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Southern Africa's leading independent administrator for products and services in the retirement fund and fiduciary industries

Retirement fund consolidation – charting a path for beneficiary funds

By David Hurford, Chief Executive Officer

As a stated aim of the Regulator, consolidation of retirement funds is well on its way. It is no great surprise that the number of registered retirement funds in the country has fallen by over 30% in the last five years. The intention is to reduce the number of stand-alone funds from 1,600 to no fewer than 200.

The desire on the part of the Regulator to have fewer funds to regulate is understandable given the high level of complexity and sophistication of the industry. Ever insightful, specialist funds writer Stephen Cranston recently surveyed the landscape of retirement fund consolidation, including the need to retain strong governance (Financial Mail, 24 June 2021).

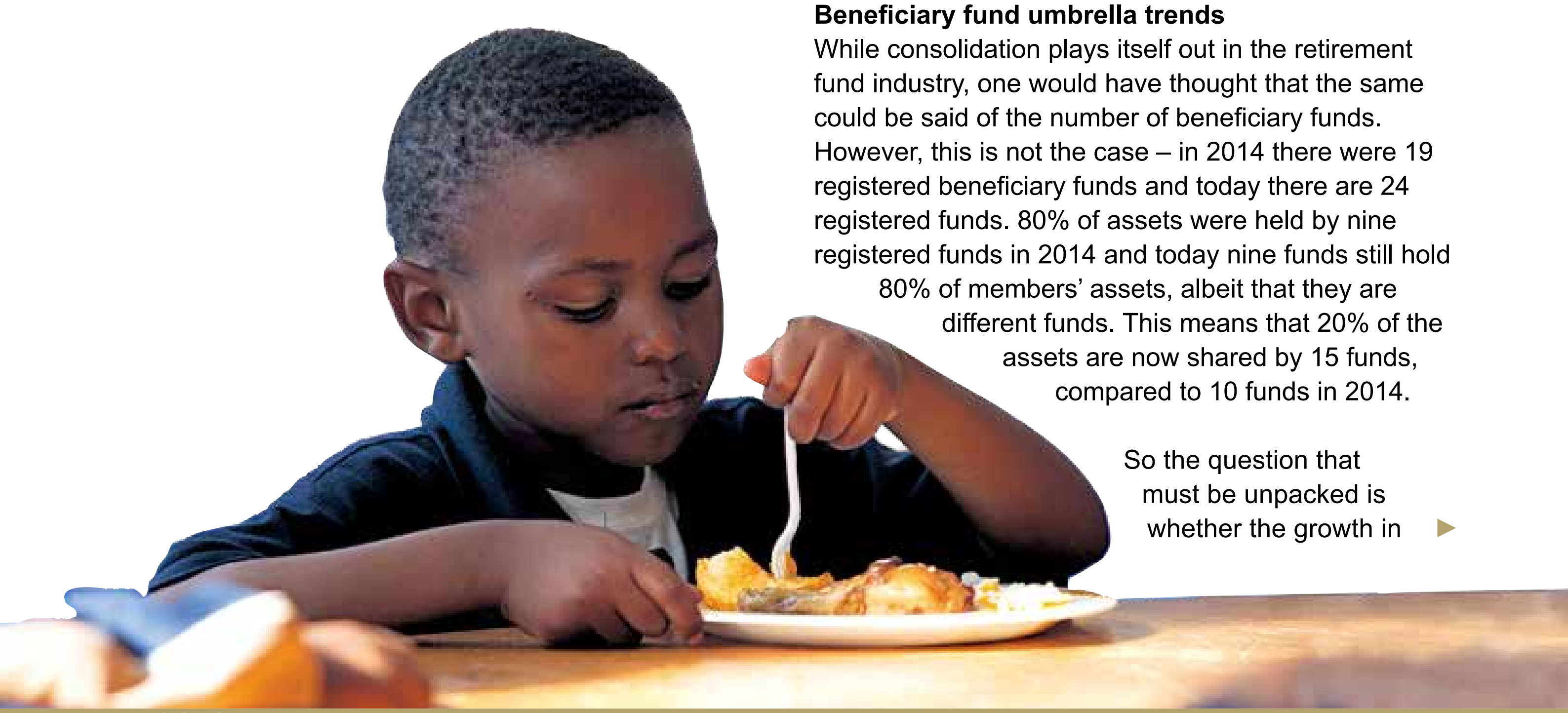
There are both pros and cons of consolidation for members. Some obvious potential benefits are reduced costs and superior service offerings flowing from the benefits of scale. Umbrellas also have the capacity to invest in the high cost of compliance, meaning that members benefit from high governance standards.

The downside of consolidation of course is the reduction in choice and competition, fewer opportunities for small-to medium-sized service providers to grow and contribute to the industry and, simply put, the commercialisation of pension funds away from not-for-profit enterprises.

Beneficiary fund umbrella trends

While consolidation plays itself out in the retirement fund industry, one would have thought that the same could be said of the number of beneficiary funds. However, this is not the case – in 2014 there were 19 registered beneficiary funds and today there are 24 registered funds. 80% of assets were held by nine registered funds in 2014 and today nine funds still hold 80% of members' assets, albeit that they are different funds. This means that 20% of the assets are now shared by 15 funds, compared to 10 funds in 2014.

So the question that must be unpacked is whether the growth in ►



In this issue

... there should be a refocus on children's needs.

the number of beneficiary funds is sustainable, and whether it is in the best interests of members?

The nature of beneficiary funds

Beneficiary funds are not preservation funds. Their primary purpose is to ensure that members, predominantly minors, can benefit from the money left to them so that they can get the best education possible. It would be a tragedy to preserve a large amount of money for a child, depriving them of the use of that money during the formative years, only to pay it out to them when they reach the age of 18.

To grow and remain sustainable, beneficiary funds must attract new members at the same rate or a higher rate than the rate at which members are paid out. The payment outflows from a beneficiary fund are high and can take the form of regular income, ad-hoc requests and final termination payment. Inflows need to keep up.

A reminder of the role played by beneficiary funds

At this juncture, we need to remind ourselves of the vital socio-economic role that beneficiary funds play. Vulnerable dependants of deceased retirement fund members need to be sustained and educated in a highly responsible manner, more than ever now during the COVID-19 pandemic.

Trustees of retirement funds need to carefully weigh up and use their discretion as to whether to pay out a lump sum directly to the guardian or rather put the lump sum into the child's name as a member of a beneficiary fund, safeguarding and professionally investing the funds, with the aim of helping the guardian to look after the child in his or her best interests.

In this way, a monthly income can help supplement the government's child grant and professional trustees can help weigh up whether a capital outlay is justified, for example for the purchase of a computer for use by the child while schools are closed and remote learning is the only option during the lockdown.

Analysis of the distribution rates on our beneficiary fund since inception show us that, on average, members are paid out 120% of what was originally placed in the fund for them through income payments, ad hoc capital payments and final benefit payments.

We therefore call on trustees of retirement funds to put beneficiary funds high up on trustee boards' agendas, to explore the use of reputable service providers in the industry, and to educate retirement fund members about the advantages of beneficiary funds. We also encourage retirement fund members to consider the option of a beneficiary fund on their nomination forms. We argue that there should be a refocus on children's needs and the necessity for urgency in tracing and getting funds to them.

Beneficiary funds need the scale to invest into technology and compliance

With all this in mind, the beneficiary fund landscape is also changing rapidly. Urbanisation together with expanding access to online services means that members are becoming far more sophisticated, demanding much higher levels of access to their service provider. In response, technology has and will continue to play a major role in expanding service delivery. Service providers need to be able and prepared to invest in the requisite technology.

At the same time, the legislative landscape is rapidly evolving in response to some significant failures on the part of the industry (think Fidentia, Bophelo). The increased scrutiny from the Regulator and other authorities is good news, as it will force unprepared and unscrupulous providers out of the industry.

These developments, while positive, come at a huge cost. The investment into new technology and systems, and the compliance costs associated with the legislative environment can only be sustained through increased scale.

Consolidation welcome

It is therefore with great pleasure that we welcomed the recent transfer of the **Nedgroup Beneficiary Fund** into our sponsored fund, the **Fairheads Umbrella Beneficiary Fund**. By joining our fund, these members will share in the benefit of belonging to a larger fund which has the capacity and scale to invest in technology, systems and governance which should be the standard for all beneficiary funds but are unachievable for those without scale.

Fairheads is the leading independent beneficiary fund service provider in Southern Africa precisely because it is our core focus – we live and breathe beneficiary funds. We strongly believe that further consolidation is necessary in an industry which has the potential to deliver huge benefits to society as a whole. ■

Message from the CEO

David Hurford

As I write this, my first Fairheads Times message as CEO, we are at a critical juncture in our country. It is with deep sadness that we see the deaths of our fellow countrymen, indiscriminate looting and destruction of property during this time while we battle the pandemic. At a time like this, keeping our staff and members safe is paramount and, as an essential service under lockdown, we at Fairheads will strive to be adaptable and agile to continue delivering services.

South Africans are a resilient people, and we have fought hard for our young democracy. We will not let it be taken away from us. We will not be victims, we will use our power to stand up against wrongdoing, corruption and criminality. We will build a fairer, more equal society.

Leadership → The senior leadership team was announced in the last issue of Fairheads Times, following the planned retirement of former CEO Richard Krepelka and CFO Marilyn Brown after an incredible 32 years of service respectively. The transition has been largely seamless and I am grateful to have an empowered, strong team alongside me. One of our major aims is to continue building depth and talent for the future.

Fund growth → Echoing our lead story on umbrella funds and consolidation, we are delighted to welcome the staff and members of the Nedgroup Beneficiary Fund which will give members further benefits from economies of scale and will allow us to continue investing in technology and systems and build further depth in technical expertise to lead the beneficiary fund industry.

Industry issues → Regarding industry and legislative events this year, we commend the Pension Lawyers Association for a successful and interesting conference in March. We have worked well in advance regarding the Protection of Personal Information Act (POPIA) and communicated to stakeholders in this regard. Cybersecurity and the protection of members' information is paramount and you can read about best practice in combatting cybersecurity in this issue of Fairheads Times.

Looking ahead, the Conduct of Financial Institutions (COFI) Bill will impact on our business and again we are working well ahead to ensure preparedness.

Women's Month in August → I would like to take this opportunity to thank all the women at Fairheads for their dedication and ongoing contribution to the business, in particular when it comes to attending to member needs with sensitivity and compassion.

I hope you enjoy this issue of Fairheads Times and please remember that my door is always open for any queries or feedback.

Kind regards
David Hurford
CEO

DID YOU KNOW?

Beneficiary funds have considerable tax advantages: No tax is paid in the fund. Furthermore, any payment out of a beneficiary fund, whether capital or income, is tax-free.

NGWEDI INVESTMENT MANAGERS

Economic commentary – June 2021

GLOBAL MACRO AND MARKET OUTLOOK

There are currently two dominant factors at play in the global economic landscape. The first is rising numbers of Covid-19 induced infections driven by the so-called Delta variant and the other is the expected rise in inflation rates and whether the upcoming inflation will be persistent or not.

Regarding the impact of the Delta variant, we believe that a potential resurgence in Covid-19 infections in the United States led by the Delta variant will have a moderate impact on consumer spending thanks to widespread vaccination campaigns and falling Covid-19 related deaths. Despite the fact that Covid-19 cases are increasing in many parts of the US and the rest of the developed world, evidence now suggests that the regions experiencing some of the highest increases are also areas with among the lowest vaccination rates.

Regarding the persistence of inflation, there was little in US Federal Reserve Chair Jerome Powell's semi-annual monetary policy testimony to suggest that officials are changing their tune that the current surge in inflation will be largely transitory. Powell is still comfortable that the recent surge is mainly due to "production bottlenecks or other supply constraints", with the upward pressure on prices likely to start fading, or even going into reverse soon. But with the outlook for real economic growth weakening and the Fed still focused on its "broad and inclusive" full employment goal, we believe that even a higher inflation will not result in a quicker policy tightening.

In summary we believe that whether inflation turns out to be persistent or not, the current economic environment means that the Fed will not be in any rush to start tightening policy. In our view the path to rate increases in the US will be preceded by a tapering announcement sometime in August followed by the start of the tapering process in early 2022. Asset purchases probably will not start to be tapered until early next year at the very least, with interest rates not raised until the first half of 2023.

SOUTH AFRICAN MACRO AND MARKET OUTLOOK

In South Africa, the macroeconomic situation is looking less rosy due to two main factors. First, the local economy has been hardly hit by the third wave of Covid-19 infections and the resulting harsher lockdowns similar to those imposed during the first wave of Covid infections. Second, the recent civil unrest in KwaZulu Natal and Gauteng have caused significant economic and social damages and these damages are likely to negatively impact an economy that was already in a soft patch.

Although there is a lot of uncertainty over how the unrest in South Africa in recent weeks will develop, we believe that a bigger risk is that the unrest signals broader discontent with the current weakness of the economy, limiting the government's ability to push through austerity and put the public debt position back on to a sustainable path.

we believe that a bigger risk is that the unrest signals broader discontent with the current weakness of the economy, Perhaps the biggest spillover effects may relate to South Africa's fiscal position and the fact that the current government is seriously considering rolling out a minimum income grant to all unemployed in the country. Although this grant when/if rolled out will significantly improve the lives of the poor and perhaps avoid further civil unrest, it remains to be seen how these grants will be financed by the central government. The public finances were already in a poor state heading into the Covid-19 crisis and, while the impact has not been as severe as initially feared, the budget deficit still came in at 11.0% of GDP in the last fiscal year and debt ballooned to 78.8% of GDP. There is also limited scope to water down the promised austerity plans without triggering a backlash from investors, which would push up local currency bond yields and put downward pressure on the rand with the resulting secondary pass-through inflation.

While we wait for the economic impact of the recent civil unrest to reassert itself, we anticipate that the Monetary Policy Committee (MPC) will keep the repo rate at the current level of 3.5%. Further bolstering this view is that the domestic economy, while recovering, continues to take knocks from Covid-19. The MPC is likely to express concerns over the recent unrest in the balance of risks to its forecast as it is too early to quantify the impact.

INVESTMENT IMPLICATIONS

From a global and domestic investment point of view we maintain our pro-risk view given the ongoing recovery from the pandemic, accommodative monetary and fiscal policies and still moderate positioning in risky asset classes.

We look for global GDP to surge in 2H on the back of a more synchronised growth boom, widespread vaccination and supportive monetary and fiscal policies that will allow for a more sustained rise in economic activity. This is certainly not an environment where the price of risky assets can fall precipitously and as such this global backdrop is likely to favour South Africa risk assets as well.

Therefore, view the recent reversal of the reflation trade as driven by a combination of technical factors and overblown fears around the Delta variant's impact on growth. In our opinion it is far too early to fade reopening trends, as we are in the early- to mid-stage of the post-pandemic recovery, and inflation is likely to continue to realize above market expectations.

If we are correct in our analysis, the current pullback in domestic and global equities creates a strong opportunity for investors to buy more risk assets such as cyclical and value assets over bonds, defensives and growth.

Combatting the rising threat of cybercrime

By John Brown, Head of IT

It is no exaggeration to say that cybercrime is one of the most dangerous and widespread threats to business worldwide. In 2020, more than 51% of all organisations worldwide experienced some form of ransomware attack causing business disruption. On average each organisation experienced three days of downtime.

There are some scary global statistics:

- Cybercrime is expected to inflict a total of $6 trillion USD in damages in 2021
- Global ransomware damage costs are predicted to reach $20 billion by 2021
- The average cost of a data breach is $3.86 million as of 2020
- 86% of breaches in 2020 were financially motivated and 10% were motivated by espionage

South Africa echoes the global trend and is in the unfortunate position of **recording the third highest number of cybercrime victims worldwide**, with some local stats to back that up:

- R2,2 billion is lost each year to cyberattacks
- 42% of South African Internet users were hit by cybercrime in 2017
- Interestingly, 90% of cybersecurity breaches are due to human error
- Two out of three Malwares are installed via email attachments
- User-downloaded viruses are responsible for 2 two 5 million attacks per day.
- 45% of breaches featured hacking, 17% involved malware and 22% involved phishing.

In 2020, Experian experienced a data breach exposing the personal information of some 24 million customers 793,749 businesses. Thankfully on this occasion the perpetrator was apprehended, and the stolen data was secured and deleted before any damage could be done. More recently, in 2021, Virgin Active experienced a sophisticated cyberattack in which they had to take all their systems offline for days until forensic experts could investigate the incident.

Best practice in combatting cybercrime

Companies should aim to adopt a best practice framework such as Information Security Management System (ISMS). ISMS is a systematic approach to managing sensitive company information including people, processes, and IT systems.

John Brown

Adopting a multi-layered approach to combatting cybercrime is key. This entails putting in place protective measures at both the front end and the back end of your company's IT systems.

To use the analogy of home security – only too familiar to South Africans - the front end could be a high wall and an electric fence around the perimeter of the property. In IT terms, this could be email advanced protection systems and firewalls.

The back end would be the on-premises protection needed. In a home this would be a burglar alarm, burglar bars and trellis doors. The equivalent in IT systems would be to deploy end-to-end data protection and artificial intelligence (AI) autonomous response systems to protect your on-premises and cloud systems and data.

Wherever possible, data should be encrypted and regular penetration tests conducted.

The aim should also be to conform with the best IT governance practice by obtaining, through audits, the international standards of ISO 27001 and ISAE 3402.

Let's hope all South African businesses can up the game when it comes to cybersecurity, so that we can drop down the ranks from being the third most susceptible country worldwide.

This article was published by EBnet in Fairheads' sponsored column, **ADMINISTRATOR'S CORNER**

Beneficiary case studies

SOME INSPIRING REAL-LIFE STORIES

In late 2020 Fairheads held a series of webinars in various languages under the heading of "Planning for your future". The webinars focused on how young people should start thinking about a career as early as age 16, in order to plan ahead and assess their financial needs for tertiary education.

Our webinars featured a few case studies, two of which are given below. Please note that we obtained permission to publish this information from the two beneficiaries who were so kind to share their inspiring stories with us.

Kim Nkahle, 27 years old

Kim's mother sadly passed on when Kim was 21 years Her guardian explained to her that a beneficiary fund account had been set up for her to take care of any future expenses.

As Kim had loved and done well at Maths and Science at high school, she decided to enrol for Engineering, finally deciding on Chemical Engineering (serious stuff!). She was fortunate to obtain a bursary to study at the University of Cape Town which is taking care of her tuition and living costs. She did not necessarily wish to use the money her mother had left her for tertiary education so she has decided to leave it in trust, with Fairheads, as an investment, secure in the knowledge that it would be safeguarded and invested wisely by experts.

Kim says: *"My advice to any younger person in high school is to play to your strengths. It is easier to cope with a career that you are passionate about."*

Siyabulela Sodladla, 25 years old

Siyabula was brought up and lives in Alexandra in Sandton, Gauteng. At the time of the Fairheads webinar, he was in his final year of a Bachelor degree in Education, with Maths as his major subject and Science as his sub-major.

He has had a tough life, losing his mother and his father in quick succession over a decade ago and leaving him in the care of his older brother, who was also at school at the time. Siya's father's employer informed the siblings that a trust had been set up to look after their financial needs into the future.

He says: *"The money helped me so much. I did not have a bursary, nor money for clothes, transport or text books. I get a monthly stipend which has helped with all these expenses. I have been determined to use the trust fund for my education."*

Interestingly – and as an inspiration to other young people – Siya first enrolled for a BsC Engineering. But he was tutoring students in Alex at the same time and he realized that his real passion lay in education, and so he switched to a Bachelor of Education.

He says: *"The country needs engineers and scientists. Maths and Science are the subjects that most students battle with, so I wanted to show them that success in these subjects is possible. My advice to high school learners is: what legacy do you want to leave to your future children and your grandchildren? What would you like them to say when they see a photo of you?"*

Siya acts as a role model to many young people in Alex. Studying is not easy as there is often a lot of noise and many parties going on. He restrained himself from partying as he did not want to disappoint himself – NOR would he liked to have disappointed his parents.

Visit Fairheads' Facebook page to watch the webinars: **FACEBOOK.COM/FAIRHEADSBENEFITSERVICES**

"It is easier to cope with a career that you are passionate about."

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