



## Pension Fund Investment Choice

18 CPD Hours

All Classes of Business



## **Copyright Protection Notice**

© 2024, Compliance and Learning Center (Pty) Ltd. All rights reserved.

No part of this publication may be reproduced, distributed, or transmitted in any form or by any means, including photocopying, recording, or other electronic or mechanical methods, without the prior written permission of the publisher, except in the case of brief quotations embodied in critical reviews and certain other non-commercial uses permitted by copyright law.

For permission requests, write to the publisher, at [ceo@virtualclc.co.za](mailto:ceo@virtualclc.co.za)

## Table of Content

Topic 1: Retirement Planning Overview	4
Topic 2: Retirement Fund Options	32
Topic 3: Retirement Fund Key Concepts	51
Topic 4: Arrangements of A Retirement Fund	68
Topic 5: Payment of Benefits	99
Topic 6: The Rights of Pension Fund Members	130
Topic 7: Funds with Investment Choice Overview	152
Topic 8: Asset Allocation in Funds with Investment Choice	173
Topic 9: Pension Fund Transactions	188

# Topic 1: Retirement Planning Overview

## 1.1 Introduction

---

Retirement marks the stage when an individual ceases employment entirely. However, it is worth noting that some individuals may choose to semi-retire, opting to engage in a retirement job rather than out of necessity.

In South Africa, there are currently no laws that specify the retirement age for employees. While the typical retirement age ranges between 60 and 65 years, an employee cannot be compelled to retire unless their employment contract outlines a specific retirement age or if there is an official company policy in place.

Regarding the rights of employees who continue working beyond retirement age, there is no legal certainty. It is therefore advisable for employers and employees to establish clear terms of employment post-retirement. This includes determining the duration of continued work and the notice required to terminate employment.

Upon retirement, individuals will no longer receive a monthly salary, necessitating the need for income provision during retirement. This can be achieved through investing in retirement funds or other investment products at various stages of their lives.

Retirement funds, in their simplest form, are nonprofit institutions that collect, invest, and manage contributions made by individuals and companies. They serve as regulated savings pools, enabling people to save cost-effectively and tax-efficiently for their old age.

Employers often provide pension or provident funds for their employees, while self-employed individuals may choose to join a retirement annuity fund by purchasing a retirement annuity policy from a life insurer.

Preservation pension and provident funds do not accept direct contributions from members or employers. Instead, they receive benefit transfers when members choose to leave their previous pension or provident funds, preserving their benefits for a later date or event, such as retirement.

There are various investment products individuals can utilize to save for retirement, including unit trusts, fixed deposit accounts, money market accounts, endowment policies, government retail bonds, and equity investments.

In cases where individuals have little to no retirement savings, they can rely on the state old-age pension, also known as the older person's grant. This minimal monthly income is available to South African citizens or permanent refugees aged 60 years or older with a monthly income below a certain threshold level.

## **1.2 South African State Pension**

---

The South African state pension, known as the older person's grant, is aimed at providing for the fundamental requirements of men and women aged 60 years or older who meet specific criteria.

The criteria for eligibility include the following:

- Must be a South African citizen, permanent resident, or refugee.
- Must reside in South Africa.
- Must not receive any other social grant for themselves.
- Must not be cared for in a state institution.
- Must not earn more than R86,280 per year if single or R172,560 per year if married.
- Must not have assets exceeding R1,227,600 if single or R2,455,200 if married. The value of the pensioner's or spouse's home is not considered, as long as the pensioner resides in the house.

As of 2022, the benefit amount for individuals aged 60 to 74 is R1,980, while those older than 75 receive R2,000.

The South African Social Security Agency (SASSA) administers pension payments through various methods:

- Cash withdrawal at a designated pay point on a specific day.
- Electronic deposit into a bank or Postbank account (with possible service charges).
- Payments to institutions such as old age homes.

### **1.3 The Economic Impact of Inadequate Retirement Savings**

---

The inadequacy of the old age grant in meeting the rising cost of living places a significant burden on older persons. As the grant falls short of covering essential expenses, such as food, shelter, clothing, and medical needs, individuals often rely on the support of their families. Family members step in to provide financial assistance and ensure the well-being of their loved ones during their retirement years.

In addition to family support, friends also play a crucial role in assisting older persons when they face financial challenges. Whether it's helping with unexpected expenses or providing emotional support, friends lend a helping hand to ensure the comfort and security of their ageing peers.

Recognizing the collective responsibility towards older members of society, the community also plays an active role in supporting retirees. Community initiatives, such as food parcel distributions and basic homecare services, help address the gaps left by the insufficient old age grant. These efforts ensure that older persons have access to essential resources and services that contribute to their overall well-being.

However, it is important to consider the wider economic implications of inadequate retirement savings. When individuals lack sufficient funds to support themselves during retirement, the burden often falls on their families and communities to provide financial assistance. This can strain their resources and impact their own financial stability.

Moreover, the significance of individual savings extends beyond personal welfare. Retirement funds, fueled by monthly contributions, serve as a vital source of capital for sustainable investments. These funds are channeled into shares and other investment products, stimulating business growth and contributing to the overall economy. By bolstering capital investments, retirement funds play a critical role in job creation, economic development, and long-term financial stability.

Therefore, it is crucial to address the issue of insufficient retirement savings and explore ways to enhance financial planning and awareness among individuals. By encouraging and facilitating saving for retirement, we can alleviate the strain on families and communities while fostering a more resilient and prosperous society as a whole.

#### 1.4 Retirement Reform Landscape In South Africa

---

Retirement reform refers to the process of making changes and improvements to retirement systems and policies with the aim of enhancing the retirement outcomes and financial security of individuals. These reforms are typically driven by the evolving needs of the population, economic considerations, and social objectives.

In South Africa, the retirement reform landscape has seen significant developments in recent years. The government has introduced various reforms to address the challenges faced by individuals in saving for retirement and to ensure a more sustainable and equitable retirement system. Some key aspects of the current retirement reform landscape in South Africa include:

- **Compulsory Preservation:** To promote long-term savings and discourage premature withdrawals, the government has implemented measures that require individuals to preserve their retirement savings until retirement or under certain specified conditions. This helps to ensure that individuals have sufficient funds to support themselves during retirement.

- **Default Retirement Savings:** The introduction of default retirement savings, also known as auto-enrollment, aims to increase retirement savings coverage by automatically enrolling eligible employees into retirement funds. This approach encourages individuals to save for retirement by making it easier for them to participate in retirement savings schemes.
- **Preservation and Portability:** The reform landscape also emphasizes the importance of preserving and transferring retirement savings when individuals change jobs. Measures have been introduced to facilitate the preservation and portability of retirement savings, enabling individuals to consolidate their savings and avoid erosion of their retirement funds through multiple accounts.
- **Harmonization of Retirement Fund Taxation:** The government has sought to harmonize the tax treatment of different retirement funds, such as pension funds, provident funds, and retirement annuities. This aims to create a more equitable and consistent tax framework, ensuring that individuals are treated fairly regardless of the type of retirement fund they contribute to.
- **Retirement Reforms for Informal Sector Workers:** Recognizing the challenges faced by informal sector workers in saving for retirement, efforts have been made to explore and implement retirement solutions tailored to their needs. This includes the introduction of simplified and accessible retirement products suitable for individuals in the informal sector.

These are some of the key aspects shaping the current retirement reform landscape in South Africa. It is important for individuals to stay informed about these reforms and understand how they may impact their retirement planning and financial well-being. Consulting with financial advisors and staying updated on legislative changes can help individuals navigate the evolving retirement landscape and make informed decisions regarding their retirement savings.



## 1.5 Comprehensive Retirement Planning

---

Retirement planning plays a crucial role in determining the desired income goals for retirement and taking the necessary actions and decisions to achieve those goals. A well-rounded retirement plan encompasses various factors, including time horizons, expense estimations, after-tax income calculations, risk assessment, and estate planning.

To assess whether the retirement income goal will be met, future cash flows are estimated, taking into account factors such as savings, investments, and potential sources of income. Starting retirement planning early is essential to leverage the power of compounding and maximize savings growth over time.

When making provisions for retirement, individuals must carefully consider three significant risks:

- **Investment Risk:** This risk pertains to the potential that investment returns earned on retirement savings may not be sufficient to provide a reasonable income throughout retirement. The level of investment risk depends on the chosen asset class and the duration of investment before funds are required (i.e., the investment horizon).
- **Inflation Risk:** Inflation risk refers to the erosion of purchasing power caused by the rising prices of goods and services over time. Predicting the course of inflation can be challenging, as it can fluctuate significantly. It is important to ensure that investment returns or a significant portion of the investment are aligned with inflation to maintain the desired standard of living.
- **Mortality Risk:** Mortality risk entails the possibility of individuals or their dependents living longer than anticipated, resulting in a shortfall in retirement funds. Many individuals tend to underestimate their life expectancy once they retire, making it crucial to plan for a longer retirement period and ensure that the pension is sufficient.

Creating a comprehensive retirement plan requires striking a balance between realistic return expectations and maintaining the desired standard of living. The subsequent sections will explore the different stages of retirement planning, taking into account these considerations.

### **1.5.1 Determining Time Horizon**

Understanding the time horizon until retirement and the duration of funds needed to last during retirement is a crucial aspect of retirement planning. This includes assessing how long you have to save before retirement and estimating how long your retirement funds will be required to sustain your lifestyle.

### **1.5.2 Determining Expenses**

During retirement, it is common for expenses to decrease compared to those of a working adult. This is primarily because pensioners no longer have certain financial responsibilities or obligations that are typically associated with raising children or maintaining a career. As a result, their living standards tend to be 70% to 80% lower than that of a working adult.

Although retirement expenses are generally lower, pensioners still need to allocate funds for their basic needs. This includes covering costs for accommodation, food, clothing, medical expenses, and transportation. While these expenses are essential, they often require less financial coverage than during a person's working years.

Several factors contribute to the decrease in retirement expenses. First, pensioners may experience financial independence from their children, as their kids have likely grown up and become financially self-sufficient. This reduces the financial burden of supporting dependents.

Additionally, individuals over the age of 65 may benefit from reduced taxes, which can help stretch their retirement income further. The tax advantages available to senior citizens can provide some relief and contribute to lower overall expenses.

Furthermore, retired individuals typically experience reduced commuting costs since they no longer have to travel to work on a daily basis. This can result in significant savings in terms of fuel expenses, public transportation fees, and wear and tear on vehicles.

Another factor that can lead to lower retirement expenses is the possibility of owning a fully paid-off house. By the time a person retires, they may have completed their mortgage payments, eliminating the need to allocate a portion of their income towards housing costs. This can free up additional funds for other retirement expenses.

However, it is important to acknowledge that retirement expenses are not solely determined by these factors. Unforeseen medical expenses, changes in personal circumstances, and individual choices can significantly impact retirement spending. It is crucial for individuals to consider these variables and plan accordingly to ensure their financial well-being during retirement.

### **1.5.3 After-Tax Rate of Investment Returns**

Retirement planning involves a critical step of assessing the feasibility of a retirement portfolio to generate the required income. One essential aspect of this assessment is calculating the after-tax real rate of return on investments.

Retirement funds, such as RAs or employer-sponsored plans, often involve taxes on investment returns. Relying solely on gross return figures can be misleading when determining the actual income available during retirement. Hence, calculating the after-tax return provides a more accurate representation of the funds individuals can expect to receive.

To calculate the after-tax real rate of return, considering the tax status upon withdrawing funds from retirement accounts is crucial. Different types of accounts have varying tax implications.

By factoring in the tax obligations at the time of withdrawal, individuals gain a clearer understanding of the net income their retirement portfolio will generate. This information plays a vital role in evaluating whether their investments will sufficiently cover retirement expenses and financial goals.

Furthermore, understanding tax status during retirement enables effective tax planning. By strategically managing withdrawals, considering tax brackets, and exploring potential deductions, individuals can optimize their retirement income while minimizing tax liabilities.

Seeking guidance from a financial advisor or tax professional with expertise in retirement planning is strongly recommended when calculating the after-tax real rate of return. These professionals possess the knowledge to navigate complex tax laws, adapt to changing regulations, and provide personalized guidance based on individuals' specific circumstances.

Incorporating the after-tax real rate of return into a retirement plan ensures its alignment with financial goals and aspirations. This approach empowers individuals to make informed decisions regarding investment strategies, asset allocation, and withdrawal plans, ultimately enhancing the overall security and stability of their retirement.

#### **1.5.4 Access Risk Tolerance Versus Investment Goals**

It is crucial for a retirement plan to align with an individual's risk tolerance and investment goals. One of the key factors to consider is the time horizon until retirement.

Longer time horizons provide individuals with the opportunity to tolerate higher levels of investment risk. This is because they have more time to recover from any potential market downturns and benefit from the long-term growth potential of higher-risk investments, such as stocks. Younger individuals who have many years until retirement may choose to allocate a larger portion of their portfolio to these riskier assets in pursuit of higher returns.

On the other hand, as individuals approach retirement age, they tend to become more risk-averse. This is because they have less time to recover from any potential market losses and have a greater need to preserve their accumulated wealth. Older individuals may opt for less risky investments, such as bonds, which offer more stable returns and lower volatility.

Balancing risk and investment goals is crucial in determining the appropriate portfolio allocation for retirement planning. It involves finding the right mix of asset classes that align with an individual's risk tolerance, time horizon, and financial objectives. This process requires careful consideration of the potential risks and rewards associated with different investment options.

It is advisable for individuals to seek guidance from financial advisors or investment professionals who can assess their risk tolerance, discuss their investment goals, and recommend a suitable portfolio allocation strategy. By aligning risk tolerance and investment goals, individuals can construct a well-diversified portfolio that aims to optimize returns while managing risk effectively throughout their retirement journey.

### **1.5.5 Stay On Top of Estate Planning**

Estate planning holds a crucial position within a comprehensive retirement plan. It encompasses various elements aimed at protecting and distributing assets according to an individual's wishes, while also addressing potential tax implications.

One essential component of estate planning is life insurance. Life insurance serves as a financial safety net, providing a payout to beneficiaries upon the policyholder's death. This ensures that loved ones are shielded from potential financial hardships and can maintain their standard of living even in the absence of the policyholder's income or assets. Life insurance can also be utilized as an estate planning tool to cover any outstanding debts, estate taxes, or funeral expenses, preventing these financial burdens from falling on family members.

Proper estate planning can help streamline the distribution of assets and minimize legal complexities. By establishing a well-structured estate plan, individuals can specify how their assets should be distributed among heirs, charities, or other beneficiaries. This allows for a smooth transition of wealth and minimizes the likelihood of disputes or conflicts among family members.

An important consideration in estate planning is the avoidance of probate. Probate is a legal process that involves validating and administering the assets of a deceased individual. It can be time-consuming, costly, and may lead to a loss of privacy. Through strategic estate planning, individuals can employ various techniques to bypass or minimize the probate process, ensuring a more efficient transfer of assets to their intended beneficiaries.

Tax planning is another critical aspect of estate planning. When leaving assets to family members or charities, it is important to consider the potential tax implications associated with gifting or transferring those assets. By working with tax professionals or estate planning experts, individuals can develop strategies to mitigate estate taxes and maximize the value of their assets for their intended recipients.

In summary, estate planning is an integral part of a comprehensive retirement plan. It involves utilizing life insurance to protect loved ones, establishing a clear distribution plan for assets, and considering tax implications. By incorporating these elements into their retirement plan, individuals can ensure the smooth transfer of wealth, minimize legal complexities, and provide financial security for their beneficiaries.

## **1.6 Retirement Planning for Different Life Stages**

---

Retirement planning is a lifelong endeavor that requires individuals to adapt their strategies and priorities as they progress through various life stages. By understanding the distinct considerations and challenges at each phase, individuals can develop a comprehensive retirement plan that aligns with their financial goals and aspirations. This section explores the attitude towards retirement planning and key factors to consider during different life stages.

### **1.6.1 Retirement Planning For 20- to 30-Year-Olds**

During the 20s and 30s, individuals are often focused on building their careers and establishing a strong financial foundation. Accommodation, transportation, and indulging in life experiences tend to be the primary financial priorities. Retirement, being a distant prospect, may not be given much consideration.

However, it is crucial for individuals in this age group to develop a saving habit early on. By allocating a portion of their income towards retirement savings, even if it is a modest amount, they can benefit from the power of compounding over time. This is an opportune period to harness the potential of long-term investments and take advantage of the extended time horizon to accumulate wealth. Educating oneself about the concept of compound interest and the advantages of starting early can help establish a solid financial foundation for the future.

### **1.6.2 Retirement Planning For 40- to 50-Year-Olds**

In the 40s and 50s, individuals usually experience a shift in priorities as they become more established in their careers and family lives. During this phase, it is important to delve deeper into financial planning and consider specific retirement needs. Building an emergency fund, securing adequate health insurance, and addressing outstanding debts become crucial steps.

Although this age group may have higher earning potential, it is important to exercise discipline and adhere to the retirement plan. The temptation to increase spending as income rises should be carefully managed to ensure that retirement savings remain on track. Seeking guidance from a financial advisor to develop a detailed retirement plan that aligns with one's goals and desired lifestyle changes is highly recommended. By paying attention to the finer details and addressing any potential shortfalls, individuals can make adjustments that will significantly impact their future retirement outcomes. The one positive is that there is still time to make adjustments that can make a big difference in future outcomes.

### **1.6.3 Retirement Planning For 50 to Retirement**

As individuals approach retirement, it becomes vital to evaluate their preparedness and ensure the availability of sufficient capital to support their desired lifestyle. This stage often brings a heightened awareness of the limited number of paychecks remaining, prompting individuals to make more intentional financial choices. Expenses such as mortgages and educational costs for children may decrease, freeing up resources for increased savings or discretionary spending if retirement goals are on track.

Avoiding a retirement shortfall becomes a primary concern during this period. If individuals realize that they are not on track to retire comfortably, they may need to make significant adjustments. This could involve reducing expenses, postponing retirement, or exploring opportunities for post-retirement employment. It is essential, however, to be cautious and avoid taking unnecessary investment risks that could jeopardize the retirement plan.

For those who have diligently planned and are on track, it is advisable to maintain a cautious approach. Settling debts and working closely with a financial planner to evaluate and mitigate risks are critical steps during the years leading up to retirement. Making prudent decisions regarding asset allocation and investment strategies will help ensure a secure and fulfilling retirement.

#### **1.6.4 Conclusion**

Retirement planning is an ongoing process that evolves with each life stage. By prioritizing retirement savings from an early age, individuals can harness the power of compounding and set a strong financial foundation. As individuals progress through their careers, their financial priorities and considerations change, necessitating adjustments to the retirement plan. By seeking professional guidance, individuals can develop tailored strategies that align with their goals and ensure a secure and enjoyable retirement.

## **1.7 Comparing Basic Needs: Perspectives of a Pensioner and a Working Adult**

---

### **1.7.1 Introduction**

Understanding the differences in basic needs between pensioners and working adults is crucial for addressing the unique challenges faced by each group. This section presents the insights gained from interviews with a pensioner and a working adult of similar age, highlighting their perspectives on basic needs and shedding light on the contrasting experiences and priorities in their respective life stages.



### **1.7.2 Interview with the Pensioner**

The pensioner interviewed is John, aged 65, who has been retired for five years. The interview aimed to explore his perspective on basic needs and how they have evolved during his retirement years.

#### **i) Financial Stability**

John emphasized the importance of having a steady and reliable income to cover basic needs, such as housing, food, utilities, and healthcare.

He highlighted the significance of budgeting and living within his means to ensure financial stability.

#### **ii) Healthcare**

John expressed the need for comprehensive healthcare coverage, including insurance and access to quality medical services.

He discussed the challenges of increasing healthcare costs and the importance of having sufficient funds to cover medical expenses.

#### **iii) Social Connections**

John discussed the value of social interactions and maintaining a strong support network during retirement.

He emphasized the importance of participating in community activities and staying connected with friends and family to address social and emotional needs.

### **1.7.3 Interview with the Working Adult**

The working adult interviewed is Sarah, also aged 65, who is currently employed. The interview aimed to gain insights into her perspective on basic needs as a working individual nearing retirement age.

### **i) Financial Security**

Sarah highlighted the significance of financial security, including saving for retirement and building a nest egg to ensure a comfortable future.

She discussed the importance of earning a stable income to meet basic needs, as well as future aspirations and unexpected expenses.

### **ii) Work-Life Balance**

Sarah stressed the importance of maintaining a healthy work-life balance, ensuring adequate time for personal interests, family, and leisure activities.

She expressed the need for flexible work arrangements and opportunities for personal growth and development.

### **iii) Future Planning**

Sarah discussed her focus on long-term financial planning, including investments and retirement savings.

She emphasized the importance of planning for healthcare costs, housing, and other potential needs during retirement.

## **1.7.4 Comparing Perspectives:**

By comparing the perspectives of John, the pensioner, and Sarah, the working adult, several key differences and similarities in their basic needs become apparent.

- **Income Stability:** While both individuals emphasized the importance of financial stability, John's focus was on managing a fixed retirement income, whereas Sarah emphasized the need for continued income generation.
- **Healthcare Considerations:** Both individuals highlighted the significance of healthcare coverage and the challenges associated with rising healthcare costs.

- **Work-Life Balance vs. Leisure Time:** Sarah emphasized the importance of work-life balance and maintaining personal interests, while John emphasized the value of social connections and community engagement during retirement.

### **1.7.5 Conclusion**

Understanding the contrasting perspectives on basic needs between pensioners and working adults of similar age is essential for addressing the distinct challenges faced by each group. The insights gained from the interviews with John, the pensioner, and Sarah, the working adult, provide valuable perspectives on financial stability, healthcare considerations, social connections, work-life balance, and future planning. By recognizing these differences, policymakers, employers, and individuals can tailor support and strategies to meet the unique needs of each group, ensuring a fulfilling and financially secure life during retirement and beyond.

## **1.8 Factors Influencing Retirement Income**

---

### **1.8.1 Introduction**

Planning for retirement income goes beyond simply saving money. It involves considering various factors that can significantly impact the amount of income available during retirement. Failure to account for these factors, such as investment risk, inflation risk, long-term care expenses, and taxes, can undermine one's envisioned retirement lifestyle. In this section, we explore the implications of these factors on retirement income planning, providing insights and strategies to mitigate their potential effects. By understanding the risks associated with investments, the impact of inflation on purchasing power, the significance of long-term care expenses, and the role of taxes, individuals can make informed decisions and safeguard their financial well-being throughout their retirement years.

## **1.8.2 Investment Risk**

Retirement income planning requires a deep understanding of the risks associated with different types of investments and how they can impact an individual's available income during retirement. This section focuses on two significant investment risks: market risk and reinvestment risk.

### **i) Market Risk**

Market risk refers to the potential fluctuations in the securities market that can lead to a reduction or depletion of the value of retirement savings. When individuals need to withdraw funds from their investments to supplement their retirement income, two crucial factors determine how long their investments will last: the withdrawal amount and the growth or earnings of the investments. Typically, individuals anticipate a certain rate of return on their investments, assuming that market fluctuations will average out over time. They estimate the duration their savings will last based on this anticipated average rate of return.

However, it's important to recognize that the market doesn't always generate positive returns. Extended periods of negative market returns can occur, lasting for several years or more. During these downturns, constant withdrawals from savings combined with prolonged negative market performance can deplete retirement savings far more quickly than initially planned.

### **ii) Reinvestment Risk**

Reinvestment risk involves the risk that proceeds available for reinvestment must be reinvested at a lower interest rate compared to the rate of the original investment that generated those proceeds. This may require individuals to reinvest at a lower rate of return or assume additional risk to achieve the same level of return. Reinvestment risk is often associated with fixed-interest savings instruments such as bonds.

When a fixed-interest investment matures, individuals face the challenge of finding comparable instruments that offer similar or better returns. However, there is no guarantee that these options will be available at the desired rate, which can affect the overall income generated from reinvested funds. Consequently, individuals must carefully evaluate reinvestment opportunities and consider potential trade-offs between risk and return.

### iii) Conclusion

Understanding these investment risks is crucial for effective retirement income planning. By comprehending the potential impacts of market fluctuations and reinvestment challenges, individuals can make informed decisions about their investment portfolio composition and develop strategies to mitigate these risks. By adopting a proactive approach and adapting their investment strategies as market conditions change, individuals can strive for greater financial security and sustainability throughout their retirement years.

### 1.8.3 Inflation Risk

Inflation poses a significant risk to retirement income as it erodes the purchasing power of money over time due to the increasing cost of goods and services. This section delves into the concept of inflation risk and its implications for individuals planning their retirement finances.

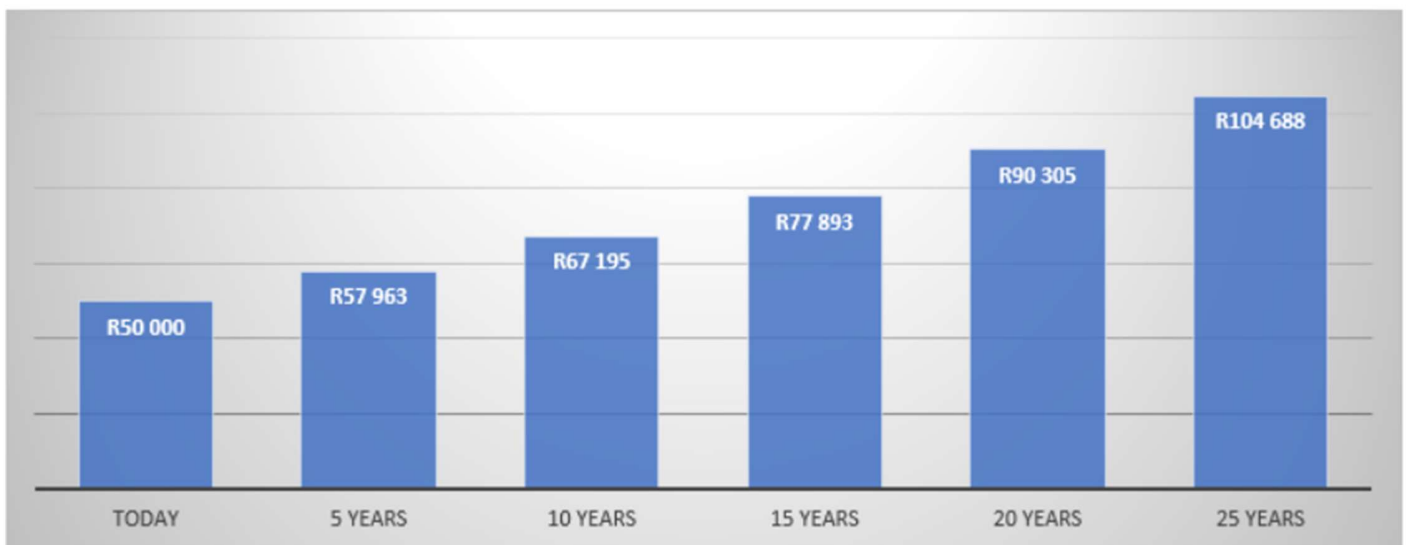
To comprehend the potential effects of inflation, it is crucial to consider its long-term average. Historically, inflation has hovered around 3%. At this rate, the purchasing power of a given sum of money is halved in approximately 23 years. However, if inflation escalates to 4%, the purchasing power would be halved in just 18 years.

To illustrate the influence of inflation on retirement income, let us consider a simple example. Assuming a consistent annual inflation rate of 3% (excluding taxes and investment returns), if an individual's retirement income requirement is currently met with R50,000, they would need R51,500 next year to maintain the same standard of living. Over a span of 10 years, the individual would require approximately R67,195 to retain the equivalent purchasing power of R50,000.

This example underscores the importance of developing strategies that enable one's income stream to grow throughout retirement in order to outpace inflation. Failing to address inflation risk could result in a significant decline in purchasing power over time, jeopardizing an individual's financial security and lifestyle.

Please note that the following hypothetical example is solely intended for illustrative purposes and assumes a 3% annual inflation rate, without considering fees, expenses, and taxes. It does not reflect the performance of any specific investment.

*Figure 1: Equivalent Purchasing Power of R50,000 at 3% Inflation*



#### **1.8.4 Long-term Care Expenses**

As individuals age, the likelihood of requiring long-term care increases. Long-term care refers to the assistance and support needed when physical or mental disabilities hinder an individual's ability to perform daily activities independently. With the rising life expectancies, it becomes crucial to consider the potential need for long-term care in retirement planning.

Paying for long-term care can have a significant financial impact on an individual's retirement income and savings, particularly for the healthy spouse. While not everyone will require long-term care during their lifetime, disregarding the possibility and failing to plan for it can leave individuals or their spouses with limited or depleted income and savings if such care becomes necessary. It is essential to acknowledge the potential costs associated with long-term care and incorporate them into retirement income planning.

One option to mitigate the financial burden of long-term care is purchasing long-term disability insurance. This type of insurance provides coverage for extended periods when an individual is unable to perform basic tasks due to disabilities. However, it is crucial to factor in the premium costs of long-term disability insurance when determining retirement income needs.

By considering the potential need for long-term care and incorporating it into retirement planning, individuals can better prepare themselves financially and ensure that they have adequate resources to cover these expenses if they arise. It is important to consult with financial advisors and explore various insurance options to make informed decisions regarding long-term care and its potential impact on retirement income and savings.

### **1.8.5 The Costs of Catastrophic Care**

As individuals plan for retirement, it is crucial to consider the potential impact of catastrophic healthcare costs. With increasing healthcare expenses and potential coverage gaps, understanding and preparing for these costs is becoming more important than ever. This section explores the costs associated with catastrophic care in retirement and emphasizes the need to factor in medical aid fees, gap cover fees, and additional health-related expenses when determining retirement income needs.

When planning for retirement, individuals must account for the costs of medical aid and gap cover. Medical aid fees cover essential healthcare services, and the premiums for this coverage can significantly impact retirement finances. Additionally, gap cover is designed to supplement medical aid by covering the difference between medical aid payouts and the actual cost of healthcare procedures. Including these fees in retirement income needs is essential to ensure adequate coverage for medical expenses.

Apart from medical aid and gap cover fees, individuals must also consider potential health-related expenses that may not be covered by their medical aid. These expenses may include specialized treatments, medications, therapies, or medical equipment not fully covered by insurance. It is important to factor in these additional costs to avoid unexpected financial burdens during retirement.

To effectively plan for catastrophic care costs in retirement, individuals should engage in proactive financial planning. This involves assessing potential healthcare needs, estimating the associated expenses, and incorporating them into the overall retirement income projection. Consulting with financial advisors, considering supplemental health insurance options, and exploring healthcare savings accounts are some strategies to help individuals prepare for unforeseen medical costs.

As healthcare costs continue to rise, preparing for catastrophic care expenses becomes an integral part of retirement planning. Understanding the impact of medical aid and gap cover fees, as well as accounting for additional health-related expenses, ensures that individuals have a comprehensive approach to managing healthcare costs in retirement. By incorporating these factors into their retirement income needs, individuals can safeguard their financial well-being and mitigate the potential financial strain associated with catastrophic care.

### **1.8.6 The Impact of Taxes on Retirement Savings and Income**

In the realm of retirement income planning, the effect of taxes on savings and income is a critical yet frequently overlooked aspect. Taxes have the potential to substantially diminish an individual's income, significantly impacting the amount available for spending during retirement. This section explores the significance of taxes in retirement planning and emphasizes the importance of understanding how investment income is taxed to accurately project overall income.

Taxes play a significant role in determining the net income available to retirees. Different sources of retirement income, such as pensions, annuities, and investment returns, may be subject to varying tax rules and rates. Failure to consider these tax implications can result in inaccurate income projections and potential financial strain during retirement.



One crucial area where taxes can significantly affect retirement income is the taxation of investment returns. Individuals should have a clear understanding of how their investments generate income and how that income is taxed. This knowledge allows them to accurately assess the tax impact on their overall retirement income.

To effectively plan for the tax implications on retirement savings and income, individuals should engage in proactive tax planning. This involves consulting with tax advisors or financial professionals who specialize in retirement planning. By leveraging strategies such as tax-efficient investment vehicles, maximizing tax-advantaged accounts, and optimizing withdrawal strategies, individuals can minimize the tax burden on their retirement income.

When projecting retirement income needs, it is crucial to account for the impact of taxes. By incorporating the estimated tax liabilities into income projections, individuals can obtain a realistic understanding of the income available for their retirement expenses. This enables more informed decision-making and helps individuals avoid potential financial shortfalls due to unforeseen tax obligations.

The impact of taxes on retirement savings and income is an often-underestimated aspect of retirement planning. Neglecting to consider the tax implications of various income sources can significantly reduce the amount available for retirees to spend during their golden years. By understanding how investment income is taxed and incorporating tax planning into the overall retirement income strategy, individuals can optimize their retirement savings and ensure a more secure financial future.

## 1.9 The Power of Compound Interest in Growing Retirement Savings

---

### 1.9.1 Introduction

In the world of investing, the power of compound interest is often hailed as a game-changer for long-term financial planning. Unlike simple interest, which only calculates returns based on the initial investment, compound interest considers both the principal amount and the accumulated interest, leading to exponential growth over time. This section explores the significance of compound interest in retirement planning and emphasizes the importance of starting early to maximize its benefits.

### 1.9.2 Understanding Simple Interest

Simple interest refers to the interest earned on an investment without reinvesting the earnings. The calculation of simple interest involves multiplying the present value by the interest rate and the time period. For instance, an R1,000 investment with an interest rate of 14% per annum would earn R140 interest over one year. The future value of the investment can also be determined by adding the interest earned to the principal amount at maturity.

$$\text{Interest} = \text{Present Value} \times \text{Interest Rate} \times \text{Time}$$

$$\text{Future Value} = \text{Present Value} (1 + \text{Interest Rate} \times \text{Time})$$

$$\text{Present Value} = \text{Future Value} / (1 + \text{Interest Rate} \times \text{Time})$$

### 1.9.3 Exploring Compound Interest

Unlike simple interest, compound interest factors in the reinvestment of earnings. It involves adding the interest earned in each period to the principal amount and calculating subsequent interest based on the new total. The future value formula for compound interest incorporates compounding periods, such as annually, semi-annually, quarterly, or monthly. By reinvesting earnings and leveraging the compounding effect, retirement savings can experience substantial growth over time.

$$\text{Future Value} = \text{Present Value} (1 + \text{Interest Rate})^{\text{time} \times \text{compounding}}$$

$$\text{Present Value} = \frac{\text{Future Value}}{(1 + \text{Interest Rate})^{\text{Time} \times \text{Compounding}}}$$

Compounding period is determined as follows:

- Annually (NACA) = 1
- Semi-annually (NACS) = 2
- Quarterly (NACQ) = 4
- Monthly (NACM) = 12

For example, R2 000 invested at 15% p.a. for 3 years will have one of the following future values depending on whether interest is paid:

Annually:  $R3\ 041.76 = R2\ 000 \times (1 + 0.15)^3$

Semi-annually:  $R3\ 086.80 = R2\ 000 \times \left(1 + \frac{0.15}{2}\right)^{3 \times 2}$

Quarterly:  $R3\ 110.91 = R2\ 000 \times \left(1 + \frac{0.15}{4}\right)^{3 \times 4}$

Monthly:  $R3\ 127.89 = R2\ 000 \times \left(1 + \frac{0.15}{12}\right)^{3 \times 12}$

#### **1.9.4 Implications for Retirement Planning**

The power of compound interest becomes especially relevant in retirement planning. By starting early and consistently contributing to retirement savings, individuals can harness the compounding effect to build a substantial nest egg. The longer the time horizon, the greater the potential returns. Therefore, it is crucial to prioritize retirement savings as early as possible to take full advantage of compound interest.

Let's consider an example to illustrate the growth potential of compound interest in retirement savings. Suppose Sarah starts investing R10,000 per year in a retirement account at the age of 25. She plans to retire at the age of 65, giving her a 40-year investment horizon. Assuming an average annual return of 8% and compounding annually, let's see how her retirement savings grow.

After 40 years of consistent annual investments and compounding interest, Sarah's retirement account would grow to approximately R1,457,864. This substantial growth is primarily due to the compounding effect, where each year's investment generates returns that are reinvested and contribute to the overall growth of the account.

This example highlights the remarkable potential of compound interest in retirement planning. By starting early, making regular contributions, and allowing the power of compounding to work its magic, individuals can significantly increase their retirement savings and ensure a financially secure future.

#### **1.9.5 Conclusion**

Compound interest is a powerful tool in retirement planning that allows individuals to maximize their savings and achieve long-term financial goals. By understanding the difference between simple and compound interest, individuals can appreciate the exponential growth potential of their investments over time. Starting early, staying consistent, and leveraging the compounding effect are key strategies for building a robust retirement portfolio. By harnessing the power of compound interest, individuals can pave the way for a secure and prosperous retirement.

## 1.10 Evaluation the Adequacy of Pension Provision for Pensioners

---

### 1.10.1 Introduction

Assessing the adequacy of pension provision is crucial for individuals who have been pensioners for five years or longer. This section explores the situations of three pensioners, compares their pension provisions, and determines whether their retirement income is sufficient to meet their financial needs.

### 1.10.2 Case Study 1: John

John has been a pensioner for over five years. His pension provision consists of a defined benefit plan, where his monthly retirement income is determined based on his salary and years of service. To evaluate the adequacy of John's pension provision, the following factors should be considered:

- **Monthly Pension Income:** Analyze the amount of monthly income John receives from his pension. Compare this income against his pre-retirement earnings and current living expenses.
- **Inflation Adjustment:** Assess whether John's pension includes an automatic inflation adjustment to maintain the purchasing power of his income over time. Evaluate the effectiveness of the adjustment in keeping up with the rising cost of living.
- **Healthcare and Other Benefits:** Consider any additional benefits provided by John's pension plan, such as healthcare coverage or spousal benefits. Determine whether these benefits adequately address his healthcare and other essential needs.

### 1.10.3 Case Study 2: Mary

Mary, another long-term pensioner, has a pension provision through a defined contribution plan. Her retirement income depends on her contributions and investment returns. To evaluate the adequacy of Mary's pension provision, the following factors should be considered:

- **Retirement Account Balance:** Review the current balance of Mary's retirement account. Assess whether the accumulated savings are sufficient to sustain her desired lifestyle during retirement.
- **Investment Performance:** Analyze the performance of Mary's investment portfolio within her retirement account. Evaluate whether the returns have been satisfactory in generating a consistent income stream.
- **Withdrawal Strategy:** Consider Mary's withdrawal strategy from her retirement account. Assess whether the withdrawal rate aligns with sustainable income needs throughout her retirement years.

#### 1.10.4 Case Study 3: Robert

Robert is a long-term pensioner with a combination of a company pension and personal savings. To evaluate the adequacy of Robert's pension provision, the following factors should be considered:

- **Total Retirement Income:** Determine the combined income from Robert's company pension and personal savings. Compare this income against his estimated retirement expenses and financial goals.
- **Longevity Risk:** Assess whether Robert's retirement income will be sustainable over an extended period, considering his life expectancy and potential healthcare costs.
- **Estate Planning:** Consider Robert's estate planning efforts and any provisions for leaving a legacy or providing for dependents.

### **1.10.5 Decision on Adequacy**

Based on a comprehensive assessment of each pensioner's situation, a decision can be made regarding the adequacy of their pension provision. Factors such as income level, cost of living, inflation protection, healthcare coverage, investment performance, and individual goals should be taken into account. If a pensioner's retirement income is found to be insufficient, adjustments may be necessary, such as increasing savings, exploring additional investment opportunities, or considering part-time work during retirement.

### **1.10.6 Conclusion**

Evaluating the adequacy of pension provision for long-term pensioners requires a careful analysis of various factors specific to each individual's situation. By considering key aspects such as income levels, expenses, investment performance, and future financial goals, it becomes possible to determine whether the pension provision in each case is adequate. Regular reassessment and adjustment of retirement plans are essential to ensure a comfortable and financially secure retirement.

## Topic 2: Retirement Fund Options

### 2.1 Introduction

---

In the realm of financial planning and securing a stable future, the concept of a retirement fund holds paramount significance. A retirement fund serves as an autonomous, non-profit legal entity entrusted with the collection, investment, and administration of funds contributed by individuals and companies alike. The primary objective of such funds is to facilitate the financing of retirement plan benefits, ensuring a reliable source of income for individuals during their retirement years.

Within the realm of retirement funds, there exist three fundamental categories, each serving a unique purpose and catering to different segments of the population.

- Government Pension Schemes
- Personal Retirement Funds:
- Occupational Retirement Funds:

Retirement funds play a pivotal role in ensuring financial stability and peace of mind during the post-employment phase of an individual's life. Whether it is through government pension schemes, personal retirement funds, or occupational retirement funds, the aim remains the same: to create a sustainable and reliable income source that supports a fulfilling retirement journey. Understanding the different types of retirement funds empowers individuals to make informed decisions, allowing them to shape their financial future and enjoy the rewards of their hard work and dedication in their golden years.



## 2.2 Government Pension Schemes

---

Government pension schemes play a crucial role in providing financial support to elderly citizens during their retirement years. These schemes, commonly known as state pensions, are funded through tax revenues. In countries like South Africa, one prominent component of the government pension scheme is the social old age grant. This grant is designed to assist elderly individuals who do not have sufficient income from other sources to meet their basic needs and ensure a dignified standard of living.

In South Africa specifically, the social old age grant plays a vital role in supporting the elderly population. It serves as a lifeline for approximately 75% of elderly individuals in the country, who rely on this grant as their primary source of income. Given the economic and social challenges faced by many elderly citizens, the social old age grant plays a crucial role in mitigating poverty and providing a safety net to those who may otherwise struggle to meet their daily expenses and healthcare needs. By providing financial assistance, government pension schemes contribute to the overall well-being and quality of life for elderly citizens, ensuring that they can age with dignity and enjoy a measure of financial security in their later years.

## 2.3 Personal Retirement Fund

---

Personal retirement funds are an essential means for individuals to secure their financial future during retirement. These funds are voluntarily entered into by individuals who contribute to them through personal contributions. One popular option for personal retirement funds is the utilization of retirement annuities.

Retirement annuities are financial products offered by insurance companies to investors. An annuity represents a contractual agreement wherein a predetermined amount is paid annually for as long as the annuitant, the person on whose life the contract depends on is alive. There are two main types of annuities: immediate and deferred.

Immediate annuities involve the payment of a single premium, which results in the annuitant receiving annual payments starting immediately and continuing throughout their lifetime. Retired individuals often opt for immediate annuities to ensure a consistent income stream that is guaranteed to last for the rest of their lives. The income received from immediate annuities is influenced by prevailing interest rates and life expectancy factors.

On the other hand, deferred annuities provide for the commencement of annuity payments at a future date. The period between the contract date and the vesting date, when payments commence, is known as the deferred period. Regular premiums are paid during this deferred period. In the event of the annuitant's death during the deferred period, the insurance company returns the premiums paid. Once payments commence, they continue until the annuitant's passing.

Several types of annuities exist, including compulsorily purchased annuities (CPA) voluntarily purchased annuities (VPA), living annuities, and composite annuities. A CPA is mandated by law to be acquired with a portion of funds received from a matured retirement annuity or pension fund. It provides lifelong payments to the annuitant. A VPA, on the other hand, can be purchased by anyone seeking a guaranteed income and can be received either for life or for a fixed term, such as 10 years.

It is important to note that CPAs and VPAs have the disadvantage of income ceasing upon the annuitant's death unless additional insurance cover is obtained for the capital or a guarantee is placed on the annuity. Living annuities offer a different approach, as the annuitant's capital is invested in equities or bonds to achieve growth. Withdrawals of approximately 5% to 20% of the investment value are made annually, with the annuitant bearing the risk of potential capital losses due to market fluctuations. Upon the annuitant's death, the remaining investment balance is passed on to their heirs.

Composite annuities represent a combination of CPA/VPA annuities and living annuities. This type of annuity offers a flexible income option from the living annuity portion while providing a guaranteed income from the conventional annuity component.

By understanding the various types of personal retirement funds and annuities available, individuals can make informed decisions regarding their retirement planning, ensuring a financially secure future.

## 2.4 Occupational Retirement Funds

---

Occupational retirement funds, play a vital role in providing financial security for employees during their retirement years. These funds are established and administered by employers for the exclusive benefit of their employees. Contributions to occupational retirement funds are made by the employee, the employer, or a combination of both parties.

Several key role players are involved in the functioning of an occupational retirement fund. These include:

- **Sponsor:** The sponsor refers to the employer or a group of employers who establish and oversee the retirement fund on behalf of their employees. The sponsor plays a crucial role in ensuring the effective management and operation of the fund.
- **Beneficiaries:** The beneficiaries of a retirement fund are the employees who actively participate in the fund. They contribute to the fund and are entitled to receive retirement benefits based on the fund's provisions.
- **Fund Manager:** The fund manager is responsible for managing the assets held within the retirement fund. Their primary objective is to maximize investment returns while mitigating risk, ensuring the long-term sustainability and growth of the fund's assets.
- **Trustees:** Trustees are individuals appointed to govern and monitor the retirement fund on behalf of the beneficiaries. They act in the best interests of the participants, ensuring compliance with legal and regulatory requirements, and safeguarding the fund's assets.

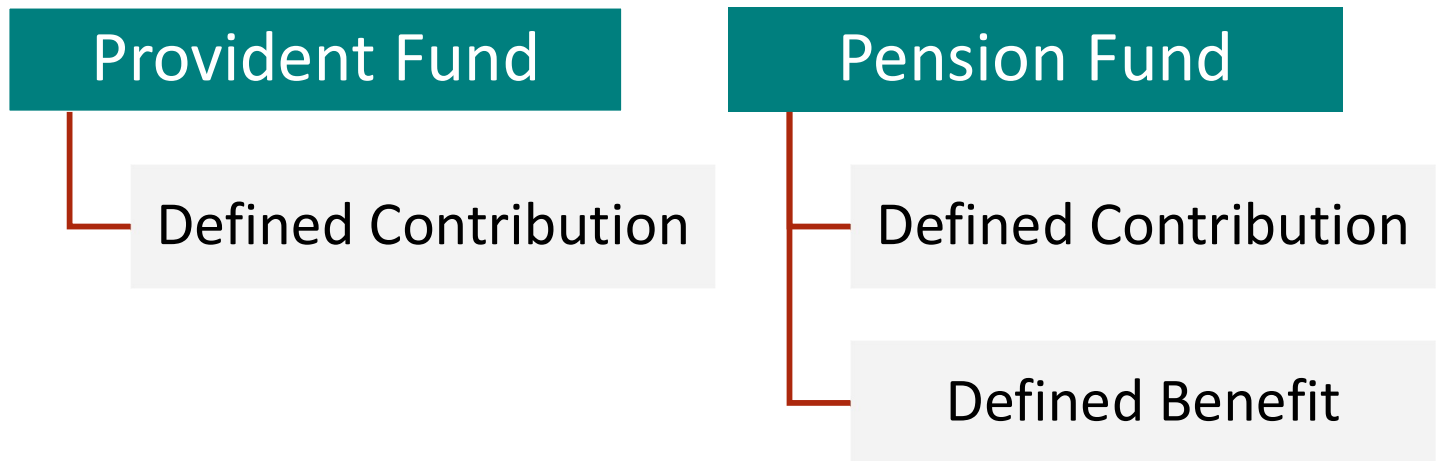
Occupational retirement funds are typically compulsory in nature. This means that if an individual is employed by a company that offers a pension fund, it is mandatory for the employee to participate in the fund. The employer's contribution to the pension fund reinforces the obligation for employees to have a pension fund, emphasizing the importance of retirement planning and financial security.

In South Africa, occupational retirement funds can be structured as either a pension fund or a provident fund. A pension fund, in turn, can be further categorized as a defined contribution fund or a defined benefit fund.

- **Defined Contribution Fund:** In a defined contribution fund, the retirement benefit is determined by the contributions made by the employee and/or employer, as well as the investment growth achieved within the fund. The final benefit is not predetermined, as it depends on the accumulated contributions and investment returns.
- **Defined Benefit Fund:** In a defined benefit fund, the retirement benefit is predetermined based on factors such as the employee's salary, years of service, and a formula specified in the fund's rules. The employer guarantees a specific retirement benefit, regardless of the investment performance or contributions made.

Understanding the structure of occupational retirement funds allows employees to make informed decisions about their participation and contribution levels. It ensures that they are well-prepared for retirement, with a clear understanding of the benefits and obligations associated with their chosen retirement fund.

Figure 2: Occupational retirement fund types



#### 2.4.1 Pension Funds

Pension funds play a vital role in providing individuals with a steady income during their retirement years, commonly referred to as an annuity. These funds are structured to ensure financial security for retired members. While a portion of the retirement benefit can be withdrawn as a lump sum, specific tax exemptions apply, and compulsory annuitization is required for balances exceeding R247,500.

Typically, the remaining balance of the retirement benefit is utilized to purchase a compulsory income, also known as an annuity, which provides the retiree with a reliable source of retirement income. In some cases, larger self-administered funds may handle the task of providing retirement income themselves instead of purchasing annuities. It is important to note that the income received from the annuity is subject to full taxation.

Pension funds can be classified into two main types: defined-contribution funds and defined-benefit funds. Many retirement funds have transitioned from defined benefit to defined contribution structures in recent years, driven by several reasons:

- **Member Understanding:** Defined contribution funds are generally easier for members to comprehend, as they have a clearer understanding of the benefits they will receive upon retirement.
- **Flexibility and Choices:** Defined contribution funds offer members a wider range of choices and greater flexibility in managing their retirement savings. Members have the opportunity to make decisions regarding investment options and contribution levels, aligning the fund with their individual needs and preferences.
- **Simplified Surplus Distribution:** Defined contribution funds reduce complexity when it comes to surplus distribution. Surplus funds are typically allocated directly to members based on their individual contributions and investment performance, eliminating intricate calculations and potential disputes.
- **Administrative Efficiency:** The administrative requirements for defined contribution funds are generally less burdensome compared to defined benefit funds. This streamlined administration process simplifies operations and reduces costs for both fund members and administrators.
- **Lower Financial Risks:** Sponsoring employers face reduced financial risks with defined contribution schemes. Unlike defined benefit funds, which carry the responsibility of guaranteeing specific retirement benefits, defined contribution funds shift the investment risk and responsibility to individual members. This lowers the financial burden on employers and allows for greater predictability in financial planning.

Understanding the structure and advantages of pension funds is crucial for individuals planning for retirement and employers providing retirement benefits. By offering flexibility, transparency, and reduced risks, pension funds contribute to the long-term financial well-being of retirees, empowering them to make informed decisions regarding their retirement savings and income.

## **i) Defined Benefit Pension Funds**

### **Benefits**

In a defined benefit fund, the retirement benefits to be paid to members are predetermined and defined in advance. These benefits are typically based on specific factors, including the member's salary prior to retirement, the duration of their membership in the fund, and an accrual factor. Additionally, most funds incorporate provisions for annual increases in pensions to preserve the real value of the benefits received by retired members. Since December 7, 2001, it has been mandatory for fund boards to aim for an increase based on a percentage of the consumer price index.

An example of a benefit formula within a defined benefit fund is outlined below:

Let's consider Company B's pension fund, which establishes a retirement contribution rate of 7.5% of earnings from the employer and 5% of earnings from the employee. Suppose a member earns a monthly salary of R10,000. Based on these contribution rates, the member's retirement contributions would be as follows:

- Employer's Contribution:  $7.5\% \text{ of } R10,000 = R750$
- Employee's Contribution:  $5\% \text{ of } R10,000 = R500$
- Total Towards Retirement:  $R750 + R500 = R1\ 250$

It is important to note that these contributions are allocated towards the member's retirement savings, which will ultimately determine the retirement benefits received upon reaching retirement age.

Defined benefit funds provide members with the advantage of having a predetermined retirement benefit based on factors such as salary, membership duration, and accrual factors. This structure offers members a level of financial security and predictability in planning for their retirement years.

Understanding the intricacies of defined benefit funds is crucial for individuals participating in such schemes. By comprehending the benefit formulas and contribution rates, members can make informed decisions regarding their retirement planning and ensure a stable financial future.

### **Contributions**

Defined benefit schemes operate on two main funding models: pay-as-you-go and funded schemes. These models determine how the funds required to pay retirement benefits are accumulated and disbursed. Understanding the distinctions between these models is crucial in comprehending the financial dynamics and risks associated with defined benefit schemes.

In a pay-as-you-go regime, the contributions made by currently employed members (known as active members) are utilized to finance the retirement benefits of members who have already retired. This approach is commonly observed in state-sponsored schemes across various European Union (EU) countries. However, a significant drawback of pay-as-you-go schemes arises when the proportion of retired members to active members increases over time. In such cases, active members bear a growing financial burden. This has prompted several countries to reduce benefits to maintain intergenerational fairness due to declining birth rates since the 1960s, resulting in a higher ratio of retired to active members.

Contrarily, funded schemes operate by channelling contributions from active members and employers into an investment fund specifically designated to provide future benefits for current active members. Unlike pay-as-you-go schemes, the primary purpose of current contributions in funded schemes is to accumulate assets to support future benefits, rather than paying immediate benefits to retired members. Funded schemes offer the advantage of securing accrued benefits for members, protecting them from potential insolvency risks of the employer.



In South Africa, employer-sponsored retirement funds predominantly operate on a funded basis. Employees contribute fixed amounts, typically a percentage of their salary, to the retirement fund. Employers, guided by the fund actuary, contribute additional amounts as deemed necessary to ensure the fund can meet future benefit obligations. The value of the fund's assets, invested in various instruments, is determined by the fund's actuarial valuation, which calculates the present value of the accrued liabilities of the retirement fund. Notably, the liabilities accumulate in a reasonably predictable manner, while asset values can fluctuate, especially if the fund holds shares as investments.

Consequently, employers bear the majority of the investment and other risks associated with defined benefit schemes. Unforeseen circumstances such as poor investment returns, substantial increases in liabilities (e.g., due to higher-than-expected disability claims), or financial hardships faced by the employer may require adjustments. This could involve requesting the board of trustees to curtail future benefits, closing the fund, or converting it to a defined contribution scheme instead of escalating contributions to ensure the fund and the sponsoring entity remain financially solvent. In light of this, members should monitor the financial health of the retirement fund and the employer, even though their benefits are clearly defined and guaranteed.

By recognizing the funding models and associated risks, members can better understand the dynamics of their defined benefit scheme. This knowledge empowers individuals to make informed decisions and actively engage in safeguarding their financial well-being within the retirement fund context.

### **Advantages And Disadvantages Of Defined Benefit Funds**

Defined benefit funds offer distinct advantages and disadvantages for both members or employees and employers. Understanding these factors is crucial in assessing the suitability and implications of participating in a defined benefit scheme.

#### Advantages for Members/Employees:

- **Guaranteed Benefits:** Defined benefit funds provide members with guaranteed retirement benefits, offering financial security during their retirement years.
- **Fixed Contributions:** Members contribute a fixed amount towards the fund, providing predictability and stability in their retirement savings.
- **Enhanced Benefits:** If the fund generates a surplus due to favorable investment performance or lower-than-expected claims, members may receive enhanced benefits beyond the initially guaranteed amounts.
- **Tailored Benefits:** Defined benefit funds can be structured to offer better benefits for early leavers or employees facing retrenchment, surpassing what is typically available in defined contribution funds.

#### Disadvantages for Members/Employees:

- **Limited Benefit Flexibility:** Compared to defined contribution funds, members usually have less flexibility in selecting their benefits, as they are predetermined by the fund.
- **Limited Investment Choice:** Members typically have no say in the selection of the fund's investment portfolio, relying on the expertise of the fund manager.
- **Employer's Financial Position:** There is a risk that the employer may be unable to increase its contributions when required, potentially leading to benefit cuts, even if investment conditions are favorable.
- **Complexity and Value Assessment:** Understanding the true value and intricacies of benefits can be more challenging in defined benefit funds compared to defined contribution schemes, making it harder for members to assess their benefits accurately.

### Advantages for Employers:

- **Attractiveness for Staff:** Employers can structure special executive packages within defined benefit funds, enhancing their ability to attract and retain top talent.
- **Cost Efficiency Potential:** Favorable investment returns or claims experience may make defined benefit schemes less costly for employers than defined contribution schemes.
- **Flexible Benefit Structuring:** Employers can design benefits to incentivize or discourage retirement, facilitating staff reduction efforts or encouraging employee retention.

### Disadvantages for Employers:

- **Uncertain Cost Projection:** Unknown costs per employee make it challenging for employers to budget accurately for contributions within defined benefit schemes.
- **Bearing the Majority of Risk:** Employers assume significant risk in providing benefits, including investment risks and potential economic weaknesses.
- **Increased Contribution Requirements:** Low investment returns often coincide with economic downturns, placing additional pressure on employers to increase contributions, exacerbating the risk.
- **Limited Surplus Utilization:** Employers may not benefit from accrued surpluses if there is external pressure to increase benefits based on surplus amounts.
- **Higher Administration Costs:** The complex nature of defined benefit schemes can lead to higher administration costs compared to defined contribution schemes.
- **Limited Appreciation of Benefits:** The complexity of benefits may result in members not fully understanding or appreciating their value, reducing the fund's effectiveness in staff retention and recruitment efforts.

Understanding the advantages and disadvantages of defined benefit funds is vital for individuals considering participation in such schemes and employers contemplating the implementation of retirement benefit programs. It enables informed decision-making and effective management of retirement savings for both parties involved.

*Table 1: Comparison of features between defined benefit and defined contribution funds*

	<b>Defined Benefit</b>	<b>Defined Contribution</b>
<b>Member Contribution</b>	A fixed percentage of salary.	
<b>Employer Contribution</b>	The amount necessary to provide for the fixed benefit.	A fixed percentage of salary.
<b>Retirement Benefit</b>	Fixed benefit as specified in the fund rules.	All the contributions plus the net investment return minus the cost of risk benefits and administration.
<b>Determination of Benefit</b>	Formula based upon final salary and accrual factor.	The regular pension amount is determined by the product purchased.
<b>Other Benefits</b>	Usually based on formulas and risk, either carried by the fund or reinsured with an insurer	Usually, a percentage or multiple of salary and almost always reinsured with an insurer.

	Defined Benefit	Defined Contribution
<b>Administration Requirement</b>	Administrative intensive, especially if none of the benefits are insured or outsourced.	Less complex administration unless members are given the opportunity to switch investment portfolios on a frequent basis.
<b>Investment Risk</b>	Carried mainly by the employer.	Carried by the employee (member)

## 2.4.2 Provident Fund

Provident funds have traditionally offered retirees the flexibility to access their entire retirement benefit as a cash lump sum. While this option provides immediate financial freedom, it also carries the risk of mismanagement or inadequate savings for long-term income needs during retirement. In response to these concerns, recent legislative changes have been introduced in South Africa to reform the landscape of provident funds.

Effective from March 2019, the retirement benefits offered by provident funds underwent significant modifications. The key aspects of these changes are as follows:

- **Segregation of Benefits:** The assets accumulated by each member until 28 February 2019, along with subsequent growth, are separately recorded. Members will retain the option to receive a cash lump sum in relation to this portion of their retirement benefit.

- **Introduction of Compulsory Annuity:** Contributions made on or after 1 March 2019, and the associated investment growth, are now subject to the same regulations applicable to pension funds. This means that the cash component of the retirement benefit is limited to one-third of the accumulated assets, while the remaining balance must be utilized to purchase a compulsory annuity for life.
- **Concession for Older Members:** Individuals aged 55 or older at 1 March 2019 are exempt from the restrictions on post-March 2019 contributions. They can still receive a full cash lump sum upon retirement, provided they remain in the same provident fund until that time. However, transferring to another provident fund will result in the cancellation of this concession, and the member will then be treated as an under-age 55 member.

These changes in retirement benefits aim to promote long-term financial security and encourage responsible retirement planning. By restricting the immediate cash payout and facilitating the provision of annuity income, retirees are better equipped to ensure a sustainable income stream throughout their retirement years. It is important for provident fund members to understand and adapt to these reforms to make informed decisions regarding their retirement savings and income strategies.

### **Benefits and Contributions**

Contributions to provident funds play a significant role in shaping retirement benefits and tax implications for members. Understanding the contribution structure and tax considerations is essential when evaluating provident funds as a retirement savings option. This section delves into the key aspects related to contributions and tax relief in provident funds.

- **Defined Benefit Nature:** All provident funds are categorized as defined benefit funds. This means that the retirement benefits provided by these funds are predetermined based on specific formulas and factors such as salary, length of membership, and accrual rates. Unlike defined contribution funds, where benefits depend on the performance of investments, provident funds offer a predetermined retirement income.

- **Tax Treatment of Contributions:** In the past, contributions made by members to provident funds did not qualify for a tax deduction. These contributions, known as benefits, were tax-free upon withdrawal. It is important to note that the tax deductibility of contributions is a crucial aspect when comparing pension and provident fund structures.
- **Employer Contributions and Salary Sacrifice:** Many employers contribute to provident funds through salary sacrifice arrangements as part of the overall salary package negotiations. Under these arrangements, the member's overall salary is reduced by the required contribution amount, resulting in a lower taxable income. This effectively provides tax relief for the member on their contributions. The employer then adds the foregone salary to their contributions, which are directed to the provident fund. It is essential to carefully structure and implement salary sacrifice arrangements to avoid potential challenges from tax authorities.
- **Changes in Tax Relief:** Significant changes to tax relief on contributions to pension, provident, and retirement annuity funds were implemented from March 2018. As a result, member contributions to provident funds now receive the same tax relief as applicable to pension funds. It is important to note that salary sacrifice arrangements are no longer eligible for tax relief from that date onwards.

Understanding the tax implications and contribution mechanisms within provident funds is crucial for both employers and members. It allows for informed decision-making when it comes to retirement planning, tax optimization, and evaluating the overall benefits provided by different retirement fund structures.

Table 2: Comparison of pension and provident fund features

	Defined benefit	Defined contribution
<b>Administration</b>	Approved by the FSCA Commissioner and the Commissioner of SARS An agreement between employer and employee must be in place	
<b>Eligibility</b>	All existing employees can join the fund New employees must join the fund	
<b>Retirement benefit</b>	Up to 1/3 can be taken as a lump sum; the balance must be used to purchase an annuity.	Prior to 1 March 2021: Member is entitled to the whole benefit in cash. The fund rules may provide for all or part of the benefit to be paid as a pension From 1 March 2021: Up to 1/3 can be taken as a lump sum; the balance must be used to purchase an annuity.
<b>Member tax deductibility of contributions</b>	27,5% of the higher of taxable income or remuneration. An annual maximum deduction of R350 000 applies.	
<b>Employer tax deductibility of contributions</b>	All contributions made to a taxpayer's retirement funds by the employer is taxed in the hands of the employee as a fringe benefit. The taxpayer is entitled to a tax deduction in respect of its own contributions and those contributions made by the employer on the taxpayer's retirement fund.	
<b>Tax-free lump sum at retirement</b>	The first R500 000 less any other lump sum previously received by the member is taxed at 0% R500 001 – R700 000 is taxed at 18% R700 001 – R1 050 000 is taxed at 27% Above R1 050 000 is taxed at 36% Previously disallowed contributions are deductible from the taxable amount.	

### 2.4.3 Comparative Analysis of Pension Fund, Provident Fund and Retirement Annuity

In the realm of retirement planning, individuals are faced with various options to secure their financial future. Pension funds, provident funds, and retirement annuities are popular vehicles designed to help individuals build a nest egg for their post-work years.



Understanding the key differences and features of these retirement savings options is crucial for making informed decisions. In this section, we provide a comprehensive comparison of pension funds, provident funds, and retirement annuities. By examining their eligibility criteria, contribution mechanisms, access to funds, payout options, and portability, individuals can gain a deeper understanding of these retirement vehicles and select the most suitable option based on their unique circumstances and long-term financial goals.

A table summarizing the key features and differences among these retirement funds will provide a valuable resource for individuals seeking clarity and guidance in their retirement planning journey.

Table 3: Comparison of a pension fund, provident fund and retirement annuity

	<b>Pension Fund</b>	<b>Provident Fund</b>	<b>Retirement Annuity</b>
<b>Eligibility</b>	Available to employees who are employed by an employer that offers membership to a workplace-based pension plan.		Available to individuals who voluntarily contribute to a retirement savings plan, such as a personal pension or retirement annuity.
<b>How to Join</b>	Employees become members of the pension fund through their employer's enrolment process.	Employees become members of the provident fund through their employer's enrollment process	Individuals can join a retirement fund by setting up a personal retirement savings account or purchasing a retirement annuity
<b>Access to Funds</b>	Typically, accessible upon retirement or upon leaving the employer (subject to certain conditions). Withdrawals may be allowed in cases of financial hardship or specific circumstances (e.g., disability).		Typically accessible upon reaching the designated retirement age or meeting specific conditions. Early withdrawals may be allowed in cases of financial hardship or specific circumstances (e.g., disability).
<b>Payout Options</b>	Pension benefits are usually paid out as regular income through an annuity, providing a steady stream of payments. Lump sum withdrawals may be permitted, allowing members to receive a portion of their pension fund as a one-time payment.		Retirement benefits can be received as a regular income through an annuity or as a lump sum payment. Members have flexibility in choosing the payout options that suit their retirement needs and goals.
<b>Portability</b>	Pension funds may offer portability options, allowing members to transfer their accumulated funds to another fund.		If an individual wishes to switch annuity providers or consolidate savings into a different plan, they can do so without incurring significant penalties or losing the accumulated value of their annuity.

## Topic 3: Retirement Fund Key Concepts

### 3.1 Introduction

---

Retirement funds play a crucial role in ensuring financial security for individuals during their post-employment years. Understanding the concepts and regulations surrounding retirement funds is essential for both employers and employees. In this chapter, we will explore various aspects related to retirement funds, including approved arrangements, membership requirements, umbrella funds, accrual rates, actuarial valuations, and more. By delving into these topics, we aim to provide a comprehensive understanding of retirement funds and the mechanisms involved in accessing and managing the funds effectively.

### 3.2 Approved Arrangements

---

In its simplest form, a pension fund benefit arrangement can only be offered as an approved arrangement. The term "approved" refers to entities that have obtained approval from the South African Revenue Service (SARS) by meeting the requirements of specific definitions. These definitions include:

- **Benefit Fund:** This encompasses a friendly society that is registered under the Friendly Societies Act, or any fund established prior to 13 June 1986, which is not registered solely due to provisions within the Friendly Societies Act.
- **Pension Fund:** This refers to a fund registered under the Pension Funds Act, including pension funds, provident funds, retirement annuity funds, pension preservation funds, or provident preservation funds.

Approval from SARS is crucial to ensure compliance with regulations and to provide the necessary tax benefits associated with these approved arrangements. By meeting the requirements and obtaining approval, these entities can operate as recognized pension fund benefit arrangements in South Africa.

### 3.3 Membership Requirement

---

According to the definitions outlined in Section 1 of the Income Tax Act, the establishment of a pension or provident fund requires an employee/employer relationship between the business entity and its employees. This means that employees are eligible for membership in these funds, including partners in a partnership who are considered employees in the context of pension and provident funds.

Various entities can establish a pension or provident fund, including:

- Companies, for the benefit of their working, salaried directors and other salaried employees.
- Close Corporations, for the benefit of their working, salaried members and other salaried employees.
- Sole proprietors, for the benefit of their salaried employees.
- Partnerships, for the benefit of their salaried employees and partners.

Once an employee qualifies for membership in a pension or provident fund, it becomes a condition of employment for all new employees. Failure to meet this requirement will result in the fund not being approved by the Commissioner of Inland Revenue.

However, eligible individuals who were already employed by the employer before their participation in the fund have a twelve-month period from the establishment date or the date they qualify to decide whether they wish to become members of the fund or not.

It is permissible for employees to be members of more than one fund, as long as they meet the eligibility rules and conditions of both funds. This allows individuals to participate in multiple pension or provident funds if they meet the respective criteria.

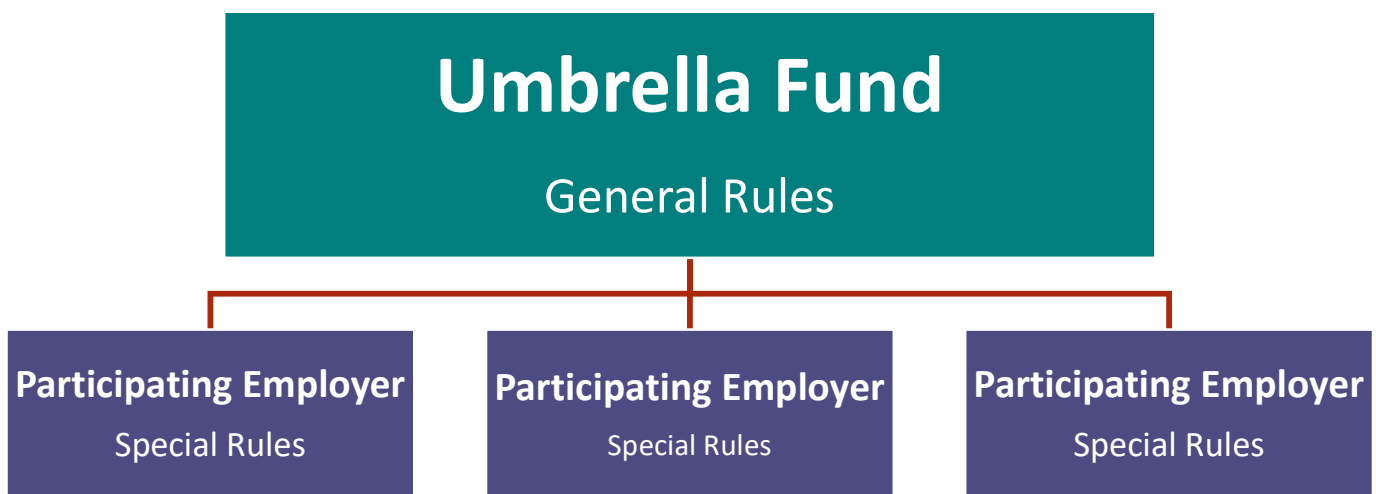
### 3.4 Umbrella Fund

---

An umbrella fund is a type of arrangement that involves establishing a single overarching fund with general rules that outline its main structures. Under this umbrella fund, participating employers' individual fund arrangements are registered, each having its own specific benefit structure outlined in a set of special rules. One key advantage of an umbrella fund is that participating employer funds do not need to have their own board of trustees, as they operate within the framework and governance structure of the umbrella fund.

This streamlined approach offers administrative efficiencies and allows participating employers to benefit from shared resources and expertise provided by the umbrella fund.

Figure 1: Structure of an Umbrella Fund



Umbrella funds offer a cost-effective solution, particularly for smaller employers, and have gained popularity among larger entities seeking to simplify their pension fund administration by eliminating the responsibilities and obligations associated with a stand-alone fund's board of trustees.

However, it is important to note that funds utilizing the umbrella fund option may have certain limitations in terms of investment choices and benefit structures compared to privately administered funds. While umbrella funds provide efficiency and convenience, participating employers within an umbrella fund arrangement do not have any direct relationship or connection to one another. Each employer maintains its own distinct arrangement within the umbrella fund.

## **3.5 Accrual Rate**

---

### **3.5.1 Introduction**

An essential aspect of determining retirement fund benefits is the accrual rate, which plays a crucial role in defining the pension benefits that members receive in a defined benefit scheme. This section provides an in-depth understanding of the accrual rate, its representation, and its impact on pensionable service.

The accrual rate represents the rate at which a member accumulates pension benefits while actively participating in a defined benefit scheme. It quantifies the proportion of the member's final pensionable salary that is accrued for each year of pensionable service.

### **3.5.2 Representation of Accrual Rate**

Accrual rates are typically expressed as fractions or percentages to provide a clear understanding of the benefit calculations.

### **Fraction Representation**

The accrual rate is commonly expressed as a fraction, such as 1/60th or 1/80th.

The numerator of the fraction denotes the percentage of the member's final pensionable salary accrued per year of service.

The denominator represents the number of years required to accumulate a full pension benefit, often referred to as the accrual period.

A lower denominator in the fraction signifies a more favorable pension benefit, as a greater portion of the member's salary is accumulated for each year of service.

### **Percentage Representation:**

In some cases, accrual rates are expressed as percentages, such as 1.25% (equivalent to 1/80th).

This percentage denotes the annual accrual rate for each year of pensionable service.

For example, in a final salary scheme, a member may accrue 1.25% of their final pensionable salary for each year of service.

### **3.5.3 Importance of Accrual Rate**

The accrual rate significantly impacts the calculation of retirement fund benefits and plays a pivotal role in determining the level of financial security a member can achieve in their retirement years. Here are key considerations regarding the importance of accrual rates:

- **Benefit Calculation:** The accrual rate directly affects the calculation of pension benefits by determining the proportion of the member's salary that will be accrued for each year of service. A higher accrual rate leads to a more substantial accumulation of pension benefits over time, providing a more favorable retirement income.
- **Incentivizing Pensionable Service:** The accrual rate can serve as an incentive for members to remain in the scheme for a longer period, as a higher rate rewards prolonged pensionable service with greater benefits.

### **3.5.4 Conclusion**

Understanding the accrual rate is crucial for comprehending how retirement fund benefits are determined in a defined benefit scheme. Whether represented as a fraction or a percentage, the accrual rate signifies the rate at which pension benefits are accrued based on a member's pensionable service. By grasping the impact of accrual rates, both members and administrators can make informed decisions to optimize retirement savings and ensure a secure financial future during the retirement phase.

## **3.6 Actuarial Valuation**

---

### **3.6.1 Introduction**

Actuarial valuation plays a critical role in evaluating the financial health of a pension fund by assessing the balance between its assets and liabilities. This section provides an overview of actuarial valuation, its purpose, and the key factors involved in determining the funded status of a retirement fund.

### **3.6.2 Understanding Actuarial Valuation**

Actuarial valuation involves a comprehensive appraisal of a pension fund's assets and liabilities. It utilizes a combination of investment, economic, and demographic assumptions to create a model that determines the funded status of the retirement fund. The primary objective is to assess whether the fund has sufficient assets to meet its present and future obligations to plan participants.



During the actuarial valuation process, the following key components are considered:

- **Assets:** The actuary evaluates the value of the pension fund's assets, including investments, cash holdings, and any other holdings that contribute to the fund's financial resources. The performance of these assets, along with their expected future growth, is analyzed to determine their contribution to meeting the fund's obligations.
- **Liabilities:** Liabilities refer to the pension fund's financial obligations towards current and future plan participants. Actuaries use actuarial science and demographic assumptions to estimate the value of these obligations, considering factors such as life expectancy, retirement age, salary levels, and expected benefit payouts. These estimations help determine the present value of the fund's future pension payments.

### 3.6.3 Factors Influencing Funded Status

The funded status of a retirement fund, determined through actuarial valuation, depends on several factors:

- **Investment Performance:** The investment returns earned by the pension fund's assets significantly impact its funded status. Positive investment performance enhances the fund's ability to meet its obligations, while negative returns may lead to a shortfall.
- **Economic Assumptions:** Economic factors, such as inflation rates, interest rates, and economic growth projections, are considered when assessing the pension fund's financial position. These assumptions affect the discount rate used to calculate the present value of future benefit payments.
- **Demographic Assumptions:** Demographic factors, including life expectancy and retirement patterns, play a crucial role in estimating the fund's liabilities. Accurate projections are necessary to account for the expected lifespan and timing of benefit payouts.

### **3.6.4 Conclusion**

Actuarial valuation provides a comprehensive analysis of a pension fund's assets versus its liabilities. By incorporating investment, economic, and demographic assumptions, this appraisal determines the funded status of the retirement fund. Evaluating the balance between assets and liabilities enables fund administrators to assess the financial health of the pension fund, make informed decisions regarding investment strategies, contribution levels, and benefit adjustments, and ensure the long-term sustainability of the fund in meeting the retirement needs of its plan participants.

## **3.7 Pensionable Service**

---

### **3.7.1 Introduction**

In the realm of retirement planning, it is crucial to accurately calculate the benefits individuals are entitled to receive upon reaching their retirement age. This section focuses on an essential factor in determining retirement benefits: the tax-free portion of gratuities and the concept of pensionable service. We explore how these elements influence retirement benefits, particularly in the context of defined benefit schemes.

The tax-free portion of gratuities, as outlined in the Second Schedule of the Income Tax Act, plays a significant role in establishing the tax-exempt portion of retirement benefits. This provision allows individuals to receive a portion of their gratuity payment free from income tax. By utilizing this item, retirees can potentially enhance the value of their retirement funds and optimize their financial planning.

### **3.7.2 Pensionable Service**

Pensionable service is a fundamental concept in determining retirement benefits, although it may not always coincide precisely with the period of employment. While pensionable service frequently aligns with the length of employment, certain scenarios can result in variations. Two notable instances are waiting periods and the possibility of purchasing past service.

#### **i) Waiting Period**

In some cases, individuals may experience a waiting period before becoming eligible to join a pension fund. During this period, they are not considered active members of the fund and, therefore, their pensionable service does not commence until the waiting period ends. Consequently, the duration of pensionable service may be shorter than the overall period of employment.

#### **ii) Purchase of Past Service**

To enhance retirement benefits, individuals may have the option to purchase past service. This means they can retroactively add previous periods of employment or other relevant service to their pensionable service calculation. By including additional years of service, individuals can potentially increase the value of their retirement benefits and ensure a more secure financial future.

### **3.7.3 Determining Retirement Benefits**

The combination of pensionable service and the tax-free portion of gratuities forms the foundation for calculating retirement benefits in defined benefit schemes. By considering the length of pensionable service and the applicable tax regulations, actuaries and pension fund administrators can determine the appropriate benefits retirees are entitled to receive. These calculations consider factors such as salary levels, contribution rates, and retirement age to arrive at a comprehensive assessment of retirement benefits.

### **3.7.4 Conclusion**

Understanding the tax-free portion of gratuities and the concept of pensionable service is vital for accurately calculating retirement benefits. The tax regulations outlined in the Second Schedule of the Income Tax Act enable retirees to receive a portion of their gratuity payment tax-free, facilitating effective retirement planning. While pensionable service typically aligns with the period of employment, variations may arise due to waiting periods or the option to purchase past service. By incorporating these factors, pension fund administrators can ensure that retirees receive their entitled benefits, offering them financial security during their retirement years.

## **3.8 Normal Retirement Age**

---

### **3.8.1 Introduction**

Determining the normal retirement age is a significant consideration in retirement planning. Traditionally, the normal retirement age has been set at 65, although certain professions, such as airline pilots, have specific age restrictions. However, there is a growing consensus that fixed retirement ages may not be suitable in today's landscape due to skill shortages, inadequate retirement savings, and increased life expectancy. This section explores the concept of normal retirement age, the need for flexibility, and recent changes in retirement annuity regulations.

### **3.8.2 The Traditional Retirement Age**

Historically, the normal retirement age has commonly been set at 65 years. This age has served as a benchmark for individuals to transition from the workforce to retirement. However, specific occupations, like airline pilots, may have age restrictions due to safety concerns related to their roles. These restrictions often limit pilots from flying commercial aircraft beyond the age of 55.

### **3.8.3 Challenges and Changing Perspectives**

In recent years, there has been a growing awareness of the challenges associated with fixed retirement ages. Many individuals reach age 65 without sufficient retirement savings, and increased life expectancy has resulted in longer periods of retirement. These factors have led to a re-evaluation of the traditional retirement age and a shift in perspectives.

### **3.8.4 Flexibility in Retirement Planning**

Recognizing the need for flexibility, there is an increasing call to remove fixed retirement ages and allow individuals to work beyond traditional retirement age if they choose to do so. This change is seen as a means to address skill shortages and provide individuals with the opportunity to accumulate additional retirement savings. The notion is that individuals should have the freedom to retire at a time that suits their personal circumstances and financial readiness.

### **3.8.5 Changes in Retirement Annuity Regulations**

In response to the evolving retirement landscape, there have been changes in the definition of a retirement annuity. Previously, retirement annuity fund members were required to retire by age 70 and commence a pension. However, this requirement did not incentivize older individuals to continue working, as delaying retirement and deferring the pension payout often resulted in a higher annuity and additional funds available for purchasing the annuity.

### **3.8.6 Diverse Retirement Ages**

In instances where different classes of members within a retirement fund have varying normal retirement ages, it is crucial for these distinctions to be explicitly stated in the fund's rules. This ensures transparency and clarity regarding the retirement age expectations for different groups of members.

### **3.8.7 Conclusion**

The concept of normal retirement age is undergoing a transformation to accommodate the changing needs and expectations of individuals approaching retirement. The traditional retirement age of 65 is being questioned, with calls for greater flexibility and the removal of fixed retirement ages. The aim is to address the skills shortage, provide individuals with more control over their retirement planning, and adapt to longer life expectancies. Recent changes in retirement annuity regulations reflect this shift, allowing individuals to delay retirement and potentially enhance their retirement benefits. By embracing a more flexible approach to retirement age, society can better support individuals in achieving financial security and a fulfilling retirement.

## **3.9 Minimum Individual Reserves**

---

The minimum benefit refers to the minimum individual reserve allocated to a member within a retirement fund. The calculation of the minimum individual reserve varies depending on the type of fund, whether it is a defined-benefit or a defined-contribution fund.

In a defined-benefit fund, the minimum individual reserve is equal to the full actuarial value assigned to the member. The actuarial value takes into account various factors such as the member's salary history, length of service, and projected investment returns. It represents the accrued benefits that the member is entitled to receive based on the fund's defined formula.

On the other hand, in a defined-contribution fund, the minimum individual reserve is determined by the member's share of the fund. This means that the reserve corresponds to the contributions made by the member and any investment growth or returns earned on those contributions. The minimum individual reserve in this case represents the accumulated value of the member's contributions and investment earnings.

The minimum benefit serves as a safeguard to ensure that each member of the retirement fund receives at least a certain level of retirement benefits. It provides a baseline level of financial security and protection for members, regardless of the type of fund they are enrolled in. By establishing the minimum individual reserve, the retirement fund ensures that members have a guaranteed minimum entitlement to retirement benefits based on their participation and contributions to the fund.

### **3.10 Minimum Pension Increases**

---

The Pension Funds Act includes provisions regarding minimum pension increases for retirees receiving pensions from a pension fund. These regulations ensure that pensioners receive a certain level of increase in their pension payments. The minimum pension increase is determined as the lesser of a full adjustment for inflation or the increase that the fund can afford.

Furthermore, the trustees of the pension fund are responsible for establishing and communicating a policy regarding a target pension increase. They must aim to provide pension increases in line with or exceeding the amount implied by this policy. This ensures that pensioners' benefits keep pace with inflation and maintain their purchasing power over time.

The minimum pension increases are subject to periodic reviews at each statutory valuation date. For defined-benefit pension funds, these valuations occur once every three years, while defined-contribution funds may require annual reviews. During these reviews, the fund evaluates its financial position and assesses its ability to meet the minimum pension increase requirements.

By implementing these regulations, the Pension Funds Act safeguards the interests of pensioners by ensuring that their pensions are adjusted to reflect changes in the cost of living. It also places responsibility on trustees to establish appropriate policies and strive to provide pension increases that align with the fund's objectives and the needs of its members.

### **3.11 Deferred Retirement Benefit**

---

The deferred retirement benefit provides retired members with the opportunity to maintain their membership in a pension fund, even after retiring from their employer. This arrangement allows members to continue their affiliation with the fund, even if they have alternative sources of income and do not require immediate access to their retirement benefits.

By offering a deferred retirement benefit, pension funds acknowledge that retirement does not necessarily equate to a complete withdrawal from the fund. Members who choose to defer their retirement can preserve their membership rights, such as access to investment options and potential growth of their retirement savings.

This option benefits retired individuals who may have ongoing financial commitments or who prefer to delay accessing their retirement benefits until a later stage. It provides them with the flexibility to make informed decisions about when to start receiving their pension income, taking into consideration their personal circumstances and financial goals.

By allowing retired members to remain in the fund, the deferred retirement benefit recognizes the importance of maintaining a long-term relationship between members and their pension funds. It reflects the understanding that retirement is a gradual process and that individuals may have different timelines and needs for utilizing their retirement benefits.

### **3.12 Employer Surplus Account**

---

In the context of a defined-contribution fund, a surplus refers to the assets that exceed the total sum of the individual shares of the fund members. This surplus can be attributed to various factors. Firstly, it may arise when members leave the fund and receive a benefit that is less than their entitled share of the fund. Additionally, any extra or ad-hoc contributions made by the employer can contribute to the surplus.



On the other hand, when considering a defined-benefit fund, a surplus represents the excess of assets over the actuarial liabilities of the fund, based on the assumptions made by the actuary. There are several circumstances that can give rise to a surplus in this type of fund. Firstly, if the investment returns exceed the expectations set by the actuary when determining the contribution rates, it can result in a surplus. Additionally, when the employer makes over-contributions to the fund, it can contribute to the surplus amount.

Understanding and managing surpluses in both defined-contribution and defined-benefit funds is important to ensure the effective administration and appropriate allocation of funds within the pension scheme. Proper management of surpluses can help enhance the financial stability of the fund and potentially provide additional benefits to the members.

### **3.13 Retirement Benefits Counselling**

---

Retirement benefits counselling, as defined by the default regulations under the Pension Funds Act, encompasses the disclosure and clear explanation, using language that is understandable to members, of various aspects related to retirement benefits. This includes providing information about available investment portfolios, their associated risks, costs, and charges, as well as the fund's annuity strategy and any other options that members may have.

Regulation 39 stipulates that members must have access to retirement benefit counselling at least three months before their normal retirement age, as determined by the fund's rules or prescribed requirements. However, the regulation offers limited guidance on the specific content and scope of this service.

To provide more clarity on retirement benefit counselling, the Financial Sector Conduct Authority (FSCA) has issued a guidance note, namely PF Guidance Note No.8 of 2018. According to this note, counselling can be provided either in person or in writing, and the fund must maintain a record of the counselling session. The individual appointed to provide counselling does not necessarily have to be a representative of a Financial Services Provider under the Financial Advisory and Intermediary Services (FAIS) Act. However, the fund's board must ensure that the appointed person possesses suitable qualifications, experience, and the ability to manage any conflicts of interest.

It is important to note that retirement benefit counselling specifically excludes the provision of advice, including tax advice. Members should be explicitly informed of this limitation. If advice on such matters is provided, the person offering the advice must be a registered representative or a tax practitioner.

It is recommended that retirement benefits counselling be offered no later than six months before a member's retirement from the fund. The fund's board should also ensure that the information provided during counselling remains relevant and appropriate when members reach their retirement age.

When members are granted access to retirement benefit counselling, it is essential that a comprehensive disclosure and explanation are provided in clear and understandable language. This should encompass details about fees, risks, costs, and charges associated with the available investment portfolios, the fund's annuity strategy, and any other options available to members. This ensures that members are well-informed and empowered to make informed decisions regarding their retirement benefits.

### 3.14 Dependent

---

A dependent is clearly defined in the Pension Funds Act. Dependent in relation to a member means one of the following:

- A person in respect of whom the member is legally liable for maintenance, for example, children from a current or past relationship, or where the member was paying maintenance towards an ex-spouse in terms of a divorce order.
- A person in respect of whom the member is not legally liable for maintenance if such a person:
  - Was, in the opinion of the board of trustees, upon the death of the member dependent on the member for maintenance, for example, an elderly parent.
  - Is the spouse of the member, including a life partner or any spouse or civil union partner married under the Marriage Act, 1961, the recognition of Customary Unions Act, 1998, the Civil Union Act, 2006 or under the tenets of any religion.
  - Is a child of the member, including a posthumous child (child born after the death of the parent), an adopted child and an illegitimate child.
  - A person in respect of whom the member would have been legally liable for maintenance, had the member not died, for example, a person to whom the member was engaged to be married.

Therefore, an ex-spouse is not a dependent, unless the member was paying maintenance to that spouse after the divorce had taken place, and if a member was in the process of getting divorced, that spouse is still considered to be dependent.

Even major children of a deceased member automatically qualify as dependents and must, therefore, be considered for the payment of death benefits.

## Topic 4: Arrangements of A Retirement Fund

### 4.1 Introduction

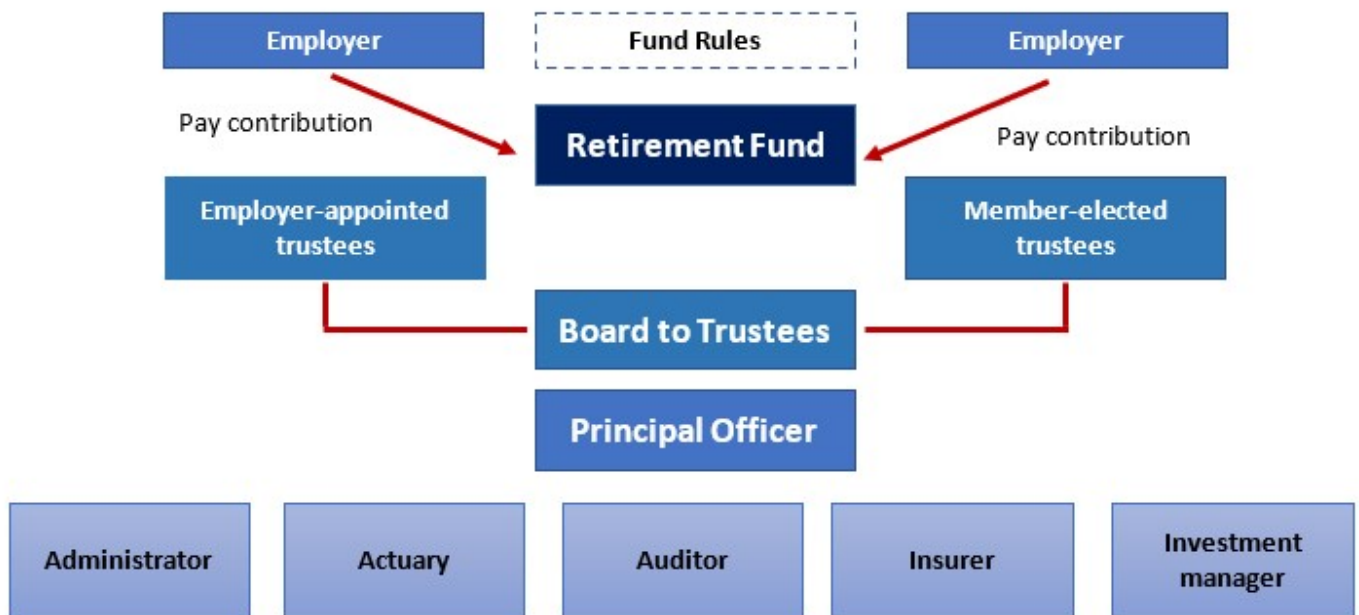
---

Retirement funds play a crucial role in providing financial security during retirement. The primary objective of a retirement fund is to offer retirement benefits to its members upon their retirement or to their dependents in the event of the member's death. In South Africa, retirement funds often extend their offerings to include additional benefits such as death and disability benefits. Moreover, there is a growing trend towards granting members greater flexibility in tailoring their benefits to align with their specific needs and preferences.

Effective governance of a retirement fund is of utmost importance, as these funds hold members' contributions in trust for their future retirement. For many employees, their retirement fund investment represents their sole means of achieving a financially stable retirement. Consequently, a poorly governed fund could potentially jeopardize or even deplete an individual's retirement savings entirely.

Given the complexity of retirement funds, there are various stakeholders involved in their operation. The following figure illustrates the different role-players that may be associated with a retirement fund. Understanding the roles and responsibilities of each party is crucial for ensuring the smooth functioning and optimal management of the fund.

Figure 3: Role-players in a retirement fund



## 4.2 Key Role-players in a Retirement Fund

### 4.2.1 Introduction

A retirement fund is a complex arrangement that involves multiple key role-players working together to ensure the effective management and administration of the fund. These role-players play critical roles in safeguarding the interests of the fund's members and ensuring that their retirement benefits are properly managed and disbursed. Understanding the responsibilities and functions of these key role players is essential for comprehending the inner workings of a retirement fund. This section explores the important role of each key player and their contributions to the overall governance and operation of a retirement fund. By examining the interactions and responsibilities of these stakeholders, individuals can gain a comprehensive understanding of the dynamics involved in managing retirement funds and promoting financial security for members.

### 4.2.2 Employer (Sponsor)

Employers play a crucial role in the establishment, administration, and oversight of retirement funds for their employees. Their involvement is vital in ensuring the effective operation of the fund and the financial security of their workforce during retirement. Let's explore the key responsibilities and functions of employers within a retirement fund.

- **Fund Establishment:** Employers are typically responsible for setting up a retirement fund for their employees. This involves making important decisions such as whether to have a retirement fund, the type of fund (pension or provident), and whether it should be a stand-alone fund or part of an umbrella fund. Employers may seek guidance from benefits consultants and engage in negotiations with employees to determine the fund's structure and features.
- **Communication and Enrollment:** Employers have a duty to effectively communicate retirement fund decisions and options to their employees. This includes providing clear information about the fund's benefits, eligibility criteria, contribution requirements, and any choices available to employees. Employers must ensure that employees understand their rights, obligations, and the importance of participating in the retirement fund.
- **Contribution Management:** Employers have the responsibility of deducting contributions from employees' salaries or wages and ensuring these contributions are promptly and accurately paid over to the fund administrators. They must maintain records of contributions made by each employee and provide a detailed member schedule within specified timeframes. Employers may also be personally liable for payment of contributions to the fund.
- **Compliance and Governance:** Employers must adhere to legal and regulatory requirements governing retirement funds. This includes complying with reporting obligations, submitting required documentation, and meeting statutory deadlines. Employers must also ensure that the retirement fund operates in accordance with good governance principles, including appointing or electing a board of trustees in the case of a stand-alone fund.

- **Employee Support and Education:** Employers play a vital role in supporting their employees' retirement planning by providing educational resources and guidance. They can facilitate access to retirement planning workshops, seminars, or professional advice to help employees make informed decisions about their retirement savings. Employers can also assist employees in understanding the implications of their benefit options and the importance of long-term financial planning.
- **Monitoring and Review:** Employers should regularly review the retirement fund's performance, investment strategies, and administrative processes to ensure their continued effectiveness. This includes monitoring investment returns, assessing the fund's financial health, and evaluating the quality of services provided by fund administrators. Employers may engage with consultants or experts to assess the fund's performance and make any necessary adjustments.

By fulfilling their role in the retirement fund, employers contribute to the financial well-being of their employees during their working years and in retirement. Through effective communication, compliance with regulations, and support for employee education, employers can foster a culture of retirement readiness and help employees build a solid foundation for their future financial security.

#### **4.2.3 Employee (Member)**

As a participant in a retirement fund, the employee, also referred to as a member, plays a significant role in the functioning and success of the fund. Understanding the responsibilities and rights of being a member is crucial for ensuring a secure and prosperous retirement.

- **Contribution:** One of the primary responsibilities of an employee is to make regular contributions to the retirement fund. These contributions are deducted from their salary or wages and are invested to accumulate savings over time. By consistently contributing to the fund, employees are actively building their retirement nest egg.

- **Benefit Selection:** Employees often have the opportunity to select the benefit structure that suits their specific needs and circumstances. Depending on the options provided by the fund, members may choose between different payout options, such as receiving a regular income through an annuity or opting for a lump sum payment at retirement. It is important for employees to consider their financial goals, risk tolerance, and lifestyle preferences when making benefit selections.
- **Investment Decisions:** In some retirement funds, members may have a degree of control over the investment of their contributions. This means they can choose from a range of investment options offered by the fund, such as different asset classes or investment strategies. It is essential for members to understand their investment choices and consider factors like risk, diversification, and potential returns when making investment decisions.
- **Stay Informed:** Employees should actively engage with the information and communications provided by the retirement fund. This includes staying informed about fund updates, investment performance, changes in regulations, and any other relevant news. By staying informed, members can make informed decisions about their retirement planning and take necessary actions if required.
- **Plan and Monitor Retirement Goals:** Members should regularly assess their retirement goals and review their progress towards achieving them. It is advisable to periodically evaluate whether their current contributions and investment strategy align with their retirement objectives. If needed, employees may consider adjusting their contribution levels or investment allocations to stay on track with their desired retirement outcomes.
- **Compliance:** Members are responsible for complying with the rules, regulations, and policies of the retirement fund. This includes adhering to contribution deadlines, providing accurate information when required, and complying with any requests or procedures related to their membership.



By actively participating in their retirement fund, employees can maximize the benefits and opportunities available to them. A proactive approach to retirement planning, coupled with responsible decision-making, empowers members to build a solid foundation for their future financial security.

#### **4.2.4 Board Of Trustees**

In South Africa, retirement funds are governed by boards of trustees that play a crucial role in overseeing and safeguarding the interests of fund members. The board of trustees is entrusted with the responsibility of managing the retirement fund in accordance with legal requirements and ensuring the efficient administration of the fund.

Section 7A (1) of the Pension Funds Act in South Africa mandates that every fund must have a board of management consisting of at least four members, with at least 50% of the board members elected by the fund's members. The remaining 50% of the board is appointed by the employer, typically including representatives from the human resources or finance departments who handle fund-related matters. In some cases, where the fund is exceptionally small, the minimum requirement of four trustees may be exempted upon application if it is not feasible or practical.

Each trustee must acquire the prescribed levels of skills and training within six months of their appointment. This requirement ensures that trustees possess the necessary knowledge and expertise to fulfil their responsibilities effectively.

In the case of umbrella funds, where multiple participating employers pool their contributions into a single fund, the right of member representation on the board may be waived due to practical considerations. Section 7B (1) (b) allows the Commissioner of the Financial Sector Conduct Authority to exempt umbrella funds from this requirement.

There is a growing trend of appointing professional independent trustees to retirement fund boards. These professionals, often retired actuaries, fund administrators, or individuals with extensive experience in the employee benefits industry, provide valuable expertise and insights during board meetings. While the employer typically appoints professional independents, in some instances, they may be elected by the fund's membership. Incorporating individuals with expert knowledge enhances the decision-making process and contributes to the overall governance of the fund.

Before engaging professional independent trustees, it is essential to review the fund's rules to ensure there are no restrictions, such as a provision that only active members and pensioners may serve on the board. While there may be a fee associated with the services of professional independents, the costs are often justified by the benefits derived from their experience and specialized knowledge.

By incorporating a diverse board of trustees, including elected and appointed members, and potentially professional independents, retirement funds in South Africa can benefit from a range of perspectives, expertise, and skills. Let's explore the key role and responsibilities of the board of trustees within a retirement fund.

- **Fiduciary Duty:** The board of trustees has a fiduciary duty to act in the best interests of the retirement fund and its members. They are responsible for ensuring that the fund is managed prudently, ethically, and in compliance with applicable legislation, regulations, and fund rules. The board must exercise their duties with skill, care, and diligence, prioritizing the financial security and well-being of the fund's members.
- **Fund Governance and Compliance:** Trustees are responsible for establishing and maintaining effective governance practices within the retirement fund. This includes formulating and implementing policies and procedures, ensuring compliance with legal and regulatory requirements, and promoting transparency and accountability. The board must oversee the fund's operations, monitor compliance with statutory obligations, and address any potential risks or conflicts of interest.

- **Investment Management:** Trustees have a critical role in the investment management of the retirement fund. They must make informed decisions regarding the fund's investment strategies, asset allocation, and risk management. The board should conduct periodic reviews of the fund's investment performance, assess the suitability of investment options, and consider the long-term financial objectives of the fund and its members.
- **Benefit Administration:** The board of trustees oversees the administration of retirement benefits, ensuring that member contributions, benefit calculations, and payment processes are accurately and efficiently carried out. They must work closely with the fund administrators to establish robust administrative systems, manage member records, and handle member inquiries or complaints regarding benefits.
- **Communication and Member Engagement:** Trustees are responsible for maintaining effective communication with fund members and keeping them informed about fund updates, changes, and any relevant information. The board should ensure that members receive regular and clear communication regarding their rights, options, and obligations within the retirement fund. They may also facilitate educational initiatives or workshops to enhance member understanding of retirement planning and financial literacy.
- **Independent and Professional Advice:** Trustees have the authority to seek independent and professional advice to support their decision-making processes. They may engage consultants, actuaries, legal advisors, or investment experts to provide expert guidance on complex matters, such as investment strategies, regulatory compliance, or fund governance. This enables trustees to make well-informed decisions in the best interests of the retirement fund and its members.
- **Board Composition and Elections:** Trustees may be appointed or elected based on the fund's rules and governance structure. The board should comprise a diverse group of individuals with relevant skills, expertise, and experience to effectively fulfill their duties. Elections, where applicable, should be conducted in a fair and transparent manner, allowing for meaningful member representation and participation.

By fulfilling their role, the board of trustees contributes to the effective management, governance, and protection of retirement funds in South Africa. Through their fiduciary duty, governance oversight, investment management, and member engagement, trustees play a vital role in ensuring the long-term financial security and well-being of fund members.

#### **4.2.5 Chairperson**

The chairperson of a retirement fund is typically appointed in accordance with the fund's rules and regulations. The role of the chairperson is of vital importance in providing leadership, facilitating effective governance, and ensuring the smooth functioning of the board of trustees. The chairperson holds a crucial position in guiding discussions, making decisions, and representing the interests of the fund and its members.

The chairperson is responsible for overseeing board meetings and ensuring that they are conducted in a fair and efficient manner. This includes setting the agenda, managing the flow of discussions, and promoting active participation from all trustees. The chairperson plays a pivotal role in maintaining a constructive and collaborative board dynamic, fostering open communication, and managing conflicts that may arise during meetings.

While it is preferable for the chairperson to be appointed or elected from among the trustees, it is not mandatory for them to be a board member. However, if the chairperson is not a board member, they will not have voting rights during trustee meetings.

In certain situations, the chairperson may possess a casting vote in addition to their deliberative vote. This casting vote is utilized when there is a tie in the number of votes in favor and against a particular decision. In such cases, the chairperson can exercise their casting vote to break the deadlock and make a final determination.

The inclusion of a casting vote empowers the chairperson to ensure that decisions can be reached even in situations of equal division among the trustees. This mechanism helps to maintain the efficiency and effectiveness of the decision-making process within the board.

One of the primary responsibilities of the chairperson is to uphold good governance practices within the retirement fund. This involves ensuring compliance with relevant legislation, regulations, and fund rules. The chairperson also oversees the implementation of policies and procedures that promote transparency, accountability, and ethical conduct within the fund's operations.

In addition to chairing board meetings, the chairperson represents the retirement fund in external engagements and interactions. This may involve liaising with regulatory authorities, industry stakeholders, and other relevant parties. The chairperson acts as the public face of the fund, conveying its mission, values, and objectives to external stakeholders.

The chairperson also plays a crucial role in fostering a strong relationship between the board of trustees and the fund's management team. This entails regular communication and collaboration to ensure alignment between strategic objectives, operational plans, and the overall governance framework. The chairperson provides guidance and support to the management team while maintaining appropriate checks and balances to safeguard the fund's interests.

Furthermore, the chairperson may be involved in representing the retirement fund in negotiations with service providers, such as fund administrators, investment managers, and consultants. They contribute to the selection process, contract negotiations, and ongoing oversight of these service providers to ensure that they meet the fund's needs and deliver value to its members.

Given the critical nature of the chairperson's role, it is essential for them to possess strong leadership qualities, effective communication skills, and a thorough understanding of the retirement fund industry and regulatory landscape. They should demonstrate impartiality, integrity, and the ability to facilitate productive discussions and decision-making within the board.

Overall, the chairperson plays a pivotal role in guiding the governance and strategic direction of a retirement fund in South Africa. By fulfilling their responsibilities with diligence and professionalism, the chairperson contributes to the effective operation of the fund, the protection of members' interests, and the achievement of long-term financial security and well-being for all participants.

#### **4.2.6 Principal Officer**

The principal officer of a retirement fund in South Africa plays a crucial role in the effective administration and management of the fund. The principal officer is appointed in accordance with the rules and regulations of the fund, and their responsibilities are outlined in the Pension Funds Act and the fund's governing documents.

One of the primary functions of the principal officer is to ensure compliance with all legal and regulatory requirements related to the operation of the retirement fund. They are responsible for maintaining accurate records, submitting required reports to regulatory authorities, and ensuring that the fund operates within the framework of the law.

The members of the board of trustees are a combination of managers from within the company, appointed by the employer, and employees who have been elected by the members of the fund. All of them will have their normal duties and functions, which will have to be performed, and will thus only be able to act as board members when they are required to attend meetings or monitor reports.

The Pension Funds Act (in Section 8) recognises this and, therefore, states that every fund must appoint a principal officer. The principal officer is the responsible official accountable to the Commissioner and would be the person to represent the fund if it were to sue or be sued. They must be appointed within 30 days of the registration of the fund, and a new principal officer must be appointed within 30 days if the previous one resigns.

Given the complexity of their role, the principal officer is expected to have a comprehensive understanding of retirement fund legislation, investment principles, and industry best practices. They are required to keep abreast of regulatory changes and market developments that may impact the fund's operations and communicate relevant information to the board of trustees and other stakeholders.

The principal officer also has a statutory duty to furnish the Commissioner with a written report within 21 days if their term of office is being terminated. Moreover, the principal officer is required to act as a whistle-blower if they feel that any aspect of the fund's operations might prejudice the fund or its members, by reporting the matter in writing to the Commissioner.

The principal officer of a retirement fund in South Africa has various duties as outlined in the Pension Funds Act and further explained in PF130. These duties include:

- **Ensuring Execution of Board Decisions:** The principal officer is responsible for ensuring that decisions made by the Pension Fund Board of Trustees are properly executed. This involves overseeing the implementation of approved strategies, policies, and actions to effectively manage the fund.
- **Ensuring Compliance with Legal Requirements:** The principal officer must ensure that the pension fund complies with all formal legal requirements. This includes adhering to directives from regulatory authorities such as the Commissioner, the South African Revenue Service (SARS), and other relevant regulatory bodies.
- **Liaising with Service Providers:** Acting on behalf of the board, the principal officer serves as a key point of contact for various service providers to the pension fund. This includes engaging with investment managers, administrators, auditors, and other professionals involved in the fund's operations. Effective communication and coordination with service providers are essential to ensure the smooth functioning of the fund.

- **Contribution to Board Meetings:** While the principal officer does not have a voting right, they play an important role in board meetings. They contribute their expertise, knowledge, and insights to discussions, providing valuable input to help the board make informed decisions. Their active participation ensures that the board benefits from their understanding of the fund's operations and regulatory landscape.

By fulfilling these duties, the principal officer contributes to the overall governance, compliance, and smooth operation of the retirement fund, safeguarding the interests of the fund's members and ensuring effective management of retirement benefits.

#### **4.2.7 2.6 Service Providers**

In the effective management and administration of a retirement fund, various service providers play vital roles in ensuring compliance, efficiency, and financial well-being. These service providers bring their expertise and specialized services to support the fund's operations and enhance the retirement benefits provided to fund members. These services may include the following:

- Fund administration
- Actuarial services
- Audits
- Benefit consulting services
- Investment management
- Risk-benefit consultation
- Annual fund audit function



A pension fund is governed by a board of trustees who generally do not have the expertise to perform all the required administrative functions of a fund. Therefore, the board of trustees may elect to contract with other service providers to perform such functions, although the board remains ultimately responsible. Insured funds may have all of the above functions included in the departments of the insurer's office apart from the auditing function where there is a statutory duty to use an external professional.

These service providers are considered in the subsections following, where we will delve into their specific roles, responsibilities, and contributions within a retirement fund.

### **i) Fund Administrators**

Fund administration service providers play a crucial role in the day-to-day operations and administration of a retirement fund. These providers are responsible for managing the administrative tasks and processes required for the smooth functioning of the fund.

In the case of insured funds, all the aforementioned functions may be included within the departments of the insurer's office, except for the auditing function which requires the use of an external professional as mandated by statutory duty.

One key appointment made by the fund is that of an administrator. In privately administered funds, the administrator refers to the area or individuals authorized and appointed to handle all operational responsibilities related to the retirement fund. Alternatively, in other administrative arrangements, the fund appoints an entity through a service level agreement to carry out the operational tasks.

The fund administrator's responsibilities encompass a wide range of crucial tasks. These include record-keeping, ensuring accurate member enrolment and withdrawals, managing contributions, calculating retirement benefits, and facilitating effective communication with fund members. It is the responsibility of the fund administrator to maintain efficient and compliant administrative processes in accordance with regulatory requirements.

By entrusting the fund administration tasks to dedicated service providers, retirement funds can streamline their operations, enhance accuracy and efficiency, and ensure that all administrative aspects of the fund are effectively managed. The expertise and specialized services offered by fund administration service providers contribute significantly to the overall success and seamless functioning of a retirement fund.

## **ii) Actuarial Service Providers**

Actuarial service providers play a critical role in the assessment and management of the financial risks associated with retirement funds. These providers utilize their expertise in analyzing demographic and financial data to project future fund liabilities and evaluate the overall financial health of the fund.

Benefits within a retirement fund are intended to be available to members upon their retirement. Consequently, it is crucial to have safeguards in place to ensure that the funds collected from employers and members are preserved and available when needed to pay out retirement benefits. Unforeseen circumstances, such as higher-than-anticipated salary increases or lower-than-expected investment returns, have the potential to deplete the value of the fund, putting the retirement benefits of members at risk, often without anyone being aware of the danger.

To address this, the Pension Funds Act stipulates a legal requirement for every retirement fund to appoint a suitably qualified valuator to conduct a valuation of the fund's assets and compare them to its liabilities at least once every three years. This triennial valuation, mandated under Section 16 of the Pension Funds Act, ensures that the fund's financial position is properly assessed and monitored. A suitably qualified person for this task is defined as an actuary or an individual possessing similar abilities and qualifications. The Commissioner of the Financial Sector Conduct Authority grants acceptance to valuers who meet the required standards to perform the valuation. It is important to note that if a fund is granted an exemption from the conditions of Section 9A of the Pension Funds Act, the services of a valuator may not be required.

The role of the actuary within the retirement fund encompasses several key responsibilities. Firstly, they ensure that the fund has been administered in accordance with the fund's rules and current legislation. They also ascertain whether the correct investment returns have been allocated to each member's share and ensure that the assets and liabilities of the fund are in balance. Additionally, actuaries verify the correct allocation of benefits to exiting members and ensure the accurate distribution of assets between member accounts and any surpluses specified in the fund's rules. Furthermore, actuarial service providers ensure that pensioner benefits, if applicable, are administered in compliance with legislative requirements.

Actuaries provide invaluable insights and recommendations to retirement funds regarding funding levels, contribution rates, benefit design, and strategies for mitigating financial risks. Their expertise and analysis enable the fund to maintain its long-term financial sustainability and uphold its commitment to providing secure and reliable retirement benefits to its members. By actively assessing and managing the financial risks associated with the fund, actuarial service providers contribute to the overall stability and viability of the retirement fund.

### **iii) Auditor**

Every retirement fund in South Africa is required by law to appoint an external auditor who is registered in accordance with the Auditing Profession Act, 2005 (Act No. 26 of 2005). The appointment of an auditor is mandated by Section 9 of the Pension Funds Act and serves a crucial role in ensuring the integrity and accountability of the fund's financial affairs.

The primary responsibility of the auditor is to conduct a thorough examination of the retirement fund's books and records. This includes scrutinizing financial transactions, verifying the accuracy and completeness of financial statements, and assessing compliance with applicable accounting standards and regulatory requirements. The auditor's objective is to provide reasonable assurance that the fund's financial records are reliable and that no funds are missing or misappropriated.

Upon completion of the audit, the auditor must satisfy themselves that all monetary affairs of the retirement fund are in order. If the auditor is confident that the financial records accurately reflect the fund's activities and transactions, they proceed to certify the revenue statement and Statement of Financial Position. These certified statements are then submitted to the Commissioner of the Financial Sector Conduct Authority, further ensuring transparency and regulatory compliance.

It is important to note that although the auditor prepares the financial statements of the retirement fund, this responsibility does not absolve them from certifying the truthfulness and accuracy of the contents. The auditor must exercise professional judgment, independence, and due diligence in their assessment of the fund's financial position and operations.

By appointing an external auditor and adhering to auditing standards, retirement funds demonstrate their commitment to financial accountability, safeguarding the interests of members and stakeholders. The audit process provides independent assurance and enhances the trust and confidence in the fund's financial integrity.

#### **iv) Benefits and Risk-benefit Consultants**

Once an employer has made the decision to establish a pension fund for its employees, it is essential to engage the services of a professional benefits consultant. These consultants possess the expertise to guide both the employer and employees in determining the most suitable benefits for the prospective fund members.

Benefit consultants play a vital role in assisting with the selection of benefits by providing insights into the associated costs and viability of different options. Their in-depth knowledge of the retirement funds industry enables them to advise negotiators on the practicality and financial implications of their ideas. By collaborating with benefit consultants, employers can make informed decisions that align with the needs and goals of the fund and its members.

Once a consensus has been reached regarding the benefits and type of fund to be established, the benefit consultant may recommend an appropriate professional to draft the fund's rules. This ensures that the rules are comprehensive, legally compliant, and reflect the agreed-upon benefits and operational guidelines.

Benefit consultants stay abreast of modern trends in the retirement funds industry and keep trustees updated on relevant developments. Their expertise enables them to provide valuable insights on industry best practices, regulatory changes, and emerging strategies. This helps trustees make informed decisions, enhance fund governance, and effectively manage the fund's operations.

In addition to benefit consulting, retirement funds also benefit from engaging risk benefit consultation service providers. These providers specialize in managing and mitigating risks associated with events such as death, disability, and other contingencies. They assist funds in designing and implementing risk benefit solutions that offer financial protection to fund members and their beneficiaries.

Risk benefit consultation service providers assess the fund's risk exposure and recommend suitable insurance coverage options to address potential risks. They ensure compliance with legal and regulatory requirements pertaining to risk benefits and assist with claims management processes. By engaging these providers, retirement funds can proactively manage risks, protect members' financial well-being, and provide peace of mind to both employers and employees.

Overall, benefit consulting and risk benefit consultation services bring specialized expertise and guidance to the design, structuring, and management of retirement benefit plans. These services help retirement funds optimize their benefit offerings, navigate legal and regulatory complexities, and ensure the long-term financial security of fund members.

#### **v) Insurer**

In certain cases, retirement funds may opt to secure benefits through an insurance policy contract with an insurer. This arrangement provides additional protection and risk management for the fund and its members. When a retirement fund decides to insure its benefits, it enters into a policy contract with an insurer.

The insurer assumes the responsibility of providing the specified benefits to the fund members as outlined in the contract. This can include various retirement benefits such as pensions, annuities, disability benefits, and death benefits. By transferring the risk associated with these benefits to the insurer, the retirement fund ensures that the promised benefits will be available to its members when needed.

The insurer plays a critical role in managing the financial aspects of the benefits covered under the policy contract. They are responsible for collecting premiums from the retirement fund and ensuring the availability of funds to meet the benefit payments as they become due. This involves diligent risk assessment, investment management, and maintaining sufficient reserves to fulfil the obligations outlined in the contract.

Furthermore, insurers provide expertise in actuarial calculations, determining appropriate premium levels, and assessing the financial sustainability of the benefits offered. They employ skilled professionals who analyse demographic and financial data, evaluate risk factors, and project future benefit liabilities. This enables them to accurately price the insurance coverage and determine the required contributions from the retirement fund.

Insurers also play a significant role in administering the benefits covered under the policy contract. They handle the processing of benefit claims, ensure timely payments to the fund members, and provide support and guidance to both the fund and its members throughout the claims process.

By partnering with an insurer, retirement funds can leverage the insurer's specialized knowledge, experience, and financial resources. This collaboration allows the fund to provide comprehensive benefits to its members while mitigating risks associated with the funding and administration of those benefits. The insurer's expertise in risk management, investment strategies, and regulatory compliance contributes to the overall stability and sustainability of the retirement fund.

It is important for retirement funds considering insurance arrangements to carefully evaluate insurers based on their financial strength, reputation, and track record in the industry. The fund should assess the insurer's ability to meet its obligations and ensure that the policy contract aligns with the fund's objectives and the needs of its members.

Overall, insurers play a crucial role in retirement funds by providing insurance coverage for the benefits offered. Through policy contracts, insurers assume the responsibility of fulfilling the specified benefits, managing associated risks, and administering the benefits efficiently. This collaboration between retirement funds and insurers enhances the financial security and peace of mind for fund members, ensuring that their retirement benefits are safeguarded.

#### **vi) Investment manager**

The value of future retirement benefits paid to members is highly dependent on the investment results of the overall retirement fund. Consequently, the appointment of a skilled investment manager is paramount. The management board of the retirement fund bears the responsibility of selecting a competent individual or organization to handle the investments made with the contributed and accumulated funds. However, the management board cannot abdicate its role in ensuring satisfactory investment decisions. The ultimate authority for investment strategy always rests with the management board.

When considering an investment manager, the board has several options to evaluate, including life insurers, various long-term insurers, unit trust/collective investment scheme managers, merchant banks, stockbrokers, and professional investment managers who have established dedicated infrastructure for this specific service. In cases where the fund is administered by an insurer, the investment of contributions and accumulated funds is often entrusted to the capable hands of the insurer. Notably, life insurers are the only entities authorized to provide insurance policies that incorporate certain investment guarantees. Nonetheless, the management board must remember that it remains responsible for the investment strategy of the fund and the resulting returns.

Investment management service providers play a crucial role in managing the retirement fund's investment portfolio. They develop investment strategies that align with the fund's objectives and risk tolerance, conduct comprehensive market research, conduct due diligence on potential investment options, and diligently monitor investment performance. The primary aim of investment managers is to optimize investment returns while prudently managing risk to safeguard the fund's assets and support the long-term financial well-being of its members.

By appointing competent investment managers, retirement funds can leverage their expertise in developing sound investment strategies and effectively managing the fund's assets. Investment managers aim to generate favorable returns while mitigating risks, ensuring the long-term sustainability and growth of the fund. Their comprehensive market analysis, strategic decision-making, and ongoing monitoring contribute to maximizing investment opportunities and mitigating potential pitfalls.

It is essential for the management board to remain actively involved in the investment strategy of the particular fund, exercising due diligence and oversight. While investment management service providers contribute their expertise, the ultimate responsibility for the fund's investment strategy and the outcomes lies with the management board. By making informed decisions and working collaboratively with investment managers, the board can strive to achieve optimal investment performance and secure the financial future of the retirement fund's members.

#### **vii) Independent Audit Firm**

In the realm of retirement funds, annual audits play a critical role in upholding accuracy, reliability, and compliance within the financial statements and operations of the fund. These audits are conducted by independent audit firms, whose primary objective is to ensure the integrity and transparency of the fund's financial information. During the audit process, the auditors thoroughly examine the fund's financial records, internal controls, and governance practices to assess their effectiveness and adherence to established standards.



The auditors provide an unbiased and objective assessment of the fund's financial position, identifying any irregularities or deficiencies that may exist. Their expertise allows them to analyze the fund's financial performance, evaluate the appropriateness of accounting practices, and verify the accuracy of reported information. In addition, they assess the fund's compliance with relevant regulations and legal requirements.

The findings of the annual fund audit serve as a valuable tool in enhancing transparency, accountability, and confidence among stakeholders. The auditors' recommendations for improvement help the management board and trustees of the retirement fund in identifying areas where adjustments or enhancements can be made to strengthen financial management practices.

By engaging an independent audit firm, retirement funds demonstrate their commitment to maintaining high standards of financial governance and accountability. The annual fund audit serves as a mechanism for ensuring the accuracy and reliability of financial reporting, fostering trust among fund members, employers, regulatory authorities, and other stakeholders involved in the retirement fund ecosystem.

### **4.3 Pension Fund Rules**

---

The establishment of a retirement fund signifies the formation of a contractual agreement between the employer and the employees. This agreement outlines the terms and conditions under which the fund will operate and is documented in a set of rules specific to that particular fund.

The rules of the retirement fund serve as a guiding framework that governs its operations and ensures compliance with the provisions outlined in the Pension Funds Act. These rules are carefully crafted to meet the legal requirements set forth by the Commissioner and the South African Revenue Services (SARS). Approval and registration of the rules by these regulatory bodies are necessary steps to ensure the fund's legitimacy and adherence to regulatory guidelines.

The formulation of the rules is a crucial task undertaken by the fund's management board and trustees, often with the assistance of legal professionals or specialized consultants. These rules encompass a wide range of aspects, including membership eligibility, contribution requirements, benefit provisions, governance structure, investment guidelines, and dispute resolution mechanisms.

It is essential for each retirement fund to tailor its set of rules to suit its specific needs and objectives while aligning with the legal and regulatory framework. The rules must be designed to safeguard the interests of the fund's members, ensure transparency, and promote effective governance practices.

By adhering to the requirements of the Pension Funds Act and securing approval from the Commissioner and SARS, the retirement fund establishes a solid foundation for its operations. The approved rules serve as a legally binding document that outlines the rights and obligations of the employer, employees, and the fund itself, providing clarity and certainty to all parties involved in the fund's administration and management. The rules of the fund should at least cover the following areas:

- Name of the fund.
- Objective of the fund.
- Requirement for membership.
- Circumstances under which membership will cease.
- Circumstances under which members or beneficiaries will become entitled to benefits.
- Nature of benefits provided by the fund.
- The default regulations.
- The benefits payable on the following:
  - Normal retirement.
  - Early retirement.

- Ill-health retirement.
- Death before retirement.
- Resignation.
- Dismissal.
- Retrenchment and redundancy.
- Late retirement.
- Deferred benefits.
- Death after retirement.
- Process to be followed in appointing the fund's officers, such as trustees and principal officer.
- Process to be followed in removing the fund's officers.
- Process to be followed in changing the fund's rules.
- Appointment of an auditor.
- Method to be followed in settling disputes.
- Custody of securities owned by the fund.
- How the fund may be terminated or dissolved.
- Appointment of a liquidator if required.
- How rules may be changed
- The appointment of an auditor
- Resolution of disputes between the fund and its members
- Termination of the fund either totally or partially
- Possible transfer to or amalgamation with another fund

- How unclaimed benefits are to be dealt with
- Establishment of a bank account (where needed)
- A commitment that a fidelity guarantee policy will be affected.

Where a fund is established for a single employer, the rules usually follow a narrative layout.

Where the fund is an umbrella fund set up for multiple employers who are usually quite independent of each other, the format consists of a basic set of rules, known as general rules, together with another set of rules, called special rules.

The reason for the division is that the umbrella fund will have conditions, which will apply across all participations, but certain features must be adapted to meet the needs of each individual participating employer. For example, retirement ages will differ between participating employers, and there will be differing criteria as to which staff may join.

This is done as the cost of registering a full set of rules for each participation is considerably more than registering a set of general rules once only, and then adding special rules as each new participation joins.

#### **4.4 Governance Of Retirement Funds**

---

Retirement funds play a vital role in safeguarding and managing the assets intended to provide members with the promised retirement benefits as outlined in the fund's rules. As custodians of these funds, retirement funds are bound by both common and statutory law, as well as the rules, codes, and policies set forth by the fund itself. It is imperative that retirement funds operate with integrity, good faith, and in the best interests of their members.

To ensure sound governance within the retirement fund industry, the Financial Services Board's circular PF No. 130 titled "Good governance of retirement funds" outlines 13 principles that encapsulate best practices in retirement fund governance. These principles serve as a comprehensive guide for retirement funds to maintain transparency, accountability, and effective management of fund assets.

Among the fundamental principles emphasized in the circular is the obligation for retirement funds to act in the best interests of their members. This requires careful decision-making processes, considering factors such as investment strategies, risk management, and benefit provisions that align with the members' long-term financial well-being. By prioritizing the interests of members, retirement funds can ensure that the assets are prudently managed and that the promised benefits can be delivered as intended.

Integrity and good faith are fundamental values that retirement funds must uphold. Acting with integrity involves maintaining high ethical standards, honesty, and the avoidance of conflicts of interest that could compromise the interests of members. Good faith requires retirement funds to exercise due diligence, act diligently, and make informed decisions in the members' best interests.

Adherence to the principles outlined in the circular promotes good governance practices within retirement funds. These principles cover a wide range of areas, including board composition and independence, risk management frameworks, internal controls, communication with members, and compliance with regulatory requirements. By embracing these principles, retirement funds can foster a culture of responsible stewardship and ensure the long-term sustainability of fund assets.

Retirement funds should strive to go beyond mere compliance with legal requirements and aspire to the highest standards of governance. By upholding the principles set out in the Financial Services Board's circular PF No. 130, retirement funds can establish a robust governance framework that instills trust, accountability, and confidence among members and stakeholders.

Table 4: Principles of good governance of retirement funds

Principle	Detail
<b>Principles 1 – 4: Governance structure</b>	
<b>1</b>	<p>The board of trustees is responsible and accountable to the members of the fund for its administration and prudent investment of the fund’s assets. Trustees owe a primary duty of care to the fund and the members, and should work together, trust one another and be worthy of trust in return.</p> <p>The chairperson of the board should proactively lead the board impartially and without bias.</p> <p>The principal officer’s duty is to the fund, and this overrides any responsibilities or obligations arising from being employed or remunerated by the employer (if applicable). The principal officer fulfils the function of administrative officer of the fund and is responsible for its regulatory compliance.</p> <p>The roles of chairperson and principal officer should be kept separate.</p> <p>The board of trustees and principal officer must avoid conflicts of interest.</p> <p>In addition to its rules, a fund should have a code of conduct, an investment policy statement, a communication policy and a performance assessment tool for trustees.</p>
<b>2</b>	<p>Board members should have sufficient capacity to deal diligently and thoroughly with their duties and responsibilities. The board may establish subcommittees to assist it with specific oversight or other board responsibilities. Each subcommittee must have a written mandate setting out its functions, scope, authority, membership requirements, etc.</p>
<b>3</b>	<p>Board members should receive induction as well as ongoing training on risk management, investment strategies, benefit structures, the legislative and regulatory framework, taxation and legal matters, and actuarial and industry reform issues.</p>
<b>4</b>	<p>The board, its subcommittees and the principal officer should be subject to performance appraisals at least annually.</p> <p>The board should act against trustees who breach the fund’s code of conduct or contravene any trustee responsibilities imposed upon them. Such action could call for vacation of or suspension from office.</p>
<b>Principle 5 to 8: Governance of fund operations</b>	
<b>5</b>	<p>An appropriate system of internal controls should be in place to ensure that operational and oversight responsibilities are carried out in accordance with the rules of the fund and in compliance with the law. Such controls should be subject to regular, effective and comprehensive board review.</p>

Principle	Detail
6	Where it lacks sufficient expertise to make fully informed decisions and fulfil its responsibilities, the board should seek expert advice. The board should apply its mind to any advice given, and if uncomfortable with the advice received, request a second opinion.
7	The fund should have a policy that provides a set of guidelines to enable it to identify, assess, manage, monitor, control and report its risks. The board should review such policy at least annually.
8	<p>Since investment performance is the most important factor in determining whether the fund will deliver on promised retirement benefits, the board should-</p> <ul style="list-style-type: none"> <li>• Ensure the mandates given to service providers clearly require compliance with Regulation 28 on fund and member level and define the board’s expectations and reporting requirements regarding investment performance.</li> <li>• Review the fund’s investment policy statement at least annually to ensure it remains appropriate in terms of the member profile and needs of the fund.</li> <li>• Appoint an independent custodian of the investment assets to give it direct access to custodian information about fund investments.</li> </ul>
<p><b>Principles 9 to 13: Management of stakeholder relationships (where stakeholders are members, employers/sponsors and Commissioner of the Financial Sector Conduct Authority)</b></p>	
9	<p>Trustees should have access to all information relating to the fund to enable them to make informed decisions. All information about the fund is confidential and may not be released to any person unless such person has a lawful right to such information, such as the rights of members to obtain copies of registered rules, actuarial valuations and audited financial statements.</p> <p>A communication policy should be established to govern the disclosure of fund information to members.</p>
10	<p>The board must communicate aspects of the operation of the fund, including the performance of the fund investments, which are of relevance to members and will assist them to assess the credibility and trustworthiness of administration of the fund and the delivery of benefits.</p> <p>Where a fund offers members investment choice, the details of the investments in respect of which members may make an election must be described, setting out the severity of any associated risk and the performance benchmarks, as well as the underlying type of investments. Members should be able to make informed decisions from such information.</p>
11	The board should establish a channel of communication with the employer/sponsor, which should be through the chairperson of the board.
12	The board should establish a policy to manage the selection and appointment of and reporting by services providers. Such policy should deal with conflicts of interest in the provision of services by service providers.

Principle	Detail
13	<p>The board should ensure that the requirements of any regulatory authority, particularly those of the Commissioner of the Financial Sector Conduct Authority are complied with.</p> <p>Any query or correspondence from such regulatory authority should be dealt with expeditiously and thoroughly.</p>

## 4.5 Researching an Organisation’s Retirement Fund

### 4.5.1 Introduction

When considering retirement planning, understanding the benefits and conditions offered by an organization's retirement fund is crucial. This section focuses on the process of researching and evaluating a retirement fund, and presenting its benefits and conditions in a diagrammatic format. By visually representing the key features of the retirement fund, individuals can gain a comprehensive overview and make informed decisions about their financial future.

### 4.5.2 Researching the Retirement Fund

#### i) Identify the Retirement Fund

- Determine the specific retirement fund provided by the organization.
- Gather information about the fund's name, type, and governing regulations.

#### ii) Access Fund Documentation

- Obtain the retirement fund's official documentation, such as the fund's rules, prospectus, or summary plan description.
- Review the documents to understand the fund's structure, investment options, and participant eligibility criteria.



### iii) Analyze Benefits and Conditions:

Evaluate the benefits and conditions offered by the retirement fund.

Identify key features, such as employer contributions, vesting periods, retirement age requirements, and payout options.

#### 4.5.3 Presenting Benefits and Conditions Diagrammatically:

To effectively communicate the benefits and conditions of the retirement fund, a diagrammatic representation can be created. The following elements can be included in the diagram:

- **Fund Structure:** Illustrate the overall structure of the retirement fund, including its relationship with the organization and any external entities involved.
- **Contribution Details:** Display the employer's contribution rate and any employee contribution requirements. Highlight any matching or additional contribution programs.
- **Vesting Period:** Represent the vesting schedule, indicating the timeframe required for employees to become entitled to the employer's contributions.
- **Investment Options:** Present the available investment options within the retirement fund, such as mutual funds, stocks, bonds, or target-date funds. Show the level of control participants have over their investment allocations.
- **Retirement Age and Payout Options:** Indicate the designated retirement age and any early retirement provisions. Display the payout options available at retirement, such as lump sum, annuity, or a combination.

#### **4.5.4 Conclusion**

Researching an organization's retirement fund and understanding its benefits and conditions is essential for effective retirement planning. By presenting this information diagrammatically, individuals can gain a visual overview of the retirement fund's key features, allowing for informed decision-making. Regular review and understanding of the retirement fund's documentation will ensure individuals maximize the benefits and make the most suitable choices for their retirement needs.

## Topic 5: Payment of Benefits

### 5.1 Processing Benefit Claims: Responsibilities and Procedures

---

When benefit claims arise within a retirement fund, it is the responsibility of the employer to inform the fund's administrator about the claim. This initiates the claim process, where the employer will submit the relevant documentation to the administrator for review.

Upon receiving the claim documentation, the administrator will assess the validity of the claim. The employer's notification of the claim is generally accepted in good faith, assuming that it has been submitted accurately and in accordance with the fund's procedures. However, the administrator will conduct a thorough evaluation to ensure compliance with the fund's rules and applicable regulations.

Some benefit claims are straightforward and can be easily processed and paid, following the guidelines outlined in the fund's rules. However, there are cases where claims may be more complex and require the exercise of discretion by either the board of trustees or the administrator. These complex claims may involve special circumstances or unique considerations that need to be carefully evaluated before a decision can be made.

Once the validity of the claim has been determined, the administrator assumes the responsibility of disbursing the approved benefits in accordance with the fund's rules. It is their duty to consider any applicable income tax implications and ensure that the necessary payments are made to the South African Revenue Service (SARS) as required by law.

Throughout the entire process, it is crucial for the employer, the administrator, and the trustees to collaborate effectively to ensure that benefit claims are handled efficiently and accurately. Open communication, adherence to the fund's rules, and compliance with relevant tax regulations are essential to facilitate smooth and timely payment of benefits to eligible recipients.

By following established procedures and maintaining a diligent approach, retirement fund administrators can fulfill their responsibilities in processing benefit claims, safeguarding the interests of members, and maintaining compliance with legal and regulatory requirements.

A member of a retirement fund may generally become entitled to its benefits in the following circumstances:

- Resignation
- Dismissal
- Death
- Retirement
- Disability
- Liquidation / partial termination of fund
- Divorce

## **5.2 Withdrawal of benefits**

---

Subject to the rules of the fund, an employee has the following choices upon withdrawal from a pension or provident fund:

- Transfer the withdrawal benefit to the new employer's pension or provident fund – if new funds allow for it.
- Transfer the withdrawal benefit to a retirement annuity fund.
- Take the withdrawal benefit in cash.
- Leave the benefit in the fund and choose to receive a deferred retirement benefit at normal retirement age.
- Transfer a portion of the withdrawal benefit to a retirement annuity fund and take the balance in cash.

- Transfer the withdrawal benefit to a preservation fund.

Take a portion of the withdrawal benefit in cash and transfer the balance of the withdrawal benefit to a preservation fund.

If the cash withdrawal benefit is transferred to another fund or preservation fund, then the ability to access the benefit before retirement will disappear and taxation can be completely avoided.

Withdrawal claims are the most common, and the rules of the retirement fund may set out provisions for the payment of different benefits. It is the administrator's duty to ensure that the correct type of benefit is established before payments are processed.

The Pension Funds Act was amended in 2001 to introduce the concept of minimum benefits. Historically, up to that point, many funds only refunded members' own contributions on leaving service, with the employer's contributions falling back into the fund to swell the fund for the benefit of the remaining members. Clearly, that could be unfair, particularly to members with long service who find themselves retrenched, near retirement and only their own contributions to fall back on.

So, the amended law makes provision, in simple terms, for the member who is leaving service through normal resignation, dismissal or retrenchment to receive not only a refund of his own contributions, but also the full benefit of the employer contributions, as well as all the investment growth on both. Similar provisions apply on transfers to other funds, conversions and fund terminations.

In a defined contribution fund, the term minimum benefits mean that the member is entitled to the full asset value build-up at the time of leaving. The position in defined benefit funds is vastly more complex and the fund valuator has to make a calculation based on guidelines from the Financial Sector Conduct Authority.

The same principles may apply to a privately administered defined contribution fund where, for example, the members do not share fully and directly in the investment growth from year to year as the valuator tries to smooth the returns.

In addition, in a defined benefit fund (and a privately administered fund for that matter), where the fund pays the pension rather than purchasing an annuity from an insurer, the fund has to formulate a policy on post-retirement pension increases.

## **5.3 Death claims**

---

The level of benefits payable to an active member of a retirement fund who dies will be defined in the rules of the fund.

There may be benefits payable in addition to the retirement savings. The additional benefit may be in the form of a pension payable to a spouse (or spouses) and minor children. Additional death benefits are, however, most commonly set up as a lump-sum benefit, for example, a death benefit equal to 2 times the member's annual salary at death. If these additional lump-sum benefits are provided through the fund, i.e. they are included in the rules of the fund, all the benefits must be distributed in terms of provisions of Section 1 and Section 37C of the Pension Funds Act. Tax may be payable on these benefits.

### **5.3.1 Admission of claims: death in service**

If a member dies before retirement, the benefit in terms of the rules of the scheme is calculated on the latest salary details. Before admitting the claim, certain documents must first be produced, and certain investigations conducted.

In the event of a death claim, the insurers will require that the administrators provide proof of death in the form of an official death certificate. Proof of age will also be called for if this has not yet been submitted. If death occurred very soon after commencement of the membership, the insurer may also ask the administrator to confirm that the member was in active fulltime employment on the date the member became eligible to join the scheme.

### **5.3.2 Equitable distribution of death benefits**

It is generally accepted that benefits will be paid to a dependent. However, not every member has clearly defined dependents. The member may never have married, be divorced, be a widow or widower, and/or die childless.

A member may also nominate a person who is not a dependent, but who he would like to receive a portion of the death benefit in the event of the death of the member. This person is called a nominated beneficiary (nominee).

Section 37C places the disposition (allocation and payment) of a member's death benefit under the control of the fund's board of trustees. The trustees have discretion regarding the application of the death benefit to the member's dependents or nominated beneficiaries in such proportions as they deem equitable (fair), based on the results of their research and investigation into the deceased member's personal circumstances and due consideration of the needs of the beneficiaries and dependents. The fund has a period of 12 months within which to trace any dependents of the member and then make the appropriate allocation.

In the event of a member's death, the trustees will first examine the member's Nomination of Beneficiary form (an expression of wish on how the member would like his death benefits to be distributed). This form is usually a good indication of the member's personal status with regard to dependents and will assist the trustees in expediting the distribution of death benefits. The trustees' final decision on disposition of the benefits must be based, however, on thorough research and they cannot simply follow the nomination of beneficiary form.

#### **i) Distribution: dependents only or dependents and nominees**

As mentioned, the trustees are required to exercise their discretion and decide on an equitable distribution under any circumstances where there are dependents involved. Only where the member leaves no dependents is the discretion of the trustees not required. The circumstances under which the trustees must exercise their discretion are the following:

- **Dependents only:** If the trustees become aware of, or are able to trace, dependents of the member within 12 months of the member's death, they must distribute the benefit to those dependents in a manner they deem equitable.
- **Dependents and non-dependent nominees:** If the member had nominated non-dependent beneficiaries and also left dependents, the board must within 12 months of the member's death distribute the benefit to the dependents and non-dependent nominees in a manner they deem equitable. It should be noted that, in this case, the trustees can decide on the portion (if any) to be allocated to a non-dependent nominee.

**ii) Distribution: no dependents, only non-dependent nominees**

If the trustees do not become aware of or are unable to trace any dependents of the member within 12 months of the member's death, and the member had nominated non-dependent persons as his beneficiaries, the benefit must be distributed according to the nomination form in the proportions selected by the member. However, the trustees may only do so once the amount by which the debts of the member's estate exceed the assets in the estate, has been settled.

**iii) Distribution: no dependents and no non-dependent nominees**

If the trustees do not become aware of, or are unable to trace any dependents of the member within 12 months of the member's death, and the member had not nominated non-dependent persons as his beneficiaries or, if he had only nominated non-dependent persons to receive a portion of the benefit and a portion remains, the benefit (or the balance thereof, as the case may be) must be paid to the member's estate. If no inventory of the member's estate had been registered by the Master of the High Court, the benefit must be paid to the Guardian's Fund.



### 5.3.3 Factors to consider when distributing death benefits

When the trustees are required to decide on an equitable distribution of the benefit to the dependents and non-dependent nominees of a member, they should consider all relevant facts, and ignore those that are irrelevant. The Pension Funds Adjudicator has identified some facts, which will be regarded as relevant to the apportionment of a benefit. These are generally referred to as the basket of factors to consider in the apportionment of a benefit. Some of these factors are considered in the subsection following.

The amount of the benefit available for distribution: First and foremost, the trustees should consider the amount they are dealing with. A benefit of R500 will certainly not require the same level of investigation and circumspection as a benefit of R1 million.

- **Extent of dependency:** The trustees should consider the extent to which each dependent had relied on the deceased for financial maintenance and, in doing so, consider the current and future maintenance needs of the beneficiary. Sometimes dependents will base their claim for dependency on trivial occasional amounts made available by the deceased on odd occasions, such as bus fares for visiting the deceased and grocery donations occasionally. Such claims do not often amount to financial dependency.
- **Age:** A young child will naturally be more dependent on the member for maintenance than an adult child, as the minor child is unable to work and will require maintenance for purposes of daily living expenses, education and medical expenses until he reaches the age of majority.
- **Current income and qualifications:** The income, job and qualifications of a potential beneficiary must be compared to the income, job and qualifications of the other beneficiaries. A beneficiary who is qualified as an attorney will not be as dependent as a beneficiary who has a Grade 8 qualification.

- **Benefits received from other sources:** The trustees should take into consideration other benefits paid to a claimant on the death of the deceased, for example, individual life insurance policies or in terms of the Will of the deceased. If, for example, one out of three of the deceased's dependents had been sole heir to his estate, the trustees should consider awarding the remaining two dependents a greater share of the fund benefit.
- **Future earning potential:** A beneficiary who is professionally qualified will have a greater chance of securing employment than a beneficiary with little or no academic qualifications, skills or experience. Remember, age or any form of disability will also play a role in respect of this factor, namely that a person past general retirement age or a person suffering from ill health will not have the same future earning potential as a healthy, young beneficiary who has just qualified to enter a certain job.
- **Relationship with the deceased:** Did the deceased and the claimant have a close relationship? Did they live together? This can be established from affidavits by relatives and colleagues, as well as from the beneficiary nomination form or the deceased's Will.
- **Wishes of the deceased:** Despite what has been stated above about the role of the beneficiary nomination form, the wishes of the deceased, as reflected on the nomination form, should be considered by the trustees, as the member would ultimately have known which persons had been most reliant on him for maintenance.

#### **5.3.4 Manner of payment of benefit**

Once the trustees have decided on the apportionment of the benefit, they are required to decide on the most appropriate method of payment to each beneficiary.

The default method of payment is to pay a benefit directly to the beneficiary. However, in many cases this is not possible because the beneficiary has limited legal capacity; for example, if the beneficiary is a minor, or if he is an adult with limited mental or other legal capacities. In such cases, a benefit should generally be paid to the parent (in the case of a minor) or the custodian (for example in the case of an adult with limited mental capacity) of the beneficiary.

Up until November 2008, the Pension Funds Act allowed for alternative methods of payment by way of payment to a trust contemplated in the Trust Property Control Act and payment from the fund by way of installments. However, certain developments in the industry (such as the ongoing Fidentia debacle) led to concerns that beneficiaries' interests might not be adequately protected.

The change to Section 37 C (2) also introduced the establishment of beneficiary funds which are only permitted to take lump-sum payments in respect of minor dependents or major dependents, who are incapable of managing their own affairs and, in return, to pay beneficiaries. These trusts are considered in the subsections following.

**i) Payment to the guardian or caregiver of the beneficiary.**

Payment of a benefit from a fund may be made to a person recognised in law (which includes the Child Care Act) or appointed by a Court as the person responsible for managing the affairs or meeting the daily care needs of the beneficiary. When one considers the provisions of the Child Care Act, such a person could include not only a biological parent or court-appointed legal guardian, but also a person who takes care of the child on a daily basis (what we would previously have referred to as the custodian of the child). What this essentially means for purposes of Section 37C of the Pension Funds Act, is that payment of a benefit may be made to any of the following:

- A natural parent.
- A guardian appointed by a court.
- A factual caregiver of a child.

**ii) Payment into trust**

As stated above, payment into trust was possible prior to November 2008, but certain concerns of the Regulator have led to further restrictions being imposed on these payments. The requirements for payment into trust are now that:

- The trust must be registered in terms of the Trust Property Control Act, 1988
- The trust must have been or be selected by any of the following persons:

- The member
- The guardian or caregiver of a beneficiary
- The beneficiary, if he/she is an adult person with full legal capacity.

### **iii) Payment to a beneficiary fund**

As a result of the Regulator's concerns about the protection of beneficiaries' benefits, provision has now been made for funds to be established specifically for purposes of the protection of death benefit beneficiaries' benefits, referred to as beneficiary funds and which funds are to be regulated in terms of the Pension Funds Act. The Pension Funds Act sets out no requirements for benefits to be paid to such funds. It is, therefore, presumed that the fact that such funds will be regulated under the same provisions of the act applicable to other retirement funds, will be regarded as sufficient to protect beneficiaries' benefits.

### **iv) Payment from the fund in installments**

A less popular option is payment from the fund in installments. The reason why this option is used less frequently than the others is that the fund retains its liability towards the beneficiaries until the installments cease. Section 37C (3) makes provision for payment of installments in respect of minor beneficiaries and Section 37C (4) for installments in respect of adult beneficiaries.

### **v) Payments to minors**

Section 37C (3) determines that interest, at a reasonable rate, having regard to the actual fund return earned by the fund, must be added to the outstanding balance of the benefit. Furthermore, the outstanding balance must be paid to the beneficiary in full when he/she reaches the age of majority.

#### **vi) Payments to adult beneficiaries**

Payment in installments to an adult beneficiary may only be made with the consent of the beneficiary in terms of a written agreement, in which the amount and frequency of payments and other terms and conditions must be included. The agreement may be canceled by either party by giving 90 days' notice in writing to the other party, after which the outstanding balance of the benefit must be paid to the beneficiary in full.

### **5.4 Disability claims**

---

Very few funds these days offer true disability benefits. These benefits are usually offered through a separate insurance arrangement. The rules of a fund must specify the action to be taken in the event of a member becoming disabled. The following options on disability are most typical in retirement fund rules:

In a defined benefit pension fund arrangement, the rules may include a clause on ill health early retirement. The retirement formula will then be applied with an adjustment, and the member will receive a reduced pension from the fund if all the disability criteria have been met. Practice does vary, however, and in some cases the disability pension may be based not only on accrued service to the date of disability but make take service not yet served up to normal retirement age into account.

In a defined contribution arrangement, there may be no additional provision made within the fund or in a separate arrangement. In this case, the member who is disabled will cease to be a member and will be paid the current value of his share of the fund.

In either a defined benefit or defined contribution fund, the rules may refer to the separate disability arrangement. If this arrangement is payable in the form of a monthly income, the disabled member may remain an active contributing member of the fund. If the separate arrangement has been set up as a lump-sum payment in the event of total and permanent disablement, the fund rules usually state that the member ceases to be a member of the fund, and the value of the benefit should be paid out. In the event of disablement, the claims process is far more complex.

### **i) Admission of disability claims**

Information must be called for from the disabled member, his medical doctor, and the employer. On the strength of this information provided by the administrator, the insurer must judge if the degree of disablement is sufficient to qualify for payment of the benefit in terms of the definitions of disablement contained in the rules.

Where large lump sums are involved and the qualifying condition is permanent disablement, the insurer may want to postpone a decision in order to test the permanence of the condition. This postponement is normally written into the rules and can be a stipulated period from the date of disablement.

Should there still be some doubt as to the permanence of the disablement, some insurers reserve the right, in terms of their policy conditions, to pay the benefit in 60 equal installments over a period of five years.

## **5.5 Retirement benefit claims**

---

The main purpose of a pension or provident fund is obviously to make provision for retirement savings. The benefit at retirement will be defined in the rules of a fund and includes provisions for early, normal and late retirement. The rules will state the fund's normal retirement age; for example, age 65. The benefits will depend on whether the fund is a defined benefit fund, in which case the benefit will be calculated in terms of the fund rule's formula, or a defined contribution fund, in which case the benefit will be equal to the member's current retirement savings value, also known as a fund credit, or share of fund.

The amount that the member can withdraw as a cash lump sum will depend on whether the fund is a pension fund or a provident fund:

With a pension fund, the member can take one-third in cash.

With a provident fund, members that were over the age of 55 on 1 March 2019 can take all of the benefits in cash. For members that were under the age of 55 on 1 March 2019, only the contributions and return on the investment earned before 1 March 2019 can be taken as cash. Contributions and return on the investment earned after 1 March 2019 is subject to the one-third rule.

Benefits taken from a fund are always subject to tax.

The rules of a pension fund may offer a member either the choice of becoming a pensioner of the fund or buying an annuity from an insurer. Where a member has the option of becoming a pensioner of the fund, annual pension increases are granted at the discretion of the trustees, taking the advice of the fund's actuary into account.

These days the majority of funds do not offer members the option of becoming a pensioner of the fund; the retiree must buy his own annuity from an insurer. Even where there is a choice of becoming a pensioner of a fund or buying an annuity outside the fund, most retirees these days opt for buying an annuity from an insurer.

## **5.6 Impact of divorce orders**

---

The State regards pension assets as special assets worthy of enhanced protection. Pension benefits are not reducible, transferable, or executable, except in the limited instances outlined in the Pension Funds Act and certain other Acts of Parliament. One of the exceptions to this general rule is the payment of a pension benefit to a former non-member spouse in terms of a divorce order issued by the High Court. Before we look at executing the payment of pension benefits, it is important to understand the background to the current situation as the treatment of pension benefits as part of a divorce order changed in September 2007.

### **5.6.1 Position prior to September 2007**

Prior to the amendment of the Divorce Act of 1979 by the Divorce Amendment Act of 1989, a spouse's interest in benefits, which had not yet accrued, was generally not regarded as an asset in his/her estate, or as an asset in the joint estate, if married in community of property. This meant that the pension interest of a member spouse was not considered when dividing assets on divorce.

The Divorce Amendment Act of 1989 changed this situation. It introduced an amendment to Section 7(7)(a) of the Divorce Act according to which a member spouse's pension interest is deemed to be an asset in his/her estate for purposes of determining benefits in the event of a divorce. It allowed the court granting a divorce in terms of the Divorce Act, in dealing with pension interests, to make an order that-

Any part of the pension interest of the member, which is due or assigned to the other party to the divorce action, shall be paid by the fund to the other party when any pension benefits accrue in respect of that member.

An endorsement be made in the records of the fund that this part of the pension interest concerned is payable to the other party.

#### **Pension interest: Definitions as per the Divorce Amendment Act, 1989**

Pension interest in pension and provident funds is a member's withdrawal benefits in terms of the rules of the fund if membership would have terminated on date of divorce on account of a member's resignation.

The pension interest in the retirement annuity fund is the member's contribution up to the



From the definition, it is clear that no allowance was made for interest and/or growth to be added to the pension interest. Thus, if the pension interest was determined as the specific value as at the date of divorce, and the benefit was eventually only paid by the fund ten, twenty, or thirty years later when the member left the service, the non-member spouse received no interest or positive growth for that period. Moreover, the assigned/transferred benefit could only be paid to the non-member spouse when the pension benefit accrued to the member.

Another problem was that, if the non-member spouse died before accrual of the benefit, it was not payable into his/her estate.

Consequently, the Office of the Pension Funds Adjudicator received numerous complaints concerning divorce benefits prior to 13 September 2007, mostly regarding the definition of pension interest.

The Pensions Fund Amendment Act, 2007 which came into operation on 13 September 2007, introduced major changes with regard to the effect of divorce orders on retirement benefits.

### **5.6.2 Position with effect from September 2007**

The Pension Funds Amendment Act, which came into operation on 13 September 2007 created a radical shift regarding the payment of divorce benefits. The fund is now entitled to deduct from the member's benefit or his minimum individual reserve, any amount assigned from his pension interest to a non-member spouse according to a divorce order in terms of Section 37D(1)(d) of the Pension Funds Act.

The pension benefit payable to the principal member is now deemed to accrue to the member on the date of the court order in terms of Section 7(8) of the Divorce Act. It can now be divided at the time of the divorce and payment can be made to the non-member spouse immediately. This is often referred to as the clean-break approach (that is, a clean and final division of the pension benefit on the date of divorce).

The meaning of pension interest on divorce has been amended with effect from 1 November 2008. Pension interest in terms of a pension fund (other than a retirement annuity fund) is now defined as the fund value at the date of divorce. (No growth after the date of the divorce is included.)

In terms of Section 37D(1)(e) of the Pension Funds Act, the deduction shall be affected by the pension fund named in the court order upon receipt of the order, and the deduction shall have the effect of reducing the accrued benefit at the date of the deduction. In terms of the new Section 37D (4) (2008 legislation), disregarding any previous arrangement, the amount allocated will immediately be deducted from the member's benefit, as well as tax on it.

The non-member spouse has the option to receive the award in cash or transfer this amount to an approved retirement fund. The fund must pay or transfer the gross amount allocated in the divorce order within 60 days of being informed.

If no election is made during the 120-day period, the fund must pay the relevant amount within 30 days of the expiry of this period in cash to the non-member spouse.

The failure to transfer within this period shall result in the fund being liable for late payment interest at the fund return rate.

Another aspect that had caused great confusion was which party to the divorce was responsible for the tax on the amount paid to the non-member spouse. After the implementation of the amendment to the Divorce Act in 1989, the member spouse paid the tax and the non-member spouse received a tax-free benefit. The tax was paid as an additional deduction from the member spouse's fund value, so that party suffered a double deduction. The member spouse could proceed against the non-member spouse for recovery of the tax, but in the circumstances few did. It was possible to avoid the problem by allowing for the payment of tax in the divorce order, but the fact was not widely appreciated and the idea of returning to court to vary the divorce order at a time of strain was distinctly unpalatable to both parties.

The position was partly rectified. With effect from March 2012, the position was further refined for post-13 September 2007 divorce orders payable after March 2012. The member spouse had no tax liability, and the non-member spouse assumed that liability in his/her personal capacity. If the non-member spouse elected to preserve the gross amount of the benefit, then no tax would be levied at that point.

## **5.7 Impact of the Maintenance Act on benefit payments**

---

Pension benefits are regarded as extraordinary assets which enjoy additional protection. However, the law allows certain deductions to be made from the pension benefit in terms of Section 37D of the Pension Funds Act. One of these deductions is maintenance claims.

Maintenance obligations are imposed by the law on certain parties, depending on the nature of the relationship between them. For example, the common law imposes a duty of support on the part of the parent to maintain a child or the law of marriage imposes a reciprocal duty of support on the spouses. The extent of the support is often captured in a court order, outlining the amount and manner of payment.

From a pension fund point of view, there are two types of maintenance claims, namely arrear maintenance and future maintenance.

### **5.7.1 Arrear maintenance**

This type of claim refers to a situation where a person has obtained a court order in respect of maintenance. Hereafter, the pension fund member fails to comply with the order and is in arrears with the maintenance payments. In such an instance, the maintenance creditor can request the fund to deduct the arrear amounts from the pension benefit payable upon the termination of the employment contract.

### **5.7.2 Future maintenance**

This claim also applies in respect of a maintenance court order where the member is not necessarily in arrears, but there is a possibility that he may not pay in future in terms of the order.

Two High Court rulings have created an avenue to secure future maintenance needs. Thus, maintenance beneficiaries must be aware of the requirement outlined by the courts, and where they suspect that a pension fund member may default on payment, they can approach the fund and request a withholding of the benefit to secure a claim.

## **5.8 Insolvency and benefit payments**

---

The disposition of retirement benefits in the event of insolvency is provided for in Section 37B of the Pension Funds Act. In case of the sequestration of the estate of any person, who is entitled to a benefit payable in terms of the rules of the fund, the benefit will not be deemed to form part of the assets in the insolvent estate of that person, and may not in any way be attached or appropriated by the trustees in his insolvent estate or by his creditors, notwithstanding anything to the contrary in any law relating to insolvency.

## **5.9 Home loans and benefit payments**

---

Section 37D makes provision for certain deductions, which may be made from retirement benefits when they become due.

Before dealing with the mechanics of home loans, it is important to understand exactly what home loans can be granted by a retirement fund. Retirement annuity funds do not generally become involved in-home loans, as there is no mechanism for reclaiming the amount on default before the member actually retires.

Pension and provident funds can become involved in housing/home loans in one of two ways:

By a direct loan from the fund assets. These days, very few funds take this route, and generally only self-administered funds have the capacity and flexibility to do so. There is a considerable amount of extra administration and record-keeping, and few funds have the expertise to operate what is essentially a building society operation.

The almost universal practice is to outsource the function to a bank or building society and the fund provides only a guarantee that funds will be made available to settle any outstanding loan on default, death withdrawal, or retirement. The bank/building society will normally charge a rate of interest linked to prime.

Funds are overly cautious as to the amount they lend or provide a guarantee for. The starting point is usually the amount payable to the member on withdrawal, and then allowance is made for the potential tax payable. There is also the possibility of the member getting divorced in the future or some order made under the Maintenance Act. As far as payment is concerned, all of this would take priority over a housing loan. So, often the amount lent or guaranteed might be as low as 20% to 30% of the withdrawal value.

Policing of housing loans is another factor, which makes many funds reluctant to grant housing loans or guarantees. Often funds made available for housing loans were not used for that purpose at all, but for settling all manner of debt.

### **5.9.1 Retirement**

Where a housing loan has not been settled by the time of a member's retirement, the deduction allowed is restricted to the cash commutation value. This means that, while all the money from a provident fund can be claimed (prior to March 2019), only the third commutation allowed in terms of pension fund rules would be available.

### **5.9.2 Withdrawal**

Where a member withdraws from a fund, while still owing money on a housing loan and the benefit is a cash lump sum, the whole of the benefit may be claimed to repay the housing loan.

Where the member is transferring his whole benefit to another fund, which is prepared to accept the responsibility for the loan, no deduction is made.

Where the receiving fund is not prepared to accept responsibility, the housing loan must be repaid, and only the balance of the withdrawal benefit transferred.

### 5.9.3 Death

The position on death is identical to that where a withdrawing member takes a cash lump sum. Further, should a member default on his home loan, and no viable solution can be found, the trustees have the authority to use the member's withdrawal benefit to pay back the loan as a last resort.

## 5.10 Ancillary benefits

---

In addition to the core features and benefits of a retirement product, ancillary benefits play a significant role in enhancing the value and appeal of the overall offering. Ancillary benefits are complementary or additional features that are integrated into a policy or investment product to provide additional protection, convenience, or incentives to the policyholder or investor.

The specific ancillary benefits available in retirement products are not standardized and can vary depending on the nature of the core product and the choices made by the individual or employer. Ancillary benefits are typically tailored to meet the diverse needs and preferences of retirees and may require an additional cost or may be included as part of the overall package.

Here are some examples of ancillary benefits that can be added to a retirement product:

- **Dread Disease Cover:** This benefit provides a lump sum payment or income replacement in the event that the policyholder is diagnosed with a specified critical illness or medical condition. It offers financial support to cover medical expenses and any other related costs during the treatment and recovery period.
- **Disability Cover:** Disability cover provides financial protection in the event of a disability that prevents the policyholder from working or earning income. It ensures that the policyholder receives regular payments or a lump sum amount to help maintain their financial stability and cover ongoing expenses.

- **Critical Illness Cover:** Critical illness cover provides a lump sum payment if the policyholder is diagnosed with a critical illness or medical condition listed in the policy. This benefit helps alleviate financial burdens during challenging times, allowing the policyholder to focus on their recovery without worrying about the associated costs.
- **Income Replacement Cover:** This benefit offers a regular income stream in the event of the policyholder's inability to work due to illness, injury, or disability. It ensures that the policyholder continues to receive a portion of their income to cover essential living expenses and maintain their standard of living.
- **Funeral Benefits:** Funeral benefits provide financial assistance to cover funeral expenses in the unfortunate event of the policyholder's death. This benefit helps relieve the financial burden on the policyholder's family or beneficiaries during a difficult time.
- **Awards Programs:** Some retirement products may include awards programs that promote healthier living or incentivize additional contributions. These programs encourage policyholders to engage in activities that contribute to their overall well-being, such as participating in wellness programs, maintaining an active lifestyle, or making additional contributions to their retirement savings.

It is important to note that the availability and specific details of ancillary benefits can vary between different retirement products and insurance providers. Policyholders should carefully review the terms and conditions of their chosen retirement product to understand the ancillary benefits included, any associated costs, and the eligibility criteria for accessing these additional features.

Ancillary benefits are designed to enhance the overall value and appeal of retirement products by providing additional layers of financial protection, flexibility, and rewards. The inclusion of these benefits allows individuals to tailor their retirement plans to better align with their unique needs and aspirations.

## 5.11 Tax Treatment of Benefits

---

The monthly pension is treated as taxable income, but there is an indirect tax benefit arising from progressive taxation in South Africa. For most members, their pre-retirement income is considerably higher than their post-retirement income. Thus, their tax rate is higher in the years that they contribute and receive a tax break and lower in the years that they receive benefits and pay tax.

### 5.11.1 On withdrawal

The Income Tax Act makes provision for different types of withdrawal such as the following:

- Deductions from minimum individual reserves in terms of pre-September 2007 divorce orders and post-September 2007 divorce orders.
- Cash withdrawals.
- Lump sums transferred to approved funds.

Therefore, when a member resigns from his employment, subject to the rules of the fund he will become entitled to elect one of the following three options in respect of his pension or provident fund:

- A deferred pension, i.e., to leave the benefit in the fund and choose to receive a deferred retirement benefit at normal retirement age.
- Transfer all or some of the benefits to another approved retirement fund.
- Make a cash withdrawal in respect of all or some of the benefits.
- We will now examine the income tax implications of each option in greater detail.

### 5.11.2 Deferred pensions

Where a deferred pension is elected, no tax will be payable until the benefit is paid at normal retirement date.



### **Transfers to other approved retirement funds**

Where benefits are transferred to another approved pension fund, pension preservation fund, provident fund, provident preservation fund, or retirement annuity fund, no income tax is payable.

### **Cash withdrawals**

That part of a benefit from a pension fund, provident fund, or preservation fund which is taken as a cash benefit, may be subject to income tax.

The first step is to determine the current taxable portion of the withdrawal benefit. This is calculated by taking the amount of the cash withdrawal less any deductions allowed in terms of paragraph 6 of the Second Schedule to the Income Tax Act.

Once the current taxable portion of the withdrawal benefit has been calculated, apply the tax table for withdrawal benefits as published in the Budget Speech each year to the taxable portion of the withdrawal benefit to calculate the income tax payable.

Where the benefit is liable for tax, the administrator must apply to the member's local revenue office for a tax directive, although increasing use is being made of a centralized SARS website system. The tax deduction requested by the revenue authorities may include arrear amounts of normal income tax and, where the member is in arrears with tax payments, an IT88 will be issued for an extra payment to be made over and above the normal tax that will be levied.

Withdrawal benefits are taxed according to the withdrawal table.

Table 5: Withdrawal benefits table

Taxation lump sum	Rate of tax
<b>R0 – R25 000</b>	Lump sum tax free
<b>R25 001 – R660 000</b>	18% of the amount exceeding R25 001
<b>R660 001 – R990 000</b>	R114 300 + 27% of the amount over R660 001
<b>R990 001 and above</b>	R203 400 + 36% of the amount over R990 001

This table is cumulative over a person’s lifetime and is applicable to subsequent withdrawal lump sums arising from membership of future funds after 1 March 2014. The taxable lump sum cannot be set off against an assessed loss.

There is also the possibility that a person may withdraw a lump sum from one fund, join another and then retire with a lump sum, join a third fund and withdraw from it with yet another lump sum.

There are many combinations, but where the event is retirement after 1. October 2007, the withdrawal lump sums taken during the members working lifetime will be considered when the tax table for retirement lump sums is applied.

Additionally, the table applies not only to withdrawal benefits but also to severance package lump sums paid after 1 March 2011.

The accumulation of withdrawal lump-sum benefits as time goes by, as well as an increased tax rates will hopefully to be a powerful incentive to encourage members to preserve their benefits for retirement.

#### **i) Tax implications of public sector funds upon withdrawal**

Prior to 1 March 1998, lump-sum benefits from public sector pension funds, i.e., state and local authority pension funds, were tax-free. With effect from 1 March 1998, such lump sums are now subject to income tax.

To provide a measure of phase-in relief, Formula C was introduced into the Second Schedule to the Income Tax Act. The idea of Formula C is to only tax that portion of the lump-sum benefit that relates to membership of the fund from 1 March 1998 onwards.

Paragraph 2A of the Second Schedule to the Income Tax Act determines how much of the lump sum is treated as being subject to the normal provisions of the Second Schedule. The amount deemed to be a lump sum subject to the Second Schedule is an amount equal to the amount determined in accordance with Formula C.

Formula C

$$A = \frac{B}{C} \times D$$

Where:

A = the amount to be the taxable portion of the lump sum to be included in gross income

B is one of the following:

Where the number of completed years of employment are in terms of the rules of the fund considered for the purposes of determining the benefits, the number of completed years of employment after 1 March 1998.

Where the years of employment are not considered in terms of the rules of the fund, the number of completed years of membership of the fund after 1 March 1998.

C = total number of completed years considered in the determination of benefits from the fund.

D = the lump-sum benefit payable to the member.

Public sector fund members can, upon resignation from employment and from the public sector fund, preserve their benefits in a private sector fund.

With effect from 1 March 2006, amendments were introduced to preserve the tax-free status of transferred public sector fund benefits that accrued prior to 1 March 1998.

### 5.11.3 Payment of death benefit

The full benefit can be taken in cash when a member of a retirement fund dies.

Where the full benefit is not in the form of a cash lump sum, the balance may be used to purchase a compulsory annuity.

Before the benefit can be paid, the administrator must obtain a tax directive.

Lump-sum benefits payable upon the death of a member by a pension fund or a provident fund are taxed in the same way as lump-sum benefits at retirement. For income tax purposes, the lump-sum benefit payable upon the death of a member is deemed to have accrued to the member on the day prior to the member's death. Therefore, any lump-sum benefit will be taxed in the hands of the deceased estate according to the tax table applicable at retirement, death, and retrenchment.

However, any tax payable by the deceased estate may be recovered from the person to whom or in whose favour the lump-sum benefit in question accrues. In practice, any income tax payable is deducted directly from the lump-sum benefit, and the net after-tax benefit is usually paid to the beneficiary.

If the beneficiary takes an annuity or pension, then the pension or annuity will be fully taxable in the recipient's hands after the death of a member of a pension fund or a provident fund.

Death benefits are taxed according to the retirement/death tax table.

*Table 6: Retirement/death tax table*

<b>Taxation lump sum</b>	<b>Rate of tax</b>
<b>R0 – R500 000</b>	Lump sum tax free
<b>R500 0001 – R700 000</b>	18% of the amount exceeding R500 001
<b>R700 001– R1 050 000</b>	R36 000 + 27% of the amount over R700 001
<b>R1 050 000 and above</b>	R130 500 + 36% of the amount over R1 050 001

Spouses' pensions (and children's pensions, in cases where the pensions are large enough) are taxed as income with monthly deductions in accordance with SITE or PAYE. As the benefit is usually an insured benefit, the insurer who pays the benefit is responsible for the deduction of the tax.

Should the fund insure its own lump-sum death benefits, the administrator (who will be responsible for the payment of the benefit) will have to deduct tax in accordance with normal SITE or PAYE.

#### **5.11.4 Payment of disability benefits**

The taxation of disability benefits is complex, as it depends on whether the person affected remains a member of the fund (permanent health insurance) or whether a withdrawal or retirement from the fund takes place (capital disability benefit).

##### **i) Capital Disability Benefit**

The other possible disability benefit is the payment of a capital lump sum on permanent disability. In this case, the member leaves the fund either by withdrawal or by retirement. Where a lump sum is payable, the benefit is added to the normal retirement or withdrawal benefit (as the case may be) for taxation purposes. In some cases, the benefit is payable as an income, in which case it is taxed in the same way as an annuity.

#### **5.11.5 On retrenchment**

A member of a pension fund or a provident fund who is retrenched from his employment may take the full fund value of the pension or provident fund as a cash lump sum.

The 2010 Taxation Laws Amendment Act amended the Income Tax Act to allow for a tax-free transfer of a lump-sum retrenchment benefit payable by one fund to another.

A lump-sum benefit received by the member due to his retrenchment or redundancy will be taxed as a retirement fund lump-sum benefit in terms of the table applicable at retirement, death, and retrenchment.

Remember that a severance benefit lump-sum benefit will also be taxed as a retirement fund lump-sum benefit in terms of the table applicable at retirement, death, and retrenchment.

### 5.11.6 Lump sum retirement benefits

If the member has decided to take a part of his benefits in cash, a payment for the appropriate amount will be made after deduction of any tax in accordance with the results of the tax directive application, which has to be made to SARS.

These lump-sum benefits will be taxed according to the retirement/death tax table.

*Table 7: Retirement/death tax table*

<b>Taxation lump sum</b>	<b>Rate of tax</b>
<b>R0 – R500 000</b>	Lump sum tax free
<b>R500 0001 – R700 000</b>	18% of the amount exceeding R500 001
<b>R700 001– R1 050 000</b>	R36 000 + 27% of the amount over R700 001
<b>R1 050 000 and above</b>	R130 500 + 36% of the amount over R1 050 001

As in the case of withdrawal benefits, the table is cumulative over a person's lifetime. So, at retirement SARS assesses all withdrawal benefit lump sums paid before 1 March 2009, together with previous retirement benefits paid after 1 October 2007, as well as any severance packages received after 1 March 2011.

#### i) Allowable deductions

The following deductions are allowable according to the Income-tax Act:

Members' contributions which were previously disallowed as deductions.

A withdrawal amount (minimum individual divorce withdrawal) transferred into the fund in terms of an election under Section 37D(4)(b)(ii) of the Pension Funds Act.

A withdrawal benefit deemed to have accrued to the taxpayer – only if it has been taxed, e.g. transferred from a pension fund to a provident fund.

An amount transferred to a preservation fund as an unclaimed benefit and which was taxed prior to such transfer.

An amount transferred from a Government Pension Fund to a private sector fund as represents the tax-free portion, i.e., pre-1 March 1998 pro-rata portion.

Any amounts previously deducted cannot be deducted again and the amount of the deductions cannot exceed the lump sum.

After commuting a maximum of up to one-third of the pension or retirement annuity fund capital at retirement, the pensioner is obliged to secure a pension for life with a minimum of two-thirds of the pension or retirement annuity fund capital.

## **ii) Retirement from public sector funds**

With one exception, the taxable portion of a cash lump-sum benefit from a public sector pension fund or a public sector provident fund is calculated in the same way as the taxable portion of a lump-sum benefit from a private sector fund at retirement. The same steps are followed when determining the tax-free portion of the cash lump sum from public sector funds, except Formula C of the Second Schedule to the Income Tax Act has to be applied first.

You have previously learnt that the purpose of Formula C is to protect the vested rights of the members of public sector funds accumulated in the fund prior to 1 March 1998. Formula C, therefore, calculates the taxable portion of the lump sum after 1 March 1998.

## **iii) Monthly pension payment**

Monthly pension payments are subject to tax if the income from the annuity exceeds the tax threshold. The person making the payment to the pensioner is responsible for the deduction of tax and accounting for it to SARS.

The principle of aggregation will be applied on such monthly pension payment.

## 5.12 The principle of aggregation

---

In terms of the Taxation Laws Amendment Act of 2009, income tax must be calculated on the aggregate of all retirement fund lump-sum benefits taken previously, i.e. on withdrawal and/or retirement, death, and retrenchment benefits (including severance benefits) taken previously.

The steps to be followed when applying the principle of aggregation when calculating the income tax payable on multiple retirement fund lump-sum benefits.

**Step 1:** Calculate the taxable lump-sum amount of the current retirement fund.

**Step 2:** Add previously taxable withdrawal/retirement lump sum amounts (After 1 March 2009).

**Step 3:** Calculate the tax payable on the total amount applying the retirement tax table.

**Step 4:** Calculate the tax payable on the previously taxable withdrawal/retirement lump-sum amounts. Apply the retirement tax table to arrive at a net taxable amount

**Step 5:** Calculate the tax payable as the Tax calculated in Step 3 minus the net taxable amount calculated in Step 4.

**Step 6:** Calculate the taxable lump-sum amount of the current retirement fund.

The following lump sums must be considered for aggregation:

**Withdrawal benefits:** All lump-sum withdrawal benefits accrued to the taxpayer since 1 March 2009; previous benefits that were taxed, using the average rate, do not need to be included.

**Retirement benefits:** All lump-sum retirement benefits accrued to the taxpayer since 1 October 2007; benefits accrued before that date was taxed using the average rate and do not need to be included.

**Severance benefits:** All severance benefits accrued to the taxpayer since 1 March 2011; previous severance benefits that were received prior to this date do not need to be included.

The following portions of lump sums must be considered for aggregation:

**Withdrawal benefits** The taxable portion of the lump sum.



Retirement benefits: The taxable portion of the lump sum.

Severance benefits: The taxable portion of the lump sum will in this instance be the full amount of the lump sum.

### **Example**

Lady A retired from her pension fund on 1 October 2009. She received a lump sum amount of R1 million from the pension fund.

Lady A previously retired from her retirement annuity on 1 August 2009 and received a lump-sum amount of R250 000.

The tax payable on the lump sums will be as follows:

<b>Step 1:</b> Calculate the taxable lump-sum amount of the current retirement fund:	R1 000 000
<b>Step 2:</b> Add previously taxable withdrawal/retirement lump sum amounts (After 1 March 2009).	+R250 000 = R1 250 000
<b>Step 3:</b> Calculate the tax payable on the total amount applying the retirement tax table.	R141 750 + 36% of amount above R945 000 = R251 550
<b>Step 4:</b> Calculate the tax payable on the previously taxable withdrawal/retirement lump-sum amounts. Apply the retirement tax table to arrive at a net taxable amount	Up to R315 000: 0%
<b>Step 5:</b> Calculate the tax payable as the Tax calculated in Step 3 minus the net taxable amount calculated in Step 4.	R251 550 – R0
<b>Step 6:</b> Calculate the taxable lump-sum amount of the current retirement fund	= R251 000

## Topic 6: The Rights of Pension Fund Members

### 6.1 Introduction

---

In the realm of personal finance and investment decisions, individuals often seek professional guidance to make informed choices and ensure their financial well-being. However, it is crucial to recognize that individuals have specific rights when it comes to seeking financial advice. These rights are established and safeguarded by regulatory frameworks to protect consumers and promote fair and transparent practices in the financial services industry.

This section will delve into the individual's rights in seeking financial advice, focusing on two key regulatory frameworks: the Financial Advisory and Intermediary Services Act (FAIS) and the Policy Holder Protection Rules. These regulations provide a framework that governs the conduct of financial service providers, ensuring that individuals receive reliable and suitable advice tailored to their unique needs and circumstances.

Throughout this section, we will explore the various rights granted to individuals and the obligations placed on financial service providers to uphold these rights. By understanding these rights, individuals can navigate the financial advice landscape with confidence and make well-informed decisions regarding their financial goals.

Key topics covered in this section include:

- **Overview of FAIS:** We will provide an overview of the Financial Advisory and Intermediary Services Act, highlighting its purpose and scope. We will explore the role of the Financial Sector Conduct Authority (FSCA) in regulating financial service providers and ensuring compliance with the Act.
- **Rights of Individuals:** We will examine the specific rights that individuals possess when seeking financial advice. These rights encompass areas such as fair treatment, access to information, suitability of advice, and the right to lodge complaints.

- **Duties of Financial Service Providers:** We will discuss the responsibilities and obligations imposed on financial service providers to protect the interests of their clients. This includes the requirement to act honestly, fairly, and with due skill, care, and diligence. We will also explore the obligations related to disclosure of information, conflicts of interest, and the duty to provide suitable advice.
- **Policy Holder Protection Rules:** We will delve into the Policy Holder Protection Rules, which set out additional safeguards for individuals who hold insurance policies. These rules aim to ensure that policyholders are adequately informed about their policies, protected from unfair practices, and have access to effective complaint resolution mechanisms.

Throughout this section, we will provide practical examples, case studies, and relevant insights to illustrate how these rights and regulations apply in real-life scenarios. By the end of this section, readers will have a comprehensive understanding of their rights as individuals seeking financial advice and the safeguards in place to ensure fair and transparent practices in the financial services industry.

## 6.2 The Financial Advisory and Intermediary Services Act and its Protection of Pension Fund Members

---

In the realm of personal finance, it is crucial for individuals to seek reliable and expert advice when it comes to managing their pensions, investments, and estate planning. With the complex nature of financial matters, the guidance of knowledgeable professionals can help individuals make informed decisions and secure their financial future.

In South Africa, the financial advisory and intermediary services industry is governed by the Financial Advisory and Intermediary Services (FAIS) Act. This legislation plays a vital role in ensuring consumer protection and promoting ethical conduct within the industry. According to the FAIS Act, any business that provides financial advice or services related to financial products must hold a license as a Financial Services Provider (FSP) granted by the Financial Sector Conduct Authority (FSCA).

The FAIS Act encompasses a wide range of financial service providers who are subject to regulation. This includes investment managers, investment advisers, insurance brokers and advisers, foreign exchange intermediaries, financial planners, and advisers. These professionals are required to meet specific competency and qualification criteria, ensuring that they possess the necessary expertise to offer sound financial advice.

By licensing and regulating businesses and professionals in the financial advisory and intermediary services sector, the FAIS Act establishes a robust regulatory framework. This framework promotes transparency, integrity, and accountability in the industry, providing consumers with a level of confidence when seeking financial advice.

The licensing process under the FAIS Act evaluates the fitness and propriety of individuals involved in financial services. Only those with a proven track record of honesty, integrity, and relevant qualifications are authorized to conduct business in the industry. This process helps protect individuals from potential misconduct or fraudulent activities by ensuring that they deal with reputable and trustworthy advisors.

Furthermore, the FAIS Act requires FSPs to comply with prescribed competency requirements, maintain a compliance function, manage conflicts of interest, and uphold operational standards. These obligations ensure that FSPs act in the best interests of their clients and provide suitable financial advice tailored to their specific needs.

In cases where disputes or complaints arise, the FAIS Act establishes the Ombud for Financial Services Providers as an independent adjudicator. This office provides a fair and impartial platform for resolving complaints that cannot be resolved internally by the fund's own complaint resolution mechanisms. The Ombud serves as a consumer protection measure, ensuring that members' rights are upheld and grievances are addressed appropriately.

Let's consider a practical example to illustrate how the regulations outlined in the FAIS Act are applied in the context of retirement funds.

### **i) Case Study: ABC Retirement Fund**

The ABC Retirement Fund is a registered retirement fund that provides pension benefits to its members upon retirement. As part of their retirement planning, the fund encourages its members to seek reliable and expert financial advice to effectively manage their pensions, investments, and estate planning. To ensure consumer protection and compliance with regulatory requirements, the ABC Retirement Fund follows the guidelines set forth by the FAIS Act.

In line with the FAIS Act, any business providing financial advice or services related to retirement funds must be licensed as a Financial Services Provider (FSP) with the Financial Sector Conduct Authority (FSCA). The ABC Retirement Fund engages the services of licensed FSPs, such as investment managers, financial planners, and advisers, who specialize in retirement planning.

The FAIS Act emphasizes the importance of competency and integrity in the financial services industry. Therefore, FSPs associated with the ABC Retirement Fund undergo a rigorous licensing process to ensure they are fit and proper persons, demonstrating a clean track record and possessing the necessary qualifications and experience.

To manage potential conflicts of interest, the ABC Retirement Fund and its associated FSPs adhere to strict guidelines. They implement conflict-of-interest management policies, ensuring that the interests of the members are prioritized and any conflicts are mitigated or avoided whenever possible.

In addition, the ABC Retirement Fund maintains sound financial practices. They hold adequate guarantees, fidelity guarantee insurance, and professional indemnity insurance, depending on the category of FSP and the handling of clients' funds or assets. The fund also complies with operational requirements such as maintaining proper accounting records, conducting annual audits, and implementing anti-money laundering control systems.

Furthermore, the ABC Retirement Fund follows the General Code of Conduct and the special Code of Conduct applicable to the retirement fund industry. These codes regulate various aspects, including client disclosure, record-keeping, advice suitability, risk management, advertising standards, and complaint resolution procedures. By adhering to these codes, the fund ensures transparency, accountability, and the well-being of its members.

Through the application of the FAIS Act, the ABC Retirement Fund demonstrates its commitment to providing members with reliable and trustworthy financial advice, adhering to regulatory requirements, and safeguarding their interests.

By following these guidelines, the ABC Retirement Fund ensures that its members have access to competent and qualified financial advisors, that their investments and pensions are managed responsibly, and that their rights as consumers seeking financial advice are protected.

### **6.3 The Treating Customers Fairly (TCF) Framework and Its Protection of Pension Fund Members**

---

In the financial services sector, the Treating Customers Fairly (TCF) framework plays a pivotal role in regulating the conduct of financial institutions towards their clients. The TCF initiative aims to ensure fair treatment of customers throughout the entire product life-cycle and advice process. This section will explore how the TCF framework protects members of pension funds and promotes market-conduct objectives within the financial services sector.

Financial services organizations, including financial product providers and financial services providers, must demonstrate their commitment to fair treatment by adhering to the following six principles or fairness outcomes:

1. **Customer-Centric Culture:** The fair treatment of customers must be embedded in the organization's culture. This ensures that customer needs are prioritized and that all employees are aware of their responsibility to treat customers fairly.

2. **Targeted Products and Services:** Products and services marketed and sold in the retail market should be designed to meet the specific needs of identified customer groups. Tailoring offerings accordingly helps ensure that customers are provided with suitable solutions.
3. **Clear and Appropriate Information:** Customers should receive clear and understandable information before, during, and after entering into a financial contract. This includes transparent disclosure of terms, conditions, fees, and risks associated with the products or services.
4. **Suitable Advice:** When customers receive advice, it must be suitable for their individual circumstances. Advisors should consider factors such as financial goals, risk tolerance, and current financial situations to provide appropriate recommendations.
5. **Performance and Service Expectations:** Financial products should perform as customers expect them to, and the overall service provided by the organization must meet acceptable standards. This ensures that customers' expectations are met and that they receive value for their investments.
6. **Easy Access and Complaint Handling:** Customers should not face unreasonable barriers when seeking to change products, switch providers, submit claims, or make complaints. The process should be streamlined and accessible, empowering customers to exercise their rights and voice their concerns.

The TCF framework extends its protection to members of pension funds, ensuring that their rights and interests are safeguarded. Pension fund administrators, trustees, and other service providers must adhere to the TCF principles when dealing with fund members. For example:

- Members must receive clear and comprehensive information about their pension benefits, including terms, fees, and investment options.
- Advice provided to members regarding retirement planning or fund investment strategies must be suitable for their specific circumstances and objectives.

- Members should have easy access to information, such as account statements, investment performance, and available options for changing providers or making claims.
- Prompt and fair handling of member complaints, with a focus on resolving issues in a transparent and efficient manner.

The TCF framework, as an integral part of the regulatory landscape, ensures that financial institutions uphold fairness and transparency in their dealings with customers. When applied to pension funds, the TCF initiative plays a vital role in protecting the rights and interests of fund members. By promoting a customer-centric culture, providing suitable advice, and facilitating easy access to information and complaint handling, the TCF framework contributes to a more equitable and secure retirement savings environment within the financial services industry.

#### **6.4 Policyholder Protection Rules: Safeguarding Members of Pension Funds**

---

The Short-term Insurance Act 53 of 1998 replaced the previous Insurance Act of 1943 and introduced separate legislation for short-term and long-term insurance, known as the Long-term Insurance Act 52 of 1998. Part of this legislation encompasses the Policyholder Protection Rules (PPRs). This section will explore the significance of the PPRs and how they protect members of pension funds.

The primary objective of the Policyholder Protection Rules is to ensure that any long-term insurance policy entered into is executed and enforced in accordance with sound insurance principles. These rules aim to protect the interests of both the client and the public by establishing guidelines for fair and ethical insurance practices.

The Policyholder Protection Rules were first published in 2017, with subsequent amendments made, most recently on 28 September 2018. These rules specifically apply to long-term insurance companies and have implications for intermediaries involved in the insurance process. It is important to note that the provisions of the Financial Advisory and Intermediary Services (FAIS) Act and the General Code of Conduct still remain applicable, and the PPRs cannot be used to bypass the requirements of the FAIS Act.



The Policyholder Protection Rules have a strong consumer protection bias. They ensure that insurance policies are entered into, executed, and enforced in a manner that adheres to sound insurance principles and practices. By upholding these rules, insurers and intermediaries aim to safeguard the interests of all parties involved, including the policyholders and the broader public.

It is important to highlight that insurers bear the ultimate responsibility for meeting the requirements set out in the Policyholder Protection Rules. This responsibility remains intact regardless of whether certain functions and duties are outsourced or delegated to external parties. Insurers cannot absolve themselves of compliance obligations by relying on third-party representatives.

Within the context of pension funds, the Policyholder Protection Rules play a vital role in protecting the rights and interests of fund members. By ensuring that long-term insurance policies are executed in accordance with sound principles, these rules help establish a fair and secure framework for members' insurance coverage. The PPRs provide transparency, accountability, and ethical standards that safeguard members' benefits and contribute to the overall confidence and trust in the pension fund industry.

The Policyholder Protection Rules serve as a critical component of the regulatory framework for long-term insurance in South Africa. By promoting sound insurance principles and emphasizing consumer protection, these rules enhance the fairness and integrity of the insurance industry. In the context of pension funds, adherence to the PPRs provides an additional layer of protection for members, ensuring that their insurance policies are executed in their best interests.

## **6.5 Consumer protection in terms of the Pension Funds Act**

---

### **6.5.1 Introduction**

Section 7D (1) (d) of the Pension Funds Act provides that the Board of Trustees must ensure the adequate and appropriate communication of information to the members of the retirement fund. In conjunction with the Act, Circular PF130 also deals with communication and access to information in the discussion of Principle 9: Communication and Access to Information.

Any member may request that the fund provide him, subject to the payment of a prescribed fee, with a copy of the following:

- Rules of the fund
- Latest revenue account.
- Latest Statement of Financial Position.
- Any member is entitled to inspect, without a charge, at the registered office of the fund, and may make extracts from the following documents:
  - Latest report (if any) prepared by a valuator.
  - Latest statement (if any), report on this prepared and submitted to the Commissioner of the Financial Sector Conduct Authority where a valuation has, in the opinion of the Commissioner, been deemed unnecessary.
  - Latest statement and report submitted to the Commissioner of the Financial Sector Conduct Authority which has been prepared at his insistence because the fund is deemed to be in an unsound financial position.

Where a concerned member is still not satisfied after having had access to the documentation mentioned herein, he can approach and attempt to persuade the Financial Sector Conduct Authority to order an inspection in terms of the Inspection of Financial Institutions Act.

### **6.5.2 Minimum communication requirements**

Following extensive consultation and substantial agreement with representatives of the retirement fund industry, it was decided to improve communication between funds and their members by setting minimum disclosure requirements to which all funds had to adhere. These minimum disclosure requirements were set out in Circular PF 86.

Every new member must be provided with an explanatory pamphlet within three months of his date of admission to the fund. An annual benefit statement must be given to every member within 6 months after the financial year-end of the fund. In the case of an underwritten retirement annuity fund, the issuing of a policy document/certificate of membership that contains all the necessary information is considered to be adequate and thus replaces the explanatory pamphlet.

Both documents may be in any format but must be fund specific and contain the information considered in the subsection following. The pamphlet must make it clear that an employee is able to refer to the rules if he requires further information.

#### **i) Details of the fund**

The following details regarding the fund must be provided:

- The fund name and its registered address.
- The name and job title of the person who can be contacted to answer queries, together with that person's relevant telephone numbers.
- The fund's reference number.

#### **ii) Details of benefits**

The following information regarding the benefits must be provided:

- The member's name (plus class of membership, if applicable).
- The member's date of birth.
- The member's date of admission to the fund and date of effective membership if different (This may happen where, for example, the member's service is backdated.)
- The pensionable salary of the member at the date of the statement.
- The date of the statement, as well as the date of the calculation of the benefits.
- A statement of the benefits that become payable at relevant instances.

- The value of any benefit payable on death.
- The value of any early retirement benefit payable as a result of disability or ill health.
- The value of any withdrawal benefit should the member withdraw within the current year.
- The value of any retirement benefit with the following information:
  - The normal retirement date.
  - For a defined benefit fund, the anticipated benefit based on current salary.
  - For a defined contribution fund, a statement of how the benefit is structured, with an explanation of investment risk.
  - For a defined benefit fund, a statement that a reduced benefit becomes payable on early retirement.
  - If the rules provide for fixed pension increases, this should be stated.

### iii) Rate of contributions

The following information regarding the rate of contributions must be provided:

- Current contributions payable by the member and the frequency thereof.
- Current contributions payable by the employer and the frequency thereof. In the case of a defined contribution fund, this should be the actual amount with an indication of whether management and risk-benefit costs are included or not. In the case of a defined benefit fund, a statement that the employer's contributions are the balance of cost will be sufficient.
- Where the calculation of a member's interest is dependent on market values, an explanation that the market risk may affect the benefit levels must be given.
- Where there are additional benefits as a result of a transfer or transfers from previous funds, these must be identified separately.

#### **iv) General**

The following additional information must be provided.

- A statement that the rules, financial returns, and the most recent actuarial valuation report may be inspected at the registered office of the fund or at the main office of the employer. Should a member want any copies, he may be asked to pay for them if this is a requirement set out in the rules of the fund.
- The procedures for internal dispute resolution and access to the Pension Funds Adjudicator.
- A note stressing the importance of nominating a beneficiary and keeping any nomination up to date.
- A statement that it is important to obtain professional advice, before electing a benefit on termination of membership.
- A statement to the effect that, if the benefit statement conflicts with the rules, the rules will prevail.
- A statement to the effect that all benefits may be subject to income tax, depending on the tax regime in place at the time.

#### **v) Additional information**

Funds that wish to provide members with additional information in excess of the required minimum, may do so.

Other matters of which members may be informed, and which may or may not be included in the scheme booklet, are as follows:

- Details of how to apply for membership and how evidence of acceptance as a member is issued.

- An outline of any provisions for the exercise of discretion by the management board in relation to benefits. In particular, where the management board has discretion to decide who should receive benefits on death, it is beneficial to explain the reason for this provision and to describe any arrangements whereby the member can indicate his preference as to a beneficiary.
- How benefits are taxed, including:
  - Taxation of lump-sum benefits.
  - Tax treatment of refunds of contributions on withdrawal or death.
  - Estate duty position in relation to death benefits.
  - Treatment of employees' contributions to a pension fund are deductible from taxable income and that relief is given by deducting contributions from pay before the tax liability is calculated.
- In general terms, how contributions are invested.
- Provisions in the event of winding up, including priority of rights and the principles governing the disposal of any surplus assets.
- It is good practice for funds to include information on the additional unapproved benefits where they are in a position to do so.

### **6.5.3 Notification to members of specific events**

Notification to members must be given to members in the following special events and are considered in the subsection following:

- Fund restructuring
- Withdrawal from service
- Retirement
- Deferred benefit
- Death

#### **i) Fund restructuring**

Fund restructuring includes the following events:

- Voluntary termination of the fund in terms of Section 28 of the Pension Funds Act.
- Withdrawal of an employer (this will not apply where the fund is an umbrella fund with unrelated employers).
- Conversion from a defined benefit to a defined contribution fund.
- Reduction or increase in benefits or contributions.
- Transfer of benefits to another fund.

The information on conversions should consist of a personal benefit statement, illustrating the effect of the conversion, stressing the difference in benefit structure and the resulting transference of investment risk.

Where the funds are to be transferred, in terms of Section 14 of the Pension Funds Act, the statement should include a note of the transfer value and the actual document must be supplied by the transferor fund. Reasonable notice, not less than 60 days, is to be given to the members of the intention to restructure the fund to allow time for objections.

## **ii) Withdrawal from service**

All the options in terms of the rules should preferably be explained to every member before he decides to take a cash payment. As a final fail-safe mechanism, the letter enclosing any cash payment must refer to any benefits that may have been forfeited as a result of selecting the cash payment option. Any facility for the payment of a transfer value should be explained.

Special mention must also be made of the fact that no income tax liability is incurred if the proceeds are transferred to another pension fund, preservation pension fund or a retirement annuity fund.

## **iii) Retirement**

A notification explaining the available options in terms of the rules of the fund must be sent to the member before he actually retires. Where the benefit is to be paid in the form of an annuity, the member must be warned that he will be required to produce a certificate of existence from time to time.

In the case of a provident fund, the member will have the option to receive the total value of the benefit available as a single lump sum (if above the age of 55 as on 1 March 2019). In this case, the notification must clearly indicate that the payment will be the full and final benefit payable from the fund and that no further payments will be made in the future.

## **iv) Deferred benefit**

In the case of a deferred benefit (for example, a preserved pension on withdrawal before retirement in the fund), written information should be provided on how this should be claimed when it becomes due.



## **v) Death**

In the event of the death of a member before retirement, the trustees of the fund will need to decide to whom the benefit(s) will be payable. Appointment of a nominated beneficiary by the member before his death will be considered, but the trustees must look to the needs of dependents who may not have been appointed, and who may have a valid claim. This is especially so if the nominated beneficiary is not a dependent. The trustees are bound to act in accordance with Section 37C of the Pension Funds Act.

The dependents or beneficiaries who are to share in the benefit must each receive a letter notifying them of the decisions made by the trustees and setting out the options available. Where the benefit is to be paid in the form of an annuity, the dependent or beneficiary must be warned that the same conditions as those for retirement from the fund will apply.

### **6.5.4 Annual disclosures**

In addition to the general information, the following information must also be disclosed to pensioners and dependents of deceased members on an annual basis:

- The date of the annual disclosure.
- A statement that the annual disclosure must be read together with the initial disclosure and the previous annual disclosures, and that it updates the initial disclosure and the previous annual disclosures.
- Details of any variations or amendments that may have occurred in the general information or initial disclosure since the date of the previous annual disclosure.

### **6.5.5 Special Disclosures**

Special disclosures must be made to all pensioners, deferred pensioners, and dependents before the happening of a special event. A special event will include, for example, the following:

- A change of address of the retirement fund or its administrator.
- The restructuring of a fund.
- A transfer to or from a fund.
- Any rule amendment that is likely to affect the membership or benefits of the pensioner, deferred pensioner, or dependent in any way.
- A special disclosure must, as a minimum requirement, include the following information:
  - The date of the special disclosure.
  - A statement that the special disclosure must be read with the initial disclosure and, if applicable, all previous annual disclosures, and that it updates them.
  - The details of the special event and the effect, if any, it will have on the pensioner, deferred pensioner, or dependent.
  - Any action that may be taken, or recourse that is available, if the pensioner, deferred pensioner, or dependent is dissatisfied with, or aggrieved by, the special event.

## **6.6 The FAIS Ombud: Resolving Complaints in Pension and Provident Funds**

---

### **6.6.1 Introduction**

The Financial Advisory and Intermediary Services (FAIS) Act established a robust complaints mechanism and dispute resolution process through the establishment of the FAIS Ombud's office. This section will explore the role of the FAIS Ombud and provide a case scenario illustrating how this mechanism operates within pension or provident funds.

The primary objective of the FAIS Ombud is to investigate and resolve complaints made by specific clients against financial services providers in a procedurally fair, informal, economical, and expeditious manner. Throughout the process, the Ombud must consider what is equitable in the given circumstances, taking into account the relevant contractual arrangements or other legal relationships.

### **6.6.2 Complaint's Process**

In the context of the FAIS Ombud, a complaint refers to a specific grievance relating to a financial service provided by a financial services provider or its representative to the complainant. A client, on the other hand, refers to a particular person or group of persons, excluding the general public, who intentionally receives or may receive a financial service or is the successor or beneficiary thereof.

Complaints submitted to the Ombud can relate to various situations, including instances where a financial services provider has contravened the provisions of the FAIS Act, resulting in financial prejudice or damage to the complainant. Complaints may also arise when the provider has acted willfully or negligently, causing or likely to cause prejudice or damage to the complainant, or when the provider has treated the complainant unfairly.

Before lodging a complaint with the FAIS Ombud, the client is required to first approach the financial services provider (FSP) involved and attempt to resolve the issue. The FSP has six weeks to address and resolve the complaint. If the matter remains unresolved, the client may escalate the complaint to the Ombud's office within six months of receiving the final response from the FSP.

The nature of a complaint determines how the FAIS Ombud will handle the case. The objective is to avoid replicating the rigid processes of the court system and instead focus on discovering the truth without insisting on formalities. The Ombud initiates a process of mediation and conciliation to explore the possibility of reaching a settlement between the parties involved. If a settlement cannot be reached or the Ombud's recommendation is not accepted, the Ombud will arbitrate the matter and issue a final determination, which holds the same weight as a court judgment.

### **Case Scenario**

For example, consider a scenario where a member of a pension fund lodges a complaint against the fund's administrator, alleging that the administrator acted negligently in managing the fund's investments. The member suffers financial prejudice due to the administrator's actions, which are in violation of the FAIS Act. The member initially approaches the administrator to resolve the issue but fails to reach a satisfactory resolution within the six-week timeframe. Consequently, the member submits a formal complaint to the FAIS Ombud within six months. The Ombud then initiates a mediation process, facilitating discussions between the member and the administrator in an attempt to reach a fair settlement. If a settlement cannot be reached, the Ombud proceeds to arbitrate the matter and provides a final determination, equivalent to a court judgment, which ensures that the member's rights are protected, and appropriate remedies are provided.

### **6.6.3 Conclusion**

The FAIS Ombud's office plays a crucial role in protecting the interests of clients within the pension and provident fund industry. By offering an accessible and efficient complaints mechanism, the FAIS Ombud ensures that grievances are addressed in a fair and timely manner. The process allows for mediation, conciliation, and arbitration to achieve resolution, providing clients with a means to seek redress and maintain trust in the financial services sector.

## **6.7 Title: The Pension Fund Adjudicator: Resolving Disputes in Pension and Provident Funds**

---

### **6.7.1 Introduction**

In the realm of pension and provident funds, conflicts between members and the fund can occasionally arise, leading to disputes and potential legal battles. Recognizing the need for a more accessible and cost-effective resolution mechanism, the government introduced the position of the Pension Fund Adjudicator. This section will delve into the role of the Pension Fund Adjudicator, eligibility to lodge complaints, the complaint process, and the objectives of the adjudicator's office. A case scenario will also be presented to illustrate the practical application of the adjudicator's role.

Previously, members had limited options and often resorted to costly legal proceedings to address disputes with their pension or provident fund. To mitigate this issue, the government created the position of the Pension Fund Adjudicator. The Minister of Finance, in consultation with the Policy Board at the Financial Sector Conduct Authority, appointed the Adjudicator to address complaints arising from the actions of a fund, its board of trustees, or its administrator. The office of the Pension Fund Adjudicator has been operational since 1 January 1998.

### **6.7.2 Complaint Process**

Various individuals or entities involved in the pension fund can lodge a written complaint with the fund or an employer participating in the fund. These include current or former members of the fund, beneficiaries or former beneficiaries, participating employers, fund boards, board members, and any person with a legitimate interest in the complaint. The complaint process enables them to seek resolution for their grievances.

Upon lodging a complaint, the complainant should expect a written response from the fund within 30 days. If the complainant does not receive a satisfactory reply or remains unsatisfied with the response, they have the right to escalate the matter to the Pension Fund Adjudicator. The primary objective of the Adjudicator's office is to address complaints in a procedurally fair, economical, and expeditious manner.

Before investigating a claim, the adjudicator may request the complainant to approach an approved organization established specifically for resolving disputes in the pension fund industry. If the complainant has already sought resolution through such an organization and remains dissatisfied with the outcome, they can still refer the complaint back to the Pension Fund Adjudicator for further examination.

There is a three-year prescription period within which complaints must be lodged. However, the Pension Fund Adjudicator has the authority, in exceptional circumstances, to waive the time barring based on the provisions of the Prescription Act, 1969 (Act No. 68 of 1969) relating to debt. Such waivers are rare and granted only when the complainant can demonstrate that they had no reasonable expectation or knowledge of available courses of action.

### **Case Scenario**

Consider a scenario where a former member of a pension fund lodges a complaint against the fund, alleging wrongful withholding of pension benefits following their retirement. The member initially approaches the fund directly, but after not receiving a satisfactory response within the stipulated 30-day period, decides to escalate the matter to the Pension Fund Adjudicator. The Adjudicator examines the complaint and, in adherence to the principles of procedural fairness, investigates the fund's actions and assesses their compliance with relevant legislation and contractual obligations. After considering all pertinent factors, the Adjudicator issues a decision that carries the same legal weight as a court order, ensuring a fair resolution and proper redress for the complainant.

### **i) Conclusion**

The establishment of the Pension Fund Adjudicator has provided a valuable avenue for resolving disputes within the pension and provident fund sector. By offering a fair and efficient alternative to costly legal proceedings, the Adjudicator's office aims to protect the rights and interests of pension fund members and provide a balanced resolution mechanism.

## Topic 7: Funds with Investment Choice Overview

### 7.1 Pension Fund Choice: Introduction

---

In the realm of retirement savings, pension funds play a crucial role in providing individuals with a secure financial future. Traditionally, pension funds operated on a standardized investment approach, where all members' contributions were pooled and managed under a single investment strategy. However, the landscape has evolved, and many pension funds are now embracing a more personalized and flexible approach through the concept of investment choice.

The concept of investment choice in pension funds allows members to select from a variety of investment options, each with its own risk profile and potential returns. The investment fund options may encompass a range of asset classes, such as equities, bonds, money market instruments, and property, allowing individuals to diversify their investments based on their risk tolerance and financial objectives. These investment choices enable individuals to align their pension savings with their unique risk tolerance, financial goals, and time horizon. By empowering members to make informed investment decisions, pension funds aim to optimize investment returns and enhance the likelihood of achieving retirement objectives.

outcomes.

The key features of a pension fund product that provides investment choice to the member include:

**Diverse Investment Options:** Members have access to a wide range of investment options, allowing them to diversify their investments and spread risk across different asset classes. This enables members to align their investment strategy with their personal financial goals and risk preferences.

**Flexibility and Control:** Unlike traditional pension funds with limited investment options, products with investment choice empower members to take charge of their retirement savings. They can adjust their investment allocations as needed, based on market conditions or changes in their financial circumstances.



**Personalized Investment Strategy:** Members can construct a personalized investment strategy that suits their unique financial situation, age, and retirement goals. Younger members with a longer investment horizon may opt for more growth-oriented portfolios, while those closer to retirement may prefer more conservative options.

**Investment Education and Support:** Pension funds that offer investment choice often provide members with educational resources and tools to make informed decisions. This may include information about the various investment options, risk profiles, historical performance, and how to assess their risk appetite.

**Regular Reporting and Monitoring:** The fund provides members with regular investment reports, performance updates, and portfolio valuations. This allows members to track the progress of their investments and make adjustments if needed.

**Professional Investment Management:** While members have the freedom to choose their investment allocations, the underlying assets within each portfolio are managed by professional investment managers. These managers are responsible for implementing the investment strategy and monitoring the performance of the fund.

It is important to note that while investment choice provides greater flexibility and control to members, it also entails higher levels of responsibility and potential risks. Members must be knowledgeable about investment concepts, understand their risk tolerance, and be actively engaged in managing their investments to make the most of this type of pension fund product.

Overall, a pension fund product with investment choice empowers members to tailor their retirement savings to their individual needs and preferences, potentially leading to better long-term outcomes. However, it requires members to be actively involved in their investment decisions and stay informed about market developments to make well-informed choices.

## 7.2 Pension Fund Choice: Fundamental Concepts

---

To understand the intricacies of pension fund Choice, it is essential to grasp three fundamental concepts related to risk benefits, fund policies, and the classification of retirement funds.

### **7.2.1 Fund Policies and Fund Member Policies**

Risk benefits are often considered as an additional component in retirement planning, conveniently incorporated into the overall retirement structure for its simplicity and efficiency. These risk benefits encompass areas such as death, disability, and funeral cover, among others. When an insurer provides risk benefits to pension fund members, the policyholder is the fund itself, and the underwriting of these risks can occur either on an individual or group basis.

In terms of policy structures, fund policies involve the issuance of a single policy that covers the liabilities of the fund towards all its members collectively. On the other hand, fund member policies entail the issuance of separate individual policies to the fund, addressing the specific liabilities owed to each member individually. While pension funds predominantly utilize fund policies, retirement annuities and preservation funds typically operate with fund member policies.

### **7.2.2 Approved versus Unapproved Funds**

pension funds can be classified as approved or unapproved, which impacts their tax implications. Approved funds have received tax approval from the South African Revenue Service (SARS), allowing tax deductions on premiums but subjecting benefits to taxation. To attain approved status, a fund must include an element of retirement funding. In contrast, unapproved funds see premiums forming part of an employee's taxable income, but the lump sum benefits paid out remain tax-free. Funds solely offering risk benefits without retirement funding are inherently unapproved.

### **7.2.3 Private versus Underwritten Funds**

Pension funds are further categorized as private or underwritten funds. Private funds have the freedom to invest in various assets within the boundaries of the Pension Funds Act. In contrast, underwritten funds are restricted to investing solely in insurance policies, making their assets primarily consist of claims against an insurer. Underwritten funds enjoy exemptions from specific provisions of the pension funds Act, provided they adhere to certain conditions. These include not maintaining a separate bank account, owning assets exclusively in the form of long-term insurance policies, having no liabilities beyond those underwritten by the policies, and appointing a single administering insurer. Contributions from fund members or employers are directly credited to bank accounts held in the insurer's name, and any benefits paid are disbursed directly by the insurer.

Understanding these concepts provides a solid foundation for navigating the landscape of pension fund Choice and the associated regulations. In "pension fund Choice: Concepts and Regulation," readers will delve deeper into these topics, gaining insights into the complexities and implications of making informed decisions within the realm of retirement planning and fund selection.

### **7.2.4 Outsourced Pension Funds Versus Pensioner-member Funds**

In pension fund structures, the treatment of pensioners can vary significantly, resulting in two distinct scenarios: pension funds where pensioners are outsourced and funds where pensioners remain in the fund. These scenarios present different approaches to managing the pension benefits of retired members.

In a pension fund where pensioners are outsourced, the responsibility for managing and paying out pension benefits is transferred to an external provider, such as an insurance company or pension administration firm. This outsourcing is typically done through the purchase of annuities, where the pension fund uses the accumulated funds to buy annuity contracts from an insurer. The insurer then assumes the responsibility of making regular pension payments to the retirees.

An example of this outsourcing can be seen when a pension fund reaches a certain size or considers it more efficient to outsource the pension payment process. By purchasing annuities, the fund transfers the risk of managing pension payments and ensuring the longevity of pensioners to the insurer, thus reducing the fund's administrative burden and exposure to investment risks associated with the pension payouts.

On the other hand, in a fund where pensioners remain in the fund, the pension benefits of retirees are managed and paid directly by the pension fund itself. In this scenario, the fund retains full control over pension payments, and the pensioners' benefits are not outsourced to external providers.

For example, some pension funds may choose to keep pensioners within the fund due to considerations such as investment strategy, cost efficiencies, or a desire to maintain a more direct relationship with their pensioner members. By retaining pensioners in the fund, the trustees and fund managers maintain control over the investment of pension assets and can continue to offer a range of investment options to pensioners, potentially resulting in more flexibility and tailored solutions for retirees.

The key difference between these two scenarios lies in the allocation of responsibility and risk associated with managing pension payments. In the outsourced scenario, the risk is shifted to the external provider, while in the scenario where pensioners remain in the fund, the fund retains full responsibility for managing and disbursing pension benefits.

Understanding these differences is essential for pension fund trustees, administrators, and members to make informed decisions regarding the most suitable approach for managing pension payments based on factors such as fund size, investment strategy, cost-effectiveness, and member preferences.

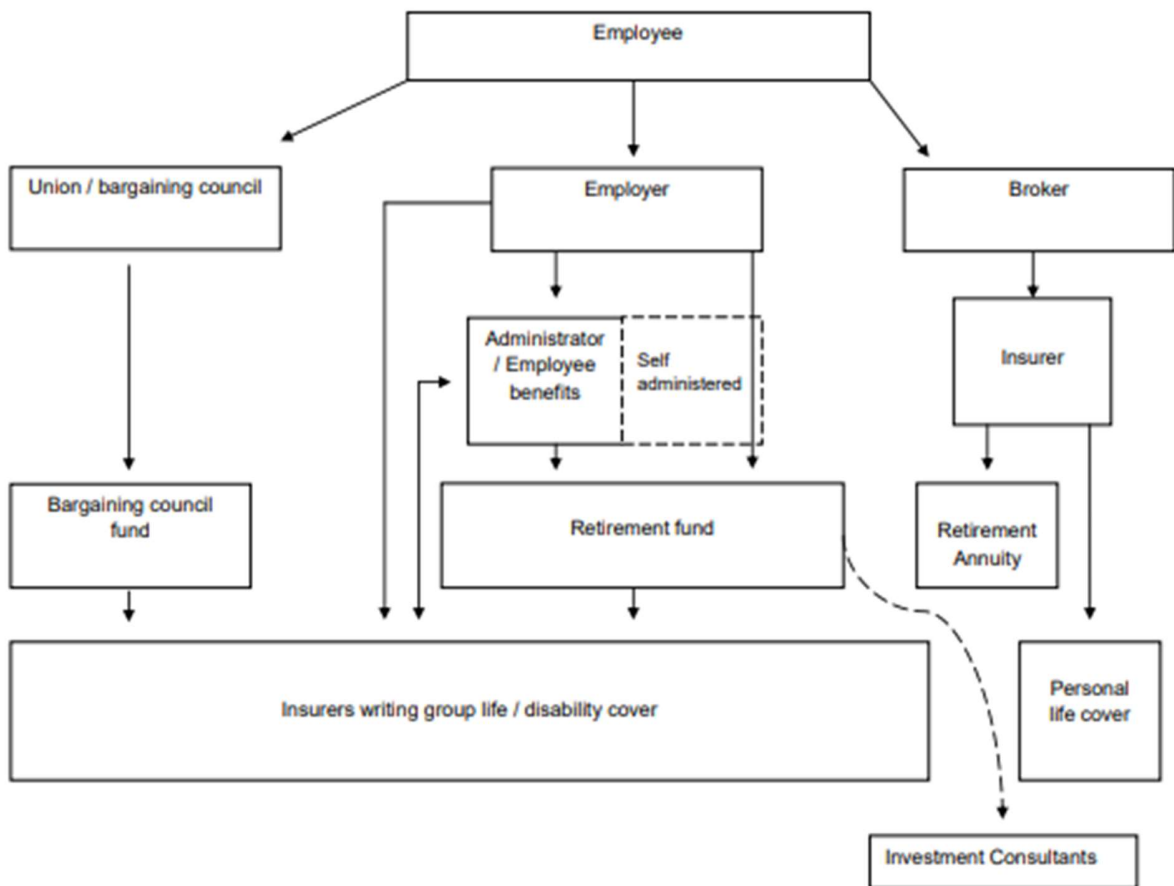
### 7.3 Pension Fund Choice: Stakeholders

In the realm of pension fund choice, various key role-players play a significant role in shaping the options available to individuals for their retirement savings. Understanding the distinct functions and responsibilities of each participant is crucial for navigating the complexities of retirement planning.

By delving into their distinct functions and collaborations, we gain a comprehensive understanding of the diverse range of choices and opportunities available to individuals when it comes to securing their financial future in retirement.

The figure below illustrates the stakeholders involved in a pension fund with investment choice.

Figure 4: Stakeholders in a Pension Fund with Investment Choice



### **7.3.1 Pension Fund Trustees**

Pension fund trustees are appointed individuals who have the responsibility to oversee and manage the pension fund on behalf of its members.

Pension fund trustees are central figures in the realm of pension fund investment choice. As fiduciaries, they bear the responsibility of overseeing and safeguarding the interests of the fund's beneficiaries.

One of the primary roles of pension fund trustees is to establish and maintain an investment strategy that reflects the fund's investment objectives, risk appetite, and long-term financial goals. They work closely with investment managers, consultants, and other industry experts to develop a well-diversified portfolio that balances risk and return, aiming to maximize investment growth while minimizing potential losses.

### **7.3.2 Principal Officer**

In the context of a pension fund with investment choice, the role of the principal officer is of paramount importance. The principal officer acts as the official representative of the pension fund and serves as a key link between the fund's board of trustees and the Financial Sector Conduct Authority (FSCA). This crucial role ensures that the fund operates in compliance with all relevant regulations and legislation.

The appointment of the principal officer is made by the board of trustees, and before assuming this position, the individual must be approved by the FSCA. This rigorous approval process underscores the significance of the principal officer's responsibilities in safeguarding the interests of the pension fund's members and ensuring the fund's overall adherence to regulatory requirements.

The principal officer plays a vital role in the day-to-day management and administration of the fund. They are entrusted with overseeing the fund's operations, ensuring that investment choices and portfolio options are effectively communicated to members, and coordinating with investment managers and administrators to facilitate smooth fund activities.

Additionally, the principal officer must also keep the board of trustees informed about the fund's performance and compliance status, enabling them to make informed decisions that align with the fund's objectives and the well-being of its members.

By serving as the Fund's representative with the FSCA, the principal officer upholds the highest standards of governance, accountability, and transparency. This role ultimately contributes to the effective management of the pension fund and instils confidence among members, knowing that their financial futures are in capable hands.

### **7.3.3 Fund Administrators**

Pension fund administrators play a crucial role in the context of pension funds with investment choice. Their primary responsibility is to ensure the smooth and efficient administration of the fund, handling various administrative tasks and processes. These tasks include managing contributions, processing member enrolments and withdrawals, maintaining accurate records, and handling member communications.

In the context of a pension fund with investment choice, administrators are tasked with providing members with clear and comprehensive information about the available investment options. They assist members in making informed decisions by offering educational resources, investment guides, and personalized advice when required. Moreover, administrators play a vital role in facilitating the investment process, ensuring that members' contributions are appropriately allocated to their chosen investment portfolios.

Administrators also serve as a liaison between the fund's trustees, investment managers, and members, facilitating effective communication and cooperation among these stakeholders. They are responsible for regularly updating members on the performance of their chosen investment portfolios, providing investment statements, and offering support with any investment-related queries or concerns.

Additionally, pension fund administrators must adhere to regulatory requirements and industry standards, ensuring compliance with relevant laws and regulations. They work diligently to maintain the fund's overall integrity and financial stability while safeguarding the interests of all its members.

Overall, pension fund administrators play a pivotal role in empowering members to make well-informed investment choices and ensuring the efficient and effective management of the fund's operations. Their commitment to transparency, professionalism, and member-centric services contributes significantly to the success and sustainability of pension funds with investment choice.

In South Africa, all pension fund administrators are required to undergo approval and licensing by the Financial Sector Conduct Authority (FSCA) before they can engage in any administrative functions. Initially, when a new pension fund is established, the responsibility of choosing the administrator falls upon the employer. However, once the fund is operational and a board of trustees is in place, it becomes their duty to appoint an administrator to oversee the fund's operations and activities.

It's worth noting that any decision to change administrators for an existing pension fund is solely within the purview of the board of trustees and not influenced by the pension plan members. This ensures that the governance and management of the fund remain in the hands of experienced and knowledgeable trustees who act in the best interests of the fund and its members.

The FSCA's stringent licensing requirements and the involvement of trustees in the appointment and oversight of administrators contribute to the overall professionalism, transparency, and accountability within the pension fund administration landscape in South Africa. By adhering to these regulatory standards, pension funds can uphold their fiduciary duty to safeguard the financial well-being of their members and maintain the integrity of the pension fund industry in the country.



### **7.3.4 Pension Fund Custodians**

Pension fund custodians are financial institutions appointed to safeguard the assets of the pension fund. They hold and manage the fund's investments, ensuring proper custody, safekeeping, and reporting of these assets. Custodians provide transparency and accountability in the investment management process.

The custodian also supports the fund's investment decision-making process by providing timely and accurate reporting on the fund's portfolio performance, valuation, and compliance with regulatory requirements. They assist in preparing periodic investment statements, performance reports, and other financial information that enables the fund and its members to assess the growth and performance of their investments.

Furthermore, the custodian ensures compliance with legal and regulatory obligations imposed on the pension fund. They work closely with regulatory authorities, auditors, and other stakeholders to ensure that the fund's investment activities adhere to applicable laws, regulations, and industry standards.

### **7.3.5 Bargaining Councils**

Bargaining councils play a crucial role in shaping the investment fund options available within pension funds. These councils, representing specific industries or sectors, serve as platforms for negotiations between employers and employees regarding various employment-related matters, including retirement benefits. One significant aspect of their involvement is the establishment and management of bargaining council funds, which are specifically designed to cater to the retirement needs of employees within a particular industry or sector.

### **7.3.6 Sponsor**

The sponsor, often an employer or a group of employers, plays a pivotal role in initiating the pension fund and providing the necessary support to ensure its successful functioning.

As the initiator and promoter of the pension fund, the sponsor is responsible for setting the fund's objectives, defining the scope of investment options, and determining the eligibility criteria for members to participate in the fund. The sponsor's involvement extends to establishing the fund's governance structure, including the appointment of trustees, principal officer, and other key personnel.

In addition to the initial setup, the sponsor is typically involved in financing the pension fund, contributing to the fund on behalf of its members, and ensuring sufficient funding for the fund's investment choices and administrative expenses. The sponsor's financial commitment is vital to ensuring the fund's sustainability and ability to deliver on its promises to members.

Furthermore, the sponsor acts as a crucial link between the pension fund and its members. They communicate investment choices, portfolio options, and other important information to ensure that members are well-informed about their retirement savings and investment decisions. The sponsor's communication efforts play a significant role in promoting member engagement and encouraging active participation in the investment choice process.

In cases where investment choices are offered within the fund, the sponsor works closely with the board of trustees and the principal officer to review and approve investment options. The sponsor's support and collaboration with these key stakeholders are instrumental in ensuring that the pension fund's investment choices align with the best interests of its members and meet the fund's overall objectives.

Overall, the sponsor's role is central to the successful operation of the pension fund with investment choice. By providing the necessary resources, guidance, and support, the sponsor contributes significantly to the financial security and well-being of the fund's members as they plan for their retirement futures.

### **7.3.7 Employees (members)**

Employees play a vital role in ensuring the success of the pension fund and in securing their financial future during retirement.

One of the primary responsibilities of the employee is to actively participate in the pension fund and contribute regularly towards their retirement savings. By making consistent contributions, employees build up a substantial fund over time, which forms the foundation of their retirement income.

In a pension fund with investment choice, employees are empowered to make informed decisions regarding their investment options. It is essential for employees to educate themselves about the available portfolio options, understand their risk profiles, and align their investment choices with their retirement goals. Taking an active role in their investment decisions can significantly impact the growth of their retirement savings.

Employees should also stay updated on the fund's performance and any changes in investment options. Regularly reviewing their investment choices and adjusting them as needed can help employees optimize their returns and adapt to changing market conditions.

Furthermore, employees should engage with the fund's communication channels, attend educational sessions, and seek advice from financial advisors if needed. By being proactive and seeking information, employees can make well-informed decisions that align with their unique financial circumstances and aspirations.

It is crucial for employees to maintain open communication with the fund's administrators and trustees, addressing any queries or concerns they may have. Engaging in constructive dialogue ensures that employees receive the necessary support and information to make sound investment decisions.

Ultimately, the role of the employee in a pension fund with investment choice is central to the success of the fund and the achievement of their retirement objectives. Through active participation, informed decision-making, and ongoing engagement, employees can take control of their financial future and build a secure foundation for their retirement years.

### **7.3.8 Insurers**

Insurers offer a range of insurance products that cover various risks, such as life, disability, funeral, and other related benefits, providing an additional layer of financial security for members and their beneficiaries.

One of the key functions of an Insurer is to underwrite risk benefits for pension fund members. This involves assessing the risk associated with providing insurance coverage to individuals or groups within the pension fund. Based on their risk evaluation, insurers determine the appropriate premium rates and coverage terms, enabling members to access valuable risk protection through their pension fund contributions.

Insurers work closely with pension fund administrators, trustees, and employee benefits consultants to design comprehensive and tailored risk-benefit options that align with the needs and preferences of the fund's members. They collaborate in educating members about the various insurance products available, ensuring that employees have a clear understanding of the coverage they are entitled to and its relevance to their individual circumstances.

Furthermore, insurers play a critical role in processing claims and providing timely benefit payouts to members or their beneficiaries when claims arise. This includes assisting with the claims submission process, assessing the validity of claims, and disbursing benefits according to the terms of the policy.

In the context of pension fund investments, some insurers also offer investment management services. They provide investment options such as unit trusts or life portfolios, allowing members to diversify their investment portfolios and access a broad range of asset classes.

As part of their role, insurers keep abreast of market trends and economic conditions, adjusting investment strategies and portfolio offerings to optimize returns while managing risk effectively. They provide investment performance reports and updates to pension fund trustees and administrators, enabling them to make informed decisions regarding the available investment options.

Overall, the role of an Insurer in a pension fund with investment choice is multifaceted, encompassing risk underwriting, providing financial protection and offering investment solutions. Their expertise and services contribute to the overall stability and growth of the pension fund, ensuring that members have access to valuable risk benefits and investment opportunities to support their financial well-being during and beyond their working years.

### **7.3.9 Employee Benefits Administrators**

Employee Benefits Administrators are responsible for designing comprehensive benefits packages that cater to the specific needs of the employer and its workforce. They work closely with employers to customize retirement and risk-benefit options, tailoring them to match the preferences and requirements of the employees.

One of the primary functions of Employee Benefits Administrators is to provide clear and concise communication about the pension fund's investment choices and other benefit offerings. They offer educational sessions, seminars, and workshops to empower employees with the knowledge they need to make well-informed investment decisions that align with their retirement goals and risk tolerance.

Administrators manage the day-to-day operations of the pension fund, ensuring that employee contributions are accurately processed and invested according to the chosen investment options. They handle administrative tasks, such as record-keeping, claims processing, and addressing employee queries related to their benefits.

Furthermore, Employee Benefits Administrators collaborate with pension fund trustees and investment managers to monitor the fund's performance and review the suitability of the available investment options. They analyze market trends, investment strategies, and fund performance reports, making recommendations to the trustees when adjustments or changes to the investment lineup are warranted.

In the context of a pension fund with investment choice, Employee Benefits Administrators serve as advocates for the employees, assisting them in navigating the complexities of investment options and providing ongoing support. They act as a valuable resource, offering expert guidance to employees on selecting the most appropriate investment portfolios based on their risk profiles and financial objectives.

Overall, the role of Employee Benefits Administrators is crucial in facilitating a seamless and beneficial experience for both employers and employees within a pension fund with investment choice. Their expertise and dedication help ensure that employees have access to a diverse range of investment options, allowing them to optimize their retirement savings and secure a prosperous financial future.

#### **7.3.10 Financial Services Providers**

Financial Services Providers often comprising financial advisors, consultants, or institutions, act as intermediaries between the pension fund and its members, offering a range of financial services and expertise.

One of the primary roles of financial services providers is to guide pension fund members in making well-informed investment decisions. They assess each member's unique financial goals, risk tolerance, and investment preferences, and then provide personalized investment advice. By analysing the available investment options within the fund and the broader financial market, these providers assist members in constructing a diversified and suitable investment portfolio.

Financial services providers also serve as educators, imparting valuable knowledge about various investment instruments, asset classes, and risk-reward profiles. They strive to enhance the financial literacy of pension fund members, empowering them to make informed choices that align with their long-term financial objectives.

In addition to investment advice, financial services providers often offer retirement planning services. They work closely with members to develop comprehensive retirement strategies, taking into account factors such as projected income needs, lifestyle expectations, and potential risks. By tailoring retirement plans to individual circumstances, these providers aim to optimize members' retirement outcomes and financial security.

Furthermore, financial services providers facilitate the administrative aspects of investment choices within the pension fund. They coordinate with the pension fund administrators and trustees to ensure smooth execution of investment instructions and facilitate regular communication between the members and the fund regarding investment updates and performance reports.

Financial services providers may also offer ongoing support and periodic reviews to assess the progress of members' investment portfolios and retirement plans. As financial markets evolve and members' circumstances change, these providers adjust investment strategies and recommend necessary adjustments to align with changing goals and risk profiles.

By collaborating with pension fund trustees and administrators, financial services providers contribute to the overall effectiveness and success of the investment choice framework. Their expertise and services play a pivotal role in empowering pension fund members to make well-informed financial decisions, ensuring that their retirement savings are optimally managed to achieve their desired financial futures.

### **7.3.11 Financial Sector Conduct Authority**

The Financial Sector Conduct Authority (FSCA) plays a crucial regulatory role to ensure that the interests and rights of pension fund members are protected. The FSCA is the regulatory authority responsible for overseeing the conduct of financial institutions and service providers, including pension funds and their administrators.

One of the primary roles of the FSCA is to enforce compliance with relevant legislation and regulations governing pension funds. It sets out rules and guidelines that pension funds and their service providers must adhere to, ensuring that they operate in a fair, transparent, and accountable manner. By establishing and enforcing these standards, the FSCA aims to promote the overall integrity and stability of the pension fund industry.

The FSCA also conducts regular inspections and audits of pension funds and their administrators to assess their compliance with regulatory requirements. This monitoring process helps to identify potential risks and areas for improvement, ensuring that pension funds are well-governed and managed to safeguard the interests of their members.

In the context of investment choice within pension funds, the FSCA plays a critical role in evaluating and approving the range of investment options offered to members. It assesses the suitability of investment products, ensuring that they align with the investment objectives and risk profiles of members. The FSCA's oversight in this regard helps to provide pension fund members with access to diversified and appropriate investment options.

Furthermore, the FSCA is responsible for overseeing the conduct of financial advisors and intermediaries who provide investment advice to pension fund members. It sets out regulatory standards for the provision of financial advice, ensuring that members receive accurate and unbiased information to make well-informed investment decisions.

Overall, the role of the Financial Sector Conduct Authority is integral to promoting the efficiency, fairness, and transparency of pension funds with investment choice. Through its regulatory oversight, the FSCA aims to foster confidence in the pension fund industry and protect the financial interests of pension fund members.

### **7.3.12 Pension Fund Adjudicator**

The Pension Fund Adjudicator plays a crucial role as an independent dispute resolution authority. The Pension Fund Adjudicator's primary function is to provide a fair and impartial forum for resolving complaints and disputes that may arise between pension funds and their members.



When pension fund members encounter issues or grievances related to their investment choices, contributions, benefits, or any other aspect of the fund, they have the option to lodge a complaint with the Pension Fund Adjudicator. The Adjudicator's role is to investigate these complaints, assess the relevant facts and evidence, and make informed and unbiased decisions to resolve the disputes.

The Pension Fund Adjudicator operates independently of pension funds and the Financial Sector Conduct Authority (FSCA), ensuring that its decisions are objective and free from undue influence. Through this independence, the Adjudicator instills confidence in members, knowing that their concerns will be treated fairly and justly.

By offering an accessible and efficient dispute resolution mechanism, the Pension Fund Adjudicator contributes to the overall stability and trust in the pension fund industry. Its decisions provide clarity and resolution to disputes, helping to foster positive relationships between pension funds and their members.

Furthermore, the Adjudicator's decisions can serve as valuable precedents and guidelines for pension funds and service providers, promoting best practices and better alignment with regulatory standards. This, in turn, helps to enhance the overall governance and operations of pension funds offering investment choice to their members.

In conclusion, the role of the Pension Fund Adjudicator is vital in safeguarding the interests and rights of pension fund members within the context of investment choice. By providing an impartial and effective dispute resolution platform, the Adjudicator ensures that members have a reliable avenue to address their grievances and helps to maintain the integrity and credibility of the pension fund industry.

### **7.3.13 South African Revenue Service**

The South African Revenue Service (SARS) is responsible for administering the tax laws in South Africa, including those related to retirement funds and pensions. It sets the guidelines and rules for the tax treatment of contributions made by employees, employers, and self-employed individuals to pension funds. These contributions may be tax-deductible up to certain limits, providing individuals with tax benefits as they save for their retirement.

Additionally, SARS oversees the taxation of the investment returns earned within pension funds. It provides guidance on the tax implications of various investment choices available to pension fund members, such as interest, dividends, and capital gains.

Furthermore, when members reach retirement age and begin receiving benefits from their pension funds, SARS ensures that the correct tax calculations are applied to these benefits. The taxation of these benefits may vary depending on whether they are taken as a lump sum or annuity.

SARS also plays a role in monitoring compliance with tax regulations related to pension funds. It conducts audits and reviews to ensure that pension funds, employers, and members are adhering to the tax laws and reporting their contributions and benefits accurately.

For pension fund members, understanding the tax implications of their investment choices and retirement benefits is crucial for effective financial planning. SARS provides the necessary information and guidelines to help members make informed decisions and optimize their tax position while saving for retirement.

Overall, SARS' role in the context of pension funds with investment choice is essential in maintaining tax compliance, providing clarity on tax regulations, and supporting pension fund members in making sound financial decisions for their retirement years.

### 7.3.14 Association for Savings and Investment South Africa

ASISA, the Association for Savings and Investment South Africa, plays a vital role in portfolio classification for pension funds with investment choice. They provide a standardized system for categorizing different investment portfolios based on their asset allocation.

This classification helps investors, including pension fund members, easily understand and compare the various investment options available to them. By using ASISA's classification, pension funds can offer their members a clear and organized selection of investment portfolios, making it simpler for them to make informed decisions about their investments.

ASISA's classification system ensures transparency and consistency, benefiting both the pension fund industry and individual investors.

## 7.4 Pension Fund Choice: Fund Rules

---

Pension funds that offer investment choice are required to establish certain legal requirements in their pension fund rules to ensure transparency, compliance, and protection of members' interests. Some of the key legal requirements include:

**Investment Policy Statement (IPS):** The pension fund must develop and maintain an IPS that outlines the principles, objectives, and strategies for investment options available to members. The IPS should consider factors such as risk tolerance, time horizon, and expected returns.

**Default Investment Portfolio(s):** The fund must provide at least one default investment portfolio for members who do not actively choose an investment option. The default portfolio should be suitable for members with various risk profiles and investment preferences.

**Member Investment Choice:** The rules should clearly specify the investment choices available to members and the process for exercising their choices. Members should have access to a range of investment options that align with their financial goals and risk appetite.

**Governance and Trusteeship:** The pension fund rules should establish the governance structure and responsibilities of the board of trustees. Trustees should act in the best interests of the members and ensure compliance with all legal and regulatory requirements.

**Disclosure of Fees and Charges:** The rules must outline the fees and charges applicable to each investment option, including any administration fees, management fees, or performance-based fees. Transparent disclosure is essential to help members make informed investment decisions.

**Reporting and Communication:** The rules should stipulate the frequency and format of reporting to members on the performance and composition of their chosen investment options. Regular communication helps members stay informed about their retirement savings.

**Compliance with Regulation 28:** The pension fund must adhere to Regulation 28, which sets limits on the extent to which funds can invest in specific assets or asset classes to manage risk and diversification.

**Risk Management:** The rules should address risk management strategies, ensuring that investment choices offered are aligned with members' risk profiles and financial goals.

**Prudent Investing:** The pension fund should demonstrate that investment decisions are made prudently and in the best interests of the members.

**Legal Compliance:** The rules must comply with all relevant pension fund legislation, regulatory requirements, and industry standards.

By establishing these legal requirements in their pension fund rules, funds offering investment choice can provide a robust and well-governed investment framework that empowers members to make informed decisions to secure their financial future in retirement.

## Topic 8: Asset Allocation in Funds with Investment Choice

### 8.1 Introduction

---

A defined contribution fund is a type of pension fund where the contributions made by both the employer and the employee are defined, but the eventual pension benefit is not guaranteed. In this type of fund, the contributions made by the employer and the employee are invested in various financial instruments, such as stocks, bonds, and other assets, with the goal of growing the value of the fund over time.

The eventual pension benefit that a member will receive upon retirement depends on the performance of the investments made with their contributions. If the investments perform well, the member's pension benefit is likely to be higher. Conversely, if the investments perform poorly, the member's pension benefit may be lower than expected.

With the understanding of defined contribution funds, we can now delve into the investment options available to members in a pension fund that offers investment choices. In such funds, members have the flexibility to select from a range of investment portfolios, each with its own risk profile and investment strategy.

### 8.2 Default Investment Portfolio

---

In a pension fund with investment choice, the default investment portfolio refers to the pre-selected investment option that is assigned to members who do not actively make a choice regarding their investments. It serves as a default option for those members who either do not wish to or do not have the knowledge or time to select their own investment strategy.

The default investment portfolio is typically designed to be a well-balanced and diversified option that aims to cater to a broad range of members with different risk profiles and investment preferences. It is often considered a conservative or moderate investment approach, taking into account the average risk tolerance of the fund's members.

The key characteristics of the default investment portfolio may include:

**Diversification:** The portfolio is diversified across various asset classes, such as equities, bonds, and cash, to spread risk and potentially reduce volatility.

**Risk Profile:** The default portfolio tends to have a lower level of risk compared to more aggressive options. It aims to provide steady, stable returns over the long term.

**Income and Growth:** The portfolio is structured to provide a balance between income generation and capital growth, aligning with the objective of building a retirement nest egg.

**Professional Management:** The default investment option is managed by professional investment managers or experts, ensuring that the funds are invested strategically and in line with the fund's investment objectives.

**Age-Appropriate:** In some cases, the default investment portfolio may be age-appropriate, meaning that the asset allocation becomes more conservative as the member approaches retirement age.

It's important to note that while the default investment portfolio is a convenient option for members who do not actively make a choice, it may not be the best fit for everyone's individual circumstances. Members are encouraged to review their investment options and consider their own risk tolerance, investment goals, and time horizon to determine if the default option aligns with their financial objectives.

Those who wish to have more control over their investments or have specific preferences may opt to switch to different investment portfolios offered by the pension fund. Regular reviews and adjustments to the investment strategy may be necessary as members' financial circumstances and risk profiles change over time.

Overall, the default investment portfolio aims to strike a balance between risk and return, providing a solid foundation for members who may not be actively engaged in managing their pension fund investments. However, individuals should always be encouraged to seek professional financial advice when making decisions related to their retirement savings and investments.

### **8.3 Portfolio Choices**

---

In a pension fund with investment choice, the process of deciding on the portfolio options involves careful consideration of various factors to provide a diverse and comprehensive range of investment options to the fund's members. The pension fund's investment committee, in collaboration with investment experts and asset managers, plays a crucial role in this decision-making process.

The first step in determining portfolio options is conducting a thorough analysis of the fund's membership demographics, risk profiles, and investment objectives. This information helps in understanding the varied needs and preferences of the fund's members, allowing for the creation of a suitable investment menu.

The investment committee then assesses various asset classes and investment strategies to construct a well-balanced set of investment options. These may include equities, bonds, cash, property, and other alternative investments. Each option is designed to offer members exposure to different risk-return profiles and investment styles, catering to a wide range of investment preferences.

Consideration is also given to the time horizon of the members, as those with longer investment horizons may be more tolerant of higher volatility and have the opportunity to seek potentially higher returns through equity investments. On the other hand, members closer to retirement may prefer more stable and conservative options to protect their accumulated savings.

Moreover, the investment committee evaluates the performance history and track record of potential asset managers who will manage the different investment options. Managers with a consistent track record of achieving their investment objectives are often preferred to ensure the portfolio's stability and performance potential.

Additionally, the investment committee takes into account the regulatory and compliance requirements of the pension fund industry. This ensures that the portfolio options comply with the relevant regulations and meet the necessary standards to protect the interests of the fund's members.

Continuous monitoring and periodic reviews of the portfolio options are conducted to assess their performance and alignment with the fund's investment objectives. Regular engagement with members through educational resources and investment seminars helps in guiding members to make informed choices that suit their individual financial goals.

Some of the potential portfolio options that a pension fund can provide its members include:

**Conservative Portfolio:** This portfolio is geared towards members seeking lower risk and prioritizing capital preservation. It primarily consists of conservative assets, such as cash, fixed-income securities, and stable, low-volatility investments. The emphasis is on generating steady returns with lower fluctuations.

**Balanced Portfolio:** The balanced portfolio is a middle-ground option, designed to provide a balanced mix of risk and return. It typically comprises a combination of equities and fixed-income investments, offering a moderate level of risk while aiming for reasonable returns over the long term.

**Growth Portfolio:** Members who seek higher returns and are willing to tolerate higher fluctuations may opt for the growth portfolio. This portfolio is weighted more heavily towards equities and other higher-risk assets, targeting potential capital appreciation over the long run.



**Aggressive Growth Portfolio:** This portfolio is intended for members with a high-risk tolerance who are seeking significant long-term capital growth. It comprises predominantly equities and other high-risk, high-reward investments, making it the most aggressive option among the standard portfolios.

**Sharia-compliant Portfolio:** This portfolio adheres to Islamic principles and guidelines. This means that the investment options within this portfolio must avoid certain activities and industries considered non-compliant with Sharia law, such as those related to alcohol, gambling, pork, and interest-based transactions. Instead, the investments focus on businesses and activities that are considered halal or permissible under Islamic law, promoting ethical and socially responsible investment practices. This type of portfolio is designed to cater to the needs of members who seek investment options aligned with their religious beliefs and values.

**Smooth Bonus Portfolio:** A smooth bonus portfolio refers to a specific type of investment option designed to provide stable and predictable returns to investors, especially during volatile market conditions. The smooth bonus portfolio typically achieves this stability by employing a mechanism called "bonus smoothing." When the underlying investments of the portfolio generate positive returns, instead of immediately passing on all the gains to investors, a portion of the returns is held back as a reserve or "bonus buffer." During periods of market downturns or lower returns, this bonus buffer is utilized to supplement the portfolio's performance, effectively smoothing out the impact of negative market movements.

**Individualized Investment Portfolio Options:** An Individualized Investment Portfolio allows pension fund members to tailor their investment strategy according to their specific risk tolerance, financial goals, and time horizon. This approach empowers members to have greater control over their retirement savings by selecting assets and asset allocations that align with their unique preferences and circumstances. Individualized Investment Portfolios offer a wide range of investment options, such as equities, bonds, cash, and alternative assets, providing members with the flexibility to create a personalized investment mix. This approach recognizes that each individual's financial journey is distinct, allowing them to optimize their retirement planning and potentially achieve their long-term objectives.

In South Africa, the board of trustees is responsible for providing guidance on the choices between which the members may choose and a default option where no option has been made.

The Pension Funds Act stipulates general maximum limits for investment in certain asset classes. Specific quantitative limits by asset classes for each portfolio are determined in terms of the rules of the fund.

## 8.4 Asset Allocation Decision

---

### 8.4.1 Introduction to Asset Allocation

Asset allocation is a fundamental strategy in managing pension funds with investment choice. It involves dividing the fund's investments among different asset classes to achieve an optimal balance between risk and return. The goal is to construct a well-diversified portfolio that aligns with the fund's investment objectives and the risk appetite of its members. By offering a variety of asset classes, pension funds provide their members with the flexibility to tailor their investment portfolios according to their individual financial goals and risk tolerance.

The asset allocation decision primarily hinges on two key factors: the time horizon to retirement and the ability to bear the investment risk.

**Time Horizon:** This refers to the expected period, measured in months, years, or decades, until the scheduled retirement date. Investors with a longer time horizon often feel more comfortable taking on higher-risk and more volatile investments, as they have the luxury of waiting out slow economic cycles and market fluctuations. Pension fund portfolios are designed with consideration for members' extended investment period until retirement. Special portfolios are crafted to protect members' assets as they approach retirement, mitigating risk.

**Risk Tolerance:** Risk tolerance represents an individual's ability and willingness to experience both positive and negative investment returns. Aggressive investors, with high-risk tolerance, are more inclined to accept short-term negative returns in pursuit of better long-term results. On the other hand, conservative investors, with a low-risk tolerance, tend to favour investments that preserve their original capital and provide minimal negative returns over time, even if the overall returns are comparatively lower.

### **8.4.2 The Long-Term Nature of Retirement Investments**

Retirement investments are inherently long-term in nature. Pension funds cater to the financial needs of their members during retirement, which often spans several decades. Consequently, investment decisions should be based on long-term growth objectives, allowing investments to compound and grow over time. The power of compounding enables even modest returns to accumulate into substantial wealth over extended periods, making long-term investment strategies crucial for achieving retirement goals.

Given the long-term nature of retirement investments and the concept of risk and reward, asset allocation plays a vital role in achieving a balanced portfolio. By diversifying investments across various asset classes, pension funds aim to spread risk and mitigate the impact of market fluctuations. The allocation to equities may provide the potential for higher returns over the long term, while fixed income and cash holdings contribute to stability and capital preservation.

### **8.4.3 Diversification**

A key principle of asset allocation is diversification. By spreading investments across different asset classes, pension funds can mitigate risk and reduce the impact of adverse market movements on the overall portfolio. Diversification helps ensure that losses in one asset class may be offset by gains in another, leading to a more stable and resilient investment strategy.

### **8.4.4 Balancing Risk and Return through Asset Allocation**

Given the long-term nature of retirement investments and the concept of risk and reward, asset allocation plays a vital role in achieving a balanced portfolio. By diversifying investments across various asset classes, pension funds aim to spread risk and mitigate the impact of market fluctuations. The allocation to equities may provide the potential for higher returns over the long term, while fixed income and cash holdings contribute to stability and capital preservation.

#### 8.4.5 Understanding Asset Classes and Their Risk-Return Profiles

In constructing a well-balanced and successful retirement portfolio, it is crucial to consider the various asset classes and their risk-return profiles. Each asset class offers unique characteristics and growth potential, allowing investors to tailor their investment strategies according to their risk tolerance and long-term financial goals.

Remember, in the realm of retirement investments, the adage "no reward without risk" holds true, emphasizing the importance of thoughtful asset allocation for long-term wealth accumulation. The main asset classes are considered in the following bullet points.

**Equities (High Risk-High Return):** Equities, also known as stocks or shares, represent ownership in a company. They are considered high-risk, high-return investments as their values can be volatile and subject to market fluctuations. However, over the long term, equities have historically outperformed other asset classes, providing the potential for substantial returns.

**Fixed Income (Moderate Risk-Moderate Return):** Fixed income investments, such as bonds and government securities, are generally considered lower-risk than equities. They offer a predictable stream of income in the form of interest payments and have a more stable value compared to equities. However, the potential for high returns is typically lower than that of equities.

**Cash (Low Risk-Low Return):** Cash and cash equivalents, like money market funds, offer the lowest risk among asset classes. While they provide stability and liquidity, they generally yield lower returns compared to equities and fixed income investments.

**Alternative Investments (Variable Risk-Variable Return):** Alternative investments encompass a broad range of assets, such as real estate, commodities, private equity, and hedge funds. Their risk-return profiles vary significantly and may not correlate with traditional asset classes. Alternative investments can offer diversification benefits and potentially enhance overall portfolio performance.

#### **8.4.6 Tailoring Investment Portfolios to Individual Preferences**

The availability of various asset classes in a pension fund with investment choice allows members to create personalized investment portfolios based on their financial objectives and risk appetite. Younger members with a longer investment horizon may opt for a higher allocation to equities to capitalize on long-term growth potential. On the other hand, those approaching retirement may choose a more conservative approach by allocating a larger portion to fixed income and cash for capital preservation.

One of the primary benefits of a pension fund with investment choice is empowering members to make informed investment decisions that align with their risk tolerance and retirement objectives. Members have the flexibility to allocate their contributions across different asset classes based on their financial goals and time horizon. Younger members may opt for a more growth-oriented portfolio, while those nearing retirement may favour a more conservative approach.

#### **8.4.7 Regular Portfolio Review and Rebalancing**

As market conditions change, the asset allocation of a pension fund may deviate from its target allocation. To maintain the desired risk-return profile, regular portfolio reviews and rebalancing are essential. Rebalancing involves adjusting the allocation of assets back to their target weights, ensuring that the portfolio remains aligned with members' investment objectives and the fund's overall risk management strategy.

#### **8.4.8 Conclusion**

Asset allocation is a fundamental strategy in pension fund management, especially for funds that offer investment choice to their members. By offering a diversified range of asset classes with different risk-return profiles, pension funds empower their members to tailor their portfolios according to their individual needs and preferences. Effective asset allocation, combined with regular portfolio reviews and rebalancing, helps pension funds achieve their investment objectives and provides members with the potential for favorable long-term retirement outcomes.

## 8.5 Default Investment Portfolios Regulation

---

Upon becoming a member of an employer-provided pension or provident fund, individuals are not required to make investment decisions or seek professional advice regarding their contribution placements. They can take comfort in knowing that the default investment portfolio, in which their contributions will be automatically invested, must adhere to specific criteria mandated by law to ensure their best interests are protected.

While this regulation does not mandate that funds offer multiple investment portfolios to their members, it does provide the flexibility for the board to consider offering more if they deem it appropriate. The primary objective is to safeguard members' retirement savings by ensuring that the default investment option meets the necessary standards and aligns with their long-term financial well-being. This approach provides a seamless and secure starting point for members, allowing them to begin their retirement savings journey without the burden of complex investment decisions from the outset.

Regulation 37 governs the default investment portfolios that pension funds with investment choice must offer to their members. This regulation is an essential aspect of providing suitable investment options to pension fund members who do not actively make an investment choice or fail to specify their preferences. It ensures that such members are automatically enrolled in a default investment option that aligns with their retirement goals and risk tolerance.

Key elements of Regulation 37 include:

**Default Investment Portfolio Design:** Pension funds must carefully design default investment portfolios that cater to the general needs and preferences of their members. These portfolios typically encompass a diversified mix of asset classes to achieve an appropriate balance between risk and return.

**Consideration of Risk Tolerance:** The default portfolios are structured with consideration of the typical risk tolerance of the average member, aiming to strike a balance between capital preservation and growth potential over the long term.

**Age-Based Strategies:** Many default investment portfolios are structured based on members' ages, utilizing age-based strategies such as target-date funds. These funds gradually shift their asset allocation towards more conservative investments as members approach their retirement age, reflecting the changing risk appetite as retirement draws closer.

**Fiduciary Duty:** Pension funds have a fiduciary duty to act in the best interests of their members. Consequently, the design of default investment portfolios must prioritize the members' long-term financial well-being while avoiding undue exposure to excessive risk.

**Disclosures and Member Communication:** Pension funds are required to provide clear and comprehensive disclosures about the default investment portfolios and how they align with the members' retirement objectives. Effective communication is crucial to help members make informed decisions regarding their investment choices.

**Flexibility and Opt-Out Options:** While default investment portfolios aim to suit the majority of members, pension funds should allow flexibility for members to switch to other investment options better aligned with their individual preferences. Adequate opt-out mechanisms should be in place to ensure members have control over their investment decisions.

Compliance with Regulation 37 is crucial for pension funds with investment choice to fulfil their duty of providing suitable default investment options to their members. By adhering to these regulations, pension funds can help ensure that members' retirement savings are invested wisely, considering their long-term goals and risk tolerance.

Overall, Regulation 37 plays a significant role in promoting better retirement outcomes for pension fund members and enhancing the overall effectiveness of the pension industry in South Africa.



## 8.6 Regulatory Investment Restrictions

---

Regulation 28, a vital aspect of the Pension Funds Act, plays a critical role in safeguarding pension fund member savings. By imposing limitations on the extent of investments in specific assets or asset classes, the regulation aims to mitigate excessive concentration risk and protect the interests of fund members. Although the regulations broaden the potential investment scope for pension funds, the ultimate decision on investments lies with the fund trustees, who determine the investment policy for each fund.

In January 2023, amendments were introduced to Regulation 28 following two rounds of public comments in 2021. The primary aim of these amendments is to explicitly enable and reference longer-term infrastructure investments by pension funds. This is achieved by increasing the maximum limits that funds may invest in infrastructure, with a specific 45% exposure limit for such investments. Furthermore, the amendments establish a separate and higher allocation to private equity assets, increased from 10% to 15%, to promote investment in infrastructure and economic development.

However, certain investments are restricted under the amended regulation. Pension funds will continue to be prohibited from investing in crypto assets due to their excessive volatility and unregulated nature. Additionally, a limit of 25% is imposed across all asset classes to restrict exposure to any single entity, not limited to infrastructure. An exception to this per-entity limit is allowed for debt instruments issued by, and loans to, the Government of the Republic, along with any debt or loan guaranteed by the Republic.

Moreover, the asset allocation to housing loans granted to pension fund members will be reduced from 95% to 65% but only applies to new loans. This measure aims to curb potential abuse of the housing loan scheme by fund members. To achieve consistency and align with various regulatory approaches, only investments in Cisca-approved hedge funds will be permitted.

The current limits for various asset classes within pension funds are specified as follows:

Cash - 100%

Equity - 75%

Offshore - 45%

Listed Property - 25%

Private Equity Funds - 15%

Africa (combined with offshore limit) - 10%

Hedge funds - 10%

Other assets (excluding hedge funds, private equity, and cryptocurrency) – 2,5%

Through these amendments, Regulation 28 continues to evolve, ensuring the protection and responsible management of pension funds, while facilitating investments in critical sectors that can contribute to long-term growth and sustainability for pension fund members.

### **8.6.1 Exchange Control Regulations**

On 25th February 2022, the South African Reserve Bank (SARB) released the Exchange Control Circular No. 10/2022, which introduced significant changes to the prudential foreign investment limits for institutional investors in South Africa. According to the circular, the foreign exposure of all retail assets, including pension funds, is now restricted to not exceed 45%. This adjustment has a notable impact on the offshore limits for Regulation 28 compliant CIS (Collective Investment Scheme) portfolios, allowing them to invest up to 45% of their portfolio value offshore.

Previously, the limit was set at 30% for global exposure, with an additional 10% limit specifically for investments in other African markets, excluding South Africa. These two limits have now been combined into a single foreign prudential limit of 45%, which applies across the board to all pension funds, insurance companies, and investment funds.

In light of these changes, the Association for Savings and Investment South Africa (ASISA) Fund Classification for South African portfolios has been updated to accommodate the increase in offshore investment opportunities. Specifically, "South African Portfolios" now refers to collective investment portfolios that invest at least 55% of their assets in South African investment markets, reflecting the new allocation requirements in light of the revised foreign investment limits.

## Topic 9: Pension Fund Transactions

## 9.1 Navigating Investment Choices

---

In the dynamic landscape of retirement planning, pension funds with investment choice have emerged as a prominent option, offering members greater control and flexibility over their retirement savings. The ability to make informed investment decisions and tailor portfolios to individual risk appetites is a key advantage of such funds.

This section delves into the intricacies of pension fund transactions within the context of investment choice. From interpreting investment instructions and disinvestment requests to managing ongoing contributions and withdrawals, we explore the processes that enable members to optimize their retirement portfolios.

Understanding these transactions is vital for both fund administrators and members, as it empowers individuals to make sound financial choices, ensuring a secure and prosperous future.

## 9.2 Timeframes for Pension Fund Transactions

---

In a pension fund with investment choice, various transactions are conducted to manage members' investments and cater to their retirement needs effectively. Understanding the timeframes for these transactions is essential to ensure smooth and efficient fund operations. Below, we identify the key timeframes for pension fund transactions, accompanied by examples to illustrate their application.

### 9.2.1 Contribution Processing Timeframe

The timeframe for processing member contributions is crucial to ensure that funds are invested in a timely manner and to maintain the integrity of the investment portfolios.

Example: The pension fund administrator processes member contributions on a daily basis, and funds are invested into the selected investment portfolios within three business days from the date of receipt.

### **9.2.2 Asset Transfer Processing Timeframe**

When members wish to transfer their assets between different investment portfolios, the timeframe for processing these transfers must be clearly defined.

Example: Asset transfers between investment portfolios are processed within five business days from the receipt of the member's written transfer request.

### **9.2.3 Benefit Payout Timeframe**

Upon reaching retirement age or under certain qualifying circumstances, members may choose to receive their retirement benefits. The timeframe for processing these benefit payouts is critical to meet members' financial needs.

Example: Upon receipt of a member's retirement benefit claim, the fund aims to process the payout within 30 calendar days, subject to the necessary verification and compliance checks.

### **9.2.4 Investment Portfolio Rebalancing Timeframe**

Fund managers may periodically rebalance investment portfolios to align with the fund's investment strategy and risk profile. The timeframe for implementing such rebalancing is crucial to maintain portfolio diversification and optimal performance.

Example: Portfolio rebalancing is conducted on a quarterly basis, and any necessary adjustments are implemented within 10 business days from the portfolio review date.

### **9.2.5 Member Communication Timeframe**

Regular communication with members is essential to keep them informed about their investments, fund performance, and any updates related to the investment options available to them.

Example: The fund administrator sends quarterly investment performance reports to all members within 15 calendar days after the end of each quarter.

### **9.2.6 Fund Reporting Timeframe**

The fund's reporting obligations to regulatory authorities, such as the Financial Sector Conduct Authority (FSCA), must be adhered to within specific timeframes to comply with regulatory requirements.

Example: The pension fund submits its quarterly and annual financial reports to the FSCA within 30 calendar days after the end of each reporting period.

By establishing and adhering to these timeframes, pension funds with investment choice can ensure efficient and transparent fund operations while providing their members with the best possible experience in managing their retirement savings and investments.

## **9.3 Regulations Governing Member Asset Transfers**

---

In a pension fund with investment choice, members may have the option to transfer their assets between different investment portfolios offered by the fund. The pension fund rules surrounding such asset transfers are crucial to ensure transparency, fairness, and protection of members' interests.

In South Africa, the rules of the funds will determine any specifics relating to individual investment choice including asset transfer (switching).

Below, we explain the key aspects related to member asset transfers, accompanied by relevant examples to illustrate their application.

### **9.3.1 Transfer Eligibility Criteria**

The pension fund rules may specify the conditions under which members are eligible to transfer their assets between investment portfolios. For instance, a member may be allowed to transfer assets after a specified holding period or on a periodic basis, such as annually.

Example: The fund's rules stipulate that members can only transfer their assets between investment portfolios once every calendar year.

### **9.3.2 Transfer Process and Procedures**

Clear guidelines should be provided on the process and procedures for initiating and completing asset transfers. This may include the submission of transfer requests, the timeframes for processing, and any administrative requirements.

Example: To initiate an asset transfer, a member must submit a written transfer request to the fund administrator at least 30 days before the desired transfer date.

### **9.3.3 Limitations on Frequency and Size of Transfers**

The pension fund rules may impose restrictions on the frequency and size of asset transfers to prevent excessive or disruptive trading activity within the fund.

Example: Members are allowed to transfer their assets between investment portfolios up to a maximum of three times per calendar year, and each transfer must not exceed 30% of their total portfolio value.

### **9.3.4 Costs and Charges**

pension fund rules should address any costs or charges associated with asset transfers, such as administration fees or transaction costs. These should be transparently disclosed to members.

Example: Members may be charged a nominal transfer fee of 0.5% of the transfer amount to cover administrative expenses.



### **9.3.5 Lock-In Periods**

Certain investment options may have lock-in periods, during which assets cannot be transferred out of the portfolio. These lock-in periods protect the fund from short-term trading activity.

Example: Members are not allowed to transfer assets out of the "Special Growth Portfolio" until they have been invested in the portfolio for a minimum of five years.

### **9.3.6 Communication and Reporting**

Regulations require the fund to provide members with regular communication and reporting on the status of their asset transfers, including updates on the transfer process and the impact on their overall portfolio.

Example: The fund administrator sends quarterly statements to members, which include details of any asset transfers made during that period.

## **9.4 Interpreting Investment Instructions**

---

In a pension fund with investment choice, members have the flexibility to provide various investment instructions to manage their retirement savings effectively. The fund's administrators play a crucial role in interpreting these instructions accurately and ensuring that the members' preferences are implemented accordingly.

The following paragraphs address the key aspects of interpreting investment instructions within such a fund:

### **9.4.1 Interpreting Investment Instructions and Allocating Funds**

When members provide investment instructions, it is essential to understand their preferences and allocate their contributions to specific investment products and asset allocations. This process involves translating members' choices into tangible investment actions.

Example: A member submits an investment instruction to allocate 50% of their contributions to a high-risk equity fund and 50% to a low-risk bond fund. The fund's administrators ensure that the contributions are allocated as per the member's instruction to the respective funds.

#### **9.4.2 Interpreting Ongoing Investment Instructions**

Members' investment needs may change over time, necessitating ongoing investment instructions to accommodate their changing circumstances, such as contributions and withdrawals. Administrators must continuously interpret these instructions to adjust the fund's investment strategy accordingly.

Example: A member provides a monthly instruction to increase their contributions by 5% every six months. The administrators implement these changes as specified to reflect the updated contributions.

#### **9.4.3 Interpreting Disinvestment Instructions and Allocating Funds:**

When members wish to disinvest or withdraw from specific investment portfolios, administrators must interpret these disinvestment instructions and allocate the withdrawn amount to new investment portfolios.

Example: A member submits a disinvestment instruction to withdraw 25% of their total investment from a property portfolio and allocate it to a more diversified equity fund. The administrators execute this disinvestment and reallocate the withdrawn amount accordingly.

#### **9.4.4 Interpreting Switching Instructions and Setting Conditions**

In a member-choice pension fund, members may request to switch between different investment portfolios. Administrators interpret these switching instructions while ensuring that the fund's switching conditions are met.

Example: A member provides a switching instruction to move their investments from a high-risk equity fund to a balanced fund. Administrators verify that the switching conditions, such as a minimum investment period, are satisfied before executing the switch.

By accurately interpreting investment instructions and promptly implementing members' preferences, pension funds with investment choice can offer their members a seamless and tailored investment experience to meet their unique financial goals and risk profiles.

## **9.5 Managing Pension Payments for Outsourced Pensioners**

---

In certain pension funds, the responsibility for administering pension payments may be outsourced to external service providers. These outsourced pensioners, who are members of the fund but receive their pension payments from a third-party provider, present unique considerations for the fund's trustees and administrators. This section explores the intricacies of handling instructions related to pension payments for outsourced pensioners within the context of a pension fund with investment choice.

### **9.5.1 Understanding the Outsourced Pensioner Arrangement**

Before delving into the specifics of pension payment instructions, it is essential to grasp the outsourced pensioner arrangement. This involves a comprehensive understanding of the contractual agreements between the pension fund, the third-party administrator, and the individual pensioner. Trustees and administrators must be well-versed in the terms of the arrangement, including the frequency and method of pension payments, potential escalations, and any special considerations that may apply to these members.

### **9.5.2 Managing Investment Choices for Pension Payments**

In pension funds with investment choice, outsourced pensioners may have varying preferences when it comes to the investment of their pension funds. Trustees must ensure that adequate investment options are made available to these members, allowing them to align their investment choices with their risk profiles and financial objectives. Clear communication regarding the available investment portfolios and associated risks is crucial to help pensioners make informed decisions that align with their retirement goals.

### **9.5.3 Handling Pension Payment Instructions**

Instructions related to pension payments can vary, ranging from changes in the payment frequency to updates in the nominated beneficiary. Trustees and administrators must have robust systems in place to process these instructions efficiently and accurately. It is paramount to maintain detailed records of all pension payment instructions to ensure compliance with legal and regulatory requirements and to safeguard the interests of outsourced pensioners.

### **9.5.4 Ensuring Compliance and Security**

When dealing with pension payments for outsourced pensioners, compliance with relevant legislation, such as the Pension Funds Act and Financial Sector Conduct Authority (FSCA) guidelines, is of utmost importance. Trustees and administrators must ensure that all processes and procedures are in line with these regulations. Additionally, security measures must be in place to protect sensitive pensioner information and funds from any potential risks or fraudulent activities.

### **9.5.5 Providing Support and Accessibility**

As outsourced pensioners may have less direct interaction with the pension fund's administration, it is essential to offer them accessible and responsive support channels. Clear communication channels and dedicated assistance should be available to address any queries or concerns related to their pension payments or investment choices.

### **9.5.6 Conclusion**

By proactively managing pension payments for outsourced pensioners and aligning investment choices with their unique needs, pension funds can enhance the financial security and well-being of these valued members, ensuring a successful and fulfilling retirement journey.

## **9.6 Reconciling Payments Made by the Insurer**

---

In a pension fund with investment choice, the management of pension payments often involves collaboration with an insurer for the administration of risk benefits, such as death or disability cover. Insurers play a crucial role in disbursing these benefits to eligible pensioners or beneficiaries. This section focuses on the process of reconciling payments made by the insurer against the instructions for pension payment within the context of a pension fund with investment choice.

### **Understanding the Relationship with the Insurer**

Before delving into the reconciliation process, it is essential to establish a clear and transparent relationship with the insurer. This involves outlining the roles and responsibilities of each party and establishing effective lines of communication. The pension fund's trustees and administrators must work closely with the insurer to ensure a seamless process for payment reconciliations.

#### **9.6.1 Aligning Instructions and Payouts**

Pension payment instructions provided by the fund members, whether in the form of annuity choices or other retirement benefits, need to be accurately aligned with the insurer's payout processes. Trustees must verify that the instructions provided by the members match the insurer's requirements for processing payments promptly and accurately.

#### **9.6.2 Regular Reconciliation of Payments**

To ensure the accuracy and completeness of pension payments, regular reconciliation of payments made by the insurer is crucial. Trustees and administrators should establish a systematic process for comparing the insurer's payment records against the pension payment instructions provided by the members. This reconciliation process should be conducted at specific intervals to identify any discrepancies promptly.

### **9.6.3 Addressing Discrepancies and Resolving Issues**

In the event of discrepancies between the insurer's payments and the pension payment instructions, a robust process must be in place to investigate and resolve the issues. This may involve direct communication with the insurer, cross-referencing records, and verifying the authenticity of any claims or requests.

### **9.6.4 Ensuring Data Integrity and Security**

Data integrity and security are paramount when dealing with pension payments and sensitive member information. Trustees and administrators must maintain secure systems for handling payment data and ensure that only authorized personnel have access to such information.

### **9.6.5 Reporting and Communication**

Reconciliation outcomes and findings should be regularly communicated to the relevant parties, including the fund members, insurer, and regulatory authorities. Transparent reporting fosters accountability and builds trust among stakeholders in the pension fund.

### **9.6.6 Continuous Improvement**

Reconciliation processes should be subject to continuous improvement to enhance efficiency and accuracy. Regular evaluations of the reconciliation procedures will help identify potential areas for optimization and ensure that the pension payment process remains streamlined and effective.

### **9.6.7 Conclusion**

By establishing a well-structured process for reconciling payments made by the insurer and diligently addressing any discrepancies, pension funds with investment choice can provide their members with the assurance that their pension payments are managed with precision and care, further strengthening the confidence in the fund's administration.



