



# AdviceAtWork

## Pension Lawyers Association Conference

### Investment Switches in Retirement Funds

By Naleen Jeram

17 March 2009



AdviceAtWork (Pty) Ltd is a wholly owned subsidiary of Momentum

# Program

1

## Introduction

- Defined contribution funds
- Systems in place to effect switches
- Role of administrators
- Accrual of benefits
- Clear instructions to be given by members
- Conclusion

# Defined Contribution Funds

2

- Unlike DB Funds – Benefit on retirement not guaranteed.
- Contributions outlined in terms of fund rules.
- Benefit largely dependent on performance of fund assets in financial markets.

- The Pension Funds Act now requires the fund to pay a minimum withdrawal benefit, which is defined at the member's individual account which is further defined as follows:

**MC+EC-X+IC+OC where -**

- (a) MC represents the contributions paid by the member;  
EC represents the contributions paid by the employer in respect of the member;  
X represents such expenses as the board determines should be paid out of the contributions paid by and in respect of the member;  
IC represents the amount credited to the member's individual account upon the commencement of the member's membership of the fund or upon the conversion of the category of the fund to which the member belongs from a defined benefit category to a defined contribution category of a fund or upon the amalgamation of his or her fund with any other fund, if any, other than amounts taken into account in terms of OC; and  
OC represents any other amounts lawfully permitted, credited to or debited from the member's individual account, if any; and
- (b) MC, EC, X, IC and OC are **increased or decreased** with fund return: Provided that the board may elect to smooth the fund return."  
(emphasis supplied)

- Loss due to negative investment performance of itself insufficient to form a claim in law.
- The Adjudicator (in *Stephenson*) highlighted this principle as follows:

“As far as the performance of the underlying portfolio in which the complainant’s benefit is invested, *something more is required than the bare fact that it has not performed well, or even that the complainant has sustained loss in investment value.* The nature of defined contribution schemes is that the member assumes the risk of investment return, and is therefore subject to prevailing market conditions. ... In any event, the complainant has not suggested that the board of trustees [management] was negligent in terms of investment decisions taken, or that there was a failure to adopt specified investment strategies. Without those allegations, it is not possible to establish any entitlement to the relief sought.” (emphasis supplied)

## Types of Investment Choice

- Pre-categorized risk investment portfolios (conservative, low, medium or high risk portfolios)
- Series of investment portfolios offered by several investment houses.
- Investment switching can occur in both of the above forms of asset investment.

- Employer had 2 separate funds for its employees.
- With effect from November 2000, the employer decided to consolidate the 2 funds into 1 fund.
- A section 14 application was submitted to the Registrar.
- In August 2002, employer received a letter from the administrator stating that the assets of the staff fund had been invested in the requested selected portfolios.
- In October 2003, the Registrar approved the transfer.
- It then came to the attention of the employer and the members that the assets had never been switched to the requested portfolios.
- As a result of the poor performance of the invested portfolios as opposed to the preferred portfolios – the members had suffered a total loss of approximately R145 000.00.

## The Adjudicator held as follows:

- From the evidence, it was apparent that the administrator had received the instructions to switch the investment portfolios.
- Notwithstanding the instruction, the administrator had failed to effect the investment switches.
- The losses suffered by the members were easily quantifiable by simply comparing the 2 investment portfolios.
- The Adjudicator ordered that the affected former members of the fund be put in the same position they would have been in had the administrator timeously effected the investment switches.

## Lessons learnt

- Service level agreements must clearly regulate the precise functions and obligations of each party with regard to investment switches.
- The time period within which switches must be processed must be understood by all parties.
- In light of volatility of markets and the effects of globalization, it is critical for administrators to give effect to investment switches expeditiously and within the time-frames stipulated in the fund rules and service level agreements



# Systems In Place To Effect Switches

9

- The time period within which a switch may be effected will invariably be determined by the underlying systems in place dealing with fund assets.
- At present, there are no statutory maximum or minimum time period for switches.
- These time periods may be agreed and regulated via the rules of the fund and the service level agreement.
- Where there is a conflict between the rules and any other agreement, by virtue of the binding nature of rules, the rules will prevail.

## Waller (PFA)

- The complainant joined an occupational fund, which offered investment choice.
- The members could make daily switches and were required to submit the elections to the administrator before 16H00 hours on each day.
- However, the investment switch form clearly stated that the switch will be effected within 5 working days of receipt of instruction.
- The fund allocated investment returns to members on a daily basis (based on the previous working day's unit prices).

- The complainant made 28 switches from November 2002 to July 2003, as a result of which his investment yielded a return of R1 588 601.00 for this period.
- Subsequently, the fund reversed this return.
- The fund contended that all 28 switches were effected on the same day the instructions were given as a result of the complainant having a certain “relationship” with an employee of the administrator of the fund.
- According to the fund, this employee brought to the complainant’s attention the 1 day mismatch in prices, which was as a result of the daily switching as opposed to switching within a 5 working day period.

## The Adjudicator held as follows:

- The rules of the fund are binding on the fund and its members.
- Notwithstanding the aforementioned relationship, the switches were all effected in accordance with the rules of the fund.
- Furthermore, the fact that the instruction stated that the switches had to be effected within 5 working days, permitted a switch on the same day the instruction was forwarded to the fund administrator.
- Thus, the fund was ordered to credit the complainant's account with the investment returns achieved plus interest thereon.

## Lessons learnt

- Allocations of returns must be aligned to the systems/method employed to facilitate investment switches.
- Funds must ensure that the maximum period required to actually effect the switch is practically achievable.
- However, the maximum period required to effect the switch should also be in the interest of members having regard to the actual time taken to implement a switch.
- The fund may also consider having different maximum time periods for different portfolio switches (eg. shorter time periods for switches within the same insurer or asset management company or switches out of cash portfolios).
- The failure to have realistic time frames of switches will create unrealistic expectations on the part of members.

## Sanlam Retirement Fund A (High Court)

- The member belonged to a pension and provident fund.
- Both funds offered investment choice and the member was invested in market portfolios.
- With effect from 31 January 1999, he was retrenched from service and was entitled to early retirement benefits payable by both funds.
- He elected to purchase pensions from a registered insurer.
- The monies were transferred to the insurer on 3 October 1999.
- The funds in the interim from 31 January 1999 to 3 October 1999 had been invested in a cash portfolio and moved out of the complainant's selected market portfolios.
- The complainant thus received the interest earned in the cash portfolios.
- The member was unhappy about the transfer and contended that his monies should have remained in the market portfolios until date of payment.

The High Court rejected the member's contention and held:

"... one must not look at this definition [of member in section 1 of the Act] in isolation for it is quite evident on a proper reading of the Act that the defining moment of membership, for purposes of a dispute like this, is the date of retirement. It is on this date that the member is entitled to know in rands and cents, for purposes of South Africa, what his member's share is. ... Consequently, if a member is entitled to have his benefits calculated on the date of his retirement, which is the same date upon which his benefits are payable, it follows that that it is incumbent upon the fund to have his benefits transferred from a market-related portfolio to a cash portfolio." (emphasis supplied)

## Lessons learnt

- The position adopted by HC clearly indicates that funds must disinvest the benefit from market related portfolios at the end of the day on which the benefit accrues to the member.
- In the case of occupational funds, this will normally be linked to the termination of the employment contract.
- The only exception to this general rule will be where the fund rules permit the member to remain in market portfolios until date of payment and this option is selected by the member.
- With regard to commercial funds – this date will be the date of retirement chosen by the member subject to legislative limits.
- In order to ease the administrative burden – it may be useful for funds to adopt default positions with regard to investment after accrual dates.

## Mokoena (PFA)

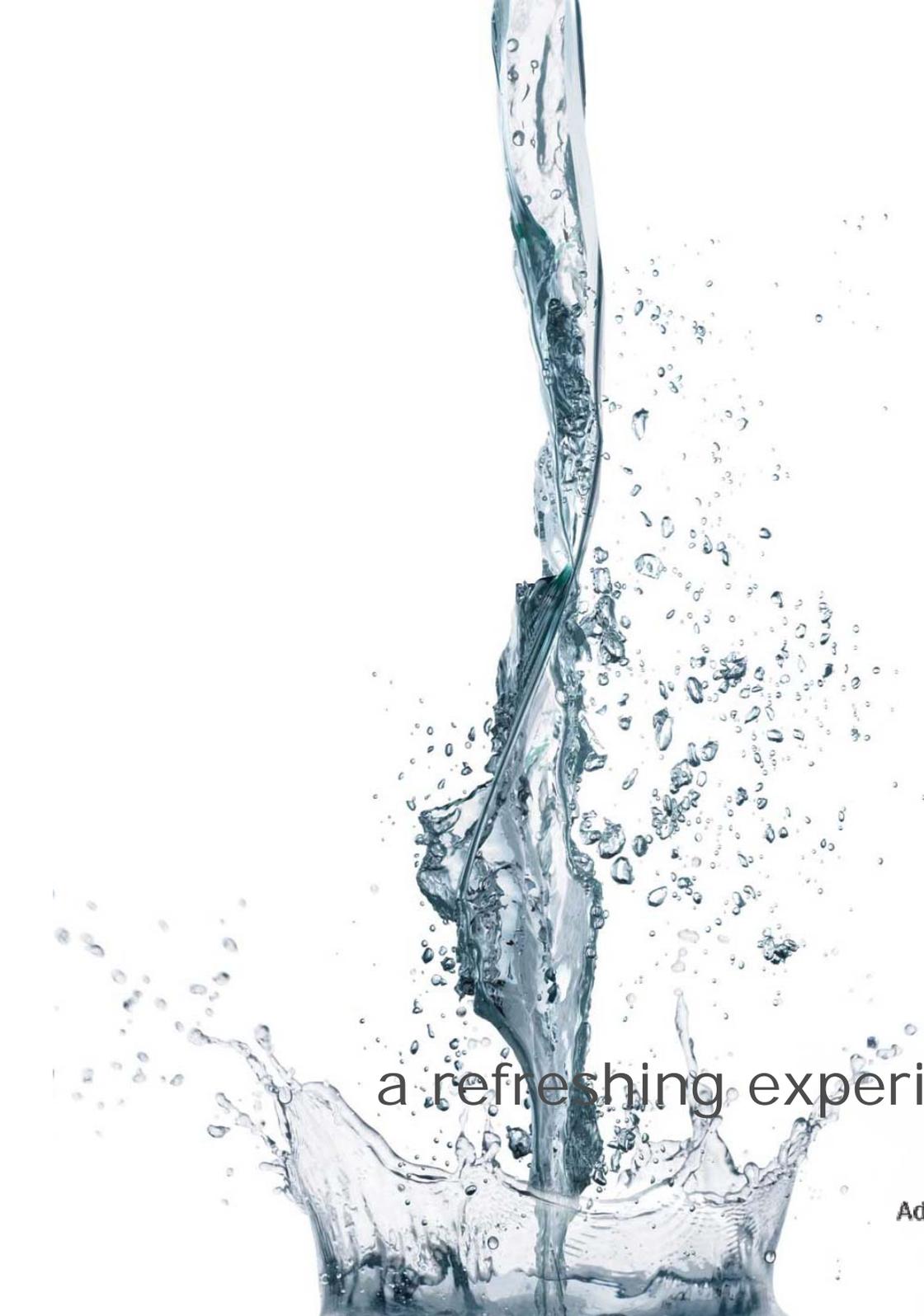
- Complainant was a member of an occupational fund.
- Upon termination of his employment contract (1 May 2000) he became entitled to a withdrawal benefit of R217 904.00.
- He transferred his withdrawal benefit to a preservation fund.
- In accordance with his instructions, the monies were invested in offshore equity fund.
- In May 2005, the complainant elected to receive a retirement benefit and was paid a benefit of R125 614.00.
- The complainant was unhappy with the negative investment performance and argued that he never consented to the monies being placed in an offshore portfolio.

## The Adjudicator held as follows:

- He accepted that the complainant may have informed his financial services provider that monies should not be invested in a “risky” investment.
- The evidence clearly showed that the member had completed and signed the application form electing that the monies be invested in an offshore portfolio.
- Moreover, the member subsequently received regular statements confirming the offshore investment.
- Thus, no fault could be ascribed to the fund which had acted in accordance with the member’s instructions.

## Lessons learnt

- Due to exponential increase in investment switches, many funds have adopted specific option forms and a defined process to be followed by members.
- This standardization of the investment switch process should assist members, who over time will develop a clear and better understanding of the process and the effect of the instructions.
- In order to protect all parties, it may be necessary to require more than a written instruction from a member for a valid switch to have been effected.
- A follow up requirement in the form of a notice or benefit statement confirming the switch may also be necessary, which should act as a proactive net to confirm that the switch has been implemented and that it has been implemented correctly.
- Standards need to be developed with regards to rules pertaining to investment switching, which will protect the interest of members, funds and administrators.



AdviceAtWork

Questions

Thank you

a refreshing experience



AdviceAtWork (Pty) Ltd is a wholly owned subsidiary of Momentum