DA proposal risks worsening pensions crisis

The Democratic Alliance's proposal to allow retirement savers to use their savings as loan guarantees would likely do more harm than good, especially at the lower end of the income scale.

Mca Townsend, business development manager at 10X Investments

Responding to the DA’s call for comment on a Private Member’s Bill to amend the Pension Funds Act, Mica Townsend, business development manager at 10X Investments, said while the proposal might be well meaning it was not necessarily well considered.

“The danger is that this amendment would give retirement savers another way to prioritise today’s needs at the expense of their much older (and likely more vulnerable) selves. This is highly undesirable from a public policy perspective," she says.

The Bill aims to amend the current Pension Funds Act to enable pension fund members to access up to 75% of the value of their pension fund before retirement as a guarantee for a loan. The DA says this would help alleviate financial pressure during an emergency, such as the coronavirus pandemic.

But, says Townsend, who is also an employee benefits consultant, it risks exacerbating an already dire situation where the vast majority of South Africans had almost no way of supporting themselves in retirement, with many thousands spending their final years struggling to make ends meet.

Accessing a loan

As indicated in the DA’s explanatory memorandum, Section 19 of the Pension Funds Act, 1956 (Act No. 24 of 1956) already enables pension fund members to access a loan, where the pension fund asset acts as security for such a loan, but this is, in essence, restricted to loans related to immovable property. The Act also permits a direct loan from the fund for this purpose.

“However, the Act does not permit pension fund members to obtain a loan for any other purpose,” the memorandum says.

There is a good reason for that, adds Townsend. Underlying both the property loan and loan guarantee by a pension fund is the implicit assumption that the member can service the loan in the normal course of their financial affairs. In both scenarios the member is still liable for monthly interest and capital repayments.

In essence, this means that a member who does not qualify for a housing loan under normal considerations, because they cannot afford it, would also not qualify for a pension-backed loan.

Also, Townsend says, many people choose to cash in their savings when leaving their jobs, meaning that the loans would have to be settled.

Additionally, there would be a burden, both in terms of cost and complexity, to the retirement funds, which are not set up to administer such guarantees. Even if it were simple to monitor that people were accessing these loans only as a last resort, it would cause a greater administration burden, potentially causing an increase in costs to the fund and, therefore, the members themselves.

Poor understanding of retirement benefits

Findings in 10X Investments’ annual Retirement Reality Report and various other studies show that members’ understanding of the existing benefits of their retirement funds is poor and confirm that alarmingly few people are on track for a decent retirement.

“Adding layers of complexity would likely only worsen these problems,” says Townsend.

The DA says the proposal is designed to alleviate financial pressure that members may be experiencing due to Covid-19.

“Realistically, members who are experiencing such financial pressure could not afford the loan repayments, which means that even if a loan were (recklessly) granted, such a loan – or rather the guarantee – would be recalled quite quickly by the lender,” Townsend says.

This, in essence, would then be little more than a roundabout and expensive way to access pension benefits early, by way of an early withdrawal. Early withdrawals are subject to withdrawal lump sum tax, further eroding the pension benefit.

Section 37A of the Pension Funds Act provides that pension benefits are not (with few specified exceptions) reducible, transferable or executable. The proposal in the DA’s memorandum would negate, or undermine, this vital and fundamental safety feature of retirement funds.

“We appreciate that the coronavirus pandemic has caused enormous financial hardship to very many people. However, we don’t believe that dismantling some of the core safeguards and preservation measures in the Pension Funds Act will provide relief to the people that the memorandum targets,” says Townsend.

“Instead, it is likely to have unintended and undesirable consequences that are likely to exacerbate this country’s retirement funding crisis.”