Are the proposed new conditions for exemption in terms of section 7B of the PFA ‘fit for purpose’?
The legal framework

We are lawyers and should start any analysis of the draft new conditions by assessing their consistency with applicable law:

• The Constitution
• The Financial Sector Regulation Act
• The Pension Funds Act
• The common law
The pension fund manifesto

• A pension fund = a special purpose, not-for-profit vehicle through which its members (and, if applicable, their employers) make provision for the payment of ‘fit for purpose’, ‘value for money’ benefits in terms of the rules in an effective and cost-efficient manner over the long term.

• These are the objects of a fund and thus its interests and the only purposes for which its board members must exercise fund’s powers.
The legal framework

- **The Constitution and the FSRA**: An unelected regulator cannot use exemption powers to frustrate the purpose of legislation enacted by democratic Parliament. See also s 281 of FSRA. Exemption power should be exercised sparingly. S108(1) of FSRA says FSCA must use its power to issue conduct standards to promote fair treatment of customers.
The legal framework

• Purposes of the PFA, reasons why Income Tax Act gives generous tax incentives and why extensive powers given to the regulator – to protect funds and their members in the public interest.
The legal framework

• Boards must ‘direct, control and oversee’ the conduct of the fund’s business.

• Must ‘avoid conflicts of interests’ and exercise an independent discretion.
The legal framework

Whose interests are consistent with those of the fund?

✓ Those of members as a whole and of unions to which members belong – in proper treatment of employee remuneration

✓ Those of employers of members – interested in the proper treatment of employee remuneration

X Not those of providers of products and services – interested in profit.
Section 7B Exemptions: Are the FSCA’s proposed new exemption conditions ‘fit for purpose’?

Pension Lawyers Association

Kobus Hanekom
Principal Officer: Sanlam Umbrella Fund
Contracted Principal Consultant: Simeka

4 July 2018
The 7B proposals - mostly good progress.

- The part that needs a great deal more work is the voting powers of the independents in commercial umbrella funds.

This is a massive departure from the King IV principles. I do not know that you will find an example like this in any other area of the law or in any other jurisdiction in the world.
Menacing gentle giant?
Careless breaching?
More sinister ... ?
The 7B proposals - mostly good progress.

- The difference in the requirements between union type umbrellas and commercial umbrellas is far too big.

**My concern is around the things that were not said**

*We will not enable commercial umbrella funds if we do not see the bigger picture and focus merely on the independent trustees.*
Pragmatic Perspective

• Smaller standalone funds are not cost effective and are not able to do justice to the growing body of legal requirements.
• As a country we need robust solutions that will ensure both
  • good governance
  • at cost effective levels.
  • good retirement outcomes for our members
• We need to think out of the box – as they have done in other jurisdictions.
• The solution includes umbrella type funds.
SA umbrella funds have been allowed to grow organically, fully registered and compliant with the disciplines of a Pension Funds Act, that still does not recognise them properly.

• All we have to do is understand the role-players (such as the sponsor), recognise them in the Act and make sure they comply with the rules and the principles and achieve the desired outcomes.
What can we learn from other jurisdictions?
The United Kingdom

Pioneers in

• Auto enrolment
• Capping of costs on defaults
• Group Personal Pension Plans - Stakeholder
Group Personal Pension Plans or Master Trust?

Employers can offer DC saving through

• contract-based pensions, such as Group Personal Pension Plans (GPPPs), or

• trust-based pension schemes. Standalone fund for an individual employer or be part of multi-employer schemes, such as master trusts.

Increasingly the realistic choice comes down to a GPPP or a master trust.

Aon Hewitt: The Search for Quality: Group Personal Pension Plans or Master Trust?
Contract-based schemes

Under contract-based arrangements
• the employer selects the pension scheme but
• the contract is between the employee and the pension provider, often an insurance company.

Independent Governance Committees (IGCs) - introduced as an additional layer of protection for members

_Aon Hewitt: The Search for Quality: Group Personal Pension Plans or Master Trust?_
This year’s assessment

For members of Aviva’s workplace pension schemes

This year, we have seen a couple of areas improve. Service under the currently marketed products has improved to “green”, and charges under the non-marketed products have improved to “amber”. This is pleasing. Our focus, going forward, will remain on helping to improve the experience for more members in older products.

Assessed as good – no areas of significant concern identified
Assessed as fair – some areas of concern identified, with action being taken
Assessed as poor – some areas of concern identified with actions not agreed or agreed but not yet delivered
Trust-based schemes - Standalone

There is no contract between the pension provider and the employee for trust-based schemes.

Rather, the employer appoints trustees to hold a scheme’s assets on trust, with the scheme being governed by the trust deed and rules.

Trustees are required to act impartially in the interests of the scheme members and to protect the assets from intervention by an employer.

Aon Hewitt
Trust-based schemes - Master Trusts

Master Trusts are (trust-based pension schemes established to provide benefits to multiple employers)

They do not fit easily into either model as, under these arrangements, the employer selects the master trust rather than sets up the pension scheme.

Aon Hewitt: The Search for Quality: Group Personal Pension Plans or Master Trust?
<table>
<thead>
<tr>
<th>Company</th>
<th>Minimum investment</th>
<th>Choose from</th>
<th>Annual fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Old Mutual Wealth</td>
<td>£100/month or £1,000/year</td>
<td>1600 funds</td>
<td>0.25% to 0.75%</td>
</tr>
<tr>
<td>Prudential Pension</td>
<td>£100/month or £1,200/year</td>
<td>1500 funds</td>
<td>0.25% to 0.65%</td>
</tr>
<tr>
<td>Royal London Pension</td>
<td>£100/month or £1,200/year</td>
<td>1200 funds</td>
<td>0%</td>
</tr>
<tr>
<td>Sanlam Investment and Pensions</td>
<td>£100/month or £1,000/year</td>
<td>216 funds</td>
<td>0.25%</td>
</tr>
</tbody>
</table>
Master trust assurance framework
developed by the ICAEW (Institute of Chartered Accountants in England and Wales) in association with The Pensions Regulator

The Pension Schemes Bill 2016, will require master trusts to demonstrate five key criteria:

1. that persons involved in the scheme are fit and proper,
2. that the scheme is financially sustainable,
3. that the scheme funder meets certain requirements in order to provide assurance about their financial situation,
4. systems and processes requirements, relating to the governance and administration of the scheme are sufficient,
5. that the scheme has an adequate continuity strategy.
Australia

Pioneers in

- Minimum retirement fund contribution
- Each member can choose their own retirement fund
- Master trust superannuation funds
- Self Managed Super Funds
The growing super story

The growth of superannuation assets in Australia has been significant

1998: $365 billion
2015: $2,045 billion

Source: APRA, "Quarterly Superannuation Performance" Dec 2015

about 29% of the super industry. Self managed
Australian master trusts

Retail Super funds

- Developed by banks and insurance companies.
- Initially for wealthier white collar customers
- A portion the profits derived from the activities of retail super funds goes to the shareholders.
Australian master trusts

Industry Super Funds

• Developed by trade union and industry bodies.
• Originally they were exclusive to their industry.
• Now “Public offer” open to the general public.
• Not-for-profit organisations.
• Historically charged lower fees on average compared to the big retail super funds. However this is changing.

Canstar - an online finance comparison site with expert ratings
Superannuation is a tax structure set up for the purpose of helping Australians save for their retirement. Within that tax structure there are various different types of superannuation funds, including:

- Corporate or public sector funds
- Industry Super Funds
- Retail Super Funds
- Self Managed Super Funds

Compare superannuation products filtered by managed funds offered in the table below, with links direct to the providers website. Please note this comparison table results is sorted by Star Ratings (highest to lowest) based on the age bracket of 30-39 years, and a super balance of up to $50,000.

<table>
<thead>
<tr>
<th>Company</th>
<th>Star Rating</th>
<th>Annual cost at $30k balance</th>
<th>Number of managed funds</th>
<th>Life &amp; Income Protection</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>AustralianSuper</strong></td>
<td>💫💫💫💫💫</td>
<td>$303.00</td>
<td>11</td>
<td>✓</td>
</tr>
<tr>
<td>AustralianSuper</td>
<td>⭐⭐⭐⭐⭐</td>
<td>$303.00</td>
<td>11</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Energy Super</strong></td>
<td>💫💫💫💫五星</td>
<td>$349.00</td>
<td>10</td>
<td>✓</td>
</tr>
<tr>
<td>Energy Super</td>
<td>💫💫五星</td>
<td>$349.00</td>
<td>10</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Hostplus Personal Superannuation Plan</strong></td>
<td>💫💫五星</td>
<td>$513.00</td>
<td>22</td>
<td>✓</td>
</tr>
<tr>
<td>Hostplus Personal Superannuation Plan</td>
<td>🌟🌟🌟🌟🌟</td>
<td>$513.00</td>
<td>22</td>
<td>✓</td>
</tr>
</tbody>
</table>
Australia master trusts

Superannuation is a tax structure set up for the purpose of helping Australians save for their retirement. Within that tax structure there are various different types of superannuation funds, including:

• Corporate or public sector funds
• Industry Super Funds
• Retail Super Funds
• Self Managed Super Funds

What does super cost?

We’ve collated the data on the minimum, maximum and average fees across the 67 superannuation products included in our 2016 Star Ratings.

Note in particular the difference between the minimum and maximum fees in the tables below. While most providers are offering competitive fees and premiums, some providers are charging substantially higher fees and premiums – so watch out!

<table>
<thead>
<tr>
<th>Profile</th>
<th>Average Super Balance ($)</th>
<th>Average Fees ($)</th>
<th>Min Fees ($)</th>
<th>Max Fees ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Starter</td>
<td>$20,000</td>
<td>$275</td>
<td>$134</td>
<td>$678</td>
</tr>
<tr>
<td>Builder</td>
<td>$80,000</td>
<td>$838</td>
<td>$450</td>
<td>$2,322</td>
</tr>
<tr>
<td>Established</td>
<td>$140,000</td>
<td>$1,406</td>
<td>$728</td>
<td>$3,966</td>
</tr>
<tr>
<td>Pre-Retiree</td>
<td>$200,000</td>
<td>$1,967</td>
<td>$998</td>
<td>$5,610</td>
</tr>
<tr>
<td>Wealth Accumulator</td>
<td>$500,000</td>
<td>$4,669</td>
<td>$2,250</td>
<td>$13,831</td>
</tr>
</tbody>
</table>

Source: Canstar

Fees include Administration Fees and Indirect Cost Ratio (including Investment Fee, Performance Fee and other indirect costs). Rounded to nearest dollar. Fees are calculated based on the average super balance specified based on funds assessed for Canstar Superannuation Star Ratings 2016.
How much do the specific types of super fees cost?

Each specific type of superannuation fee that we’ve outlined below will cost a different amount depending on your account balance. Based on the profiles assessed by Canstar for its 2016 star ratings, we have calculated the following minimum, maximum and average fee breakdown across the different profiles assessed.

### Starter

<table>
<thead>
<tr>
<th>Fee/Cost</th>
<th>Average Fees</th>
<th>Min Fees</th>
<th>Max Fees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Member Fee</td>
<td>$89</td>
<td>$0.00</td>
<td>$480</td>
</tr>
<tr>
<td>Administration Fee</td>
<td>$49</td>
<td>$0.00</td>
<td>$246</td>
</tr>
<tr>
<td>Investment Fee</td>
<td>$118</td>
<td>$0.00</td>
<td>$480</td>
</tr>
<tr>
<td>Other Indirect Costs</td>
<td>$60</td>
<td>$4.00</td>
<td>$215</td>
</tr>
<tr>
<td>Performance Fee</td>
<td>$9</td>
<td>$0.00</td>
<td>$101</td>
</tr>
</tbody>
</table>

Source: [Canstar](https://www.canstar.com.au)

Fees are calculated based on an average super balance of $20,000 on funds assessed for Canstar Superannuation Star Ratings 2016.
## Wealth Accumulator

<table>
<thead>
<tr>
<th></th>
<th>Average Fees</th>
<th>Min Fees</th>
<th>Max Fees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Member Fee</td>
<td>$81</td>
<td>$0</td>
<td>$480</td>
</tr>
<tr>
<td>Administration Fee</td>
<td>$1,095</td>
<td>$0</td>
<td>$5,199</td>
</tr>
<tr>
<td>Investment Fee</td>
<td>$2,955</td>
<td>$0</td>
<td>$12,049</td>
</tr>
<tr>
<td>Other Indirect Costs</td>
<td>$1,511</td>
<td>$100</td>
<td>$5,399</td>
</tr>
<tr>
<td>Performance Fee</td>
<td>$228</td>
<td>$0</td>
<td>$2,550</td>
</tr>
</tbody>
</table>

Source: Canstar

Fees are calculated based on an average super balance of $500,000 on funds assessed for Canstar Superannuation Star Ratings 2016.
Peter and Jane are average 25-year-olds in jobs that pay $50,000 annually. Both believe they will retire at 67 and have chosen a balanced investment option with their fund. For the purpose of this example, our superannuation calculator says the annual return on Peter and Jane’s super funds is consistently 9% before fees and tax.

Peter invests in ABC super fund, which charges a membership fee of $52 per annum and has a management expense ratio (MER) of 0.75%. Peter’s super balance at the time of retirement, based on our calculations, would be approximately $416,000 in today’s dollar terms.

Jane invests in XYZ super fund, which charges the same membership fee of $52 per annum but has a MER of 1.75%. This means her super balance at the time of retirement is approximately $333,000 in today’s dollar terms, based on the above assumptions.

That’s $83,000 Jane potentially misses out on down the track simply because her fund charges a higher fee.
The Management of Master Trusts
The management structure

Chair, NEST Corporation

Trustee Members

Committees

Employers’ Panel and Members’ Panel

Trustee Member meetings

Executive Team
Authorisation of master trust schemes

• From 1 October 2018, master trust pension schemes will have six months to apply for authorisation from us in order to continue operating.

Master trust readiness review

• Between 1 May and 15 June you can submit a draft authorisation application to us using our online portal. We will then provide feedback about the quality of your application by the end of August. This process is known as a readiness review.
Fit and proper persons requirement
Regulation 5- [section 7 4 (a) & (b)]

Master trusts: role identification form 3
• Section 1: Trustees 4
• Section 2: Scheme strategist 9
• Section 3: Scheme funder 13
• Section 4: Scheme establisher 16
• Section 5: Persons who can appoint or remove trustees 18
• Section 6: Persons who have the power to vary the terms of the trust, or vary the master trust if it’s not held under trust 21
• Section 7: Scheme promoter or marketer 23
• Section 8: Other connected persons 25
51. **Scheme strategists** will be required to prepare, maintain and submit a **business plan** to the Regulator which will include the key financial information for its financial assessment.
Scheme funder requirements
Regulation 8 - [section 10(a)]

53. The scheme funder

is a person responsible for financing the Master Trust scheme where its administration charges are not enough to cover its costs, or who is entitled to receive profits where the scheme’s income exceeds its expenditure.
Back to the Section 7B proposals
The 7B proposals - mostly good progress.

My concern is about the things that were not said

We will not enable commercial umbrella funds if we do not see the bigger picture and focus merely on the independent trustees.
The 7B proposals

The market has changed, needs have changed

When you agree to a packaged retirement solution you will know exactly who will provide the service and at what price.

You want the latest in technology, communication and member support etc.

This goes far beyond the capacity of a handful of independent trustee. You need a sponsor
Is there a law in South Africa that says a commercial fund may not have a sponsor who takes responsibility for aspects such as the business plan and the design / population of the fund offerings – for the consideration and approval of the Board?
Section 7C. Object of board

(1) The object of a board shall be to direct, control and oversee the operations of a fund in accordance with the applicable laws and the rules of the fund.

(2) In pursuing its object the board shall -
   (a) take all reasonable steps to ensure that the interests of members in terms of the rules of the fund and the provisions of this Act are protected at all times, especially in the event of an amalgamation or transfer of any business contemplated in section 14, splitting of a fund, termination or reduction of contributions to a fund by an employer, increase of contributions of members and withdrawal of an employer who participates in a fund;
   (b) act with due care, diligence and good faith;
   (c) avoid conflicts of interest;
   (d) act with impartiality in respect of all members and beneficiaries.
Principle 4

The governing body should recognize that the organisation’s core purpose, its risks and its opportunities, strategy, business model and sustainable development are all inseparable elements of the value creation process.
The SPONSOR takes responsibility for the design of the various benefit structures/offerings and undertakes to use its considerable resources to provide -

• promotional and marketing support to ensure ongoing economies of scale and market relevance;

• guidance on stakeholder communication and disclosure strategies, employing the latest infrastructure and technology;
Sponsor responsibilities ...

- guidance on benefit structures/offervings which align with the needs of various groups of MEMBERS and EMPLOYERS, are easy to understand, convenient to use, offer outstanding value, and are transparent and cost effective; and

- ongoing research and development to identify the changing needs of MEMBERS and EMPLOYERS with a view to ensuring timeous adjustments and improvements that may be required.
The BOARD takes responsibility for the ongoing management and control of the FUND.

The BOARD will ensure that the FUND is able to provide the benefits and services of the various offerings and will direct, control and oversee the operations of the FUND in accordance with the applicable laws and the RULES of the FUND.
Management and control of the fund

Business plan and design of the offerings

- Trustee Members
- Committees
  - Employers’ Panel and Members’ Panel
  - Trustee Member meetings
- Executive Team
A sound management structure aligns the energies of the stakeholders to focus on the outcomes.
Australia

Both Industry and Retail funds

• In a game of swings and roundabouts, the lines between Retail and Industry funds are starting to blur.

Canstar - an online finance comparison site with expert ratings
Contract or Master trusts?

Cost and value for money

Historically, GPPPs have been considered cheaper than trust-based schemes. The growth and development of master trusts have challenged this, and in today’s environment there is increasing convergence in charging structures between the two.

Aon Hewitt: The Search for Quality: Group Personal Pension Plans or Master Trust?
South Africa

**Objective**: robust solutions (200 funds) with -
- good governance
- that is cost effective and ensures
- good retirement outcomes for our members

**Action**: we need to
- embrace commercial umbrella funds,
- understand the crucial role of the sponsor and
- align the legislation to ensure that it serves the members
Are the proposed new conditions for exemption in terms of section 7B of the PFA ‘fit for purpose’?
1.1 This Guidance Notice intends to clarify and reflect the position of the Financial Sector Conduct Authority on exemptions in terms of section 7B(1)(b) of the Pension Funds Act, 1956 (PFA) and provides details of the conditions that may be imposed by the Authority in such cases.

1.2 The default position as regards the composition of the board of management of a fund is in section 7A(1) of the PFA, which requires that every fund have a board consisting of at least four members, at least 50% of whom the members of the fund shall have the right to elect. Section 7B of the PFA provides an alternative to the provisions of section 7A in certain defined circumstances.
Which funds are eligible?

2.1 For the purposes of section 7B(1)(b), the PFA recognises the following types of funds that may be granted exemption from the provisions of section 7A(1) -

• funds established for the benefit of employees of different employers ... commonly known as umbrella funds;

*Kobus observation: This includes all umbrella funds – A and B*  
*Rose observation: It should not include umbrella funds for employees of companies related to each other by shareholding. There is no reason why they should not be able to give their members the right to elect trustees.*

• retirement annuity funds; beneficiary funds; and pension and provident preservation funds as defined in section 1 of the Income Tax Act, 1962.
Fixed period v indefinite exemptions

2.5 After receiving representations in this regard from funds and re-considering the provisions of section 7B(1)(b) of the PFA, the Authority concluded that exemptions granted upon written application by a fund will no longer be time bound or subject to a specific period. Paragraph 6.4 of Circular PF No. 96 is therefore replaced and the exemption granted by the Authority on application by a fund will be of indefinite duration if it is granted.

- **Kobus observation**: We fully support this measure
- **Rose**: I do not. The principal officers of exempted funds merely need to set up a reminder on their computers to apply for a fresh exemption before the existing one expires. Regular reconsideration by the regulator is important.
Funds which don’t give members right of indirect election must have at least 50% independent board members

- Unless (in the case of union, bargaining council, sectoral determination & municipal funds) members given right of indirect election or FSCA persuaded otherwise, at least 50% of board members must be independent

- **Kobus observation:**
  - No election is required. The fund appears free to find a way in which to appoint independent trustees
  - Unequal treatment of commercial v non-commercial umbrella funds not justified

- **Rose observations:**
  - Inconsistent with object of section 7A.
  - Not sufficient for compliance with the law or to ensure that the board does not use its powers principally for the benefit of the fund’s sponsor. Some funds with 50% independents still seem ‘captured’.
Qualifications for independents

• Relevant experience and expertise
• Free of relationships suggesting lack of independence
• Never expelled from professional body, Never convicted of crime involving dishonesty or violence (Kobus & Rose – why violence? Replace with removal from a position of trust)
• Has sufficient time to fulfill duties (Kobus & Rose, how do you measure this? Should apply to all board members anyway)
• If board member ceases to comply with criteria, board must take ‘remedial action’ and board member automatically ceases to be board member (Rose – this could cause chaos, right to be heard?)
Sub-committees

- If fund has sub-committees, requirements re composition will apply to them too
  - *Kobus observation: Not practicable. Ignores fact that:*
    - Some sub-committees operate within narrow mandates given to them by main boards;
    - Some sub-committees including external experts for good reason.
  - *Rose observation:*
    - Agreed
    - Plus, any member of a sub-committee who seems unable to exercise an independent discretion should be expelled from it.
Duties of independents

• An independent board member must report any irregularities and concerns to the Authority and he or she shall not be held liable or to be victimized as a result of the reporting;
  – *Kobus observation: These are provided for in relation to all board members already*
Voting powers of independents

Rules of a fund must provide for
• A quorum of at least 4 board members including all independent trustees;
• No decision will be binding unless supported by
  • At least 50% of the board members;
  • At least 70% of the independent board members

Kobus observations: This would give the independents effective veto rights and allow them to choose investment portfolios provided by sponsors’ competitors. They could ‘capture’ the funds.

Rose observations: If they had good reason for thinking the competitors’ portfolios were best of breed, that would be a good result. Commercial umbrella funds can be captured by their sponsors even if 50% of their trustees are ‘independent’ or ‘member-elected’. Better if all were independent.
Authority may require Mancos at employer, sector or regional level

- **Kobus observations:**
  - Does this mean that joint forums / or local boards at the level of each participating employer will become compulsory for each employer?
  - Not sure how the size of the umbrella fund should determine the need for a management committee. I think they mean the size of the employer?

- **Rose observations:**
  - A subordinate governance structure does not have to be employer-based. It could be determined by reference to region, occupation, industry or some other basis for community of interest.
  - Management committees may take the form of committees of an umbrella fund, and which are intended to assist the board of management to liaise better with members and employers, thus ensuring adequate and timeous communication, interaction and understanding of matters which impact these stakeholders.