# NEGOTIATED PROVIDENT FUNDS IN SOUTH AFRICA

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## Introduction

In 1981 the South African government introduced a Bill to Parliament known as the "Preservation of Pensions Bill". A major provision of the Bill was to ensure that pension entitlements accrued within pension funds would be preserved for retirement. Benefits would remain within the fund on a member's termination from the fund.

The Bill was seen by a large part of the working population of South Africa as being against their interests. They argued that the monies accrued in the pension plans were, in many cases, their only savings, and, in the absence of a sophisticated unemployment insurance system, the money would be required to survive a period of unemployment.

The cause was taken up by the union movement, particularly in the Eastern Cape Province and in Natal, and industrial action followed. There were several "mass withdrawals" from pension funds when fund members were paid their withdrawal benefits in full.

The Preservation of Pensions Bill was eventually withdrawn.

**Perceived Problems with Pension Funds**

Research carried out in South Africa in 1981 and 1982 highlighted the following problems perceived by black members of pension funds:

- The formula used to calculate the pension benefit was generally not understood.
- The high mortality of black employees results in few surviving to retirement age and actually receiving a pension.
- Those black employees who do retire on pension will receive their pensions for shorter periods than white employees because of the higher mortality.
- There was distrust that pensions would in fact be paid by a company for whom the employee no longer works.
- Difficulties are encountered in the actual receipt of pension cheques in the black "homelands" to which many black pensioners will retire.
- The pension fund did not meet the worker's needs which tended to be short term, to house his family and educate his children, rather than long term savings for retirement.
- Only one third of the pension benefit may be paid in cash at retirement.
- Benefits on leaving the fund prior to retirement were usually limited to the member's own contributions together with a nominal rate of interest. There was rarely provision for any benefit enhancement on resignation.
- The existing programmes did not take account of the employees' needs, such as the need for a family funeral benefit as part of the package.
- No consultation had ever taken place with employees on the structure or management of the employee benefit programme.

**Product Design**

Research indicated that requirements of any employee benefit programme to suit the needs of black employees must include the following considerations:

- Consultation and negotiation is the key to the establishment of a successful programme. It is important that employees, through their representatives, are involved in the design and conditions of the employee benefit programme.
- Any benefit payment should be in the form of a cash lump sum rather than an annuity.
- Benefit formulae should be simple.
- Interest rates used in calculations of benefits should be market related.
- The employee benefit programme should include benefits for the contingencies of retirement, death, disability, withdrawal from the fund by way of resignation or retrenchment, and should include family funeral benefits.
- Ongoing management of the fund should include member Trustees.

Within the South African legislative context, these benefit considerations can be met by a money purchase defined contribution provident fund together with Group insurance add-ons.

A typical negotiated provident fund would include the following provisions:

- Contributions from members and the employer to provide retirement benefits. These contributions would also be refunded with interest if the member leaves the fund for any reason, with certain provisos on resignation or dismissal mentioned below.
- Contributions from the employer to meet the cost of any insured benefits; usually death, disability and funeral benefits.
- Retirement benefit of a cash lump sum equal to the member's contributions plus the employer's contributions plus interest.
- Death benefit of a multiple of annual earnings together with a refund of the member's and employer's contributions plus interest.
- Lump sum permanent and total disability benefit of a multiple of annual earnings together with a refund of the member's and employer's contributions plus interest.
- Temporary disability income benefit for short term non-permanent disabilities of up to 2 years duration.
- Funeral benefits for family members for relatively small lump sums.
- Resignation and dismissal benefit of a cash lump sum equal to the member's contributions plus a portion of the employer's contributions plus interest. The portion of the employer's contribution payable will be subject to negotiation.
- Retrenchment and redundancy benefit of a cash lump sum equal to the member's and employer's contributions plus interest.

Interest is most often defined as the rate declared by the Trustees on the advice of the Actuary. The declaration of the interest rate is discussed later in this paper.

Eligibility for membership of the provident fund is subject to negotiation, but will not necessarily be limited to black employees or unionised employees.

The provident fund will usually exist alongside the existing pension fund with the only requirement being that an employee must belong to one fund or the other.

## Role of the Unions

The controversy generated by the abortive Preservation of Pensions Bill attracted the attention of the trade union movement. The proposed legislation had the effect of focusing workers' grievances on the pension fund issue and coincided with the emergence of a strong non-racial trade union movement in South Africa.

Certain unions affiliated to the non-racial Federation of South African Trade Unions (FOSATU) were first to add discussion of employee benefits to their bargaining demands.

One of the first negotiated provident funds to be established in South Africa was agreed in Natal between CG Smith Sugar and the Sweet Food and Allied Workers Union whose General Secretary, Jay Naidoo, is currently General Secretary of the Congress of South African Trade Unions (COSATU), the organisation that replaced FOSATU.

Many COSATU affiliated unions have negotiated provident funds with employers and other unions are now also adding provident funds to their negotiation demands.

Because of the strong union pressure, negotiated provident funds are now firmly established in South Africa. The concept has been so successful because:

- The funds are designed in discussion with the employees who will ultimately enjoy the benefits.
- The negotiated employee benefit programmes are easily understood and easily communicated to members.
- The funds are jointly managed by employer and member trustees. Employees therefore have a continuing say in the running of their fund.

The funds are also beginning to provide a forum which may be able to assist in addressing certain of the immediate problems facing South Africa; such as housing, job creation, and education. There may be scope for the assets held in negotiated provident funds to be utilized in these areas and, because of the strong member presence on the Boads of Trustees of these funds, they may take a lead in promoting investment in "socially desirable" projects.

## Financial Considerations

South African legislation requires that defined benefit pension and provident funds be actuarially valued at least every 3 years. This requirement does not apply to money purchase defined contribution funds.

However, the necessity to declare an interest rate for use in benefit calculations, or to make an equishare calculation, results in financial reviews of the negotiated provident funds being undertaken annually.

Financial reviews have three purposes:

- To ensure the fund's solvency
- To recommend an interest rate declaration for the last financial year
- To recommend an interim interest rate for use in the benefit calculations for the next financial year.

## Solvency

Invariably, the lump sum death and disability benefits and any temporary disability benefits are reinsured. The maximum liability of the fund is therefore limited to the total member contributions, employer contributions towards retirement, plus interest at the rates declared from time to time.

The fund may therefore be considered solvent at the review date if the value of the assets exceeds the maximum liability.

**Surplus**

It is possible to value the negotiated provident funds on an equishare basis so that all of the assets at the review date are equitably distributed to all of the members of the fund.

However, if an interest rate declaration approach is taken, there is the possibility of the fund being in surplus at the review date.

Sources of surplus or deficit are:

- The employer's contributions to provide for insured benefits not being equal to the actual cost of such benefits.
- Moneys not paid to members who resign or are dismissed without fulfilling the requirement for receipt of all of the employer's contributions.
- An interest rate declaration higher or lower than the return achieved by the investment of fund assets.

There are two primary uses for this surplus:

1. The initial negotiation of the terms and conditions of the provident fund will result in the agreement of a fixed employer contribution rate. This rate will be split into a provision for retirement benefits and a provision for reinsurance costs.

   Reinsurance costs are likely to vary from year to year, and, due to the impact of AIDS, are likely to increase over time.

   A shortfall in the employer's contribution to reinsurance costs could be met from surplus accrued from the first two sources mentioned above.

2. In order to retain the credibility of the provident fund among its relatively unsophisticated membership, it is important that the fund is seen to provide benefits in line with expectations. One such expectation is a stable market related interest rate declaration.

   It is important that the declared interest rate does not have too much volatility and a smoothing can be achieved by utilizing surplus held back from the third source above.

## Transfers from other Funds

The majority of potential members of negotiated provident funds are members of existing pension funds. Issues for negotiation will therefore include the basis of transfer of benefits from the pension fund to the new provident fund.

It has become standard practice for such transfers to be made on the basis of a minimum of the actuarial reserve of each member in the pension fund. These actuarial reserves would be calculated on a full prospective basis on the assumptions used in the latest triennial actuarial valuation.

However, union demands are now that transfers should include a share of any surplus in the existing pension fund. This demand has raised the same arguments as are currently being debated in Canada regarding the ownership of fund surplus.

Employers argue that the surplus should remain in the pension fund because it has arisen due to their paying higher contributions then they otherwise could have. Unions argue that the surplus has also arisen from excess investment earnings on their members' contributions and from withdrawal profits when their members left early.

No compromise solution has yet been accepted and the issue continues to be the most contentious of the negotiation process.

## Conclusion

The concept of negotiated provident funds is still relatively new to the South African employee benefits environment, and this market will continue to develop rapidly in the years ahead.

There is no doubt that the negotiated provident funds will play a role in addressing some of the social and economic issues facing South Africa in the 1990's. This will particularly be true in the field of investments where the funds will control a significant share of the pension and provident funds' assets.

The advent of negotiated provident funds in South Africa has given employees far more influence over their employee benefit programmes, and in the near future the funds may enable South African workers to have a greater influence over their own destinies.

The introduction of negotiated provident funds has given employees benefit programmes that are perceived to meet their needs, and has contributed to an improved industrial relations environment in the country.

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