

A flexible national pension plan?

Should cash from retirement funds be made readily available for major financial needs, asks Maya Fisher-French

Recommendations by a leading authority on pension economics go against the more commonly held view that retirement funds should not be accessible before retirement.

David MacCarthy, a senior lecturer in finance at the Tanaka Business School at Imperial College in London, says that experiences in developing economies show compulsory savings are seldom successful.

Encouraging people to save can be done by reducing the cost of saving and providing access to those savings for major financial needs.

MacCarthy says rather than introducing the national social security system (NSSS) as envisaged, the government should focus on the needs of the individual.

"What South Africa needs is a trustworthy, low-cost and easy-to-access savings vehicle," says MacCarthy.

He cites Bolivia as an example of the failure of a compulsory system where less than 10% of economically active people contribute. People find ways to avoid contributing by working informally or for smaller employers.

A recent survey by FinMark Trust showed that lower-income earners prioritise housing and education above long-term retirement savings.

The reality is that for many people in the lower-income groups, the cur-

rent social old age pension (Soap) will provide a greater income than they earn now.

They are aware also that there is a high chance they might not reach retirement age. It is therefore financially rational for them to prioritise current financial needs.

MacCarthy says because many people in this segment have erratic income, their savings have to be liquid to provide financial assistance during times they are not earning.

If people are forced to place funds in inaccessible, long-term investments, they will find a way to opt out of the system.

The majority of respondents to the Sanlam employee benefits retirement fund survey believed that a national pension fund will have a negative effect on retirement savings. There was also a strong view that funds would experience higher levels of resignations so that people can access their funds prior to the implementation of the proposed NSSS. There were concerns about labour unrest among lower-income earners who would not be able to access these funds.

A retirement survey conducted by Old Mutual showed that 53% of people surveyed had mixed feelings about the NSSS.

MacCarthy says for people to participate willingly, the fund should be viewed as a savings vehicle that can be accessed for major financial



Siela Meyer from the Swartland community outside of Malmesbury collects a monthly government grant that helps to support her family. Photographs: David Harrison

needs, such as housing, education and healthcare.

The Singapore pension system is an example of how successful this type of model can be. It has an extremely high level of contribution as a percentage of salary, about 40%. However, members are allowed to access these funds for key financial requirements.

In most cases members access the funds to buy homes, the same priority highlighted in the FinMark Trust survey.

MacCarthy says that although the actual replacement ratio (retirement savings as a percentage of salary) is lower in Singapore, it does not mean the system has failed but rather that it has met the needs of the people. He argues that people are far more rational about their financial needs and will make the correct financial choices.

Costs are one of the biggest hurdles to savings. MacCarthy says an investment with an annual management fee of 1.5% will reduce the total balance of the total value of the investment by 30% after 40 years. This is an area where a central savings pool can be used to reduce costs dramatically.

MacCarthy says the UK is developing a pension system where costs will be reduced to 0.3% a year, meaning the total value of an investment after 40 years will be reduced by only about 8%.



Lower-income earners prioritise housing and education above long-term retirement savings

In the UK the fund will be a default option, which citizens can opt out of and elect their own fund.

Experience shows that people tend to stick to the default option simply because they cannot be bothered to make the change. MacCarthy says the same inertia applies to savings.

Although people faced with major financial crisis would go to the trouble of accessing these funds and filling out the necessary forms, it is unlikely that people would go to all that trouble if they just want to buy a car or spend on a higher lifestyle.

David O'Brien, who heads the Old Mutual retirement fund reform

team, disagrees. He says the debt crunch has seen many people resigning from their jobs to access their pension funds.

He argues that if people are prepared to risk their jobs to access cash for debts, they would have no problem in dipping into flexible savings arrangements.

He says in the South African context where there is virtually no social welfare, access to funds for a life crisis might be necessary. He believes it would be preferable to see a payment of income from the pension fund rather than a lump sum during periods of financial need.

