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Are you worried about interference in your retirement savings? You should be

If trustees could not act in the best interests of fund members, then the introduction of prescribed assets could do more harm than good

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A lot has been said recently about prescribed assets in SA. It is important for all of us to appreciate that retirement funds are custodians of retirement benefits of millions of South Africans.

The term "prescribed assets" refers to a government policy that requires investors, like retirement funds, to hold a certain amount of investments in government-specified assets, such as government or state-owned companies' bonds.

All the published reactions to the possible reintroduction of prescribed assets have argued strongly against such a move. The reasons provided include concerns around lower returns, market distortions, compromised pensioner benefits and reduced participation in retirement funds.

The last concern is worth highlighting because there is nothing in SA law that compels employees to be members of retirement funds, unless an employer provides one as a condition of employment.

Another concern is that prescription can weaken the disciplining mechanism embedded in a market-driven economic system. Even though not always perfect, freedom of choice is a basic tenet that all customers enjoy in SA. This includes the ability for investors to freely change their investments to adapt to changing market conditions and investment goals.

The Financial Sector Conduct Authority (FSCA), as the regulator of retirement funds, deems it appropriate to weigh in on the debate. It is the FSCA's opinion that the reasons and concerns given by the public are sound and justified.

Bonds are an inevitable asset class for retirement funds, especially if the funds practise asset and risk diversification and require stable income. Prescription does not seem, therefore, to be of absolute necessity, and even if it were to be necessary, it seems to result in unintended consequences that might do more harm than good. History does repeat itself at times, but previous mistakes need not be repeated, and SA has been down this path before.

The statistics do not seem to indicate a dire shortage of funding. In the past 17 years, retirement funds have, on average, held about 20% of their total assets in government and state-owned companies' bonds. For the right product and price, there should be a buyer or investor, and current RSA bonds yield good returns compared with other foreign sovereign bonds. The question, most probably, should be whether this 20% is enough.

The answer to this question is best left to retirement funds and, in particular, the trustees who govern and manage these funds on behalf of members. Section 7C of the Pension Fund Act imposes an explicit duty on trustees to act in the best interest of their members and the fund.

One could ask, but what exactly is this duty towards members? It is the duty to ensure that members' assets are invested and managed in the best interest of the members, so that they can retire comfortably. This is the goal that prompted the Treasury to roll out much-needed and extensive retirement reforms in the past eight years. These reforms ensure that the member is put at the centre of every decision made by funds and their service providers.

It is a statistical fact that SA households experience challenges when it comes to discretionary savings and retirement savings. This lack of preservation means that many South Africans reach their retirement age with insufficient savings. Four factors are important to reach one's retirement goals: first, start contributing early; second, contribute consistently and preserve; third, ensure that costs are fair and reasonable, especially in a low-return environment; and last but not least, ensure that the savings earn a decent return.

In the absence of mandatory preservation, it becomes even more imperative that funds earn a decent return, meaning at least above-inflation adjusted returns in the long term at a reasonable cost. Any investment decision resulting in assets being purchased at overvalued prices because of artificial demand, or which does not yield above-inflation returns or has an opportunity cost (because in the long term, equities usually outperform bonds), means that the member is likely to be worse off and not have a comfortable retirement. This also means that trustees would be failing in their fiduciary duties — but then they can only be blamed for a fund's poor performance if they are the sole key decision makers.

This fiduciary duty is something the FSCA has a legal duty to monitor. Why is this fiduciary duty also important to the regulator? This is because any fettering of the trustees' decisions has the real potential to compromise their ability to act in the *best* interest of fund members. This would further compromise the long-term wellbeing of members, which is undesirable given that it is difficult to recover from bad retirement decisions.

Funds, through their trustees, should be the ones making the decisions, difficult as they might be, on how best to constitute their portfolios based on the demographics and needs of their members and pensioners. This allows the FSCA to hold them accountable for bad decisions.

It is also fair to say that there is no point in ensuring that workers have decent retirement benefits only for them to retire in wastelands, under- or undeveloped areas and societies plagued by extreme inequality and social ills. As a result, society has also appealed to large drivers of capital, such as retirement funds, to contribute towards addressing these socioeconomic challenges. This is not only a South African issue but a global one.

Does this, therefore, mean prescription is the solution to these challenges? The FSCA does not think so. Instead, the FSCA would like to continue nudging the industry into doing what is right and good for the environment and society as this responsibility falls on all who live in SA. The FSCA would also like to encourage the market to continue providing scalable projects and investable instruments.

To this end, the FSCA recently issued a guideline on sustainable investing to help retirement funds to comply with the law (regulation 28) on environment, societal and governance (ESG) issues. Sustainable and impact investing do not mean investment choices that yield sub-optimal or no returns. They still mean undertaking sound investments for a return but bearing in mind the risk and consequences of such investments on all of us.

The best results in life come with balancing various difficult objectives and realities. The ability to make such decisions freely and take responsibility for them is important in supporting the principles of freedom and progress in a democratic society.

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