Pre-prepared interview of Bruce Cameron on the Money Show with Bruce Whitfield – Cape Talk – Radio 702

Recently I was asked about effectively the looting of retirement funds on Bruce Whitfield's The Money Show.

The actual title was: "How it Works – Retirement Funds – Can Government, unions or any other institution access my retirement funds".

In thinking about it there seemed to be a lot of facts that I had to get into order, so I sat down and wrote this column.

There is a lot of money in retirement funds.

In fact, R10.8 trillion rand, of which the Government Employees Pension Fund (the GEPF) has about R2,3 trillion. And the returns on that are in the billions depending on the state of markets which may affect by billions as well.

Take Steinhoff collapse or the sub-prime property melt down in 2008 as an example.

There are a number of points that must be made first.

Retirement funds over the years have been the target of government, unions and employers which have attempted to reap the benefits from retirement benefits that are due to the people who have or are due to retire.

1. **The apartheid Government**, which had prescribed investments from 1958 through 1989.

A prescribed investment is when some person or entity, like a retirement fund, is forced to invest money at a discount. So, a bond sold by the government, or one of its utilities like Eskom, means it can borrow money on the cheap. This is to the disadvantage of those who saved their money.

Initially prescribed investments were done to protect retirement savings against poor investments of the private sector. The prescribed investments also applied to life assurance funds. But as the apartheid government sought money, mainly for arms, it started to discount the bonds it was selling.

The worst period was in the 1970s. A large amount had to be invested at discounted interest rates.

This was simply a destruction of retirement wealth.

Over the '70s the average real return was minus 2 percent. In nominal terms the inflation rate was 11 percent and the return on the bonds average 9 percent.

At the same time the equity (share) market was going up by 24 percent.

At that stage prescribed investment involved prescribed investment and forced investment in ordinary bonds of 77,5 percent of retirement fund assets.
So, there was a nominal loss of minus two percent but an opportunity loss of 24 percent. That is a loss of 26%.

In 1988 the Jacobs Commission advised against prescribed investments and they were lifted.

The Jacobs Commission found that there are numerous negative effects. The forced investments meant there was no efficient pricing of bonds because of the lower prices forced on retirement funds, which also affected normal bonds. It could also impact on equity markets whose prices would go up or down. This would result in less foreign investment.

With the ANC government a Retirement Fund Tax was introduced in 1996. The Government taxed the investment returns of retirement. It started at 17 percent then went up to 25% for most of the years before dropping to 9% in the year before in was scrapped from March 2007.

2. **The private sector**. Many employers over the years used different attempts to loot retirement funds from raiding the surpluses, to taking contribution holidays to using the money to invested in the own companies through to fund servicer providers bulking the bank accounts of retirement funds to earn a high undeclared interest.

On top of this the life assurance industry literally stole money from investors with confiscatory penalties if they stopped investing in retirement annuities, while hiding away the underlying investments from scrutiny.

They also got their sales-people to lie telling them to sell the annuities at least until 55-years-old when it could be matured. This meant higher sales and higher commissions.

The higher sales would be reinforced by the confiscatory penalties applied if people stopped or reduced payments for any reason.

The problem was the lie. The law required savers to contribute to any fund until the age of 55 – but it never said a contract had to be that long. You could take out one a year retirement annuities and no more. When I wrote about this lie I was roundly condemned by ignorant sales people.

3. **Many of the funds were also raided by the trade unions** as well, using the assets in many cases as profits to the union. This included setting up in between as middleman service providers to the fund and then passing on the jobs to the proper service providers, all at an unjustified profit. Some just literally stole money from the funds.

Now we have threats by both the government and the unions to finance Eskom's debt servicing bill of R86 billion (capital R48 billion and interest of R38 billion). This amounts to a shortfall of R50 billion. This in turn has been found to be a bit odd, because the service should be closer to R90 billion at an interest rate of 9%.

Someone has to pay this debt. It does not seem likely that many who plundered Eskom from the Gupta's downward will pay much soon - or anything.
The graft is so deep that municipal coffers have been emptied by widespread theft and corruption that they cannot pay their electricity bills - many of which had been paid by the ultimate consumers.

Eskom wants a massive hike in electricity rates. Clearly people, including businesses, buying electricity cannot pay as it will result in the closure of business and drop in electricity consumption.

This is what is referred as the death spiral. It seems to forget about price elasticity – charge too much and consumption falls, increase the price again to make up and consumption falls again.

It is much like falling into debt yourself to the point that you can no longer pay off the debt because the interest payments are just too high.

If the government pays the bill from taxpayers' money it will reduce appropriations to other departments, and the Government is already in trouble because the widespread graft that has and seemingly is still continuing which undermines its finances.

So, who else can pay – pension funds – the easy target.

There are a number of approaches that could be considered:

1. **Prescribed investments**.

It should be remembered that retirement fund investment is also in government bonds, but at market prices. Prescribed investments are at a discount to market prices.

It is very likely that prescribed investments will be challenged legally in what is likely to be a long drawn out battle. Advocate Paul Hoffman of Accountability Now, recently wrote an article for the Daily Maverick arguing that the Constitution and Bill of Rights are resistance blocks to this.

Despite this, the ANC has this as one of its policy objectives. This would not only mean prescribed investment for retirement funds, but also on life assurance and collective investments. In other words, most people will not be able to escape some form of investment, except the very rich.

The main problem with prescribed investments is that it will seriously disrupt investment markets. Retirement funds are the single biggest investor of the stock exchange. Remove investments and the JSE value of about R7 trillion will be undermined. The same applies to the bond market which will not be properly priced.

2. **A new Retirement Fund Tax**.

We had the original Retirement Fund Tax on returns given to a fund from interest, rent etc. This could be re-introduced but it would take time to collect the sizable amount.

3. **Tax incentives:**
Reduce the current tax incentives used to encourage retirement savings.
The government, particularly in recent years, has come with a whole package in tax investments to save for retirement. The main purpose is so that the government does not have to pay social pensions to those without money.

These incentive savings include:

4.1 You deduct from taxable income up to 27,5 percent in contributions to a retirement fund, including an RA, up to R330 000 a year

4.2 Lump sum at retirement – First R500 000 tax free and then progressive amounts after that.

4.3 No longer forcing people to retire at age 69. You keep contributing depending on the rules of your fund, until you die. This removes a lot of savings from the tax net. For example, I convert discretionary investments to a retirement annuity. This can mean you pay no tax at all.

4.4 No income or capital gains tax on any retirement returns in the build-up and in retirement.

4.5 And there are tax advantages for heirs.

The moral questions
What is important are the moral questions.

Environment, social and governance (ESG)
ESG is also known as sustainable investing. In most countries overseas the main target has been investment in things such as renewable energy and not things such as coal, that impact on climate change.

In South Africa the main subject has been to invest in social issues, particularly improving the lot of the poor. Don't do it and the chances of revolution grow.

It is part of the legislative brief through what is known as Regulation 28 of the Pension Funds Act, which dictates investment limits for retirement funds.

This means that many asset managers try to find funds that encourage investment in things that help the poor.

However, it remains a problem for most retirement funds. An example is Independent Newspapers in which the Public Investment Commission (PIC) is invested. It's owner claims this is part promotion of an employment equity company – but there are no returns, or even capital repayment, for the PIC. The PIC is trying to get its money back.

Investment risks

All investments are subject to risk - fraud and corruption is one of many. But fraud and corruption is avoidable if there is rule of law – which we simply do not seem to have as a result of the Zuma years.

So why should retirement funds contribute to where little has been done to return stolen funds and while the theft still continues.

And remember whatever is taken from the retirement fund goes into the common kitty – so any corruption could be funded by it.

Effectively what Cosatu is recommending is that the PIC fund a large percentage Eskom’s losses – even if this is kept to the PIC and the Government Employees Pension Fund (the GEPF) - it will affect its value.

The GEPF is a defined benefit fund. This means that your retirement money is based on various fixed factors, like your years of membership. It is also what is known as a fully-funded fund. In other words, it must hold assets equal to its liabilities (current and future pensions).

The assets of the GEPF are, on a daily basis, subject to many factors but mainly returns on investments. Let the values drop and it could move into negative territory but if they improve there will be a surplus in the fund. So Steinhoff had a major effect.

This could mean an under-funded fund. It would also mean a fund that may never get its money back.

If the GEPF allows for the funding of Eskom it is quite unlikely to get its money back. They only way it is likely to recover the money is from its own pensioners. This could be done in of the following ways:

1. It could do what the Transnet Second Defined Pension Fund did after it was under funded mainly as a result of poor investment. It limited all pensions increases for many years to 2% of inflation, while inflation was running at about 6%. In other words the members got poorer and poorer each year to the extent that they could not even afford their medical aid.
The GEPF would find it difficult to limit the initial pensions payments which are guaranteed, but there is not much that can be done about future increases which could be decreased to well below inflation.

2. The government could always change part of the fund to an unfunded fund, where the next generation pays for the retirement of this generation. It has been something tried in Europe with now terrible downsides as people live longer but still retire at the same age on the whole. The next generation will not be able to afford the bill!

The question is why should people, who have saved for their retirement, pay the bill for graft and corruption!