TRUSTEES DUTIES IN RELATION TO MEMBER CHOICE INVESTMENTS
PRESENTATION: PENSION LAW CONFERENCE
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There has been an explosion in financial products market – hundreds of policies, dozens of insurance products, each with its own terms, benefits and risk profiles. Some offer gradual, steady and relatively small growth. Others are far less conservative – higher growth potential, but also higher risk and higher volatility.

Most of the larger RA and other investment funds now enable members to select from a range, probably a large range. Some of the policies in the range are conservative, old school, some more exciting but also more risky.

In this situation, what are the trustees' duties as regards the range of products to be made available? Are they obliged to exclude certain policies entirely, take them out of the shopping basket available to their members because of the risk profile attached thereto? Do they take on the role of investment advisor? Or can the trustees argue, for example, that their duties are minimal, restricted to warning fund members of the risks and benefits attaching to each available product, and leaving it to fund members to decide for themselves?

In considering what investment duties rest on the fund trustees, in this realm, we will look at:

- Any relevant principles to be extracted from judgments handed down by our courts;
- Any applicable legislation, including subordinate legislation.
- Recently promulgated PF circular 130.

THE COURTS

The courts have not been particularly helpful, in laying down investment guidelines to be followed. They will ordinarily refuse to state, in advance, whether investment in a certain type of instrument is proper, holding the view that the trustees must decide this for themselves when and if the question arises, on the circumstances then applicable (**Colonial Banking & Trust Co Ltd v Estate Hughes 1942 AD 1**). Some of the earlier decisions adopted the view that it was never justified for trustees to take the slightest risk (**Johnson v Estate Johnson 1945 NPD 66; Peffers NO & Another v Attorneys, Notaries & Conveyancers Fidelity Guarantee Fund Board of Control 1965 (2) SA 53 (C)** at **55G – 56A**). But that approach has, at least, been ditched in favour of modern day economic realities by the Supreme Court of Appeal. In **Administrator Estate Richards v Nicol 1999 (1) SA 551 (SCA)**. The SCA laid down a few very broad guidelines, namely:

- Changes in the economy, and factors such inflation, mean that to preserve the capital of the trust, trustees may well have use investment vehicles carrying an element of risk;

- Trustees must, nevertheless, in carrying out their investment duties, exercise due diligence and care, avoid investments which are of a speculative nature and seek to spread the investments of the trust over various forms of undertakings, in order to balance stability and growth.

These can be described as vague guidelines, lacking in substance, forcing us to look elsewhere to find out what facts should govern investment decisions by trustees.

SECTION 7 OF THE PENSION FUNDS ACT

Firstly, section 7C of the Pension Funds Act requires that, in pursuing a fund's objects, the trustees must take all reasonable steps to ensure that the interests of members are protected at all times, and that they must act with due care, diligence and good faith. Section 7D imposes a duty to communicate adequate and appropriate information, and to make use of expert advice where necessary. That section applies to all trusts – employer driven, voluntary, retirement annuities, preservation funds. It is not possible for trustees to exempt themselves from these duties. Accordingly, trustees may be on thin ice in arguing that they took no steps, and had no duties, to protect members – that they made detailed disclosure of the risk profiles of investments, and left it members to decide for themselves. Underpinning the various 7C duties are two realities:

- Not all of their members have the acumen and savvy to appreciate and apply the investment information given to them;

- Members join a particular fund *inter alia* because of its investment history, and because it has a particular reputation for soundness, stability, growth or whatever else. Ensuring that it lives up to that reputation is part of the network of duties created by Section 7C.

REGULATIONS

Regulation 28 states that a registered fund may only invest in specified assets and specifies the percentage which may be held in each such asset. Regulation 28(3) does not apply where membership of a fund is not compulsory and the fund operates by means of individual policies issued in respect of each member of the fund, by virtue of the exemption contained in Regulation 28(3).

Regulation 30 imposes a number of requirements as to what the fund's rules should and should not contained .It is compulsory for the rules to include:

- A recordal of the investment powers of the fund;

- (Regulation 30W). Where the assets of the fund consist exclusively or in part of fund member policies, the rules must:

  - indicate whether the fund's liability to provide benefits is funded exclusively or partially by those policies;

  - record that the policy is administered by the insurer, and all values and benefits of the policy are determined in accordance with the policy's prescriptions;

  - require that every member must select the policy which funds or is to fund the benefits provided in respect of that member;

  - remind members that the fund or its board do not provide advice with regard to the selection of policies;

  - (Regulation 30(W)(v)) – provide that the trustees must, to reasonably satisfy themselves that the fund member policies are suitable for the membership profile of that fund, within a year after promulgation of the sub-regulation, review the existing range of fund member policies available for selection and thereafter conduct such review annually and approve all new fund member policies.

Particularly this last regulation, Regulation 30W(v), makes it quite clear that the minimalist approach not part of our pension law – trustees have a duty to actively review the range of policies available to ensure that they are "*suitable for the membership profile of the fund*". That means:

- They must know what that profile is – have details pertaining *inter alia* to age, financial position and risk vulnerability of members; financial requirements and pension planning aims of members: to what members are, or wish to be, involved in decisions regarding the choice of investments;

- Having obtained this data, possible to divide members into certain categories;

- Having determined membership profile, they must satisfy themselves that policies are "*suitable for the membership profile of the fund*" – do that in a manner consistent with their overall Section 7C duty – category by category. If fund consists predominantly of mid-range income earners with few investments beyond their pension fund entitlement, don't invest in the South Asian Water Buffalo market, Bolivian Silver Futures or any other flavour of the month risk fund which offer spectacular growth one year, spectacular crashes the next.

PF CIRCULAR 130

To thus far, the most comprehensive codification of the investment duties resting on the fund is that found in PF Circular 130 – issued by the Registrar during 2007. Bear in mind that these circulars do not lay down substantive law – they do, however, provide a guideline as to the norms in the industry and the manner in which the Registrar will administer the subject matter of the circular (**MEC for Agriculture, Conservation, Environment & Land Affairs v Sasol Oil (Pty) Ltd & Another** **2006 (5) SA 483 (SCA)** at **490 B**). Trustees should familiarise themselves with Pension Fund Circular because:

- Should a member, disgruntled with the performance of the insurance product applicable to time, decide at some future date to refer a dispute to the Adjudicator, alleging that trustees did not comply with their duty under Regulation 30(W), the question of whether they adhered to the guidelines contained in PF Circular 130 and if not, why not, will arise;

- If the funds do not co-operate and comply with PF 130, its requirements may well at a future date be embodied in a regulation.

Pay particular attention to Regulations 6, 7, 20, 30, 39, 44, 45, 51 and 52.

I predict that, at some future date, a member in a fund offering investment choices who is dissatisfied with the manner in which his chosen investment has performed, will institute proceedings against trustees. If the trustees have not complied with PF 130, the chances of such member succeeding are increased unless trustees can advance sound explanation for such failure.

I close off with certain comments regarding the practical implementation of PF Circular 103. There are certain realities which will play a role in any attempted implementation thereof:

- Even in the best fund member communication systems, there will be mistakes and misunderstandings;

- Trustees and fund administrators operate under several constraints which limit the extent of their dealings with members- you can't, for example, sit down with each new member of a large fund and explain, paragraph by paragraph, the fund's investment and risk policies, and how they affect that member;

- The fund cannot be expected to act as financial advisors;

- Despite all the protection that FAIS tries to create, there will be intermediaries who do not comply with their obligations thereunder – accordingly, investment decisions by fund members will not always be based on the best, or most appropriate, advice.

Taking all of these into account, the following measures are suggested for incorporation in a fund's rules and/or investment policy documentation:

(1) There must be a mechanism according to which investments are chosen;

(2) There must be strict and non-variable criteria, according to which policies are included or excluded from the range available;

(3) The fund must have a membership profile – a database containing information that the fund needs to divide its members into categories and determine which of the range of policies it had on offer is suitable to each category – call in the help of actuaries (age, financial position, level of participation in investment decision-making, aims – category of investors);

(4) Selling out of risk category into which policies are divided, and characteristics governing each category;

(5) There should then be entry criteria for each policy in the range;

(6) There should be criteria aimed at preventing members from having an "*unbalanced*" portfolio – for example, that high risk products account for on a certain percentage of their membership interest;

(7) What are the factors relating to switching from one investment to another, and what bearing do they have on the question of suitability?

(8) Is access provided to appropriate financial information? The trustees cannot act as financial advisors, but should they not set up the mechanism to ensure that reliable information available;

(9) What are the benchmarks of each investment? Do they change? How is the investment tracked against such benchmark?

(10) What is the default portfolio? How is it put together?