



EVOLUTION OF THE SOUTH AFRICAN RETIREMENT FUNDS INDUSTRY

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Welcome and Introduction

Honoured guests, ladies and gentlemen, let me start by welcoming all of you to our first Retirement Funds Conference sponsored exclusively by the FSCA.

The conference was conceived by our former legal specialist, Mr Radesh Maharaj, to enable the regulator to engage directly with trustees, and for free. As a friend of mine once said, never say no to free and compulsory education.

It is a conference where we can directly exchange ideas and views, where you can ask unlimited questions without being time constrained. A conference for us as the regulator to inform you of our workings and expectations, to update you on various local and international developments, and to clarify certain matters.

The conference should not be seen as a competitor to the industry association conferences. It should, instead, be seen as a complement.

To do justice to the theme of the conference, I would like to start by briefly taking you through the reform journey embarked by the policy-maker and regulator over the past years, starting in 2011.

The evolution of the retirement funds landscape

2008 saw the advent of the Global Financial Crisis. As Winston Churchill said, *“Never let a good crisis go to waste”*. Indeed, the National Treasury seized this moment and published in 2011 a document called *“A safer financial sector to serve South Africa better”*, which is literally the blueprint for our new Twin Peaks regulatory model. In the same year, the then Financial Services Board (FSB) announced the Treating Customers Fairly initiative, which is the cornerstone of the new FSCA’s regulatory approach.

The FSCA came into being on 1 April 2018, together with its twin, the Prudential Authority (PA) at the SA Reserve Bank, following the promulgation of the Financial Sector Regulation Act in 2017.

The FSCA is the conduct regulator, which means we supervise how financial institutions, including retirement funds, deal with and treat their clients, which includes members of funds. The PA supervises the financial soundness of financial institutions, to ensure that they meet their financial commitments to clients.

You might ask, why is conduct of financial institutions so important today? Because if you look carefully at the Global Financial Crisis of 2008, its trigger was bad conduct by financial institutions which offered mortgages or bonds to customers who were most likely to default.

Some of these customers were not even told that the interest rates would reset to a higher rate in the future.

The only slight tweak to our Twin Peaks model, compared to other countries, is that the FSCA retains both the conduct and prudential supervision of retirement funds, at least for three years.

I will not steal my boss’ thunder, Mr Dube Tshidi, who is going to talk to you later about the origin and evolution of the FSB into the FSCA.

Coming back to retirement funds. It is common cause that South African households are struggling to save, with the household saving rate, as a percentage of GDP, hovering around 0%.

Those of us who are lucky to be employed, are at least compelled by the employer to save for our retirement – one example where compulsion is good for us!

However, we also know that even some of us who are working are not saving enough for retirement.

We contribute sub-optimally; we do not preserve when changing jobs; we go for retirement products which could be expensive; we do not like taking life annuities, which are meant to protect us from outliving our savings; and we choose high draw-down rates for our living annuities.

These challenges led Treasury to come up with various policy proposals, and a lot of them have been effected into law in the last 7 years; from default regulations, tax harmonisation and higher tax benefits, enhanced governance provisions in the PFA, enabling members to delay retirement, etc. The framework is now there, and it is for us the regulator and most importantly, you as trustees, to give effect to it.

Behavioural economics

The new area of economics, called behavioural economics, has tried to give insight into dealing with some of these problems through analyzing human behaviour. And its key message is that as humans, we can be inherently and justifiably irrational, because;

we procrastinate; we have doubts and cannot decide if offered too many choices; sale persons can take advantage of our ignorance; we excessively focus on the short-term and we can be greedy!

So important is behavioural economics that Richard Thaler was awarded the Economics Nobel price in 2017. I would encourage you to get his classic book called Nudge. The default regulations were largely fashioned around behavioural economics.

Value for money

A discussion paper released by the National Treasury in 2013 titled “*Charges in South African retirement funds*” showed how “...a regular saver who reduces the charges on his retirement account from 2.5 per cent of assets each year to 0.5 per cent of assets

annually would receive a benefit 60 per cent greater at retirement after 40 years, all else being equal.”

Charges or costs are important, especially in this era of low returns. And I do know how a certain Mr Stevan Nathan feels about the finalised default regulations – which required a difficult balancing act, especially between active and passive investments.

Internationally, especially in America and certain parts of Europe, there has been a growing shift from active managed assets to passive. The research also shows that it is difficult to always beat the market and get alpha, and that most asset managers have struggled to beat the market. Patrick Cairns of Moneyweb has written extensively on this.

We should probably be less obsessed with shooting down the lights by trying to always beat the markets. Instead, we should consider aiming for decent long term growth. Do not get me wrong – earning a return is still important, and more so earning a return which beats inflation. But it should not be at the expense of everything else or paying too high fees to achieve this. A well balanced portfolio in various asset classes should be able to yield an optimal outcome.

Today, you will hear from some of the best minds when it comes to the important debate on costs. These are experts who are passionate about passive investing, active investing and a middle ground like smart-betas. You will then have to decide which strategy will be best for your funds and members.

Linked to this issue is the need for consolidation in the retirement funds industry. At least 1500 funds are active. There are simply too many funds, and too many small funds, which are even audit exempt. Retirement funds are about economies of scale – the better the scale, the better the costs as you are able to spread them among a larger number of members. The question still remains how best to achieve such consolidation, and this is the only slight difference between me and Mr Jan Mahlangu.

Maybe a good outcome and interim step could be a few number of funds made up of a combination of umbrella funds, large and few medium sized standalone funds, subject

to them demonstrating value for money and good governance. It is also the case that having the right governance in place costs money.

Going forward, as part of our new enhanced regulatory approach of being intrusive, intensive and pro-active, we will be looking closely at funds financial statements to analyse how their costs compare to benchmarks or industry averages. Funds will be asked to explain major deviations from benchmarks.

Trustees conduct

Coming now more directly to you, as trustees. I have always said that being a trustee is a difficult job. I therefore commend you for the courage you have. But my boss, Mr Dube Tshidi, recently asked me a simple but profound question, which he said every trustee must ask themselves; Am I trustworthy? Can I be trusted with other people's money and livelihood? Because if I am not, I should never raise my hand to be a trustee.

We should be frank with one another. There are trustees who have failed and are failing their funds and members. These failings could be attributed to lack of sufficient and regular training and skilling, lack of integrity – which no formal education can teach you, lack of proper judgment – which links to over reliance on consultants and asset managers. Remember that as trustees, as much as you can seek expert advice, and you are encouraged to do so, you are still required to make the decision on that advice.

Whenever a financial institution fails, the regulator is quickly blamed, and maybe fairly so given our role. The reality is that the regulator does not manage or run financial institutions – this role and duty is left to the directors and trustees of firms and funds. As the regulator, we rely on you to not only comply with the law, but to always ask yourself – what is in the best interest of the fund and its members. Put the member at the heart of every thought, decision and action you take.

And please remember, it is not your money but someone's money. This applies also to service providers – whether they are asset managers, administrators or insurers.

We have issued Directive 8 to stop gratification and undue influence on you by service providers, because we have records of how such behaviour can lead to conflict of

interests and compromise member's savings. Trust me, we are monitoring compliance, and you will be called to account.

You should also not be scared to whistle-blow, because we cannot visit all the funds at the same time. We therefore rely on you to assist us and will treat the information carefully with the necessary confidentiality.

Trustee-toolkit

We are busy finalising the standard on the FSCA trustee toolkit, to at least assist you with acquiring free and compulsory education. You can always supplement this.

Transformation

It will be remiss of us not to talk about transformation. We all know our history as a country, the legacy of which still lingers to a certain extent. However, we now have 25 years after our first democratic elections, and therefore we should be seeing reasonable progress on some of our critical societal and economic objectives like attaining a more fair, equal and just society.

But we must also understand human history and dynamics – man has always fought for limited resources to ensure his survival. Unfortunately, taken to the extreme, this leads to wars, hatred, oppression, discrimination, and environmental damage.

One of the biggest dangers in any society is having someone who has nothing to lose, because they will make everyone worse off. It is therefore imperative that we cherish diversity everywhere. For example, the inclusion of women on boards and as asset managers, locally and globally, is as imperative as any other inclusion. Research shows how diverse boards are able to make better decisions.

We need to blend youth and experience. We need to consider how incubation can assist us in bringing to the industry new asset managers to enable a balanced distribution of asset management which reflects the demographics, bearing in mind that this also means enabling our future competitors.

However, this must also be said; we are dealing with long term savings here. We are dealing with sacrifices workers are making every day to get a decent income in

retirement. We, therefore, need to do the right thing with other people's money. We need to show a higher care than we would with our own money and do things properly.

We need to adhere to high standards in the products and services we deliver, and not lower them for historical or transformational reasons.

Responsible Investing

Milton Friedman, another Nobel Laurette, famously said the only purpose of a company or its directors is to maximize wealth or profits for its shareholders.

As with everything in life, take this saying or postulate to its extreme, you will end with unfortunate outcomes.

To its extreme it means extracting as much value out of workers without fair compensation or time to rest; to its extreme it means over-pricing products; to its extreme it justifies greed; to its extreme it means excessive exploitation of the planet – the only one so far we know supports life. To its extreme, life itself could be threatened, and probably is already threatened if one goes with recent recorded climate anomalies.

Balance is key. The returns that companies make are the returns your funds earn and therefore your members benefit from. There is nothing wrong with making a financial return, as long as it is made sustainably and does not hurt anyone in the process.

The sole pursuit of return is now very old economics! There will be nothing to enjoy with that excessive return if there is no planet to grow food, extract raw materials to produce various commodities we so much rely on for our daily existence and indulgence.

Trustees, you therefore need to understand and appreciate your critical role in this world. The world is in a precarious situation.

We have relatively evolved from seeing unfair discrimination as normal; we have relatively evolved from tolerating the abuse of animals because we realise we have no right to ill-treat something we have not created; we have become impatient with greed which brings down markets, causes economic depressions and job losses.

As trustees, you must take a stand and do what is right! You should ask yourselves, do I want to retire in a wasteland; and may be this is extreme.

Ask yourself, do I want to retire in a society grossly unequal, lacking proper infrastructure to enable safe and cheap commuting for myself and grandchildren; do I want to retire in a country where big corporates collapse because of fraud or mismanagement or governance failures? Don't say you will cross the bridge when you get to it – because you might not even get to the bridge.

Be active asset owners; ask questions of the asset managers and the companies they invest in. You give them the money and mandate – it has never and should never be the other way round. It is your mandate that asset managers should carry out.

And responsible investing does not and will never mean charity or sub-optimal investing! It also does not mean allocating 10% in green bonds or infrastructure and saying you have achieved responsible investing. No! Regulation 28(2)(c)(10) and Guidance Notice 1 of 2019 on sustainable investments are clear - you must assess that all the investments you make, the asset classes you are in, are sustainable.

Although not specified in the guidance, we are expecting funds to start reporting on their responsible investment approach in their next financial years.

Please, do not say Guidance Notice 1 is simply guidance and therefore you will implement once it is obligatory. That will be a travesty. Reg 28(2)(c)(10) already requires you to consider ESG, the guidance tries to help you to comply with Reg 28.

We should not always be compelled to do what is right. Inculcate in yourselves as Trustees the culture to do the right thing without having to be compelled or punished for not doing right.

Prescribed Assets

This leads me to the recent topical issue of prescribed assets. The arguments presented against prescribed assets have been sufficiently ventilated in the public. It is my view that it might not be necessary to re-introduce prescribed assets. Instead, we would prefer that the regulator be given an opportunity to nudge the industry into

supporting the initiative to kick-start the economy through investments in infrastructure and other factors of production.

The other not so often spoken of real danger of prescription is that if something goes wrong with that asset, then it will be easy for the prescriber to be used as a scapegoat. Linked to this, it would also provide you as trustees with an excuse, if not reason, to not exercise your fiduciary duties. The PFA has left the decision on how best to invest the funds' assets in your hands as trustees.

This is too important an issue for you as funds and your associations to be quiet about. At least express a view.

International and Market developments

South Africa is privileged to be part of the International Organisation of Pension Supervisors (IOPS). Trust me, the same issues we are grappling with locally are also being discussed internationally. Issues around ESG are receiving great prominence and IOPS will soon be releasing guidance on this.

There is also an attempt to encourage industry to come up with new generation annuities which will give members both worlds – that is longevity protection and flexibility.

Even internationally, retirees are not keen on life annuities – it is seen as a grudge payment. South Africa has recently enabled the inclusion of hybrid-annuities as part of the default regulations to encourage members to annuitise and not default to take their savings as lump sums.

The economy is also struggling. We see companies closing down. However, to deduct contributions from a member's salary and not pay it into the fund is a crime in terms of the PFA – a crime which also pierces the corporate veil; meaning that as funds you can take the directors of that company or municipality to court for such an offence.

And I suppose this is easier said than done, because as trustees you probably worry about the repercussions of taking your employer to court. You do, though, have a duty to enforce this law. We are also engaging with SARS and other law enforcement

agencies on how we can assist trustees in enforcing section 13A which deals with contributions, and have received encouraging feedback. As trustees, you should not hesitate to put the employer on notice when it comes to arear contributions.

For the employer, the regulator's appeal is that engage with the trustees and the workers when you experience financial difficulties, so that you can reach some arrangement, rather than making deductions and not paying them over to the fund.

Terminating funds

Speaking of terminating funds. We issued Information Circular No. 1 this year informing the industry on what we expect when it comes to terminating dormant funds. I must say, we do need to deregister funds which are dormant as they simply add clutter to the system and divert regulatory resources. All we need to ensure is that such termination does not entail funds which have assets. It is common cause now that the regulator relied on incorrect information from service providers to make its decisions. Errors will be made, and the aim is to keep them minimal throughout the chain. And if mistakes are happen, they will be corrected.

We are tightening the process, and hence our request to the auditing profession to assist us in checking, to the best of their ability, that funds applying for termination do not have assets in them. We have also internally re-organised ourselves to have a team which will assess such applications so that the burden does not fall on one person. I am again, appealing to all insurers and administrators to please come forward if you discover that there might be funds you applied for termination in error.

Unclaimed benefits

The latest value of unclaimed benefits sits at R42 billion. This money rightfully belongs to workers who contributed to retirement funds and/or to their dependents, and therefore all efforts must be made by funds, insurance companies and administrators to trace them.

However, there is also the reality that not all beneficiaries will be traced, because some might have passed on or went back to their home countries. Unclaimed benefits are really a tragedy of history and the migrant labour system South Africa had in the past.

People concealed their true identities just to be employed. People did not have ID numbers – in fact there are records which literally record zeros for the entire ID number.

Employers did not provide information to their employees, and some employees did not share information with their spouses – something which unfortunately still persists today.

At some point, we will need a policy direction on what to do with unclaimed benefits we know it will be near impossible to trace beneficiaries.

Administrators probably also did not invest sufficiently in their data systems. If you have incorrect data, you will struggle to make correct calculations of a member's benefits. Worse, you will struggle to locate them. And maybe we have been too focused on the fees charged by asset managers and neglected the important role played by administrators.

We are also considering adopting the principle of KYC – Know-Your-Client - for retirement funds. This is an important principle which should be applied to every financial entity, including retirement funds. It will assist with ensuring that employers and funds, when they onboard workers or members, obtain the right details about them and constantly update such information. And honestly, even the least income paid person in South Africa has a cellphone, and we hardly change our cell numbers.

We have also been sensitised to the vexed issue of section 37C, which deals with the distribution of retirement benefits upon the death of a member. Last month I requested your associations, Batseta and IRF, and the Pension Lawyers Association, to work together and advise the regulator what are the practical challenges with the provision and how they can be overcome, including also possible legislative amendments.

Litigation

Also, please tone down on litigation, especially against the regulator, and unless if we have done something terribly wrong. We are always open to discussion and to answer questions where appropriate, but of course not where you have flouted the laws. There is a lot of frivolous litigation which ultimately is a cost to the fund and members.

Section 14 transfer delays

I have also been very disheartened by the number of applications I receive from your funds requesting extensions and further extensions in relation to section 14 transfers.

I understand, to a certain extent, that part of the challenge is the missing tax directives, which also talks to missing tax numbers when you onboard employees. The process of transferring members takes too long, and therefore not fair on members and the regulator. Unfortunately, many of you abuse the 180 and 60 days periods in the PFA. We are starting to reject many of these extension requests, and are also now considering proposing to the policy-maker the reduction of these periods.

SLA

The FSCA is going to be very intrusive, and it is going to make some of you uncomfortable. We are going to ask uncomfortable questions. Delays in submitting statutory returns and reports will attract penalties (currently R4000 per day of non-compliance), and you will have to explain to your members why you did not perform your duties properly or in time. Do not try to hide behind the point that a penalty reduces a member's benefits – you must account to them why you have been penalised.

However, we also accept as the FSCA that there are certain things we can do better. Nobody likes criticism, even when they tell you they welcome it. It is human. Please, do provide constructive criticism if you feel we delay in our responses or that certain matters are taking too long to address. Give us the opportunity to explain and where we cannot, we will own up. Your feedback will assist us in becoming a better regulator.

But do not be rude, aggressive or patronising in your complaints. We will treat you with respect, and we ask the same of you. We will take action against you if evidence confirms infringement, and this will be done without fear, favour and prejudice.

Conclusions

Let me conclude by stating that our retirement system is not broken, and we should not break things which work, even if they work sub-optimally. There are some cracks in the system, and I believe these can be fixed.

Let me take this opportunity to thank you all for attending. To specifically also thank the speakers who have sacrificed their time and borne the costs of traveling to be part of us; Dr Susan de Witt, Mr Malcolm Fair, Mr Brenton Lalu, Ms Mabatho Seeiso,

Mr Rowan Burger, Mr Steven Nathan, Ms Kirshni Totaram, Ms Nerina Visser, Ms Fatima Vawda, Mr Kgomotso Ramokala, Comrade Mr Jan Mahlangu, Mr Leon Campher and Ms Fiona Rollason. I truly appreciate your assistance and presence.

Special thanks to the presence of the National Treasury too, who have been with us in this long reform journey.

To the entire FSCA team, because I am not going to have another opportunity today, thank you very much! And to Mr Naheem Essop, who has been coordinating the entire project, thank you! You have ALL, irrespective of positions and rank, put a lot of excellent effort into this process and I am grateful, irrespective of how the event turns out later.

Thank you