



Fees and value for money in private pension systems

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Agenda

- Role of trustees
- Methods of charging / types of cost
- Introduction of defaults
- Consolidation of pension funds
- Conflicts of interests
- Focus on market conduct
- Supervisory activities
- Governance requirements
- Limitation of certain charges

Role of Trustees

- Retirement funds in South Africa acquire their own legal personality once registered in terms of the Pension Funds Act. Fund assets are held in each fund's name and therefore belong to the fund.
- Each fund must appoint a Board of Management with Board Members (colloquially referred to as trustees)
- Objects:
 - Take all reasonable steps to ensure that the interests of members ... are protected
 - Act with due care, diligence and good faith
 - Have fiduciary duties to members and the fund ... to responsibly manage and govern the fund
- Duties
 - Ensure that adequate and appropriate information is communicated to members

Methods of charging /types of cost

	% of salary	% of contribution	Rc from contribution	% of assets	Rc from assets
Administration	y	y	y	y	
Investment				y	
Consulting and professional				y	y
Trustee					y

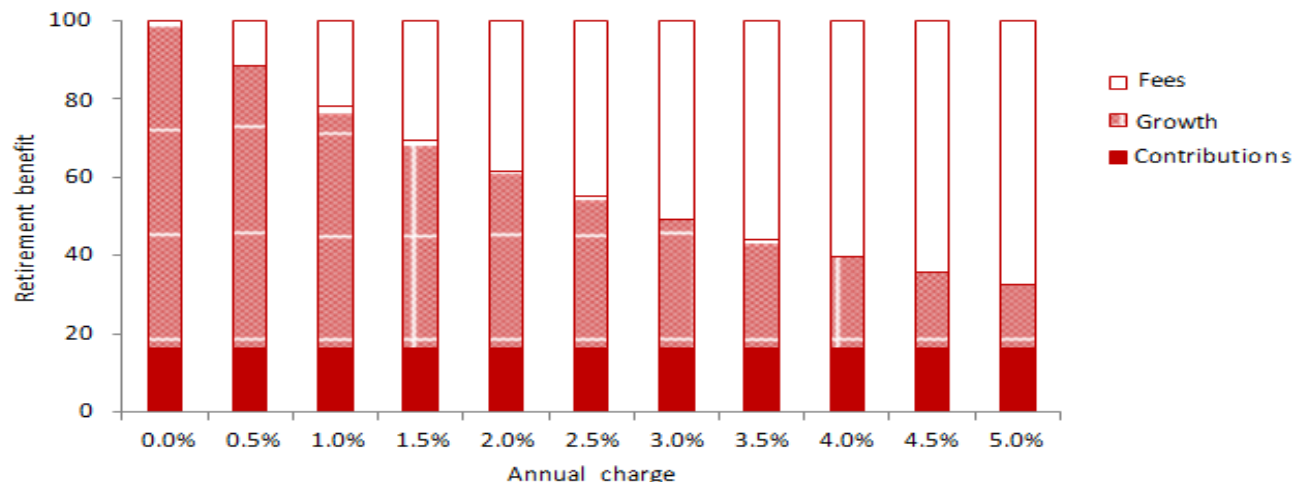
Determinants of fund costs

- Size of the fund
- Degree of preservation
- Extent of compulsion
- Degree of subsidy
- Level and cost of risk benefits
- How assets are invested
- Functions performed
- Quality of services

Effect of charges on retirement benefits



Figure 1: Effect of recurring charges on retirement fund accumulations after 40 years



Source: Treasury modelling. Model assumes annual contributions increasing in line with wages over 40 years. Results are not sensitive to investment returns.

Charges in the South African Retirement system



Estimated 20-year *RiY/ACA* and *RiMV* for different South African retirement funding channels

	<i>RiY / ACA</i> §	<i>RiMV</i>	Notes
Large stand-alone funds	0.99% p.a. (Davies)§ 1.04% p.a. – 1.65% p.a. (Rusconi)§ 1.03% p.a. (G&E)	~10% (Davies)* ~10% - 17% (Rusconi)* 12.75% (G&E)	These estimates may understate costs because employers may bear some fund costs themselves.
Commercial umbrella funds	2.03% p.a. (Davies)§ 1.90% p.a. (G&E) 1.65% p.a. (G)	~20% (Davies)* 18.68% (G&E)	G&E and G exclude very low-income individuals from their sample and exclude guarantee charges. Value refers to average <i>RiY</i> across members with varying terms to retirement.
Retirement annuity funds	3.51% p.a. (R, R200 p.m.) 3.05% p.a. (R, R1 000 p.m.) 3.60% p.a. (G&E, R600 p.m.) 3.40% p.a. (G&E, R1500 p.m.)	28.4% (R, R200 p.m.) 25.75% (R, R1 000 p.m.) ~36% (G&E, R600 p.m.)* ~34% (G&E, R1 500 p.m.)*	These are 'old generation' RA contracts. Figures exclude additional early surrender penalties, which may be substantial.
	~2.3%*	22.6%	This is an average across four providers for 'new-generation' RA contracts, details shown in Table 5

*These values are calculated using the approximate relationship between *RiY/ACA* and *RiMV* shown in the text assuming an average term of 20 years

Numbers indicated by this symbol are ACA-type measures rather than Reductions in Yield. See the appendix for a description of the conditions under which these are comparable.

Source: Davies (2011), Gluckman and Esterhuyzen (2011), Gluckman (2013) and Rusconi (2004) Treasury calculations

Defaults



- As with several other jurisdictions, the large majority of members fall in a fund's default investment portfolio
- Aim to lower charges and improve market conduct in the retirement industry
- **Investments**
 - Appropriate, not complex, reasonably priced, well communicated, offer value for money
 - *"The fees and charges in respect of the default investment portfolio(s) or the assets held in respect of the default investment portfolio(s) are reasonable and competitive, taking into account of size, asset allocation and other characteristics of the fund"*
 - Trustees to monitor regularly
 - Performance fees subject to standards to be issued
 - Forced to at least consider passive investments
 - No complex fee structures
 - All fees and charges must be disclosed

Defaults

- **Annuitisation**
 - Annuity strategy
 - Soft default (members must opt in)
 - Appropriate, not complex, reasonably priced, well communicated, offer value for money
 - *“fees and charges in respect of the annuity or assets held in respect thereof are reasonable and competitive, considering the benefits provided”*
 - All fees and charges must be disclosed

Defaults

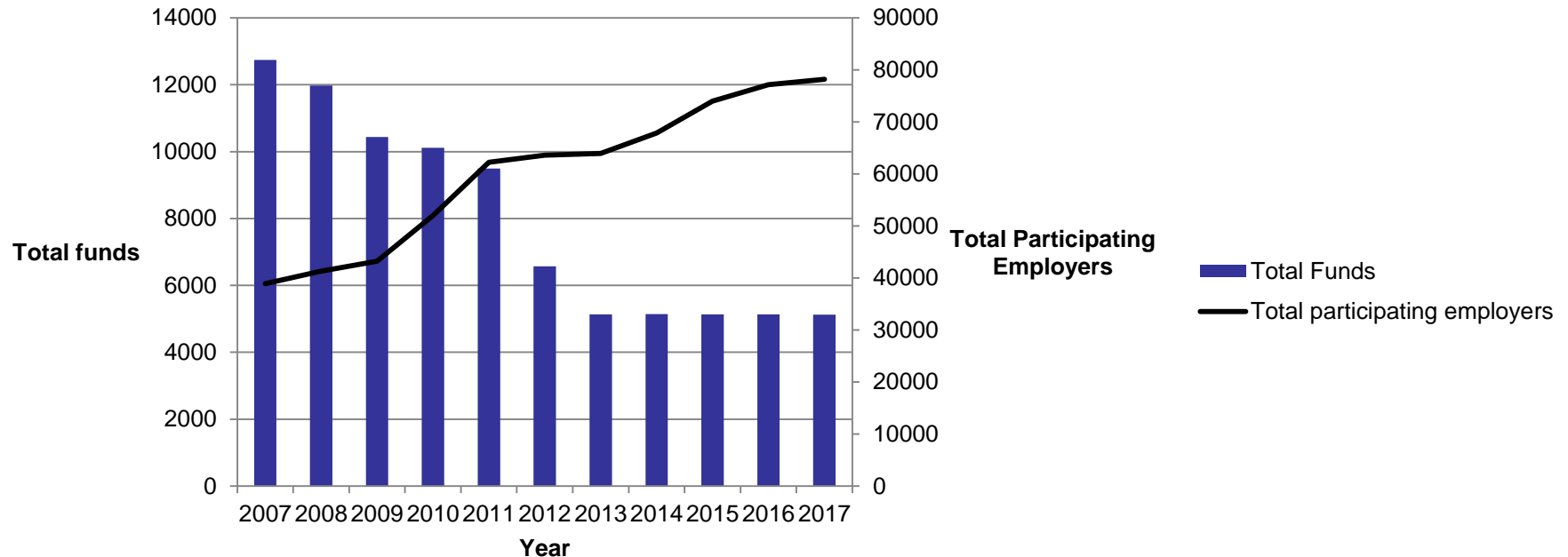
- **Preservation**
 - Investment fees and charges may not differ on basis of paid-up versus active
 - Fees must be fair, reasonable and commensurate with the cost of providing the administration service
 - No initial once-off charge may be levied

Consolidation of funds

- Economies of scale
- Less resources to regulate
- Movement from free-standing occupational funds to multi-employer funds
- Policy prerogative – lower costs result in greater retirement savings

Consolidation of funds

Total funds and Participating Employers



Conflicts of interest

- Conflicts of interest, bribery, corrupt behaviour potentially increase cost
- Could affect trustees' fitness and propriety to hold office
- Issued directive (draft for comment) limiting gratification (that could create conflict of interest)
- Examples: overseas trip / holiday – provider will recoup from clients leading to increased costs

Focus on market conduct

- Financial Sector Conduct Authority
- Outcomes based regulation
 - Aim to achieve a desired outcome
 - High level, broadly stated outcomes (e.g. TCF).
 - Must demonstrate the delivery of outcomes, without specifying the detail of “how”
 - Firms/pension funds write own rules

Focus on market conduct

- RDR
 - Strict standards for advice fees will mean trustees can (and must!) actively negotiate fees and scope of advice offering with their advisers
 - Focus on meaningful disclosure of all fees (including advice fees), including their impact on returns
 - Adviser remuneration model for annuities needs decision (To avoid arbitrage between remuneration for living annuities vs. fixed interest annuities)

Focus on market conduct



- Issued TCF guides for retirement funds
- TCF is a consumer protection framework that requires all regulated financial institutions - including retirement funds and their service providers - to demonstrate that they are delivering the 6 TCF outcomes in the way they conduct their business.
- Some requirements related to fees
- Should achieve ultimate goal in providing appropriate retirement income
- Trustees should not be influenced to offer inappropriate products that do not offer value for money. Providers to ensure value for money
- Be careful of bundling all services
- Ensure members and beneficiaries receive appropriate information (including fees, costs and charges)
- Ensure members know the impact of fees on retirement benefits
- No unreasonable barriers to change

Supervisory activities

- Licensing of pension funds, administrators and other service providers
- On-site visits
- Scrutiny of financial statements and actuarial valuation reports
- Consider the fitness and propriety of trustees, service providers and consultants
- Inspections
- Requesting of information
- Specific limitation on causal event charges
- Interventions in the management of funds and administrators -
Appointment of curator or statutory manager

Governance requirements

- King IV – sets out general principles of corporate governance, which may be applied to funds and administrators
- Pension Funds Act
 - Provides for the registration and licensing of funds and administrators, and conditions attached to their operation
 - Sets out objectives and duties of trustees
- PF Notices and Directives – sub-ordinate legislation issued by the Registrar, which may be applicable to a fund or funds generally
- Circulars – give the Registrar's view on aspects affecting funds and administrators, it is not law though

Limitation of certain charges

- Causal event charges
- Transfers of fund policies

Thank you