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Retirement Funds Provided by Private Bargaining Councils in South Africa

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on behalf of the Department of Labour

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INTRODUCTION

1. Background and Scope

1.1 Background

The Department of Labour has commissioned a research project on the benefits offered by private sector bargaining councils in South Africa through negotiated pension, provident and related schemes. The project has 3 parts:

1. An overview of the negotiated funds – the characteristics of bargaining council funds and how they compare to their private employer fund counterparts, as well as the proposed NSSF.
2. Determining the value for money offered by these funds – a quantitative and qualitative look at 5 selected funds in 5 different councils. The components of value for money under investigation include value of benefits, operative efficiency and governance.
3. A comparison of the negotiated funds to the proposed National Social Security Fund (NSSF) as well as other funds existing in the market, and recommendations regarding integration with the NSSF.

Part 1: Overview of funds

Part 2: Value for money

Part 3: NSSF comparison

1.2 Purpose of the research

The planned reform of the social security and retirement arrangements in South Africa will both be influenced and have influences on existing retirement fund arrangements in the country. Bargaining councils and their funds are a major constituent of the current system of retirement provisions, and research into the functioning and effectiveness of these funds could answer three major questions:

How efficient are bargaining council funds at delivering value to their members and the councils?

Value to members and councils

Councils establish retirement funds to help their workers save for retirement. By doing so, councils increase their value to the employers in the industry, which should affect representivity. It is therefore important to understand whether the funds deliver the value promised.

We examine the value offered by these funds in Parts 1 and 2 of this paper.

What can the NSSF designers learn from bargaining council funds?

Lessons for retirement reform design

Some aspects of bargaining council retirement funds make them similar to the proposed NSSF. Such similarities include the demographic profile of the membership, the large size and functioning across different employers. There may be lessons to be learnt from the operation of bargaining council funds which will be of value to the Inter-Departmental Task Team which is designing the NSSF.

This question is addressed in Part 3 of this paper.

Role in new retirement framework

How can bargaining council funds contribute towards the new retirement framework?

Bargaining council funds provide benefits to a large number of South Africa's formally employed. Are these benefits sufficient and tailored to meet the needs of the population they cover? If so, these funds could be candidates for exemption from the NSSF and simultaneous accreditation for the provision of retirement benefits. It is therefore important to examine whether these funds meet the potential requirements proposed for opt-out and accreditation, and if not, how this could be achieved.

Part 3 makes recommendations on how council funds can add to the proposed framework.

1.3 Scope

Only private bargaining councils

The scope for Part 1 of this paper includes all private bargaining councils. The other two types of councils, government and local government councils are excluded from the investigation.

Part 2 concentrates on 5 bargaining councils (1 fund per council) selected by the Department of Labour. These councils and funds are:

- MEIBC – Metal Industries Provident Fund;
- MIBCO – Motor Industry Provident Fund;
- National Bargaining Council for the Clothing Manufacturing Industry – Cape Clothing Industry Provident Fund;
- Bargaining Council for the Furniture Manufacturing Industry, KwaZulu/Natal – Provident Fund for the Furniture Manufacturing Industry -KZN, and;
- Hairdressing and Cosmetology Services Bargaining Council (Semi-National) – Hairdressing and Cosmetology Industry Provident Fund.

We present our results in the format of five case studies.

1.4 Terminology

Accredited fund (also approved fund or accredited provider) means a fund which, under the proposed new retirement framework, will be able to provide retirement benefits which are mandatory and privately administered.

Act means the Pension Funds Act.

Annuity factor is the price that needs to be paid to purchase one unit of pension. So an annuity factor of 14 means that a pension of R1000 p.a. costs R14 000 to purchase.

Council funds means pension and provident funds negotiated by councils. Also “negotiated funds”.

Councils means private bargaining councils.

Council agreement (or just Agreement) is the agreement negotiated between employer and union parties. The council agreement defines the operation of the bargaining council.

Defined benefit fund – a fund which provides benefits at retirement which are defined at outset. The contribution rate varies from year to year to be able to fund such defined benefits.

Defined contribution fund – a fund where a defined contribution is invested each month, but benefits at retirement depend on investment returns and cannot be determined in advance.

Department means Department of Labour.

Extended – refers to extended agreements, where the Minister of Labour extends a council agreement to apply to employers who were not party to the original negotiation of the agreement (non-party employers).

FSB means the Financial Services Board which regulates retirement funds.

Individual Member Choice (**IMC**) means members of a retirement fund can individually select their investment portfolios.

Labour Relations Act (LRA) is the act under which bargaining councils are established.

Negotiated funds – see “Council funds”

Means Test - A test of income and assets intended to determine if a person qualifies for state support.

Non-party means an employer which did not partake in council negotiations but falls under the council agreement when the agreement is extended.

NRR means Net Replacement Ratio, which is the ratio of a retiree’s post retirement income to their income before retirement.

NSSF means the National Social Security Fund.

Party means a party to a council agreement, i.e. one of the bodies which negotiated and signed the agreement.

Pension fund means a retirement fund which pays out a minimum of 2/3rds of its final benefit as an annuity. Also see Provident Fund.

Pension Funds Act (PFA or "the Act") is the act which governs pension and provident retirement funds in South Africa.

Pension Funds Information Circular 130 (PF130) deals with the good governance of retirement funds and sets out various principles for funds to follow.

Preservation is the concept of preserving benefits for retirement and not paying them out ahead of the retirement needs of the member. Preservation refers to preventing pre-retirement payouts (such as cash paid on withdrawals) and also to preventing the payment of the entire benefit at retirement (such as a lump sum at retirement) which may lead to insufficient income in later years.

Private employer funds means non-council retirement funds operated by employers in South Africa.

Provident fund means a retirement fund which can pay out up to 100% of retirement benefits as a cash lump sum.

Registrar means the Registrar of Pension Funds at the FSB.

Retirement funds means pension and provident funds.

Risk benefits means death and disability benefits offered by a retirement fund.

Risk pooling refers to the proposed system of sharing the cost of death benefits in all funds in South Africa. This is one of the elements of the reform proposals.

Salary means the remuneration paid to fund members.

Self insurance means that risk benefits are paid from the fund's own accounts and are not backed by an external insurance company.

Smoothing is the process of creating an investment reserve to which excess returns are allocated in times of good performance and which is used to enhance returns in times of poor investment performance.

SOAG means the Social Old Age Grant payable to individuals aged 60 or over who qualify via a Means Test.

Strategic asset allocation is the long term targeted split of assets between equities, bonds and other asset classes.

Surplus apportionment is a process of distributing surpluses which accumulated in pension funds. This was introduced by an amendment to the Pension Funds Act in 2001. All funds are required to identify the surplus in the fund and decide on an appropriate division between former members, pensioners, current members and employers.

Tactical asset allocation is the variation from the strategic asset allocation at any given time to maximise the investment objectives of the fund in the current economic environment.

Umbrella fund means a fund which has many employers which participate in the fund. In a type A umbrella, these employers are unrelated to each other. In a type B umbrella, the employers are all subsidiaries of a larger company.

2. Acknowledgements

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PART 1: OVERVIEW OF THE BARGAINING COUNCIL RETIREMENT FUNDS

3. Introduction

We approached all council funds with the goal of presenting an overview of these funds. Section 4 presents a summary of our findings. We address the history of council funds in Section 5. Section 6 deals with the membership of the council funds and the coverage achieved by these funds. Section 7 describes the benefits offered by these funds and compares them to private employer funds and the proposed NSSF. Section 8 looks at the assets held by council funds. Section 9 deals with governance structures and administration practices, while section 10 describes the approach we adopted in gathering comparative information to complete this part of the research.

4: Summary

5: History

6: Membership

7: Benefits

8: Assets

9: Governance and Administration

10: Methodology

4. Summary

4.1 History and Background

The Labour Relations Act allows employer and member organisations to establish a bargaining council for a sector and area. Such councils are vehicles for collective bargaining, but can also provide employees with a range of benefits including retirement funds, medical aid, sick pay, holiday, unemployment funds and training schemes. The number of councils grew to peak at 104 in 1983, and had reduced to 48 by 2004, partly due to mergers. The membership represented by these councils continues to grow, indicating that the councils themselves are becoming larger.

Councils can provide benefits

Councils are required to be representative of the industry they operate in. Sufficiently representative councils are permitted to extend their agreement to employers who are not party to the agreement. Extended agreements automatically cover all employers and employees in a particular sector and area, and employers need to apply to be exempted from any part of the agreement. According to Godfrey, Maree and Theron (2006), 25% of the 9.5 million employees in South Africa who fell under the Labour Relations Act at the time were covered by bargaining councils.

Representivity allows for extension of agreements

4.2 Coverage and Membership

There are 40 private councils in South Africa, of which 29 councils have a total of 43 retirement funds. 24 councils and 28 funds are included in this survey.

43 private council retirement funds, 28 included in this study

Many but not all bargaining councils offer retirement funds. Regional councils are more likely to have a retirement fund than national councils. Where funds are offered the take up is relatively high; in some funds non-council workers participate in the retirement fund.

The majority of employers who participate have 40 employees or less. They are too small to run a free-standing fund, and benefit from having access to centralised arrangements.

Average employer has 40 employees

The members appear to be mostly low income workers who change employment often, and do not as a rule accumulate high member shares. As such, they are representative of the population group chiefly targeted by the retirement reform proposals.

4.3 Benefits

All council funds are defined contribution and around 75% are provident funds. Provident funds have 94% of the members and 95% of the assets of the council funds in our study.

95% of members and assets in provident funds

Provident funds pay out a cash rather than income benefit on retirement, a feature that appeals to employee organisations in particular. Regular pension payments are historically difficult to administer in rural areas. However, provident funds may be phased out under the retirement reform proposals, which endorse preservation and income-type benefits over cash. This may be a challenge to council funds.

The range of benefits offered by council funds includes retirement, withdrawal, death, disability, funeral and other benefits, and this range of benefits is on par with what is offered by private employer funds. However, the actual level and structure of the benefits is less favourable than in private employer funds and the proposed NSSF. The impact of this issue may be lower if the Social Old Age Grant (SOAG), an income type benefit which could meet a large proportion of a low-income retiree's needs, is made available to these members.

Full range of benefits offered

Benefit levels low

Death and disability benefits in particular, averaging at around 2 times annual salary, are lower than comparable benefits in the private employer funds at 3.5 times annual salary for death and 2.7 for disability benefits.

Death benefits 2 times salary vs. 3.5 times for private employer funds

Social Security Reform

Proposals for a reformed social security system in South Africa are currently being developed.

The key premise is the creation of a National Social Security Fund (NSSF). This fund would be mandatory, contributory and provide a basic income benefit in retirement.

Current proposals allow for diversification, where other funds would be approved, or accredited, to provide a similar retirement benefit. These funds and their members would effectively "opt-out" of the NSSF and be an alternative retirement saving vehicle.

Criteria for opt-out are likely to include cost efficiency and good governance practices.

Retirement benefits, averaging very approximately at around 2 times annual salary based on actual benefits paid, are also lower than required to support post-retirement needs.

4.4 Contributions

Contribution levels in council funds are around 12.9% of salaries on average, lower than the private employer funds at 15.8% and the

Contributions 12.9% vs. 15% - 18% for NSSF

NSSF proposals which target 15% - 18%. The employer contribution rate is generally equal to the member contribution rate in council funds. National funds have higher contributions than regional funds and are more aligned with NSSF levels.

4.5 Preservation

High rate of member turnover

Length of membership at retirement is affected by the rate of turnover in the funds. Council funds have a high rate of turnover, more so than the private employer funds. Withdrawal of benefits on resignation and the need for preservation is a problem across all South African funds. This has been identified by the reform proposals. Indications are that it is particularly severe in council funds.

4.6 Assets

Cash and bond heavy balanced mandates

Investment returns constitute another factor in the final level of the retirement benefit. Most assets are managed by external managers, but in a few cases are managed internally by the trustees.

A few unorthodox strategies underperform

The majority of strategies utilised are balanced type mandates with an above-average allocation to cash and bonds. This may be a reflection of the lower risk appetite in these funds, combined with the short term investment horizon due to the high level of turnover. Returns measured over 2004 – 2008 tend to be below the average balanced portfolio, but above CPI + 5% which is a reasonable target for retirement funds. Funds which severely underperform tend to have unorthodox investment strategies.

Altogether, returns are generally in line with expectations for low risk portfolios.

4.7 Governance

Governance is key to accreditation in the retirement reform proposals.

Member communication challenging

Governance structures appear to have been implemented by most council funds, with the majority reporting that procedures and policies have been put in place in line with the requirements of regulations. Communication appears to be a challenge, with the level of communication being lower than in private employer funds. This may be caused by the education level of the members and lack of access to technology.

4.8 Administration

Contribution collection challenging

The chief cause for concern in terms of administration issues is the delay in collection of contributions.

Severe delays in collection common

Many funds are not able to meet the requirements of the Act to collect contributions by the 7th day of the following month. Many are not targeting this deadline in their operations, and many funds report that a significant number of employers are on average more than 3 months behind in contributions. While this is a known issue in the council environment, where there are many small employers not all of whom are supportive of belonging to the funds, it is still likely to be one of the most significant obstacles to opt out of the NSSF. National funds suffer markedly less from this issue than regional funds.

Value to members and councils?

Where funds exist, participation from employers is generally good.

Council employees are unlikely to get benefit from another source – these funds are their only opportunity to save for retirement.

Benefits are low in some cases – but as alternative to no fund at all, still valuable.

Pre-retirement leakage is high and a cause for concern.

Contribution to the new retirement framework?

Large, national funds have high membership numbers and sufficient contribution levels – this makes them good candidates for opt out from the NSSF.

Contribution collection, while challenging, appears to be manageable in these larger funds.

Issues such as unorthodox investment approaches and below average death and disability benefits need be addressed in order to improve the likelihood of achieving accreditation.

Regional funds generally have contribution rates that tend to be below those proposed for the NSSF. Regional funds are also generally smaller, making them potentially less cost-efficient to administer.

Lessons for NSSF designers?

Members of council funds are low income, blue collar workers – similar to the bulk of potential NSSF members. Mandatory participation is enforced, with mixed results – non-registration and not paying contributions are common problems. Communication to members is also challenging.

The NSSF is likely to experience similar challenges, and contribution collection in particular needs to be carefully addressed.

5. History of Bargaining Councils

5.1 Introduction

The South African Labour Relations Act of 1995 ("LRA") provides that "one or more registered trade unions and one or more registered employers' organisations may establish a bargaining council for a sector and area".

Section 28 of the LRA gives registered councils the power to "establish and administer pension, provident, medical aid, sick pay, holiday, unemployment and training schemes or funds … for the benefit of one or more of the parties to the bargaining council or their members".

Bargaining Councils – in a nutshell

Bargaining councils were created as a platform for collective bargaining, but soon they were also providing employee benefits.

If a council represents enough of the employers and trade unions in its sector and area, it becomes mandatory for all employers to register under the council – this is called "extending the agreement to non-parties". Employers may apply for exemption from participation.

25% of South Africa's 9.5 million workers are covered by bargaining councils.

This research focuses on the benefits provided by the retirement funds established by bargaining councils. This section contains a brief overview of bargaining councils in general, based on the research by Godfrey, Maree and Theron (2006), Godfrey, Theron and Visser (2007) and Budlender and Sadeck (2007).

5.2 History of bargaining councils

Councils are platforms for negotiation

Bargaining councils are established when employer and employee bodies (trade unions) in a particular industrial sector and geographical area agree to come together to engage in collective bargaining. The employer associations and unions that agree to do so are referred to as 'parties' to the bargaining council (Budlender and Sadeck (2007)).

While bargaining councils currently operate in terms of the LRA, the majority were established as industrial councils in terms of the predecessor act, the Industrial Conciliation Act. These councils were established as basic platforms through which unions and employer organisations in particular industries could negotiate. They generally started off as very standardised agreements but have developed over the years through piecemeal amendments into more complex and diverse structures.

Godfrey, Theron and Visser (2007) provide an overview of the development of collective bargaining pre-1994. Under the dual system of labour relations in the apartheid period, collective bargaining through industrial councils was almost exclusively the preserve of unions representing White, Coloured and Indian workers. Black workers could form and join trade unions but these operated without any legislative protection. They could not join industrial councils which made collective bargaining for black workers almost non-existent.

This changed in the early 1970s, with the emergence of non-racial unions that largely represented the black workers. These unions were not popular with employers who did their best to prevent them from organising their workers.

1970's – emergence of non-racial unions

Their growth, however, was phenomenal and in 1977 the government appointed the Wiehahn Commission to investigate the industrial relations system. As a consequence a series of amendments to the newly renamed Labour Relations Act gave black workers the same rights as workers of other races. Initially these new unions were reluctant to participate in the conservative industrial councils, still preferring shop-floor and company-level bargaining. However, by the early 1980s the new unions had become significantly bigger and more dominant in negotiations, and their emphasis shifted to centralised bargaining via the industrial council system. These became very effective platforms for collective bargaining and helped redefine industrial relations in South Africa.

Early 1980's: bargaining councils gained popularity

According to Godfrey, Maree and Theron (2006), the number of councils reached a peak of 104 in 1983 and has been decreasing steadily since then, to 87 in 1995 and 48 in 2004. Part of this decrease can be explained by mergers of smaller regional and sub-sectoral councils into larger national councils. Despite the decrease in the number of councils, the number of employees covered has increased substantially in recent years.

Number of councils declined from 104 in 1983 to 48 in 2004, but membership is rising.

5.3 Aspects affecting bargaining councils

Godfrey, Theron and Visser (2007) state that the LRA is fully committed to the promotion of collective bargaining, with a focus on bargaining councils as the platform. They discuss various aspects of the legislative framework and other challenges affecting the effectiveness of bargaining councils.

5.3.1 Representivity

For a new bargaining council to be approved by the National Economic Development and Labour Council (NEDLAC) the trade unions and employer organisations involved must be "sufficiently representative" of the sector and area. Once registered, the council can have its collective agreements extended to non-party members who fall within the scope of the council.

Representivity key to extending agreement to non-parties

There is constant pressure on councils to maintain representivity, as economic growth creates new employees and employers who do not necessarily join the trade unions and employers' organisations that participate on councils. Failure to maintain representivity exposes councils to the risk of non-extending agreements.

5.3.2 Extending agreements to non-party employers

The Minister of Labour can extend the agreement if satisfied that the majority of employees covered are members of party trade unions, and the party employers employ the majority of employees.

Agreement can be extended if representivity is high

Without the ability to extend collective agreements to non-party employers, a council may collapse, since party employers could be undercut by non-party employers not bound by the agreement.

5.3.3 Exemptions

Another challenge for the councils is the treatment of firms (normally small non-party firms) who can apply to be exempted from some of the council agreements. Granting an exemption is at the discretion of the exemption committee of the council.

Exemptions can be applied for – partial or full.

The council must have established an independent body to hear non-party appeals for exemption. The agreement must contain the fair criteria to be used by the independent body when considering the appeal. The Minister must be convinced that the terms of the collective agreement are not discriminatory against non-parties before allowing an agreement to be extended to non-parties.

5.3.4 Non-compulsory Membership

Unions and employer organisations together participate in councils voluntarily and can opt out if they choose. The continued existence of a council is thus based on a mutual relationship and trust amongst the parties to the council.

Unions and employer organisations participate voluntarily

Some employer organisations opt out of councils, citing irregularities in the way the councils conduct themselves. In extreme cases applications to wind up councils have been submitted to the Minister. Some councils have been reduced to only performing dispute resolution functions and administering benefit funds, and are no longer forums of collective bargaining. The more employers and employees opt out of the councils, the harder it is for bargaining councils to maintain the necessary level of representivity.

5.3.5 Other bargaining platforms

Yet another challenge for bargaining councils is the relationship of bargaining at the council level with company-level negotiations. In most instances this has been ruled in favour of agreement to bargain at the council only and the agreements prohibit company-level bargaining over issues covered in the council agreement.

5.4 The extent of coverage

In terms of operations and activities, bargaining councils are very diverse. There are large national councils that cover the entire country and a number of sectors or have a fairly narrow sectoral focus; there are regional councils that together cover a reasonable proportion of an industry, and there are small local councils that cover only a few hundred workers.

According to Godfrey, Maree and Theron (2006), most of the sectors of the economy have at least one bargaining council. However, the number of employees represented by the councils compared to those eligible for representation is quite low. Of the approximately 9.5 million employees covered by the LRA and the Basic Conditions of Employment Act (BCEA) in 2006, about 25% were covered by bargaining council agreements. Of employees in occupational categories 4 – 9 only 33% were covered.

25% of 9.5 million workers in SA covered by bargaining councils

The above figures hide the large diversity among bargaining councils in different economic sectors. Bargaining councils cover a significant proportion of employees in only three sectors, namely manufacturing, transport & storage, and community services. In other sectors, like agriculture & fishing, mining, trade, finance & business, bargaining councils are totally or virtually absent.

Councils concentrated in manufacturing, transport and storage, and community services

5.5 The extent of the exemptions

Godfrey, Maree and Theron (2006) refer to exemptions as the 'safety valves' allowing employers to apply for some concessions to address the issue of differences in interests amongst participating parties. Only parties complying with the terms and conditions of the council may apply for exemptions from some or all of the provisions of a collective agreement. A non-compliant party can not apply for exemption. Compliant non-party employers can apply.

Employers must first comply before applying for exemption

Councils review exemption applications either through the full council, a sub-committee or an independent committee appointed for this purpose. Any appeal against the refusal for exemption must be heard by an independent appeals body. Exemptions are generally granted for a specified period and reviewed thereafter.

Appeals heard by independent body

Exemptions granted for specified period only

Different councils have different exemption policies but the general purpose is to ensure that exemptions do not compromise the object of existence of the council. With some councils the exemption criteria are well defined while with others the individual circumstances of each application are looked at.

5.6 Bargaining council benefit schemes

Budlender and Sadeck (2007) conducted research into the various benefit schemes that have been established by bargaining councils.

Retirement benefits, death benefits and disability benefits form the core of our research and are covered in section 5 of this report. A brief summary of the various types of other benefit schemes and funds available in 2007 is set out below.

5.6.1 Medical and Sick Benefit Funds

Historically, medical aid funds (16 in 1979) generally covered skilled, higher income workers, while medical benefit funds (29 in 1979) provided for the low income earners. By 2007 only 15 councils were providing a medical or sick benefit fund of some sort. These funds assist employees in meeting the cost of health care by covering medical fees, providing free or cheap consultation with panel doctors, or care through clinics operated by the fund.

15 councils offered medical benefits

5.6.2 Sick Pay Funds

In 1974 industrial councils had 49 sick pay schemes but these are reported to have been of little benefit to employees, since no benefits were paid in the first few days of sickness. Currently the Basic Conditions of Employment Act (BCEA) provides for full sick pay in respect of short term illness while the Unemployment Insurance Act provides for payments in respect of long term illness. There remained only 14 sick pay funds in 2007.

14 sick pay funds – popularity reducing

5.6.3 Leave and Holiday Pay

The BCEA requires a minimum number of paid leave days in a year for all employees. Leave and holiday pay funds generally provide for extra days of paid leave or for a bonus during the employee's annual leave. Prior to the legislation of paid leave entitlement for all employees, these funds were very common. Today, there are about 14 councils with leave and holiday pay schemes.

14 councils had holiday funds

5.6.4 Unemployment Benefits

The Unemployment Insurance Fund (UIF) provides cover across all industries for those who become unemployed, as well as for maternity and longer term illness. Only one council had an additional unemployment benefit scheme, providing almost double the benefit of the UIF.

Unemployment mostly funded from UIF

5.6.5 Other benefit funds

Five councils provided maternity benefits, nine provided some sort of housing benefit and twenty provided funeral benefits.

Other benefits: maternity, housing, funeral

6. Coverage and Membership

6.1 Summary of findings

Coverage and Membership – at a glance

Most but not all bargaining councils offer retirement funds. Where funds are offered the take up is generally high, with even non-council workers sometimes participating.

Employers who participate are small to medium in size and would generally not start their own fund. Access to a council fund with larger economies of scale means workers who would not otherwise be covered can save for retirement.

Members are low income workers who change employment often, and do not as a rule accumulate high member shares.

40 private councils

29 councils with funds

43 funds

75% of employees under councils have access to a council fund

There are currently 40 private bargaining councils in South Africa. 29 of these councils have one or more retirement fund. There are a total of 43 retirement funds, which gives around three quarters of the employers and employees covered by councils access to council funds.

Regional councils more likely to have fund

Therefore, while offering a retirement fund is fairly common among councils, it is not universal practice. Regional councils are more likely to offer a retirement fund than national councils.

28 funds, 832 000 employees, 41 000 employers included in this report

Non-council workers join some of the funds

Of the 43 council funds in South Africa, 28 funds (operated by 24 councils) participated in our survey, representing around 832 000 employees and 41 000 employers. Coverage within these funds, defined as the proportion of employees in the council who belong to the fund, varies from 26% to 138%, but is generally above 80%. Coverage exceeds 100% in some cases as a result of non-council employees being permitted to join the council fund.

Most employers have 40 employees or less

The majority of employers have 40 employees or less. This number varies, with Food Producers at 163 and Support Services and Automobile sectors at less than 10.

The employees represent mainly low-income, blue collar workers, representing the income group chiefly targeted by the NSSF proposals.

Average contributions: R4 500 per year

Average savings: R27 000

Turnover >30% higher than for private employer funds

Annual contributions per member vary from R660 to R15 700, averaging at R4 500 per year. Member shares average R27 000 per member, or approximately 6 times annual contributions – an indication that the average active member has been in their fund for about 6 years. Turnover figures confirm that these funds experience more membership movements than private employer funds – per 1000 members, there were an average of 222 exits and 260 new members per year compared to 173 and 172 in private employer funds.

6.2 Characteristics of bargaining councils

The bargaining councils have characteristics which we examine separately from the funds operated by those councils. We consider these councils in terms of the industry sectors they represent, the size of the councils, and the extent to which retirement funds are offered.

The employer and employee numbers in this section are derived from the 2009 representivity report produced by the Department of Labour. These numbers however do not always reconcile with our findings. This may be caused by a difference in the dates at which measurement was taken, or by data errors in either the representivity report or the questionnaire survey results. Where differences were significant, we sought confirmation of the correctness of the figures from both the Department of Labour and the bargaining council officials, and made some data adjustments. However, there remain unreconciled results, where we either assumed that there is a reasonable explanation for the discrepancy, or removed suspect data from our investigation.

6.2.1 Retirement funds as a bargaining council feature

In this section we investigate the provision and access to retirement funds within bargaining councils. We define the term "**access**" as ***the availability of a retirement fund to party or non-party employers of a bargaining council***. So for example, employers in the auto industry are considered to have "access" to a council retirement fund, regardless of whether they actually participate in the council fund, since they have the ability to join a council fund. Similarly, employees are deemed to have "access" if their employer does, even if they do not have the ability to join the fund if their employer does not participate.

Based on the representivity report of 2009, there are currently 40 private bargaining councils in South Africa. These 40 councils represent 25 800 employers with 992 000 employees in total. Of these, 11 councils representing 6 900 employers and 247 400 employees do not offer any retirement funds. There are therefore 29 councils which offer retirement funds representing 18 900 employers and 744 800 employees. Thus 73% of employers and 75% of employees covered by bargaining councils have access to bargaining council retirement funds. Of the 29 councils offering retirement funds some have two or more retirement funds, making a total of 43 bargaining council retirement funds.

The following table shows which bargaining councils have retirement funds. We have also indicated which of the councils/funds participated in this study.

Zooming in on coverage

"Coverage" is an indication of membership in council funds. But there are a number of questions to consider:

How many workers in South Africa are covered by bargaining councils?
- about 25% of 9.5 million workers

How many of those workers covered by councils are in a council with a fund?
- about 75% - This is "access" as defined in section 4.2.1

How many of the workers in councils with funds are members of those funds?
- generally, more than 80% - see section 4.3.2

Each of these percentages is derived from different sources – so they may not be strictly comparable. But the indication is that the number of members covered is substantial.

75% of council workers have access to a council retirement fund

	Number of funds		Partici-pated in survey?
	Pension Fund	Provident Fund	
1 - Motor Industry Bargaining Council (National)		2	2
2 - Bargaining Council for the Building Industry (Bloemfontein)		1	1
3 - Building Industry Bargaining Council (Kimberley)	1	-	1
4 - Building Industry Bargaining Council (Southern and Eastern Cape)	1	1	1
5 - Building Industry Bargaining Council (Cape of Good Hope)	1	1	2
6 - Building Industry Bargaining Council (East London)	1	1	
7 - Building Bargaining Council (North and West Boland)	1	1	
9 - Bargaining Council for the Diamond Cutting Industry (SA)	1		
10 - Furniture Bargaining Council		1	1
11 - Bargaining Council for the Furniture Manufacturing Industry WC		1	1
12 - Bargaining Council for the Furniture Manufacturing Industry, Kwa Zulu Natal		1	1
13 - Bargaining Council for the Furniture Manufacturing Industry - EC		1	1
14 - Bargaining Council for the Furniture Manufacturing Industry – SW Districts			
15 - Bargaining Council for the Hairdressing Trade, Cape Peninsula		1	1
16 - Hairdressing and Cosmetology Bargaining Council KwaZulu-Natal	1		1
17 - Bargaining Council for the Hairdressing and Cosmetology Trade, Pretoria		1	1
18 - Hairdressing and Cosmetology Services Bargaining Council (Semi-National)		1	1
19 - Metal and Engineering Industries Bargaining Council (National)	**1**	1	1
20 - Bargaining Council for the Jewellery and Precious Metal Industry (Cape)	1		
21 - Bargaining Council for the Laundry, Cleaning and Dyeing Industry (Cape)		1	1
22 - Bargaining Council for the Laundry, Cleaning and Dyeing Industry (Natal)		1	
23 - National Bargaining Council of the Leather Industry of South Africa		1	1
25 - Bargaining Council for the Meat Trade, Gauteng	1	1	2
26 - National Bargaining Council for the Road Freight Industry		1	1
27 - National Bargaining Council for the Sugar Manufacturing Industry			
28 - Bargaining Council for the Restaurant, Catering and Allied Trades			
29 - Bargaining Council for the Food Retail, Restaurant, Catering & Allied Trades			
30 - South African Road Passenger Bargaining Council (SARPBAC)			
31 - Motor Ferry Industry Bargaining Council of South Africa (National)			
32 - Bargaining Council for the Goods Canvas Industry - Gauteng)		1	1
33 - Bargaining Council for the New Tyre Manufacturing Industry (National)			
34 - Bedingingsraad vir die Graankooperasiebedryf (National)		1	1
35 - Bargaining Council for the Contract Cleaning Services Industry (KZNI)		1	1
36 - Transnet Bargaining Council (National)			
37 - National Bargaining Council for the Electrical Industry of South Africa	3	2	1
38 - National Bargaining Council for the Chemical Industry			
39 - National Bargaining Council for the Wood and Paper Sector			
40 - Bargaining Council for the Fishing Industry (National)			
41 - National Bargaining Council for Clothing Manufacturing Industry		4	2
42 - National Textile Bargaining Council		1	1
Total	**13**	**30**	**28**

The bargaining councils are numbered from 1 – 42 to be consistent with numbering used by the Department of Labour in information provided to us. This numbering is used throughout this report to identify councils. Councils 8 and 24 have had their registrations cancelled and are omitted from the above table.

Number of funds has been difficult to ascertain – no formal list exists

In a number of cases, we discovered a council to have a different number or type of funds to information we had. These are:

- Motor industry (council 1) – has 2 provident funds; previous research indicated 1 pension and 1 provident fund.

- Furniture manufacturing Western Cape (council 11) – has only a provident fund, not a pension and a provident fund.
- Grain council (council 34) – has one provident fund. It was previously indicated to have no funds.
- Clothing manufacturing (council 41) – has 4 provident funds in different regions of the country.
- Electrical industry (council 37) – has 5 funds, namely 3 pension funds and 2 provident funds.

In addition, the restaurant catering and allied trades council (council 28) offers a death benefit scheme but does not offer a pension or provident fund. We do not include this death benefit scheme in this report.

In summary, providing a retirement fund arrangement as part of the benefits offered to workers is not a universal practice for bargaining councils. About three quarters of all employers and workers who are part of a bargaining council have access to a retirement fund.

6.2.2 Funds per council

Where councils offer only one fund, it is likely to be a provident fund more often than a pension fund.

Councils which offer more than one fund do so for a variety of reasons:

Reasons for > 1 fund per council:

In many cases, both a provident and a pension fund are offered. We found the benefit structure to be similar in such related funds, intended probably to give employers choice as to the type of benefit they prefer.

- Choice between pension and provident

In one fund (council 1 – motor industry), we were able to confirm that the two provident funds offered are targeted at different classes of employees. All employers have access to both funds, but the Autoworkers Provident Fund is intended for lower grade employees while the Motor Provident Fund is for employees of higher grades.

- Different funds for different classes of employees

Some national councils (councils 37 – electrical industry, and 41 – clothing manufacturing) have regional retirement funds under the national council. We treat such funds as regional funds in our investigation.

- Regional funds under national council

6.2.3 Sectors

Bargaining councils have been established in a number of different industry sectors. We have divided the councils into the different sectors by applying the FTSE/JSE Global Classification System, using the "Economic Group" where possible or the "Sector" if further differentiation seemed appropriate.

Sector classification according to FTSE/JSE Global Classification System

This grouping is different from the Department of Labour's own classification, but in our view serves to group similar employers together, aiding comparison between relatively homogenous groups.

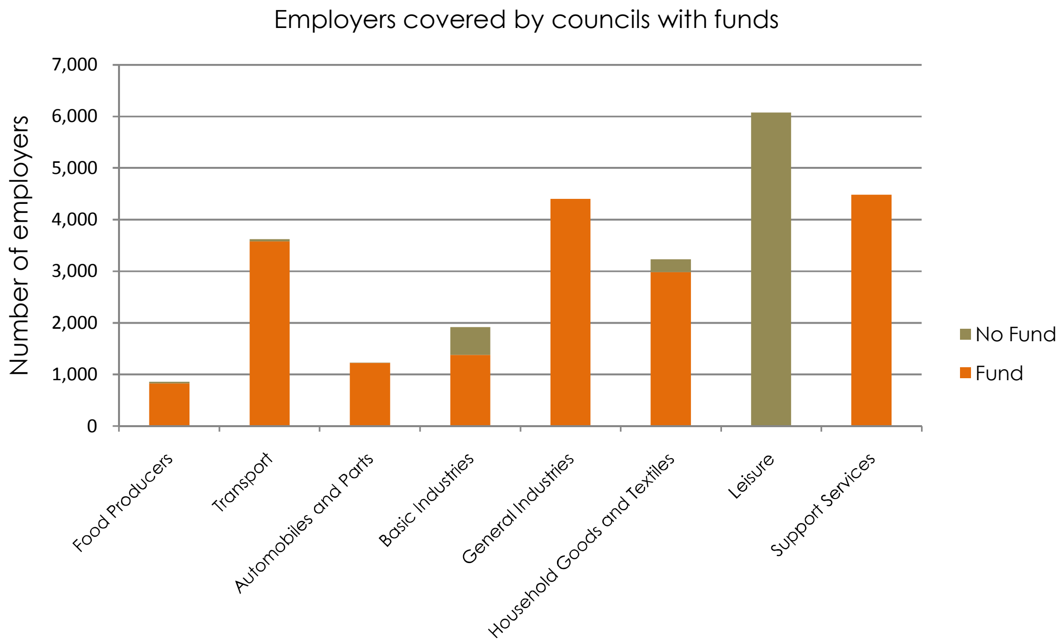
The numbers below correspond to the full council names above:

Automobiles and Parts	**Food Producers**	**Leisure**
1 – Motor	25 - Meat Trade	28 – Restaurant
33 – Tyre	27 - Sugar	29 - Food Retail
Basic Industries	34 - Grain	**Support Services**
38 - Chemical	40 - Fishing	15 - Hairdressing - Cape
39 - Wood and Paper	**Household Goods and Textiles**	16 - Hairdressing - KZN
2 - Building - Bloemfontein	10 - Furniture	17 - Hairdressing - Pretoria
3 - Building - Kimberley	11 - Furniture Manufacturing - WC	18 - Hairdressing - Semi-national
4 - Building - SE Cape	12 - Furniture Manufacturing - KZN	21 - Laundry - Cape
5 - Building - Cape	13 - Furniture Manufacturing - EC	22 - Laundry – KZN
6 - Building - East London	14 - Furniture Manufacturing - SW	35 – Cleaning
7 - Building - N&W Boland	9 - Diamond Cutting	**Transport**
General Industries	23 - Leather	26 - Road Freight
37 - Electrical	32 - Goods Canvas	31 - Motor Ferry
19 - Metal and Engineering	41 - Clothing	36 – Transnet
	20 - Jewellery	30 - Road Passenger
	42 - Textile	

Bargaining councils are not evenly spread through all the industry sectors. Some sectors, such as *Financial Institutions* or *Mining*, do not have any bargaining councils while other sectors, such as *Household Goods and Textiles*, are well represented.

Sectors without bargaining councils:
- *Financial Institutions*
- *Mining*

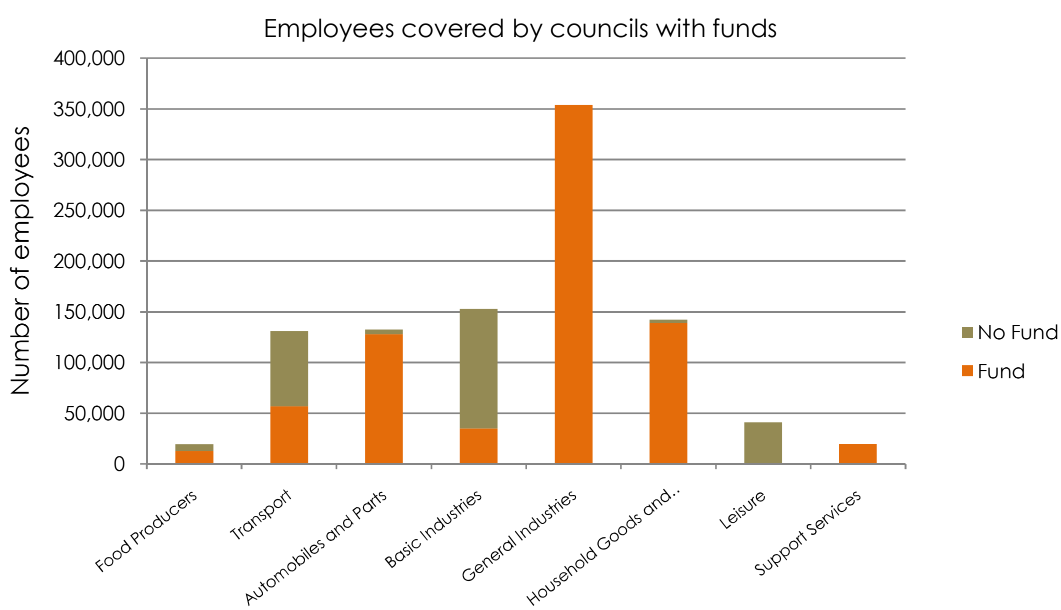
Using the above classifications, we investigated the extent to which employers and employees that fall under bargaining councils in each of these industry sectors have access to council funds:



Fund access to employers in virtually all sectors appears high. The exceptions are the *Basic Industries* sector, where there is no fund for the wood and paper council (council 39) or the chemicals council (council 38) and the *Leisure* sector (restaurant and catering bargaining councils) which has a very high number of employers, but no bargaining council funds.

Leisure sector councils have no retirement funds

The picture changes somewhat when employees are considered as the graph below shows:



While the *Leisure* sector has no access to funds, only a relatively small number of employees are affected due to the small size of the participating employers. Significant lack of access to council retirement funds is seen in the *Transport* and *Basic Industries* sectors. In *Transport*, this is due to the Transnet (council 36), motor ferry (council 31) and road passenger (council 36) councils, which have 44 relatively large employers who employ 74 000 staff with no access to council retirement funds. In *Basic Industries*, 118 000 workers in wood (council 39) and chemicals (council 38) have no access to council funds causing the low coverage shown above.

Leisure sector has no funds but the number of workers in the sector is small

High number of Basic Industries employees without fund

In Transport sector, a few very large councils lack fund

Where bargaining councils have not established funds, it is left to the trade unions or the employers themselves to establish funds for employees. The number of such staff covered has not been investigated.

Different sectors, different picture

In each sector, historical developments have determined a different spread of councils and council funds. This would have been affected by the existence and bargaining power of trade unions and employer organisations. As a result, some sectors have no councils, some have councils but lack retirement funds, and some have both:

Sectors without bargaining councils:

- Financial Institutions
- Mining

Sectors with councils but no retirement funds:

- Leisure

Sectors with councils and some retirement funds:

- Transport
- Basic Industries

Sectors with councils and with retirement funds:

- Automobile
- General Industries
- Household Goods
- Support Services

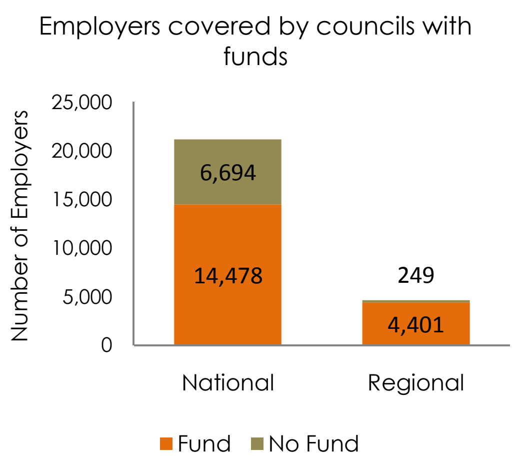
6.2.4 Regional characteristics

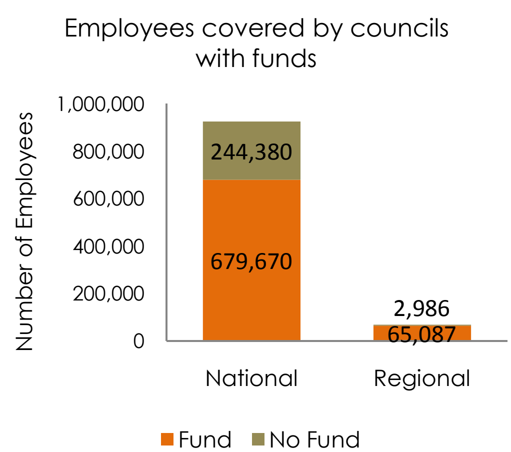
Bargaining councils can cover the whole country (national) or a particular region. 21 councils are national (or "semi-national"), and the remaining 19 are regional. The national councils are much larger on average, and the vast majority of employers and employees are covered through the national bargaining councils. Out of a total of 992 000 employees reported in our survey, 924 000 (93%) are covered by national councils and only 68 000 (7%) by regional councils.

National councils make up 53% of councils but have 93% of members

It appears that the employees and employers in regional councils are more likely to have access to a council retirement fund. This could be explained by the closer relationship between the council and the employers in a regional council.

Regional councils more likely to have fund





The link between council and fund

On a regional level, it seems nearly impossible to run a council without offering a retirement fund. Why is the link so strong?

It could be that for these smaller, regional councils the existence of the fund is the main justification for the existence of the council. The fund generates interest in the council and provides an incentive to register, and the council has the unique ability to reach members of the local industry.

At national level, the council has a broader mandate and is less reliant on having a fund as a benefit. The link between council and members is also more distant.

Elsewhere in this report, we suggest that the benefits offered by regional funds tend to underperform national funds. We should be asking ourselves if these two results are linked: if regional councils tend to be more insistent on establishing a fund, they may be willing to engage in more compromises and negotiation in order to get the buy in of all stakeholders. This may mean less generous benefits but more funds and higher coverage to compensate.

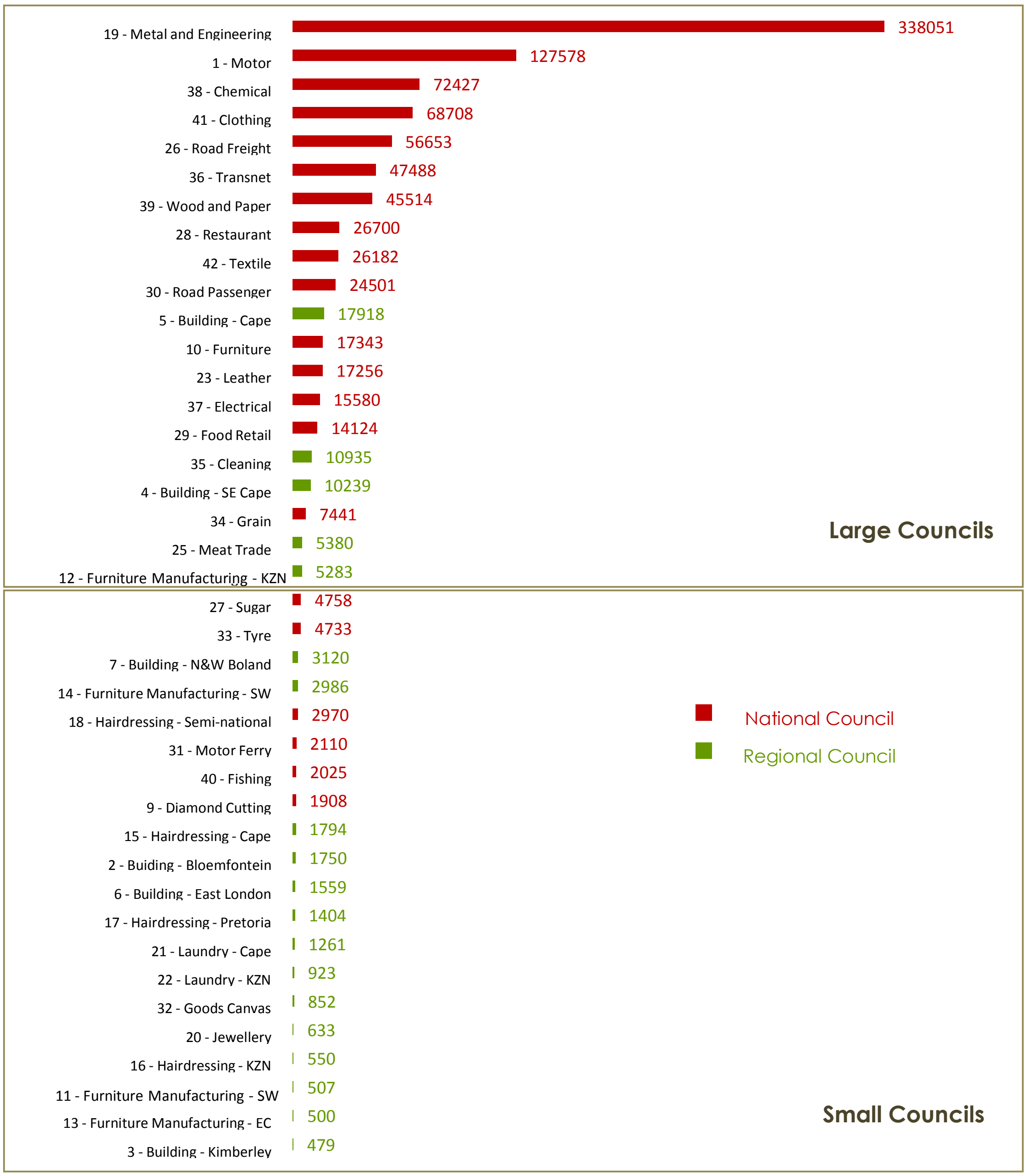
6.2.5 Council membership

We divided the councils we examined into categories according to the number of employees. Given the small sample size, only 2 groupings were made: "large councils" with more than 5 000 employees and "small councils" with less than 5 000 employees. This splits the councils into two equal groups of 20 each.

Large: 20 councils with >5000 members

Small: 20 councils with 5000 or less members

Number of employees covered by bargaining councils



We have used council membership of 5 000 as the division, mostly to align with criteria used for membership size elsewhere in the report. The majority of small councils are regional, and most of the large councils are national.

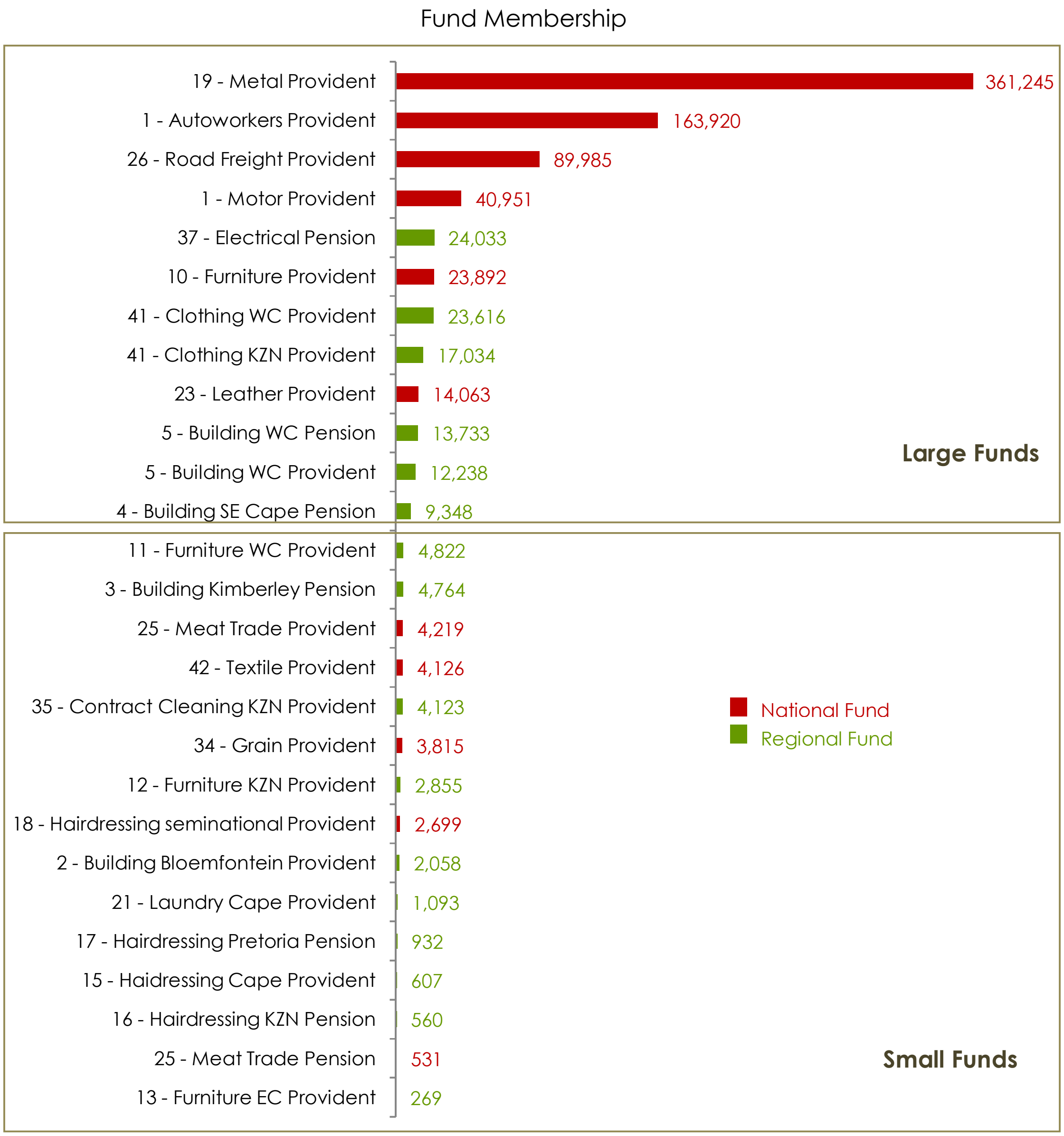
6.3 Characteristics of bargaining council funds

The previous section considers the total population of private bargaining councils, regardless of whether they have a retirement fund or not. This section explores into only those councils with funds. The data is based on our own investigation and therefore includes only those councils and funds which have participated in our study.

6.3.1 Fund Membership

27 funds provided us with membership numbers. The fund membership ranges from 269 to 361 000 active members, with an average of about 30 000 members per fund. We have categorised the funds into large and small based on membership over and under 5 000 active members, mostly to maintain consistency with other surveys such as the Sanlam Benchmark Survey and the NSSF proposals. On this basis, 12 of the funds are "large" and 15 are "small".

Smallest fund: 269 members
Largest fund: 361 000 members



The total membership of the funds which responded to our survey is 832 000. Although this figure may include some active fund members who are not necessarily employees falling under the bargaining councils concerned, the proportion of such members is expected to be small.

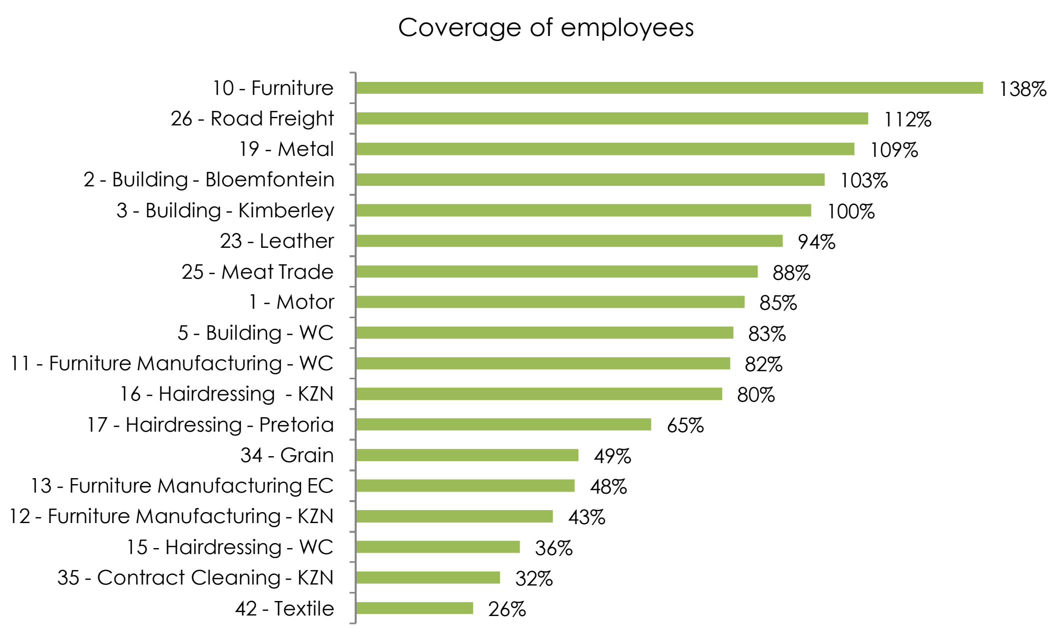
94% of the members of council funds are in provident funds, and only 6% in pension funds. Similarly, 84% of the members are in national funds and only 16% in regional funds.

6.3.2 Coverage

All employers under bargaining councils which have retirement funds qualify for membership in those funds. Therefore, it is interesting to examine to what extent employers participate in these funds.

We compared the number of members in the funds from our questionnaire to the number of members in the industry from the representivity report. However, we could not reconcile the representivity report with the data supplied by the funds. Serious discrepancies were found, such as the number of members in the funds significantly exceeding the number of members in the council. These could be errors, or may be caused by a difference in the date of the two reports. In some cases, we established that the differences are caused by funds admitting employees from outside the council as members. We have submitted a list of all discrepancies to the Department of Labour, but do not compare the two sets of data in this report.

We did, however, request funds to provide both the number of active members in the fund and the number of employees under the council. We exclude from our analysis 8 councils where we did not receive information from all the funds, as these would clearly be understating coverage. We also exclude 3 funds where membership information is insufficient. The figures for the remaining 18 funds are shown in the graph below.



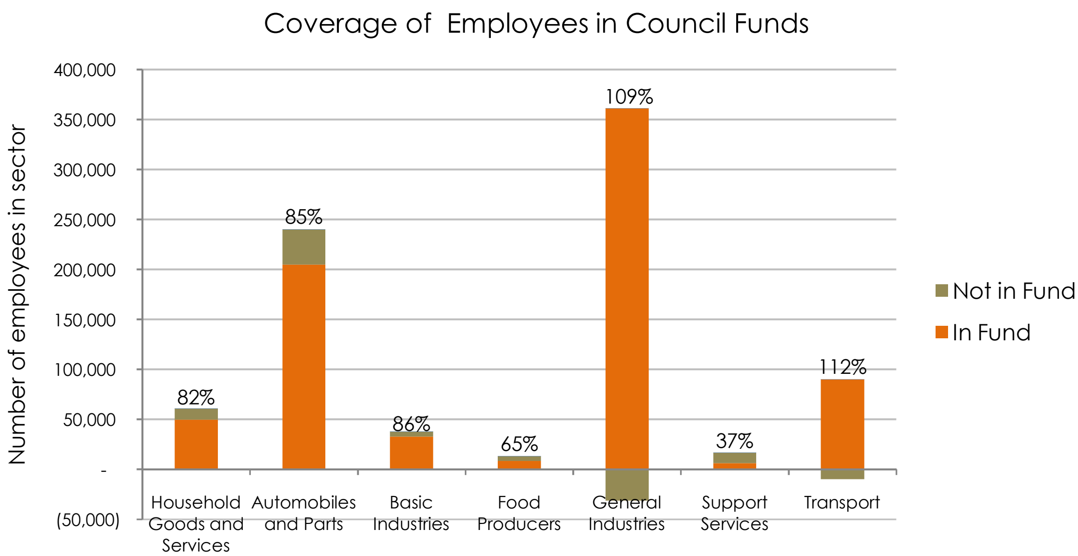
This analysis shows that some funds report a larger number of members in the fund than employees under the council (councils 10, 26, 19 and 2

Coverage from 26% to 138%

above). Some of our respondents confirmed that they admit non-council employees into the funds on a voluntary basis.

Non-council workers join some of the funds – coverage can be >100% as a result

Grouping the membership by industry, and again only considering these 18 councils where we obtained responses from all the funds, the level of coverage per industry is as follows:



Coverage (indicated as a percentage above each column) appears to be reasonably good across most sectors, suggesting that exemptions are not widely utilised. It is only in the Food Producers and Support Services that the coverage is below 80%. The Support Services sector has a particularly low level of coverage at 37%.

Coverage generally above 80%

Support services coverage low at 37%

Where the above graph shows negative coverage, this indicates that the fund has more members than workers in the industry. This could be the result of non-council workers joining the fund.

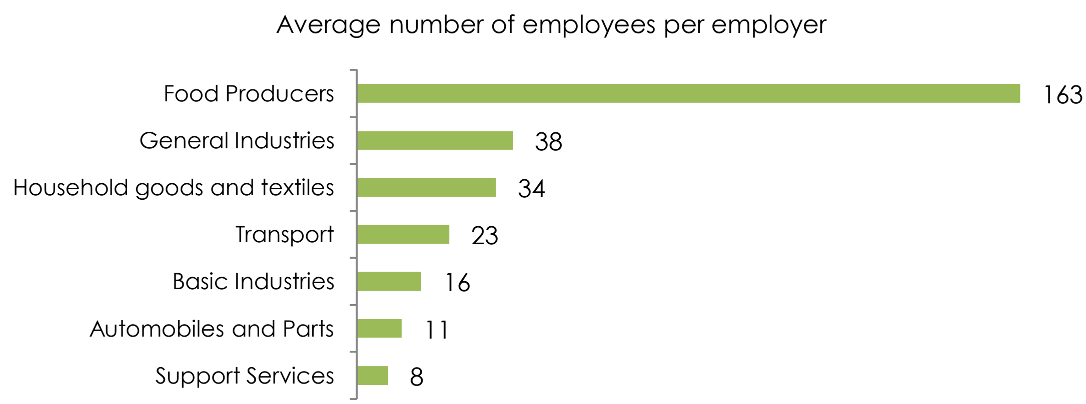
The details of coverage information (only for councils where all funds responded to our survey) are presented as Table 1 in Appendix 4.

Average employer has 40 staff

6.3.3 Employer size

The average number of fund members per participating employer ranges widely from 3 to 477, with an average of 40 across the 24[1] funds for which this information was made available.

[1] We grouped the 2 motor industry funds (council 1) together for this comparison as they were both based on the same number of employers.



Most of the sectors average 15 to 40 employees per employer. The main exceptions are the Food Producers, with 163 employees per employer, and the Automobile and Services sectors which have low average numbers at around 10 employees per employer.

Most employers between 15 and 40 employees

At such a small average membership per employer, these funds are in our opinion ideally served by belonging to a council fund. Free standing funds are in our experience not administratively efficient for such small memberships. Additionally, many small employers might not consider it a priority to provide for their workers' retirement, and would not voluntarily start a retirement fund. This is exacerbated if retirement benefits are negotiated on top of current salaries and therefore constitute an increase in total cost to the employer.

Small employers unlikely to set up their own fund – council funds perform an important role

The full details of members and employers are in Appendix 2 – Table 2.

6.3.4 Salaries

Bargaining councils tend to operate in sectors where salaries are lower than the national average. These are generally the sectors where unions have the most significant involvement. As a result, the earnings profile of the members makes them very similar to the income group chiefly targeted by the NSSF.

Estimating Salaries

Salaries are a useful measure of benefit levels – a benefit of R20 000 means something different to a worker who earns R40 000 per annum than to a worker who earns R200 000 per annum.

In order to express benefits as a multiple of annual salaries, we estimated salaries from available data. This estimate was derived from the contributions per member divided by the contribution rate.

Unfortunately, the approach is only very approximate: it does not account for timing differences, part-time workers, and many other factors. To improve on the results, where the average calculated was lower than the minimum wage for the council, we increased it to equal the minimum.

The results are very approximate and should be taken as such – a detailed salary survey of council workers would need to be conducted to derive more reliable results.

The total monthly active member salaries amount to R2.8 billion, and vary from R635 000 to R1.2 billion per month per fund. The average individual monthly salaries, adjusted for minimum wage information, vary between R1 700 and

R8 400 per fund with an overall average of R3 300 per month or about R40 000 per annum. We caution the reader that these figures are very approximate and should only be seen as a rough indication of the actual salaries paid in these industries.

Estimated average salary of R40 000 per annum

6.3.5 Contributions

The total (employer and member) annual active member contributions vary from R1 million to R2 billion per fund with an overall average of R190 million. 70% of funds have total contributions in excess of R5 million per year, in contrast to the private employer funds surveyed in the Sanlam Benchmark Survey 2009, where 57.5% of funds have contributions in excess of R5 million per year. The average annual contributions per member vary between R660 for the grain industry fund (council 34) and R15 700 per member for the Motor Industry Provident Fund (council 1) with an overall average of R4 600. R660 appears implausibly low; however, another 2 funds had similarly low contributions. This may indicate that the total contribution amounts and the active member number were mismatched, possibly due to timing differences. There could also be other effects, such as part-time work lowering contribution amounts.

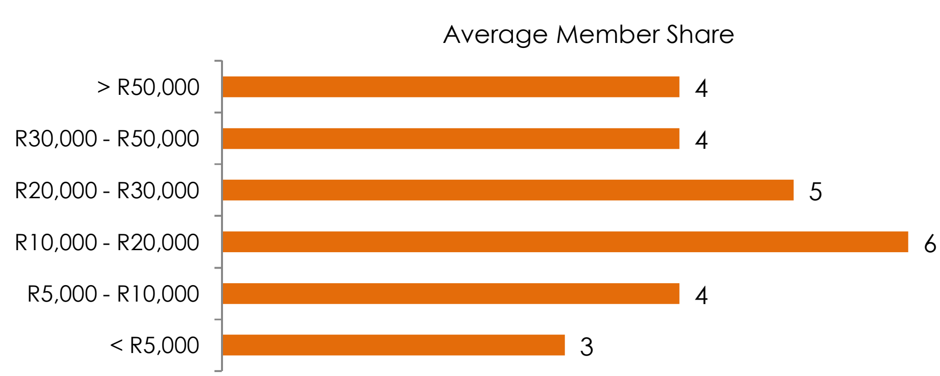
Estimated average contributions of R4 600 per annum

6.3.6 Member Share

26 funds supplied information regarding active member liabilities. These vary from R3.2 million to R23.8 billion per fund with an average of R1.4 billion.

It is, however, more relevant to look at the average individual member share per fund. The average individual member share varies between R3 000 for the building industry Kimberley (council 3) and R90 000 for the Motor Industry Provident Fund (council 1) with an overall average of R27 000. Unfortunately, no comparative figure is available for the private employer funds, and we instead investigated the average assets per active member in section 6.2.2.

Average member share of R27 000



Given that average annual salaries are estimated to be in the region of R40 000 per member, the average member share of R27 000 equates to 0.6 times annual salary in savings. Since average annual contributions are R4 600, the member shares are on average 6 times annual contributions - a very rough indication that the average member has been in a bargaining council fund for about 6 years.

Member share indicates about 6 years of membership

6.3.7 Membership turnover

Per 1000 members, an average of 222 leave in a year, mostly as a result of withdrawals. We have not investigated whether members leave and rejoin the fund as they change employment within the sector. Per 1000 members, an average of 260 join the same year.

Exits = 22% of current members p.a.
New members = 26% of current members p.a.

The Sanlam 2009 Benchmark survey, which investigates South African private retirement funds, provides some comparative statistics on joiners and leavers in the private employer funds. According to this survey, private employer funds experience 173 exits and 172 new entrants per 1000 members on average. Turnover in council funds therefore appears to be significantly higher than in the private employer funds sector.

New members 50% higher than in private employer funds

Exits 30% higher than in private employer funds

The details of turnover are included as table 3 in Appendix 2.

Turnover is investigated in more detail in Section 5: Benefits.

For a summary of the member statistics discussed in the above section, please consult Table 4 in Appendix 2.

7. Benefits

The benefits offered by a retirement fund are a key feature of the fund. We examined both the benefits in the rules of the fund, and the actual benefits paid out. Average values are unweighted averages unless stated otherwise – for a comparison to weighted averages, refer to Table 5 in Appendix 2.

Benefits – in a nutshell

The majority of funds are provident and pay out cash on retirement.

Contributions at 12.9% are too low compared to NSSF. Regional funds are particularly low.

Benefits on retirement are low, mainly due to lack of preservation. For every retirement, there are 11 withdrawals each year.

Benefits on death and disability are around 2 times salary, lower than in private employer funds. Funeral benefits are on par.

7.1 Summary of findings

75% of funds are provident 25% are pension

We analysed the benefits of 28 retirement funds provided by 24 bargaining councils. All of the funds are defined contribution funds, and 75% are provident funds while 25% are pension funds. Council funds are predominantly provident in nature, more so than their private counterparts. This is likely a consequence of the negotiated nature of these funds and the needs of the members as low income workers.

The proposed reforms endorse preservation and therefore may introduce changes preventing the payout of retirement benefits in cash. This may be a challenge for council funds.

Total contributions 12.9% vs. 15-18% proposed NSSF

Equal member/employer contributions

Regional funds have much lower average contributions

The average total contribution rate of the funds is 12.9% of salaries, which is significantly less than the average of 15.8% for private employer funds, and the 15%–18% envisaged for the NSSF. The employer and member contribution rates are mostly equal to each other, while private employer funds tend to have a higher employer than member contribution rate. National funds fare better than regional funds, with a contribution rate of 15.4% compared to 11.6%. Opt out from the NSSF is likely to be linked to at least matching the contribution rate in the NSSF, and a large proportion of council funds would be found lacking in this respect.

On retirement, benefit = 1.5 times salary on average

There is a very large variation in the average level of retirement benefits paid out by the different funds but very few funds can be considered to be paying adequate retirement benefits. The average retirement benefit of 1.5 times estimated salary is far from being adequate to provide reasonable security in retirement. The fact that the benefits are paid as a lump sum rather than a pension income for life further reduces the security provided by the benefits. The chief cause of the low level of benefits appears to be the rate of withdrawals, where there appears to be a correlation between high withdrawal rates and low retirement benefits.

Withdrawals are major cause of leakage from system

For every one member retiring in any one year, 11 withdraw, making withdrawal benefits probably the most significant benefit provided by the funds. Withdrawal benefits are however much lower than retirement benefits, averaging 0.5 times annual salary. This situation is not unique to council funds, but due to the nature of employment in the low income sectors, the situation may be worse for these funds than in the private employer funds. Reducing withdrawals and improving preservation is a major goal of the reform proposals. Compulsory preservation of benefits can have a significant impact on the nature of the benefits paid, and will increase the size of the retirement benefit dramatically at the expense of the withdrawal benefits.

11 withdrawals for 1 retirement

Most funds provide a death benefit, averaging at 2.2 times annual salary, compared to 3.5 times salary for private employer funds. A disability lump sum benefit is less common, but is on par with death benefits where it is offered. The actual levels of death and disability benefits are higher than withdrawal benefits.

Death benefit = 2.2 times salary, vs. 3.5 for private employer funds

67% of the funds provide funeral benefits of typically R5 000 or R10 000, which is on par or slightly ahead of the private employer funds. The NSSF would likely not offer a funeral benefit, leading to a possible reduction in benefit for members who move to the NSSF from a council fund. A similar comment can be made regarding housing loans, which, while not extensively utilised by council funds, would most probably also be lacking from the NSSF.

Funeral benefits comparable to private employer funds or better

Contribution to new retirement framework?

Council funds already fit in with some of the aspects of the reform: they are defined contribution funds which offer the full range of benefits.

Preservation is a serious issue, even more so than in comparable private employer funds. Most South African funds will find it a challenge to improve preservation unless legislation is changed.

Council funds lag behind the potential requirements for NSSF opt-out and also behind their private employer fund counterparts in several important areas: contribution rates, in particular for regional funds, are too low; and death and disability benefits are lower than in the private employer funds.

Lessons for NSSF designers?

Should council fund members qualify for the SOAG, a proportion of their post-retirement needs relative to their pre-retirement salaries may be met, reducing the need to increase contributions or preservation.

The NSSF proposals should consider this in the contribution design. Just increasing the required employer contribution at low salary levels could be unaffordable and may lead to staff reductions to maintain profitability.

7.2 Benefits as defined in the fund rules

We investigated the benefits offered by the bargaining council funds and the contributions payable, as defined in the rules of the funds. We considered aspects such as the types of benefits, the structure and level of these benefits and the nature and level of contribution rates.

7.2.1 Pension and provident funds

The Department of Labour provided a list of 40 councils of which 29 councils have retirement funds, and a total of 43 retirement funds are provided by these councils. 30 of the funds are provident funds and 13 are pension funds. Within our sample of 28 funds, 21 (75%) are provident and 7 (25%) are pension funds.

75% provident, 25% pension

Budlender and Sadeck (2007) found that of the 42 councils they surveyed, 26 councils provided a total of 35 retirement funds. 13 councils had a pension fund, while 22 had a provident fund arrangement. 9 councils had both types of funds.

In a **provident fund** the total retirement benefit can be paid as a lump sum. In a **pension fund** a maximum of one third of the retirement benefit may be paid as a lump sum, while the balance of the retirement benefit must be paid in the form of an annuity (a monthly income) to the pensioner. In a provident fund, member contributions are not tax deductible, while in a pension fund member and employer contributions are tax deductible (up to certain limits). These are requirements of the Income Tax Act.

The Sanlam Benchmark Survey (2009) shows that among private employer funds, 58% are provident and 31% are pension funds. This suggests that provident funds are more popular in the bargaining council context than in private employer funds. This is to be expected due to the lower income profile of the membership of council funds and the influence of trade unions, which historically favoured provident funds.

Another way to look at the data is that out of the 40 councils, 11 offered no fund, 4 offered pension funds only, 19 provident funds only and 6 both types of funds.

Cash or Pension?

Pensions seem to be the perfect retirement benefit: income and expenditure are matched over the life of the pensioner, and there is no risk of poverty in old age.

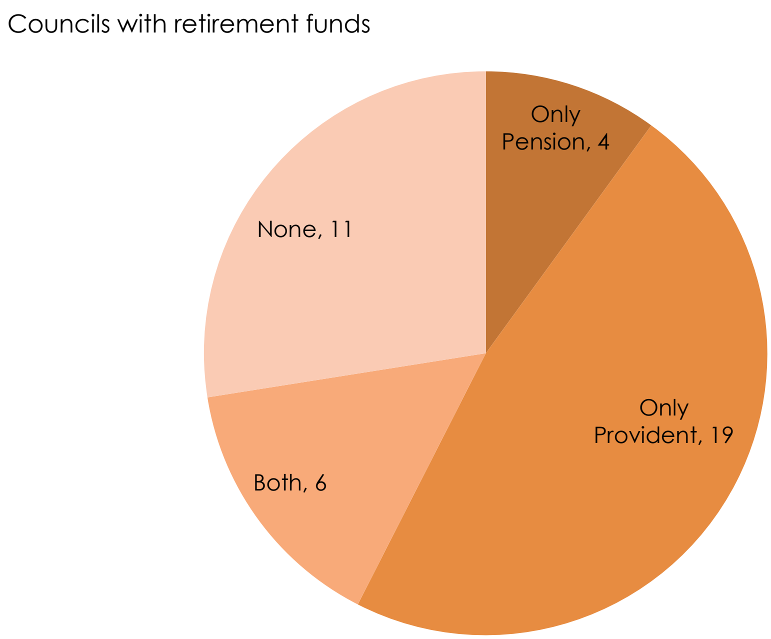
Why then are cash benefits so sought after by workers and their representatives?

For one, the preference for a single, large lump sum is an understandable human desire. In the low income sector, other factors support this: if the pension is small and the recipient lives in a rural area, the cost and delivery mechanism are more aligned with a lump sum.

Additionally, South Africa's low income workers do not necessarily get a "good deal" when it comes to buying an annuity: to protect themselves from the risk of anti-selection, most insurers do not account for the higher mortality experienced by these workers. The result is that the pension is lower than warranted.

If cash seems to be preferable to many of these workers, why are the reform proposals focussing on overcoming the cost, delivery and mortality rating issues and delivering pensions instead?

The main problem with cash benefits is that retirees are at risk of old age poverty when the benefit is spent quickly and nothing remains to supply the retiree's daily needs.



It has often been suggested within the context of retirement fund reform that the distinction between pension funds and provident funds in the Income Tax Act should be eliminated and replaced with a single retirement tax dispensation, with the emphasis on paying retirement benefits in the form of an income rather than a lump sum.

Provident funds not aligned with reform proposals

This is also the approach suggested by the NSSF. Such a legislative change would have a drastic effect on the bargaining council funds which have been negotiated by their union organisations as predominately provident funds and the communication and education process with members will be important. A major challenge will be if cash withdrawals are to be allowed, resignations before retirement date will again give a cash benefit and effectively a 'provident type' environment will remain.

7.2.2 Defined contribution and defined benefit funds

All 28 funds that completed questionnaires in our research are defined contribution funds. There are no funds with defined benefits.

In a **defined contribution fund** the retirement benefit of the member is based on the total contributions available for retirement benefits, accumulated at a rate of interest related to the return on the assets in the fund. As a result the members effectively carry the investment risk, i.e. the higher the investment returns, the higher their retirement benefits will be, and vice versa. Virtually all provident funds are defined contribution funds.

South African retirement funds now predominantly defined contribution

In a **defined benefit fund**, the retirement benefit of the member is based on the number of years of service and some definition of the member's salary prior to retirement. The members do not carry the investment risk directly, since the employer is normally liable to fund any deficit in the fund. Traditionally most pension funds were defined benefit funds. In recent years, many defined benefit funds have converted to defined contribution, and defined contribution pension funds are more common now.

For all the pension funds which answered this question, the nature of the retirement benefit is described as "combination of cash and annuity". Most provident funds describe the retirement benefit as "cash", with exception of the funds for the building councils in Bloemfontein and the Western Cape (councils 2 and 5), as well as the textile industry (council 42), which use the description "combination of cash and annuity". The Income Tax Act specifies that a provident fund may pay out an annuity, so this classification is possible, although unexpected.

The move away from defined benefits to defined contributions has been a dominant trend in the retirement industry over the last three decades and no reversal of this trend is likely. In our experience this move was driven by the members, unions and employers alike. The important issue that needs to be addressed in defined contribution funds, where the members carry the investment risk, is the protection of members against unwise investment decisions and against fluctuations in investment returns.

The planned reform is aligned with the defined contributions system. While the NSSF itself may be a hybrid defined benefit / defined contribution arrangement, it appears that accredited providers are mainly considered to be defined contribution funds. Reform proposals do make mention of defined benefit funds, but more as the exception than as the rule.

"Accredited Providers" under new framework most likely defined contribution

7.2.3 Contribution rates

Nature of contribution rates

In a defined contribution fund the retirement benefit is a direct function of the total contributions available to be invested for retirement benefits. The level of the contribution rate is therefore crucial in determining the adequacy of the retirement benefit.

The normal practice in the retirement industry is to express the contribution as a percentage of the salary of each member.

Of the 28 funds, three funds have at least one membership category where the contributions are fixed at a certain rand amount rather than as a percentage of salaries. The pension and provident funds of the building industry of Western Cape (council 5) have contribution rates of R92 per week for general workers, R158 per week for tradesmen and R210 per week for artisans, and these funds are excluded from the analysis of contribution rates expressed as a percentage of salaries. The provident fund for the furniture industry (council 10), has a membership category with a fixed rand contribution rate of R89 per week and this category has also been omitted from further analysis.

Of the 26 funds with contributions expressed as percentage of salary, 23 funds base their contribution on actual salary, (of which one indicated that bonuses/overtime are included), while 3 funds base their contributions on minimum salary.

Most contributions expressed as % of actual salary

Of the 26 funds where contributions are a percentage of salary, 21 funds have the same contribution rates for all members. 5 funds have different contribution rates for different member categories, which we included in the analysis on an average basis.

Contributions defined as a fixed rand amount, contribution rates expressed as a percentage of minimum wage, and different contribution rates for different member categories are not in line with general accepted practice in our opinion and bargaining council funds with such definitions of contribution rates may need to adjust such structures.

Minimum Salary vs. Actual Salary

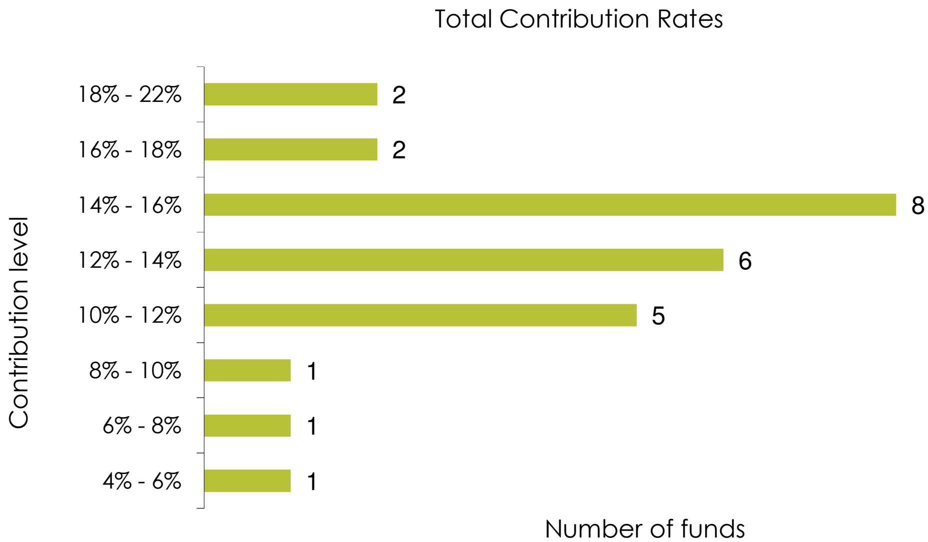
If contribution rates are expressed as % of minimum salary, converting them to % of actual salary would mean reducing the rate.

For example: a contribution of 12% based on a minimum salary of R5 000, is equivalent to a contribution of 10% based on an actual salary of R6 000.

We did not have sufficient salary information to make this adjustment. Instead, we left the contribution rate the same. This is the same as assuming that average salaries are close to minimum salaries for the three funds in question.

Total contribution rates

The graph below shows the number of funds in various contribution rate ranges, based on the total member plus employer contribution rates:



The total contribution rate varies from the lowest of 5% of salary (for council 18 - hairdressing semi-national) to the highest of 20.5% of salary (for council 26 – road freight). Nearly three quarters of the funds have a total contribution rate of between 10% and 16%, and the unweighted average contribution rate is 12.9% of salary.

Lowest contribution: 5%
Highest contribution: 20.5%

Average contribution: 12.9%

The Sanlam Benchmark Survey (2009) shows that private employer funds receive average total contributions of 15.8% of salary, significantly higher than the 12.9% we measured in bargaining council funds.

The NSSF proposals are targeting a contribution rate of 15% - 18%[2], and it is likely that council funds will need to match this in order to qualify for opt-out and accreditation. This means that of the 28 funds, 21 funds may need to increase their contribution rate to meet NSSF requirements.

NSSF proposed contribution: 15-18%

75% of council funds below NSSF level

Employer and employee contribution rates

In 18 out of 28 funds the member and employer contribution rates are equal. Where they are not equal, the employer contribution generally exceeds the member contribution by a small amount. The exception is the grain industry (council 34), where the member contribution rate is 5%/6%/7% in three member categories, while the employer contribution rates are more than double that, at 13%/14%/14%.

[2] We estimate this based on assuming 10-12% towards retirement, plus another 4% towards risk benefits, and another small addition towards expenses. 15%-18% is the total contribution mentioned in the reform proposals.

The average employer contribution rate is 6.7% compared to 9.9% for private employer funds while the average member contribution rate is 6.2% compared to 5.9% for private employer funds, from the Sanlam Benchmark Survey (2009). It therefore seems that while member contributions are in line with private employer fund contributions, employer contributions are significantly lower.

Employer contribution 6.7% vs. 9.9% in private employer funds

Member contribution rate 6.2% vs. 5.9%

Setting contribution rates

Comparing council funds with private employer funds in terms of the employer/member contributions highlights a very significant difference between the two systems:

In **private employer funds**, contribution rates are generally part of the total cost to company. The split between employer and member rarely matters, and is decided to maximise tax rebates in most funds. As a result, many provident funds may have only employer contributions. This does not mean that members do not pay for the plan – the employer contribution comes out of total package.

In **bargaining council funds,** the contributions are the result of careful negotiations. The employer contribution is generally negotiated as an **additional** amount, over and above the salary, in most cases. This explains why most funds arrive at a 50:50 split of contributions – it only seems fair. In addition, taxation is generally not a major concern since members do not earn enough to pay income tax.

Given this background, what would happen in council funds if the contribution rate had to increase? Would employers pay for the full increase, or would the additional cost again be split between member and employer? It is interesting to note that if the cost is split, the average council fund member contribution would be significantly higher than that of private employer fund members.

We examined the contribution rate separately in provident and pension funds, in large and small funds and by different industry sectors, and detected no significant trends other than fairly low contribution rates in the Support Services sector.

Provident and pension fund contributions similar

However, there is a marked difference between the contribution rates of regional and national funds. National funds have an average total contribution rate of 15.4% (8.2% employer, 7.2% member) while regional funds have an average total contribution rate of 11.6% (6% employer, 5.6% members). National funds therefore have significantly higher contribution rates and are much closer to the average total contribution rate of 15.8% for private employer funds. Out of the 9 national funds, 6 have a contribution rate greater than 15% and therefore likely to be considered acceptable in terms of the reform proposals.

Average contribution in national funds: 15.4%

Average contribution in regional funds: 11.6%

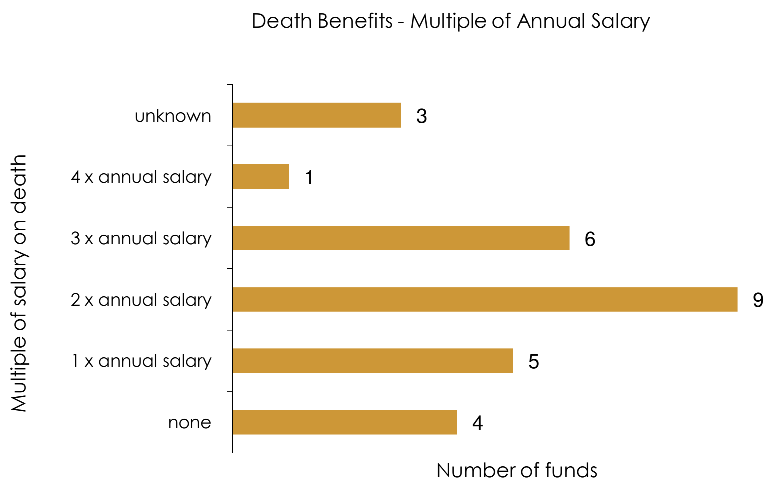
7.2.4 Death benefits

Of the 28 funds, 25 funds provide a multiple of salary on death. The multiple of salary varies between 1 and 4 times salary, with 9 funds providing 2 times salary. In the case of the funds for the Western Cape building industry (council 5) the multiple varies from 1 to 4 depending on years of service – in our analysis we used 2.5 as an approximation. For the clothing manufacturers KZN (council 41), there are two membership classes with a benefit of 0.63 and 1.5 times salary respectively, and we used one times salary as the average.

Average lump sum on death: 2.2 times salary vs. 3.5 times salary in private employer funds

The average death benefit for all funds is 2.2 times salary. National funds are on average slightly higher than regional, at 2.4 compared to 1.9 times salary.

The graph below shows the number of funds providing a given multiple of salary as death benefit.



The Sanlam Benchmark Survey (2009) indicates that private retirement funds provide a higher average lump sum on death, namely 3.5 times annual salary. The NSSF death benefit levels have not been fixed as yet.

60% of the private employer funds provide a lump sum benefit of more than 2 times salary, compared to 25% of bargaining council funds.

Majority of council funds pay member share in addition to multiple of salary on death

Of the 28 bargaining council funds, 25 indicated that the fund credit is paid in addition to the multiple of salary on death. In contrast, 33% of private employer funds do not pay out the member share as part of the death benefit. Given that the member share for bargaining council funds, on average, is about 0.6 times salary[3], this increases the total average benefit on death for bargaining council funds to 2.8 times salary. This is still lower than the average of 3.5 times salary for private employer funds, in addition to which 61% of private employer funds also still pay the member share, which is likely to be higher on average than that for council funds. The NSSF benefit structure has not yet been

[3] The salaries used here were estimated as explained in the box in section 4.3.4.

fully determined, and the advantages of including or not including the member share are still being evaluated.

3 funds pay a fixed lump sum at death, which in one case was quantified as R25 000. None of the funds provide any death benefits after retirement. Free standing group life assurance or disability schemes were ignored for the purpose of this investigation.

In general, we are of the opinion that the total benefit paid on death is lower in council funds than in private employer funds.

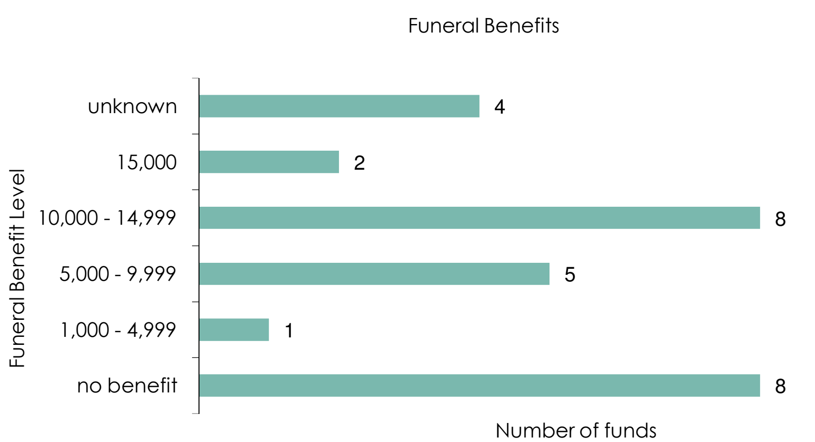
7.2.5 Funeral benefits

Funeral benefit for member and family common.

Funeral benefit generally R10 000

19 of the 28 funds provide a funeral benefit to members and family. One fund provides a funeral benefit to the member only, and the remaining 8 funds do not offer a funeral benefit. The lowest funeral benefit is R3 000 and the highest is R15 000, with most funds providing a funeral benefit of R10 000. Funeral benefits are generally not related to salary but are a fixed lump sum, and contributions are therefore also fixed in monetary terms and not related to salaries. In our experience, these benefits are highly valued by low-income individuals.

The graph below shows the number of funds providing a given amount of funeral benefits.



This is in line with the private fund industry, where the majority of funeral benefits are either R 5 000 or R 10 000. 60% of private employer funds offer this benefit as compared to 71% of the council funds. The council funds appear therefore to be on par or slightly more generous than the private industry funds.

While plans have not yet been finalised, the NSSF may not offer a funeral benefit. Members who are therefore currently covered would lose this benefit if they move from a bargaining council fund to the NSSF. Such a change in benefits should be well communicated where bargaining council funds are not exempted from the NSSF.

7.2.6 Disability benefits

20 out of 28 funds indicated that they provide a disability lump sum benefit as a multiple of salary. Where funds provide both death and disability benefits, they are equal in the majority of cases. However, fewer funds provide disability benefits than death benefits.

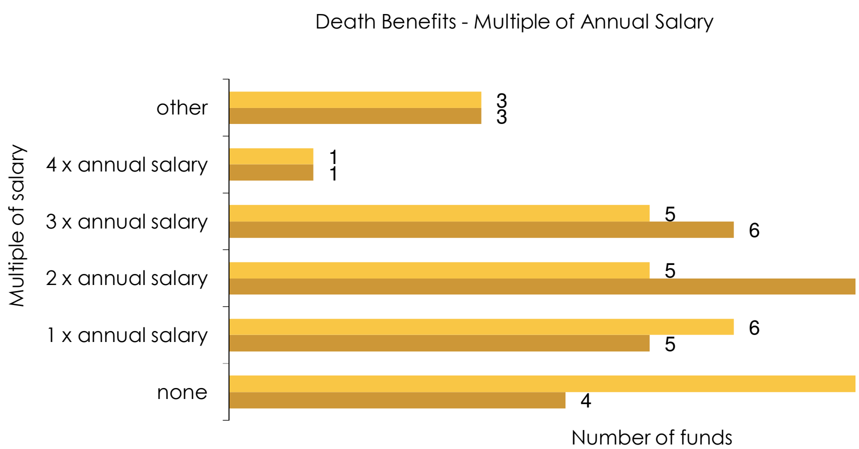
The average disability benefit for those funds that provide it is 2.1 times salary.

Average disability benefit: 2.1 times annual salary

In 17 funds, the disability benefit includes the fund credit, which is on average equal to about 0.6 times salary. The total disability benefit provided by those funds is therefore about 2.7 times salary on average.

We did not request information on a disability income benefits, but two funds volunteered information showing that this may be an alternative to a lump sum benefit in a few cases.

The graph below shows the number of funds offering a given multiple of salary as disability benefit, compared to the corresponding death benefits.

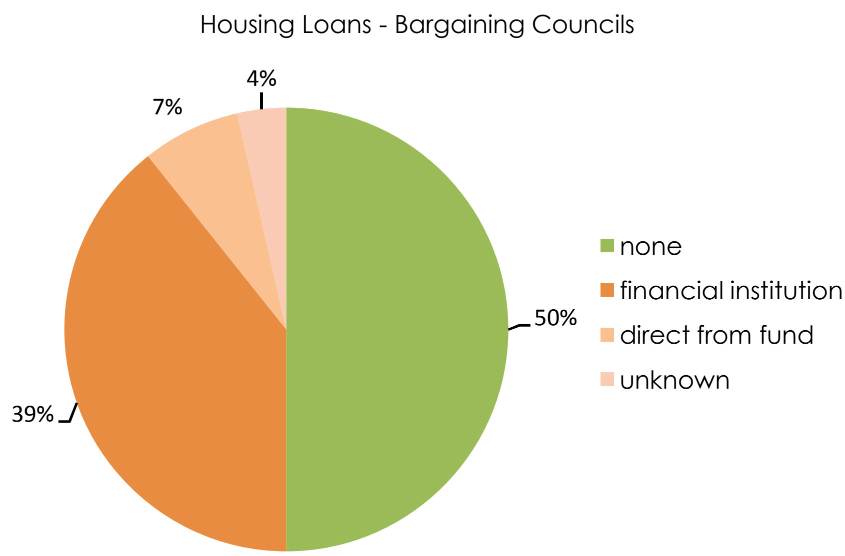


The average disability benefit for private employer funds is 2.7 times salary according to the Sanlam Benchmark Survey (2009). Private employer funds, offer lump sum disability benefits in 37% of cases, compared to 71% for council funds. Private employers often offer a disability income benefit separately from the retirement fund. We did not investigate this practice in council funds.

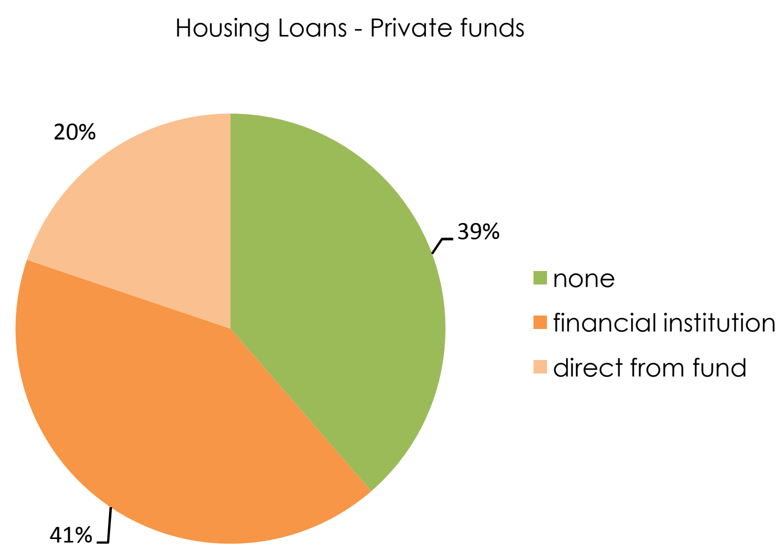
7.2.7 Housing loans

14 of the 28 funds indicated that they provide housing loans, of which 11 indicated that loans are provided through a financial institution, and 2 directly from the fund.

Majority of housing loans provided through a bank



For private employer funds from the Sanlam Benchmark Survey (2009), the pattern is as follows:

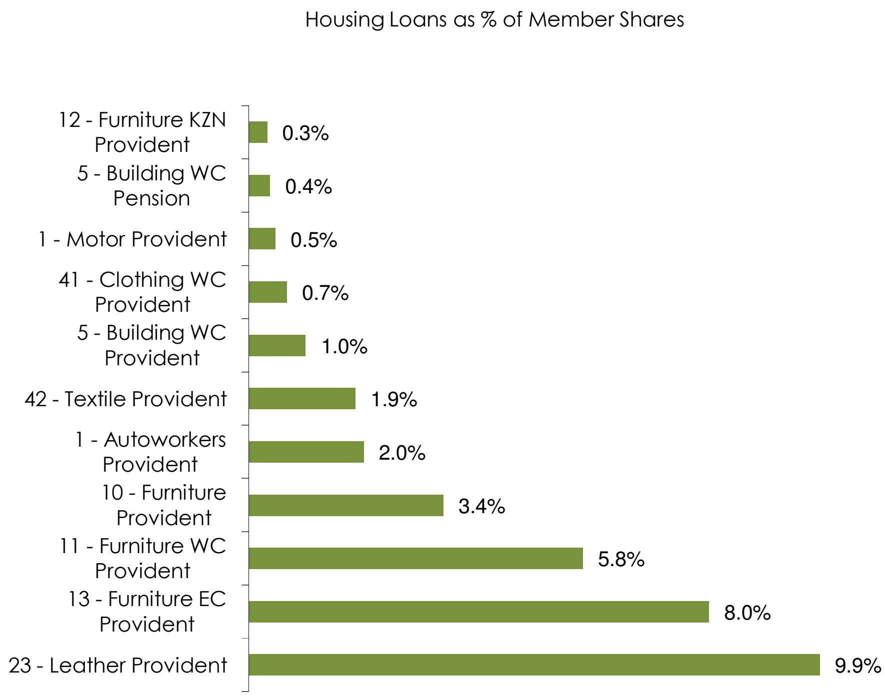


It seems housing loans, and particularly loans directly from the fund, are less common in the council environment than amongst private employer funds.

Housing loans are less common in council funds than in the private employer funds

For council funds, the maximum housing loan vary between 60% and 90% of the fund credit. Two funds indicated a fixed maximum of R20 000 / R25 000 and one (council 41 - clothing manufacturing, Western Cape) a fixed maximum of R80 000.

The level to which housing loans are utilised is not very high. The following graph compares the housing loans granted to the active members' shares (i.e. the fund credit), of all active members.



Housing loans not significantly utilised

The rate of interest charged was disclosed by 6 funds and ranges from prime minus 2% to prime plus 2.5%. It is interesting to note that three of the funds where housing loans are in excess of 3% of member shares, charge the highest mortgage rates.

Wide range of interest rates charged

The NSSF is not expected to provide housing loans to fund members. For members of funds where this benefit is popular, moving to the NSSF may have the impact of losing access to such benefits.

7.3 Actual benefit payments

We investigated the extent of actual benefit payments by the funds over one year, in terms of the number of payments, the total amounts paid and the average benefit amounts. This provides some indication of the relative importance of each benefit to the fund members.

We requested information from participants regarding the number and amount of benefits paid out by their funds over a year. From this, we were able to calculate approximate average benefit levels experienced by members in these funds.

7.3.1 Retirement benefits paid

1.7% of active members retire each year

20 funds provided us with sufficient information to calculate the number of retirements per 1 000 active members, which amounts to 17 on average.

16 funds supplied us with sufficient information to analyse the amount of benefits paid out. 10 funds provided insufficient information and two funds had less than 10 retirements for the year, and are excluded from the calculation of average retirement benefits, as the numbers are too small to provide a reliable average.

Retirement benefit on average R54 000

The average lump sum individual retirement benefits ranges from R8 400 (for council 2, the Bloemfontein building industry) to R160 000 (for council 23, the leather industry), with an overall average of R54 000 for the 16 funds analysed.

Expressed as a multiple of estimated average salary[4], the retirement benefits range from 0.1 to 4.4 times salary, with an average of 1.5 times salary. We did not have information about the salaries of the members who retired and used an estimate of the average salary of all the members of the fund.

Net Replacement Ratios

When evaluating pension benefits, the NRR is often used as a measure of value. How much of your salary will be sufficient to cover your expenses in retirement? The NSSF proposals focus on a NRR of 40% as a target.

Using the NRR seems simple and clear. But a single ratio may be too simple: 40% of salary may be enough for a person earning R200 000 per year, but is R4 000 sufficient for someone earning R10 000 per year?

It is unclear if low income earners require a higher NRR to ensure they do not suffer poverty in retirement. We have taken the proposed 40% NRR as a guideline throughout, but the final answer may be more complex than a simple ratio.

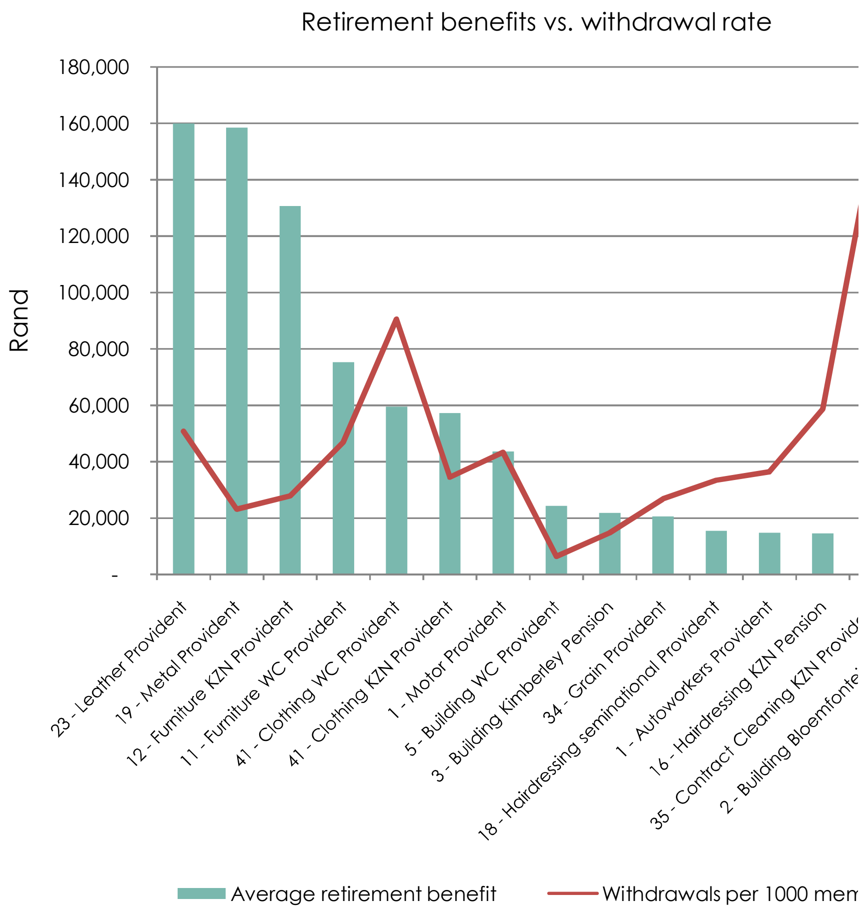
13 of the 16 funds have an average retirement benefit payout lower than 4 times annual salary. Very roughly, if the lump sum benefit is to be used to purchase a pension, then a lump sum of 4 times salary purchases a pension of 40% of salary, (using a very favourable annuity factor of 10 – commercial annuity factors are generally higher than this). This means that 13 of the 16 funds would not have achieved a replacement ratio of 40% Net Replacement Ratio (NRR) which is the NSSF target.

It is clear that the actual level of retirement benefits paid out is not adequate to provide sufficient security to members retiring, and the fact that the benefit is paid in cash with no regular income reduces the security even further. The reasons why retirement benefits are so low is the subject of our investigation in Part 2 of this report, and could be the result of low contribution rates, investment returns, high expenses, but in particular high withdrawal rates. When we compare the amount of benefit paid on retirement with the number of withdrawals a fund experiences, the results suggest that there may be a relationship

[4] This is the estimated salary as explained in the box in section 4.3.4 and should only be seen as a very rough estimate

between low withdrawal rates and high retirement benefits. (It must be noted that the withdrawal rates and benefits compared relate only to one reporting year, and are therefore not ideal for this analysis.)

High turnover linked to low retirement benefits



A similar comparison with contribution rates does not yield a clear trend, suggesting contribution rates have a lesser impact on retirement benefits than withdrawals.

7.3.2 Withdrawal benefits paid

24 funds provided us with sufficient information to calculate the number of withdrawals per 1 000 active members, which amount to 193 on average.

19.3% of members withdraw each year

21 funds supplied us with sufficient reliable information to analyse the amount of benefits paid out, while 7 funds provided insufficient information or had less than 10 withdrawals and are therefore excluded from the analysis of average benefit payments.

The average withdrawal benefits paid out per fund are the lowest in the Bloemfontein building industry fund (council 2), at R4 500. The upper bound is R86 000 for the furniture manufacturing industry fund

KZN (council 12). The average withdrawal benefit for all 21 funds included in the analysis is R19 000.

Average withdrawal benefit R19 000

Expressed as a multiple of estimated salary[5], the withdrawal benefits range from 0.07 to 2.1 times annual salary, with an average of 0.5 times salary.

Virtually none of the respondents reported transfers being made to other funds on withdrawal.

Transfers not utilised

The amount paid out in withdrawal benefits is a significant portion of the benefits paid from the funds. If compulsory preservation is introduced, this amount will be greatly reduced. Such a change is going to have wide reaching effect on the pattern of benefits paid to members. Although we believe that compulsory preservation is essential in preventing the leakage of benefits from retirement funds, the effect of not permitting withdrawals will be particularly problematic at low income levels, such as those in council funds. The retirement reform proposals attempt to address this issue by outlining some models for limited withdrawals.

7.3.3 Death benefits paid

23 funds provided us with sufficient information to calculate the number of deaths per 1 000 active members, which amount to 10 on average.

1% of members die each year

16 funds supplied us with sufficient reliable information to analyse the amount of benefits paid on death. Death is not a frequent event and we had to exclude 5 funds from our analysis of average benefit payments, due to the number of deaths for the year being lower than 10.

The average death benefits paid out per fund ranges from R10 500 (for the building industry Western Cape pension fund – council 5) to R210 500 (for the furniture manufacturing industry KZN – council 12), with an overall average death benefit of R61 500.

Average death benefit R61 500

The death benefit is effectively a combination of the withdrawal benefit at death plus a lump sum of some multiple of salary as defined in the rules. The average death benefit for funds with a lump sum of 3 or 4 times annual salary is R38 300 whereas for funds with 0 – 2 times salary the average is R17 000.

7.3.4 Disability benefits paid

15 funds report having disability claims but only 5 have a sample of more than 10 claims per year and are included in our analysis of average benefit payments

[5] Again, estimated salaries were used as set out in the box in section 4.3.4.

On average, 2 disability benefits per 1000 active members are paid out. This figure is for all 23 funds for which we had disability information and includes funds which reported 0 disability claims.

0.2% of members become disabled each year

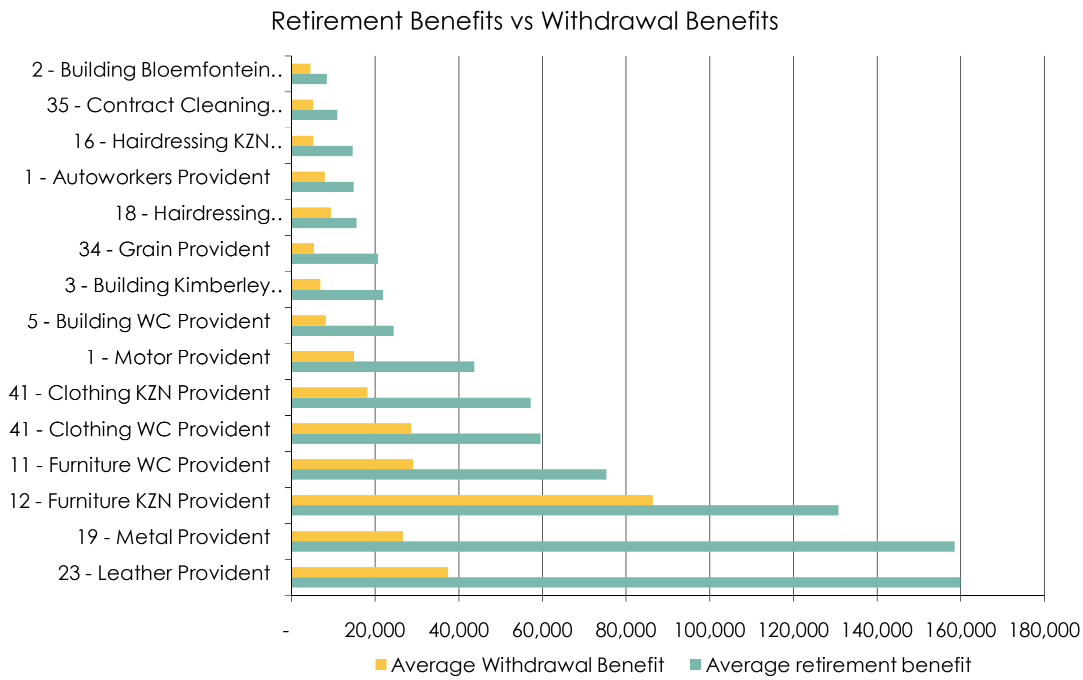
The average disability benefits paid out per fund ranges between R36 200 and R122 700, with an average of R67 500 for the 5 funds included.

Average disability benefit R67 500

7.4 Comparison

7.4.1 Average benefits paid

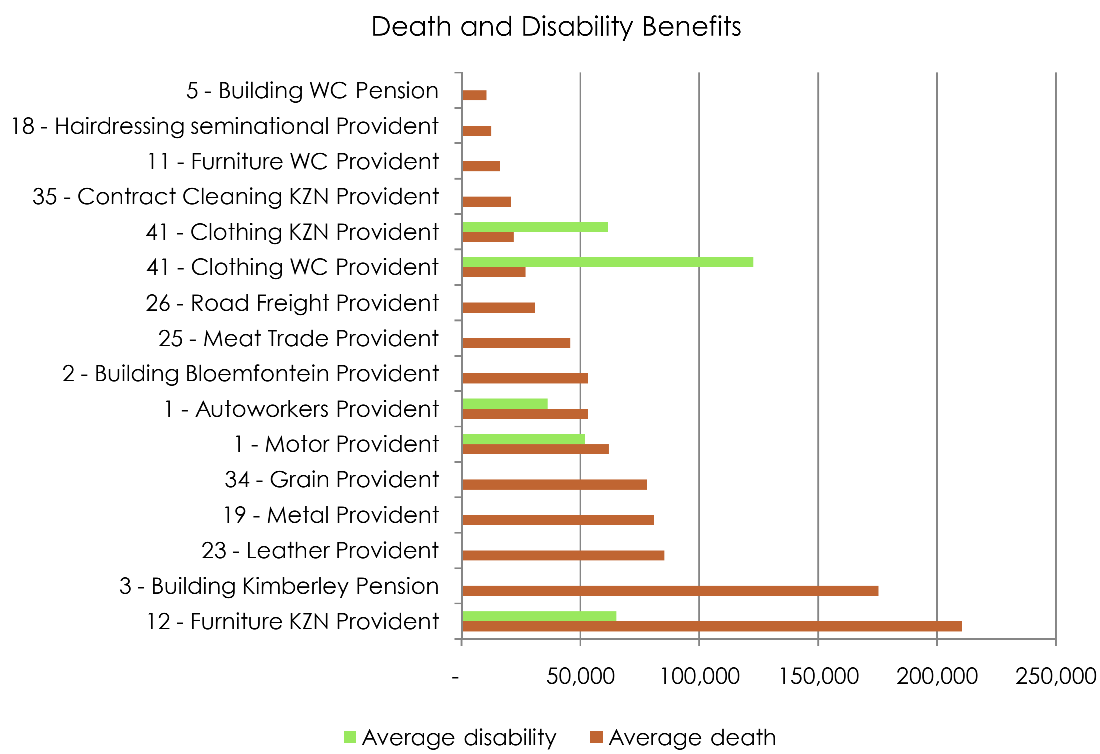
The following graph compares the average withdrawal benefit and the average retirement benefit paid for each of the 15 funds in the analysis.



For all 15 funds where a comparison was possible, the average retirement benefit exceeds the average withdrawal benefit. On average, the retirement benefit is almost 3 times the withdrawal benefit.

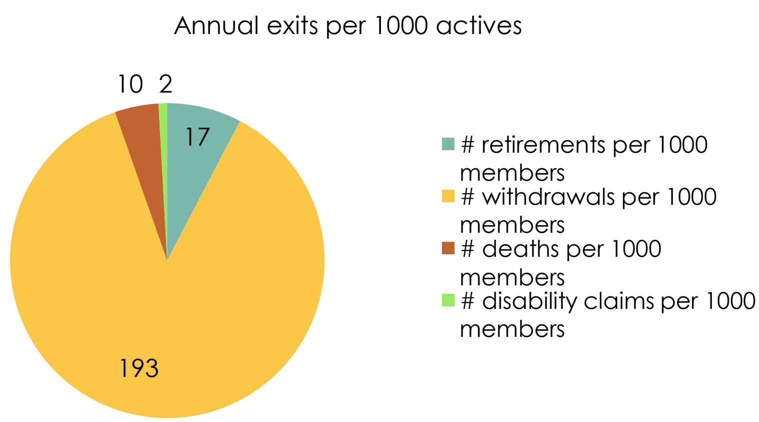
Retirement benefit 3 times larger than withdrawal benefit

The following graph shows the average death benefit paid and the average disability benefit paid for each of the funds where we had sufficient data.



7.4.2 Exits from the fund

The following graph shows the average number of exits per year per 1000 members from all the funds analysed.



In one year, out of a 1000 members, the average number of withdrawals is much higher than any other exit. In particular, for every retirement there are 11 withdrawals on average.

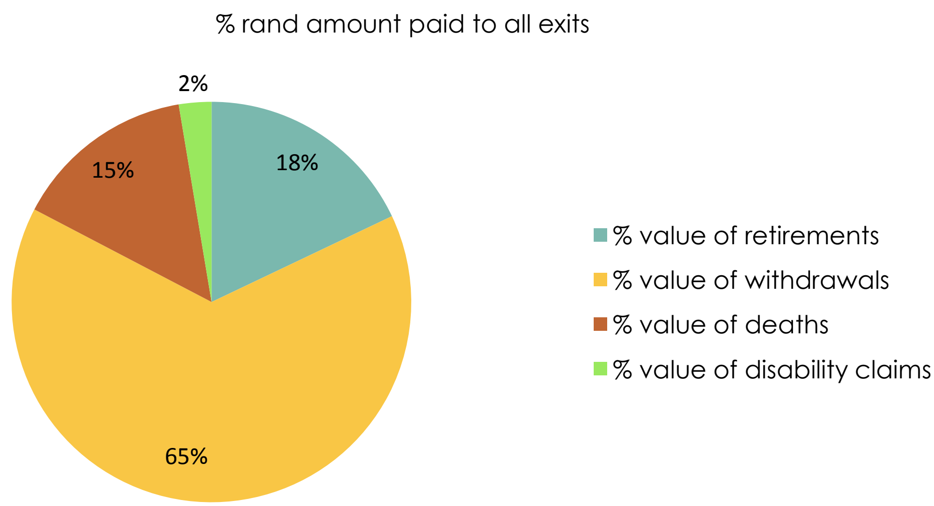
11 withdrawals for 1 retirement

7.4.3 Total benefit payments

The total amount of benefits paid to exiting members over a year is on average equivalent to 12.7% of the value of the assets of the fund.

12.7% of fund assets paid out as benefits each year

For the 21 funds for which this information is available, the average monetary value of all benefits paid is spread as follows between the different benefits:



This graph and the previous one show the very high number of withdrawals and the very high total amount paid out on withdrawals. 87% of all exits from the funds are withdrawals, and 65% of the total benefits paid are withdrawal benefits. More than 8% of the total assets in the funds are paid out per year as withdrawal benefits, and the total amount paid as withdrawal benefits is 3.5 times as much as what is paid as retirement benefits.

87% of all members who leave funds are withdrawals

65% of all assets which are paid out of the funds are to withdrawals

These figures indicate that withdrawal benefits are important to the members. The high level of withdrawals is the main reason for the relatively low retirement benefits paid out by the bargaining council funds. Compulsory preservation of retirement benefits on withdrawal is one of the important reforms envisaged as part of the social security and retirement fund reform process, but the impact of that on the needs and expectations of bargaining council fund members may be more severe than in the rest of the retirement industry.

Savings Account or Retirement Fund?

Retirement funds provide for benefits in old age. Savings vehicles are shorter term – saving for unemployment, for example. Given the rate of withdrawals, council funds seem to serve mainly as savings vehicles, with few members achieving a significant retirement benefit.

Is this necessarily a problem? This depends on post-retirement needs. In particular, if the SOAG is extended to cover all South Africans, and no earnings floor is implemented in the NSSF and accredited provider contribution structures, bargaining council workers (who according to our estimates may be earning as little as R3 300 per month) can achieve a replacement ratio of 30% from just the SOAG alone. If a little more can be achieved from a retirement fund, the targeted NRR of 40% could easily be reached.

Is a NRR of 40% enough at such low income levels? If so, utilising additional retirement savings as a withdrawal benefit which likely helps the individual through a period of unemployment could be seen as a reasonable application of funds. If not, preservation needs to urgently be prioritised to improve retirement poverty levels.

8. Assets

The assets of a retirement fund constitute a vital part of the fund's operations. The investment strategy and performance is one of the main drivers of the final value actually paid to members on leaving the fund. Therefore, we examined the assets of the council funds, particularly with a view to determine how they compare to other funds vying for opt-out from the NSSF.

8.1 Summary of findings

Assets – at a glance

Assets are concentrated in national and in provident funds.

Investments are mostly managed by external asset managers, with evidence of possible over-diversification in managers.

Individual investment choice is not offered.

Investment strategies are generally balanced between asset classes with heavier than usual weightings towards cash and bonds, possibly as a result of high turnover and low risk appetite among the members.

Returns are mostly commensurate with the strategies and acceptable. Some funds employ unorthodox asset allocations and these funds tend to underperform.

The 27 funds (20 provident and 7 pension) which provided us with asset information hold R38 billion in assets, estimated to account for around 2% of the total retirement fund industry assets in South Africa. The variation in size among council funds is enormous: R22 billion alone is from only one fund, the metal industries provident fund, while 10 funds have assets of less than R100 million. The bulk of the assets (95%) are held by the 20 provident funds. As we expected, national funds were by far the largest in terms of assets, holding 89% of the total assets.

2% of retirement fund assets in South Africa belong to council funds

95% of assets held by provident funds
89% held by national funds

Bargaining council funds are generally large in membership but few (5 out of 27) exceed R1 billion in assets.

Assets per member average R30 000 with the highest being R95 000. This is significantly below the level of private employer funds which average R194 200 per member. This is one of the most significant differences between private employer funds and council funds, and a clear indication that be it through lower contributions, lower investment returns or most likely due to lower salaries and higher member turnover without preservation, the members of these funds could expect much lower benefits than elsewhere in the market. Average assets are particularly low in regional funds at R18 000 per member.

Average assets per member: R30 000

Bargaining council funds have a membership of low-income, high-turnover members, leading to a lower level of asset accumulation than in private employer funds. Mandatory preservation, if it is introduced as part of the reform, would have a dramatic effect on the members of these funds, but also lead to a rapid increase in the asset base.

Most funds managed by external asset managers

The management of assets is handled by external fund managers in all but two cases. However, one of these exceptions is the metal industries fund which invests 62% of its R22 billion internally, putting a significant proportion of the assets we examined directly under the control of the trustees.

Number of managers per fund high

The number of managers used by each fund is in general higher than what would in our experience be appropriate given the size of the various funds. This may lead to some level of inefficiency in terms of management complexity and over-diversification.

No individual choice

The use of investment consultants is on par with the private employer funds industry. Individual investment choice is not utilised by these funds, and only a few offer a capital protection option.

Investment strategies: balanced but heavy in cash and bonds.

Returns acceptable given low risk strategies

Most of the funds employ a balanced-type investment strategy, with an allocation to all the major asset classes. However, even for these balanced mandates, the allocation to equities appears markedly lower than what is expected in the average fund, and the allocation to cash is commensurately much higher than generally expected. This is borne out in the returns of these funds which, over the period from 2004-2008, appear to mostly have underperformed the average market value fund. These asset allocations and returns, however, may have been distorted by the financial crisis of 2008-2009. Returns do, for the most part, outperform a target of CPI + 5% which is a reasonable long term target for retirement fund mandates.

Unorthodox mandates underperform

Funds with less orthodox investment mandates, for example a 0% allocation to equity, or a very high (40% or more) allocation to property or "other" assets, generally show a significantly poorer performance. Out of 4 funds which underperformed CPI + 2% over 2004 - 2008, 3 have such unusual mandates.

Contribution to new retirement framework?

The council funds are aligned with the NSSF proposals in terms of not providing individual choice, having conservative investment strategies, and utilising external investment managers and advisors.

Potential barriers to accreditation could be the small asset size of some of the funds, the more unorthodox investment strategies which are struggling to deliver reasonable returns, and the use of internal fund management.

8.2 Results

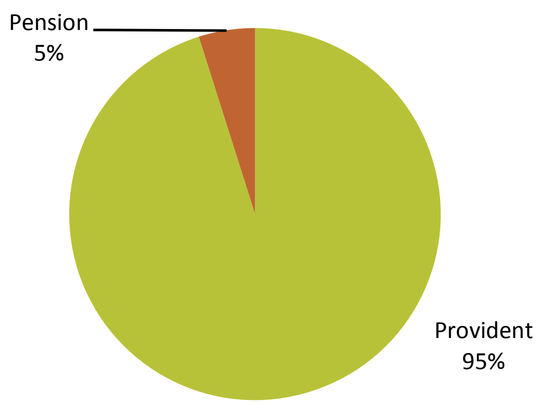
8.2.1 Total Assets

27 funds (20 provident and 7 pension) provided us with their total assets.

The total assets held by these bargaining council funds are R38 454 million, with R36 569 million (95%) held by provident funds and R1 885 million (5%) by pension funds. Therefore, while a significant number of pension funds still exist, it is clear that the majority of the assets are on the provident fund side. This is to be expected since the provident funds are more palatable to unions and low income employees, providing easier access to cash benefits.

Total assets in the survey: R38 billion

Total Assets of Pension and Provident Funds

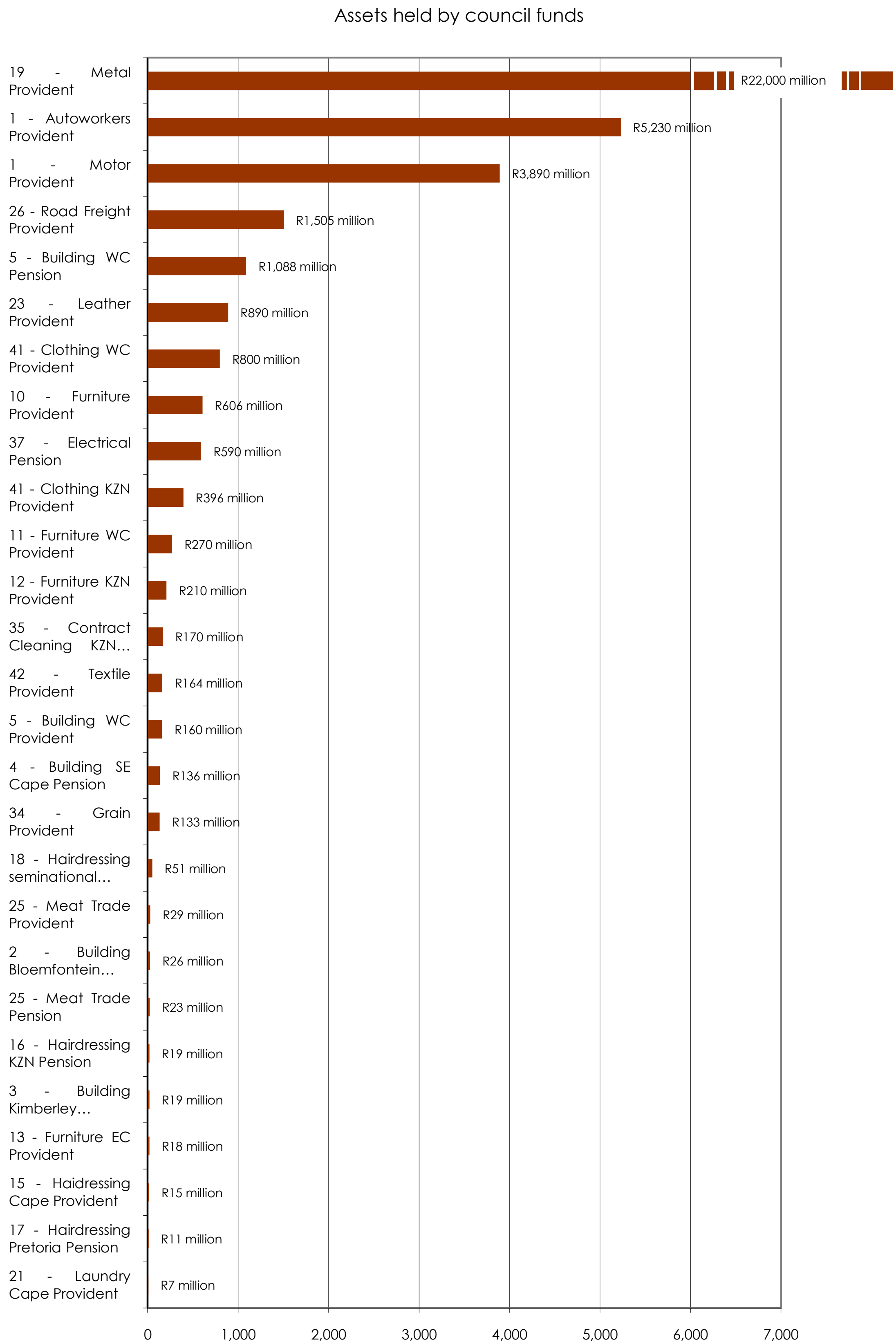


95% of assets in provident funds

The relative distribution of the assets of the funds ranges from R7 million to R22 billion, and is shown in the graph below. The average assets per fund are R1.4 billion, and 19% of funds have assets over R1 billion. By comparison, private retirement funds in the Sanlam Benchmark Survey have average assets of R347 million, with 10% having assets over R1 billion.

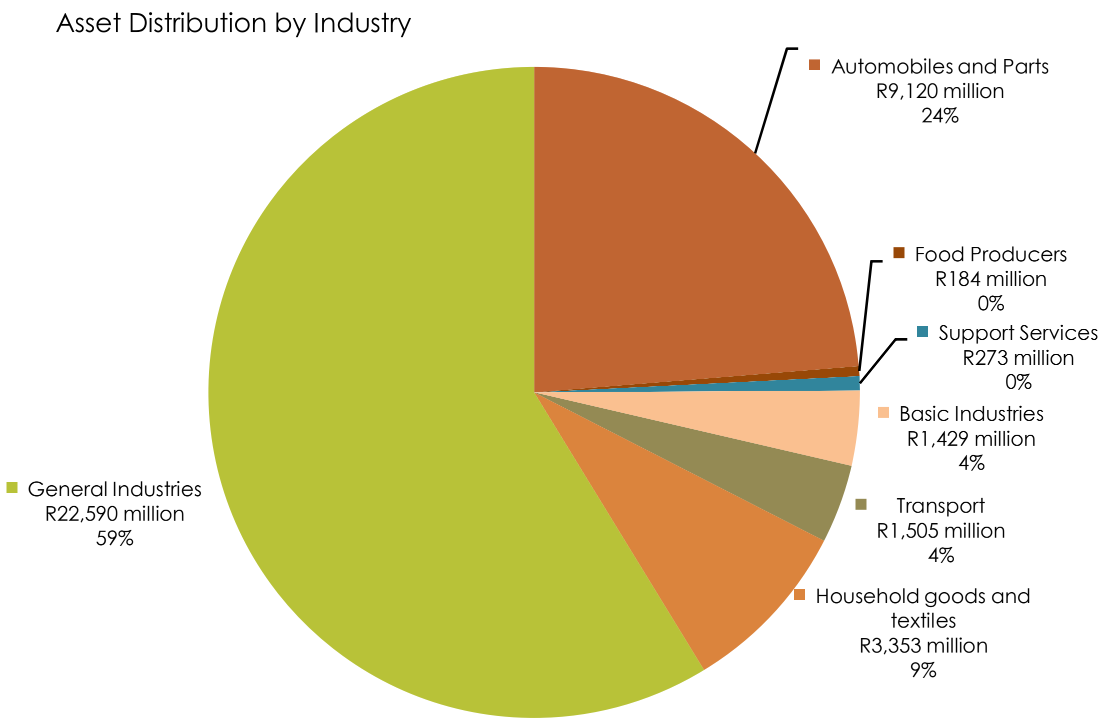
This suggests council funds are on average larger than private employer funds. However, this is to be expected as council funds are more akin to umbrella funds, having multiple participating employers. While this may suggest that council funds are in general large funds which could offer a serious alternative to the NSSF, the range of assets is very broad. More than 80% of the assets are held by the top 3 funds, while the bottom 10 funds, each with assets less than R100 million, together account for less than 1% of the total assets.

Wide range of fund sizes – from less than R100 million to R22 billion


Assets held by council funds
19 - Metal Provident
R22,000 million
1 - Autoworkers Provident
R5,230 million
1 - Motor Provident
R3,890 million
26 - Road Freight Provident
R1,505 million
5 - Building WC Pension
R1,088 million
23 - Leather Provident
R890 million
41 - Clothing WC Provident
R800 million
10 - Furniture Provident
R606 million
37 - Electrical Pension
R590 million
41 - Clothing KZN Provident
R396 million
11 - Furniture WC Provident
R270 million
12 - Furniture KZN Provident
R210 million
35 - Contract Cleaning KZN...
R170 million
42 - Textile Provident
R164 million
5 - Building WC Provident
R160 million
4 - Building SE Cape Pension
R136 million
34 - Grain Provident
R133 million
18 - Hairdressing seminational...
R51 million
25 - Meat Trade Provident
R29 million
2 - Building Bloemfontein...
R26 million
25 - Meat Trade Pension
R23 million
16 - Hairdressing KZN Pension
R19 million
3 - Building Kimberley...
R19 million
13 - Furniture EC Provident
R18 million
15 - Haidressing Cape Provident
R15 million
17 - Hairdressing Pretoria Pension
R11 million
21 - Laundry Cape Provident
R7 million
0
1,000
2,000
3,000
4,000
5,000
6,000
7,000

There is a possibility that these smaller funds would not be perceived as a suitable alternative to the NSSF if asset size becomes one of the criteria for accreditation.

Considering the asset split by industry, the result is as follows:



In particular, *Food Producers* and *Support Services* have a very small share of the assets.

National funds hold 89% of the assets, 8 times more than the regional funds. This is to be expected as national funds have a larger membership.

National funds hold 89% of the assets

According to the Registrar of Pension Funds' annual report, in 2006 the pension industry in South Africa as a whole held R 1 620 billion in assets. There is a time mismatch between this value and our measured R 38 billion, however one can extract an approximation of the possible proportion of the country's pension fund assets held by bargaining councils as something in the region of 2%.

Council funds estimated to hold 2% of total retirement fund assets in South Africa

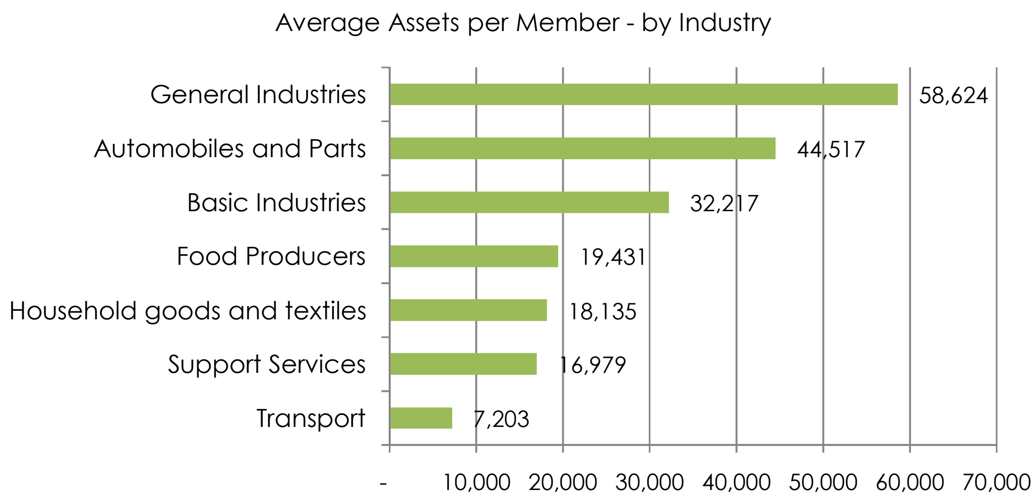
8.2.2 Average Assets

15 funds provided us with asset information as well as membership information.

For those funds, the assets per member (including active members, pensioners and unclaimed benefits), range from R4 000 to R95 000, and average at R30 000. For comparison, average assets per member in the private employer funds, in the Sanlam Benchmark Survey 2009, are R194 200, 6.5 times as much as those in the bargaining councils. This is one of the most significant differences between council funds as compared to their private employer fund counterparts. This could be attributed to higher salaries, higher contribution rates, or a lower rate of withdrawals in the private employer funds.

Average assets per member: R30 000 vs. R194 000 in private employer funds

The averages were as follows for the different industries:



There appears to be a correspondence between the funds with the largest assets and the highest assets per member. This could be a reflection of surplus assets held in those funds.

National funds have higher assets per member than regional

National funds have average assets of R42 000 per member, while regional funds are lower at R18 000 per member.

These results once again point to the lack of preservation in the bargaining council space as one of the chief challenges in terms of the proposed reform. The introduction of mandatory preservation, should this take place, would lead to a rapid increase in the industry assets in our opinion.

8.2.3 Investment approach

We requested information regarding the management of assets and whether advice on asset management is provided.

Most funds use external asset managers

2 manage some or all assets in-house – including the largest council fund

24 funds informed us that they manage their assets through external asset managers, while only 1 fund manages them internally. At least one other fund, the metal industries fund (which is by far the largest of those surveyed) uses some external managers but manages 62% of its assets internally. Out of the R38 billion in assets, and chiefly due to the metal industries' exposure to internal management, internally managed assets amount to R13.6 billion, or 35%.

Internal vs. External asset management

The assets of the fund are the responsibility of the trustees. The trustees may choose to invest the assets themselves, or delegate this to a specialist asset manager.

Where external managers and investment consultants are employed, professional expert advice is given, stringent governance requirements must be fulfilled and standard processes put in place, increasing the level of governance and the quality of investment decisions achieved by the fund.

The same result may be achieved by trustees managing the assets in-house, but it is harder to monitor the processes in this case, and more responsibility rests with the trustees themselves. There is increased opportunity for mismanagement going unnoticed.

The NSSF proposals tend to favour a public/private cooperation model where asset management in particular is handled by private providers.

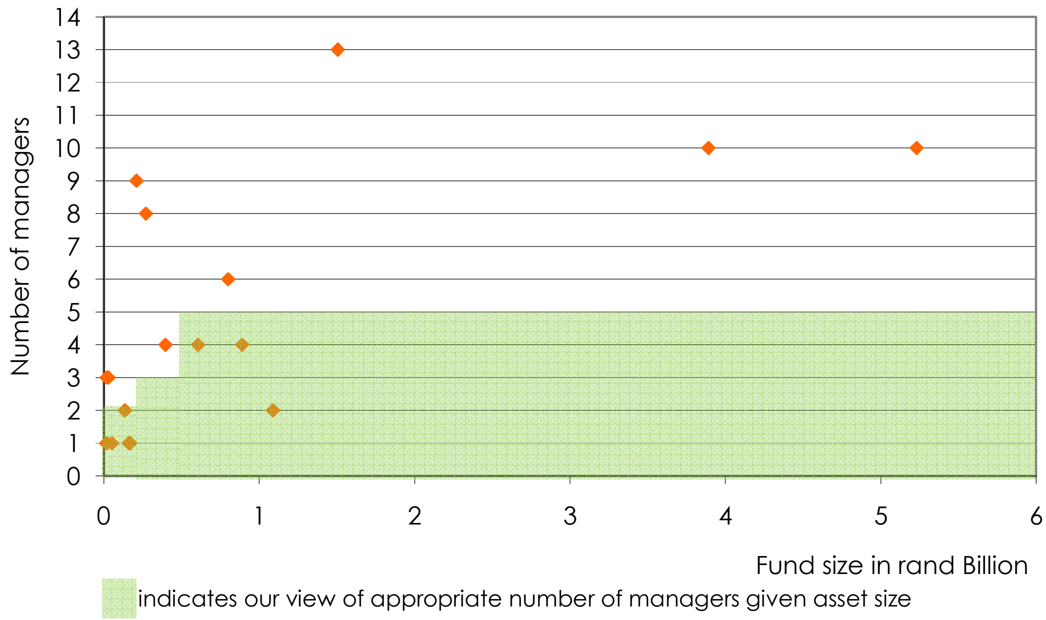
Investment consultants widely utilised

16 funds informed us that they utilise an investment consultant to advise them on investment strategy. 4 funds do not use investment consultants, one of these being the fund which manages its assets internally. 8 funds did not provide an answer to this question. For comparison, 75% of private employer funds in the Sanlam Benchmark Survey (2009) are advised by an investment consultant – there seems to be no significant difference between private employer funds and council funds in this arena.

Of the 24 funds which manage assets externally, 22 provided the number of managers used to manage the assets. Between 1 and 13 different managers are used per fund. The average number of fund managers[6] is 4 per fund.

We have mapped the number of managers used as compared to asset size.

[6] Managers in this case could include multi-managers as we did not make that distinction in our questionnaire.



Given that there is no member choice (see the next section) used in these funds, in our experience we expect to see in the region of 1-2 managers for funds under R100 million, 1-3 managers for funds up to R500 million, and perhaps 1-5 managers for funds in the region of R1 billion. These levels are highlighted in green above, and would be likely to achieve a reasonably efficient distribution of assets given the size of the fund. Using more managers than this may be less than efficient, and may dilute outperformance as the different strategies effectively cancel out. However, very large funds can put in place specialist mandate strategies which require more than 5 managers.

High number of asset managers per fund

From the above, it appears that most of the funds tend to exceed the number of managers required to manage the assets efficiently. We have not investigated the reasons for this, but it may be that the funds' performance can be improved in general by reviewing and reducing the number of managers used.

There does not appear to be a significant indication of a correlation between asset size and the number of managers utilised, although in the current sample, only funds with asset size in excess of R1.5 billion utilise 10 or more asset managers.

8.2.4 Member choice

No individual investment choice offered

None of the 28 funds offers individual investment choice. This is in stark contrast to the private fund industry, where 52% of private employer funds offer member choice. However, the Sanlam Benchmark Survey also reveals that 89% of members in private employer funds with individual member choice use the default choice. Member choice, while increasingly popular amongst private employer funds, has yet to prove that it is of value and use for the majority of members. The reform proposals are not supportive of individual choice, and in the NSSF tier and alternative approved funds, there is a very low likelihood of providing any individual choice. This is aligned with the approach taken by the council funds.

8.2.5 Capital Protection Option

A capital protection option is a type of limited member investment choice, which usually allows the member a single switch into a stable type portfolio after a certain age (usually 5 or 10 years before retirement). Capital Protection Option is offered by 6 out of 24 funds which answered this question.

Capital protection offered by a few funds

8.2.6 Investment allocation

24 funds provided us with information regarding the allocation of assets between different asset classes. In one case (the metal industries fund), the question was incompletely answered and we have excluded this result from investigation.

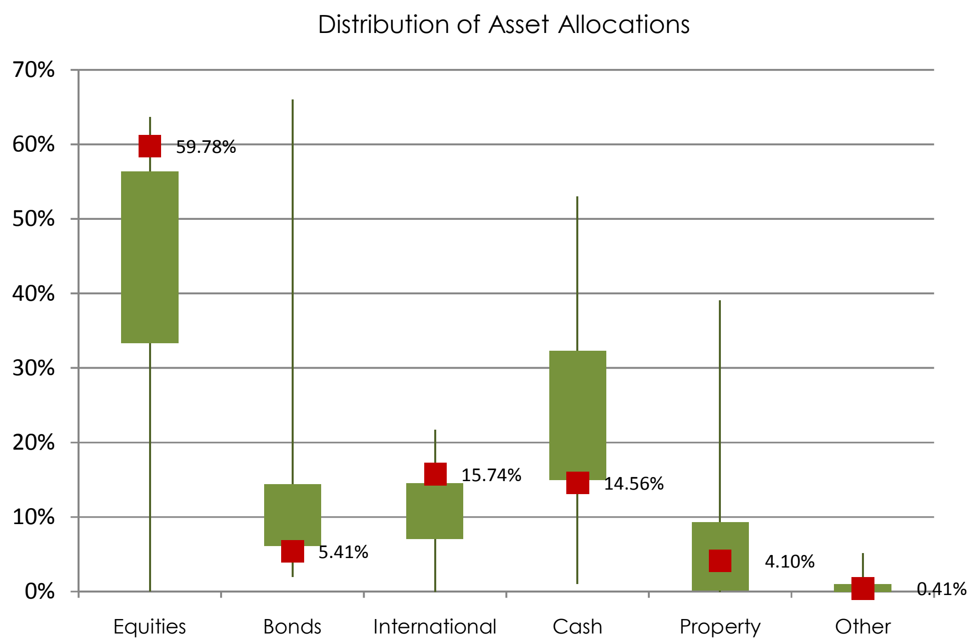
In most cases, the allocation is predominantly a mixture of equities, interest-linked assets, international assets and cash, with less significant allocations to property and other classes. In 3 funds, the asset mix is less conventional:

Majority in balanced mandates

- In the clothing manufacturer funds in KZN and the Western Cape, a significant portion of the assets (55.6% and 31.5% respectively) is invested in "other". In the case of the Western Cape, this is described as "Absolute & Loans & Debentures".
- In the laundry industry fund, the assets are fully invested in a mixture of cash and property investments.

We have excluded all 3 of these funds from analysis below as they would distort the spread of assets. However, we do consider them when we analyse returns in the next section.

The asset allocations for the remaining 21 funds can be summarised as follows:



The red markers show a best investment view allocation for balanced funds from the Alexander Forbes Balanced Manager Watch ("AF Watch") at 31 December 2008[7].

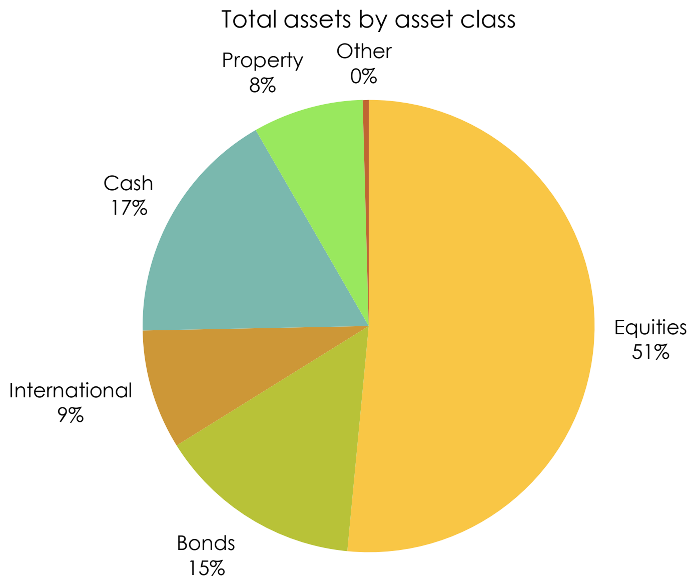
High allocation to cash and bonds

The interesting item to note is that even when unorthodox approaches (such as an allocation to only property and cash) are excluded, the result is still relatively low on equities and high on cash and bonds. The majority of cash holdings are in the region of 15% to 32%, while equity is predominantly around 35% - 55%. In our experience and according to the AF Watch, private pension funds have generally maintained higher overall equity allocations. This effect may however be caused by the financial crisis of 2008-2009, during which many funds reported lower equity holdings. This may have distorted our results.

The collective allocation to various asset classes is as follows:

	Total Investment	%
Equities	R7,483 million	51.5%
Bonds	R2,125 million	14.6%
International	R1,242 million	8.5%
Cash	R2,469 million	17.0%
Property	R1,146 million	7.9%
Other	R62 million	0.4%

[7] The Alexander Forbes Balanced Manager Watch surveys the "Global Best Investment View" of asset managers who run balanced funds for their retirement fund clients. We have taken it as an indication of a reasonable investment allocation for a retirement fund.



Why all the cash?

An asset strategy should be judged by how well it meets the objectives of the fund. So why do councils tend to employ cash-heavy, equity-light strategies?

1. **Aversion to market volatility.** Equities tend to outperform other asset classes in the long run, but in the short run they are very volatile. If members cannot accept this volatility and do not understand that their fund values can move down as well as up, the strategy needs to remain conservative to match the low risk appetite of members and trustees.
2. **Cash needs are high**. Funds hold cash to meet short term benefit payments. If funds experience high turnover and need to pay out many withdrawals, the proportion of the fund allocated to cash needs to be higher.
3. **Timing**. Market movements and asset manager decisions can mean that the asset allocation may temporarily deviate from the strategy. Our survey is based on data from 2008/09, during the time of the financial crisis. The low equity holdings may be a result of equities having lost a lot of value, or managers having moved out of the falling equity market to protect the fund.

All of the above are acceptable reasons for a high allocation to cash. A lower allocation to equities does mean lower expected returns, and as long as the target returns are suitably adjusted, such strategies have their merit.

8.2.7 Returns

20 funds provided us with a history of annual returns. Histories of 2 - 10 years were provided, most terms ending in 2008 or 2009, but one fund only provided a history up to 2006. It is unclear whether the returns quoted were net or gross of investment fees, and we assume that returns are net of investment fees throughout.

Returns measured over 5 years: 2004 - 2008

The average annual return over the 5 years from 2004 to 2008, which is the common period for 15 of the funds which provided histories, is 12.5% p.a., with a range from 0.7% to 20.2%. For comparison, the average pension fund invested in a balanced market value portfolio, according to the Jacques Malan Market Value Surveys, performed at 17.3% p.a. over the same period. It should be highlighted that the period in question included the financial crisis of 2008-2009, which may have distorted returns. On the other hand, this period is a particularly good test of different market conditions.

This comparison is difficult to make, as we do not in this instance have access to the performance benchmarks for the council funds. By comparing to the average fund invested in a balanced market portfolio, we merely get a sense of the returns these council funds could be achieving if their strategy was to invest in a balanced type vehicle. The fact that the average returns are below this notional benchmark, and that in fact 11 of the 15 funds underperformed this benchmark, does not indicate that funds are badly managed. It does however draw the attention to the fact that the investment strategy in these funds, which is fairly cash-heavy, causes these funds to lose out on potential returns compared to the average balanced fund strategy.

Average return 12.5% p.a.

- *Lower than average balanced fund at 17.3%*
- *Higher than CPI+5% at 11.2%*

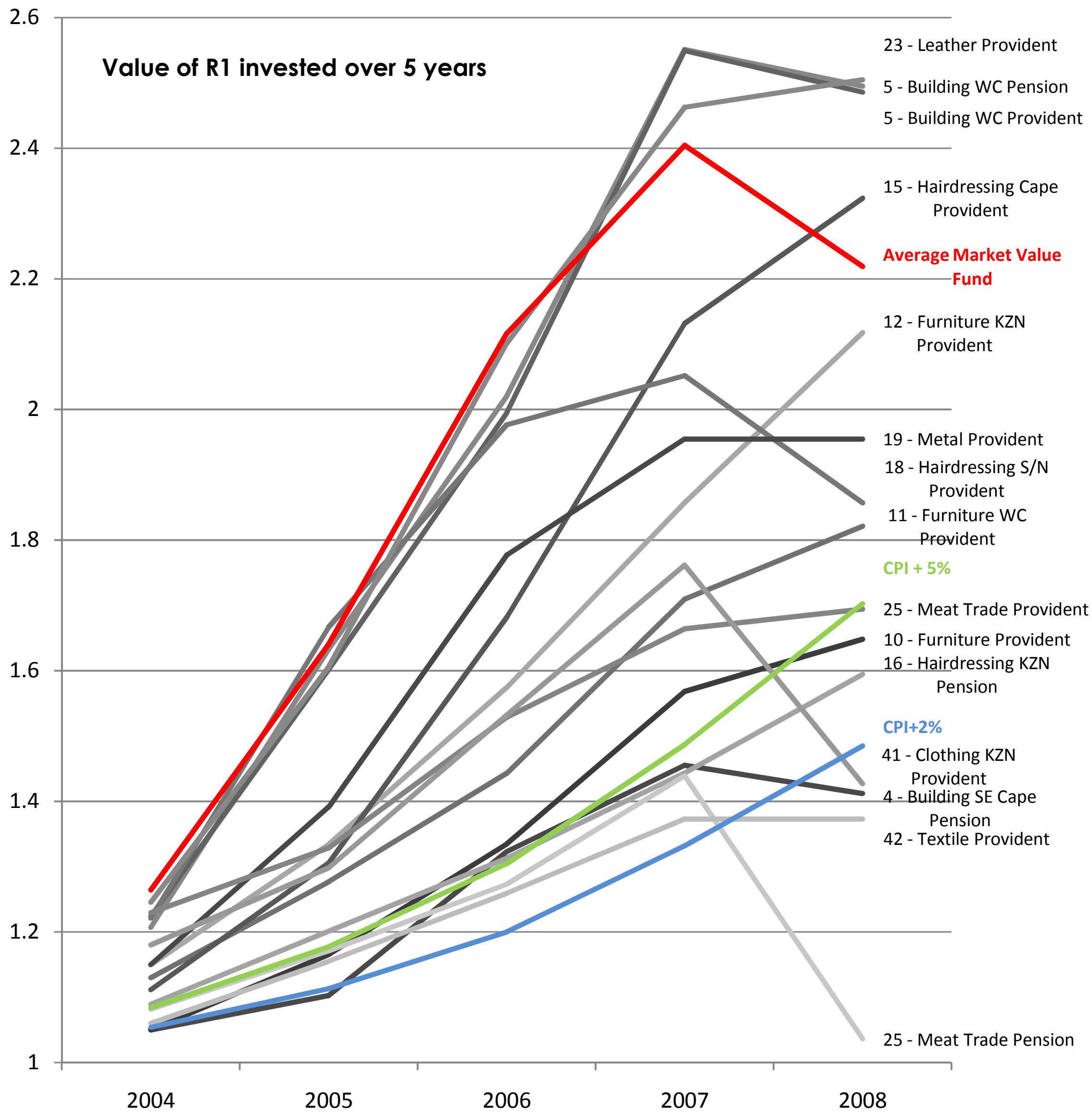
Another possibility for comparison is to use a CPI-linked performance benchmark. CPI+5% is the performance benchmark we associate with pension fund investment policies. CPI+5% averaged at 11.2% p.a. over this 5 year period. Therefore, the council funds on average outperformed this target (8 funds underperformed and 7 funds outperformed CPI + 5%). This is a reasonable result.

Funds with unusual strategies underperformed

Another benchmark is CPI+2%. This is mooted as a possible return target for the NSSF – a guaranteed return of CPI+2% or CPI + 3% has been suggested by some commentators. 4 funds underperformed this CPI+2% target in our exercise:

- the clothing manufacturing KZN fund, which has a 55.6% allocation to "other"
- the textile industry fund, which has a 0% equity allocation
- the meat trade pension fund, which has a below average allocation to equities combined with an unusually high allocation to property (39.1%), and
- the building industry for the Southern and Eastern Cape fund, which seems to have a very standard asset allocation model.

The observation here is that of the 4 funds which performed particularly poorly, 3 have unusual investment strategies. These strategies may be detrimental to the returns experienced by members.



9. Governance and Administration

9.1 Summary of findings

Governance and Administration – in a nutshell

Governance structures such as policies and trustee boards have been put in place.

Implementation of structures and governance principles needs to be tested.

Communication is a challenge.

Contribution collection challenging. Special measures such as collection agents are in place but collections still lag FSB requirements.

Benefit payments seem to be in line with general practice.

It is our conclusion that bargaining councils have reasonable governance structures in place, which are comparable to those of private employer funds. Most bargaining council funds have the right management structures, policies dealing with key governance areas, and communicate to members on a regular basis.

Structures in place:
- *Policies*
- *Boards of trustees*
- *Basic communication*

The use of independent trustees was limited – this may need to increase in the future as regulations on governance come into force.

Use of independent trustees limited

There is some anecdotal evidence that gaps in governance may exist – some funds reported different numbers of trustees than those stipulated in their rules, and there are some gaps in communication where funds only send out benefit statements on demand or do not issue any information during the year other than the benefit statement.

Some gaps in governance

We can also not comment on whether policies are strictly enforced and the quality of member communication.

As far as administration is concerned, we expected based on past research to find contribution collection in particular to be a cause for concern. Indeed, in most bargaining council funds (77%) the collection of contributions takes longer than the 7 days as stipulated in the Act. Almost half of the funds (46%) have employers with contributions outstanding for more than three months. Contribution collection appears to be the chief issue experienced in the administration of council funds and the main concern in terms of the potential opt-out of the NSSF and accreditation. It is also significant that the councils employ 'inspectors' that are involved in monitoring compliance in a number of areas like contribution and membership monitoring.

Contribution collection greatest challenge

Most funds collect after 7th day

Half of the funds have employers >3 months in arrear

Councils employ agents to aid collection

Benefit payments, which present the other side of administration efficiency, appear to be more on par with our experience in the private employer funds. Most withdrawal and retirement benefits are processed within 6 months of the event. Death claims take longer in general, but this is likely caused by the more onerous process of determining who the claim is paid to, and finding these beneficiaries. On the whole, and given the likely challenges of operating in the lower income sectors of the population, we feel that the responses on benefit payments show that benefits are paid within a reasonable period of time.

Benefit payments do not seem problematic

Contribution to new retirement framework?

In terms of governance, council funds seem to be on the right path. Structures are being put in place; but the real test will be to see if these structures result in proper governance principles being embraced.

On the administration side, council funds fulfil a very important role: collecting contributions from employers reluctant to pay them. The processes used there have been honed over many years, specifically to find non-compliant employers and ensure that they pay. This ability makes council funds invaluable tools in ensuring low income workers are provided for in retirement.

Lessons for NSSF designers

Contribution collection in a mandatory participation environment is hard.

Even when the collecting body is local, intimately involved with the affairs of the employers, and has put in place dedicated agents to ensure contribution collection, contributions are still late.

The NSSF will face similar challenges without some of the advantages of council funds. Serious thought should be given to measures that could be implemented to improve compliance.

The disposal of death benefits may also present a challenge. This is evidenced by the existence, in many of the funds, of a dedicated subcommittee for the disposal of death benefits.

9.2 Results - Governance

Governance in the spotlight

There is an increasing focus on governance in the retirement fund industry today. This has been driven by some of the events in the private retirement industry, such as fraud and mismanagement, which have highlighted the need for improved governance and controls.

Pension Funds Information Circular 130, issued in 2007, deals with good governance principles. It details a number of measures expected from boards of trustees, including putting in place various policies, obtaining sufficient training, and guidelines on the appointment of trustees.

The planned social security reform is likely to bring further changes to regulations to support this. In particular, it is thought likely that any opt-out of the NSSF and accreditation would be dependent on meeting governance criteria.

Measuring governance

Governance is a subjective, qualitative concept, which is difficult to measure using a generic questionnaire. We therefore confined ourselves to checking that governance structures were in place – policies and processes which enable governance.

The results therefore reflect governance structures rather than actual governance principles. We attempt to evaluate governance principles more accurately for the 5 funds which are examined in Part 2 of our research.

9.2.1 Management Structure

Bargaining council funds are now obliged to register with the FSB and comply with the Pension Funds Act, which requires that a retirement fund is managed by a board of trustees.

However, before these funds became regulated by the FSB, some were managed by the bargaining councils themselves rather than separate trustee boards. We investigated whether the transition to the board of trustees has been accomplished, and in 25 of the 26 of the funds that responded to this question that is the case. The fund which indicated that it is governed by the management board of the bargaining council (council 10 – furniture industry) may have answered the question incorrectly, as its rules refer to a board of trustees.

Most or all funds have board of trustees

Therefore it appears that all or most funds are governed by a board of trustees. Prior research by Budlender and Sadeck (2007), however, found that governance by a board of trustees (a management board) was likely where the fund had been extended, but where funds are part of a main agreement, governance was by the council itself. This change may indicate a move towards independent boards of trustees over the last two years as a result of these funds now being regulated under the Act.

As to opting out of the NSSF, we would expect that at a minimum compliance with the Pension Funds Act's requirement to have a separate board of trustees would be needed. We believe that this will not however constitute a major challenge for council funds.

9.2.2 Composition

Another requirement of the Pension Funds Act is that member-nominated trustees constitute at least 50% of the board. In council funds, the trustee boards are generally made up of employer and union representatives. We have assumed that union representatives fulfil the requirement of being "member nominated". Most of the funds we surveyed have 50:50 employer:union representation. In 4 instances the number of union trustees exceed the number of employer trustees, which is also permitted by the Act. In addition to these 4 funds, the grain industry fund (council 34) has 10 employer and 10 union trustees per the rules, but appeared to have modify this to 9 employer, 9 member and 4 union trustees according to our respondent.

Number of union trustees generally equal and sometimes greater than employer trustees

25% of the funds have independent trustees appointed to the board. This is in line with the Deloitte survey results showing that 25% of private employer funds have independent trustees appointed to the board. The inclusion of independent trustees generally indicates a commitment of the board to run the fund in the best interest of all stakeholders. However, the NSSF proposals suggest there may be future requirements to have one or more independent trustees on the board as a standard. This is also already reflected in the requirements for umbrella funds, which in many ways resemble council funds by having many participating employers. Umbrella funds are required to have at least 1 independent trustee, we expect that this requirement may increase in the future. Council funds, where focus is on negotiated structures and power-sharing, would need to consider if they are able to accommodate such potential requirements.

25% funds have independent trustees

In prior research, Budlender and Sadeck (2007), interviews with informants suggested that stakeholders believe that governance of bargaining council funds is better than that of private employer funds, because of the 50:50 representation and the fact that members have access through their unions and representatives. Union representatives on the management boards are not necessarily fund members, but may on the other hand be well equipped to understand the affairs of the fund.

Our conclusion is that the council funds have a balanced system of governance which aligns with the Pension Funds Act, and would not have a problem with becoming accredited to opt out of the NSSF on this basis.

9.2.3 Leadership

According to the Pension Funds Information Circular 98; *it is preferable that the chairperson be elected by the board*. Our survey results show that in all instances the chairman of the board is chosen by all the representatives.

Chairman generally elected by full board

The NSSF opt out requirements, which are likely to follow the recommendations of the information circulars in our opinion, would likely require that the chairman election is by a vote of the full board.

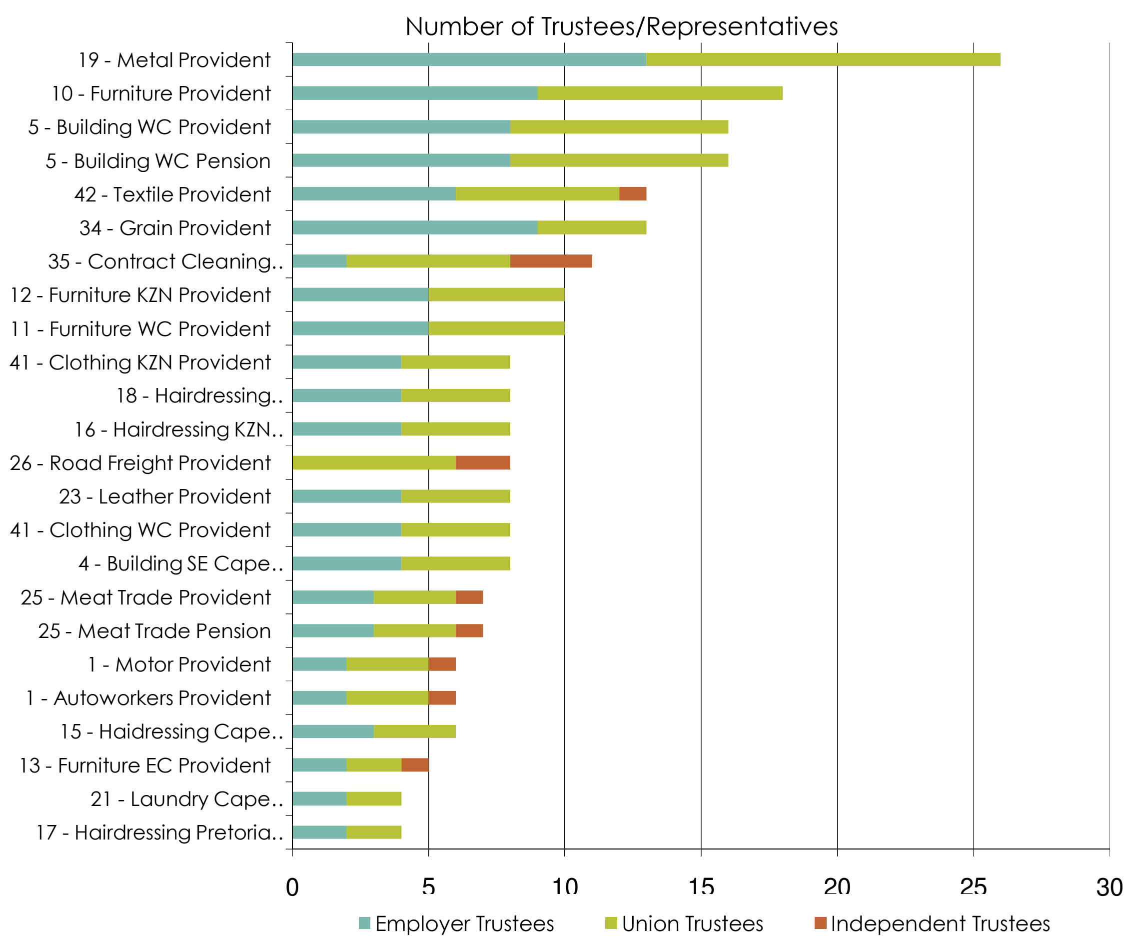
9.2.4 Size

Boards tend to be larger than for private employer funds

10 trustees per board on average

The total number of trustees or representatives vary from 4 to 26 with an average of 10 trustees per board. 25% of the funds have boards of more than 13 members. Private employer funds average less than 8 trustees per board in the Sanlam Benchmark Survey (2009), and only 5% of funds have boards of more than 13 members.

In the metal industries fund (council 19), we found through a discussion with our informants that the size of the board is flexible and depended on the number of members controlled by the various employee organisations. The number of employer trustees is set to equal the number of member trustees. This is an unusual approach that explains the large size of that board.



Given that council funds are larger on average than private employer funds, resembling more closely umbrella funds, and that the councils are negotiated agreements where it is likely that more emphasis is placed on representation, the slightly large size of the boards is not surprising. In our opinion, boards in excess of 12 to 15 members tend to become less effective in their operation and decision making.

Boards > 12-15 members may be less efficient

All funds appear to follow the requirement of the Act that a board should be constituted of at least 4 members.

9.2.5 Remuneration

In 9 out of the 24 funds which answered the questions about trustee remuneration, trustees are receiving remuneration for their duties. However, 7 of these 9 funds have independent trustees and it is these that are most likely remunerated and not the rest. Furthermore, those that are remunerated are mostly paid per meeting, with remuneration per meeting ranging from R50 to R1 200 with an average of R456. One fund (council 26, road freight industry) remunerates trustees at a rate of R4 000 per month. This council has 4 meetings per annum making the rate per meeting very high at R12 000. According to the Sanlam Benchmark Survey (2009) 91% of private employer funds do not remunerate trustees, and in the few cases they do it is mostly a fixed rand amount per meeting.

Remuneration not common

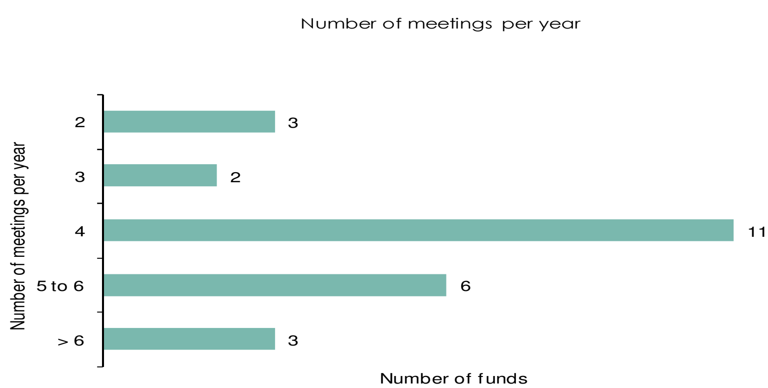
If paid, average rate = R500 per meeting

In conclusion, it appears that independent trustees, and in some cases employer and member trustees, are remunerated for their services in council funds. The rate of remuneration seems reasonable to low.

9.2.6 Meetings

According to the Deloitte survey most private employer funds meet on 4 or more occasions per annum. The number of bargaining council funds trustee meetings per annum is in line with this. The number of annual meetings varies from 2 to 11, with most funds having 4 meetings per year. This is a standard approach and should not be detrimental to potential accreditation.

Average of 4 meetings per year



9.2.7 Policies and Committees

Policies

PF130 recommends a number of policies are put in place to drive the governance of a retirement fund. While merely having a policy in place is not a guarantee of good governance, pro-active alignment with PF130 is a good indication of the willingness of a fund to focus on governance. We therefore measured which policies are in place among bargaining council funds.

The number of funds with policies in place is as follows:

Funds with the following formal written policies in place	Result out of 28 responses
Investment Policy Statement (IPS)	22
Code of conduct	18
Risk Management Policy	15
Communication Policy	12
Policy on gifts	16
Declaration of conflict of interest	18

According to the Sanlam Benchmark Survey (2009) most private employer funds utilise an Investment Policy Statement which is normally reviewed on an annual basis. This is also the policy that is most widely adopted by the bargaining councils. This suggests that trustees of council funds have a particular focus on managing the assets of the members appropriately.

Most funds have an investment policy statement

The Deloitte survey investigated various policies which would make a useful comparison point. However, the date of the survey is 2005, which is some time before the introduction of PF130. In our experience with private sector retirement funds, most improved their governance measures substantially after the introduction of PF130, and therefore we would expect that current governance levels are significantly higher than measured by this survey in 2005. In 2005, only 25% of private employer funds had implemented a formal communications policy. In our survey, 12 out of 28 of the bargaining council funds declared that they have a formal communication policy. This is better than the Deloitte result, which may suggest that council funds were motivated by PF130 to improve their governance. A similar trend is found for code of conduct policies and risk management policies.

In general it seems that most bargaining councils have policies in place governing key areas of the fund and have embraced the requirements of PF130 to a certain extent. However, it is possible that the requirements for opting out of the NSSF would be more onerous than those suggested by PF130.

Committees

Another indication that the affairs of the fund are carefully considered and therefore that there is a good level of governance is the existence of dedicated subcommittees devoted to various areas of the operations of the fund. By finding out what type of subcommittees are in place, we also learnt which aspects of running the fund are receiving more attention than others.

The most common committees under the funds are investment committees (11 out of 28) and death benefit disposal committees (16 out of 28). There are also a few funds with committees for other purposes (7 out of 28) such as legal, risk and bursary allocation.

Death benefit disposal in particular is an area where we expected council fund trustees to become very involved. The low income, blue collar workers who are members of such funds often live in informal arrangements and in our experience have complex family structures, leaving behind multiple dependents with various degrees of dependency and relationship to the member. Trustees are expected to apply their judgement to death claim allocation and this can form the bulk of management effort for such funds in our experience.

Most common subcommittees

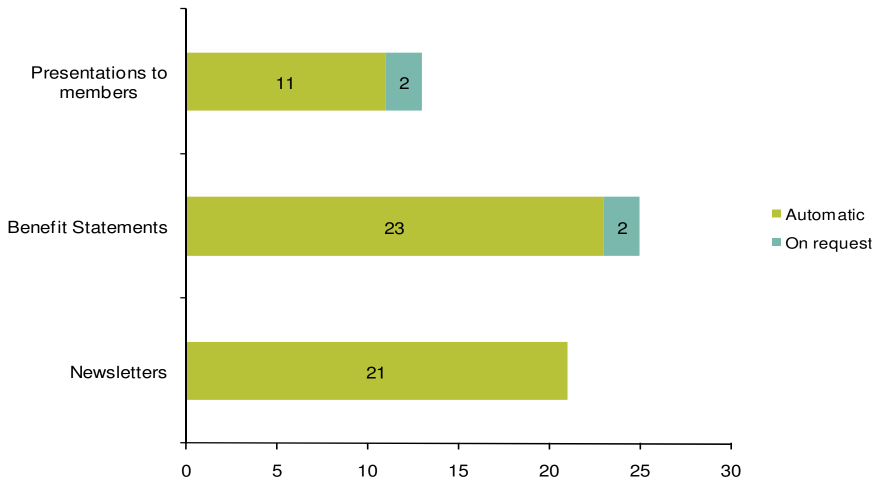
1. *Investment*
2. *Death benefit disposal*

One learning point for the proposed NSSF is the importance of death benefit allocation in the low income earner environment, and the challenges that this brings. The NSSF proposals are suggesting a more simplistic method of allocation is embraced, and one that is more formulaic. However, the signs are that an allocation based on a formula may fall short of being fair to the member and their families.

9.2.8 Member Communication

A high level and quality of member communication is likely to be another criterion for opt-out of the NSSF and accreditation. Bargaining councils, as negotiated entities, would be expected to have good lines of communication to their members since member representation and buy-in for these councils are implied in their nature. Most bargaining council funds do have formal communication policies in place. However, the question is whether those channels of communication are actually employed to inform members of retirement fund related matters. We tested what types of communication are used and how often. Our survey focussed on three major channels of communication: newsletters, presentations and benefit statements.

Most funds have a communications policy in place



It can be noted that:

- Most of the funds (21) issue newsletters at least once per year;
- Most funds issue benefit statements, most (23) automatically, 2 only on request. 3 funds did not indicate they issue benefit statements;
- Presentations to members are not held frequently, but 11 funds indicated that they do take place from time to time; and
- 4 funds see the annual general meeting as another form of communication to members.

Not all funds issue newsletter

Not all funds issue annual benefit statement

Tools mostly used to communicate to members in private employer funds are similar to those used in bargaining council funds.

Budlender and Sadeck (2007) interviewed stakeholders with regard to knowledge of benefits, which is connected to communication. Their report found that:

- Most members are aware that they were entitled to benefits because deductions are being made from their wages.
- Information is provided initially when workers are signed up.
- Companies are provided with information when registering with the council.
- Some employers inform their employees about deductions and payments.
- It seems common to send a benefit statement to members.
- Trade unions should play an important role in educating members about their benefits.
- Communication in general can be improved.

Communication in general could be improved

The findings of this prior research may be outdated as council funds were not subject to the Act or PF130 at the time this survey was conducted.

In conclusion, it seems that basic communications have been embraced by council funds, but there is scope to improve communications. Given the likely lack of financial education by members of council funds, effective communication is a greater challenge within these funds than in private employer funds.

9.3 Results - Administration

9.3.1 In-house and outsourced administration

Internal administration: 30% of funds, but 74% of members

Most funds (17 out of the 25 funds which answered this question) are administered externally. However, the 8 funds which are administered internally account for 74% of the active members under administration. This is mainly a result of the 3 largest funds (for councils 1 and 19, automobiles and metal industries) being administered internally. This makes sense since internal administration tends to work more efficiently in large funds where sufficient experience can be generated to support an administration team.

In-house or external?

Administration of retirement funds involves management of membership data, contribution collection, investment allocation, benefit payments, as well as many other functions.

There are many specialist administrators who can be employed by a fund to perform these tasks. The advantage is that external administrators are expected to be experts. They also should benefit from economies of scale since they administer a large number of funds.

The alternative is to do administration in the fund or council itself. Internal administrators may have the advantage of specialising on the funds they manage and understanding the members' needs better.

9.3.2 Collection of contributions

One of the areas of concern highlighted by prior research is that council funds generally struggle to collect contributions by the 7th day of the following month[8], which is the period mandated by the Act. This delay could be seen as a result of poor administration measures, but on closer examination it appears that many council funds are particularly geared towards collecting contributions. According to Budlender and Sadeck (2007), many funds employ numerous collection agents whose function is to ensure employers do pay the contributions. It therefore appears that the delays and problems with contribution collection reported by previous researchers and also borne out by our own investigation may be caused by the nature of council funds rather than by the quality of administration. In particular, we expect that many employers participate in funds reluctantly and are therefore not motivated to pay contributions on time, making collection agents and delays inevitable.

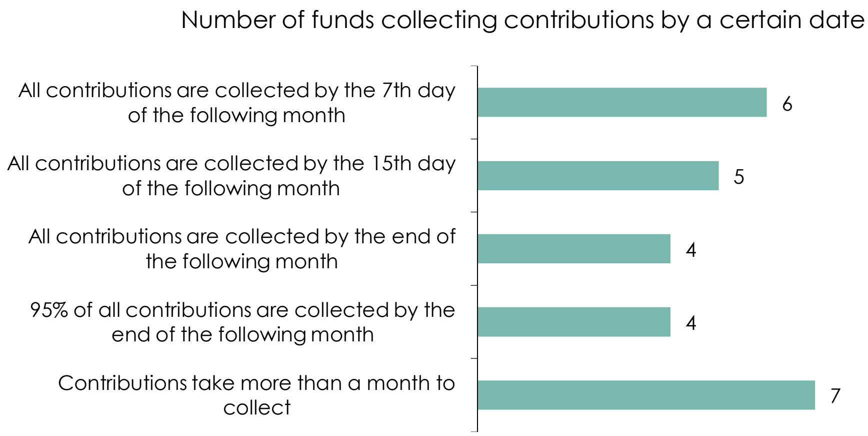
23% target collection by 7th day

The timing of the collection of contributions varies significantly from fund to fund. Of the 26 funds that supplied information, only 6 manage to collect contributions by the 7th day of the following month as

[8] Some funds have been able to gain an extension to this deadline from the Registrar of Pension Funds.

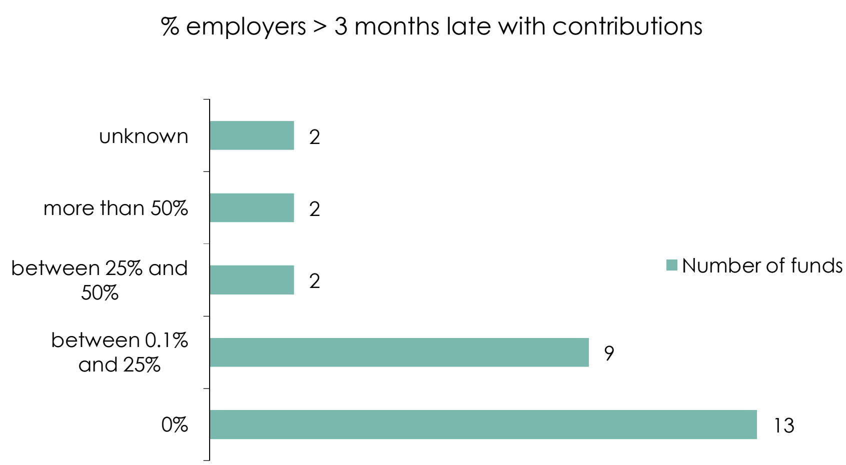
required by legislation. 19 funds manage to collect at least 95% of the contributions by the end of the following month, while 7 funds (5 of which are internally administered) take more than a month to collect contributions as shown graphically below:

27% do not manage collection within 1 month of due date



Further to the above, a number of funds (13 out of 28) have employers with contributions outstanding by more than three months. This is the case in most internally administered funds (6 out of 8). In 12 of those cases (where sufficient information was available), we measured the percentage of the employers whose contributions were more than 3 months behind.

46% have contributions more than 3 months in arrear



The most significant delays are for the laundry fund in the Cape (council 21), where 72% of employers were affected, and the fund for the clothing manufacturing industry Western Cape (council 41), where every employer was more than 3 months in arrears.

In 2 funds, more than half the employers more than 3 months late

This problem of arrears is less severe in national funds, where only 2 out of 9 funds had employers 3 months in arrears, than in regional funds, where 11 out of 19 funds had employers who were late.

National funds more success at collection

There were some discrepancies discovered in the answers to the questions regarding collection of contributions. In particular, a number of funds indicated that, on the one hand, contribution collection is accomplished within less than one month of the end of the month; but on the other hand, a large number of employers appear to be more than 3 months overdue on contributions. We have challenged these funds where possible and it appears that in a number of cases, the policy of the fund is to collect within the period indicated in the first graph, while the actual practice is reflected in the second graph. This suggests that the situation is worse than it appears: not only do some funds have a significant proportion of employers 3 or more months in arrear, but even their targeted collection dates are not in line with the 7 days required by the Act.

The delays in contribution collection, in our view, constitute one of the main issues that would have to be resolved to support council funds in opting out of the planned NSSF and becoming accredited.

The majority of funds (18 out of 22) charge late payment interest on outstanding contributions. The Act stipulates that if contributions are not paid within the 7 day period, late payment interest should be added from the first day they became due up to the date of payment of the contributions. Any funds which do not charge late payment interest would therefore be in contravention of this requirement. In particular of the 2 funds in which the proportion of employers more than 3 months in arrear was the highest (clothing manufacturing WC – council 41, 100% of employers in arrears; and laundry – council 21, 72% in arrears) the former did not indicate whether interest is being charged, while the latter stated that no interest is being charged.

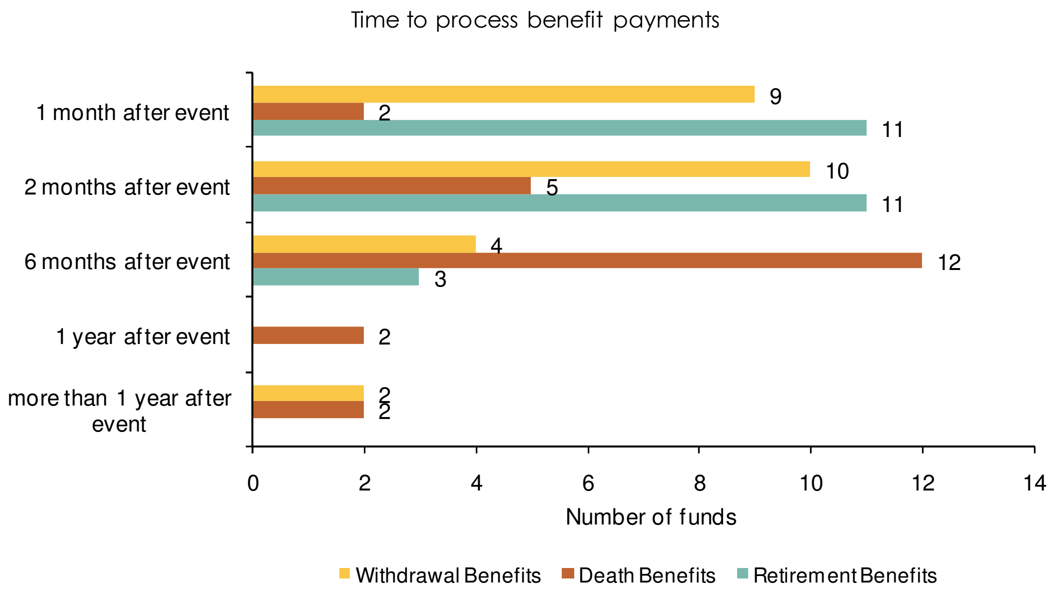
Majority charge late payment interest

9.3.3 Timing of benefit payments

The Sanlam Benchmark Survey (2009) states that according to the trustees of the surveyed private employer funds the payment of claims is the most important administration function. From our survey results it seems that retirement benefits are processed the fastest and death benefits take the longest time to be paid. This is understandable since the death benefit payment process requires that a certain amount of time is spent looking for dependants. Claim payments are on average made faster in funds that are administered externally.

Retirement benefits processed fastest; death benefits take the longest

The graph below shows the timing of retirement, death and withdrawal payments from the surveyed funds:



Based on our experience with private employer funds, this pattern of processing benefit payments is not out of line with expectations, particularly taking into account the environment in which these funds operate. Our question was phrased fairly loosely, making detailed analysis difficult. However, we feel that there is no particular cause for concern compared to the private funds industry.

Benefit payment processed reasonably quickly on the whole

10. Methodology and data

10.1 Approach

Part 1 lays the foundation for answering the questions posed in section 1.2 of this paper: What value do these funds deliver to the members and the councils? What can the NSSF learn from bargaining council funds? And how can these funds contribute to the new retirement framework?

Prior research on bargaining council funds and information provided by the Department indicated that information on retirement funds offered by bargaining councils is sketchy and not up to date. Bargaining councils themselves are monitored somewhat closer by the Department, but the funds they offer are not directly examined in a formal way.

Sources of information:
- *Department of Labour*
- *FSB*
- *Councils and council funds*

We identified potential sources of information as the Department of Labour, the FSB, prior research, and the councils and funds themselves.

The Department could provide us with contact details of council officials. We used this information to enable us to contact the funds directly.

FSB records do not show if a fund is a council fund

The FSB was a promising source of information, since council funds have recently become governed by the FSB and would need to have registered as pension or provident funds with the Registrar of Pensions, and submit certain returns which would have been useful to us. However, not all funds are yet registered with the FSB. More importantly, the FSB has not made any reference in their registration database which would distinguish these funds from any other South African retirement fund. Therefore, to extract data from the FSB, at least the full name or the registration number of the fund is needed, and this list has not, as far as we know, been officially compiled to date. We did, however, turn to the FSB in cases where the information was not forthcoming from the funds, with limited success. Information in most cases is unfortunately limited and out of date.

Prior research into bargaining councils tends to focus on the entire agreement, and not just the retirement fund provisions which are only one aspect. However, we obtained useful information from a research paper commissioned by the Department in 2007 (*Council and other benefit schemes* by Debbie Budlender and Shaheeda Sadeck, referred to as "Budlender and Sadeck (2007)" throughout) which examined the types of benefits offered by bargaining councils, and included a discussion of retirement funds. Other research was useful in establishing the workings of bargaining councils and the dynamics of coverage and exemptions.

Given however that no official listing of the retirement funds operated by the councils had been compiled before, the funds themselves became our prime sources of information for Part 1 of the project.

The Department of Labour facilitated our research by issuing a circular informing the councils of our research and requesting their cooperation. The Department has also been of ongoing assistance in addressing various communication issues that arose as a result of our investigation.

Our approach was to design a questionnaire which covered the following areas:

Part 1 based on questionnaire survey

1. Request for fund documentation
2. Contact details of fund officials and service providers
3. Membership statistics
4. Benefit Structure
5. Assets
6. Costs
7. Governance
8. Administration

The full questionnaire is attached as Appendix 3 to this report.

The questionnaire was distributed by email to contact persons at the councils, and followed up by telephone calls and visits by members of our wider research team. The questionnaire was designed to avoid ambiguity as much as possible and provide comparable, numerical or at least standardised data as far as possible. We attempted to make an experienced industry professional available to each fund to assist with the questionnaire to ensure questions were not misunderstood. In some cases, where cooperation was not forthcoming, we requested fund documentation from the FSB and completed the questionnaire ourselves.

10.2 Communication with funds

We experienced a mixed level of cooperation from the councils we approached. For this report, we have worked with all questionnaires which were returned to us before 12th February 2010. At that date, 28 out of 43 funds had returned a completed questionnaire. The level of response by 12th February 2010 can be summarised as follows:

	Councils	Funds
Total number of councils:	40	
Councils without funds*:	11	
Councils with funds:	29	43
- which have responded**	24	28
- which have not responded:	5	14

24 out of 29 councils responded

28 out of 43 funds responded

*This includes 1 council with a death benefit only fund, which we have excluded from this investigation as it has different characteristics from retirement type funds.

**This includes councils which did not respond but where we were able to obtain information from the FSB which allowed us to complete the questionnaire on behalf of the fund.

All funds with large membership included

We feel that we were able to achieve a good degree of coverage particularly as 24 out of 29 councils with funds provided information for at least one of their funds. We ensured that all funds with a large membership in particular completed a questionnaire.

Specific comments on our interaction with the funds are listed below:

Some unions initially not sympathetic to research

Union reaction: While we are uncertain of the impact of this on the return of questionnaires, we did receive one response from a union representative which indicated that the research was not welcomed by some of the unions. We highlight this response here to draw attention to the possible communication challenges in future dealings with council funds, and the need to address the concerns of unions in particular. We involved the Department with clarifying the research project to the union representatives and the problem was resolved.

Some service providers reluctant to assist

Service provider issues: a number of funds turned to their service providers (mostly the administrator or the consultant) for assistance with the questionnaire. This was mostly a very successful tactic as it expedited the questionnaire survey and ensured that the questions were answered correctly. In a few cases (3 councils with 5 funds in total) the service providers were not supportive of the research or required payment of a fee in order to cooperate.

Lack of time to answer questionnaire

Prioritisation: Several of the questionnaires which have not been returned are from funds where fund officials appeared sympathetic to the investigation, but had no time to address the questionnaire due to workloads.

Questionnaire too onerous to complete

Refusal to participate: A number of funds refused to complete the questionnaire. The reason was that this was too onerous a task for the fund officials, despite the availability of a consultant to assist them on site.

Lack of comprehensive list of funds

Lack of information about existence of funds: In all cases where we knew that a fund existed, we would be able to follow up until the questionnaire was completed or it was clear that the fund was not willing or able to complete it. In some cases, however, we did not become aware of the existence of a fund until it was too late. In some cases this was as we discovered that a national council had a number of regional funds that we were not aware of, or where a council recently established a fund. The final number of funds, 43, could therefore still exclude some funds where we have not been informed of their existence.

10.3 Data

28 funds completed our questionnaire. All of the respondents except for the canvas goods fund (council 32 – refer to section 4.2.1 for list of councils and reference numbers), which is part of an umbrella fund and therefore has no separate financial statements, completed all sections of the questionnaire or at least attempted all sections. Therefore, this report is based on data from 28 respondents unless stated otherwise.

1 fund participates in an umbrella fund

10.4 Supporting documentation

We requested the following documents from bargaining council funds, and received those marked in the table below. Only 28 funds completed questionnaires and were therefore expected to provide supporting documentation.

	Rules of the Fund (Prior to FSB compliance)	Rules of the Fund (Post FSB Compliance)	Annual Financial Statements	Actuarial valuation report (if any)	Any submissions made to the FSB/Department of Labour	Investment Policy Statement (if any)	Administration report (if any)	Example of a benefit statement	Surplus documentation (if any)	Criteria for Exemption
1-Autoworkers Provident		x	x	x		x			x	x
1-Motor Industry Prov.		x	x	x		x				x
2-Building Bloemfontein		x	x	x			x	x	x	
3-Building Kimberley	x	x	x	x		x	x	x		
4-Building SE Cape										
5-Building WC - Pension		x		x		x				
5-Building WC – Prov.		x		x		x				
10-Furniture	x	x						x		
11-Furniture WC										
12-Furniture KZN	x	x	x			x		x		x
13-Furniture EC	x	x	x	x			x	x	x	x
15-Hairdressing WC										
16-Hairdressing KZN	x		x				x	x		
17-Hairdressing Pretoria		x					x			
18-Hairdressing S-Nat.	x	x	x			x		x		
19-Metal Industry	x		x	x		x		x		
21-Laundry– WC										
23-Leather	x	x	x	x			x	x	x	x
25-Meat Trade – Pen.	x	x	x			x		x		x
25-Meat Trade – Prov.	x	x	x			x		x		x
26-Road Freight						x		x		
32-Goods Canvas					x			x		
34-Grain	x									
35-Contr. Cleaning KZN	x	x	x	x				x	x	x
37-Electrical Council	x		x							
41-Clothing Man. KZN	x	x	x	x	x					
41 -Clothing Man. WC	x	x	x	x	x	x	x			
42-Textile	x	x	x				x		x	

We have used some of the information contained in these supporting documents to improve on the responses given to the questionnaire, particularly where we identified any apparent error or discrepancy in the data.

10.5 Contact details of fund officials and service providers

The answers to this section are useful in terms of following up on the research and bringing additional questions to the right person. The database of contact details created through this exercise will be submitted to the Department of Labour.

10.6 Data validation

The remainder of the questionnaire dealt with fund-related information which we have collated in this report.

We performed the following checks and adjustments on the data:

- We ensured that all numbers were entered in a numerical format, that questions with multiple choice answers were indicated consistently, any typing errors were corrected, and that answers were typed into the correct fields.
- We analysed answers for internal consistency, and where discrepancies were discovered, cross-checked those items against supporting documentation. In cases where the correct answer remained unclear, we either followed up with a contact person in the fund, or removed that answer from our analysis.
- In cases where answers were missing, we followed up on supporting documentation and completed where possible.
- Many of the respondents commented on questions outside of the areas provided. We examined the comments and adjusted answers if the comment necessitated that. In some cases, the comment led to a removal of the answer as it became clear that the question was misunderstood or was not applicable to the fund.
- Answers where several membership categories had different results were averaged between the categories.
- Where information was based on a particular year or point in time, we did not make adjustments for inflation or any other changes over time. In most cases, information was provided within the 2008-2009 period. However, in some cases information was older and no adjustment was made for this timing difference.
- In cases where data was not statistically significant (such as for example the average retirement benefit in a fund where only 2 retirements took place), we removed such data from our workings.
- Large numbers were rounded as far as was possible.

Different membership categories averaged

PART 2: VALUE FOR MONEY OFFERED BY COUNCIL FUNDS

11. Introduction

Part 2 of our research is an investigation of value for money offered by council funds, conducted through 5 case studies. We have set three criteria for achieving value for money: the value of the benefits produced by the fund, the quality of administration and the governance measures of the fund.

5 case studies

We begin in Section 12 by describing the background information for each fund. Section 13 outlines our approach for calculating the value of benefits and shows comparative results for the five funds. Section 14 sets out how the funds' administration, and Section 15 deals with the governance framework of the funds.

12: Fund background

13: Value of benefits

14: Administration

15: Governance

This section is followed by the five case studies:

Section 16: Metal Industries Provident Fund
Section 17: Motor Industry Provident Fund
Section 18: Clothing Manufacturing Industry Provident Fund for the Western Cape
Section 19: Provident Fund for the Furniture Manufacturing Industry KwaZulu-Natal
Section 20: Hairdressing and Cosmetology Industry Provident Fund

16: Metal

17:Motor

18: Clothing

19: Furniture

20: Hairdressing

12. History and Background

12.1 Background

Each case study begins with an examination of the history of each of the funds, the parties to the agreement, the current membership numbers and fluctuations in size in the past.

The Metal Industries Provident Fund ("the Metal fund") is a national fund with 360 000 members and R22 billion in assets. It was established in 1957.

Metal: national, large

The Motor Industry Provident Fund ("the Motor fund") is a national fund which caters to higher grade employees only. It has 40 000 members and R4 billion in assets, and it was created in 2004.

Motor: national, large, high grade workers

The Clothing Manufacturing Industry Provident Fund for the Western Cape ("the Clothing fund") is a regional fund and has 23 000 members and R800 million in assets. It has been in operation since 1954.

Clothing: regional, large

The Provident Fund for the Furniture Manufacturing Industry Kwa-Zulu Natal ("the Furniture fund") is a regional fund with 3 000 members and R200 million in assets. It dates from 1954.

Furniture: regional, small

The Hairdressing and Cosmetology Industry Semi-national Provident Fund ("the Hairdressing fund") has 3 000 members and R50 million in

Hairdressing: semi-national, small

assets. It covers several separate regions and has been in operation since 1976.

The funds are all operating under an extended council agreement, making membership compulsory for employers in their industry and region.

All extended agreements

12.2 Benefits provided by the council

We considered all the benefit schemes operated by the council, how these are administered, and the links between them.

All the councils have a provident fund, which in the case of Metal, Motor and Clothing also provides death and disability benefits. All funds except for Hairdressing offered housing loans.

3 large funds: death and disability

Other schemes provided by councils included sickness, holiday pay, maternity and accident.

Separate sickness, holiday, maternity, accident

12.3 Stakeholder views

The views of stakeholders such as employers, members, council officials and fund officials allow us to assess the importance of the funds to the various parties.

Generally, the views of the funds were positive and the relationship between council and fund is seen as important, as it adds to efficiency and also creates trust in the fund.

Funds viewed positively

12.4 Recent developments

Where possible, we examined recent developments in the fund, council and in the broader South African politics and economy and the effects these had on the fund.

The recent economic downturn has reduced membership numbers in the funds and layoffs were reported.

Economic downturn

The announcement of the reform proposals caused negative responses from members which ranged from queries to resignations.

Reaction to reform proposals

13. Value of Benefits

The first determinant of "value for money" is the actual projected value of benefits that can be achieved given the benefit structure and strategies of the fund.

Our simple model is as follows: a member and employer contribute towards retirement (C), those contributions net of risk premiums (R) and expenses (E) are invested at an average investment return (i) during the service period of the member (n), and at retirement the benefit is paid out as a lump sum. This can be represented as:

Benefits =
Contribution-
- Expenses
- Risk
+ Investment returns

$LS = \sum(C_t - E_t - R_t)*(1+i)^{n-t}$

If this lump sum is converted to an annuity at retirement, we can calculate the expected NRR achievable by the fund as:

$NRR = (LS / a_{NRA})/Salary_{NRA},$

Where

a_{NRA} = annuity factor at retirement

$Salary_{NRA}$ = Annualised Salary before retirement

Each of the components of the benefit is examined separately and its effect on the final benefit is quantified.

We then generally consider three cases:

- The benefit that is likely to be achieved at the moment, given the current structure of the fund;

Achievable at the moment

- The benefit that may be achievable if certain improvements are made to operations; and

Achievable after improvements

- The benefit, including the above achievements, adjusted for changes which may be brought about by the new retirement framework.

Achievable after reform

This allows us to examine what items have a significant effect on final benefits.

13.1 Contributions

We consider the gross contributions, any deductions towards expenses, risk premiums and in some cases contributions to other council schemes, and arrive at a net contribution towards retirement. All rates are expressed as a percentage of salaries:

	Metal	**Motor**	**Clothing**	**Furniture** (Non-party | Party)	**Hairdressing**
Employer	6.6%	8.0%	6.3%	7.25%	3%
Member	6.6%	7.5%	6.0%	7.25%	3%
Total contribution	**13.2%**	**15.5%**	**12.3%**	**14.5%**	**6%**
Risk	(3.3%)	(1.5%)	(2%)	(0.4% | 4.9%)	-
Expenses	(0.4%)	(0.3%)	(1%)	(4.7%)	(1.4%)
Net contribution	**9.5%**	**13.7%**	**9.3%**	**9.4%|4.9%**	**4.6%**

The contributions are negotiated between unions and employers, and are part of the greater wage negotiation. This leads to some funds arriving at very low contribution rates (such as the Hairdressing fund's total gross contribution of 6% of salaries).

Hairdressing contributions 6% total

Compared to potential gross contributions of 15% of salaries into the NSSF, only the Motor fund starts off with a high enough contribution. Metal and Furniture are close to 15% and could attempt to negotiate

Only Motor fund meets NSSF level

increased contribution rates to improve their chances of accreditation. Hairdressing is far off, but the fund is aware of the challenge and there are plans to improve contributions and also to merge several hairdressing funds in different regions.

Most funds could get to NSSF levels

After deductions (discussed in the section below) the net contribution rates compared to the possible NSSF benchmark of 10% of salaries are very generous in the case of the Motor fund. Metal, Clothing and some of Furniture's members come close to the 10%. However, if risk pooling is introduced and the risk contribution increases to 4%, the only funds within reach of the 10% net contribution will be Metal and Motor.

Risk pooling will reduce net contribution

13.2 Risk premiums

Each of the funds provides a different level of risk benefits at a different cost. The benefits are self-insured, and the self-insurance arrangements have not been supervised by an actuary, resulting in some cases in stated contributions to risk benefits which do not reflect the actual experience. We adjusted the cost in those cases to be more realistic.

All self insured

No actuarial supervision before Act

Metal: 3 x salary on death and disability, plus fund credit. Cost is stated at 3.3% of salaries. We believe it may be higher but did not adjust it upwards, recommending the benefit levels are reviewed instead.

Metal: 3 x salary at > 3.3%

Motor: 3 x salary on death and disability, plus member's portion of fund credit. Cost is stated as 1.3% of salaries, we adjusted it to 1.5% of salaries based on recent claims. This is nevertheless very cost effective compared to the Metal fund – this may be caused by longer life expectancy among higher grade workers.

Motor: 3 x salary at 1.5%

Clothing: 1.5 x salary on death and disability, plus fund credit. The cost is stated as 0.5% of salary, we adjusted it to 2% based on estimated market rates.

Clothing:1.5 x salary at estimated 2%

Furniture: No death or disability benefit. An adjusted contribution of 0.4% of salaries goes to separate funeral scheme. For workers employed by party employers, 4.5% of salaries is transferred to a sickness scheme. This is a cause of concern as for these members the net contribution towards retirement is insufficient as a result.

Furniture: no death or disability.
4.5% to separate sickness fund

Hairdressing offers no risk type benefits.

Hairdressing: no risk benefits

A benchmark for the cost of such benefits is the mooted NSSF contribution towards risk benefits, which we expect to be 4% of salaries or more. There is a possibility that the NSSF includes a risk-pooling, arrangement where all funds pay the same rate for death and disability benefits, which would mean that members of all funds would need to contribute 4% of salaries or more towards risk benefits. This would be an increase for all funds in the case study.

Risk pooling cost > current cost

13.3 Expenses

We consider the total expense of running the fund, which includes administration as well as any service providers. Investment costs are not evaluated here as they form part of the investment returns contemplated in the next section.

The three large funds, Metal, Motor and Clothing, had costs of less than 1% of salaries, which in our experience is a very efficient result. In Metal industries, costs were 0.4% of salaries or R14 per member per month. If this level of expense is achievable in a large fund, this could be a possible target for the NSSF expenses.

Large funds < 1% of salaries

The costs for these three largest funds can be expressed as a charge ratio of expenses to contributions. The results range from 2% to 8% of contributions. Rob Rusconi in his 2004 paper *Cost of Retirement in South Africa* calculates the cost ratio for South African retirement funds as more than 13% of contributions. The results achieved by large council funds therefore compare very favourably.

Large funds < private employer funds

The Furniture fund, by comparison, has estimated fees equal to 4.7% of salaries, R 132 per member per month, or between 32% and 47% of contributions depending on membership class. This is very expensive by any of those measures. Additionally, fees are not transparent and are taken out of fund returns rather than from contributions, making analysis difficult.

Furniture very expensive; Lacks transparency

The Hairdressing fund uses an external administrator and runs at 1.4% of salaries or R38 per member per month. This is in our experience not excessive for a relatively small fund of 3000 members. When expressed as 23% of contributions, the ratio looks high. This is due to the very low gross contribution in this fund.

Hairdressing external admin

13.4 Investment Returns

The main determinants of the potential long term return achievable by the fund are the investment strategy of the fund, and the actual implementation of that strategy. The target set by the strategy should account for investment costs. Historically smoothing has been very common amongst the larger funds and proved effective at delivering positive returns from year to year. However, the introduction of minimum benefit legislation which requires the payment of any investment reserve to members on early termination has resulted in funds moving away from this approach.

Return driven by strategy and implementation

Smoothing popular but needs to be reviewed due to Act

Past performance compared to benchmarks is secondary, and should not be seen as a guide to future performance.

Past performance not a guide to future

The two largest funds, Metal and Motor, have a fairly aggressive target of inflation plus 5%, which is supported by relatively high equity

Metal and Motor: CPI + 5%, smoothing

allocations. The goal of preventing negative returns is addressed through internal smoothing of returns.

Clothing, Furniture, Hair: CPI + 3% - 3.5%

Clothing, Furniture and Hairdressing target returns of inflation plus 3% - 3.5%. This is appropriate as risk tolerance amongst members of council funds is very low, and negative returns are difficult to communicate. Clothing does conduct internal smoothing which suggests that a more aggressive target could be contemplated.

13.5 Length of service

Preservation key to final benefit level

The length of service over which members contribute without withdrawing their benefit is in our experience the major determinant of the final retirement benefit.

Withdrawals taxed on lifetime basis

In South Africa, members are permitted to withdraw their benefits when they leave their employer. The withdrawals are subject to tax: the first R22 500 withdrawn by a member is tax free, but tax is payable thereafter, and consecutive withdrawals are taxed cumulatively with previous lump sums taken out. So a member who has previously withdrawn and taken R50 000 of which R22 500 was tax free will not qualify for any tax free amount if he withdraws again. This system is aimed to discourage pre-retirement withdrawals, but has had limited success in the past.

Lack of preservation has the result that members usually only retire on benefits accumulated during their most recent employment period. The reduction due to pre-retirement withdrawals is frequently cited as one of the main reasons for retirement benefits in South Africa being very low in general.

Council funds are industry funds – fewer opportunities for withdrawal

Waiting periods

In council funds, theoretically there is an opportunity to improve on this pattern as members may change employment but, if they remain in the industry, technically should not withdraw from the fund. However, we have found that this does not necessarily deter withdrawal payments. To counteract withdrawals, three of the funds in our case studies introduced waiting periods of 2 to 6 months for withdrawals on resignation.

Withdrawals still high

Despite these measures, withdrawals are frequent and we estimated that the average service at retirement is in the region of 10 to 15 years.

13.6 Salary Increases

General negotiations aim for CPI

If benefits are to be considered in comparison to salaries, it is necessary to also project salaries. Generally, it is expected that both benefits and salaries will experience increases related to inflation.

Career progression limited

Council workers are generally remunerated in line with minimum wages which are set through a negotiation each year. In each of our case studies, the expected level of increases to those minimum wages was inflation. Therefore, the only opportunity for salary increases greater than inflation is for members to move into a different wage category. We have assumed that scope for this is limited, and have worked on an aggregate assumption of salary increases of inflation plus 1% as a result.

Assume CPI + 1% for salaries

All comparisons to the proposed NSSF are made assuming that the salary levels of the membership of the funds fall below the salary ceiling for compulsory provision.

Assume NSSF ceiling > salaries in funds

13.7 Conversion to income

A retiring member has the option of converting their lump sum benefit to a pension by purchasing an annuity from an insurer. This option is, according to our informants, rarely taken up by the members.

Annuitisation rare

However, the reform proposals focus on the provision of income in retirement. It is possible that provident funds may need to be converted to pension funds as part of the reform. Additionally, if the NSSF offers an income in retirement, it is vital to compare like with like and convert the lump sum benefit payable from this fund to an income.

The option we have adopted is to use an approximation of commercially available annuity rates. This is what a member of this fund would be able to get if they bought the annuity in the market. We consider with-profit annuities and inflation-linked annuities in particular, since we are interested in an income that keeps pace with inflation over time. In our view, an annuity factor of 14 is a reasonable representation of market levels.

Commercial annuity factor of 14

Annuities currently sold in the market suffer from a major disadvantage when it comes to low income workers. In South Africa, socio-economic factors and in particular HIV/AIDS mean that low income, blue-collar workers experience a much higher mortality than higher-earning citizens. This high mortality is however not reflected in commercially available annuity rates, which do not price for such individuals. The result is that the conversion rate is particularly penal for such workers and offers poor value.

Commercial annuities not appropriate for council workers

The NSSF proposals are attempting to address this by creating a universal, state-financed annuity that would be equal for men and women, and be based on the mortality rates experienced by the lower-earning sectors of the population.

NSSF annuity proposed

13.8 Analysis

If preservation does not improve, we expect service at retirement to be in the region of 10 – 15 years. Under those circumstances, none of the funds in the case studies deliver a sufficient benefit at retirement.

Current service at retirement = 10 – 15 years

If preservation can be improved so that service at retirement is 30 years, the funds could deliver the following benefits:

Assume service 30 years

	Metal	**Motor**	**Clothing**	**Furniture** (Non-party | Party)	**Hairdressing**
Total contribution	13.2%	15.5%	12.3%	14.5%	6%
Risk premiums	(3.3%)	(1.5%)	(2%)	(0.4% | 4.9%)	-
Expenses	(0.4%)	(0.3%)	(1%)	(4.7%)	(1.4%)
Net contribution	9.5%	13.7%	9.3%	9.4% | 4.9%	4.6%
Investment Returns	CPI + 5%	CPI + 5%	CPI + 3.5%	CPI + 3.5%	CPI + 3%
Salary increases	CPI + 1%	CPI + 1%	CPI + 1%	CPI + 1%	CPI + 1%
Service	30	30	30	30	30
Multiple of annual salary at retirement	5.3	6.6	4.1	4.1 | 2.2	1.9
NRR	38%	47%	29%	29% | 15%	13%

The Motor fund delivers a generous benefit in this case, and the Metal fund is close to the target of 40%. The other funds do not deliver sufficient benefits.

Motor sufficient
Metal close

We recommend certain improvements to the benefit structure in each case study. If these are implemented, the potential benefits are improved as follows:

Improvements to structure:

	Metal	**Motor**	**Clothing**	**Furniture**	**Hairdressing**
Total contribution	**13.7%**	15.5%	**15%**	14.5%	**12%**
Risk premiums	(3.3%)	(1.5%)	(2%)	(0.4%)	**2%**
Expenses	(0.4%)	(0.3%)	(1%)	**(3%)**	(1.4%)
Net contribution	**10%**	13.7%	**12%**	**11.1%**	**8.6%**
Investment Returns	CPI + 5%	CPI + 5%	CPI + 3.5%	CPI + **4%**	CPI + 3%
Salary increases	CPI + 1%	CPI + 1%	CPI + 1%	CPI + 1%	CPI + 1%
Service	30	30	30	30	30
Multiple of annual salary at retirement	**5.6**	6.6	**5.3**	**5.3**	**3.5**
NRR	**40%**	47%	**38%**	**38%**	**25%**

In our view, all funds except for the Hairdressing fund could achieve a benefit structure that delivers a net contribution towards retirement of 10% of salaries or more, and expected NRRs after 30 years of close to 40%. The exception is the Hairdressing fund where it is unlikely that contributions will increase by more than 6% of salaries in the short to medium term.

With improvements, benefits sufficient for all except Hairdressing

13.9 Effect of other benefits

South African citizens are entitled to a State Old Age Grant payable on a means tested basis. If the means testing were to be removed and replaced with a flat pension instead, then retiring members from the

Effect of SOAG = R1000 per month

fund would be entitled to an additional R1 000 per month[9] over and above their pensions from the fund.

In our case studies, we estimated potential pensions that would arise from the funds assuming 30 years of service, salary increases of inflation plus 1% and benefits as per design. The resulting pensions were as follows, shown with the NRR and the effect of adding the SOAG:

	Metal	Motor	Clothing	Furniture (Non-Party | Party)	Hairdressing
Estimated Pension (Rand per month)	1300	3800	725	850 | 450	260
Estimated NRR	38%	47%	26%	29% | 15%	13%
SOAG	1000	1000	1000	1000	1000
Estimated NRR with SOAG	67%	60%	62%	50% | 64%	63%

With SOAG, NRR > 60%

Therefore, the SOAG in almost all cases increases the expected NRR from less than the 40% targeted by the reform proposals, to more than 60%.

14. Operation of funds

The efficiency of the operations of the fund is another determinant of value for the members. This includes the fund's ability to collect contributions, correctly keep data, calculate returns and pay out benefits. If the fund is prone to neglect any of these tasks or make mistakes, the value deliverable to members is reduced.

14.1 Administration systems

4 funds administered internally

All funds except for Hairdressing were administered internally by their council. The cost of this service was very low for Metal, Motor and Clothing and very high for Furniture.

Legacy systems lack flexibility

The internal administration systems were developed from the council's own systems and therefore were not designed to manage retirement funds. As a result, they lack certain capabilities such as:

- Some are unable to calculate the member share on withdrawal and use an approximation
- Some are unable to pay out the share of investment reserve on withdrawal.

Motor and Metal are upgrading systems

The Metal and Motor funds are addressing these and other issues by upgrading their systems.

[9] This assumes that the SOAG will keep pace with CPI + 1% for simplicity.

The Clothing fund has issues with data integrity which appear serious and are a concern.

Clothing: serious data integrity issues

14.2 Contribution Collection

Contribution collection serious challenge

All council funds suffer from issues to do with contribution collection. Factors affecting non-payment or late payment are generally size of the employer and the state of the economy. Funds use councils and council agents to collect, but find the measures available to persuade employers to pay are insufficient.

15. Governance

The last aspect of value for money we examine is governance. A fund which does not have strong governance structures is prone to overlooking important issues, making incorrect or non-optimal decisions on behalf of its members, and is generally more exposed to errors and fraud. We have therefore evaluated the governance measures and challenges faced by these five funds.

15.1 Pension Funds Act

Bargaining Council Funds originally operated under the Labour Relations Act (LRA) and were only required to register under the Pension Funds Act in 2007/8. The LRA treated these funds as one more aspect of the council, and legislative oversight was minimal. Registration under the Act was therefore challenging and many new requirements had to be fulfilled.

Registration under Act recent
Still in transition stage

All funds have now registered but some are still transitioning their arrangements and do not necessarily meet all the requirements of the Act. We recommend that this position is reviewed again after one to two years to see if compliance has been achieved.

15.2 Pension Fund Circular 130

Pension Fund Information Circular 130 (PF130) was issued in 2008 and deals with principles of good governance in pension funds. PF130 describes various measures to be put in place to ensure good governance is achieved. The funds have begun to follow the recommendations of this circular in general.

PF130 implementation in progress

Fund at a glance

Members: **361 000**
Employers: **9 400**
Average salaries: **R3 500 – R4 000 p.m.**
Assets: **R 22 billion**
Gross contribution: **13.2%**
Net contribution: **9.5%**
Expenses: **0.4% of salaries or R14 pppm**
Investment expectation: **CPI + 5%**
NRR after 30 years: **38%**

16. Case Study Metal Industries Provident Fund

16.1 Summary

16.1.1 Background

The Metal and Engineering Industries Bargaining Council ("the council" in this section) was established in 1944 and has provided retirement benefits since 1957.

Fund started 1957

The Metal Industries Provident Fund ("the fund" in this section) was created as an alternative to the existing pension fund to address difficulties with pension payments in rural areas.

The fund has 361 000 members, 9 400 employers and R22 billion in assets. Employers employ 40 workers on average.

360 000 members
R22 billion assets

The council provides retirement, death, and housing loan benefits through its two retirement funds. A separate disability scheme and a sick pay scheme are also in place.

Retirement, death, housing loan in fund.
Disability, sickness separate.

The fund is seen as valuable by workers and employers, but does not appear to be crucial to the existence of the council.

16.1.2 Value of Benefits

The benefit structure and projected retirement benefits for a member retiring at 65 with 30 years of service are as follows:

	Current structure	Effect of proposed changes
Member contributions	6.6%	**6.85%**
Employer contributions	6.6%	**6.85%**
Expenses	(0.4%)	(0.4%)
Risk benefits	(3.3%)	(3.3%)
Net Contributions towards retirement	9.5%	10%
Investment returns	CPI + 5%	CPI + 5%
Salary growth	CPI + 1%	CPI + 1%
Service	30	30
Lump sum at retirement	5.3 x annual salary	5.6 x annual salary
NRR at retirement	38%	40%

Interesting features

- Disability scheme funded from retirement fund
- Internal asset manager for around 50% of portfolio
- 8 week waiting period for withdrawals – to improve preservation
- Large surplus in fund – likely due to former members
- Internal administrator has purchased commercial administration system
- 230 000 members with unclaimed benefits - mostly from transfers from previous fund
- Number of trustees not fixed – based on representivity
- Each trustee group has own advisors
- High trustee training spend
- Sharing of facilities with other councils to improve service delivery

In addition, death benefits are equal to 3 times annual salary plus fund credit.

Death benefit = 3 x salary

The potential retirement benefit is currently eroded due to a lack of preservation. If the average service at retirement is 10 years as we estimate, a lump sum of 1.1 times salary or an NRR of 8% would be payable.

Lack of preservation – actual NRR expected = 8%

Concerns

- Net contribution to retirement of 9.5% slightly lower than NSSF
- Separate disability scheme funded from fund
- Self insurance scheme not adequately monitored
- Cost of risk benefits may be higher than allocation
- Tactical asset allocation decisions made by trustees
- High exposure to internal manager – hard to realign if underperforming
- Investment reserve not being paid out to withdrawals
- Administration system lacks flexibility

16.1.3 Member views

Members vaguely understand the concept of the fund but have no concept of how contributions are calculated or what benefit to expect. Benefit statements and newsletters are issued but are considered inadequate as there are universally not well understood. There was a strong demand for advice and education. The major misconceptions about the fund were that it is a savings account rather than a retirement fund, and that the benefit that will be paid should be much higher.

16.1.4 Administration

The fund is internally administered. Significant economies of scale and a non-profit approach result in very low cost of services at R14 per member per month, equivalent to 0.4% of salaries. There are 1050 active members per administration staff member.

Internal admin, R14 pmpm Shortcomings being addressed

The administration system has shortcomings in its functions, but those are being addressed as a new system has now been purchased.

40 council agents for collections

Contribution collection is handled by the council which has 40 agents who assist in the process. Smaller employers are more likely to delay contributions, and at present 15% of employers are more than 3 months in arrears.

15% of employers > 3 months late

16.1.5 Governance

The fund has complied with some of the requirements of the Pension Funds Act ("the Act") on a voluntary basis since it was established in 1991. The fund registered under the Act in 2007. Outstanding issues include contribution collection and the payment of the investment reserve to

Voluntary compliance since 1991

Successes

- Very low cost of administration
- Voluntary participation of non-production workers
- Diversified investment structures, high return objective achievable
- Administration system is being upgraded to specialist retirement system
- Smoothing approach successful
- Surplus apportionment: agreement to use residual surplus to increase contributions

withdrawing members; this is being addressed.

The board of trustees has been in place since 1991. It consists of equal numbers of representatives of the employer and employee organisations. The total number of trustees depends on the number of members represented by each union. Each group of trustees has appointed its own advisors.

Size of board dependant on number of members in unions

The chairman is elected by the trustees and the position alternates between the employer and union representatives.

Alternating chairman position

The trustees meet 5 times a year. Six subcommittees of 8 members each meet monthly to address day to day issues.

Meetings 5 times p.a.

Training of trustees is a high priority, and last year R400,000 was expended on training.

High spend on training

16.1.6 Conclusion

Improve preservation
Slight increase in contributions
Upgrade systems

If preservation is addressed, contributions are slightly increased and the administration system upgrade is completed, we expect that this fund will be a good candidate for future accreditation.

Recommendations

- Increase contributions by 0.5% or more
- Manage risk benefits to stay at 3.3% of salaries
- Maintain expense level at 0.4% of salaries
- Pay disability scheme contributions directly, not via retirement fund
- Closely monitor self insurance scheme, consider reinsurance
- Clarify tactical asset allocation process in IPS and delegate to professionals
- Improve member education and offer more advice

16.2 History and Background

16.2.1 Background

The Metal and Engineering Industries Bargaining Council ("the council" in this section) is the national council for all workers in sectors such as metallurgical industries, heavy engineering, light engineering and related sectors, even extending to general manufacturing in the plastic sector recently. The council was established in 1944 and it has provided retirement benefits to its workers since 1957.

Council started 1944
Fund started 1957

The original fund was a pension fund, but in 1991 the Metal Industries Provident Fund ("the fund" in this section) was created. One of the main reasons for the creation of the new fund was that the old pension fund paid out monthly pensions, which were difficult to pay out to pensioners in rural areas. Workers were given the option to transfer to this new fund. This option was exercised by the majority of the workers, and the provident fund currently has around 361 0000 members. The pension fund was retained and remains available as an option to new members, but only has 30 000 members.

Current fund started 1991

Pension payments in rural areas not practical

Pension fund less popular

The main parties to the agreement are 32 employer organisations and 6 trade unions. Most of the employer organisations have formed a federation which jointly represents them. The employer organisations include various engineering, metal and electrical component manufacturing organisations. The trade unions include NUMSA (National Union of Metalworkers of South Africa), MEWUSA (Metal and Electrical Workers of South Africa) and Solidarity. The council operates nationally and the agreement has been extended to cover non-party employers.

32 employer organisations
6 trade unions

The fund is an internally administered provident fund.

Internal administration
Provident fund

16.2.2 Membership

Membership in one of the funds is compulsory to all production workers. Non-production staff, such as engineers and clerical staff, may however also join on a voluntary basis. This option is frequently exercised, which indicates that the fund is perceived as good value by such voluntary participants.

Membership compulsory for production workers

Voluntary membership of clerical staff common

The fund's current membership is 361 000, but this has fluctuated over the years with the fortunes of the industry. The highest level of employment in the council is reported as 475 000 in the 1970s.

361 000 members

Minimum salaries range from R 3 560 per month for unskilled workers to R 6 774 for skilled workers.

Salaries R3500 – R6500 pm

The average employer has 40 workers, but there is a range of sizes. According to our informants, around 75% of the members are working for about 25% of the employers.

Average employer = 40 staff

The industry is mature and existing employers in the industry tend to be registered with the council. There does not appear to be concern that significant numbers of employers are avoiding registration.

Mature industry, most employers registered

16.2.3 Benefits provided by the council

Death benefits of 3 times annual salary plus fund credit are offered within the fund and there is a separate disability scheme outside of the fund. All risk benefits are self-insured. There are no funeral benefits. A popular housing loan scheme which uses the retirement fund credits as collateral for the loan is in place.

Death = 3 times salary
Disability in separate scheme
Self insurance
No funeral
Housing loan scheme

The disability benefit scheme is separate from the fund, but contributions are collected by the retirement fund, with 1.5% of salaries being notionally allocated to the disability scheme. The actual transfers made to the disability scheme are ad hoc and do not necessarily reflect this allocation.

Disability contributions channelled through retirement fund

The council also provides a separate sick pay scheme.

Separate sick pay scheme

The administration for all the benefit schemes is being handled by the same internal administrator.

16.2.4 Stakeholder views

The fund is seen as a valuable benefit by industry workers. This is demonstrated by clerical-type staff joining the fund on a voluntary basis. The perception is that the fund offers good value as it has low costs of administration mainly due to economies of scale.

Fund seen as valuable

Non-production workers join voluntarily

However, unlike some of the other funds in this study, the fund does not appear to be crucial to the existence of the council. The perception is that the council benefits from the existence of the fund, as contributing to the fund strengthens the relationship between council and employers. However, the council does not rely on the fund as a source of revenue from employers in the industry.

Council not reliant on continued existence of fund

16.2.5 Recent developments

The fund has complied with some of the requirements of the Pension Funds Act on a voluntary basis since it was established in 1991. The fund registered under the Act in 2007. This has brought about a number of changes to the operation of the fund, for example vesting scales on withdrawal were removed, and a surplus apportionment exercise is now being undertaken.

Registration under Act brought changes

Surplus apportionment in progress

The administrator of the fund and the internal asset manager have also become registered as administrators under the Act in order to comply with the new requirements.

Internal administrator registered under Act

16.3 Value of Benefits

16.3.1 Summary

The total contribution to the fund is 13.2% of salaries. 3.3% are used for death and disability, and 0.4% for expenses. The remaining 9.5% are utilised for retirement savings. Fund credits are invested at a target rate of return of inflation plus 5% per annum.

Total contribution 13.2%
Death and disability 3.3%
Expenses 0.4%
Net contribution: 9.5%

Investment target: CPI + 5%

If members remain in the fund for 30 years, the fund should yield a lump sum of 5.3 times annual salary on retirement at age 65. This could be converted into a pension of 38% of salary.

After 30 years, NRR = 38%

In addition to this, the fund pays out 3 times annual salary, plus fund credits, on death, and a separate scheme pays out the same amount on disability.

There is a possibility that the 3.3% allocation towards death and disability benefits is too low to pay for the promised benefit in the long term. The benefit is self-insured and the cost is being reviewed to ensure affordability in the future.

3.3% for death benefits could be too low

Our recommendations are:

Recommendations

1. Consider an increase in total contributions of 0.5% or more to be in line with potential NSSF levels of 10% of salaries

Increase contributions by 0.5%

2. Manage the cost of death and disability benefit to remain at the current level of 3.3% by reducing benefit levels. Alternatively, an increase in total contributions can be negotiated.

Reduce death/disability to be affordable at 3.3%

3. Maintain expenses at the current level of 0.4% of salaries which is very low.

Maintain expenses at 0.4%

In our view, the fund delivers good value for money and with the above adjustments, should be able to deliver benefits in line with expected accreditation criteria.

Good value for money
Candidate for accreditation

Below, we examine each element affecting benefit levels and comment on possible deviations from these assumptions, as well as what could be done to improve the final benefit and reduce such deviations.

16.3.2 Contributions

Employers and employees contribute 6.6% of salaries each, making the total contribution 13.2% of salaries.

Employer: 6.6%
Employee: 6.6%

A deduction of 1.5% of salaries for disability benefits and 1.8% of salaries for death benefits is then made, notionally from the employer contribution although this has no bearing on quantum of benefit. A further deduction of 0.4% is made to cover expenses. The net

Death: 1.8%
Disability: 1.5%

Expenses: 0.4%

contribution towards retirement after these deductions is therefore 9.5%.

Net: 9.5%

The above cost of risk benefits may be insufficient in the long term, and we address this in the next section.

These contribution levels have, according to our informants, not changed significantly over time.

Stable over time

Compared to proposed NSSF levels of 10-12% of salaries towards retirement, this net contribution level is slightly too low. We recommend that the fund consider increasing total contributions by 0.5% or more.

Slightly lower than potential 10% NSSF

16.3.3 Risk premiums

The fund offers a death benefit, and a disability benefit is offered by an affiliated scheme but funded from the retirement fund.

The death benefit is a lump sum of 3 times annual salary, and is paid on top of the member share. This benefit is self insured. The experience of this benefit has not been closely monitored in the past, and the 1.8% contribution which is made towards it does not cover the death claims which arise each year. The balance is met from fund reserves at the moment.

1.8% death contribution too low given claims experience

Balance funded from reserves

The disability benefit is also equal to a lump sum of 3 times annual salary, and the fund credit paid out from the retirement fund. The disability scheme is separate from the fund, but the practice has been to notionally allocate 1.5% of salaries from the contributions to fund this benefit. In practice, 1.5% of salaries has not regularly been transferred to the disability scheme. Rather, transfers have been ad hoc to cover costs as they arose. We are concerned about this practice, but the fund has obtained a legal opinion that supports this approach.

1.5% disability contribution too high given claims experience

Balance left in retirement fund

This system is now being reviewed by the fund actuary. We have been informed that there is an intention to rebalance the 1.8% / 1.5% split between death and disability benefits. Our informants stated that the total of 3.3% would still be sufficient to cover both benefits, since disability benefits are infrequent and much less costly and much of the contribution towards this benefit can be channelled to death benefits instead.

Plan to rebalance death and disability contributions

We compared the amounts paid out in 2008 and 2009 to estimated annual salaries. This resulted in estimated death benefit costs of in the region of 4.7% of salary in each of these 3 years respectively. This is much more than the 3.3% contribution which is available to cover death and disability benefits. We have allowed for member share paid out on death on an approximate basis.

Death benefit cost estimated at 4.7% from claims

Given this information, we are concerned that 3.3% of salaries may not be sufficient to finance the death benefit alone. To add to this, the disability benefit must also be funded. Our informants suggested that

3.3% insufficient

the real cost of this may be in the region of 0.5% of salaries. We do not have data relating to the disability scheme and could not analyse this assumption.

However, we conclude that the allocation to risk benefits is insufficient at the moment and would need to be increased to at least 5% in order to maintain current benefit levels.

Need to increase risk contribution to 5% or more

Given that the fund's contributions to retirement are already lower than what is likely to be required, the alternative to increasing risk contributions is to reduce the quantum of the risk benefits. 3 times annual salary is above the level we observed in other bargaining council funds. We think it is likely to be above the benefits offered by the proposed NSSF. Private employer fund benefits are generally in the region of 3 times salary but would generally have lower mortality experience and hence lower cost of benefit.

We would recommend that the level of the death and disability benefit be adjusted to ensure the cost remains at 3.3% combined if the contribution level is to be maintained at the above level.

Recommend reducing death/disability benefits instead

If the NSSF risk-sharing proposals are implemented, the cost of death and disability benefits will need to be increased to 4% of salaries. The quantum of the risk benefits would likely decrease..

Risk pooling may increase risk premium to 4%

16.3.4 Expenses

The fund finances expenses through a deduction from the monthly contributions. This deduction is 0.4% of salaries at the moment, having increased from 0.3% recently.

Expenses 0.4% of salaries

At the moment, the fund has significant surplus as the surplus apportionment exercise has not been completed. This surplus has been used as a buffer for expense overrun, but with the increased allocation, this has now been corrected. The actual expense level in the 2008 financial year was 0.39% of salaries.

Surplus used as buffer in the past

0.4% of salaries is equivalent to R60 million per annum. Given a membership of 361 000, this is equivalent to a contribution of R14 per member per month to cover all the expenses of the fund. This is an excellent expense level and very affordable. Our informants emphasised the non-profit nature of the administration as well as the significant economies of scale as the main reason for this very lean expense level.

R14 pmpm

In our view, this level of expenditure is below what is envisaged in the reform and would be difficult to improve on.

Lower than NSSF proposals

16.3.5 Investment Returns

Asset size

The assets of the fund amount to around R22 billion. This is the largest of the council funds.

R22 billion assets

Investment approach

A specialist asset class approach is adopted with asset allocation set at a fund level (strategic asset allocation). This is a suitable structure for the size of fund.

Specialist approach

Return objectives

The fund targets a return of inflation plus 5% (net of costs) measured over a rolling 5 year period. This is achieved via an equity exposure of 50% to 65% of assets.

Target CPI + 5% over 5 years

The combination of the strategic asset allocation and selected benchmarks is designed to achieve the Fund's return objective and in our opinion the target is achievable.

Absolute risk, i.e. the risk of losing capital, is of concern and the fund does not permit leverage or investment in high risk strategies to reduce this risk. Details of this requirement and how it is achieved within the fund are unclear from the documentation provided.

An investment reserve is maintained to allow the fund to smooth returns to members. This approach to internal smoothing has historically been adopted very successfully by a large number of funds. There is however a view in the market that the legislated minimum benefit requirement requires the payment of any investment reserves on benefit payments, preventing such smoothing. This is a grey area within the industry and given the goal of avoiding negative returns and the risk aversion of the members, smoothing is a reasonable approach.

Smoothing via investment reserve

Asset class allocation

The asset allocation ranges permitted by the IPS, together with the actual allocation on 31 December 2009, are as follows:

Asset class	Target	Actual at 12/2009
Equities	50% - 65%	68%
Interest Bearing	15% - 35%	18%
International	10% - 15%	12%
SRI/Private Equity	2.5% -10%	2%

The portfolio was slightly overweight in equities but this was noted and rebalancing was suggested.

Slightly overweight equities

Implementation of strategy

The fund's trustees have delegated the implementation of the investment strategy to the Investment Committee; however the full Board is responsible for appointing and replacing managers. This is the market norm.

Investment committee

A significant proportion of the fund's assets (in the region of 50% but fluctuating over time) are managed internally by the MIBFA investment department. In our opinion this is the most unusual aspect of the fund's investment structure. The issue is the relative value of this arrangement compared to other options and whether this has been independently assessed.

50% of assets managed internally

The fund is very large which enables it to invest in more flexible investments, utilise the broader financial services industry and make use of facilities not available to smaller funds. This is demonstrated by the following:

- Specific allocation to SRI investments (Socially Responsible Investments)
- Direct investment in property
- Script lending activities (controlled by master custodian)

Structure

A core / satellite approach is adopted which is well suited to the South African market. The core is run on an enhanced index approach (1.5% tracking error). Satellite equity mandates target 5% above the CAPI. The domestic equity range is 50% to 65% and international equity range is 10% - 15%. This is in line with the objective of 5% p.a real return particularly as the measurement period of 5 years is long by industry standards.

Core/satellite approach

Core = enhanced index

The fund's investment policy document is silent on the subject of tactical asset allocation (TAA) and rebalancing. The stated range for each of the asset classes indicates that TAA plays an important factor, but it is not clear who is responsible for this aspect and how it is managed. Since asset allocation is the primary driver of short term performance this is a significant factor and should be fully understood. The IPS states that the Investment committee will not be involved in sectoral allocation and stock selection which implies that they may be responsible for the TAA decision, however it is not clear on how these decisions are made and implemented and importantly, how they are measured and evaluated.

IPS silent on TAA

Manager selection and allocation

The fund currently uses a number of different managers to implement its core/satellite strategy. The domestic managers utilised are:

Core equity managers	**Core bond managers**
Internal	JM Busha
Kagiso	Sanlam
Mergence	Internal
OMIGSA	

Satellite equity managers	**Satellite bond managers**
Afena	FutureGrowth Bond
Allan Gray	Investec Bond
Argon	Stanlib Bond
Coronation	
Investec	
RMBAM	

Internationally, institutions such as Morgan Stanley, Brandes, the Bank of Ireland and State Street Advisors are managing the offshore component.

> 20 managers – fine given size and strategy

This is a large number of managers but given the size of the fund and the strategy, this is justified.

IPS simplistic on manager rebalancing

The Fund's IPS states that the investment committee will make recommendations to the board to reduce exposure to under-performing managers and increase exposure to performing managers. We are concerned about this approach as, assuming the selected managers are the best within each particular style and approach, any under or out performance should be a function of the market and not an indication of the manager's skill. As such, increasing exposure to a manager who is outperforming will result in greater exposure to the style or approach which the market favours and which often have a lower probability of future outperformance. If the Trustees have concerns about a manager's skill, in our view the manager should be evaluated using far broader criteria than performance. If necessary, the manager should be replaced with a more suitable manager of the same style, rather than increasing exposure to managers of a different style.

Internal Asset Management

Internal manager underperforming over 30 months

A large proportion of the Fund's assets are managed on an enhanced index mandate by an internal investment management team. The investment consultants have reported that this mandate has underperformed consistently over the 30 month period to the date of review. The proposed solution is to reduce the tracking error of this mandate i.e. reduce the ability of this manager to detract from value. However, it does not appear that the trustees or their advisors have considered whether an alternative manager would be able to deliver better value to the fund.

Unclear if replacement of internal manager is an option

It is unclear to us whether the trustees or the fund would consider replacing the internal manager with external alternatives, regardless of whether better value could be obtained for members.

Fees

No information on investment fees has been provided and an analysis of the relative fees is recommended. The bulk of the assets are managed on an enhanced index mandate. These are traditionally very cheap, which should have a positive effect on the overall fee structure. However the fact that a large portion of these assets are managed internally is significant and the overall cost structure will depend on the degree to which the fees associated with the internal management are market related.

Recommend analysis of investment fees

Conclusion

On the whole, we expect that the stated target of inflation plus 5% is achievable by the fund's investment structures. We are concerned, however, that the internal manager's performance may not be optimal, and that there are insufficient options to address long-term underperformance of the internal manager.

CPI + 5% achievable, but internal manager may not be optimal

16.3.6 Length of service

Our informants stated that an 8 week waiting period is in place for members withdrawing from the fund. If a member withdraws but joins another employer in the industry within those 8 weeks, the withdrawal benefit does not become payable, and membership continues. However, despite this we have found that a sample of retirees we examined had no instances of service longer than 20 years. The fund also experienced 37,000 withdrawals during the 2008-2009 year, which is about 10% of the members.

2 month waiting period on withdrawals

10% withdrew during one year

The value of retirement benefits are curtailed by the short length of service at retirement as the result of withdrawals during service. We were unable to conduct a full analysis of withdrawal and retirement experience in the fund. However, given that about 10% of members withdraw from the fund each year, we estimate that the average service length is around 10 years.

Estimate average service at 10 years

Another cause for a reduction in length of service is early retirement which is permitted from age 55. In our small sample of 95 retirements, about 20% retired at the earliest possible date (55), and on the whole about 50% retired at age 64 or above. Retirement at age 55 constitutes a significant reduction in potential service, coupled with a prolonged post-retirement lifespan which needs to be provided for. This has the effect of doubly diluting post-retirement income.

Early retirement permitted

50% retired at > 64

We have examined a small sample of 95 actual retirements. None of the members retired with 20 years of service or more. The majority of retirees in our sample had service in the range of 15-18 years, although this was a small sample and is not representative.

Of 95 retirements, all had < 20 years service

The total retirement benefits paid out in 2009 were R 598 million, paid to 3 775 retirees. Therefore, the average retirement benefit was R158 000, or between 2 and 4 times annual salary, lower than our estimate of 5.3 times. The most likely reason for this discrepancy, in our view, would be that the actual periods of service on retirement were lower than the 30 years assumed above.

Retirement lump sum = 2 – 4 times salary

Lower than expected per fund design due to shorter service

However, we can conclude that the fund performed, in general, better than the fund design would suggest, probably as a result of better than expected investment returns. The major cause of reduction in retirement benefits is the shortened service period to retirement.

16.3.7 Funding position

The fund is significantly overfunded. The last actuarial valuation dated 1 April 2008 (a preliminary valuation which will become the Surplus Apportionment Valuation) reveals the following funding position:

Assets:		R25.4 billion
Liabilities:		R14.3 billion
Actives	R12.5 billion	
Unclaimed	R 1.8 billion	
Surplus before reserves		**R 11.1 billion**
Investment Smoothing Reserve		R 3.8 billion
Permanent Disability Reserve		R 1.9 billion
Net surplus		**R 5.4 billion**

Surplus of R5.4 billion

The surplus apportionment exercise has not yet been conducted but is in progress. Our informants report that regular meetings are being held with the FSB to review progress and that they foresee no major obstacles to finalising this exercise.

Surplus apportionment in progress

Until the surplus apportionment exercise has been completed, it is difficult to comment on the funding level of the fund. However, we suspect that much of the surplus is likely to be allocated to former members. This is due to the fund utilising withdrawal scales in the past, and due to the investment reserve not being paid out to withdrawing members (this is still currently the case). On the other hand, we would expect that the fund is required to reduce the investment smoothing reserve to a lower level, releasing more surplus, much of which may again be due to former members. On balance, we do not expect a significant surplus to be available for distribution after the former member payments have been addressed.

Expect most allocated to former members

The stakeholders have, according to our informants, in principle agreed that any residual surplus will be used to increase the current employer contributions from 6.6% to a higher level. This would likely only be for a limited time, but we would expect that this may be a platform which leads to permanently increased contributions.

Residual surplus agreed to be used to increase contributions

If the investment smoothing reserve is retained after the surplus apportionment exercise is complete, this would increase the likelihood of achieving targeted returns in the future.

16.3.8 Salary Increases

Salary growth, according to our informants, is generally negotiated to keep pace with inflation. However, these are increases within the same grade of employment and do not allow for career progression. We have therefore allowed for CPI plus 1% as salary growth.

Salary increases = CPI + 1%

16.3.9 Effect of other benefits

Average achievable pensions, using 30 years of service, a real salary growth of 1% and commercial annuity rates, were estimated at R1 300 per month. Therefore, the addition of R1000 in the form of the SOAG increases pensions to R2 300, and the NRR from 38% to 67%.

SOAG doubles pension

The SOAG is therefore a potential significant source of post retirement income, delivering nearly as much as the benefit from their own fund.

16.3.10 Analysis

The average expected retirement benefits currently achieved in the fund can be summarised as follows:

Contributions	13.2%
Expenses	(0.4%)
Risk benefits	(3.3%)
Net Contributions towards retirement	9.5%
Investment returns	CPI + 5%
Salary growth	CPI + 1%
Service	10
Lump sum at retirement	1.1 x annual salary
NRR at retirement	8%

Current NRR = 8% due to lack of preservation

The fund is not likely to provide significant replacement ratios for its members if members only remain in the fund for a period as short as10 years before retiring.

If a member works for a 30 year period rather than 10 years, i.e. if preservation is improved, the above table can be revised as follows:

Contributions	13.2%
Expenses	(0.4%)
Risk benefits	(3.3%)
Net Contributions towards retirement	9.5%
Investment returns	CPI + 5%
Salary growth	CPI + 1%
Service	30
Lump sum at retirement	5.3 x annual salary
NRR at retirement	38%

If service = 30 years, NRR = 38%

Therefore, if a reasonable service period is achieved, the fund is likely to deliver close to the targeted 40% NRR.

If however the NSSF proposal for risk equalisation is implemented, we may expect that all funds would need to contribute 4% of their members' salaries towards such shared risk benefits. This will result in the following outcome:

Contributions	13.2%
Expenses	(0.4%)
Risk benefits	(4.0%)
Net Contributions towards retirement	8.8%
Investment returns	CPI + 5%
Salary growth	CPI + 1%
Service	30
Lump sum at retirement	4.9 x annual salary
NRR at retirement	35%

If risk pooling at 4%, NRR = 35%

We recommend that the trustees consider negotiating higher overall contributions to achieve a net contribution to retirement benefits of 10% of salaries, to increase their chances of accreditation.

Recommend increase in contributions by 0.5%

16.3.11 Other Benefits

Death

The fund offers a benefit of 3 times annual salary plus the member's fund credit on death. This is higher than most bargaining council funds and on par with private employer funds. The benefit is self-insured with a contribution of 1.8% of salaries, which has been insufficient to cover this benefit. There is a proposal to increase the contribution and also to establish a risk reserve which will assist in managing the funding cost.

Self insured, insufficient allocation

There is a practice in the fund to pay out some of the death benefits in instalments. This is apparently done when the recipients are minors. The fund manages the payment of instalments, and no separate beneficiary fund appears to be used.

Death benefits to minors paid in instalments

In the past, given the low contribution rate, this benefit has been very good value for the members.

Disability

There is no disability benefit payable from the fund, but a separate disability scheme which pays a lump sum of 3 times annual salary is in place. The fund pays out the fund credit in addition to this. This is higher than most council funds and on par with private employer funds.

Self insured, ad hoc

The benefit is self-insured. The cost is fixed at 1.5% of salaries and is funded from the contributions to the retirement fund, which are intended to be transferred out of the retirement fund and into the disability scheme. Due to changes in the Income Tax Act in 2000, these transfers have not been regular (but ad hoc transfers have been made from time to time). A reserve has built up in the retirement fund. Annual claims on this scheme are low, and the actuary of the fund is of the view that the 1.5% allocation is too high.

Allocation too high

There is a proposal to reduce the contribution to this benefit and use the excess contribution to fund the death benefit instead. The actuary is of the view that the combined contribution towards these two benefits will be sufficient to cover the cost of claims. Based on death benefit claims paid in the last two years, we are of the opinion that death and disability benefit costs may exceed the 3.3% of salaries contribution level.

Combined contribution to death and disability too low

Funeral

There is no funeral benefit payable from the fund.

No funeral

Withdrawal

The withdrawal benefit is the member share.

Member share on withdrawal

Due to limitations of the administration system, no share of the investment reserve was paid to withdrawals in the past. This will be corrected when the new administration system is implemented. However, the non-payment of the investment reserve is an issue and may lead to the need for top up payments in order to bring past benefits in line with the Act.

Investment reserve not paid out

Housing Loans

The fund offers housing loans, which are provided via a number of different banking institutions and use the fund credit as collateral. The benefit is limited to 80% of the fund credit, although it appears that this limit may be reduced depending on the requirement of the banking institution.

Housing loans max. 80% of fund credit

The current amount of loans, according to our informants, is around R 3 billion, which amounts to nearly 15% of the assets of the fund and nearly 25% of active member liabilities. In our informants' views, housing loans are the most appreciated benefit offered by the council, valued more highly than retirement or disability benefits.

Total loans very high

16.4 Views of Former Members

16.4.1 Approach

4 interviews with former members

Four individual 60 minute in-depth interviews were conducted with former members of the bargaining council provident fund within the metal sector by African Response, a specialist market research company. The respondents comprised workers who had retired and workers who had left the sector and had hence withdrawn from the fund. The findings discussed in this research are based on their responses and cannot be generalized to reflect the views of other members within the metal sector, but they can be used as key lessons that can be taken forward as to how to gauge the perceptions of the fund from workers who have either retired or withdrawn from the fund.

The full report is attached as Appendix 4 to this report.

16.4.2 Summary of findings

Simplistic understanding of fund

Not aware that contributions are % of salary

Aware of employer contribution but not how much

All respondents had a simplistic understanding of provident funds. Generally they found about the provident fund when starting to work in the metal industry and all of them understood that an amount was deducted from the salary and that this money was used to give them a pay out when they left their employment. Respondents did not indicate any knowledge of the contribution being based on a percentage of their salary, although it was understood that there was a relationship between their salary and their contribution. Also most respondents showed an understanding that the amount increased as their salary increased, usually every year. The respondents were vague as to the actual amount they contributed but they knew that their employer was also contributing to the provident fund; the respondents also did not seem aware of how much their employer contributed.

Aware of need for retirement saving

Payouts used to settle debts

This research revealed that respondents saw it as important to contribute to such a provident fund, in order to secure their future, retirement years. They expressed a need to care for themselves but they were facing challenges such as caring for their loved ones and their extended family members. Also there are problems in that they had to use the payouts to pay off their debts and improve their standard of living hence they seem to have had to postpone their dream of retirement because of these problems.

Lack of information and communication

Communication and lack of information were major issues highlighted by respondents; they relied on the statements they received once or twice a year that gave them an update on the status of their provident fund. Because communication was minimal (the statements, payslips, newsletters were the only sources of information that they can rely on), they spoke to other colleagues for advice on how the provident fund operated. These methods of communication were not sufficient to assist employees with more information on the queries that they had and for clarification purposes. Lack of proper systems in place to assist employees with relevant information on their provident fund led to the employees making bad decisions especially on how to invest into the provident fund and ultimately on how to handle their payout. Also it was mentioned that uneducated employees were the hardest hit because there were was nobody available to explain what was written on paper and they could not understand the whole process.

Need better information to make decisions

Employees cannot read

Respondents who withdrew from the fund would have liked to have received proper advice in time so that they could plan on how to use their payout. One respondent indicated that he had received advice but he saw it as having come too late as it was given to him at a time when he was about to receive his payout and the amount received was not what he had expected. Another respondent did not get any form of advice and she mentioned that the lack of advice did contribute to her misusing the payout somehow. Both respondents have gone back to the employment sectors and are hoping that they would not commit the same mistakes again.

Need advice for leavers

Both of the respondents who retired received their fund pay out without any problems. One received a lump sum that he used to cancel debt. The other received four payments over four months that she used to improve her living conditions and make a five-year fixed term investment that she intends to use to pay for her granddaughter's education. Both are supplementing their income with a state pension and would have liked to have been able to work longer, because they are unable to support themselves from the income they now receive.

Retirement cash used for debt; grandchildren's education

State pension

Insufficient income

16.4.3 Misconceptions

Two most important misconceptions are revealed from the sample:

- Payouts should have been higher than those eventually received. Their expectations are too high and information should be made available in time to assist in decision making.

Amount saved too low – expectations too high

- Provident funds are a kind of savings plan, resulting in a pay out that can be used to pay debts, improve a home, save for grandchildren's education.

Retirement fund = savings account

16.5 Operation of funds

16.5.1 Administration

Internal administration

380 admin staff

The fund is administered by an internal administrator, Metal Industries Benefit Fund Administrators (MIBFA). The administration office is a separate division in the council, employing 380 staff who are devoted to the administration of council funds. The total staff of the council is 530, so the administration office makes up 72% of the council workforce.

1050 members per admin staff

Given that the membership is 361 000 in this fund and a further 30 000 in the pension fund, this means that there are 1050 members per administration staff member.

Very low cost of admin

The administration cost is very low. This is partly because of economies of scale and partly due to the non-profit or low-profit nature of the administrator's business. The introduction of the new computer system may raise costs slightly but given said economies of scale this is not expected to be significant.

Arrangement on office sharing with other councils

The council seeks out opportunities for economies of scale. There is an arrangement in place to share local offices with the motor industries and road freight councils to give members in more areas access to their council. This kind of initiative is likely to lead to reduced costs and better service provision in the long term.

16.5.2 Internal Administration

Outsourcing not suitable

The fund has always been administered internally. In earlier years, the council developed administration capability to deal with various aspects of managing the council, and the fund was catered for in this arrangement. Given the size of the membership, and the internal structures which are already in place, there is no consideration to outsource administration to external suppliers, as this would increase costs while internal administration of other benefits would need to continue.

Administrator could take on other funds or portion of NSSF

The administration capability is sufficiently developed so that, in our informants' views, the administrator could take on other funds. This may be a potential solution for other bargaining council funds in different industries. The other potential utilisation is administration of some portion or aspect of the national fund.

Using internal administration has many advantages for the fund and the members in this case. The administrators are familiar with the industry, queries regarding all benefits are handled centrally, there is a central link from the council records to the fund administration records, and contribution collection is performed by the council's agents. The administration office is sufficiently large and specialised to maintain the required level of expertise and governance required by the Act.

The internal administrator is registered in terms of Section 13B of the Act.

16.5.3 Administration system

The administration system is currently being converted from a system developed internally to a dedicated retirement fund administration system purchased from Alexander Forbes. There is some evidence that the old system was not able to deal with all the complexities introduced when the fund registered under the Act. For example, the investment reserve has not to date been paid to withdrawals from the fund, apparently due to administrative limitations. The new system has been designed specifically to deal with such problems.

Conversion to Alexander Forbes developed system in progress

16.5.4 Contribution collection

Contribution collection is a serious challenge for all bargaining council funds.

In this fund, contributions are paid directly into the fund bank account, and the system is capable of alerting the administrators as soon as it is clear which employers have not paid by the 7th day of the following month. The target for contribution collection is the 7th day, which is in line with the Act. Before the fund formally registered under the Act, the target collection date was the 14th day of the following month.

Contributions paid directly to fund account

Target 7th day

Contribution collection can be enforced by either using the provision of the Pension Funds Act or the Labour Relations Act (LRA) which governs bargaining council agreements. The second option is preferred by fund officials as it is thought that this is more efficient and more immediate measures can be taken under this act by the council's agents.

LRA preferred to follow up on late contributions

The council employs 40 agents who assist with contribution collection.

40 agents

According to our informants, about 80% of the employers contribute without trouble each month. Those that don't comply are generally the smaller firms, 10 employees or less. Such companies are said to be run fairly informally, and have little interest in the paperwork that accompanies their business. They also tend to experience cash flow problems, where there is a tendency to postpone the payment of any ancillary benefits until the income resulting from the past period has been collected. Collection can take up to 3 months.

80% of employers on time

Small employers most often late

At the time of our investigation, 15% of the employers in the council were more than 3 months in arrear with contribution collection. This may be higher than usual as a result of the economic situation in the country at this time. Late payment interest is being charged on overdue contributions.

15% of employers > 3 months late

Late payment interest charged

Not all contributions are eventually collected.

Not all contributions collected

16.5.5 Benefit Payments

According to our informants, benefit payments do not present a particular challenge in this fund. Retirement and withdrawal benefits are generally paid out by the 6th month after exit. This is a little longer than we would expect but not critically so. Withdrawal benefits are deliberately subjected to a waiting period to ensure that members are discouraged from taking a withdrawal payment when changing employers.

Retirement and withdrawals take up to 6 months

Death benefits are generally paid out after 1 year. This is not unusual due to the mechanism of allocating such benefits which may involve a period of searching for additional dependants. There is a dedicated death benefits allocation subcommittee.

Death benefits take 1 year

The fund has over 230 000 former members with unclaimed benefits, about 95% of which are over 6 months old. These represent slightly over 10% of the member liabilities. Our respondents stated that these are mostly very old claims transferred in from the engineering industry pension fund. It was also suggested that the most common cause for unclaimed benefits are members who leave with very short service, and had not become aware that a benefit is due to them.

230 000 unclaimed benefits

Most from another fund

This may be an issue of communication with regards to fund benefits.

16.6 Governance

16.6.1 Pension Funds Act

The fund voluntarily complied with some aspects of the Pension Funds Act since inception in 1991. However, this voluntary compliance did not entail complete compliance with the requirements of the Act. For example, contribution collection was traditionally performed in accordance with the requirements of the Labour Relations Act and the deadlines of the Pension Funds Act were not targeted. This changed when the fund registered under the Pension Funds Act in 2007.

Voluntary compliance since 1991

Registration in 2007

The surplus apportionment exercise has also not been completed, as the surplus apportionment date is only March 2008 (the first valuation date after the fund became regulated by the Act). The fund has significant surplus which needs to be investigated. It is likely that a majority of the surplus will be allocated to former members in our view.

Surplus apportionment still in progress

The other aspect of complying with the Act was for the administrator and the internal asset manager to become registered under the Act. This has been done.

Administrators registered under the Act

16.6.2 Policies

Pension Fund Information Circular 130 (PF130) requires various policies to be put in place, and this seems to have been attempted. The fund has implemented an Investment Policy Statement. This is a comprehensive document which has been compiled by the fund's two separate investment advisors on behalf of the trustees.

IPS comprehensive

A policy on gifts and a declaration of conflicts of interest have also been put in place.

Policy on gifts and conflict of interest in place

Various other policies, such as risk management, communications and code of conduct for the trustees have not yet been put in place.

Risk management and communications policies still outstanding

16.6.3 Records of the fund

It appears that the fund has put in place the correct procedures to keep records of the fund such as minute books, attendance registers and so forth.

Record keeping done

16.6.4 Board of trustees

The board of trustees was created in 1991, when the fund was first created. The number of trustees is variable but employer and employee organisations are equally represented. There are no independent trustees.

Board of trustees in place since 1991

Equal employer and union trustees

The principle is that employee organisations are able to appoint a number of trustees related to the number of members they represent – roughly, 1 trustee for 8 000 members. Employer organisations are then allowed to appoint the same number of trustees as the employee organisations. This ensures there are the same number of trustees appointed by both sides, and that all unions achieve a fair allocation of trustees. This is further reinforced by a rule that states that if any side is under-represented at a meeting, the equivalent number from the other side will be disqualified from voting at the meeting.

Unions appoint 1 trustee per 8000 members

Union trustees are selected by a regional vote within the relevant unions. Employer trustees are selected by the council of the federation of employer organisations.

In practice, about 5 or 6 trustees from each side attend each meeting.

10 – 12 trustees per meeting

The two groups of trustees are clearly separate from each other. An interesting feature is that each group appoints its own fund consultant and investment consultant. The practice is that a preparatory meeting is held on the day before each trustee meeting, where both groups meet with their consultants and are briefed on and debate the issues of the fund. According to our informants, such meetings can last all day but do ensure that all trustees are prepared for the main trustee meeting, which is then conducted reasonably swiftly.

Each trustee group has own advisors

Trustees are not remunerated for their services, but their costs of travel and accommodation are paid if needed, and an allowance for personal expenses is also provided.

Trustees not remunerated but expenses paid

The chairman is elected by the trustees every two years. The rules specify that the position of chairman must alternate between an employee organisation and an employer organisation representative.

Chairman elected every 2 years
Position alternates

The trustees meet about 5 times per year.

Trustee meetings 5 times p.a.

As required by PF130, the principal officer is not the chairman of the board or a trustee.

16.6.5 Subcommittees

The fund has subcommittees dealing with investments, death claims, disability claims, audits, surplus and communication. The committees are composed of 8 trustees, 4 from each side, and meet monthly.

Subcommittees for:

- *Investments*
- *Death claims*
- *Disability claims*
- *Audits*
- *Surplus*
- *Communication*

This is a large number of subcommittees but warranted given the size of the fund. We expect that the subcommittees add significant value to the fund and improve the governance.

16.6.6 Training

PF130 introduced requirements to provide trustees with regular training. The fund appears to be serious about training. Last year, the trustee training expenditure was in the region of R 400 000 (excluding travel and accommodation). Training included six sessions of two days each throughout the year, plus additional sessions for all new trustees. The intention is to structure training in such a way as to lead to a formal qualification. A number of trustees have already completed the UNISA pension funds course.

R400 000 spent on training last year

It seems that training is extensive and taken very seriously by the fund.

16.6.7 Service providers

The fund has an internal administrator, but external service providers are appointed as the actuary, investment consultants and fund consultants. There is only one actuary, but the consultants are duplicated for employer and employee trustees.

One actuary but 2 sets of consultants

Service providers are appointed using a tender process and are reviewed regularly, although one of the informants stated that parties prefer to stay with providers they know.

16.6.8 Communication

A member is given an information booklet when joining the Fund which includes a summary of the rules of the fund, the last annual

Information booklet at joining

administration report, as well as a registration form which captures the personal details of the member.

Annual benefit statements and admin report

Annually, members receive their benefit statements as well as an administration report.

Employers receive rules

All employers receive a full set of rules, which members are also given on request as per the requirements of the Act. The administrator's marketing department also visits companies to present benefits to new members and deal with member questions.

Web access

Members can also access their benefit statements electronically on the administrator's website. Members are issued with passwords which enable them to do this.

17. Case Study
Motor Industry Provident Fund

Fund at a glance

Members: **41 000**
Employers: **18 000**
Average salaries: **R8000 p.m.**
Assets: **R 4 billion**
Gross contribution: **15.5%**
Net contribution: **13.8%**
Expenses: **0.3% of salaries or R23 pppm**
Investment expectation: **CPI + 5%**
NRR after 30 years: **47%**

17.1 Summary

17.1.1 Background

The Motor Industries Bargaining Council ("the council" in this section) offers 3 retirement funds. One is a closed pension fund. The other two are provident funds, one aimed at low grade and one at high grade employees.

The Motor Industry Provident Fund ("the fund" in this section) was created in 2004 caters to high grade employees. Average salaries are high at R8000 per month. The fund has 41 000 members, and most employers have 20 workers or less, with 2 to 3 being of high enough grade to qualify for this fund. The lower grade employees join the Auto Workers Provident Fund.

Fund caters to high grade employees

Average salaries R8000 pm Employer = 20 workers but only 2 – 3 join this fund

The council provides retirement, death, disability and housing loan benefits through its retirement funds. Separate schemes offer sick pay, accident and maternity, and holiday benefits.

Retirement fund: retirement, death, disability, housing loans

The fund is held in high esteem by stakeholders.

Separate schemes: Sick pay, maternity and accident, holiday

17.1.2 Value of Benefits

The benefit structure and projected retirement benefits for a member retiring at 65 with 30 years of service are as follows:

After 30 years of service, NRR=47%

	Current structure
Member contributions	7.50%
Employer contributions	8.00%
Expenses	(0.28%)
Risk benefits	(1.45%)
Net Contributions towards retirement	13.77%
Investment returns	CPI + 5%
Salary Growth	CPI + 1%
Service	30
Lump sum at retirement	6.6 x annual salary
NRR at retirement	47%

Interesting features

- The fund caters to higher grade employees only, unique in the council space
- Death benefit excludes employer portion of fund credits
- The allocation to expenses is much higher than required, and the remainder is given back to members in investment returns
- Withdrawal benefits are calculated on an approximate basis due to administration system limitations
- President of council is a trustee
- Chairman is elected by trustees from outside of the board

Concerns

- Limitations of administration system could result in some cross subsidies which may be inequitable
- IPS is not sufficiently comprehensive

Death and disability benefits are 3 times annual salary plus member's portion of fund credits, which is higher than the average council fund.

3 x salary on death and disability
Member's portion of fund credit

The benefit structure is generous and allows for sufficient benefits to build up for retirement. These potential benefits are however eroded due to a lack of preservation. If the average service at retirement is 15 years as we estimate, a lump sum of 2.6 times salary or an NRR of 18% would be payable.

Estimated service at retirement 15 years = NRR of 18%

The fund has completed its surplus apportionment exercise and is in the process of distributing surplus to former members.

Surplus apportionment complete

Successes

- Low cost of administration
- Surplus apportionment completed
- Introduction of direct interface with SARS to speed up tax clearances on claims
- Successful self insurance arrangements
- Successful investment smoothing process
- High risk benefits
- Low cost of risk benefits
- Employer's portion of member credit to be included in risk benefits in future
- Default preservation at withdrawal

17.1.3 Administration

The fund is internally administered. The cost of administration is low at 0.28% of salaries, equivalent to R23 per member per month. There are 3950 members per administration staff member.

Internal admin

R23 pmpm

3950 members per admin staff

The administration system has shortcomings in its functions, but those are being addressed as the system undergoes redevelopment.

Redevelopment of system

17.1.4 Governance

The fund has voluntarily complied with the Pension Funds Act ("the Act") since 2001 and meets all the requirements of the Act.

Voluntary compliance since 2001

The board of trustees consists of 3 employee representatives, 2 employer representatives, the president of the council, and one additional member chosen by the trustees who is also the chairman.

Trustee board small and unusual composition

Trustees meet once a month, and 4 subcommittees are in place to assist with investments, administration, claim and audit issues.

12 meetings per year

17.1.5 Member views

Members saw the fund as a savings scheme rather than as a retirement provision. Members also expected to be able to predict their benefit and did not understand that unpredictable elements such as market movements played a role in the determination of the benefit.

Members view fund as savings scheme

Lack of understanding of benefit

Members lacked information regarding the fund and particularly options on exit.

Lack of information

17.1.6 Conclusion

The fund's benefit structure is in our view already better than that proposed by the NSSF, and it has strong governance measures. Some administrative issues are being addressed. Thereafter, we are of the view that the fund would be able to meet expected requirements for accreditation.

Strong benefit structure

Good governance

Admin issues under review

Good candidate for accreditation

Recommendations

- Update administration system
- Reduce allocation to expenses and increase allocation to retirement directly to improve transparency
- Update IPS to make it more comprehensive
- Consider introducing a waiting period on withdrawals to improve preservation
- Improve education regarding benefits and introduce systems to address queries

17.2 History and Background

17.2.1 Background

National council

Extended agreement

The Motor Industry Bargaining Council ("the council" in this section) is a national council whose agreement has been extended to cover non-parties.

3 retirement funds
- *1 closed*
- *1 low grade*
- *1 high grade – case study*

The council operates three retirement funds, one of which, the Auto Workers Pension Fund, is closed to new members. The other two funds, are the Auto Workers Provident Fund and the Motor Industry Provident Fund ("the fund" in this section), which was established in 2004 and is the subject of this case study.

The two active funds accept new members according to job grade, with lower grades being accepted by the Auto Workers fund which is the larger of the two, and the higher grade workers joining the Motor Industry fund.

Internal administration

All three funds are administered by the Motor Industry Fund Administrators (MIFA), an in-house company established in 1952. The core business of MIFA is to administer the funds that provide occupational retirement funding for employees in the non-manufacturing sector of the motor industry

17.2.2 Membership

41 000 members

The fund had an active membership of 41 000 as at 31 March 2009. These are drawn mostly from those in the job grades 7 or higher within the motor industry.

<20 workers per employer, 2 – 3 right grade for this fund

Majority in Auto Workers fund

The average employer has less than 20 workers, but the staff contingent spread ranges from as small as 3 to as high as 300. For each employer, only a few workers are of high enough grade to join this fund. The majority join the Auto Workers Provident Fund.

The fund membership of the Motor Industry fund decreased from about 51 500 in 2008 to 41 000 in 2009. This could mostly be attributed to the effects of the recession in the economy (and more specifically the motor industry) in 2009.

Average salary R8000 per month – high
Still below NSSF ceiling

As the fund is for higher grade employees, we would expect higher average salaries. The estimated average monthly wage in the fund is R8 000, much higher than in our other case studies but still below the mooted NSSF ceiling of R150 000 per annum.

Exemptions possible if own fund same or better

Applications for exemptions from membership in the fund at employer level are considered on a case-by-case basis. To qualify for exemption the employer must demonstrate sufficient evidence of the existence of an alternative retirement fund offering equal or superior benefits. Where exemptions have been granted bargaining council agents undertake standard inspections regularly to ensure that conditions based on which the exemptions were granted continue to be satisfied.

Failure to satisfy these conditions may result in the exemption status being withdrawn. We were also informed that although it is usually employers that apply for exemptions members can also individually apply under certain conditions.

17.2.3 Benefits provided by the council

The fund provides retirement, death and disability benefits to its members. Housing loans are also available.

Retirement fund: retirement, death, disability, home loans

The council also offers a sick pay, accident and maternity fund as well as an additional holiday fund to its workers.

Council: Sick pay, Accident and maternity, holiday

17.2.4 Stakeholder views

According to the chairman and fund officials the fund is regarded in high esteem by all stakeholders. One of its strongest areas is considered to be its efficiency in the collection of contributions and payment of benefits which rely heavily on the infrastructure of the bargaining council and a strong working relationship between MIFA and the bargaining council regional offices.

Fund regarded as efficient

17.2.5 Recent developments

The fund has voluntarily complied with the Pension Funds Act since 2001, before the recent amendments to the Pension Funds Act that made it compulsory for bargaining council funds.

Voluntary compliance since 2001

The fund has undergone a surplus apportionment exercise in compliance with statutory requirements. A Surplus Apportionment Committee was established to monitor and control the process of tracing potential beneficiaries. A benefit recovery company was appointed to assist in tracing qualifying former members.

Surplus apportionment complete

Payments being made

A direct interfacing capability with South African Revenue Services was recently put in place for the electronic application for and receipt of tax directives in respect of benefit payments. This significantly reduces processing time.

Direct interface with SARS

17.3 Value of Benefits

17.3.1 Summary

The total contribution to the fund is 15.5% of salaries. 1.45% are estimated as necessary to fund death and disability benefits. A further 0.28% are required to meet expenses. The remaining 13.7% can be utilised for retirement savings. Fund credits are invested at a target rate of return estimated as inflation plus 5% per annum.

Total contribution:	*15.5%*
Risk premiums:	*1.5%*
Expenses:	*0.3%*
Net contribution:	*13.8%*

Target return: CPI + 5%

If members remain in the fund for 30 years, the fund should yield a lump sum of 6.6 times annual salary on retirement at age 65. This could be converted into a pension of 47% of salary.

After 30 years, NRR of 47%

In addition to this, the fund pays out 3 times annual salary, plus the member's portion of fund credits, on death, and a separate scheme pays out the same amount on disability.

Benefit structure sufficient

The benefits are in our opinion sufficient and we do not see a need to adjust the benefit structure.

Below, we examine each element affecting benefit levels and comment on possible deviations from these assumptions, as well as what could be done to improve the final benefit and reduce such deviations.

17.3.2 Contributions

Employer contribution: 8%
Employee contribution: 7.5%

Employers contribute at a rate of 8% and employees contribute at a rate of 7.5% of salaries resulting in total contributions to the fund of 15.5% of salaries. A total deduction of 4.03% of salaries for risk benefits and expenses leaves a net contribution of 11.47% to be allocated towards retirement benefits. These contribution levels are not anticipated to change any time in the near future.

Deduction for risk and expenses too high

Unallocated contributions of 2.45% allocated with fund returns

According to the latest actuarial valuation report only 1.58% is required to pay for fund expenses (i.e. 0.28% of salaries) and risk benefits (1.30% of salaries), resulting in unallocated contributions of 2.45% of salaries. We have tested the cost of risk benefits and estimate that it may be somewhat higher than the 1.3% of salaries allowed for. Therefore we allow for an additional 0.15% of salaries towards the cost of risk benefits, resulting in an unallocated amount of 2.3% of salaries. It is expected that a this amount will essentially be distributed to members as part of the annual bonus declaration.

Assume unallocated contributions are allocated immediately

For the purpose of our investigation, we have therefore assumed that the net contribution towards retirement is 13.77%, i.e. 11.47% plus 2.30%. We recommend that the fund consider operating in this manner in the future.

It should be noted, however, that it is the intention to improve risk benefits to include full fund credit as opposed to member's portion only, in which case the unallocated contribution level will reduce. Furthermore, the allocation in the past has not necessarily included the full additional amount as stated here, and therefore members with past service will not necessarily be able to achieve the benefit levels outlined in this document.

Net contributions > NSSF levels

This fund therefore notionally exceeds the intended retirement contribution levels of the NSSF of 10-12% of salaries. If the opting out criteria would require an equal or better benefit design than the NSSF this fund will not require contribution increases.

17.3.3 Risk premiums

The fund offers lump sum death and disability benefits.

The death benefit is a lump sum of 3 times annual salary plus the member's portion of fund credit. This benefit is self insured directly by the fund. The disability benefit is similar to the death benefit. The disability definition is subject to the discretion of the trustees as these benefits are directly provided by the fund. Both benefits are currently under review to increase them to 3 times annual salary plus the member's full fund credits.

Death and disability: 3 x salary plus member's portion of fund credit

Under review to include employer fund credit.

The fund holds a reserve determined on the registrar's recommended basis for holding a risk benefit contingency reserve.

Risk reserve for self insurance

The fund has the critical mass from a statistical point of view to self-insure its risk benefits. The experience will however need be monitored on a regular basis to ensure that the contribution allocation towards meeting the costs of the benefits continue to be adequate. The latest actuarial valuation of the fund revealed that 1.3% is currently required towards the cost of death and disability benefits.

Self insurance appropriate

Actuary recommends 1.3%

We were able to compare the amounts paid out over the latest three financial years to estimated annual salaries. This resulted in estimated actual risk benefit costs of 1.43%, 1.39% and 1.38% of salary in each of these 3 years. Our calculations approximately allowed for the member's portion of the fund credit and also reduced the cost by the employer's portion of the fund credit, which is available for additional funding.

Past claims experience suggests 1.5%

We therefore adjusted the cost of death benefits from 1.3% to 1.45% to allow for this slightly higher estimated cost.

The risk premiums in the NSSF for death and disability cover are likely to be around 4% of salaries. This would mean that the unallocated contributions of 2.45% of salaries would be absorbed in full should the risk pooling proposals be implemented.

Risk pooling = significant increase in cost of risk benefits

17.3.4 Expenses

The fund finances expenses through a deduction from the monthly contributions.

This deduction is 0.28% of salaries at the moment. It was 0.31% in 2008 and 0.21% in 2007. The average as a percentage of salary is quite low. 0.28% of salaries of R5.67 billion per annum is equivalent to R15.9 million per annum in expenses. This converts to about R23 per member per month based on the 31 March 2009 valuation membership figures. Although some council funds achieve less per member per month this is still a reasonable expense level and very affordable.

Expenses around 0.3% of salaries

R23 pmpm

We gathered from the meetings we had with the fund officials that the low average cost per member is attributable to the bargaining council infrastructure that the fund has access to. The council has a wide network of walk-in centres across the country and some operations of the fund, like the collection of contributions, are regarded as part of the wider bargaining council functions.

Council infrastructure supports low cost admin

17.3.5 Investment Returns

The fund targets a return of inflation plus 5.5% per annum. This target is supported by a relatively high exposure to equities. However, we adjust this target to inflation plus 5% below, due to lack of detailed information.

Investment target CPI + 5.5% - adjusted to CPI + 5% here

The asset size is around R4 billion.

R4 billion in assets

The information provided by the fund was limited to the investment policy statement and the underlying manager returns for 2009. Unfortunately, the policy of the fund is not to release investment managers' information to third parties. As a result, we are limited in our evaluation of the fund's investments.

Some information not available

The fund's investment policy statement (IPS) is not very comprehensive. It provides very broad statements regarding the fund's objectives with no details on how the fund is structured to meet these objectives. The IPS states that the fund targets returns of inflation plus 5.5% but it is not clear over what period this is to be measured. This needs to be balanced with the fund's tolerance for risk, however the IPS simply states that the trustees will decide on the respective investment risk without defining acceptable ranges.

IPS not comprehensive
- *No details on investment structure*
- *Period over which returns are measured not stated*
- *Unclear on risk management*

The underlying investments are managed on a specialist basis however the nature of the mandates, the benchmarks being used and the manner in which these mandates are blended is not included in the fund's IPS or other information provided to us.

The fund's strategic asset allocation has a significant exposure to equities (71%) which should be sufficient to achieve the target return in the longer run but will result in significant volatility of returns, which is unusual with industry funds. Returns are however smoothed to reduce volatility. An investment reserve equal to at least 5% of the member liabilities is maintained to prevent negative bonus declarations. This aids the fund in stabilising the returns from its fairly aggressive investment allocation.

71% equity exposure – supports high target

Internal smoothing

The asset allocation range is large and no details are given as to how the tactical asset allocation decisions are made. It appears that the trustees are responsible for rebalancing the fund's portfolios.

Unclear on tactical asset allocation

We recommend that the IPS is reviewed and that issues such as performance measurement and risk tolerance, as well as tactical asset allocation are addressed in the policy. In the absence of sufficient information, we have used a CPI plus 5% investment return in our projections.

Recommend review of IPS

17.3.6 Length of service

Council funds have an opportunity to improve preservation by discouraging withdrawals in the instances where members change employers but staying within the same industry. Currently the administrator's default practice is to preserve past service benefits if members move from one employer to another within the bargaining council but cannot prevent a member from taking a cash benefit.

Benefits preserved if member does not leave industry

Based on the data we received from the fund, more than 95% of exiting members in 2009 had stayed in service for a period of less than 10 years. It is our understanding that most of these members do not preserve their benefits but utilise these to cover their immediate financial needs.

Majority of withdrawals < 10 years of service

Further analysis of the 2009 exit data shows that about 90% of all exits in the year were as a result of termination of services with employers.

90% of exits are withdrawals

We have examined a sample of 105 actual retirements which took place in 2009. Only 26 of the members retired with 20 years of service or more. The average service was 15 years.

Retirement on average 15 years

If we assume the members in the sample did not preserve any retirement savings prior to joining the fund, those with 20 years of past service at retirement would be expected to achieve a lump sum of only 3.7 times final annual salary (or a NRR of 26%) at retirement based on the assumptions. Those with 15 years of past service at retirement would be expected to achieve a lump sum of only 2.6 times final annual salary (or a NRR of 18%) at retirement based on the assumptions.

Expected NRR = 26% after 20 years

From the sample we established that those retirees with roughly 20 years past service achieved an average NRR of 41% and for those with around 15 years past service an average NRR of 37% was achieved.

Actual NRR = 41% after 20 years

These actual NRRs offer better value to the members than assumed in the calculation basis which likely results from actual bonus declarations being more favourable relative to salary growth over the relevant period.

High NRRs due to high investment returns

We have assumed that the average service to retirement is 15 years in this fund.

Assumed 15 years service at retirement

17.3.7 Funding position

As at the 2009 financial year-end the fund's financial position was as follows:

Assets:	**R3.85 billion**
Members Fund Credits:	R3.72 billion
Investment Reserve:	R0.08 billion
Risk Reserve:	R0.02 billion
Data Reserve:	R0.02 billion
Surplus & Surplus Expense Res. Acc:	R0.01 billion
Total Liabilities and Reserves:	**R3.85 billion**

No surplus in the fund

The fund holds an investment reserve account for the purpose of smoothing returns allocated to fund members. The current balance in this account is 2.1% of member's fund credits which is lower than the fund's target of 5%. The investment reserve is expected to fluctuate significantly between financial year ends. The level of the investment reserve is estimated throughout the year in order to award an appropriate bonus allocation when members exit the fund between financial year ends.

Investment reserve low

The Data Reserve Account is set at 0.5% of members' fund credits plus Investment Reserve. The Risk Reserve is calculated according to the registrar's recommended basis for a risk contingency reserve.

Data reserve and risk reserve reasonable

The surplus related accounts relate to former members and will be distributed as and when these members are successfully traced and paid.

The fund is financially sound and offers reasonable contingency measures in our opinion.

Financially sound

17.3.8 Salary Increases

The council aims to negotiate for salary increases of between 7% and 9% every year subject to a minimum of the annual inflation applying in that year. If the long term inflation target of 3% to 6% per annum is taken as a realistic long term estimate, it is clear that the target level of investment returns of inflation plus 5.5% will exceed salary growth. We have, after consultation with the fund administrators, allowed for salary growth at CPI + 1%.

Salary increases at CPI + 1%

17.3.9 Effect of external benefits

If the 47% NRR we project is achieved, and average salaries are R8 000 per month, then the expected pension after 30 years of service is R3 800 per month. If the SOAG becomes universally available and is equal to R1 000 per month, this would raise the pension to R4 800 per month, increasing the NRR to 60%.

SOAG increases pension from R3800 to R4800 pm

Since salaries in the fund are higher than in the other funds, and the targeted NRR is already fairly high, the SOAG does not make as much of a difference as for the other funds in this study.

SOAG impact low

17.3.10 Analysis

The average expected retirement benefits currently achieved in the fund can be summarised as follows:

Contributions	15.50%
Expenses	(0.28%)
Risk benefits	(1.45%)
Net Contributions towards retirement	13.77%
Investment returns	CPI + 5%
Salary increases	CPI + 1%
Service	15
Lump sum at retirement	2.6 x annual salary
NRR at retirement	18%

After 15 years, expect 18% NRR

The fund is not likely to provide significant replacement ratios for its members if members only remain in the fund for a period as short as 15 years before retiring.

If a member works for a 30 year period rather than 15 years, i.e. if preservation is improved, the above table can be revised as follows:

After 30 years, expect 47% NRR

Contributions	15.50%
Expenses	(0.28%)
Risk benefits	(1.45%)
Net Contributions towards retirement	13.77%
Investment returns	CPI + 5%
Salary increases	CPI + 1%
Service	30
Lump sum at retirement	6.6 x annual salary
NRR at retirement	47%

Therefore, if preservation is ensured, the fund's benefit structure is such that a reasonable level of benefits should be generated at retirement.

If preservation fixed, benefits sufficient

If however the NSSF proposal for risk equalisation is implemented, we may expect that all funds would need to contribute 4% of their members' salaries towards such shared risk benefits. This will result in the following outcome:

Contributions	15.50%
Expenses	(0.28%)
Risk benefits	(4.00%)
Net Contributions towards retirement	11.22%
Investment returns	CPI + 5%
Salary increases	CPI + 1%
Service	30
Lump sum at retirement	5.3 x annual salary
NRR at retirement	38%

The risk equalisation proposal therefore is likely to erode value for the members of this fund, and we expect that the actual death and disability benefits will be lower than what they currently receive. However, even with this reduction in value, the fund is capable of generating an NRR of close to 40%.

Risk pooling reduces NRR but still sufficient.

17.3.11 Other Benefits

Death and Disability

The fund offers a benefit of 3 times annual salary plus member's portion of fund credit on death in service. The disability benefits are the same. These benefits are much higher than what is offered by most bargaining council funds and are on par with most private employer arrangements.

Death and disability generous.

The benefits are self-insured by the employer portion of fund credit together with a current cost contribution of 1.3% of salaries. Compared with other funds the costs of these benefits are quite low. The combined effect of higher benefits at lower average costs means the fund has managed to offer real value to its members in this regard.

Death benefits low cost

There are plans to increase both benefits to pay out the full fund credit instead of only the member's portion. We estimated, based on the costs and salaries of the 2007 – 2009 financial years, that the costs would average about 1.45% of salaries. This is still relatively low when compared with the costs incurred by other funds on these benefits.

Proposal to include employer share of credits

A compulsory participation in the NSSF will increase these costs by around 2.5% of salaries for similar benefits and would therefore destroy significant value currently offered by the fund.

Risk pooling = 2.5% increase in contributions

Funeral

There is no funeral benefit payable from the fund.

No funeral benefit

Housing Loans

The fund provides housing loans through a banking institution. The amount is limited to 70% of the member's credit. In 2009, the total outstanding loans were valued at R17 million, or 0.5% of member credits.

Housing loans max. 70% of fund credit

Total loans small

Withdrawal

The withdrawal benefit is the member's fund credit.

The administrator calculates withdrawal benefits on a pragmatic basis as 150% of accumulated member contributions plus exit bonus (i.e. proportion of investment reserve). Based on the history of employer contribution allocations this approximation is a fair basis. However, a more accurate calculation method would be required should employer contribution allocations deviate significantly over time.

Withdrawals calculated on approximate basis

From an individual perspective, there could be skewed allocation of investment reserves, e.g. for a member exiting after short service who transferred a large amount into the fund. This member may benefit significantly from additional returns funded from the investment reserve on a large portion of fund credit that did not participate in the creation of the investment reserve over time. Given the size of the fund such instances will not distort the financial position, however, it is a more technical and finer design feature to consider.

Approximate proportion of investment reserve paid out

Another technical consideration for the current design is that an exiting member could forfeit 2.45% of salaries for up to 12 months due to unallocated contributions.

17.4 Views of former members

17.4.1 Approach

Four individual 60 minute in-depth interviews were conducted with former members of the fund by African Response, a specialist market research company. The respondents comprised workers who had retired and workers who had left the sector and had hence withdrawn from the fund. The findings are based on their responses and cannot be generalized to reflect the views of other members within the clothing sector, but they can be used as key lessons that can be taken forward as to how to gauge the perceptions of the fund from workers who have either retired or withdrawn from the fund.

Interviews with exited members

The full report on this fund is in Appendix 4 of this paper.

17.4.2 Summary of findings

All respondents knew how the fund worked and also showed some understanding of the processes of contribution to the fund. Generally respondents found out about the provident fund when starting to work in the motor industry and most of them saw it as compulsory to join the fund. However, lack of information and unavailability of proper systems in the workplace that are supposed to assist employees with their fund related queries are highlighted as major concerns. Respondents, especially those who withdrew from the fund, strongly indicated that the lack of representatives who were supposed to assist with more

Members knew how fund worked

Information was provided on joining

Lack of systems for handling queries

information on the provident fund made it very difficult for them to understand what the payout processes were.

Information regarding payment of benefits not available

This research has shown that communication with regards to the provident fund was minimal at the motor sector. The respondents alluded to the fact that there was no further communication on the fund and there were only two "methods of communication" from the side of the employer or the council, which was not sufficient to keep them updated about their status on the fund. These "methods of communication" were their payslips at the end of the month and when they received the "magazine". With regards to the magazine they said it was not informative enough to assist them with the kind of questions they had. The respondents also depended on their colleagues, friends and families for advice and that did not yield any fruitful results because, in general, the respondents had a superficial understanding of retirement funds. The respondents who left the motor sector had to adjust their expectations of the fund to understand it as a kind of a savings plan, rather than a provision for unemployed retirement years.

Communication minimal

Payslips and "magazine" only source of information

Information sourced informally

Exited members saw fund as savings account

Respondents who withdrew from the fund were unsatisfied with the fact that they were unable to leave the money in the fund to grow or transfer it to their new employment. There were also transparency issues surrounding tax implications and the final payout amount which did not meet their expectations. In terms of the retirement experience, one respondent felt that the lump sum is fair in the light of the payments made. Furthermore, an opportunity was missed to increase contributions and some respondents' expectations were too high hoping to receive larger amounts compared to what they have received, owing to lack of information received and miscalculations.

Members would have liked to leave money in the fund or transfer to new fund

Lack of transparency regarding tax

Members miscalculated expected benefits and were disappointed

17.4.3 Major misconceptions regarding the fund

Two major misconceptions are revealed from this study:

- Provident funds are a kind of savings plan, resulting in a pay out that can be used to pay debts, improve a home, buy a car
- The (mis) calculations made by respondents seem not be in line with what the fund is going to payout.

Misconceptions:

- *Fund is a savings plan*
- *Fund benefits can be calculated based on contributions*

It seems that these misconceptions could be attributed to a general lack of complete information about provident funding and retirement planning.

Lack of complete information

17.4.4 Communication

The only information provided to the respondents came when joining employment and from colleagues, friends and families. A lack of information was evident, especially about how much they contribute on a monthly basis, how much they have contributed in total and what these contributions will amount to at the end of the contribution term. Information that would be most beneficial to employees in terms of

Information only at joining, and from colleagues

Lack of information about contributions fostering greater understanding of the provident fund would need to include:

Information required on:

- Implications of government pension vs. provident fund
- Implications of provident fund if employee leaves the industry (even if this was never intended at entry level)
- Basic financial management skills for retirees
- Continual (annual) updates on status of provident funds

- Government pensions
- Exit benefits
- Financial skills
- Fund status updates

17.5 Operation of funds

17.5.1 Administration

The Motor Industry Fund Administrators (Pty) Ltd, or MIFA (Pty) Ltd, was established in 1952 to administer the various funds that provide retirement funding for employers that fall within the Motor Industry Bargaining Council agreement. The relationship between MIFA (Pty) Ltd and the Motor Industry Bargaining Council is defined as: "It is to be regarded as a cardinal principle that the MIFA (Pty) Ltd is to remain under the control of the Associations or Bodies which are parties to the National Industrial Council for the Motor Industry".

Fund administrator controlled by council

MIFA has 52 staff members and administers 205 000 members under the three funds, making the ratio 3950 members per administrator.

52 administration staff, 3950 members per admin staff

MIFA collects contributions via the council infrastructure and thereafter manages the investments of the fund. MIFA is responsible for the maintenance of all appropriate records and final determination and payment of pension and other benefits in terms of the rules of the fund. The fund pays an administration fee in return.

MIFA is registered as a Retirement Fund Administrator in terms of section 13B of the Pension Funds Act.

Registered as administrator under Act

17.5.2 Administration system

The administration system is in-house developed, fully automated and is currently undergoing redevelopment. The administration system has evolved over time with the advancement in information systems. Since inception the administration processes have been constantly changing in line with the demands of time and the increases in the memberships of the different funds that the company administers.

Admin system is being redeveloped

Based on recent actuarial valuation reports the system allows for calculation of individual benefits on a pragmatic basis. Bonus top-up declarations are made annually one year in arrears and on exit a bonus is allocated reflecting the member's estimated share of the investment reserve.

Pragmatic administration

Fund credits are currently calculated as 150% of accumulated member contributions which simplifies the administration and record keeping of individual fund credits. However, this approach will only

Fund credit = 150% of accumulated member contributions = approximation remain accurate provided the employer contributions allocated towards retirement remain constant since inception.

Our understanding is that the unallocated contributions of 2.45% of salaries indeed results from the limitations of the administration system to handle fluctuations in retirement allocation levels. However, since the unallocated contributions are included in annual bonus declarations, members are not prejudiced by this system limitation unless they leave before the final bonus is declared.

Unallocated contributions of 2.45% a result of limitations of admin

Most administration systems available in the retirement fund industry offer a more sophisticated capability for administering individual records – for example, daily unitisation of investment returns and daily reconciliation between assets and liabilities is possible. However, the fund actuary is comfortable that the current approach is acceptable and appropriate for the unique features of the fund.

System lacks sophistication

It should be noted that the current approach requires active involvement of the actuary in order for the trustees to declare appropriate bonus rates.

Active involvement required from actuary

17.5.3 Contribution collection

Contributions are collected by the council and passed on to MIFA. Most contributions are collected within the stipulated 7 day period although occasionally there are employers with outstanding contributions of more than a month. The reasons cited for this range from poor employer administration systems to liquidity problems. Once an employer is in contribution arrears the agreement enforcement mechanisms of the bargaining council are initiated.

Council collects contributions

Most contribute on time

In the view of the fund officials the contribution collection system works very well as most errant employers eventually pay their contributions.

Very few contributions remain uncollected in the long term

17.5.4 Benefit Payments

Retirement and withdrawal benefits are generally paid out by the 2nd month after exit. This is quite consistent with the standard turnaround times in the private sector. With withdrawals if the system picks up that an employee has changed employers within the bargaining council and is already contributing under a new employer before a claim is paid, the payment is withheld and the fund credit transferred to the new participating employer's record. The member is considered to have a right to the benefit though and the payment will be made if the member insists. This "default preservation" practice attempts to solve one of the leakage problems relating to members failing to preserve their benefits when they withdraw prior to reaching retirement age.

Retirement and withdrawal paid out within 2 months

System checks if worker has joined another employer

Death benefits are generally paid out after 6 months. This is quite quick considering that trustees need to first satisfy themselves on the eligibility of all beneficiaries before any benefits can be paid out.

Death benefits paid out after 6 months

Overall, the amount of outstanding benefit payments is around R1 million, very small compared to the total asset size of over R4 billion.

17.6 Governance

17.6.1 Pension Funds Act

The fund voluntarily complied with the Pension Funds Act since inception in 2001 and meets all the requirements of the Act. All service providers are licensed. The accounts are audited annually. Actuarial valuations are produced annually as a standard good practice even though the statutory requirement is every three years. The fund is in a process of distributing surplus to former members following the approval of the surplus apportionment scheme by the Registrar of Pension Funds. The latest actuarial valuation revealed that the fund is financially sound.

Voluntary compliance since inception

Complies with requirements of the Act

The fund operates reserve accounts that are acceptable in terms of legislation and the registrar's recommended approach.

17.6.2 Policies

Pension Fund Circular 130 on good governance requires that various policies be put in place and the fund is in the process of drafting most of the outstanding ones.

Policies being drafted

17.6.3 Board of trustees

The fund is managed by a board of 7 trustees:

- 3 of represent the employee organisations,
- 2 represent the employers,
- the president of the council, according to the current rules, is the ex-officio 6th trustee, and
- the 7th trustee is elected by the other 6 and becomes the chairman of the board.

Board of trustees:

- *3 employee*
- *2 employer*
- *Council president*
- *Chairman elected from outside of board (independent)*

According to our information, the fund has submitted a rule amendment reducing the total number of trustees to 5.

Plan to reduce to 5 trustees

The board evaluates its collective performance on an ongoing basis, and that of the Principal Officer and advisors on both an ongoing and annual basis. The board has an independent trustee and this helps to address the concerns of all stakeholders regarding matters of transparency and equity. Trustees are kept fully informed on all fund related matters. On average trustees meet once every month. In the private sector boards of trustees meet on average 4 times a year. All Trustees have alternates.

Meetings once per month

The fund has fidelity and indemnity insurance policies in place. However, no claims have been made on these policies ever since inception.

17.6.4 Subcommittees

The fund has 4 sub-committees:

Subcommittees:

The Investment Committee – responsible for all investment matters of the fund. The committee is advised by an independent consultant.

- Investments

The Administrative Committee – responsible for all matters of administration of the fund including record keeping and benefit payments.

- Administration

The Claims Committee – responsible for examining and approving all claims for ill-health retirement, death and disability benefits and for the establishment of beneficiary distribution accounts for dependents.

- Claims

The Audit Committee – established in terms of the King Report on Good Corporate Governance.

- Audit

17.6.5 Training

It is essential for good governance that trustees receive regular training on retirement fund matters. For the Motor Industry Provident Fund, providers of training services are selected on the basis of cost and expertise and regularity of training is dependent on trustee requirements.

Ad hoc training provided

17.6.6 Service providers

Service providers are appointed on the basis of relevancy of expertise to the requirements of the fund. Experienced and well qualified service providers are actively sought for the specific requirements of the fund from time to time. Investment managers, particularly, are identified on the basis of their track record and ability to match their underlying philosophy with the liability profile of the fund.

Service provider appointment process in place

Any potential areas of conflict of interests amongst the service providers are cleared out and statements of disclosures are requested. Once on board the performance of a service provider is reviewed annually and costs are checked regularly for market relatedness. Investment performance is monitored monthly at a high level and in depth quarterly with guidance from the investment consultants.

Service providers reviewed annually

17.6.7 Communication

Members receive a benefit statement annually. These are also available on request from the Administrator's office or from the council's offices. Alternatively statements can be requested through the internet. Two newsletters are sent out per year and members are given their fund breakdown on leaving service.

Annual benefit statements

Internet capability

2 newsletters p.a.

In the opinion of fund officials, members' level of understanding of the fund can be considered to be fair and their level of satisfaction with the operations of the fund can be regarded to be good. The level of complaints from members is very low. Our interviews with members however indicated that more education about the fund is required.

The fund has never had an adverse ruling from the Adjudicator.

No adjudicator rulings

18. Case Study
Clothing Manufacturing Industry Provident Fund for the Western Cape

Fund at a glance

Members: **23 000**
Employers: **263**
Average salaries: **R2500 p.m.**
Assets: **R 800 million**
Gross contribution: **12.28%**
Net contribution: **9.28%**
Expenses: **1% of salaries or R27 pppm**
Investment expectation: **CPI + 3.5%**
NRR after 30 years: **29%**

18.1 Summary

18.1.1 Background

The National Bargaining Council for the Clothing Manufacturing Industry ("the council" in this section) was established in 2004 when several regional councils merged. The retirement funds offered by these councils were not merged.

2004 – regional councils merge into national

The National Bargaining Council for the Clothing Manufacturing Industry Provident Fund for the Western Cape Region ("the fund" in this section) has existed since 1954.

Cape council started in 1954

The fund has 23 000 members, 263 employers and R800 million in assets. The average employer has around 100 staff which is large in the bargaining council context. Salaries average at R2 500 per month.

23 000 members
R800 million assets
R2 500 pm salaries

The council's Western Cape sub-chamber provides retirement, death, disability and housing loan benefits through the fund. A separate health care fund is also in place.

Retirement fund: retirement, death, disability, housing loans

Separate: Healthcare

18.1.2 Value of Benefits

The benefit structure and projected retirement benefits for a member retiring at 65 with 30 years of service are as follows:

After 30 years, NRR = 29%

	Current structure	Effect of proposed changes
Member contributions	6.03%	**7.5%**
Employer contributions	6.25%	**7.5%**
Expenses	(1%)	(1%)
Risk benefits	(2%)	(2%)
Net Contributions towards retirement	9.28%	12%
Investment returns	CPI + 3.5%	CPI + 3.5%
Salary growth	CPI + 1%	CPI + 1%
Service	30	30
Lump sum at retirement	4.1 x annual salary	5.3 x annual salary
NRR at retirement	29%	38%

In addition, death and disability benefits are equal to 1.5 times annual salary plus fund credits.

1.5 x salary on death and disability

Interesting features

- The fund used to provide unsecured housing loans of up to R80 000 per member, which were very popular but frequently defaulted.
- Members frequently retire early at age 55, take their benefit and continue working until 65, claiming a second benefit.

The current benefit structure is not sufficient to produce a satisfactory level of retirement benefit even with 30 years of service. This potential benefit is currently further eroded due to

29% NRR not enough

Concerns

- The data integrity of the administration system is questionable
- Non-Metro category has contributions of only 4% of salaries
- Self insurance arrangements are not actuarially monitored and contributions are lower than benefits
- A portfolio of unsecured housing loans remains and is likely to suffer defaults
- The IPS is out of date and the investment committee has not been actively meeting
- There may be an investment guarantee which has been promised to members but is not accounted for in the investment strategy
- Investment reserves may be insufficient for smoothing
- One of the 6 external managers is very high risk and inappropriate to the fund
- Allowing early retirement at 55 followed by a continuation in employment may be to the detriment of members

a lack of preservation. If the average service at retirement is 13 years as we estimate, a lump sum of 1.4 times salary or an NRR of 10% would be payable.

After 13 years, NRR = 10%

18.1.3 Administration

The fund is internally administered. There are 1250 active members per administration staff member. This results in acceptable cost levels of 1% of salaries.

Internal administration
1250 members per admin staff
Fee = 1% of salaries

Successes

- The fund is seen as a constructive platform for collaboration between unions and employers and has strengthened the relationships between those parties
- An application made to the registrar correctly identified a number of issues particular to council funds and shows pro-active desire to comply with Act.
- 3 month waiting period for withdrawals improves preservation

The administration system appears to have serious issues with data integrity, which need to be addressed.

Serious data issues

Contribution collection is a problem particularly with smaller employers. As much as 20% of contributions remain outstanding in the long term.

20% of contributions never collected

18.1.4 Governance

The fund registered under the Pension Funds Act ("the Act") in 2008 and has applied for a number of exemptions with mixed success.

Registered under Act 2008

The board of trustees consists of 8 members, 4 each from employer and employee organisations. Trustees are appointed for a 3 year term.

4 employer, 4 union trustees

The chairman is elected by the trustees and the position alternates between the employer and union representatives.

Chairman alternates

The trustees meet 6 – 8 times a year. There are two subcommittees, investments and death benefits.

6 – 8 meetings p.a.

Risk benefits are self-insured and this has been flagged as a risk by the actuary due to lack of supervision.

Self insurance not supervised

One company provides all supporting services and this may be a potential conflict of interest.

Only 1 service provider

18.1.5 Views of former members

Fund seen as savings account
Expectation that employer has ensured there will be sufficient benefits

The fund was seen as a savings scheme rather than provision for retirement. The members expected that the employer would ensure that the contribution into the fund is enough to provide for a sufficient pension, which is not the case.

Information insufficient

Information regarding the fund came mainly from union representatives and was considered insufficient.

18.1.6 Conclusion

Fund must address issues

The fund is stable and valued by stakeholders. However, a number of issues need to be addressed to improve benefits and governance before the fund will be ready to be considered for accreditation.

Recommendations

- Increase contributions by 3% or more
- Review the administration system and address data issues
- Review self-insurance and get actuarial advice on reserves, contributions, reinsurance etc.
- Review and update IPS
- Ascertain if 100% guarantee is in place and adjust IPS accordingly
- Replace high-risk asset manager

18.2 History and Background

18.2.1 Background

The National Bargaining Council for the Clothing Manufacturing Industry ("the council" in this section) was established in May 2004 as an amalgamation of all the regional bargaining councils which covered the clothing manufacturers in different regions of South Africa. The agreement has been extended to cover non-parties.

National council created 2004

Regional councils merged

Agreement extended

The main parties to the agreement of the council are the trade union SACTWU (Southern African Clothing and Textiles Worker's Union) and the following employer organisations: Cape Clothing Association, Eastern Province Clothing Manufacturers Association, Natal Clothing Manufacturers Association, Free State and Northern Cape Clothing Manufacturers Association, Transvaal Clothing Manufacturers Association and Northern Decentralised Clothing Manufacturers Association.

Many of the regional clothing bargaining councils had been established in the 1950s, and had offered provident funds to their workers since their inception. These funds were not amalgamated in 2004 when the bargaining councils amalgamated, and still function as regional funds under a national council.

Funds not merged

The provident fund for the Cape clothing industry ("the fund" in this section) was established in 1954 to provide retirement and ancillary benefits for employees in the clothing and associated industries in the Western Cape. The current full registered name of the fund is the National Bargaining Council for the Clothing Manufacturing Industry Provident Fund for the Western Cape Region.

Fund started 1954

The fund is an internally administered provident fund.

Internal administration
Provident fund

18.2.2 Membership

Membership in the fund is restricted to members earning below a certain wage. This basically excludes managerial staff, who have to make their own retirement provisions. However, these are a very small fraction of the industry. The majority of members are women.

Membership only for low wage earners

The clothing industry has experienced a serious decline over recent years, mainly as the result of competition from cheap foreign imports. The fund currently has around 23 000 active members and 78 000 dormant members. The membership has decreased steadily with employment rates in the clothing industry, and is currently at a long term low. At the height of the industry, in the period 1985-90, the membership was in the region of 65 000.

Industry decline

23 000 members
Membership at long term low

At the end of 2008 the fund had 263 participating employers, which implies an average of 91 employees per employer. According to our

263 employers
91 workers per employer – large for council

informants, 15-20 employees is a small business, 50 – 150 employees is a medium business and 250 and over is a large business, with some employers having as many as 800 members. The clothing industry therefore consists of larger businesses than most other councils.

The lowest salary level of members is currently about R580 per week (R2 500 per month) for factory workers and the highest level is R1300 per week (R5 600 per month) for "head cutters". Average salaries estimated from contributions are in the region of R2 500 per month.

Salaries R2500 – 5 600 pm

Average low at R2 500

According to our informants, coverage is high within the industry with few employers being exempted or avoiding registration.

Good coverage

18.2.3 Benefits provided by the council

The Western Cape sub-chamber of the national council provides retirement and health care benefits to its regional members in the clothing industry.

Council provides retirement fund, healthcare fund

Retirement benefits are provided through the provident fund which is the subject of this case study. The fund also provides death and disability benefits. Unsecured housing loans used to be provided from the fund, before it became subject to the Pension Fund Act. Housing loans are now secured with the members' fund credits.

Retirement fund provides retirement, death disability, housing loans.

Housing loans previously unsecured, defaults high

Health care benefits are provided through a separate health care fund.

The same administration platform is used for all the council benefit funds.

18.2.4 Stakeholder views

According to our informants, the provident fund and health care benefits are valued by employees. The council has conducted a survey to assess the level of appreciation attached to these benefits, and the overall evidence is that they are perceived as positive.

Internal survey results positive

The trustees added an interesting perspective in that the benefit funds offer an opportunity for constructive collaboration between union and employer organisations. This is a departure from the usual position of debate and conflicting demands, and has in our informants' views strengthened the relationships in the council.

Funds allow for cooperation between parties

18.2.5 Recent developments

The rumours surrounding retirement fund reform in 2008-2009 were detrimental to the fund, with significant reported resignations to protect benefits from the imagined threat of these being taken away by the government. Our informants suggested that the key to the opposition to the NSSF is the idea that money would move away from the local council, where it is perceived to be accessible to members: "They can come to the fourth floor and ask for it" stated one of our

Resignations after reform proposals

Trust in money staying in local fund

informants. In a national system, it is thought members would feel their benefits are not accessible to them.

18.3 Value of Benefits

18.3.1 Summary

The total contribution to the fund is 12.28% of salaries. We estimate 2% could be needed for death and disability, and 1% for expenses. The remaining 9.28% are utilised for retirement savings. Fund credits are invested at a target rate of return of inflation plus 3.5% per annum.

Total contribution: 12.3%
Risk premium: 2% (est.)
Expenses: 1%
Net contribution: 9.3%

Investments: CPI + 3.5%

If members remain in the fund for 30 years, the fund should yield a lump sum of 4.1 times annual salary on retirement at age 65. This could be converted into a pension of 29% of salary.

After 30 years, NRR = 29%

In addition to this, the fund pays out 1.5 times annual salary, plus fund credits, on death and disability.

Death and disability = 1.5 x salary

Our recommendation is to consider an increase in total contributions of 3% of salaries or more to achieve an NRR closer to 40% at retirement.

Recommend increase contributions by 3%

Below, we examine each element affecting benefit levels and comment on possible deviations from these assumptions, as well as what could be done to improve the final benefit and reduce such deviations.

18.3.2 Contributions

Employers contribute 6.25% of salaries and employees contribute 6.03%, making the total contribution 12.28% of salaries. This applies to the majority of the employees who are in the Metro, Country and Knitting category of members.

Employer: 6.25%
Employee: 6.03%

For a small group of employees, the “Non-Metro” category, employers contribute 4.0% of salary, while the employee contribution is zero. This is a new category of membership which was introduced in 2007 for employers in the non-metro areas, who had previously been exempted from membership of the fund. According to our informants, the aim is to increase the contribution rate over time to a more meaningful level. At this stage a 4% contribution was the maximum considered affordable by the parties. A total contribution rate of 4% of salary is inadequate to provide any meaningful retirement benefit in our view. Our informants suggested that only about 20% of the membership belongs to this category, and we have excluded this category from further analysis. It should however be noted that it is possible, with the decline in profits in the industry, that manufacturers may choose to shift their operations to the rural areas where cost of employment is lower. This would have the effect of increasing membership in the 4% category in the future.

Separate category: 4% total contribution

New category Contributions may grow in time

The rules state that an amount, as determined by the trustees from time to time, must be deducted from the 6.25% employer contribution and allocated to a Risk and Reserve Account to provide for death and disability benefits and fund expenses. The current deduction is 1% of salaries. We were told that this deduction consists of a deduction of 0.5% from each of the employers' contributions and the members' contribution.

Expenses and risk premiums deduction: 1%

A deduction of 1% from the total contribution leaves a net contribution of 11.28% of salaries towards retirement benefits, which compares well to the proposed NSSF contribution levels of 10% -12% for retirement. However, 1% of salaries is insufficient in our view. If the expenses and risk premiums are adjusted to realistic levels, as described in the sections below, the net contribution is closer to 9.28% of salaries.

Deduction insufficient

These contribution levels have, according to our informants, been fairly stable for a number of years. Previously wage negotiations determined the total increase which the unions could then decide how to allocate to take-home pay or benefit contributions, but recently it has been agreed that the negotiated percentage increase in wage would also apply to benefit contributions.

Stable contribution rates

18.3.3 Risk premiums

The fund offers a lump sum on death in service, and on disability, of 1.5 times annual salary plus the member share.

Lumps sum on death and disability: 1.5 x salary + fund credit

This benefit is self-insured. According to the actuary of the fund, the contribution towards risk benefits is 0.5% of salaries, which is deemed inadequate. It seems that the shortfall has in the past been funded from the reserve accounts of the fund. This is not sustainable in the long term. The actuary of the fund has expressed a strong reservation about the current approach and it is likely that this approach will be reviewed as a result.

Self insured

No financial supervision

Deductions insufficient

In 2008, there were 84 deaths with a total of R2.27 million death benefits paid. This gives an average death benefit of about R28 000. This is less than one times the annual salary of the lowest income category and is probably not correct. We have queried this with the fund consultant but did not receive clarification. The actuary of the fund also reported that the amounts paid out appear too low given the expected mortality in the fund.

Death benefit data issues

There were 47 disability claims in 2008 with a total disability benefit payment of R5.77 million. This gives an average disability benefit of about R123 000. This is almost twice the annual salary of the highest income category and is probably not correct. We have queried this with the fund consultant but did not receive clarification.

Disability benefit data issues

The total death and disability claims for 2008 amounted to R8 million, which is equal to 1% of salaries. However, we are not convinced that the underlying information is correct.

We therefore do not have sufficient information to reliably analyse the real cost of death and disability benefits in the fund. However, we estimate a market related cost for such a benefit to be in the region of 2% of salaries.

Market related premium: 2%

We are of the opinion that the allocation to retirement is currently unsustainable, and that the contribution towards risk benefits will have to be increased in the future.

Current allocation unsustainable

18.3.4 Expenses

According to the 2008 valuation report, 0.5% of salaries are deducted from the contributions to cover expenses of the fund.

Expense deduction 0.5%

In the 2007 Annual Financial Statements the administration expenses for 2007 were stated as R11.9 million. This, however, incorrectly included a provision of R3.4 million for bad debt (outstanding employer contributions). The adjusted administration expenses were R8.5 million. The total members' plus employers' contribution of 12.28% of salaries was R100.8 million, which implies that the administration expenses amounted to 1.04% of salaries. A similar calculation based on the adjusted administration expenses of R6.8 million for 2006 results in a figure of 0.86% of salaries for administration expenses.

Actual expenses 1%

It would therefore seem that the administration expense alone, without any provision for the death and disability benefits, amounts to approximately 1% of salaries.

Expense allocation too low

The adjusted administration expenses are equivalent to around R27 per member per month, based on an average active membership of 26 500 for the year 2007.

Admin cost R27 pmpm

In the questionnaire the fund stated their administration cost as R7.7 million per year for 2008, which also equates to a cost of R27 per member per month based on an active membership of 23 600. In our view this is not an unreasonable fee for administration and is competitive compared to rates offered by private administrators.

It is not clear how the 1% deduction towards risk benefits and administration expenses is in fact allocated towards administration and exactly how administration expenses are funded. The provisional 2008 Valuation Report stated that it would seem as if the allocation of contributions to fund credits do not take into account the cost of the risk benefits and the cost of the expenses of running the fund.

Administration issues with deductions

We recommend that the fund conduct a detailed review of costs and processes within the fund in order to align the contribution towards expenses with the actual cost of running he fund, and ensure that expenses are correctly deducted from members.

Recommend review of cost and admin

18.3.5 Investment Returns

The fund has an investment policy statement (IPS) which was drawn up in 2001 by the previous investment consultants. This is currently in the process of review with the current investment consultants. As the current investment structure is not in line with this historical document, we have not commented on the asset structure set out in this outdated IPS.

IPS out of date

Review in progress

The IPS does however state that investment returns are not passed directly to members but rather the fund smoothes investment returns by the maintenance of an investment reserve. The fund has continued to declare smoothed returns, however, the levels of reserves kept in the fund have been small and may have been insufficient during the recent volatility.

Smoothing of returns

Very low investment reserves

The main purpose of the fund is to provide retirement benefits, which means that the investment strategy will generally focus on the long term. For monitoring the investment performance of the various investment managers, the focus is on performance over a rolling three-year period. In our view, this is a suitable approach for a defined contribution provident fund.

3 year measurement period

The long term objective of the fund is to earn annual returns of at least 3.5% above inflation, after provision for investment fees and any retirement fund tax. The IPS assumes an investment fee of 0.7% which is low, particularly for absolute return mandates. This translates to a gross real return of 4.2% per annum.

Target CPI + 3.5%

Assumed fees low

There are conflicting statements regarding the fund's ability to declare negative returns. The fund's actuary has indicated that members have a guarantee of no negative bonuses. The fund's current investment structure does not provide such a guarantee. We recommend that the existence of any guarantee is formally established and if it does exist, that the new IPS sets out how this is to be achieved.

Guarantee unclear

The most recent asset allocation available to us is set out in the valuation report as at 31 Dec 2008. The fund employs six asset managers:

6 asset managers

- three have market related funds with strategic asset allocation in all asset classes.
- two other asset managers provide a bond portfolio and a Guaranteed Fund respectively.
- the sixth asset manager provides a portfolio of high risk unsecured loans and debentures which cannot be considered a suitable type of investment for a defined contribution retirement fund. The current investment consultants have advised the fund to disinvest from this portfolio but that seems to be problematic.

3 market related

1 bond
1 guaranteed fund

1 unsecured loans and debentures
- inappropriate

It is not clear how these managers were selected or blended.

Manager selection unclear

We were provided with the history of investment returns allocated to the members over 12 years. The average return over the 13 year period is approximately 15%p.a. The average CPI inflation rate over the same period was 6% p.a., which means that members enjoyed a real return of 9% per annum, far in excess of the target real return of 3.5%. It does, however, seem that the strategy to smooth returns allocated to the members was not consistently followed after 2004, with large returns granted in 2005 and 2006, followed by zero returns in 2008.

Smoothing not consistent

The current asset / liability position of the fund cannot be determined due to data problems but the actuary has indicated that no positive investment reserve exists.

Surplus unknown – data issues

18.3.6 Length of service

The normal retirement age is defined as 65 in the rules, but the rules allow early retirement between age 55 and 65 at the request of the member. We were told that most members take the early retirement benefit at age 55, equal to their fund credit plus any portion of the relevant reserve accounts. They then frequently remain in employment as contributing members up to age 65, at which time they are then entitled to a withdrawal benefit equal to their fund credit.

NRA 65

Early retirement from 55

Members continue working after early retirement

The fact that members are allowed to take the bulk of their retirement benefit at age 55 while they continue to work to age 65 is peculiar, and in our opinion it reduces the adequacy of the retirement provision. Members receive a retirement benefit at a time when they do not really need it, since they are still in employment and receiving their full salary. There is a considerable risk that they may spend the benefit (unwisely) rather than preserve it to provide for their old age. When they reach actual retirement at age 65 they receive a benefit based on only 10 years of service. It is also questionable whether this practice is acceptable from a legal perspective, and we recommend the fund investigate the legal position of this practice and also whether this is in the best interest of the members.

Recommend legal advice

Apart from the above "early retirement" at age 55, many members withdraw from service during their working lifetime and few reach retirement age with full service.

Members who change employment within the clothing industry are not allowed to withdraw but must remain members of the fund. For this purpose there is a waiting period of 3 months before the withdrawal benefit is paid.

3 month waiting period for withdrawals

According to our survey, 9506 members withdrew in the 2008 financial year while only 556 members retired during the same period, resulting in 17 withdrawals for each retirement. It is unclear if those withdrawals include members who are working after taking early retirement or not.

17 withdrawals for 1 retirement

9506 withdrawals from a population of 23 616 members hints at an average period of service of only 2.5 years. This is very low and may have been influenced by retrenchments during this period.

High turnover

The average retirement benefit was R59 500. Average salaries are estimated in the range of R33 500 per annum. Therefore members are not achieving the multiple of salary implied in the scheme design based on 30 years service. Their benefit is furthermore boosted by very favourable investment returns in the last ten or more years. If these investment returns are adjusted for, the estimated length of service drops to 12-13 years.

Service at retirement 12-13 years

In our view, the most significant destruction of pension provisions out of all the factors in this model is the short service, resulting from the loss of retirement benefits at withdrawal and the practice of allowing early retirement at age 55.

18.3.7 Funding level

The fund has not yet undergone a surplus apportionment process, as this only became required upon registration under the Act. The surplus apportionment date is 2008 and the actuarial valuation at that date is still being prepared.

Surplus apportionment still to be done

The draft valuation report as at 2008 shows that the funding level is close to 100%, so there would be little surplus to be apportioned. However, the actuary has many concerns regarding the quality of the information supplied to him, and has recommended that a data clean up exercise is urgently conducted. This may lead to a change in this position.

Concerns over data quality

The draft valuation does allow for significant reserves including solvency, risk and expense, processing error and data error and others. Together, these reserves amount to nearly 25% of the fund. It is questionable whether such a large reserve would be accepted by the FSB. If not, some surplus may emerge and improve benefits of past members in particular.

Current reserves very high

18.3.8 Salary Increases

Salary growth, according to our informants, is generally negotiated to keep pace with inflation. We expect that inflation plus 1% is the maximum that can be allowed for.

Salary increases = CPI + 1%

18.3.9 Effect of other benefits

Average pensions, using commercial annuity rates, were estimated at R725 per month. Therefore, if a SOAG of R1000 per month becomes payable to these retirees, the NRR achievable after 30 years of service increases from 26% to 62%.

SOAG > pension from fund

This is a significant improvement. The SOAG would deliver more pension to these members than their fund currently can.

18.3.10 Analysis

The retirement benefits we believe are currently achievable in the fund, given actual estimated cost of expenses and risk benefits, can be summarised as follows:

Contributions	12.28%
Expenses	(1%)
Risk benefits	(2%)
Net Contributions towards retirement	9.28%
Investment returns	CPI + 3.5%
Salary increases	CPI + 1%
Service	13 years
Lump sum at retirement	1.4 x annual salary
NRR at retirement	10%

After 10 years, NRR = 10%

The fund is therefore not likely to provide significant replacement ratios for its members if the current practice is borne out in the future.

If a member works for a 30 year period rather than the above 13 years, i.e. if preservation is improved, the above table can be revised as follows:

Contributions	12.28%
Expenses	(1%)
Risk benefits	(2%)
Net Contributions towards retirement	9.28%
Investment returns	CPI + 3.5%
Salary increases	CPI + 1%
Service	30 years
Lump sum at retirement	4.1 x annual salary
NRR at retirement	29%

After 30 years, NRR = 29%

Therefore, improving preservation is not sufficient to achieve long term NRRs of 40% or more.

Benefits insufficient

It is our conclusion that while the expense ratio and risk benefit costs are not unreasonable, the total contribution is simply too low to achieve the targeted NRR. If the SOAG is made available universally, the combined arrangement can deliver sufficient value. However, if the intention is for the fund to deliver a 40% NRR, we recommend that an increase in total contributions should be contemplated. In the case of this fund, a total contribution of 15% of salaries is needed to achieve an NRR close to the desired 40%.

Recommend increase contributions to >15%

The last consideration is risk pooling, which if introduced would increase the cost of death and disability benefits to 4% of salaries, making the required total contribution for this fund around 17% of salaries.

Risk pooling – increase contribution to >17%

18.3.11 Other Benefits

Death

The fund provides a death benefit equal to 1.5 times annual salary, plus the full fund credit.

1.5 x salary plus fund credit on death

Historically, death benefits started off as fixed rand amount, then changed to 1 times annual salary, and later in 1999 changed to the current amount of 1.5 times salary.

Disability

The fund provides a disability benefit of 1.5 times annual salary, plus the full fund credit.

1.5 x salary plus fund credit on disability

One of the reasons for maintaining regional funds, even though the councils have merged into a national fund, is the issue of the cost of death benefits. Our informants were very clear about their reluctance to enter into a national fund where the AIDS risk would be considerably higher, particularly with the inclusion of KZN members. They view the AIDS risk in the Western Cape as significantly lower than that in other regions and do not want their members to subsidise increased costs of other regions. The concept of risk sharing in the NSSF does not appeal to them.

Low cost of death benefits in WC

Funeral

There is no funeral benefit payable from the fund and there is no separate funeral benefit scheme provided by the council. Provision of funeral benefits is regarded as the domain of the trade unions.

No funeral

Withdrawal

The withdrawal benefit is the fund credit.

Member credit on withdrawal

Housing loans

Before the fund became registered under the Pension Fund Act, it provided unsecured housing loans to members regardless of the member's fund credit. These loans were seen as a way to assist members who did not have access to commercial loans from banks. Initially the maximum housing loan was R30 000 but this was later increased to R80 000.

Housing loans unsecured in the past

R80 000 maximum

This practice was stopped since section 19 of the Pension Fund Act does not allow loans which are not backed by fund credits. Existing housing loans continue but must be paid off when a member exits the fund. It appears that this has resulted in a large number of defaults and bad debt in the past. Housing loans are now limited to 80% of the member's fund credit.

Act requires collateral

This was met with a negative response as members effectively felt their housing loan privileges were severely curtailed. According to our informants, there are now cases where a member who has the opportunity to purchase a house at a low cost resigns in order to access their benefit. In the past, that member would have requested a loan instead.

Negative response to change

Increased resignations

18.4 Views of former members

18.4.1 Approach

Four individual 60 minute in-depth interviews were conducted with former members of the fund by African Response, a specialist market research company. The respondents comprised workers who had retired and workers who had left the sector and had hence withdrawn from the fund. The findings discussed in this research are based on their responses and cannot be generalized to reflect the views of other members within the clothing sector, but they can be used as key lessons that can be taken forward as to how to gauge the perceptions of the fund from workers who have either retired or withdrawn from the fund.

Interviews with 4 former members

The full report is included in Appendix to this paper.

18.4.2 Summary of findings

All respondents used their benefit to take out policies as recommended by their union, with little information received about what this lump sum should be used for. They recognised that the funds were not compulsory and seemed to feel that it was important to make provision for a time when one will not receive a regular salary. Most respondents seemed to see the funds as a form of security, something that would benefit them later in life, but there was a concern that their small contributions would not be enough in future years. All the respondents felt that government has a duty to care for retired persons once they reach the age of between 55 and 65. Because people who have been gainfully employed for all of their adult lives have contributed towards the economy, most people felt that these people deserved something back.

Benefit used to take out policies

Concern contributions insufficient

Expectation of government assistance

Perceptions and experiences of the fund showed that respondents became aware of the fund on joining employment. They received information from shop stewards in employee meetings, usually at the start of their employment. Some had also received information from other employees' experiences of their fund, from friends or family who had experience of another fund, or from sons or husbands. Despite receiving some information, at least at the time that they joined the fund, in general the respondents had a cursory understanding of retirement and provident fund. In particular, respondents who leave the sector may adjust their expectations of the fund to understand it as

Shop stewards main source of information

Advice from family and friends

Cursory understanding

Fund seen as savings plan

a kind of a savings plan, rather than a provision for unemployed retirement years.

Mixed experiences were reported in terms of the withdrawal experience, with negative impressions relating to not being able to leave the money in the fund to grow, as well as transparency issues surrounding tax implications and the final payout amount. In terms of the retirement experience, there was a feeling that the lump sum is fair in the light of the payments made, but that an opportunity was missed to increase contributions and therefore final payout, owing to lack of information received.

Negative experience on withdrawal

Unable to leave money to grow

No understanding of tax

Would have wanted to contribute more

18.4.3 Misconceptions regarding the fund

Two major misconceptions are revealed from this study:

- Provident funds are a kind of savings plan, resulting in a payout that can be used to pay debts, improve a home, buy a car;
- The contributions stipulated by an employer would be sufficient to provide for the employees' retirement years.

Misconceptions:

- *Fund is for savings*
- *Expect sufficient benefit*

It seems that these misconceptions could be attributed to a general lack of complete information about provident funding and retirement planning.

Lack of complete information

18.4.4 Communication

The only information provided to the respondents came from shop stewards of the union. While it is possible and likely that these people understand retirement and provident funds, they are not well placed to give union members help in retirement planning. A lack of information was evident, especially about how much they contribute on a monthly basis, how much they have contributed in total and what these contributions will amount to at the end of the contribution term. Information that would be most beneficial to employees in terms of fostering greater understanding of the provident fund would need to include:

Shop stewards only source of info

Lack of info on contributions and expected benefits

- Implications of government pension vs. provident fund
- Implications of provident fund if employee leaves the industry (even if this was never intended at entry level)
- Basic financial management skills for retirees
- Continual (annual) updates on status of provident funds

Information requirements

- *Government pensions vs. Fund*
- *Exit from fund*
- *Financial management*
- *Annual updates*

18.5 Operation of funds

18.5.1 Administration

The fund is administered internally by the Western Cape sub-chamber of the national council. This sub-chamber employs a total of about 140 staff for the administration of council itself, the provident fund and the health care scheme.

Internal administration

140 council admin staff

The administration function is also leased to some other regional funds of the council.

Administration provided to other funds

We were informed that the administration of the council and fund used to be very inter-twined but an attempt has been made to separate these functions. Now there are a number of people who only work on the fund where the fund pays the direct cost. Then there are certain central shared services (e.g. finance, premises, telephones, etc) for which the fund pays the council by agreement.

Separation of fund and council ongoing

Admin fee related to actual cost

According to the Annual Financial Statements, administration expenses incurred by the council which are not directly attributable to a specific entity are allocated to the council, the health care fund and the provident fund at an agreed ratio of 14:43:43.

General expenses apportioned pragmatically

There are 9 staff members who work exclusively on the benefit payments of the fund and there are 10 staff members in the reconciliation department who work partly for the fund. The majority of the staff of 140 is involved in the administration of the health care scheme.

19 fund admin staff

Given 19 dedicated administrators, the ratio of members to administrator is 1250.

1250 members per admin staff

18.5.2 Internal Administration

The internal administrator is registered in terms of Section 13B of the Act.

Internal administrator registered under Act

The fund believes that the cost of its internal administration is lower than what outsourced administration would cost. They have tested the market and found it to be significantly more expensive. The council believes that the direct access that members have to the council and fund administration provides a more effective and personal service.

Internal admin seen as:
- *Cheaper*
- *More personal*

The administrators are familiar with the industry, queries regarding all benefits are handled centrally, there is a central link from the council records to the fund administration records, and contribution collection is performed by the council's agents.

Link with council beneficial

18.5.3 Administration system

The current administration system was developed by an outside company called Cybase in 2002/2003. The system is now being maintained in-house by the council. It is not a pure retirement fund administration system, but is a combined administration system for the council, the health care fund and the provident fund. An important aspect of the administration is the collection of contributions for all three these institutions.

Admin system multi-function

At the time of our investigation, the actuarial valuation for 31 December 2008 was not yet completed largely as result of problems

Valuation data issues

with the reconciliation of membership data and allocation of contributions. These issues included:

- Membership movements not being accounted for correctly;
- The contribution allocation method being incorrect, with many members receiving 0 or negative contributions;
- Financial statements not reflecting membership data;
- Previous valuation results not being reconcilable with the current valuation.

The actuary strongly recommended that the administration process be reviewed and that a data cleaning exercise is undertaken before the valuation can be finalised.

Data cleaning exercise needed

The actuary also commented that the problems were partly due to the fact that the system is not uniquely designed for fund administration, but that the fund administration is an extension of council membership administration. It is difficult to expect the council employees who perform a wider range of services to keep up with pension fund regulations and requirements in particular.

Admin system extension of council system

Council employees lack retirement fund expertise

However, the data errors reported by the actuary are of serious concern. We also requested sample data from the fund and found a large number of errors in the sample. This calls into question the system's ability to pay out correct benefits to members.

Serious data concerns

18.5.4 Contribution collection

Contribution collection is a serious challenge for the fund.

Under the Pension Fund Act, contributions must be paid by the 7th of the following month. In terms of the rules of the fund, employers have to pay over contributions by the 14th of the month and the FSB has granted the fund a temporary exemption until 2011 from the 7 day requirement.

Temporary exemption from 7th day requirement

Somewhat contradictory evidence was provided in the initial questionnaire and the group interview regarding contribution collection. In the questionnaire it was indicated that 95% of contributions were paid in by the end of the following month. In our interview we were told that about 30% do not pay within the 14 day period, and that about 20% is still outstanding after 30 days and remains outstanding, which is a very high percentage. The verbal information is probably a slight overstatement but it highlights the challenge. The problem is mainly with the small to medium employers of less than about 100 employees.

20% of contributions remain uncollected

The enforcement process for outstanding contributions is conducted by the bargaining council, under the terms of the Labour Relations Act. A letter of demand is firstly send, followed by a compliance order if there is no reaction. If this is not complied with, the matter is referred to

LRA used for collections

an arbitrator who hears the evidence and can make an award. This is then submitted to the CCMA, who makes it an order of court. If the employer still does not comply, the matter is handed over to the sheriff who would issue a written execution and may attach whatever assets there are. This process may take 3 to 6 months and is very costly for the council and not very efficient. Our informants added that employers would employ drastic strategies to avoid payment of contributions, such as moving to new premises.

3 – 6 month process
Costly and inefficient

18.5.5 Benefit Payments

The fund pays a benefit when a member retires, withdraws, dies or becomes disabled. The fund does not seem to experience problems with benefit payments and our informants reported a turnaround time of 3 to 4 weeks for payment. In the questionnaire it was stated that retirement benefits are paid on average within one month after retirement, and death benefits within 2 months after the submission of a claim. This is very quick in our experience as death claims require a lengthy investigation. Our respondents however indicated that a full investigation is performed before payment is decided.

Benefit payments quick

Unclear if investigation on death done

In the case of withdrawal benefits, the fund has a waiting period of 3 months in the rules, intended to prevent members from cashing out their benefits when moving between employers within the industry. This strategy is reported to be effective at reducing withdrawals, but still the observed numbers of withdrawals are very high. This may be caused by genuine lay-offs within a shrinking industry.

3 month waiting period for withdrawals

18.5.6 Governance

18.6 Pension Funds Act

Like all bargaining council funds, the fund became registered under the Pension Funds Act in 2008, as a self-administered, type A umbrella fund sponsored by the council. In our view, all bargaining council funds are type A umbrella funds, i.e. multi-employer funds where the participating employers are independent of each other. However, this fund is the only one of our Part 2 case studies where this classification has been acknowledged and addressed by the trustees. The chief differentiation is that an umbrella fund should have at least one independent trustee, and that there is no requirement for member-elected trustees.

Fund recognises it is an umbrella

The fund is internally administered. The administration office also recently registered as a retirement fund administrator under Section 13B of the Act. A number of changes were made to the administration and governance processes as a result of the requirements of the Act.

Internal admin

On registration, the fund made an application to the Registrar of Pensions for a number of exemptions from various provisions of the Act:

Applications for exemption:

- Exemption from the requirement to have an independent trustee (as required for umbrella funds) as the fund has member appointed trustees (which most umbrella funds do not). This was approved.

  - *No independent trustee √*

- Exemption from collection of contributions by the 7th day of the following month. This was granted to the extent that until 2011, the fund may collect by the 14th day of the following month.

  - *Contribution collection by 14th day √*

- Exemption from charging late payment interest on contributions which were in arrear at the date of registration of the fund. This was allowed.

  - *No interest on old outstanding contributions √*

- Exemption from charging penalty interest on late contributions – this was not permitted.

  - *No interest on new outstanding contributions X*

- Permission to continue to impose a waiting period on withdrawal benefits – this was acceptable to the FSB.

  - *Waiting period on withdrawals √*

- Various exemptions with regard to housing loans, intended to make the loans higher, repayable at a lower interest, over a longer period, and applicable to a wider range of structures (Wendy houses etc.) than what is permitted by the Act. The FSB indicated that it would be unlikely to be able to grant such exemptions. This highlights the importance of housing loans to members of this fund and the negative effect of registration under the Act for members.

  - *More generous housing loans X*

- Permission for the council's exemption committee to have certain powers over the fund and the employers in the fund – this was granted with the provision that it be stated in the rules of the fund.

  - *Powers to council exemption committee √*

- Exemption from the provisions of the Act regarding liquidations, as they were contrary to the council agreement. The FSB has refused this application.

  - *Liquidation process X*

We commend the fund for conducting a thorough review of the requirements of the Act and engaging openly with the FSB regarding exemption from various provisions. This demonstrates a sensible approach to new regulations and a willingness to comply with these requirements. It also casts an interesting light on the effect that the registration under the Act had on council funds. We suggest that all council funds are encouraged to examine their provisions and to make an application to the FSB where required.

Open engagement with FSB commendable

18.6.1 Policies

The fund has implemented an Investment Policy Statement in 2001, which is now in the process of being reviewed with the help of their consultants. The current policy is outdated and does not reflect the actual strategy of the fund, according to our informants.

IPS outdated

The fund has also drafted a Risk Management Policy, a Code of Conduct for the trustees, a policy on gifts and policy on conflicts of interest. A communications policy has not yet been put in place.

Communication policy still outstanding

18.6.2 Records of the Fund

It appears that the fund has put in place the correct procedures to keep records of the fund such as minute books, attendance registers and so forth.

Records in order

18.6.3 Board of trustees

The fund is governed by a board of trustees consisting of 8 members, of which 4 are employer representatives and 4 are member representatives appointed by the trade union.

4 employer trustees
4 union trustees

The member trustees are not directly elected by the members of the fund, but are elected to the regional council by the trade union members, from where they are then appointed to the Board of Trustees. The employer trustees are similarly appointed by the employer organisations.

Trustees are appointed for a 3 year term, but these appointments are confirmed annually.

3 year term

The fund has no independent trustee, but has sought permission for this from the FSB and this has been approved.

The chairman is elected by the trustees and rotates on a three year cycle between the employer trustees and the employee trustees. The current chairman is a union representative.

Alternating chairman

The trustees meet once every 6 weeks and have 6 to 8 meetings per year. The trustees are remunerated for each meeting, but at R50 per meeting the fee is extremely low.

6 – 8 meetings p.a.

R50 per meeting

18.6.4 Subcommittees

The board of trustees has two subcommittees, namely an investment committee and a death benefits subcommittee.

Investment subcommittee
Death benefits subcommittee

We were informed that few problems were experienced in the allocation of benefits. The death benefit committee do a full investigation into the financial position of dependants and present their recommendations to the trustees.

It seems that the investment committee has not been very active and at present the whole board is involved in reconsidering the investment strategy.

Investment committee not active

18.6.5 Principal Officer

The principal officer is not a trustee of the fund, which complies with the requirements of PF130. The position is traditionally held by the general secretary of the Western Cape chamber of the council. However, due to staff changes in that position, the current principal officer is the general secretary of the council at the national level.

Council secretary is PO

18.6.6 Training

PF130 introduced requirements to provide trustees with regular training. The training is performed by the fund's consultants and is done as part of the regular trustee meetings.

Training as part of meetings

18.6.7 Communication

The main items of communication to members are the annual benefit statement and council newsletters.

Annual benefit statement
Council newsletter

The benefit statements have always been issued, but as a result of becoming regulated by the Act, some minor changes were introduced to align them with requirements of the Act and PF 130. It was suggested that members really appreciate their statements and that they check them thoroughly.

Statements welcome

The other communication channel utilised by the fund are circulars which are issued by the council dealing with various topics, including fund-related issues. These are issued on an ad-hoc basis.

Ad hoc circulars

18.6.8 Service providers

The fund employs Pan African Benefit Services to provide all the consulting services. Their appointment was preceded by a tender process. In our view, the new consultants are adding value to the process of aligning the fund with the requirements of the Act. However, the fund only has one service provider for all the services which is not ideal from a governance point of view.

Single service provider

The fact that the last three actuarial valuations have been performed by three different firms of actuarial consultants is worth mentioning. The 2006 report was done by Alexander Forbes who had been the consultants for many years. The 2007 report was done by an independent actuary, and in 2008 the fund has appointed Pan African Benefit Services who are the current consultants.

Actuaries change frequently

18.7 Self-insurance

The fund self-insures its death and disability benefits. The most recent actuarial report highlights a number of concerns regarding this approach:

Concerns on self insurance

- The contributions towards these benefits are too low, and they do not reflect the actual experience of the fund.

- Contributions too low

- The shortfall in contributions is funded from reserve accounts, which in the fund actuary's view may be unsustainable and inequitable. As the fund has not yet undergone a surplus apportionment exercise, there is no clarity how these reserves arose and whether it is suitable to distribute them in such a way.

  - Benefits funded from reserves but surplus apportionment not complete

- The benefits reported as being paid appear lower than what would be expected from a fund of this size, and there is a concern that administration errors have led to an underestimation of the quantum of this benefit.

  - Very low benefits paid may be in error

- There is no reinsurance in place to protect the fund from possible financial implications of this self-insurance arrangement, and the board of trustees does not have the expertise to manage such an arrangement.

  - No reinsurance

- No separate reserve has been established for the risk contributions and benefits to be allocated to. This makes it difficult to assess the risk of the self-insured arrangement.

  - No risk reserve

In our view, the fund actuary is correct in his concern and we trust that the trustees will implement the recommendations regarding the death and disability arrangements.

More transparency needed

The basic reason for supporting such a change is that it is preferable that members understand the correct situation regarding costs of benefits and administration, and that all subsidies are clearly shown. The cost structures can then be best managed in the interest of all members for the future. The complexity regarding the surplus exercise may also effectively reduce the ability of the fund to maintain such large reserve accounts and then the benefits may be under pressure to be maintained at the current level.

Surplus apportionment may reduce reserves

19. Case Study
Provident Fund for the Furniture Manufacturing Industry KwaZulu-Natal

Fund at a glance

Members: **3000**
Employers: **262**
Average salaries: **R3000 p.m.**
Assets: **R200 million**
Gross contribution: **14.5%**
Net contribution: **4.9% / 9.4%**
Expenses: **4.7% of salaries or R132 pppm**
Investment expectation: **CPI + 3.5%**
NRR after 30 years: **15% / 29%**

19.1 Summary

19.1.1 Background

The Bargaining Council for Furniture Manufacturing Kwa-Zulu-Natal ("the council" in this section) was established in 1954 and has provided retirement benefits since that time.

Council and fund started 1954

The Provident Fund for the Furniture Manufacturing Industry KwaZulu-Natal ("the fund" in this section) has 3 000 members, 262 employers and R200 million in assets. Employers have 10 workers on average. The industry is shrinking and membership is at an all time low.

3000 members
262 employers
R200 million assets

10 workers per employer

The council provides retirement and housing loan benefits through its provident fund. A separate funeral scheme, a holiday fund and a sickness fund are also in place.

Retirement and housing loans from fund

Separate funeral, holiday and sickness schemes

The fund is seen as valuable mainly by the workers, and is central to the success and continued operation of the council. Members responded very negatively to the retirement reform proposals and even to registration under the Pension Funds Act ("the Act").

Fund central to council
Negative reaction to reform proposals

19.1.2 Value of Benefits

The benefit structure and projected retirement benefits for a member retiring at 65 with 30 years of service are different for party and non-party employers:

After 30 years, NRR 15% - 29%

	Current structure		Effect of proposed changes
	Party	Non-Party	**Merged**
Member contributions	7.25%		7.25%
Employer contributions	7.25%		7.25%
Expenses	(4.7%)		**(3%)**
Funeral benefit	(0.4%)		(0.4%)
Sickness fund	(4.5%)	-	**-**
Net Contributions towards retirement	4.9%	9.4%	**11.1%**
Investment returns	CPI + 3.5%		CPI **+ 4%**
Salary growth	CPI + 1%		CPI + 1%
Service	30		30
Lump sum at retirement	2.2 x salary	4.1 x salary	5.3 x salary
NRR at retirement	15%	29%	38%

Interesting features

- Sickness fund contribution taken out of retirement fund contributions creates 2 member classes
- Investment strategy with balanced fund core and specialist satellites
- 6 month waiting period on withdrawals

The current benefit structure does not deliver adequate benefits even if preservation is achieved. This is mainly due to very high

Benefits not adequate

Very high costs

expense levels and a high contribution towards a separate sickness fund. We make recommendations in this regard, which should bring the benefit structure up to a reasonable level.

Concerns

- Expense levels very high
- Lack of transparency in expenses
- Contribution to sickness fund reduces party employer contributions to very low levels
- Council approach to fund as source of easily increased income
- Ability of administrator to keep up with requirements of the Act
- Limitations of internal administration system
- Lack of death and disability benefits
- Investment structure not cost efficient for small fund
- Potential conflict of interest due to relationship between investment advisor and asset managers

The fund does not provide any death or disability benefits. These may have to be introduced if accreditation is desired, and additional contributions will need to be negotiated for these benefits.

No risk benefits

However, benefits are currently further eroded due to a lack of preservation. If the average service at retirement is 10 years as we estimate, a lump sum of 0.5 / 1.1 times salary or an NRR of 4% / 8% would be payable.

After 10 years service, NRR 4% - 8%

19.1.3 Administration

200 members per admin staff

The fund is internally administered, with around 200 members per administration staff member.

R132 pmpm
Very high cost

The level of cost is very high and there is little transparency about cost. The current level is R132 per member per month or 4.7% of salaries. This is not cost effective and a major cause of reduction of value in the fund.

System lacks flexibility

Council relies on income from fund

The administration system was developed by the council as a general solution for all council needs, and lacks some of the flexibility of commercial retirement systems. However, the attachment to the internal administration is strong and the council relies on the retirement fund for income and in order to justify current staff numbers.

4 agents for collections

The council collects contributions, and 4 agents are employed in this process. Contribution collection is difficult especially amongst smaller employers, and in times of economic downturn. Currently, R2 million is outstanding compared to total annual contributions of R14 million.

19.1.4 Governance

Registration under Act onerous

Separation of council schemes

The fund and the administrator registered under the Act in 2008. This was an onerous process and a number of changes were made to the operation of the fund as a result. This included a separation of the different council schemes from the fund, the establishment of a board of trustees, outsourcing of investments and appointment of compliance officers for the fund and for the administrator.

Successes

- Close relationship between council and fund
- Integration of fund and council services offers single point of contact
- 6 month waiting period on withdrawals improves preservation
- Proactive communication using council circulars

The new board of trustees consists of 10 members, 5 from employer and 5 from employee organisations. The trustees are appointed for a 3 year term and elect the chairman from their number. Trustees are said to be generally likely to follow recommendations from the administrator who has more experience with the fund.

5 employer trustees
5 union trustees

Administrator has much influence

19.1.5 Conclusion

The fund is very expensive to run and cross subsidies between the fund, the council and the other benefit schemes are present. There is a lack of transparency. The fund will need to make significant changes before it can be considered for accreditation in our opinion.

Expensive

Lack of transparency

Significant changes needed

Recommendations

- Conduct expense review, aiming to reduce expenses to minimum
- Change the way expenses are expressed to % of salary
- Negotiate for the sickness benefit to be funded by additional contributions
- Negotiate risk benefits through an additional contribution
- Review investment structures of the fund for efficiency and conflict of interest
- Review governance structures and empower trustees
- Consider outsourcing administration to reduce cost and improve flexibility
- Consider merger with other furniture funds to improve efficiency/reduce cost

19.2 History and Background

19.2.1 Background

The Bargaining Council for Furniture Manufacturing KwaZulu-Natal ("the council" in this section) is one of 5 bargaining councils in South Africa which cover furniture manufacturers in different regions of the country. The council was established in 1954 and has offered a provident fund to its workers since about the same time. The fund has been operating as the Provident Fund for the Furniture Manufacturing Industry KwaZulu-Natal since 1978.

5 furniture councils

Council and fund started 1954

Current fund 1978

The main parties to the agreement are the trade union NUFAWASA (National Union of Furniture and Allied Workers of South Africa) and the employer organisations KwaZulu-Natal Furniture Manufacturers' Association and the Furniture & Wood Products Manufacturers' Association. The council operates in the region of KwaZulu-Natal and its agreement has been extended to cover all furniture manufacturers in the region.

Regional council
Extended agreement

The fund is an internally administered provident fund.

Internal administration

19.2.2 Membership

According to our informants, the council is a "blue collar fund specifically designed to cater for lower income workers" with salaries of around R800 per week on average. The fund is an internally administered provident fund and offers no death or disability benefits other than the payment of the member share.

Blue collar fund

Salaries R 3000 per month

The fund has around 3 000 members. This number fluctuates with employment rates in the furniture industry, but is currently at a long term low. In the past, membership numbers used to be in the region of 7 000 – 8 000 members.

3000 members

Long term low

There are 262 employers registered with the council, making the average business be around 10 workers.

262 employers
10 workers per employer

Our informants were of the view that some small employers in the industry were avoiding registration under the council, but could not estimate how many.

Employers avoid registration

19.2.3 Benefits provided by the council

The fund was originally created to answer requests from the labour side to provide for workers' retirement benefits. Other benefit schemes were also created to cater for other needs. These include a death benefit scheme that provides a funeral-type benefit, a holiday fund and a sickness fund. The retirement, sickness and funeral funds were originally run as one entity, but after the registration of the provident fund under the Pension Funds Act in 2008, the various schemes were notionally

Other schemes: funeral, holiday, sickness

Schemes recently separated

separated. The funds are still administered together and financial cross-subsidies appear to exist.

Financial cross-subisides

The fund provides different benefits to workers employed in businesses that were party to the council agreement ("party employers") and those working for employers that did not participate in the negotiation of the original agreement but fall under it now that the agreement has been extended to non-parties ("non-party employers"). The difference is that for party employers, part of the retirement fund contribution is channelled to the separate sickness fund. Our informants suggest that the number of members in the two groups is about the same.

Party employers: contribution split between retirement and sickness

Non-Party employers: full contribution to retirement

50:50 party:non-party split

19.2.4 Stakeholder views

According to our informants, the provident fund is central to the council, and without the fund, the council would struggle to continue its existence. It seems that the main reason for the council's dependence on the fund is that most of the council employees are involved in administration of the fund, and the fees earned by the council as the administrator subsidise its operations.

Council would struggle to continue without fund

Admin fees support council

The fund is seen as a value add by workers and member organisations due to its compulsory nature. It is thought that employers would not widely participate in the fund if it were not compulsory. One of our informants stated that "the fund purely exists because there is a collective agreement in place" and that the fund would disappear if the agreement were not there.

Compulsory membership essential

Our informants were of the opinion that the separate sickness benefit was more highly valued than the retirement benefit by members, but both were respected.

Sickness benefit highly valued

19.2.5 Recent developments

The fund became registered under the Pension Funds Act in 2008. Since the fund is internally administered, the administration office also registered as a retirement fund administrator under Section 13B of the Act. A number of changes were made to the administration and governance processes as a result of the requirements of the Act.

Fund registered under Act

Administrator registered under Act

The furniture manufacturing industry in KZN is declining and according to our informants this is brought on by the proliferation of cheap foreign imports. This has resulted in a decrease in membership numbers. The council also seems quite sensitive to economic swings, with our informants reporting large scale lay-offs in 1998 and again during the recent financial crisis.

Declining membership

The rumours surrounding retirement fund reform in 2008-2009 were also detrimental to the fund, with significant reported resignations and in some cases mass resignations to protect benefits from the imagined threat of these being taken away by the government. Even registration

Retirement reform – negative reaction

Registration under Act – negative reaction under the Pension Funds Act was fraught with queries as members feared that such registration might rob them of their benefits.

19.3 Value of Benefits

19.3.1 Summary

The total contribution to the fund is 14.5% of salaries. For party employers, 4.5% is transferred to the sickness fund, leaving a contribution to the retirement fund of 10%. The separate funeral scheme costs around 0.4% of salaries. Expenses are high at 4.7% of salaries. That leaves 4.9% of salaries for party and 9.4% for non-party employers as a net contribution to retirement. Fund credits are invested at an expected rate of return of inflation plus 3.5% per annum.

Total contribution: 14.5%
Party: 4.5% to sickness
All: 0.4% to funeral
All: 4.7% to expenses
Net retirement contribution:
4.9% party
9.4% non-party

If members remain in the fund for 30 years, the fund should yield a lump sum of 2.2 times annual salary for party and 4.1 for non-party members. This can be converted to achieve an NRR of 15% or 29% respectively.

After 30 years, NRR = 15% party, 29% non-party

The fund has no death or disability benefits.

No death or disability

Our recommendations are:

Recommendations:

1. Conduct a review of expenses with a view to reducing to at most 3% of salaries.
2. Review expense allocation to be more transparent and expressed as a percentage of salaries.
3. Negotiate to move the sickness fund contribution outside of the fund and have it funded as an additional contribution.
4. Negotiate for death and disability benefits to be introduced with additional contributions payable for those benefits.
5. Review the investment structures to improve cost efficiency and remove possible conflicts of interest.

- *Review and reduce expenses to <3%*
- *Transparent expenses*
- *Sickness fund contribution in addition to retirement*
- *Introduce death and disability*
- *Improve investments*

We are concerned that this fund is unlikely to meet the requirements for accreditation under the new framework unless significant changes are made to the benefit structure. The fund has however reached a lot of members who are now within the retirement system due to its existence. We recommend that the council and fund attempt to address the issues listed above to ensure the continued viability of the fund.

Serious changes needed

Below, we examine each element affecting benefit levels and comment on possible deviations from these assumptions, as well as what could be done to improve the final benefit and reduce such deviations.

19.3.2 Contributions

The contributions to the funds are different for party and non-party employers and our summary is as follows:

	Party	Non-Party
Employer Contribution	7.25%	7.25%
Member contribution	7.25%	7.25%
Total contribution	**14.50%**	**14.50%**
Sickness fund	(4.50%)	-
Funeral Benefit	(0.40%)	(0.40%)
Administration and other Expenses	(4.70%)	(4.70%)
Net total contribution towards retirement	**4.90%**	**9.40%**

Employers and workers contribute 7.25% of salaries each, making the total contribution 14.5% of salaries.

Employer contribution: 7.25%
Employee contribution: 7.25%

For party employers, 2.25% of both member and employer contributions, i.e. 4.5% altogether, is deducted as a contribution towards the separate sickness scheme. The net contribution towards the retirement fund for party employers is therefore 10% of salaries before expenses.

Party: 4.5% to sickness

The sickness scheme is operated by the furniture industry union NUFWASA. Non-party employers are not permitted to make use of this union-operated scheme. The total contribution towards retirement for non-party employers is therefore 14.5% of salaries before expenses.

Sickness scheme union operated

The contribution towards administration and other expenses is not explicitly defined in the fund documentation. In section 4.1.3 below, we estimate it to be 4.7% of salaries. We also have attempted to estimate the actual cost of funeral benefits, at 0.4%, and have adjusted the expense allowance to account for this.

Admin contribution not defined

Estimated 4.7%
Estimated funeral: 0.4%

If this very high figure for expenses is correct, the net contribution towards retirement is then 4.9% for members working for party employers and 9.4% for members who are employed by non-party employers.

Net contribution:
Party: 4.9%
Non-Party: 9.4%

The gross contribution levels have, according to our informants, not changed since the establishment of the fund in 1978.

Stable contributions

Compared to proposed NSSF contribution levels of 10-12% towards retirement, these contribution rates, particularly for party employers, are too low. The main issue is the level of expenses.

Too low vs. NSSF

19.3.3 Risk premiums

There are no death or disability benefits in this fund.

No death / disability

For party employers, a contribution of 4.5% of salaries is made to a separate sickness scheme from the retirement fund contributions.

4.5% sickness

For all employers, R0.60 per week is subtracted from retirement contributions to finance a separate self insured funeral scheme (called the "death benefit scheme"). This funeral scheme provides a lump sum benefit based on length of service on the death of the member. The cost of this funeral scheme is higher than the R0.60 per week contribution and it appears to be subsidised from the administration fees paid to the council.

Funeral scheme subsidised by council

In our experience, a more accurate cost for such a funeral benefit would be in the range of R3 per week. If we assume average salaries of R800 per week, this means that the actual cost of the funeral benefit is not 0.1% of salaries (60c per week) but rather 0.4% of salaries (R3 per week). This would mean that the administration and other expenses can actually be seen as not 5% of salaries, but 4.7% of salaries (0.3% of salaries being used to subsidise the funeral benefit).

Estimated funeral cost including subsidy: 0.4%

The fund currently does not offer death and disability benefits. These may have to be introduced to keep retirement benefits on par with what is offered by the NSSF. The proposed contribution to risk benefits in the NSSF is 4% of salaries. The current net contribution towards retirement benefits in the fund is not sufficient to allow for a further deduction of this nature, and an increase in contribution rates would be required.

Risk pooling – reduce retirement contributions by 4%

19.3.4 Expenses

The expenses of the fund are difficult to analyse due to a lack of clarity in approach and fund documentation.

Lack of clarity

Documentation

The Investment Policy Statement (IPS) states that expenses are equal to 1.65% of salaries. This does not reconcile with actual deductions and seems incorrect.

Documentation inconsistent

The administration agreement states that administration expenses are

Concerns

- Expenses are inconsistently documented.
- The expense includes:
  - An administration fee of 1.2% of assets (=2.4% of salaries)
  - A commission payable to the council, calculated as a % of each transaction made.
  - Some of the actual costs of running the council (repairs and maintenance)
  - Expenses payable to external parties (consultants etc)
- The total is 4.7% of salaries which is very high.
- This is not transparent to members.
- The council uses its expense income to subsidise a separate funeral scheme but this is not transparent.
- Expenses are deducted from investment returns making reconciliation difficult.

equal to 1.2% of assets. This reconciles with the administration expense item in the fund accounts, which is around 1.26% of the assets at the end of the year. However, the accounts list additional expenses that increase the total cost to 2.4% of the assets. This amounts to R5 million, which is equivalent to 5% of annual salaries, or R140 per member per month. We have taken the expenses as 4.7% of salaries or R132 per month in cognisance of the subsidies made to funeral benefits.

Agreement: 1.2% of assets for admin

Additional costs: 1.2% of assets Total: 2.4% of assets = 5% of salaries

Less 0.3% subsidy for funeral = 4.7%

Actual Expenses

4.7% of salaries is a very high expense ratio which is difficult to justify. We examined the accounts and arrive at the following approximate split:

Recipient	Fee	R'000	Total
Council	Administration fees*	2,654	R 3,921,000 = 3.9% of salaries
	Commission	641	
	Repairs and maintenance	318	
	Other	308	
External Parties	Actuarial and Consultancy	278	R1,072,000 = 1.1% of salaries
	Legal	247	
	Audit fees	164	
	VAT	371	
	Other	12	
		4,993	

*We assumed the funeral subsidy is funded from here.

Administration fees: To express administration fees as a percentage of assets is an unusual approach. According to our informants, this was necessitated by registering under the Pension Funds Act. This resulted in an agreement between the administrator and the fund, which specifies the annual fee as 1.2% of assets. According to our informants, this was determined as a market related fee, and was therefore driven by the cost of external administration rather than internal costs. In our view, 1.2% of assets is higher than what we would expect from an external administrator. In our experience, external administration companies generally charge fees based on Rand per member per month, or percentage of salaries.

Admin fee as % of assets – unusual

Agreement new under Act

1.2% taken as market related

Too high

Commission: We have been informed that this is an additional fee payable by the fund to the council in respect of asset management. This fee is determined based on a percentage of each transaction, i.e. trade, made by the council on behalf of the fund. Most of the assets are with external managers and do not qualify for this, but some investments are held internally and those incur this fee. We do not view this fee as an asset administration fee, as according to our informants it is not based on actual costs of trading but is seen as an additional source of income for the council. If some or all of this fee is to be seen as an investment fee, the total expense figure could decrease by 0.6%,

Additional council fee

Based on investment transactions

but there would be a commensurate adjustment to expected investment returns.

Repairs and maintenance: This is clearly a council expense that is being paid by the fund. We would generally expect this to be included in the administration fee.

Further council expense

Additional items that may be questionable are the VAT and the legal fees, which are surprisingly high.

High VAT and Legal

In previous years, the total fee was slightly lower. Rather than charging a flat percentage of the assets, the administration fee was replaced by a cost of salaries of R1.3 million (about 50% of the admin fee in 2009). The total fees in 2008 were R3.5 million or 3% of salaries, still very high but lower than current.

Lower fees in prior years

Funeral benefits

The council operates a self-insured funeral scheme which appears to be subsidised from the administration expenses charged to the fund. We estimate the cost of this subsidy to be in the region of 0.3% of salaries. Therefore, the administration fee may effectively be 4.7% of salaries, but there is an additional contribution to funeral benefits of 0.3% of salaries.

Funeral cost subsidised from expenses

Payment of expenses

The expenses of the fund are taken out of the entire fund as and when they occur. This basically means that they are taken out of returns, as the final return allocated to members is net of those expenses. This is not a transparent way to charge fees and the true quantum of expense is therefore not clear to members and the trustees. We recommend that this is revised to a percentage of salary contribution.

Expenses taken from fund not from contributions

Not transparent

Cost Efficiency

The expenses that we have analysed may have been excessive because of the higher cost experienced to implement new structures to manage the fund for the future in line with requirements of the Act. Should the costs be managed better in the future the value for money for members may be better than illustrated below.

High cost of registration under Act

At the current level of 4.7% of salaries or R132 per member per month, we have serious concerns about the cost efficiency of the fund. Our discussions with fund officials also suggested that administration fees are regarded as an "easier" source of income than the levies payable by employers, which need to be negotiated with the employers.

Not cost efficient

Council sees fees as easy income

However, keeping the administration internal, if a more reasonable expense ratio can be achieved, may have advantages:

- The council acts as the administrator and takes advantage of the relationships it has with employers to improve on contribution collection in particular. If an external administrator

Relationship of council with employers is appointed, there may be opportunity for lower cost but this may be at the expense of efficiency.

- The council employs 4 collection agents specifically to improve on contribution collection success. An external administrator would not have such agents and may have to hire them from the council at an additional cost.

Collection agents provided

- In the view of our informant, the council would not survive without the administration fee. An increase in levies is not likely to be accepted by the parties. Since the success of the fund is closely related to the existence of the council such a cross-subsidy therefore supports the existence of the fund.

Council relies on fund and may discontinue

We are certain that a better expense ratio can be achieved and it would be in the best interests of the members that this is attempted.

Attempt lowering cost

Conclusions

We gained the impression that the fund expenses are a major source of income for the council acting as the administrator. There is no separation of duties as far as council staff go, with all 16 employees of the council being somewhat involved in administering the fund.

Admin fees source of income for council

If the fund and council can conduct a review of expenses, we expect that cost savings should be achievable. Assuming costs can be reduced to 3% of salaries, this is equivalent to an improvement in NRR to 35% (non-party) or 21% (party).

Cost savings achievable

The NSSF proposals have mentioned an amount for expenses equal to around 1% of salaries. If this was achieved in this fund, the NRR could increase to 41% for party and 27% for non-party members.

19.3.5 Investment Returns

The fund targets a return of inflation plus 4% measured over rolling 3 year periods. We have adjusted this to inflation plus 3.5% for our calculations.

Stated target CPI + 4% over 3 years
Adjusted to CPI + 3.5%

The total asset size is in the region of R200 million.

Assets R200 million

The investment returns are allocated to members via a monthly index; there appears to be no smoothing.

Monthly index, no smoothing

The investment policy statement (IPS) reflects two objectives: The primary objective of real return of CPI plus 4% over rolling 3 years, with a secondary objective of outperforming an index based benchmark. In our view, this addresses both the member's expectations while giving the managers a meaningful benchmark. This is a suitable approach for a retirement fund.

Secondary objective of outperforming benchmark

Suitable approach

The strategic asset allocation is

30% local equities
30% local bonds
25% local cash
15% international assets

Low equity target

The total equity exposure is not specified, as the international assets are not broken down by asset class. We expect that the target for the total equity allocation is in the region of 40% which in our view would make the real return objective of 4% achievable most of the time, but not all the time.

4% real not achievable

According to the IPS, the fund is adopting a specialist approach. This is a complex structure and relatively expensive for a fund with R 200 million in assets – quite small relative to other funds in the industry. The IPS states that the fund should use segregated building blocks. Most managers of this type of portfolio, however, have a minimum of R200 million for each segregated building block.

Specialist approach too complex and expensive

The underlying investments consist of a blend of a balanced fund with a number of specialist funds. All underlying investments are pooled, it appears, in unit trusts, but they may be pooled asset class specific funds. Unit trusts are generally more expensive than other options available to institutional investors.

Unit trusts expensive

The approach of blending a balanced fund with specialist structures is unusual – the normal specialist approach usually involves an index tracking fund at the core with specialist funds added to enhance returns. It should also be noted that there is significant exposure to funds which are related to the investment consultant. This may indicate a conflict of interest and inappropriate investments being chosen based on service provider bias.

Balanced core unorthodox

Conflict of interest

This investment structure is very new and is related to the fund falling under the Act. The previous approach was to manage the investments in-house, and the administrator was chiefly responsible for the investment decisions. The investments were predominantly government bonds, which had been purchased at an opportune time and held for more than 20 years until they matured. This achieved a very good return for the fund in the past, but would not be reproducible today given current bond returns.

New structure

Previous investment bonds

It is also interesting to note that because the fund has a 6 month waiting period on withdrawals, it is possible to plan in advance for disinvestments.

Waiting period allows planning of cash flows

Given the strategic allocation, we would say that a reasonable long term target would be closer to CPI plus 3.5%.

CPI + 3.5% achievable

This could be improved by employing more appropriate and cost effective investment vehicles.

19.3.6 Length of service

A 6 month waiting period applies before any withdrawal benefits become payable. Despite this, our informants felt that members frequently withdraw savings from the fund, and in many cases in fact resign and take a 6 month break in employment, financed by UIF benefits, specifically to access these savings.

6 month waiting period for withdrawals

12% withdrew last year

According to our survey, 354 out of the 2855 members (12%) withdrew in the last financial year. From this, we have assumed that the average duration of members in the fund is 10 years. Only 33 members retired during the same period, resulting in 11 withdrawals for each retirement.

Assumed service 10 years

1% retired

The 33 members who retired from the fund during the last year received an average benefit of R130 000 each. This is approximately 4 times annual salary. Unfortunately, it is unclear if these retirements were party or non-party members. It can however be said that it appears that benefits achieved are on par or better than suggested by our model. This may have been caused by better than expected investment returns.

4 times salary on retirement

Early retirement is permitted from age 55 but we have no information as to whether this is frequently taken up.

Early retirement from 55

In our initial calculation, we dealt with a member with 30 years of service at retirement. However, the pattern of withdrawals which reset the savings to zero means that the actual period of saving for retirement may be closer to 10 years. This reduces the expected NRR to 4% - 8%.

After 10 years, NRR 4% - 8%

19.3.7 Funding position

The fund has not been required to conduct actuarial valuations in the past, and therefore we cannot report on the actuarial funding position. The fund has engaged an actuary to complete a valuation of the fund and assist with the surplus apportionment exercise.

Fund not valued

From information provided to us in our questionnaire, it appears that there may be a surplus in the region of R40 million or 20% of the liabilities. The surplus apportionment exercise needs to be conducted to evaluate if any of that surplus may lead to better benefits for members.

Surplus apportionment outstanding

19.3.8 Salary Increases

Salary growth in the council, according to our informants, is generally negotiated to keep pace with inflation. However, these are increases within the same grade of employment. Overall, it is reasonable that as senior staff leave and junior workers join the council, the average growth in salaries should even out to inflation, but individual workers may receive experience-related increases to their pay. We feel that these are likely to be low, since there is not a lot of scope for promotion amongst the ranks of manual labourers in the furniture manufacturing business. We expect that inflation plus 1% is the maximum reasonable assumption.

Salary increase = CPI +1%

19.3.9 Effect of other benefits

Average pensions, using commercial annuity rates, were estimated at R450 (party) and R850 (non-party) per month. Therefore, if a SOAG of R1000 per month becomes payable to these retirees, the NRR after 30 years of service increases from 15% to 50% (party) or 29% to 64% (non-party).

SOAG increases pensions 2-3 times

Therefore, the SOAG is higher than the likely benefit payable from the fund and would constitute the bulk of each member's income.

19.3.10 Analysis

The retirement benefits currently achievable in the fund can be summarised as follows:

	Party	Non-Party
Contributions	10%	14.5%
Expenses	(4.7%)	(4.7%)
Risk benefits	0.4%	0.4%
Net Contributions towards retirement	4.9%	9.4%
Investment returns	CPI + 3.5%	
Salary increases	CPI + 1%	
Service	10 years	
Lump sum at retirement	0.5 x annual salary	1.1 x annual salary
NRR at retirement	4%	8%

The fund is therefore not likely to provide significant replacement ratios for its members if the current practice is borne out in the future.

Benefits insufficient

If a member works for a 30 year period rather than the above 10 years, i.e. if preservation is improved, the above table can be revised as follows:

	Party	Non-Party
Contributions	10%	14.5%
Expenses	(4.7%)	(4.7%)
Risk benefits	0.4%	0.4%
Net Contributions towards retirement	4.9%	9.4%
Investment returns	CPI + 3.5%	
Salary increases	CPI + 1%	
Service	30 years	
Lump sum at retirement	2.2 x annual salary	4.1 x annual salary
NRR at retirement	15%	29%

Therefore, improving preservation is not sufficient to achieve NRRs of 40% or more.

If service 30 years, benefits still insufficient

We have examined various aspects of the fund and recommend that the following improvements are attempted in the short term:

Recommend

1. Review the cost structure and work to reduce costs to 3% of salaries or R84 per month per member

- Reduce contributions

2. Review the investment structures and simplify to reduce fees and increase the achievable investment return to CPI + 4%.

- Streamline investments

3. Negotiate within the council to make contributions to the sickness scheme payable separately and not out of the retirement contributions. This will bring party employers in line with non-party employers.

- Negotiate for the sickness scheme to be funded separately

If these improvements are achieved, we would see the following result:

Contributions	14.5%
Expenses	(3%)
Risk benefits	0.4%
Net Contributions towards retirement	11.1%
Investment returns	CPI + 4%
Salary increases	CPI + 1%
Service	30 years
Lump sum at retirement	5.3 x annual salary
NRR at retirement	38%

The NRR achievable under those circumstances is close to the 40% targeted by the NSSF. Further reductions in cost should be strived for in the long term.

After improvements, benefits sufficient

However, the fund, after implementing the above improvements, still does not offer a death or disability benefit. If the NSSF proposal for risk equalisation is implemented, we may expect that all funds would need to contribute 4% of their members' salaries towards such shared risk benefits. This will result in a dramatic reduction in benefits for this fund:

Contributions	14.5%
Expenses	(3%)
Risk benefits	(4%)
Net Contributions towards retirement	7.5%
Investment returns	CPI + 4%
Salary increases	CPI + 1%
Service	30 years
Lump sum at retirement	3.6 x annual salary
NRR at retirement	25%

Therefore, if a death benefit is introduced, our advice is to negotiate this additional contribution with employers in order to prevent benefits from eroding to below target levels.

If risk pooling, need higher contributions

19.3.11 Other Benefits

Death

There is no death benefit payable from the fund, other than the member share.

No death benefit

Disability

There is no disability benefit payable from the fund, other than the member share.

No disability benefit

Funeral

There is no funeral benefit payable from the fund. However, a separate funeral benefit scheme is in place. The benefits offered range from R1 200 to R12 000 based on service in the fund. The cost is funded partly from retirement fund contributions (R0.60 per member per week) and partly subsidised from the expense allocation within the retirement fund. The benefit is self-insured.

Sliding scale funeral

Cost subsidised

Withdrawal

The withdrawal benefit is the member share.

Fund credit on withdrawal

Housing Loans

The fund offers housing loans and these are valued by the members. The loans are offered through a bank and limited to 90% of the member credit. Currently, about R0.5 million or 0.25% of member credits are utilised as loans.

Housing loans of 90% fund credit

19.4 Operation of funds

19.4.1 Administration

The fund is administered internally by the council. The council employs 16 staff all of whom are involved with the administration of council benefits: this includes the retirement fund, the sickness fund, the funeral scheme and the holiday fund. Before 2008, when the retirement fund was not subject to the Pension Funds Act, this internal administration appears to have had few controls. Contributions were collected from employers and managed together; benefits were paid and there appears to have been little ring fencing of the various assets or benefits.

All 16 council staff work on fund

Limited controls before Act

After 2008, the council has made an effort to separate the retirement fund from the other benefit funds. This division is somewhat superficial: contributions are still collected together and paid into the retirement fund before some are transferred to the sickness and funeral scheme; the funeral scheme is subsidised from the fees paid for retirement fund administration.

Division between council and fund superficial

Given that there are 16 employees all of whom assist in the administration, and around 3 000 members, the number of members per administrator is just under 200.

200 members per administrator

19.4.2 Internal Administration

The fund is internally administered for historical reasons. It seems that the council relies on this service as a basis for its existence and if administration were to be outsourced, the council would struggle to remain viable. Using internal administration has some advantages for the fund. The administrators are familiar with the industry, queries regarding all benefits are handled centrally, there is a central link from the council records to the fund administration records, and contribution collection is performed by the council's agents.

Council relies on fund

Relationship between council and fund has advantages

However, our informant remarked that because of the wide range of services performed by the council employees, they are "a jack of all trades and literally a master of none". He referred to the need to keep up with pension fund regulations in particular.

Too small to specialise in retirement fund admin

The internal administrator is registered in terms of Section 13B of the Act, but this was a challenge to accomplish and has required that a number of changes were made to the way the administration was performed. Our informant was of the view that becoming registered has significantly increased the cost of administration to the fund. The prospect that the registration may have to be renewed every year in the future was causing some consternation in terms of effort and cost.

Registration was a challenge and increased cost

Our informant was of the opinion that switching to external administration would be prohibitive for a number of reasons:

Reluctance to outsource admin:

- Increased cost – this is doubtful
- Contribution collection function would still be retained by the council and be an extra cost
- The council would struggle to survive without the administration fee income

- *Additional cost of collection*
- *Council may be affected by loss of income*

Other council funds in the furniture industry had apparently switched administrators, and had in our informants' view experienced all of the above problems.

19.4.3 Administration system

The system was developed internally and is a part of the council's own system which keeps track of all employers and employees on the council. It seems that the system has been developed over many years to meet the needs of the fund and the council. These did not include sophisticated outputs such as valuation data provision. We gained the impression that the system has been stretched to be able to manage the retirement fund, but has not been developed as a retirement fund administration tool. Some of our requests for data have not been met by the system since it has not been geared to provide such information.

System lacks flexibility

19.4.4 Contribution collection

Contribution collection is a serious challenge for the fund. As it is mandatory for all employers under the council to participate, there is a high incidence of non-compliance.

High level of non-contribution

The council has a sub-committee dealing with contribution collection. It is felt that the means available to council officials under the current legislation are not harsh enough. The Labour Relations Act provides for measures that can be taken to enforce compliance, but there is ultimately not much that can be done to force employers to pay. Our informant suggested that until the non-payment of contributions becomes a criminal offense, there is not enough that can be done to force employers to pay.

Legal measures insufficient

The council employs 4 agents who enforce contribution collection. These agents work for the council, not for the fund, since the contributions are entrenched in the bargaining council agreement and not in the rules of the fund.

Our informant indicated that the large employers were generally more likely to comply with contribution payments, but some smaller employer simply "ignored" the council.

Small employers more likely to lapse

There are currently R2 million of contributions that are outstanding. This compares to R14 million in annual contributions. However, some of these are long overdue.

19.4.5 Benefit Payments

The fund pays out the member share when a member retires, withdraws, dies or becomes disabled. Benefit payments do not appear to be a major challenge. In our experience, the disposition of death benefits can be a complex matter, but our informants stated that this was relatively straightforward in the fund and that death benefits were not very common in any case.

The challenges we expect with death benefits relate to finding the dependants and ensuring that all possible dependants were considered. Our informant stated that "beneficiaries are usually quite good and turn up with the death certificate". This raises some concerns as to whether all dependants are considered in each case or if the trustees simply pay out those dependants who "turn up".

Proper investigation on death may not be done

In the case of withdrawal benefits, the fund has a rule that withdrawal benefits are only paid after a 6 month waiting period. This is intended to prevent members from cashing out their benefits in-between employers, but according to our informant members will resign and wait for 6 months in order to access these benefits.

6 month waiting period on withdrawal

19.5 Governance

19.5.1 Pension Funds Act

When council funds were brought in under the Pension Funds Act, this entailed significant new requirements for both the fund and the council as the administrator.

The fund changed a number of aspects of its operation: a board of trustees was appointed where previously the fund was operated by the management committee of the council; the fund was separated from the other benefit scheme at least at a superficial level; the investments have been outsourced to external asset managers and an internal compliance officer (who is also the principal officer and the chairman of the council) was appointed; the rules were registered under the Act.

New under Act
- *Board of trustees*
- *Separation of funds*
- *External asset manager*
- *Compliance officer*

The council had to register as an administrator under section 13B of the Act. According to our informants, this was onerous and involved significant cost. For example, an external professional compliance officer was appointed to the administrator.

Registration under 13B was onerous and costly

One of the chief challenges for the fund was to meet the requirement of the Act that contributions must be collected within 7 days of the end of the month for which they are due. The collective agreement originally targeted the 20th day, so there was an immediate discrepancy. The fund was able to obtain an extension from 7 days to 10 days from the Registrar. This is still insufficient to collect all contributions but it does show that there is some flexibility in the 7 day rule.

Extension from registrar on collections

The registration under the Act also had to be carefully communicated to members. A Q&A circular was issued at the time to address queries such as "Will the fund become a pension fund?" and "Will the government now take our money?".

Negative reaction to registration under Act

19.5.2 Policies

The fund has implemented an Investment Policy Statement (IPS).

The IPS seems to be a generic one rather than fund specific. For example, it details both the balanced and specialist approaches without indicating which is adopted by the fund. It also states that the fund will base its SRI policy on sound investment principles but does not state what the policy is or give the principles. We would recommend that the policy be reviewed to deal with the actual investment structures which the trustees have decided to adopt.

Generic IPS

The fund has also put in place a Risk Management Policy with the help of its actuaries.

Various other policies, such as communications, code of conduct for the trustees, policy on gifts and policy on conflicts of interest, have not yet been put in place, but our informants stated that this was on the agenda and that pro-forma policies were freely available which would make this an easy task.

Some policies outstanding

Our impression was that the fund was planning to align with the requirements of governance as per Pension Funds Circular 130 on good governance principles, but that the measures proposed were not considered as a tool which would change the way the fund operates. It seems from our informants that the current operation of the fund has its own checks and balances which will be retained, but that requirements imposed by legislation are not being embraced as governance tools, rather more as a tick-list of compliance.

19.5.3 Records of the Fund

It appears that the fund has put in place the correct procedures to keep records of the fund such as minute books, attendance registers and so forth.

Records in order

19.5.4 Board of trustees

The board of trustees was created a year ago and consists of 10 members, 5 appointed by the employer organisations and 5 appointed by the employee organisations. All trustees are members of the fund, although this is not compulsory. However, it appears that trustees have to be employed in the industry.

5 employer trustees
5 union trustees

The trustees from employee organisations are appointed by unions that are party to the fund. These appointments are divided amongst the members of the unions' executive boards.

The employer trustees often are higher paid employees with an accounting or finance background.

Trustees are appointed for a 3 year term, although changes in their personal circumstances can mean that they depart earlier – one trustee lost her position within the union and accordingly stopped being a trustee.

3 year term

Our informant suggested that employers were not interested in participating on the board of trustees in general, while union trustees were very keen to get involved. However, the general assessment of the board's enthusiasm and active contribution to decision-making was that they were mostly happy to follow recommendations.

Board follows recommendations

The fund has no independent trustees. There is no complete clarity in our opinion as to whether these council funds are being treated as Type A Umbrella funds (funds which have many participating employers who are independent of each other), but their make-up certainly suggests that they should be seen as such. In that case, the requirement is that at least 1 independent trustee is appointed. However, the FSB has granted other funds an exemption from this requirement.

No independent trustees

The chairman is elected by the trustees. The current chairman is a union representative, and there was no mention of a balancing system which ensures this position is equally shared between union and employer representatives as in some other councils.

No alternation of chairman

The principal officer of this fund is not the chairman of the board or in fact a trustee, which is in line with recommended practice.

19.5.5 Subcommittees

The fund had a death benefit subcommittee for a limited period, but mostly death claims are dealt with on the board level. According to our informant, there are not a lot of death claims and the members' families are pro-active about bringing the right paperwork to the attention of the board. It was unclear whether a proper investigation was done on each death.

Currently no subcommittees

The fund has no other subcommittees.

19.5.6 Training

PF130 introduced requirements to provide trustees with regular training. The training is performed by the fund's consultants and is done as part of the regular trustee meetings. Our informant mentioned the difficulty of getting trustees to meetings as this meant that they were away from work. A separate training day was difficult to justify, hence the solution of training sessions following normal board meetings.

Training with trustee meetings

19.5.7 Communication

Benefit statements

The main item of communication to members is the benefit statement. It was suggested that members really appreciate their statements and that they check them thoroughly, and would query any problems – the main problem being any decrease in benefits. Negative investment returns are very difficult to communicate, and this demonstrates the natural risk aversion found in the bargaining council space.

Aversion to negative returns

The benefit statements have always been issued but as a result of becoming regulated by the Act, some minor changes were introduced to align them with requirements of the Act and circulars.

Ad hoc council circulars

The other communication channel utilised by the fund are circulars which are issued by the council dealing with fund-related issues. These are issued on an ad-hoc basis, with 4 circulars being sent in the period 2008-2009. The items dealt with included dispelling of rumours regarding registration under the Act and also about retirement reform, and announcements of bonus declarations and improvement to funeral benefits.

Fund at a glance

Members: **3000**
Average salaries: **R2 000 p.m.**
Assets: **R 50 million**
Gross contribution: **6%**
Net contribution: **4.6%**
Expenses: **1.4% of salaries or R38 pppm**
Investment expectation: **CPI + 3%**
NRR after 30 years: **13%**

20. Case Study Hairdressing and Cosmetology Industry Provident Fund

20.1 Summary

20.1.1 Background

The Hairdressing and Cosmetology Services Bargaining Council (semi national) ("the council" in this section) is a regional council which was established in 1937 and has offered a provident fund since 1976. The council agreement has been extended to cover all employers in its regions.

Council started 1937
Fund started 1976

The fund has 3 000 members, and R50 million in assets. Each employer has 2 to 3 employees on average. Membership is currently compulsory to union members only but is being extended to non-union employees in 2011.

3000 members
R50 million assets
2 – 3 workers per employer
Only union members join fund

The fund provides retirement benefits only. The council operates a separate sickness fund.

Only retirement benefit plus separate sickness scheme

Registration under the council is very poor with large numbers of employers who work informally avoiding registration.

Low registration levels

There are currently plans to merge the 4 regional hairdressing industry funds into a national fund, and improve benefit levels.

Merger and improvement of benefits planned

20.1.2 Value of Benefits

The benefit structure and projected retirement benefits for a member retiring at 65 with 30 years of service are as follows:

After 30 years, NRR = 13%

	Current structure	Effect of proposed changes
Member contributions	3%	**6%**
Employer contributions	3%	**6%**
Expenses	(1.4%)	(1.4%)
Risk benefits	-	**(2%)**
Net Contributions towards retirement	4.6%	**8.6%**
Investment returns	CPI + 3%	CPI + 3%
Salary increases	CPI + 1%	CPI + 1%
Service	30	30
Lump sum at retirement	1.9 x annual salary	3.5 x annual salary
NRR at retirement	13%	25%

Concerns

- Very low contribution and benefit levels
- Low level of registration
- Low level of contribution collection
- No risk benefits

Successes

- Planned merger into national hairdressing fund
- Contribution increase from 5% to 6% and planned further increases
- Success at registering and providing benefits to some informal workers

Interesting features

- Lowest contribution levels of all council funds
- Employers are small and avoid registration successfully
- Contributions based on basic wage but stylists receive large commissions which are not pensionable
- Membership currently only compulsory for union members
- Union members disadvantaged in recruitment as a result, as their cost is higher for employers

Benefits insufficient

Even with the suggested improvements the benefit on retirement is still insufficient, and in the long term the benefit structure would have to improve further.

Preservation erodes benefit more

In addition, this potential benefit is currently eroded due to a lack of preservation, making actual benefits we expect from this fund negligible.

20.1.3 Administration

External administrator

The fund is externally administered. The cost is reasonable for a fund of this size in our opinion.

Very difficult collections

Contribution collection is very difficult due to the small size and informal nature of the employers, and the proportion of contributions collected is very unpredictable from month to month.

20.1.4 Governance

Changed to external admin because of Act

The fund registered under the Pension Funds Act ("the Act") in 2008. Its internal administrator did not register and the administration was outsourced at that time.

4 employer trustees
4 union trustees

5 meetings p.a.

The board of trustees consists of 8 trustees, 4 each from employer and employee organisations. They meet 5 times a year. An executive committee of 3 trustees meets more frequently and handles most of the day to day affairs of the fund.

20.1.5 Conclusion

Low benefit levels
Plans to improve

Coverage of informal workers
Will not meet accreditation criteria

The fund provides a low level of benefits but there are plans in place to increase this over the next few years. The planned national fund for the industry may improve economies of scale. The fund accesses informally employed workers who would be unlikely to join the NSSF, but does not look like it would qualify for accreditation under the criteria we expect.

Recommendations

- Proceed with merger and contribution improvements
- Engage with Department of Labour and IDTT at an early stage to discuss possibilities for exemptions or transition periods for accreditation.

20.2 History and Background

20.2.1 Background

The Hairdressing and Cosmetology Services Bargaining Council (semi national) ("the council" in this section) is one of 4 bargaining councils in South Africa which cover hairdressing and beauty services providers in different regions of the country. The council was established in 1937 and has offered a provident fund since October 1976.

4 hairdressing councils

Council started 1937

The main parties to the agreement are the trade union UASA (United Association of South Africa), which represents the majority of union workers registered with the council, and the employers' organisations Employers Organisation for Hairdressing, Cosmetology and Beauty (EOHCB), and AHBEASA (Afro Hairdressing & Beauty Employers' Association of South Africa).

The semi national council operates in several regions: Gauteng (excluding Pretoria, Wonderboom, Cullinan), Klerksdorp, Potchefstroom, East London, Port Alfred, Port Elizabeth, Uitenhage, Humansdorp, and the Free State. Its agreement has been extended to cover all hairdressing and beauty service providers in these regions. There is a constant drive to extend the council into other regions currently not covered.

Semi-national

The fund is an externally administered provident fund.

External administration

20.2.2 Membership

The council has around 3 000 members. The majority are "operators" who provide support services in salons, but stylists and learners are also members.

3000 members

Until now, membership in the fund was compulsory only for union members. This is set to change from 2011, when all workers will be required to participate. Our informants estimate that this could as much as double the fund membership.

Only union members must join

Compulsory for all from 2011

Hairdressing and beauty salons are small businesses, with each employer having on average 2-3 employees.

2 – 3 workers per employer

Basic salaries are low, ranging from R1 000 to R5 000 depending on geographic area, qualification and experience. Given that the majority of the members are operators, we use R2 000 as the average salary for the fund. Stylists receive commissions based on turnover in the salon in addition to their basic salaries, but these commissions are not pensionable.

R2000 average salary

Commissions non-pensionable

The council has different categories of employers, with the largest groups being Caucasian hairdressers and Afro hairdressers. Registration levels are generally poor in the entire council, as the vast majority of hairdressing businesses are very small and hard to find. However, registration among the Caucasian hairdressers is estimated to be at

Poor registration levels

around 80% of employers, whereas the level of registration among Afro hairdressers is very low, with estimates ranging from less than 5% to maybe 30%. Estimates are difficult to make as the actual number of businesses is not known.

Informal employers

However, we are of the opinion that the council and fund have been successful in drawing employers and workers who work in the informal sector into a form of retirement savings. These workers in many cases are not part of the formal economy, have no ID numbers, and are not registered for tax or UIF. They therefore would be unlikely to become members of a national fund. Therefore, in our view, even though there are large gaps in coverage, the council is still bringing benefits to members who would otherwise not be reached.

20.2.3 Benefits provided by the council

Only retirement benefits in fund

The fund provides a retirement benefit and no other benefits, although insured benefits are being contemplated.

Separate sick pay scheme

The council also operates a sick pay fund.

20.2.4 Stakeholder views

Fund not high priority in negotiations

According to our informants, employers generally recognise the value of providing retirement benefits. However, the low level of registration and non-payment of contributions, and the low level of contributions that has been negotiated, suggest that the fund is not a high priority for the employers in the industry and the existence of the fund does not appear to be an enticement to register with the council.

Non-fund members preferred by employers

Our informants suggested that one of the reasons membership is now to be compulsory for non-union workers is that union members were disadvantaged in the recruitment process. Employers tended to favour non-union applicants as these would not have to join the fund, and the employer would save on contributions.

20.2.5 Recent developments

Registration under Act
Move to external administration

The fund became registered under the Pension Funds Act in 2008. This caused the fund to move the administration to an external provider.

Changes as result of reform:

The fund is undergoing a lot of changes at the moment, and further changes are being negotiated. These changes were at least partially driven by the reform proposals, and include:

- Contribution increased by 1%
- Further increases planned

- An increase in the total contribution rate from 5% to 6% of salaries has already taken place. There is a plan to continue increasing contributions over the next years, with the target of raising them to at least 12% in the long term.

- Compulsory to all workers

- Compulsory membership for non-union workers is being introduced from 2011.

- Negotiations are underway to merge the retirement provisions across the regional councils. The plan is to create a national fund for the industry and to move members from the existing regional funds to this national fund.

- It is proposed that the merged fund is a pension fund to align it with the requirements of the reform proposals by providing income rather than lump sums in retirement.

- There are also plans to gradually introduce insured death benefits.

- Merger of regional funds

- Creation of pension fund not provident

- Introduction of risk benefits

There are also ongoing registration drives to improve participation.

Registration drives

The reform proposals appear to have galvanised the industry to improve their retirement provisions. We were however also informed that the reaction to the national fund was overwhelmingly negative and that it was a communication challenge to prevent withdrawals following the publication of the proposals.

Negative member reaction to reform

20.3 Value of Benefits

20.3.1 Summary

The total contribution to the fund is 6% of salaries. 1.4% are used for expenses. The remaining 4.6% are utilised for retirement savings. Fund credits are invested at a target rate of return of inflation plus 3% per annum.

Total contribution: 6%
Expenses: 1.4%
Net contribution: 4.6%

Investment target: CPI + 3%

If members remain in the fund for 30 years, the fund should yield a lump sum of 1.9 times annual salary on retirement at age 65. This could be converted into a pension of 13% of salary.

After 30 years, NRR of 13%

The fund offers no death or disability benefits.

No death or disability

Our recommendations are:

1. Proceed with the plan to increase total contributions to 12% of salaries over a period of time.

2. Consider introducing insured death benefits in the future.

- Increase contributions to 12%

- Add risk benefits

In our view, the fund delivers very low benefits, and even with the above improvements, is likely to fall short of the level of benefits offered by the NSSF. It should be noted that fund decision makers are aware of the shortcomings and are making an effort to address them. However, in the long term, further enhancements would be needed.

Benefits insufficient

Below, we examine each element affecting benefit levels and comment on possible deviations from these assumptions, as well as what could be done to improve the final benefit and reduce such deviations.

20.3.2 Contributions

Employers and workers contribute 3% of salaries each, making the total contribution 6% of salaries.

Employer: 3%
Employee: 3%

The contribution towards administration and other expenses is estimated as 1.4% of salaries. There are no risk benefits.

Expenses: 1.4%

The net contribution towards retirement is therefore 4.6% of basic salary.

Net: 4.6%

It should be noted that stylists, who make up a minority portion of the fund but are the highest earners, receive significant commissions over and above their basic salaries. These commissions are not pensionable, but according to our informants can make up as much as 90% of the member's income. In those cases, the benefit provided by the fund is even less compared to the actual income of the stylist.

Stylist earnings mostly commission

The contributions have recently increased from 2.5% from each party to 3%. This is apparently part of a process intended to bring contributions up to at least 12%, in line with other hairdressing councils.

Recent increase in contributions

Compared to proposed NSSF contribution levels of 10-12% towards retirement, the current contribution rates are inadequate. However, it is encouraging that increases are being contemplated.

Contributions inadequate

20.3.3 Risk premiums

There are no death or disability benefits in this fund.

No death or disability

There is a plan to introduce some such benefits in the future, however.

20.3.4 Expenses

The expenses of the fund amounted to R1.4 million in the 2008/09 financial year. The accounts for the previous period show a much lower expense of R0.4 million. Our informants stated that this is a misrepresentation and not a valid comparison. It appears that the accounts may not have included the cost of internal administration. This supports our view that before the registration under the Pension Funds Act, there was no onus on the council to split out the expenses of the fund from general council expenses.

Expenses previously reflected incorrectly

R1.4 million was equivalent to 1.4% of salaries during this period.

Expenses 1.4% of which administration 1%

Of this, R1 million was the fee payable to the administrator.

20.3.5 Investment Returns

The fund targets a return of inflation plus 3% measured over rolling 3 year periods.

Target: CPI + 3% over 3 years

The total asset size is in the region of R50 million, around half of annual payroll. This is very small for a retirement fund.

Assets: R50 million
= half of annual payroll

The investment policy statement (IPS) is a generic document and gives limited insight into the workings of the fund. There are two return objectives: to deliver CPI plus 3% over rolling 3 year periods, and to deliver positive returns on a rolling 12 month basis. This approach is suitable for a retirement fund with low risk tolerance. We expect that since members are very low income earners, the tolerance for risk would be particularly low since there would be little financial understanding. The fund does also not employ smoothing so more a conservative asset allocation is needed to minimise negative returns.

IPS generic

Second target: positive short term returns

No smoothing

The strategic asset allocation is very broad, with 30% to 60% in equities.

Broad allocation

The investment structure is a 100% investment in a segregated portfolio with Investec. The fund's investment consultant is also employed by Investec, leading to potential conflict of interest.

1 portfolio
Investment advisor related to manager – conflict

Given the limited information available to us, we are comfortable the target of CPI plus 3% is achievable.

CPI + 3% achievable

20.3.6 Length of service

The fund experiences significant turnover, with 400 out of 2700 members withdrawing over the last year.

High turnover

There is no explicit waiting period, but all withdrawal applications are reviewed by the trustees before being permitted. This review process introduces a lag of 1-2 months into the withdrawal payment. Our informants stated that all withdrawals are checked against contributions, which ensures that members who changed jobs but did not leave the industry are not paid a benefit. This was said to be successful in reducing withdrawals.

No waiting period

Trustees approve withdrawals

Early retirement is permitted from age 50 but we have no information as to whether this is frequently taken up. Normal retirement is at age 60.

Early retirement from 50
Normal retirement 60

In our initial calculation, we dealt with a member with 30 years of service at retirement. However, the pattern of withdrawals which reset the savings to zero means that the actual period of saving for retirement may be closer to 7 years.

Service at retirement = 7 years

20.3.7 Salary Increases

Salaries increase with inflation or less than inflation. The employment categories change with 5 and 10 years of service, where the salaries increase by 5% and 10% respectively. Therefore, we have assumed that CPI + 1% may be achievable.

Salary increases: CPI + 1%

20.3.8 Effect of other benefits

Average expected pensions after 30 years of service, using commercial annuity rates, are estimated as 13% of average salaries of

R2000 per month, i.e. R260 per month. If the SOAG is paid to these members, it will increase their post retirement income by a factor of 5.

SOAG increases pension 5 times

20.3.9 Analysis

The retirement benefits currently achievable in the fund can be summarised as follows:

Contributions	6%
Expenses	(1.4%)
Risk benefits	0%
Net Contributions towards retirement	4.6%
Investment returns	CPI + 3%
Salary increases	CPI + 1%
Service	30 years
Lump sum at retirement	1.9 x annual salary
NRR at retirement	13%

After 30 years, NRR = 13%

The fund is therefore not likely to provide significant replacement ratios for its members if the current design is retained. The above benefit also ignores leakage and assumes a 30 year working life. This is not achieved at the moment by most members, and the actual benefits are therefore much lower.

Benefits insufficient

Further erosion from leakage

We have been informed that various improvements are contemplated for the fund. These are intended to make the fund competitive in the NSSF environment, and include:

Planned improvements

1. Plans to increase contributions to 12%
2. Plans to merge the regional funds. This would result in a larger fund. However, the current administration cost is already quite favourable and we do not believe it would be reduced by this merger.
3. Introduction of death/disability benefits. We do not know what level and cost would be achievable, but have assumed that 2% of salaries could be used to fund this cost.

- *Increase conts to 12%*
- *Merger of regional funds*
- *Death and disability benefits*

If these changes are introduced, we expect the following benefits to be achievable:

Contributions	12%
Expenses	(1.4%)
Risk benefits	2%
Net Contributions towards retirement	8.6%
Investment returns	CPI + 3%
Salary increases	CPI + 1%
Service	30 years
Lump sum at retirement	3.5 x annual salary
NRR at retirement	25%

The NRR achievable under those circumstances is still very low but the improvement is significant.

Benefits after improvements still too low

If the NSSF proposal for risk equalisation is implemented, we may expect that all funds would need to contribute 4% of their members' salaries towards such shared risk benefits. This will result in a dramatic reduction in benefits for this fund:

If risk pooling is introduced, NRR reduced

Contributions	12%
Expenses	(1.4%)
Risk benefits	4%
Net Contributions towards retirement	6.6%
Investment returns	CPI + 3%
Service	30 years
Lump sum at retirement	2.7 x annual salary
NRR at retirement	19%

20.3.10 Other Benefits

Death

There is no death benefit payable from the fund, other than the member share.

No death benefit

Disability

There is no disability benefit payable from the fund, other than the member share.

No disability benefit

Funeral

There is no funeral benefit payable from the fund.

No funeral benefit

Withdrawal

The withdrawal benefit is the member share.

Fund credit on withdrawal

Housing Loans

The fund does not offer housing loans.

No housing loans

20.4 Operation of funds

20.4.1 Administration

The fund is administered externally by Verso Financial Services.

This is a new arrangement which was brought about by registering under the Pension Funds Act. At this stage, it was deemed that the internal administration division of the council would not be registering under Section 13B of the Act. As a result, an external administrator was appointed.

Internal administrator did not register

20.4.2 Contribution collection

Contribution collection is a tremendous challenge to the fund in an environment where many employers would prefer not to be registered under the council. Our informants stated that in the Afro sector, 800 employers were registered during a special registration drive last year. Of those, 50 were now contributing to the fund. The situation is better amongst the Caucasian salons, but still as much as 60% - 70% of each months contributions are likely to be late, and 5% - 10% are reportedly not collected at all.

Employers don't register, don't contribute

Contributions late, some never collected

Again, this should be viewed in light of the informal employment in this industry, and any contribution that is collected contributes positively to the welfare of workers who otherwise would not be looked after at all.

For informal workers still better than no fund

The council collects contributions by sending an account to each registered employer for all levies and contributions. The full amount is paid into the council's bank account, and from there transferred to the retirement fund. If all goes well, this process should take a maximum of 30 days, but this is rarely the case.

Contribution collection process inefficient

Our informants report that an extension has been obtained from the registrar on the 7 day rule. This extension is unlikely to be sufficient in light of the described process.

Extension for 7th day collection

20.5 Governance

20.5.1 Pension Funds Act

When council funds were brought in under the Pension Funds Act, this entailed significant new requirements for the fund.

The fund was guided through the process by its consultants, who have assisted with policies and documentation, and also took over as the administrator of the fund.

Consultants assisted with registration

20.5.2 Policies and training

The fund is in the process of putting in place the various policies required for good governance as per Pension Fund Circular PF 130.

Policies in progress

Training is being conducted by the consultants of the fund.

Training ongoing

20.5.3 Board of trustees

The board of trustees has been in operation for some time. It consists of 8 trustees, 4 representing employers and 4 representing the unions.

4 employer trustees
4 member trustees

The chairman is elected by the trustees.

The board of trustees meets 5 times per year. These meetings are coordinated with council meetings.

5 meetings p.a.

There is also an executive committee which consist of one union and two employer trustees at the moment. The executive committee meets more often than the board and certain functions of the board, such as reviewing withdrawal applications, are delegated to this group.

Executive committee meets more often

It was suggested that trustees are interested and engaged in running the fund, but demand (and receive) training so that they can make a more meaningful contribution.

Trustees demand training

20.5.4 Communication

Members joining the fund receive a rule booklet.

Rule booklet on joining

Annual communication is done chiefly through the benefit statement.

Annual benefit statement

The council also issues ad hoc communiqués on behalf of the fund when necessary.

Ad hoc council communication

PART 3 – NEGOTIATED FUNDS AND THE NSSF

21. Introduction

In brief

Council funds deliver value and should be encouraged towards accreditation.

Councils funds will have to make adjustments to qualify for accreditation:

- Improve benefits
- Lower costs
- Improve governance and communication
- Consider mergers

Assistance and transitional support should be offered to enable accreditation.

Part 3 of this paper examines the results of the Part 1 overview and Part 2 case studies in light of the proposed reform. We consider both how council funds can add value to a new retirement framework, and the lessons that can be learnt from council funds in designing a national fund.

Section 22 summarises the results and makes recommendations for the future. Sections 23 and 24 introduce the proposed retirement reform. Section 25 summarises the value offering of council funds in light of the reform. Section 26 makes recommendations on how council funds can become part of the new framework, and Section 27 highlights the potential impact of this framework on council funds. In Section 28, we discuss the lessons that can be learnt from council funds in terms of how a national fund can be designed.

22: Summary
23: Background
24: Reform proposals
25: Value offered by council funds
26: Recommendations to council funds
27: Impact on council funds
28: Lessons for reform design

22. Summary

22.1 Retirement reform proposals

A reform of the social security and retirement framework in South Africa is planned. The proposals for this reform have not been finalised, and we have based our summary of the proposals on the 2007 *National Treasury Second Discussion Paper* and the 2009 document *Reform of Retirement Funding*.

Sources: 2007 and 2009 National treasury papers

The key principles of the reform are social solidarity, adequate benefit protection, and administrative efficiency.

Solidarity, protection, efficiency

A four tier system is proposed:

Tier 0: tax-funded social grants, including the Social Old Age Grant (SOAG)

T0: Social grants

Tier 1: contributory, mandatory National Social Security Fund (NSSF)

T1: NSSF

Tier 2: contributory, mandatory private Accredited Funds

T2: Accredited funds

Tier 3: contributory, voluntary Individual Retirement Framework (IRF)

T3: Voluntary

The contribution to the NSSF is 15% - 18% of salaries under the earnings ceiling of around R150 000 per annum. Of this, 10% - 12% are net contributions to retirement after expenses (1%) and death and disability premiums (4% or more).

Contributions: 15% - 18%

On retirement, the NSSF would pay a pension, with a target Net Replacement Ratio (NRR) of 40%.

Target: 40% NRR

Criteria for becoming an accredited fund would be based on cost-effectiveness, equity, benefit protection and governance. Benefits provided by approved funds need to be equal to or higher than the NSSF benefits. Accredited funds may be able to opt out of the NSSF and provide Tier 1 benefits themselves.

Accreditation: cost, equity, protection, governance

Assume accredited funds can opt out of NSSF

Future of council funds

If council funds cannot obtain accreditation and opt out of the NSSF, they could face dissolution. Providing top-up benefits over and above the NSSF would diminish contributions and reduce efficiency making the funds untenable.
To achieve accreditation, we recommend the funds:

- Increase contributions to 15% or more
- Where the increase is too high, prepare a long term plan for increases
- Conduct cost analysis and reduce costs
- Conduct independent review of governance structures and improve
- Review IPS to avoid negative returns
- Use guaranteed type investment vehicles or attempt smoothing if large enough
- Educate members on retirement and fund matters
- Consider introducing waiting periods on withdrawals to improve preservation
- Consider mergers between councils or funds to improve economies of scale

Funds that are cost efficient administrators can also:

- Consider extending the fund to another council
- Consider becoming the administrator for other council funds
- Consider becoming on administrator for the NSSF

22.2 Value offered by council funds

Council funds cover around 950 000 low income workers. Coverage is reduced through non-registration and exemptions. Registration levels tend to be higher in industries where the fund is appreciated.

1 million workers in council funds

Council fund benefit levels are in general slightly lower than under NSSF proposals but most funds are expected to be able to negotiate sufficient improvement if necessary. Some funds have benefit levels significantly below the NSSF level and it is unlikely these could improve sufficiently in the short term.

Benefit levels
< private employers,
< NSSF

Protection of benefits from investment fluctuations is achieved through conservative investment strategies and smoothing of returns in larger funds. Protection from cash withdrawals is attempted in some funds by introducing waiting periods on withdrawals. Nevertheless, withdrawal levels were at around 20% per annum.

Protection:
conservative investments
smoothing
waiting periods

Withdrawals high

Cost is driven by membership size, with internally administered large funds achieving costs of less than 0.5% of salaries. Internal administration systems are not well-suited to retirement administration, but improvements are being attempted. The greatest administration challenge is the collection of contributions.

Large funds: cost < 0.5%

Internal admin issues being addressed

Contribution collection challenge

Governance measures are still new since council funds only recently came under the Act. The relationship between council and fund results from a mutual dependence, but in some funds leads to cross-subsidies and a lack of transparency.

Registration under Act recent

Council and fund relationship

The relationship between members and the fund is based on trust which arises from the negotiated nature of these funds. Members relate positively to their funds, whereas the reaction to the national fund proposals has been distrustful.

Members trust funds

22.3 Impact of new framework on council funds

Mandatory participation regulation is likely to improve the registrations under the councils and may reduce the number of exemptions, increasing overall coverage.

Mandatory participation – increased registration

Mandatory preservation is likely to be opposed, and will need to be introduced gradually.

Mandatory preservation not welcome

Risk pooling at a national level will cost 4% of salaries or more, and will increase the cost of death and disability benefits in most of the funds and reduce the allocation to retirement.

Risk pooling expensive

Increased contributions may lead to lay-offs or increased poverty depending on who funds the increase.

Increased contribution = lay-offs, poverty

Smaller councils depend on their funds for survival and may be unable to continue their work if their fund is dissolved. The coverage of retirement benefits in those sectors may also reduce if the fund is dissolved and the underlying employers find ways to avoid registration under the NSSF.

Small councils may be threatened

Lessons for design of retirement reform

- Employers and members will opt out of mandatory arrangements if they do not support them.
- Average wages for industrial workers are below tax threshold and the SARS system will not necessarily assist
- If funds are accredited, the exemption process will need to be monitored to avoid loopholes
- Accreditation needs to be collaborative process, not hurdle
- Targeting net contributions as benchmark for accreditation encourages cost-effective administration
- Low income workers like simple benefits with no negative returns and no member choice
- Housing loans are desirable benefits
- Administration at R14 pmpm or less than 0.5% of salaries possible
- Lump sums at retirement are very popular and some access could be considered
- Limited access (housing loans, unemployment grants) during working life could make introduction of preservation easier
- Penalties for non-contributing employers need to be severe and swift
- Simple communication of benefit design is key to members

23. Retirement reform proposals

23.1 History of Proposals

A reform of the social security provisions in South Africa has been mooted for many years. A series of proposals and papers have been published over the last decade:

In 2002 the Taylor Committee of Inquiry into a Comprehensive System of Social Security for South Africa published a comprehensive report, which covered a range of potential benefits, from basic grants including a Basic Wage Grant, through retirement and disability benefits, to healthcare and other social provisions.

2002: Taylor Committee report

In 2004, National Treasury produced a Discussion Paper on Retirement Reform, which lay down some of the framework for the discussions taking place today.

2004: First NT discussion paper

In 2006, the Department of Social Development presented its views in a paper entitled Reform of Retirement Provision: Discussion Document.

2006: Department of Social Development paper

This was followed in 2007 by the National Treasury's Social Security and Retirement Reform: Second Discussion Paper, and the Department of Social Development's Reform of Retirement Provision: Feasibility Studies.

2007: Second NT discussion paper, DoSD studies

Work on the reform has continued since then, and an Inter-Departmental Task Team (IDTT) has been appointed to produce a proposal that unifies the views of the different departments. The IDTT has representation from National Treasury, the Department of Social Development, the Department of Labour and other parties. It is advised by representatives of many industry bodies.

IDTT appointed

In formulating our recommendations, we have based our views on the reform proposals in the 2007 papers and information which has become available to us since, through informal presentations by IDTT representatives. We were also given access to an unpublished 2009 paper produced by the National Treasury for the IDTT, *Reform of Retirement Funding*, which provided further insight into what the potential design of the reform may be.

2009 NT paper on reform

However, it should be borne in mind that the reform proposals have not been formalised yet and that many design issues have not yet been agreed between various parties. It is hoped that our research on the bargaining council funds may further inform the design process.

Proposals not final

23.2 Overall proposed reform

23.2.1 Goals of the reform

Social solidarity, pooling of risks, adequate benefit protection and administrative efficiency are the key reform principles, particularly for the NSSF.

Social solidarity
Pooling risks
Benefit protection
Administrative efficiency

The envisaged reform encompasses the social security benefits offered by the government, different forms of retirement savings, and potentially also healthcare and other social benefits.

Reform of social security, retirement, healthcare

There are many factors that have motivated such a reform as South Africa has transformed its political system during the last two decades. The current private retirement savings system only covers a limited portion of the population, and the benefits emerging from private funds are often too low to secure a sufficient post retirement standard of living. The private pensions industry also suffers from problems such as erosion of benefits due to high costs, lack of transparency and understanding of benefits and cases of fraud and mismanagement. Improving governance is a major challenge for all retirement funds in South Africa.

Private system: limited coverage, leakage, erosion of benefits, fraud

The proposed system is intended to address some of these challenges. The design principles that are generally considered non-negotiable are:

- The provision of unfunded grants to the most needy
- Mandatory participation leading to higher coverage and improved efficiency of provision
- Mandatory full or partial preservation to enhance benefit levels

- *Unfunded grants*
- *Mandatory participation*
- *Mandatory preservation*

23.3 World Bank model of retirement systems

The proposals have been framed in terms of the World Bank's model of social security arrangements. This model is based on 4 tiers:

World Bank model: 4 tiers

Tier 0: Social Security Benefits

These are grants funded from general taxation, and include such benefits as the Social Old Age Grant, Children's grant, Disability Grant, and others.

T0: Social grants

Tier 1: Mandatory Contributory State-administered tier

T1: National fund

These are benefits which are provided by the state and financed from contributions made by all or most of the population, who are compelled to contribute. The contributions may either be invested to provide for future benefits (funded system) or they may be used to pay out current benefits (pay as you go).

Tier 2: Mandatory Contributory Private tier

T2: Accredited funds

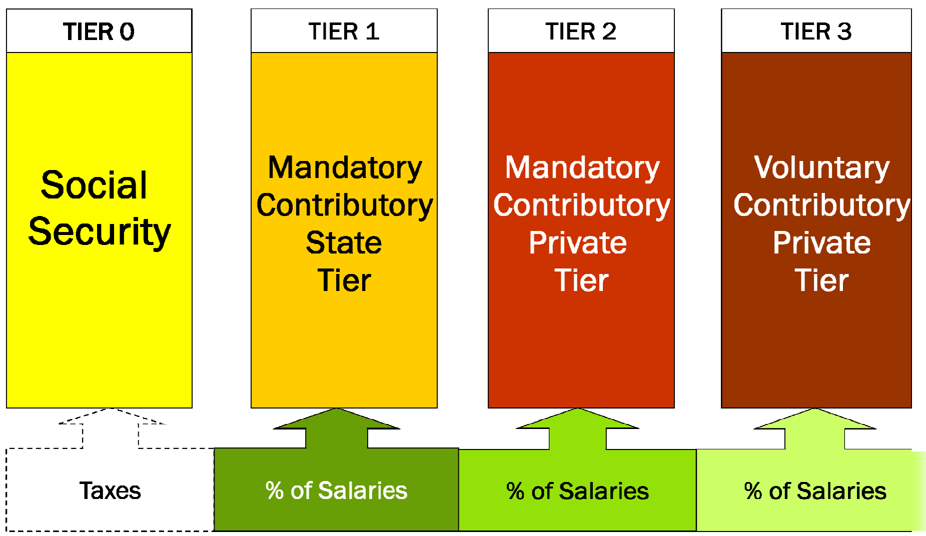
These are additional benefits which are administered by private providers. Membership is still mandatory, and these kinds of systems are funded (contributions are invested for future benefits).

Tier 3: Voluntary Contributory Private tier

T3: Voluntary additional

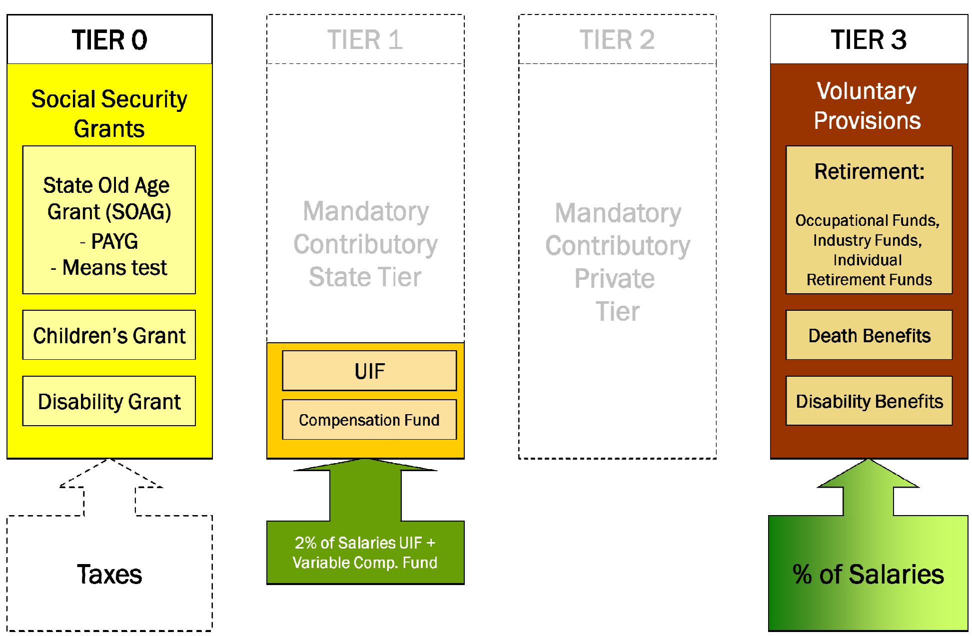
These are additional benefits which can be obtained by paying contributions on a voluntary basis.

The tiers can be graphically represented as follows:



23.4 Current South African System

The model can be applied to the current South African social security and retirement system as follows:



Current SA system:

T0: SOAG

Tier 0 : A number of grants are currently available. The State Old Age Grant (SOAG) in particular, is subject to a Means Test, under which only retirees whose income or assets is below a certain level qualify for the SOAG.

T1: UIF, Compensation fund

Tier 1: One mandatory contributory benefit offered by the government under the current dispensation is the Unemployment Insurance Fund (UIF), which is funded though a contribution of 2% of salaries under R150,000 per annum. Another contributory mandatory fund is the Compensation Fund, which pays out in the event of an occupational injury or disease.

T2: none

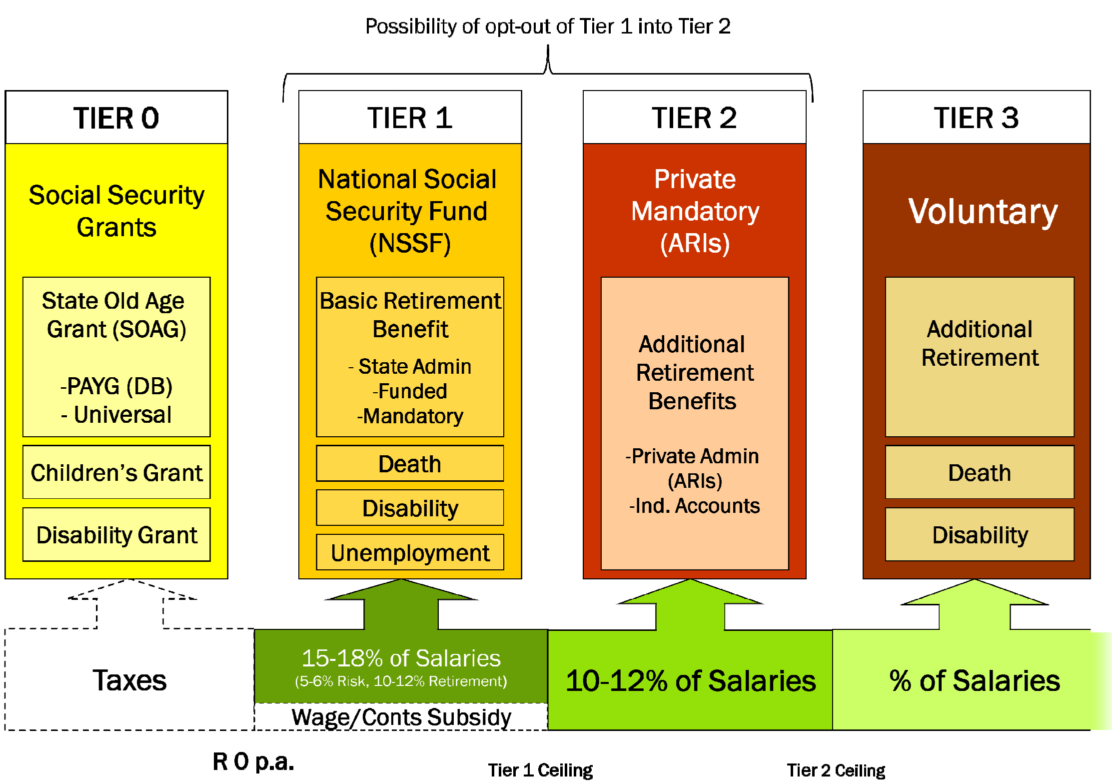
Tier 2: There are no private benefit arrangements that are mandated by the state at the moment. Other entities, such as employers or bargaining council funds, may enforce membership in a retirement or benefit fund, but this is not seen as mandated by the state.

T3: Private retirement funds

Tier 3: The current retirement fund industry, including private employer funds as well as bargaining council funds, and other funds such as local government funds, falls into the private, non-mandatory tier. Such funds are voluntary i.e. the employer or council must decide to start a fund.

23.5 Proposed system

The current proposals have not yet fully specified the new social security and retirement framework. However, based on current discussions, the proposed system may look as follows:



The next section deals with the proposals for each tier in detail.

24. Outline of Current Proposals

24.1 Tier 0: Social Grants

Tier 0 is likely to remain largely unchanged. It would continue to be funded from general taxation, and to offer a range of grants to those in need.

Grants funded from tax

The SOAG inception age has changed over the last few years to 60 for both males and females. The previous starting age of 65 for males and 60 for females was seen as inequitable. This is one aspect of the reform that has already been implemented.

SOAG age adjusted to 60

An additional proposed change to the SOAG is to remove the Means Test and make this benefit universally available to all persons over the age of 60. The primary motivation for this is to remove any disincentive to save at low income levels. The effect of making the benefit universal would be to increase the cost to the state. It has been proposed that some of this cost is clawed back from pensioners with higher earnings in the form of an additional tax.

Means test could be removed

24.2 Tier 1: National Social Security Fund

National Social Security Fund (NSSF) is planned as a provider of tier 1 benefits. The NSSF would be mandatory, contributory and likely to be managed through a public/private partnership. Contributions would be made from salaries under a certain limit (amounts such as R75,000 per annum or R150,000 per annum have been suggested). The benefits provided would cover death and disability, retirement, and also unemployment.

Mandatory, contributory, public/private partnership

24.2.1 Mandatory contributions

Participation in the system will be compulsory for all South Africans, within certain limits:

- It is envisaged that contributions for the NSSF will be limited to some maximum income level, called the earnings ceiling. Earnings above the ceiling level will not be subject to NSSF contributions. The level of the ceiling has not been fixed yet, but amounts such as the UIF ceiling, which is R150,000 per annum, or half the UIF ceiling, at R75,000 per annum, have been used as a starting point in the discussions.

Earnings ceiling

- It is also possible that there will be an earnings floor. Workers earning less than the earnings floor would not be subject to contributions to the NSSF. The floor may be set at some level comparable to the minimum wage. The reasoning is that at the lower income levels, workers cannot afford to contribute, and also they qualify for the SOAG which would meet their post-retirement needs.

Earnings floor

- The alternative to an earnings floor is a wage subsidy funded out of general taxation, which is sufficient to pay the contributions for very low income workers.

- *Wage subsidy*

24.2.2 Contribution levels

The proposed level of contributions is in the region of 10% to 12% of salaries towards retirement, plus a further 4% or more towards risk benefits, and 1% towards expenses. The total is therefore in the region of 15% to 18%. The discussions on this topic are ongoing and it has been suggested that the final level may be adjusted. We have however assumed that 15% to 18% is what is going to be implemented and have based our recommendations on this assumption.

Net contribution 10% - 12%
4% for risk benefits
1% for expenses

Total: 15% - 18%

24.2.3 Benefits

The proposals focus on a pension rather than lump sum benefit on retirement, although a partial lump sum may be permitted to allow retirees to settle debts. The main goal however is to prevent the benefit from being depleted too early. It has been suggested that the pension is paid from the NSSF using annuity rates that reflect the actual mortality levels of the low income population. Commercial annuities do not tend to allow for such impaired mortality levels, with the result that commercial annuities are not good value for the low income population. The NSSF would offer a unisex, fixed conversion rate which is more favourable than the commercial annuities.

Pension at retirement

Preservation

NSSF annuity

The target for retirement benefits is to achieve a Net Replacement Ratio (NRR) of 40% at retirement.

Target 40% NRR

Death benefit levels have not been set yet. One of the issues that still needs to be decided is whether the death benefit will be a multiple of salary or a multiple of salary plus the accumulated fund credit. The first option would be more cost effective. Because of the inclusion of the low income sector of the population, death benefits are likely to be expensive as mortality is likely to be high.

Death benefits not set yet

Disability benefits have also not been described in detail. One of the predicted difficulties with providing disability benefits is the ability to assess disability claims in a national context. Again, the question of whether the fund credit is to be included still needs to be addressed.

Disability benefits not set yet

Challenge in assessing claims

While the levels of death and disability benefits have not been decided yet, the amount mentioned as the contribution towards these benefits has been 4% of salaries or more. We have assumed that the cost will be 4% of salaries based on this information.

4% risk premium

It is proposed that a risk pooling approach is adopted where all approved funds charge the same cost for these benefits and the costs are equalised between various arrangements.

Risk pooling

24.2.4 Preservation

One of the key issues facing South African retirement reform is preservation of benefits. Currently, members of retirement funds are able to withdraw their benefits on leaving employment. This option is frequently exercised, with the result that the period of saving for retirement is much shorter than required to achieve a reasonable post-employment income level.

Leakage on withdrawals

In recent times, other areas of retirement provision leakage have also become apparent, for example the provision of housing loans which use the member's fund credits as collateral, In addition the recent divorce regulations have allowed members to access a part of their retirement savings without having to resign from employment.

Housing loans
Divorce settlements

Further leakage often takes place at retirement, where in provident funds the option to take the entire benefit as a lump sum is exercised by most members. The result is that the benefit is spent too quickly and there are no funds left to live off in old age.

Lump sums at retirement

The reform proposals have focussed on preventing such leakage and increasing preservation. It is not envisaged that unilateral withdrawals will be permitted from the NSSF. However, it is possible that mechanisms are created to allow limited withdrawals in certain circumstances, for example prolonged unemployment. The mechanism for preservation has however not yet been fully decided.

Reform preservation

Limited withdrawals or none

24.2.5 Interface between NSSF and private fund arrangements

This has been the subject of some debate since the 2007 proposals were first published. The original proposals envisaged very little scope for opting out of the NSSF and allowing private funds to be alternative providers of tier 1 benefits. The most recent National Treasury paper of 2009, however, recommends diversification of providers at the tier 1 level and suggests that approved funds would be able to become alternatives to the NSSF, and that the members of such funds would effectively be exempted from joining the NSSF. The key message in this approach is that the NSSF would aim to cover gaps in retirement provision rather than to add another layer of retirement provisions to workers currently adequately covered. Other outcomes, such as a low contribution NSSF with very limited opt-out, could also be possible. In our review, we have chiefly focussed on the approach that would allow for accredited funds to opt out of the NSSF arrangements.

Accredited funds to opt out of NSSF?

The criteria for approval (also referred to as "opt out of the NSSF" or "accreditation") are therefore crucial aspects of the proposals, and are discussed below.

24.3 Tier 2: Approved fund framework

24.3.1 Role of non-state funds

We have assumed that existing funds would be able to apply for accreditation based on a set of objective qualifying criteria. Once funds are approved, they would be able to provide retirement benefits in both tier 1 and tier 2 capacity (i.e. mandatory, contributory arrangements). We have also assumed that death and disability benefits may be provided on a centralised basis or through some risk sharing mechanism.

24.3.2 Criteria for approval

Cost-effectiveness, equity, benefit protection as well as adherence to a governance framework have been suggested as criteria for approved funds. The basic principle is that the benefits provided by accredited funds must be on par with or better than those provided by the NSSF.

Benefits >= NSSF

The approved fund framework is likely to be limited to employer-based funds, such as private employer funds or bargaining council funds. DB funds or DC funds with a default investment portfolio and investment and longevity risk sharing mechanisms are likely to achieve accreditation if they meet efficiency and governance criteria.

Employer funds only

The governance framework required would likely encompass having a strong, representative and independent board of management, which has been properly trained; management of fiduciary duties and conflicts of interest; and careful management of service providers to avoid inappropriate advice resulting in decisions which are not in the best interests of the members.

Strong, capable board

Management of conflicts

Protection of benefits involves enhanced portability, protection from creditors, but in particular protection against market movements. The lack of understanding of market risk at the very low income levels creates a problem in terms of communication and uncertainty regarding benefits.

Portable benefits
Protection from negative returns

It is unclear how cost effectiveness will be measured. However, there is an expectation of consolidation among smaller funds leading to better economies of scale.

Cost effectiveness

24.4 Tier 3: Private, Voluntary Provisions

The Individual Retirement Framework (IRF) envisaged under tier 3 is a voluntary membership system intended to give members access to additional retirement, death and disability benefits. These would entail much more flexible benefits and more options for the members. It is still unclear if this tier would be tax incentivised. If it is, we expect that benefits will be restricted to a partial lump sum, and the remainder would be paid out as an annuity.

Voluntary

No tax incentives?

The IRF has little impact on the bargaining council funds and we therefore do not focus on this tier in much detail.

25. Value offered by council funds

25.1 Coverage

Council funds cover around 950 000 workers in 43 funds across 29 councils.

43 funds
950 000 members

The extent of coverage of workers that fall under the council is important in measuring the success of the council at providing benefits. Coverage is reduced illegitimately through non-registration, and legitimately through exemptions.

25.1.1 Registration

In some councils, employers avoid registration even though the agreement has been extended and registration is mandatory. The challenge for the councils is to find such non-registered employers, which tend to be small businesses which can operate in fairly informal quarters and are hard to detect.

Small employers can avoid registration

The extent to which non-registration is prevalent is difficult to estimate, as by definition there is no record of unregistered employers. The situation also varies from one council to the next. For example, in the hairdressing industry, the council has had very little success in registering employers in its “Afro” sector, with an estimated 30% or less of employers being registered. On the other hand, in industries such as motor and engineering or metal, our informants stated that the level of non-registration is negligible.

It is our view that registration is better in industries where the fund is valued. Member and employer views of the fund could be one of the determinants of non-registration.

Registration better if fund is valued

25.1.2 Exemptions

Under the Labour Relations Act, bargaining councils whose agreements are extended to non-parties are required to put in place a mechanism that enables exemptions from the council. Employers may be exempted from the entire agreement or from part of the agreement, which could be the retirement fund specifically.

The exemption is decided by an exemption committee within the council. There is no uniform approach to granting such exemptions. Some funds have defined criteria which may include the existence of another fund provided by the employer seeking exemption, and the benefits of such a fund exceeding or equalling the council fund’s benefits. Other funds have vague criteria where each exemption is decided on a discretionary basis, which is difficult to investigate.

No uniform approach to exemptions

Many councils have discretionary criteria

Exemptions are granted for a limited period only and need to be reapplied for after that period expires.

Exemptions not permanent

25.2 Benefits

25.2.1 Benefit structures

Council funds:
- *DC*
- *No investment choice*
- *Conservative investments*

The majority of council funds are defined contribution funds with no investment choice and fairly conservative investment strategies focussed on avoiding investment losses.

Regional contributions 11.6%
National contributions 15.4%

Regional funds contribute at an average rate of 11.6% of salaries, while national funds are at 15.4%. We expect the NSSF level to be around 15% of salaries, which would require 75% of the funds in our survey to increase their contributions.

Death and disability: 2 x salary

Cost < NSSF 4%

Council funds do however by and large provide death and disability benefits, on average equal to 2 times annual salary. In our 5 case studies, the cost of these benefits was lower than 4% of salaries for each of the 3 funds which provided them.

Housing loans popular

Council funds frequently provide housing loans, which are very popular with members.

Provident funds more popular

The majority of council fund members are in a provident fund, which allows benefits to be taken as 100% cash.

25.3 Protection of benefits

25.3.1 Stable investment returns

Smoothing of returns in larger funds

Cash heavy investments

The larger funds in our case study used annual bonus declarations and investment reserves as a means of smoothing returns. These methods have allowed these funds to maintain positive returns over the years. Internal smoothing however requires certain economies of scale to be successful. The smaller funds in our study did not employ smoothing, but generally investment strategies were cash heavy to reduce the chance of negative returns.

Large investment reserves

In some funds, smoothing has led to large investment reserves building up over the years. This may indicate that bonus declarations were too conservative and past members were unnecessarily deprived of returns.

Smoothing ad hoc in the past

In the past, smoothing was not generally overseen by an actuary and was decided by the trustees on a discretionary basis. This is changing as funds which perform smoothing are required to appoint a valuator under the Pension Funds Act.

25.3.2 Protection from leakage

95% of members in provident funds

Provident fund pays cash

Most council funds are provident funds (95% of members and assets of council funds are concentrated in provident funds). Provident funds were created particularly to respond to union demands for lump sum cash benefits. Our investigation confirmed that benefits were mostly paid out in cash. Member interviews suggested that annuities were not considered as an investment after retirement. Even in pension funds, benefits often fell under the minimum amount where it is permissible to pay out the full benefit in cash, and lump sums were paid there too.

Annuitisation rare

In addition to this, withdrawals during the course of service are very common. The funds we investigated experienced 11 withdrawals for 1 retirement each year. Out of 1000 members, 17 retired while 193 withdrew during one year. Members who withdraw generally take the benefit as cash, and transfers to other funds are rare.

11 withdrawals for 1 retirement
2% retired p.a.
20% withdrew p.a.

As council funds operate across an industry, they should be able to achieve higher preservation, as members who change employment mostly remain in the same industry and therefore in the same fund.

Industry funds – better preservation?

However, the chief issue is the differentiation between becoming unemployed and changing jobs. There is no easy way to differentiate between these two scenarios from the fund's point of view. Some funds have adopted the approach that if a member insists on a benefit at resignation, this cannot be denied. Other funds have introduced waiting periods, which in one case appear to have been approved by the FSB. The waiting period is used to test if the employee has re-entered the industry. If at the end of the waiting period the member is contributing again, no benefit is paid.

Members attempt to take savings anyway

Waiting periods on withdrawal help

This is a sound approach to reducing leakage. Unfortunately, in the funds that employ these measures, there are still significant levels of withdrawals and it is difficult to measure the effectiveness of the waiting period.

Lack of preservation was the major cause of low retirement benefits in the council funds.

25.4 Administration

25.4.1 Costs

We examined costs in five funds, and concluded that size is a crucial driver of cost efficiency, particularly for self-administered funds. Large funds are able to keep total expense to less than 1% of salaries, which given that members are low income workers is very efficient and likely to exceed the requirements of the reform. The largest funds operate on as little as 0.3% - 0.4% of salaries or between R14 and R23 per member per month.

Large funds = low cost admin

R14 pmpm possible

A smaller fund (3000 members), however, was not as cost efficient. Expenses were at 4.7% of salaries, or R132 per member per month. The fund cited reasons such as the onerous requirements of the Pension Funds Act and the cost of council assistance with contribution collections as the reason for the level of the expenses. It however appeared that there was a significant cross-subsidy from the fund to

Small funds, internal administration – high cost the council, where it was difficult to determine the actual cost of administration, and instead the fee seemed to be based on perceived external administration cost levels plus other council costs as deemed applicable. This removes the advantage of running a non-profit or low-profit administrator which is what these funds should be experiencing.

Lack of transparency

Greater economies of scale could be achieved if membership increased.

25.4.2 Systems

Administration systems for the 30% of funds which had internal administration have grown out of the council's own systems, and are not designed to cope with the demands of the Pension Funds Act, such as the payment of a portion of investment reserve on exit, or provision of valuation data.

Internal admin systems not specific to retirement funds

Larger funds appear to be addressing these issues by improving systems.

25.4.3 Contribution collection

In all councils, contribution collection was reported as a serious challenge. Despite complex structures being put in place to aid collection, and compliance being enforced in terms of both the Labour Relations Act and the Pension Funds Act, small employers in particular tend to delay and avoid contribution collection frequently. Our study was conducted during a period of economic downturn, which may have exaggerated the findings, but our informants were clear that the problem is an ongoing one.

All councils have collection issues

Small informal employers most likely to default

Many of our informants suggested that the measures that could be taken in terms of the two acts were not strong enough, and that employers had many ways of subverting the lengthy legal process which needs to be undertaken to enforce collection. Informants suggested that only the threat of criminal action would motivate employers to comply.

Stronger measures needed

25.5 Governance

One of the driving forces behind the reform is the need for better governance within retirement funds. Good governance is key to ensuring members are treated fairly, trustees make decisions in the best interests of the members, and that the fund operates as an independent entity concerned with ensuring that members' needs are met.

Council funds have only recently registered under the Act. They are still adapting to the requirements of the Act and in our view, some more time will be necessary before the concepts of good governance are fully implemented by these funds. The success of this transition has been mixed, but our most significant findings were:

Registration under Act recent

Governance not fully implemented

25.5.1 Relationship between council and fund

Council funds were created as a result of collective bargaining, and existed for a long time as an extension of the council. The result is that there is an intermingling of fund and council at all levels which is proving hard to disentangle. Most of the employees of the council are involved in administering the fund; there is no distinction between tasks performed for the fund and for the council. The offices of the fund and of the council are the same. The officials of the council play important roles in the fund – such as being the Principal Officer or the Administrator.

Council and fund interlinked

When viewed in terms of the requirements of the Pension Fund Act, the structures operated by these funds at times appear inappropriate or un-transparent and are to the detriment of the members.

Hard to assess fund in isolation

However, since these cross-subsidisations benefit the council as the administrator, they are still utilised for the benefit of the labour force. The existence of the council, which adds value in terms of protection of workers, wage negotiations, and other benefits, may be dependent on the fees generated by the fund, and removing them may have wider reaching social consequences.

Fund supports council – council supports workers

It should also be remembered that the structures in operation today are likely to have been achieved through a bargaining process, i.e. with the approval of both employer and member organisations, and any cross-subsidisation may therefore be considered to be taking place with the support of both those parties.

Structures a result of negotiation

If greater transparency of costs and relationships within the council and fund is achieved, it will be easier to evaluate the need for any other adjustments.

Transparency needed

25.5.2 Relationship between members and fund

Councils operate in an environment of trust. As negotiated entities which are partially controlled by unions, they are seen as an entity that can be relied on to look after the workers. While not all members were positive about the communication of benefits and related matters, none of them expressed a doubt over the honesty of the council or fund, or any concern that the benefit was at risk from the council.

Members trust council

On the other hand, news of a national fund provoked instant reactions of resignations or threats from all funds in our case study. There seems to be no trust that a national system would be a safe place for benefits.

Members reacted negatively to NSSF

This trust built up through union participation and negotiation is one of the key value adds for the council funds.

25.5.3 Role of the trustees

In some cases, where funds were overseen by the management committee of the council, the election of the trustee board has not changed this practice. In effect, fund decisions are made by council officials and endorsed by the trustees.

Trustees not always the decision makers

Multiple informants also stated that while unions are interested in managing the affairs of the fund, it is hard to persuade employers to appoint trustees. This may result in decision making being biased towards one party.

Employer trustees lack interest in fund

Council funds are treated as umbrella funds, as they are multi-employer funds. In many cases, they lack independent trustees which are required by the FSB for umbrella funds. This would however not be difficult to amend as most respondents stated that they would not be averse to appointing independent trustees in addition to the employer and union trustees. Additionally, one of the funds in our case study has been granted an exemption from this requirement on the grounds that the fund had member representatives which are normally not present in umbrella funds.

26. Contribution to new retirement framework

If the reform proposals are implemented in their current format, the options for bargaining council funds will be as follows:

Options under reform:

- Adapt to become part of the accredited framework
- Provide "top up" benefits above the levels of the NSSF
- Stop providing benefits and let members move into the NSSF

- *Accredit and opt out*
- *Accredit and top-up NSSF*
- *Not accredit and dissolve*

Become accredited: Our discussions with the council funds show that in all of the funds, there is continued interest and attachment to the funds. Most of our informants believed that these funds add value to the councils and members alike, and expressed an interest in continuing with benefit provision in the funds. In some cases, our informants were of the view that dissolving the fund would weaken the council itself and harm the negotiated industry agreements.

Strong interest in continuing fund

The view was also that council funds have advantages in terms of understanding the industry, the needs of the workers and the channels for communication that make them more effective at benefit provision than the planned NSSF is likely to be.

Advantages of council expertise and relationships

In our view, accreditation and becoming approved funds is a course of action that should be considered by most council funds.

Recommend all funds consider accreditation

Discontinuation: Council funds may be forced to be discontinued, if the opt-out mechanism is not implemented as described above. If opt-out is possible, funds which are not motivated to negotiate benefit improvements and change their internal structures would also not be likely to gain accreditation.

If not accredited, will not survive

Top up benefits: If opt-out is not implemented, council funds would in our view not be suitable for providing top-up benefits. Salaries are below the contemplated NSSF ceiling, and contribution rates are lower than in the private employer funds and lower than 15% of salaries for 75% of the funds. Even if the NSSF contribution level were to reduce to say 10% of salaries, the top up contributions to council funds would amount to a few percent. Administration costs would not reduce, and cost efficiency or in fact any kinds of economies of scale would be impossible at those levels. We are of the opinion that council funds would not continue under those circumstances.

Top-up benefits over and above NSSF not suitable

Low salaries

Low contributions

No reduction in admin costs

Lack of economies of scale

The options discussed below are therefore limited to **discontinuation** and **accreditation**. We also discuss further options for funds under the accredited framework.

26.1 Council funds discontinued

If some or all councils lose their funds, their members will be compelled to join the NSSF instead. This has a range of possible consequences.

Consequences of dissolution

26.1.1 Sustainability of councils without retirement funds

It seems that the smaller the council, the more dependent it is on the existence of a retirement fund.

Small councils depend on fund:

- Having a retirement fund justifies the employment of a sizeable staff complement, that can be used to perform council related services;
- The retirement fund generates the largest amount of contributions (compared to other benefit funds) from which expenses can most easily be funded. This has become a major source of revenue for some of the councils.
- Furthermore, the expense allocation from contributions is much more easily increased than other sources of income such as levies. Levies need to be negotiated with the employers, whereas expenses are in many cases simply charged to the fund.
- Having a fund makes the council more of a tangible entity in the eyes of members and employers. If no benefits are provided, the council is merely a platform for negotiation with no real influence over its members.

- More staff

- Fees

- Easier source of income than levies

- More stature to council

The smaller councils are however most at risk of losing their funds, for reasons such as lack of governance and cost efficiency.

Our informants in the smaller funds were of the view that if the council retirement fund were dissolved, it would be very likely that the council would not survive without it. The key to the success of the council is representivity and the extension of the agreement, and without the fund, representivity is likely to reduce. This risk is lower in the larger councils where the other functions of the council are more prominent.

Council may not survive dissolution of fund

Therefore, one potential consequence of the reform is the dissolution or reduction in scope of some of the councils. Assuming councils are valuable as part of the labour process, this would have negative knock-on effects in those industries.

Impact on labour relations

26.1.2 Reduction in coverage

In industries where the average wage is low and there are many informal businesses, for example in the hairdressing an furniture manufacturing industries, the dissolution of the council fund may lead to a reduction in overall retirement coverage.

Dissolution may reduce overall coverage

In such industries, employers are difficult to find and persuade to join a fund. Informal businesses operate without any kind of registration, on a cash basis. Employees are paid in cash, earn below the tax threshold and are not registered anywhere. The council funds in those industries generally have a poor record in convincing employers to register, despite vigorous activity on the part of the council. We expect that the NSSF would have a lower penetration of this population segment, and removing these council funds would lead to members who are currently covered leaving the system again.

Informal workers may "opt-out"

Even in industries which have higher paid workers and more formalised, we would expect a general drop in participation if their funds are removed. Any change in where one framework is dissolved and another introduced carries such a risk in our opinion.

Change in framework = risk of participants dropping out

26.1.3 Implications for members

If members of council funds are moved into a national fund, we expect general opposition to the move. There appears to be a distrust of "government" arrangements in general. Anecdotal reactions to the NSSF proposals thus far, and even to seemingly innocuous events such as registration under the Act, were negative and had to be carefully managed by the councils. In our view, such negative attitudes are likely to translate into non-compliance, and members will find ways to remove themselves from the system where possible.

Opposition to NSSF

26.1.4 Increase in contributions

If the NSSF contributions are higher than the current retirement contributions in the council fund, employers and/or members will have to increase contributions.

Higher contributions under NSSF – lay-offs, poverty

If employers are to fund all or some of the increase, this may lead to lay-offs as employers cannot afford the increased wage bill.

If members are to fund the increase or some of it, this may have an effect on household income and poverty levels.

Where such a move is possible, we would expect some employers and members to attempt to circumvent the system by leaving the formal economy.

26.2 Accreditation

Some of the funds we examined are in our view likely to qualify, while others have severe issues which would need to be addressed. All should consider the potential criteria and goals of accreditation and attempt to qualify, in our opinion.

26.2.1 Improve benefits and contributions

The accreditation criteria are likely to include providing benefits equal to or better than the NSSF. The NSSF benefits have however not yet been fully defined.

If the current proposals are implemented, the target benefit structure is likely to be 10-12% of salaries as contributions towards retirement, additional contributions of around 4% (if risk sharing proposals are implemented) towards risk benefits (the quantum of benefits is unknown), plus an additional contribution towards expenses.

First step: raise contributions

For many council funds, the first step would be to raise contributions. Where this is a 1%-2% increase, we expect that negotiations could be conducted to achieve this. In some councils, our informants were very positive about the possibility of negotiating such an increase. In others, the view was expressed that employers would never agree to contribution increases. It remains to be seen what the actual outcome would be in the face of possible dissolution of the fund.

Increase needs to be negotiated

If large increase, phase in

For some funds the required increase would be much higher. This is particularly true for funds where there are currently no death and disability benefits and contributions towards retirement are still lower than 10%-12%. We recommend that the contribution increases are attempted in stages, and that a long term plan is put in place which demonstrates willingness to improve.

Risk pooling contributions could be paid on top

If the risk pooling proposals are implemented, contributions to the shared risk arrangements could be negotiated as a separate benefit, and the current retirement fund contributions would then be available purely for retirement. This would in most cases bring the funds much closer to the required level. The splitting of small contributions and payment to a separate entity will however add to the cost and complexity structure of a solution.

26.2.2 Improve cost efficiency

Recommend independent analysis of costs

We recommend that council funds conduct an independent analysis of costs. This could be coordinated at a national level by the Department of Labour in order to achieve consistency. The first step is to improve transparency, and express all costs as a percentage of salaries or contributions. This is not done in all funds at the moment, and expenses are sometimes effectively taken off investment returns, making the true amount unclear.

Improve transparency

Such an analysis should be performed regarding the record administration on the one hand, and relative to the managing of the investments of the fund on the other hand. The separate focus on the two areas would assist in clarifying the cost drivers.

For funds where the administration is internal, it is important that the full cost of such administration is known. In many funds, we found that besides an administration fee, the fund paid for buildings and maintenance, or salaries – these need to be accounted for as part of the administration fee.

Identify cost in internal admin funds

Once the true cost of running the fund is known, we recommend reviewing each component independently, if possible by engaging in a formal tender process for each service to identify if a cost saving can be obtained. The tenders should consider quality as well as cost. If cost savings can be identified without affecting quality, those service providers should be appointed.

Review each component

If the fund is internally administered, there may be good reasons for not moving the administration to an external provider. However, if the tender process suggests significant cost savings are possible, this is an indication that the internal provider may not be cost efficient. Steps should be taken to reduce the cost of internal administration. If there is a cost subsidy from the fund to the council which is causing administration to be unduly expensive, this is to the detriment of the members. We recommend that the council renegotiate levies in order to fund council activities from council income and fund activities from fund contributions, and avoid cross subsidies.

Compare to external and outsource or improve

Any costs that are not attributable to service providers need to be examined separately. What is the reason for the costs, and are they likely to recur annually? Can a cost saving be achieved somehow without affecting the members?

This exercise should result in cost savings in most cases. The target cost will depend on the final version of the reform proposals, but we suggest funds aim for less than 1% of salaries in order to ensure their continued viability.

Goal: 1% of salaries or less.

Expressed as a ratio of charges to contributions, assuming contributions of 15%, this is 7% of contributions. Rob Rusconi (2004) shows that currently, South African funds tend to pay in the region of 13% or more of contributions. A useful comparison is with large industry funds in Australia, which have charge ratios of 5% for defined contribution funds. By comparison, the Metal fund in our case study had a charge ratio of 3%, and the Motor fund 2%.

Large funds achieve excellent charge ratios

26.2.3 Improve governance

We expect that funds that wish to be accredited as approved funds under the reformed framework would also need to meet strict governance criteria.

Council funds have generally started to improve their governance processes since 2008, when they were first registered under the Pension Funds Act. The Labour Relations Act, which was the previous applicable legislation, was not specific to funds and did not impose particular governance criteria on the funds.

LRA did not impose governance

We have found that council funds understand that more rigorous governance is required of them now and have started to implement the required structures. However, it is our impression that the mindset created by the Labour Relations Act has not entirely changed yet. The key premise of governance is acting in the best interest of the members, and running the retirement fund as an independent entity accountable to the members.

Transition to PFA in progress

We found that the mindset of running the fund as a service provided by the council still prevails in many of the funds we examined. Funds are inextricably linked to councils, decision makers at the council tend to make or influence the decisions of the fund, and in internally administered funds the administrator is often effectively the decision maker.

Fund is still seen as a council service

This situation does not mean that the funds are mismanaged. However, there is potential for decisions to be made without considering the members as the main stakeholder.

Potential for sub-optimal decisions

We recommend that funds consider an independent review of governance structures to identify potential conflicts of interest, and to focus on the inherent conflict between running the business of the council and the business of the fund.

Review governance structures

26.2.4 Improve communications

Council funds issued some communications to members, but one of the key findings from interviews with ex-members was that fund benefits were not understood and that some major misconceptions about the fund had developed. We recommend that funds focus on member education rather than information in order to empower members to make decisions about their fund.

Members do not understand their benefits

Focus on education

26.2.5 Improve protection of benefits

Criteria for accreditation are likely to include protection of benefits. That involves both protection from leakage in the form of withdrawals and cash rather than pension benefits, as well as ongoing protection from investment fluctuations.

Stability of returns

Given our understanding of member needs, we support the need for smoothed returns and avoidance of negative returns. We recommend that;

Review IPS for minimising risk

- Funds review their IPS and if necessary, include a goal of minimising negative returns in the short term;
- Funds which cannot smooth internally consider investment vehicles which provide guarantees and smoothing;
- Funds which are large enough to smooth returns consider doing so and obtain appropriate assistance from an actuary.

Either internal or external smoothing

Protection from leakage

Revision to regulation to reduce withdrawals

Protection from withdrawals and leakage will be improved if the Act is revised to limit or prohibit withdrawals from funds. We understand that this is one of the goals of the reform and it will assist the council funds in delivering value.

Education on withdrawals:

While withdrawals are still allowed, we recommend that funds consider educating members on the options available to them at retirement, and emphasising:

Tax

- That tax is payable on withdrawal benefits but not on transfers; and

Transfers

- That transfers are permitted and what the process is of making a transfer.

Enable transfer process

The process of making a transfer should be simplified and ideally should be the default option.

From our interviews with members, we gathered that very little information was provided with respect to withdrawals and that more information may have led to members making better choices with their benefit.

Waiting periods

The waiting periods introduced by 3 of the funds in our case studies should have a positive effect on preservation and we recommend other funds consider similar measures.

26.2.6 Conversion to income

Self-insurance of annuities

If it does become a requirement that retirement benefits are paid as pensions rather than as cash, it may be worth it, for the large council funds, to self-insure such annuities. Currently, we have come across few examples of pension-type benefits, and virtually no pensions payable from a fund in the council environment. However, given the closed nature of the fund and the particular mortality rates experienced in each industry, it is very likely that such self-insured pensions would present much better value to members than commercially purchased annuities.

An alternative to insuring pensions in the fund is for a council fund to approach an insurer for an annuity that is created specifically for that fund, and takes account of the actual mortality experience.

Tailor made annuities

If the NSSF provides annuities, it will be in the interests of councils to take these up.

NSSF annuities

26.3 Further options

26.3.1 Mergers

We recommend that mergers are considered between funds. This will lead to larger funds and improve economies of scale:

Larger funds =

- Larger funds were found to have lower cost levels. In our case studies, the 3 funds with 20 000 members or more had expense ratios of 1% of salaries or less. The 2 smaller funds had higher expense ratios.

Lower cost

- On the investment side, larger total assets mean more effective investment structures can be put in place and risk and return can be better managed.

Larger assets – better structures

- Self insurance is possible when a fund is large enough to have predictable experience. Self insurance can be more cost effective as there is no profit element.

Self insurance

- Smoothing of returns, which is valuable for members who do not understand investment risks, can be achieved more easily when the asset pool is large.

Internal smoothing

- Larger funds are likely to have better governance structures as more time can be devoted to the running of the fund, and better assistance can be afforded.

Better governance

Mergers could be accomplished at the council or the fund level. Our informants seemed to think that combining funds would be easier to negotiate than entire councils.

Fund or council mergers

Possible candidates for mergers are:

- Regional funds of the same industry
- Funds for similar or related industries where links already exist

Regional funds
Similar industries

In cases where one council has more than one fund, for example pension and provident, or funds for different classes of employer, we expect that mergers would be less effective at improving economies of scale. This is because these councils probably already benefit from some of these economies of scale. However, mergers between such funds could be contemplated and trustees should consider if cost savings could be achieved. Provident and pension funds have different benefit structures at the moment, but we expect that provident funds could be phased out in the future to improve on preservation.

We expect that merging unrelated funds from completely different industries may be more challenging.

We have identified the following private council funds in South Africa at the moment:

	Number of funds		Estimated total membership
	Pension Fund	Provident Fund	
1 - Motor Industry Bargaining Council (National)		2	> 200 000
2 - Bargaining Council for the Building Industry (Bloemfontein)		1	1 000 - 5 000
3 - Building Industry Bargaining Council (Kimberley)	1		1 000 - 5 000
4 - Building Industry Bargaining Council (Southern and Eastern Cape)	1	1	5 000 – 10 000
5 - Building Industry Bargaining Council (Cape of Good Hope)	1	1	20 000 – 30 000
6 - Building Industry Bargaining Council (East London)	1	1	1 000 – 5 000
7 - Building Bargaining Council (North and West Boland)	1	1	1 000 – 5 000
9 - Bargaining Council for the Diamond Cutting Industry (SA)	1		1 000 – 5 000
10 - Furniture Bargaining Council		1	20 000 – 30 000
11 - Bargaining Council for the Furniture Manufacturing Industry WC		1	1 000 - 5 000
12 - Bargaining Council for the Furniture Manufacturing Industry, Kwa Zulu Natal		1	1 000 - 5 000
13 - Bargaining Council for the Furniture Manufacturing Industry - EC		1	< 1 000
15 - Bargaining Council for the Hairdressing Trade, Cape Peninsula		1	< 1 000
16 - Hairdressing and Cosmetology Bargaining Council KwaZulu-Natal	1		< 1 000
17 - Bargaining Council for the Hairdressing and Cosmetology Trade, Pretoria		1	< 1 000
18 - Hairdressing and Cosmetology Services Bargaining Council (Semi-National)		1	1 000 – 5 000
19 - Metal and Engineering Industries Bargaining Council (National)	1	1	> 200 000
20 - Bargaining Council for the Jewellery and Precious Metal Industry (Cape)	1		< 1 000
21 - Bargaining Council for the Laundry, Cleaning and Dyeing Industry (Cape)		1	1 000 – 5 000
22 - Bargaining Council for the Laundry, Cleaning and Dyeing Industry (Natal)		1	< 1 000
23 - National Bargaining Council of the Leather Industry of South Africa		1	10 000 – 20 000
25 - Bargaining Council for the Meat Trade, Gauteng	1	1	1 000 – 5 000
26 - National Bargaining Council for the Road Freight Industry		1	50 000 – 100 000
32 - Bargaining Council for the Goods Canvas Industry - Gauteng)		1	1 000 – 5 000
34 - Bedingingsraad vir die Graankooperasiebedryf (National)		1	1 000 – 5 000
35 - Bargaining Council for the Contract Cleaning Services Industry (KZNI)		1	1 000 – 5 000
37 - National Bargaining Council for the Electrical Industry of South Africa	3	2	30 000 – 50 000
41 - National Bargaining Council for Clothing Manufacturing Industry		4	30 000 – 50 000
42 - National Textile Bargaining Council		1	1 000 – 5 000
Total	**13**	**30**	

If regional funds for the same industry were merged together (as marked above in the colour bands), this would consolidate the following industries:

Building industry national

Building Industry (merging funds in councils 2, 3, 4, 5, 6 and 7) : 20 000 – 50 000 members

Furniture national

Furniture (merging funds in councils 10, 11, 12 and 13) : 30 000 – 50 000 members

Hairdressing national

Hairdressing (merging funds in councils 15, 16, 17 and 18) : 1 000 - 5 000 members

Laundry (merging funds in councils 21 and 22): 1 000 – 5 000 members

Laundry national

These four mergers eliminate 5 out of the 6 councils with less than 1 000 members, and reduce the number of councils with 1 000 – 5 000 members from 14 to 8, without detriment to the councils themselves.

We have been informed that the hairdressing industry has already in principle agreed to a merger of their four funds (the councils are to remain separate). The impetus for this merger has been the proposed retirement reform.

Consider other options

The above suggestions are not the only mergers possible in the current space, and we suggest that councils consider the possible partners and synergies that can be obtained from a potential merger. Some councils already have relationships which rely on common services and sharing local offices, for example. Where a relationship already exists, it could be considered if further value cannot be gained through a merger of the benefit funds as well.

26.3.2 Increased scope for successful funds

Internally administered funds which are cost efficient could play a role under the new dispensation by assisting other councils and funds to improve their value offered to members.

Accept members from other industries

For example, such cost-efficient funds could accept members from other industries. These could either join the main fund, or a separate category could be created. There are examples of this happening in the past, for example the motor industries funds have in the past accepted members from one of the electrical councils. The key to this extension of the fund's scope is that the members of the new council join the fund on a mandatory basis to avoid anti-selection.

Administer other council funds

Another possible solution is for the administrators of cost efficient funds to administer funds of other councils. For example, the administrator of the metal industries funds states that their system has the capacity to take on further funds and that this is something they may consider. Cross-council cooperation is already taking place in other arenas, for example where metal industries, road freight and electrical councils are planning to use each others' regional offices to better deal with member queries. We therefore envisage that sharing successful administration services could also be possible.

26.3.3 Become NSSF Administrator

Administer portion of NSSF

A further opportunity exists for the larger internal administrators in the bargaining council space to offer their services to the NSSF. The plan is to administer the NSSF through a public/private partnership, and if administration is handled privately it may need to be distributed amongst a number of administrators. The largest of the bargaining council administrators, MIBFA (Metal Industries Benefit Fund Administrators) manage a fund of over 350 000 members and in the past administered as many as 500 000. Their representatives have stated that they have capacity to take on another large fund. They may be well equipped to assist with the administration of the NSSF or parts thereof.

27. Impact of new framework on council funds

27.1 Coverage

Increased coverage

If participation becomes mandatory country-wide, and a way is found to enforce it universally (for example by linking contribution collections to the income tax collection mechanism), we expect this to reduce the number of unregistered employers. Employers not registered under the council would find themselves automatically registered for the NSSF. This may motivate them to register with the council.

If the NSSF and mandatory participation are introduced, exempted employers would either need to offer an approved fund themselves, or their employees would become members of the NSSF. This may in some cases lead to the employer forfeiting their exemption in order to participate in the fund.

27.2 Contribution Collection

Measures to improve contribution collection

If contribution collection is linked up to the SARS system, this would assist approved council funds in collecting contributions from taxpaying members.

27.3 Mandatory preservation

Improved preservation

It seems likely that the ability to access funds through withdrawals will be curbed under the new framework. This preservation may, during the transition period, apply only to funds accumulated after a certain point in time.

The introduction of mandatory preservation is likely to have two major consequences in our opinion:

- Opposed by members

Members are likely to oppose the reform if access to funds is denied. We have seen with one of the funds we investigated, members reacted negatively when their fund was registered under the Pension Funds Act. The Furniture KZN council issued a Q&A specifically to explain to members that registration would not mean the "government will take your money". Any measure that curbs members' ability to withdraw their savings is likely to be seen as an attempt to "take the money" in our opinion.

We recommend that any changes in preservation are introduced gradually and sensitively, and that the communication strategy around this issue is carefully considered.

However, if preservation is successfully introduced and enforced, the levels of benefits achievable by these funds should be greatly improved in the long term.

- Higher benefits

27.4 Pooling of risks

If risks are pooled, the cost of death and disability benefits is likely to be in the region of 4% across the board. Most council funds in our investigation had a lower cost than this – by offering modest benefits or no benefits at all; by having a better mortality experience than the rest of the country; or by subsidising benefits from surplus and reserves. If risk pooling is introduced, the net allocation to retirement will reduce.

Risk pooling increases costs / reduces benefits

28. Lessons for retirement reform design

28.1 Coverage

28.1.1 Informal opt-out

Employers and members will opt out of compulsory arrangements if they do not support them. This was most clearly seen in the hairdressing industry, where employers and workers operate or can easily operate within a cash economy and are difficult to find and register. Our informants suggested that there was not a lot of support for a national fund among the workers in the various industries. This was demonstrated by objections voiced when various reform proposals were published, and in one case even objections to registering under the Pension Funds Act.

Members will opt-out of NSSF informally

28.1.2 Coverage of low-earning workers

It should also be noted that SARS does not cover low-earning workers, particularly in informal businesses. Small barbershops are an example in the hairdressing industry. There, it is likely that the NSSF will achieve a lower level of penetration than the councils have. We recommend that this factor is considered and that these funds are assisted in attaining accreditation however possible. If those council funds are closed down and replaced with the NSSF, overall coverage in those industries would in our opinion reduce. There are severe challenges regarding costs in informal and small employer environments, but there are worthwhile achievements in this sector too.

SARS does not cover some workers in council funds

28.1.3 Exemptions from council funds

Councils currently have a system for allowing employers to be exempted from the council fund. If council funds become accredited under the new dispensation, the designers of the NSSF should be mindful that the exemption process does not become a loophole through which employers may avoid providing retirement benefits altogether.

Exemption system of councils needs to be reviewed

In the same way, rule amendments to reduce benefits/contributions or fund closures must be monitored by the party allowing opting out.

28.2 Accreditation

Most council funds do not automatically meet the potential criteria for accreditation. However, most council funds do deliver value.

Our view is that where funds are already in place, and much work has been done to gain the trust of participants and their participation in a retirement saving system, that accreditation should be a collaborative process rather than an impossible hurdle. Whatever the final shape of accreditation will be, flexibility and support to existing funds in attaining accreditation will be crucial. Where funds do not meet accreditation criteria, we suggest that assistance and guidance is offered to help these funds adjust their structures to comply. We also recommend that there is a transition period during which these adjustments can be implemented.

Accreditation process needs to be collaborative

28.3 Benefit Design

28.3.1 NSSF approach confirmed

Some aspects of the proposed NSSF are reflected in the negotiated benefits provided by council funds, confirming that the approach is likely to be suitable for low income workers. These aspects include:

- No investment choice
- Low risk investment strategy
- Smoothing and investment guarantees
- Benefits are simple and easily communicated.

Council funds negotiated similar design to NSSF:

- *No investment choice*
- *Low risk investments*
- *Smoothing*
- *Simple benefits*

To smooth or not to smooth?

Large council funds successfully employ smoothing to reduce variance of returns. But if preservation is addressed, is smoothing still needed, and is it worth paying potential fees for this service? We suggest the answer is yes:

- Smoothing is not just for withdrawals, retirement benefits also need smoothed returns particularly close to retirement;
- Council funds found that communicating negative returns is difficult, whether members plan to withdraw or not. Smoothed returns mean that benefit statements show an increasing benefit from year to year which is what members want to see;
- The cost of smoothing is only incurred if an external provider is involved. Internal smoothina is low cost.

28.3.2 Contribution rate design

It needs to be considered whether funds will be accredited based on their gross contribution being in line with the 15%-18% of salaries proposed for the NSSF, or whether the more important result is the net contribution towards retirement, after the cost of risk benefits and expenses has been deducted. In that case, the target would be 10-

Accreditation based on net contribution – encourages cost efficiency

12% of salaries. Using net contributions as a target encourages funds to improve their cost efficiency, and we recommend that this is the approach followed.

28.3.3 Pensionable salary

Commissions may distort income and lower effective NRR

It is unclear what the current NSSF proposals may define as pensionable salary. It is however likely that the definition will be basic salary, as it is in pension funds. However, examples such as the hairdressing industries show that salaries may be structured to have a low basic and high commission type remuneration. This may reduce effective NRRs achieved by the system. It may also give employers opportunity to save on pension costs by restructuring salaries.

28.3.4 Funeral benefits

Funeral benefits provided by unions

In some cases, the provision of funeral benefits is seen as the provenance of the unions. If the NSSF provides such benefits, this may have an impact on this offering which may disempower the unions to some extent and also remove a source of revenue.

28.3.5 Housing loans

Housing loans important to members

Housing loans are a significant benefit for council workers and were in many cases quoted as the most important benefit offered by council funds. We recommend that the NSSF allow for housing loans as part of their system as this is a valued benefit and counteracts the constraints of preservation to some extent.

Housing loans also aid in post-retirement quality of life – if a retiree owns their own home, their income needs are reduced. On the other hand, this may also lead to members investing their retirement resources in luxuries or too expensive houses, where the ability to continue living in the house is affected by the drop in post retirement income.

28.3.6 Effect of SOAG

SOAG is powerful at low income levels

With average income in the region of R40 000 per year, the SOAG, at R12 000 per year, would provide an NRR of 30%. In our case studies, we tested this and saw the SOAG increasing the NRR by between 13% to 50% of salaries. Making the SOAG universal would drastically change the income needs of the members of these funds and make the combined benefit from the fund and the SOAG adequate.

It should be noted that we have assumed that the SOAG increases at the same pace as low income sector salary increases in this simple scenario.

28.3.7 Salary increases

Salary increases are low

We found limited salary progression for workers under the councils. Wages are usually agreed in negotiation and targeted to increase in line with inflation. Above inflation increases can only be achieved by progressing from one category of employment to another, and the scope for this is limited. Examining minimum wages in council funds and how they have changed over the years may be a useful guide to deriving the salary assumption for NRR calculations in the NSSF. In our assumptions, we used CPI + 1% as the salary growth assumption.

28.3.8 Form of benefit at retirement

The reform proposals have a strong focus on providing the benefit at retirement in the form of a pension. The reason for this is to ensure continued income into old age and prevent a benefits from being spent too quickly.

Lump sum at retirement still preferred

However, our examination of council funds reveals strong preference for lump sum benefit payments. Provident funds, which pay out lump sums, were the result of union demands in the past, and we do not see that the needs which led to the creation of these funds have changed today. Our informants stated that provident funds were put in place, for example, when regular pension payments were difficult or impossible to administer in rural areas.

Pension payments difficult to administer

There are other reasons for considering some form of cash payment at retirement:

SOAG may meet income needs

- If the SOAG is universally available, it is likely to meet all or most of low income members income requirements;

Annuity rates not suitable

- The conversion rate to pensions offered by South African insurers is not suitable for low income earners; however, the NSSF pension may address this.

Informal opt-out a consequence of unwanted benefits

- Not offering a lump sum benefit may cause informal opt-out rates to increase significantly.

In our view, the focus should be to develop the savings first, and then to improve on the ability to provide reasonable benefits to those that use their savings to create a regular income. The fear of 'losing your money on death' when you acquire a pension – especially where members believe that they do not have the prospect of being on pension for a long time - is a problem that is very difficult to address where a measure of choice exists. If able to, members may resign just before retiring to rather get the cash rather than be forced into a pension.

Relief from preservation should be considered

We recommend that the designers of the NSSF consider some relief from preservation at retirement to arrive at a workable solution. Introducing an unpopular benefit decreases the chance of success for a national system.

28.3.9 Pre-retirement preservation

Lack of trust in government

It is clear from the examination of council funds that these funds are used as a savings vehicle by the low income workers who participate in them. Changing this approach will be a challenge. There is a lack of trust towards the government and if money is not accessible, it is likely to be considered as "taken away" by the government. Enforcing preservation will be difficult and we recommend that ways are found to allow some limited access to funds to mitigate this problem. This could be in the form of housing and other loans or unemployment benefits, or partial needs-based withdrawals.

Limited access recommended

28.4 Administration

28.4.1 Cost efficiency

Large council funds are able to achieve very cost efficient administration: it seems that expenses can be limited to as little R14 per member per month, less than 0.4% of salaries for that particular fund. This can be used as a benchmark for the NSSF design. It must be remembered that the cost is very sensitive to the services that will be required and the additional costs that are generated if the data is compromised. The costs observed in the council funds generally exclude the cost of contribution collection and the council interactions with all parties.

Cost targets as low as R14 pmpm possible

While large funds undoubtedly achieve lower cost levels, it is unclear what the optimum size is and whether expenses level out after a particular size is reached.

28.4.2 Collection of contributions

One of the main challenges for council funds is ensuring contributions are paid. This problem particularly affects the smaller employers, and worsens during periods of economic downturn. We envisage that the NSSF will experience similar problems. We recommend that contribution collection mechanisms are carefully considered in this light, and that severe measures are put in place to enable the fund or trustees to act against non-complying employers swiftly and with the full support of the state. These measures should be made available to all approved funds as well, as in our experience many private funds in South Africa are experiencing similar problems to some degree.

Severe measures for non-compliance needed

If SARS is used as the agency for contribution collection, it should be noted that currently in council funds, wages are separate from employer contributions. Employer contributions are in some cases invoiced to employers and may be paid entirely separately from wages. If this is rolled into a SARS system, an adjustment will be needed for this approach.

Wages and contributions currently not paid together

28.5 Governance

28.5.1 Communication of benefits

We have found that there is limited understanding of financial issues among council fund members. There is no appreciation of investment risk at all, for example, and complicated benefit structures such as individual investment choice have no place in a low income environment. We recommend that the design is as simple as possible –

Simple benefit design

an annual bonus declaration, consistent positive investment returns, simple benefits on death and disability. The underlying structure must support this design – an investment reserve may be appropriate to smooth returns, for example.

In our investigations, we found the large funds were adopting such simplified approaches, where the DC accounts were managed on an approximate basis rather than keeping detailed individual values. However, it should be noted that currently, investment smoothing approaches may be hampered by minimum benefit legislation which can negate the smoothing in the fund.

Review system of minimum benefits which undermines smoothing

Additionally, education of workers about retirement benefits is the most pressing need we identified through member interviews.

Member education essential

28.6 Taxation of benefits

EET system

The current system is based on tax exempt contributions and investment returns, followed by taxed benefits. Taxation is more severe for withdrawal than for retirement benefits.

Penal taxation on withdrawals

Members are not aware of the tax position and do not realise that they will be taxed on withdrawal. This negates the intended effect of discouraging withdrawals through taxation.

System not understood by members

We recommend that education focuses on this aspect to make consequences of early withdrawal clear.

Education essential to reduce leakage

APPENDICES

29. Appendix 1: References

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Bargaining Councils Retirement Fund Rules and Documents - various

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30. Appendix 2: Tables

30.1 Table 1: Coverage

Fund Name	Employees in Council	Members in Fund	Coverage
10 – Furniture	17,300	23,900	138%
26 - Road Freight	80,000	90,000	112%
19 – Metal	330,000	361,200	109%
2 - Building – Bloemfontein	2,000	2,100	103%
3 - Building – Kimberley	4,800	4,800	100%
23 - Leather	15,000	14,100	94%
25 - Meat Trade	5,400	4,800	88%
1 - Motor	240,000	204,900	85%
5 - Building - WC	31,300	26,000	83%
11 - Furniture Manufacturing - WC	5,900	4,800	82%
16 - Hairdressing - KZN	700	600	80%
17 - Hairdressing - Pretoria	1,400	900	65%
34 - Grain	7,800	3,800	49%
13 - Furniture Manufacturing EC	600	300	48%
12 - Furniture Manufacturing - KZN	6,600	2,900	43%
15 - Hairdressing - WC	1,700	600	36%
35 - Contract Cleaning - KZN	13,000	4,100	32%
42 - Textile	16,000	4,100	26%

30.2 Table 2: Average employer size

	Employers in Fund	Active Members in Fund	Average Members per Employer
1 - Autoworkers Provident	18,000	204,900	11
1 - Motor Provident			
2 - Building Bloemfontein Provident	138	2,100	15
3 - Building Kimberley Pension	119	4,800	40
4 - Building SE Cape Pension	1,500	9,300	6
5 - Building WC Pension	1,453	13,700	9
5 - Building WC Provident	1,453	12,200	8
10 - Furniture Provident	1,326	23,900	18
11 - Furniture WC Provident	250	4,800	19
12 - Furniture KZN Provident	242	2,900	12
13 - Furniture EC Provident	13	300	21
15 - Hairdressing Cape Provident	203	600	3
16 - Hairdressing KZN Pension	140	600	4
17 - Hairdressing Pretoria Pension	306	900	3
18 - Hairdressing semi-national Provident		2,700	
19 - Metal Provident	9,417	361,200	38
21 - Laundry Cape Provident	104	1,100	11
23 - Leather Provident	270	14,100	52
25 - Meat Trade Pension	148	500	4
25 - Meat Trade Provident	513	4,200	8
26 - Road Freight Provident	3,967	90,000	23
32 - Goods Canvas WC Provident	15		
34 - Grain Provident	8	3,800	477
35 - Contract Cleaning KZN Provident	232	4,100	18
37 - Electrical Pension		24,000	
41 - Clothing KZN Provident	411	17,000	41
41 - Clothing WC Provident	263	23,600	90
42 - Textile Provident	204	4,100	20
Total	**40,695**	**831,500**	
Average	**1,628**	**32,000**	**40**

30.3 Table 3: Turnover

Short name	New members per 1000	Retirements per 1000	Withdrawals per 1000	Deaths per 1000	Disability per 1000	Total Exits
1 - Autoworkers Provident	178	10	162	7	4	183
1 - Motor Provident	206	13	193	3	2	211
2 - Building Bloemfontein Provident	989	7	306	34	-	347
3 - Building Kimberley Pension	46	2	66	2	1	71
4 - Building SE Cape Pension	139	47	79	8	1	135
5 - Building WC Pension	46	19	28	2	-	49
5 - Building WC Provident	74	3	29	0	-	32
10 - Furniture Provident	137	3	244	7	2	256
11 - Furniture WC Provident	23	9	209	3	1	222
12 - Furniture KZN Provident	132	12	124	12	9	157
13 - Furniture EC Provident	201	22	532	4	-	558
15 - Hairdressing Cape Provident			12		-	12
16 - Hairdressing KZN Pension	186	29	261	16	4	309
17 - Hairdressing Pretoria Pension	181	10	78	1	-	89
18 - Hairdressing S/N Provident	167	30	149	9	3	190
19 - Metal Provident	225	10	103	20	-	134
23 - Leather Provident	257	22	226	6	-	254
25 - Meat Trade Pension	224		104	13	2	119
25 - Meat Trade Provident	360		85	11	1	96
26 - Road Freight Provident	217		261	31		293
34 - Grain Provident	194	12	119	15	2	148
35 – Contr. Cleaning KZN Provident	1,536	39	706	10	1	756
42 - Textile Provident	226					-
41 - Clothing KZN Provident	354	15	153	5	6	179
32 - Goods Canvas WC Provident						-
41 - Clothing WC Provident	198	24	403	4	2	432
Average	**260**	**17**	**193**	**10**	**2**	**222**

30.4 Table 4: Membership statistics

	Active Member Liability (Rands)	Ave Individual Member Share (Rands)	Active Member Monthly Contributions (Rands)	Monthly Contributions (Rands)	Active Member Monthly Salaries (Rands)	Ave Individual Monthly Salaries (Rands)
1 - Autoworkers Provident	5,239,121,000	31,961	86,066,936	525	555,270,555	3,387
1 - Motor Provident	3,693,239,000	90,187	53,431,052	1,305	344,716,465	8,418
2 - Building Bloemfontein Prov.	29,085,330	14,133	1,846,570	897	11,541,063	5,608
3 - Building Kimberley Pension	14,206,391	2,982	361,676	76	2,583,401	2,407*
4 - Building SE Cape Pension			2,308,000	247	16,485,714	1,764
5 - Building WC Pension	486,911,970	35,456	5,937,560	432		
5 - Building WC Provident	132,403,427	10,819	4,126,101	337		
10 - Furniture Provident	506,691,725	21,208	10,807,193	452	90,059,942	3,769
11 - Furniture WC Provident	114,000,000	23,642	2,000,000	415	16,000,000	3,318
12 - Furniture KZN Provident	169,843,989	59,490	1,431,260	501	9,870,761	3,457
13 - Furniture EC Provident	5,307,968	19,732	89,000	331	635,714	2,363
15 - Hairdressing Cape Prov.			217,332	358	1,811,104	2,984
16 - Hairdressing KZN Pension	5,253,673	9,382	106,917	191	890,972	1,730*
17 - Hairdressing Pretoria Pen.	6,710,443	7,200	210,216	226	2,802,883	3,007
18 - Hairdressing S/N Provident	44,055,901	16,323	548,596	203	10,971,926	4,065
19 - Metal Provident	23,801,130,000	65,886.	162,680,583	450	1,232,428,662	3,560*
21 - Laundry Cape Provident	4,897,026	4,480	105,510	97	1,055,098	1,686*
23 - Leather Provident	820,997,433	58,380	4,700,000	334	42,727,273	3,038
25 - Meat Trade Pension	23,248,768	43,783	126,196	238	1,261,960	2,377
25 - Meat Trade Provident	23,192,794	5,497	842,711	200	8,427,105	1,997
26 - Road Freight Provident	893,597,378	9,9301	44,156,637	491	215,398,230	2,769
32 - Goods Canvas WC Prov.	3,167,481					2,572*
34 - Grain Provident	124,186,209	32,552	211,194	55	1,083,046	**
35 – Contr. Cleaning KZN Prov.	71,043,000	17,231	2,751,411	667	19,652,933	4,767
37 - Electrical Pension	244,459,374	10,172	8,856,443	369	59,042,956	4,980*
41 - Clothing KZN Provident	350,421,701	20,572	3,403,582	200	30,941,651	1,987*
41 - Clothing WC Provident	652,659,386	27,636	8,105,765	343	99,579,419	4,217
42 - Textile Provident	102,600,000	24,867	1,500,000	364	11,842,105	3,278*
Total	**37,562,431,366**		**406,928,442**		**2,787,080,936**	
Average	**1,444,708,899**	**26,540**	**15,071,424**	**382**	**111,483,237**	**3,223**

* Salary estimated based on minimum wage for unskilled workers.

** Salary estimate omitted as too low – minimum monthly wages were not available.

30.5 Table 5: Averages and Weighted Averages

In Part 1 of the report, various quantities were presented as arithmetic averages. This prevented the results from skewing towards the larger funds, and ensured that the benefit structures of smaller funds are taken into account.

The table below highlights some key values and shows both the arithmetic average used in the report, and an active membership weighted average. We also show the values for the 2 largest funds, metal industries (council 19) and autoworkers (council 1)

	Average	Average weighted by active membership	19 - Metal Industries Provident Fund	1 - Auto Workers Provident Fund
Employer contributions as % of salary	6.7%	7.3%	6.6%	8.0%
Employee contributions as % of salary	6.2%	7.1%	6.6%	7.5%
Total Contribution as % of salary	12.9%	14.4%	13.2%	15.5%
Contributions per member per year (R)	4,382	5,768	5,404	6,301
Lump sum on death as multiple of annual salary	2.23	2.68	3.00	3.00
Lump sum on disability as multiple of annual salary	2.06	2.39	separate scheme	3.00
Actual benefit at retirement as multiple of annual salary (R)	1.51	2.45	3.71	0.36
Actual benefit at withdrawal as multiple of annual salary	0.52	0.45	0.62	0.20

31. Appendix 3: Questionnaire

This is attached as a separate document.

32. Appendix 4: Member Interviews – Full reports

The full reports of interviews with members conducted in Part 2 of the paper are attached as a separate document.