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28 November 2005

Dear Sir

RETIREMENT FUND REFORM DISCUSSION PAPER

1. In the discussion paper issued by National Treasury on "Retirement Fund Reform" in December 2004 ("the discussion paper") public comment was invited on the content and proposals of that paper. My comments on the discussion paper are set out below.

2. Please note that I make these comments in my personal capacity. I am an admitted attorney with over 20 years experience in practice. In recent years I have practised mainly in the law relating to employee benefits. I consult to retirement funds, life insurers, retirement fund administrators, medical schemes and employers on legal matters relating to employee benefits. I am also an independent trustee on 14 funds (being a mixture of umbrella funds, retirement annuity funds and preservation funds), of which the sponsors are 3 large and competing asset managers and a life insurer. I am the immediate past national president of the Pension Lawyers Association and have made submissions to the Registrar of Pension Funds ("the Registrar") in respect of the governance of retirement funds and issues around umbrella trusts.

3. I have categorised my comments into the following topics which are linked to the relevant parts of the discussion paper –

- Objectives of retirement funding policy;
- Compulsion;
- Costs;
- Powers of Registrar;
- Governance;
- Member rights and protection;
- Umbrella funds;
- Individual Retirement Funds;
- Death benefits;
- Dispute resolution;
- Intersection of employment law and pension law;
- Post retirement medical aid issues;
- Investment Regulation.

Objectives of Retirement Fund Policy

4. I am not an economist and have no training in the regulation of financial markets. However, I would have thought that one of the objectives of retirement funding policy would be the establishment and nurturing of an environment for healthy competition amongst those who provide certain services in the retirement fund arena. The discussion paper places a heavy emphasis on increased powers of regulation but it would appear to me that if competition could be stimulated there would hopefully be less need for regulation. In this way there can continue to be innovative development amongst the service providers. In particular, it would be highly advantageous for retirement funds (and members) if conditions can be created for enhanced competition amongst the administrators, sponsors of individual retirement funds (including preservation funds), life insurers involved in the retirement fund industry and investment advisers involved in the retirement fund industry. Retirement funds after all do represent a significant concentration of economic power and through their service providers have "a key role to play in ensuring the integration, efficiency and liquidity of financial markets".[1] It is through these service providers that retirement funds play such a key role in our economy, and it is vital that there is healthy competition amongst these service providers.

5. As will become apparent below in the comments relating to costs, it is my submission that the healthier the competition that exists the less there should be a need for any regulation relating to costs since an acceptable level of costs will be determined by the market. This presupposes that in such competition amongst service providers the balance of power is evenly weighted between the service providers and the members and pensioners who ultimately bear the costs of such service providers. One essential component for this is the publication by the Registrar of comparative costs.

6. The powers of the Registrar should, accordingly, also be directed at endeavours to ensure that the retirement fund environment is, as far as the service providers are concerned, competitive whilst at the same time ensuring a measure of protection of members and pensioners.

Compulsion

7. **(page 20, para 1.6.1.2)** I support compulsion as proposed, but suggest that it only be made applicable to employees in respect of whom an employer must pay PAYE. The requirement to pay PAYE must indicate that there is a payroll facility in place which can cope with the requirement of making payment to a retirement fund in respect of each employee. Furthermore, to facilitate the payroll requirement in respect of small to medium enterprises I suggest that there be promulgated annually by regulation a minimum retirement funding amount to be paid in respect of each employee up to a certain level of income, with that retirement funding to be a proportion of the PAYE payable. This will make the payroll computation in respect of the retirement funding obligation easy to calculate and also easy to understand for the employee.

Costs

8. **(page 26, para 4.2.6)** I suggest that the disclosure to be made must be made annually and within a certain time period after the year end of each retirement fund, and also that only the fees charged by such service providers as the Registrar determines must be reflected. Furthermore, the publication by the Registrar of the comparative fees should only be in respect of such service providers as the Registrar determines.

[1] Per Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 (more commonly known as the European Directive on Pensions, which binds all Member States) ("the European Directive").

9. **(page 27, para 4.2.8)** Most, if not all, individual retirement funds will provide for members to determine the investments backing the liability of the fund to each member. There should, accordingly, be a provision permitting the investment advice charges of each member to be payable from those assets, subject to the trustees of the fund concerned being satisfied as to the reasonableness thereof.

10. **(page 39, para 3.12.3.4)** Trustees should have a responsibility to trace a member who has not yet claimed his or her benefit from the fund, with the reasonable costs of such tracing to be deducted from that member's benefit.

11. **(page 40, para 3.12.3.5)** In my view this is stated too broadly because it precludes a member from remunerating out of his own pocket any properly qualified person from advising that member. I would have couched this provision differently as follows –

> "Only the member (and not the fund) may reward any person for inducing, facilitating or assisting that member to transfer his or her savings to the transferee fund; and then only provided the member acknowledges that the services of this person are not required for that member to so transfer his or her retirement savings."

12. **(page 46, para 3.17.3.4)** The same provision as stated in para 11 above should also be of application here.

13. **(page 56, para 5.4)** There should also be a provision that any amount paid to a service provider by any party other than the fund itself and relating to the assets of that fund must have a defensible commercial basis. What is stated in this para presupposes that amounts are simply paid as rebates. There exist situations where such payments are made which do not appear to me to have a defensible commercial basis and are effectively masking a rebate. It would be helpful to counter this to establish the principle that such service providers owe a fiduciary obligation to the fund and its members (see further below) and accordingly the arrangements made by them must reflect appropriately this position of trust which such service providers occupy.

14. **(page 58, para 5.6.14)** I agree with what is stated here but would add in para 5.6.14.1 that the prohibition must be in respect of any direct or indirect reward.

Powers of the Registrar

15. **(page 52, para 1.11.2)** It may be helpful with regard to what is proposed to refer to the provisions of section 15A of the Deeds Registries Act, No. 47 of 1937 (read with Regulations 43, 44 and 44A to that Act), whereby an admitted conveyancer (who may be a person comparable in what is being proposed to a licensed practitioner) must certify the documents lodged with the Registrar of Deeds. That certification carries with it a personal responsibility that the authority to act has been established and that the facts stated in that deed are correct. In the same way, a licensed practitioner may be empowered by his or her certificate to grant legal status to any rule amendment and in the process assume personal responsibility that the rules of the fund are not inconsistent with the Pension Funds Act, No. 24 of 1956 ("the Act"). This might also be extended to other responsibilities of the Registrar under the Act, such as the approval of section 14 transfers. It would also be appropriate, in some circumstances for such a licensed practitioner (assuming such a practitioner to be a lawyer with established expertise in retirement fund law) to be required to act in conjunction with a valuator (as defined in the Act); particularly if there are transactions involved which have a predominant actuarial content such as section 14 certificates.

16. **(page 52 – 53, para 1.11; page 59, para 5.6.16)** The Registrar should also have specific powers relating to trustees. In particular, no appointment of a trustee (whether as employer appointed, member elected, co-option or by the sponsor in respect of an independent trustee) should be effective unless within 30 days of the date of such appointment certain prescribed details of such trustee is placed on record with the Registrar. Similarly, the Registrar must be advised when any trustee vacates office. The Registrar should be empowered to preclude any person from being appointed to the office of trustee if that trustee has been found to have acted in breach of his or her fiduciary obligations as trustee of a retirement fund in any matter before the High Court, the Appeal Board of the FSB or the Pension Fund Adjudicator. No person should be permitted to act as an independent trustee unless such person is accredited as an independent trustee by the Registrar who may in such accreditation determine the criteria for a person to act as independent trustee; and in respect of any independent trustee who is not an accountant, actuary or lawyer, the Registrar should determine the maximum

remuneration as independent trustee by the issuing of regulations with tariffs in that regard from time to time.

Governance

17. **(page 54, para 3.4)** The investment information required to be disclosed to each member annually should include the gross performance and the net performance so that members can see what the investment costs have been. As stated in para 23 of the preamble to the European Directive (see footnote 1), proper information for members and beneficiaries is "crucial". In my view it is appropriate also, as stated in Article 11 of the European Directive, that in addition to what is stated in the current Act and the discussion paper, each member be entitled to receive a copy of the fund's investment policy statement (see further below). Furthermore, each member on retirement or when other benefits become due, must receive "appropriate information on the benefits which are due and corresponding payment options".[2]

18. **(page 57, para 5.6.4)** Of particular concern is the proposition in the discussion paper that trustees owe only the fund a fiduciary obligation and merely the duty of good faith to members and beneficiaries. My comments on this are the following –

    18.1. Not only does this proposition (that trustees owe a duty of good faith only to members and beneficiaries) contradict strong case law to the contrary[3] where it was accepted by the Supreme Court of Appeal that trustees owe a fiduciary obligation to members and beneficiaries, but it also deprives those persons of significant rights if trustees do not owe them a fiduciary obligation. Trustees of retirement funds undoubtedly meet the requirements for having a fiduciary obligation to members and beneficiaries if the criteria for such a fiduciary obligation, as laid down in the landmark Supreme Court of Appeal judgment in *Philips v Fieldstone Africa (Pty) Ltd*[4], are applied to them.

[2] See the European Directive
[3] see*Tek Corporation Provident Fund v Lorentz* 1994 (4) SA 884 (SCA) and *Meyer v Iscor Pension Fund* 2003(2) SA 715 (SCA)
[4] 2004 1 ALL SA 150 (SCA)

18.2. The significance of trustees owing a fiduciary obligation to members and beneficiaries is that-

18.2.1. it is not necessary for members and beneficiaries to demonstrate that the trustees owe them a duty of care for delictual liability (ie. a claim for damages) to be established;

18.2.2. at least at common law[5] such members and beneficiaries would enjoy the right of derivative action against trustees;

18.2.3. trustees must avoid a conflict of interest in respect of those persons to whom the fiduciary obligation is owed unless their free and informed consent is given;[6]

18.2.4. trustees must, subject to the terms of the trust, ensure that the object of the trust (or the fund) is fulfilled;[7]

18.2.5. trustees have a duty to give to those to whom they owe their fiduciary obligation an accounting of the assets administered by them;[8]

18.2.6. trustees must in the performance of duties and the exercise of powers act "with the care, diligence and skill which can reasonably be expected of a person who manages the affairs of another";[9] and

18.2.7. except as regards questions of law, a trustee is bound to exercise an independent discretion.[10]

18.3. The right of derivative action is the right of the member to require any trustee who has caused a loss to a fund to repay that loss to the fund. This is particularly important in the context of a defined benefit fund where a member himself or herself may not be able to

[5] See *Gross v Pentz* 1996 (4) SA 617 (A)
[6] See *Phillips v Fieldstone*, supra
[7] See "Honoré's South African Law of Trusts", 5th Edition; p 262
[8] See Honoré, supra, p 331
[9] See Honoré, supra, p 262

establish that he or she has personally suffered a loss even though the fund may have suffered a loss. Shareholders enjoy such a right of derivative action in terms of section 266 of the Companies Act but this has not, to my knowledge, been used. Nevertheless it is an important component of the rights of a member and beneficiary which the new Act should seek to enhance rather than limit (see further below).

18.4. It is also undoubtedly clear (and the same case law referred to above supports this proposition) that trustees must owe the fund a fiduciary obligation. But that fiduciary obligation is limited because the fund has one single object, which is to deliver the benefits promised in terms of its rules. Put differently, a fund exists to benefit the members and beneficiaries. It would be more appropriate, therefore, for the obligation of trustees to be couched in terms that require them to owe a fiduciary obligation to members and beneficiaries subject to ensuring that the object of the fund (the delivery of the benefits promised) is met. This will ensure that trustees must maintain the solvency of the fund and also that they must balance the competing interests of the full spectrum of membership from the younger active members with a lifetime of employment and retirement ahead of them, to the pensioners. Importantly this gives content to the obligations owed by trustees to the fund and the members.

18.5. I understand that one objection to trustees owing both the fund and its members a fiduciary obligation is that it splinters the single loyalty which underlies the fiduciary obligation. This is not correct. The fiduciary obligation owed by trustees to the fund is different from the fiduciary obligation owed by the trustees to members and beneficiaries. The reason for this is that the fiduciary obligation owed by trustees to the fund is a far more limited obligation because its content is simply to ensure that the object of the fund (to deliver the benefits promised in terms of the rules, see para 18.4 above) is met. By contrast, subject to this, the fiduciary obligation of the trustees to members and beneficiaries is to ensure that they actually receive the benefits promised in terms of the fund rules. Members and beneficiaries are thus profoundly dependant on the conduct of the trustees, and this dependency is an essential component of a fiduciary obligation. This dependency is not required to exist in an

[10] See Honoré, supra, p 262

obligation of good faith, and it is therefore more appropriate for the true nature of the obligation of trustees to members and beneficiaries to be characterised as that of a fiduciary. There is no prohibition in our law, as far as I am aware, of a fiduciary obligation owed to one category of persons being subordinate to the fiduciary obligation owed to another category of persons where there is a conflict.

18.6. In any event, the nature of the office of trusteeship often entails the requirement that competing interests of those to whom a fiduciary obligation is owed are weighed against each other and resolved. This typically happens in trust law where trustees must chart a course of action which weighs appropriately the competing interests of different classes of beneficiary (such as an income beneficiary prior to the termination of the trust and a capital beneficiary on the termination of the trust). As it is, trustees of retirement funds do in fact manage the competing interests of members and beneficiaries in determining the investment policy of that fund and in making payment of death benefits to dependants where there is insufficient to meet the needs of all the dependants eligible to receive that death benefit.

18.7. In short, I propose that the situation established by judgments in the Supreme Court of Appeal, that trustees owe members and beneficiaries a fiduciary obligation, is retained; and that to avoid a conflict with the fiduciary obligation owed to the fund that fiduciary obligation to the fund is defined as set out in para 18.4 above with the fiduciary obligation owed to members and beneficiaries subordinate to this.

18.8. The acknowledgement that trustees owe members and beneficiaries a fiduciary obligation is also in line with the obligations of trustees as understood in the United Kingdom, Canada, United States of America and Australia. For trustees now not to be declared as having a fiduciary obligation to members would send a significant statement to members and beneficiaries that the obligations of trustees are less onerous than what they were before. With the greatest of respect, this is not justified and would send the wrong message about the appropriate responsibilities of trustees.

19. **(page 58, para 5.6.8)** In my view it is not sufficient for the management of a conflict of interest to be dealt with simply by declaring that conflict. It is quite clear in our law that conflicts of interest must be avoided unless the free and informed consent of the principal[11] is given. In this instance that consent would have to be given by the remaining trustees. This should be the minimum requirement for the management of a conflict of interest since but for such consent the only solution is for that trustee to arrange for the conflict to be removed, which may require the trustee to vacate office. Furthermore, this provision regarding conflicts of interest should also be applicable as a fundamental principle to service providers. It does underlie what is stated in other aspects of the discussion paper (such as para 5.6.14 on page 58), but it would be more valuable for the principle to be expressly as being applicable equally to service providers.

20. **(page 58, para 5.6)** Proper governance should also require a clear definition of the content of the obligation of good faith owed to the employer and, if the sponsor is a different entity, the sponsor. In respect of the employer and the sponsor, this is dealt with further below. What is significant from the governance aspect is that trustees, as the body of persons responsible for the governance in a fund, must be required to understand clearly the nature of the relationships in which they as trustees participate: having a fiduciary obligation to the fund and its members and beneficiaries and what that entails, and having a duty of good faith to the employer and sponsor and what that entails; and also what is required of them in their relationship with their respective service providers.

Member Rights and Protection

21. **(page 53, para 3.1)** I am surprised that the protection of members as stated in this paragraph does not include the rights enjoyed by members and beneficiaries against trustees and service providers. In this regard no more need be said that members and beneficiaries enjoy such rights against the trustees and service providers as exist in terms of the fiduciary obligations of the trustees and service providers to the members and beneficiaries. Furthermore, it should be stated that members and beneficiaries enjoy as part of this the right of derivative action and the right to require an accounting.

22. **(page 53-54, para 3)** In my view some form of protection needs to conferred on pensioners who are no longer members of a fund because annuities have been bought for them by their fund from a life

[11] See *Philips v Fieldstone,* supra.

insurer. These pensioners are the most vulnerable of all categories of the stakeholders in the retirement fund environment and have no employer or body of trustees to represent them when they have exited from a fund. No pension increase policy is applicable to them and they are utterly at the mercy of the insurer which typically enjoys a discretion over the level of annuity increase given to the member. Although this intrudes into the domain of the long term insurance regulator, this is an aspect in the retirement fund reform which needs clearly to be looked at very closely. The problem is exacerbated by the fact that with the growth of umbrella funds there will be an increasing number of pensions secured by such insurance policies on the retirement of members of such umbrella funds. If such annuities fail to keep pace with inflation there will gradually be an increase in the dependency on SOAP, and an erosion of the very purpose of second pillar pension arrangements.

23. **(page 57-58, para 5.6.7)** I do not see how this proposition is feasible. How will the consent of pensioners be obtained if an action is taken which benefits active members, and *vice versa*? As stated above, trustees should as part of their fiduciary obligations be able to manage the competing interests of stakeholders.

Umbrella Funds

24. **(page 60, para 5.6.20)** If in fact nearly 10,000 of the 13,420 funds registered in terms of the Act have less than 50 members (as stated by the Chief Actuary at the 2005 Pension Lawyers Association conference) there is a clear need (and a social purpose) for umbrella funds. My comments on what is proposed are the following –

24.1. Realistically, such funds will not be altruistically established and as a fact life insurers and large administrators and others have only established them because they have seen the possibility of a viable business proposition in so doing. In the main that business proposition has revolved primarily around the establishment of such umbrella funds being a mechanism to control the investments of a retirement fund. Controlling the investments of a retirement fund is, from my perception, much more profitable than merely administering a retirement fund.

24.2. If umbrella funds can therefore be said to serve a social purpose it behoves the Registrar to determine what is an acceptable business proposition in the establishment of those umbrella funds. The reason for this is that an umbrella fund, unlike individual retirement funds, is difficult for the individual member to exit because he or she is required as a term and condition of employment to belong to that fund. The Registrar should seek to establish what an acceptable business proposition as part of his or her endeavours to create an environment where competition can be the main determinant of costs.

24.3. From my experience most trustees (including independent trustees) enjoy an indemnity from the sponsor of an umbrella fund. That indemnity in turn is dependant on the administration of the benefits of that fund being carried out by the sponsor or a subsidiary of it. In my view this is not an inappropriate arrangement provided the costs of that administrator are competitive (which should be determined by reference to the statistical information which the Registrar should publish in that regard) and provided the quality is reasonable. The members are not thereby prejudiced and the sponsor can be assured that it will only be exposed to any loss in respect of the fund if the benefit administrator or the trustees make a mistake for which they are liable. In any event, such an umbrella fund is on this basis probably able to enjoy the preferential rates of the fidelity cover which the sponsor itself enjoys.

24.4. With regard to the investments of an umbrella fund, in my view these should be required to be best of breed as determined by the trustees alone provided that at the request of the sponsor any of its investment products may be included in any investment choice but only on the basis that any sponsor investment products which are not best of breed must be indicated in all communication as being not best of breed. All other service providers to an umbrella fund should be appointed on the same basis as in respect of any employer fund; that is, on the basis of quality of service, cost and appropriateness. Put differently, the only captive service provider to an umbrella fund should be the administrator subject to the provisos in that regard as expressed in para 24.3 above.

24.5. The issue of unallocated deposits in umbrella funds is deeply problematic. It should therefore be a requirement that any deposit which is not allocated to the sub-fund of a particular

employer in an umbrella fund within, say, 30 days of receipt should be required to be returned to the bank from whence it came. There should also be the requirement also that no deposit may be made into the bank account of an umbrella fund without an indication of the bank account of the depositor so that any unallocated deposit can be returned to that bank account.

24.6. I see no merit in the requirement that there be a limitation of the number of employers which can participate in one umbrella fund. The very essence of an umbrella fund is to obtain efficiencies through economies of scale supported by sophisticated administration systems; and it does not necessarily follow that an administration system which can cope with say 20 mid sized employers will not be able to cope with 200 small employers. In my view the real determinant of the number of employers that should participate is the extent to which the internal accounting can manage this. That should be determined by the external auditor who should be required to certify (as stated in para 5.6.20.1 of the discussion paper), that the systems and controls are adequate. In particular, this should be an emphasis on the systems and control of the administrator rather than the fund; but should also extend to the reconciliation of investments (as required of the custodian to an administrative FSP under the FAIS Act). Furthermore, in my view it should be a requirement in respect of each umbrella fund that a valuator confirms that there are sufficient assets backing the accrued retirement funding of each member.

Individual Retirement Funds

25. **(page 26-27, para 4; page 60, para 5.6.21)** During the cooling off period any monies received by the fund in respect of the member should be retained in a money market account or at least not invested in any way as to incur any investment charge or to expose the investment to any risk since the fund should not be liable to make good any shortfall in the event that the member elects to withdraw his or her membership before the expiry of the cooling off period.

26. **(page 60, para 5.6.21)** The issues relating to the unallocated deposits and the accounting arrangements, as set out in respect of umbrella funds above (paras 24.5 and 24.6), are of equal application to these funds.

Death Benefits

27. **(page 35, para 3.4.1.4, page 45, para 3.16.5.3 and page 46-47, para 3.18)** The current arrangement in respect of the distribution of death benefits in terms of the Act is deeply problematic. My comments on this and a fresh proposal are set out below.

27.1. Not only is it possible for a death benefit to be dealt with differently where the deceased had retirement savings or a death benefit payable through different retirement funds (for example, a member may have had a benefit retained in a preservation fund, also voluntary retirement savings in a retirement annuity fund, with a death benefit payable through his or her employer fund and also potentially might be a paid up member of another fund), with the result that the determination of dependants is determined differently according to each fund; but regard is not always had to the manner in which death benefits are payable by each fund. Furthermore, the costs involved by the fund are often extensive with the result that a deceased member whose personal affairs are in a muddle causes an expense to be borne by the other members of the fund. Clearly a simplified mechanism is required for dealing with death benefits which will not only protect the current socially desirable arrangement of providing for dependants but will also be cost effective.

27.2. It is not precisely clear what is being proposed in the discussion paper: on page 35, para 3.4.1.4, it is stated that death benefits are to be distributed in accordance with the member's nomination of beneficiary form "unless compelling reasons exist why this should not be followed". This would appear to indicate that it is the nominee, rather than the dependants, who will enjoy priority unless there are "compelling reasons" (whatever those may be). This appears to be fortified by what is stated on page 45, para 3.16.5.3. However, on page 44 in para 3.16.2 it is stated that "retirement savings are intended for the protection of the member and his/her dependants. The "compelling reasons" proviso is repeated again in para 3.18.3.1 on page 47.

27.3. I propose the following process for dealing with death benefits. This process is that the death benefits should be paid to the nominated beneficiary or beneficiaries only, unless a claim for

maintenance is lodged by any dependant (as currently defined in terms of the Act) with the executor of the deceased members estate or any retirement. The executor must then determine that claim, taking into account all the death benefits payable by each retirement fund of which the deceased was a member on his or her death, the proceeds of any life policies also payable (and which must be declared to the executor in terms of the Estate Duty Act) and the assets of the estate administered by the executor. The quantum of such maintenance would be determined according to the law that has evolved in this regard in the Act, and would be payable as a first charge proportionately against the death benefits payable by any retirement fund.

27.4. Any aggrieved dependant should enjoy the right of a appeal to the Maintenance Court in terms of the Maintenance Act. Failure to lodge a claim for maintenance within 8 months would absolve any retirement fund from having to make the death benefit available for this purpose if the distribution is made before the claim is lodged (but after the 8 month deadline). The reason for the 8 month period is that a liquidation and distribution account must be lodged within 6 months of the issuing of letters of executorship, which typically takes between 1 and 2 months to be issued by the Master of the High Court; and which may in some circumstances require a dependant himself or herself to be appointed as executor.

27.5. This process would remove retirement funds of the cost burden involved in dealing with death claims and would also ensure that death claims are dealt with in a single manner with any disputes being resolved in a specialised judicial tribunal. However, this process will require amendments to the Administration of Estates Act and the Maintenance of Surviving Spouses Act as well as, possibly, the Maintenance Act. And provision should also be made for an executor to be compensated for dealing with such maintenance claims, possibly on the same basis of assets administered by an executor in respect of so much of such death benefits as are applied to meet the maintenance claim. The benefit also of this process is that an executor in the course of winding up an estate is required to advertise for debtors and creditors, and this may be amplified to require claims for maintenance to be lodged with the executor.

27.6. In short what is proposed is that the death benefit is made payable to the nominated beneficiary, with any person who would in terms of the Act currently be entitled to enjoy a claim as a dependant being entitled to exercise that claim, but with the executor resolving that claim.

27.7. No mention is made in the discussion paper regarding the payment of any death benefit to a trust for the benefit of a beneficiary as is currently permitted in terms of section 37C(2) of the Act. In my view there are distinct benefits in permitting any death benefit to be payable to a trust where the person who would otherwise have received the benefit is under some form of disability, whether legal (minority or mental incapacity) or not (where the recipient patently does not have the financial skills to manage a substantial amount of money responsibly). These benefits are apparent from the well administered umbrella trust industry which currently exists, and include the low administration costs and the flexibility of distributing benefits according to need.[12] However, the provisions of the Trust Property Control Act are completely inadequate for the proper regulation of an industry where I understand (in the umbrella trust industry) the assets under administration are approximately R10 billion.

27.8. It should be mandatory for such umbrella trusts to be subject to audit; each account in an umbrella trust for a beneficiary should be payable to that beneficiary only; there should be the same provisions applicable to unclaimed benefits as apply in respect of retirement funds; the same provisions relating to the reconciliation of assets as are applicable to the custodian of administrative FSP's in terms of the Financial Advisory and Intermediary Services Act should be applicable to the administrators of such umbrella trusts; each umbrella trust should be subject to the same requirement of an independent trustee as apply to umbrella funds; once the payment of the death benefit is made to an umbrella trust there is no further responsibility by the retirement fund or executor in respect of that payment; the only criterion for the payment of a death benefit to an umbrella trust should be for it to be in the best interests of the beneficiary; such an umbrella trust may be in the form of a vesting or bewind trust, or may be in the form of a discretionary trust according to what the retirement fund or the executor considers to be most appropriate; an administrator of an umbrella trust should be subject to

regulatory approval in the same way as a benefit administrator of a retirement fund. Attached is a submission I made to the Financial Services Board on 27 October 2004 in this regard in which these issues are set out in more detail. It should be pointed out that it is no longer my view that each sub-trust in respect of a beneficiary should have its own bank account: provided there is an adequate reconciliation (as certified by the auditor of the trust), the additional costs of a separate bank account are not justified.

27.9. There needs also to be clarity regarding the taxation of death benefits; in particular that such taxation does not penalise the payment of death benefits in such a manner as is in the best interests of the beneficiary.

Dispute Resolution

28. **(page 54-55, para 4)** In my view there is no overlapping of the jurisdiction as currently exists in respect of the Appeal Board of the Financial Services Board and the Pension Funds Adjudicator. Accordingly, I submit that the current delineation of jurisdictions between these two forums should remain. With regard to the Pension Funds Adjudicator, my interpretation of the provisions of Chapter VA of the Act is that the process in dealing with a complaint before the Pension Funds Adjudicator is one of cost effective pre-trial arbitration. Accordingly, if a party dissatisfied by the determination of the Adjudicator takes the matter further in the High Court the matter is not an appeal or review but a re-hearing of the matter, where fresh argument and facts can be placed before the High Court. In my view it is preferable that this arrangement remain in place because, from my research, there have at the date of this letter been 16 reported cases of matters before the High Court relating to decisions of the Adjudicator. I have only been able to ascertain the results of 15 of those 16 cases; but what is noteworthy about these results is that in only two of the 15 matters heard by the High Court was the decision of the Adjudicator confirmed. Of the remaining 13 cases, 12 of those resulted in the decision of the Adjudicator being overturned, with one matter being rejected by the High Court because no final order had been made by the Adjudicator. I have not been able to ascertain whether in those cases where the Adjudicator's decision was overturned this was as a result of fresh argument or facts before the High Court. Whether or not there was fresh argument or different facts placed before the High

[12] I understand that the average umbrella trust has a value of R30 000 and that the annual administration cost of the average umbrella trust is approximately that of operating a current account with a registered commercial bank.

Court is not relevant: what is relevant is that the High Court should clearly have the same right as exists now to hear the matter *de novo*.

Intersection of Employment Law and Pension Law

29. **(page 61, para 6)** The new Act should also make clear that in respect of occupation retirement funds the trustees have an obligation to the employer and the members to ensure that the provisions of the fund do not contradict any terms and conditions of employment. More specifically, to the extent that the employer and those employees who are members of the fund may agree on certain aspects which have a bearing on the terms and conditions of employment, such as the age of retirement, the contribution rates (whether increased or decreased) and benefits payable on retrenchment or termination of service, those provisions must be replicated in the rules of the fund in respect of the members with whom the employer has reached such an agreement. The trustees should not consider that their fiduciary obligations extend to an interference in the employment relationship which exists between the employer and its employees.

30. **(page 62-63, para 6.5.1)** There needs also to be clarified in the new Retirement Funds Act the basis on which an employer may terminate its participation in a fund, the notice period therefor and how the accrued retirement funding of those active members of such a fund are to be dealt with.

Post Retirement Medical Aid ("PRMA") Issues

31. **(page 29, para 6.5.2, page 37, para 3.8)** Typically the PRMA obligation has not been defined by employers and is very often vague with different obligations being owed to different categories of employees. Furthermore, there is currently a move towards outsourcing the employer's obligation to a third party (such as a long term insurer) and for the future component of the obligation to be prefunded. I am concerned that the use of a retirement fund may bring with it complexities which may divert trustees from the (in my view) more important obligation of providing retirement fund benefits for members and pensioners. Accordingly, I propose that –

    31.1. no retirement fund be permitted to accept any monies in respect of the employer's PRMA obligation unless the employer warrants the terms of that obligation (ie. the employer gives the obligation a definition which it warrants to be correct);

31.2. unless those to whom the PRMA obligation is owed consent to the transfer of the liability from the employer to the fund, the employer acknowledges that it remains liable for the fulfilment of the PRMA obligation to the extent that the fund cannot meet that;

31.3. flowing from para 31.2 above, where the employer remains so residually liable, the trustees must take account of that residual obligation when determining the investments backing the PRMA obligation;

31.4. the assets backing the PRMA obligation in the fund must be ring-fenced from the other creditors of the fund, and any costs which the trustees are directly able to contribute to the settlement of the PRMA obligation must be settled from the assets backing the liability of the fund in respect of the PRMA benefit;

31.5. no person other than a person who would otherwise be a member of the fund may receive a benefit from the assets backing the liability of the fund in respect of the PRMA benefit;

31.6. if the employer retains a residual liability in respect of the PRMA obligation then, on the instruction of the employer, the fund must, provided this does not serve at that time to reduce the PRMA benefit, pay the assets backing the liability of the fund in respect of the PRMA benefit to such third party as the employer may direct, provided the fund is thereby released from its liability in respect of the PRMA benefit. It may be, by way of an explanation for this point, that the employer may prefer that an annuity policy with a long term insurer be purchased to meet its PRMA obligation;

31.7. on liquidation of the fund any amount retained by the fund in respect of the PRMA benefit must, if the employer retains a residual obligation in respect of that, be paid to the employer unless the employer itself is in liquidation or the trustees elect to transfer the amount to a long term insurer or another fund in which the employer participates;

31.8. whether or not the employer is residually liable in respect of the PRMA obligation, a fund should not accept any monies in respect of the PRMA benefit unless the employer warrants the annual escalation rate of the benefit to be paid by the fund. The reason for this is that at present there is uncertainty in our law as to the escalation rate applicable, if at all, in respect of PRMA benefits because the escalation of such benefits differs from employer from employer and may be less than CPI, the equivalent of CPI or the equivalent of medical inflation. It is a recipe for litigation for trustees not to have clarity at the outset as regards any commitment relating to the escalation of the PRMA benefit.

31.9. The PRMA arrangement within the fund should permit both payments in respect of the accrued PRMA liability of an employer, and also the prefunding of the future PRMA obligation of the employer. The taxation of such payments to the fund will require clarification and should, where the payments are in respect of the prefunding of the future obligation, have subject to them the same provisions relating to the contributions payable in respect of retirement funding (section 13A of the Act).

Investment Regulation

32. **(page 65, para 7.5.5)** The properly formulated investment strategy must be incorporated into an investment policy statement which also sets out the investment risk strategy and, where there is member investment choice, the risk tolerance attributable to each investment choice. Furthermore, this document should define the fund's socially responsible investments which I submit it should be mandatory for a fund to include as part of its investment policy. This investment policy statement must also be communicated each year to members and the employer.[13] Furthermore, the investment policy statement should indicate why an insurance policy as an investment vehicle has been chosen in preference to a segregated portfolio with a specific investment mandate.

33. **(page 65, para 7.6.2)** Trustees should also be required to ensure that on an annual basis that each asset manager complies with the investment mandate given to it by the fund.

[13] National Treasury may find of interest the provisions of Article 18 in the European Directive which require, *inter alia*, that fund investments must be invested in the best interests of members and beneficiaries with any potential conflict of interest being dealt with by ensuring that the investment is only in the interests of members and beneficiaries; the assets must be invested in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio as a whole; the assets must be predominantly invested on regulated markets; investment in derivative instruments must be limited to a reduction of investment risks or the facilitation of efficient portfolio

34. **(page 65, para 7.6)** I did not see any reference in the discussion paper regarding the custody of the investments of a fund. From my experience the custodian arrangements are sometimes entered into by the investment manager on behalf of the fund. In my view this is not appropriate since the contractual relationship regarding the custodian of the assets of the fund should be directly between the fund and the custodian with, naturally, provision for reporting to be made to the investment manager. This should be clarified in the new Act.

Other Comments

35. **(page 22, para 2.5.1.2(a)(d))** It is likely that there will be a problem also with unallocated deposits in the NSF. I propose the same provisions relating to unallocated deposits in respect of umbrella funds in this regard as set out in para 24.5 above.

36. **(page 22, paras 2.4 and 2.5(d))** The prospect of major leakage from the NSF for "times of life crisis" must be avoided as much as possible. Whilst the need for a very limited withdrawal in times of life crisis cannot be denied, the definition of a "life crisis" must be carefully and narrowly defined, as well as closely monitored.

37. **(page 23, para 22)** In my view it is not appropriate for trustees to have a responsibility to encourage a member to move to the NSF even if "it is clearly to their benefit to move". The reason for this is that the primary function of trustees is to ensure that the fund delivers the benefits promised in terms of the rules. Whilst trustees should advise members as to what their options are on withdrawal or retirement from a fund, that is an obligation which flows from the trustees ensuring that a critical time (on withdrawal or retirement) members are aware of what the provisions of the rules of the fund permit them to do. That obligation does not mean that the trustees must formally advise members as to what is in their interests to do at that critical time, since that would require trustees to investigate the personal circumstances of each member so withdrawing or retiring from the fund, and playing the role of a personal financial adviser. Equally, the trustees or retirement fund should not have a similar responsibility in advising any member whether or not it is in the interests of that member to transfer to the NSF since the same responsibilities (of investigating the personal or financial circumstances of the

management; the assets must be properly diversified; investment in the employer or sponsor must be limited to 5% of the portfolio as a whole and 10% of the group in which the sponsor or employer belongs.

member) arise. Rather, the trustees should have an obligation simply to inform members of their rights to transfer to the NSF at any time.

38. **(page 24, para 3.5.3)** Cross-subsidisation would appear to me to be inevitable in any defined benefit fund; but should be avoided as far as possible in a defined contribution fund. With regard, however to any risk benefit, whether self-insured by a fund or not, a cross-subsidization inevitably applies according to the overall membership profile in the fund. That cross-subsidization appears to me to benefit effectively the less well paid membership of a fund who are likely, because they are less well paid, not to have as advantageous social circumstances which enhance their health and longevity. For social reasons such cross-subsidisation is in favour of the financially less well off membership of a fund and is therefore desirable and should be maintained.

39. **(page 25, para 3.5.3)** In my view a member should have the right of choice as set out in the discussion paper, subject only to the stipulation that this choice exists only at inception of employment or at certain designated ages or employment categories. This should be required to be stipulated in the employment contract of the member, with a default position established in law. The limitation of the right to migrate to another fund is essential to avoid unnecessary movements which would be disruptive for the administration of a fund it may possibly also have a negative impact on the investment performance of the members interest in the fund.

40. **(page 30, para 1.1)** In my view living annuities should only be permissible if there is a contractual arrangement for a financial adviser to advise the annuitant, which contractual arrangement should permit the annuitant to substitute that contractual adviser and to which contractual arrangement must specify the fees payable by the annuitant.

41. **(page 40, para 3.14)** In my view it is the function of the trustees of a fund to pay to members or beneficiaries their benefits from the fund. But a member or beneficiary is equally responsible to claim his or her benefit; and if such beneficiary fails to claim his or her benefit then after a reasonable period (say two years) the trustees should be relieved of this responsibility so that they can focus on their other onerous and demanding responsibilities as trustees. After the reasonable period has elapsed the trustees should be required to deliver to the Unclaimed Benefits Fund the unclaimed benefits in respect

of any member or beneficiary, plus investment return thereon, as well as such information in respect of the member or beneficiary as they may have. I would include in the function of the unclaimed benefits fund also the tracing of beneficiaries, on the same basis, of umbrella trusts which have retained benefits for beneficiaries of retirement funds.

Yours faithfully

JONATHAN MORT