Fairheads Benefit Services (Pty) Ltd
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FAIRHEADS Benefit Services
Authorised financial services provider

Southern Africa's leading independent service provider of beneficiary funds and umbrella trusts

Continuous learning and development

Zukiswa Peter, Fairheads' Financial Manager and Olefile Moea, Director: Communication, attended Batseta's Imbasa Yegolide Awards in February, where they received the National Certificate: Professional Principal Executive Officer. According to Annemarie D'Alton, CEO of Batseta, this certification confirms that Principal Officers have met the high standards associated with being a professional in the retirement fund industry. We are proud of Zukiswa and Olefile and are confident they will add value to the Boards of Trustees on which they serve.

Fairheads innovates with new home loan product

The housing crisis in South Africa is a complex problem, inherited by this generation from our past and still unresolved. Ownership of a property, setting roots to the land and a home to live in are fundamental to a strong, vibrant and stable society. Home ownership is, arguably, one of the first steps to economic freedom in that it provides a safe place to live and store possessions and allows an accumulation of wealth through equity in the property – something which can be leveraged to pay for health, education, and other critical needs of which many South Africans are deprived.

Purchasing a house, unfortunately, remains out of reach for too many of us and new and creative ways must be found to end this cycle. Fairheads wants to be a part of the solution and has developed a loan product which is designed to make property ownership more accessible and affordable.

Pension-backed lending schemes are not new and many banks and other financial intermediaries have served this market. The Pension Funds Act allows members of a retirement fund, subject to the rules of the fund, to use their pension fund credit as security for a loan. The loan must be used to purchase or renovate a home, or can be used to clear an existing debt which was used for this purpose. There is a limit to the amount that the member can borrow against their retirement fund credit, usually around 60% or 70% (but no more than 90% as prescribed by the Act).

The theory behind these schemes is and has been that the lender's risk is significantly reduced and the ►

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borrower should be compensated with a reduced interest rate. In reality, this has not always proved to be the case, with banks providing meagre reductions to their carded rate.

Simply put, the banks have been charging a margin, sometimes quite significant, on loans which are relatively low risk. In addition, there are often high transaction and set-up fees associated with the loans.

A NEW APPROACH

Fairheads' approach is different. As an independent administrator, we have partnered with the retirement fund to provide loans directly to its members, effectively disintermediating the banks.

The retirement fund lends the money to its members and the loan is administered by Fairheads. This provides the member with a very competitive interest rate, and the interest that they are paying is actually returned to their retirement savings. Fairheads provides the administration services to the fund at a significantly lower cost than many of the banks.

The Fairheads home loan product can also be used in conjunction with a standard housing loan if the property price exceeds what is available in the member's fund credit.

We are tremendously excited about the benefits of this new product. It has the potential to unlock real value for retirement fund members by providing them with the opportunity to purchase their home, something we believe is essential to growing wealth, stability and happiness.

Please contact **David Hurford**, Director: Marketing and Consulting, at david@fairheads.com.

MESSAGE FROM THE CEO

Richard Krepelka, CEO

With the political and economic turmoil of 2017 behind us, it is with great optimism that we look forward to the coming year. South Africa remains a land of vast untapped opportunity and the challenge for us all is to convert that opportunity into prosperity for all.

Fairheads is taking a leading role in this by adding a new product to our basket of offerings – administration services for Pension Backed Housing Loans. Affordable housing is one of the pillars of a stable society in which its people can live with dignity, create stability for their family and accelerate the process of wealth accumulation. Read more on this in our article on product innovation.

Government too has been active in providing industry with a set of Default Regulations governing retirement fund investments, preservation and annuitisation. Although we believe that the new defaults do not apply to beneficiary funds, we explore the ways in which we comply with the spirit of the legislation.

With all the talk of rating agency downgrades, Guy Toms from Prescient Fund Managers provides some insight into what this means for the South African bond market and how prices may be affected by further downgrades.

We also spend some time dealing with a perennial issue: paying out lump sum benefits to 18 year olds who may still be in school and who's ability to manage large sums of money may be quite limited. Where legislators have failed to provide a legal mechanism to the problem, Fairheads has found some interesting solutions.

We talk about our commitment to our neighbouring countries in our article about the Swaziland Retirement Fund industry's quest to adapt to the changing legislative landscape, where we have shared some of our learnings with respect to death benefit allocation.

Finally, we congratulate Mr Olefile Moea and Ms Zukiswa Peter, both of whom successfully graduated from the Principal Officers diploma offered by Batseta. We would also like to congratulate the winners of the recent Imbasa Yegolide Awards. We were disappointed that Fairheads couldn't enter as the rules do not allow successive previous winners to be nominated. We look forward to participating in 2018.

South Africa truly is the land of opportunity and we have the chance to enter into new social partnerships between Government, the private sector and the citizens of this great nation to capitalise on that opportunity.

We hope you enjoy this latest edition of the Fairheads Times.

RISK MANAGEMENT

We asked **William Lourens, Head of Internal Audit and Risk**, at Fairheads Benefit Services, to provide some insight into Fairheads' approach to managing risk and optimising opportunities in a demanding business environment:

"Enterprise risk management is driven by dedicated and passionate individuals who have been strategically placed and empowered. Under their leadership our risk maturity has advanced in leaps and bounds. Risk management and compliance feeds directly into our processes and procedures ensuring a timely response to risk changes, while capitalizing on opportunities.

Achieving a balance between operational efficiency and a control framework that ensures our clients are safe with us is paramount. Decisions made are academic by nature and supported by sufficient business information. The flow and consolidation of business information across all levels of defence is vital in maintaining this balance. For this purpose, we have invested in software that ensures the integration of Risk Management, Compliance and Assurance work. Our software ensures the seamless transfer and management of risks between business units as well as external sources such as Auditors and Trustees. Accurate and timely business information is critical for effective risk management. Combined assurance work performed across all levels of defence is utilised to measure performance and ensure the adequacy and effectiveness of our control framework.

Our enterprise risk management framework is ever evolving to ensure that we are in line with best practice and the latest guidelines. COSO forms the basis of our framework and we have embraced the guidelines offered by King III and the continuation into King IV. Enterprise risk management is critical in achieving the governance outcomes of: an ethical culture, good performance, effective control and legitimacy. These outcomes are at the heart of King IV and have been communicated throughout our group to ensure a uniform application and understanding. Strategic objectives are thus set and aligned across the group with sufficient oversight committees to ensure continuous monitoring."

GOING TO THE PEOPLE

Our 8th annual Guardian Roadshows were successfully completed in November 2017 and we wish to extend our thanks to the Funds that participated and the guardians, caregivers and members who attended.

The guardian roadshows were held in Gauteng, Eastern Cape and KwaZulu Natal. Once again we exceeded all our expectations with many thousands of guardians and beneficiaries coming out to meet with us, access services and learn more about what their fund has to offer.

A special focus was placed on engaging with our members 15 years and older in order to educate them about beneficiary funds and trusts and lay the foundation for them to make informed decisions about their funds at termination.

Visit Fairheads' YouTube channel to see the video capturing the spirit and the people of the Guardian Roadshows. YouTube

Beneficiary funds are growing roots in Swaziland

While Swaziland's Retirement Funds Act 2005, allows the placement of death benefits into a beneficiary fund, the establishment and use of beneficiary funds in the country have been slow off the mark. This seems to be set to change, however, given the interest shown by the delegates of the Swaziland Retirement Funds Breakfast Seminar held in Swaziland late last year. Principal officers, trustees and other retirement fund parties had the opportunity to learn more about beneficiary funds from industry peers, one of whom was Giselle Gould, Fairheads' Business Development Director.

Giselle was excited about the opportunity to participate in this seminar: "I'm always keen to exchange knowledge and experience with our counterparts in neighbouring countries because Fairheads has a fair number of beneficiaries living in these areas. Currently, more than 1400 beneficiaries residing in Swaziland have trusts or beneficiary funds administered by Fairheads. This kind of forum helps me to better understand those beneficiaries' realities."

Muzi Dlamini, Fiduciary Trustee Services Director, Silindile Dlamini, representing Swaziland's Financial Services Regulatory Authority, Zethu Shongwe, Consultant at Fiduciary Trustee Services, Sabelo Zwane, representing the office of the Ombudsman of Financial Services, Swaziland, Jolly Mokorosi, MD, Mokorosi Financial Consulting, Giselle Gould, Business Development Director, Fairheads Benefit Services and Chris Gama, Associate at Fingroup Swaziland Retirement Fund Consultants.

Giselle Gould, Business Development Director, Fairheads Benefit Services.

The forum, in its second year, focuses on equipping financial services fiduciaries, in particular those involved in employee benefits and retirement funds. Hosted by Mokorosi Financial Consulting and Fiduciary Trusteeship Services, the event further serves as a platform for networking and the discussion of issues that are pertinent to the industry. A number of representatives from the office of the Ombudsman of Financial Services, Swaziland, attended.

A panel discussion allowed Giselle to provide insight into the benefits and advantages of beneficiary funds, especially in helping children achieve a level of education that may not have been possible had a lump sum payment been made to a guardian.

There was also some discussion around the allocation of death benefits and Giselle shared how the retirement industry in SA has adjusted to legislation in respect of the allocation of death benefits and definition of dependents. Trustees and principal officers were interested in the practical aspect of how our industry identifies dependants. This is an area which presents some challenges in Swaziland where cultural and traditional beliefs around the allocation of death benefits do not necessarily align with what the Act defines as a dependant.

Adding weight to the academic discussion was the testimony of Zethu Nkala of Fiduciary Trusteeship Services who shared her own positive experience of having been a member of a beneficiary fund. Zethu's education was paid for by money bequeathed to her by her late father and placed in a beneficiary fund. Her education placed her in a position to pursue a successful career. Some of her peers, in similar positions, were not so fortunate. Lump sums paid to guardians or themselves were not used as wisely.

Keynote speaker, Sabelo Zwane, Senior Legal Advisor from office of Ombudsman of Financial Services, was encouraging of the partnerships that made the seminar a success and Giselle agrees, "Fairheads looks forward to more partnership opportunities with our peers in Swaziland as it can only be positive for the retirement and fiduciary industries in southern Africa. I would like to thank Jolly Mokorosi, Managing Director of Mokorosi Financial Services and the team from Fiduciary Trusteeship Services for inviting Fairheads to participate." ■

Default regulations: what they mean for beneficiary funds

The Default Regulations 37, 38 and 39 which deal with default investment portfolios, default preservation of funds and default annuities, were finally released in August 2017. They come into effect on the 1st of September 2017 and allow 18 months for funds to comply with the new regulations. The objective of the regulations is to ensure that in the absence of an explicit member decision, Boards of Trustees must provide appropriate, value for money options which will automatically apply when members join a fund, leave their employment or leave the fund.

This can only be a good thing for retirement fund members and should be welcomed by the industry. Regulations 37 and 38 apply to defined contribution pension and provident funds, and regulation 39 applies to all pension, pension preservation and retirement annuity funds. Certainly it would appear that the first two regulations do not apply to beneficiary funds, and it is debatable that regulation 39 would apply. However, it is worth taking note of the requirements of the regulations in terms of the rules and Investment Policy Statement of a beneficiary fund.

Regulation 37 sets out the requirements for default investment portfolios:

- There must be at least one default investment portfolio.
- Fees and charges must be reasonable, competitive and fully disclosed.
- In determining the default investment portfolio, both active and passive investments should be considered.
- Members should not be locked in and should be able to switch from the default portfolio at least once every 12 months.

Regulation 38 sets out the requirements for default preservation:

- Applies to paid up members, that is, those who have left the employment of their employer
- Also applies to new members transferring in to a fund
- Fees and charges must be the same as for active members
- Paid-up member certificates must be issued within 2 months

In essence, this regulation provides for members to continue their membership in the fund, without continuing to contribute to their retirement savings.

Regulation 39 sets out the requirements for default annuities:

- Applies to retiring members
- Must be suitable for the member in terms of income level, risk and income protection
- Fees and charges must be reasonable, competitive and fully disclosed
- Can be either a Living Annuity or a Life Annuity, the latter of which can be provided by the fund or a long term insurer
- Must be reviewed annually for suitability

Fairheads is of the view that regardless of whether these regulations in fact apply to beneficiary funds, our rules and IPS are already compliant with them.

Our aim will continue to be to provide for the best possible outcomes for our members, and any intervention by the Registrar to assist in this aim is welcomed. ■

The state of the SA bond market

By Guy Toms, Chief Investment Strategist, Prescient Fund Managers

The South African bond market performed well in 2017, helped by a rally in yields towards the end of the year after Ramaphosa won the ANC election. The high real yields on offer and flows into EM bond markets continued to support the market. We believe the key risks in 2018 are: a rise in global bond yields and any associated reversal in EM flows: the risk of a downgrade from Moody's that would result in exclusion from the WGBI and subsequent bond sales.

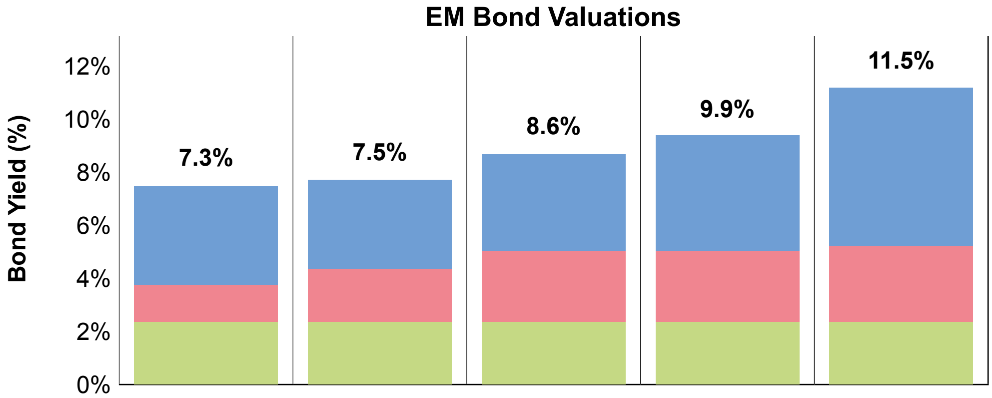
Positive momentum in global growth and employment has meant the output gaps in most developed markets have closed. This has results in all the major central banks declaring that QE is close to an end and central bank purchases of bonds in the secondary market will likely reduce sharply in 2018. Without central bank buying intervention and with global bond yields at historically low yields, any inflation pressure coming through in the developed markets would see sell offs in the bond markets globally. As a result, volatility would likely increase and this would provide good trading opportunities.

SA bond yields seem to be fairly priced versus other EM bond markets. In the graph below we compare the valuation of EM peers by breaking down the valuation into three components: the base rate or US 10-year bond yield; a risk premium for sovereign risk and a risk premium for currency risk. The aggregate of these three factors equate to the domestic bond yields for each EM. (see bottom of page).

Compression in sovereign risk premia has continued as the weight of flows into EM bond funds has persisted. While SA is in line with its peers, the sovereign risk premia are probably too flat across all the different economies and do not reflect the difference in fundamentals correctly. In a scenario of weakening global bond yields the sovereign risk premia could start to diverge as investors become more tuned into the fiscal positions and ability of each economy to service its debts. Here the management of SA's SOE debt issues will also be crucial.

SAs currency risk premium is lower than its peers and this is due to investors' faith in the SARB to manage inflation in the 3% to 6% band. Other EMS considered have much more interventionist monetary policy and their inflation track records are not as solid as SAs.

So on a peer relative basis, SA bonds seem to be fairly valued with the risk that that US base rate rises and that sovereign risk premia as a whole are at risk of rising. Any exclusion from the WGBI would result in sales of SA bonds and could provide a good buying opportunity relative to EM



	India	Russia	South Africa	Brazil	Turkey
Currency Risk Premium	3.6%	3.0%	3.6%	4.9%	6.3%
Sovereign Risk Premium	1.1%	1.9%	2.5%	2.4%	2.6%
US 10 Year Yield	2.6%	2.6%	2.6%	2.6%	2.6%

	India	Russia	South Africa	Brazil	Turkey
Domestic Rating – Local Currency	AAA	AAA	AAA	AA	AA+
International Rating – Local Currency	BBB-	BBB-	BB+	BB-	BB+
International Rating – Foreign Currency	BBB-	BB+	BB	BB-	BB

peers as yields rise on selling pressure. Of course the trajectory of SAs fiscus will be of paramount importance and the markets would penalise SA if there was any deterioration in this in a scenario where EM outflows occur.

Having said all that, on an absolute basis with yields at 9% and inflation expectations in the order of 5%, a real yield of 4% on bonds is attractive. In what is likely to be a volatile year for bonds, any bouts of weakness in the bond market could provide opportunities to lock in even higher real yields.

Duration management will be key this year and Prescient will continue to manage downside risk. The strategy will be to remain invested in high real yielding bonds and to use derivatives to protect against downside risk where possible. In periods where the bond market offers good value, we will look to add exposure to lock in the yields on offer.

Over the election period towards the end of 2017 we held a duration that was shorter than the benchmark ALBI as we remained concerned over the 2018 budget and a possible downgrade in March. However, we purchased call options to protect the portfolios in the event of a Ramaphosa win. The result was that the portfolio was fairly well protected in December. We have recently reduced duration post the rally in yields and are positioned to take advantage of any unwinding of the risks we have highlighted above. The real yield on the portfolio remains high at close to 5% currently.

Thus the portfolios remain in a position to earn good positive real yield, whilst the duration risk in the portfolio is being closely managed.

COMMUNICATING FREEDOM OF CHOICE TO MAJOR MEMBERS

Much of the effort in administering beneficiary funds has traditionally been focussed on paying out members' benefits and terminating their membership of the fund once they reach the age of majority. In fact, until recently the reduction in overdue terminations was one of the key success measures employed by Boards of Trustees to evaluate the performance of the administrator.

At the same time, the Boards of transferor retirement funds, guardians and many others have voiced strong concerns about paying out large benefits to members when they reach the age of 18. Many of these members are still in school and consequences of the sudden payment of relatively large amounts of money can be devastating if not managed properly. Guardians at our annual roadshows have complained about children dropping out of school as a result of these payments, with the money being squandered in a matter of months. There have even been cases where the guardians have been actively hiding the fact from the minor member that money is held in the beneficiary fund, to prevent such a situation.

More recently however, the Board adjusted the strategy away from simply paying out benefits at age 18, to one which emphasises the freedom of choice for members. There is no restriction on funds being held in a beneficiary fund with a major member's consent,

and it is arguable that for many this is a very good investment vehicle to house these benefits because of the low fees, institutional investment management and tax exemption that applies to these funds.

Communication is therefore key: The message is simply that members can retain their membership in the fund, and can request it when they need it, either in part or in full. There are no termination fees, lock in periods or any other restrictions on retaining membership of the fund. The administrator is then able to focus efforts on those who are not aware of their benefits to ensure that they are fully informed and can access their money when they need it.

Sowing seeds of success

Enterprise development is something we passionately believe in at Fairheads and some of our most satisfying moments are when we see the tangible results of our support of ED programmes. One such instance was when we shared the pride felt by the team at **Abraham Kriel Childcare's Emdeni Skills Development Centre**, which Fairheads has partnered with since 2014.

Bathobile Magagula, a graduate of the Centre, was employed as a Personal Assistant at the Department of Education in Gauteng last year. Bathobile was a student at the Emdeni Skills Development Centre where she acquired business management skills whilst doing a course on Hydroponic Tunnel Agriculture. Before she graduated, she applied and was successful in being employed at the Department, much to the joy of the Abraham Kriel community.

The Emdeni Skill Development Centre in Soweto, Gauteng, strives to provide skills training to a growing number of youth each year so they can access the labour market and/or establish their own micro enterprises when they have enough skills and knowledge. The youth are then able to support their families and most importantly, contribute to the alleviation of poverty in their communities.

Since starting her job at the Department of Education, Bathobile spends her weekends tending to her crops. Bathobile's dream is to eventually start her own business in the agriculture sector. Her family have always been involved in traditional farming. Bathobile also wants to continue expanding the business management skills she gained from the Skill Centre. Last year, she volunteered at the Centre's admin office and her determination to succeed stood out to those she worked with.

We join the team at Abraham Kriel Childcare and the Emdeni Skills Centre in wishing Bathobile every success in her career!

Learn more about the Abraham Kriel Childcare organisation. https://abrahamkriel.org/

Besides skills development to disadvantaged youth, the organisation's focus is to provide care and skills development for traumatised children and youth in need, in the greater Johannesburg area.

and most importantly, contribute to the alleviation of poverty

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