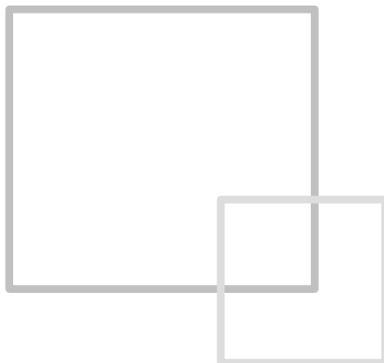


COMMENTS BY OLD MUTUAL

**On The Retirement Fund Reform Discussion Paper
Issued By The National Treasury Of The Republic Of South Africa
December 2004**

**Submitted by Old Mutual
29 March 2005**



INDEX

1	INTRODUCTION	6
2	PRINCIPLES OF RETIREMENT REFORM	7
3	FUND GOVERNANCE AND REGULATION	8
4	THE SOUTH AFRICAN RETIREMENT FUNDS LANDSCAPE	11
5	COMPULSION	13
6	NATIONAL SAVINGS FUND	16
7	DIFFERENTIATION	23
8	INDIVIDUAL RETIREMENT FUNDS	25
9	ADEQUACY OF RETIREMENT BENEFIT	31
10	PENSION INCREASES	33
11	BENEFITS AVAILABLE FROM A RETIREMENT FUND	35
12	POWERS OF THE REGULATOR	53
13	STATISTICAL REPORTING	55
14	DISPUTE RESOLUTION	56
15	GOVERNANCE AND TRUSTEE CONDUCT	57
16	INVESTMENT REGULATION	69
17	FUNDING AND CALCULATION TECHNIQUES	72

SUMMARY OF OLD MUTUAL'S MAIN COMMENTS

The paper provides an excellent basis for discussion of the envisaged future regulatory framework.

Umbrella Funds [par 3 & 15.20 et seq.]

The New Act must give special attention to umbrella funds:

- It is paramount that members' interests be properly protected.
- It is crucial that the role played by sponsor in the success of a umbrella fund be duly recognised, particularly the financing of set-up costs, product development costs and marketing costs.
- The regulatory regime must fairly balance the interests of the sponsor, members and other stakeholders.
- In the interest of cost- efficiency, and in order to achieve economies of scale, no limit should be placed on the number of sub-funds that may form part of an umbrella fund.
- Full disclosure to be made to members regarding contributions, costs and investment performance, as well as essential features of the umbrella fund in question.
- At least half the board to consist of professional independent trustees and trustee remuneration (if any) to be paid by the fund.
- Governance of funds to be documented in governance documents, particularly agreements between the fund and service providers, as well as between the fund and sponsor, trustee code of conduct, mandates of sub-committees, risk matrix, etc.
- The sponsor should initially have the right to appoint the service providers and to determine the investment products offered. However, trustees should determine service level standards and monitor performance.
- The trustees should have the right to terminate the appointment of a service provider if it fails to meet the agreed standards and to remedy the failure

within a reasonable period, subject to prior consultation with the sponsor and members.

- In the event of such a termination of the appointment of a service provider appointed by the sponsor, the sponsor should have the right to terminate sponsorship agreement and recoup its reasonable product development and marketing costs, to the extent that the fund received or will in future receive value from the efforts of the sponsor.
- Participating employers or member committees of a sub-fund (if appointed) should have the right to terminate participation in the fund without penalty, but subject to conditions relating to the types of investment portfolios involved, as well as payment of costs of transfer to another fund.

Tax Dispensation [par 3.7 et seq.]

- The regulatory framework and tax dispensation should be developed in tandem, as tax dispensation is critical to achieve the objectives of the envisaged policy.

Compulsion [par 5]

- Retirement provision should become compulsory. Any resistance encountered to enter the formal sector should be countered by appropriate tax incentives.

National Savings Fund [par 6]

- Other alternatives to the National Savings Fund (NSF) should be investigated in consultation with the private sector. If regulatory constraints are removed, the private sector should be able to offer simple, low cost savings solutions.
- Decentralisation of NSF should be considered to facilitate effective administration.
- Access to savings in the NSF must be limited to prevent leakage.

Differentiation [par 7]

- Old Mutual supports harmonisation of tax treatment for retirement funds, subject to the protection of accrued rights
- Protection against unfair discrimination should not exceed the protection afforded by the Promotion of Equality and Prevention of Unfair Discrimination Act

Individual Retirement Funds [par 8]

- The regulatory framework should, in the interest of promoting low cost products, provide for an alternative regulatory model in terms of which retirement savings products could be regulated without requiring the interposition of a retirement fund.
- This regulatory framework could also be extended to group products where an appropriate body exists to represent members.

OLD MUTUAL COMMENTS

1 INTRODUCTION

- 1.1 Old Mutual wishes to congratulate the National Treasury (“Treasury”) on an excellent discussion paper (hereinafter referred to as “the Treasury Principles” or “the discussion paper”, depending on the context). We are impressed with the lucid and balanced way in which often very complex issues have been discussed.
- 1.2 The Treasury principles in our view embody a comprehensive and in depth analysis of the pertinent issues relating to retirement savings in South Africa and, as such, provides a sound basis for discussion by the various stakeholders of the future retirement savings regulatory framework.
- 1.3 Although Old Mutual will, as usual, feed comments through to the various industry bodies for consideration in making their submissions, we consider the matter of such importance that we would also like to contribute to the debate by way of this direct submission to Treasury. We would also welcome the opportunity to discuss these issues with the appropriate persons representing National Treasury.
- 1.4 As an overriding principle we believe it is necessary to balance the desire to limit costs with the need for appropriate levels of governance and a suitable framework to encourage savings for retirement.
- 1.5 In our comments we shall -
 - 1.5.1 follow the sequence of the discussion paper and provide our comments under the same headings;

1.5.2 generally contextualise our comments with a preceding reference to the proposals of Treasury to which our comments relate.

1.6 References in square brackets refer to the relevant paragraphs/pages of the discussion paper.

2 PRINCIPLES OF RETIREMENT REFORM (“Principles”)

Objectives of retirement funding policy [discussion paper p 4]

2.1 We fully agree with the stated broad objectives of retirement policy and with the conclusion that the time is ripe for a review of the existing regulatory framework. However, we wish to caution that such review should not interfere with accrued rights, particularly in relation to tax consequences.

2.2 In addition to encouraging individuals, employers and employees to provide for retirement funding, consideration should also be given to encourage affinity groups like churches, sports clubs, etc., to facilitate retirement provision for their members.

2.3 The greatest challenge in our view is to ensure that the three-quarters of our population that reaches retirement age without a funded pension benefit [discussion paper p 4], is substantially reduced.

2.4 Old Mutual is committed to do its part in achieving this goal.

3 FUND GOVERNANCE AND REGULATION

Treasury: *Umbrella funds to receive special attention* [discussion paper p 8, Principles paragraph 6]

3.1 *In the context of the protection of members, the discussion paper states that the “new Act must give special attention to **umbrella funds** and the accompanying difficulties attached to the management of those funds.”*

Old Mutual

3.2 We fully agree that the new Act should give special attention to umbrella funds.

3.3 Besides the matters raised in the paper, due recognition should also be given to the important role umbrella funds play in enabling small and medium employers to give their employees access to a cost efficient retirement savings vehicle.

3.4 The Orion umbrella funds sponsored by Old Mutual for instance have approximately 4 500 participating employers and 170 000 plus members, spread over South Africa. Many of the employers only have small numbers of employees participating in the fund (less than 50 employees).

3.5 The active involvement of the sponsor in the establishment and promotion of these umbrella funds, as well as the development of suitable products, is critical to their success. This requires a significant investment by the sponsor that can only be recouped over a relatively long period. The sponsor should accordingly be afforded reasonable

protection in the Treasury principles while adequately protecting the interests of the members and other stakeholders. We make practical suggestions in this regard from paragraph 15.20 below.

Treasury: *Tax to be dealt within broader framework of institutional reform* [p 9, Principles final paragraph]

- 3.6 *In the conclusion to the Principles of Retirement Reform on p 9, final paragraph, the discussion paper points out that the proposals do not deal with the tax treatment of retirement funds.*
- 3.7 *According to the discussion paper “This important aspect of the retirement reform project needs to be dealt with in the context of a broader framework of objectives and institutional reforms, and will be the subject of a separate discussion paper.”*

Old Mutual

- 3.8 We fully agree that the tax treatment of retirement funds is an **important aspect** of retirement reform.
- 3.9 In our view the future regulatory framework relating to retirement savings should not be developed in isolation from the future tax dispensation, as it is integral to the total regulatory framework. This is demonstrated by the fact that the discussion paper itself found it necessary to recommend that the NSF be exempted from the payment of Retirement Fund Tax [on page 23, Annexure 2, paragraph 2.5.1.2. (e)].
- 3.10 We strongly believe that the achievement of the laudable objectives set out in the Treasury principles to **encourage individuals** to provide adequately for their own retirement and to **encourage employers** and

employees to provide for retirement funding as part of the remuneration contract (which we wholeheartedly support), will very much depend on the future tax dispensation relating to retirement savings.

- 3.11 In considering the future tax dispensation, it should be taken into account that inflation has, over time, considerably reduced the value of the deductions allowed in real terms. We furthermore wish to point out that Retirement Fund Tax is complex and has severely reduced members' benefits, and also added to the complexity and costs of administration.

4 THE SOUTH AFRICAN RETIREMENT FUNDS LANDSCAPE

- 4.1 We generally find ourselves in agreement with the outline given of the South African Retirement Funds Landscape in Annexure 1.

Treasury: Costs of administration [Annexure 1, par 2.7; p 17]

- 4.2 *The costs of administration and insurance premiums are a major concern and must be kept in check.*

Old Mutual

- 4.3 While we agree with the principle, we need to point out that the costs and risks to service providers in providing administration services are high and, contrary to popular belief, the profit margins low. It is essential that changes to legislation do not make the rendering of services by the private sector commercially unviable.

- 4.4 The main contributors to the high costs of administration are the following:

4.4.1 A large number of pay points (particularly if the pay point serves only a small number of members).

4.4.2 Incorrect or incomplete information provided by participating employers and claimants.

4.4.3 Costs related to compliance with regulatory requirements.

4.4.4 Tax administration duties imposed upon administrators.

- 4.5 We do not believe that any regulatory intervention is needed. The best

way of ensuring reasonable profit margins would be to create a business environment for the existence of retirement funds in which there is healthy competition amongst service providers. The fostering of such an environment, subject to proper governance guidelines and powers of the Regulator to intervene when appropriate, will be far more effective in the longer term.

5 COMPULSION

Treasury: No need to compel employees [Annexure 2, par 1.5 to 1.6]

5.1 *There is no need to compel employees to belong to retirement funds. [Annexure 2, par 1.5 at p19]*

5.2 *If an employee is not required to belong to a particular retirement fund as a condition of employment, the employer will be required to offer each new employee [Annexure 2, par 1.6.1.2 at p 20]:*

5.2.1 *Education on the need for retirement savings and information on retirement savings options;*

5.2.2 *Payroll facilities so that the employee may join an individual retirement fund or the National Savings Fund.*

Old Mutual

5.3 In our view a strong case can be made out for compulsion.

5.4 The paper argues that the current private retirement fund system has flourished without compulsion. This is true in respect of full-time employees in the formal sector, but this is not the main concern. The informal sector, part-time and contract workers are not adequately covered. Compulsion will, in our view, significantly contribute to the broadening of coverage in those areas and reduce the risk of an increase in the number of persons dependent upon SOAP.

5.5 The paper argues that South Africa's population is not ageing to the same extent as others. We are not aware of any research to support the suggestion made that the dependency ratio will not deteriorate over

the next 20 years (footnote12). The impact of AIDS is likely to increase the dependency ratio significantly.

- 5.6 The paper argues that compulsion may encourage people and businesses to remain in the informal sector. In our view these real or perceived obstacles need to be overcome, possibly by way of appropriate tax incentives. Compulsion with limited exemptions could also be explored, for example in respect of employees earning less than a certain minimum wage (e.g. employees' that are likely to qualify for SOAP anyway).
- 5.7 Compulsion does not appear to clash directly with any of the other proposals, especially if limited temporary exemptions are given. Exemptions can be gradually reduced to phase in compulsion over a period.
- 5.8 If the recommendation made in the discussion paper, namely that there is no need to compel employees to belong to a retirement fund, is ultimately accepted, we would agree in principle with the paper that, if an employee is not required by his/her employer to belong to a particular retirement fund, the employer should generally be required to offer each employee education on retirement savings and payroll facilities.
- 5.9 We, however, wish to caution that the costs, administrative burden and practicality of imposing this recommendation upon small/medium employers, need careful consideration.
- 5.10 The payroll facilities of these employers are limited and the administration and cost burden to allow each employee to choose a retirement fund to which contributions must be paid, should not be underestimated, as most of these employers will not have a payroll

system or automated payroll processing and payment functions.

5.11 We accordingly recommend that the proposal be qualified as follows:

5.11.1 Due to the high costs involved in providing such a facility, the obligation of the employer should be limited to no more than two providers approved by the employer, in consultation with its employees.

5.11.2 Small employers should be given the option to apply to the Registrar for exemption from the obligation to provide the facility.

5.11.3 If an employee requires that the employer must provide payroll facilities in respect of any other provider, the employee must bear the costs of the employer attributed to the provision of the facility.

5.12 Alternatively we suggest that the option of a debit order facility be considered in terms of which the fund is authorised to deduct the contributions due directly from the members' bank accounts.

5.13 The employer can then, based on the deductions paid to the fund, calculate the correct tax if there are any tax advantages associated with contributing to the fund.

5.14 The education and information material should as a minimum comply with guidelines prescribed by the Registrar.

6 NATIONAL SAVINGS FUND

Treasury: Table 3.1 [Annexure 2 par 2.3, page 21]

6.1 *The above table analyses working age individuals in terms of their likely sources of income during retirement.*

Old Mutual

6.2 We would like to draw attention to the following:

6.2.1 The impact of the recent high inflation environment (late 90's to early 2000's) followed by a reduction in equity markets' erosion of retirement funding in a defined contribution environment is probably not visible from the table.

6.2.2 There are people in their mid 60's who will be accessing the SOAP, having been PAYE taxpayers who are now below the means test.

6.2.3 We believe the impact of ageing and peaks in inflation should be properly addressed.

Treasury: NSF should be created [Annexure 2, par 2, p 20]

6.3 *The discussion paper recommends that for people with **low incomes**, a new savings vehicle, the National Savings Fund ("NSF"), should be created in consultation with bodies that have initiated other measures to encourage savings and the extension of banking services across the population. [Annexure 2, paragraph 2.5]*

Old Mutual

- 6.4 Old Mutual strongly agrees that the future dispensation should ensure that the sectors of the population who until now had restricted or no access to retirement fund funding (“the low income sector”) are duly catered for.
- 6.5 Although the establishment of a National Savings Fund (NSF) certainly has merit, the matter in our view needs more investigation together with other alternatives of providing for retirement savings.
- 6.6 In our view, the following constraints in the current regulatory dispensation inhibit the creation of an appropriate savings vehicle for the low income sector by the private sector:
- 6.6.1 The requirement that regular monthly contributions must be made.
 - 6.6.2 The requirement that each pension fund must have a participating employer.
- 6.7 If these constraints are removed or exemption may be obtained, the industry would, in our view, be able to offer appropriate products to the relevant market segment.

Treasury: NSF will ensure affordable administration [Annexure 2, par 2.5.1.2 (a) & (d), p 22]

- 6.8 *It is envisioned that the NSF would ensure affordable administration costs through economies of scale and require the administrator of the fund to permit irregular contributions.*

Old Mutual

- 6.9 As far as the administration of the NSF is concerned, we wish to point out that one of the biggest expenses to a fund is the collection and allocation of contributions, particularly relative to small amounts.
- 6.10 The manner in which contributions will be collected and allocated, especially if the contributions may be made sporadically, will need careful consideration. This can become an extremely costly exercise and could potentially lead to large amounts of unallocated income, (experienced in this area by the industry already). Deposits into the NSF should not be permitted without the necessary member detail so that each deposit is credited to the member concerned.
- 6.11 Rigorous measures will have to be put in place to ensure that correct information is provided when contributions are made.
- 6.12 Maintaining contact with members for the ultimate purpose of being able to pay benefits will also be enormously difficult, especially given the erratic nature of the contribution pattern from different employment resources. This is a risk area for the NSF as failure to pay benefits could lead to bad publicity and give rise to public mistrust. High-level financial management will be required to address this risk.
- 6.13 These difficulties might very well cause one big national fund to be extremely difficult to administer and to become cost inefficient.
- 6.14 Consideration should be given to the establishment of a number of funds or sub-funds in the various regions or industries, and that these be administered by a number of experienced administrators.
- 6.15 Another alternative would be to license service providers to administer

sub-funds and possibly even to allow for competition in order to create efficiencies and reduce fees.

Treasury : Access in times of life crisis [Annexure 2, par 2.4 & 2.5(b), p 22]

6.16 *The Treasury principles seem to contemplate that drawings be allowed in times of life crisis, but states that retention for retirement should be incentivised, e.g. a bonus being payable if moneys are retained in the NSF until retirement.*

Old Mutual

6.17 Allowing members of the NSF to withdraw funds on demand would in our view present an opportunity for massive “leakage”, and could be seriously counter-productive. In addition the administration involved is likely to be costly and time consuming.

6.18 This would for instance allow a member before retirement to be in a position to withdraw a large amount of his/her savings as a result of which only an insignificant proportion of the benefit might still be payable on retirement.

6.19 In our view, withdrawal before retirement should be restricted, e.g. by providing that only a percentage of the NSF savings should be permitted to be withdrawn before retirement.

6.20 Allowing withdrawal before retirement is also at odds with the stated intention of bringing about compulsory preservation on leaving employment.

6.21 In our view the suggested bonus will be an inadequate measure to

prevent leakage in the low-income category. How the bonus is to be funded is also an issue. Returns on withdrawal benefits will have to be compromised to achieve an end bonus. Then, if 100% withdrawal is allowed before retirement, who will benefit from the monies set aside for the bonus? Is there to be a type of cross-subsidisation here?

- 6.22 We anticipate that it will be extremely difficult, if not impossible, to define the concept of “life crisis” such that it would not allow for unwarranted withdrawal or abuse of the exception allowed.

Treasury: Trustees possibly to have duty to advise employees to move to NSF [Annexure 2, par 22, footnote 22, p23]

- 6.23 *The discussion paper moots the possibility of imposing a duty on the trustees to advise employees to move from an occupational fund to the NRF “if it is clearly to their benefit to move”.*

Old Mutual

- 6.24 The suggestion in the last sentence of footnote 22, namely that it could also be made one of the duties of trustees to advise such employees to move, if it is clearly to their benefit to move, is cause for concern.
- 6.25 The retirement vehicles will be difficult to compare, as they will not have the same rules applicable to them.
- 6.26 It will be extremely difficult for trustees to assess whether it is “clearly to [employees’] benefit to move”.
- 6.27 From a taxation perspective, it may be to an employee’s benefit, but it will not necessarily be to his/her benefit to move out of a compulsory membership fund, where no withdrawals are allowed until retirement,

into a savings-type vehicle where ad hoc withdrawals are allowed. The trustees will not be able to assess whether or not the member will be tempted to early-withdraw his/her savings to his/her ultimate detriment at retirement.

6.28 It will also be very difficult for trustees to assess the future investment performance of the funds. For instance, if the NSF is to be invested mainly in Government Bonds per footnote 21, it will generally be very difficult for trustees to predict whether the broader investment base of the occupational fund will not have out-performed such bonds at retirement age of the member.

6.29 The best the trustees can be expected to do is to point out the differences, advantages and disadvantages, and then leave it to the member to decide. Advising a member whether or not it is in his/her best interest to transfer to the NSF would require the trustees to investigate the personal circumstances of each member and play the role of personal financial adviser. It is not appropriate to impose such a duty on trustees.

Treasury: The NSF should be exempt from Retirement Fund Tax [Annexure 2, par 2.5(e) - (h), p 23]

6.30 *The discussion paper recommends that the NSF should be exempt from the payment of Retirement Fund Tax. The discussion paper furthermore states that the TTE approach should limit abuse of the NSF by the affluent and furthermore mentions various measures that can be introduced to limit abuse by the affluent.*

Old Mutual

- 6.31 The recommendation that the NSF should be exempt from the payment of Retirement Fund Tax seems to indicate an acceptance by the discussion paper that Retirement Fund Tax will remain payable by occupational and individual retirement funds in the future dispensation.
- 6.32 In our view the future tax regime should not be dealt with piecemeal but rather holistically and should include serious consideration as to whether Retirement Fund Tax should be retained.
- 6.33 On the assumption that the future tax regime will favour the NSF above the other retirement funds, we will certainly agree that measures be taken to prevent abuse by the affluent. A related matter to be dealt with is the question as to what happens if a person who qualifies for participation in the NSF later ceases to qualify.

7 DIFFERENTIATION

Treasury: Tax treatment to be harmonised for all types of funds
[Annexure 2, par 3, p 23 to 26]

7.1 *The discussion paper recommends that for people with middle and higher incomes, conditions for favourable tax treatment should be harmonised for all types of retirement funds, including those that do not operate in the context of an employment relationship.*

Old Mutual

7.2 Old Mutual supports the harmonisation of tax treatment for retirement funds, subject to appropriate protection of accrued rights.

Treasury: No unfair discrimination [Annexure 2, par 3.5.3, p24]

7.3 *The discussion paper makes various recommendations to address unfair discrimination.*

Old Mutual

7.4 Old Mutual supports the proposals, but recommends that the measures inhibiting unfair discrimination should not exceed those appropriate in terms of the Promotion of Equality and Prevention of Unfair Discrimination Act.

7.5 Defined contribution funds are based on the principle of an equal contribution rate by the employer, on behalf of each member. In order to avoid cross-subsidies, benefits of equal value should thus be offered to each member. This will mean that members will not necessarily receive the same level of benefit (as the cost of each member's benefit

might be different). Differentiation is thus important in defined contribution funds in order to avoid cross-subsidies between members. For example, if death benefits are set at the same level for all members in a defined contribution fund, then cross-subsidies will occur as the cost of the benefit depends on age, sex, etc.

- 7.6 If all members receive the same benefit, then each member will receive a different value of benefit from the fund. Members may then prefer to receive cash, or obtain individual cover outside the fund to avoid these cross-subsidies. This might lead to no (or insufficient) death cover for dependants and increase the burden on the State if dependants don't have appropriate cover.
- 7.7 We generally agree with the recommendation made in paragraph 3.5.2.1 of Annexure 2 on p 24 (i.e. unfair discrimination should be addressed by prohibiting restrictions placed on eligibility for membership on grounds of race, age, gender, sexual orientation, state of health or employment status), but not for risk benefits, except if contributions for each member correspond to the value of the benefits offered to that member.

8 INDIVIDUAL RETIREMENT FUNDS

Treasury: *The emergence of Individual Retirement Funds will be a natural consequence of harmonising tax conditions [Annexure 2, par 4; p 26 to 27]*

8.1 *In the discussion paper various recommendations are made regarding individual retirement funds, including irregular contributions allowed, no employer/employee relationship required, choice of benefits & contributions allowed.*

Old Mutual

8.2 We generally agree with the recommendations made.

8.3 The regulatory regime¹ should however in our view go further and permit -

8.3.1 Death and disability benefits, and the corresponding premiums, negotiated with the individual members, separate from the savings element (i.e. such premiums would be separately stated in any communication to the members).

8.3.2 A regulated product approach to the savings element: The compliance officer to see that the unitisation of moneys and administration by an individual member is in accordance with regulations (much as currently happens with Collective Investment Schemes). The compliance

¹ Our comments in this regard are based on views expressed by Jeremy Andrew.

officer would report compliance to the regulator.

- 8.3.3 The sponsor would package investment management services, administration, and communication to members (to standards laid down by regulation) within the savings element of the product.
- 8.3.4 Disclosure of the cost structure, which will all be on an “as and when” basis except for any initial charges that may apply when the product is sold (or presumably when new money is invested).
- 8.4 Payment for advice at an individual member level, as a separate item, to be negotiated between the individual member and the advisor, but legislation to allow the payment to be made directly from the savings vehicle, in that not all members of the public can afford to pay these fees as a separate item.
- 8.5 The individual member must be able to uplift the balance in the savings element without penalties (or any deduction of unrecouped expenses) at any time on the giving of reasonable notice. (The regulations could lay down some protection for the investment manager in case there is a run on the bank or unusual market conditions, much as form part of the Collective Investment Schemes Act.) Following such upliftment, the risk benefits would cease unless the contract provided for these to be continued on a stand-alone basis.
- 8.6 The regulation of individual retirement savings products could function very simply. The parameters within which the product may be designed should be regulated. This could include the following:
 - 8.6.1 The regulators lay down the requirements applicable to the

product (e.g. no benefit to be paid prior to a stated retirement date).

8.6.2 The product provider would submit its product to the regulator for approval.

8.6.3 Once approved the product would be marketed to individuals as a simple, cost effective, tax efficient means of saving for retirement.

8.7 The costs of trustees and other expensive regulatory compliance requirements would be eliminated or largely reduced; compliance costs would be built into the product. This should enable the market to offer basic retirement savings products at low cost.

8.8 The consumer would not be compromised as the products would be regulated, and the compliance officers of the product companies could be required to report to the regulator on compliance with such regulations.

8.9 Such a product regulatory regime could, in our view, also be extended to group retirement savings product offerings, as well as a group approach to the provision of advice for death and disability benefits where the members have an appropriate body who can represent the interests of members, such as the managing body of an affinity group or a duly authorised representative of the group and could even include bodies representing employees. Old Mutual is currently investigating the matter in more detail and plans to make a further submission to Treasury in this regard.

8.10 We believe a regulatory regime for contract based offerings (not requiring a retirement fund) but rather regulating the product would:

- 8.10.1 Solve the potential conflict of interest issue between the management of the fund and the sponsor of a commercial scheme.
- 8.10.2 Open up new opportunities for bringing to market products that would be more cost efficient and also be accessible to seasonal workers and the informal sector.
- 8.11 The disclosure requirement (in Annexure 2, par 4.2.6 of the discussion paper, namely the fund must disclose all fees to its members and to the fund by its service providers) should stipulate that it is an annual disclosure and that it should apply only in respect of the fees of such service providers as the Regulator may stipulate. Also, the publication of the comparative fees should be on an annual or quarterly basis (the discussion paper does not stipulate the frequency of publication). Individual retirement funds should be subject to audit and, where investment choice is permitted, permit the deduction from the credit in respect of a member of such investment adviser's reasonable fees.

Treasury: Individual retirement funds not to pay commission [Annexure 2, par 4.2.8, p27]

- 8.12 *The discussion paper recommends that individual retirement funds must not pay commission or service fees to an intermediary for inducing a member to join the fund.*

Old Mutual

- 8.13 While we associate with the desire to reduce costs of retirement and prevent churning, we have reservations concerning the recommendation that funds should not pay commission or service fees

to an intermediary for “inducing” a member to join a particular fund.² If it would be in the interest of the fund to expand its membership, we see no reason why an intermediary should not be duly remunerated for services rendered in this regard.

Treasury: Post-retirement medical aid subsidy [Annexure 2, par 6.5; p28]

8.14 *The discussion paper recommends that an employer who wishes to pre-fund the medical aid contributions which the employer is obliged to make in respect of pensioners, should be able to use an occupational retirement fund for this purpose.*

Old Mutual

8.15 Although we welcome the proposal, we would like to draw attention to the following conclusion set out in the paper submitted to the Chief Director of Tax Policy on 24 April 2004 by the South Africa Institute of Chartered Accountants entitled the “Funding of post retirement medical aid liabilities:

“Of all the above-mentioned products the preferred option would tend to be an insurance product, provided the product is properly structured.”

8.16 In our view the retention by a retirement fund of any pre-funding made by an employer in respect of the post retirement medical aid (PRMA) obligation should be conditional on the employer retaining a balance of

² Instead of using the word “induce”, we would prefer to refer to the intermediary’s activity as one of “advising” the client to join a fund.

cost obligation toward the persons who enjoy the benefit of that subsidy, because, on this basis, the employer should have the following rights and obligations -

- 8.16.1 To determine the investment policy (including investment risk tolerance) in respect of the PRMA credit in the fund.
 - 8.16.2 The right to require the trustees to transfer the whole or part of the amount retained by the fund in respect of the PRMA liability to such other entities the employer may stipulate.
- 8.17 Furthermore, the PRMA credit in the fund must also be ring-fenced against the creditors of the fund unrelated to the provision of this PRMA benefit; and equally the other assets of the fund must be ring-fenced against the PRMA creditors. On liquidation of the fund, the PRMA credit must revert to the employer or must be paid to a third party as stipulated the employer.
- 8.18 The trustees should only permit the PRMA arrangement if it is stipulated by the employer what the annual escalation rate of the benefit is at inception of the arrangement; and that the trustees are obliged to accept any change of the escalation rate if it is negotiated by the employer with its employees and persons eligible to receive the PRMA benefit.
- 8.19 The Act should also provide for a person who is not eligible to be a member of the fund to receive a benefit from the PRMA arrangement in the fund if that is within the terms of the PRMA promise by the employer to its employees.

9 ADEQUACY OF RETIREMENT BENEFIT

Treasury: Government's objective in terms of adequacy [Annexure 3, paragraph 1.1 p 30 to 32]

9.1 *The discussion paper points out that **Government's objective** in terms of adequacy is that -*

9.1.1 *Members should be able to accumulate sufficient assets to provide an income after retirement at age 65.*

9.1.2 *The resulting income should -*

9.1.2.1 *Retain purchasing power in the face of inflation;*

9.1.2.2 *Be payable for the lifetime of the member;*

9.1.2.3 *Include a pension payable for the lifetime of the surviving spouse on the member's death after retirement of 50% of the member's pension, or an equivalent pension to be paid to any dependant children until the age of 18, if there is no surviving spouse.*

Old Mutual

9.2 *Although it may be an ideal solution, an annuity payable for life, inflation adjusted and with spouse's benefit, is not always achievable.*

9.3 *If the individual chooses lower than full inflation increases to get a bigger initial pension, and understands that he/she will get steadily poorer in an inflationary environment, the individual should be*

permitted to purchase an inflation-linked product.

- 9.4 We should however point out that a CPI-linked “joint and survivor” annuity is an expensive product as index-linked bonds normally trade at low real yields. Consequently for most pensioners the income provided, particularly in the initial years, is likely to be low compared to earnings prior to retirement.
- 9.5 The additional cost of providing inflation protection of the pension will also require a much higher tax-deductible limit to ensure a reasonable level of income at retirement. Members may struggle to save at the rate required.
- 9.6 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 further drive up the costs of these products, to the detriment of members, as there is a scarcity of assets available to match such a liability.
- 9.7 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.
- 9.8 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.

10 PENSION INCREASES

***Treasury: Preserve provisions of Pension Funds Second Amendment Act
[Annexure 3, par 2.4.1, p 33]***

10.1 *The discussion paper recommends that the provisions of the Pension Funds Second Amendment Act, 2001 providing for full inflation-proofed increases if the fund can afford them, be preserved and implementation problems addressed.*

Old Mutual

10.2 Preserving the provisions of the Pension Funds Second Amendment Act, 2001, allows trustees of retirement funds to decide on the appropriate level of inflation protection for pensions.

10.3 We wish to point out that members may be prepared to have a lower level of guaranteed inflation protection in return for a chance of receiving pension increases that are greater than inflation (and the associated risk of receiving an increase that is less than inflation). This would be the case if the assets backing the pensions were not invested so as to hedge inflation perfectly.

Treasury: Assets backing pensions must be invested separately [par 2.4.2, p33]

10.4 *The discussion paper recommends that if a fund's liability is not underwritten by an insurer, the pensions paid from the fund should be backed by assets that are separately invested from the other assets of the fund and pensioners should receive the benefit of the investment return earned on these dedicated assets.*

Old Mutual

- 10.5 Ring fencing the pensioner assets eases the application of the provisions of the Pension Funds Second Amendment Act, 2001, and prevents cross-subsidies between active and retired members.
- 10.6 Consideration should be given to exempting such dedicated assets from Retirement Funds Tax, rather than the current tax rebate, which creates anomalies and practical problems. Our preference though is that retirement fund tax be abolished in its entirety.

11 BENEFITS AVAILABLE FROM A RETIREMENT FUND

Treasury: The “package” option recommended, but board must structure cost-effective benefit package. [Annexure 3, par 3, p 33 to 35]

- 11.1 *The discussion paper recommends that the “package” option be adopted in the South African context, subject to various constraints.*
- 11.2 *One of the constraints recommended is that the management board of a fund should be required to structure a cost-effective benefit package utilising the full range of employee benefits available in the market place, provided that every fund has a meaningful retirement savings component, which is separate from any ancillary benefits included.*

Old Mutual

- 11.3 We welcome the recommendation that a fund be allowed to provide employee benefits other than retirement savings benefits.
- 11.4 However in our view the management board should not be obliged by law to provide for such benefits; the provision of the benefits should be left to the discretion of the management board, subject to the proviso that if sufficient funds are made available for that purpose, the trustees must be obliged to provide for such benefits in the event of an agreement between the employer and the members of the fund, in terms of which the fund is to provide the benefits.
- 11.5 The requirement that the board should structure the benefit package utilising the “full range of employee benefits available in the market place” should in the case of an umbrella funds be subject to the

minimum protection to be afforded to such funds on the basis proposed in paragraph 3 and 15.20.1 et seq of this response.

Treasury: Contribution rate, administration costs and insurance premiums to be set out in rules [par 3.4.1.2, p34]

11.6 *The discussion paper proposes that the management board of a fund must ensure that the allocation of the total contribution rate between retirement savings, administration costs, and insurance premiums is set out in the rules and disclosed to members (as must be any reduction of ancillary benefits following premium increases).*

Old Mutual

11.7 We strongly support the principle of full disclosure of the allocation of the total contribution to members. However, the proposal that the allocation of the total contribution rate between retirement savings, administration costs, and insurance premiums must be set out in the rules might be difficult to implement. Insurance premiums change regularly, and it will not be efficient to change the rules every time a premium review is undertaken.

11.8 Instead of requiring the rules to set out these details, the change in allocation of contribution rate could be notified to members, including the information in their annual benefit communication currently required under PF86. It could also be made a requirement that members be notified of the basis of the allocation of the total contribution rate between retirement savings, administration costs, and insurance premiums, as well as the percentage split.

11.9 We propose that the trustees must be obliged to give effect to any

change in the contribution rate as negotiated between the employer and the members.

- 11.10 It would be preferable, furthermore, for the minimum proportion of the contribution payable by or in respect of members to be allocated to retirement savings. If this is not possible because the employer wishes to cap its total obligation, then there must at least be an annual disclosure to each member of the split of the total contributions received between retirement funding, administration costs and provision (or premiums) in respect of the risk benefits.

Treasury: Board should ensure competitiveness of administration costs
[Annexure 3, par 3.4.1.3, p 35]

- 11.11 *The discussion paper recommends that the management board of a fund must ensure the competitiveness of the administration costs and insurance premiums.*

Old Mutual

- 11.12 We support the recommendation and in addition suggest that service providers be required to disclose their costs and fees in a uniform way in order to facilitate comparison on an equal basis.
- 11.13 The regulator/legislation should furthermore give guidance on the factors to be taken into account in determining the competitiveness of service offerings and should include factors such as the quality of the services, the capacity of the service provider as well as the security provided by the financial strength of the service provider.

Treasury: distribution of benefits to be in accordance with member's

nomination [Annexure par 3.4.1.4, p 35]

11.14 *The discussion paper proposes that management must ensure that any benefits are distributed in accordance with the member's nomination of beneficiary form, unless compelling reasons exist why this should not be followed. Legislation may prescribe the type of annuity that must be used and any contingent pensions payable to the member's spouse or dependants following the member's death after retirement. Legislation should permit the management board to pay benefits into a discretionary trust established for the benefit of the member and/or his/her dependants.*

Old Mutual

11.15 Old Mutual generally agrees that benefits must be distributed in accordance with the member's nomination and that the legislation should permit the management board to pay benefits into a discretionary trust for dependants.³ This recommendation should in our view be extended to permit the purchase of an annuity policy, which will often be cheaper than the trust option.

11.16 We recommend that guidelines be provided on what would constitute compelling reasons for not following a nomination.

Treasury: Fluctuating Contributions to be allowed [Annexure 3, par 3.6, p35]

11.17 *The paper recommends that subject to the rules of the fund in which they participate, members should be allowed to vary their contribution rates, provided the limit on the tax deductible*

³ The matter is more fully discussed in par 11.60 et seq.

contribution by a member and employer combined is not breached.

Old Mutual

- 11.18 A member should in our view be allowed to contribute above the rate allowed for tax deduction.
- 11.19 A minimum retirement contribution rate should be set so that members are forced to save at least this minimum.
- 11.20 Fluctuation in employers' contributions should in our view also be allowed.
- 11.21 We should, however, point out that there might be additional administration costs for this extra flexibility.

Treasury: Post Retirement Medical Funding [Annexure 3, par 3.8, p37]

- 11.22 *The National Treasury Task Team recommends that an employer be permitted to make contributions to the "employer surplus account" with the express purpose of funding post retirement medical aid obligations, within limits to be determined by the revenue authorities, in conjunction with the regulator.*

Old Mutual

- 11.23 The final paragraph of 3.8.1 acknowledges the difficulties associated with predicting obligations determined by future medical aid contributions and points out that the employer should have the right to recover any over-provision. We believe that such recoveries should be

possible through either contribution holidays or contribution refunds or both.

11.24 The proposal regarding the use of the employer surplus account is helpful.

11.25 In this context, we believe that National Treasury needs to state the following for clarity:

11.25.1 Whether the employer's liability in respect of post retirement medical aid also transfers to the nominated retirement fund, if the employer chooses to fund via the employer surplus account. We would not be in favour of this.

11.25.2 Whether the employer will be able to make contributions to the employer surplus account in respect of employees/pensioners who are not members of the nominated retirement fund associated with the surplus account.

11.25.3 Whether the employer will be able to use the contributions made to the employer surplus account specifically to fund post retirement medical aid obligations or to fund other types of employer obligations as well.

Treasury: Members acquire no rights to any part of the employer surplus account [Annexure 3, par 3.8.4.2, p 37]

11.26 *The paper recommends that members acquire no rights to any part of this account, unless they retire from the service of the employer in circumstances, which entitle them to subsidy of their medical aid*

contributions. In such circumstances the employer could authorise the payment of sufficient capital from the special account to secure an annuity for the retired member. This annuity may either be paid from the fund or purchased from an insurer. Alternatively, the retiree's medical aid contributions could be paid from that account and such payments could cease if the member, for example, leaves the country and is no longer a member of the employer-nominated medical scheme.

Old Mutual

11.27 From the above we understand that any of the following options, as well as combinations thereof, will be available to employers:

Options	Payments made from	Payments made to
<i>A</i>	<i>Surplus account</i>	<i>Medical Aid Scheme</i>
<i>B</i>	<i>Retirement fund</i>	<i>Retired member</i>
<i>C</i>	<i>Insurance company</i>	<i>Retired member</i>

11.28 In this context, we believe that National Treasury should clarify the following:

Under B -

11.28.1 Whether the proposals envisage that, on retirement, the employer will authorise a payment of sufficient capital from the employer surplus account **to the underlying retirement fund**, which will then be used by the fund to pay the annuity to the pensioner for as long as he/she lives or qualifies for the benefit.

Under C -

- 11.28.2 Whether the proposals envisage something similar to a GN-18 transfer, i.e. whether the surplus in the retirement fund can be used to purchase an insurance contract. In particular, whether the transfer would take place from the employer surplus account directly to the insurance company.

Treasury: Leakage [Annexure 3, par 3.9, p 38]

- 11.29 *According to the discussion paper an analysis of benefit payments and anecdotal evidence suggests that primary cause of poverty in old age of people who have throughout their careers been a member of a retirement fund is the failure of many funds to pay adequate withdrawal benefits and members drawing these benefits in cash when changing jobs rather than preserving them for retirement.*

Old Mutual

- 11.30 In our view, the main reasons for poverty in old age is that benefits in cash are often spent and not preserved for retirement. This is partly due to a lack of appreciation of the importance of providing for retirement from an early age from the member, and a failure to communicate the importance of this need to those who received such a benefit, as well as other pressing financial needs at the date of exit from employment.

Treasury: Preservation and portability [Annexure 3, paragraph 3.12; p 39 to 40]

- 11.31 *The discussion paper recommends that no party may reward, directly or indirectly, any person for inducing the member to transfer his/her savings to the transferee fund.*

11.31.1 *The whole, or a portion, of the benefit may be paid in cash*

11.31.1.1 *Where the amount involved is lower than a minimum amount determined by the regulator; and/ or*

11.31.1.2 *Where the fund has guaranteed a member's housing loan, and the member defaults, in which case the retirement fund must pay any residual amount to the National Savings Fund on behalf of the member.*

Old Mutual

11.32 In our view, a financial adviser who assisted a member concerning the choice of individual retirement fund to which his/her benefit should be transferred should be able to charge the member a reasonable fee for the service rendered.

11.33 The importance of saving for retirement from early enough in life is not widely understood by the vast majority of the population at all levels of sophistication and education.

11.34 In our experience very few people directly approach retirement funds or insurers with a view to purchasing a retirement annuity product early in their lives. They are alerted to this need by intermediaries, who also play an important role in providing advice on the selection of the right fund for their needs,⁴

11.35 However without being able to receive remuneration for their efforts,

⁴ This type of advice is particularly needed as there are many different kinds of funds catering for different needs and each individual would have different financial requirements depending on their individual financial arrangements.

the intermediaries will not market and advise on retirement savings products. The remuneration should be adequate so as to ensure that the right level of person is attracted to the profession.

- 11.36 We accordingly recommend that the payment of commission or service fees to an intermediary should be permitted provided the member has acknowledged in writing both his acceptance of those fees and an acknowledgment by the member that he is aware that no fees would be payable to an intermediary if he or she (the member) joined the fund without the assistance of the intermediary.
- 11.37 The proposal that the residue after a housing loan default be paid to the NSF should be expanded to an individual fund or the member's new occupational fund (as the case may be).
- 11.38 We agree preservation legislation should be implemented. The potential leakage through the NSF needs to be limited; otherwise the preservation principle will be undermined.

Treasury: Interest on late payments [Annexure 3, paragraph 3.13; p 40]

- 11.39 *The discussion paper proposes that once a claim is admitted and the member's interest in the fund becomes payable, the management board should be required to invest this amount in an interest bearing account and pay the interest earned when the claim is settled.*

Old Mutual

- 11.40 In our view it should be up to the fund whether the benefit is retained in the existing investment or put into an interest bearing account, but the fund earnings (net of tax and expenses) on the benefit amount should be paid to the beneficiary.

Treasury: Unclaimed Benefits [Annexure 3, par 3.14; p 40 to 41]

- 11.41 *The discussion paper proposes that the board of a retirement fund should be required to attempt to locate any individual or his/her dependants who are entitled to benefits under the retirement fund. After a period of no more than, say, 24 months after benefits become due to a former member, the corresponding value should be paid to a central "unclaimed benefits fund" tasked to take reasonable steps to trace former members or their dependants.*
- 11.42 *If the central fund is unsuccessful the central fund may release moneys to the State.*

Old Mutual

- 11.43 We strongly agree with the principle that regulatory measures must be put in place to ensure that adequate steps are taken to trace beneficiaries.
- 11.44 We have, however, reservations as to whether this should be achieved via the establishment of an unclaimed benefits fund for the following reasons:
- 11.44.1 The establishment and need for administration of the central fund would add an unnecessary layer of costs. All the suggestions made in par 3.14.3.2 through to 3.14.3.4 can be imposed upon the fund.
- 11.44.2 The fund will have a far better chance of locating the members and determining the validity of the claim than a central fund, and the burden of doing this will be less as

they will not have to deal with the entire country's unclaimed benefits.

11.44.3 We are concerned that a central fund would give rise to enormous administrative difficulties without adding substantive value to the process, where the individual fund can retain focus and connections with employers.

11.45 We suggest that the following approach be considered -

11.45.1 Impose a duty on a fund to trace beneficiaries with minimum standards of tracing and that a list of unclaimed benefits to be advertised in the Government Gazette and published annually.)

11.45.2 The fund should establish a help line that members can phone and be provided with the administrator's details of their former funds' as they will have this on their database.

11.45.3 Extend the prescription period in respect of unclaimed benefits to 15 years.

11.45.4 Allow the fund, after the prescription period, to apply the relevant assets for improving the pensions payable to its members.

Treasury: Housing loan guarantees [Annexure 3, paragraph 3.15.1; p 41 to 43]

11.46 *The discussion paper recommends that only housing guarantees should continue to be permitted, subject to certain the conditions.*

Old Mutual

- 11.47 Old Mutual generally supports the proposals.
- 11.48 In Annexure 3 par 3.15.1.3 the discussion paper states that the amount of any guarantee should be subject to a “specified rand value”.
- 11.49 In our view it should be made clear whether this specified amount may or may not include interest accruing on the loan.
- 11.50 In a defined contribution fund, the guarantee should not exceed a legislated percentage of the member’s share, less an estimate in respect of tax. The entire amount of the member’s accumulated value should not be subject to the guarantee, as declines in the financial markets can reduce the member’s share.

Treasury: Access as a result of other life crisis needs [Annexure 3, par 3.15.2, p 43]

- 11.51 *The discussion paper recommends that an occupational or individual retirement fund must not be permitted to provide loans or guarantees for any purpose other than housing, but the National Savings Fund should permit withdrawal of savings for any purpose, but incentivise retention.*

Old Mutual

- 11.52 In our view the management board should be granted the discretion to allow limited access to retirement savings in cases of prolonged unemployment and accelerated payments of the insured portion of death benefits to the terminally ill.

Treasury: Deductions [Annexure 3, par 3.16; p 44 - 45]

11.53 *The discussion paper recommends that in order to prevent the abuse of the protection afforded to retirement savings by the payment of voluntary contributions into the fund to avoid claims by creditors, the management board must be able to determine and pay out such voluntary contributions plus the net investment return earned thereon to creditors.*

Old Mutual

11.54 Although we agree with the principle that abuse of the protection afforded to retirement savings should be prevented, consideration should be given to the treatment of *ad hoc* contributions to individual funds and the NSF. In many cases, such contributions could be classified as voluntary contributions, but then based on the proposal, they would not be protected on insolvency.

Treasury: Divorce [Annexure 3, par 3.16; p 44 to 45]

11.55 *The discussion paper proposes that a member's minimum individual reserve should be deemed to form part of his / her assets available for splitting on divorce and makes various proposals aimed at giving effect to the principle.*

Old Mutual

11.56 We generally support the proposals, but would like to add the following comments:

11.56.1 There should be provision for immediate transfer out to

another fund of the ex-spouse's share.

- 11.56.2 The effect of housing guarantees must be considered and adjusted at the time of divorce.
- 11.56.3 The "clean break" principle is welcomed, but it may not be appropriate in every case that the non-member spouse becomes a member of the fund. The fund should be able to provide in its rules that the non-member spouse is required to transfer his/her share of the benefit to an occupational fund of which the non-member spouse is a member, an individual fund or to the NSF.

Treasury: Payment of benefits on death [Annexure 3, par 3.18, p 46]

11.57 *Section 37C of the Pension Funds Act is a source of great difficulty for trustees, and consequently of cost in the running of a fund; particularly in funds with large numbers of members.*

11.58 *The discussion paper proposes that*

11.58.1 *the trustees should be obliged to comply with the expressed wishes of the deceased member unless, in their opinions, there are compelling reasons why they should not; and*

11.58.2 *process difficulties which are evident in the current Act be minimised.*

Old Mutual

- 11.59 We welcome the recommendation that benefits generally be distributed in accordance with the member's nomination of beneficiaries, unless compelling reasons exist why the member's nomination should not be followed.
- 11.60 A person's retirement savings are very often his/her biggest asset and he/she should (as is the case with the rest of his/her estate) be able to direct to whom the assets should be transferred after his/her death.
- 11.61 Clear guidance should be given for deviating from members' nominations in the legislation, e.g. a dependant comes forward with evidence that the member did not make adequate provision for the dependant's support in his/her will or nomination.
- 11.62 A limited time period should be allowed for claims that compelling reasons exist for deviating from a nomination, to avoid undue delay in the payment of death benefits to beneficiaries.
- 11.63 We suggest that the nomination form should be signed in the presence of two witnesses and that the member be informed of the importance of providing for dependants who are dependent on him/her for support, particularly minor children.
- 11.64 Consideration should be given to an appropriate process of dealing with maintenance claims, e.g. that
- 11.64.1 Such claims must be filed with the executor of the estate of the deceased;
 - 11.64.2 In the event of a dispute, the executor must refer the matter to the Maintenance Court);

- 11.64.3 A maintenance claim must be settled as a first charge against the death benefit payable other than a death benefit in the form of a pension or annuity in terms of the rules stipulated for beneficiaries (such as spouse or child);
- 11.64.4 Unless any such claim for maintenance is lodged with the executor within 6 months of the death of the deceased, the right of the executor to require any death benefit to be used to settle this maintenance claim lapses; and accordingly no death benefit should be payable without the consent of the executor before 6 months after the death of the deceased.
- 11.65 This recommendation would involve a material change from current practice and would also require, if National Treasury accepted it, a change to the provisions of the Administration of Estates Act and possibly also the Maintenance Act. But it would relieve funds of a substantial administrative and cost burden in determining the allocation of death benefits. The social purpose of providing a benefit to dependants would thus be retained, and would also ensure that all death benefits are taken into account in the settlement of a death claim. There should, naturally, also be built into this process a provision that the executor can settle any maintenance claim by making payment to a trust for the benefit of a person requiring maintenance, directly to the beneficiary himself or herself if of full contractual capacity, or through the purchase of an annuity policy.
- 11.66 The suggestion that legislation should facilitate payment to a discretionary trust is supported on condition that all of the beneficiaries of the trust would have been entitled to the death benefit. If not, then there will be a need to ensure that the trust deed

provisions allow for a “ring-fencing” of the retirement benefit for the use of the appropriate beneficiary only.

- 11.67 It is also submitted that legislation should clarify whether or not it is acceptable that a beneficiary nomination be made in the name of an entity, such as a charity or religious organisation.
- 11.68 We recommend that the proposed legislation should permit the management board to pay benefits into a discretionary trust be expanded to permit the purchase of an annuity from a long-term insurer, as the latter alternative might be cheaper than the trust alternative.
- 11.69 If benefits are required to be paid by annuity, the fund must be allowed to transfer the capital to an annuity provider and have no further obligation, as long as certain minimum conditions are met.
- 11.70 The cost of providing annuities can be expensive, whereas a specialist annuity provider can effectively reduce the cost of doing this.

12 POWERS OF THE REGULATOR

*Treasury: Certain powers to be given to authorised practitioners
[Annexure 4, paragraph 1.11; p 52 to 53]*

12.1 *The discussion paper makes various recommendations regarding the powers of the Registrar.*

Old Mutual

12.2 We generally support the proposals.

12.3 Licensing of authorised practitioners may require more detailed guidelines in the legislation to ensure consistency of decisions and clear codes of administrative behaviour.

12.4 Interventions by the Registrar should not be limited to punitive inspections, but the Registrar should also have sufficient powers to assist and advise.

12.5 Recognition should be given to the principle that regulatory intervention should, as far as possible, avoid interfering/damaging the legitimate business of the regulated enterprise concerned.

12.6 The Registrar should have the power to appoint a board or individual board members in the case where a fund does not have a properly constituted board and to amend the rules of such a fund to the extent necessary to ensure that the governance of such fund is not stifled by its current rules.

12.7 Any trustee of a retirement fund should be required to have such information concerning him/her, as the Regulator may require, to be

placed on record with the Regulator upon the appointment of that trustee.

12.8 Similarly, the Regulator should be required to be advised of that trustee vacating office. The Regulator should also have the power to appoint an independent trustee, whether or not the rules of a fund permit this, with special reporting obligations to the Regulator.

12.9 The Regulator should have the power to blacklist any person from acting as trustee, whether independent or not; and no person should be permitted to act as an independent trustee unless the Regulator has confirmed that appointment. The Regulator should also be obliged to maintain a list of independent trustees.

13 STATISTICAL REPORTING

Treasury: Statistical Reporting by Funds [Annexure 4, paragraph 2; p 53]

13.1 *It is proposed that the regulator be empowered to require registered retirement funds to submit to him/her specified information.*

Old Mutual

13.2 The provision of statistical information is currently being addressed by the Financial Services Board via the introduction of a new format for financial statements. This process has proven tedious and lengthy, largely as a result of trying to combine accounting reporting with statistical reporting.

13.3 We would strongly recommend that reporting by retirement funds should follow other financial institutions that are required to submit statistical information via submissions that are outside of the accounts, but which are still required to be signed off by the fund's auditor.

13.4 In this way the accounts can be simplified and made more user friendly, and the regulator can receive statistical information on a more regular and consistent basis, say quarterly, through the return. Banking and insurance institutions are already doing this.

14 DISPUTE RESOLUTION

Treasury: Jurisdiction of specialist tribunal to be expanded [Annexure 4, paragraph 4; p 54 to 55]

14.1 *The discussion paper makes various recommendations aimed at expanding the scope of dispute resolution by a specialist tribunal.*

Old Mutual

14.2 We generally agree with the recommendations but would like to add the comments set out below.

14.3 The jurisdiction of the regulatory appeal board (currently the FSB Appeal board) should be retained in respect of decisions made by the Registrar.

14.4 Potential conflicts/overlaps in jurisdiction with other specialist tribunals need careful examination.

14.5 The essential procedures to be followed in the dispute resolution process should be prescribed by the legislation.

14.6 The current appeal to the High Court against a decision of the Adjudicator (Specialist Tribunal) must be retained.

15 GOVERNANCE AND TRUSTEE CONDUCT

Treasury: Members should elect at least 50% of Board [discussion paper Annexure 4, paragraph 5.6.2]

- 15.1 *Members of funds should be given the right to elect at least 50% of the members of the fund's board, unless the fund is exempted from this requirement for reasons which the Registrar considers in the best interests of members.*

Old Mutual

- 15.2 We propose that the guideline for exemption (i.e. for reasons which the Registrar considers in the best interests of members) might be difficult to apply.
- 15.3 In our view, the approach followed in section 7B(1) of the Pension Funds Act is more practical, namely to empower the Registrar to exempt a fund from the requirement that the members elect 50% of the board if the fund has been established for the benefit of employees of different employers which are not subsidiaries of a single holding company or is a retirement annuity fund.

Treasury: Trustees to undergo training [Annexure 4, par 5.6.10, p58]

- 15.4 *The discussion paper recommends that trustees who lack appropriate expertise must undergo training at the expense of their funds to obtain such expertise or seek the advice of appropriate experts.*

Old Mutual

- 15.5 We are mindful of the challenges that this will present to trustees, be they employer-elected or employee-nominated, and recommend that minimum standards be defined in this regard.
- 15.6 The Sarbanes-Oxley Act, for instance, requires trustees to be “financially literate”. This should certainly be the minimum standard to which all funds aspire in terms of their trustees.
- 15.7 Old Mutual would recommend that an additional point be added, building on the themes brought out in paragraphs 5.6.4, 5.6.7 and 5.6.8, that draws to the attention of employer-nominated trustees their primary responsibility to the fund. Guidelines should be provided to employer-nominated trustees on how to conduct themselves given the inherent conflict of interest.

Treasury: Number of sub-funds of umbrella fund to be limited [paragraph 5.6.20.1]

- 15.8 *The paper recommends that an umbrella or multi-employer fund should be subject to a limit on the number of funds which can form part of one umbrella fund.*

Old Mutual

- 15.9 We strongly disagree that a limit should be placed on the number of sub-fund numbers that an umbrella fund may accommodate.
- 15.10 We are uncertain as to the rationale for this recommendation.
- 15.11 If the concern is that systems constraints may prevent efficient

administration, then that can be dealt with by way of the current certificate that is required with regard to systems capability. Also, a possible requirement for the annual auditor's report to report that the size of the umbrella - be it in terms of membership or number of funds - is not compromising the operation of the umbrella in general, and specifically in respect of matters such as member communication, dispute resolution etc.

- 15.12 If the number of sub-funds are limited, additional umbrella funds will simply be set up, and instead of there being one umbrella fund with 1 000 funds, there will be 10 umbrella funds run by the same administrator, each with 100 funds. The systems will have the same capability issues, and additional costs will have been incurred, which will inevitably filter down to the members.
- 15.13 In our view the economies of scale that can be achieved by a large umbrella fund could materially benefit members and support the drive to extend retirement savings products to the market.
- 15.14 We should point out that umbrella funds sometimes accommodate employers with relatively small groups of employees, e.g. less than 50. If an umbrella fund with many such small employee groups is limited to say 10 sub-funds, the umbrella fund will hardly be able to achieve economies of scale.
- 15.15 If the rationale for the proposal of limiting the number of sub-funds is to prevent a situation arising that employee committees would not be functional due to the large number of sub-funds, we wish to submit that a large number of employee committees will not constitute a problem as a large umbrella fund would have the necessary resources to effectively communicate with such member committees.

Consideration could also be given to group employees together, on the basis of region, for instance.

Treasury: Separate financial statements for sub-funds [Annexure 4, par 5.6.20.3, p 60]

15.16 *The discussion paper recommends that umbrella funds should be required to prepare separate annual financial statements for each sub-fund and should be prohibited from allowing cross-subsidisation between sub-funds.*

Old Mutual

15.17 The extent of the prohibition on cross-subsidisation will need to be clearly defined, taking into account that one of the benefits of joining an umbrella fund is to diversify the risk pool and reduce costs.

15.18 We assume the intention of the Treasury principles is to prohibit the use of contributions and returns of one sub-fund for the benefit of another sub-fund. If this is what is intended, we fully support the proposal.

Treasury: Rules of umbrella fund may not compel use of a specified service provider [Annexure 4, par 5.6.20.6, p 60]

15.19 *The paper recommends that the legislation should include a provision stating that any fund rule which purports to make use of a specified service provider compulsory, be of no force or effect.*

Old Mutual

15.20 Although we agree with this recommendation, we propose that the Treasury principles should give recognition to the following:

Umbrella funds play a significant role in providing retirement benefits

15.20.1 Umbrella funds play an important role in making retirement savings solutions available to particularly the employees of small and medium businesses.

15.20.2 The benefit it brings in terms of economies of scale is vividly demonstrated in appendix A, which contains a cost analysis of a stand alone 100-member fund and an umbrella fund participating employer of the same size. The cost differential is significant.

Factors crucial to the success of an umbrella fund

15.20.3 The role of the sponsor is crucial to the success of the umbrella fund. The sponsor generally:

15.20.3.1 Meets significant set-up costs that it is only able to recoup over a relatively long period (these costs include costs in connection with the development of suitable products for the fund and the creation of systems necessary for the administration of contribution and benefit payments).

15.20.3.2 Provides the strength of brand and reputation to back the fund.

15.20.3.3 Markets the fund (often at significant costs).

15.20.3.4 Provides administration services and investment products to the fund.

15.20.4 Furthermore, the umbrella fund is generally identified with the sponsor and the decision to join such a fund, taken in the context of the employment contract and relationships, is influenced by the substance and reputation of the sponsor.

15.20.5 Another factor crucial to the success of the umbrella fund is the economies of scale it offers to the participating employers and members. Size affects the administration cost and the risk benefit cost per member.

Crucial factors to protect members

15.20.6 The following factors are crucial to the protection of member interests:

15.20.6.1 A competent board of trustees.

15.20.6.2 Sound administration.

15.20.6.3 Costs commensurate with benefits.

15.20.6.4 Knowledge of costs and benefits by the member.

15.20.6.5 The existence of structures to alter the sponsor/service provider's behaviour if the above are not met, or alternatively, the power to move to another fund or another service provider without severe loss.

Balancing of interests vital

15.20.7 In order to ensure the sustained success of umbrella funds in an environment that would adequately protect the interests of members and other stakeholders, it is vitally important to develop a regulatory regime that would: (a) fairly balance the interests of the sponsor (particularly, its need to protect its investment, to achieve an adequate return on the capital invested in the development and maintenance of the necessary infrastructure, and the marketing of the fund); and (b) the interests of the other stakeholders, particularly members who need to be protected against a sponsor or service providers that fail to meet their promises.

Proposal for high-level regulatory regime

15.20.8 With the above factors in mind, we propose the following as a high level regulatory regime for umbrella funds (a defined contribution environment is assumed):

15.20.8.1 No limitation should be placed on the number of participating employers or members in umbrella funds. Apart from being easy to circumvent, this proposal in the discussion document strikes at the root of the cost effectiveness of umbrella funds.

15.20.8.2 Annual audit of the systems used to administer the umbrella fund. The administrator must furnish the results of the audit to the trustees of the umbrella fund

annually.

15.20.9 Annual disclosure to each member of:

15.20.9.1 Contributions made by and on behalf of him/her.

15.20.9.2 Costs deducted from contributions (and individual accounts, where applicable).

15.20.9.3 Benefit contingencies and amounts payable

15.20.9.4 Performance of investments underlying each member's individual account.

15.20.10 Half the trustee board should consist of professional independent trustees (i.e. not employed by the sponsor, the administrator or any subsidiary or associate of either) or member-elected trustees if the regulator is not prepared to exempt the fund in terms of the recommendation in Annexure 4, paragraph 5.6.2 of the Discussion Paper.⁵

15.20.11 The remuneration of trustees should be paid by the fund, not the sponsor.

15.20.12 Governance of the fund to be in terms of a set of governance documents, including an agreement between the fund and the sponsor (outlining the relationship between the fund and the sponsor and detailing the obligations of the sponsor), a trustee code of conduct, mandates of sub-committees, risk matrix, etc.

⁵ Old Mutual is of the view that the appointment of professional trustees from a panel approved by the Registrar would generally best serve the interests of members of an umbrella fund.

- 15.20.13 The regulatory regime should require that the essential features of the umbrella fund in question be clearly communicated to members prior to them joining the fund. These should include the terms of the fund/sponsor agreement, the administration agreement, full particulars of the investment range and the termination provisions.
- 15.20.14 The sponsor should initially appoint the administrator and investment service providers as part of the product offering to potential participants. Where members are given individual investment choice, the sponsor will initially determine the choice of investment providers, provided there are adequate alternatives.
- 15.20.15 However the trustees should be fully involved in determining service level standards, taking account of industry good practice and which includes performance measurements.
- 15.20.16 Furthermore, the trustees should:
- 15.20.16.1 Monitor the performance of service providers.
 - 15.20.16.2 Take action if performance fails the agreed standards.
 - 15.20.16.3 Review the service standards against developing industry practice.
- 15.20.17 If a sponsor-appointed service provider fails to meet the standard and to remedy the failure within a reasonable period or in the event of a persistent/repetitive failure to

meet the standard, the trustees should have the right to terminate the fund's agreement after consultation with all stakeholders, including the sponsor. In the event of such termination, the sponsor should have the right to terminate its sponsorship agreement with the fund and to recoup its reasonable product development and marketing costs to the extent that the fund received or will in future receive value from the efforts of the sponsor.

- 15.20.18 The trustees should also be entitled to terminate the fund's agreement with the sponsor, if the sponsor breaches its agreement with the fund and fails to remedy the breach upon due notice.
- 15.20.19 A participating employer (after consultation with the members of the sub-fund in which it participates) or a member committee (if such committee has been established in respect of the members of a sub-fund) should have the right to require the employer to exit from the fund at any time without penalty (subject to conditions relating to types of investment portfolio involved and reasonable costs attributable to the transfer of the sub-fund concerned to another fund).
- 15.20.20 In the event of a dispute, the parties should be able to make use of the dispute resolution mechanism proposed under Annexure 4, paragraph 4.4. of the discussion paper.

Treasury: Members to be given “cooling off” period [Annexure 4, par 5.6.21]

15.21 *The paper recommends that retirement funds, membership of which is by individual choice, must give members a “cooling off” period after joining during which they may elect to withdraw their membership without charge (and with full refund of any moneys paid to the fund).*

Old Mutual

15.22 We have reservations about the introduction of a cooling-off period for the following reasons:

15.22.1 A full refund of monies after a cooling-off period may not be possible, unless the contributions are invested in cash/money market products, which do not require that costs be deducted upon disinvestment.

15.22.2 An obligatory cooling-off period will be difficult to administer and is likely to add to administration costs.

15.22.3 In cases where the monies originated from an occupational fund, that occupational fund must be repaid. In practise, funds are often reluctant to receive the return of such monies in that their rules cannot accommodate the receipt of funds in respect of a non-member.

15.22.4 Where the amount is not exactly the same as the amount that left the occupational fund (because of market movements and third-party costs), further complications often arise.

Treasury: On liquidation of under-funded defined benefit fund, employer to fund shortfall [Annexure 4, par 6.5.2, p 62]

15.24 *The discussion paper recommends that on liquidation of an under-funded defined benefit fund, the employer must fund any shortfall, unless the financial burden on the employer would be so great as to compel it to retrench staff or be liquidated itself.*

Old Mutual

15.25 Old Mutual generally agrees with the proposals, but suggest that greater clarity be provided on the exception relating to the effect of the financial burden on the employer, with reference to (a) the company's underlying audited financial statements (balance sheet), relative to (b) the amount by which the fund is under-funded.

16 INVESTMENT REGULATION

Treasury: Regulator to set bench marks re performance of asset managers [Annexure 4, paragraph 7.6.1; p 65]

16.1 *The regulator should be required to suggest benchmarks against which the performance of asset managers may be assessed.*

Old Mutual

16.2 Old Mutual would not have a problem with the regulator suggesting a range of benchmarks, provided they are not too prescriptive.

16.3 Trustees should be required to regularly monitor and measure the performance of asset managers against such benchmarks.

Treasury: Investments in socially desirable investments [Annexure 4, par 7.6.3 - 7.6.4, p 66]

16.4 *The paper proposes that funds should be required to state in writing to members and participating employers whether they intend to invest any part of the assets of the fund in socially desirable investments which are likely to yield returns lower than those which may be expected of other investments by the fund.*

16.5 *Funds should be permitted to invest up to 10% of their assets (by value) in such investments through collective investment or private equity schemes provided that it can reasonably be expected that such investment will yield a return of not less than the increase in the rate of inflation.*

Old Mutual

- 16.6 Socially desirable investments should be pursued in terms of the Financial Services Charter.
- 16.7 The key issue is the maximisation of the risk/return relationship. Modern portfolio theory recognises that an investment/asset class that is not highly correlated with other investments in the portfolio, may, even, if it is expected to deliver a lower long-term return than those other investments, be more suitable for the portfolio as a whole.
- 16.8 SDI vehicles, and indeed all investment vehicles, should not be evaluated on a stand-alone basis, but rather on their portfolio impact.
- 16.9 Trustees should be required to assess the impact of such investments on the overall risk/return relationship of the portfolio.

Treasury: Investment choice [Annexure 4, par 7.6.5, p 66]

- 16.10 *The paper recommends that only a limited number of options from which to choose be granted.*

Old Mutual

- 16.11 We strongly support the principle of only allowing a limited number of options, but wish to point out that a requirement to reduce current investment options given, in some cases as much as 500 to 3 or 5, will be a massive task as members very often do not respond to requests relating to investments.
- 16.12 To expect the trustees to unilaterally amend members' fund choices without any knowledge of the personal circumstances or risk profiles of

those members would, in our view, not be appropriate. This matter will need careful consideration.

17 FUNDING AND CALCULATION TECHNIQUES

Treasury: Pensioner liabilities to be valued annually [Annexure 4, par 8.4.2]

17.1 *The paper proposes that if a fund's pensioner liabilities are not underwritten, the assets and liabilities of the fund must be actuarially valued every year before a pension increase may be determined.*

Old Mutual

17.2 Since minimum increases only need to be valued every three 3 years, we do not believe annual valuations for purposes of pension increases is warranted, having regard to the costs.
