



THE LINKED INVESTMENT SERVICE PROVIDERS ASSOCIATION

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COMMENT ON THE RETIREMENT FUND REFORM DISCUSSION PAPER ISSUED BY THE NATIONAL TREASURY

About LISPA

LISPA is the representative body for those financial institutions (commonly referred to as LISP's) whose main business consists wholly or partly of investing on behalf of clients in units in a collective investment scheme on the basis that such units are bought and held in bulk. These institutions package, distribute and administer a broad range of unit trust based investments spanning voluntary to retirement planning products. Any investment made through these products provides a client a single entry into a selection of investment elements whereby a financial advisor assists in designing a suitable investment or retirement plan.

LISP's are regulated by the Financial Services Board, mainly in terms of the Financial Advisory and Intermediary Services (FAIS) Act, 2002, and its Codes of Conduct. LISP's are typically licensed as Administrative Financial Services Providers, or Discretionary Financial Services Providers, in terms of this Act.

Most LISP's make a range of retirement-based investment products available to investors, including pension and provident preservation funds, retirement annuity funds, and umbrella pension and provident funds. A feature of these LISP-administered funds is that member choice of investment portfolios is allowed, and that members are typically advised and serviced by financial advisers of their own choice.

However, the administration of retirement funds is not the core function of most LISP's, and accordingly, commentary on this discussion Paper will generally be limited to those areas which impact the types of funds and products that LISP's do operate, and to the issues surrounding them. LISPA nevertheless wishes to place on record that, by not commenting on other aspects of the Paper, it is not necessarily in agreement with such aspects.

Comment on aspects of the discussion Paper

1. General statement of support

1.1 LISPA welcomes the current drive, initiated through the National Treasury, to modernise, streamline and rationalise the retirement funds environment, and to establish a consolidated legislative framework within which the retirement funds industry can operate. Subject to comment on specific areas, set out below, LISPA supports the broad principles set out in the Retirement Fund Reform discussion document. However, it wishes to caution against an inflexible implementation of any such new principles that may have the effect of eroding the strengths of the existing retirement fund industry, and thus lead to investors being discouraged from being part of the retirement funding net.

- 1.2 LISPA believes that its members have the expertise and capability to operate retirement funds, and to administer their underlying investment portfolios in a manner that will be cost-efficient, prudently managed, transparent and fair, thus encouraging the investing public, from all walks of life, to take responsibility for their own retirement provision, according to their respective means.

2. Comment on specific aspects

2.1 Accessibility of NSF benefits

- 2.1.1 The Paper proposes that members of funds in the formal sector should have the option to transfer to the NSF. Accessibility to fund benefits in the formal sector will be more restrictive than in the NSF. These members could, therefore, transfer to the NSF in order to access their fund benefits. This may result in an increased dependency on the State at retirement, clearly defeating one of Government's major objectives. We propose that the rules on accessibility of fund benefits be aligned in respect of members belonging to the NSF and those employees in the formal sector earning below the tax threshold belonging to occupational retirement funds in order to prevent members from transferring to the NSF to withdraw from the fund.

2.2 The tax environment

- 2.2.1 We take note of the statement in the introduction to the Paper, that the consideration of the tax treatment of retirement funds has not been addressed, but that this aspect should be part of a separate discussion Paper. We agree that the issue of taxation of retirement funds, and the benefits flowing from them, is a complex area of law, advice and practice, and that it should best be dealt with by a specialist task team dedicated to that subject alone. However, it is proposed that these two areas of reform should not be dealt with in isolation, but rather, should be harmonised to achieve the most optimal result.

- 2.2.2 Having made the statement above, the Paper nevertheless goes on to address various tax issues. For example, Annexure 3, para. 1.2 seems to imply that there should be no (or a limited) tax incentive for persons under the age of 40 to start saving for retirement. This proposal is not supported, as it is felt that saving for retirement should ideally commence as early as possible, and if this can be achieved through the offering of appropriate tax incentives, then so much the better.

2.3. Benefits available from a retirement fund

- 2.3.1 Although the Paper advocates some sort of capping of ancillary benefits, it appears to favour "packaged" retirement funds over "investment-only" retirement funds. We would argue that most sophisticated individuals would cater separately for their life and disability cover. We believe that these individuals will not be attracted to "packaged" individual retirement funds where they would be obliged to purchase life and disability cover. We therefore propose that there be no restriction on offering investment-only retirement funds, especially investment-only *individual* retirement funds, but that both options continue to be made available.

2.4 Prohibition on payment of commission to intermediaries

- 2.4.1 The Paper proposes that individual retirement funds should not be allowed to pay commission or service fees to an intermediary for inducing a member to join the fund. We believe that a distinction should be made between a member being "induced" to join a fund, which somehow implies the member being persuaded against his better judgement, and a member being correctly advised on the benefits and advantages of joining a fund. In most instances, intermediaries engage members in an advisory role with the view to assisting the member, rather than to induce them to join a fund.

2.4.2 We support a recommendation that commission or service fees may in fact be payable to intermediaries for providing a member with appropriate advice to join a fund. A substantial number of members who join funds have little financial education and may therefore purchase inappropriate financial products and are most likely to make inappropriate investment choices if not assisted by a financial intermediary. In terms of the FAIS Act, financial intermediaries must disclose all fees and costs. Should there be no incentive for financial intermediaries to assist prospective members, the wide percentage coverage in the voluntary sector might drop significantly. Members do rely on financial intermediaries for advice. It is therefore important that financial intermediaries should be allowed to receive a service fee and/or commission. Furthermore, there may be justification for low-income earners to receive advice on investment matters within the fund, and that the fees for this advice be paid to the intermediary by the fund itself. This will prevent such advice being available only to members who can afford to pay such fees themselves.

2.5 Form and adequacy of benefit payment

2.5.1 Whilst we support the principle that benefits should be taken mostly in the form of an income, with a limited proportion being payable as a lump sum, care should be taken to avoid interfering with the vested benefits of members, specifically those in provident funds, and their financial planning that has been undertaken in terms of the current legislative scenario. To this end, members of provident funds should be entitled to retire with the lump sum benefit that has accumulated to date of the change in legislation, with the balance to be taken as an annuity.

2.5.2 An annuity payable for life, inflation adjusted and with spouse's benefit, although it may be an ideal solution, is not always achievable. A CPI-linked "joint and survivor" annuity is an expensive product and for most pensioners would provide an income that is completely insufficient for their needs. A normal escalating annuity or with-profit annuity can produce increases, but not necessarily in line with actual inflation. To require CPI linked annuities will cause serious issues for pension funds and insurers alike, in that there is a scarcity of assets available to match such a liability.

Flexible annuities, or "living annuities" as they have become known, could play an extremely valuable role in achieving the need to produce an annuity that keeps up with inflation, and provides for a surviving spouse and/or dependants. Although these products have not received favourable press of late, this should not detract from the fact that if they are well managed, and issued within reasonable, regulated parameters, they can fulfil a need that other types of annuities are unable to do.

In times of low interest rates, annuity rates available for conventional annuities are also low. Even though interest rates may subsequently go up, the annuitant is locked into the low annuity rate applicable at the time of purchase. In the case of a living annuity, no such problem applies, and the income stream can be managed from year to year. An extremely beneficial aspect of these annuities is that the capital, if managed responsibly, has the ability to grow, enhancing the retirement provision of the annuitant after retirement. Furthermore, if the annuitant should die sooner than expected, the capital is not forfeited to the insurer as in the case of conventional annuities, but continues to be available to provide an annuity for a surviving spouse or other dependants. Most insurers allow the conversion of these annuities into conventional annuities at any time.

(The long-term, retirement fund and LISP industries have recently forwarded proposals to Mr Vlok Symington of SARS, which currently regulates living annuities, on suggested changes to the way in which these annuities operate and are administered. We believe that this aspect of the Paper can be aligned with this initiative). It is submitted that the parameters within which living annuities are allowed to operate, should be formally regulated by way of regulations issued under the Pension Funds Act, as opposed to the current scenario where the only

intervention by the authorities is RF1/96, which has been issued by the South African Revenue Services.

2.6 Restriction on member choice

2.6.1 The LISP industry has been founded on the principle of allowing individual investors own choice when selecting the underlying investment instruments forming part of their selected investment product, whether for voluntary or retirement investment products. Closely linked to this choice, is the role played by the intermediary who provides the investor with the appropriate advice for his particular circumstances. We believe that sophisticated individuals will not be attracted to an individual retirement fund that offers only four or five choices. Fortunately the risk of insufficient advice is far lower within an individual retirement fund, where most providers insist on the involvement of a qualified financial advisor¹. We therefore propose that there be no restriction on the number of member-choice options within an individual retirement fund.

2.6.2 We are also of the view that there is no adequate reason to limit member-choice in an occupational fund either. Financially sophisticated members of occupational funds also want control over their retirement benefits. Where occupational retirement funds do offer unlimited investment choice, and the trustees:

- monitor the investment performance of asset managers;
- communicate and provide information on the underlying funds;
- educate members;
- issue health warnings to members, e.g. that members should only invest in portfolios that meet his or her risk profile;
- insist that members consult with financial intermediaries; and
- ensure that individual member investment must comply with regulation 28,

there should be no restriction on the number of member-choice options within an occupational retirement fund either.

2.7 Preservation and Portability- recovery of expenses

2.7.1 The Paper proposes that fund benefits may not be reduced to recover any expenses from the member's benefit. This proposal should be carefully considered and clarified. In certain instances the administrator of the fund or the product provider does not charge any initial administration costs, with the intention to recover the initial administration cost over a period while the funds remain under the administrator's administration. Should the transferor fund not be allowed to recover unrecouped administration costs, annual administration fees will be increased, or an upfront fee will be charged, which may not be in the interest of members staying in the fund for a long time.

2.8 Board of trustees

2.8.1 It should not be a requirement in respect of individual retirement funds, where employer-employee relationships do not exist, that 50% of the board should consist of member elected trustees, as proposed by in the Paper. In the absence of an employer infrastructure, this requirement will be unnecessarily costly and will not necessarily meet the objective, as the members will not know each other. A requirement that individual retirement funds should be compelled to appoint 50% independent trustees will be more effective, and this should be the default option, rather than requiring funds to apply specifically to the Registrar for an exemption in this regard.

¹ A Canadian practice would allow trustees of occupational and individual retirement funds to satisfy their fiduciary duties by ensuring that members have access to a registered financial advisor, thus allowing members access to both information and the requisite expertise when called upon to exercise member choice. This gives members greater control over their retirement provision. The continued involvement of a financial advisor could be checked at various stages of a member's life.