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PRESERVATION FUNDS: TIME FOR AN OVERHAUL?

Today's Trustee

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YOUR MONEY YOUR POWER

A fractured system:

the case for social protection and pension reforms

by Rob Rusconi

Today'sTrustee

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YOUR MONEY YOUR POWER

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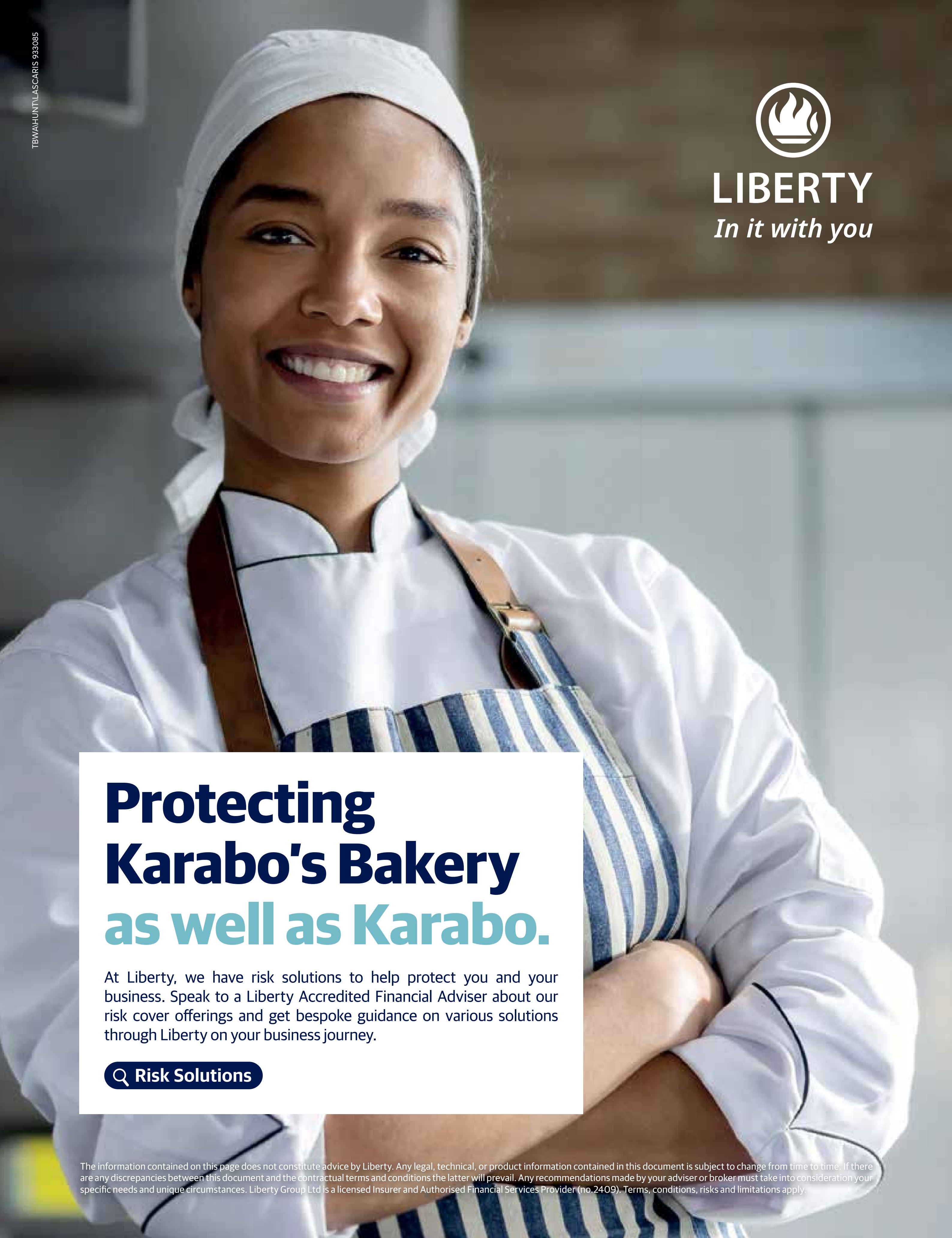

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CURRENTS

Godongwana lifts funds' global investment cap to 45%

There was one feature of finance minister Enoch Godongwana's otherwise lacklustre budget speech that drew widespread applause: the announcement that pension funds will soon be allowed to invest up to 45% of their assets outside SA's borders.

Godongwana said that changes to regulation 28 of the Pension Funds Act will be published in March, lifting the limit for offshore investment to 35% which, when combined with the 10% allocation for investment in Africa, lifts the overall limit to 45%.

It was an innovation roundly welcomed by economists and the pension industry.

Intellidex's Peter Attard Montalto described this as a "progressive change" which "substantially frees up offshore investment by SA funds".

Warren Ingram, co-founder of Galileo Capital told *Business Day* that this move "makes retirement funds more attractive, and sends a great signal that exchange controls are reducing… the opposite to what has been predicted by fearmongers in the past."

This continues the trend of relaxation of offshore investment limits. In 2011, when regulation 28 came into effect, the offshore asset allocation was a maximum of 25%, with another possible 5% in African markets.

This relaxation was, however, one of only a few specific actions flagged in Godongwana's maiden budget. Veteran economist Raymond Parsons said that otherwise, this budget seemed more like a "holding operation".

Godongwana . . . tough policy decisions

As Parsons put it: "It appears that several of the key tough policy decisions – which are badly needed for much higher job-rich growth than 1.8% – were either postponed or subjected to further delayed processes."

The BIG hole in the budget

If there was one surprising omission in Enoch Godongwana's budget speech, it was the absence of any mention of a Basic Income Grant (BIG).

While non-profit lobby organisations have been pressurising the government to implement a BIG — a call bolstered by the fact that unemployment, at the widest definition, has now expanded to 46.6% — Godongwana drew a line in the sand when it came to the affordability of such an innovation.

Though he extended the R350 per month Social Relief of Distress (SRD) grant for another 12 months, Godongwana repeatedly stressed that this was a temporary move. As it is, the Treasury only found the room to extend the SRD grant because it got a R182bn windfall in extra tax revenues from mining companies, which cashed in from the commodities boom.

But metals prices are unlikely to keep up this frantic pace. As a result, Treasury deputy director general Ismail Momoniat said that any permanent expenditure programme — like a BIG — couldn't be funded by money that comes in from temporary sources, like a commodity boom.

Rather, as the Budget Review put it, "any permanent extensions of social support need to be matched by new tax measures or expenditure reductions".

As it is, the extension of the SRD grant will cost the country an extra R44.4bn — and it remains to be seen whether the government will be able to terminate that grant after that 12-month extension period without provoking a wider backlash.

Natasha Huggett-Henchie of NMB Benefits said the Covid grant is almost turning into a "basic income grant by stealth". "The longer it is extended, the [more] difficult it will be to take this away," she said.

The budget documents also revealed how disturbingly reliant the country has been on grants: about half SA's population gets some kind of grant from the government, including 10.5 million recipients of the SRD grant.

Nonetheless, some critics felt that Godongwana should have used this opportunity to implement some form of BIG.

The Institute for Economic Justice, a lobby group, said it was "worrying" that Godongwana didn't mention a BIG in his budget speech at all. "The finance minister has effectively, unilaterally, ruled out a universal basic income support in the medium term. This is not a decision the minister or Treasury can make alone and by fiat — they need to be removed from determining social security policy as they lack the necessary expertise," it said.

Pave the way for "worker democracy", says Blackrock

Larry Fink, CEO of BlackRock, the largest fund manager in the world with $10 trillion under management, has written a new letter to CEOs calling for every investor — including workers — to participate in running the companies they own.

"We are committed to a future where every investor — even individual investors — can have the option to participate in the proxy voting process if they choose," Fink wrote. The idea is to get everyone, including workers whose savings are invested, to vote at AGMs.

This will "bring more democracy and more voices to capitalism", argued Fink.

Fink . . . sleight of hand?

It's not a new idea, however. As has been detailed exhaustively in *Today's Trustee*, the move towards true "stakeholder capitalism" has been years in the making. And yet, it still hasn't truly happened.

Mariana Mazzucato, economics professor and advisor to President Cyril Ramaphosa, was withering about Fink's suggestions, describing it as nothing more than a "shell game".

"We've heard all this before… but far too little has changed, largely because the vision expressed by Fink and other corporate leaders stops short of the radical reforms needed to transform capitalism in the interests of people and the planet," she wrote.

The problem, she says, is that Fink doesn't propose authentic stakeholder capitalism, but rather a sleight of hand in which shareholder value is always the bottom line, rather than truly creating value for public benefit.

Ramaphosa . . . abstained from the UN vote

Russian invasion wreaks havoc on investments

Russia's invasion of the Ukraine has illustrated, once again, that the governing ANC is little more than a credulous organisation in search of a snake oil salesman.

After foreign affairs minister Naledi Pandor condemned the invasion, President Cyril Ramaphosa walked back from that position. It culminated in SA "abstaining" from the UN vote to condemn the invasion of another sovereign territory, primarily because of an archaic loyalty to Russia, stemming from that regime's support for the liberation party during the communist era.

But of interest to trustees is the impact that the invasion has had on investments. While commodities, like gold, oil, platinum, and palladium initially exploded — gold tore through the $2,000/ounce level and Brent crude oil came within a whisker of $120/barrel — the rest of the JSE, and global markets, were pummelled.

The question is, how should investor's respond?

Anchor Capital calculated that only about 4% of the negative returns of the S&P 500 have any correlation with the political conflict in Eastern Europe. Rather, it is global inflationary fears — and the Fed's response — which is weighing on stock prices globally.

Ruan Breed, financial advisor at Brenthurst Wealth, pointed out that since the economies of Russia and the Ukraine represent just 2% of the global economy, it will only be if other countries get involved in Putin's circus that we could see a big knock-on for financial markets.

"The war in Ukraine is already largely priced into markets, but Putin's next move will be the deciding factor. Only if he decides to invade one of the NATO member countries, will volatility pick up in the short term," he says.

Brenthurst says that when it comes to contained localised wars, "on average, it has taken markets three weeks to bottom out since the start of a war and a further three weeks to recover the initial losses."

As Breed says, panic selling is exactly the wrong approach. "Expect market volatility and rather use it to your advantage. If you decide to wait for market clarity and for the dust to settle, you will most likely wait until the end of the world," he says. ■

PROFILE

Kamlana's plan to give the FSCA more bite

The regulator's commissioner, Unathi Kamlana, has only been in the job for a few months, but he's determined to add skills and resources to make the FSCA a success.

By Phakamisa Ndzamela

The Financial Sector Conduct Authority (FSCA) is adding serious muscle, and aims to increase its workforce by 15%, says the regulator's commissioner Unathi Kamlana.

Armed with a R1bn annual budget, Kamlana wants the FSCA to be more agile, proactive, deploy technology better, and move with greater speed. It's all part of his plan to enhance the integrity of SA's financial markets, while cracking down on the unfair treatment of customers by financial institutions.

"Part of the challenge is that, as soon as you take action, people lawyer up, and that can cause delays. Of course, they have rights as well. This means the FSCA team is under enormous pressure to do investigations clinically," Kamlana told *Today's Trustee.*

But additional resources will help. As it is, the FSCA has 590 employees — but Kamlana's plan is to increase that to 680 in the next three years.

It's a mammoth task for Kamlana, who has only been in office since June last year, after former finance minister Tito Mboweni announced him as the new head of the regulator.

He now oversees an organisation responsible for monitoring retirement funds with a combined value of R3 trillion, overseeing the country's collective investment schemes and the rest of the financial sector, and policing market conduct.

Born in 1980 and raised in the Mdantsane township in the Eastern Cape — a location established in East London in 1963 and known to be the boxing mecca of SA — Kamlana has come a long way from his disadvantaged upbringing.

> *Vertically challenged but brimming with confidence, [Kamlana] is testament to the adage that dynamite comes in bantamweight packages.*

Vertically challenged but brimming with confidence, he is testament to the adage that dynamite comes in bantamweight packages. As if military trained, he sits up dead straight, while his bespectacled eyes pierce through

Kamlana . . . ruling nothing out for his future

those of the interlocutor.

"I was predominantly raised by my grandparents in a large extended family," he says.

Holding up a bare-knuckled fist in front of his grey-bearded face, Kamlana says: "the first thing you learn as a boy in Mdantsane is how to shape."

"I was in the same class with Vuyani Bungu," he says, referring to the renowned world boxing champion. It was a busy time though, as Kamlana also played cricket and soccer, and participated in the church choir.

His grandfather was a priest, keenly devoted to the development of the Mdantsane community, and this shaped Kamlana's commitment to public service. Initially, this expressed itself in his involvement in his grandfather's agricultural community projects, and he recalls selling oranges, apples and potatoes at his school.

At the time, he harboured ambitions of becoming a doctor or following his grandfather into the church — and even today, in his 40s, he hasn't completely discounted the idea of becoming a man of the cloth.

After completing school at Hlokoma Senior Secondary School in Mdantsane, Kamlana enrolled at Rhodes University.

"The reason I did not pursue [medicine] is because I did not get a scholarship to do it. I got funding for a BCom degree at Rhodes, funded by Eskom. [Because] it was a scholarship and not a bursary, there was no commitment to work for them," he says.

In his final year of undergrad studies, a graduate placement job opportunity opened up at Standard Bank. The bank flew him to Johannesburg for an interview on Simmonds Street at the bank's headquarters — Kamlana's first trip in an airplane, he recalls.

Standard Bank was evidently impressed, and he joined on February 4, 2002.

"My exposure to structured finance at Standard Bank motivated me to understand tax. Standard Bank introduced me to an area of finance [and] law," he says.

> *"I have an appreciation of the role of the state in shaping and developing an economy."*

From there, he joined the public service when he took a role in National Treasury's tax unit. "I have an appreciation of the role of the state in shaping and developing an economy… This is what keeps me going," he says.

Determined not to stagnate, Kamlana has kept adding to his qualifications over the years. This includes arming himself with a masters degree in tax from Rhodes, an MSc in economic policy from SOAS University of London, and certificates from Harvard University, the Federal Reserve Bank of New York and Duke University.

Treasury provided invaluable experience too. Besides being part of the core team that crafted the Twin Peaks reforms from 2011 to 2018, he worked with policy architects such as Treasury deputy director general Ismail Momoniat.

When he later joined the SA Reserve Bank, Kamlana worked closely with the incumbent governor, Lesetja Kganyago, who affectionately referred to Kamlana as "young man" — before the grey spots began to appear in his goatee.

At the Bank, his tasks were varied, including a stint as deputy registrar of banks.

A calculated career move

While this would have provided ample grounding for his new role at the FSCA, there are some who question why he veered away from central banking, where has was, in some circles, touted as a potential replacement for Kganyago.

Kamlana, however, isn't ruling out a return to the central bank, or even 40 Church Square, the home of the National Treasury in Pretoria, at some stage.

"All options are open," he says. "The current focus is to make sure that Twin Peaks works. I work very closely with the Reserve Bank and Treasury."

It illustrates that he's a discreet operator, unlikely to be seen shooting his mouth off at the annual Christmas party. Rather, the noisiest place you're likely to find him is in Church, or at the gym, working on his core.

In the longer term, however, you wouldn't want to bet against him making the shortlist to replace well-reputed officials such as Kganyago or Momoniat.

If anything, his appetite for bobbing and weaving against the large financial operators during his tenure at the FSCA would seem to be a calculated career move. It'll provide him with invaluable experience in both prudential matters, and market conduct.

Having been at the institution for less than a year, Kamlana concedes that it has taken some getting used to.

"The culture is different. The FSCA is relaxed and casual and the SARB is formal. This is not to say the other is better than the other. Pitching to work without a tie and jacket has been quite an adjustment to me," he says.

Not that dressing down suggests he's slacking off. Describing his typical day, Kamlana says: "I work 10 to 12 hours a day. At 7am, I am at my desk checking emails. The days are full of meetings. At about 5pm, I read, comment and sign-off things for approval."

Some of his time is spent on licensing decisions, some on fine-tuning the regulatory and enforcement framework, and between that, he chairs the FSCA's executive committee.

In recent times, the FSCA has been displaying considerably more bite too.

In October 2020, a few months before Kamlana joined, the FSCA issued a R162m fine on former Steinhoff CEO Markus Jooste for insider trading — a fine since set aside by the Financial Services Tribunal as too high.

This came a few months after the FSCA fined Steinhoff R1.5bn for publishing false accounts — a sanction it since cut to R53m in recognition of the retailer's weak financial position.

More recently, the FSCA also controversially fined short-seller Viceroy R50m for publishing "false, misleading or deceptive statements" in its research report warning of severe problems at Capitec Bank. Viceroy's Fraser Perring has vowed to fight this ruling.

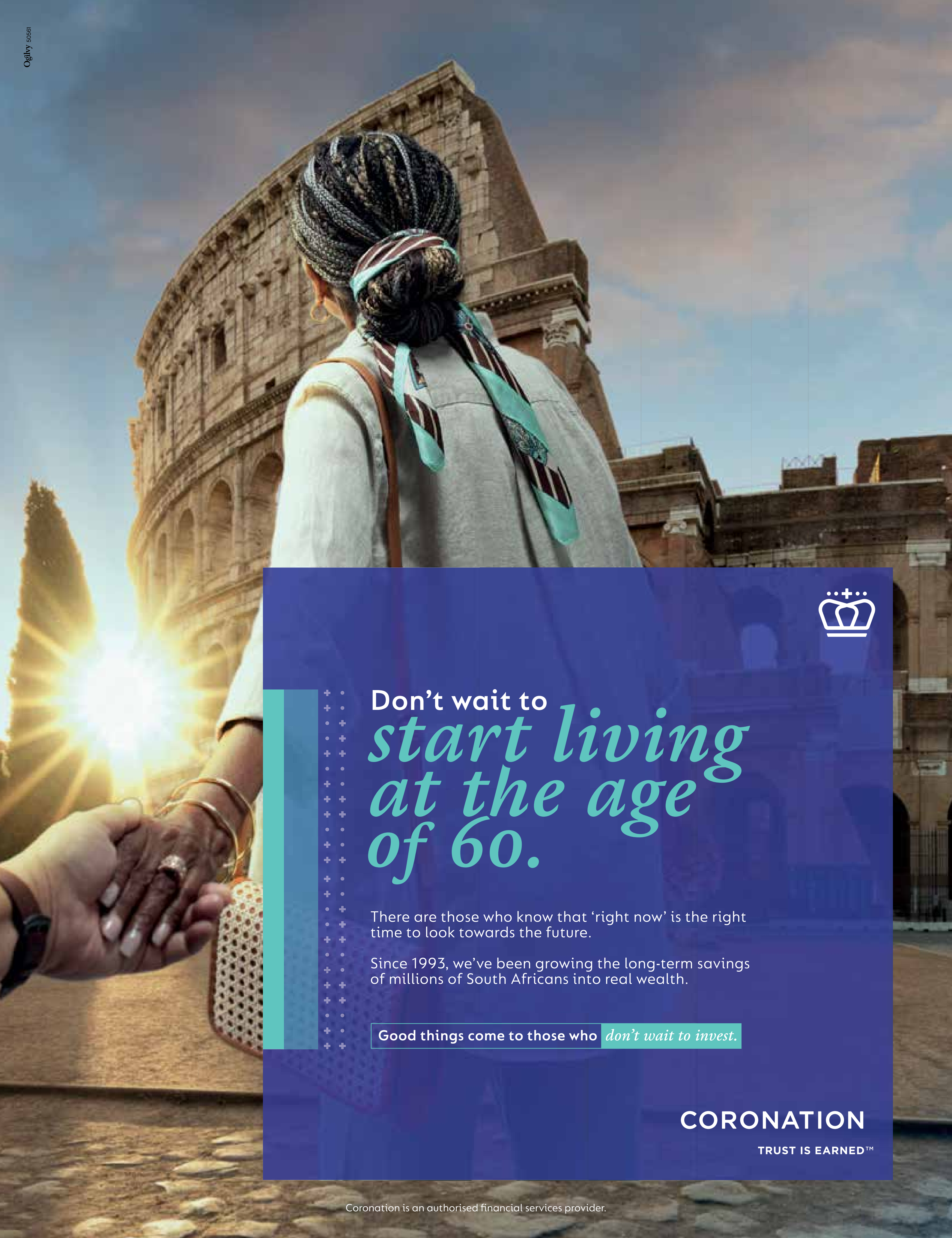
Asked whether the regulator is now cracking a bigger whip than in the past, Kamlana says the Twin Peaks structure was deliberately designed to ensure "the conduct part should have teeth."

Nonetheless, he says, the system is not without recourse — institutions that feel aggrieved by the FSCA can always appeal to the Financial Services Tribunal.

Now that he's had the chance to shake the furniture, what is Kamlana's biggest concern at the regulator?

"The first thing is the capacity and resources," he says. "The FSCA has an extended mandate in Twin Peaks compared to its predecessor [the Financial Services Board]. It requires a lot of skilled people. Organisational development has been a focus."

Clearly then, bulking up capacity has to be a priority. But throughout, Kamlana says he'll ensure the FSCA, as a publicly-funded organisation, remains transparent and accountable to society. ■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INVESTMENT INSIGHT

The word RISK, and its impact on investors

When investing, risk can really be opportunity, insists Andrew Davison, head of advice at Old Mutual Corporate Consultants.

The word *risk*, we're told, is "a situation involving exposure to danger".

Most humans are conditioned to avoid danger, so something deemed risky is generally best avoided. Unless, of course, you're a thrill-seeker who chooses to engage in wingsuit flying or base jumping — but then you're on the extreme.

In investments, however, an outright aversion to risk can be quite harmful: either investors try to avoid any danger, and thus end up with meagre returns, or they pay a lot of money for protection from risk, which also hurts returns.

To help people become better investors, it's critical to get them to understand and embrace risk. But to do this, you need to be able to distinguish between risks that are actually *opportunities*, and those involving *genuine* danger, where the word risk should be sprinkled liberally across all the documents.

How successful investors see risk

Obviously, in investments, it is necessary to take some risk because that is where the opportunities for outsized returns lie. Being too conservative actually presents a risk in itself, as well as a lost opportunity cost. So, successful investors, rather than running away from the danger, tend to:

- First, train themselves to view risk as an opportunity to make a higher return.
- Second, learn about risk and be able to distinguish between sensible risk with good potential for upside, and pure danger where the odds aren't in their favour.
- Third, take a number of different calculated risks, because the future is uncertain and the world is complex — so it's not possible to be sure that all risk-taking will pay off.
- Fourth, be patient: taking risk seldom pays off quickly and compounding takes time to work.

Let's dig deeper into what this all means

The first step, requires investors to grasp the notion that a sound, long-term investment strategy does not mean avoiding risk at all costs, but seeking out the sensible risks.

Davison . . . are the risks you take worth it?

In the second step, people are actually investing in their own knowledge, and building up an ability to distinguish between risks that are opportunities, and ones which are hazardous to their wealth.

Take one example. Putting cash into a business is an investment in the potential future profits that it might generate. Yet, businesses aren't guaranteed to be wildly profitable, so there's always a risk that it might make losses and even fail.

So as an investor, you need to evaluate the business model, the quality of the management, the competition, the value being placed on the business and various other factors to assess the odds that it will succeed. Even if you find a business with a competitive proposition, a solid business plan, competent and reputable management with a sound track record, and at a good price, it's *still* a risk — but the odds are now in your favour.

In contrast, handing over money to a little-known entity, without a clear explanation of how they plan to make any return, a limited track record and poor transparency, but with the promise of exceptional returns, just exposes you to danger.

Unfortunately, too many investors don't know enough, or aren't willing to do the work to weigh the risks against the potential rewards — so they take the safe route of investing in nice, safe bank deposits.

The third step is really all about the boringly often-repeated mantra of diversification.

Of course, just because it's boring doesn't mean it's not the right thing to do. Taking risk is undoubtedly right for retirement fund savers, but it's about sensible risk and taking lots of small positions in risky investments that have the potential to do well. Some will fail, so you don't want your whole strategy dependent on those. And it's also critical to ensure the risks you take aren't closely linked or correlated: you don't want all your risky positions to fail at the same time and for the same reason.

Diversification requires a deliberate, intelligent, careful approach – it's not just about randomly allocating your assets to lots of things.

The fourth step is often the most difficult one. We live in a world of instant gratification, so we want our returns to be big, and we want them to arrive soon. But retirement investing is a lifetime objective, which requires a long-term mindset.

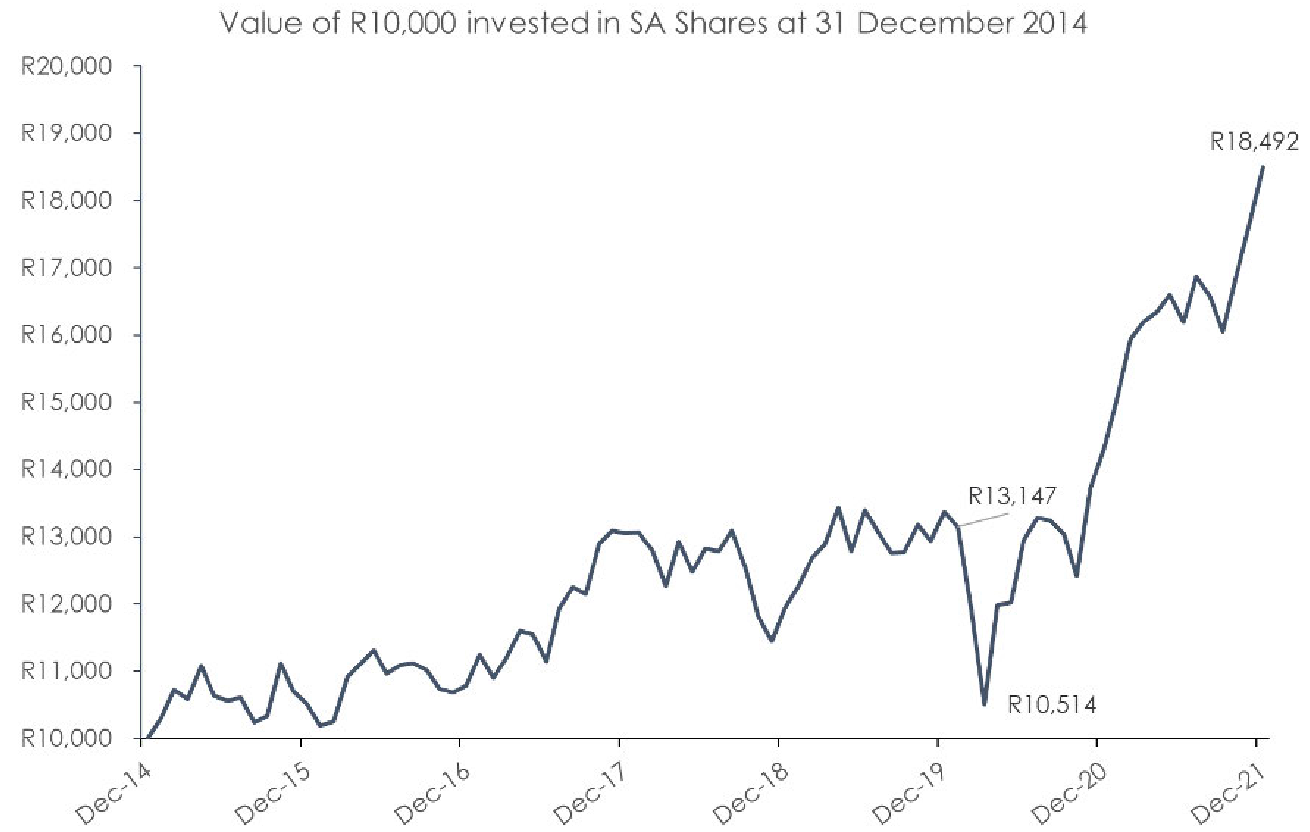
What the last few years have taught us

In the markets, the emotional rollercoasters of a lacklustre economy and Covid haven't been easy. But it's provided valuable lessons about risk and patience.

Consider a novice investor who invested their first R10,000 in the market (tracking the JSEs all share index) at the end of December 2014 (see graph). This person picked a truly inopportune time to take the plunge.

Their R10,000 trundled along in a moribund SA economy for years, generating almost no return. At the end of January 2020, after just more than five years of patient investing, our dissatisfied investor has only R13,147 — a paltry return of 5.5% per year, relative to inflation of 5% per year. Had they kept their money in the bank that would have earned interest of 7.2% per year. So much for taking risk.

Figure 1



Source: Refinitiv Datastream

But then it all gets much worse. Over in China, there's a nasty virus starting to spread and before long it becomes a global pandemic. As we know, the resulting lockdowns and panic led to a selloff in stock markets around the globe. So, by the end of March 2020, our investor's savings had fallen more than 20% to R10,514.

Now their mettle is severely tested. This is the situation many trustees found themselves in at the time. After a prolonged period of weak returns, Covid had the potential to stoke real panic. Many boards of trustees asked their asset consultants, "Surely we should get out of shares?" or "Isn't cash much safer right now?" or "Shouldn't we be in cash and ride out this storm?"

But that was a time for cool heads.

Over the 21 months following March 2020, the stock market staged a remarkable recovery. That investor's R10,514 grew by a phenomenal 76% in under two years to R18,492 at the end of December 2021.

Only those investors who didn't panic and sell out of risky assets would have been around to participate in this recovery.

To generate the returns that members need, trustees need courage. They need to do their homework to understand risk so they can spot opportunities and avoid scams, and they need to take calculated risks across investments that behave differently. If they use experts to help them, they need to pay a fair fee — but a fee that doesn't erode all the extra returns they deserve, based on the risks. And they need to be patient and avoid panicking when dips and setbacks occur.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COVER STORY part 1

Failing our people

Lots of talk and very little action. SA is patently failing in its constitutional mandate to provide effective social protection for all its elderly people.

By Rob Rusconi

The system of social grants for the indigent is highly regarded and broadly effective, albeit mired in controversy. SA's middle- and upper-class workers are also in decent shape. They receive generous tax breaks and access to reasonably well managed retirement arrangements, so they really have only themselves to blame if they don't retire well. For those in-between, however, the situation is dire.

"Everyone has the right to have access to… social security," states Section 27 of the Constitution, "including, if they are unable to support themselves and their dependants." So what is the role of government in this process?

Again, the Constitution tells us that the state "must take reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of these rights."

Is this happening? On the one hand, yes. The state exercises its responsibility to meet the needs of the deeply indigent through the provision of social assistance. Though the system of old age grants is obviously not operationally perfect, research consistently indicates that it provides strong benefit to recipients of the grants and, through them, to their extended families. Cost may be an issue, increasingly so as demographics shift to the elderly, but the constitutional requirement to provide social assistance is broadly met.

On the other hand, emphatically no. The signs of a broken system are all around us. Substantial arrangements run by profit-making entities are getting larger, growing in their pricing power but not in their transparency. Many employers meanwhile are putting their workers into the care of these profitable institutions. So-called professional consultants are frequently subject to conflicts of interest. Retirees hand over their hard-earned savings to commissioned agents with strong incentives not to provide the best advice but to run an ill-conceived investment portfolio, drawing their own income from these assets as they do so.

There is no disagreement in this regard. Read the Taylor report of 2002, the Department of Social Development reports of 2006 and 2007, the National Development Plan of 2012, and a slew of policy proposals by the National Treasury, in 2004, 2007, in a large block in 2012 and just about every year since.

All agree. These writers state not only that we have a problem and that we are not addressing it, but they also agree broadly on the nature of this problem. They agree that we have a constitutional obligation, that we should consider the obligation to provide social protection holistically and that the private sector has a legitimate part to play in meeting this responsibility.

They are in accord on the challenge of regulatory weakness, the inadequacy of outcomes and the wastefulness in the system. They acknowledge that, Constitution downwards, progressive

Rusconi . . . the situation is dire

implementation is acceptable.

Then it gets messy. Some ask for a centrally managed mandatory system, more akin to a social security arrangement than what we have now, arguing that this makes for a fairer system. (Mind you, hope for widespread buy-in to a government scheme right now may be a little slender.)

Others insist that all we need is compulsory contributions and preservation until retirement (though, admittedly, many of those have a financial interest in such an approach). But there again, any government mandate to save is politically unpalatable right now too.

The policy process is not pretty, either. On 18 August last year, the Department of Social Development released what it referred to as a "government policy discussion paper" that largely repeats what was published a few years before. Yet it was withdrawn two weeks later.

On 14 December, National Treasury published a pair of papers that we consider in more detail later. But it includes misleading statements like: "Government will also introduce legislation to enable automatic/mandatory enrollment to expand coverage for more vulnerable, contract and temporary workers". This suggests there is agreement on expanding the existing system, contradicting the short-lived green paper issued a few months before. And NEDLAC, the great hope of cooperative development, seems to be less than fully effective.

On the 20th anniversary of the Taylor enquiry, it is hard to be optimistic that firm, clear policy built around carefully developed consensus is just around the corner.

Putting in place markers of success

The first step to a more robust and effective retirement framework is an agreement on the definition of success. The National Planning Commission puts forward five functions of a social protection system, saying it should be: protective, preventative, promotive, transformative, and developmental.

The International Labour Organisation (ILO) points out that social protection contributes to human development, political stability and inclusive growth. It describes social protection for the elderly in terms of human rights, dignity and income security, stressing the importance of access to social services.

The international community broadly agrees that the effectiveness of a funded retirement system can be measured in terms of its efficiency, sustainability, coverage, adequacy, and security. The system should deliver its benefits at acceptable cost, and it should be designed to remain financially achievable in the long run. It should reach as high a proportion of the people as possible, should provide benefits to them sufficient for an objective minimum standard of living, and not expose them to undue risk.

In SA, we urgently need a set of objectives. Setting aside ideological differences, we need to agree on what we want to achieve, and how we'll know once we've done it. Once that is agreed, the way is then open to the development of sound transitional arrangements: government puts forward one plan, comments are received, and the plan is reviewed and adopted.

Nobody says it will be easy — but that is what policy development is about.

A broken system

Coverage matters. If a social protection system is to be effective, a good proportion of the working age population must participate by making contributions. The international community agrees that this is a key metric of success, and National Treasury has explicitly identified inadequate coverage as problematic.

Developing a clear picture of coverage in SA is difficult, but we need to be careful what we count. With total assets of R4 trillion — which is nearly equal to the country's annual GDP — our industry is the largest among developing countries: in dollar terms, we are second only to Brazil.

Of course, we need to be careful not to be too impressed by the numbers alone. We depend heavily on the effectiveness of this system because, outside of the social old-age grants, we do not have an alternative, as many countries do.

But we may have been deceived by the statistics. At the end of 2017, the Financial Services Board (now the Financial Sector Conduct Authority) reported total fund membership of 16.9 million — not bad against a labour force of 22.1 million and total employed of 16.2 million.

However, some individuals are counted twice or three times, if they are members of more than one fund and some are pensioners.

National Treasury provides a different perspective by referring to our tax records. In 2018, only 6.8 million taxpayers contributed to a pension fund. Hundreds of thousands, furthermore, have cashed out their retirement savings early over the last few years.

Either way, what we do know is that 16.9 million people is an overstatement and 6.4 million is an understatement. We also know from separate research that, among some sectors of even formally employed individuals, coverage is poor.

So, we have an extraordinary pension system, with more than R4 trillion in assets, but with patchy coverage and from which many have been withdrawing.

Of course, inadequate retirement system coverage is not a problem unique to SA. Policymakers in Latin America are scratching their heads over poor take-up and poor retirement outcomes, despite the government mandate to their citizens to save in individual pension accounts.

The problem extends to wealthy countries as well. Around a million private sector workers in Ireland, for example, have no pension savings at all. At least they have some form of state pension to fall back on — though questions are being asked about the sustainability of that system.

> *Part of the coverage problem in SA is that active, deliberate saving for retirement is rare.*

Part of the coverage problem in SA is that active, deliberate saving for retirement is rare.

Employees whose companies offer access to a retirement fund typically only put money away because they must. The self-employed typically pour their spare cash into their businesses but may manage to save a little. Those who survive in the informal economy are unlikely to save, not just because they don't have the spare resources, but because they regard formal-sector products as inflexible. Furthermore, they don't benefit from tax incentives, and they are not granted access to retirement savings in times of need — and times like those are plentiful.

In short, in an environment of very low trust in government, something needs to give if we are to be told that we must save for retirement when we don't feel that we can afford to do that.

Is the two-pot policy response the remedy?

The two-pot system put forward by National Treasury proposes splitting all contributions into what may be described as an "accessible account" and a "retirement account".

Making sense of the terminology

Social security: the system utilised by the state to provide basic services to its people or to encourage them to provide such services themselves. Typically utilised in developed countries to refer to tax collection from workers in the formal economy and social benefits to those in need.

Social assistance: that aspect of social security aimed at the indigent, typically provided by government without any corresponding obligation to contribute.

Social protection: the broad term, mostly in developing countries, to describe the incremental delivery of support, or incentives at private support, of basic needs to improve the quality of life of the people of a country.

Funded retirement system: an approach to providing for a country's elderly that calls for contributions to be paid during working lives and invested to provide for income in old age, contrasting an alternative in which the contributions of today's workers are used to cover the costs of pensions of today's elderly, which is also called a pay-as-you-go system.

Compulsion: in the context of a retirement system, a government mandate on all workers to contribute to retirement funds, either private arrangements or a centrally managed fund, or both. Compulsion is not applied in South Africa.

Preservation: an approach under which retirement savings may not be accessed prior to retirement. The absence of mandatory preservation in South Africa leads to a high rate of early cashing-in of savings, typically by resigning a job first.

Umbrella funds: multi-employer retirement arrangements under which the workers of many different companies contribute to and benefit from a single fund, usually with flexibility of design options at the level of the employer.

Coverage: the extent to which a social protection system, like the framework that provides for old age, reaches people. It is typically defined as the proportion of the working-age population (or sometimes the working population) that is included in the entities that form part of the system, retirement funds, retirement annuities or, in the case of a compulsory system, a national social security fund.

Informal-economy workers: those workers operating informally, either because they are self-employed and not registered or because their employers do not offer them the normal protection offered to employees under labour law.

Tax incentives: South Africa offers to taxpayers an exemption on that part of their income that they direct to retirement saving, subject to a limit, to encourage them to save for retirement. Part of the lump sum received by pension fund members at retirement is tax-free, but any withdrawals before retirement are heavily taxed.

Under the proposal, one-third of contributions are allocated to an accessible account. The accumulation in this account may be drawn down, subject to some constraints, whenever the member needs the cash. The money in the retirement account, in contrast, to which the balance of contributions is made, must be left until retirement, though some payout on prior death is likely.

The logic for splitting contributions, and limited access to retirement savings, is an established part of the system designed for informal-economy workers. Convincing these individuals to put aside part of their meagre resources for the long-distant future depends on a measure of access in time of need. Several such systems exist around the developing world.

It's certainly bold to offer fund members — who've already been given a tax incentive — an option to remove part of their savings. Any tax incentive already received can be returned to the fiscus in proportion to the amount withdrawn. This is innovative as well, probably a world-first for an established formal-sector pension system. It also goes some way to addressing the twin problems of low contributions and poor preservation of existing retirement savings.

But the proposal is not a slam-dunk.

For a start, the tax implications are not simple. The administrative obligations on retirement funds would be significant. And special consideration would be needed for defined benefit arrangements. Funds would also need to consider the differences in the respective investment strategies applying to each account.

In truth, however, they already manage the uncertainty of members resigning and cashing in their retirement savings early, so this might even be an improvement.

However, the most significant problem with the proposal is that it represents another example of fractured policy. It assumes, as do most of Treasury's recommendations, that the social protection will continue largely as it is. Yet that is not in line with the thinking of the green paper issued last year by the Department of Social Development, which envisages mandatory contributions without early access to saving. Once again, we don't know how seriously to take this innovative proposal, because we cannot work out how it fits into the bigger policy picture.

Agency-principal conflicts

Incentives are powerful. Offer an agent a reward that is in proportion to the success achieved and they are more likely to do it in line with the wishes of the principal. The key lies in the alignment of the reward to the desired outcome.

Three problems with conflicts are worth noting.

First, we may never know the impact because we have nothing to which we might compare the outcome. The counterfactual, in formal language, doesn't exist. The consultant may provide biased advice, for example, but we can't be sure that the outcome is poorer than the alternative.

Second, even where incentives appear to be sound, conflicts can have an adverse effect. A study found that estate agents achieved higher prices when settling their own houses than when selling those of others, despite the apparent alignment of interests in the commission structure.

Third, the potential for poor outcomes is greater where those outcomes are difficult to measure over time. It is hard to determine whether the advice provided by an independent intermediary is the best for the customer or not, not just because the counterfactual doesn't exist, but because of the sheer complexity of an imaginary calculation covering a long period.

The potential for agency-principal conflicts in retirement funds is enormous. Members, the ultimate principals, are not in a good position to represent their own interests. Providers of service of all types, all of them agents, have the information and power to act in a way that lines their own nests but does not necessarily serve the interests of their principals. The potential impacts of these conflicts of interest ought always to be considered.

A fractured system: the case of umbrella funds

For an example of the fractured retirement industry, consider the case of umbrella funds.

Now, running a retirement fund isn't easy. For a company whose core business is retail sales, say, or manufacturing, the issues can be complex. A board of trustees must be convened, administrator and investment managers contracted, a set of rules written up and approved, and decisions made regarding the ongoing management of the fund. Professional advisers are frequently contracted, because the trustees cannot be expected to know everything about running the fund. The advice that the advisers give, however, is sometimes tainted by conflicts of interest.

Employers of all sizes used to take this on, typically as an extension of their ethical obligation to provide a sound set of remuneration benefits to their workers.

But over the last few years, many of these employers have asked themselves whether this is worth the effort and have chosen to utilise an umbrella fund to provide this service. This appears to be encouraged by government policy, which seeks to rationalise the number of registered retirement funds in the interests of efficiency. Moving to an umbrella fund is surely better than no retirement savings at all, but is it the best for these employees?

> *Umbrella funds promise to deliver to members everything that the company would like its employees to have, but without the hassle.*

Umbrella funds promise to deliver to members everything that the company would like its employees to have, but without the hassle. With all the needed services available under one roof, overseen by experienced trustees, employers must ask what could possibly go wrong.

The short answer is that when commercial interests get too close, special care needs to be taken to protect member's interests.

Within the constraints of its capabilities and licensing, a retirement fund can choose whether to deliver services itself or outsource them. The major services are typically administration, the provision of death and disability benefits and managing the fund's assets. If the fund outsources these services, the service providers charge a fee, and aim to make a profit. Good management of a fund demands that the best possible services are obtained at the best possible price.

Umbrella funds are registered retirement funds, so they are not-for-profit entities. They fall, however, into two broad camps. The National Treasury paper, referring to these as Type A and Type B funds, distinguishes between the types of rules that apply to each.

The distinction that matters, however, is whether a commercial entity has an interest in the fund and its success. Type B funds are typically not commercial, devoted to meeting the needs of workers in an industry sector. But not all Type A funds are commercial in nature either.

For example, the Sentinel Retirement Fund, with R87bn in assets, is a Type A arrangement open to new groups of members that are not part of a financial group. (See parts 2 and 3 for elaboration on this.)

But consider these commercial entities a little more closely. If a profit-making entity establishes an umbrella fund, it does so at its cost and it expects to receive some reward. The reward is typically achieved by providing profitable services to the fund. This puts significant constraints on the trustees of that fund, who are required under law to manage it in the best interests of the fund and its members.

So, what if the administration provided by the commercial entity is poor or expensive? What if the range of investment funds is inadequate or the fees are not competitive? The reality is that the trustees' actions are constrained. This surely undermines the legal and ethical framework within which they are required to operate.

Commercial umbrella funds have other advantages over their non-commercial counterparts. Though they cannot legitimately use the assets of the fund to market themselves to potential customers, their commercial hosts can do so, so these funds benefit from the brand strength and marketing budgets of their hosts. They may benefit from the propensity of the employee-benefit advisory teams to direct groups to consider using the commercial funds — a conflict of interest surely. They can provide a full range of death and disability benefits from within the financial group.

Their non-commercial counterparts find it very difficult to compete with this. They may have a form of captive market where they exist to serve the members of an industry sector, or their roots lie in this sector. But, they cannot use sizeable amounts to market their services because this is not a responsible use of the resources over which the trustees have control. Under law, they also cannot directly provide certain benefits, such as temporary or permanent disability benefits or funeral benefits.

But do these conflicts of interest have an effect in practice?

They appear to. Commercial retirement arrangements in Australia have long been characterised by higher fees than their non-commercial sector-specific counterparts, though this gap appears to be closing.

In SA, silence sometimes speaks louder than words. Unambiguous, regular, industry-wide disclosure of the fees and charges of these commercial umbrella funds would quell any concerns that their commercial parents are taking advantage of the captive nature of these arrangements. Commercial umbrella funds claim transparency of fees (see their responses to questions in part 3), but the comprehensive surveys of costs that characterise the Australian environment are strangely absent here.

More concerning, and probably more dangerous, are the hidden costs of these constrained arrangements. Charges need to be understood in the context of the corresponding benefits provided. If administration is provided by the commercial host at acceptable rates but poor quality, who speaks up for the members whose precious retirement information is put at risk? If the quality of investment management is not up to scratch and members are losing value in their single largest asset, who speaks for them?

Finally, for competition to work, it should be easy to exit. Yet it isn't easy for an employer to transfer from one umbrella fund to another. It is well-nigh impossible to re-establish the independent fund that existed before. That is not a level playing field.

New policy to address the conflicts of interest

These problems have been acknowledged for some time by National Treasury, which agrees that a sustainable solution to a fragmented retirement environment is required.

Its recent paper puts forward several proposals concerning clarity of disclosure and minimum standards of governance. It even suggests that services to commercial umbrella funds must be awarded on an open-tender basis, echoing the blind auctions for services to members in some Latin American markets.

However, it is not clear that these recommendations could effectively address the fundamental problem resulting from commercial conflicts of interest. Changes could amount to window dressing. It doesn't help to insist that half of the trustees are independent if, in practice, they do not have the freedom to fire underperforming or overcharging providers of service.

> *Transparency is not useful if it doesn't promote comparability of charges and performance, or if it is practically difficult for an employer to leave an umbrella fund.*

Transparency is not useful if it doesn't promote comparability of charges and performance, or if it is practically difficult for an employer to leave an umbrella fund.

Policymakers have tough choices to make. If the system of commercial umbrella funds is systemically unfair, then introducing a few rules to improve competitive dynamics may not be sufficient to address the underlying problem. But policymakers need to show leadership, and grapple seriously with this.

With able leadership and a sound strategy, government could deliver on its mandate from the constitution. Sound, effective policy could be formulated around a clear set of objectives. Regulated entities could be called to account, not just by the regulator but by those whose life savings they hold. And trustees would do a better job of looking after their members, while members could ensure that their representatives do the right thing well. ■

Rob Rusconi is a pensions and insurance policy researcher and consultant.


When it comes to making an impact,
this is how we shine.
Our range of impact portfolios supports responsible investing to create investments that are good for our clients and the planet. As an example, the Momentum Alternative Energy Fund invested in the refinancing of Karoshoek, a round 3 plant in South Africa's Renewable Energy Independent Power Producer Procurement Programme. Karoshoek is situated about 30km from Upington in the Northern Cape, which is an ideal spot for harvesting the energy of the sun to generate electricity. It's an example of impact investing – investments that spark positive, measurable social and environmental effects with a financial return. Because, when it comes to sustainable investment growth, for us, it's personal.
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COVER STORY part 2

Responses to questions: non-commercial umbrella funds

1. How do you ensure that the composition of the board of trustees fairly represents the interests of the members of the fund?

Omar Gire, principal officer, Metal Industries Provident Fund and Engineering Industries Pension Fund: The member trustees are member elected union representatives and union appointed officials, who play an important role in disseminating fund information back to members. Representivity of the number of member trustees on each fund is proportionate to the union membership. There are an equal number of employer appointed trustees and an independent trustee.

Eric Visser, chief executive officer, Sentinel Retirement Fund: The current composition of the board reflects to a large degree our mining industry origins and comprises two employer nominated trustees, eight trustees nominated by various organised labour organisations and an independent trustee, appointed by the board, who is also the chairperson of the board. The nomination and subsequent appointment process is managed by the board through a nominations committee, mandated to assist and advise the board on the composition and capacitation of the board and its sub-committees, including, independence, representation, fit and proper, skills, knowledge, experience, and transformation.

The fund is working towards applying for indefinite exemption in terms of section 7B of the Pension Funds Act and the requirements as set in Guidance Note 4 of 2018 and is also guided by the governance principles embodied in PF130 and King IV. Current capacitation of our six board sub-committees with several independent professionals reflects major strides in this regard.

2. How do you ensure that your benefit offerings are appropriate for your members, that is, are fit for purpose, and represent value for money for them and for government that provides the supporting tax incentives?

Metal Industries Provident Fund: The pension fund offers an in-fund annuity to retirees based on very low administration costs and competitive annuity rates. The fund has consistently awarded pension increases comparable to or better than inflation and pensioners received a 13th cheque and a 14th cheque last year. Concerns regarding the pension ceasing on early death have been addressed by offering a 20-year guarantee period. National Treasury, at the fund's request, assisted provident fund members by passing legislation to allow provident fund members to transfer to the pension fund immediately prior to retirement to purchase the in-fund annuities.

The death and disability benefits are self-insured to ensure there is no leakage of insurance profits and costs. Administration and investment fees are tightly controlled to ensure the contribution allocations to retirement savings are maximised.

Sentinel Retirement Fund: Sentinel, as a self-administered fund, provides benefits allowed in terms of the Pension Funds Act. This includes approved death cover and lump-sum disability cover, with flexibility at employer level in terms of participation in the products and cover levels selected. The fund also provides in-house annuity options to retirees, including a living

Gire . . . Metal Industries Provident Fund

Visser . . . Sentinel Retirement Fund

annuity, through its seamless and costless Pension Income Choice model.

As an approved fund, Sentinel is prohibited from providing certain benefits that traditionally fall within the domain of life assurers, such as permanent and temporary disability income benefits and funeral lump-sum benefits that are not subject to section 37C of the Pension Funds Act.

If we were able to offer these products/benefits to our participants in-house, this would, in our opinion, improve on our risk products being fit for purpose, potentially reduce costs for participants and ultimately enhance member outcomes.

3. How do you ensure competitive fees and transparent disclosure of your charges?

Metal Industries Provident Fund: The funds are administered by Metal Industries Benefit Funds Administrator (MIBFA) which is a non-profit company. This, together with the economies of scale in respect of the funds (combined they have some 250,000 in-service members and pensioners) ensure that the administration and other fund expenses of 0.5% are low relative to most other retirement funds. MIBFA only administers the two funds and can therefore focus on a high level of service to the members and pensioners.

The assets are managed in a combination of passive and active portfolios. A portion of the funds' assets are managed in-house and the trustees have negotiated very low fees in respect of the externally managed assets. The total asset fee is less than 0.2%, with the saving increasing the investment return allocated to member benefits. Investment returns have been excellent and are consistently in the top half of the main investment performance surveys.

Sentinel Retirement Fund: The fund's self-administered mutual society business model directly benefits participants as only actual costs incurred are recovered. To ensure transparency, we follow a "Total Cost" recovery model that includes all fund entity, administration, and asset management costs. "Total Cost" is communicated monthly based on the ASISA retirement savings cost standard.

The largest component of "Total Cost" is asset management fees emanating from our multi-manager LDI investment strategy underpinning our life stage, member investment choice and pensioner portfolios. With assets under management exceeding R90 billion, we are able to negotiate highly favourable asset management fee structures, which again, directly benefit participants.

The fund does not levy any other fees or charges when, for example, a retiree becomes a pensioner in the fund, or when counselling and advice is provided. Our "mutual society" business model is, in our opinion, highly competitive as no "profits" are generated from participation in the fund. ■

Transforming the transition management landscape

Northern Trust recently joined Standard Bank on its journey to provide South African institutional investors with an expanded and innovative investor services offering.

After experiencing a resilient stock market for the past two years, 2022 started on a surprisingly volatile note. Only two months into the new year, a swift market correction has already occurred. Although an expected movement of a functioning stock market, many financial experts warn that above average stock market volatility lies ahead.

With heightened volatility, the risks associated with portfolio restructuring increases. Consequently, cost-effective transition management strategies supplemented with robust project management will be critically important for risk mitigation.

The challenge is that transition management has become an increasingly complex undertaking as more investment managers, stakeholders, and strategies are involved in the process.

Innovative investor services

With an ambition to deeply understand customer challenges and provide innovative, collaborative solutions, Standard Bank set out to connect with the right partner to fill the strategic gap in its transition management offering.

After a comprehensive vetting process, Standard Bank recently entered into a memorandum of understanding with Chicago-headquartered financial services company, Northern Trust. This partnership will enable the delivery of innovative transition management services across South Africa.

"Critical to this partnership was Northern Trust's ability to anchor and enhance Standard Bank's overall investor services business and echo the strategic priorities of its financial services ecosystem", says Adam Bateman, Head of Business Development, Investor Services at Standard Bank.

Over the past five years, Northern Trust has executed over 1000 transitions, with a value in excess of US$400 billion, across their global client base.[1]

Standard Bank clients will have access to Northern Trust's full suite of transition management services and specialist expertise in transition management for institutional asset owners and asset managers.

The complexities of commingled funds

One such area of expertise in transition management is navigating the complexities of commingled fund purchases and sales. Moving securities between segregated accounts and pooled vehicles require more than simply conveying instructions to a fund services provider.

Craig Blackbourn, Head of Transition Management EMEA, at Northern Trust, cautions that careful planning is necessary to understand market intricacies and any potential explicit, or implicit costs. A number of factors need to be considered to reduce risk and cost, which are:

- minimising cash drag;
- understanding the fund vehicle's settlement cycle

[1] Source: Northern Trust. As of 31 December 2021.

Standard Bank

and valuation point;

- identifying change of beneficial ownership transfer taxes; and
- calculating potential spread costs or anti-dilution levies.

He suggests that although cash subscriptions may be the most prominent avenue to gain exposure to offshore commingled vehicles, it might not be the most cost advantageous.

Understanding and reducing risks

Another potential pitfall is fund transactions, which can appear straightforward. Blackbourn warns that the scope for performance drag with unintended exposure to cash is a real concern.

Consider this scenario. An investor wants to move from an offshore fund, which is passively managed, to a broad-based index or comparable fund, offering a more active management approach. Understanding how and what pricing points are used for these two independent funds is key.

If the passive fund uses a prior day valuation point (T-1) to assess the value of the cash redemption, yet the target active manager uses prices on the actual trade date (T), this creates an out-of-market event for the investor. While each fund offers the same trade date (in calendar terms), the exposure to the market is lost on the day prior with the subsequent reinvestment on a next day basis. This potential risk becomes more pronounced if the settlement cycles are not aligned. A single day of risk can soon balloon to multiple days or weeks of being out of the market.

Experts you can trust

The question exists whether it wouldn't be more advantageous to take receipt of the investor's portion of the fund via a transfer of the underlying securities, retain the common names, and avoid the additional associated trading costs. And the answer for many investors has become a resounding "yes", cementing the rationale for an in-specie transition event.

That said, partnering with an experienced transition manager such as Northern Trust will be key when transacting in global assets. With a custom cost-benefit analysis, its team can determine whether the savings from the overlapping securities truly outweighs any prospective in-specie transfer costs.

By leveraging the combined expertise of the Standard Bank-Northern Trust partnership, customers can have a clear view of potential hurdles on the path to protecting their portfolio's economic value – in 2022 and well beyond.

NORTHERN TRUST

COVER STORY part 3

Responses to questions: commercial umbrella funds

1. How do you ensure that the composition of the board of trustees fairly represents the interests of the members of the fund?

David Gluckman, board chairman; sponsor-appointed trustee, Sanlam Umbrella Fund:

i. All highly capable professionals.
ii. Diversity e.g. race and gender.
iii. 50/50 split between sponsor-appointed and independent trustees.
iv. Clear separation of the sponsor-appointed trustees from the sponsor – including incentivisation.
v. Careful selection of sponsor-appointed trustees – credible, experienced, pragmatic, outstanding reputations and who believe in the fund's vision.
vi. Member representatives vote for the independent trustees from a panel of industry experts.
vii. By defining the highest standards to qualify as independent.
viii. Hosting an AGM and publishing an annual Trustee Report wherein work done is described and performance assessed.

Malusi Ndlovu, director of large enterprise, Old Mutual Corporate: The King IV report does not differentiate between types of trustees. All have the same responsibility towards members. Through professionalism, independence and diversity of trustees (by way of background, industries, and experience), we ensure that members' interests are foremost. We have two out of eight trustees who are sponsor-appointed, however, as per above the role of sponsor and independent trustees is to protect the interests of members.

Elio E'Silva, head direct corporate solutions, Alexander Forbes: The board ensures diverse skillsets and backgrounds covering legal, communication, finance, investments, actuarial, operations and employee benefits. The diverse, robust skillset allows the board to manage the fund holistically in the interests of the members. The board is made up of 50% independent trustees, who chair the board and most committees. The board appoints trustees after disclosing candidates and calling for objections. An annual AGM is held. Trustees regularly review member complaints. Sponsor trustees do not hold any special rights or veto abilities. Trustees seek ways to improve the outcomes of the members and ensure that the fund remains appropriate.

Nashalin Portrag, head: FundsAtWork, Momentum Corporate: The FundsAtWork Umbrella Fund trustees take all reasonable steps to protect members' interests. The funds are guided by good governance, legislation and fund rules. The trustees act impartially in respect of members and beneficiaries.

Trustees have extensive knowledge and experience across various fields. More than half are independent and have no relationship with Momentum. Our rules make it mandatory for every participating employer to appoint an advisory body, irrespective of member numbers. This group represents the needs of members on the employer's scheme. We support each advisory body with appropriate training and communication regarding their duties and the industry.

Alisha Corbett, head Liberty Corporate Umbrella Fund: We believe that an appropriately selected combination of trustees provides the best balance

Gluckman . . . Sanlam Umbrella Fund

Ndlovu . . . Old Mutual Corporate

of objectivity, industry knowledge and diverse experience, which are needed to represent the typically broad and diverse member constituency of a large commercial umbrella fund.

The trustee selection process is rigorous, to ensure optimal representation of the interests of all members of the fund. Each trustee brings appropriate qualifications, skillset and diversity, such that sound decisions are taken and credible discussions and debates may be held in the interests of all members of the fund. Furthermore, trustees' actions are guided by, and continuously measured against, their fiduciary duties.

2. How do you ensure that your benefit offerings are appropriate for your members, that is, are fit for purpose, and represent value for money for them and for government that provides the supporting tax incentives?

Sanlam: Sanlam offers a very broad universe from which each employer constructs its own unique benefit offering. This broad universe is continually reviewed by a sponsor product committee and the board. No offering is included unless it satisfies various criteria, including the six Treating Customers Fairly principles. Every employer is advised by a FAIS-accredited Contracted Benefit Consultant, remunerated on a transparent fee-for-service basis, who makes a formal recommendation on the most appropriate benefit offering for the sub-fund. Ongoing service delivery and complaints are monitored to quickly identify areas for improvement. Customer and consultant feedback aids the ongoing product enhancement process.

Old Mutual: Our Old Mutual SuperFund umbrella has a number of package options available to employees to ensure there is a suitable match. Employers can select benefit structures including contribution rates, risk benefits and selection of insurer in conjunction with their advisor.

Trustees continuously review the benefit structure of the fund to ensure that it is still suitable for members and employers.

Annually, on fee review, the SuperFund trustees ensure that only inflation-related increases are passed on to the members.

Alexander Forbes: We conduct research into retirement outcomes and challenges faced. The

E'Silva . . . Alexander Forbes

advice framework then focuses on understanding and adjusting the levers that impact outcomes via benefit design, solutions and defaults implemented. Member outcomes are tracked through advanced tools, showing both aggregate and individual outcomes and the impact of any adjustments to levers.

Clients are advised by skilled specialists in designing competitive benefit offerings which offer value for money. Value for money is an assessment of cost, quality and outcome – all considered in the research and advice, which allows us to impact positively on clients and improve outcomes with our holistic solution.

Momentum: We invest heavily in data analytics and extensive immersive research to understand members' needs. The insights from these investigations inform benefit design, ensuring offerings are fit for purpose. We've also created high levels of flexibility at both employer and employee level. For example, members can choose different levels of insurance cover, contribution rates and have access to a comprehensive range of investment portfolios. This allows them to personalise benefits. We also use state-of-the-art digital platforms, that are not only many members' preferred engagement channels, but reduce service and communication costs and improve value for money.

Liberty: Through our Umbrella Fund Solutions, encompassing retirement benefits, risk benefits, and value-added services, we aim to look after members' financial and emotional wellbeing. The underlying products and solutions aim to provide appropriate and adequate risk cover while ensuring sufficient savings towards a comfortable retirement. We also encourage members to use our assistance and emergency services when needed most. Our products and services are regularly reviewed to ensure that the underlying features remain suitable and cost effective for our members. By solving for members' long-term needs, the risk of individuals depending on the government once they retire is significantly reduced.

3. How do you ensure competitive fees and transparent disclosure of your charges?

Sanlam: The commercial umbrella fund market is highly competitive. Transparent disclosure of all charges (including a clear separation of the various layers i.e. administration, advice, investment management and other) tends to ensure our charges remain competitive. The philosophy is to quote all-inclusive fees reviewable annually which helps customers and consultants to evaluate the combined impact of all charges. We also publish all charges with every new business quotation and amendment showing RSC disclosure compliant with the ASISA standards, and any member can request their individual EAC disclosure. Ongoing actuarial analysis is performed to identify any potential improvements.

Old Mutual: We have a member-level effective annual cost, which is now included on all statements and available to all members on request.

Our quotes to clients include the ASISA recommended RSC tables. In addition, our fees are fully disclosed and transparent to members and employers on their statements and the detail is available to members online at any time.

Trustees conduct regular detailed reviews of the investment managers and portfolios. These factor

Corbett . . . Liberty Corporate Umbrella Fund

Portrag . . . Momentum Corporate

various aspects including fee competitiveness.

Alexander Forbes: The umbrella market is extremely competitive. We follow ASISA standards on quote cost disclosures and members can access their effective annual costs (EACs). Regular disclosure of fees to trustees, employers, mancos and members is accompanied by annual administration fee review and detailed disclosure. Investment fees disclose all constituents of the TIC. Our administration fees are typically an all-inclusive fee without additional charges. We review fees against the market to ensure competitiveness, considering value for money (quality, reliability, dependability, and flexibility) as well as member outcomes. Cutting crucial costs to be the cheapest does not guarantee better outcomes.

Momentum: Our aim is to keep fees competitive but sustainable, while offering value-for-money solutions. As one of the big five umbrella funds (GraySwan Survey 2021), we leverage economies of scale to keep fees competitive. Our market-leading wellness and rehabilitation centre facilitates a speedy return to work following a disability, reducing the duration of claims, which helps to keep insurance pricing competitive. Full transparency is reflected through a detailed breakdown of all fees on members' benefit and investment statements, with clear explanations of the services the member pays for, supported by digital engagement. Marketing material includes a breakdown of fees payable.

Liberty: Regular reviews and market analysis are conducted to determine the appropriate fee structure and levels that are fair to members, while ensuring business sustainability.

We believe that transparent disclosure of all charges is of paramount importance and ensure this is done broadly and continuously by reporting to members and employers.

We disclose retirement fund charges, for example, through two reports. A Retirement Savings Costs Disclosure is an illustration of these costs at an employer level, while an Effective Annual Cost Disclosure is an illustration of the charges that a member of a retirement fund is likely to incur. ■

POLICY

R136bn: Unclaimed, but not unwanted

Non-profit organisation Phakelwa calls for a combined public and private sector initiative to find the millions of people entitled to stranded financial assets.

By Sipho Shezi and Rosemary Hunter

In 2019, Phakelwa, a non-profit organisation, estimated that there were unclaimed or unpaid financial assets — essentially, stranded financial assets — worth at least R136bn.

This shouldn't be so. There are individuals, and families, spread across southern Africa, entitled to this money. At a time when unemployment has breached record levels, the benefit to these families (and local economies) if they could be found is self-evident.

As it is, many retirement funds and financial institutions have tried to locate those people, with partial success. At the same time, thousands of people who're entitled to benefits say they face immense obstacles when trying to claim what they're owed.

It's clear that the government, along with the private sector, need to come together to find a new way to tackle this problem.

What makes it more complicated is that the unclaimed money sits in a variety of funds and accounts. This included, at last count:

- About R50bn in deposits sitting in dormant bank accounts;
- About R17.1bn in unclaimed proceeds languishing in collective investment schemes, and risk benefit policies;
- An estimated R95.8m due to claimants by the Legal Practitioners' Fidelity Fund, and an estimated R42.9m due by the Sheriffs' Fidelity Fund;
- A reported R11.1bn in unclaimed money held by the Guardian's Fund;
- About R19.1m held by the Department of Justice, consisting of unclaimed bail money, maintenance, and other payments to various courts;

Hunter . . . those entitled to stranded financial assets need to be traced

Shezi . . . a detailed note has been given to the President

- R555.5m due to claimants by the Occupational Injuries and Diseases Fund;
- About R5bn held by the Silicosis Trust Fund on behalf of claimants following the successful class action lawsuit some years back; and
- An estimated R500m in unclaimed money held by the Unemployment Insurance Fund.

This of course isn't a comprehensive list.

There were other stranded assets too — where the amounts aren't known — including dividends paid to nominee companies for unidentified shareholders, and shares that rightfully belong to people through the demutualisation of various companies.

There is also money due to people by the Property Practitioners' Fidelity Fund, and amounts due to clients by their attorneys. And there's also money due to claimants by the Compensation Fund, under the Occupational Diseases in Mines and Works Act.

Why are these funds in purgatory — and what can be done?

There are a number of reasons why this is. Poor record keeping is one, ignorance of the rules is another, while the fact that some people failed to tell their dependants about what they were entitled to, before they passed away, is also a factor.

In other cases, foreigners left the country soon after their jobs came to an end without claiming what they were owed, while others had inadequate access to the claims system.

The bigger question is, how can we fix this?

Phakelwa — which was created by more than 40 financial services professionals acting in their

individual capacities — has a number of proposals.
For example:

- Create a public-private partnership organisation, governed by a board of competent people of impeccable integrity and reputation, to manage this process.

- Establish a secure and well-governed information exchange to record the details of the people entitled to those assets, and the amounts concerned. This should collate information from various government departments — including communications, home affairs, labour, justice, and the SA Social Security Agency (SASSA) – and private sector financial institutions and other bodies.

- Prioritise efforts to inform the public of their rights, and how to enforce them, when it comes to stranded financial assets.

- Organise shared tracing facilities and efforts (such as the use of "triangulation" facilities to trace people using cellphone numbers obtained from the RICA database).

- Create income-earning opportunities for young people, by training them to help members of the public complete and upload their claims of various kinds to a cloud-based system that will direct them to the right institution for processing.

- Establish a new "stranded financial assets fund" governed by a board of public and private sector appointees of indisputable integrity, with the legal duty to find and pay people the money due to them.

- Use assets held for unidentifiable or untraceable people to fund the costs of these facilities and efforts, and development projects designed to fulfil social security objectives.

Times of trouble

Because the success of this project will depend on co-ordination and direction of a range of public sector role-players, the Presidency has already been given a detailed note on how it could work. A representative of the Presidency was initially keen to meet with Phakelwa to discuss a way forward. However, this meeting still hasn't happened, which is disturbing.

Back in 2018, the National Treasury said it planned to consult with organisations like Right2Know and the Casual Workers Advice Office on ways to address the problem of unpaid retirement fund benefits. Since then, however, it has ignored requests by the Unpaid Benefits Campaign — of which both NGOs are a part — to discuss this.

Instead, Treasury has held private meetings with representatives of the Association for Savings and Investments South Africa (ASISA), representing the big life offices, to discuss this matter. And there has been no announcement of any definitive plan.

What Treasury has proposed is an amendment to the Pension Funds Act to establish an "unclaimed benefits fund" to which all retirement funds will be required to transfer their liabilities for unpaid benefits. But it seems unclear how that will improve the position.

As this issue continues to drag on, it is time for President Cyril Ramaphosa to take control of this process from the Treasury and the Financial Sector Conduct Authority (FSCA). As a start, he ought to mandate the inter-ministerial task team on retirement funding and social security to meet with Phakelwa to discuss these proposals.

At this point, it seems like the most tangible step that could be taken to deal decisively with the problem of stranded financial assets. This isn't just in the interests of the families entitled to them, but it'll be of benefit to the wider economy too. ■

Shezi and Hunter are members of Phakelwa. Shezi has been an academic, activist, and consultant to the World Bank. His last position in government was as special advisor to former minister of social development Bathabile Dlamini, who fired him. Hunter is a pensions and financial services expert, and partner at Fasken attorneys. She was the deputy registrar of pension funds at the FSCA before returning to practice.

Sanlam Benchmark Research 2021

Key take-outs from the 40th retirement industry survey

1 Cost of retirement fund administration

0.55%
Cost for stand-alone funds (slight reduction since 2019)

0.59%
Cost for participating employers in umbrella funds (the same as 2020)

R52
average cost for stand-alone funds in rands

R41
average cost for participating employers

2 Contribution trends

Stand-alone funds and participating employers' employer contribution levels are **steadily increasing again since a drop in 2018.** However, 2021 recorded a slight drop in employee contribution levels in umbrella funds of 0.7% although still up from 2018 levels.

Employer contribution

10.8% average employer's total contributions in stand-alone funds

9.4% average employer's total contributions in umbrella funds

Member contribution

Ave 6.6%
of total package contributed by members in stand-alone funds

Ave 6.3%
contributed by members in participating employers in umbrella funds

3 Contribution suspension

41.0%
of participating employers in umbrella funds suspended retirement contributions due to Covid-19

27.0%
in stand-alone funds

4 Retirement funds and rewards/loyalty programmes have not yet gained traction in a retirement funds context.

88.9%
of stand-alone funds said they do not offer rewards/ loyalty programmes

79.0%
of participating employers in umbrella funds do not offer rewards/ loyalty programmes

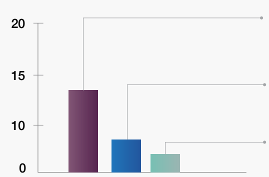
5 Health integration

49.0%
of stand-alone funds and,

36.0%
of participating employers believe a holistic, integrated health and financial wellness programme delivers higher productivity and staff happiness.

6 Investments

More funds and employers are selecting a combination of default investments with and without member choice



Less (10.0% to 13.0%)
funds and employers are offering default investment portfolio plus member choice.

Proposed changes to Regulation 28

Only 6.6% of stand-alone funds and,

4.7% of participating employers will be investing in infrastructure investments.

7 Default regulation and member behaviour

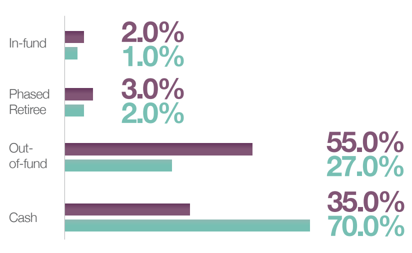
Stand-alone funds have not seen a significant improvement in member behaviour since the implementation of default regulations.

57.0%	46.0%	25.0%
Preservation	Annuitisation	Retirement Benefit counselling

- Base: All those who have not seen an improvement in member behaviour
- Stand-alone funds

8 Retirement benefits counselling outcomes

Impact of Retirement Benefit Counselling at retirement



The Sanlam Umbrella Fund data indicates that members that are counselled at withdrawal are twice as likely to preserve

9 Impact of Covid-19

Impact of Covid-19 on cyber security

Increase in the risk of cyber security as a result of staff working remotely.

46.0%
41.0%

- Stand-alone funds
- Participating employers

Impact of Covid-19 on Members' Finances

31.0%
of participating employers reported retrenchments at the workplace.

For 40 years, the Sanlam Benchmark Survey has been South Africa's most comprehensive retirement industry research.
In 2021, 90 stand-alone funds, 10 stand-alone union funds and 100 participating employers in umbrella funds were surveyed.

Sanlam
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PENSION PONDERINGS

Conflicts of interest and the abuse of social security funding

By Rosemary Hunter

One of the ways in which the state fulfils its constitutional obligation to "achieve the progressive realisation" of the right to social security is to provide generous tax incentives to persuade companies to enrol staff in retirement funds to save for their retirements.

It's not just companies that this applies to, however. The self-employed are also given tax incentives to save through voluntary vehicles like retirement annuities.

Largely, these incentives take the form of tax deductions for contributions to retirement funds, tax-free accounts, and a generous tax treatment of benefits payable by those funds to their members and beneficiaries.

These are incentives that cost the fiscus many, many billions of rands.

This, in effect, makes the state a co-investor in retirement funds, including those established by for-profit companies, trade unions, and financial services providers. Those funds are, in effect, vehicles for the delivery of social security benefits.

As a result, you could argue that retirement funds are "organs of the state", as defined by the Constitution.

Hunter . . . incentives cost the fiscus billions

If so, this would oblige those funds to "respect, protect, promote and fulfil the rights in the Bill of Rights," including the right to social security.

The implications of this interpretation are many. For example, it suggests that retirement funds would

What tax exemptions on retirement fund contributions cost the State

According to Annexure B ("Tax expenditure statement") to the 2022 Budget Review, the country's tax expenditure (or "revenue foregone") in the form of the deduction of retirement fund contributions from income for tax purposes was some R94 billion in the year ended March 2020. Some R19 billion of this tax expenditure was recouped through tax deducted from retirement and early withdrawal benefits paid out during that year (see National Treasury discussion paper 2021121401 Two-pot system retirement proposal and auto enrolment.pdf (treasury.gov.za) at p 6) leaving a net incentive cost to the fiscus of approximately R75 billion.

then be obliged to exercise public power, and perform in a way that is "ethical, transparent and accountable" and use their resources effectively.

The Pension Funds Act, passed by Parliament in 1956, recognised that it was in the broader public interest that funds be run fairly, properly, and successfully. So, this legislation gave extensive powers of regulation and supervision to the registrar of pension funds. Today, it is the Financial Sector Conduct Authority (FSCA) which wields that regulatory power.

In 1998, however, there was a dramatic change to the governance of funds. The Pension Funds Act was amended to require each fund to have a board of management to act as its "directing mind and will", and ensure that the fund is "fit for purpose" and offers "value for money" benefits.

With that in mind, it is strange that the FSCA thought it appropriate in 2018 to issue a "guidance note" saying it may exempt umbrella funds, beneficiary funds, unclaimed benefit funds, retirement annuity funds and preservation funds from the obligation to give members the right to elect at least half of the members of their boards when no more than 50% of their board members are "independent". And has granted many such exemptions in those circumstances since then.

With the best will in the world, board members appointed by organisations with financial interests in the way the funds' business is conducted cannot reasonably be expected to ignore those interests when it comes to making decisions. And with half of the board of a fund "conflicted", how can it do its job properly?

Back in 2013, a judgment in the case of the Council for Medical Schemes v Liberty Medical Scheme spelt this out.

The court said: "the law of fiduciary duty rests not so much on morality or conscience as on the acceptance of the implications of the biblical injunction that '[n]o man can serve two masters'… duty and self-interest, like God and Mammon, make inconsistent calls on the faithful."

> *The Pension Funds Act itself requires the board of a fund to "act independently" and "avoid conflicts of interest".*

The Pension Funds Act itself requires the board of a fund to "act independently" and "avoid conflicts of interest".

How the FSCA reconciles its decision to continue to allow funds to be effectively controlled by board members who are appointed by and answerable to sponsors with financial interests is a mystery. ■

Rosemary Hunter is a pensions lawyer, former deputy registrar of pension funds and now partner at Fasken attorneys (incorporated in SA as Bell Dewar).

Not just bricks and mortar: the environmental and social impact in listed property

Lesiba Ledwaba, Head of Property Portfolio Management, explains.

Listed property is an asset class that has delivered steady income as well as capital growth over the long-term. The predictability of income streams from underlying properties is fundamental to the investment merits and returns of this asset class and naturally informs the investment decision making process.

However, over the past few years there has been a growing focus on aspects related to Environmental, Social and Governance (ESG) when it comes to property investments, with emphasis on the environmental part.

According to a World Green Building Council global status report, buildings and construction together account for 36% of global final energy use and 39% of energy-related carbon dioxide (CO_2) emissions when upstream power generation is included. The energy intensity per square metre (m^2) of the global buildings sector needs to improve on average by 30% by 2030 (compared to 2015) to be on track to meet global climate ambitions set out in the Paris Agreement. This is why there is a push towards a net zero emission strategy adoption by property owners.

The listed property sector has certainly made inroads when it comes to the environmental component, which was often necessitated by unreliable water and unsustainable electricity price increases from local government and/or Eskom. It's for this reason that landlords have had to adopt technology and invest in infrastructure that provides more efficient and environmentally friendly use of resources such as water and electricity.

The Coronavirus pandemic has heightened the focus on ESG and put a greater focus on the S in ESG.

This is especially relevant and important in a country like South Africa (SA) which faces significant socio-economic challenges. Since the start of the pandemic, the SA listed property sector has been at the forefront of providing substantial relief to small businesses and tenants in order to support jobs and ensure the survival of these businesses through the various lockdowns and waves of the pandemic. The SA REIT Association estimates that the listed property sector has so far provided rental relief of c.R3 billion.

Ledwaba . . . unlock the social values of properties

What is often not clearly articulated is that property has always had a strong social utility, much of which is intangible and difficult to quantify. Think of mankind's basic need for shelter which is catered for by the residential developments in the inner cities as well as high-end mixed-use developments. Property is also a vital part of the supply chain that enables the global and local distribution of goods and large warehouse facilities which are springing up to fulfil this role. Retail centres, student accommodation and offices have always been places of social confluence within safe environments.

One of the things to reflect on is how the eco-system around rural and township retail centres plays a role in social dignity and upliftment of communities within which they operate.

From their development up to operation, jobs are being created. These centres also create safe environments for the disbursement of social grants as they are located closer to communities. Transport costs to travel to collect grants are reduced. There is always some form of informal trade that also exists alongside these centres, typically small informal traders or retailers operating just outside their perimeter.

Although to ensure inclusivity, it would be ideal if property owners found a way of working together with informal traders to make them part of the greater retail precinct instead of having them operate outside the centres.

For investors and fund managers, it is important to also evaluate property funds against their social upliftment plans. Property companies must not only talk to their intentions but also provide tangible evidence and examples of putting this into action and advancing the social imperative.

Investors must also engage with property companies to assist them in finding ways to unlock the social values of properties and their role in addressing our country's socio-economic challenges.

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GOVERNANCE

How Covid changed group schemes

Insurers have changed their actuarial models after two years of Covid. So how does this affect increases and cover, asks Londiwe Buthelezi.

The past two years have been the most challenging for group life schemes. Covid has brought unprecedented death claims and, even between waves, the level of claims continues to remain elevated.

Take the case of Momentum Corporate. Before the pandemic, it received around 6.4 claims per 1000 lives from public sector group schemes.

During the first wave, this increased by 58%. The successive waves got worse as claims from state organisations and other government-related schemes increased by 108% in the second wave and 74% in the third wave.

"The claims experience of government and state organs tended to be worst than other clients," says Lelo Mashatile, the actuarial pricing analyst at Momentum Corporate.

Mashatile believes that one of the reasons for this pattern is that many public sector services were classified as essential during lockdowns. As a result, employees continued working on-site, making them more susceptible to Covid.

The CEO of group risk at Sanlam Corporate, Michele Jennings, says that her claims statistics showed that municipalities had a 57% higher claim volume than expected. And in rand terms, claims from municipal employees were 89% higher than expected.

Mashatile . . . essential workers were more susceptible to Covid

Wealthier South Africans in the firing line

While public sector workers stood out as a group, Jennings says that no industries were spared. Even among industries that had lower claim volumes in general, the claim size was significantly bigger because of the number of older claimants.

Thomas . . . assess health and risk holistically

Jennings . . . no industries were spared

"The industries that were the worst affected were almost always those with higher average ages and salaries, for example, industries with high executive pay," she says.

This included IT professionals, engineers, politicians, financial services workers, medical professionals, and other high-paying industries.

Graham Thomas, the divisional executive of risk products at Liberty Corporate, says that there are a number of reasons why Covid claims were skewed more towards high-income earners.

For a start, older members often have higher salaries as they hold more senior roles. While historically, this group tended to have lower mortality rates generally than the lower earners, Covid changed this.

Mashatile points out that before the pandemic, high-income earners also enjoyed better healthcare than lower earners. But when Covid hit, access to healthcare – public and private – became constrained, thus increasing the mortality risk of higher earners.

"Another reason could be the higher prevalence of comorbidities across higher earners," says Mashatile.

Could the pandemic change the way insurers underwrite their well-heeled clients?

Mashatile says that insurers don't have much wiggle room on group schemes because most members have typically bought cover without medical underwriting. So, it wouldn't be possible to change the underwriting rules and send high earners for medical tests, unless they apply for cover that exceeds "free cover limits".

Instead, insurers try to address the elevated risk by asking questions about previous Covid infections, vaccination status, and remaining symptoms.

"This is then assessed, together with any other medical conditions that may be seen as comorbidities. And based on that, we will assess the member's health and risk holistically and decide whether we will grant cover or not above that scheme's free cover limit," says Liberty's Thomas.

Vaccination status will be critical in future risk rates

As it stands, insurers say many employers don't have good quality data on what proportion of their staff have been vaccinated quite yet.

But those who can provide evidence of staff vaccinations might enjoy lower premium increases in future, when group schemes review their rates.

Hacking . . . Long Covid claims will emerge over time

"Ultimately, any intervention that reduces the mortality experience of a group will lead to improved insurance rates," says Old Mutual Corporate COO Hugh Hacking.

Thomas agrees, pointing out that Liberty will also take vaccination rates into account when setting prices for employers that have reliable data.

Mashatile says Momentum Corporate's approach to pricing will continue taking multiple factors into account. But the insurer will also consider the percentage of employees vaccinated, as well as the existence of a vaccine mandate, when it comes to setting rates.

"For larger clients, we will look at the impact the waves had on their claims experience when setting their rates. For smaller schemes, we rely on the experience of our book of business," she says.

In Sanlam's case, the average vaccination status of South Africa's adult population has already been factored into the group's projections of future claims.

In particular, it doesn't provide reduced rates for schemes simply because the employer has made vaccination mandatory. But if an employer can prove high vaccination levels, and Sanlam can verify this through the Electronic Vaccination Data System (EVDS), it will give a "benefit" to those clients.

Keeping an eye on Long Covid

All insurers interviewed by *Today's Trustee* say they have not experienced an increase in disability and critical conditions due to Covid just yet. If anything, there was a material decrease in the number of disability claims during the early days of the lockdown.

While some believed this trend would reverse in 2021 — perhaps reaching pre-pandemic levels — this hasn't happened. Only Sanlam and Liberty say they have received Long Covid related claims, and then only a few.

Thomas says that where they have got claims like this, it was mostly caused by scarring of the lung tissues and brain dysfunction due to a lack of oxygen to the brain after a Covid infection.

Old Mutual Corporate has also seen a higher number of disability claims due to Covid.

However, the insurers are concerned about the possibility of a spate of mental health claims caused by the economic squeeze wrought by the pandemic. Sanlam says it has already begun to see evidence of this.

As more data becomes available about the impact of Long Covid on disability claims, it is likely to influence the level of premium increases. But it remains to be seen to what extent.

As more data becomes available about the impact of Long Covid on disability claims, it is likely to influence the level of premium increases. But it remains to be seen to what extent.

Sullivan . . . employers are experiencing financial distress

"If disability claims increase in future due to Long Covid, then we are likely to see an increase in premium cover rates," says Hacking. "While most acute Covid disability income claims have a relatively short payment period, the true duration – and hence cost – of Long Covid claims will emerge over time."

Either way, Jennings says many group schemes have already hiked premiums due to the higher mortality experience, and the likelihood of future waves. Insurers are also incorporating what they've learned about Covid in the past two years into their actuarial models.

How to navigate the pandemic's setback on retirement savings

The question is, how should retirement schemes navigate Covid from here?

At the beginning of the pandemic, many employers applied for retirement contribution holidays. While retirement fund administrators say most schemes have fully recovered, there are pockets of industries that are struggling to get back on track. Hacking says that most of those who are struggling ended up terminating their membership of umbrella funds.

"The hospitality sector was severely affected, with many of the scheme terminations coming from this industry," he says.

But the negative impact on retirement savings stretches beyond just contribution holidays.

For a start, as contributions towards risk benefits increased in 2021 in response to higher death claims, less money ended up being saved for retirement — unless members chose to hike their contributions.

"Potentially, there may be a few gaps," says Belinda Sullivan, the head of corporate consulting strategy at Alexander Forbes. "Firstly, the increase in risk rates; and secondly, any contribution holidays, reduced contributions or suspensions."

Sullivan adds that because many employers are experiencing financial distress, they may not be able to increase their contribution rates to retirement funds.

So, she suggests that trustees could consider changing their contribution structures and managing the risk of future claims by tweaking their healthcare arrangements. If employers put early intervention mechanisms in place — such as managing absenteeism — they could proactively act on potential claims before they occur.

On contribution structures, trustees could consider an auto-escalation plan, in which annual contributions are hiked at salary increase dates, to limit the impact on take-home pay.

"[This would help] members increase contributions, benefit from the tax deductibility, and still help them to protect their take-home pay," says Sullivan.

Alternatively, she says, trustees can introduce an additional voluntary contribution facility, which will give members the flexibility to pay additional amounts as and when they have extra money to do so.

The pandemic, Thomas says, creates a welcome opportunity for boards and companies to review their employee benefits, in the best interests of their staff. ■

Micro pensions ideal for two-pot retirement system

Petri Greeff, head of investment advisory, RisCura

The government released proposed measures for a two-pot retirement system in December 2021. The system, which would allow for one or more withdrawals before retirement from their "access pot", comes with the trade-off that members need to keep the balance of their retirement fund savings in their "preservation pot" until they retire should they resign.

While the government's attempts at addressing multiple retirement issues are to be applauded, in their effort to make retirement funds everything to everyone, they also risk reducing their impact to nothing for no one.

The amount of work and consultation that must be done to re-design the existing retirement system to allow for limited withdrawals and mandatory preservation is extensive, and legislating the inclusion of a two-pot system will require retirement funds to develop additional investment strategies and increase their monitoring, administration, and governance burden.

Instead of imposing reforms onto existing funds, the government should consider micro pensions schemes. With micro pensions, small amounts of money that informal and formal workers can individually save during their working lives are invested collectively not to only provide for short-term requirements but also to yield returns in the long-term.

Micro pensions have successfully been deployed in many frontier and emerging market countries, including India, Uganda, Ghana, Nigeria, and the Solomon Islands.

This kind of innovation could be adopted by South Africa, which has a long history of informal savings in the form of stokvels and other savings clubs.

South Africans also appear ready for such an alternative based on recent consumer research by market research firm, KLA. They surveyed potential recipients of the proposed basic income grant (BIG), asking them what they would do with a monthly grant. While basic needs were considered important, there is an indication that consumers are also thinking of ways to save and grow their money to create financial security – with 51% indicating they would open a savings account to save their money, 20% would join and contribute money to a stokvel, while another 34% would invest money in unit trusts, shares and bonds.

Along with the will to save evidenced in this research, South Africa also has a well-developed investment and pensions industry with the skills and experience to manage short- and long-term savings.

The country's well-developed banking industry also has a large digital footprint amongst both formal and informal workers.

Banks are increasing their digital footprint by, for example, allowing new clients to sign up online without visiting a branch. Capitec Bank announced earlier this year that in the six months up to August, they managed to increase their digital client base by 22% to nine million clients. That means that more than half of their 17 million client base is now digital. Digital financial inclusion strategies like this provide an excellent platform for micro pensions to operate. Micro pension schemes seem like an obvious answer to meet the needs of both government and the people.

Signs of the times

Mike Adsetts, Deputy Chief Investment Officer of Momentum Investments, discusses retirement fund signals from the budget.

Reviewing South Africa's latest budget documentation after the budget speech on 23 February 2022, Momentum Investments gained some valuable insights into how retirement funds and their investments will evolve in the future. Here are a few of the important takeaways.

Exchange control

This budget continued the trend towards relaxing exchange control, with institutional investors allowed up to 45% offshore exposure (including exposure in Africa). There may be some back-pedalling due to unintended consequences, but it is clear that National Treasury is on a journey of relaxing exchange control.

With the current permissible exposure, the role of offshore exposure will become far more central to and integrated with the local components of portfolios. The days of a bolt-on approach are behind us, and the role of global partners, as well as deeper involvement of local investment teams with global asset classes, will continue to increase.

Infrastructure and public-private partnerships

The need for infrastructure in South Africa and, more generally, around the world, is evident. Decades of underinvestment and a lack of comprehensive maintenance have left the infrastructure stock in poor shape. Apart from energy infrastructure, which we have become acutely aware of thanks to challenges at Eskom, critical investment is also required in, among others, water, sanitation, transport and logistics infrastructure.

Government's mix of revenue and expenditure, with the lion's share of expenditure on items such as staff expenses and debt-servicing costs, leaves the government with an acute lack of resources to undertake capital projects on its own. As such, the role of public-private partnerships (with the private sector building, running and maintaining infrastructure) and the crowding in of private capital from retirement funds, are critical for the success of government's infrastructure programme. A lot of trust must be built between the public and private sector, but the trend is clear: the role that the private sector and markets plays in infrastructure will increase amidst the navigation of many potholes.

The green revolution

A clear directive generally, and even a co-incidental factor in the infrastructure programme, is the desire to incorporate climate action far more centrally in investment processes.

From a government perspective, commitments to climate action (for example, COP26 and net zero by 2050) continue to drive this as a key consideration on the agenda. From a South African perspective, the balance between climate action and a just transition (not further entrenching social issues through decommissioning and stranding assets) is a delicate balancing act that will have real-world consequences for investments and the communities affected by them.

Crypto investments

There is a commitment to regularise the investing framework for crypto investments, as this area has been covered extensively in the media, albeit with a heightened focus on cryptocurrencies.

Perhaps the fundamental difficulty with any approach to regulate cryptocurrencies is that they were specifically designed to operate outside of a regulated or national environment.

The technologies underpinning crypto investments will change the digital financial world. It is, however, not known whether crypto investments will be the winners in the long run. As such, we fully anticipate that the approach to crypto investments will be very measured and cautious, with permissible exposures being relatively low when they are allowed.

Regulatory burden

The institutional investment arena continues to be a highly regulated space, and this trend is set to continue. A myriad planned regulatory changes is on the horizon, such as auto-enrollment (all employees over time needing to be part of a retirement fund), changes to Regulation 28 of the Pension Funds Act to allow more infrastructure investment and governance of umbrella funds.

The regulatory burden on the different components of the retirement and institutional investment landscape comes with a hefty price tag. One of the unintended consequences of this is likely further consolidation across the industry. It is simply too expensive for small businesses to operate profitably and the need for scale is also a key driver that will shape the landscape in future. This pressure is amplified by pressure from investors and regulators to provide cost-effective investments.

In summary

The retirement landscape is a fascinating environment, with powerful national and global forces shaping it. Some of the changes listed will have long-term implications for the retirement and institutional investment industry, which will make this a dynamic and evolving field.

Ultimately, the industry stands in service to investors and members of the retirement sector, and it is worthwhile to know, as well as keep a measure on, the key factors and drivers affecting it.

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PRESERVATION FUNDS

Time for an overhaul?

Phakamisa Ndzamela considers whether investors should be allowed to make additional contributions to their current preservation funds.

Over the past decade, South Africans have shunted billions of rand into preservation funds — aimed at improving their eventual retirement situation.

Preservation funds seek to protect the value of retirement savings of those people who change jobs, are retrenched or are dismissed. When someone leaves a job, they're given the option of shifting retirement savings to a new employer, to a standalone preservation fund, or keeping it in their old employer's fund until they retire. Or they can cash it out — if they want to pay a hefty tax.

In this context, preservation funds have been a big hit.

According to the Financial Sector Conduct Authority (FSCA), current assets under administration of the 192 standalone preservation funds that submitted financials for 2020 stood at R262bn. (There are actually 257 registered preservation funds — but some aren't classed as "standalone funds" if their members simply left their benefits paid-up.)

This shows that policymakers have done well to educate people about the role that preservation funds can play. Arguably, a large chunk of the R262bn in

James . . . legislative changes could simplify things

Lightbody . . . rationalise pension fund types

savings would have been squandered had National Treasury's product architects not actively educated members about preservation.

But as successful as this has been, experts believe there is still room for Treasury to tighten up the legal framework on this score.

This is because a big limitation of preservation funds has been that, for those keen to grow their savings faster, they aren't allowed to make new regular contributions. Instead, they have to take out a new retirement annuity — adding to their fees and fragmenting their savings pool.

An obvious immediate solution would be for Treasury to change the law to allow people to make regular or ad hoc payments to preservation funds — a radical departure from the current situation, where people typically make one lump sum contribution.

"It would be beneficial to allow people to contribute to a preservation fund, and thereby grow their assets further and avoid segmentation," says Andrew Davison, head of advice at Old Mutual Corporate Consultants.

"Preservation funds were introduced to allow people to park their capital when they left a contributory occupational scheme. The assumption could have been that people would join another fund and contribute there — but that is not always the case."

Perhaps policymakers wanted to keep things simple by creating one fund whose sole job was to preserve savings. Or maybe they felt that this simple structure would better allow the authorities to monitor the tax deductibility of contributions.

But while Davison says that policymakers could change the legislation easily enough, there are other considerations which have to be thought through.

For one thing, retirement funds provided by employers now have to allow members to preserve their savings within the fund if they want to, rather than forcing them to transfer their cash to a separate preservation fund.

Davison warns that allowing ex-employees with no link to the payroll to contribute an ongoing amount to the fund will alter that fund's identity, and probably push up costs. On the other hand, if only non-occupational preservation funds are allowed to collect ongoing contributions, this would also tilt the playing field.

"[It's] not as simple as it may seem," he says.

Old Mutual, in its corporate business, manages about R3bn of preservation funds, for 39,146 people in its SuperFund Preserver Provident Fund and Preserver Pension Fund. This doesn't include its retail business, which also has its own preservation funds.

Scattered products equals higher fees

Davison is right that it would be easy to tweak the existing preservation system, if policymakers wanted to. It wouldn't be the first time.

Sonday . . . contributions wouldn't be practical

In September 2012, Treasury published a series of reforms aimed at addressing pre-retirement leakages, while increasing preservation and the portability of benefits between funds.

An important innovation introduced at the time allowed people who were retrenched to make a once-off cash withdrawal from their pension before retirement, to alleviate any cash crunch.

It was a vital change, but the problem is that this withdrawal has been used not just by people who're retrenched, but by people switching jobs. This cut into retirement savings.

Jaco van Tonder, advisor services director at Ninety One, agrees that while it sounds like a good idea to change the policy to allow for regular contributions to preservation funds, rather than forcing people to take out a new product, this adds complexity to the equation.

"Sometimes transfers to preservation funds are done for very specific reasons – for example, the winding-up of an old employer-sponsored retirement fund where there are special rules and benefits that need to be honoured and preserved for members. In these cases, it makes sense to ring-fence the assets in a closed preservation fund," he says.

> *But Van Tonder agrees that it's tricky for people to keep track of what's going on if their retirement savings are scattered across multiple products — and it costs them more in fees too.*

But Van Tonder agrees that it's tricky for people to keep track of what's going on if their retirement savings are scattered across multiple products — and it costs them more in fees too.

By the end of January 2022, Ninety One managed R27bn held in two preservation funds, on behalf of about 22,800 people. Over the past two years, Van Tonder says that the assets under administration in those two preservation funds grew by about 8% per year — lower than the 12% per year growth of assets held in Ninety One's retirement annuity over that time.

The simplify option: create just one fund

Others, however, say the legislative overhaul should go further.

As Rosemary Lightbody, a senior policy advisor at the Association for Savings and Investment SA (ASISA), says: "the solution is not to allow ongoing or ad hoc contributions to preservation funds, but rather to rationalise the different pension fund types so that there is only one type of fund in which a

Van Tonder . . . it's a complex situation

member contributes, preserves, and makes additional payments."

It's an alluring idea, but that would entail a radical overhaul of the current structure.

Others see no need for such an intervention.

Saleem Sonday, head of group savings and investments at Allan Gray, says that preservation funds should be seen as just one part of the broader retirement funding system.

On the question of the inefficiency created by the fact that people can't contribute more to a preservation fund, Sonday says it wouldn't be practical to expect employers to administer their funds on behalf of all current and previous staff members.

"In the retail market, [linked investment service provider] platforms allow investors to manage their portfolios across preservation funds and retirement annuities," he says. "For investors, [these] platforms represent quite an efficient way to continue to contribute to retirement savings alongside a preservation fund."

Allan Gray has two preservation funds with assets of approximately R36bn held on behalf of 37,000 members. Over the last five years, the total capital growth on the preservation funds has been 32%. The pre-retirement withdrawal rate in those funds over that time was 14%.

Elton James, head of corporate business at Glacier by Sanlam, says it's fair to argue that the situation for people with savings in preservation funds is fragmented.

But, he hopes that legislative changes could simplify things. If there was just one set of retirement rules, this would be better for members.

James says there is R34bn invested in his company's preservation funds. Glacier has 30,646 preservation fund clients in its retail arm, of which 28% are over the age of 55, and 56% are aged between 40 and 55.

"The value of the assets in [these] various funds has grown by 27% over the last five years, taking into consideration the contributions, growth, withdrawals and exits," James said.

Whether preservation funds are effective in improving replacement ratios for clients, James says is difficult to predict, and depends on each person's situation. But, he says, Glacier's withdrawal rate for those older than 40 is below 4% — a sign people are preserving their retirement capital.

Clearly, preservation funds have improved SA's savings landscape — the R262bn is incontrovertible evidence of that. But tweaking the system to allow for regular contributions would surely allow for this number to grown handsomely in years to come. ■


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