed (see DSDSA, 2006, for example) are that the system does not work effectively to mitigate the retirement risks of those with low income or interrupted work and that redistribution to the poor implicit in the system of social grants is inadequate. Representatives of labour typically argue that it is unfair to require low-income workers to preserve accumulated saving until retirement in the absence of more effective social protection against working-age challenges. Though discussion of the retirement industry predates the 2002 Taylor Committee, it is not an exaggeration to suggest that policy on old-age provision has stood still since that time, a period of nearly two decades, subject only to minor changes.

4.3.6 Policymakers appear not to be able to agree on priorities for social protection and the potential path of reform. It is not clear where this leaves South Africa's retirement funds or the regulator overseeing them.

35 Data accessed at <https://data.oecd.org/hha/household-savings.htm> on 9 June 2020.

4.4 The challenges of retirement fund regulation

4.4.1 Before turning to examining the manner in which the FSCA establishes its priorities, consideration is given to the challenges of regulating retirement funds. These entities are marked by complexity of various forms.

4.4.2 Perhaps the most obvious of these to actuaries is the challenge of ensuring sufficient funding for those vehicles that provide benefit guarantees, such as defined benefit funds. This is a problem that requires careful attention, skill and experience, calling for judgement over demographic and financial uncertainty of exceedingly long duration and with sometimes substantial consequences (see GEPI, 2019, for example, for a sense of the scale of the decisions). Regulators in a number of jurisdictions apply sophisticated methods to determine the risks of financial difficulty or poor governance in arrangements of this type (see Hinz & Van Dam, 2008; IOPS, 2018 and OSFI, 2018, for example). Less obvious but perhaps more dangerous is the risk borne by members of defined contribution funds and the mounting evidence that these members are largely not able to manage this risk and are inadequately assisted in this respect by the trustees of these funds, a problem enlarged upon in the discussion that follows.

4.4.3 It is the contention of this study, however, that the most serious difficulty for the regulator of entities operating in pension markets is that it is not clear how retirement funds contribute to policy objectives. Consider the five criteria commonly stated for a retirement system. These are efficiency, sustainability, coverage, adequacy and security (ACFS & Mercer, 2017; OECD, 2013; Price et al., 2016). The extent to which privately-managed retirement funds are able to contribute to all of these goals is questionable. These funds have no influence on the extent to which coverage objectives might be met, for example. They are, in South Africa as in some other countries, structured as not-for-profit entities that do not actively seek new members. Defined contribution arrangements cannot deliver on the goal of adequacy unless the contributions paid by employers and members are adequate.

4.4.4 These constraints typically leave the regulator focusing on operational efficiency and integrity and on the role of governance in supporting the security of member claims on the fund (Ashcroft & Stewart, 2010; Randle & Rudolph, 2014). This is only a small part of delivering on the promise of retirement funding:

DC pension systems faced criticism in the wake of the financial and economic crisis for not delivering adequate and sustainable pension incomes at retirement. Much of the problem has centred around the misalignment of PFMC [pension fund management company] and pension fund members' interests, with the focus on short-term volatility rather than delivering adequate pension income over the long-term. Pension supervisors themselves have struggled to correct for these market failures. Part of the problem may be that many supervisory authorities themselves have not focused sufficiently on the ultimate long-term pension income objective. (Randle & Rudolph, 2014: 26)

4.4.5 If they are to be effective, the objectives that the regulatory authority establishes must recognise the flaws in the market under consideration and the steps that may

be taken to mitigate these flaws. Retirement funds have a number of problems to overcome. Operations are complex. Optimising the investment of assets is not straightforward. Perhaps the most intractable problem to the regulatory authority, however, is the complexity inherent to the system of governance and the deep dependence of retirement-fund members on the effectiveness of such governance in practice.

4.4.6 In South Africa, as in many countries, the legal framework establishing oversight of retirement funds concentrates enormous responsibility in the hands of a few. The exercise of this responsibility is inadequately scrutinised by the ultimate stakeholders of these funds, the members and beneficiaries, who generally do not have the skill to exercise such scrutiny. South Africa, in addition, employs a limited approach to enforcing minimum standards of expertise and experience of these few. The management board of a retirement fund, whose members are typically referred to as trustees in South Africa, represents the interests of the fund and all of its stakeholders. Quite how it balances the respective interest of the fund and its members has been the subject of vigorous debate.³⁶

4.4.7 Consider the complex dynamics of the principal-agent relationship. The trustees play the role of agent for the principals, ultimately the members and beneficiaries. Typically, though, the trustees do not have the expertise to invest the assets of the fund themselves. Bearing in mind the nature and extent of their responsibilities, they engage asset managers and advisors of various types to facilitate this. In this engagement, however, they act as principals over a range of agents, many of whom are experts in their fields and have considerable information advantages over their clients. Even simple interactions between principals and agents introduce the possibility of far-reaching conflicts of interest and distorted incentives (Gintis, 2009). With the stakes as high as they are in retirement funds, the regulatory task to minimise the potential for market distortions and their consequences is formidable, perhaps even impossible.

4.4.8 Rusconi (2008) discusses a number of potential sources of market distortion, arguing that conflicts of interest, information inequity, and confusion of the distinction between principals and agents play significant roles in contributing to this distortion. A case in point is the set of multi-employer funds, typically referred to as umbrella funds in South Africa. They appear to be the preferred vehicle of the regulator for addressing operational inefficiency by consolidating smaller funds. These entities present a pertinent challenge in the management of conflicts of interest, however. Umbrella funds are, in nearly all cases, established and controlled by a for-profit entity, which seeks a return on its investment. This fundamentally distorts the operation of a fund that, in law at least, is supposed to operate in the interests of its members and beneficiaries. Efforts to address this, forcing options to allocate assets elsewhere, for example, or ensuring that at least half of the trustees are independent, cannot overturn the underlying commercial conflict.

36 This debate was largely resolved with the release of Pension Fund Circular No. 130, issued by the Financial Services Board, which states that "the board shall at all times act with the utmost good faith towards the fund and in the best interest of all members." (FSB, 2007: 1, paragraph 2)

4.4.9 The very structure of the commercially-sponsored umbrella fund, and its relationship with its sponsor, bring into question the impartiality of the oversight that trustees exercise over the decisions affecting its members. In those rare instances of umbrella funds not established by commercial entities, the funds cannot compete effectively for new members the way their commercially-minded counterparts can, despite the fact that they offer clear advantages of impartiality and governance. Similar concerns may be expressed regarding the so-called retirement annuity funds, which are established primarily for the benefit of individual savers and are, by law, overseen by boards of trustees, but which typically fall under the influence of a commercial entity.

4.4.10 These issues provide a taste of the intractable challenges facing the regulator of retirement funds in South Africa. If a regulator of financial markets ought to identify market flaws and establish the best way to mitigate them (see Section 2), where should the regulator of a retirement market start? It is not clear what the objectives of these funds, and hence of the regulator, should be. The funds have enormous investing potential and substantial responsibility to millions of members. They are typically overseen by trustees, often with inadequate skill who, in delicate positions, have to manage as best they can in the face of the substantial power and interests of information-rich providers of service. The power imbalances and conflicts of interest that characterise this market appear to introduce intractable market distortions.

4.4.11 Objectives should surely focus on outcomes. What more important outcome could there be of a retirement funding system but adequate and secure provision for retirement?

5. SOUTH AFRICAN SUPERVISORY OBJECTIVES

In the discussion that follows, the stated objectives of a number of South Africa's financial-market regulators are considered, ending with the goals of the retirement fund unit of the FSCA.

5.1 Stated objectives

5.1.1 The assessment starts by considering whether, in its responsibility to regulate other parts of the financial markets, South Africa's policymakers and regulators generally have taken care to express their regulatory objectives and determine progress against these objectives. At legislative level, objectives are consistently defined with clarity. The objectives of the PA, for example, are expressed in law as follows:

to (a) promote and enhance the safety and soundness of financial institutions that provide financial products and securities services; (b) promote and enhance the safety and soundness of market infrastructures; (c) protect financial customers against the risk that those financial institutions may fail to meet their obligations; and (d) assist in maintaining financial stability. (Financial Sector Regulation Act, 2017, Section 33, formatting modified)

5.1.2 These objectives are consistent with, but not identical to, the high-level goals set out in the paper that established the way forward for the financial sector (NTSA, 2011b). The legislation continues with a description of the functions required by the PA to meet its objectives and of the power to put in place further functions in order to achieve the objective established for it.

5.1.3 The market-conduct regulator is similarly authorised to act in pursuit of its objectives, which are set out as follows:

- to (a) enhance and support the efficiency and integrity of financial markets; and
 - (b) protect financial customers by (i) promoting fair treatment of financial customers by financial institutions; and (ii) providing financial customers and potential financial customers with financial education programs, and otherwise promoting financial literacy and the ability of financial customers and potential financial customers to make sound financial decisions; and (c) assist in maintaining financial stability.
- (Financial Sector Regulation Act, 2017, Section 33, formatting modified)

5.1.4 Law sets out high-level objectives. These need to be translated by regulators into a more tangible set of outputs if they are to be useful (see ¶2.4.3). The PA has expressed its objectives, the five priorities that it intends to focus on in pursuit of these objectives and, for each of these, the outcomes that it regards as defining adequate progress towards achieving these priorities (PASA, 2018). The first annual report of the PA (PASA, 2019) indicates its progress to date, albeit not directly against the goals and outcomes set out in its strategy.

5.1.5 Under the terms of the Financial Sector Regulation Act (2017), the FSCA is required (Section 70) to develop and adopt a regulatory strategy, which must set the regulatory and supervisory priorities for the next three years and describe the principles under which it is to perform its functions. It must also review its strategy no less frequently than annually. The FSCA strategy paper (2018) sets out priorities for the FSCA as a whole, among them “a robust regulatory framework that provides fair customer treatment, informed financial customers [and] strengthening the efficiency and integrity of our financial markets” (FSCA, 2018: 5). It does not define objectives specific to its mandate to oversee retirement funds.

5.1.6 Under the draft terms of the Conduct of Financial Institutions Bill (2018), which was issued in December 2018 and by June 2020 had passed through the first draft of consultation, the FSCA is furthermore mandated to promote the objectives of the law, which are set out in the Bill itself. It also makes reference to the objectives of the FSCA, as defined in the Financial Sector Regulation Act (see ¶5.1.2) and sets high standards of the FSCA to assess the success with which any provisions that it makes under the Bill achieve its stated objectives. The FSCA, in other words, has the power to establish its regulatory objectives and the mandate to report on the success with which it achieves them.³⁷

37 In a presentation to a seminar hosted by the Life Assurance Committee of the Actuarial Society of South Africa, on 24 June 2020, Caroline da Silva, Deputy Executive Regulatory Policy at the FSCA described the expectation of FSCA performance as demonstrating a proactive, pre-emptive, intrusive approach and the ability to identify emerging risks. She reported that the FSCA had established a

5.1.7 More widely South Africa's financial-sector policymakers also have a good track record of explaining the reasons for proposed reforms to the regulatory framework (§ 2.4.2 and supporting footnotes). Among regulators, the SARB is particularly transparent in its statement of objectives and the extent to which it is making progress against these goals (SARB, 2016 and 2017).

5.1.8 A look back at the practices of the FSB are helpful. The supervisory authority had a sound history of stating its goals and expanding its mission and vision into a number of parts. It set itself the goal (FSB, 2016b:10 and FSB, 2017a:13) of promoting:

- the fair treatment of the consumers of financial products and services,
- the financial soundness of regulated institutions,
- the systemic stability of financial services markets,
- the integrity of financial markets and participating institutions, and
- appropriate initiatives in pursuit of effective consumer education.

5.1.9 The FSB also defined objectives and performance indicators. It stated progress against these indicators, in broad terms. In its last few annual reports (FSB, 2017a, for example), it described progress against a number of performance indicators. On its objective to promote consumer financial education, for example, it reports holding 218 consumer-education workshops in the 2015/16 financial year, targeting 250 for the following year and exceeding this target by holding 465 workshops.³⁸ Other objectives expressed in the 2016/17 annual report (FSB, 2017a) include the promotion of industry transformation, an effective stakeholder management strategy, a regulatory framework in line with international standards, adequate internal resourcing, effective systems, processes or procedures, and full readiness for transition to the FSCA along with appropriate organisational design.

5.1.10 Retirement funds are represented in a dedicated part of the FSB annual reports. That section includes descriptions of the responsibilities of key departments within the retirement-funds unit, a discussion of significant industry-related issues and a range of statistics regarding the retirement industry (FSB, 2017a). Objectives are not included, but the mission of the retirement fund unit is set out as follows:

to promote a safe and stable environment for members of retirement funds so that obligations of all stakeholders are met when due through our commitment, professionalism and teamwork. (FSB, 2017a:32).

5.1.11 The most recent available report covering retirement funds at the time of drafting (June 2020) appears to be the final report of Registrar of Pension Funds (FSB, 2018), issued in December 2018 and covering the calendar year 2017. This paper describes

market-research department whose brief included monitoring progress on policy objectives of improved levels of financial inclusion.

38 This might not translate directly into the desired success underlying the objective, more effective markets with reduced information inequity, for instance, but it represents a sound effort at transparency.

the activities of the unit and extensive statistics on retirement funds, but does not report on progress against regulatory objectives. The FSCA, since its inception, does not appear to have published a report covering retirement funds.

5.1.12 To date, in conclusion, the FSCA does not appear to have formulated a set of regulatory objectives in significant depth or breadth. While the criteria governing the success of a retirement system may be described as efficiency, sustainability, coverage, adequacy and security (see ¶4.4.3), the retirement funds unit at the FSCA appears to have focused its objectives on safety and stability for the members of retirement funds. This suggests that, up until now, it has put much of its attention into the fifth of the proposed criteria, security.³⁹

5.1.13 In mitigation, it may be suggested that its objectives include elements of efficiency and adequacy. Evidence for the first exists in the market-conduct framework of which it forms a part, in statements regarding the need for industry consolidation and in its concern over the communication to members of projected retirement benefits. Regarding the second, the release of draft rules covering the calculation underpinning the description of projected retirement benefits (FSCA, 2020b) is another example of the customer-centric approach of the FSCA. If these are indeed objectives of the retirement fund unit, however, this has not been made explicit and is not reflected in supporting activities.

5.1.14 If retirement outcomes represent the overarching goal of the system, then these outcomes should be reflected in the corresponding objectives of the regulatory authority.

5.2 The impact of policy uncertainty

5.2.1 South Africa's retirement funds regulator operates in the context of considerable policy uncertainty. This paper includes a number of references to the start-stop nature of the development of this policy over many years (see ¶4.2.4 and Section 4.3, for example). The most recently issued document that may lay claim to the status of a policy position (IDTTSA, 2012) is more than eight years old, is marked 'Draft for consideration of Cabinet' and is labelled 'version 11.9'. It reached the public domain only some years after completion. This was followed by numerous attempts, with varying success, by the National Treasury (NTSA, 2014b, 2015 and 2016), to introduce incremental measures to improve the operation and effectiveness of retirement funds, some of which were introduced and then reversed.

5.2.2 Opaque policy regarding the role of retirement funds may make it more difficult for the regulator to set its objectives. Recently, however, with the powers granted to the FSCA to develop regulation (primarily by the Financial Sector Regulation Act, 2017), the status of the overseeing entity was effectively raised from the position of supervisor to regulator. This gives the FSCA the authority to amend its regulatory strategy at any time, subject to consultation with the Minister of Finance, the PA and the National Credit Regulator

39 Further evidence of this may be illustrated by recently issued guidelines on appropriate rates of income drawdown in retirement (FSCA, 2020a).

(Financial Sector Regulation Act, 2017, Section 70). In summary, notwithstanding the policy uncertainty, clarifying the role of the retirement fund regulator through agreement and publication of objectives with measurable outcomes may enhance the extent to which it is able to execute on its uncertain mandate. Thoughts in this regard are considered in the next section.

6. RECOMMENDATIONS

The discussion that follows considers the options available to the FSCA to clarify its regulatory objectives concerning retirement funds. This calls for a systematic approach to the retirement funding system, the risks of market failure and the actions that may be taken by regulators to overcome these risks. Regulation is at once complex and delicate. It is not within the knowledge or perspective of an outside commentator to advise the regulator how best to meet its demanding obligations to the members of South Africa's retirement funds. The approach that follows instead considers, for each of the primary goals of a framework for old age provision, efficiency, sustainability, coverage, adequacy and security (see ¶4.4.3), what role the retirement fund unit at the FSCA might play to develop and meet its regulatory objectives.

6.1 Efficiency

6.1.1 Defined contribution retirement funds are effectively owned by their members. The trustees of these funds should be doing everything they can to ensure that they utilise member resources as effectively as possible, taking into account the costs and corresponding benefits of alternative actions. The market-conduct framework of the FSCA facilitates appropriate oversight of the extent to which funds manage their expenses in the pursuit of the most appropriate outcome for their members.

6.1.2 A number of approaches might be used by the FSCA to track fund expenses and influence trustees to operate with appropriate efficiency. Setting limits is not recommended as it runs the risk of distorting the operation of markets, but requiring funds to report expenditure electronically on a standard form and gathering comparative information across the industry could lead to the development of benchmarks that might influence behaviour appropriately. Extending the responsibility of trustees for the welfare of their members beyond the date of retirement by calling for an improved focus on the fees and charges of annuity products could further add to the overall efficiency of retirement provision.

6.1.3 Perhaps more important, however, and more closely in line with the market-conduct philosophy of the FSCA, is that retirement funds demonstrate their focus on efficiency through their commitment to sound and effective governance. Boards of trustees themselves ought to acknowledge the impacts that their decisions have on the welfare of their members and make every effort to manage fund expenditure accordingly. Requiring the demonstrable implementation of effective governance and risk management by retirement funds would assist in building this responsibility.

6.1.4 Effective governance helps to overcome the potential for the pursuit of low costs at the expense of effective delivery. Efficiency can only be gauged in terms of the effectiveness with which outcomes are delivered, which must take both costs and benefits into account.

6.2 Sustainability

6.2.1 At first glance, issues of sustainability fall outside of the brief of the retirement funds regulator. Sustainability is concerned with whether the value of contributions payable is sufficient, in the very long run, for the benefits provided. Old-age funding systems that are not sustainable are typically those that promise benefits without pre-funding and suffer the impacts of changes to the balance of contributors and beneficiaries. Defined contribution arrangements do not suffer from this problem but if contributions are insufficient or members withdraw savings prior to retirement, then the sustainability of the system is without question inadequate as well. South Africa surely suffers this problem.

6.2.2 Much can still be done, at the level of the retirement fund, to improve sustainability. Good governance, along with disciplined record-keeping, financial management and regular actuarial reviews all contribute to the financial viability of a retirement fund and ultimately to the sustainability of the system as a whole by ensuring that the risks that members bear are managed as effectively as possible. A strong focus by the regulator on these disciplines, ultimately on the effectiveness with which members are supported in their risk-management challenge, would represent a sound contribution to sustainability at system level.

6.3 Coverage

6.3.1 Coverage also seems to fall outside of the remit of the regulator, which does not have the power to require employers to make available to their workers a retirement fund or an efficient alternative individual arrangement.

6.3.2 The FSCA accepts its responsibility to deliver financial education to South Africans. Highlighting the importance of saving for retirement should form part of this, not just in the environment of the workshop but through efforts to grow public awareness. Contributing to efforts to identify more accurately how many South Africans are preparing financially for old age and how effectively they are doing so (see Section 7.2) would also be helpful. Finally, the FSCA has a significant role to play in contributing actively to the development of sound government policy regarding provision for old age.

6.4 Adequacy

6.4.1 South Africa faces enormous challenges regarding the adequacy of provision for old age. This is particularly acute among low-income workers who do not have access to a retirement fund and workers at all income levels who choose not to preserve their accumulated retirement saving when they leave employment or switch from one job to another. The FSCA surely has access to the best available data to bring these concerns to

light. Gathering sound information and reporting it through appropriate channels would contribute meaningfully to the development of sound policy.

6.4.2 Adequacy is also of critical importance at the level of the fund. Defined benefit funds typically provide for income in old age at a relatively generous rate, though they should be required to explain to members both the nature of this promise and the consequences of leaving the arrangement prior to retirement.

6.4.3 For members of defined contribution funds, the situation is a great deal more difficult. These members bear the risk that, when they reach retirement, they have not accumulated sufficient assets in their fund, along with any other arrangements that they have made. They also take investment risk in the fund, a risk that these members typically do not have the skills to manage. A number of retirement funds undertake good work to communicate to their members the importance of planning ahead for old age by projecting the income expected from savings accumulated to date along with future contributions and investment returns. Under the responsibilities imposed on these funds by the market-conduct framework, the standards covering communication to members of the risks to which they are exposed and the means for mitigating these risks should be high. The FSCA could assist in this process of communication, perhaps by issuing regular information leaflets, using a variety of media, that are designed for consumption by fund members. Under its market-conduct mandate, furthermore, the FSCA could establish minimum standards of communication to members by trustees (see ¶5.1.12). Overall, however, it is not clear that sufficient work is undertaken to test the effectiveness of communication to members. Communication that is either not understood or is not converted into appropriate action is wasted. The profession has a great deal to offer by way of research of this subject (see ¶7.2.5).

6.4.4 This is extremely difficult, some may protest. The complexity and subtlety of these risks defies straightforward communication. This is true, but perhaps it then becomes a matter for policy. If members cannot be expected to manage these risks, both before and after retirement, we might ask why policymakers have permitted such a situation to arise, not least when public servants, in a defined benefit scheme underwritten by government, are not exposed to such risks. The FSCA surely has an active part to play in contributing to improving the adequacy of the retirement savings of the members of the retirement funds under its oversight.

6.5 Security

6.5.1 The security of retirement savings is the national objective that lends itself most closely to the regulatory model, which, in South Africa's case focuses on promoting "a safe and stable environment for members of retirement funds" (FSB, 2017a:32, see ¶5.1.10). This is a sound statement but, as it stands, not easily converted into measures of success. It would be helpful as a start for the FSCA to explain what it means by safe and stable and to identify the actions that it takes to achieve these ends.

6.5.2 Since the objectives underpinning regulation typically identify potential market failures and the steps required to address these, the FSCA could take this approach

to defining its role as part of the ongoing process of establishing its regulatory mandate, taking into the approaches utilised elsewhere. Is it interested in addressing dynamics of competition, contestability and competitive neutrality (as in Australia)? Does it require trustees of retirement funds to establish and follow strategic plans (also Australia)? What measures does it use to improve the manner in which retirement funds are managed (United Kingdom)? Does it undertake stakeholder surveys, such as those carried out by a number of regulators, to gather evidence on industry and public perceptions of its success? Does it have sound methods to ensure that retirement funds overcome tendencies to view investment performance through a conservative short-term lens that can contribute, through herding behaviour (Ashcroft & Stewart, 2010; Randle & Rudolph, 2014), to systemic risk, when members really need long-term success?

6.5.3 The retirement unit of the FSB had for some years been employing a framework of risk-based supervision. Utilising a system of quality checks and supported by the risk assessments submitted electronically by all retirement funds (IOPS, 2012d), the unit considered each entity from the perspective of the risks to which it exposed its members. Under the powers now available to the FSCA to ensure an effective framework of market-conduct regulation, the regulator is well able to require all retirement funds to meet minimum requirements of governance and risk management and to demonstrate that they do so in the interests of all members. This could be supported by minimum standards of disclosure to members and a truncated version of this disclosure released for public consumption, facilitating comparison across funds. These changes would also create the space for the FSCA to modify some of the rules-based regulations currently in place that may do more harm than good.⁴⁰

6.5.4 It is not clear how commercially-established multi-employer arrangements would be able to demonstrate a best-practice approach to governance (see ¶4.4.8) that is sufficiently strong to overcome the natural bias resulting from the commercial relationship of the fund with one financial-services entity. One possibility for the consideration of regulator is to recognise that, by virtue of the inseparable relationship between the not-for-profit fund and the commercial entity that established it, additional regulatory requirements may need to be placed on these entities. These might be perhaps along the lines of the pre-emptive approaches used in Chile and other countries, in which a few commercial administrators have considerable market power over a large number of customers. These may help to address the limits to investment choice, the potential for compromises to the effectiveness of governance and the distortions to competitive dynamics between these entities and their standalone counterparts. While price controls are particularly dangerous to the effective

40 Regulation 28 imposes limits on investment in certain asset classes. In the absence of effective governance and risk management, and in the presence of a very strong service sector, this somewhat paternalistic philosophy may be appropriate to protect members from the effects of excessive investment in dangerous classes. Where it actively prevents the adoption of sound investment strategies, for example, through its 75% ceiling on local equities, which may be sub-optimal for young members, it may need to be reviewed. Further research is advisable.

operations of markets and are not recommended, an alternative might be minimum levels of public transparency of these entities concerning the fees that they charge and the range of services that they offer. Finally, it is difficult for groups of members to leave multi-employer arrangements, again impacting competitive dynamics. Minimum standards in this regard may be helpful.

6.6 Concluding comments

6.6.1 The FSCA has been established with a strong mandate and supporting powers, and with no constraining limits on scope to exercise a lasting effect on the market:

A strong market conduct policy framework should support the delivery of desired policy outcomes in the financial sector, enable the monitoring of the extent to which those outcomes are being achieved, ensure preventative action is taken to mitigate the risk of poor outcomes, and ensure remedial action is taken when poor outcomes are in fact produced. (NTSA, undated: 11)

6.6.2 It is precisely the development of those outcomes that this paper encourages. Further development of the existing approach to risk-based supervision (see ¶6.5.3) is also urged. The trustees of a retirement fund take enormous ethical and technical responsibility for the well-being of their members. They should be required to demonstrate how they meet minimum standards of governance, disclosure and risk management, failing which firm action should be taken by the regulator to improve these standards. Improving the seriousness with which retirement funds meet the needs of their members would go a long way to meeting the fundamental purpose of the FSCA and to clarifying the contribution of these funds to the social protection framework of the country.

7. FURTHER RESEARCH

Research is critical in support of FSCA goals to improve the effectiveness of market operation to the advantage of the ultimate beneficiaries of these markets. The discussion that follows summarises the research that has been carried out in this country, first giving examples of similar research carried out elsewhere, and sets out some of the questions that might benefit from further scrutiny.

7.1 Developments in international and local retirement research

7.1.1 A widespread global transfer of risk from the sponsors of retirement funds, governments or employers, to the members of these funds has taken place over recent decades. It is imperative, if these markets are to be regulated effectively, to understand the nature of the outcomes for members of these funds and the rationale for the decisions that they take. This does not include the large body of research that considers the design of national systems of old age provision.⁴¹

41 Examples include Montoro et al. (2019), which compares the archetypal systems of Chile and Spain,

7.1.2 A number of recent studies from around the world, admittedly most of them from the United States, are worth considering in more detail for application to South Africa. These include:

- surveys and analyses of saving for retirement and questions on the reasons for inadequacy (Biggs et al., 2019; Chen et al., 2018; Dushi et al., 2015; Johnson et al., 2017; Munnell et al., 2016);
- the impacts of financial education and literacy on retirement saving (Anderson & Collins, 2017; Hastings & Mitchell, 2018; Hauff et al., 2020; Kaiser et al., 2020);
- decision-making around annuitisation (Brown et al., 2019; Horneff et al., 2017; Illanes & Padi, 2019; Laitner et al., 2018; Munnell et al., 2019), options for annuitisation in Australia (Asher, 2018 and 2020; Asher et al., 2017; Alonso-García & Sherris, 2017; Iskhakov et al., 2015) and the response of UK savers to their new-found freedom of choice regarding annuitisation at retirement (Loibl et al., 2017);
- an analysis of trends in retirement ages (Rutledge et al., 2015), the impacts of delayed retirement on mortality and morbidity (Zulkarnain & Rutledge, 2018) and questions on the efficiency of reforms encouraging delayed retirement (Laitner & Silverman, 2012);
- aspects of investment choice in retirement funds (Anantanasuwong et al., 2019; Mitchell & Utkus, 2020; Orlova et al., 2015) and the degree of exposure of retirement saving to market risk (Chen & Gok, 2020);
- the impacts of persistently low returns on retirement saving (Clark et al., 2017; Fichtner & Seligmann, 2017; Horneff et al., 2018) and the effects of the 2008–09 financial crisis on retirement saving (McFall, 2011);
- the relationship between near-retirement debt and the retirement decision (Butrica & Karamcheva, 2019; Lusardi et al., 2017 and 2020);
- default contribution rates in state-supported auto-enrolled retirement plans (Zhong, 2020);
- the role of assets in mitigating elderly poverty (Wimer & Manfield, 2015);
- a modelling approach to optimising a personal retirement strategy (Emms, 2012); and,
- issues of psychology around retirement (Foster, 2018, for example, among many).

7.1.3 A number of actuaries have contributed research into the dynamics of retirement planning in South Africa. Megan Carswell (née Butler) has led or supported a range of studies over the last ten years. She found little evidence for a sharp decline in consumption on retirement, asking questions of the conventional wisdom that income needs after retirement are typically well below the corresponding need for income immediately prior to that date (Butler, 2011, refined in two parts as Butler & Van Zyl, 2012a and 2012b). She explored

and Santoro (2017), which looks at the impacts of reform options for Chile on expected GDP. Agnew (2013) considers the strengths and weaknesses of Australia's retirement system. John and Levine (2009) apply the systems of Australia, Chile, New Zealand and the United Kingdom to possibilities for the United States.

alternative investment strategies following retirement through the lens of the probability of ruin (Butler et al., 2013). She contributed to the thinking on effective governance in retirement funds by applying a number of ethical theories to the development of a decision-making framework (Butler et al., 2015) and she supported a study led by colleague Susan Abraham that considered the possibility of pushing back the retirement age of defined contribution arrangements (Abraham et al., 2018). She also considered the attributes of effective benefit statements to the members of such arrangements (Carwell et al., 2019).

7.1.4 Other South Africans have contributed significantly as well.⁴² Natalie and Danie van Zyl, also actuarial professionals, applied the lessons of behavioural finance to the decisions made by the members of retirement funds and considered the potential for improved outcomes (Van Zyl & Van Zyl, 2016). Eben Maré (2016) looked at the challenges of determining safe rates of income drawdown in retirement (Maré, 2016). Michelle Reyers (2018) considered the implications of her survey of the confidence of South Africans regarding their preparation for retirement. Johann de Villiers and Elze-Mari Roux explored the possibility of assisting retirement planning by proposing a sustainable lifestyle level (De Villiers & Roux, 2019). Bomikazi Zeka and her colleagues surveyed over 400 black South Africans in the Eastern Cape, finding an association between the attitude to retirement saving and the likely retirement outcome (Zeka et al., 2020). Dr Zeka has undertaken other work that suggests that black South Africans do save significantly, but that retirement is typically not regarded as a priority for such saving.⁴³

7.2 Thoughts on further research

7.2.1 Consideration of the five policy objectives for old-age provision (see Section 4.4.3) suggests a wide range of possibilities for further research in South Africa. Coverage and adequacy of retirement saving, both of which impact the sustainability of the system, have been seriously under question for some time. Efficiency may require more careful consideration, given the impact of an inefficient system on the interests of the members of defined contribution arrangements and the need for an appropriate balance between cost and benefit. The security of member interests is also surely paramount to the overall effectiveness and credibility of the system. Some thoughts follow.

7.2.2 Coverage and adequacy of retirement savings represent burning ships that need urgent attention. Membership numbers published by the regulator (see §4.2.3) surely

42 This list that follows does not include the often-helpful information put out by industry participants that is not subject to the standards of peer-reviewed journals and may be affected by commercial priorities. Examples, listed at the end of the references, include: 10X (2018 and 2019), Alexander Forbes (2013 to 2019), a number of which ventured quite far from the starting point of retirement, Old Mutual (2008, 2013, 2018 and 2019), a number of which are no longer available, and Sanlam (2017a, 2017b, 2017c, 2017d, 2018a and 2018b) which doesn't formally publish the results of its survey every year.

43 Zeka (2019), 'Most Black South Africans Don't Save for Retirement. How to Change This', The Conversation, accessed at <https://theconversation.com/most-black-south-africans-dont-save-for-retirement-how-to-change-this-111757> on 23 June 2020.

include substantial double-counting. Evidence of very poor coverage in industry sectors and income bands (§4.2.6) gives further cause for concern. In truth, not enough is understood about the quality of retirement fund coverage in South Africa and the split between those, with the benefit of tax incentives, who are saving for an income in retirement and those, members of provident funds, most likely on lower incomes, who will receive a lump sum and may well then draw an old-age grant. Little is also known about the nature of old-age income security, given the poor rates at which retirement proceeds are converted into lifetime annuities (§4.2.6). Furthermore, the extent to which accumulated saving is preserved until retirement is not well understood, though it appears to be low (§4.2.5). All of these provide an excellent reason for systematic information-gathering and analysis, in all likelihood combining a number of sources. The FSCA itself may be in a strong position to coordinate this activity.

7.2.3 While concerns may be expressed in terms of coverage and adequacy, South Africa's retirement fund system may also be suffering a deep sustainability problem. Poor rates of preservation by the members of retirement funds and continued resistance to the prospect of mandatory preservation (even where limited to future accrual) could lead to increased dependence on the old age grant provided by the state. Long-term modelling of this possibility would contribute to the debate regarding the nature of the national system of social protection.

7.2.4 Efficiency considerations should also be high on the FSCA agenda, given its focus on sound market conduct. Analysis of the overall expenditure of retirement funds, on a year-by-year basis, suitably normalised to allow for asset- and membership differences, should give to external commentators and to the funds themselves (not to mention their members) an opportunity to assess differences in the efficiency of these vehicles. The FSCA probably has better access to information than others and could carry out and publish this analysis itself. Industry bodies should have an interest in promoting transparency of this nature. Multi-employer funds and entities designed for individual take-up should be interested in publishing appropriately-calculated and soundly-balanced assessments of efficiency. The Association for Savings and Investment South Africa should also be supportive of efforts to improve industry transparency.

7.2.5 Perhaps the most challenging area for scrutiny is that of the security of retirement saving. High-quality, detailed, reliable data is a necessary condition for effective research, but it is not sufficient. Market failure presents itself in a number of ways. Many of these channels have an adverse impact on security because they affect the extent to which customers are able to act fairly in their own interests. It is not sufficient, for example, to note that administrative services or risk benefits are priced competitively but not asset management, as appears anecdotally to be the case, if this is not supported by a careful understanding of why this may be the case and what might be done to address it.

7.2.6 High-quality research would be useful in a number of areas, for example:

- the decisions that members of defined contribution members take regarding the allocation of member accounts to asset classes, both before and after retirement,

- the effectiveness of communication to members in terms of improved understanding and appropriate conversion of thoughts into action,
- the potential for goals-based arrangements and other methods from the disciplines of behavioural finance to improve retirement outcomes,
- the quality of governance and risk management at retirement funds, and the consequences of this quality on the performance of the funds and outcomes for members,
- the impacts, positive and negative, of the constrained models of governance that characterise funds that fall exclusively under the operational oversight of a commercial entity, multi-employer funds and those aimed at individuals, for example (see ¶4.4.9),
- the impacts on the overall outcome for members of pricing investment management services as a percentage of assets under management rather than on an alternative basis such as a fee for service,
- the potential for inappropriate incentives to asset managers arising from performance-based investment fees, and
- the costs and benefits of directing resources to the management of operational risk in retirement funds.

7.2.7 The FSCA is surely the party most directly interested in an effectively-operating retirement-funding market. It probably also has the best access to fund-level information. It should be able to play a critical facilitating role in coordinating research into the market and its participants.

8. CONCLUDING COMMENTS

8.1 Like many retirement funding markets, South Africa's ecosystem for private-sector old-age provision is large, complex and very important to a wide range of players, including all of those affected by the investment decisions of pension fund managers and their agents. It is also fragile and characterised by deep weaknesses, particularly with regard to the challenges of aligning incentives between principals and their agents. This ecosystem requires sound, effective oversight.

8.2 The FSCA has been granted the power to exercise this oversight. To do so effectively, however, it needs to establish a set of regulatory objectives that are clearly stated and are translated into measurable outcomes. Progress against these outcomes should be reported upon regularly. In the context of opaque government policy regarding the role that privately-managed retirement funds are to play in the social protection framework, this is difficult. It is nevertheless critical.

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