PENSION LAWYERS
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Goals for 2010 & beyond

2010 PLA CONFERENCE - SPIER - WESTERN CAPE

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Topic Rehabilitation of Funds in Distress

At what point does one categorise a fund as being in distress?

- No fund can claim to be operating perfectly.
- Is a fund in distress because of –
  - A governance failure always?
  - The fault of service providers always?
  - The environment generally?
  - The regulatory environment?

At what point does one categorise a fund as being in distress? (cont.)

- A fund is in distress when -
  - There is a failure to deliver the promised benefits;
  - The benefits are very poor, or are exposed to an inappropriate level of risk;
  - The costs are excessive, alternatively cannot be justified;
  - The process of delivering the benefits is so untrustworthy to the stakeholders (members, employer, sponsor, Registrar) as to warrant intervention / involvement by Registrar.

Purposes of good governance

- Four purposes -
  - To ensure the benefits promised are delivered;
  - To ensure the benefits are optimal within the constraints of appropriate risk;
  - To ensure that the costs are transparent and justifiable;
  - To ensure that the process of delivering the fund benefits is credible and can be trusted by the fund stakeholders.
- Fulfillment of these governance purposes ensures that a fund is viable, that is that it fulfils the object of its existence.
- Similarly, a fund can be said to be in distress when its viability is under a serious threat which is likely, on a balance of probabilities, to eventuate over the short term.

Sources of fund failure

- Inadequate governance -
  - Dysfunctional board;
  - Board lacking in skills;
  - Inadequate exercise of oversight responsibility or discretion;
  - Inadequate communication with stakeholders.

But it is not only governance failure which may cause a fund to be in distress

- Inadequate / hostile service providers –
  - Administrator
  - Investment manager
  - Legal adviser
  - Actuary
- Legacy issues, such as poor member data or unreconciled employer contributions;
- Environmental factors, eg. difficult to ensure employer compliance with section 13A;
- Employment issues, eg. major retrenchment exercise or M&A;
- Sponsor issues – commercial proposition under threat, or sponsor will not involve itself in a major issue affecting the fund (especially in DB fund);
- Major change in the regulatory environment, eg. new methodology for actuarial valuations, surplus requirements.

Red flags of funds in deep distress

- Umbrella funds;
- Member data is very poor;
- Poor compliance with section 13A;
- Unhappy relationship with administrator;
- High member and employer dissatisfaction;

Red flags of funds in deep distress (cont.)

- High trustee costs;
- Non-compliance with fund rules;
- Poor exercise by board of oversight function;
- Board regularly makes poor decisions;
- Abuse by service providers.

Where does one start with rehabilitation?

- Acceptance of failure –
  - In every annual trustee appraisal there should be an acceptance of failure to some extent.
- Apportioning blame does not cure the problem!
- Involving the Registrar to regularise the situation.

What is the function of the Registrar?

- It is not to have governance responsibility;
- But you can ask the Registrar if any fund arrangement is an undesirable practice in terms of the FI Act;
- You can ask the Registrar to undertake an inspection of the fund and its service providers;
- You must, if you think the fund is in distress, be –
  - Completely transparent;
  - Co-operative;
  - Report regularly to the Registrar on progress made in regularising the situation.

Rehabilitation of distressed fund

- Put the fund governance on a sound footing –
  - Proper reports about administration and investments;
  - Ensure the rules are understood properly by the board;
  - Review contractual arrangements;
  - Communicate regularly to stakeholders;
  - Identify and prioritise what must be done, and give a reasonable time frame;
  - Accept that there is a financial cost involved in rehabilitating a distressed fund.

Restoring good governance

- Consider appointing independent trustee/s;
- Put in place governance structures (sub-committees with proper mandates, regular board meetings);
- Put in place proper governance policies and processes (code of conduct, communication policy, IPS, death claim process, etc);
- NB: the above does not ensure good governance -
  - The board may still be ineffective or dysfunctional.
- Trustee training;
- Remuneration and cost issues.

Restoring fund data

- Fund data is usually a problem so need to get a proper sense of what is needed to restore it.
- This takes time, resources and costs money.
- Need also to have confidence in on-going administration.
- Industry (administrators) needs to play a supportive role because the failure of a fund impacts the credibility of the industry as a whole.
- Clean fund data makes a fund attractive to administer and reduces the administration costs.

But should one not proceed against those to blame?

- If the fund has suffered a loss as a result of a service provider then that loss must be recovered, even if it means litigation.
- What about the trustees?
- What about the Registrar?
- Need to assess the cost / benefit of litigation, and restoring credibility by holding accountable those responsible for the loss.
- Important to involve the Registrar in a decision on this.

Importance of on-going risk management

- One cannot anticipate every risk.
- Far more funds are exposed to serious risk periodically than is realised.
- Must be more conscious always of the risks to fund viability, and be able to react quickly and flexibly.
- Perhaps a need for FSB help-line?

Thank you

QUESTIONS ARE WELCOME